ANZ Research

June 2023 Quarter CPI Review

19 July 2023

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Data summary

	% qtr	% ann
Headline CPI	1.1%	6.0%
Tradable	0.8%	5.2%
Non-tradable	1.3%	6.6%

Not a good news day after all

- Annual CPI inflation decelerated from 6.7% in Q1 to 6.0% in Q2, a little stronger than our forecast of 5.9%, but slightly below the RBNZ's May MPS forecast of 6.1%. That was where the good news ended for the RBNZ, however, with an unwelcome upward surprise in the key non-tradables inflation component.
- Non-tradables inflation came in at 6.6% y/y, stronger than the May MPS forecast of 6.3% y/y and our forecast for 6.4%. And the upward surprise was broad-based, rather than reflecting unexpected moves in one or two components.
- Core inflation measures were mixed. CPI excluding food, fuel, and energy fell to 6.1% y/y (6.5% previously). Trimmed mean measures largely remained flat or eased slightly. At the 30% trim level, inflation eased from 6.1% y/y to 6.0% y/y. Weighted median inflation rose sharply from 5.6% y/y to 6.6% y/y.
- Tradables inflation (largely imported) came in at 5.2% y/y (6.4% previously), well below the RBNZ's forecast of 5.8%, but largely reflecting base effects (as rising fuel prices in the wake of the war in Ukraine fell out of the annual calculation), as well as an expectedly sharp fall in international airfares.
- All up, these data show that risks to the inflation outlook remain firmly to the upside. While annual headline inflation fell sharply, which is helpful for inflation expectations, the details suggest persistence in non-tradables inflation, with associated potential medium-term challenges.
- We maintain our forecast that the RBNZ is not in fact done hiking yet, with a 25bp hike pencilled in for November. The focus now moves to Q2 labour market statistics (2 August).

Big picture

The RBNZ will take little comfort from the fall in headline inflation today. The sharp fall in the annual headline largely reflects sizable base effects rolling out of the equation. The details still show clear underlying persistence, with the quarterly non-tradables inflation rate annualising to 6.1% y/y, after taking into account seasonal patterns. And with the headline rate still obviously far higher than it's supposed to be, it's by no means 'job done' for the RBNZ. Monetary policy is working to cool inflation pressures, but there's a long way to go, and it's not clear that progress is fast enough.

Breaking it down, while headline inflation came in slightly weaker than the RBNZ had expected, all of the downward surprise reflected tradables inflation. Ongoing goods disinflation, fading supply chain disruption, a sharply lower oil price, and the rapid normalisation in shipping costs are all tailwinds for bringing headline inflation down that actually have very little to do with the RBNZ's actions thus far. On that score, the persistence of domestically driven inflation, tied to a labour market that we suspect isn't capitulating from unsustainably tight levels as rapidly as the RBNZ believes, remains a key concern.

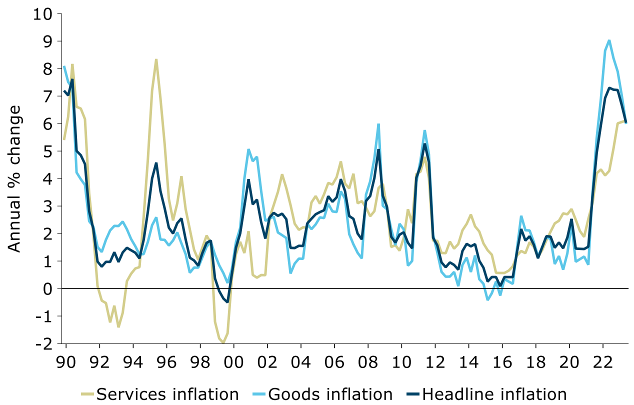
Services inflation remained flat at 6.1% y/y. The quarterly impulse was weaker at 0.6% q/q, however once stripping out transport services, we estimate the quarterly services impulse of around 1.1%, likely closely linked to the strength of the labour market. Pretty rapid improvements will need to be evident across the second half of the year for the RBNZ to be confident that monetary policy is sufficiently restrictive to get overall inflation sustainably back to target.

The suite of core measures showed some evidence of moderation, but it is by no means enough for the RBNZ to breathe easy. Trimmed mean measures were either flat or eased a touch, with the 30% trim measure falling from 6.1% y/y to 6.0%. Inflation excluding food, fuel and energy fell from 6.5% y/y to 6.0%. However, the proportion of the CPI basket running in excess of the 2% target increased to 84%, while the proportion of the basket running at greater than 5% fell. That suggests extreme inflation is now fading, but at the same time, inflation could be normalising above the RBNZ's target midpoint of 2%.

