# Economic Note

2024 Q1 CPI Review

17 April 2024

## Strong domestic inflation to delay RBNZ cuts

- Q1 24 inflation printed lower than we expected, but higher than RBNZ forecasts. However, the details highlighted that domestic inflation pressures are proving stubborn to stamp out.
- Annual non-tradable inflation remains stubbornly high and the RBNZ will have wanted to see more movement on this front. Core measures were unchanged to slightly lower, highlighting that returning inflation to target continues to be a slow grind.
- The RBNZ will be very wary of the risk of inflation being stuck above 3%: **we now expect the RBNZ to wait until February 2025 to cut the OCR**.

| Q1 2024 CPI % | Actual | ASB | RBNZ | Market |
|---|---|---|---|---|
| CPI qoq | **0.6** | 0.7 | 0.4 | 0.6 |
| CPI yoy | **4.0** | 4.1 | 3.8 | 4.0 |
| | | | | |
| Non-tradable qoq | **1.6** | 1.3 | 1.1 | |
| Non-tradable yoy | **5.8** | 5.5 | 5.3 | |
| | | | | |
| Tradable qoq | **-0.7** | -0.1 | -0.8 | |
| Tradable yoy | **1.6** | 2.2 | 1.5 | |

## Summary and implications

**Headline Q1 CPI was marginally weaker than we had expected but, in many ways, the print was actually an upside surprise.** The ongoing strength in domestically-generated inflation was evident throughout the numbers. Enduring price rises in sectors of the economy highlight that the RBNZ will not be in any rush to ease monetary policy. Indeed, it raises the risk that it will now take longer until the RBNZ is confident that inflation is trending back towards the midpoint of the 1-3% inflation target, on a sustained basis.

Some of the price rises that occurred in Q1 were outside of the RBNZ's control, while others were one-offs. Nevertheless, **the price pressures were broad based enough to concern the RBNZ that recent downward momentum could be stalling**. The data highlight that the last percent or so of disinflation may be hard won, something the RBNZ is acutely aware of. We don't think the data will prompt the RBNZ into doing more, so to speak. Activity data are very weak and highlight that monetary policy is working. **However, absent of clear evidence that domestic and core inflation measures are heading back to target, the risk is clearly skewed to the RBNZ joining the slower to lower camp of central banks. As a result, we now think the RBNZ will wait until February 2025 to cut the OCR.**

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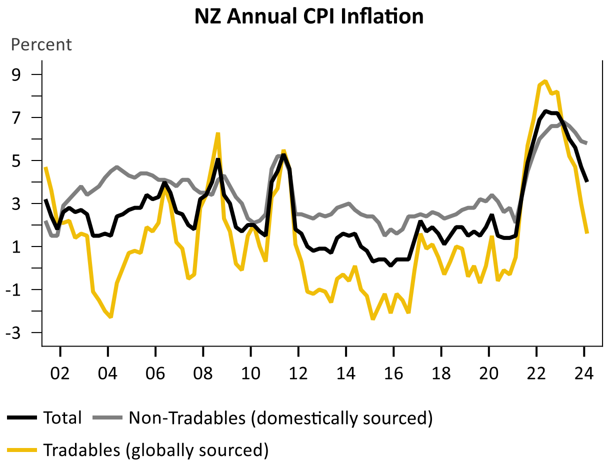
## Something for everyone at first glance

**Q1 CPI rose 0.6%, with annual inflation cooling to 4.0% yoy. At 4.0%, annual inflation in New Zealand is the lowest it has been since Q2 2021.** The print was largely in line with market expectations, but stronger than the RBNZ had forecast in February (pre-dating two months of selected price index data which comprise 45% of the CPI basket). The upshot is that any surprise factor for the RBNZ from today's headline print is likely to be smaller than the February forecast profile might imply.

**The headline print was slightly softer than we expected, with the downward surprise contained to weaker than expected tradable inflation.** In contrast, **non-tradable inflation was stronger than expected**, with annual inflation barely moving between Q4 23 and Q1 24, something the RBNZ is unlikely to look favourably on.



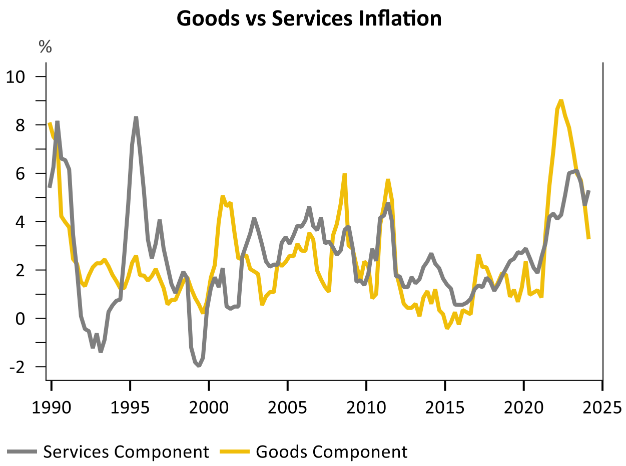
Source: Macrobond, ASB

**Tradable inflation continues to be the driving force behind cooling headline inflation.** Tradable inflation fell 0.7% qoq in Q1 2024 and is now just 1.6% higher than Q1 2023, well within the RBNZ's 1-3% inflation target. This was the lowest annual rate of tradable inflation since Q1 2021 and well off the peak of 8.7% reached in Q2 2022. Weaker than expected prices across vehicle purchases (-2.5% qoq), as well as household contents (e.g. furniture, furnishings and floor coverings -4.5% qoq) contributed to the softer tradable print.

