ANZ Research

March 2022 Quarter CPI Review

21 April 2022

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Contact

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Data summary

	% qtr	% ann
Headline CPI	1.8%	6.9%
Tradable	2.4%	8.5%
Non-tradable	1.5%	6.0%

Domestic inflation intensifies

- Consumer prices rose 1.8% q/q (6.9% y/y) in the March quarter, up from 1.4% q/q (5.9% y/y) previously. That's lower than our forecast of a 7.4% lift, and consensus expectations (7.1% y/y), but is in-line with the RBNZ's view that inflation was likely to "peak around 7 percent" in the first half of this year, as expressed in the April Monetary Policy Review.
- Imported inflation pressures remain strong, with annual tradables inflation lifting to 8.5% (6.9% previously). But more concerning for the RBNZ is the continued intensification in domestic inflation pressures. Annual non-tradables inflation has accelerated to 6.0% (5.3% previously), and measures of core inflation continue to increase further above the RBNZ's 1-3% target range.
- Today's data will firm the RBNZ's resolve that they need to continue to rapidly raise interest rates to get ahead of the domestic inflation pulse, including, we think, with another 50bp OCR hike at the May MPS. Inflation is increasingly permeating through the domestic economy, and with the labour market likely to tighten further yet in 2022, there's still work to be done to tame inflation, and to keep a lid on inflation expectations.

Key points

Annual CPI inflation accelerated to 6.9% y/y in the March quarter (5.9% previously), less than our forecast for a 7.4% lift and a touch below consensus expectations (7.1%). Today's data are in-line with the RBNZ's view, given their comment in the Monetary Policy Review that inflation was likely to "peak around 7 percent in the first half of 2022", but that will be cold comfort given the ongoing strength in measures of core inflation.

A significant chunk of the headline inflation figure continues to reflect the inflationary global environment, with tradables inflation (just under 40% of the CPI basket) reaching 8.5% y/y (6.9% previously). Not only has COVID continued to gum up global supply chains, but the Russian invasion of Ukraine has triggered massive commodity price volatility globally (alongside the tragic loss of life). As a small open economy, it's no wonder New Zealand has seen such strength in imported prices over the past year.

However, the real concern for the RBNZ is that domestic inflation pressures have continued to intensify. Non-tradables inflation (just over 60% of the CPI basket) lifted to 6.0% (5.3% previously). Measures of core inflation calculated by Stats NZ now range from 3.9% to 5.9% - uncomfortably far outside the RBNZ's 1-3% target range. And this domestic inflation is the kind that doesn't go away quickly. The labour market is set to tighten further over 2022 (especially if the border opening leads to a net outflow of people from New Zealand). That should see wage inflation take off over this year, providing even more persistence to the domestic inflation pulse, and necessitating ongoing interest rate hikes by the RBNZ (including another 50bp OCR hike at the May MPS).

The details

Inflation pressures remain broad-based. Of the 1.8% q/q increase in consumer prices in the March quarter:

- Food was the largest driver, adding 0.6ppts. Food prices have surged globally, with struggling supply chains running into intense commodity price volatility as a result of the Russian invasion of Ukraine (the 'breadbasket of Europe'). Domestic inflation pressures have only added to the cost at the checkout.
- Transport costs added 0.4ppts, as the Russian invasion triggered a massive spike in oil prices. Petrol prices rose 8.8% q/q in Q1 (32.3% y/y). While the Government's temporary cut to the fuel excise tax has provided some relief, that's going to come through more in the Q2 inflation figures, given it only came about later in March.
- Housing related costs added 0.5ppts, largely reflecting another painful 3.5% q/q lift in construction costs – now up 18.3% y/y. While the housing market has softened in recent months, it takes a while for that to flow through into cost pressures for building, especially given how much building work is still in the pipeline. Dwelling consents, for example, are still extremely elevated compared with the past decade. And, cost expectations for construction firms in our Business Outlook survey have certainly shown no signs of slowing.
- Alcoholic beverages and tobacco added 0.2ppts, as the annual increase in the tax on tobacco products captured the 4.9% inflation print in Q3 2021.

Monetary policy implications

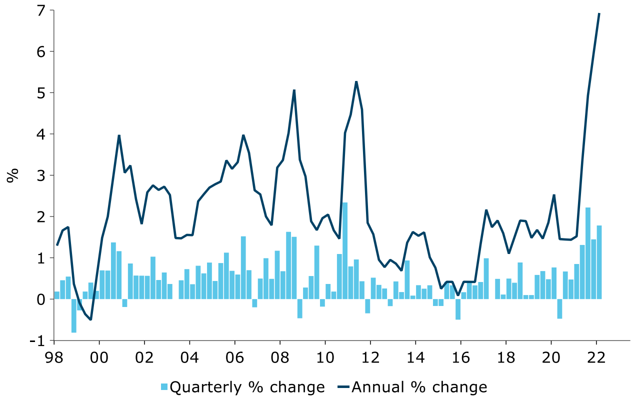
The obvious question is; was today's data the peak in inflation? At a headline level, it definitely could be. Barring some un-forecastable shock, we're unlikely to see another massive spike in commodity prices like we saw in Q1 – and so mechanically it will be difficult to see inflation rise above what we just saw.

