Research

Economy Watch

17 July 2024

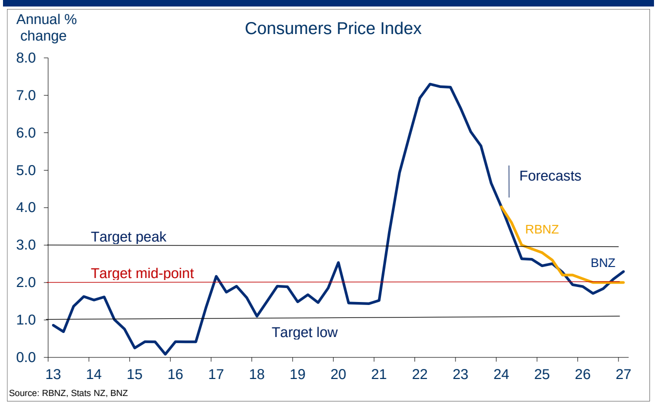
CPI inflation to be within target range next quarter

- **Annual inflation eases to 3.3%**
- **Inflation set to be inside target band next quarter**
- **Adds to case for rate reduction this year**
- **But non-tradeables, services inflation a bit sticky**
- **We stick with November for first move**

There was considerable market focus on today's Q2 CPI figures following the change of tone from the RBNZ in last week's MPR. The market was looking for confirmation that interest rate cuts are imminent. In the event, there were mixed signals in that regard.

There is certainly positive news in headline annual CPI inflation continuing to ease. It retreated to 3.3% in Q2, from Q1's 4.0%. That is very much heading the right way for the central bank as annual inflation approaches its target band of 1% to 3%.

Nearly there



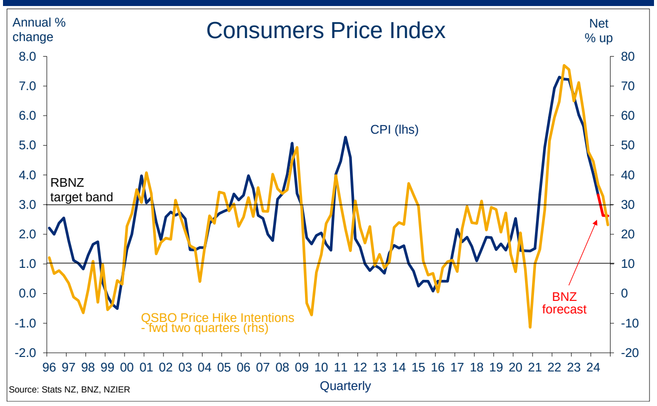
The Q2 result was lower than the 3.6% anticipated by the RBNZ in its May MPS. This will be welcomed by the Bank as more progress is made towards its target range. It will add to its confidence that annual CPI inflation will be back inside the target range in the second half of this year. This supports the change of tone in last week's MPR. Whether it is enough to see a cut in August is moot.

The quarterly 0.4% increase was a tick lower than we had anticipated while the annual 3.3% was two ticks lower. Not that far from expectations in the big scheme of things but consistent with our view that the RBNZ will be cutting rates much sooner than it indicated in its May MPS.

Consumers Price Index - 2024 Q2	Actual	Mkt Pick	May MPS	Q1
CPI - qtly % chg	**+0.4**	+0.5	+0.6	**+0.6**
CPI - ann % chg	**+3.3**	+3.4	+3.6	**+4.0**
Non-tradables qtly % chg	**+0.9**	+0.8	+0.8	**+1.6**
Non-tradables ann % chg	**+5.4**		+5.3	**+5.8**
Tradables qtly % chg	**-0.5**	+0.1	+0.3	**-0.7**
Tradables ann % chg	**+0.3**		+1.1	**+1.6**

We haven't yet gone through all the CPI details yet, but the lower starting point adds to our conviction that annual inflation will be back inside the target band next quarter. That is consistent with pricing indicators from the recent QSBO. Confirmation of inflation falling, and more talk of it to continue to do so, will help maintained downward pressure on inflation expectations.

