17 July 2018

CONSUMERS PRICE INDEX – 2018Q2

PRICE CHECK AISLE TWO

BOTTOM LINE

- Headline CPI inflation in Q2 was a touch below market expectations but stronger than we expected, owing to stronger non-tradables inflation.
- Housing related inflation remains at the fore. Core inflation measures were also a touch firmer.
- Today’s release was in-line with the RBNZ’s May MPS forecast. At the margin the details were perhaps a little stronger though, which will provide it with some reassurance that inflation will rise and broaden in time.
- But we still expect it to continue to bide its time until there’s a little more certainty that inflation is set to rise in a sustainable fashion.

KEY RESULTS

- **Headline CPI rose 0.4% q/q in Q2, which was below consensus expectations (0.5%) but above our own (0.1%).** This saw annual inflation pick up to 1.5% y/y from 1.1% in Q1. Tradable prices rose 0.3% q/q (0.1% y/y), while non-tradable prices rose 0.4% q/q (2.5% y/y). It was the strength in non-tradables inflation that proved to be the biggest surprise for us, as it was a much stronger result than implied by our ANZ Monthly Inflation Gauge.

- **In terms of the details, June is typically a soft quarter for inflation – today’s print was around middle of the road in that regard.** It was not overly weak, but not strong either. Seasonality in New Zealand’s tourism industry saw both accommodation services and domestic airfares make their usual journey south, down 1.7% and 12.5% respectively. In the case of the latter, this was a larger dip than we expected despite higher fuel costs being passed through to ticket prices. However, we always expected this to impact Q3 more.

- **But there were some offsets.** Broadly as expected, the food group rose 0.8% q/q and petrol prices rose 3.2% q/q. The latter reflecting recent NZD weakness and higher oil prices. Petrol will likely make another positive contribution in Q3 given the recent lifts in fuel taxes.

- **The housing group remained at the fore, and despite our expectation for the recent deceleration to remain in a holding pattern, housing-related prices proved they haven’t found a limit just yet.** The purchase of housing rose 1.1% q/q (3.9% y/y). This is still below the average of 1.3% q/q over the past three years and its peak of 6.7% y/y in Q1 2017. After running so hot for so long, anecdotes suggest building cost inflation is decelerating because of already-high prices, but this wasn’t as obvious in Q2. Rents lifted 0.8% q/q (2.5% y/y), which is a lift from Q1’s student induced bustle, possibly reflecting some of the policy-related cost rises to landlords.

- ** Tradable price inflation was as we expected. However, beyond petrol and the seasonal lift in some food prices, we’re still left with a picture of soft retail prices, likely a result of intense competition.** Annual apparel inflation continues to run soft at -0.7 y/y (but
was up 0.5% q/q). The household contents and services group was flat q/q, with furniture and furnishings down 1.3% q/q. This is consistent with recent business surveys which suggest retail margins are squeezed, but competition is making it difficult to increase prices. New and second hand car prices fell 0.9% q/q and 3.3% q/q respectively. The latter possibly reflecting previous supply disruption owing to the brown marmorated stink bug which saw over 10,000 imported cars turned away in Q1.

- **Overall, while there were hits and misses, today’s release still had firmer tone than were expecting.** Annual non-tradables inflation accelerated from 2.3% to 2.5%, and non-tradable inflation ex purchase of housing rose 0.2%pts to 2.4%. In seasonally adjusted terms, non-tradable inflation rose 0.7% q/q, a slight tick-up from Q1’s 0.6% pace.

- **Core and underlying inflation measures also strengthened slightly.** The trimmed mean measures lifted across all levels of the trim in annual terms and the weighted median gained 0.3%pts to 2.3% y/y. The focus now turns to the RBNZ’s sectoral factor model estimate (out at 3pm today), which has ranged between 1.4-1.5% since Q3 2015. Our own model estimate suggests it will print at 1.7%, which is up from an estimated 1.6% last quarter (the ‘official’ estimate is currently 1.5%). An increase of that magnitude, while consistent with an ongoing lift in domestic inflation pressures, would provide some food for thought given that it would be the highest result since 2011. We estimate that the proportion of the CPI basket currently with inflation above 2% y/y rose to 37%, up from 36% in Q1.

- **It is clear housing-related inflation is a key source of domestic inflation pressures at present.** Aside from that, the strength of domestic inflation is a little stronger than we expected. We are of the view that domestic inflation will rise and broaden in time, particularly since firms’ margins are currently being squeezed and cost pressures are on the rise.

- **But the outlook is far from clear cut.** The economy has lost some momentum recently and the outlook for wages is a key uncertainty in light of higher minimum wages and government wage negotiations taking place. On the other hand, the impacts of fiscal stimulus or higher inflation expectations (perhaps related to minimum wage increases and higher tradables inflation) could lead to more sustained inflationary pressures than currently expected.

- **While the print is stronger than expected and rising (or stable) core inflation will provide some tentative reassurance, today’s data are consistent with the RBNZ maintaining a cautious stance.** Inflation is still below the RBNZ’s target midpoint and the outlook is far from clear cut. As such, we expect the RBNZ will be looking for inflation to increase in a consistent, broad based way from here and will retain a neutral stance, signalling that the next move in interest rates could still be up or down, until it is confidence the underlying inflation pulse has strengthened. **If inflation materialises as we expect, the RBNZ will eventually increase the OCR – but that’s a long way away yet and any moves will be gradual.**
2018Q2 CPI REVIEW

Figure 1. Headline CPI inflation

Figure 2. CPI groups – June 2018 quarter

Figure 3. CPI inflation components

Figure 4. Non-tradables and ANZ Monthly Inflation Gauge

Source: ANZ, Statistics NZ
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