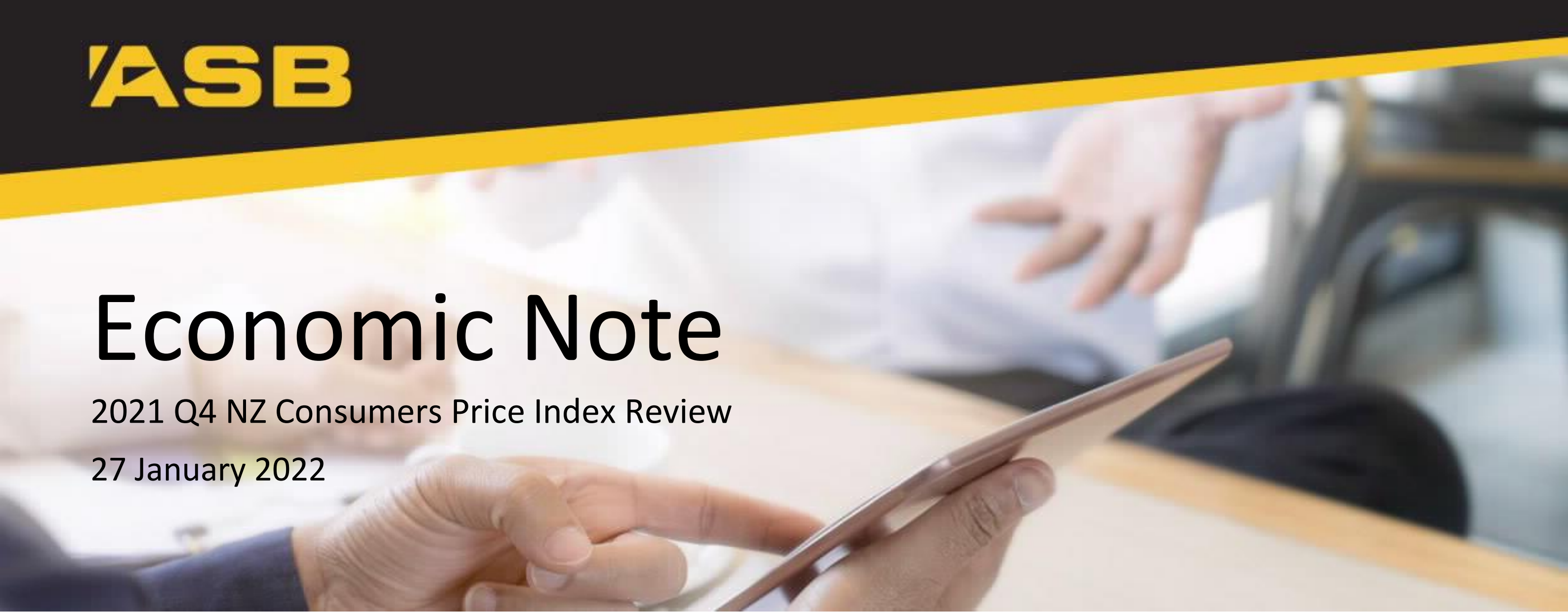

Economic Note

2021 Q4 NZ Consumers Price Index Review

27 January 2022

Annual CPI inflation set to top 6% in early 2022

- Q4 NZ CPI was above market and RBNZ expectations, with annual CPI inflation a shade below 6% and the highest in more than 30 years. NZ inflation looks set to crack the 6% annual inflation mark early in 2022
- High NZ inflation does not look to be transitory. A broadening front of rising inflation is emerging that will be difficult to slow
- The RBNZ clearly has more work to do, with today's Q4 2021 CPI print raising the odds of a faster pace of OCR hikes and a higher OCR endpoint than the RBNZ's 'considered steps' mantra

Q4 2021 CPI %	**Actual**	ASB	RBNZ	Market
CPI qoq	**1.4**	1.6	1.2	1.3
CPI yoy	**5.9**	6.1	5.7	5.7
Non-tradable qoq	**1.5**	1.4	1.3	
Non-tradable yoy	**5.3**	5.2	5.1	
Tradable qoq	**1.3**	2.0	1.1	
Tradable yoy	**6.9**	7.6	6.7	

Summary and implications

Headline CPI inflation was a shade below our expectations, but above market expectations and the RBNZ pick. Annual inflation rose to a shade under 6%, its highest in more than 30 years. What was particularly noticeable was that inflationary pressures are broad-based and attributable to a number of domestic and external catalysts. We expect annual CPI inflation to push above 6% in early 2022 and to remain above 3% until later in 2023. Persistently high inflation and an extraordinarily tight labour market backdrop and outlook has the risks on the side of a faster pace of OCR hikes and higher OCR endpoint than the RBNZ's 'considered steps' mantra. The RBNZ looks to have an inflation problem that they need to deal with.

The details

Consumer prices rose 1.4% in Q4 (1.447% to 3dp) with annual CPI inflation rising to 5.9% (5.945%), the highest since mid-1990, or mid-1988 when adjusted for GST increases. This was below our Q4 forecast but higher than the market median and the November Monetary Policy Statement (MPS) pick. **It marked yet another high inflation surprise for the RBNZ.**

Higher than expected tradable and non-tradable prices accounted for the upward surprise to the RBNZ forecast, with annual rates for both topping 5%. **This suggests that pricing pressures reflect both domestic and external drivers.** What's more, we were expecting a faster pace of increases for tradable goods prices, with petrol prices and some other tradable prices surprising us to the downside. **This looks to be a matter of timing and we expect more upside pressure to emerge in early 2022.**

