



ECONOMIC BULLETIN

CPI review, December quarter 2023.



24 Jan 2024 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

The inflation dragon hasn't been slain (yet).

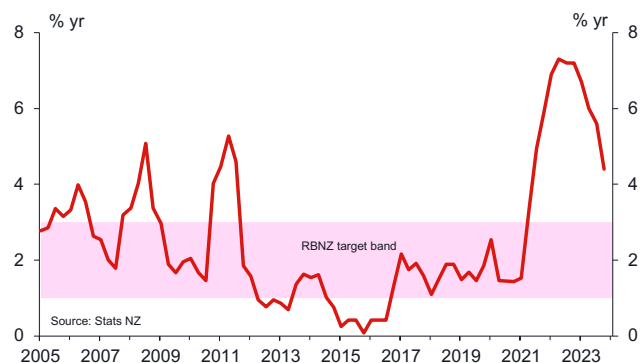
- New Zealand consumer prices rose 0.5% in the December quarter, leaving prices up 4.7% over the past year.
- The strong inflation headwinds that have been buffeting the New Zealand economy are moderating, but it's a mixed picture beneath the surface. While imported price pressures are cooling, prices for many domestically produced goods and services continued to sizzle.
- The decline in headline inflation will be welcome news for the RBNZ. However, with lingering strength in domestic prices and measures of core inflation, the RBNZ can't take its foot off the brake just yet. We remain comfortable with our view that 2024 will be a year of an unchanged OCR.

Consumer price inflation

	Dec-2023	Forecasts	
	Actual	Westpac	RBNZ (Nov MPS)
Headline inflation			
Quarterly	0.5%	0.5%	0.8%
Annual	4.7%	4.7%	5.0%
Non-tradables inflation			
Quarterly	1.1%	0.8%	0.9%
Annual	5.9%	5.6%	5.7%
Tradables inflation			
Quarterly	-0.2%	0.0%	0.7%
Annual	3.0%	3.2%	4.0%

As expected, December's update on consumer prices showed that inflation in New Zealand is continuing to cool. Consumer prices rose by 0.5% in the December quarter. That saw the annual inflation rate dropping to 4.7% –down from 5.6% in the year to September and the lowest annual inflation has been in more than two years.

Annual inflation

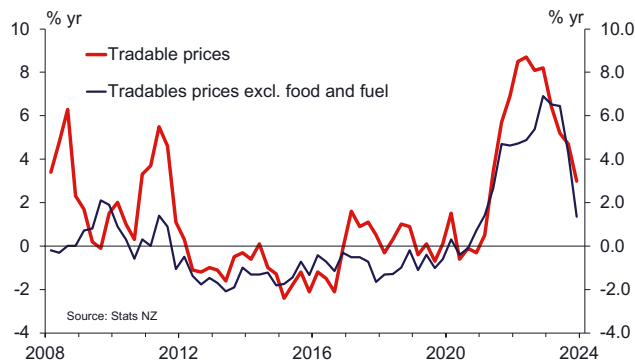


Today's result was in line with our own estimate, but it was lower than the RBNZ's last published forecast which was finalised back in November. Notably, inflation has

actually been lower than the RBNZ has been expecting for most of the past year.

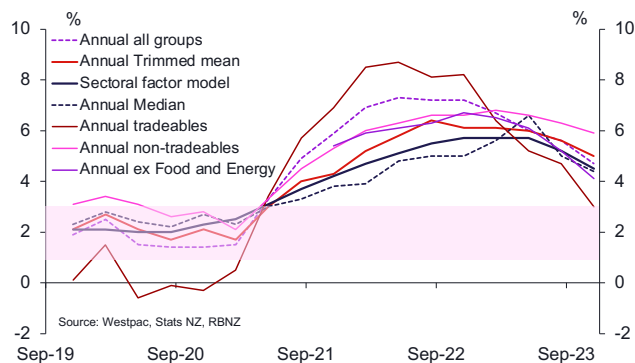
Driving the fall in inflation and the continued downside surprises to the RBNZ's forecasts has been lower import prices (often referred to as tradables inflation). Much of that relates to volatile items like food and motor vehicles. However, movements in those sorts of volatile items are not the key focus for the RBNZ when setting monetary policy.

