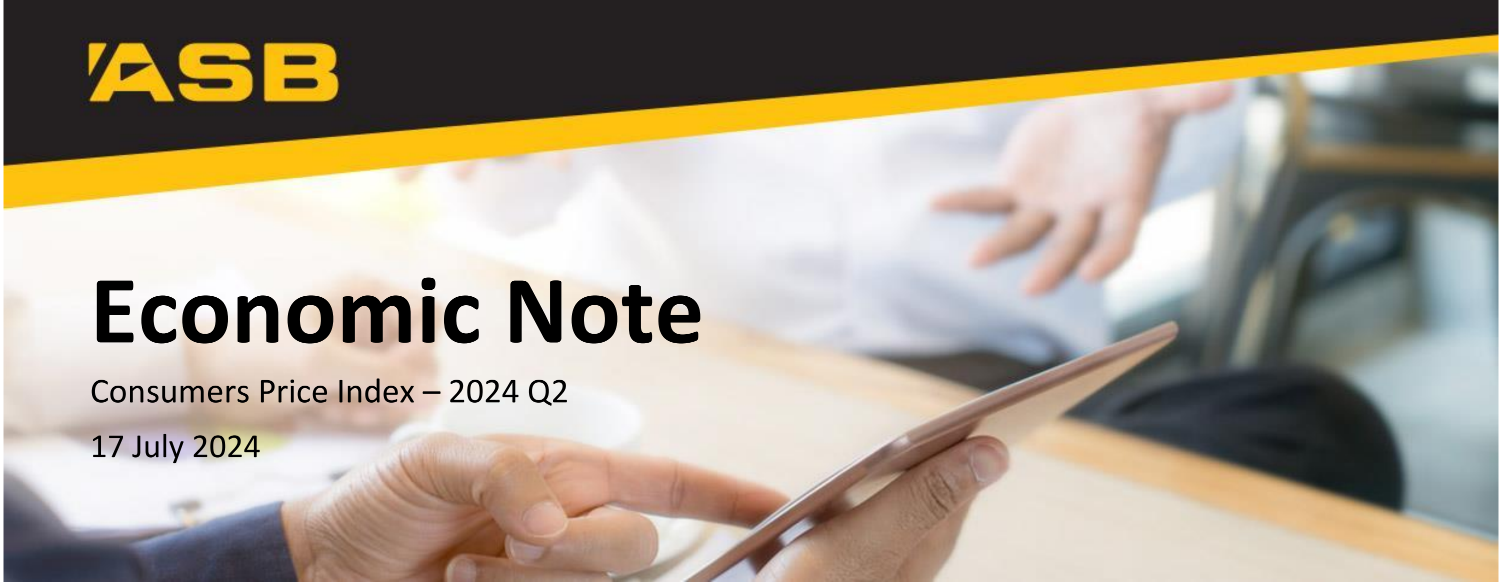

Economic Note

Consumers Price Index – 2024 Q2

17 July 2024

Underlying price pressures rapidly cool

Summary

- Q2 inflation surprises the RBNZ to the downside again, with annual CPI inflation down to 3.3%, its lowest since mid-2021. Highly restrictive OCR settings are generating significant traction.
- Non-tradable inflation has been slower to cool but this is partly reflective of cost driven influences that monetary policy should seek to look through. Stripping out some of these cost increases suggests that annual CPI inflation is already well below 3% and is rapidly cooling.
- Today's data tilts the risks towards earlier and larger OCR cuts. All remaining OCR decisions over 2024 are effectively 'live'. In our view a 25bp OCR cut in November looks to be the bare minimum of what the RBNZ will need to deliver over 2024.

