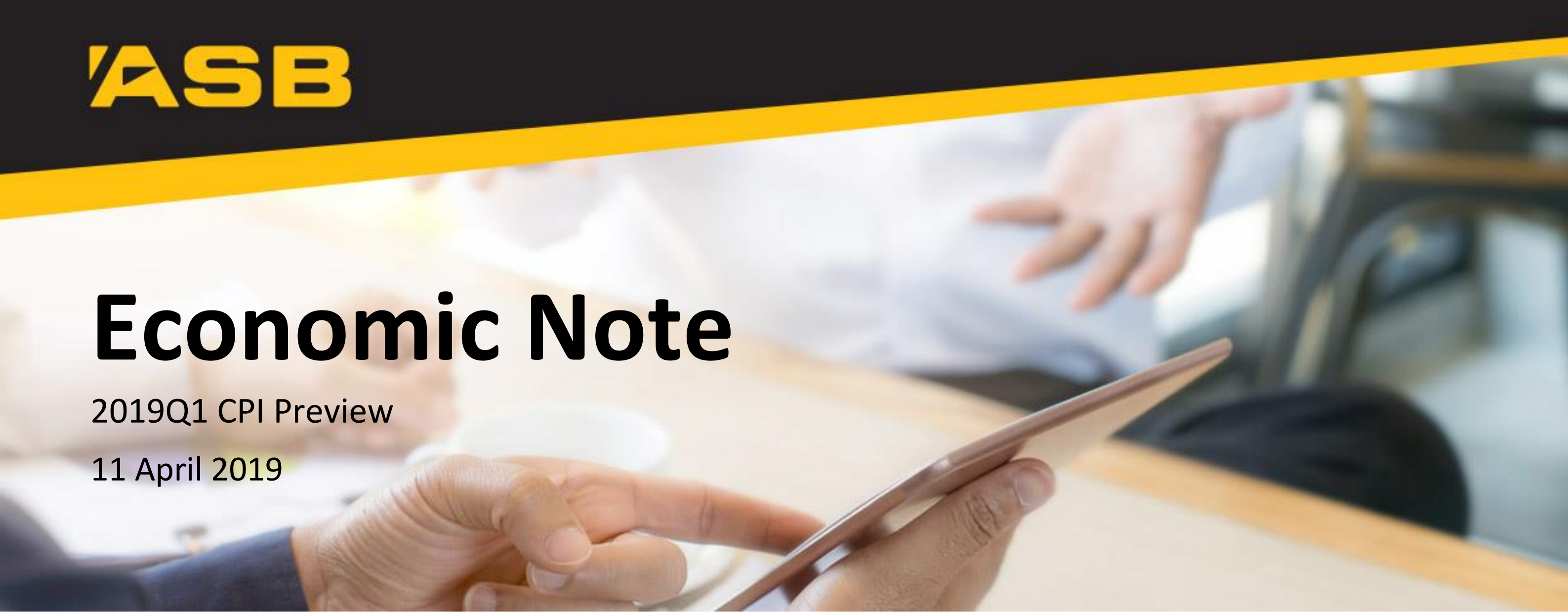

Economic Note

2019Q1 CPI Preview

11 April 2019

Taking stock

- We expect the CPI to lift 0.2% qoq in Q4, taking annual inflation for 2018 to 1.6%. Risks are broadly balanced.
- Core inflation measures are expected to be clustered around (or slightly below) 2% yoy.
- We do not expect the NZ economy to have sufficient momentum to keep medium-term inflation comfortably within the 1-3% target band. A lower OCR beckons and the RBNZ appears to be coming around to this view.

Q1 2019 CPI %	Previous	**ASB**	RBNZ
CPI qoq	0.1	**0.2**	0.2
CPI yoy	1.9	**1.6**	1.6
Non-tradable qoq	0.7	**1.0**	1.0
Non-tradable yoy	2.6	**2.8**	2.8
Tradable qoq	-0.4	**-0.8**	-1.0
Tradable yoy	0.8	**0.1**	-0.1

Summary & implications

We expect overall consumer prices to rise 0.2% in the March quarter, lowering annual CPI inflation to 1.6%. Our forecasts are in a similar ballpark to those of the RBNZ and, although we are on the cusp of a quarterly 0.3% outturn (+1.7% yoy), risks appear broadly balanced. Abstracting from seasonal and transitory influences on the inflation process, we expect annual readings from the core inflation measures produced by Statistics NZ to oscillate around 2%, with annual inflation from the RBNZ sectoral factor model stuck below 2%. Our view is that downside risks to the inflation outlook have grown in recent months and the NZ economy looks increasingly unlikely to be able to generate sufficient economic momentum that will be able to keep inflation comfortably within the 1-3% CPI inflation band. However, we freely acknowledge the risk that this may take time to become readily apparent in the NZ inflation figures. We believe the RBNZ will grow increasingly concerned over the inflation outlook and will cut the OCR by 50bps over 2019. The exact timing on OCR moves remains fluid.

Cost pressures building

We expect consumer prices to register a modest 0.2% increase in Q4, with annual CPI inflation to end 2018 at around 1.6%, the eighth consecutive quarter that annual CPI inflation has been below 2%.

