ANZ Research

Sep 2022 Quarter CPI Review & OCR call change

18 October 2022

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Contact

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75s now expected for Nov and Feb

- **We have changed our OCR call, and now expect the RBNZ to hike the OCR by 75bp in both November and February before stopping to take stock. This takes the OCR to a peak of 5% by February (previously 4.75% by May).** Both hikes are contingent on global financial markets keeping it together. Such large moves so late in the cycle are risky, no question, and could well turn out to be a mistake. But today's data gives the RBNZ little choice. They are further behind the inflation game than thought.
- Inflation remained far too strong in the September quarter, with consumer prices lifting 2.2% q/q (7.2% y/y), versus 1.7% q/q (7.3% y/y) previously. While there were some big movements in volatile components of the CPI, prices across the CPI generally lifted by more than expected, which was reflected in core inflation measures continuing to rise.
- Inflation retaining a 7-handle is alarming enough, but the details of the data confirm that underlying inflation didn't just remain strong, but actually continued to increase in the September quarter. Non-tradables inflation hit a new record high, with prices up 2.0% q/q (6.6% y/y), versus 1.4% (6.3% y/y) previously. Key measures of core inflation produced by Stats NZ increased, ranging from 5.0% y/y to 6.4% y/y.
- With Q3 CPI inflation coming in miles ahead of the RBNZ's August MPS forecast of 6.4%, and domestic inflation pressures only continuing to build, this is a very concerning inflation report for the Monetary Policy Committee.

Data summary

	% qtr	% ann
Headline CPI	2.2%	7.2%
Tradable	2.2%	8.1%
Non-tradable	2.0%	6.6%

Key points

CPI inflation barely budged in the September quarter, with prices rising 7.2% y/y, versus 7.3% y/y in June (much stronger than our pick of 6.6%, market expectations for 6.5%, and the RBNZ's August MPS pick of 6.4%). To be sure, there were some volatile components that contributed to the stronger-than-expected print, for example international airfares lifted 20.1% q/q, adding 0.3ppts to headline inflation. This has been a massively volatile series in recent quarters, and that volatility matters a lot more now that the weight has been revised up to 1.5% of the CPI basket (from 0.2% during COVID). All up, tradables prices lifted 8.1% y/y, higher than our 6.8% y/y pick, and miles ahead of the RBNZ's 6.5% August forecast.

Even more worryingly, there was a much stronger underlying inflation pulse than expected, reflected in core and domestic inflation not just remaining strong, but continuing to increase in the September quarter. Non-tradables inflation lifted to a new record high of 6.6% y/y (versus our and the RBNZ's expectation that it would remain flat at 6.3% y/y). And measures of core inflation continued to lift, now ranging from 5.0-6.4%. CPI ex-food, energy, and fuel rose to 6.3% y/y (6.1% previously), weighted median inflation rose 5.0% y/y (4.8% previously), and 30% trimmed mean inflation jumped to 6.4% (5.8% previously). The RBNZ's sectoral factor model of core inflation is released at 3pm.

The details

Inflation pressures remain broad-based. Of the 2.2% q/q increase in consumer prices in the September quarter:

