ANZ Research

June 2024 Quarter CPI Review

17 July 2024

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Contact

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Data summary

	% qtr	% ann
Headline CPI	0.4%	3.3%
Tradable	-0.5%	0.3%
Non-tradable	0.9%	5.4%

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Reassuring

Bottom line

- Annual CPI inflation decelerated from 4.0% to 3.3% y/y in Q2, in line with our forecast, and below the RBNZ's May MPS forecast of 3.6%.
- Non-tradable inflation (domestically generated) came in at 5.4% y/y, marginally above our and the RBNZ's forecast of 5.3% y/y. However, relative to our expectation the miss was driven by an unusual 9.9% q/q increase in the 'other private transport services' component. Stats NZ has reassessed how it calculates road-user charges and a correction has been made in this quarter following previous underreporting. This can be treated as volatility and a one off. Without this, non-tradable inflation would likely have printed in line with our forecast.
- The suite of core measures moderated. At the 30% trim level, inflation eased from 4.5% y/y to 3.8% y/y. Weighted median inflation eased from 4.4% y/y to 3.5% y/y. CPI excluding food, fuel, and energy fell from 4.1% y/y to 3.4% y/y. Overall, these were larger falls than we were expecting.
- Tradables inflation (largely imported) came in at 0.3% y/y (1.6% previously), slightly below our forecast of 0.6% y/y and well below the RBNZ's forecast of 1.1% y/y. There are certainly volatile components such as food and airfares contributing to this weakness, but the impacts of weak consumer demand are becoming increasingly evident, particularly for durables.
- All up, the Q2 CPI data highlight that weak demand and increasing spare capacity across the economy is now flowing through to lower domestic inflation outcomes. Our OCR call change is under review and we intend to publish an updated call shortly.

Big picture

Today's CPI report all but confirmed annual inflation will return to the RBNZ's 1-3% target band next quarter. Headline inflation continues to fall sharply. While that continues to be led by weak tradable inflation, there is now clear evidence that the transmission of weak demand into lower domestic inflation outcomes is occurring.

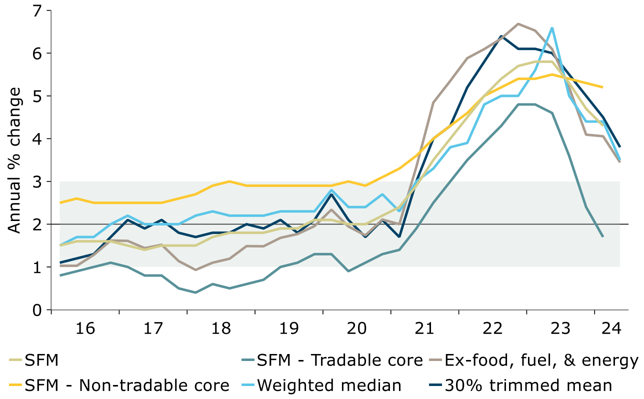
That said, the fact that annual non-tradable and services inflation are both still above 5% highlights that further progress is needed. But the RBNZ's target is not here and now; given the lags with which monetary policy operates, its focus is on the medium term. And synchronised weakness across all domestic data releases in the past couple of months has significantly increased both our and the RBNZ's confidence that domestic inflation is set to continue to fall over the medium-term. Activity indicators are heading south, labour market indicators point to a deterioration in labour demand and a continued increase in spare capacity, and the latest housing data mitigated the risks that any near-term recovery could fuel renewed demand and inflation pressures. Yes, they are second-tier releases, but it's hard to ignore these 'soft data' when they are all in accordance.

The RBNZ needs confirmation that these disinflationary dynamics are manifesting in the 'hard' data in order to have the confidence required to ease the OCR. And we think today's data marked a decent step along that path, with it set to become increasingly clear in the coming quarters. Core measures of inflation continued to moderate, and are all below 4%. Services inflation was unchanged at 5.3%. That was slightly higher than we were anticipating, but this likely reflects the methodological change in how Stats NZ calculate road user charges. The RBNZ's own measure of core inflation, the Sectoral Factor Model, will be released at 3pm today.