Overall, today's data suggest that underlying inflation is proving persistent, which will be a big worry for the RBNZ. That said, the fall in annual headline inflation is no less welcome for the fact that it reflects base effects (ie the unsustainable commodity price surge in the wake of the Russian invasion of Ukraine dropping out) and some sharp falls in tradables components. It all helps.

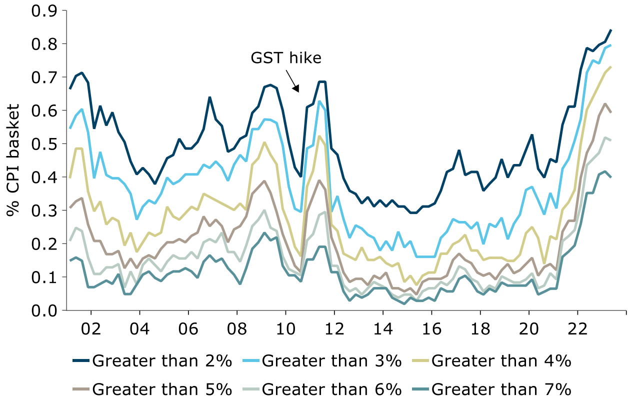
It's a long way back to target and that challenge will become increasingly evident once the low-hanging fruit of base-effects has all been gathered. Upside risks to medium-term inflation have not gone away, a fact we expect will become increasingly evident as the year goes on. For now, the economy is evolving broadly in line with the RBNZ's expectations. However, we'd caution against any complacency that the battle against inflation is over. How quickly the labour market capitulates holds the key. Today's data ups the ante on the score, insofar as it will make a dent in the RBNZ's ability to be patient. Our forecast continues to be that the economy is not in fact set to roll over as rapidly as the RBNZ expects, and that the next move in the OCR is upwards.

Figure 1. Goods and services inflation



Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Proportion of the CPI basket running greater than X% y/y



Source: Stats NZ, Macrobond, ANZ Research

The details

Turning to the details, of the 1.1% q/q increase in consumer prices in the June quarter:

- Food prices (18.0% of the CPI basket) lifted 2.2% q/q. Food prices continue to be pushed higher by disruption from extreme weather events and challenges with access to markets due to strained transport infrastructure. However, global food prices are well off their peaks, and while we haven't seen any evidence of that in New Zealand yet, the widening gap between domestic and global trends is likely to prove unsustainable.

- Housing-related costs (28.3% of the CPI basket) remain a key driver, rising 1.2% q/q – stronger than the 0.8% q/q we pencilled in. Rent prices were up 1.1% q/q, to be up 4.2% y/y. Housing construction costs also rose 1.1% q/q, slightly stronger than our expectation of 1.0% q/q. Construction cost inflation is below the historical average, as expected, given weakening demand and fading supply-side disruption. However, it remains unclear how far construction cost inflation will fall, given still-tight labour market conditions, a housing market showing signs of life, and residential construction intentions rising off their lows in recent months.

- The transport group (14.2% of the CPI basket) fell 1.9% q/q, much weaker than the 0.2% fall we expected. Petrol prices declined 1.5% q/q, more than the 0.3% q/q fall the weekly fuel price data had suggested. Domestic airfares fell 0.4% q/q, much less than the 5.0% q/q fall we had expected. On the other hand, international airfares fell 11.9% q/q, a much bigger fall than we had pencilled in. International airfares remain elevated, and further normalisation should occur across the second half of the year.

- The recreation and culture group (8.5% of the CPI basket) lifted 1.1%, much stronger than the 0.7% q/q we had pencilled in. The group was a tale of two halves: generally weaker inflation for the goods components, while services component inflation remained robust.

- Household contents and services (4.2% of the CPI) rose sharply up 2.6% q/q, stronger than the 0.8% lift that we had pencilled in, based on moderating global goods prices. That didn't eventuate, however and the level of prices in the group remains exceptionally elevated. We expect to see some normalisation moving forward.

Monetary policy implications

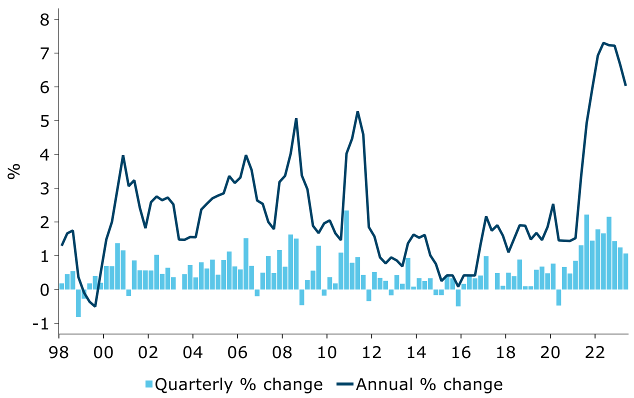
The Q2 CPI data is a smaller step in the right direction than the RBNZ would have been hoping to see. Glass half full, both global and domestic-driven inflation pressures are off their peaks. Falling headline inflation is likely to support a continuation of the downtrend in inflation expectations seen in recent months. But that doesn't prove that inflation is set to neatly roll all the way into the target hole.

