ANZ Research

June 2023 Quarter CPI Preview

13 July 2023

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Contact

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Consumers Price Index – June 2023 Quarter

	Prev	ANZ	RBNZ
CPI – q/q	1.2%	**1.0%**	**1.1%**
CPI – y/y	6.7%	**5.9%**	**6.1%**
Tradable - q/q	0.7%	**0.9%**	**1.4%**
Tradable - y/y	6.4%	**5.3%**	**5.8%**
Non-tradable - q/q	1.7%	**1.0%**	**1.0%**
Non-tradable - y/y	6.8%	**6.4%**	**6.3%**

Running before we walk

The bottom line

- We expect annual CPI inflation to decline to 5.9% in Q2 2023, below the RBNZ's May MPS forecast of 6.1%.
- The bulk of the decline in annual headline inflation reflects an anticipated sharp fall in annual tradables inflation from 6.4% to 5.3%, as the price increases seen in the wake of the war in Ukraine last year fall out of the annual calculation.
- We expect annual non-tradables inflation is also past its peak, falling from 6.8% to 6.4%, still roughly twice the level consistent with the RBNZ's overall CPI target. We'll be looking for further moderation across the suite of core measures.
- All up, a faster deceleration in annual inflation will certainly be welcomed by the RBNZ. We don't see next week's figures as deterring the RBNZ from their current strategy to hold the OCR unchanged while they "watch, worry and wait." However, we suspect non-tradables inflation will prove persistent later in the year. If we're right, that will only become evident once some large base effects roll out of the equation.

The view

Stats NZ will release CPI inflation figures for the June quarter next Wednesday (19 July). We expect quarterly inflation slowed in Q2 to 1.0% q/q (RBNZ: 1.1% q/q), with tradables inflation of 0.9% q/q (RBNZ: 1.4% q/q) offsetting still-sticky non-tradables inflation of 1.0% q/q (RBNZ: 1.0% q/q).

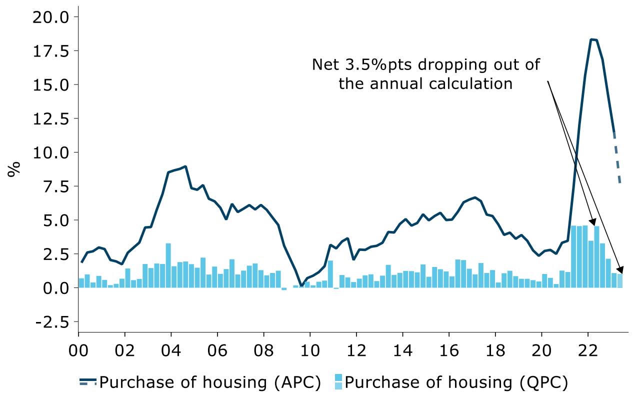
With the bulk of the downside surprise relative to the RBNZ's expectation reflecting tradables inflation, we're still far from "job done". Non-tradables inflation exhibits seasonality, and after accounting for that, we estimate non-tradables inflation rose 1.2% q/q in Q2. While that's a sharply lower inflation impulse than experienced in the past year, it still corresponds to an annualised rate of 4.9% y/y. That's well in excess of the level of non-tradables inflation of about 3% y/y that's historically been consistent with headline CPI inflation at target.

With annual non-tradables inflation now likely to have peaked, the focus turns to how quickly it will decline. Base effects will do a lot of the heavy lifting over coming quarters, particularly via construction costs. In Q2 alone, we expect a net 3.5%pts to fall out of the annual calculation of these costs, knocking nearly 0.6%pts off annual non-tradables inflation. In addition, there's some low-hanging fruit on the tradables side of the ledger: ongoing global goods disinflation reflecting slowing momentum in China, fading supply-chain disruption, a much lower oil price than a year ago, and a dramatic normalisation of shipping costs. That is likely to make for an orderly decline in headline inflation in the near term, but in our view, it will mask an underlying inflation impulse tied to a relatively resilient labour market.

Falling headline inflation from any source is good news for the RBNZ, given the risk that inflation expectations could be sticky at levels inconsistent with the inflation target. Weaker headline inflation will support the downward trend in inflation expectations that has been evident across our consumer and business surveys in recent months. And as long as things look on track, the hurdle for any change in strategy from its "watch, worry and wait" stance will remain high. With the unwind of the fuel excise duty, road user charges and public transport subsidies, and large rate bills on the cards in Q3, it's not all tailwinds on the headline inflation front. But at the end of the day, the outlook for the OCR is going to depend on whether the economy is rolling over or ticking over. As such, we remain in a world where any "good" news about resilient demand is a double-edged sword.