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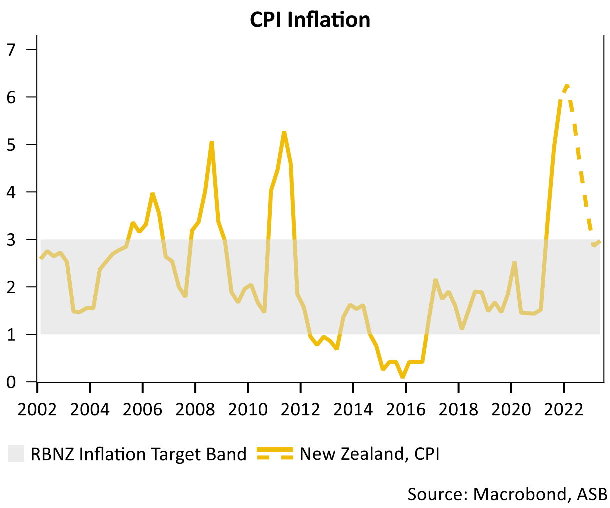
Price increases were particularly acute in the transport (3.9% qoq, 7.6% yoy) and the housing group (2.0% qoq, 15.0% yoy), which combined to contribute close to three-quarters of the increase in the Q4 CPI. Prices for petrol rose 7.7% qoq (30.7% yoy) and look set to push higher in 2022, weighing on household budgets. Supply chain frictions and stock shortages pushed up prices for vehicles (1.9% qoq), with sizeable increases for passenger transport.

Construction costs continued to ratchet higher, with a sizeable 4.6% Q4 gain following the similar Q3 lift and seeing annual inflation from this sector accelerate to 15.7%. Property maintenance services (+2.7% qoq) saw another hefty increase. Dwelling rents rose 1.2% qoq (+3.8 yoy) and are expected to move higher given the impacts of higher CPI inflation on rental adjustments.



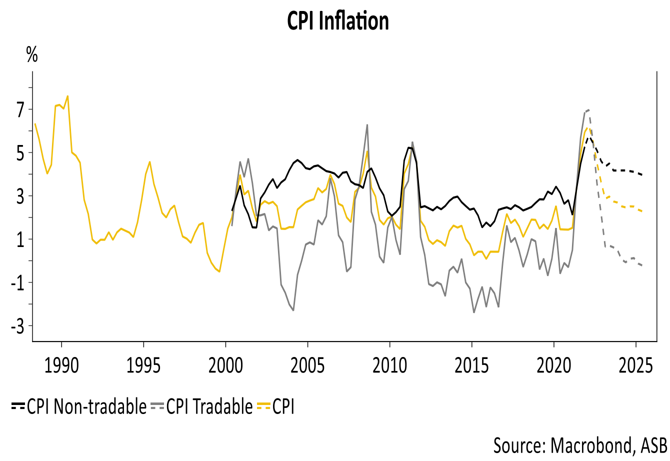
There were further signs of supply chain disruptions impacting on consumer prices. Prices within the recreation & culture (2.1% qoq) and household contents & services (+2.2% qoq) groups moved higher, consistent with recent anecdotes and survey evidence. However, Statistics NZ details showed that a net 11% of items were discounted in Q4, which is not much different to the 10% of items a year ago. **We expect supply disruptions to boost consumer prices over 2022.**

Core inflation also picked up. Annual inflation lifted for the various core measures, including the weighted median (1.0% qoq, 3.8% yoy), 10% trimmed mean (1.6% qoq, 5.0% yoy), and CPI excluding food, fuel and energy (1.6% qoq, 5.4% yoy). **The Q4 print from the RBNZ Sectoral Factor model (released at 3pm today) is expected to move well above its Q3 2.7% yoy value.**

The Q4 figures confirmed a broad front of rising prices that will concern the RBNZ. The distributional measures show more price increases than usual seem to be being pushed through (60.1% of items, 70.4% of CPI by expenditure weight). **This is reflective of the myriad of inflation stocks hitting the economy.**

Outlook and implications

We expect annual CPI inflation to pick up and then subside. After peaking just above 6% in early 2022, annual CPI inflation is then expected to cool but remain above the 1-3% inflation target until late 2023 (see chart). Coolling tradable price inflation is expected to drive the moderation in overall CPI inflation, whilst non-tradable inflation is expected to remain elevated.



Our view has long been that high inflation in NZ is not transitory. Capacity bottlenecks, supply constraints and resilient demand conditions are expected to keep inflation elevated. We see the risk of high inflation being more persistent which will erode the purchasing power of households, unless offset by higher incomes.

Given stretched capacity and the seemingly never-ending stream of upward cost shocks, a wage-price spiral is a risk. It could require more aggressive RBNZ action to stop it. We will be closely watching next week's Q4 labour market prints for a sign of how much spare capacity there is (not a lot by our reckoning). Next month's RBNZ survey of expectations will be particularly useful to ascertain whether short-term inflation expectations are still climbing (we suspect they will) and whether longer-term inflation expectations start to deviate from the 1-3% inflation target mid-point (a growing risk in our view).

Persistently high inflation and an extraordinary tight labour market backdrop and outlook warrants a faster pace of OCR hikes and a higher OCR endpoint. High and persistent inflation rates in many of our trading partners mean that the RBNZ will not be the only central bank hiking rates this year. For now, we expect a measured pace of 25bp hikes and a 2% OCR peak in late 2022, but events can change quickly. The RBNZ looks to have an inflation problem that they need to deal with.

Market reaction

NZ interest rates had been rising leading up to the CPI release but have subsequently backtracked to end up about square for today's session. Market reaction was sizeable in the local interest rate market. There was little immediate currency market reaction, with the NZD about 40pips lower following this morning's FOMC meeting and acknowledgement of pending interest rate hikes.

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