MOSTLY NOISE

BOTTOM LINE
- Headline CPI inflation was slightly stronger than expected in Q1, largely owing to the magnitude of change in some of the more volatile components.
- 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 were mixed, but broadly stable overall.
- We suspect the RBNZ will continue to bide its time until there’s a little more certainty that inflation is set to rise. A meaningful lift in wages being one likely catalyst.

KEY RESULTS
- **Headline CPI rose 0.5% q/q in Q1, which was above consensus and our own expectations of a 0.4% lift**, but in line with the RBNZ’s latest forecast. This saw annual inflation drop back to 1.1% y/y from 1.6% in Q4 as the strong 2017 Q1 print of 1.0% q/q dropped out. Tradable prices fell 0.1% q/q (-0.4% y/y), while non-tradable prices rose 0.9% q/q (2.3% y/y) as predicted by our ANZ Monthly Inflation Gauge. Relative to our own expectations, the majority of surprise came from slightly stronger petrol prices and a little more non-tradable inflation.
- **As expected, policy-induced price rises were broadly offsetting**, with the usual increase in tobacco excise duty adding 0.3%pts and fees-free territory education pulling the education group down 5.6% q/q and subtracting 0.1%pts (instead of its typical Q1 rise, which would normally add around 0.1%pts).
- As has been the case for the past few quarters, **some of the more volatile components made broadly offsetting contributions**. The usual seasonal decline in international airfares (-14.4% q/q) made a -0.3%pt contribution – this was a little more severe than we expected, but at the end of the day is just seasonal noise. Accommodation services rose 6.1%, making a 0.1%pt contribution and reflecting a strong tourism season. Food prices rose 0.5% q/q, making a 0.1%pt contribution, and petrol prices rose 2.7% (0.1%pt contribution, compared to our expectation of 0.0%pts) going a long way to explain the surprise in today’s print.
- **Looking through the noise, the same old story of housing leading the pack continued**, with purchase of housing (an implied construction cost excluding land measure) up 0.4% q/q (4.7 y/y) and rents up 0.6% q/q (3.1% y/y). That said, there are some signs that construction cost inflation is slowing, with annual inflation slowing from 6.7% in Q1 2017. Rents were particularly strong in Wellington (1.8% q/q, 4.2% y/y) and remained elevated in Auckland (0.5% q/q, 2.5% y/y), reflecting strong population growth and rising costs for landlords. Anecdote around the Q1 student surge in Wellington appears validated. Housing-related pressures remain soft across Canterbury.

DATA SUMMARY

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<tr>
<td>Headline CPI</td>
<td>0.5%</td>
<td>1.1%</td>
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<tr>
<td>Tradable</td>
<td>-0.1%</td>
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<tr>
<td>Non-tradable</td>
<td>0.9%</td>
<td>2.3%</td>
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Overall, today’s outturn provided little evidence to suggest that inflationary pressures are broadening outside of housing, but we expected that. Non-tradable inflation ex housing rose 1.2% q/q, which on first blush is a respectable rise, but on an annual basis was up just 1.7% y/y, down from 1.9% in Q4. In seasonally adjusted terms, non-tradable inflation rose 0.5% q/q, unchanged from Q4 last year. We suspect a broader lift in inflation is likely to remain absent until we see a meaningful lift in wage growth.

Tradeable prices were broadly as expected, with the small contraction consistent with recent business surveys pointing to squeezed margins and difficulty lifting prices. A 0.2% q/q decline in apparel and only a partial (0.7% q/q) retracement in the household contents and services group continue to paint a picture of an intensely competitive retail backdrop. New car prices rose 4.2% q/q following a 6.2% plunge in Q4.

Core and underlying inflation measures were mixed, with a few rebounding on a q/q basis but generally softening on an annual basis (some moving further outside of the 1½-2% range). In what appears to be a bit of an outlier, the weighted median measure rose 0.2%pts to 2.2% y/y. On the other hand, the trimmed mean measures were down across all levels of the trim in annual terms.

The focus turns to the RBNZ’s Sectoral Factor Model estimate (out at 3pm today), which has held at either 1.4% or 1.5% since Q3 2015. Our own model estimate suggests it will print at 1.6%, which is the highest since 2011 (although it has admittedly been overstating results over the past few quarters). Nevertheless, a lift would be consistent with a gradual lift in domestic inflation pressures. That said, it is still a mixed bag, with our estimate of the proportion of the CPI basket currently experiencing an annual price increase over 2% falling to 36%, down from 42% in Q4.

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. If sustained, the recent lift in oil prices (alongside possibly higher petrol duties) will also contribute. However, a deeper broadening in inflation 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.
Figure 1. Headline CPI inflation

Figure 2. CPI groups – March 2018 quarter

Figure 3. CPI inflation components

Figure 4. Proportion of CPI basket rising >2% y/y

Source: ANZ, Statistics NZ
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