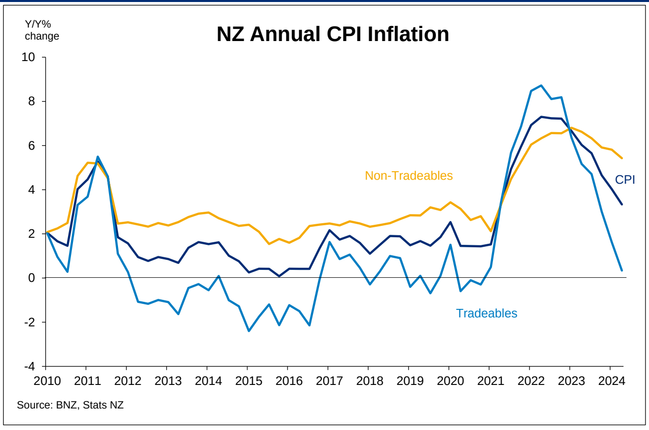
Inside target band next quarter?



In contrast to the headline undershoot relative to RBNZ expectations, non-tradeables inflation printed a touch higher than the central bank's expectations. Non-tradeables inflation matched our priors in lifting 0.9% q/q and 5.4% y/y. The latter eased from Q1's 5.8%. But it was a nudge higher than the 5.3% y/y expected by the RBNZ.

If the Bank continues to focus on non-tradeables inflation, the somewhat higher than expected print could discourage it from cutting as soon as August. The Bank has noted a risk of domestic inflation remaining more persistent than it expected. Today's non-tradeables print will do nothing to dampen those concerns. In a similar fashion, services annual inflation didn't budge from Q1's 5.3%.

High and low



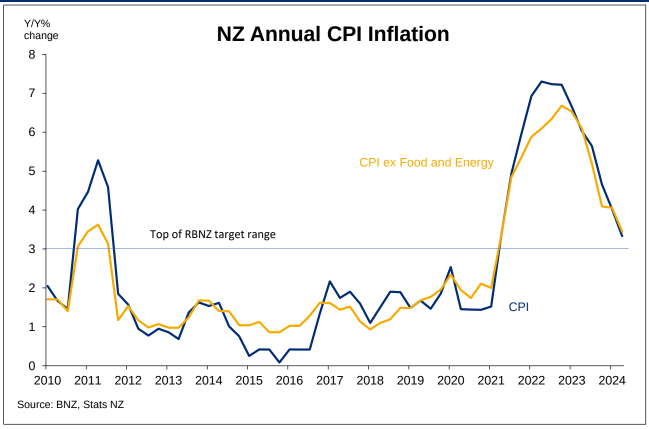
So some sticky bits that could keep the RBNZ on hold for the time being. But more broadly, we maintain our long-held view that annual inflation pressures are easing and will continue to do so such that the OCR can start to be reduced before too much longer. We stick with our central view that the first OCR cut will come in November this year, although we wouldn't rule out an earlier move. A cut as soon as August remains a possibility.

Beyond the precise timing of the first cut, our bigger picture view remains that the OCR is headed materially lower over the coming year or two.

Today's CPI figures were a smidgeon under market expectations. But with so much OCR easing already being front loaded into this year post last week's MPR, and the somewhat mixed signals via the headline inflation reading versus the likes of non-tradeable and services components, wholesale rates pushed up a few points post the CPI data.

Other core measures gave similar messages to the headline reading. Annual inflation in CPI ex food and energy eased to 3.4% from Q1's 4.1%. The weighted median eased to 3.5% from 4.4% and the 10% trimmed mean eased to 3.6% from 4.5%. Let's call that core inflation in the mid-3s and heading toward target but not there yet. We await this afternoon's sectoral factor model from the RBNZ to see if it concurs with that broad assessment. Its annual rate was 4.3% in Q1.

Similar core message



For those looking at annualising Q2's 0.4% quarterly outturn and suggesting it is running below the target's midpoint already, it is important to acknowledge seasonality in NZ's CPI. On a seasonally adjusted basis, Q2 CPI rose 0.6% q/q. That follows 0.7% in Q1 and Q4 last year. Annualising those shows annual inflation on track to be inside the target band next quarter. Q3 tends to be a relatively higher quarter and we think it will be again this year with a hefty impulse coming from the likes of local authority rates. But with now three quarters of close to (albeit marginally above) midpoint readings, headline annual inflation is set to print inside the target range next quarter.

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