Tradables inflation



The RBNZ is more concerned with the underlying trends in consumer prices. On this front, we are seeing signs that the strong inflation headwinds that have been buffeting the New Zealand economy are moderating, but gradually. Most core inflation measures are now running at annual rates of around 4% to 5%. Although that's down from the rates of over 6% that we saw over the past years, it's still uncomfortably high. The RBNZ's own sectoral model of core inflation fell from 5.2% to 4.5%

CPI – Annual core inflation measures



The easing in underlying inflation pressures will be welcome news for the RBNZ. However, digging under the surface, it's clear that the RBNZ can't take its foot off the brake just yet. The easing in underlying inflation is mainly due to falls in the retail prices of imported goods. Domestic inflation pressures, which are a bigger focus for the RBNZ, are still running hot. Non-tradable prices were

up 1.1% over the quarter - higher than we or the RBNZ expected. And on an annual basis, non-tradables inflation is running at a still-strong rate of 5.9%, with particular strength in areas outside of the construction sector. Those lingering domestic price pressures mean that it will still be some time before overall inflation returns to levels consistent with the RBNZ's target.

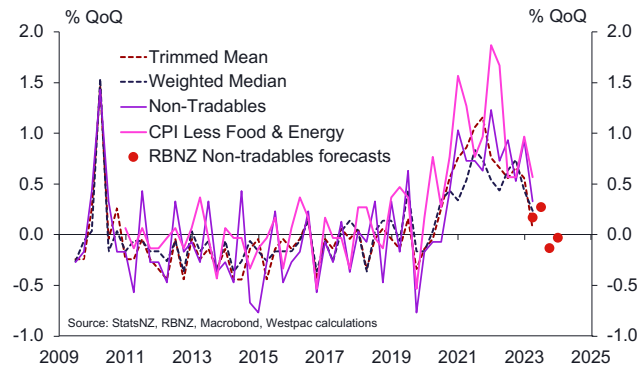
Non-tradables inflation



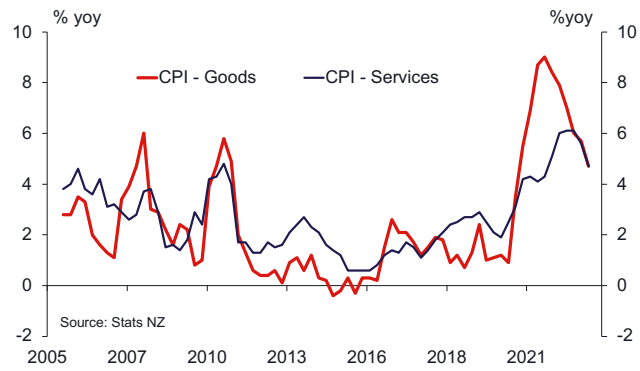
Policy implications.

This CPI is showing some encouraging progress towards the RBNZ's 1-3% target range, but the strength of non-tradables and other core inflation indicators remains. The lower than RBNZ forecast headline outcome will likely make the RBNZ comfortable that inflation expectations will remain in check. But ongoing sticky core inflation will likely be viewed with caution by the RBNZ and emphasises that there is still work to do before they can be sure that inflation reaches 2% in the second half of 2025 as is required by their new more focused mandate. We remain comfortable with our view that 2024 will be a year of an unchanged OCR. More indications of declining core inflation will likely be required before an adjustment lower in the OCR occurs.

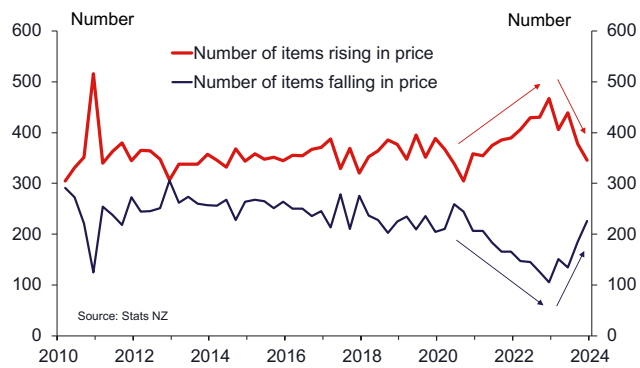
Quarterly core inflation indicators relative to 1995-2019 average



CPI – Goods versus Services inflation



CPI – Distribution of price changes



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