MORE NOISE THAN SIGNAL

- We expect headline CPI rose 0.4% q/q in Q1, which would see annual inflation slow from 1.6% to 1.0% y/y – a touch below the RBNZ’s expectation of 1.1%.

- The fall in annual headline inflation is more noise than signal. Nonetheless, evidence of a broadening in domestic price increases beyond housing remains elusive. Core inflation measures are expected to be broadly stable.

- Policy-induced price rises will be broadly offsetting, with higher tobacco duty offsetting fees-free first-year tertiary education.

KEY POINTS

- We expect headline inflation rose 0.4% q/q in the 2018 March quarter (released 19 April). This would see annual inflation dip to 1.0%, slightly below the RBNZ’s February MPS forecast of 0.6% q/q and 1.1% y/y. However, there are a number of temporary factors at play including policy changes and base effects.

- Policy settings should make a broadly neutral contribution. The usual annual increase in tobacco excise duty is expected to make a +0.3%pt q/q contribution, while the fees-free first-year tertiary education policy will broadly offset this, with a 4% fall in the education group instead of its typical Q1 rise.

- Other seasonal changes will be broadly offsetting. International airfares are likely to take their usual March quarter trip south (around -10% q/q), making a -0.2%pt contribution. Accommodation services should rise around 3% q/q (0.1%pt contribution) on the back of a strong tourism season (and consistent with our Monthly Inflation Gauge). Monthly data is pointing towards a 0.5% q/q rise (0.1%pt contribution) in the food group.

- While petrol prices have been unusually stable on a quarterly basis, the contribution to annual inflation will remain solid. A further lift over Q2 seems likely, given recent moves in oil prices.

- The housing group will remain at the forefront. We expect rents (+0.9% q/q) and the purchase of housing (+1.1% q/q) to together make a 0.2%pt contribution. March typically sees solid rent increases and anecdotes suggest this year is no exception.

- Outside of housing, the inflation pulse is expected to remain soft. We expect a 0.8% q/q lift in non-tradable inflation, which would see annual inflation in this measure dip to 2.2%. As implied by our Monthly Inflation Gauge, it is still mostly housing driving this. A broader lift in inflation is likely to remain absent until we see a meaningful lift in wages.

- Tradable prices are expected be broadly flat on a quarterly basis, (~0.3% y/y), with the dip in international airfares offset by higher food prices. It’s possible that the lower TWI over the back half of 2017 supports a small broad-based rise across tradable prices, but we don’t think it likely as survey data suggests businesses have struggled to lift prices in the quarter. However, with capacity utilisation and margins pressures highs, firms will need to lift prices at some point.
Core inflation measures should be broadly steady. In Q4, the suite of core measures we monitor showed a mild softening, if anything. For Q1, the expected decline in annual headline inflation is partly due to base effects which shouldn’t impact core measures to the same extent. We expect inflation to pick up again over coming quarters. Core inflation measures such as the weighted median and trimmed mean should smooth through this noise.

We retain a view that domestic inflation will rise and broaden in time. That is largely predicated on our view that the cyclical low in wage inflation is behind us and that courtesy of both skill shortages and government policy changes, wage inflation will continue to lift. However, this is far from certain. Given we see GDP growth in the next year or so running around trend, there is little to suggest that inflation is about to break out any time soon.

With this in mind, we suspect the RBNZ will continue to bide its time until there’s a little more certainty that inflation is set to rise. But with a new Governor there is naturally more uncertainty than usual, and Mr Orr’s first Monetary Policy Statement on 10 May will be perused with great interest, despite a clear market expectation of an unchanged OCR for a long time yet.

### ANZ Q1 CPI component-level forecast

<table>
<thead>
<tr>
<th>Groups</th>
<th>q/q%</th>
<th>%pt cont.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Alcoholic beverages and tobacco</td>
<td>4.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>-0.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Housing and household utilities</td>
<td>0.7</td>
<td>0.2</td>
</tr>
<tr>
<td>Household contents and services</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Health</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Transport</td>
<td>-0.6</td>
<td>-0.1</td>
</tr>
<tr>
<td>Communication</td>
<td>-0.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Education</td>
<td>-4.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>Miscellaneous goods and services</td>
<td>0.6</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>0.4</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Source: ANZ, Statistics NZ

### Selection core inflation measures

Source: ANZ, Statistics NZ, RBNZ
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