Q2 2024 CPI %	**Actual**	ASB	RBNZ	Market
CPI qoq	**0.4**	0.4	0.6	0.5
CPI yoy	**3.3**	3.3	3.6	3.4
Non-tradable qoq	**0.9**	0.8	0.8	
Non-tradable yoy	**5.4**	5.4	5.3	
Tradable qoq	**-0.5**	-0.3	0.3	
Tradable yoy	**0.3**	0.5	1.1	

Source: ASB, Statistics NZ

Summary & implications

NZ Q2 CPI inflation came out in line with our expectations but was below market expectations and undershot the RBNZ pick. **The Q2 data confirmed generalised cooling**, but with more of the heavy lifting done by tradable prices as the COVID-19 price premium unwinds. Non-tradable inflation has been slower to cool but is partly reflective of cost driven influences that monetary policy should seek to look through. **Stripping out some of these cost increases suggests that annual underlying CPI inflation is already well below 3%, and it looks set to continue to cool.** We do not expect these higher costs to trigger a resurgence of wage and pricing pressures in the current environment.

Softening signs on the pricing side of the economy increase our confidence of CPI inflation falling below 3% in 2024 H2. This and the significant easing in labour market capacity pressures of late increases our confidence that core inflation will settle in the 1-3% target range, even with some modest OCR cuts.

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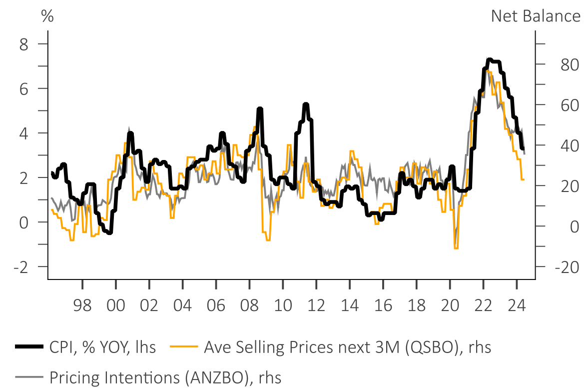
The remaining OCR decisions over 2024 are effectively 'live" and cuts could start as soon as next month. Risks are strongly skewed towards at least 50bps of OCR cuts being delivered over 2024 (75bps of cuts could be on the cards if the data continues to undershoot). A 25bp cut in November looks to be the bare minimum of what the RBNZ will need to deliver.

Consumer prices undershoot RBNZ and market expectations

Q2 CPI rose 0.4% qoq (0.6% qoq seasonally adjusted), the lowest quarterly movement for a June quarter since late 2020. This pushed down annual CPI inflation to 3.3%, the smallest annual increase since 2021Q2.

Inflationary pressures are continuing to cool:

CPI Inflation and Pricing Intentions



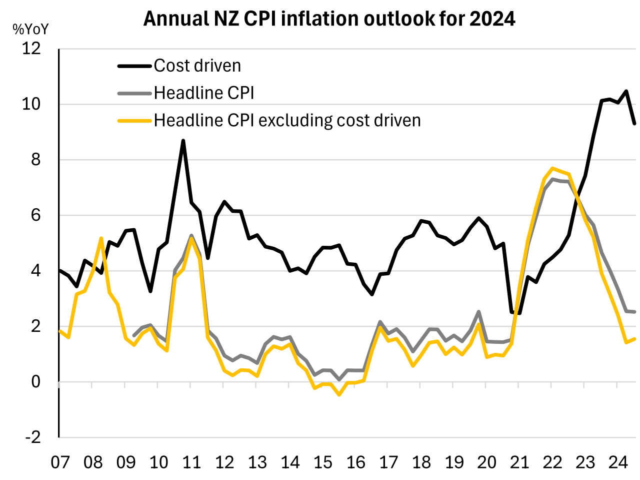
Source: Macrobond

- **Food prices were up just 0.1% in Q2, with the 0.2% annual increase the lowest since 2018**. Lower prices for fruit and vegetables, more modest wage inflation, weaker consumer demand, and cooler global food price inflation points to little change over aggregate food prices by year end.
- **A 1.1% Q2 increase was registered for housing, with annual inflation slowing to 4.4%.** Construction cost inflation is cooling with a 0.9% qoq rate (3.0% yoy) but is set to cool further given recent anecdotes. Rents advanced at a solid 1.2% qoq (4.8% yoy) clip but looks to have peaked. Higher prices were registered for household energy (+2.3% qoq), but this looks to be more cost related.
- **Transport prices showed their third consecutive quarterly fall** (-0.5% qoq, 3.5% yoy). Lower domestic (-5.3% qoq) and international airfares (-3.5% qoq) and lower prices for vehicles was partly offset by a 0.7% gain in petrol prices. The reintroduction of road user charges for EV's and the ending of half price public transport fares for the under 25's does not look to have gone through into the Q2 numbers, but they will.
- **Other monthly price data shows a chunky 0.8% lift in tobacco and alcohol prices over the quarter, with annual inflation from this component still at an elevated 6.9%.** Excise related cost increases look to be the primary driver and have kept non-tradable inflation high. These will slow.
- **Residual pricing pressures remained evident in some components, but these were thinning out. Chunky increases were evidence for insurance costs (3.1% qoq), with sizeable rises for some services**. However, accommodation costs registered their first quarterly fall in more than 3 years, with the 4.5% Q2 fall contributing -0.2ppts to Q2 CPI.
- **Price rises are trending lower.** The distributional measures showed considerable fewer price rises being pushed through relative to a year ago (55.5% of items, 70.7% of the CPI weight). The average weighed price rise eased to 2.1%. **Price falls are becoming reasonably commonplace despite the recent spike in shipping costs,** with around 32.7% of prices falling (21.4% of expenditure weight), with the weighted average price fall a chunky 5.3%. **Both would be welcomed by the RBNZ.**
- **Moreover, there was more discounting going on.** Statistics NZ details showed that a net 14% of items were discounted in Q2. Prices fell for vehicles (-2.3% qoq), household appliances (-0.5% qoq), and domestic airfares (-5.1% qoq).

Tradables do the heavy lifting, but higher costs slows the non-tradables inflation decline

Prices for tradable goods and services undershot RBNZ expectations, falling 0.5% in Q2, with the 0.3% annual increase the lowest since late 2020. Goods price inflation is slowing (2.0% yoy). The unwinding of the COVID-19 price premium for tradable goods and services is taking place. Despite higher shipping costs, this disinflation process has a while to run in our view. Surveyed pricing intention point to continuing cooling.

Non-tradable inflation has proved to be much slower to moderate, with a 0.9 rise in Q2 and with annual inflation easing slightly to 5.4%. Services inflation was steady at 5.3% yoy.



Source: Statistics NZ, ASB

Part of the increase in non-tradable CPI prices was reflective of cost-push influences that monetary policy should not address directly. There is also some inertia from CPI indexation. Annual Inflation rates for insurance (14.0% yoy), local authority rates (9.6% yoy) and tobacco & alcohol (6.9% yoy) remain extremely high, with prices for this overall component up 10.1% yoy. It has accounted for around 30% of the annual increase in the CPI, despite having only 13% of the CPI weight.

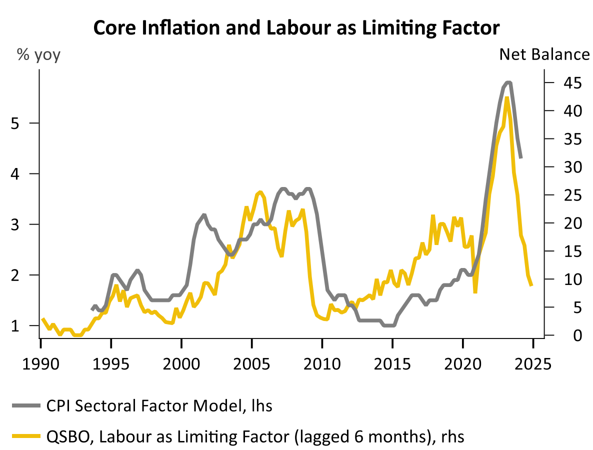
Annual CPI inflation excluding these costs is now down to 2.4% in the June 2024 year, its first sub 3% CPI print since early 2021. The trajectory for this "underlying inflation" is for further sharp cooling over 2024 and is set to move below 2% by year end. The deceleration in non-tradable inflation excluding these costs has also been stark, with annual inflation down to around 4.2% in the June 2024 year. It is on track to approach 3% by year end.

