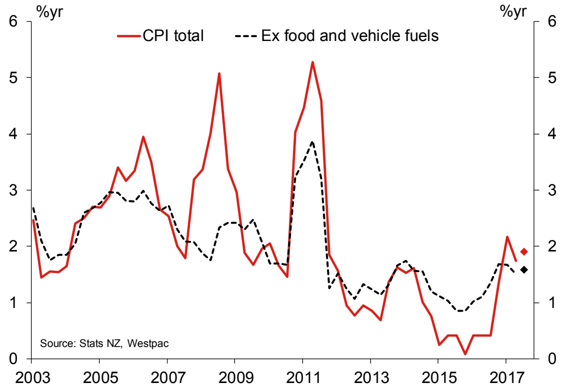
Signs of life

September quarter CPI preview: 17 October, 10:45am

12 October 2017

- We expect a 0.5% rise in the Consumer Price Index (CPI) for the September quarter, lifting the annual inflation rate to 1.9%.
- Food prices rose for the quarter, while fuel prices fell.
- The strong New Zealand dollar was a disinflationary force over the first half of this year, but we expect its influence to wane in the September quarter.
- We expect inflation to exceed the Reserve Bank's forecast for the quarter.
- However, with economic growth and house prices falling short of the RBNZ's forecasts, we think that interest rates will need to remain low for even longer than the market expects.

Annual inflation forecast



Consumer prices are likely to have been a bit livelier in the September quarter, after the flat outturn in June. We expect a 0.5% rise in the September quarter CPI, which would lift the annual inflation rate from 1.7% to 1.9%. Measures of core inflation (i.e. excluding volatile items and one-offs) are likely to tell a similar story: inflation has picked up from its lows in the last couple of years, but remains short of the 2% midpoint of the Reserve Bank's target band.

Our forecast is a fair bit higher than what the RBNZ expected in its August Monetary Policy Statement (0.2% quarter, 1.6% annual). Nearly all of the difference is in the tradables component of the CPI, and probably reflects the additional information we've received since August, particularly food and fuel prices. We do also expect a slight rise in non-tradables inflation, up from 2.4% to 2.5%. But that's no higher than it's been in the past three years.

An outturn in line with our forecast would, on its own, be a small plus for the RBNZ's interest rate projections. However, this comes at a time when other factors – lower than expected GDP growth, and a marked slowdown in the housing market – point towards keeping interest rates low for even longer than the market is expecting.

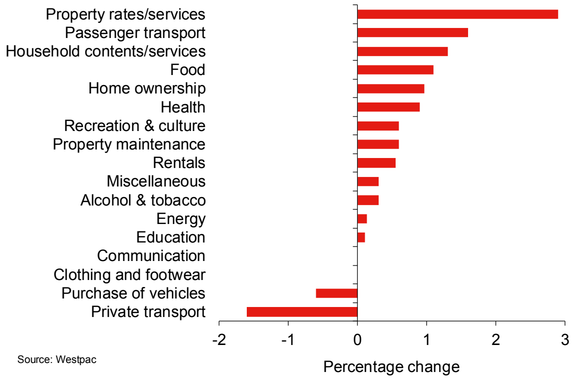
Details

Food prices will make the most significant contribution to the rise in the CPI for the September quarter. Vegetable prices have largely receded from their April-May spike, when wet weather wiped out some crops. However, grocery prices have been picking up in recent months – particularly for dairy products such as butter, reflecting the rise in global prices this year.

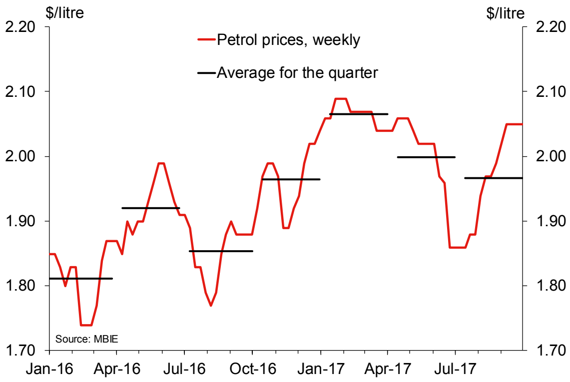
Fuel prices were lower on average over the quarter, but they did rise sharply in August and September. This explains some of the difference between our inflation and the RBNZ's, which was calculated before fuel prices started to rise. If fuel prices had remained steady since July, our CPI forecast would be 0.1% lower.

We're expecting modestly higher prices (or smaller decreases) for many of the import-heavy categories such as household goods. The New Zealand dollar was actually a disinflationary force over the first half of this year: the trade-weighted exchange rate rose by about 10% in the year to September 2016, and the lag from exchange rate movements to retail prices is typically in the order of two to three quarters. So we expect the exchange rate's influence to have waned in the September quarter.

Components of quarterly inflation forecast



Petrol prices



On the non-tradables side, the housing-related categories are likely to dominate once again. Local body rates are increased in the September quarter; we estimate an average rise of 3%, which is in line with last year but relatively low compared with history. Prices for newly-built homes are likely to continue to rise strongly, given the capacity constraints on the building industry. In contrast, we expect rents to continue their steady but modest rise.

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