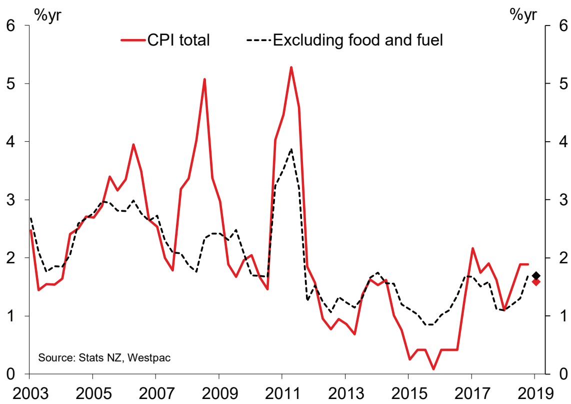
Delicately poised

March quarter CPI preview: 17 April, 10:45am

11 April 2019

- We expect a 0.2% rise in the Consumer Price Index (CPI) for the March quarter, which would see annual inflation slow from 1.9% to 1.6%.
- The sharp drop in fuel prices at the end of last year is entirely responsible for the slowdown. We expect measures of underlying inflation to hold steady.
- The CPI release will be crucial ahead of the Reserve Bank's next *Monetary Policy Statement*. A result in line with or below expectations would support our forecast of an OCR cut in May.
- However, a substantial upside surprise would make a May OCR cut a more marginal prospect.

Annual inflation forecast



The March quarter CPI is released next Wednesday. We are expecting a subdued 0.2% rise for the quarter, which would take the annual inflation rate down from 1.9% to 1.6%. The expected slowdown is entirely due to the recent pullback in fuel prices. We expect the various 'core' inflation measures to hold steady at close to, but just below, the 2% midpoint of the Reserve Bank's target range.

The CPI report comes at a time when the outlook for monetary policy is delicately poised. Following the RBNZ's change of tone in the March OCR review, we shifted our call to expecting further cuts in the OCR, with the first coming as early as the May *Monetary Policy Statement*. But we emphasised that the timing of a move was highly uncertain, and would be subject to upcoming local data releases and overseas developments.

Our CPI forecast is in line with what the RBNZ expected in its February *Monetary Policy Statement*. If the March quarter prints in line with expectations or lower, it's likely that we'll see inflation remain below 2% for the remainder of this year. That in itself wouldn't warrant an OCR cut, but it wouldn't stand in the way of it either. However, if annual inflation prints at 1.8% or higher, a May OCR cut would become more difficult to envisage.

Forecast details

As is often the case, fuel prices will have a significant impact on the CPI this quarter. Petrol prices fell sharply at the end of 2018, and though they've started to tick up again recently, the average price over the quarter was down by more than 6%. Compared to a year ago, petrol prices are close to flat, which in turn will act as a drag on the overall inflation rate.

The March quarter typically sees large seasonal price movements in both directions, with a slightly positive impact on balance. On the plus side, the most significant impact will come from the annual increase in tobacco excise duty (10% plus the inflation rate). We note that this is the last increase of this size that has been legislated; there may be further increases in the future, but the Government has expressed concern that raising prices so high may be doing more harm than good. Tobacco excise increases have contributed 0.2-0.3 percentage points to annual inflation in recent years.

The other major seasonal price increases will be in food (particularly fruit prices) and education. Both of these will actually work to boost the annual inflation rate. Food prices rose by 1.1% in the March quarter, compared to a 0.5% rise a year ago. Meanwhile, university fees saw the usual 2% annual increase, after being dragged down sharply last year by the introduction of zero fees for the first year of study.

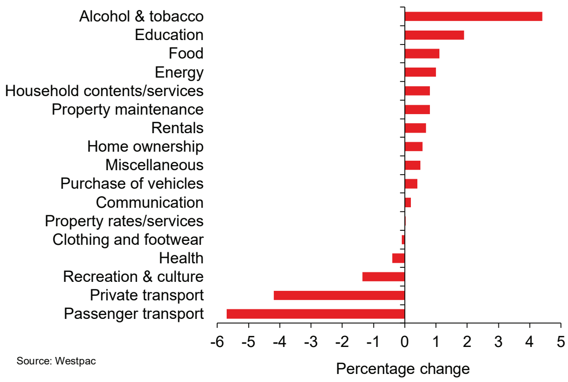
On the downside, we expect to see large seasonal declines for international airfares and car rentals. In contrast, domestic airfares were slightly higher on average over the March quarter, which includes the peak holiday travel period. Air New Zealand announced a steep cut in fares on many domestic routes in March, but this will show up more in the June quarter.

Our forecast includes a few one-off influences. Electricity prices reportedly rose in the March quarter, which is unusual in that price rises usually occur in the June quarter. Healthcare prices will be dragged down by the extension of free GP visits to under-14 year olds (previously for under-13s). Finally, in the December quarter there was a 13% jump in prices for toys and games; that looked suspicious and we're assuming it will be reversed. That item alone knocks 0.1% off our inflation forecast.

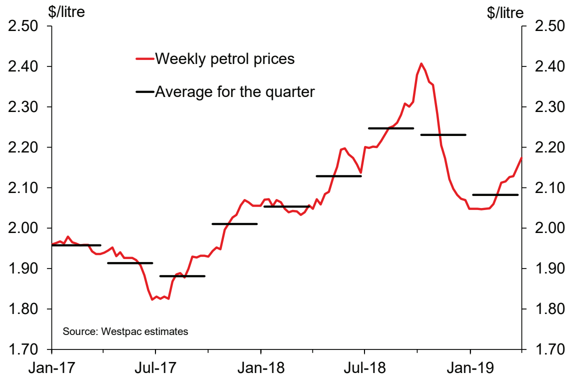
Housing remains an ongoing contributor to overall inflation. Prices for newly-built homes have slowed, in line with the cooling in the housing market, but rents continue to rise at a steady pace. From the June quarter Stats NZ will adopt a new method of calculating rents, which has historically run a bit hotter than the old method. This change won't be backdated in the CPI, but it should add around 0.1% to annual inflation in the future.

Michael Gordon
Senior Economist

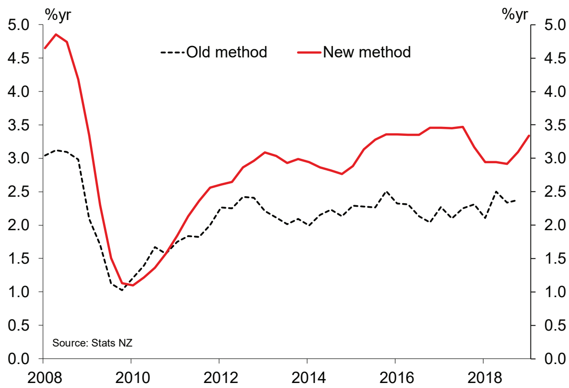
Contributions to Q1 inflation forecast



Petrol prices



CPI rents, annual change



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