There are certainly still components where inflation pressures are proving persistent, but they are increasingly becoming the select few. Of the close to 60 subcomponents that we analyse, the top 15% with the highest annual inflation rate are insurance, council rates, hospital services, cigarettes and tobacco, petrol, telecommunications equipment and household textiles (these two just look like volatility), and various passenger transport services where inflation rates have been distorted by both the end of public transport subsides over the past year and the aforementioned change to how road user charges are measured. These are all components where monetary policy has limited influence, and nearly all of them are non-tradable. With headline inflation now approaching target, and a clear and broad downward trend in inflation outside of these components, core measures of inflation are likely to increasingly become the focus of the RBNZ, rather than the overall non-tradables measure.

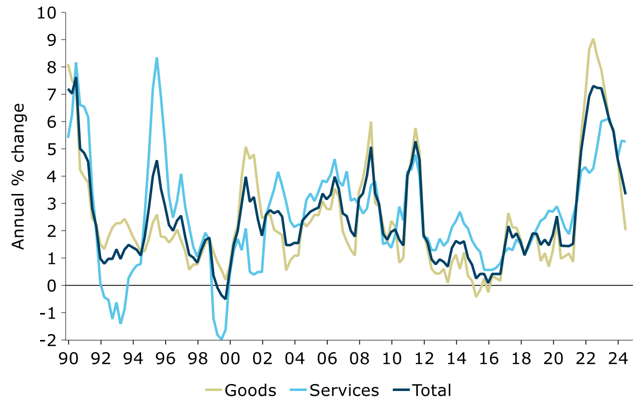
It's entirely appropriate for the RBNZ to look through some of these components, given the starting point for headline inflation is now much lower and risks to inflation expectations largely mitigated. In that environment, the cure for persistence is simply time, allowing the lagged adjustment to past high inflation to occur, rather than needing to maintain restrictive interest rate settings for longer.

Figure 1. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

Figure 2. Goods vs services inflation



Source: Stats NZ, Macrobond, ANZ Research

The details

Breaking down the details of the 0.4% q/q increase in CPI in the March 2024 quarter:

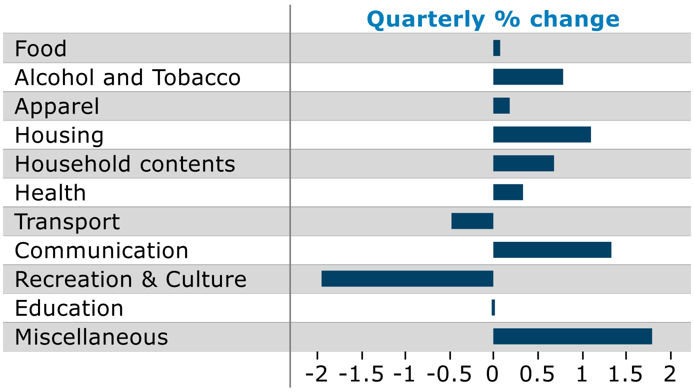
- **Housing-related costs** (27.8% of the CPI basket) rose 1.1% q/q, stronger than the 0.8% q/q we had pencilled in. Rent prices were up 1.2% q/q, to be up 4.7% y/y. Housing construction costs also rose 0.9% q/q, a little stronger than our expectation of 0.6% q/q, but remain below the historical average of around 1% q/q. We are watching this component with interest as we see significant scope for weakness moving forward. Property maintenance also was stronger than forecast.

