ANZ Research

December 2022 Quarter CPI Preview

19 January 2023

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Contact

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Consumers Price Index – December 2022 Quarter

	Prev	ANZ	RBNZ
CPI – q/q	2.2%	**1.4%**	**1.7%**
CPI – y/y	7.2%	**7.2%**	**7.5%**
Tradable - q/q	2.2%	**0.7%**	**1.5%**
Tradable - y/y	8.1%	**7.4%**	**8.3%**
Non-tradable - q/q	2.0%	**1.8%**	**1.9%**
Non-tradable - y/y	6.6%	**6.9%**	**7.0%**

The devil in the detail

The bottom line

- We anticipate annual CPI inflation was flat at 7.2% in Q4 2022, a touch below the RBNZ's November MPS forecast of 7.5%.
- Lower petrol prices and moderating global inflation pressures mean we expect tradables (ie imported) inflation eased to 7.4% y/y (8.1% in Q3).
- However, with labour shortages remaining acute and the resurgence of international tourism injecting fresh demand into our supply-constrained economy, we expect non-tradables inflation rose to 6.9% y/y (RBNZ: 7.0%), versus 6.6% in Q3. Core inflation measures may also print higher again in Q4.
- This week's Q4 QSBO and the December ANZBO suggest the economy could lose momentum faster than the RBNZ forecast in the November MPS. But with actual and expected price and cost measures in the QSBO *increasing* in Q4, it's not clear the RBNZ will feel they have the flexibility to ease back on the aggressive pace of OCR hikes.
- We continue to forecast a second 75bp OCR hike at the February meeting, but next week's CPI data will be key. It's looking like the RBNZ may get a downside surprise on headline inflation, but that's probably not a domestic inflation story. The best-case scenario would be much lower non-tradables inflation than expected, which, combined with leading indicators falling rapidly, could be the trigger that would see the RBNZ move to smaller hikes. Unfortunately, we suspect non-tradables inflation will get worse before it gets better.

The view

Stats NZ will release CPI inflation figures for the December quarter next Wednesday (25 January). We anticipate the data will echo themes seen in inflation globally, with overall inflation continuing to stabilise as goods inflation abates, but core inflation remaining far too strong (if not increasing further) as an extremely tight labour market and the struggle to rebuild capacity in the tourism sector put continued pressure on domestic services prices over the summer months. We're anticipating consumer prices lifted 1.4% q/q in the December quarter, which would see annual CPI inflation remain flat at 7.2% (down only slightly from the 7.3% peak in Q2).

Breaking down the 1.4% q/q anticipated increase in headline CPI inflation:

- **Food prices** increased markedly in the December quarter (a time when they usually post seasonal declines). Inclement weather, high input costs, geopolitical tensions, and ongoing labour shortages have all contributed to high levels of food price inflation over 2022. With the Food Price Index showing that food prices were up 1.8% in the three months to December (3mma basis), we anticipate that will add 0.4ppt to quarterly CPI inflation. 2023 kicked off with egg shortages, carbon dioxide shortages, and an ex-tropical cyclone hammering parts of the North Island. Risks around food price inflation remain firmly to the upside.