We do not envisage that higher costs from these pockets will feed through into generalised increases in inflation in the current environment. In fact, they seem to be a significant added cost to household budgets and could have a disinflationary impact on inflation.

The RBNZ will be encouraged by falling core inflation

Core inflation pressures look to be cooling, with generally slowing rates for the trimmed mean measures (Q2 30% trimmed mean 0.7% qoq, 3.8% yoy), **and the 50% weighted median** (0.9% qoq, 3.5% yoy). Inflation from the CPI ex food, energy, and fuels (+0.3% qoq, 3.4% yoy) is cooling as are a range of other exclusion-based measures.

Today's 3pm reveal of the RBNZ Sectoral Factor model (4.3% in Q1) will be looked at for signs of moderation, and we expect to see Q2 readings (and potentially historical estimates) ease as generalised inflation cools.

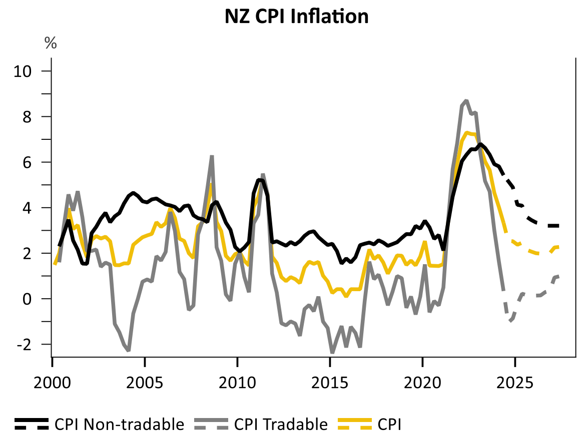


Source: Macrobond, ASB

Looking ahead – increasing confidence sub 3% inflation will be delivered and sustained

The inflation outlook remains uncertain. However, we are increasingly confident that annual headline inflation is on track to fall below 3% in the second half of this year. There are mounting signs that the weak economic backdrop and consumer restraint is having an impact in cooling pricing pressures.

Also important is our increased confidence that CPI inflation will settle in the 1-3% target range, even with a modest easing in currently restrictive OCR settings. The economy is in the midst of a protracted downturn and pricing pressures are cooling. Growing spare capacity in the labour market, the modest 2% April rise in the minimum wage and the challenging corporate profitability backdrop (at around 25-year lows as a share of nominal GDP) could result in a sharp deceleration in wage inflation and trigger job losses. **This will significantly dampen services, core and non-tradables CPI inflation.**



Source: Macrobond, ASB

The dataflow over the next few months will be particularly important. On top of the selected monthly price indices, key data includes quarterly labour market prints for Q2 (August 7) and Q3 (November 6), the Q3 RBNZ survey of business (August 8) and household inflation expectations (August 13), the Q3 QSBO data (October 1) and Q3 CPI (October 17). These will be particularly important data prints ahead of the August 14, October 9 and November 27 OCR policy announcements for 2024.

In our view all OCR decisions over the remainer of 2024 are now 'live', although more confirmation of slowing inflation will be needed to force the RBNZ's hand. The underlying softening in the pricing side data and increasing spare capacity in the labour market heightens the risk of RBNZ cuts coming as soon as next month. **Risks are strongly skewed towards at least 50bps of OCR cuts being delivered over 2024 (75bps could be on the cards if data undershoots expectations), with a 25bp cut in November increasingly looking to be the bare minimum of what the RBNZ will need to deliver before year end.**

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