

March 2023 Quarter CPI Preview

17 April 2023



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The price is wrong

The bottom line

- We expect annual CPI inflation to remain steady at 7.2% in Q1 2023, a touch below the RBNZ's February MPS forecast of 7.3%.
- Underpinning that is an expectation that annual non-tradables inflation (aka domestic inflation) will accelerate from 6.6% in Q4 to 6.8%, and annual tradables inflation will slow from 8.2% to 7.4%.
- If our expectation is correct, annual non-tradable inflation will come in 0.3%pts below the RBNZ's February MPS forecast. However, we're not convinced a 'miss' this size will have much bearing on the RBNZ's broader strategy. Markets may disagree with this assessment on the day, but the RBNZ did signal a potential upgrade to their inflation outlook in the April Monetary Policy Review, owing to larger cyclone impacts and the potential for further fiscal expansion.
- Our forecast is for a follow-up 25bp OCR hike at the May MPS, taking the OCR to 5.5%, which appears to be the Committee's 'happy place', where they can 'watch, worry and wait'.

The view

Stats NZ will release CPI inflation figures for the March quarter next Thursday (20 April). We've pencilled in another painfully strong read of 1.7% q/q (7.2% y/y), led by food, housing and the usual Q1 increase in the excise duty on cigarettes and tobacco (the latter is indexed to inflation in the year to September, and that came in at a whopping 7.2% y/y).

For the RBNZ, non-tradable and core measures of inflation will be their primary concern, as both are at risk of being persistently too high to facilitate a sustained return of headline inflation to within the target band. That is, long after high global inflation (ie tradable) pressures have come down to earth, there is a real risk that domestic inflation proves sticky at high levels, potentially necessitating another round of rate hikes after the RBNZ has held the OCR at its 'watch, worry and wait' level for a few quarters (which they have signalled is 5.5%).

But sticky non-tradables appears to be a risk for later in the year (possibly 2024). Insofar as non-tradables inflation goes in Q1, the RBNZ's February MPS forecast of 1.9% q/q sets the hurdle to an upside surprise pretty high. We're certainly not ruling out the possibility of non-tradables coming in this strong, but our monitoring suggests it'll come in at 1.7% q/q (which is still around twice the pace of its 20-year average).

Should quarterly non-tradable inflation indeed come in 0.2%pts lower than the RBNZ's latest forecast, we're not convinced this can be interpreted as making a 25bp hike in May significantly less likely (although markets may disagree). It's worth remembering that the April Monetary Policy Review signalled that the RBNZ could be gearing up to revise their inflation outlook higher, hinting that cyclone impacts could be greater than they previously estimated – particularly if coupled with an unfunded increase in government spending. Further, while a downside surprise will certainly be welcomed by

Consumers Price Index – March 2023 Quarter

	Prev	ANZ	RBNZ
CPI – q/q	1.4%	1.7%	1.8%
CPI – y/y	7.2%	7.2%	7.3%
Tradable – q/q	1.4%	1.7%	1.7%
Tradable – y/y	8.2%	7.4%	7.4%
Non-tradable – q/q	1.5%	1.7%	1.9%
Non-tradable – y/y	6.6%	6.8%	7.1%

the RBNZ, non-tradable inflation at 1.7% q/q is still way too high to declare 'job done'. Annualised, 1.7% q/q is consistent with non-tradable inflation running at around 7%, which is pretty scary when you consider how sticky non-tradable inflation tends to be.

As we noted in [last week's Data Wrap](#), a lot still needs to go right from here before the RBNZ's OCR projection is consistent with a simple Taylor Rule: inflation and inflation expectations need to fall, and a negative output gap needs to open up. This all seems to be moving in the right direction, but inflation expectations are hardly in free fall, and the degree of stickiness in non-tradables inflation has plenty of scope to surprise later in the year.

Turning to the details, our expectation that quarterly inflation will come in at 1.7% is driven by:

- **A sharp rise in food prices.** Broadly, it's been a nasty cocktail for food prices, and there isn't much sign of this easing significantly in the near term. Extreme weather events, rising input costs, geopolitical tensions and ongoing labour shortages have all contributed to high food price inflation in recent quarters, with the monthly Food Price Index showing Q1 was no exception: food prices were up 3.3% in the three months to March (3mma basis), and we anticipate this will add 0.7ppt to quarterly CPI inflation.
- **Housing-related costs** are likely to remain a key contributor to quarterly inflation. We expect the housing and household utilities group increased 0.9% q/q, adding 0.3ppt to headline inflation. Within this group:
 - The Rent Price Index showed overall rents up 0.9% q/q (3mma basis) in Q1, which at almost 10% of the CPI basket contributes nearly 0.1ppt to headline inflation.
 - Construction costs are expected to have lifted 1.8% q/q, their slowest pace since March 2021. Construction costs tend to follow the housing market relatively closely, and that suggests further easing is on the cards over coming quarters as the residential construction pipeline continues to shrink. Again, at just under 10% of the CPI basket, construction costs are expected to add almost 0.2ppt to headline inflation.
- **The annual lift in the excise duty on cigarettes and tobacco** is expected to add 0.2ppt to headline inflation. The excise tax is indexed to annual CPI as at September, and that came in at a whopping 7.2% y/y.
- **The household contents and services group is expected to lift 1.1% q/q**, making a 0.1ppt contribution to headline. We've pencilled in a relatively small but broad-based lift on the likes of furniture through to appliances, including some small positive judgement owing to flooding and cyclone-related demand.
- **The transport group is expected to lift 0.7% q/q**, with second-hand cars experiencing a little more demand on the back of recent weather events, and capacity constraints preventing domestic and international airfares from declining as much as they normally would at this time of year. According to the MBIE petrol data we monitor, the (typically volatile) petrol component is expected to be little changed in the quarter. All up, the transport group is expected to add 0.1ppt to headline inflation.