- **Housing-related costs** are likely to remain the largest contributor to CPI inflation. We expect the housing and household utilities group increased 1.1% q/q, adding 0.4ppt to headline inflation. Within this group:
  - The Rent Price Index showed that overall rents were up 0.8% q/q (3mma basis) in Q4. However, a significant slowdown in rental inflation for new tenancies does point to an easing in overall rent inflation as we move through 2023.
  - Construction costs are expected to have lifted 2.7% q/q, slowing further from the high of 4.5% seen in Q2 2022. Current high levels of construction activity are still putting upward pressure on construction costs, despite the correction we are seeing in the housing market. We expect construction cost pressures to ease over 2023 as the RBNZ's aggressive interest rate hikes are reflected in a significant decline in residential construction activity. But the timing and magnitude of any easing in construction costs remains uncertain.
- **Recreation & culture** is expected to add 0.3ppt to headline inflation. This has been the first summer since the border was closed in 2020 in which international tourists could arrive en masse, and the pressure on domestic accommodation, tourism hotspots, and an already stretched hospitality sector has been immense. The additional demand in the economy generated by this is a key reason why we don't expect overall CPI inflation to fall below 7% until Q2 – it's a factor the RBNZ is closely focusing on too.
- **Transport costs** are once again the only group in the CPI that we anticipate will post a quarterly decline. We estimate a 0.4% q/q fall in transport costs will shave 0.1ppt off the quarterly inflation print.
  - A big part of this story is the sharp drop in oil prices (and the appreciation of the NZD versus the USD) over Q4, which we estimate saw petrol prices drop 11.5% q/q. That alone would chop 0.5ppt off the headline inflation print.
  - Given the pressure on airline capacity over the December quarter, we're anticipating another increase in domestic and international airfares added 0.4ppt to headline inflation. After increasing around 20% q/q in Q3, we've pencilled in a further 15% increase in domestic and international airfares, which would represent a larger-than-usual Q4 increase for both. These prices have been extremely volatile over 2022, so there's plenty of room for a forecast miss that could see inflation coming in higher (or lower) than expected. But given airline capacity continues to recover, airfares will likely turn to a drag on inflation at some point this year.
- **The final 0.4ppt** consists of broad-based price rises across all the other CPI groups (table 1).

Globally, inflation is increasingly rotating towards services prices, while goods price inflation is slowing markedly (and even turning into deflation in some countries). We expect that pattern will be reflected in New Zealand as well, with goods price inflation (the first to increase in 2021) stabilising, but services prices continuing to feel the pressure from labour shortages, surging wages, and the additional domestic demand created from the resurgence of international tourism in New Zealand.

In this environment, it's entirely possible that we will continue to see headline inflation stabilise and then begin to fall, even as domestic inflation pressures intensify (indeed that has been our forecast for some time). Tuesday's Q4 QSBO read certainly brought no comfort in that regard. While measures of activity, employment, and confidence all tanked, experienced and expected cost and price measures all increased. Given the additional capacity pressures generated by the reopening of international tourism over the 2022/23 summer, we expect non-tradables inflation worsened in Q4, lifting to 6.9% y/y, versus 6.6% in Q3. This should be a temporary dynamic, but it's a dynamic that will give the RBNZ no comfort that core inflation is about to turn the corner.

Monetary policy implications

Timely indicators across the QSBO, ANZBO, and job ads all indicate that the economy may be losing momentum even faster than the RBNZ expected in the November MPS. Normally, it would be a no-brainer for a central bank to ease up on the hawkishness when looking at such dire leading indicators.

However, those same leading indicators (particularly the QSBO) also point to domestic inflation actually getting worse over the summer, from already unacceptable levels. Measures of price and cost rises lifted further in the Q4 survey, as did the difficulty of finding skilled and unskilled labour. Labour as a limiting factor eased slightly from Q3's all-time high, but partly because capacity as a limiting factor increased – still an inflationary supply-side problem. So the RBNZ is now between a rock and a hard place, with activity measures looking sickly, but no evidence emerging yet that that weakness has translated into lower inflation pressures.

Of course, this was always going to happen to some extent, given the dynamics of how monetary policy affects the economy – first confidence, then activity, then finally inflation. But the X factor this time is that the RBNZ feels a sense of urgency to get inflation down to more acceptable levels before it becomes normalised. It will only have the luxury of "watching, worrying and waiting" once there is a fair degree of certainty that wage-price spiral risks have been quashed and inflation expectations are receding.

Despite the increasingly soft outlook for economic activity, Q4's CPI report will be key. If non-tradables inflation comes in as strong as we and the RBNZ expect (6.9% y/y and 7.0% y/y respectively), it won't be straightforward for the RBNZ to meaningfully shift away from its hawkish stance any time soon, even if headline inflation 'only' comes in at 7.2% y/y as we are forecasting (versus the RBNZ's 7.5% forecast).

