

Low

December quarter CPI preview: 20 Jan, 10:45am

- We expect the annual inflation rate to fall to a fresh low of 0.2% in the December 2015 quarter.
- The Consumer Price Index (CPI) typically falls in the December quarter due to seasonal effects. However, we expect a larger than usual 0.4% decline this time, led by falling petrol and food prices.
- Even with a weaker New Zealand dollar boosting import prices, we expect inflation to remain below the 1-3% target band until the end of this year.

The inflationary pulse remained very soft over the last year despite a weaker New Zealand dollar, as falling world commodity prices and growing spare capacity had the greater influence. We estimate that the CPI fell by a further 0.4% over the December quarter, which would bring annual inflation down to 0.2%, a new low point for the current cycle. This would be another mark in favour of our view that the OCR will need to be cut further.

The CPI typically falls in December quarters, due to the seasonal influence of items such as fruit and vegetables. However, the 0.4% fall that we're expecting would be even larger than usual, due to two factors in particular. First, the fall in food prices was unusually large (down 2.1%), with declines in meat and groceries as well as fresh produce. Second, the renewed plunge in world oil prices dragged down petrol prices by more than 5% over the quarter. Indeed, the fall over the December 2015 quarter was just as large as in the December 2014 quarter, meaning no net impact on the annual inflation rate.

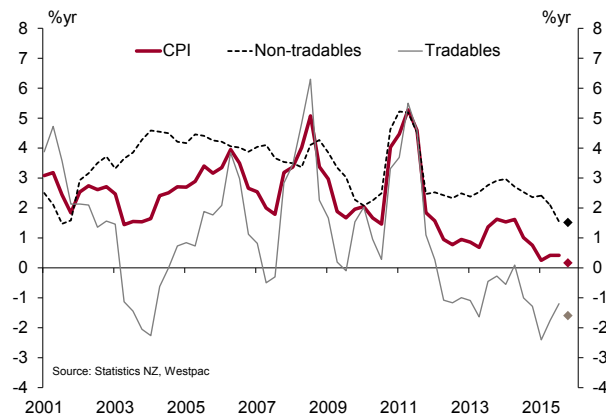
Outside of food and fuel, we expect modest gains in tradable goods prices, with the fall in the New Zealand dollar over the last year or so gradually feeding through into retail prices. We expect this process to continue over 2016, although we don't think it will be enough on its own to lift annual inflation back within the 1-3% target band until the end of this year.

We expect the story on non-tradable goods and services to be similar to recent quarters, with rising prices in housing-related categories but limited price pressures elsewhere. The biggest wildcard for the quarter is domestic airfares: lower fuel prices and more competition on some regional routes suggest that airfares should be heading substantially lower, but quarterly movements are very volatile.

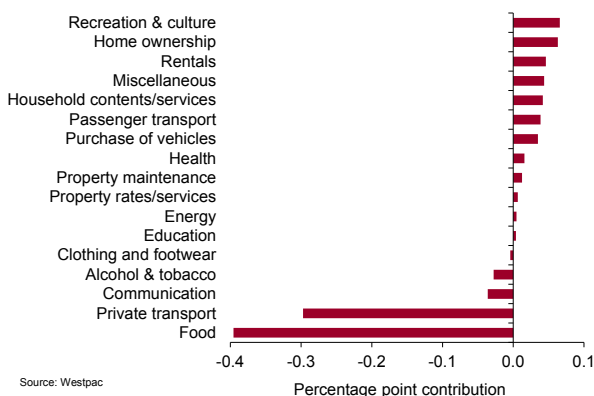
Our forecast is lower than the 0.4% annual inflation rate that the Reserve Bank forecast in the December *Monetary Policy Statement*, as food and fuel prices have fallen further since then. Crucially, this means it's now likely that annual inflation won't be back within the 1-3% target range by early this year, as the RBNZ had been counting on. The RBNZ's focus rightly remains on medium-term inflation, but the reality is that the longer that inflation remains below the target range, the harder it will be to justify looking through it. We expect the OCR to be cut further to 2% this year.

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CPI inflation



Components of quarterly inflation



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