Research

Economy Watch

17 April 2025

Inflation Accelerates

- **Annual inflation lifts to 2.5%**
- **Core measures mixed, but balance lower**
- **Enough for the RBNZ to continue reducing the OCR**
- **Eyes remain on global risks**

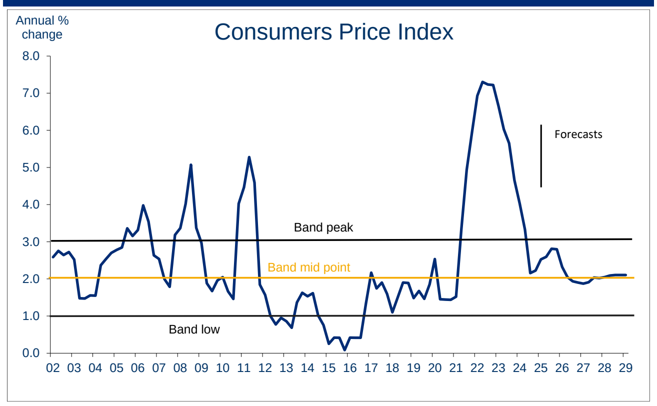
Given the mayhem occurring offshore and the uncertainty it puts around the economic outlook, local data continue to command less than usual market interest.

It was no surprise to us that inflation came in a touch above market and RBNZ expectations. And, equally, it was no surprise to us that there was very little market reaction to the news. There are simply much bigger issues circulating. But we shouldn't ignore current inflation readings altogether. The starting point for inflation is worth noting.

A 0.9% quarter lift in Q1 CPI saw annual inflation lift to 2.5%, from 2.2% in Q4. This matched our expectations but was a tick higher than both the market and RBNZ picks.

Today's figures confirm our view that annual inflation is creeping higher, and we think that will extend a bit further in the near term, before easing next year.

Creeping higher

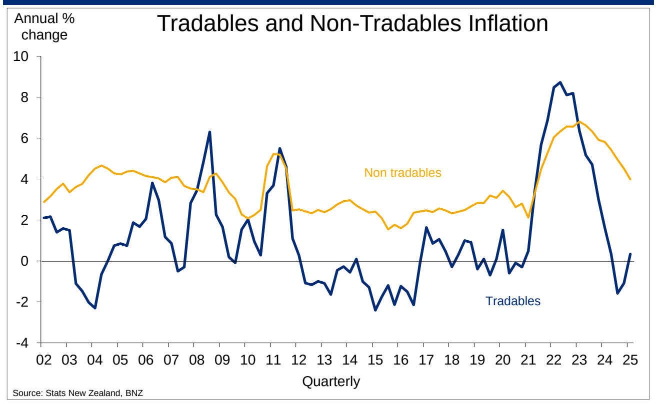


The lift in annual inflation was driven by tradeable inflation rising to 0.3% from -1.1%.

Annual non-tradeable inflation eased to 4.0% from 4.5% in Q4. This is consistent with domestic inflationary pressures easing as we have long anticipated following a large and persistent negative output gap.

Consumer Price Index - March Quarter 2025		
Group	Qtly % Change	Annual % Change
Food	1.8	2.6
Alcoholic beverages and tobacco	1.8	3.4
Clothing and footwear	0.2	-0.7
Housing and household utilities	0.7	4.3
Household contents and services	-0.4	-0.1
Health	0.3	4.7
Transport	0.8	-0.3
Communication	0.3	3.0
Recreation and culture	-0.1	0.8
Education	8.9	0.6
Miscellaneous goods and services	0.8	4.5
All groups	0.9	2.5

Different directions



Non-tradeable annual inflation would have declined by more, had it not been for a very large (22.6% q/q) increase in tertiary and other post-school education prices in Q1.

This drove the 8.9% q/q increase in education, although annual inflation in education was subdued as the large policy-induced decline in Q3 2024 remains in the annual calculations.

The Q1 jump in tertiary fees relate to a free fees for the first year of study stopping at the end of 2024. It was replaced by a free fees for the final year of study. This policy began in 2025. Stats NZ notes that 'students who have already claimed first-year Fees Free are ineligible to claim final-year Fees Free, meaning more students are paying the full study cost in 2025'. This suggests there will be some unwind in due course.

