Economic Bulletin.

13 July 2021

Preview of June quarter CPI: Friday 16 July, 10:45am.

- We expect the upcoming Consumers Price Index will show that New Zealand consumer prices rose by 0.8% in the June quarter.
- That would see annual inflation rising to 2.9% (up from 1.5% in March). That would be the highest annual inflation rate since 2010.
- Our forecast for June quarter inflation is higher than the RBNZ factored into their last set of published forecasts from their May policy statement.
- Underlying inflation is being boosted by a combination of higher oil prices, supply disruptions and firm conditions in the construction sector.
- Strength in demand has given businesses more leeway to pass on cost increases in the form of higher prices. This strength in demand also increases the risk that the lift in inflation will be more enduring.

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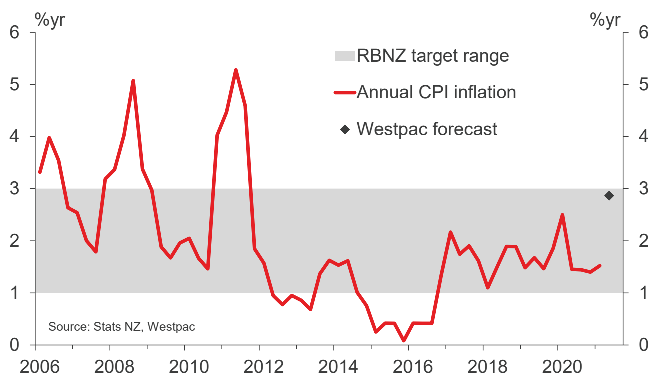
We're forecasting a 0.8% rise in consumer prices in the June quarter. That would see annual inflation rising to 2.9% (up from 1.5% in March). That would be the highest annual inflation rate since 2010's GST related spike.

Some of the increase in inflation in train is a result of Covid-related disruptions to normal pricing patterns. For instance, after plummeting in early 2020 as Covid spread around the globe, oil prices have doubled over the past year. In addition, in the wake of the outbreak we've seen significant disruptions to global shipping and the closure of the borders, with resulting shortages of materials and labour. That's seen costs of production pushing higher for many local businesses.

Significantly, these supply disruptions have come atop of much stronger than expected demand conditions. The past few months have seen economic activity consistently surprising to the upside, with strength in retail spending, a resilient housing market and improving trading conditions for businesses across a range of sectors. This firmness in demand has given businesses greater leeway to pass on cost increases into the prices of consumer goods.

Annual inflation forecast



Our forecast for June quarter inflation is in line with the median market forecast. However, it is higher than the 0.6% rise the RBNZ factored into their last set of published forecasts from their May policy statement. That's mainly due to our expectation of higher tradables inflation (which includes the import-heavy retail categories, like home furnishings).

Probably more important will be what this week's CPI report and recent demand indicators signal for the coming quarters. The RBNZ has assumed annual inflation will peak in the June quarter, with modest increase further ahead. However, we think that the inflation outlook is stronger than the RBNZ has been assuming. Consistent with that, we expect this week's measures of underlying inflation (like the RBNZ's sectoral inflation model and Stats NZ's core inflation measures) will also push higher this quarter, to levels close to or above 2%.

Details.

The major category that added to the CPI in the June quarter was food prices, which were up 1.6% over the quarter. Much of that rise is related to the seasonal increases in vegetable prices. We've also seen firmness in the prices for restaurant and takeaway meals following the recent increase in the minimum wage.

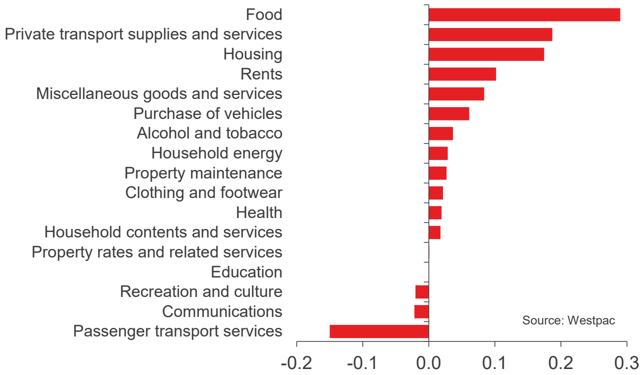
Transport costs will also be a significant contributor to June quarter inflation. Global oil prices have risen strongly in recent months, with local petrol prices up by around 4.3%. The related increase in transport costs is also boosting prices in the economy more generally.

Prices are also on the rise in the housing and construction sectors. With low interest rates boosting the demand for houses, new home construction has been charging higher. At the same time, supply and staff shortages have seen input costs climbing. Combined, those conditions signal a sharp rise in the cost of home building in the early part of this year. We've pencilled in a 2% increase in the cost of purchasing a newly built home. Adding to the rise in housing costs, we're forecasting a 1% rise in housing rents.

On the downside, we're expecting a pullback in international airfares after last quarter's rise. This is a key area of uncertainty for our forecast as the normal seasonal pattern in airfares has been disrupted by restrictions on travel. Airfares to Australia were slashed when the travel bubble was opened in April. However, there is some uncertainty about prices for some routes which haven't been updated since the border closed last year.

The other key area of uncertainty around our forecasts is the price of used cars. We're expecting another solid increase in prices in June, building on gains seen in earlier months. However, prices for used cars are now well above pre-Covid levels, and there is a possibility that we will see some easing off in price growth.

Contributions to Q2 CPI forecast (percentage points)



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