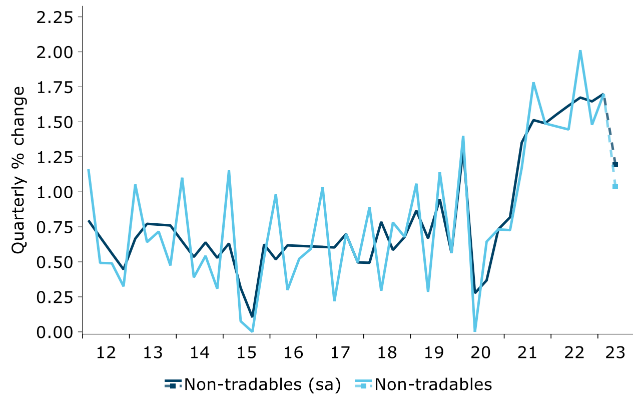
All up, we think it's too early for any complacency that the fight against inflation is done and dusted, given the relative resilience of the labour market, the sizeable injection of fiscal stimulus in the next 12 months, the rapid increase in migration, a housing market showing signs of life, and a cautious turn in sentiment among consumers and businesses. Things are definitely going the right way: Q2's Quarterly Survey of Business Opinion suggested capacity is opening up rapidly in the economy. But there's a long way to go, and we suspect that squeezing that last excess inflation out of the system could be an uphill slog. But that's a story for another day; we expect, next Wednesday will be a good news day for the RBNZ.

Figure 1. Construction costs inflation



Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Non-tradables inflation



Source: Stats NZ, Macrobond, ANZ Research

Turning to the details, our expectation that quarterly headline inflation will come in at 1.0% is driven by:

- **Food prices** have continued to rise higher after the surge following the Auckland flooding events and cyclone Gabrielle. While the pace of increase has softened from the intense increases earlier in the year, annual food price inflation is still running at 12.5%. New Zealand's poor run of weather is hampering production and strained transport infrastructure is impacting access to markets. The climate transition to El Niño may provide some reprieve, bringing drier conditions to the east, but for now prices pressures remain intense. The 2.0% q/q increase in food prices in the three months to June is expected to add 0.4%pts to quarterly headline inflation in Q2.

- **Housing-related costs** are expected to add 0.3%pts to the quarterly headline figure. Within this group:
  - The Rent Price Index rose 1.1% q/q (3.9% y/y) in Q2. That's expected to add 0.1%pts to headline inflation. The recent surge in migration and disruption from the Auckland flooding events and cyclone Gabrielle have likely put upward pressure on rents, but given the slow-moving nature of the stock measure in the CPI, this may take some time to appear. A surprisingly strong read of 0.5% m/m for rents in June may signal these impacts starting to emerge.
  - Construction costs are expected to have lifted 1.0% q/q, adding 0.1%pts to overall inflation. However, construction costs are a source of considerable uncertainty in the forecast. While house prices have declined around 16% from their peak, which are normally associated with easing construction cost inflation, a divergence has opened between new builds and existing houses as tight labour market conditions have maintained pressure on building costs. Easing supply constraints and weaker demand saw construction cost inflation fall to around the average seen last decade in Q1 and experienced cost increases in the construction sector fell in Q2's Quarterly Survey of Business Opinion, though still remained historically elevated. While we do expect some further easing across the second half of the year, with the housing market on the cusp of turning and residential construction intentions increasing from extreme lows in our Business Outlook survey, we aren't yet convinced a sharper correction is on the cards.
- **Transport costs** make a very small negative contribution to overall inflation. Petrol prices declined around 0.3%, while diesel prices have fallen nearly 8% in Q2. Weaker transport-related inflation, however, will be short-lived with the unwind of the fuel and public transport subsidies likely to add 0.6%pts to CPI in Q3.
- **The final 0.3%pts** consist of price rises across all the other CPI groups, reflecting the broad-based nature of the current inflation surge.

Overall, there's likely to be some good news in the Q2 CPI report. Inflation seems to be well and truly on its way down, however it's by no means "job done" for the RBNZ. Getting inflation from above 7% down to a print with a 4- or 5-handle, is the easy part, supported by some chunky base effects rolling out of the annual calculation. Thereafter, the RBNZ face a real challenge in getting from there back to target. That's evident in our expectation that the Q2 non-tradables inflation impulse is still annualising at a rate of 4.9%, after accounting for seasonality.

