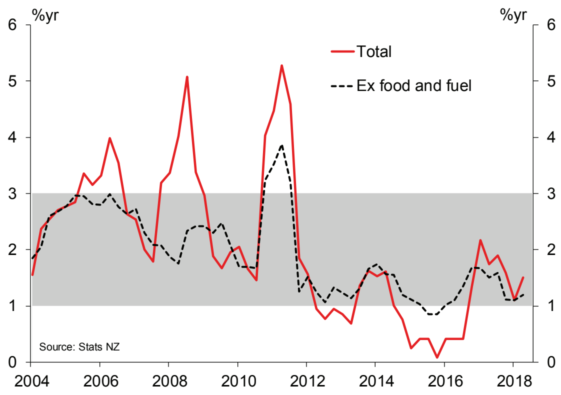
Beyond the headlines

CPI rose 0.4% in June quarter, annual inflation 1.5%

17 July 2018

- The Consumer Price Index (CPI) rose by 0.4% in the June quarter, less than market forecasts.
- The details were firmer than the headline. Tradables inflation was soft, partly due to some unusual factors, but the more persistent non-tradables component was stronger than expected.
- Annual inflation rose from 1.1% to 1.5%, and we expect a further increase into year-end. However, this partly reflects soft CPI outturns a year ago; the underlying trend is more of a gradual pickup in inflation pressures.
- We continue to expect the Reserve Bank to keep the OCR on hold for some time.

Annual inflation



Consumer prices rose 0.4% in the June quarter, lifting the annual inflation rate from 1.1% to 1.5%. Fuel and food prices made the biggest contribution, but a range of 'core' measures of inflation also rose modestly on an annual basis.

Interpreting the trends in inflation sometimes requires some caution. As we noted in the March quarter, when annual inflation fell to 1.1%: "This was by no means a weak result – in fact it was one of the stronger quarterly outturns in recent times. The low level of annual inflation is more a reflection of soft inflation through the middle part of 2017." That same factor drove much of the rise in annual inflation this time, and is likely to support a further rise towards 2% by the end of the year. But the underlying trend is one of a gradual pickup in inflation, rather than a sudden change.

The result for the quarter was below the median market forecast of 0.5% and our forecast of 0.6%, but was in line with the Reserve Bank's forecast in its May Monetary Policy Statement. However, the details of the CPI paint a less benign picture. The tradables side was softer than expected, but the non-tradables component was stronger than forecast. The latter, where price pressures tend to be more persistent, is likely to carry more weight in the RBNZ's thinking. We think that OCR hikes are still some time away, but on balance today's release weakens the case for the next move to be a cut.

Details

As expected, the biggest positive contributions to the June quarter were food and fuel prices. The 0.8% rise in food prices was largely seasonal – vegetable prices go up as we head into winter. There was also a faster increase in the cost of eating out, which was influenced by the larger than usual increase in the minimum wage in April.

Petrol prices rose 3.2% over the quarter, as world oil prices rose and the New Zealand dollar fell. However, the impact of costlier fuel doesn't appear to have spread widely – in particular, airfares were softer than we expected given the rise in fuel prices over the last year or so.

Setting aside food and fuel, the tradables component of the CPI was softer than we expected. However, there was nothing in the details that would point to an ongoing source of weakness, such as a squeeze on retailers' margins or a lack of exchange rate passthrough. Instead, there were some notable idiosyncratic price movements.

The first was a 3.3% fall in second-hand car prices, with Stats NZ citing discounting by dealers to clear excess stock. This was likely related to the delays in car shipments earlier this year, after the discovery of marmorated stink bugs. Once these imports had been cleared, dealers may have found themselves overstocked. The impact on prices should fade before long.

The other big surprise was a massive 14.5% fall in prices of audio-visual equipment (which includes TV and cameras). This category is heavily quality-adjusted – the idea is that as the technology improves, buyers get more bang for their buck – so it typically enters the CPI as a negative. Even so, the decline this quarter was much larger than anything we've seen previously. Unfortunately the quality adjustment process is opaque, so we don't know what made the latest observation so unusual.

