ANZ Research

June 2024 Quarter CPI Preview

11 July 2024

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Consumers Price Index – June 2024 Quarter

	Prev	ANZ	RBNZ
CPI – q/q	0.6%	**0.4%**	**0.6%**
CPI – y/y	4.0%	**3.3%**	**3.6%**
Tradables - q/q	-0.7%	**-0.2%**	**0.3%**
Tradables - y/y	1.6%	**0.6%**	**1.1%**
Non-tradables - q/q	1.6%	**0.8%**	**0.8%**
Non-tradables - y/y	5.8%	**5.3%**	**5.3%**

Closing in on the target band

The bottom line

- We expect the CPI rose 0.4% q/q in Q2, taking annual inflation down from 4.0% y/y to 3.3% y/y. This is well below the RBNZ's May MPS forecast of 0.6% q/q (3.6% y/y).
- We expect non-tradable (domestically driven) inflation rose 0.8% q/q (5.3% y/y), in line with the RBNZ's forecast. We view the risks as balanced around that pick. That said, with weak activity data signalling downside risks are building around the medium-term inflation outlook, a downward surprise would likely be significant for increasing the RBNZ's confidence in the disinflation trajectory.
- We expect tradable (largely imported) inflation of -0.2% q/q (0.6% y/y), well below the RBNZ's forecast of 0.3% q/q (1.1% y/y). Underpinning this is weakness in volatile components such as food, energy and airfares. The impacts of weak domestic demand are expected to be evident across durable goods components.
- Core inflation measures are likely to move lower. Of the measures that we focus on, we expect 30% trimmed mean inflation and CPI ex food, fuel and energy to move below 4%, while weighted median inflation is expected to fall, though remain above 4%.
- A material undershoot to the RBNZ's headline inflation forecast will likely further fuel bets that OCR cuts are imminent. But if it's volatile components that are driving the weakness relative to RBNZ expectations, it's less significant than otherwise. Alone, the Q2 CPI report is unlikely to bring imminent OCR cuts into play without a meaningful downward surprise to non-tradable inflation. But when viewed in the context of very soft domestic data and deteriorating labour market conditions, the RBNZ may give more weight to a headline undershoot.

The big picture

Much has been made of a return to the 1-3% target band being the prerequisite for the RBNZ to contemplate OCR cuts. Q2's CPI report is likely to fall just short of that mark, while confirming that that threshold is highly likely to be passed in Q3. But there is more nuance to the story of when cuts will come than headline inflation. The RBNZ must be confident that inflation is *sustainably* returning to the 2% target midpoint. That confidence will certainly grow as inflation falls, and the RBNZ's capacity to absorb positive inflation shocks correspondingly rises, but the sustainability of the return to 2% will predominately be determined by the path of domestic inflation.

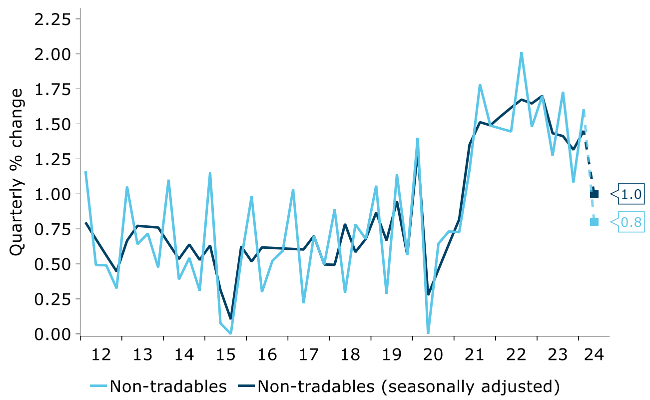
To date, the tradable basket has been the key driver of falling headline inflation. That's primarily reflected the post-COVID normalisation in global supply lines, the recovery in food production from severe weather, and resolution of supply-demand imbalances in energy markets following the Russian invasion of Ukraine. However, weak domestic demand is clearly weighing too, particularly on goods components, as firms find customers more resistant to price rises. In short, while the RBNZ can only take a little bit of the credit, tradable inflation has been well behaved. Rather, the RBNZ has of late focused on non-tradable inflation outcomes due to the concerning persistence exhibited over recent quarters.

The strength of Q1 non-tradable inflation, which was a whopping 0.5%pts higher than the RBNZ's forecast, drove a hawkish tilt at the May MPS, with the RBNZ signalling it believed the economy must have had less spare capacity of late than it had previously assumed. In our view, in contrast, persistence in current domestic inflation has very likely reflected the lagged response to past inflation outcomes, which doesn't necessarily imply it's going to take a deeper or longer growth slowdown to do the job. But that persistence is likely to continue to play out over the next few quarters, to some extent masking domestic disinflation progress.

