ANZ Research

September 2024 Quarter CPI Review

16 October 2024

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Contact

Miles Workman for more details.

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Data summary

	% qtr	% ann
Headline CPI	0.6%	2.2%
Tradable	-0.2%	-1.6%
Non-tradable	1.3%	4.9%

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Bottom line

- Annual CPI inflation slowed from 3.3% in Q2 to 2.2% y/y in Q3, weaker than our and the RBNZ's August MPS forecast of 2.3%.
- Non-tradable inflation (largely domestic driven) slowed 0.5% pts to 4.9% y/y, below our forecast of 5.2% and the RBNZ's expectation of 5.1% y/y. However, this miss is largely owing to the one-off impact of the FamilyBoost rebate, which saw the early childhood education class fall 22.8% q/q (vs +6.9% excluding the rebate). Had this not occurred, non-tradable inflation would have come in at 5.2% y/y.
- Turning to the suite of core measures, most are now back in the 1-3% target band. At the 30% trim level, inflation eased from 3.8% y/y to 2.7% y/y. Weighted median inflation eased from 3.5% y/y to 2.8% y/y. CPI excluding food, fuel, and energy fell from 3.4% y/y to 3.1% y/y. In broad terms, these measures fell a little faster than our expectation.
- Tradables inflation (largely imported) came in at -1.6% y/y, in line with our and the RBNZ's forecast. Lower petrol prices played a key role, but these data also reflect the fact that New Zealand is currently importing broader disinflation from the rest of the world.
- All in all, there's lots of policy-related noise in these data, but the big picture is still that the imported and import-competing side of the CPI basket has done most of the heavy lifting in terms of bringing headline inflation back into the target band from its 7.3% peak. Non-tradables inflation has clearly turned a corner, but progress has been slow to date and it's still running way too hot. That said, an increasing degree of spare capacity in the labour market and continued signs of weak economic momentum suggest that further falls in domestic inflation are well in train. And that means taking the OCR back at to a more neutral level quickly is a strategy that's easy to justify. We don't see anything in today's data that'll deter the market from pricing in high odds of another 50bp cut in November, nor the RBNZ from delivering it. The marginally weaker tone across the suite of core inflation measures could see talk of a 75bp cut gain some momentum, but for the RBNZ to consider that we'd likely need to see a much weaker Q3 labour market read (out 6 November) than expected.

Big picture and monetary policy implications

As universally expected, annual headline CPI inflation fell back into the 1-3% target band in Q3, largely owing to weak tradable inflation.

Annual non-tradable inflation is still running just below 5%, which is too high to be called consistent with headline inflation running sustainably at 2%. However, given the typical lags, if the RBNZ were to wait for this measure to get to levels consistent with 2% inflation (ie around 3%) before withdrawing monetary restriction, they'd be guaranteed to overdo it, causing unnecessary economic pain. Monetary policy has to be forward-looking, and looking forward there's more downward pressure on domestic inflation to come.

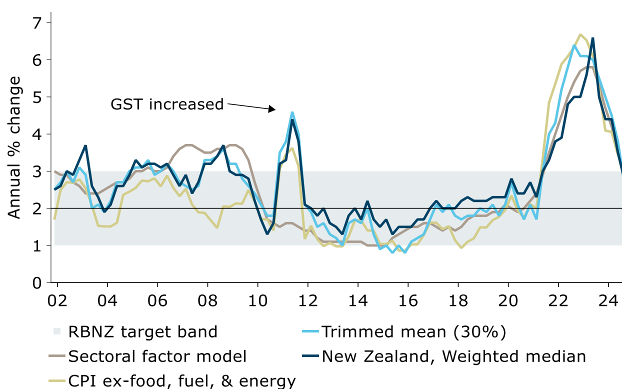
While there are plenty of structural reasons to think parts of the CPI basket (eg council rates, insurance, electricity) may run hotter than their historical pace over coming years (eg weather-related risk and infrastructure

needs), there is also plenty of evidence to suggest the RBNZ has engineered enough spare economic capacity to tame inflation in a cyclical sense. In fact, there are some indicators suggesting the RBNZ has been a little slow to cut the OCR, which, all else equal, increases the risk they'll have to take monetary conditions into stimulatory conditions for a time.

