ECONOMIC BULLETIN

New Zealand inflation update.

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

Swiftflation pushing prices above the RBNZ's forecast

- **We have revised up our forecast for New Zealand March quarter inflation slightly.**
- **We now expect that New Zealand consumer prices will rise by 0.8% in the March quarter (previously we forecast a rise of 0.7%). That would see the annual inflation rate dropping to 4.2%, down from 4.7% at the end of 2023.**
- **Inflation is likely to be stronger than the RBNZ assumed at the time of their February Monetary Policy Statement. While inflation pressures are easing, that decline is occurring gradually. Notably, we're still seeing strong price increases in parts of the domestic economy.**
- **February saw food price inflation surprising to the downside. However, that was more than offset by strength in areas related to travel, like the cost of airfares and overseas accommodation (with price rises in accommodation coinciding with the recent Taylor Swift concerts).**

Consumer price inflation

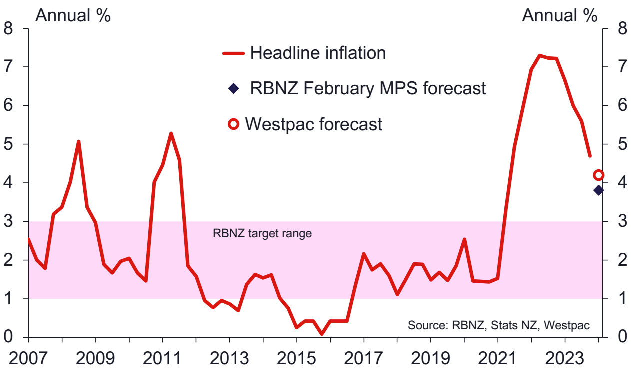
	Dec-23	Mar-24 forecast	
	Actual	Westpac	RBNZ
Headline inflation			
Quarterly	0.5	0.8	0.4
Annual	4.7	4.2	3.8
Non-tradables inflation			
Quarterly	1.1	1.4	1.1
Annual	5.9	5.6	5.3
Tradables inflation			
Quarterly	-0.2	-0.1	-0.8
Annual	3.00	2.2	1.5

We expect that the March quarter inflation report (due for release on 17 April) will show that consumer prices rose 0.8% in the first three months of the year. That would see the annual inflation rate dropping to 4.2%, down from 4.7% at the end of 2023 and the lowest annual inflation has been since 2021. This updated forecast is slightly higher than our previous published forecast for a 0.7% quarterly rise, reflecting updates in Stats NZ's February Selected Prices update.

Inflation is dropping back as demand cools. That's been seen most clearly in the retail sector, with the prices for many imported consumer goods dropping back. However, we expect that the moderation in overall inflation will be gradual. While the New Zealand economy is cooling, it's not 'weak'. Unemployment remains low and wages have continued to rise at a brisk pace, climbing 4.3% over the past year. In addition, we're still seeing sizeable increases in areas such as housing rents, insurance and local council rates. More generally, businesses have continued to report pressure on operating costs.

Compared to our forecast, the RBNZ's last published projections (released on 28 February) assumed a more pronounced easing in inflation in the early part of this year. The RBNZ is forecasting inflation of 0.4% in the March quarter, with the annual inflation rate forecast to slow to 3.8%. We think the risks to the RBNZ's forecasts for both domestic and imported inflation are to the upside.

Annual headline inflation



Inflation drivers.

In part, our forecast for March quarter inflation reflects seasonal influences. For instance, cigarette and tobacco prices have already risen by 6.4%, with much of that related to the annual increase in the excise tax.

We're also expecting to see continued firmness in the housing components of the CPI. With the March quarter a peak time for new rentals and population growth booming, we're forecasting a solid 1.1% rise in rents in the three months to March. That would leave rents up 4.5% over the past year (rents account for 9% of the CPI).

In addition, we're expecting a 0.8% increase in construction costs. Residential construction activity remains strong, but it has been slowing with fewer new projects coming to market. Balancing those influences, we expect a modest rise this quarter, similar to the rates seen in recent quarters.

Lastly, we also expect solid increases in some insurance premiums, continuing the rises seen over the past few quarters.

Balanced against those increases, we expect a 3% fall in petrol prices, as well as falls in both domestic and international airfares.

Both imported and domestic inflation on track to surprise the RBNZ on the upside.