The domestic dataflow has been weak for some time now, but the most recent data has taken a further turn south. The NZIER's Q2 Quarterly Survey of Business Opinion indicated that the transmission of weak demand and rising spare capacity across the economy into lower inflation outcomes is now occurring. Cost and pricing indicators dropped sharply, a similar theme to our own June Business Outlook survey (only more pronounced). Both surveys also indicate a rapid downward adjustment in wage inflation in response to rising spare capacity in the labour market. These data signal that domestic disinflation progress is on the cusp of accelerating.

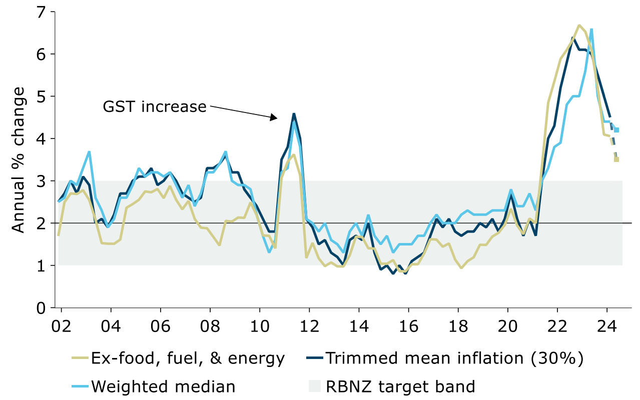
To confirm that the disinflationary dynamics evident in recent 'soft' data are indeed now flowing through to the CPI, domestic and services inflation components will be key. We expect the suite of core inflation measures that we focus on (weighted median, 30% trimmed mean inflation, and CPI ex food, fuel and energy) to move lower, with 30% trimmed mean and CPI ex food, fuel and energy both heading below 4%. That will be reassuring for the RBNZ after a couple moved sideways in the previous quarter.

Figure 1. Quarterly non-tradable inflation



Source: Stats NZ, Macrobond, ANZ Research

Figure 2. Core inflation measures



Source: Stats NZ, Macrobond, ANZ Research

Overall, while recent activity and capacity indicators highlight downside risks to medium-term non-tradable inflation are building, we don't expect the Q2 inflation report to be the 'hallelujah moment'. After all, a 0.8% q/q increase in non-tradable inflation is still above the level consistent with headline inflation at target, after seasonal adjustment. But it would mark real progress, and importantly, the end of the run of upward surprises versus RBNZ expectations. The inflation starting point certainly matters for RBNZ calibrations (as we saw in May!), but when it comes to actually pulling the trigger on cuts, the Q2 labour market and GDP data will be important too. The RBNZ will need to be confident that disinflationary dynamics evident in surveyed activity, pricing and cost measures are indeed showing up in the ‘hard’ data (CPI, labour market statistics and GDP), before they are in a position to ease the OCR. There are different views out there as to when that threshold will be crossed, but no disagreement that it's likely coming earlier than previously thought.

The details

Breaking down our forecast for a 0.4% q/q increase in headline inflation:

- **Housing-related costs** are expected to add 0.3%pts to the quarterly headline figure. Within this group:
  - The Rental Price Index rose 1.2% q/q (4.8% y/y), adding 0.1%pts to headline inflation. Dynamics in the rental market are now shifting, likely reflecting weakening labour market conditions. However, due to its lagged response, the CPI measure of rents is expected to remain robust across most of 2024.
  - Construction costs are expected to have lifted 0.6% q/q, adding 0.1%pts to headline inflation. Construction activity has slowed significantly, and price inflation has now eased below the long-run average. That said, construction cost inflation has yet to meaningfully correct following the surge in 2021. We expect weakness in the sector to continue to result in a further moderation, and there is the potential for an outright contraction. This component is one to watch.
  - Household energy prices are expected to have lifted 2.8% q/q, adding 0.1%pts to headline inflation, reflecting an increase in electricity prices.
- **Miscellaneous goods and services** are expected to add over 0.1%pts to headline inflation, mostly reflecting continued strength in insurance cost inflation. The continued strength of insurance pricing will partly reflect the effects of the past period of high inflation, which should moderate with time. However, structural factors such as the increase in weather-related risk, which monetary policy cannot influence, are more problematic for the RBNZ.
- **Food price inflation** is expected to add 0.0%pts to headline inflation. Weaker food price inflation continues to be a drag on headline inflation, with the key driver being the normalisation in fresh produce supply following last year’s severe weather events. Restaurant price inflation, which has been a key driver of non-tradable inflation, has also showed signs of moderation.
- **Recreation and culture** are expected to subtract 0.1%pts from headline inflation, the bulk of which reflects larger-than-usual seasonal falls in domestic accommodation services.
- **Transport inflation** is expected to subtract 0.1%pts from headline inflation, largely reflecting seasonal falls in domestic and international airfares. Petrol prices have been weaker than our prior assumption, and one of the drivers of the downward revision to our pick. Due to quarterly averaging, this will also affect Q3 CPI.
- **The remaining 0.2%pts** is a mixed bag of ups and downs across the other components.

