Giving the slip

- We expect headline CPI was flat in the December quarter, with annual inflation slipping from 1.9% to 1.8%. Tradable inflation is expected to print at -0.8% q/q, while non-tradable inflation is expected to post a 0.4% q/q rise. We expect that measures of core inflation will track broadly sideways.
- CPI in line with our expectations would add to the case we see building for a more dovish stance by the RBNZ in February. The RBNZ may take a degree of comfort from the fact that Q4 weakness is expected to be concentrated in tradable inflation. But the medium-term outlook for domestic inflation is more troubling. The RBNZ needs to see accelerating GDP growth to achieve a sustained lift in inflation, and the prospect of that is slipping away.

Key points

December quarter CPI figures are released next Wednesday (23 January). We expect headline CPI inflation will print at 0.0% q/q, with annual inflation dipping from 1.9% to 1.8%. This is lower than the 0.2% q/q (2.0% y/y) rise incorporated in the RBNZ’s November MPS. CPI in line with our expectations may add to increased caution from the RBNZ in February, though the RBNZ is likely to take a degree of comfort from the fact that weakness is expected to be concentrated in tradable inflation, which tends to be more transitory. Tradable inflation is expected to print at -0.8% q/q (0.5% y/y after revisions; see page 2 for more details), driven largely by lower petrol and food prices.

We expect non-tradable inflation to post a 0.4% q/q rise, consistent with the RBNZ’s November expectations. This would see annual non-tradable inflation moderate from 2.5% to 2.4% (after revisions), broadly continuing along its recent sideways track. After ticking up earlier in the year, core inflation has lost momentum and we see the range of measures tracking broadly sideways.

For the RBNZ, the medium-term outlook for non-tradable inflation is troubling. Domestic inflationary pressures appear fragile, in spite of clear capacity constraints and cost pressures. The RBNZ needs to see accelerating GDP growth to achieve a durable lift in inflation, but the prospect of that is slipping away. The economic cycle is losing steam, credit headwinds are set to take hold, and the peak in resource pressures appears to be behind us. Meanwhile, the global backdrop is looking less supportive, with downside risk to the fore. In our view, this suggests the midpoint of the inflation target will become more elusive, with OCR cuts required in time.

Our expectation for a flat CPI print reflects the following:

- **Food prices are expected to provide their usual seasonal drag.** Food prices fell 1.3% q/q in the quarter and alcoholic beverages also saw seasonal declines. Together, these are expected to detract 0.3%pts.
- **Secular forces continue to weigh, especially on tradable inflation.** Durable prices look set to drag in the quarter, reflecting seasonable sales and continued weakness in retail prices, in part due to weak import prices. The same factors are also contributing to non-existent inflation in apparel prices. Communications prices are also expected to continue to decline, dragging on inflation. These forces together are expected to subtract 0.1%pts from inflation.
- **Petrol price declines will also impact.** Petrol prices fell 3.5% in the quarter on the back of lower oil prices and some retracement in the NZD. This is expected to provide a 0.2%pt drag.

- **Airfares reached their seasonal peak.** Prices for international airfares will reach their seasonal peak, providing a 0.2%pt boost. However, domestic airfares are not expected to provide their usual contribution, after increasing strongly in Q3. Combined with lower petrol prices, price movements in the transport group are expected to make a very small positive contribution.

- **Housing-related prices continue to support domestic inflation.** Rents are forecast to increase 0.6% q/q and purchase of housing is expected to increase 1.3% q/q, with smaller contributions from property maintenance and higher electricity prices. The household and household utilities group is expected to boost CPI inflation by 0.2%pts.

- **Accommodation prices will see seasonal strength.** Accommodation prices are expected to have risen 6.9%, contributing 0.2%pts.

On the whole, we see risks to our flat Q4 CPI forecast as balanced. There is scope for an even lower tradable inflation outturn, reflecting weakness in imported prices and pass-through of lower petrol prices. On the other hand, there is scope for an upside surprise on non-tradable inflation if rents increase more than expected, as signalled by our ANZ Monthly Inflation Gauge.

A re-allocation of international pre-paid holidays from non-tradable to tradable CPI will result in some small revisions to these components from September 2017 onwards. This will not affect headline inflation. For the September 2018 quarter, we expect that tradable inflation will be revised from 1.0% to 0.8% y/y and non-tradable inflation will be revised from 2.5% to 2.4% y/y.

