ANZ Research

December 2023 Quarter CPI Preview

18 January 2024

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Contact

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Consumers Price Index – December 2023 Quarter

	Prev	ANZ	RBNZ
CPI – q/q	1.8%	**0.6%**	**0.8%**
CPI – y/y	5.6%	**4.7%**	**5.0%**
Tradables - q/q	1.8%	**0.1%**	**0.7%**
Tradables - y/y	4.7%	**3.4%**	**4.0%**
Non-tradables - q/q	1.7%	**0.9%**	**0.9%**
Non-tradables - y/y	6.3%	**5.7%**	**5.7%**

Hardly a home run

The bottom line

- We expect annual CPI inflation decelerated sharply to 4.7% y/y in Q4, below the RBNZ's November MPS forecast of 5.0% y/y.
- However, the expected downward surprise versus the RBNZ's November forecast is driven entirely by the tradables component, which we expect fell from 4.7% to 3.4% y/y.
- We expect non-tradable inflation of 5.7% y/y, in line with the RBNZ's November forecast. Given the RBNZ's focus on this component, it's surprises here that will matter for the OCR outlook, particularly in context of the RBNZ's impatience as expressed in the November Monetary Policy Statement. We see the risks as balanced around 5.7%.
- We expect the suite of core inflation measures to move materially lower. This is absolutely what the RBNZ needs to see, but we are cognisant that these measures are also influenced by weaker tradables inflation, whereas the RBNZ's primary focus is domestic inflation risks.

The big picture

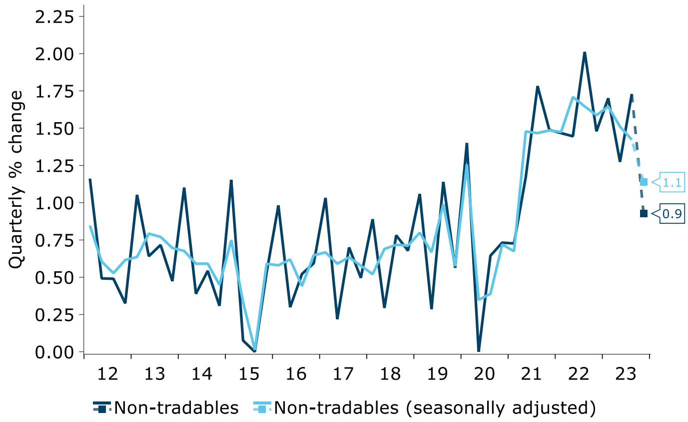
In recent months, New Zealand has benefited from a strong supply-side recovery that we expect has contributed to a sharp deceleration in inflation in Q4. The rebound in airline seat capacity (though we note international airfares surged 42% m/m in December!); the recovery from cyclone-related weather disruption to food production; falling prices at the petrol pump; the resolution of global supply-chain stresses and falls in shipping costs (albeit which are now in reverse); these have all contributed to an easing in headline inflation over the quarter.

Our forecast for a 0.6% q/q increase in headline inflation is slightly lower than the Reserve Bank's November MPS forecast of 0.8% q/q, but all of the expected downside surprise is driven by tradable inflation (ANZ: 0.1% q/q, RBNZ: 0.7% q/q). Our forecast for non-tradables inflation of 0.9% q/q is in fact in line with the RBNZ.

While disinflation from any source is welcome, as long as non-tradable inflation remains elevated the RBNZ will not relax. Tradable inflation is volatile, and the RBNZ's influence on it is limited. December's Selected Price Indexes made that volatility very clear: international airfares surged 42% m/m in December.

Sustained disinflation is contingent on non-tradables inflation falling. And it's important to note that there has been real progress on that front. Official CPI data is not seasonally adjusted, even though it is in fact very seasonal, and looking at seasonally adjusted data can help highlight trends. Our forecast of non-tradable inflation of 0.9% q/q equates to 1.1% q/q on a seasonally adjusted basis. This would be the lowest seasonally adjusted quarterly increase since Q1 2021 – the beginning of the inflation surge – and is a meaningful stepdown from the extreme domestic inflation rates we've seen over the past few years (figure 1, over).