**On the other hand, Q1 CPI confirmed that non-tradable prices are much stickier, with prices rising 1.6% in Q1. Annual non-tradable inflation edged lower to 5.8% yoy** (from 5.9% yoy in Q4 23) and is running at more than three times the rate of tradables inflation.

Some of the contributors to the non-tradable print will be looked through by the RBNZ. For example, tobacco prices (+6.5% qoq), rents (+1.2% qoq) and insurance (+3.6% qoq) continue to notch up hefty price rises. While the RBNZ cannot directly impact inflation in these areas, the ongoing price gains are not helpful to the overall price trend across the economy.

**Nevertheless, it's clear that there is more work to be done on domestically-generated inflation, with lingering capacity constraints in the services sector still evident in pricing data.** The goods/services split highlights that price rises remain more acute in the services sector (+1.3% qoq) than in the goods sector (+0.3% qoq). Recreational services, miscellaneous services, out-patient services, hospital services, road passenger services, and rail passenger services all recorded price gains of between 1.5% and 3.4% in the quarter.

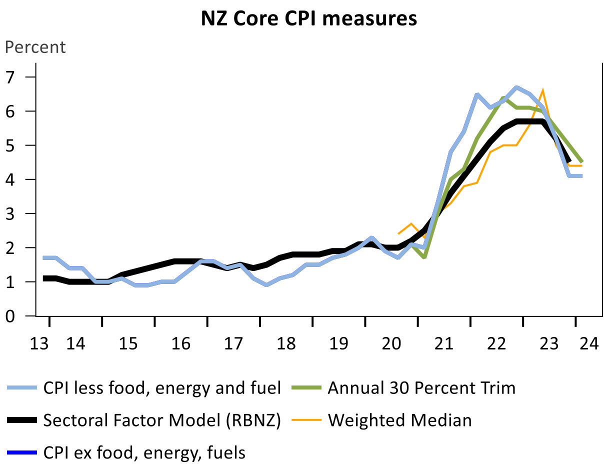


Source: Macrobond, ASB

Education prices surprised to the upside (+3.9% qoq), with Stats NZ noting that private primary and secondary school fees, as well as higher tertiary education fees, drove the rise. Construction costs rose 0.8% qoq, (3.3% yoy), with price pressures still evident in the sector despite falling building consents. Accommodation services rose 6.7% qoq. There could have been a bit of an Eras Tour boost to the overseas accommodation cost that should wash out in Q2 24. Nevertheless, domestic accommodation costs still rose a robust 6.2% qoq, a pace which is not consistent with the RBNZ's 1-3% inflation target.

## Downard trend in core measures loses momentum

**The recent cooling in core and underlying inflation measures looks to have stalled somewhat in Q1 2024**. The 30% trimmed mean rose 0.7% qoq, with the annual rate dipping to 4.5% from 5.0% in Q4 23. The 50% weighted median rose 0.8% qoq and the annual rate was unchanged at 4.4% yoy. CPI ex food, energy and fuels rose 0.9% qoq with the annual rate also remaining unchanged at 4.1% yoy. Non-tradables less housing and housing utilities rose from 6.9% yoy to 7.0% yoy in Q1 24. Clearly, the RBNZ's interpretation of these numbers is that monetary policy will need to remain at restrictive levels for some time yet, because it's not yet clear inflation will settle within the 1-3% inflation band.



Source: Macrobond, ASB

**Distributional measures also showed an increase in the proportion of prices rising across the economy** (55% of items, 68.8% of the CPI weight). However, the average weighed price rise eased to 2.2%. **Price falls were less commonplace in Q1,** with around 31% of prices falling (22.7% of expenditure weight), with a weighted average fall of 4%.

Meanwhile, a net 14% of items were discounted in Q1, down from 16% in Q4 23. Discounting activity continues to be most prevalent in the household contents and services group. This is one of the sectors bearing the brunt of weak consumer demand, as many households pull back on big ticket items while their wallets are being squeezed.

## What now for the RBNZ?

**In terms of the immediate future, attention will quickly shift to the RBNZ's Q1 sectoral factor model which is released this afternoon (3pm).** We are firmly of the view that these core measures are more policy relevant than the headline or tradable/non-tradable figures. For example, in an interview with Bloomberg earlier in the year, RBNZ Governor Orr noted that "we observe headline but we are targeting in a large sense core inflation."

**The RBNZ will want to see the sectoral factor model ease further (+4.5% in Q4 23 – the lowest since December 2021). However, today's CPI print suggests a substantial downward shift is unlikely.** Signs that historical readings have been revised lower would also be welcome news. While not our base case, the emergence of downward historical revisions would suggest there has been a meaningful turning point in the data (i.e. lower inflation outcomes in the future are more likely).

Once today's dust settles, we don't think the outlook will have substantially changed for the RBNZ. Q1 CPI highlighted that core inflation is continuing to cool, albeit very slowly. Patience in the pursuit of sustained low inflation is, in our view, likely to guide the RBNZ's actions and narrative throughout much of 2024. Activity data are very weak, which should start to translate more obviously into pricing data. And although today's data are still consistent with headline inflation being back within the target band by Q3 2024, it highlights the risk that this doesn't occur. **As a result, we now think that the RBNZ will not begin to ease monetary policy until February 2025**, with November 2024 now looking too early for the RBNZ to have the required level of comfort on the inflation outlook.

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