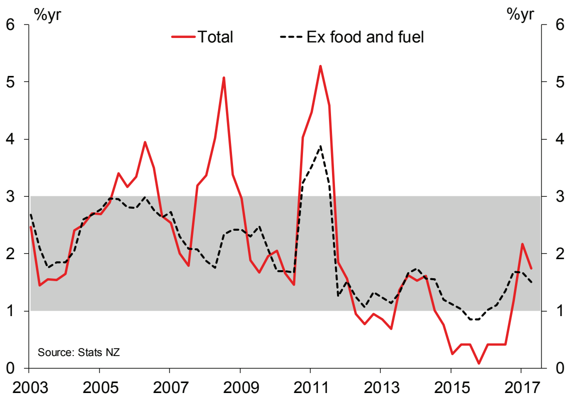
Been and gone

June quarter CPI flat, annual inflation slows to 1.7%

18 July 2017

- The Consumer Price Index (CPI) was unchanged in the June quarter, taking the annual inflation rate down from 2.2% to 1.7%.
- Groceries, fuel and domestic airfares were softer this quarter, and the rising New Zealand dollar continued to suppress imported goods prices.
- Measures of underlying inflation retreated a little this quarter, though they have come off their lows since 2015.
- The result was even softer than the market and the Reserve Bank expected, and will only reinforce the RBNZ's view that Official Cash Rate hikes are a long way off.

CPI inflation



Much of the heat that seemed to emanate from the previous inflation report has dissipated in the latest figures. Consumer prices were flat for the June quarter, dragging the annual inflation rate down from 2.2% to 1.7%. This overstates the degree to which inflation has slowed, as it includes volatile items such as fuel prices. But a range of measures of underlying inflation also saw some slowdown.

Today's result was slightly below our forecast of a 0.1% rise for the quarter, and substantially below the Reserve Bank's forecast of a 0.3% rise. The RBNZ has been emphasising lately that it expects inflation to be volatile for a while as one-off price changes work their way through, and was already forecasting inflation to (temporarily) drop back towards the bottom end of its 1-3% target range by early next year. So today's figures were at least in the spirit of the RBNZ's views.

However, these inflation figures should lead to a substantial rethink in financial markets, which have been persistently pricing a hike in the Official Cash Rate by mid-2018. Our view is more aligned with the RBNZ's: while inflation has come off its lows, the economy is not in danger of overheating, and we see no need for OCR hikes this year or next year. In fact, while we have 2019 pencilled in for the first OCR move, our view more generally is that hikes are too far away to be specific about the timing.

The New Zealand dollar fell by 70pts to 0.7270 after the release, although it has since recovered some of this move on the back of a weaker US dollar. The two-year swap rate has fallen by four basis points to 2.21%, and it could go further as offshore markets reassess the odds of an OCR hike.

Details

Some of the factors that drove the 1% rise in the CPI last quarter were unwound this time. Food prices were less of an influence, with the well-publicised spike in vegetable prices balanced out by a pullback in grocery prices. Domestic airfares had an unusually large seasonal decline, after having risen to near-record highs in March. Finally, petrol prices were down 2% on average over the quarter – and are shaping up to be a sizeable negative for the September quarter CPI as well.

Elsewhere, prices were subdued across a broad range of categories. The main downside surprises for us were in some of the import-heavy categories such as household goods and electronics, which may reflect the delayed impact of the New Zealand dollar's rise over the last year or so. The electronics categories tend to be driven more by 'quality' adjustments than by actual price movements, which makes them difficult to track.

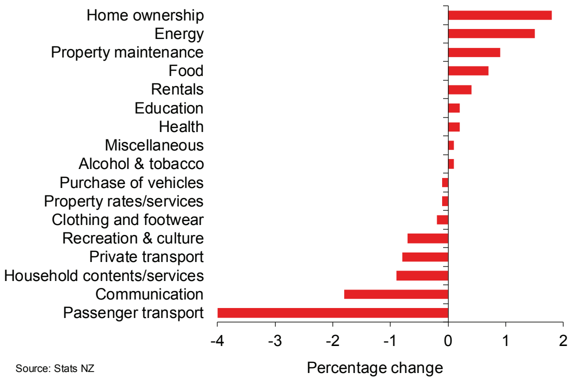
The one area where price pressures remain rampant is in housing construction. Prices of newly built homes were up 1.8% for the quarter, and 6.4% over the last year. Cost pressures are especially apparent in Auckland, with an 8.1% rise over the last year and a 3% rise in the June quarter alone.

However, new home prices have been rising strongly for years, with no sign that these price pressures are spilling over into other components of the CPI. And we question how long these sorts of price hikes can be sustained, now that prices for existing homes are flattening out, and even falling in the case of Auckland.

Rents – the single largest item in the CPI – saw a modest 0.4% rise for the quarter, with the annual rate of increase slowing to 2.1%. Rents in the Canterbury region continue to fall as the housing stock returns to pre-quake levels, and rents appear to be rising only modestly in the rest of the country, even in Auckland.

Michael Gordon
Acting Chief Economist

Components of quarterly inflation



Source: Stats NZ

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