Figure 1. Non-tradables inflation, raw and seasonally adjusted



Source: Stats NZ, Macrobond, ANZ Research

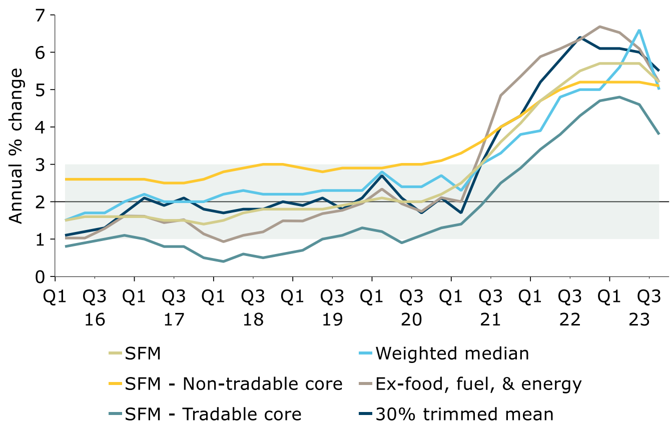
However, non-tradable still too high for any sense of 'job done' for the RBNZ. Historically, seasonally adjusted non-tradable inflation averaging around 0.7-0.8% q/q has been consistent with inflation at 2%. So we're getting there, but there's still a way to go, and as long as that remains the case the RBNZ will remain concerned about the risk that the economy could rebound or another inflationary shock come along before non-tradable inflation is beaten.

The RBNZ needs to see real progress in the components responsible for inflation's persistence to be confident that the downtrend in inflation is sustainable. The suite of core measures (figure 2) will be crucial for assessing that. We are expecting a material reduction across the suite. But many of the measures are not immune to influences from falls across tradable components, which the RBNZ is less concerned about. The non-tradable core component of the RBNZ's sectoral factor model provides the best indication of medium-term inflation risks. It finally ticked lower in Q3, and we'll be hoping to see further progress.

Monetary policy is working, and given the output gap is now likely negative, the economy has the met the precondition for core disinflation. But progress on getting non-tradables inflation down has been slow to date, which is making the RBNZ antsy. It's likely a question of timing, but time is finite, particularly given the markets ambition for cuts as soon as May.

As always, the details of next week's release will be key. We turn to the details of our forecast on the next page.

Figure 2. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

The details

Let's break down our forecast of a 0.6% q/q increase in headline inflation.

- **Housing-related costs** are expected to add 0.2%pts to the quarterly headline figure. Within this group:
  - The Rent Price Index rose 1.0% q/q (4.5% y/y) in Q4, adding 0.1%pts to quarterly headline inflation. Given that the CPI measure of rent inflation takes into account tenancies over the past 8-10 years, it is slow to reflect changes. Rent inflation for new tenancies is currently running at 7.0% y/y, reflecting the surge in net migration, and the RBNZ has signalled its concern about the likely persistence of large rent rises over 2024.
  - Construction costs are expected to have lifted 0.5% q/q in Q4, adding less than 0.1%pts to quarterly headline inflation, but are a source of risk. Pricing intentions in the construction sector eased dramatically in Q4 according to both our Business Outlook survey and NZIER's QSBO. In fact, the latter suggested that construction costs were in outright deflation. However, with construction intentions improving, likely supported by loosening policy settings and the demand pulse from net migration, there are risks that the trend of easing construction costs reverses over 2024.
- **Recreation and culture** are expected to add over 0.1%pts to headline inflation, reflecting the ongoing recovery in tourism-related sectors supporting price growth.
- **Miscellaneous goods and services** are expected to add over 0.1%pts to headline inflation, the bulk of which reflects the continued strength in insurance cost inflation. The repricing of climate risk and rising replacement costs due to broad-based past inflation are likely to keep insurance cost inflation elevated into 2024. The influence of monetary policy is fairly limited here. However, the RBNZ will still be concerned about the potential influence on inflation expectations.
- **Alcohol and tobacco** are expected to add 0.1%pts to headline inflation, largely reflecting an unusual 3.0% q/q increase in cigarette prices. Cigarette price increases tend to occur in January of each year with the annual increase in tobacco excise rates.
- **Transport** is expected to add 0.1%pts from quarterly headline inflation. The bulk of this reflects a significant surge in international airfares in December. But this is volatility and could easily reverse in the new year.
- **Food price inflation** is expected to have subtracted 0.2%pts from headline inflation. This is the first quarterly contraction since December 2021. While some of this weakness is seasonal, the ongoing supply recovery from cyclone-related disruption, and past falls in imported food prices finally reaching New Zealand's shelves are also drivers. Softer food price inflation should endure into 2024.
- **The remaining 0.1%pts** is a mixed bag of ups and downs across the other components.