### Table 1. ANZ Q4 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>-1.30</td>
<td>-0.25</td>
</tr>
<tr>
<td>Alcoholic beverages and tobacco</td>
<td>-0.47</td>
<td>-0.03</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>-0.01</td>
<td>0.00</td>
</tr>
<tr>
<td>Housing and household utilities</td>
<td>0.70</td>
<td>0.17</td>
</tr>
<tr>
<td>Household contents and services</td>
<td>-1.03</td>
<td>-0.04</td>
</tr>
<tr>
<td>Health</td>
<td>0.29</td>
<td>0.01</td>
</tr>
<tr>
<td>Transport</td>
<td>0.23</td>
<td>0.03</td>
</tr>
<tr>
<td>Communication</td>
<td>-1.78</td>
<td>-0.05</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>1.61</td>
<td>0.15</td>
</tr>
<tr>
<td>Education</td>
<td>0.07</td>
<td>0.00</td>
</tr>
<tr>
<td>Miscellaneous goods and services</td>
<td>0.54</td>
<td>0.04</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>0.03</strong></td>
<td><strong>0.03</strong></td>
</tr>
</tbody>
</table>

Source: Statistics NZ, ANZ Research
This document is intended for ANZ’s institutional, professional or wholesale clients, and not for individuals or retail persons. It should not be forwarded, copied or distributed. The information in this document is general in nature, and does not constitute personal financial product advice or take into account your objectives, financial situation or needs.

This document may be restricted by law in certain jurisdictions. Persons who receive this document must inform themselves about and observe all relevant restrictions.

Disclaimer for all jurisdictions: This document is prepared and distributed in your country/region by either: Australia and New Zealand Banking Group Limited (ABN11 005 357 522) (ANZ); or its relevant subsidiary or branch (each, an Affiliate), as appropriate or as set out below.

This document is distributed on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (recipients).

This document is solely for informational purposes and nothing contained within is intended to be an invitation, solicitation or offer by ANZ to sell, or buy, receive or provide any product or service, or to participate in a particular trading strategy. Distribution of this document to you is only as may be permissible by the laws of your jurisdiction, and is not directed to or intended for distribution or use by recipients resident or located in jurisdictions where its use or distribution would be contrary to those laws or regulations, or in jurisdictions where ANZ would be subject to additional licensing or registration requirements. Further, the products and services mentioned in this document may not be available in all countries.

ANZ in no way provides any financial, legal, taxation or investment advice to you in connection with any product or service discussed in this document. Before making any investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

Whilst care has been taken in the preparation of this document and the information contained within is believed to be accurate, ANZ does not represent or warrant the accuracy or completeness of the information Further, ANZ does not accept any responsibility to inform you of any matter that subsequently comes to its notice, which may affect the accuracy of the information in this document.

Preparation of this document and the opinions expressed in it may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this document and are subject to change without notice; and, all price information is indicative only. Any opinions expressed in this document are subject to change at any time without notice.

ANZ does not guarantee the performance of any product mentioned in this document. All investments entail a risk and may result in both profits and losses. Past performance is not necessarily an indicator of future performance. The products and services described in this document may not be suitable for all investors, and transacting in these products or services may be considered risky.

ANZ expressly disclaims any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense (Liability) arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this document to the extent permissible under relevant law. Please note, the contents of this document have not been reviewed by any regulatory body or authority in any jurisdiction.

ANZ and its Affiliates may have an interest in the subject matter of this document. They may receive fees from customers for dealing in the products or services described in this document, and their staff and introducers of business may share in such fees or remuneration that may be influenced by total sales, at all times received and/or apportioned in accordance with local regulatory requirements. Further, they or their customers may have or have had interests or long or short positions in the products or services described in this document, and may at any time make purchases and/or sales in them as principal or agent, as well as act (or have acted) as a market maker in such products. This document is published in accordance with ANZ’s policies on conflicts of interest and ANZ maintains appropriate information products and services mentioned in this document may not be available in all countries.

Your point of contact can assist with any questions about this document including for further information on these disclosures of interest.

Country/region specific information: Unless stated otherwise, this document is distributed by Australia and New Zealand Banking Group Limited (ANZ).

Australia. ANZ holds an Australian Financial Services licence no. 234527. For a copy of ANZ’s Financial Services Guide please click here or request from your ANZ point of contact. If trading strategies or recommendations are included in this document, they are solely for the information of ‘wholesale clients’ (as defined in section 761G of the Corporations Act 2001 Cth).

Brazil, Brunei, India, Japan, Kuwait, Malaysia, Switzerland, Taiwan. This document is distributed in each of these jurisdictions by ANZ on a cross-border basis.

Cambodia. This document is distributed in Cambodia by ANZ Royal Bank (Cambodia) Limited (ANZ Royal Bank). The recipient acknowledges that although ANZ Royal Bank is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank.

European Economic Area (EEA): United Kingdom. ANZ is authorised in the United Kingdom by the Prudential Regulation Authority (PRA) and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This document is distributed in the United Kingdom by Australia and New Zealand Banking Group Limited ANZ solely for the information of persons who would come within the FCA definition of “eligible counterparty” or “professional client”. It is not intended for and must not be distributed to any person who would come within the FCA definition of “retail client”. Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the Prudential Regulation Authority (PRA) and the FCA. ANZ is authorised in the United Kingdom by the PRA and is subject to regulation by the FCA and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request.

Fiji. For Fiji regulatory purposes, this document and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this document.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong.

India. If this document is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing.