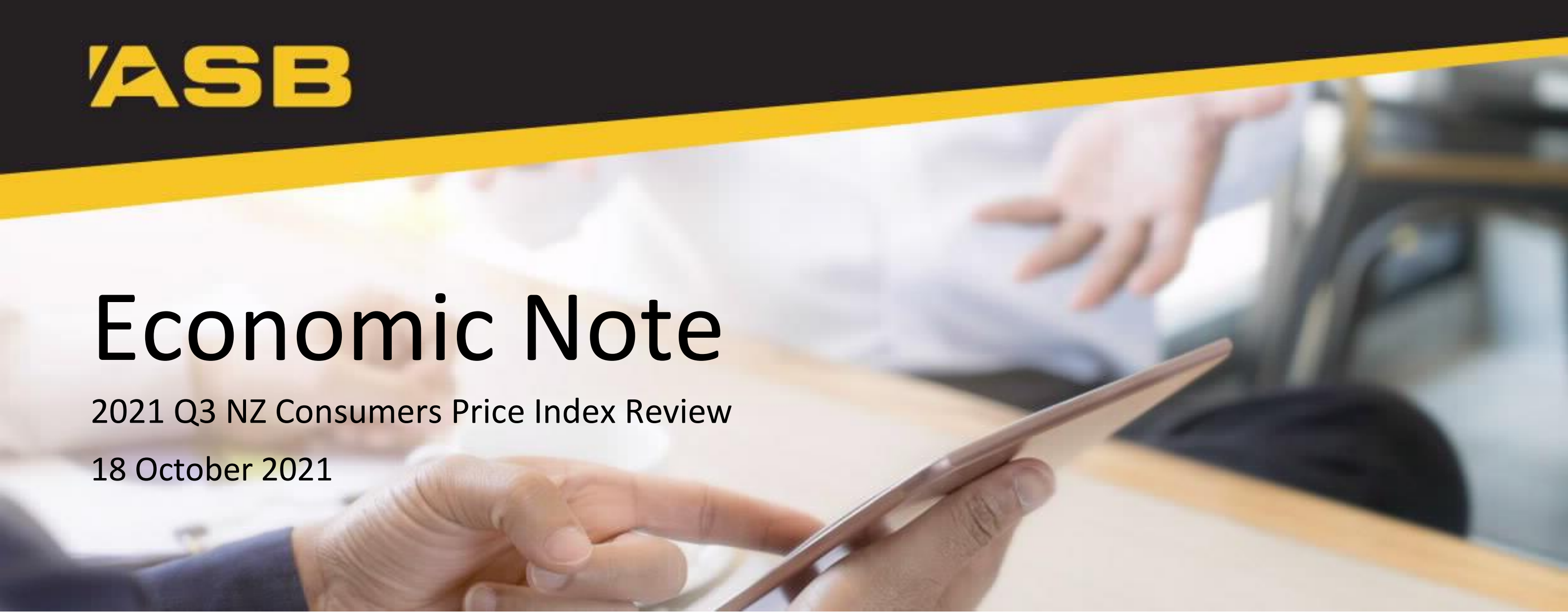


Economic Note

2021 Q3 NZ Consumers Price Index Review

18 October 2021

Annual CPI inflation on track to top 5% over 2021

- Consumer prices surged 2.2% in Q3, pushing annual CPI inflation to a new decade high of 4.9% and considerably above ASB, market and RBNZ expectations.
- ASB expects annual headline inflation to move above 5% by the end of the year. There is the clear risk that high inflation outcomes persist well into 2022 (and likely beyond that).
- The path of the OCR is largely contingent on the economic scarring caused by the ongoing restrictions to contain the spread of COVID and whether inflation expectations and other inflation anchors become unstuck.

Q3 2021 CPI %	**Actual**	ASB	RBNZ	Market
CPI qoq	**2.2**	1.7	1.4	1.5
CPI yoy	**4.9**	4.4	4.1	4.2
Non-tradable qoq	**1.8**	1.2	1.2	
Non-tradable yoy	**4.5**	3.9	3.8	
Tradable qoq	**2.8**	2.3	1.8	
Tradable yoy	**5.7**	5.2	4.7	

Summary and implications

Annual CPI inflation hits a new decade high of 4.9% yoy, considerably above ASB, market and RBNZ expectations. Upward surprises were evident in a number of areas, making it difficult to identify any specific catalyst, and likely reflecting a combination of transitory and more persistent influences. ASB expects annual headline inflation to move above 5% by the end of the year and there is the clear risk that high inflation outcomes persist well into 2022 (and likely beyond). The RBNZ has (rightly) maintained its focus on the medium term and will 'look through' the near-term spike in inflation. Still, the RBNZ will be somewhat wary about the short-term inflation outlook and signs of a broadening front in inflationary pressures. We expect follow-up 25bp hikes in November and February and a 1.50% OCR endpoint from late 2022. The path of the OCR is largely contingent on the economic scarring caused by the delta outbreak and whether inflation expectations and other inflation anchors become unstuck.

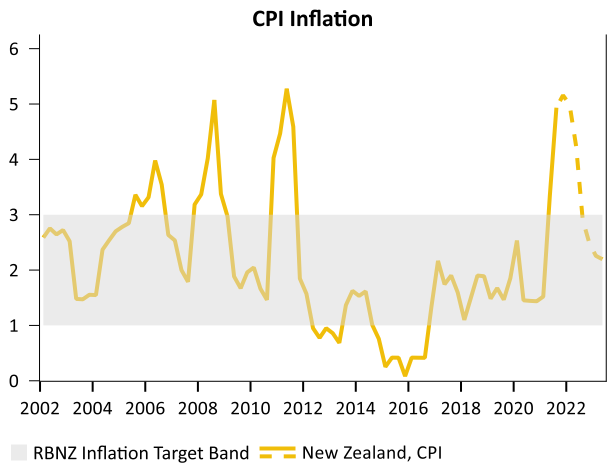
The details

Consumer prices surged 2.2% in Q3, considerably stronger than ASB, market and RBNZ expectations, with annual CPI inflation ticking up to 4.9%, its highest rate since 2011. Today's CPI data provided yet another massive upward surprise to the RBNZ, that looks to be due to a number of causes (mostly one-sided).

Major upward contributions came from prices in the food (2.7% qoq, +0.5% CPI contribution), housing & household

Mark Smith – Senior Economist (027) 578 5635 mark.smith4@asb.co.nz

utility (2.6% qoq, +0.7% to Q3 CPI) and transport groups (4.2% qoq, +0.5% to Q3 CPI). Upward surprises were evident for the latter two groups and look to have reflected a combination of transitory and more persistent influences.



Source: Macrobond, ASB

Higher global energy prices boosted petrol prices (+6.5% qoq, +0.03 ppt contribution). The subsequent push higher in oil prices (to 7-year highs in USD terms) and widespread increases in global energy costs point to further increases in energy-dependent goods and services. This will sap discretionary spending. Surprisingly, lower prices for new cars and bicycles pushed down vehicle prices (-0.6% qoq).

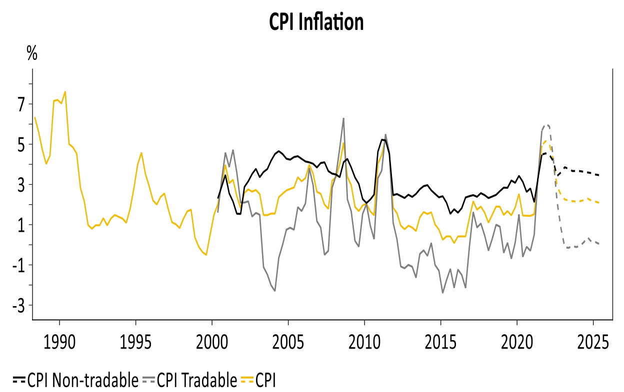
Statistical tweaks provided a modest boost to the inflation numbers. Adjustments by Statistics NZ to allow for COVID-19 impacts, including lowering the materiality criteria for international airfares (despite a lower expenditure weight), saw international airfares surge 65.7% in Q3, adding 0.02 percentage points to Q3 CPI. Domestic airfares climbed 8.2% in Q3. These impacts are unlikely to reverse under the current level of restrictions.

Higher housing costs were also apparent, with prices in the housing group up 2.6% qoq (6% yoy). Local authority rates soared 7.0% in Q3, partly in recognition of higher costs, but also reflective of **still-robust housing market conditions. The latter conditions, dwelling shortages, increases for raw materials, rising costs and stretched capacity pushed construction costs higher still** (4.5% qoq, 12% yoy). Dwelling rents rose just 0.7% qoq (+3.2% yoy), but are expected to move higher given the impacts of housing policy changes.

Food prices rose 2.7% qoq, 3.1% yoy. Part of the rise was seasonal with the spike in fresh fruit & vegetable prices (7.3% qoq) expected to unwind **but rising global food commodity prices point to a modest pick-up in overall food price inflation over 2021.**

There were further signs of supply chain disruptions impacting on consumer prices. Prices in the recreation & culture (2.9% qoq), household contents & services (+1.3% qoq) and miscellaneous goods and services (+1.3% qoq) groups moved higher, consistent with recent anecdotes and most survey evidence.

Annual core inflation measures firmed. Annual inflation for both the 10% trimmed mean (4.4% yoy in Q3) and 50% weighted median (3.3% yoy) were above the top of the 1-3% inflation target and look to remain so for a while yet. Excluding food, fuel and energy, annual CPI inflation surged to 4.8% yoy from 3.3% yoy in Q2. The Q3 print from the RBNZ Sectoral Factor model (released at 3pm today) is expected to move well above its Q2 2.2% yoy value.



Source: Macrobond, ASB

Of more concern to the RBNZ is that inflationary pressures look to be broadening. The distributional measures showed that more price increases than usual seem to be being pushed through (59.5% of items, 72.2% of CPI by expenditure weight), with correspondingly fewer price falls (25.6% of items and 20.8% by weight, respectively). **This points to quite a number of inflationary pressure points in the economy, from a myriad of sources.** What's more, consumers seem resigned to accepting higher prices.

Our view

We have long been wary of two key upside risks. First, that the peak in CPI inflation proves to be consistently higher than earlier expected by the market and the RBNZ. The second major risk is that the uplift in inflation ends up having a more persistent impact on consumer prices over the medium term.

Despite the widespread number of surprises, we don't expect there to be pushback in the Q4 numbers. As such, today's numbers point to a higher spike in annual CPI inflation. **We can now see annual CPI inflation exceeding 5% by the end of this year. It is still early days, but the widespread nature of price increases shown today was not a comforting sign**. If it were not for the delta variant outbreak, the pace of OCR hikes being implemented by the RBNZ would potentially be quicker than 25bp increments.

We still expect 'considered steps' from the RBNZ, with 25bp hikes in November and February 2022, with the OCR hitting 1.50% by the end of next year. The speed and magnitude of subsequent OCR moves remains conditional on a range of factors, including the degree of economic scarring caused by restrictions to contain the delta outbreak and whether inflation expectations and other inflation anchors are consistent with the 1-3% medium-term target or become unstuck.

Market reaction

Market reaction was sizeable in the local interest rate market. NZ swap yields jumped 10-20bps across the curve, with markets now pricing in the distinct possibility of a 50bp move by early 2022 (60bps of hikes priced in by early 2022, 130bps by late 2022). The NZD briefly spiked above 71 US cents and is currently 20 pips above pre-CPI levels.

ASB Economics & Research			**Phone**
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5957
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Economist	Mike Jones	mike.jones@asb.co.nz	(649) 301 5661
Economist	Nat Keall	Nathaniel.Keall@asb.co.nz	(649) 301 5720
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915

www.asb.co.nz/economics

@ASBMarkets