Research

# Economy Watch

16 October 2024

# Inflation beaten into submission

- **CPI inflation settling near target mid-point**
- **Non-tradables high but in retreat**
- **Market rushes to price in 75 basis point cut at November MPS**
- **We are sceptical**
- **RBNZ is already going hard**

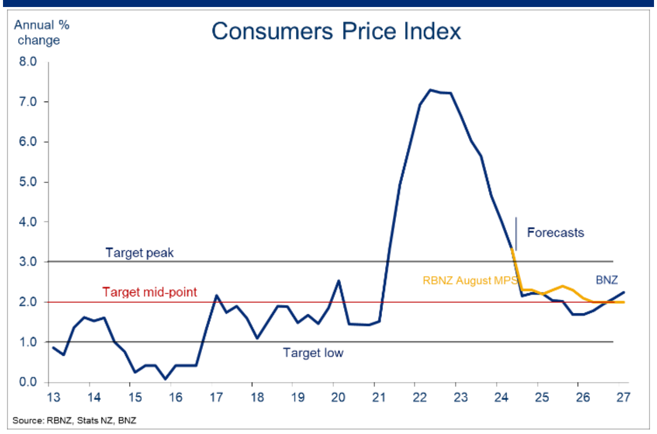
The Reserve Bank of New Zealand should be overjoyed with today's inflation outturn. One can never claim that inflation is dead and buried but, for the time being, it's as near as dammit.

Consumer prices rose just 0.6% in the September quarter, delivering an annual increase of 2.2%. This is the first time annual inflation has been within the Bank's target band since March 2021. Moreover, it's not just inside the band but sits close enough to the 2.0% midpoint to be immaterially different.

The quarterly outturn was 0.2% below the RBNZ's expectation for the quarter. The annual reading was a, slightly reduced, 0.1% miss by dint of rounding. In our opinion, the deviation from expectation is inconsequential but at least it will reinforce the RBNZ's optimism that it has everything under control.

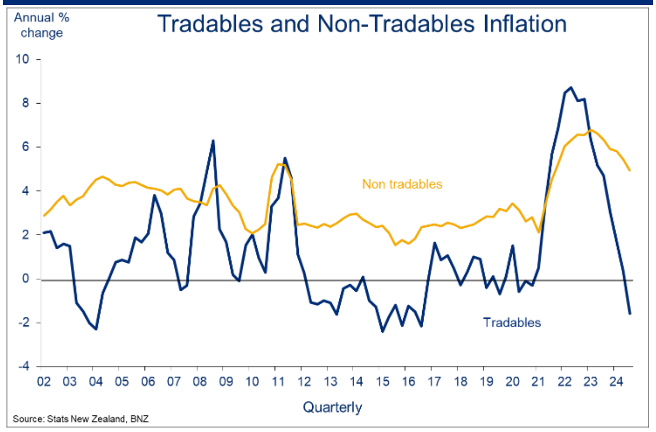
In its August Monetary Policy Statement, the RBNZ forecast inflation would hit the target midpoint in June 2026. Our view was that it would not only get there more quickly but that inflation would fall to sub 2.0% next year. Now there is a chance we might get there even earlier.

What inflation?




The RBNZ will also be happy with the composition of the fall in inflation. Non-tradable inflation, which has had a habit of surprising to the upside, was lower than the Bank had assumed in being 1.3% for the quarter and 4.9% for the year.

Non tradables starting to behave




To cap things off, all measures of core inflation continued their strong downward trend though it should be noted they were mainly toward the top half of the target band with the important CPI ex food and energy series still inflating at 3.1%.

We await the RBNZ's factor model calculations due later today but they should paint a very similar picture.

With inflation surprising the RBNZ to the downside, there is the inevitable cry by some for a 75 basis point cut at the upcoming November 27 Monetary Policy Statement. In addition, interest rate markets have rallied on the back of today's outturn such that a 40% chance of a 75 point cut is now priced in. The rationale is that the economy is weaker than anticipated, inflation is lower and so the Reserve Bank must get its cash rate to neutral quickly.

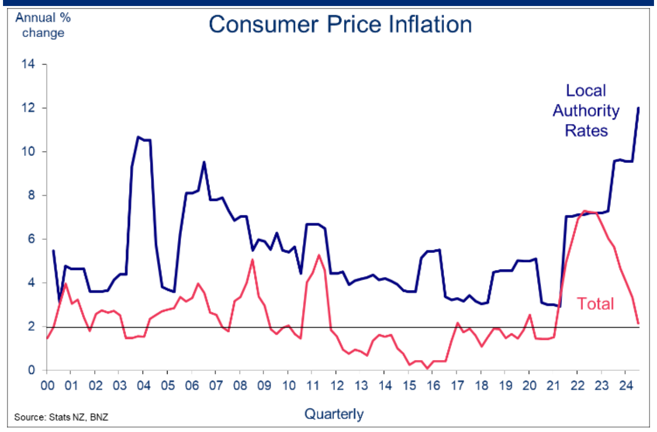
We fully endorse the rationale but are more sceptical of the quantum. Bear in mind that when the Reserve Bank produced its August Monetary Policy Statement it was effectively projecting 25 basis point cuts in October and November. In cutting its cash rate 50 points in October the Bank has already acknowledged the downside risks. If it goes a further 50 in November, as we project, then it will be acknowledging an even bigger miss. And, to cap things off, we think its November track for the pace of rate cuts in

2025 will be more aggressive indicating an even bigger recognition of those risks. For the Bank to go 75 in November it would seem to us that a much bigger negative shock would yet be required.

With that in mind, we also warn there are elements of the Q3 outturn that demand caution. Without the 22.8% quarterly drop in early childhood education fees (resulting from the government's subsidy) and the 6.5% drop in petrol prices the quarterly read would have been 1.0%. Now, we know that there are other factors which you could remove on the other side of the ledger, such as local authority rates, but we think rates' inflation will continue to be a problem (albeit a lesser one) whereas the aforementioned factors will likely be temporary.

The impact of local authority rates on inflation is writ large in today's release. While the annual increase in the CPI fell to a three and a half year low, annual inflation of 10.1 % for central and local government charges has not been surpassed in the 35 years of data we have for this series. Local authority rates rose 12.0% for the year.

Rates forever inflationary




For now, much of the focus will be on what the RBNZ does next. While we concede there are multiple approaches the RBNZ could take in terms of pace, for most businesses the important message to be gleaned from the CPI is that the cash rate will continue to fall, it will keep falling for some time, and the low in the rate is highly likely to be 3.0% or less. Ultimately, this will encourage spending and investment albeit that it will take some time for this to flow through especially with consumers facing into ongoing increase in local-authority imposed taxes and a weakening labour market.

stephen_toplis@bnz.co.nz

# Contact Details

## BNZ Research

**Stephen Toplis**
Head of Research

**Doug Steel**
Senior Economist

**Matt Brunt**
Economist

**Jason Wong**
Senior Markets Strategist

**Stuart Ritson**
Senior Interest Rate Strategist

**Mike Jones**
BNZ Chief Economist

## Main Offices

**Wellington**
Level 2, BNZ Place
1 Whitmore St
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

**Auckland**
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

**Christchurch**
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854