

Economic Note

Q1 CPI Review

19 April 2018

No sign of inflation running away yet

- The Q1 CPI rose by 0.5% in Q1, marginally higher than ourselves and the market were expecting. The annual rate of inflation dipped to 1.1%, pretty much in line with market expectations.
- As expected education costs were a key drag on inflation in Q1, but overall tradable inflation also remained subdued.
- Today's result reiterates our view that the RBNZ will leave the OCR on hold well into 2019.

Summary & implications

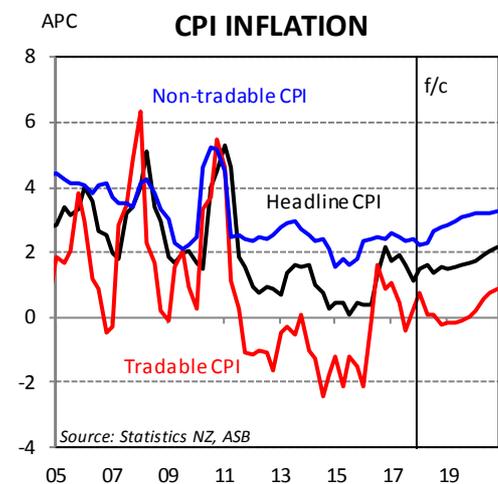
The CPI rose by 0.5% qoq, taking the annual rate of inflation down to 1.1%. Tradable inflation remains the key drag on headline inflation, with quarterly tradable inflation negative for the second consecutive quarter. At the same time, non-tradable inflation is not lifting fast enough to offset the softness the tradable drag. Core inflation measures also continue to point to a subdued underlying picture, with a number of measures easing on an annual basis. We do not expect the RBNZ to change course as a result of the Q1 release and believe the RBNZ will remain comfortable leaving monetary policy on hold for now.

Details

There was a lot of noise behind Q1's result, including the introduction of one year of free tertiary education and an annual 10% lift in tobacco excise tax. Outside of these impacts, the underlying picture remains subdued, especially on the tradable side of the equation. Core measures of inflation reinforce this view with the 10% trimmed mean dipping slightly to 1.4% and headline CPI excluding food, energy and fuel lifting only 0.9% over the year. However, the weighted median actually picked up slightly to 2.2%.

Today's result highlighted that tradable inflation remains the key drag on inflation, falling 0.1% over the quarter to be 0.4% lower on an annual basis. This fall comes despite a 2.7% qoq lift in petrol prices. International airfares were soft over the quarter as expected (-14.4% qoq), as were household textiles and appliances (-2.2% and 0.3% qoq, respectively), AV equipment (-4.2%) and books (-4.3% qoq). However, Q1 tends to be a seasonally-weak quarter for tradable inflation and indeed, on a seasonally-adjusted basis, tradable inflation lifted 0.3% over the quarter.

Non-tradable inflation on the other hand, lifted reasonably strongly in Q1, despite a 16% fall in tertiary education costs. Interestingly, it appears that the fall in tertiary education was almost entirely offset by the lift in the tobacco excise tax. Non-tradables inflation excluding the cigarettes and tobacco subgroup lifted just 0.5% qoq. Outside of government changes, housing construction costs continue to be a key driver of domestic inflation pressures. But in saying this, construction costs were softer than we were expecting in Q1 at just +0.4% qoq. Regionally, construction



costs were highest in the North Island (+0.7%), but, with Auckland and Wellington construction costs only lifting 0.3% for the quarter, it suggests the real construction inflation heat was elsewhere in the regions in Q1. Rent costs were also weaker than expected over the quarter, but a 1.8% lift in Wellington rental costs was the main driver of the +0.6%qoq increase. In Auckland, rents rose a more subdued 0.5%. Accommodation costs and insurance were also behind the slight upwards surprise on the non-tradable side this quarter, rising 6.1% and 1.2%, respectively.

All up, the Q1 release suggests that the RBNZ will be comfortable leaving the OCR on hold for some time yet.

Annual tradable inflation remains negative and annual non-tradable inflation is not lifting fast enough to completely offset the tradables drag from tradables inflation. We continue to expect domestic inflation to firm on the back of higher wages and will be watching developments in wage costs and expectations closely over coming quarters. But for now the RBNZ has time on its side. We do not expect the RBNZ to raise the OCR until August 2019.

Q1 2018 CPI %	Actual	ASB	RBNZ	Market
CPI qoq	0.5	0.4	0.6	0.4
CPI yoy	1.1	1.0	1.1	1.1
Non-tradable qoq	0.9	0.8	0.7*	
Non-tradable yoy	2.3	2.3	2.1	
Tradable qoq	-0.1	-0.1	0.3*	
Tradable yoy	-0.4	-0.3	0.0	

*ASB estimate

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