8 October 2015

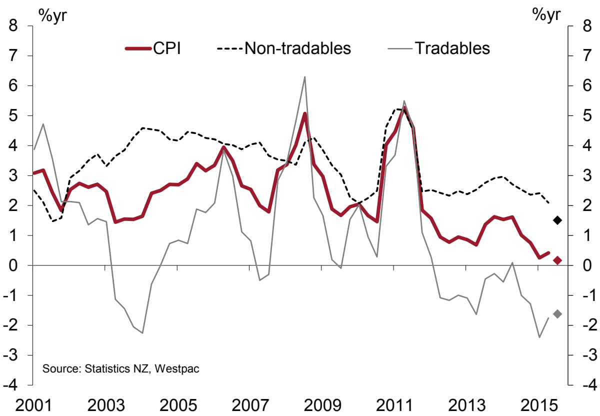
Westpac Institutional Bank

Cost-cutting drive

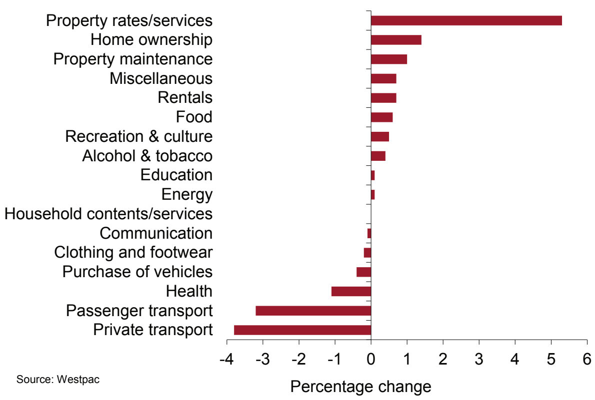
September quarter CPI preview: 16 Oct, 10:45am

- We estimate that the Consumer Price Index (CPI) rose by just 0.1% in the September quarter, bringing annual inflation down to a new cycle low of 0.2%.
- A sharp drop in vehicle registration fees will alone reduce inflation by around 0.3 percentage points.
- We expect the weaker New Zealand dollar to have had only a modest impact on prices to date.

CPI inflation



Components of quarterly inflation



New Zealand's run of very subdued inflation is likely to continue with next Friday's release of the September quarter CPI figures. We expect an increase of just 0.1% for the quarter, reflecting changes in various government charges. This would take annual inflation down to 0.2%, which we think will mark the low point of this cycle.

The ACC levy component of car registrations was slashed in July. We estimate that this alone will knock about 0.3 percentage points off the inflation rate over the next two years (another similar-sized cut is planned for next year). We also expect a modest drop in healthcare costs, with the government subsidising free doctors' visits for 6-12 year olds.

These two factors will be partly offset by an unusually large annual increase in local body rates, led by Auckland Council's whopping 9.9% increase. We expect an overall increase of around 6%, compared to an average of 3.8% in recent years.

Aside from government charges, the most significant change that we expect for the September quarter is a sharp drop in domestic airfares. Prices on some regional routes plunged as Jetstar re-entered the market; however, we can only guess at how much impact this will have on the nationwide average.

The remainder of the CPI is expected to continue the long-running themes of strong housing-related inflation (rents and new dwelling prices) against subdued import prices. We expect tradables prices to fall at a slower pace in the September quarter as the effects of a lower New Zealand dollar flow through. However, the greater impact from the exchange rate is more likely to be felt next year.

Our forecast of a 0.1% quarterly increase is less than the Reserve Bank's forecast of 0.3% in the September *Monetary Policy Statement*. However, our annual inflation forecast of 0.2% is in line with the RBNZ, due to some recent upward revisions to the March and June quarters. We think that the result would have to be significantly weaker than this to prompt another OCR cut at the 29 October review given that dairy prices – the RBNZ's biggest concern in September – have improved dramatically since then.

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