Economic Update
CPI Review – Q2 2017
18 July 2017

All is quiet outside of construction, rents

- The Q2 CPI was flat over the quarter and rose 1.7% yoy, weaker than ourselves and the market were forecasting.
- The outcome was also substantially weaker than the RBNZ's forecast.
- We still expect the first OCR increase in late 2018, earlier than the RBNZ's current view. But there is no rush.

The CPI was flat over Q2 and, on an annual basis, inflation pulled back to 1.7% yoy. As expected, falls in fuel prices weighed on inflation over the quarter. However, non-tradable inflation was also a key source of weakness.

Both ourselves and the RBNZ view domestic capacity pressures as a key source of inflationary pressures over the coming years. If that view is correct, non-tradable inflation should soon start showing signs of broad-based price rises (outside of construction and rents). We continue to expect the RBNZ will not lift the OCR until late 2018 – certainly there is no hurry for the RBNZ to act any earlier based off the Q2 CPI. Heading into the August Monetary Policy Statement, the RBNZ will remain very comfortable with its recent stance of holding the OCR down for a considerable period.

Q2 2017 CPI %	Actual	ASB	RBNZ	Market
CPI qoq	0.0	0.1	0.3	0.2
CPI yoy	1.7	1.9	2.1	1.9
Non-tradable qoq	0.2	0.3	0.5	
Non-tradable yoy	2.4	2.5	2.6	
Tradable qoq	-0.2	-0.2	0.1	
Tradable yoy	0.9	0.9	1.1	

Looking at the details, **key sources of weakness on the non-tradable side included recreation** (including an **8.1% qoq fall in accommodation services**) as well as **a 2.8% qoq fall in credit services** and a softer than anticipated lift in other miscellaneous services (+0.1% qoq).

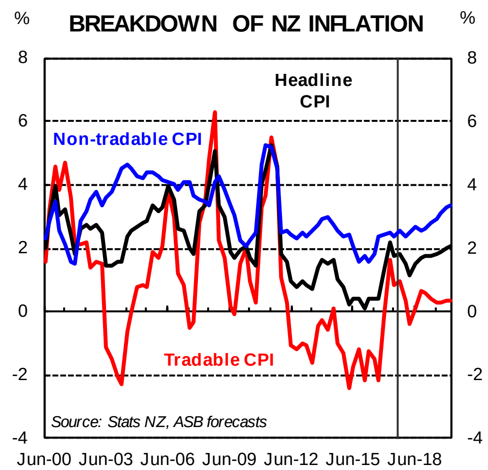
Transport prices also weighed on non-tradable inflation over the quarter with passenger transport services prices falling 4.0% (largely driven by a **14.5% qoq fall in domestic airfares**) and private transport supplies and services down 0.8% over the quarter.

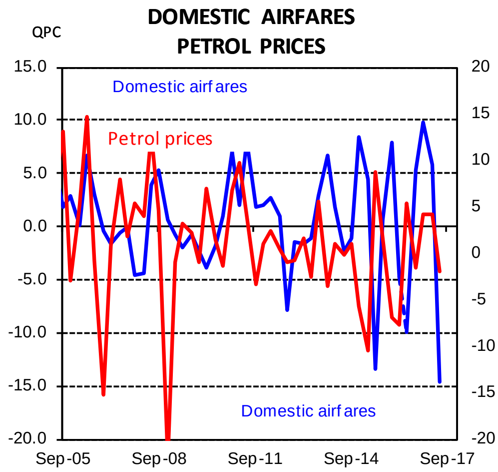
However, as expected, **housing costs continue to rise and were up 1.8% over the quarter, driven by a 3.0% rise in construction costs in Auckland.** The sustained price increases we have seen in the construction sector recently reflect increasingly tightening capacity pressures around the country, but particularly in Auckland. **Rental prices also continued to lift higher, albeit by less than we had anticipated.** Rental prices rose 0.4% qoq, with the greatest price rise once again contained to Auckland (+0.8% qoq).

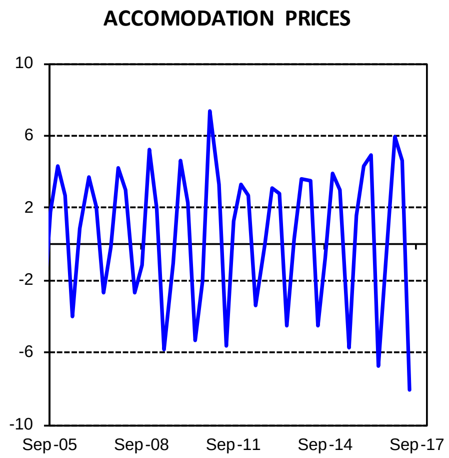
On the tradable side, i**nflation fell as expected, largely driven by a 1.9% fall in fuel prices.** However, other sectors were also weak including household contents, audio-visual equipment and communication (down 0.9%, 8.9% and 1.8% qoq respectively).

Lion's Tour:

Note that impacts from the Lion's Tour were, for the most part, largely uncaptured in the Q2 survey. For example, accommodation prices were surveyed before the tour began. **As a result, Q2 CPI provides a relatively accurate picture of underlying inflation, as it wasn't impacted by this one-off event.**







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