

Economic Bulletin.

18 January 2021



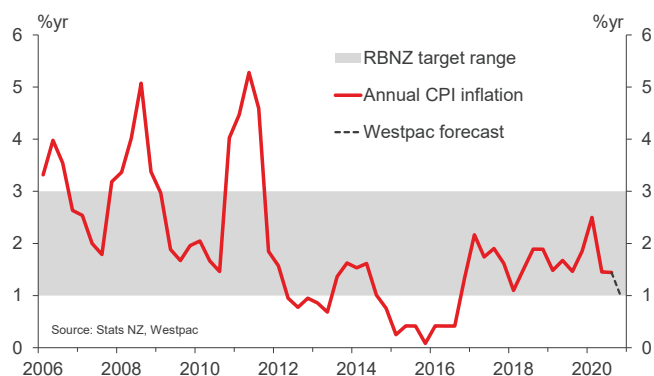
Preview of December quarter CPI: 22 January, 10:45am.

- We expect consumer prices to be flat for the December quarter, which would see the annual inflation rate drop to 1.0%.
- Food prices have eased off from their winter highs.
- Travel-related prices will make a smaller than usual contribution.
- Disruptions to imports could have an impact on prices, albeit temporarily.
- Our forecast is slightly lower than market and Reserve Bank estimates.
- Ongoing monetary policy support will be needed to keep inflation on target.

Michael Gordon, Senior Economist

+64 9 336 5670

Annual inflation forecast



Economic activity in New Zealand has bounced back rapidly after the shock of the Covid-19 lockdowns last year. For the Reserve Bank, though, the piece of the puzzle that's still missing is evidence of sustained inflation pressures.

The December quarter CPI, to be released this Friday, is likely to show a further slowdown in inflation over the near term. We expect a flat outturn for the quarter, which would see the annual inflation rate drop from 1.4% to 1.0%. That's on the lower side of market forecasts, and a little below the RBNZ's forecast of 1.1% annual.

The reasons for our lower forecast are on the tradables side of the CPI, where price changes tend to be more transitory and are a less immediate concern for the RBNZ. That said, the more domestically driven non-tradables component has also softened since the Covid shock, and we expect it to slow further in the early part of this year. Monetary stimulus will be needed for some time to get inflation back on target.



Details.

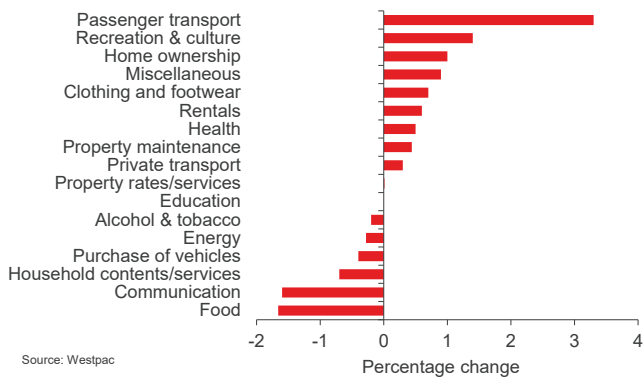
The December quarter CPI is usually a soft one, mainly due to seasonal declines in food prices as we enter spring and summer. Some fruit and vegetable prices were elevated over winter due to Covid disruptions, which had led to a relatively large 1.7% pullback in food prices in the December quarter.

At the same time, some of the usual seasonal increases will be absent this time. Overseas airfares normally rise sharply in the December quarter, during the peak summer holiday period. But with the international borders largely closed, overseas airfares are being temporarily excluded from the CPI. We do expect to see some increase in domestic airfares and vehicle rentals, but by less than usual.

Housing-related inflation continues to bubble away. Average rents have been rising steadily, though with some differences at the regional level. The strength in house sale prices in recent months suggests that prices for new home builds will soon follow.

The main uncertainty for our forecast is around the recent disruptions to imports, with delays in some arrivals and a rise in shipping costs. We haven't seen much evidence of outright increases in retail prices as a result, but it could manifest instead as a reduction in discounting, which would have the same effect on the CPI. This presents some upside risk to our forecast, although any impact on the inflation rate would be temporary and it's likely that it would eventually be unwound.

Contributions to Q4 CPI forecast



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

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