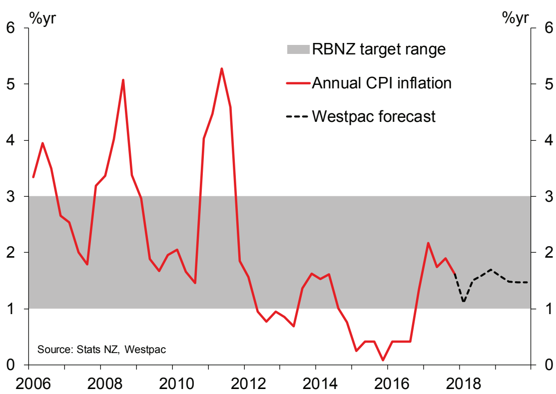
Down a bit

March quarter CPI preview: 19 April, 10:45am

16 April 2018

- We expect a 0.5% rise in the Consumer Price Index (CPI) for the March quarter. This would see annual inflation drop to 1.1%, its lowest since September 2016.
- We estimate that the new Government's policy of a year's free tertiary education will knock 0.2% off the CPI.
- The dip in annual inflation is partly a timing issue that is likely to be short-lived.
- However, we expect inflation to remain on the lower side of the Reserve Bank's inflation target for some time yet.

Annual inflation forecast



We expect a modest 0.5% rise in consumer prices over the March quarter, which would bring the annual inflation rate down from 1.6% to 1.1%. This dip in annual inflation is likely to be temporary, and has been well anticipated by both the market and the Reserve Bank. That said, we don't see a lot of impetus for inflation to test the upper half of the RBNZ's target range any time soon.

There are two factors behind the expected drop in annual inflation. The first is the new Government's introduction of a year's free tertiary education for those who haven't studied before. It's not clear how much weight this will carry in the CPI, but we estimate that it will knock 0.2% off the inflation rate this year. Other forms of education will see their usual annual fee increases.

The second factor is base effects. Food prices rose sharply in the March quarter last year, as vegetable crops were hammered by poor weather and dairy prices rose strongly from their lows. A rise in fuel prices also added to inflation to a lesser degree. These forces saw the annual inflation rate briefly spike to 2.2%, before easing off over the rest of the year.

This year, food prices were relatively stable in the March quarter (though there was a weather-related jump in the March month), and the 2% rise in petrol prices was smaller than the same time last year. So we expect a reversal of last year's pattern: a brief downward spike in annual inflation, unwinding over subsequent quarters.

Setting aside this volatility, there is still little evidence of a sustained pickup in inflation. Tradables prices are no longer consistently falling, but there has been no real lift in non-tradables inflation in recent years.

The lower New Zealand dollar over the last year should be starting to lift imported goods prices by now; we expect small gains in the household contents, clothing and recreation categories. However, given the usual lags between the exchange rate and retail prices, the greater impact is likely to come later this year.

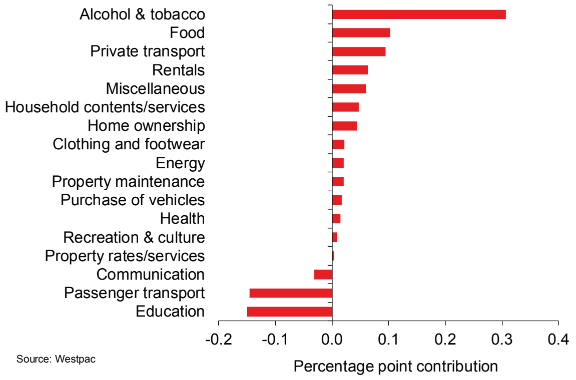
The biggest positive impact on the CPI for the quarter – though not on annual inflation – is the annual increase in tobacco excise duty. The excise increase is 10% plus the inflation rate in the previous year to September, which means that this year's increase will be a little larger than in recent years.

The biggest negative for the quarter, apart from tertiary education, is a seasonal fall in international airfares as the peak travel period passes. We expect this to be partly offset by a rise in domestic airfares.

The housing-related categories continue to add to inflation, but we don't expect to see an acceleration. Prices for newly-built homes are rising, but the rate of increase appears to have peaked as the housing market has slowed. Rents are accelerating in some regions (Wellington), but are cooling in others (Auckland, Canterbury).

Michael Gordon
Senior Economist

Contributions to Q1 inflation forecast



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