- **Recreation & culture** is expected to add 0.1ppt to headline inflation as domestic accommodation services (and other related industries) work through the first summer uplift in international visitor arrivals since 2019/20.
- **The final 0.2ppt** consists of relatively small price rises across a wide variety of goods and services.

All up, there's every chance that the Q1 CPI data contain something for everyone. Chances are non-tradables inflation will surprise the RBNZ's forecast to the downside, and that could signal a little less persistence in inflation than otherwise (all else equal). However, non-tradables inflation will still be running way too hot, and it's still likely to accelerate from Q4 in y/y terms. Core measures could end up a bit of a mixed bag, but the sectoral factor model (released by the RBNZ at 3pm on CPI day) is likely to have some persistence to it. But even if CPI surprises to the downside, this may not deter the RBNZ from taking the OCR to their signalled 'happy place' of 5.5%. There's way too much upside pipeline inflation risk to let a small miss on Q1 CPI change the RBNZ's assessment of appropriate monetary conditions, particularly when inflation expectations are this high (figure 3).

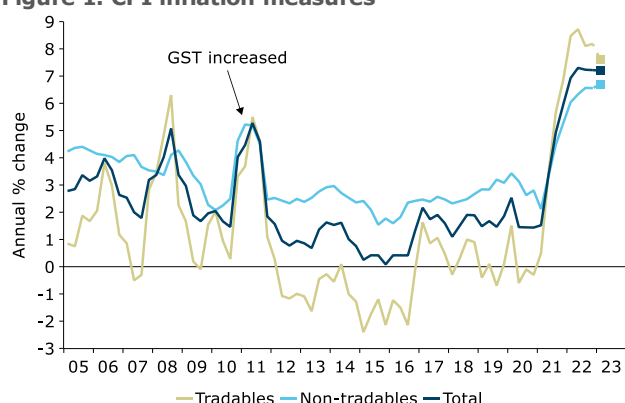
Lastly, Q1 CPI data certainly won't be the final word ahead of the May MPS. The Q1 labour market release and Budget 2023 are yet to come, and both could easily end up on the more inflationary side.

Table 1. ANZ Q1 CPI component-level forecast

	-0.5 0.0 0.5 1.0 1.5 2.0 2.5 3.0 3.5 4.0	q/q%	%pt cont.
Total		1.7	1.72
Food		3.3	0.69
Housing & Household Utilities		0.9	0.33
Alcoholic Beverages & Tobacco		3.6	0.31
Transport		0.7	0.13
Miscellaneous Goods & Services		1.2	0.10
Recreation & Culture		0.8	0.07
Household Contents & Services		1.1	0.05
Education		1.8	0.03
Health		0.7	0.03
Communication		-0.4	-0.01
Clothes & Footwear		-0.3	-0.01

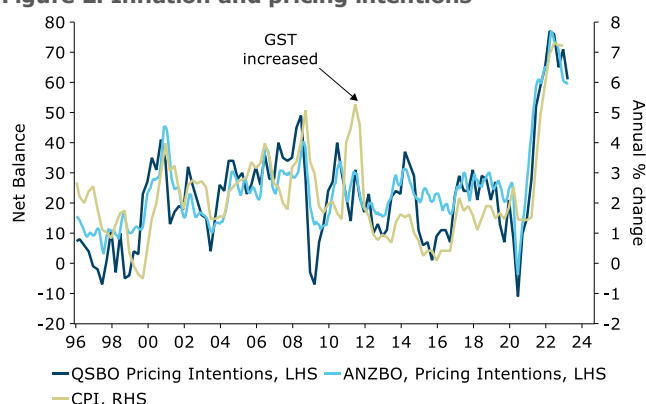
■ Quarterly % change ■ Percentage point contribution
Source: Stats NZ, Macrobond, ANZ Research

Figure 1. CPI inflation measures



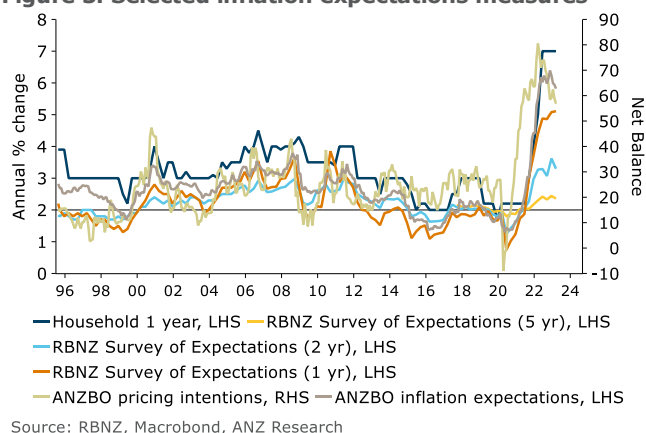
Source: Stats NZ, Macrobond, ANZ Research

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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Last updated: 1 September 2022

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