Indeed, as well as the unwelcome upward surprise in non-tradable inflation today, in the near term, there's still some strength (albeit largely transitory) expected in Q3, with the unwind of the subsidies on fuel excise, road user charges and public transport, a sizeable lift in alcohol excise, and a significant rise in council rates all on the cards. The hike in prices at the pump, still-intense food price increases, and pressures building in the rental market – all necessities, not luxuries, and therefore highly salient to household budgets – may yet see inflation expectations hold up.

Looking further ahead, with clear evidence of underlying inflation pressures persisting, the RBNZ won't be as comfortable in their on-hold stance as they were yesterday. We wouldn't overplay it – the outlook for demand is more important than a 0.3%pt surprise on the starting point for non-tradable inflation. On that score, we continue to expect a picture of relative resilience of demand across the second half of the year, as the impulse from net migration, sizeable fiscal stimulus in the next 12 months, improving business sentiment and a housing market showing signs of life conspire to prevent the economy from rolling over as quickly as the RBNZ currently forecasts. That amounts to upside risks around labour market resilience, and thus medium-term inflation. We've always said our call for an eventual resumption of hiking would likely look wrong before it looks right, based on the data flow between now and the end of the year. We're patient. But today's data reduces the RBNZ's ability to be patient in terms of waiting to see the full impacts of their actions thus far play out.

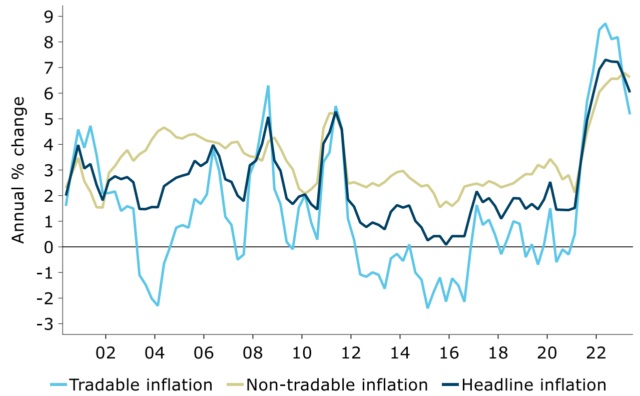
It's clear that the economy is slowing, but both the speed at which this is happening, and the speed at which it needs to happen, are topics of vigorous debate. Today's data don't give a great deal of evidence to settle either question – the million dollar question is how quickly spare capacity is opening up in the economy. Next stop, Q2 labour market data in two weeks.

Figure 3. Headline CPI inflation



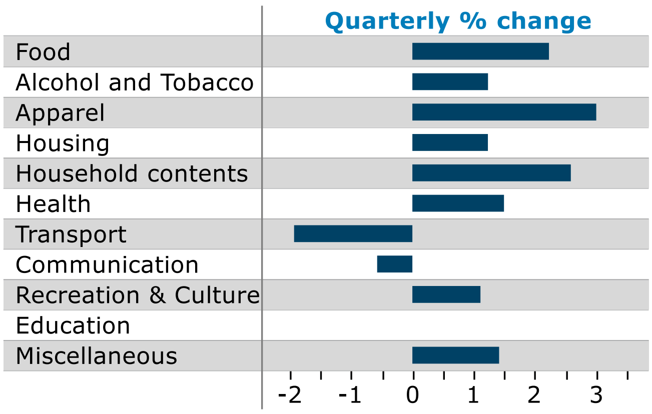
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. CPI inflation components



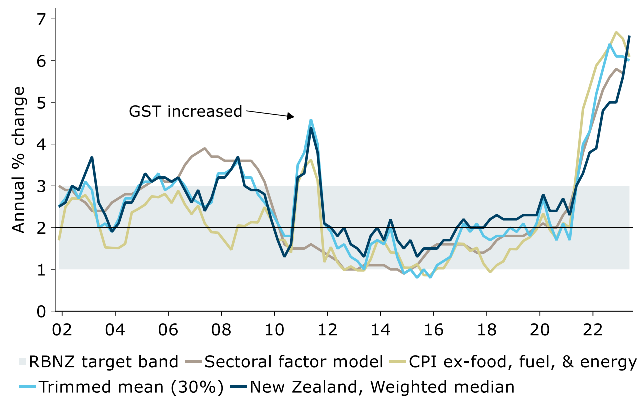
Source: Stats NZ, Macrobond, ANZ Research

Figure 5. CPI groups – June 2023 quarter



Source: Stats NZ, Macrobond, ANZ Research

Figure 6. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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