Running out of gas

- CPI increased 0.1% q/q in Q1 – below the 0.2% q/q rise incorporated in the RBNZ’s February MPS, and below ANZ and market expectations. Annual inflation dipped to 1.5% y/y, from 1.9%.

- However, the details of the release add to the case that a cut in the OCR is not a matter of urgency. The RBNZ will take some comfort from stronger domestic inflation, as expected (+1.1% q/q), with weakness concentrated in the relatively volatile and transitory tradable component (-1.3% q/q). However, with the peak in capacity pressure behind us, we expect that by August it will be clear that an OCR cut is required to see higher growth and a sustained lift in inflation.

Key points

CPI increased 0.1% q/q, below ANZ and market expectations, with annual inflation declining to 1.5% y/y, from 1.9%. Falling petrol and durables prices drove down tradable inflation (-1.3% q/q, -0.4% y/y), while non-tradable inflation rose a solid 1.1% q/q, as expected. Annual non-tradable inflation ticked up from 2.7% to 2.8% – the highest level in five years.

Today’s print for CPI inflation was slightly below the 0.2% q/q rise incorporated in the RBNZ’s February MPS. But the details of the print were broadly in line with their expectations, with volatility in tradable prices driving the RBNZ miss. Looking forward, a lower NZD should start to feed more fully into tradable prices, and oil has already rallied 50% from the December low. This will result in a higher tradable inflation forecast in the May MPS, limiting any perceived risk of lower inflation expectations affecting pricing.

Most importantly, non-tradable inflation was bang on the RBNZ’s (and our) expectation. While inflation is a lagging indicator, the RBNZ will take a degree of comfort from the fact that non-tradables is at its highest level in five years, with weakness concentrated in the volatile and transitory tradable component.

A large proportion of the quarterly pick-up in non-tradable inflation was due to regulated prices (tobacco and education). Core inflation measures tracked broadly sideways, continuing to stabilise following strength earlier in 2018. The annual 30% trimmed mean dipped a touch to sit at 1.9%. The weighted median was stable at 2.2% y/y, and inflation excluding food and energy remained at 1.5%. The focus now turns towards the RBNZ’s sectoral factor model (3pm) for confirmation of the stable core inflation signal.

Today’s data were solid under the hood and we expect the fall in the NZD to continue to fade as the detail is digested. Looking forward, we may see some further uplift in domestic inflation, as past capacity pressure feed through. But the medium-term outlook remains troubling. The expansion is losing steam, the global environment is no longer a tailwind, and the peak in capacity pressures is behind us. Domestic inflationary pressures appear fragile in this context.

The RBNZ’s focus is forward-looking; it is the durability of inflation that matters. We expect the RBNZ to retain its recently adopted dovish tone in May, with the solid details of today’s data buying the RBNZ time to be sure that OCR cuts are indeed required. We think the evidence will be unambiguous by August, after one more round of GDP and inflation data.
For those interested in the details, key price moves were as follows.

- **Regulated prices added to strength in non-tradable prices.** Seasonal cigarette and tobacco tax hikes and increases in education fees contributed 0.3%pts to quarterly CPI inflation.

- **Housing and utilities prices were in line with expectations.** Rents increased 0.6% and purchase of housing rose 0.7%. The household and household utilities group contributed 0.1%pts to inflation, a bit less than in recent years.

- **Health prices were weaker than usual, reflecting government policy changes.** They fell 0.2%, but made a negligible contribution to headline CPI.

- **Communication prices were stronger than usual.** Broadly as expected, prices fell only -0.1% on the quarter, in contrast to usual larger falls, reflecting copper broadband price increases.

- **Prices for miscellaneous goods and services were a touch weaker than expected,** up 0.5% q/q. This may reflect the past build-up in capacity pressures flowing through to prices, but beginning to wane.

- **On the tradable side, petrol price falls weighed.** Petrol prices fell 7.0% in the quarter, largely as expected. Adding to this, prices for international airfares fell, reaching a seasonal trough. Overall, the transport group provided a -0.5%pt contribution.

- **Durables prices fell and apparel prices rose,** but on net were weaker than expected, with a flat contribution. This appears to be due to specials on furniture. While it may partly reflect the weaker housing market, a degree of bounce-back seems likely. The effect of the NZD depreciation since 2017 has yet to be fully felt in import prices.

- **Food prices provided a small seasonal rise.** Food prices rose 1.2% q/q in the quarter, with strong increases in fruit and vegetables and moderate rises in other subgroups. Together with modest increases in alcoholic beverage prices, this contributed 0.3%pts.

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*Source: Statistics NZ*
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