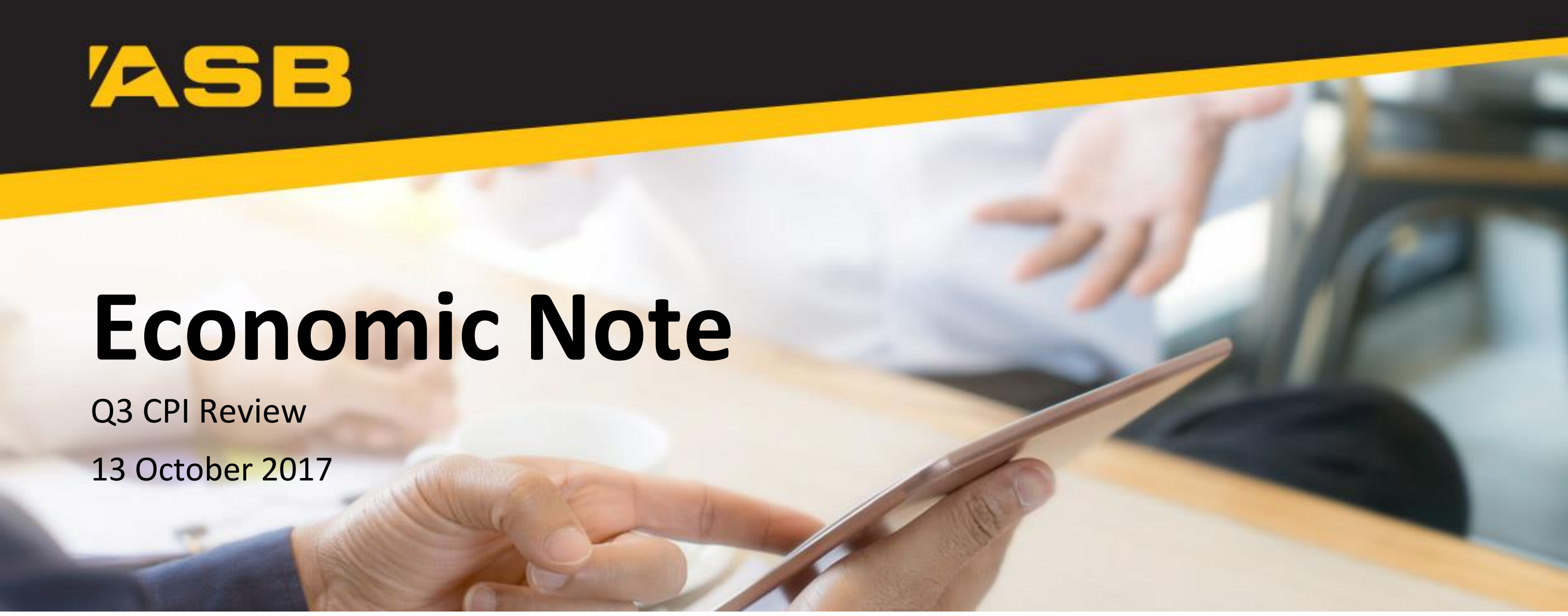


Economic Note

Q3 CPI Review

13 October 2017

Modest inflation print unlikely to concern RBNZ

- We expect the CPI to lift by 0.4% qoq in Q3 (+1.8% yoy), a touch higher than the RBNZ's forecast.
- Housing and food continue to be the key drivers of inflation, with pressures soft elsewhere.
- A low inflation backdrop will keep notions of OCR hikes on ice until early 2019, and possibly beyond that.

Summary & implications

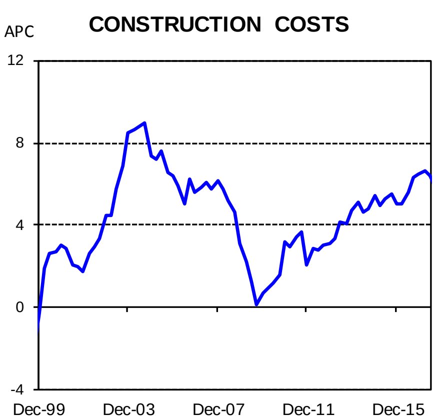
We expect the CPI to print at 0.4% qoq in Q3, with annual CPI inflation firming to 1.8%. Rising petrol prices and a stronger near-term outlook for food prices likely explain much of the difference with the **RBNZ's +0.2% qoq pick.** We expect the CPI to confirm that domestic inflation pressures remain subdued outside of one or two pockets and while the outlook for economic activity remains constructive and the beneficiary of a number of key supports, evidence of a firming in inflationary pressure is mixed at best. In such an environment, and given a number of downside risks still lurking in the background, there is plenty of sense in the RBNZ holding the pause button for a while longer.