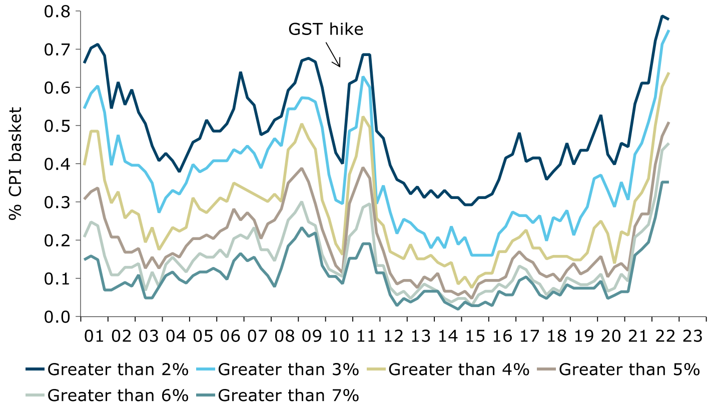
- Food prices (18.0% of the CPI basket) lifted 4.1% q/q, adding 0.7ppts to the quarterly print. That was about as expected, given the 8.3% y/y lift in the Food Price Index in the 12 months to September. Inclement weather, geopolitical tensions, rising domestic labour costs, and a sharply lower NZD versus key trading partners (notably the US) have all conspired to drive up the cost of food over 2022.
- Housing-related costs (28.3% of the CPI basket) were once again a key driver, adding 0.6ppts.
  - Rents lifted 1.0% q/q (adding 0.1ppts), council rates were up 7.3% q/q (adding 0.2ppts, slightly more than we had pencilled in), and construction costs lifted 3.3% q/q (adding 0.3ppts, in line with our expectations).
  - While cost pressures in this group have been intense in recent months, there are some signs that a reduction in inflation pressures is due. The Rent Price Index showed rents for new tenancies were down 1.3% y/y in September, suggesting some easing in rental inflation could be in the pipeline (the CPI captures all new *and* existing tenancies, so current market movements take time to be reflected in the data).
  - The housing market continues to soften. Historically that's been a reliable indicator that a reduction in construction cost inflation will occur after about six months. With construction activity remaining elevated, and the industry still dealing with acute labour shortages, we haven't seen cost increases slow much yet. But as interest rate hikes and the slowing housing market take their toll, construction cost inflation should ease. However, the timing remains uncertain, and could be a significant source of forecast errors going forward.
- The transport group (14.2% of the CPI basket) unexpectedly added 0.2ppts to headline (we had expected costs to fall in the quarter). Petrol prices were down 4.5% q/q (significantly less than the 8% drop we had pencilled in based on weekly fuel price monitoring), knocking just 0.2ppts off headline. The big driver of the transport group surprise was airfares, with domestic and international airfares both increasing by around 20%, adding a combined 0.4ppts to headline CPI inflation. These were always big uncertainties heading into the forecast.
- In terms of other forecast misses, there was generally just a stronger underlying inflation pulse than anticipated across a broad range of domestic and international components of the CPI. Alcoholic beverages and tobacco lifted 1.4% q/q, adding 0.1ppts (helped by a large increase in the excise tax), clothing and footwear was up 1.2% adding 0.05ppts, while recreation and culture, education, and miscellaneous goods and services all made non-trivial positive contributions to the headline CPI figure.

Monetary policy implications

Today's data definitely puts a very large spanner in the works for the RBNZ. A sizeable drop in headline inflation (and stabilisation in domestic pressure) had been widely expected (and the RBNZ had pencilled in 6.4% y/y). Instead, headline inflation barely budged, and core inflation measures continued to accelerate, now between 5.0% y/y and 6.4% y/y.

While we had expected core inflation pressures to remain elevated, the significant increase in these measures from already-high levels, combined with non-tradables (ie more domestically oriented) inflation lifting 0.3ppts to 6.6% y/y means the domestic inflation surge is looking worse by the day. A whopping 78% of items in the CPI experienced a price rise of over 2% in the last 12 months, and larger price rises are becoming more common too (figure 1).

Figure 1. Proportion of CPI basket increasing by percentage threshold



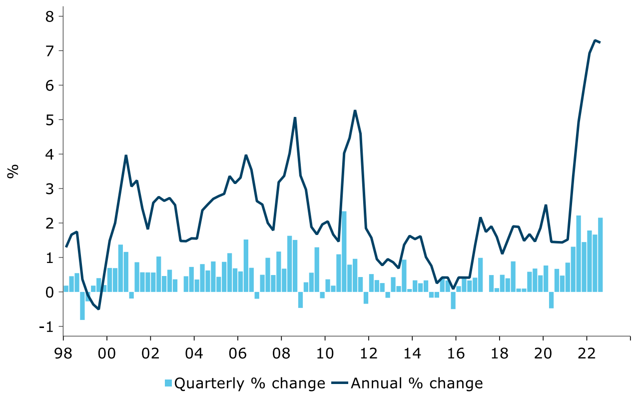
Source: Stats NZ, Macrobond, ANZ Research

The data highlight that underlying inflation pressures are only continuing to increase, despite widespread expectations that we were at the peak (and the RBNZ delivering an extremely rapid 325bp lift in the OCR over the past 12 months). The RBNZ are further behind the inflation curve than previously thought, and in our view tips the odds in favour of a 75bp OCR hike at the November MPS (especially in the wake of their comment in the October Monetary Policy Review that "the Committee considered whether to increase the OCR by 50 or 75 basis points at this meeting").

