

Research Economy Watch

15 August 2024

Disinflation

- **Selected prices add to case Q3 inflation firmly in band**
- **We lower our Q3 CPI inflation pick to 0.8%**
- **Supports case for further OCR reductions**
- **Card spending confirms ongoing retail woe**

This morning's Selected Price Indexes support the notion of firm disinflation. It's only one month, and a lot of components are volatile, but the direction of travel is clear.

The data strongly support our long-held view that annual CPI will be back inside the RBNZ's target band in Q3. In fact, today's data reinforce the case. With the numbers coming in a touch on the weaker side of our priors, in totality, we have nudged our Q3 CPI pick down to 0.8% from 1.0%. This would see annual inflation drop to 2.3% in Q3 from Q2's 3.3%. It all adds to our view that further material reduction in the OCR lies ahead.

Our prior inflation forecast had been lower than that projected by the RBNZ until the bank lowered its near-term view yesterday. That – and a very weak economy – was key to us thinking the RBNZ would cut the OCR yesterday. As it happens, a Q3 annual CPI inflation outcome of 2.3% is what the RBNZ projected in its August MPS yesterday. So, on its own, today's figures are unlikely to alter the Bank's broad view. But the trajectory bears monitoring closely.

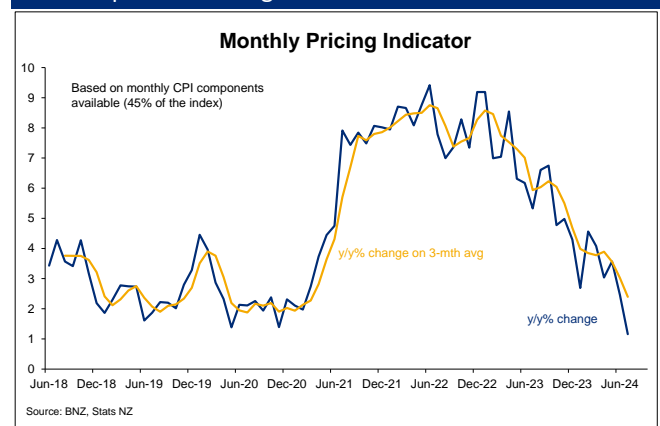
Note that the annual change in the weighted average monthly inflation figures that we calculate has dropped to 1.2%. It is now lower than pre-covid equivalents and raises the risk that annual inflation is easing faster than some care to believe. But one must be wary of the volatility in the monthly price data, it can be very choppy. The three-month moving average has eased to 2.4%.

In any case, recall that the monthly price data covers only 45% of the full CPI index and we know there will be some very large increases in Q3 in some other components such as local authority rates. By the same token, we expect material declines in other components in Q3 like early childhood education.

Beyond some idiosyncratic factors, we have been sensing some accumulating downside risks even to our generally softer inflationary view for such things as accommodation

and rents. We got some confirmation of that today with a 4.9% drop in domestic accommodation prices in today's July figures, seeing prices in that component 6.2% lower than a year ago.

Inflation pointers falling



The 0.2% m/m gain in rents was only a tick under what we had pencilled in, but it is more evidence that annual rent inflation is now cooling, nudging down to 4.3% in July from 4.5% in June and down from a recent peak of 4.6% most recently seen in May. We think annual rent inflation will slow further, as already indicated by annual inflation in the 'flow' rent (think new rental agreements) measure at a lower 2.5%.

The 0.4% increase in food prices was lower than we had pencilled in for the month. Yes, fruit and vegetables prices saw a chunky lift, as is often the case at this time of year, but other components were more subdued including restaurant meals and ready-to-eat food. That is another non-tradeable component that shows slowing inflation, alongside the likes of domestic accommodation and rents. The RBNZ will be pleased to see this.

A key driver of the disinflation we are seeing stems from a very weak economy and the significant financial pressures that have been on the household sector. Other data released this morning simply provided more evidence that is the case.

Electronic card transactions continue to track below year earlier levels. In July, total transactions were 0.4% down,

retail 4.9% lower, and core retail 5.2% behind a year ago. All that is on a dollar value basis. Contractions on a volume basis would be weaker still and even more so on a per capita basis. There was a bit more variation in the month with total transactions rising 0.7%, but retail and core retail both posted their sixth consecutive monthly declines with -0.1% and -0.5% respectively. It all says economic growth continues to struggle into Q3.

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