The view

While the Q2 CPI report is unlikely to be sufficient to give a green light to imminent OCR cuts, we do expect it to confirm the return to the 1-3% target band is highly likely to occur in Q3. Weakness in survey-based data has signalled that disinflationary dynamics are strengthening across the economy and risks to the inflation outlook are beginning to skew to the downside.

The RBNZ’s attention will be fixed on non-tradable inflation. This component of CPI inflation has surprised the RBNZ to the upside for four consecutive quarters since it went on hold in May 2023 – they expected it to be 4.4% y/y by Q1 and instead it was 5.8% y/y. A fall to 5.3% in Q2, as we and the RBNZ are forecasting (figure 3), would go some way to closing the gap.

While we are forecasting the same outcome for non-tradable inflation as the RBNZ, with balanced risks, it’s worth thinking about what the RBNZ would make of a surprise in either direction. A downward surprise would likely be significant for signalling a shift in inflation risks, increasing the chance that the RBNZ’s first OCR cuts comes earlier than our current forecast for February 2025. However, that will likely need to be supported by dovish signals in upcoming Q2 labour market and GDP data. An upward surprise, on the other hand, would likely have a limited impact on the RBNZ’s view, given yesterday’s Monetary Policy Review highlighted growing confidence in the medium-term inflation outlook.

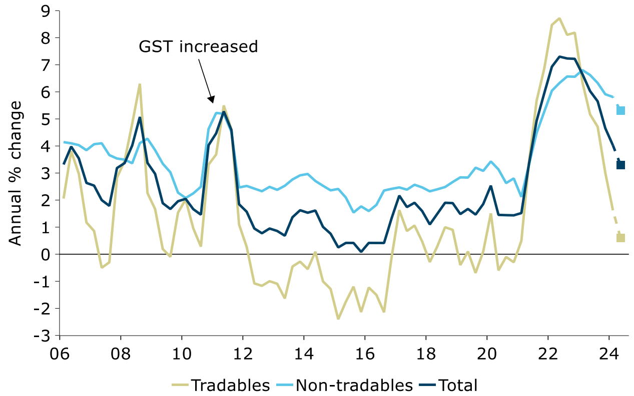
Table 1. ANZ Q2 CPI component-level forecast

	% (-1.5 -0.5 0.5 1.5)	q/q%	%pt cont.
Total		**0.4**	**0.37**
Housing & Household Utilities		0.8	0.28
Miscellaneous Goods & Services		1.5	0.13
Alcoholic Beverages & Tobacco		0.7	0.06
Household Contents & Services		0.9	0.04
Health		0.6	0.03
Food		0.1	0.02
Clothes & Footwear		0.6	0.02
Education		0.0	0.00
Communication		-0.3	-0.01
Transport		-0.6	-0.10
Recreation & Culture		-1.2	-0.11

■ Quarterly % change ■ Percentage point contribution

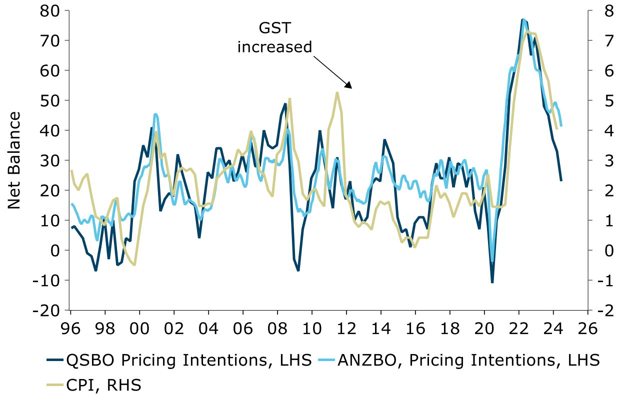
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. CPI inflation measures



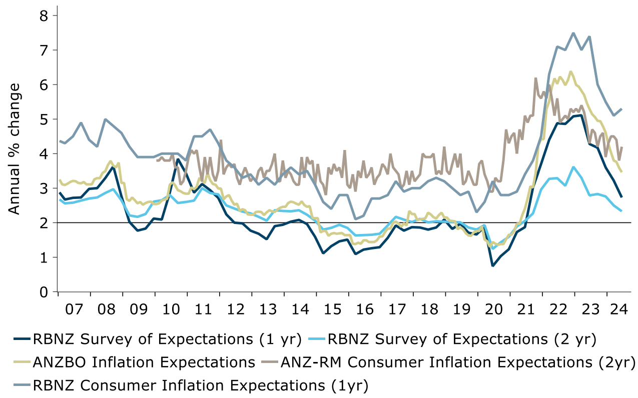
Source: Stats NZ, Macrobond, ANZ Research

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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