Given current cyclical indicators, including the widening degree of slack in the labour market, it's fair to say that withdrawing the first 150bps or so of monetary restriction is a relatively low-risk strategy. That is, of course, provided we and the RBNZ are right in assuming the neutral level of the OCR over the medium term is below 4%; there's always significant uncertainty on that score. Beyond that, as the OCR approaches the common range of neutral estimates (between 3-4%), the RBNZ is likely to tread more cautiously, particularly if it is concerned about a potential premature reacceleration in domestic inflation pressures.

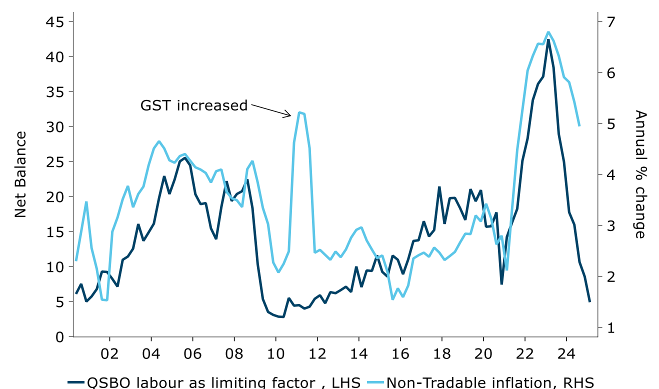
But for now, measures of underlying inflation are going the right way and there is nothing in today's data that presents a meaningful challenge to another 50bp cut in November. Talk of a 75bp cut in November might gather momentum between now and then, and may well be something the RBNZ considers if the Q3 labour market data (out 6 November) comes in significantly weaker than forecast. But based on today's data, we remain comfortable with our expectation for a 50bp cut next month.

Figure 1. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

Figure 2. Non-tradables vs labour as a limiting factor



Source: NZIER, Stats NZ, Bloomberg, Macrobond, ANZ Research

The details

Breaking down the details of the 0.6% q/q increase in CPI in the September 2024 quarter:

- **Housing-related costs** (27.8% of the CPI basket) rose 1.9% q/q, making a 0.55%pt contribution to quarterly inflation. This was slightly stronger than the 1.8% q/q we had pencilled in. Council rates rose a whopping 11.9% q/q (adding 0.4%pts to quarterly inflation), a little less than our expectation of 13% q/q, but still enormous. Meanwhile, rents were up 0.9% q/q (as expected) and housing construction costs rose just 0.1% q/q (well below the historical average of around 1% q/q and weaker than expected – the downturn in this very cyclical part of the economy is clearly translating into prices).

- **The food group** (18.8% of the CPI basket) lifted 1.3% q/q as signalled by the Food Price Index. This group contributed 0.2%pts to quarterly inflation.

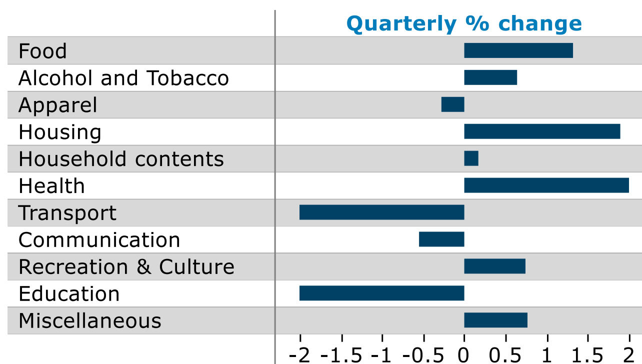
- **The health group** (just under 4% of the basket) lifted 4.2% q/q, adding 0.2%pts to quarterly inflation. The reinstatement of prescription copayments saw the pharmaceutical products class rise 17% q/q (stronger than our estimate).

- **Miscellaneous goods and services** (7.3% of the basket) rose 0.8% q/q, slightly weaker than our forecast of 1.2% q/q and adding 0.1%pt to quarterly inflation. Strength here continues to reflect rising insurance costs.
- The largest drag in the quarter came from **the transport group** (13.5% of the basket), which fell 2.1% q/q (-0.3%pts contribution), slightly weaker than the 1.9% q/q fall we had pencilled in. Lower petrol prices (down 6.5% q/q) were behind the bulk of the decline, driven by lower oil prices and the removal of Auckland's regional fuel tax. The price of second-hand motor cars also dragged (down 2.8% q/q).
- **Other parts of the CPI were broadly as expected** in that they didn't contribute strongly to quarterly inflation one way or another.