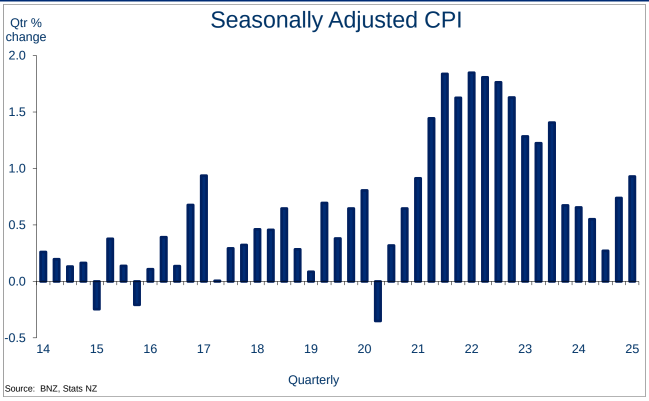
The 1.1% quarterly rise in non-tradeable inflation was a bit higher than the 0.9% forecast by the RBNZ. It is not clear how much of an increase in tertiary education fees the RBNZ built into its non-tradeable inflation forecasts. To the extent that the upside surprise was driven by the free fees impact, it is more likely to be discounted as an indicator of underlying price pressures.

The impact of the policy change for tertiary fees looks to be in the order of adding 0.1 percentage points to the CPI and 0.2 percentage points to non-tradeable inflation in the quarter.

Various core and underlying CPI measures were mixed in the quarter, with the balance showing annual inflation marginally lower.

On the upside, a 0.9% lift in the CPI on a seasonally adjusted basis looks strong, especially as it follows a 0.7% gain in Q4. And the 10% trimmed mean measure saw annual inflation lift to 2.5% from 2.3%.

Looks strong

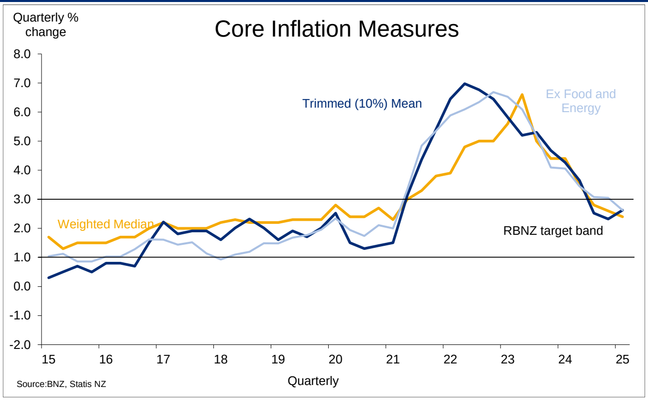


On the softer side, in addition to easing non-tradeable annual inflation, CPI ex food and energy annual inflation dropped to 2.6% from 3.0%. The 30% trimmed mean eased to 2.3% from 2.5% and the weighted median slowed to 2.4% from 2.6%.

We await to see what the RBNZ's sectoral factor model of inflation has to say at 3pm today. It was 3.1% in Q4. A similar-to-down outcome would seem consistent with the balance of core measures noted above.

Our average of annual inflation in the core measures eased to 2.5% from 2.6%. Comfortably within the RBNZ's target band, albeit still in the upper half.

In the band



We don't think today's data will have a large impact on the RBNZ's thinking for policy ahead. RBNZ had previously suggested it intends to look through its projected increase in annual inflation to 2.7% in Q3 this year. In its April Monetary Policy Review, it noted downside risk to the outlook for inflation, although that was not unanimous across MPC members.

Inflation hawks could point to headline inflation being 0.1% higher than the Bank had projected, the seasonally adjusted increase in the quarter, and the upside surprise in non-tradeable inflation. Higher headline inflation raises the chance of inflation expectations pushing upward.

Doves could highlight easing annual non-tradeable inflation with the upside surprise seemingly a function of idiosyncratic price movements, and an easing trend in the balance of core measures.

For us, there is nothing here to change our long-held view that the cash rate is likely headed below 3%. But there is enough here to warrant some caution in the process, dependent on just how things evolve offshore. For now, we maintain our view that the cash rate will be progressively cut by 25 basis points per meeting to a low of 2.75%.

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