ANZ Research

June 2022 Quarter CPI Review & OCR Call Change

18 July 2022

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Contact

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Inflation pressures demand three more 50bp hikes

- Consumer prices rose 1.7% q/q (7.3% y/y) – higher than our expectation of a 7.1% y/y lift, and the RBNZ's forecast for a 7.0% print. **We have changed our OCR call and now expect the run of 50bp hikes to continue through to November, meaning an OCR endpoint of 4.0% rather than 3.5%.** A 75bp hike at the August MPS is a very real possibility, particularly if the labour market data on 3 August delivers another hawkish surprise.
- As expected, tradables (ie mostly imported) inflation rose to 8.7% y/y (8.5% previously), pushed higher by surging petrol prices in the wake of the war in Ukraine. More concerning is the increased strength in non-tradables (ie mostly domestic) inflation, which increased to 6.3% – ahead of the RBNZ's forecast for a fall to 5.7% and our expectation of 6.0%. Domestically driven inflation tends to stick around a lot longer than the imported variety, and as such, the mix of inflation pressures revealed today demands a more aggressive RBNZ response.

Key points

Annual CPI inflation lifted to 7.3% y/y in the June quarter (6.9% previously) – higher than our forecast (and market consensus) of 7.1%, and the RBNZ's May MPS prediction of 7.0%. Non-tradables inflation has continued to lift (to a new record high of 6.3%), and measures of core inflation have increased steeply. Until we see clear evidence of inflation pressures waning, it's hard to see the RBNZ turning away from their path of aggressive rate hikes. Accordingly, we have changed our OCR forecast to now include 50bp hikes (rather than 25bp) in both October and November, taking the OCR to a peak of 4% rather than our previous forecast of 3.5%.

Not surprisingly, global developments are still helping to push headline inflation higher, with tradables inflation (just under 40% of the CPI basket) reaching a record high of 8.7% y/y (8.5% previously). New Zealand is physically far removed from the tragedy unfolding in Ukraine, but we're still feeling the economic shockwaves, with oil prices trading over USD100/barrel for much of the quarter, helping to push petrol prices over NZD3/litre (despite the temporary cut to the fuel excise tax). Global inflation pressures remain intense, with US annual CPI inflation hitting 9.1% in June.

Non-tradables inflation (ie the more domestically driven component of the CPI) is even more concerning. Non-tradables prices were up 6.3% y/y – increasing from Q1's 6.0% print, and coming in well ahead of the RBNZ's forecast for a 5.7% lift in domestic prices. Core inflation measures also rose, with weighted median inflation up to 4.8% y/y (3.9% previously), and the 30% trimmed mean up to 5.8% y/y (5.2% previously). CPI ex-food, fuel, and energy was 6.1% y/y (5.9% previously).

The data suggest a significantly more domestically oriented inflation pulse than the RBNZ anticipated back in May. That's a double-edged sword. Domestic inflation tends to be more persistent – but the RBNZ also has more influence over it (in contrast to tradables prices like petrol). With

Data summary

	% qtr	% ann
Headline CPI	1.7%	7.3%
Tradable	1.9%	8.7%
Non-tradable	1.4%	6.3%

labour demand remaining insatiable, and the Australian unemployment rate at a near-50-year low of 3.5%, super-tight domestic and global labour markets will keep the pressure on inflation.

The one ray of hope for domestic inflation to start to ease in the near future is that the housing market has continued to cool, with prices now down 6.6% from their November 2021 peak. At some point, that should reduce some of the pressure on construction costs (a big non-tradables driver). However, we are yet to see that – housing construction costs were up 4.5% q/q in Q2, stronger than expected. The timing of any reduction in inflation pressures in this sector is uncertain, given ongoing strong consenting activity, labour shortages, and materials shortages.

The details

Inflation pressures remain broad-based. Of the 1.7% q/q increase in consumer prices in the June quarter:

- Transport costs added 0.3ppts, as the Russian invasion of Ukraine pushed oil prices above USD100/barrel for much of Q2. In New Zealand, that's helped drive a 32.5% annual increase in petrol prices – even with the fuel excise tax cut temporarily taking some of the edge off. By our estimates, if it hadn't been for the fuel excise tax cut, inflation could have printed pretty close to 8%.
- Passenger transport services (a component of transport costs) subtracted 0.1ppts from headline, helped by the Government's cost of living package, for example half-price public transport. Rail passenger transport prices were down 50% q/q (but that took less than 0.05ppts from headline CPI).
- Housing-related costs were the most significant driver, adding 0.7ppts, with building costs still increasing (up 4.5% q/q). The housing market is slowing, but there's still a large amount of consented work in the pipeline, keeping the pressure on construction costs for now. Rent prices are also on the rise (lifting 1.2% q/q, or 4.3% y/y – the largest increase since the data began in 2000).
- Food prices lifted 1.3% q/q, adding 0.2ppts to headline CPI inflation. Surging domestic costs (including sharply rising wages) have combined with global pressures to create broad-based rises across all food categories.
- The rest came from a broad range of price increases across the CPI basket (figure 3). On an annual basis, every group of the CPI added positively to inflation in the June quarter.

Monetary policy implications

Today's data represents a significant starting point surprise for the RBNZ. While it is our expectation that signs of softening domestic demand will become increasingly evident over the second half of this year, the RBNZ has more work to do. As such, we have changed our OCR forecast to a continuation of 50bp OCR hikes, in August, October and November, taking the OCR to a peak of 4%, rather than our earlier forecast of 3.5%.

