ANZ Research

December 2021 Quarter CPI Preview

20 January 2022

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Contact

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High, but how high?

The bottom line

We expect that consumer prices rose 1.5% q/q in the December quarter – seeing the annual rate of inflation accelerate to 6.0% y/y (from 4.9% in Q3). The actual number is highly uncertain, but what's clear is that the inflation dragon, which has been asleep for decades, has well and truly awoken. Aggressive action by the RBNZ will be needed for inflation to be tamed. It's very likely that next week's CPI data will be stronger than the 5.7% y/y print the RBNZ was expecting, and more worryingly, so too will be the trend in underlying inflation – meaning an even higher OCR track will likely be in the February MPS projection. And whenever Omicron arrives in the community, it's likely to cause similar levels of disruption as overseas – hurting growth but giving inflation yet another boost at the same time as inflation expectations have drifted steadily higher, above the RBNZ's target.

The view

CPI inflation figures for the December quarter are released on Thursday next week.

We expect consumer prices rose 1.5% q/q (6.0% y/y) in the December quarter, versus 2.2% q/q (4.9% y/y) in September. A lower quarterly number might sound like good news, but it's not. The CPI is highly seasonal, with inflation usually slowing in Q4, as items like fresh fruit and vegetables fall in price. So a 1.5% q/q print is as much of a painful outlier as the 2.2% q/q rise we saw last quarter (figure 3, page 3).

Inflation is everywhere. COVID disruption and wider global inflation pressures are expected to see tradables prices rise 7.6% y/y in Q4 (5.7% previously), while domestic pressures (including surging construction costs, labour shortages, and rising government spending) should see non-tradables inflation lift to 5.1% y/y (4.5% previously). Inflation has well and truly shed the 'transitory' label that was being applied to it this time last year, and the challenge for the RBNZ will now be to rein in surging inflation pressures and smoothly return inflation to the 2% midpoint of their 1-3% target range. That won't be painless, at a time where rising costs and ongoing disruption from COVID have seen firms report stalling trading activity and falling business confidence, while cracks are finally starting to appear in what's been a housing market with nine lives.

Breaking down the 1.5% q/q rise in headline CPI in the December quarter:

- **Food prices** are expected to subtract 0.1ppts from headline inflation, with summer falls in seasonal produce bringing a temporary reprieve from surging food prices over the middle of 2021.
- **Petrol and other fuel prices** are expected to add 0.4ppts to headline, with petrol prices forecast to have risen 10.1% q/q, on higher oil prices and further NZD weakness against the USD over Q4.
- **Housing-related costs** are expected to add 0.4ppts, largely reflecting rising construction costs as new builds keep getting consented at a record pace, while labour and materials shortages drive up costs.

Consumers Price Index – December 2021 Quarter

	Expected	Prev
CPI – q/q	1.5%	2.2%
CPI – y/y	6.0%	4.9%
Tradable - q/q	2.0%	2.8%
Tradable - y/y	7.6%	5.7%
Non-tradable -q/q	1.3%	1.8%
Non-tradable - y/y	5.1%	4.5%

- **Recreation and culture** should add 0.3ppts, reflecting the impact of ongoing global cost pressures on imported goods, as well as a summer surge in domestic accommodation costs.
- The final 0.5ppts represents our attempt to capture the broad-based impact of ongoing COVID disruption on the price of imported goods and services. This is not a precise exercise – with a case in point being last quarter when the 2.2% quarterly CPI print came in 0.4ppts ahead of our 1.8% pick.

Policy implications

It might be a new year, but the uncertainty and volatility that dogged the economy over the past two years are far from over. We've pencilled in a 6% annual inflation print – but anything from 5.5% to 6.5% (or even a bit higher) wouldn't be too surprising.

What's more important for monetary policy is that the inflation surge we're seeing is looking more and more persistent.

Globally, inflation has continued to build rapidly. In the US, inflation jumped to 7.0% y/y in December, and given how New Zealand's inflation often follows global trends (figure 2, over), that'll be another boost from the tradables side. In the 2010s, globalisation kept the prices of imported goods and services either stable or falling – contributing to below-target inflation for much of the decade. But for now, that script has been flipped on its head – and with the Omicron variant stressing already-fragile supply chains, global price pressures are still intense. Fortunately, central banks around the world have gradually come to the same conclusion as the RBNZ – that inflation is here to stay, and needs to be shown the door with rate hikes. That should gradually reduce global pressure on inflation.

Domestically, the labour market is well beyond anything that could be described as consistent with low and stable inflation. Jobs growth was accelerating at the end of 2021, indicating a good chance that unemployment declined in Q4, in contrast to our expectation that Delta would cause a small uptick. If the record-high participation rate were to decline, a dynamic that's been seen in other countries with large COVID outbreaks, then unemployment could pretty soon have a 2-handle. That's very inflationary – especially considering that robust employment intentions and job vacancies indicate labour demand isn't letting up.

The biggest concern for the RBNZ is the surge in non-tradables inflation – which is only going to be reinforced by the inflationary labour market. The RBNZ needs to get ahead of any potential wage-price spiral if they want to bring inflation back to target over their forecast horizon. And while they have been far quicker than their international peers to end asset purchases and raise interest rates, it's very likely that both the labour market and inflation are already further from target than the RBNZ (or we) predicted back when the November MPS projections were published.

