

NEW ZEALAND ECONOMICS

DECEMBER 2016 QUARTER CPI PREVIEW

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BAND CAMP

KEY POINTS

- **We expect a 0.3% q/q headline CPI result for the December 2016 quarter** (released 26th January), which is a touch above the RBNZ's November *MPS* pick (0.2%). Annual inflation is forecast to lift to 1.2% – back in the RBNZ's target band for the first time since Q3 2014.
- **Higher petrol prices and base effects largely account for the lift in annual inflation.** Retail fuel prices are estimated to have risen by 5% over Q4, in stark contrast to the 7% drop seen in the same quarter a year earlier. This results in a mechanical bounce in annual CPI inflation. New Zealand is not unique in this phenomenon; headline inflation is rising globally as oil prices stabilise after the late 2015/early 2016 falls.
- **More importantly, there should be further evidence of a turn in the domestic inflation cycle.** While non-tradable inflation, at an estimated 0.5% q/q (2.3% y/y), is still low historically, it is trending higher and we see risks skewed to a modestly stronger outcome in Q4. Our Monthly Inflation Gauge is hinting at price increases beyond just housing, which is consistent with growing capacity strains across the economy.
- **Tradable inflation should remain soft, however, at -0.1% q/q and -0.5% y/y.** While still negative, this would represent the highest annual tradable inflation since Q2 2014, largely reflecting petrol prices. Outside of petrol, tradable inflation is expected to print at -0.7% q/q (-0.5% y/y).
- **In terms of the details, there will be some offsetting movements:**
 - **Food prices will experience a large seasonal fall.** Monthly data points to prices having fallen 1.3% over the quarter – a 0.2%pt drag.
 - **Housing should again make a large positive contribution.** Another large lift in implied construction costs (1.8% q/q), together with stable rental and property maintenance inflation (0.6% and 0.8% q/q respectively), will see the housing group rise 0.7% q/q.
 - **Some tradables prices that surprised in Q3 should reverse.** Q3 saw some durable-type goods (audio visual equipment, household appliances, furniture etc) post some surprising price gains, perhaps on earlier NZD weakness. However, subsequent NZD strength and retail competition are likely to see these gains at least partially reverse.
 - **Modest lifts in both domestic and international airfares,** which is in part seasonal. Accommodation-type prices are also expected to lift.
- **'Core' measures should drift a little higher.** There is some dispersion in various measures at present (between ¾% and 1¼%), but modest lifts on average towards the RBNZ's target mid-point are likely. Additionally, 41% of the CPI basket saw annual inflation above 2% in Q3 (a four-year high). A further increase in that proportion wouldn't surprise us, although holding around the same level is probably more likely.

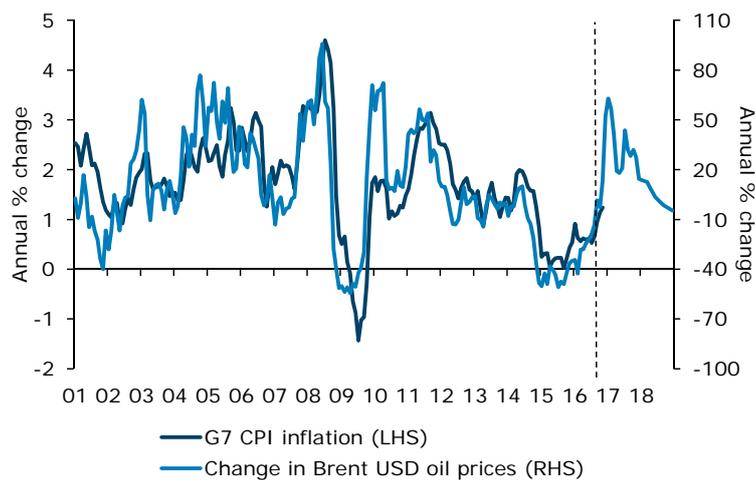
CONSUMERS PRICE INDEX – DEC 2016 QUARTER

	Expected	Prev
CPI – q/q	0.3%	0.3%
CPI – y/y	1.2%	0.4%
Tradable - q/q	-0.1%	0.0%
Tradable - y/y	-0.5%	-2.1%
Non-tradable -q/q	0.5%	0.5%
Non-tradable - y/y	2.3%	2.4%

2016Q4 CPI PREVIEW

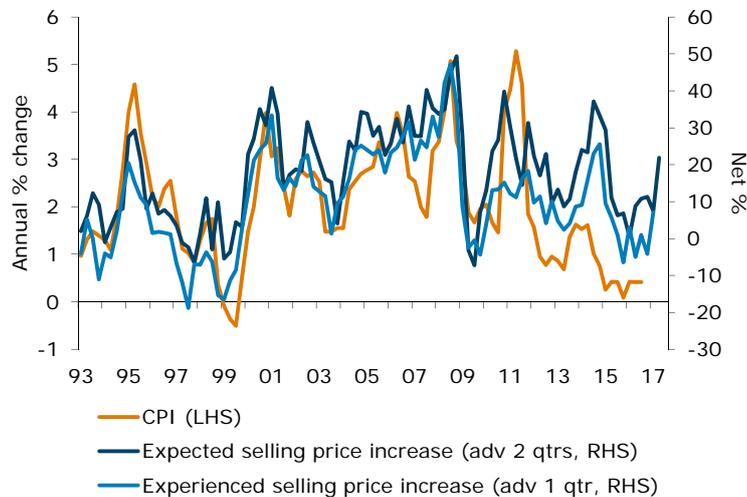
- Inflation pressures should continue to gradually build over 2017.** Deflationary influences are certainly still present (NZD, technology, competitive retail environment etc), which will ensure inflation doesn't run away. But these factors are expected to be increasingly usurped by traditional demand-pull forces and the simple mechanics of falls in oil (petrol) prices being replaced by increases. Inflation has been a missing element of the expansion to date, but evidence is building (rising firm pricing intentions, positive output gap, tighter labour market, stronger global inflation etc) that it is now starting to return. The Q4 inflation figures will be a step in that direction.
- However, that doesn't necessarily suggest that the OCR should follow inflation upwards in quick succession. Given two false starts to tightening since the financial crisis, the hurdle for lifting the OCR should be high.** The RBNZ needs (and will likely want) to see the whites of the eyes of inflation before tightening, rather than risking taking another pre-emptive strike that eventually proves unwarranted.

FIGURE 1. OIL PRICES AND GLOBAL CPI INFLATION



Source: ANZ, Bloomberg

FIGURE 2. CPI VS PRICING INTENTIONS



Source: ANZ, NZIER, Statistics NZ

DATA REVIEW

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