Westpac

Institutional Bank

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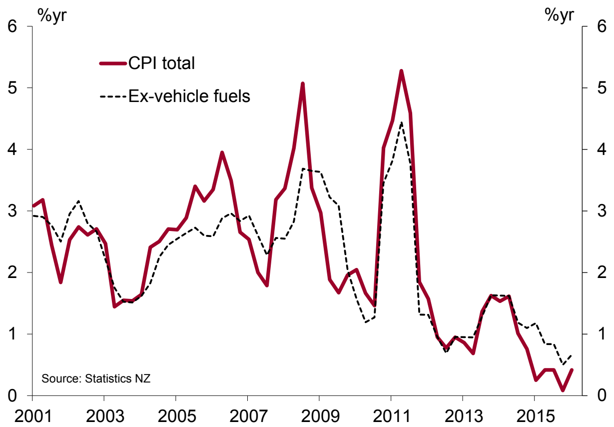
No fuel for the fire

Mar quarter consumer prices rose 0.2%, annual inflation 0.4%

- The Consumer Price Index (CPI) rose 0.2% in the March quarter, slightly ahead of market forecasts. Annual inflation rose from 0.1% to 0.4%.
- Lower oil prices helped to drive a sharp fall in fuel prices and airfares.
- Elsewhere, the lower New Zealand dollar over the last year led to some moderate upward pressure on prices of imported items.
- The result was in line with the Reserve Bank's forecast, with a mild upside surprise on the more domestically driven non-tradables component.
- We expect another cut to the OCR in the near future. But today's release detracts from the case for a move as soon as next week.

CPI inflation



Consumer prices rose 0.2% in the March quarter, reflecting a balance between falling fuel prices, the delayed impact of the lower New Zealand dollar, and some administrative price increases. The annual inflation rate rose from 0.1% to 0.4%, due to a particularly ugly -0.2% print in the March quarter last year now dropping out of the calculation.

The result was slightly ahead of market forecasts (including our own) that were clustered around a 0.1% quarterly rise. However, it was right in line with the Reserve Bank's forecast in its March *Monetary Policy Statement,* and may even constitute a mild upside surprise given a larger than expected 1% rise in the non-tradables category, which is considered to be driven more by domestic conditions.

Persistently low inflation argues for keeping monetary conditions loose, and we expect at least one more OCR cut this year. However, today's CPI release does not add to the case for a cut as soon as next Thursday's review. Market pricing for a cut next week has receded to around a 30% chance, which is more in line with our own assessment.

Details

The makeup of the March quarter CPI was in line with what we expected, with the surprises largely being around the magnitude of the biggest price movements. The largest increases came from a 9.4% increase in tobacco, reflecting the last of the scheduled hikes in tobacco excise duty, and a 2.5% rise in education fees at the start of the new study year.

The main negative influences were connected to the steep fall in world oil prices. First, prices at the pump were down 7.7% for petrol and a whopping 17.7% for diesel. Second, there were sizeable falls in airfares, due to a combination of cheaper fuel, seasonal changes, and in the case of domestic airfares, new competition on some regional routes. That said, the price falls (domestic airfares down 4.8%, international airfares down 11.9% and package holidays down 7.2%) were less than what we had assumed. Combined with a bigger than expected increase in accommodation prices (up 4.9%), this suggests that the growing demand for travel may be helping to prop up prices.

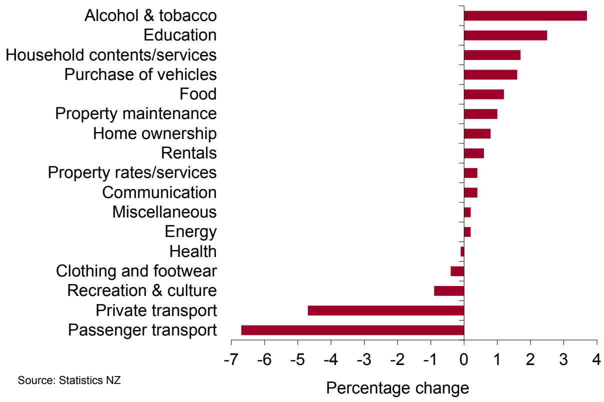
As we expected, there was a moderate degree of pass-through from last year's decline in the New Zealand dollar, including a 1.7% price rise for household contents and a 1.6% rise in car prices. Exchange rate movements tend to have a delayed impact on retail prices, and the timing is not easy to pin down – indeed, this was one aspect that fell substantially short of our forecasts in the previous quarter.

Interestingly, the housing-related areas of the CPI were more subdued than we expected. The price of newly-built homes rose by a relatively low 0.8% for the quarter, although the annual increase held steady at 5%, highlighting the capacity pressures on the construction industry. Meanwhile, rental growth slowed from 2.5%yr to 2.3%. This was largely due to a sharp slowdown in the Canterbury region, as the housing stock gradually recovers from the earthquakes.

The various core measures of inflation, which can strip out volatile items such as fuel, food or government charges, generally showed an uptick in the annual rate of increase, emphasising that the increase was reasonably broad-based (just as the slowdown in inflation last quarter was broad-based). We wouldn't be surprised if the RBNZ's sectoral model of core inflation, published later this afternoon, shows a small pickup as well.

Michael Gordon
Senior Economist

Components of quarterly inflation



Source: Statistics NZ

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