

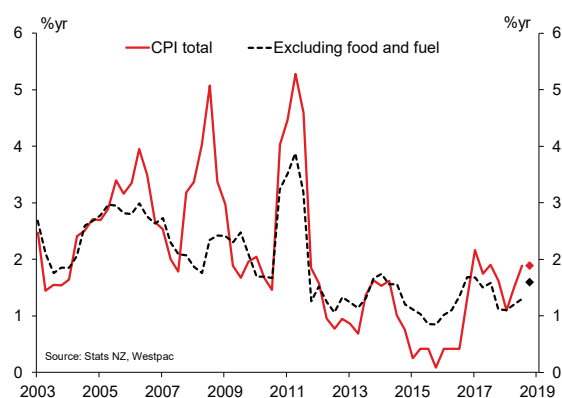
The mix matters

December quarter CPI preview: 23 January, 10:45am

17 January 2019

- We expect a 0.1% rise in the Consumer Price Index (CPI) for the December quarter, with annual inflation holding at 1.9%.
- The recent volatility in fuel prices will end up having little bearing on the December quarter figures, though it will weigh on inflation in the early part of this year.
- The tightening labour market and the lower New Zealand dollar are expected to support a pickup in underlying inflation.
- While we expect overall inflation to come in a little below the Reserve Bank's forecast, that's entirely due to the recent drop in fuel prices. We think that domestically-generated inflation will be stronger than the Reserve Bank's forecast.

Annual inflation forecast



We expect next Wednesday's CPI report to show a 0.1% rise in prices for the December quarter, which would maintain the annual inflation rate at 1.9%. Not long ago it seemed likely that inflation would end the year above the Reserve Bank's 2% target midpoint, as fuel prices spiralled higher. But the subsequent plunge in oil prices has taken some of the pressure off.

Our forecast is similar to the 0.2% quarterly increase that the Reserve Bank forecast in its November *Monetary Policy Statement*. However, we think that the details will be 'hawkish' from the RBNZ's point of view. The sharp drop in fuel prices came as a surprise, but this is a temporary shock and is more easily looked through. In contrast, we expect a 0.7% rise in the more persistent non-tradables component, compared to the RBNZ's forecast of a subdued 0.4% rise.

The details of the December quarter CPI are typically dominated by large seasonal price changes in both directions. Vegetable prices alone will knock more than 0.3 percentage points off the quarterly CPI, as they pull back from their winter peaks. On the upside, we typically see sharp rises in airfares, car rentals and accommodation over the peak travel period, though the extent of these price changes is much more uncertain.

Fuel prices have been on a rollercoaster ride lately, with a steep climb up until early October followed by an even steeper plunge. Ironically, this will end up having little bearing on next week's report, with the average petrol price over the December quarter only slightly lower than the September quarter. However, the low starting point means that fuel prices will be more of a drag on the inflation rate in early 2019.

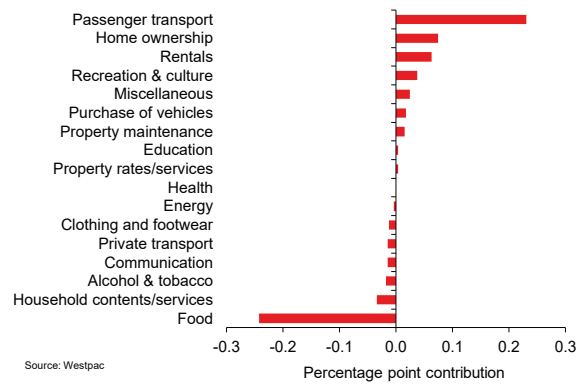
Excluding the volatile food and fuel categories, our forecast implies an uptick in annual 'core' inflation to around 1.6%. Some of that pickup reflects the fortunes of the New Zealand dollar, which fell over the course of 2018. It typically takes 6-12 months for exchange rate movements to have a bearing on the retail prices of imported goods, so we should expect to see some impact by now. Recent business surveys have shown a pickup in both costs and pricing intentions in the retail sector.

Housing remains an ongoing contributor to the rise in non-tradables prices. We expect a modest increase in prices of newly-built homes – more so outside of Auckland, in line with the recent performance of regional housing markets.

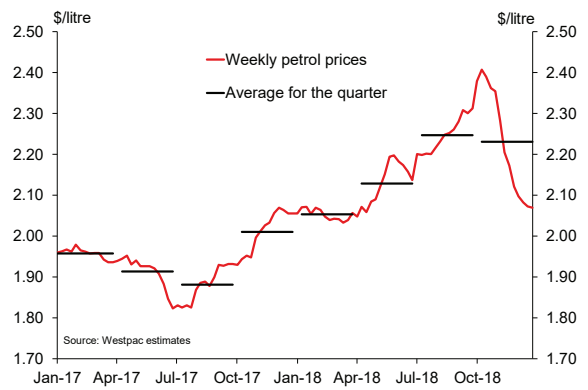
Meanwhile, tenancy bond data suggests a slight pickup in rental growth, although the CPI series doesn't vary a lot from quarter to quarter.

Michael Gordon
Senior Economist

Contributions to Q4 inflation forecast



Petrol prices



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