Further wins on the non-tradable front are likely to come down to the state of the labour market, where increasing slack is sorely needed. That appears to be well underway, with the rapid surge in migration and corresponding increase in labour supply helping to ease constraints and taking pressure off wages, evident in Q2's QSBO as well as falling job vacancies and sharply increasing applicants per ad, as reported by Seek. However, its going to take some time to for the labour market to transition to an outright disinflationary state. With the unemployment rate still hovering near record lows, we don't expect that to happen until the middle of 2024.

Given we’re expecting non-tradables inflation to print in line with the RBNZ’s expectation in Q2, the persistence of non-tradables inflation may well not be next week’s story. In fact, our expectation of a faster fall in headline inflation may provide some insurance in the case non-tradables inflation doesn’t play ball later this year, enabling the RBNZ to tolerate a slower return of non-tradables inflation to target.

Overall, we don’t expect the Q2 data to make a compelling case for the RBNZ to deviate from their current plan to keep the OCR on hold at 5.5% and “watch, worry and wait.” But as the dataflow evolves over the coming months, and in our view, reveals a picture of relative resilience and sticky non-tradables inflation compared to RBNZ’s forecasts, we’d caution against complacency. We continue to expect that the RBNZ will be back at the hiking table by November.

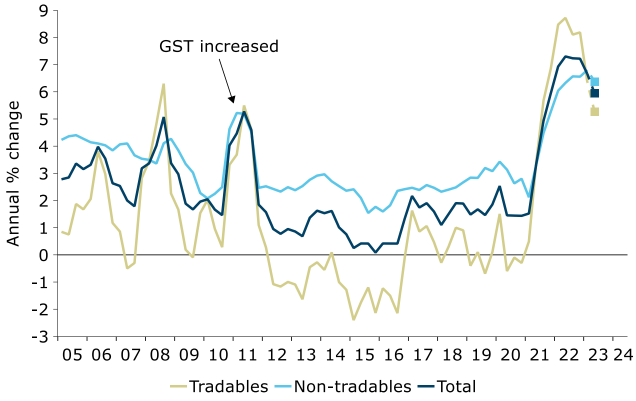
Table 1. ANZ Q2 CPI component-level forecast

	q/q%	%pt cont.
Total	**1.0**	**0.97**
Food	2.0	0.43
Housing & Household Utilities	0.8	0.28
Miscellaneous Goods & Services	1.0	0.09
Recreation & Culture	0.7	0.07
Alcoholic Beverages & Tobacco	0.5	0.05
Health	0.9	0.04
Household Contents & Services	0.8	0.04
Clothes & Footwear	0.6	0.02
Education	0.0	0.00
Communication	-0.5	-0.01
Transport	-0.1	-0.02

■ Quarterly % change ■ Percentage point contribution

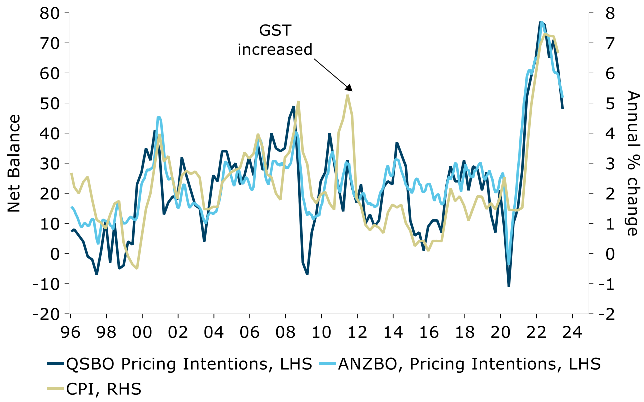
Source: Stats NZ, Macrobond, ANZ Research

Figure 1. CPI inflation measures



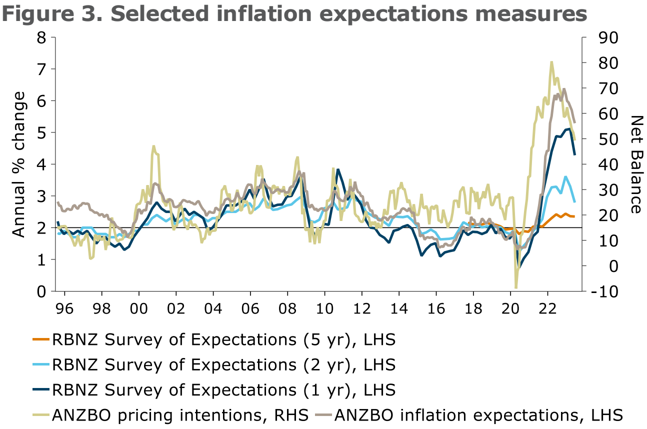
Source: Stats NZ, Macrobond, ANZ Research

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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