But it's too early to claim the RBNZ's job is done on inflation. First, inflation has persistently surprised forecasters to the upside over the past year (both here and overseas). The global environment is still highly inflationary, and with global food prices surging, and China grappling with COVID outbreaks, we could feasibly still see higher headline inflation prints over the middle of this year. Second, and more importantly, the domestic inflation pulse has continued to increase, with non-tradables inflation at 6.0% y/y, and measures of core inflation far too high (and headline in the wrong direction). The labour market is set to be a big driver of inflation over 2022, as wages start to get the memo about record-low unemployment.

So if anything, this continued rise in domestic inflation pressures only reinforces the need for ongoing interest rate rises by the RBNZ. Sure, headline inflation may well have peaked – but only because we expect the RBNZ will continue to quickly raise interest rates to force inflation down. Without the ongoing tightening in monetary policy that we're forecasting, we'd likely see rising inflation expectations and the tight labour market bounce off each other in an inflationary spiral that could be very hard to tame.

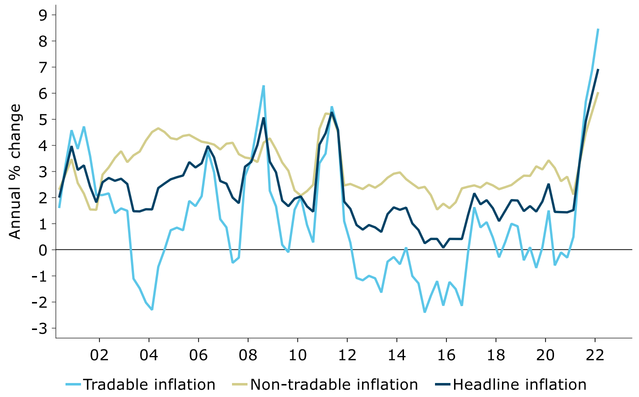
Touch wood then, that was the worst of it. But higher interest rates will still squeeze indebted households over this year – and engineering a soft landing for this overheated economy will be quite the task for the RBNZ, especially with the housing market already softening. But at the end of the day, while the monetary policy medicine may not be pleasant, it's a heck of a lot better than letting inflation get out of control.

Figure 1. Headline CPI inflation



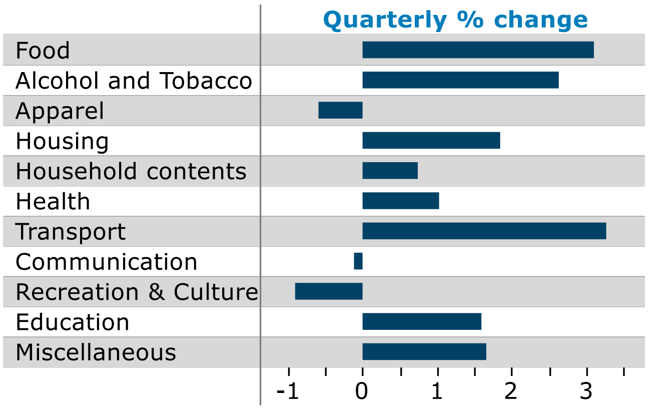
Source: Stats NZ, Macrobond, ANZ Research

Figure 2. CPI inflation components



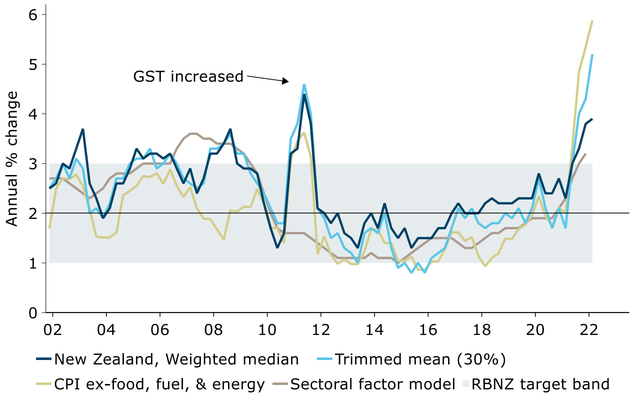
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. CPI groups – March 2022 quarter



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Core inflation measures



Source: Stats NZ, RBNZ, Bloomberg, Macrobond, ANZ Research

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