We expect that both domestic and imported inflation will be stronger than the RBNZ has assumed in the March quarter. Although we don't know the exact breakdown of the RBNZ's forecasts, we do have Stats NZ's updates on monthly price movements for both January and February. Those data cover 45% of the CPI, including data on several of the more volatile components that drive much of the quarter-to-quarter swings in the CPI. Importantly, the latest update was released after the RBNZ finalised their latest forecasts.

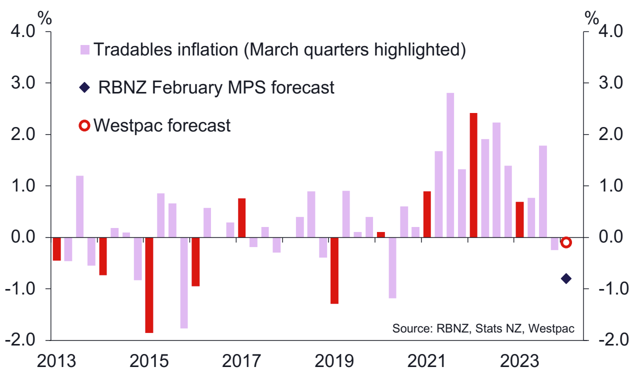
In terms of imported prices (sometimes referred to as tradables), the RBNZ is forecasting a 0.8% drop over the quarter. That would be the lowest result in four years. In contrast we expect a more modest 0.1% decline.

Data from Stats NZ indicate that petrol prices (which account for 4% of the CPI) were down 4% in the first two months of the year. We've also seen some softness in food prices, which account for around 20% of the CPI, which fell 0.6% in February (though that followed a sizeable 1.2% lift in January).

That softness in food and fuel prices isn't enough to get overall tradables inflation down to the levels the RBNZ is expecting. We'd also need to see sharp falls in other tradable prices for the RBNZ's forecast to hold. However, while it's true that we often see sharp falls in those prices in the March quarter, that has typically been due to seasonal falls in the cost of international travel and accommodation. But this year – at least through until February – we have not seen sharp declines in those prices. In February international airfares only posted a modest 1.7% drop. And the cost of international accommodation booked in New Zealand actually rose by 7.1%. In the case of international accommodation, those increases were driven by higher costs in Sydney and Brisbane – coinciding with the recent Taylor Swift concerts.

Putting that altogether, we think we're set for a more modest fall in tradables prices than the RBNZ was expecting.

Quarterly tradables inflation



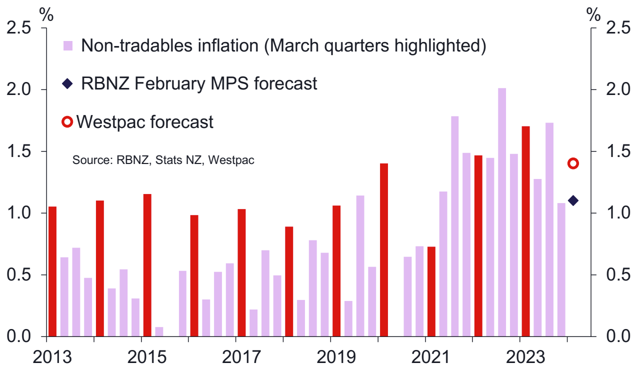
While the RBNZ might shake off a miss on their tradables forecasts (especially if it's due to swings in volatile items like airfares), domestic inflation pressures are also likely to be higher than they expected. The RBNZ is forecasting a 1.1% rise in non-tradables prices, while we expect a larger increase of 1.4%.

The monthly price data has already shown a sizeable 6.4% lift in cigarette and tobacco prices (4% of the CPI). We've also seen solid increases in housing rents (up 0.3%

in January and 0.4% in February), with alcohol prices also pushing higher.

Given those movements, the RBNZ would need to see a sharp slowdown in inflation in other categories. But that doesn't seem to match what we're seeing in terms of wage pressures, or the feedback we've received from businesses about continued cost pressures.

Quarterly non-tradables inflation



Balance of risks.

In terms of the risks to our own forecasts, weak consumer spending could be a larger drag on tradables prices than we have assumed, especially for items like new and used cars. On the domestic front, we could see smaller than expected increases in the costs for services like insurance following the large rises in recent quarters. But even allowing for such risks to our own forecasts, the risks to the RBNZ's forecasts still look like they lie to the upside.

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