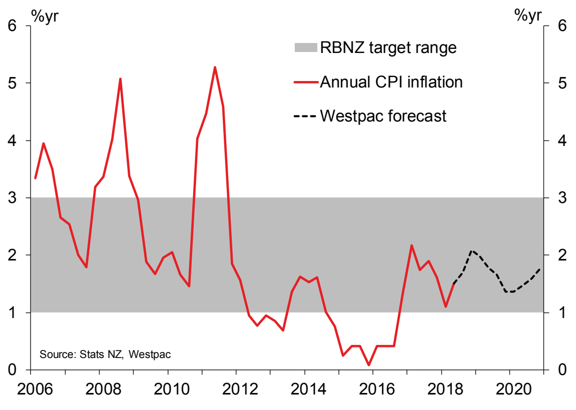
Gas in the tank

September quarter CPI preview: 16 October, 10:45am

11 October 2018

- We expect a 0.7% rise in the Consumer Price Index (CPI) for the September quarter, taking annual inflation up to 1.7%.
- Higher fuel prices account for much of the expected quarterly rise, and are likely to push annual inflation higher again in the near term.
- We also expect the lower exchange rate over the last year to have an impact on prices of imported goods.
- Inflation is shaping up to rise above the midpoint of the Reserve Bank's target range, for at least a short period.
- A petrol-induced rise in inflation could make OCR cuts a harder sell in the near term, though it certainly wouldn't preclude rate cuts if the economy faltered.

Annual inflation forecast



Inflation in New Zealand is starting to pick up from its lows, although the underlying pace of increase has been more gradual than the volatile headline figures suggest. We expect the September quarter CPI, released next Tuesday, to show a 0.7% rise for the quarter, lifting the annual inflation rate to 1.7%.

If we're correct, that will be a fair bit higher than what the Reserve Bank forecast in its August *Monetary Policy Statement* (0.4% quarter, 1.4% annual). The difference between our forecasts is entirely on the tradables side, some of which – but not all – can be pinned on the continued rise in fuel prices since August.

A result in line with our forecast probably wouldn't perturb financial markets, as a stronger outturn is well anticipated by now. Subsequent quarters could be more interesting, however – it's looking increasingly likely that annual inflation will move above the 2% midpoint of the RBNZ's target range, for at least a short period.

Rising fuel prices are a mixed bag for monetary policy, adding to inflation up front, but weighing on activity over the medium term. Higher inflation caused by petrol prices certainly wouldn't prevent the RBNZ from cutting the OCR if there were signs that the economy were faltering. But in the near term, it could make it harder to sell the idea that OCR cuts are needed for the purpose of generating more inflation.

The single biggest contribution to our inflation forecast is a 6% rise in petrol and diesel prices, stemming from a trifecta of rising world oil prices, a falling exchange rate and the introduction of a regional fuel tax in Auckland. Together, these account for a 0.3 percentage point rise in the CPI for the quarter. The impact on the December quarter is shaping up to be even greater, given the high starting point for fuel prices and a nationwide increase in petrol taxes in October.

Over time, higher fuel prices will also affect travel prices, and any items where transport makes up a significant portion of costs. While the lags can be long, oil prices have been rising for some time, and there is now clear evidence of rising prices in areas such as domestic airfares.

The September quarter CPI typically receives a boost from seasonal factors, of which the biggest is the annual increase in local body rates. We estimate that rates rose by around 4% on average this year, compared to 3.5% last year. While the Auckland Council has capped its increases at 2.5% a year, many of the smaller regions have lifted rates substantially this year, citing a need to invest to catch up with population growth.

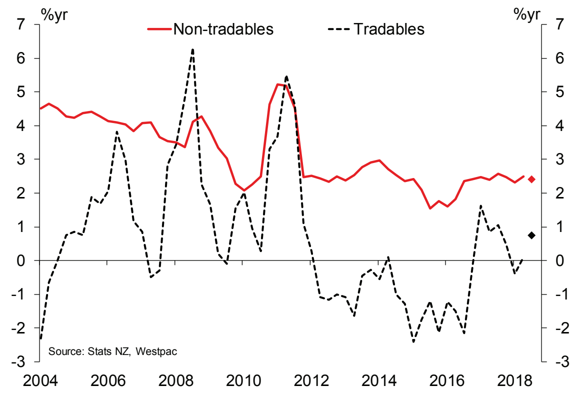
Food prices also tend to see a seasonal rise in the September quarter, largely due to higher vegetable prices at the tail end of winter. On an annual basis, food prices are broadly flat, aside from the cost of eating out which was influenced by the minimum wage hike in April.

Setting aside fuel and food, we expect a modest lift in the prices of tradables for the quarter. The trade-weighted New Zealand dollar index has fallen 6% in the last year. We find that it typically takes 6-12 months for changes in the exchange rate to show up in retail prices, so we should expect to see some impact by now – and more so in subsequent quarters.

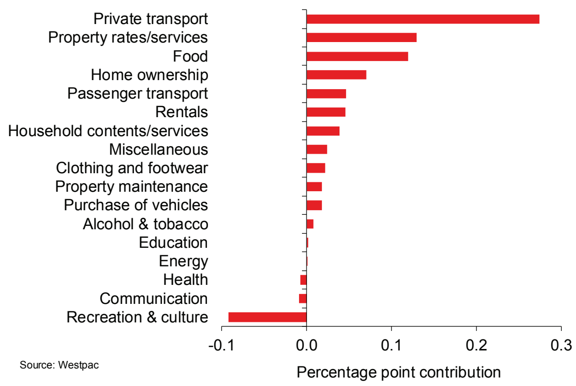
While non-tradables prices were surprisingly strong in the June quarter, there are no clear signs of this strength persisting into the September quarter. Prices for new home construction tend to follow the trend in house sale prices, which has been subdued so far this year. Meanwhile, rents – which account for nearly 10% of the CPI – have been mixed, with growth slowing in Auckland even as it picks up in other parts of the country.

Michael Gordon
Senior Economist

Inflation components



Contributions to Q3 inflation forecast



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