To be clear, downside risks to growth are building, with the housing market now cooling rapidly and COVID continuing to hold back activity. But with some of the downside activity risks due to the constrained supply side, the simple equation that 'weaker growth = weaker inflation' doesn't necessarily hold anymore. But more fragile growth does unfortunately increase the risk of an eventual hard landing in response to tighter policy.

Speaking of things going wrong, there's the small matter of the Omicron variant. It's incredibly infectious, and there's a consensus that it's a matter of when, not if, it arrives. The international experience suggests a short-lived but ferocious bout of disruption and shortages. Another one-off spike in inflation is not helpful when inflation expectations and core inflation are already drifting higher and higher.

All up, even with growth headwinds building, it's looking like inflation will be a more persistent foe over 2022 than initially thought – especially as pandemic disruptions continue through into the new year. That implies the RBNZ will need to do more than otherwise to engineer a return to target – and we think that'll involve the OCR rising to 3% in early 2023.

Obviously, uncertainty around any forecast at present is enormous. A lot has to go right for the RBNZ to be able to keep hiking for that long, quite apart from that high. And there are upside risks as well. Odds of a forecast revision before April 2023 are roughly 99%. But precise numerical OCR forecasts aside, the key theme of our updated view is that inflation is not going away on its own, and unless something dramatic happens, the RBNZ is going to have to keep on hiking right through a housing slowdown. Buckle up.

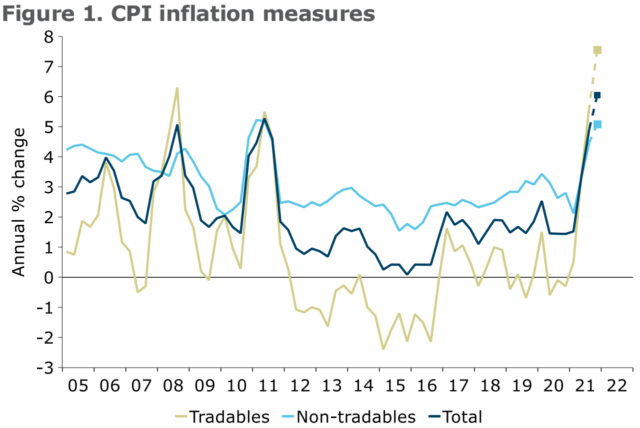
Table 1. ANZ Q4 CPI component-level forecast

	q/q%	%pt cont.
Total	**1.5**	**1.55**
Transport	5.3	0.69
Housing & Household Utilities	1.2	0.39
Recreation & Culture	3.3	0.27
Miscellaneous Goods & Services	1.5	0.12
Household Contents & Services	2.4	0.10
Clothes & Footwear	2.0	0.08
Health	1.0	0.04
Education	0.1	0.00
Alcoholic Beverages & Tobacco	-0.1	-0.01
Communication	-0.7	-0.02
Food	-0.6	-0.12

■ Quarterly % change ■ Percentage point contribution

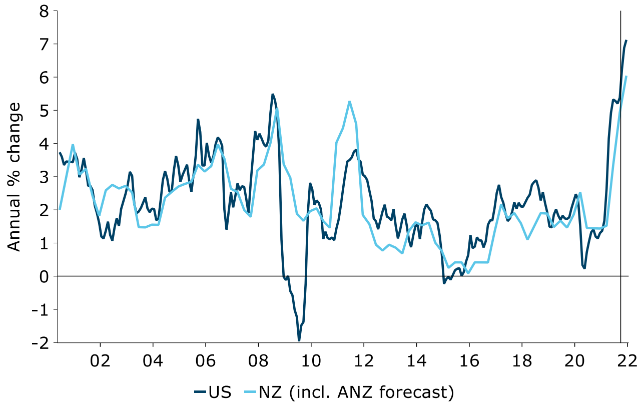
Source: Stats NZ, Macrobond, ANZ Research

Figure 1. CPI inflation measures



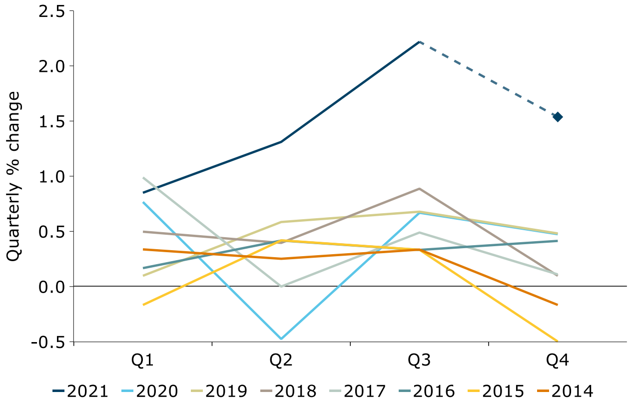
Source: Stats NZ, Macrobond, ANZ Research

Figure 2. US and NZ inflation



Source: BLS, Stats NZ, Macrobond, ANZ Research

Figure 3. Quarterly inflation



Source: Stats NZ, Macrobond, ANZ Research

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