- **The transport group** (13.5% of the CPI basket) fell 0.5% q/q, slightly less than the 0.6% q/q fall we had pencilled in. That largely reflects the 9.9% q/q increase in other private transport services, due to changes to the measurement of road user charges. Sharp falls in second-hand passenger vehicles drove the downward surprise to our tradable inflation forecast.
- **Miscellaneous goods and services** (7.3% of the CPI basket) rose 1.8% q/q, slightly stronger than our forecast of 1.5% q/q. Strength continues to reflect rising insurance costs.
- **The recreational and cultural group** (9.7% of the CPI basket) fell 1.9% q/q, a larger fall than the 1.2% q/q fall we had anticipated. The larger-than-usual seasonal fall in domestic accommodation services (down 16.5% q/q) was the key driver, though other tradable goods components surprised to the downside too. However, recreational and cultural services were stronger than our forecast.

Monetary policy implications

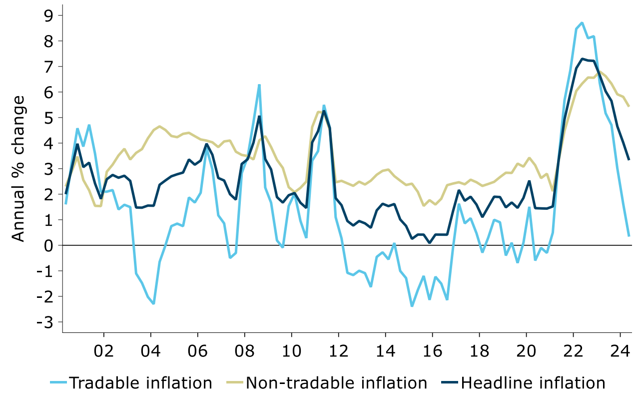
Overall, today's CPI data adds to the growing body of evidence that the RBNZ has done enough. There are now clear signs that weak demand and increasing spare capacity across the economy are flowing through to lower domestic inflation outcomes. In the context of the recent deterioration in domestic activity and labour market indicators, today's CPI starting point points to downside risk to our medium-term inflation outlook. We will be reassessing our inflation forecasts and are likely to centralise these downside risks accordingly. Our OCR call is under review and we will publish a note shortly outlining our updated expectations.

Figure 3. CPI groups – June 2024 quarter



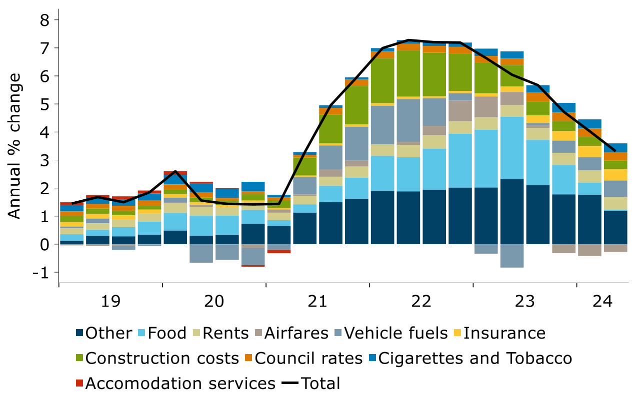
Source: Stats NZ, Macrobond, ANZ Research

Figure 5. CPI inflation components



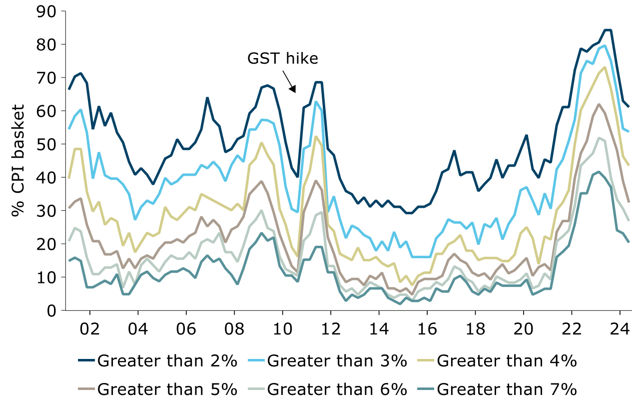
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Headline inflation decomposition



Source: Stats NZ, Macrobond, ANZ Research

Figure 6. Proportion of CPI basket running greater than X%



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