The best-case scenario would be a broad-based downward surprise on non-tradables inflation (eg not just from volatility in domestic airfares). Non-tradables and core inflation coming in cooler than expected would certainly give the RBNZ the green light to reduce the size of the OCR hikes being delivered, in deference to very real hard-landing risks. But given that non-tradables inflation has relentlessly surprised to the upside over the past year, the RBNZ will remain wary of more of the same. They may well feel they have to wait for a fall in actual core inflation before backing off, with a fall in its own forecasts of it not cutting the mustard.

For now, we continue to forecast a second 75bp OCR hike will be delivered at the 22 February meeting (with a peak of 5.75% reached by May). But with Q4 CPI and labour market reports due between now and then, and leading indicators sharply lower, we'll be watching the data closely for signs that domestic inflation is fading faster than the RBNZ (or we) expect.

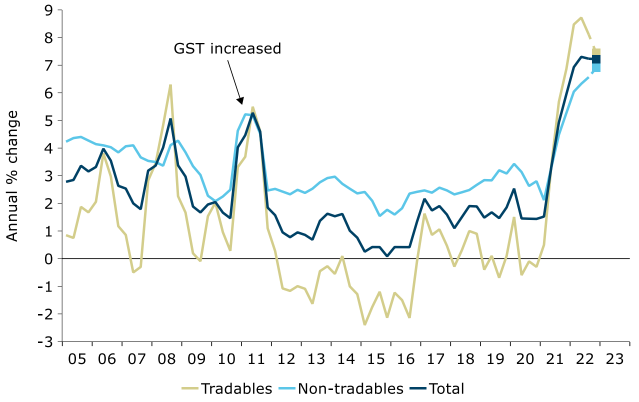
Table 1. ANZ Q4 CPI component-level forecast

Component	q/q%	%pt cont.
Total	**1.4**	**1.44**
Housing & Household Utilities	1.1	0.40
Food	1.8	0.38
Recreation & Culture	3.5	0.33
Miscellaneous Goods & Services	1.4	0.13
Household Contents & Services	2.5	0.12
Clothes & Footwear	1.6	0.06
Health	0.9	0.04
Alcoholic Beverages & Tobacco	0.4	0.04
Communication	1.3	0.03
Education	0.2	0.00
Transport	-0.4	-0.07

■ Quarterly % change ■ Percentage point contribution

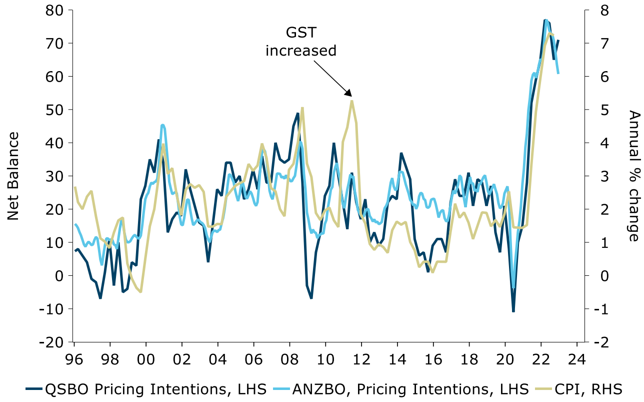
Source: Stats NZ, Macrobond, ANZ Research

Figure 1. CPI inflation measures



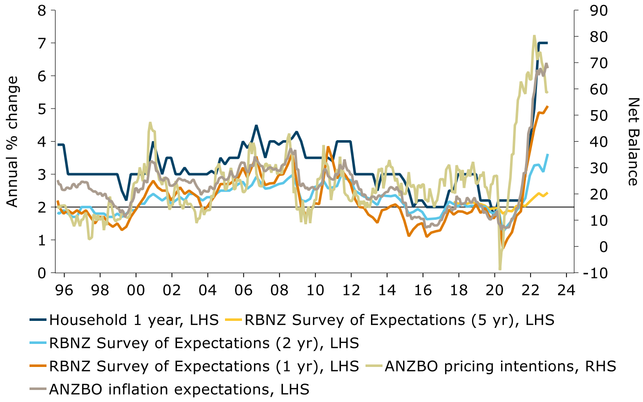
Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Inflation and pricing intentions



Source: NZIER, Stats NZ, Macrobond, ANZ Research

Figure 3. Selected inflation expectations measures



Source: RBNZ, Macrobond, ANZ Research

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