All in all, with the exception of the one-off impact from the FamilyBoost rebate, the main drivers of inflation in Q3 were largely as forecast, but there were the usual overs and unders in the components. Our updated forecast will bank the weaker starting point, but today's data do not present a significant challenge to our broader CPI inflation outlook. We'll publish our updated forecasts in this week's Data Wrap (out Friday).

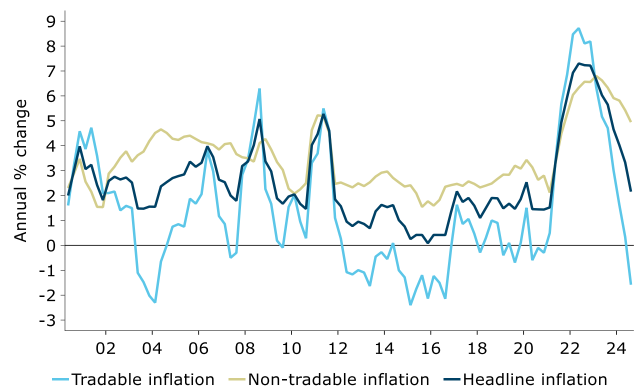
Market reaction to the data wasn't significant, but the miss on non-tradables saw the Kiwi drop around 20bps and the 2yr swap rate fall a couple of points, extending earlier declines following the overnight fall in global bond yields. Our sense was that markets would likely sway more towards debating a 75bp cut in November on any undershoot versus the RBNZ's 2.3% y/y pick and the 2.2% result has done exactly that, with markets now pricing in -61bp (ie split roughly 55/45 between a 50bp or 75bp cut).

Figure 3. CPI groups – September 2024 quarter



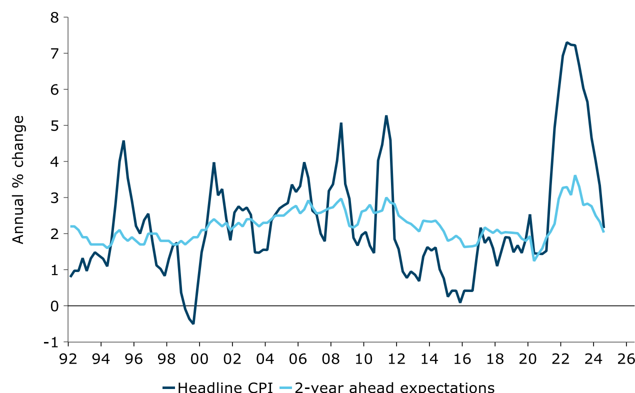
Source: Stats NZ, Macrobond, ANZ Research

Figure 5. CPI inflation components



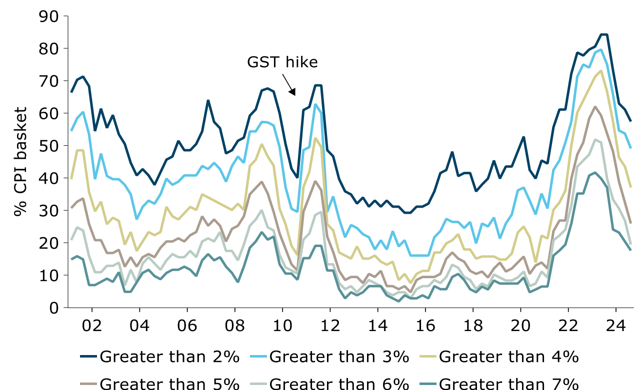
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Headline inflation vs inflation expectations



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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



Source: Stats NZ, Macrobond, ANZ Research

Contact us

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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 9 357 4094
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, economic developments, labour market dynamics, inflation, fiscal and monetary policy.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Henry Russell
Economist

Macroeconomic forecasting, economic developments, GDP and activity dynamics and monetary policy.

Telephone: +64 21 629 553
Email: henry.russell@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

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