A 75bp hike is not without its risks – the global picture is deteriorating rapidly and will contribute to a slowdown in domestic growth and inflation pressure – and has the potential to create a step-change in the economic outlook. Given the RBNZ said last month that they considered a 75bp hike, arguably their credibility would be stretched if they didn't go 75bp now, in the face of this news. One could reasonably ask "what more would it take?" And in that vein, we have labour data on 2 November. Given we expect the early November labour market data to also come out strong, we've also changed our February call to a 75bp hike. That's a massive amount of tightening in a very short timeframe, and we expect the RBNZ to call a halt at that point to see how events unfold.

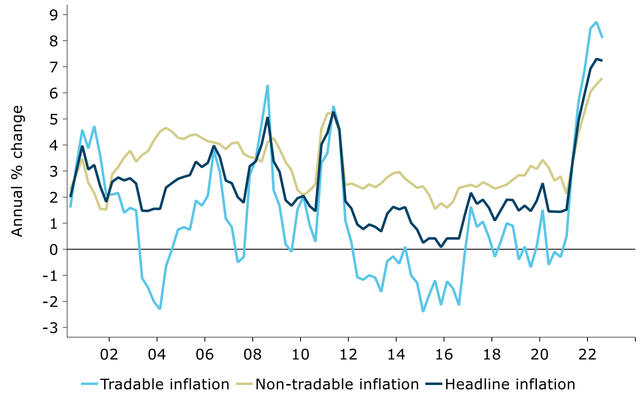
It's worth noting that the RBNZ are expecting to see a rapid acceleration in wage growth, with private sector average hourly earnings forecast in the August MPS to lift by 8.3% y/y in Q3 (versus 7.0% y/y in Q2). That's only going to reinforce an underlying inflation trend that is far stronger and more persistent than anticipated.

Figure 2. Headline CPI inflation



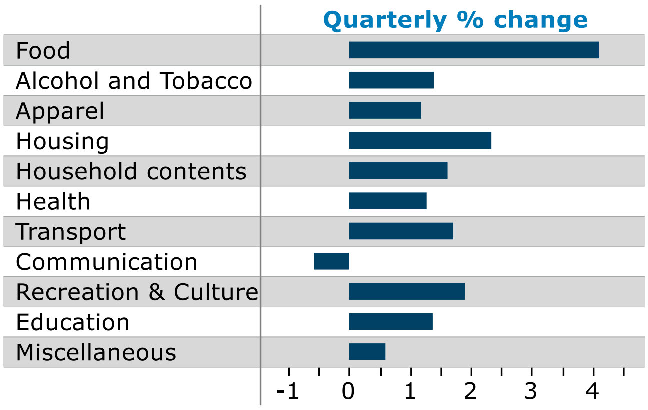
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. CPI inflation components



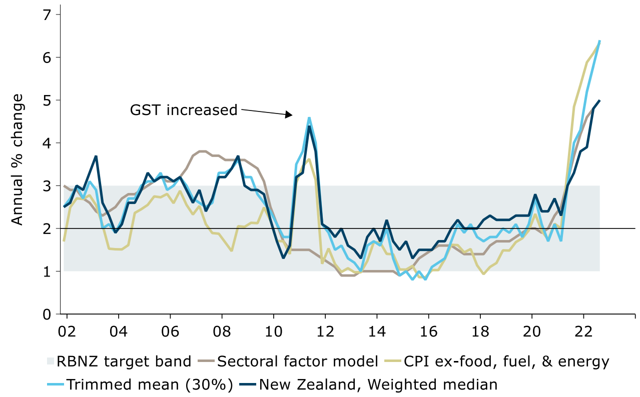
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. CPI groups – September 2022 quarter



Source: Stats NZ, Macrobond, ANZ Research

Figure 5. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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