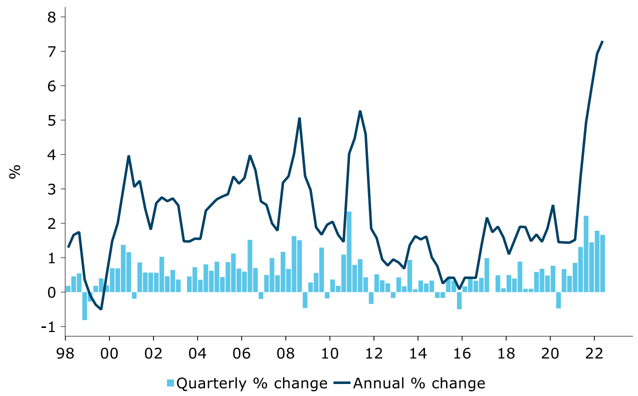
However, uncertainty remains high. The next data that could put serious pressure on forecasts for how fast and how high the OCR needs to go is the labour market data suite on 3 August. That data will no doubt also influence the market's bets on how likely it is that the RBNZ could decide to front-load the job and raise the OCR 75bp in August. We certainly wouldn't rule that out, but given the RBNZ's stated opinion that 50bp moves can do the job, we think they'd need a bit more of a push. The labour data could well provide that (unemployment or wages – or both) if anecdote is anything to go by.

The real challenge for the RBNZ is how broad-based and persistent inflation is looking, rather than the headline number itself. Tradables inflation could fall away quite quickly – especially if oil prices drop sharply and/or global supply chains recover from COVID disruption. But non-tradables inflation is likely to stay high over 2022 and into 2023 as an increasingly tight labour market generates strong wage rises. These wage rises are likely to far exceed productivity growth – and so will in all likelihood be passed on through higher-than-otherwise prices. So while we're (very tentatively) assuming that Q2 was the inflation peak, the RBNZ's inflation fight is far from finished.

Markets

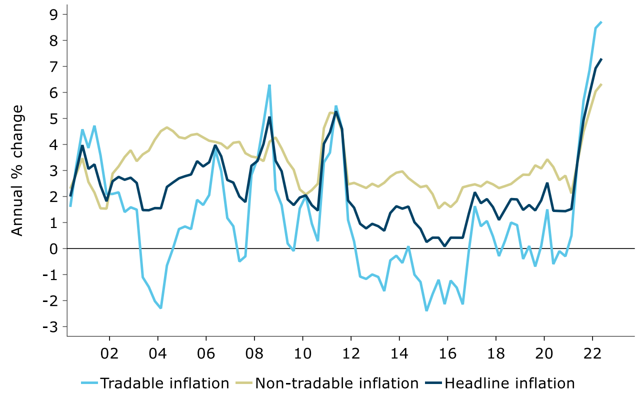
The headline reading was far enough above our and the RBNZ's pick to keep the market on the back foot, and the strength in non-tradables and the core measures has only contributed to a sense of unease that a 75bp OCR hike may in fact be on the cards. Short end swap rates rose a few basis points following the data, but even now, market pricing (which is consistent with a peak OCR of around 4.1% by November) is only slightly above what we are now forecasting, and it is easy to envisage short-end swap rates rising further if we do experience another bout of illiquidity. Fears of a hard landing are growing, but if a higher OCR (and high inflation) are at the core of those fears, that's not going to be of any comfort for the short end. The NZD blipped up on today's data as short-end interest rates rose, but how resilient it will be to growing hard-landing fears and the recent softening in commodity prices remains to be seen.

Figure 1. Headline CPI inflation



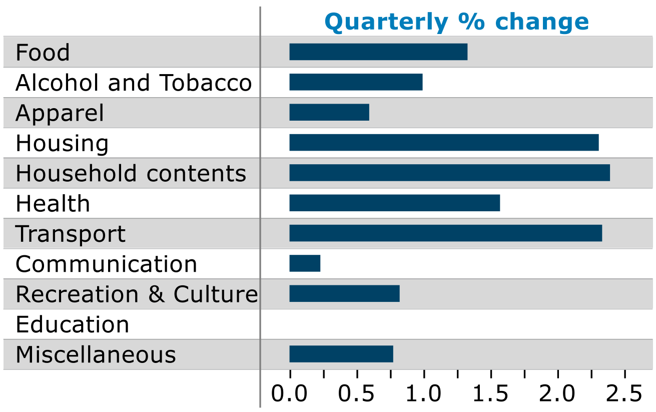
Source: Stats NZ, Macrobond, ANZ Research

Figure 2. CPI inflation components



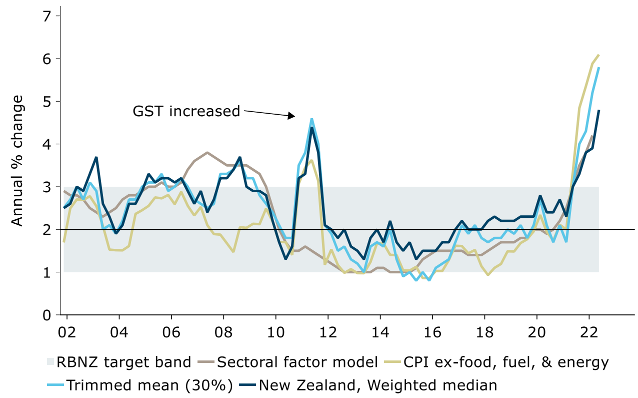
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. CPI groups – June 2022 quarter



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Core inflation measures



Source: Stats NZ, RBNZ, Macrobond, ANZ Research

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