22 January 2025

Inflation no threat to further rate cuts

- **CPI inflation near expectations**
- **Nothing to change anyone's view as to the way ahead**
- **Near term upside surprise likely**
- **But medium term containment on track**
- **RBNZ to cut 50 in February**

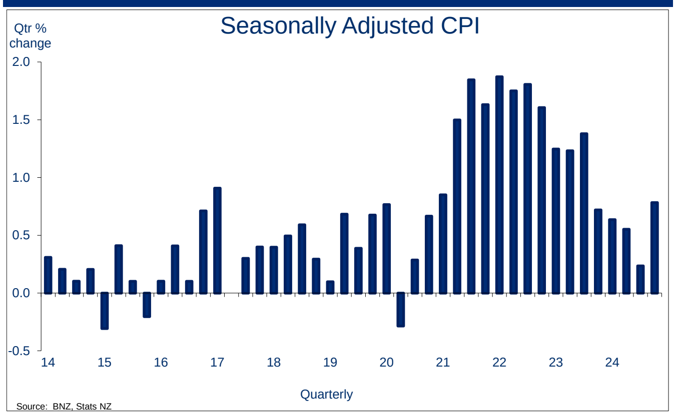
With almost half the data that goes into the CPI now published on a monthly basis, there is little room for surprise when the quarterly data are released. And so it proved to be the case today. The 0.5% increase in prices reported for the quarter was bang on market expectations and a rounding error 0.1 below our own projection.

The outcome was 0.1% higher than the RBNZ's printed forecasts but we don't think the Bank will have been genuinely surprised as it would have been very well aware that petrol prices had spiked post the publication of its estimates.

There was nothing in today's data to change our view of the world and, similarly, we doubt there was anything that will change the Reserve Bank's thinking.

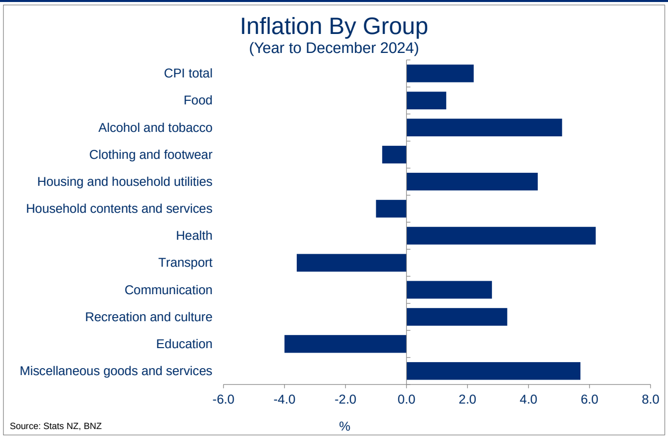
Hawks will take some solace that headline inflation was 0.1% higher than the Bank had assumed and when those aforesaid hawks ferret around in the data they may get excited by the fact that the seasonally adjusted move for the quarter was 0.8%, that's an annualised 3.2% and the highest reading since Q3 2023.

A seasonally adjusted jump



In contrast, the doves will revel in the fact that non-tradables inflation was a tad weaker than expected with tradables providing the surprise. Moreover, the data were confirmation that annual inflation was settling near the midpoint of the RBNZ's target band.

Many moving parts



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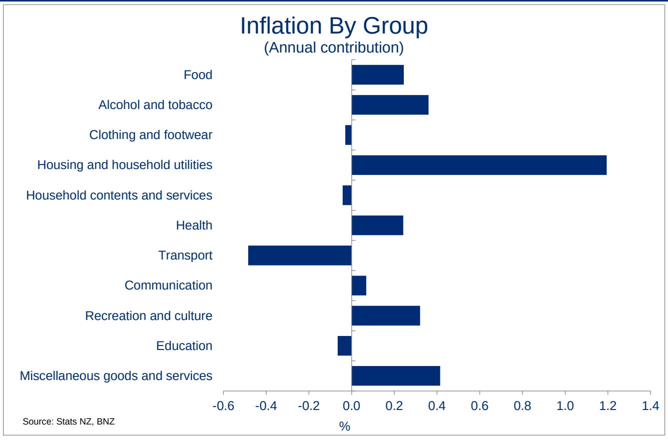