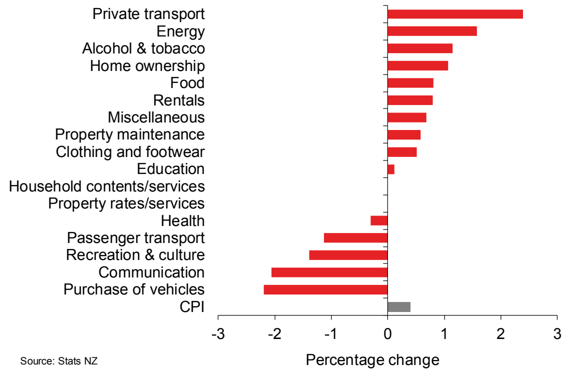
In contrast with tradables, the non-tradables component of the CPI was peppered with upside surprises. Electricity prices have regained some momentum after a few years of subdued gains, alcohol prices saw an unusually large increase, and accommodation prices saw a surprisingly small decline from their seasonal peak.

The biggest surprise for us was in rents, which make up almost 10% of the CPI. The 0.8% rise was the biggest increase for a June quarter since 2006. And the gains were fairly broad-based – Auckland rents have cooled off a little in recent times, but they are no longer falling in Canterbury and are picking up in the rest of the country.

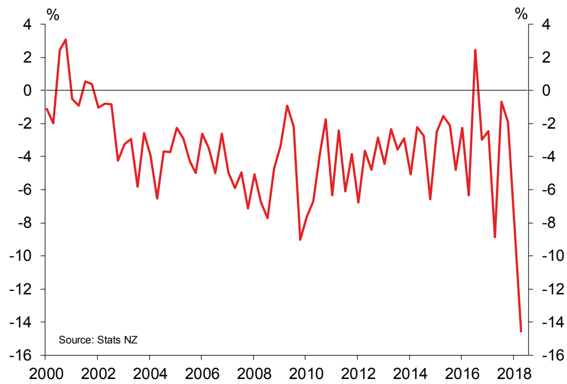
Prices of newly-built homes rose by 1.1%, which was in line with our forecast. New home prices tend to follow the trend in existing home prices, so the rate of growth has eased off in recent times as the housing market has cooled. At a national level, the annual growth rate slowed to 3.9%, compared to a peak of 6.7% in early 2017. But as with rents, the regional differences are apparent. The rate of growth is slowing in Auckland, but has picked up elsewhere, especially in the smaller regions of the South Island.

Michael Gordon
Senior Economist

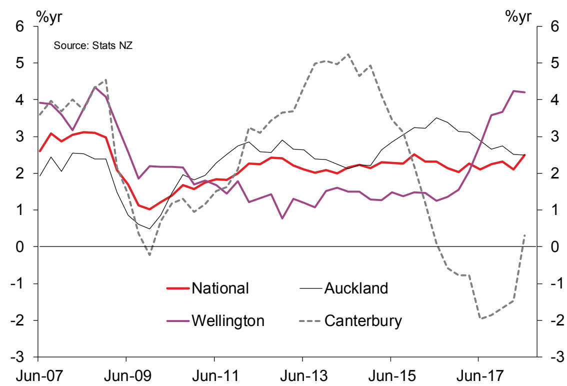
Components of quarterly inflation



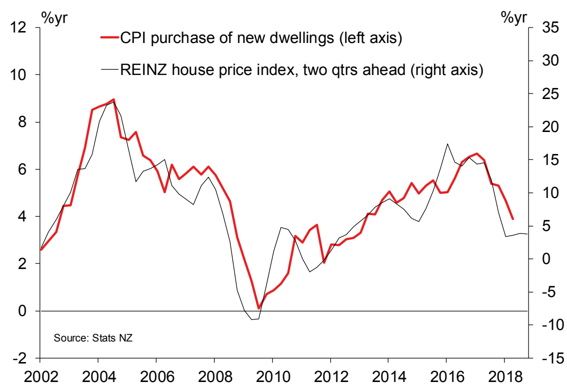
Audio-visual equipment, quarterly change



Rents, annual change



House price inflation



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