ECONOMIC BULLETIN

CPI preview, March quarter 2024 – Wednesday 17 April, 10:45am.

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

Inflation's easing, but not as quickly as the RBNZ expected in February

- **We expect that New Zealand consumer prices will rise by 0.8% in the March quarter. 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, with measures of core inflation lingering at levels above the RBNZ's target range. Notably, we're still seeing strong price increases in parts of the domestic economy.**

Consumer price inflation

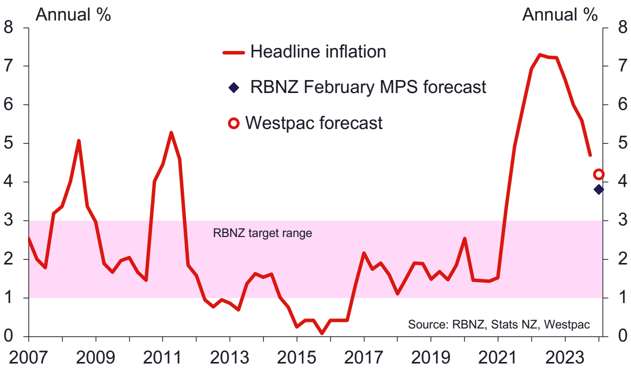
	Dec 2023	Mar 2024 forecast	
	Actual	Westpac	RBNZ
Headline inflation			
Quarterly	0.5	0.8	0.4
Annual	4.7	4.2	3.8
Non-tradables inflation			
Quarterly	1.1	1.4	1.1
Annual	5.9	5.6	5.3
Tradables inflation			
Quarterly	-0.2	-0.2	-0.8
Annual	3.0	2.1	1.5

We expect the March quarter inflation report (out on 17 April) will show that inflation has continued to ease, but not as quickly as the Reserve Bank had assumed.

We estimate 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. That would be the lowest annual inflation rate since 2021. However, it is still well above the RBNZ's 2% target midpoint.

Our forecast incorporates Stats NZ's monthly update on selected prices for March (covering around 45%) of the CPI basket. The March data did present some surprises, such as softer food prices, but firm prices for holiday accommodation. But on balance, this data did not change our forecasts for the quarter as a whole.

Annual headline inflation



Underlying our forecast for a solid rise in consumer prices is continued strength in domestic price pressures (aka. non-tradables inflation). We estimate that non-tradable prices rose 1.4% over the quarter, leaving them up 5.6% over the past year. The March quarter result will be boosted by the annual increase in the tobacco excise tax, as well as increases in housing rents. In addition to those factors, businesses have reported ongoing pressure on operating costs. We also expect further sizeable increases in the cost of services like insurance.

In contrast, the imported tradable components of inflation have been softer. We've pencilled in a 0.2% fall this quarter, which would see annual tradables inflation slowing to 2.1%. Much of that is due to falls in food and fuel prices. However, tradables inflation more generally has also taken a sizeable step down over the past year as earlier disruptions to supply chains have eased and as New Zealand households have wound back there spending in many areas (including spending on imported durable items).

Smoothing through the quarter-to-quarter volatility in prices, the underlying trend in inflation has been easing, but that's occurring gradually. In fact, excluding volatile items like fuel and food prices, we expect that measures of core inflation will continue to run at rates of around 4% in the year to March. While that's down from the eye-watering rates we saw in 2022 and 2023, it's not low by any stretch of the imagination.

In the detail: What's underpinning inflation in the March quarter?

Ahead of the full quarterly CPI report, Stats NZ now releases monthly data covering 45% of prices in the CPI basket. This is a timely source of data and covers some of the more volatile components of the CPI which often drive the quarter-to-quarter swings in inflation.

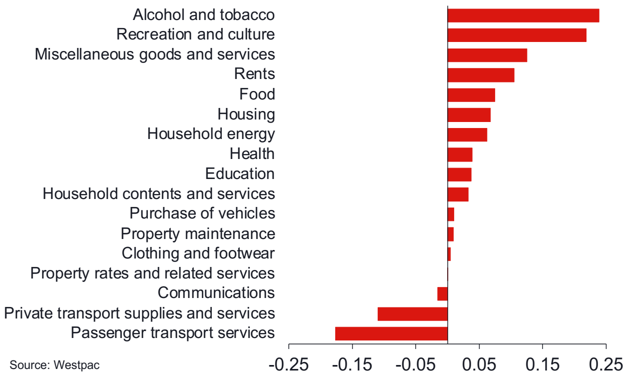
On balance, that monthly data has already revealed some sizeable price rises over the March quarter, with much of that due to seasonal increases.

