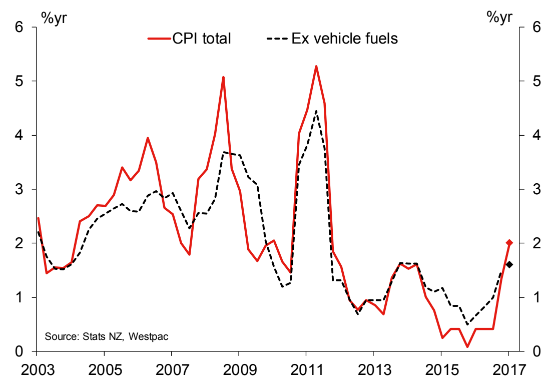
Early arrival

March quarter CPI preview: 20 April, 10:45am

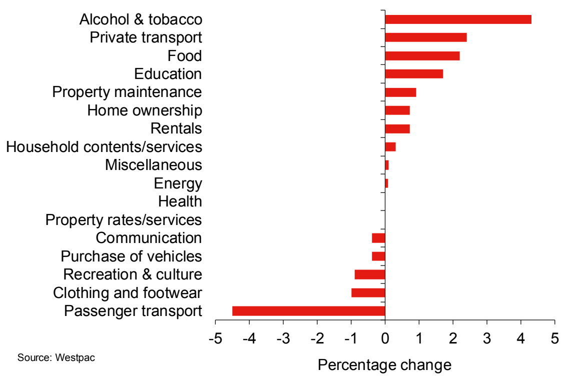
13 April 2017

- We expect a 0.8% rise in the Consumer Price Index (CPI) for the March quarter. This would lift the annual inflation rate to 2%, which is the midpoint of the Reserve Bank's target range.
- The expected rise in annual inflation largely reflects an unusually large seasonal spike in fruit and vegetable prices, and the rebound in oil prices from their lows over the past year. Neither factor will have a sustained impact on the rate of inflation.
- As a result, we don't expect the inflation rate to move any higher over this year.

Annual inflation



Components of quarterly inflation forecast



The inflation story in New Zealand has reached a new chapter. For several years, inflation had been persistently below the 2% midpoint of the Reserve Bank's target, reflecting the ample spare capacity in the economy, the strength of the New Zealand dollar, and in more recent times the plunge in world oil prices. However, by the end of last year inflation had rebounded from near-zero levels to 1.3%. And measures of 'core' inflation, which strip out volatile aspects such as fuel prices, suggest that inflation pressures have been gradually picking up for the last year or so.

In a sense, this is a good thing – it shows that monetary policy works. Interest rates are typically believed to have their greatest impact on inflation with a lag of 18 to 24 months. The RBNZ began to lower the Official Cash Rate in June 2015; longer-term interest rates, in their usual pre-emptive manner, were falling by late 2014. So the lift in underlying inflation is right on schedule.

In contrast, the rise in the headline inflation rate has been more sudden. We expect it to rise to 2% in next Thursday's CPI release, reaching that mark more than a year earlier than the RBNZ expected. That would no doubt raise questions about whether interest rates need to be kept at super-low levels for much longer. However, we think that the RBNZ will recognise the influence of temporary factors on the March quarter, and will set its focus on the more slowly evolving, domestically focused components of the CPI.

Details

We expect a 0.8% increase in the CPI for the March quarter. With a fairly weak result in the March 2016 quarter dropping out of the calculation, this would lift the annual inflation rate from 1.3% to 2.0%.

There are two factors in particular that account for the pickup in inflation. The first is that petrol prices are up 12% compared to a year ago. But this time last year was an historic low for world oil prices. So that rate of increase is unlikely to be maintained over the rest of this year.

The second factor is that prices for some fresh produce such as carrots, apples and pears had unusually large seasonal spikes at the start of this year. At least part of this appears to have been weather-related, for instance a delay in the carrot harvest in the North Island. But if that's the case, these price increases are likely to fully reverse as the season progresses – in fact, many of them were already pulling back by March.

These two factors alone – food and fuel – would have pushed the annual inflation rate up to 2.1%. So the remainder of the story, according to our forecasts, is actually one of slightly diminished inflation pressures this quarter. In particular, we expect the strong rise in the New Zealand dollar over 2016 to have an ongoing dampening effect on the retail prices of imported goods (there were signs of this starting to come through in the December quarter).

The March quarter typically features a number of seasonal influences. The most prominent is the annual increase in tobacco excise duty, up 10.4% this year. Educational fees also rise in the March quarter as the new study year begins, although notably the 2% increase in university fees this year is smaller than it has been in past years.

On the downside, we expect a sizeable drop in airfares compared their December quarter peaks. Airfares are a major source of uncertainty in our forecasts from quarter to quarter – they've exhibited much larger seasonal swings in recent years, perhaps reflecting a greater use of peak pricing as tourist numbers around the globe have boomed.

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