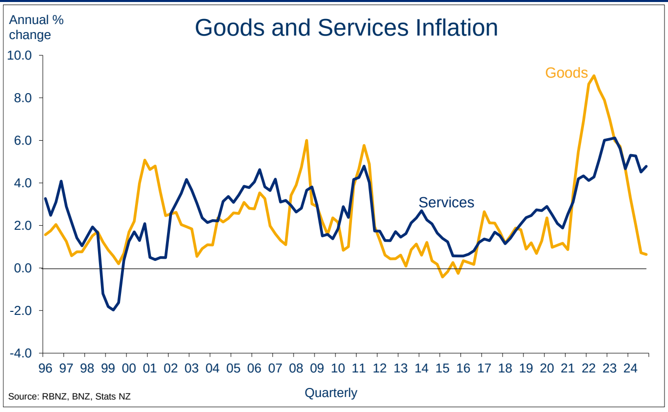
On balance the doves seem to have just gained the upper hand in terms of market pricing with the market edging back to fully pricing in a 50 basis point cut at the February meeting.

We have no difficulty with this presumption though we are quick to reiterate that we believe there is a greater chance of a 25 basis point cut in February than there is of 75 basis points. And we also strongly believe the pace of cuts thereafter will moderate to 25 points a meeting. Some of this presumption remains because we still think annual CPI inflation will climb over the next quarter or so and, in so doing, risks nudging inflation expectations higher. The RBNZ can easily look through bumps in the road generated by such things as the recent surge in oil prices but will not be comfortable if inflation expectations move higher. The falling currency also adds a medium term inflationary pulse.

Despite the CPI leaving thoughts largely unchanged, there were a few bits and pieces in the detail that are worth pondering.

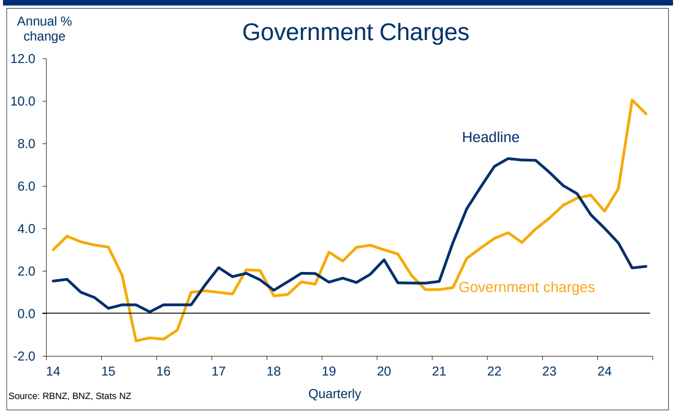
The deviation between goods and services inflation remains stark. Goods prices were actually unchanged in the quarter and up only 0.6% for the year. In contrast services prices rose 1.4% to be 4.8% higher than a year ago.

Services inflation still a problem



Part of the upward pressure on services inflation will be charges imposed by central and local government. These charges increased 9.4% over the last twelve months. This was, of course, led by the 12.0% increase in local authority rates. But to get such a weighty number it can't just be local authority rates that are doing the damage. If you exclude central and local government charges then annual inflation is just 1.5%.

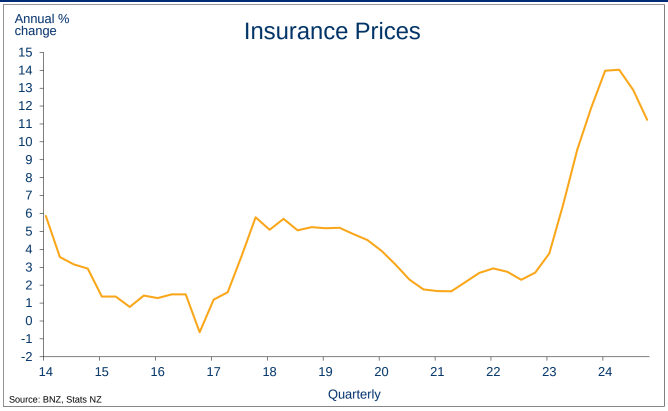
Government charges soar



Another driver of services inflation has been insurance costs. There appears to be a modicum of good news on this front. While insurance inflation remains very high, the 1.8% increase for the quarter was the lowest quarterly increase since March 2023. We had believed insurance inflation would fall further over the course of 2025 but we now have doubts given the massive cost to insurers of the Los Angeles fires.

