

Economic Note

Q4 CPI Review

23 January 2019

Price pressures broaden in Q4

- The Q4 CPI lifted 0.1% qoq, with the annual inflation rate unchanged at 1.9%. This was slightly higher than our forecast but lower than the RBNZ's expectation.
- The soft headline result masks a lift in underlying inflation pressure over the quarter.
- However, given the recent slowing in economic growth, we expect the RBNZ to remain patient. We continue to expect the RBNZ to leave the OCR on hold until August 2020.

Summary & implications

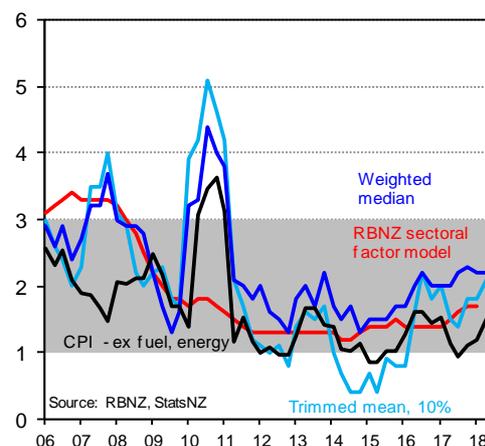
The CPI lifted 0.1% in Q4, to be 1.9% higher on an annual basis. However, the details of the release were surprisingly strong, with non-tradable and measures of underlying inflation all lifting. Further, there was evidence that price pressure is spreading beyond housing-related sectors. From the RBNZ's perspective, underlying inflation was stronger than expected and suggests that economic momentum over 2017 and early 2018 supported inflation pressures. However, given the recent slowdown in growth and the ongoing downside risks to the inflation outlook, we expect the RBNZ to remain patient for now. We don't expect the RBNZ to raise the OCR for a considerable period of time, but today's release confirms that there is a high hurdle to rate cuts in the current environment.

Underlying inflation measures firm

The CPI rose 0.1% qoq in the December quarter, slightly higher than our forecast, while lower than the RBNZ's 0.2% qoq forecast at the November Monetary Policy Statement. **Despite the muted headline figure, measures of underlying inflation firmed.** Annual inflation from the 10% trimmed mean and weighted median measures were both above 2%, while CPI ex food, household energy and fuel lifted 0.6% over the quarter to be 1.5% higher annually.

Non-tradable (or domestically generated) prices rose 0.7% qoq, to be 2.7% higher on an annual basis. This is stronger than both we and the RBNZ were expecting. Further, the details highlighted relatively widespread price increases. **For a while now, non-tradable inflation had been largely contained to housing-related costs, but today's release suggests that these pressures are starting to spill out into the wider economy.** Prices from the health group rose 0.5% over the quarter, driven largely by a 1.2% increase in hospital services. Communication costs rose off the back of a 1.0% qoq lift in telecommunication services and recreational and culture services also rose a strong 2.5% over the quarter, underpinned by broad-based increases amongst the components. These lifts came on top of still strong increases in

MEASURES OF CORE INFLATION

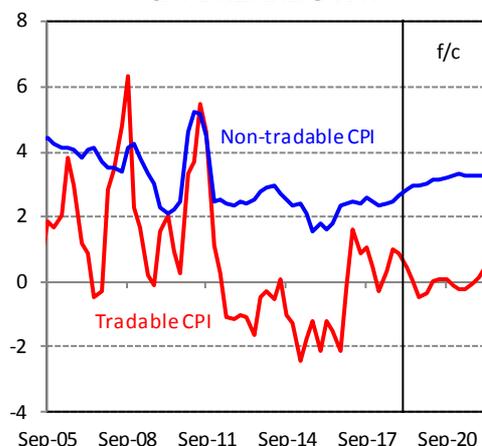


rents (+0.6%) and construction costs (+0.9%).

The fall in tradable prices was more modest than we had expected. A softer than expected fall in petrol prices over the quarter (-0.6% qoq) weighed less on the headline CPI figure than we had expected. Prices for other vehicle fuels also unexpectedly rose 2.6% over the quarter. We expect lower fuel prices to have a more dampening impact on quarterly consumer price inflation in the first half of 2019. **This will be occurring at a time when annual non-tradable inflation is likely to continue firming, complicating policy deliberations for the RBNZ.**

The 0.1% lift in headline CPI inflation masks a lift in underlying inflation over the quarter. The RBNZ will no doubt view today's release as positive and an example that momentum (and therefore price pressure) has been building in the economy. As a result, the RBNZ will likely take today's release as an indication that core inflation is firming, and moving back towards the midpoint of the RBNZ's 2% inflation target. **We will await today's 3pm RBNZ estimates for core inflation to corroborate these findings, with upside risk to the RBNZ's sectoral factor model estimates of core inflation (1.7% in the September 2018 year).**

CPI BREAKDOWN



Economic momentum has slowed over H2 2018 and as a result, there is a risk that underlying inflation pressure could also ease in coming quarters. Given the recent slowdown in economic growth and ongoing downside risks to the economic growth outlook, we think the RBNZ will remain patient for now. We continue to expect the RBNZ to leave the OCR on hold until August 2020.

Q4 2018 CPI %	Actual	ASB	RBNZ
CPI qoq	0.1	0.0	0.4
CPI yoy	1.9	1.8	2.0
Non-tradable qoq	0.7	0.5	0.4*
Non-tradable yoy	2.7	2.6	2.5
Tradable qoq	-0.4	-0.6	-0.1
Tradable yoy	0.9	0.5	1.0

*ASB estimate

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