Economic Bulletin.

16 April 2021

Preview of March quarter CPI: Wednesday 21 April, 10:45am.

- We expect a 0.7% rise in consumer prices in the March quarter.
- That would see annual inflation slipping back to 1.3%, with the annual rate dampened by changes to tobacco excise taxes.
- Underlying inflation is being boosted by a combination of higher oil prices, supply disruptions and firm conditions in the construction sector.
- Ongoing disruptions to trading activity across sectors in the wake of last year's outbreak continue to cloud the near term outlook for prices.

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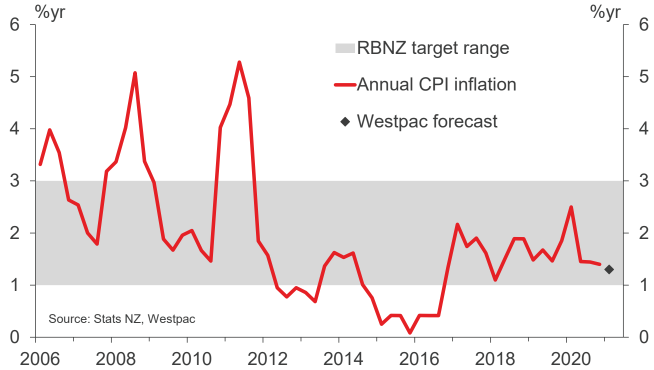
We expect the upcoming March quarter Consumer Price Index will show that New Zealand consumer prices rose by 0.7% in the early part of 2021. That would see annual inflation slipping back to 1.3% (down from 1.4% in December).

Our forecast is lower than the 1% quarterly increase assumed in the RBNZ's last set of published forecasts from February. That's mainly due to our lower forecast for tradables prices which in part reflects the flattening-off of food prices over the quarter. Earlier this week, the RBNZ signalled that it expects to maintain very stimulatory policy settings for an extended period. A result in line with our forecast would reinforce that view.

Annual inflation for the year to March will be restrained by a change to the normal adjustment in tobacco excise taxes. In recent years, those taxes have risen by around 10% per annum as part of efforts to discourage tobacco consumption. This year's increase will be much more modest– we're expecting a 1.4% rise in line with the trend in overall prices over the past year. Compared to what we've seen in recent years, that change will shave about 0.3 percentage points off annual inflation.

Annual inflation forecast



The risks around our forecast mainly stem from disruptions to normal trading patterns in the wake of last year's outbreak. We have made some upwards adjustment to our forecasts for those developments. However, the coming quarters could see unusual price movements in many categories.

Looking at the broader trends in prices, inflation pressures are building, with core measures trending back towards 2%. In part, this has been underpinned by disruptions to global manufacturing and shipping in the wake of last year's outbreak, as well as the related increase in commodity prices. The resulting shortages have seen rises in the prices for some imported consumer goods (or at least less discounting than usual). Supply disruptions are now also spilling over into increases in costs of production in sectors like construction. We expect this will boost consumer prices over the coming months.

But while prices are on the rise for now, we expect the upcoming firming in inflation will be temporary and that inflation will drop back again next year. Global production levels have been ramping up in recent months, and the disruptions to local and international distribution networks will eventually clear. At the same time, economic activity in New Zealand remains below trend and unemployment remains above the levels we saw prior to the outbreak.

Details.

The major factor adding to the CPI in the early part of this year has been the rise in petrol prices. Global oil prices have risen strongly in recent months. That's resulted in local pump prices rising by around 5% over the March quarter, and the related increase in transport costs is also boosting prices in the economy more generally.

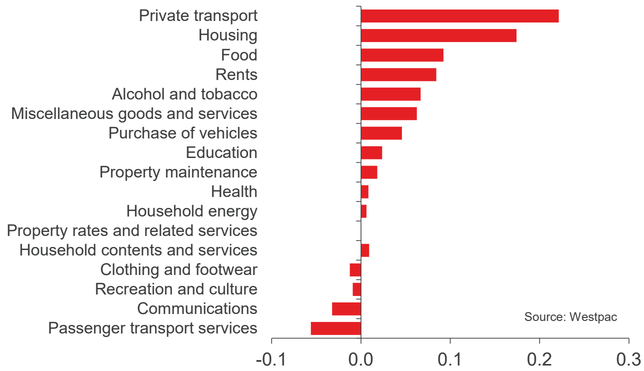
Prices are also on the rise in the housing and construction sectors. With low interest rates boosting the demand for houses, new home construction has been charging higher. At the same time, supply shortages have seen input costs climbing. Combined, those conditions signal a sharp rise in the cost of home building in the early part of this year. We've pencilled in a 2% increase in the cost of purchasing a newly built home.

Adding to the rise in housing costs, we're forecasting a 0.8% rise in housing rents. The March quarter tends to see larger increases in rents, with the start of the year typically seeing a large number of new tenancies commencing or existing ones rolling over.

Food prices will also be a positive contributor to the March quarter result. However, the 0.5% increase in prices over recent months has actually been more modest than we usually see at this time of the year.

On the downside, international airfares typically drop sharply in the March quarter, and we are forecasting a drop. However, this is a key area of uncertainty for our forecast. Travel with Australia has been opening up again since late last year. Even so, international flight capacity has been severely curtailed since the outbreak and airlines are struggling with rising costs and reduced demand. As a result, prices may not follow the normal seasonal pattern. We expect a 5% drop - a smaller fall than we typically see at this time of year.

Contributions to Q1 CPI forecast (percentage points)



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