Economic Bulletin.

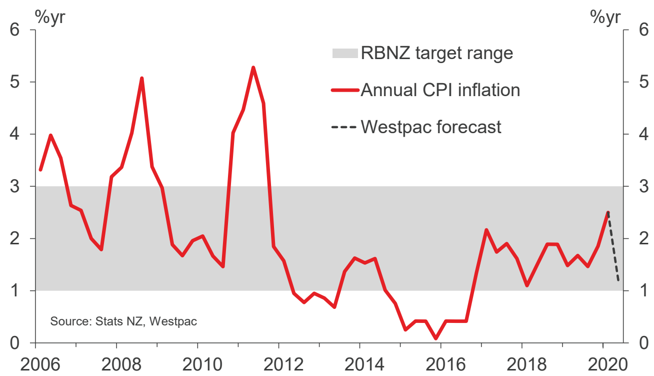
14 July 2020

Preview of June quarter CPI: 16 July, 10:45am.

- We expect a 0.7% fall in consumer prices for the June quarter, taking annual inflation down from 2.5% to 1.2%.
- The main contributors were a sharp drop in fuel prices and some temporary falls in other transport costs.
- Our forecast is below the average market forecast of -0.5%, with the difference likely reflecting the uncertainty around COVID-19's impact on prices.
- We expect inflation to slow further over the next year, prompting further easing measures from the Reserve Bank.

Michael Gordon, Senior Economist
+64 9 336 5670

Annual inflation forecast



After a surprise jump at the start of this year, inflation has abruptly dropped back again. We expect a 0.7% fall in consumer prices in the June quarter, taking the annual rate down from 2.5% to just 1.2%. Lower fuel prices are the main factor, with changes wrought by the COVID-19 lockdown also expected to have a negative impact on balance.

This is a downward revision from our initial forecast of -0.5%, after a smaller than expected rise in food prices for the June month. We've also incorporated some recent guidance from Stats NZ about how it has dealt with COVID-related disruptions to the measurement of prices. The latter is only a temporary factor, so we've also revised up our September quarter forecast from 0.8% to 0.9%.

Our pick is below the average market forecast of -0.5%, with the difference likely reflecting the uncertainty around COVID's impact on prices. The Reserve Bank also forecast a 0.7% drop in its May *Monetary Policy Statement*, though this was more on the tradables side (oil prices were much lower at the time the RBNZ prepared its forecasts), rather than the drop in non-tradables prices that we expect. A weaker outturn would reinforce market expectations that the RBNZ will need to do more to meet its targets. We expect an extension of its bond purchase programme in the coming months, and a move to a negative OCR next year.

Forecast details.

The biggest drag on June quarter prices was fuel. World oil prices fell sharply in late March as the COVID outbreak weighed on demand, though they have recovered a little in recent weeks. We estimate that petrol prices were 13% lower on average over the quarter, knocking 0.6 percentage points off the CPI.

The other big negative that we're expecting is the passenger transport category, where COVID-related disruptions were rife. First, the border closures meant that overseas airfares were not available to be measured during the quarter. Stats NZ has accounted for this by applying the change in the overall CPI to this category – that is, a small negative, rather than the seasonal increase that we usually see at this time of year.

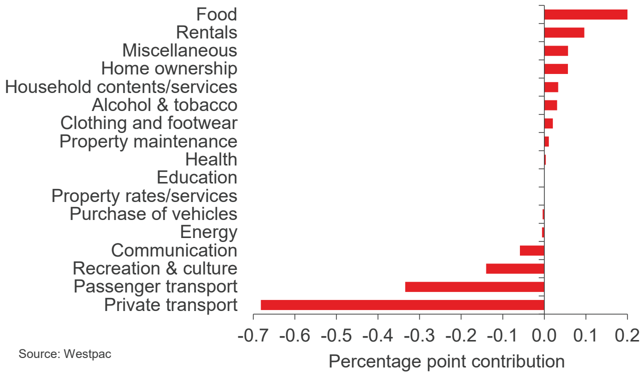
Second, domestic flights were sharply reduced, making the measurement of prices more uncertain. We estimate that airfares were down in the June quarter, but only a little more than the usual seasonal decline. Finally, during the Alert Level 4 lockdown in April some services such as buses, trains and carparking were made free. While these were meant to be limited to essential workers, their weight in the CPI basket has not been adjusted for this.

On the positive side of the ledger, food price inflation continued to accelerate in the June quarter. One of the drivers has been high world prices for exported items such as meat; another has been the larger-than-usual minimum wage hikes over the last couple of years, which have boosted prices for dining out and takeaways.

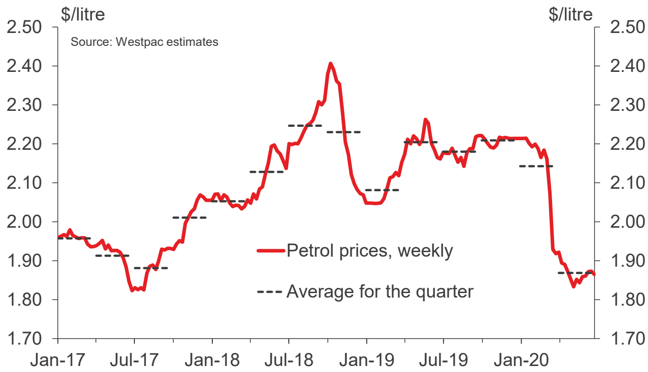
Housing-related inflation continues to burble away. We expect another solid 1% rise in rents for available homes (the single largest category in the CPI), despite the temporary freeze on rent increases for existing tenancies.

There have been some stories about price hikes for household goods, due to higher freight costs and/or limited supplies. We don't have evidence that this has been a widespread issue, so for now we're just noting it as an upside risk to the near-term inflation outlook. Over the medium term, we think that softer demand rather than supply disruptions will be the dominant factor, and we expect annual inflation to slow to around zero by early next year.

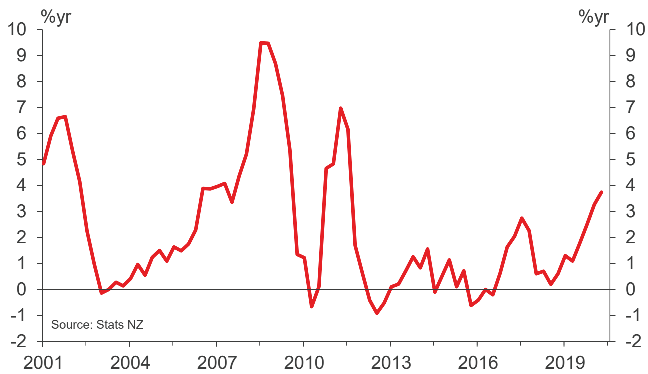
Contributions to Q2 CPI forecast



Petrol prices



Food prices



Contact the Westpac economics team.

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.