CPI breakdown Q%	Mar-17	Jun-17	Sep-17
Food	2.2	0.7	1.1
Alcohol & tobacco	4.0	0.1	0.2
Clothing & footwear	-0.5	-0.2	-0.2
Housing & h/h utilities	0.6	0.8	0.9
H/h contents & services	0.6	-0.9	0.2
Health	0.5	0.2	0.8
Transport	0.8	-1.3	-1.3
Communication	-1.1	-1.8	-1.0
Recreation and culture	-1.0	-0.7	0.8
Education	1.8	0.2	0.0
Misc.goods & services	0.8	0.1	0.4
CPI	**1.0**	**0.0**	**0.4**
Tradable	**0.8**	**-0.2**	**0.0**
Non-tradable	**1.0**	**0.2**	**0.6**
CPI Annual	**2.2**	**1.7**	**1.8**

Stonger than the RBNZ's forecast

Our 0.4% qoq pick for Q3 CPI is stronger than the RBNZ's forecast published in the August MPS (+0.2% mom, +1.6% yoy). Since the RBNZ forecasts were finalised, retail petrol prices have firmed, whilst recent food price outturns have arguably been stronger than the RBNZ would have expected.

Housing and food still the key drivers



Construction costs continue to be a key source of inflation, reflecting very high construction demand. We expect annual construction cost inflation to stay elevated at around 6%, more than three-times the rate of headline inflation. Combine this with a 3% increase in rates over the quarter and higher rents, and the housing component accounts for over half of the inflationary pressure in Q3.

Fruit and vegetable prices also remain at high levels following the weather-related spikes we saw earlier in the year. Grocery prices have also increased by more than 1% over the quarter, largely reflecting higher dairy prices. Butter prices in particular have increased sharply

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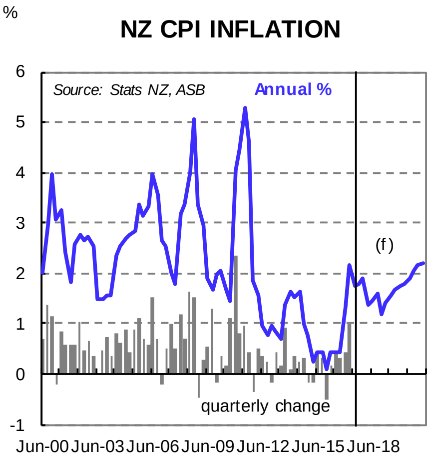
(+60% yoy) as global demand has surged.

Elsewhere, inflation is harder to find

Outside of construction and food, the underlying inflation picture looks more benign. Pricing pressure remains soft in the retail sector as online competition continues to weigh on retailers' pricing power. Despite strong population growth, annual dwelling rental inflation is expected to remain modest at around the inflation-target mid-point. The RBNZ's measure of core (underlying) inflation, which will be released at 3pm on Tuesday, is expected to continue to show core inflation sitting at around 1.4%, well below the headline rate.



Inflation outlook remains murky

Looking forward, annual CPI inflation looks set to decline towards the lower bound of the inflation target by early 2018. Whilst the usual historical relationships would tend to suggest a subsequent firming in inflationary prints, the jury remains out on how persistent the run of low domestic and global inflationary prints will be. In such an environment, actual inflation outturns will have more of an impact on OCR settings. Our expectation of a mild outlook for inflation suggests the RBNZ should be in no rush to raise the OCR. We continue to expect the RBNZ to leave the OCR on hold until early 2019, with the risk of a longer pause if inflation prints continue to remain benign.

Q3 2017 CPI %	Previous	**ASB**	RBNZ
CPI qoq	0	**0.4**	0.2
CPI yoy	1.7	**1.8**	1.6
Non-tradable qoq	0.2	**0.7**	*0.5*
Non-tradable yoy	2.4	**2.5**	2.4
Tradable qoq	-0.2	**0.1**	*-0.5*
Tradable yoy	0.9	**0.9**	0.4

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