The view

Economic data over recent months has clearly softened. The economy is much smaller than the RBNZ had anticipated at the November MPS. Capacity pressures have faded, and slack is now emerging across the economy. Labour demand is cooling and labour supply has grown rapidly, seeing wage growth ease. The RBNZ is likely to revise down its estimate of the output gap somewhat. And the starting point for inflation is a little lower than they thought. Things are on track.

That said, we remain concerned about sticky domestic-driven inflation risks, given early signs of a stabilisation in domestic demand across our Business Outlook survey and the NZIER QSBO suggest that economic activity may have bottomed out earlier than the RBNZ expected, somewhat offsetting the news that historical growth has been weaker than was known. Disinflation is not a linear process. The RBNZ is likely to proceed with caution, given the potential costs of pivoting too early remain very high. We'll update our OCR outlook in a note later today.

While the RBNZ looks with interest at all the economic data that comes across its path, at the end of the day, it's surprises on non-tradables inflation outcomes that have driven the big moves in OCR expectations in recent years. A material downward surprise could pave the way for an early pivot (though a lot still needs to go right for the RBNZ); a material upward surprise could see the market back away from its expectation of a cut by May, and even put decent odds on a hike in February.

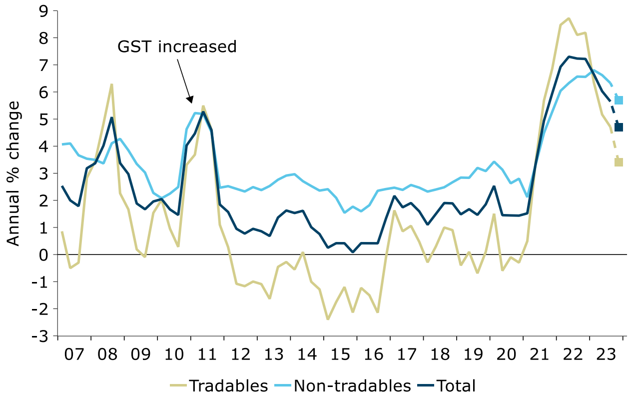
Table 1. ANZ Q4 CPI component-level forecast

	q/q%	%pt cont.
Total	**0.6**	**0.58**
Housing & Household Utilities	0.5	0.17
Miscellaneous Goods & Services	1.8	0.15
Recreation & Culture	1.8	0.15
Transport	0.7	0.13
Alcoholic Beverages & Tobacco	1.1	0.10
Health	0.9	0.04
Clothes & Footwear	0.7	0.03
Household Contents & Services	0.6	0.03
Communication	0.6	0.01
Education	0.0	0.00
Food	-1.0	-0.21

■ Quarterly % change ■ Percentage point contribution

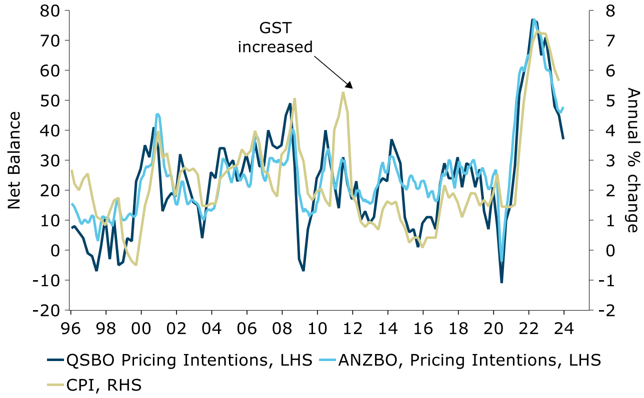
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. CPI inflation measures



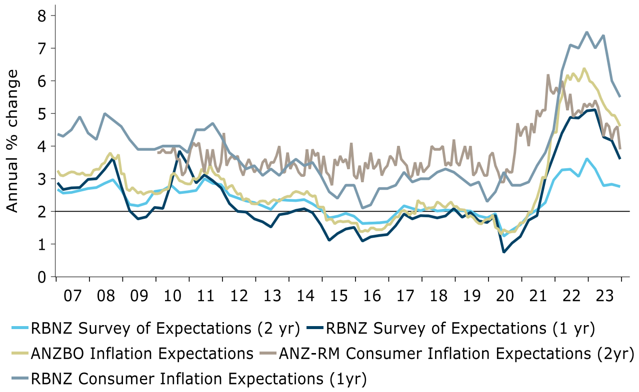
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Inflation and pricing intentions



Source: NZIER, Stats NZ, Macrobond, ANZ Research

Figure 5. Selected inflation expectations measures



Source: Stats NZ, ANZ, RBNZ, Bloomberg, Macrobond, ANZ Research

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