

Research Economy Watch

13 March 2024

An inflation surprise

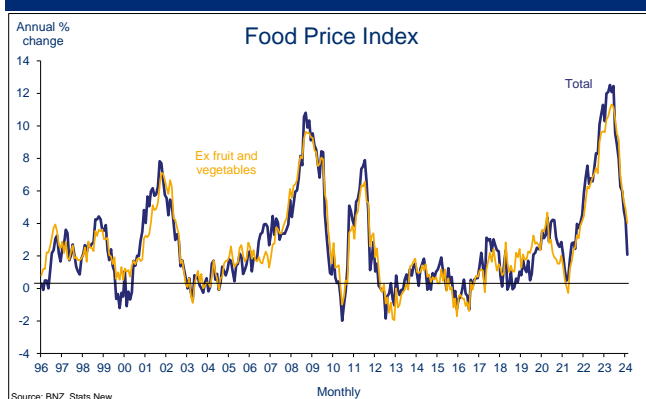
- We revise our Q1 CPI pick to 0.8%
- Well above the RBNZ's 0.4% expectation
- Prices for staples well behaved
- But "luxury good" prices surge
- Cost of overseas accommodation having a major impact

February's selected price indicators have given us a lot to think about. As always, volatile monthly numbers ask more questions than they provide answers but the questions that today's figures provide are very interesting indeed.

In a nutshell, you could describe the release as being good news for the average punter but highly challenging for the Reserve Bank.

For the person in the street the best news is that food price inflation is not only falling but declining faster than anticipated. The 0.6% drop in prices for the month sees annual food price inflation falling to 2.1%, its lowest since May 2021. Leading the drop are the prices of fruit and veges, which are now down 9.1% on year earlier levels thanks largely to an improved growing season, in turn due to the absence of floods and cyclones. This downward pressure should be sustained for months to come.

Some relief



But it's not just fruit and vege prices that are behaving themselves. Annual meat, poultry and fish inflation is just 1.2% and, importantly, general grocery food inflation is falling. Annual inflation in this category still 3.9% but it is a far cry from the 14.0% peak back in April of last year. Moreover, we expect annual grocery food inflation to be sub 2.0% within two months.

In other good news for householders, petrol prices look as if they will have dropped for the third consecutive quarter despite the 4.1% increase in the month. And, to cap things off, the 0.4% monthly increase in rents indicates rental increases are not accelerating, albeit that the level of rents is still a major concern for many.

All the above are household staples so it is great to see that price pressures are eroding household disposable incomes far less now than has been the case.

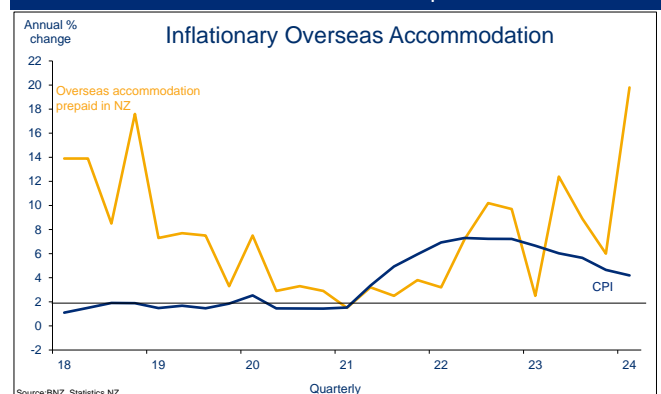
Had we just looked at the above factors we would have been contemplating a reduction in our CPI forecasts. Alas, however, there are several other price hikes coming through in the data that we have underestimated. Moreover, the upward price movements are so strong that they more than offset the downward impact of the staple goods.

For the many folk who are struggling to make ends meet these upward price moves will matter little because they are largely confined to "luxury" goods. But for the Reserve Bank, whose target is CPI inflation, they are a genuine headache.

In brief the big movers that caught us by surprise were:

- non-alcoholic beverages (soft drinks);
- restaurants and takeaways whose annual inflation sits at 6.7%;
- domestic airfares, which jumped 7.4% in the month; and
- overseas accommodation services which were prepaid in New Zealand and rose 7.1% for the month, 24.5% for the year.

Overseas accommodation an inflationary problem

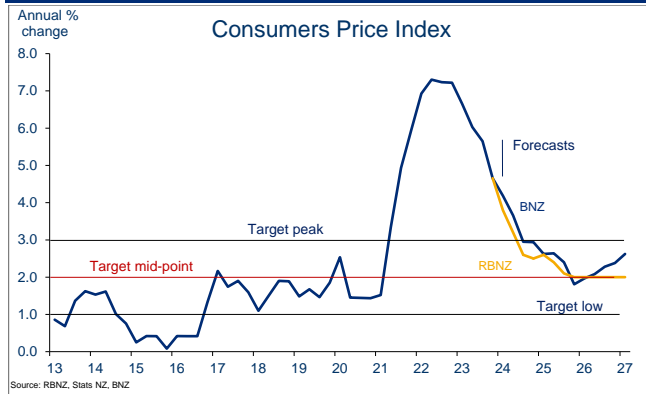


The last factor is particularly interesting. By our reckoning the annual CPI for the year ended March 2024 would be

0.4 percentage points lower were this not included. This is a very strong argument for why the central bank should, as it does, look very closely at core measures of inflation, and not just the headline reading, when it makes its deliberations.

When we put all the above together, we find ourselves edging our Q1 CPI forecast 0.2 percentage points higher to 0.8%. This means annual inflation will fall to 4.2% from the 4.7% reported for the year ended December.

CPI forecasts revised higher



At face value, if we are right, this will be highly bothersome for the central bank whose current forecast is 0.4% for the quarter, 3.8% for the year. From our perspective, the upward revision to the Q1 CPI is fully unwound in Q2 as we see some of the latest reported price increases reversed. So we still have annual inflation within the target band by the end of this year.

Given the nature of the shocks hitting the CPI we think the RBNZ will look through any near term upside surprise but the data will give it further supporting evidence for its assumption that rates are on hold through calendar 2024.

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