- There has been a 6.5% increase in cigarette and tobacco prices in recent months (accounting for 3% of the total CPI basket). Prices in this group typically rise at this time of year due to the annual increase in the excise tax.
- Housing rents (9% of the CPI) have risen 1.1% in the three months to March and are up 4.6% over the past year. The early part of the year is a peak time for new rentals, and the pressure on rents has been compounded by booming population growth.
- Food prices (19% of the CPI) were up 0.4% in the March quarter, with falls in the prices of fresh produce and meat offset by higher prices for groceries and restaurant/takeaway food.
- Prices for some recreational services, have also been firm in recent months. Notably, the cost of overseas accommodation booked in New Zealand has risen by nearly 7%.
- On the downside, petrol prices (4% of the CPI) fell 2.6% over the quarter. There have also been falls in the cost of domestic and international airfares.

Turning to the areas where we do not receive monthly updates, insurance costs are likely to post another large increase this quarter, with the cost of cover rising in response to factors such as the risk of severe weather events.

In the construction sector, we expect a 0.7% increase in the cost of purchasing a newly built home (10% of the CPI). Construction cost inflation has slowed sharply over the past year as earlier materials shortages have eased and the number of new projects coming to market has dropped away. However, while the construction sector is turning down, for now the level of activity is not low compared to history, and that is limiting how far building costs have eased.

Contributions to March quarter inflation forecast (percentage points)



Risks around our forecasts and the RBNZ's assumption.

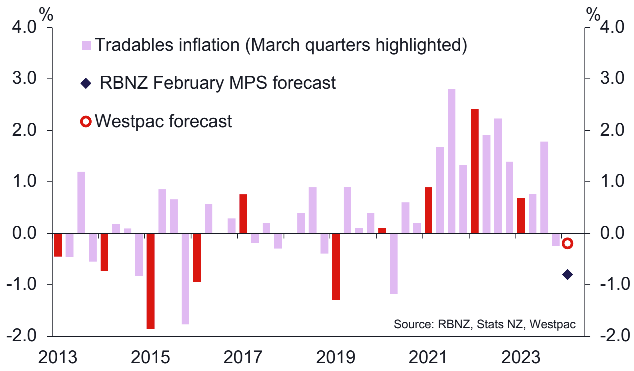
In terms of the risks to our own forecasts, weak consumer spending could be a larger drag on tradables prices than we have assumed, especially for durable items like new and used cars. In addition, we could see more moderate increases in the costs for services like insurance following the large rises in recent quarters. Balanced against those downside risks, businesses across the economy continue to report pressure on operating costs.

Even allowing for such risks to our own forecast, the risks to the RBNZ's February forecast lie firmly to the upside. The RBNZ's last published set of projections assumed a muted 0.4% rise in prices over the March quarter, which would see annual inflation slow to 3.8%. However, that forecast was finalised back in February – before the release of monthly price data for the last two months of the quarter. In their April *Monetary Policy Review* earlier this week, the RBNZ acknowledged that the monthly price data signalled upside risk to that earlier forecast.

While the RBNZ will be braced for a larger rise than was assumed in their February policy statement, the source and extent of those surprises will be important for the stance of policy.

Much of the risk to the RBNZ's forecasts relates to tradable prices, which the RBNZ had assumed would fall 0.8% over the quarter. That would be the largest drop in five years. While we have seen softness in prices for some items like food and fuel, tradables prices more generally don't look like they will be quite as soft as the RBNZ had assumed. Consistent with that, we're forecasting a much more moderate 0.2% decline. Much of the reason for our higher forecast is because the monthly price data have already shown firmness in the prices for services like international travel and accommodation.

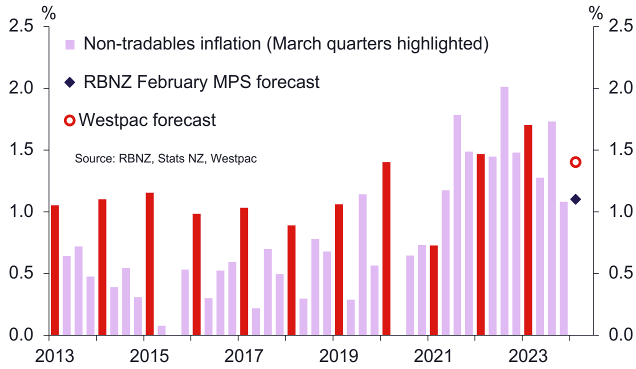
Quarterly tradables inflation



Swings in the prices of volatile items like airfares probably won't worry the RBNZ too much. However, domestic inflation is also likely to be stronger than the RBNZ had expected. The RBNZ had assumed a 1.1% rise in non-tradables prices, while we expect a larger increase of 1.4%. Monthly price data have already shown a sizeable increase in cigarette and tobacco prices and housing rents. In addition, with firmness in areas like insurance and businesses continuing to report pressure on operating costs, overall non-tradables prices are likely to record a solid rise in the early part of the year.

That firmness in domestic inflation will be important for the RBNZ. Outside of the construction sector, domestic inflation pressures have continued to run hot more than two years after the RBNZ first raised the cash rate. Continued strength on this front would reinforce the likelihood that rate cuts are still a way off. While financial markets are pricing rate cuts from August, we don't expect them until February next year.

Quarterly non-tradables inflation



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