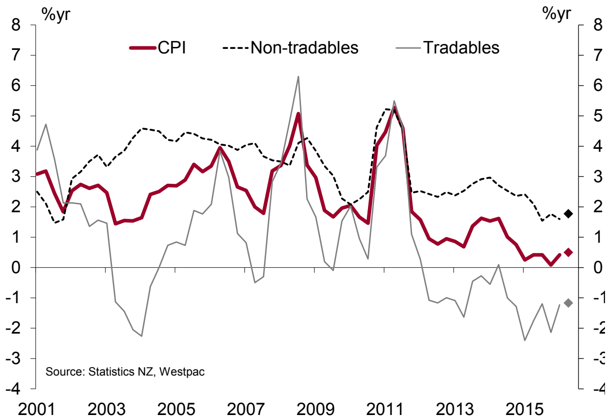
Westpac Institutional Bank

Two steps forward

June quarter CPI preview: 18 July, 10:45am

- We expect a 0.5% increase in the June Consumer Price Index (CPI), both quarterly and annual.
- A bounce in fuel prices after their early-year plunge accounts for about half of the expected increase for the quarter.
- The underlying picture remains one of muted price pressures outside of the housing group.
- Our pick is below the Reserve Bank's forecast of 0.6%, and we see further downside risk to inflation over the coming year if the New Zealand dollar sustains its recent rise.

CPI inflation



We are expecting a 0.5% increase in the CPI for the June quarter, which will be released next Monday. That quarterly increase would also lift the annual inflation rate to 0.5%, a second modest gain after bottoming out at just 0.1% at the end of 2015.

A rebound in fuel prices and ongoing gains in the housing-related categories are expected to account for most of the quarterly increase. Elsewhere, the picture looks similar to recent quarters, with muted passthrough from last year's fall in the New Zealand dollar and no real sign of home-grown inflation pressures emerging outside of housing.

With world oil prices having bounced back from their early-year plunge, the risk of New Zealand slipping into outright deflation seems to have passed. But the return to the midpoint of the Reserve Bank's inflation target is likely to remain a very gradual process. And even more so if the sharp rise in the New Zealand dollar in recent weeks is sustained.

Our forecast is below the Reserve Bank's forecast of a 0.6% increase, although we'd add that our forecast is a 'high' 0.5%, meaning we see a slightly greater chance of it turning out higher. At the margin, an outturn below the RBNZ's forecast might help to turn the market's attention away from housing and financial stability concerns, and back towards the primacy of the RBNZ's inflation target. But in our view, the stronger NZ dollar already presents a greater challenge to the inflation outlook than anything that might come out of next week's release.

Details

The gyrations in world oil prices will once again make a significant contribution to New Zealand's CPI. In the previous quarter, the drop in fuel prices subtracted 0.35 percentage points from the CPI; this time, we estimate that it will add 0.25ppts. Note that petrol prices swings are likely to feature in the next quarter as well: thanks to the stronger NZ dollar, the rise in petrol prices over March and April has already been almost completely unwound.

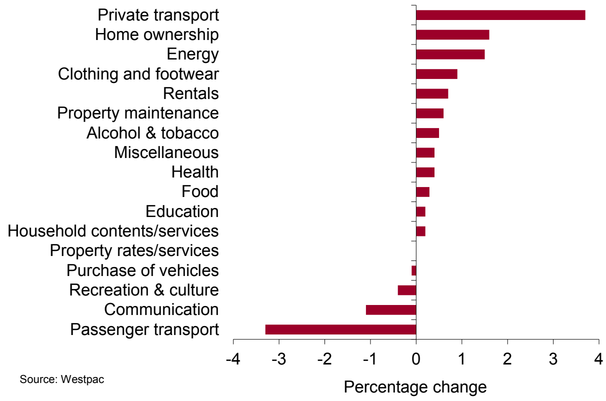
Setting fuel aside, we expect some modest upward pressure on tradable goods prices, as the fall in the New Zealand dollar last year continued to have a lagged impact. However, the sum of the exchange rate impact to date has been fairly muted compared to history, and we suspect that it is close to having run its course. Over the next year or so, the NZ dollar is shaping up to become a disinflationary force again.

The ongoing pressures in the housing market mean that we are likely to see further strong gains in rents and newly-built dwelling prices. Price increases in these two categories are running at around 2.5% and 5% a year respectively, although it's notable that neither has shown any further acceleration in the last few quarters.

There are no special factors such as government charges this time, and while there are a few seasonal price movements in the June quarter, they tend to balance out. Electricity prices are typically reviewed annually during the June quarter (we estimate a 1.5% increase), while domestic airfares usually decline after the peak summer travel period.

Michael Gordon
Senior Economist

Components of quarterly inflation



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