

# Economic Bulletin.

21 April 2021



## Actually, the price of everything *isn't* going up – CPI rose 0.8% in March quarter, annual inflation 1.5%.

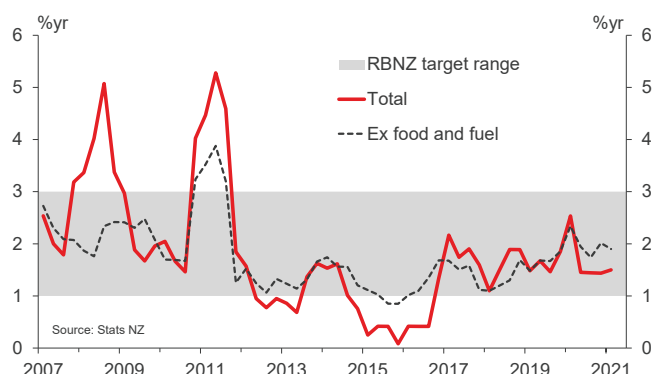
Consumer price inflation has started to edge higher, and we think there is more to come over the course of 2021. However, the underlying detail of today's report has poured some cold water on suggestions that a supply-related rise in inflation could force the RBNZ to hike the OCR sooner than planned.

- The Consumers Price Index rose 0.8% in the March quarter. That saw annual inflation rise to 1.5% (up from 1.4% last quarter).
- Today's result was in line with market expectations, but below the RBNZ's assumption.
- While supply disruptions and input cost pressures are adding to inflation, the boost from those factors has not been as large as expected. In fact, after shortages pushed the prices of many household items higher in late 2020, early 2021 saw the prices for many items easing back.
- We expect inflation to rise to around 2.5% over the coming year. However, that rise is likely to prove temporary. The medium-term outlook for inflation remains well contained.
- We continue to expect the RBNZ will keep the OCR on hold for an extended period.

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### Annual inflation



### In the detail.

The CPI rose by 0.8% in the March quarter. That was just slightly above our forecast for a 0.7% rise and in line with the average market expectation. Importantly, however, the result was lower than the 1% increase the RBNZ had factored into their last set of published forecasts (released in February).

Underlying the quarterly rise in inflation was a 7.2% increase in petrol prices. We also saw increases in other transport related items. That included a 10% increase in international airfares and a 4.4% increase in the prices of second-hand cars.

The other area of strength was the housing group with a 1% increase in rents and 1.2% increase in the cost of building a new home. In the case of building costs, we expect further solid increases over the coming year, with strong building activity and rising supply pressures.

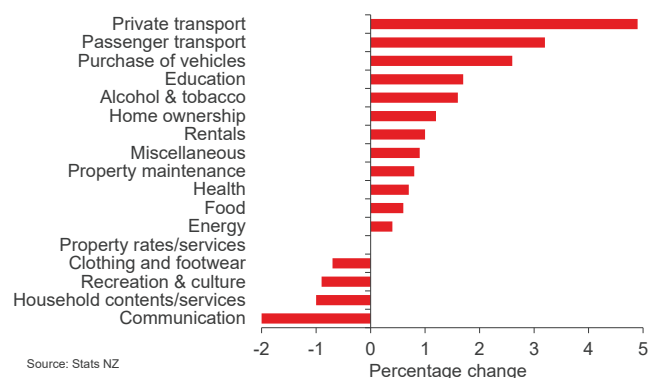
On the downside, the March quarter saw softer prices for many imported household items. The recreation and culture



group (which includes items like toys and audio equipment) fell 0.9%, while prices for household furnishings were down 2.7%.

The annual inflation rate has risen to 1.5%, up from 1.4% last quarter. That rise was restrained by a change to the normal adjustment in tobacco excise taxes. In recent years, those taxes have risen by around 10% per annum as part of efforts to discourage tobacco consumption. This year's increase was more modest, with tobacco prices rising by 2.7%. Compared to what we've seen in recent years, that shaved about 0.2 percentage points off annual inflation.

### Quarterly price changes



### Implications.

Looking at the underlying trends in prices, inflation pressures are building. In large part, that's due to increases in cost stemming from recent supply disruptions. Those same factors have been pushing inflation higher around the globe, and the resulting 'reflation' trade has seen financial markets pricing an increased chance of central banks hiking policy rates sooner than planned.

However, although inflation is firming, the underlying details of today's report do not indicate that the RBNZ will deviate from its plan to keep the OCR on hold for an extended period. The March quarter result was boosted by some unusual results such as a large increase in international airfares. That's notable as, rather than signalling a build-up in underlying inflation pressure, this likely reflects disruptions to normal travel patterns as a result of the Covid outbreak (international airfares usually fall in March quarter). Similarly, prices of second-hand cars were also stronger than expected, but prices in this group can be volatile on a quarter-to-quarter basis.

At the same time, it looks like some of the upwards pressure on prices that we saw over the peak Christmas shopping season has actually eased in early 2021. The prices for imported retail goods (like household furnishings) fell by more than expected in the March quarter. These are the same items that surprised to the upside last quarter and where international supply disruptions have been a major concern

On top of that, we're not seeing a significant lift in non-tradables inflation. Non-tradable prices are closely related to domestic price pressures and are a key focus for the RBNZ. As

shown in the chart below, non-tradables inflation (excluding tobacco prices) has actually taken a step down over the past year. That's consistent with the economy still running well below trend in the wake of last year's outbreak.

Most of the various 'core' measures of inflation, which strip out volatile items, remain below the 2% midpoint of the Reserve Bank's target range, and a number of those measures slipped back this quarter.

### Non-tradable inflation (excluding tobacco prices)



We expect that annual inflation will push higher from here, rising to around 2.5% through the middle of the year. That's mainly due to recent supply disruptions and the related increases in business costs.

But while prices are on the rise for now, we expect the upcoming firming in inflation will be temporary and that inflation will drop back again next year. Global production levels have been ramping up in recent months, and the disruptions to local and international distribution networks will eventually clear. At the same time, economic activity in New Zealand remains below trend and unemployment remains above the levels we saw prior to the outbreak. The softness in the prices of many imported consumer items seen in today's release supports that view.

Overall, today's result reinforces our expectation that the RBNZ will keep the OCR on hold for an extended period. We're not expecting hikes until 2025.

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