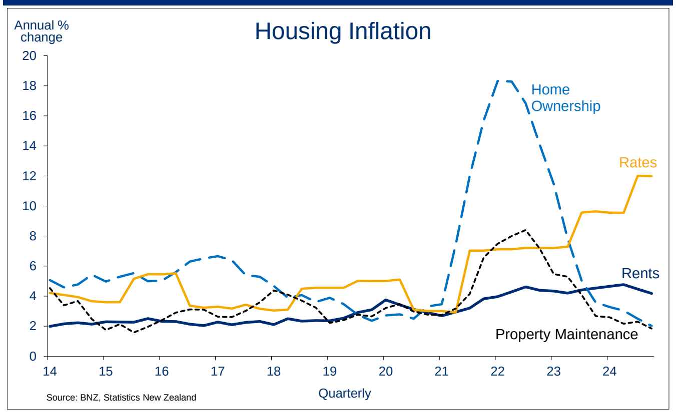
Generally, housing related costs have been front of mind and there is now increasing evidence that the pressure from this source is abating. Annual rental inflation (4.2%) was last lower than this in the year to March 2022. Home ownership inflation (2.0%) was last lower in September 2010 and property maintenance inflation (1.8%) is the lowest since September 2015.

Insurance inflation peaks

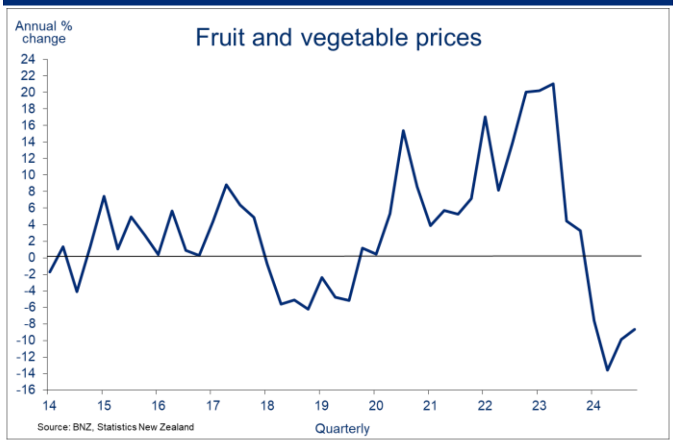


On a different note, it's worth pointing out the artificially high level of deflation in fruit and vegetable prices. Through 2023 and into 2024 the price of these goods skyrocketed largely due to weather conditions. Now we are seeing those prices reset to more normal levels. Hence, the 8.6% decline in prices for the year. While further declines are plausible the current negative impact on the CPI is unlikely to be repeated. This will add at least 0.2% to the CPI in the year ahead.

Housing inflation abates



Fruit and vege prices in retreat



Similarly, the non-repetition of the 23% cut in early childhood education costs will add another 0.1%.

So, in short, and unsurprisingly, there are a lot of moving parts to consider.

Our interpretation of all this is that CPI inflation will surprise to the upside in the near term. However, we remain quietly confident that, across our forecast time horizon, inflation should remain relatively well behaved and provide a green light to the Reserve Bank to move policy settings progressively to stimulatory from the current position of contractionary.

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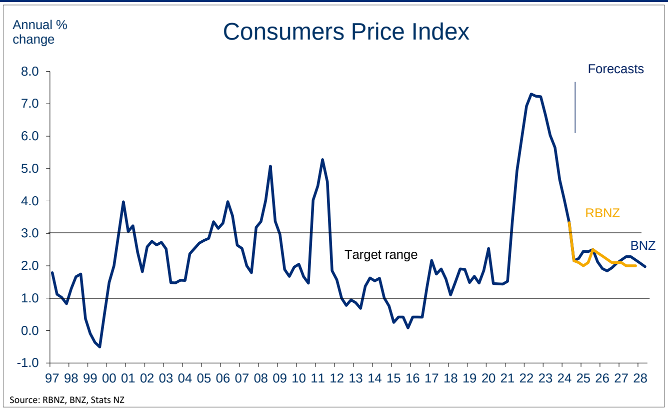
Under control



Source: RBNZ, BNZ, Stats NZ

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