A FAMILIAR LOOK

- We expect headline CPI inflation to hold steady at 1.9% y/y in Q4. That is a touch above the RBNZ’s expectations.

- Some of the more volatile components (food, petrol and airfares) will make broadly offsetting contributions.

- Housing will again contribute positively, but evidence of a broadening in domestic price increases will remain tentative at best. Core inflation measures are likely to be stable around 1½-2%.

- We still expect domestic inflation to rise gradually in time. However, questions over when and how aggressively this occurs will likely remain unanswered by these figures, keeping the RBNZ side-lined.

KEY POINTS

- We expect headline inflation to rise 0.4% q/q in the December quarter (released 25th January), which would see annual inflation hold steady at 1.9% y/y. This would be modestly above the RBNZ’s November MPS forecast of 0.3% q/q (1.8% y/y).

- The figures will incorporate an updated CPI basket and weights as part of the 2017 CPI review. Among other things, the changes see the weight on food, purchase of housing, purchase of vehicles and insurance lift modestly, versus lower weights on property maintenance, electricity, petrol and telecommunication services.

- These weighting changes haven’t altered our forecast for the quarter. However, they do shift the risk profile modestly lower. That is due largely to a higher weight on food prices, where monthly data is pointing to a 1.6% q/q fall, and a lower weight on petrol, where we estimate prices rose 6.2% q/q. Overall, food prices are expected to have recorded a 0.3%pt drag on headline inflation, while petrol will make a +0.2%pt contribution. Other volatile components, domestic and international airfares, are estimated to make a combined +0.2pt% contribution, reflecting largely seasonal forces.

- Yet again, the housing group (0.7% q/q) will make a positive contribution. We expect the purchase of housing component to rise at a similar pace as it did in Q3 (1.1% q/q), which is actually a touch below the average of the past 12 months. Household energy is expected to rise 0.8% q/q, while rental inflation is expected to hold broadly steady (0.5% q/q).

- But outside of housing, evidence of a lift in domestic inflation pressures will be tentative at best. We have pencilled in a 0.6% q/q lift in non-tradable inflation, which would hold annual inflation in this measure at 2.6%. But as implied by our Monthly Inflation Gauge, it is still really just housing and a few bits and bobs driving this. In Q4, domestic airfares will certainly contribute positively to non-tradable inflation, as will the early impact of a lift in EQC levies on home and contents insurance premiums. However, questions of whether we are on the cusp of a broader lift in inflation will remain unanswered.
• **Tradable prices are expected to lift a touch** (+0.1% q/q, 0.9% y/y). The main contributors reflect factors already mentioned (food, petrol and international airfares), although we are also expecting to see seasonal discounting in a number of household durable goods (furniture and floorings & appliances). Telecommunication equipment prices should also re-exert their downward trend after holding flat in Q3.

• **Core inflation measures should be broadly steady.** In Q3, the suite of core measures we monitor generally rebounded after falling in Q2. Headline inflation excluding food, fuel and energy prices rose 0.5% q/q, lifting annual inflation to 1.5% y/y (from 1.4%). The weighted median and trimmed mean measures were both at 2.0% (from 2.0% and 1.8%) respectively. But the main message is really one of stability, highlighted by the RBNZ’s Sectoral Factor Model holding at 1.4%. It is not a message we expect to change dramatically following the Q4 figures.

• **We retain a view that domestic inflation will rise and broaden in time.** That is largely predicated on the belief that a cyclical low in wage inflation has been seen and through the combination of skill shortages and government policy changes, wage inflation will continue to lift. However, it is far from a clear picture. Other policies (such as the first year of free tertiary education) will have a mechanical offsetting impact. And together with recent movements in oil prices and the NZD, the ongoing impact of structural deflationary forces still evident globally, and the fact that we see activity growth in the next year or so only at trend and not above, it remains a mixed picture. And it is this mixed picture that we suspect will leave the RBNZ somewhat cautious and side-lined for some time yet.

### 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>-1.6</td>
<td>-0.3</td>
</tr>
<tr>
<td>Alcoholic beverages and tobacco</td>
<td>-0.6</td>
<td>0.0</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Housing and household utilities</td>
<td>0.7</td>
<td>0.2</td>
</tr>
<tr>
<td>Household contents and services</td>
<td>-1.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Health</td>
<td>0.6</td>
<td>0.0</td>
</tr>
<tr>
<td>Transport</td>
<td>3.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Communication</td>
<td>-2.5</td>
<td>-0.1</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>1.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Education</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Miscellaneous goods and services</td>
<td>0.8</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>0.4</strong></td>
<td><strong>0.4</strong></td>
</tr>
</tbody>
</table>

Source: ANZ, Statistics NZ

### Selection core inflation measures

Source: ANZ, Statistics NZ, RBNZ
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