The following influences underpin our CPI pick:

– **Fuel prices are expected to remain volatile and impact headline inflation.** Fuel prices rose by 10 cents per litre over the 2nd half of 2018. Our estimates suggest retail petrol prices fell roughly 7% in the March quarter (-0.3 percentage point contribution), but are expected to firm by a similar margin in the June quarter.

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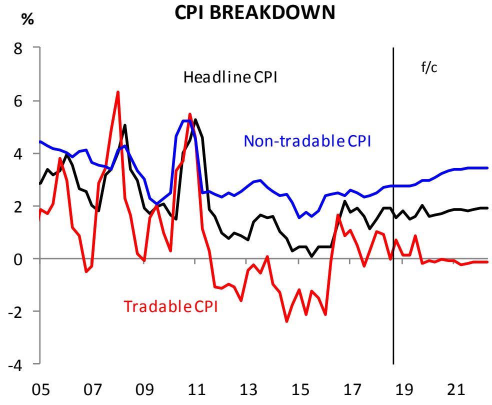
– **Government charges will add to the tune of 0.3 percentage points to quarterly inflation**. Increases in tobacco excise should facilitate a 10% increase in prices for tobacco.
– **Seasonality will likely contribute to quarterly volatility.** Increases are expected for food prices (+1.1% qoq, +0.2 percentage point contribution to inflation, as suggested by the monthly food price data), apparel, accommodation, personal care, household contents and insurance. Countering this will be March quarter falls in international airfares, and personal effects.
– **Housing-related costs are also expected to be a key contributor to price pressures**. Seasonal increases in private dwelling rents and solid rises in construction costs and property maintenance services are expected.
– **The lagged impact of the lower NZD will have a modest impact.** Falls against the USD and yen have been modest to date, but this could push up goods prices including vehicles, apparel and recreational goods.
– **Inflation readings are expected to remain contained outside of a number of specific pockets.** There will be a scattering of price increases throughout the CPI regimen (there always are), but few signs of a broadening front in pricing pressures is emerging.

Offsetting movements for tradable and non-tradable prices

The tradable/non-tradable split is expected to highlight the offsetting influences on the inflation process. Non-tradable prices are expected to rise 1.0% qoq (2.8%), underpinned by increases for tobacco, housing, domestic airfares, road and rail transport services, healthcare, personal care, insurance and wider services prices. Tradable prices are expected to be little changed on a year earlier, a testament to the benign global inflation backdrop. Lower fuel prices and seasonal falls for international airfares are expected to dampen Q1 tradable prices (-0.8% qoq, +0.1% yoy). However, it won't be all downside for tradable prices. Food prices will rebound from their Q4 seasonal fall and a modest seasonal lift is expected for apparel prices. Car prices could also nudge higher.

CPI BREAKDOWN

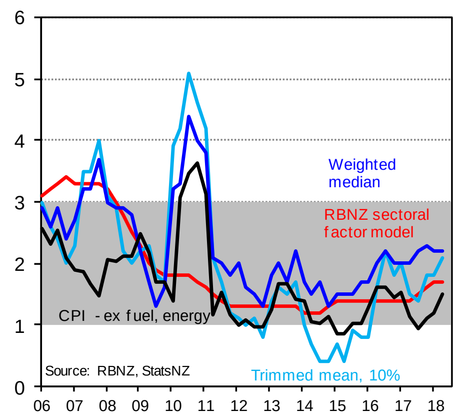


Source: Statistics NZ, ASB

Focus on the core measures and medium-term inflation outlook

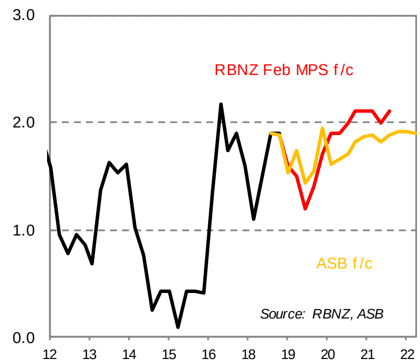
Our focus will be on the core inflation measures, which are expected to oscillate around 2% yoy. Seasonal quarterly increases are expected for both the 10% trimmed mean and 50% weighted medians, but the risk is that annual inflation of these measures falls towards 2%. **We do not expect annual inflation from the RBNZ's sectoral factor model (released next Thursday at 3pm) to shift from 1.7%, but we note that the RBNZ estimates of core inflation are subject to historical revision.** There is the risk that the weaker domestic outlook for economic activity could act to dampen pressures on domestic inflation. Contained readings for core consumer price inflation – despite stretched capacity pressures – suggest there is a structural (long-lasting) element to the inflation process. It would further underscore the need to focus more on direct inflation influences rather than capacity metrics.

MEASURES OF CORE INFLATION



Over the medium term, the risks to the inflation outlook remain skewed to the downside. Global growth is slowing, and this will weigh on the NZ economy. The latest GDP figures (released after the RBNZ last published its forecasts in February), confirmed that the NZ economy lost momentum over 2018 and the domestic growth outlook for 2019 now looks weaker. **Spare capacity in the NZ economy will likely dampen medium-term inflationary pressure.** We expect the RBNZ to concur with our view and cut the OCR by 50bps by the end of 2019. We have pencilled in 25bps OCR cuts in May and August. We note, however, the timing of OCR moves is fluid and will likely depend on a range of factors, including the domestic and global outlook, actions by overseas central banks, and the NZD, as well as domestic CPI data.

CONSUMER PRICE INDEX



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