Economic Note

2019Q3 CPI Preview

10 October 2019

Middling core and low annual headline CPI

- We expect a 0.6% qoq increase for the CPI in Q3, dropping annual CPI inflation to 1.4%. Risks are broadly balanced.
- Annual core inflation measures are expected to remain somewhat firmer, clustered around 2% for the Statistics NZ measures, but stuck below 2% for the RBNZ sectoral factor model.
- A low inflation backdrop and growing spare capacity necessitates more policy support. We expect a further 50bps of OCR cuts and a 0.50% OCR floor this cycle.

Q3 2019 CPI %	Previous	**ASB**	RBNZ
CPI qoq	0.6	**0.6**	0.5
CPI yoy	1.7	**1.4**	1.3
Non-tradable qoq	0.3	**0.8**	0.7
Non-tradable yoy	2.6	**2.8**	2.7
Tradable qoq	0.9	**0.4**	0.1
Tradable yoy	0.8	**-0.4**	-0.7

Summary and implications

Courtesy of seasonality and higher prices in the housing group, we expect overall consumer prices to rise 0.6% in the September quarter (+1.4% yoy), slightly above the Reserve Bank of New Zealand's (RBNZ) August Monetary Policy Statement (MPS) pick. Risks to our pick are broadly balanced. 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%. Despite a lower NZD, entrenched low inflation and growing spare capacity within the economy look set to push the OCR lower still. We expect a 25bp cut in November followed by a further 25bp cut in February.

Fuel-driven volatility

We expect consumer prices to climb 0.6% qoq in Q3, with annual CPI inflation dropping to 1.4%, an 18-month low and the 11th successive quarter below the midpoint of the 1-3% inflation target. Risks to our forecast are broadly balanced.

The following influences underpin our CPI pick:

– **Housing-related costs are also expected to remain a key contributor to price pressures**. A circa 3% quarterly increase in local authority rates, construction costs and solid quarterly increases for dwelling rents

Mark Smith – Senior Economist (649) 301 5657 mark.smith4@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz

and dwelling maintenance services should deliver a 1% qoq increase for this group (+0.3 percentage point contribution).

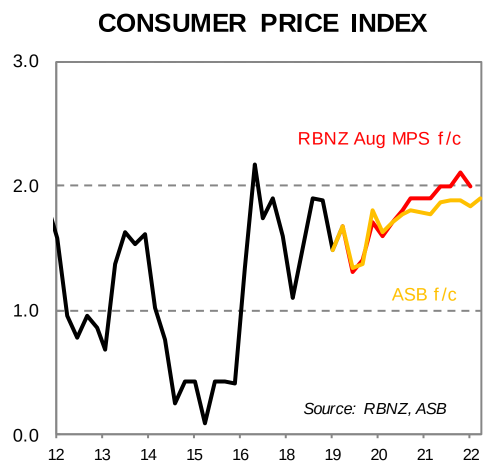
- **A seasonal rise in food prices.** The monthly food price data point to a 1.3% qoq rise in food prices in Q3 (+0.2 percentage point contribution).
- **Higher transport costs**. Higher petrol prices, seasonal rises for domestic airfares, increased charges for vehicle servicing and repair and an increase in costs for most car registrations (due to higher ACC levies) should deliver a 1%+ quarter (+0.1 percentage point contribution).
- **The usual scattering of rises and falls throughout the CPI regimen.** Insurance premiums look set to move higher still, as do other miscellaneous goods and services prices. Partly offsetting this will be falls in apparel and communications. The NZIER Quarterly Survey of Business Opinion (QSBO) identified a sharp drop in firms' selling price expectations in Q3, and we expect the patchy consumer demand environment and sale-focused consumers to keep retail discounts coming.

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 lift 0.8% qoq (2.8% yoy), supported by higher local authority rates, rising domestic airfares, and solid increases for rents and construction costs. Seasonal increase in food prices are expected to deliver a 0.4% qoq rise in Q3 tradable prices (-0.4% yoy). Despite the NZD hovering just above 10-year lows against the USD, there are few signs of an imminent pick-up in tradable prices. The low global inflation backdrop and competitive pressures are expected to cap price increases in the tradable goods sector.

But, low and stable core inflation

Our focus will be on the core inflation measures, which are expected to oscillate around 2% yoy. We expect annual inflation for both the 10% trimmed mean and 50% weighted median to remain above headline CPI at around 2%. Annual inflation from the RBNZ's sectoral factor model (released Wednesday 16 October at 3pm) has not been above 2% for 10 years. We expect another 1.7% yoy print. **Low readings for core consumer price inflation suggest there is a structural (long-lasting) element to the inflation process.**



The RBNZ remains confident that the economy will respond to the policy stimulus delivered, which should eventually push inflation higher. We harbour doubts as to whether the economy will respond with as much vigour. **Spare capacity in the NZ labour market and economy in general looks set to increase and this will likely dampen medium-term inflationary pressure**. More policy support will be needed to drive inflation higher and we expect a further 50bps of OCR cuts by early 2020.

ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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