In transit

- Q3 headline inflation came in stronger than market and slightly above our own expectations at 0.9% q/q. Non-tradables was as we expected at 0.8%, with tradables a touch stronger at 0.9%. The suite of core inflation indicators was broadly stable.

- The solid CPI print does not take the possibility of an OCR cut off the table. Patchy data-flow alongside global uncertainties suggest risks to the RBNZ’s medium-term activity and inflation forecasts are skewed to the downside.

Key points

- Headline CPI rose 0.9% q/q in Q3, which was above consensus and our own expectation (0.7% and 0.8% respectively). This saw annual inflation pick up to 1.9% y/y from 1.5% in Q2. Tradable prices rose 0.9% q/q (0.8% y/y), while non-tradable prices rose 0.8% q/q (2.6% y/y).

- Directionally the majority of price moves were as expected. Petrol prices lifted 5.5% q/q (making a 0.3%pt contribution), pushed up by the lower NZD, higher global oil prices and increased fuel taxes. By region, Auckland petrol prices led the way, up 8.8% q/q, compared to 4.8% in Wellington and 4.3% across the South Island. Property rates rose 4.5%, in line with their usual Q3 move. Food prices made a 0.1% pt contribution, rising 0.6% q/q on winter-related increases in fruit and vegetable prices and possibly a touch of minimum wage-induced price rises for restaurant meals.

- But there were some surprises. International airfares rose 1.2% q/q versus our expectation for a 3% q/q decline. Strong demand appears to have held up despite rising fuel costs being passed through into ticket prices. This, together with slightly stronger than expected domestic airfares (up 4.9% q/q), provided an extra boost to the transport group. Elsewhere, we expected a strong rise in accommodation services owing largely to the recent inclusion of overseas accommodation prepaid in New Zealand into this category and the signal from our Monthly Inflation Gauge. However, this component actually fell 0.1% q/q. We had identified this component as a probable source of surprise given the change in methodology.

- Housing-related prices continued to hold up, with rent up 0.4% q/q and the purchase of housing (a proxy for building costs) up 1.3%. It appears the purchase of housing has staged a minor comeback, with annual inflation running at 4.1%, 0.2%pts higher than Q2 but still down from its peak of 6.7% y/y in Q2 2017.

- Retail-related price moves remained on the softer side, consistent with the signal coming out of our ANZ Business Outlook Survey – competition is high and firms are finding it difficult to pass on costs. Clothing and footwear prices fell 0.1% q/q to be down 1.0% y/y. Some bigger-ticket durables prices were also on the softer side (household appliances -2.6% y/y and furniture and floor coverings +0.4% y/y), consistent with a softening housing market. Telecommunication equipment prices fell 8.6% q/q with quality adjustments a factor.
Core and underlying inflation measures were broadly stable. The trimmed mean measures were either stable or rose a touch across various levels of trim in annual terms. The weighted median slipped 0.1%pts from Q2 to 2.2% y/y. In addition, we estimate that the proportion of the CPI basket with inflation running above 2% y/y ticked up to 39% from 37% in Q2. That is still well below its recent high of 49% in Q1 2017. Now the focus turns towards the RBNZ’s sectoral factor model (3pm) for confirmation of the core inflation signal. Our own model estimate suggests it will be unchanged at 1.7% (but could perhaps rise at the second decimal point level). At the margin it suggests that the acceleration in core inflation seen over recent quarters may be beginning to moderate.

Today’s outturn was significantly stronger than the RBNZ’s August MPS forecast for a 0.4% q/q rise (1.4% y/y). However, less so on the non-tradables side, which tends to be more persistent. And in light of its medium-term mandate the Bank will look through the transitory impacts of higher petrol prices and minimum wages, while considering their possible adverse economic impacts such as lower discretionary spending (due to higher petrol prices) and softer-than-otherwise employment growth (courtesy of higher wage costs).

Overall, we think the RBNZ will be quick to look beyond Q3’s print towards the medium-term direction for economic activity and core inflation. And in that regard, patchy data-flow and global developments suggest economic activity may struggle to keep inflationary pressures elevated. While today’s solid inflation print presents something of a communications challenge for the RBNZ, we doubt it would do much to delay an OCR cut should the Bank deem the growth outlook to be deteriorating.
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