WESTPAC ECONOMIC BULLETIN

CPI preview, September quarter 2022 – Tuesday 18 October, 10:45am.

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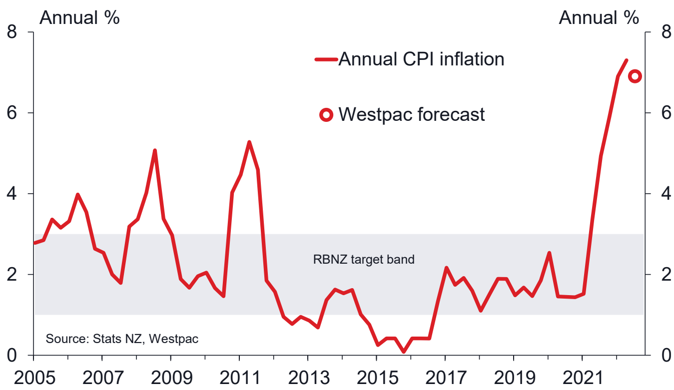
Even less bang for your buck.

- We expect the upcoming Consumers Price Index will show that New Zealand consumer prices rose by 1.8% in the September quarter.
- That would see annual inflation slipping to 6.9%, down from 7.3% last quarter. Nevertheless, that would still leave us with a picture of consumer prices that are continuing to charge higher, with annual inflation running close to multi-decade highs.
- The September quarter saw particularly large increases in food prices and housing related costs. Those increases were only partially offset by the easing in fuel prices.
- Measures of core inflation are expected to remain elevated, consistent with the ongoing pressure on wages and other operating costs, as well as the resilience in demand.
- Our forecast is higher than the RBNZ's last published forecast. A result in line with our forecast would reinforce the recent rise in market pricing for the OCR.

Annual inflation forecast



Next week's Consumers Price Index (CPI) is set to reveal another big rise in consumer prices. We're forecasting a 1.8% increase in the CPI over the three months to September. That would see the annual inflation rate slipping to 6.9%, down a little from the 32-year high of 7.3% that was reached in the June quarter. Even so, it will still leave us with a picture of consumer prices that are continuing to charge higher.

The September quarter inflation result will be boosted by the seasonal rise in vegetable prices, along with the annual increases in local council rates and alcohol taxes. But underlying the large price rises in those specific areas, we're also continuing to see widespread inflation pressures rippling through all corners of the economy.

In part, that broad-based strength in inflation is due to continued pressure on businesses' operating costs. Notably, recent months have seen wage costs rocketing higher as businesses have struggled to attract and retain staff.

Those elevated cost pressures have been compounded by the continued firmness in demand. That's been seen most clearly in the construction sector, with building activity charging higher over the past year. However, strong demand has also seen growing pressures on operating capacity in other parts of the economy, especially in service sector industries like hospitality.

That combination of firm demand and the related pressures on operating costs will also be reflected in measures of core inflation. Those measures track the underlying trend in prices, and we expect they will continue to run well above the RBNZ's 1% to 3% target band.

Up the elevator, down the stairs – inflation past its peak.

While the economy is continuing to be buffeted by powerful inflation headwinds, the annual inflation rate is actually expected to soften in the September quarter. That easing is mainly due to swings in petrol prices, which rose rapidly over 2021 as the global economy emerged from the pandemic and the demand for fuel picked up again. While prices at the pump remain well above the levels we saw prior to the pandemic, they have dropped sharply in recent months. In addition, the very large petrol price increases that we saw last year are now dropping out of the annual CPI calculation. Nevertheless, this still leaves us with annual inflation that is running close to a multi-decade high, signalling ongoing pressure on households' spending power.

September quarter inflation to reinforce the RBNZ's hawkish bias.

Our forecast for September quarter inflation is higher than the RBNZ's latest published forecast for a 1.4% rise. However, the RBNZ's forecast was finalised in August, and since that time we have seen a hawkish shift from the central bank. At its October policy review, the RBNZ signalled larger increases in the Official Cash rate will likely be needed to dampen inflation than it previously anticipated. That suggest that the RBNZ is already braced for a stronger rise in the CPI.

Recent weeks have seen financial markets pricing in the likelihood of large Official Cash Rate increases continuing into the new year. A result in line with our forecasts would cement those moves.

Breakdown of expected price movements.

The largest contribution to inflation in the September quarter is expected to be food prices, which have risen by 4.1% over the past three months. That's mainly due to the seasonal rise in vegetable prices, which was a bit larger than usual this year due to earlier poor weather. However, we've also seen sizeable increases in some other categories. For instance, grocery prices have been boosted by strong international demand for commodities and ongoing disruptions to global supply chains. In addition, wage costs have been pushing higher, contributing to large increases in the prices for some takeaway food and restaurant meals.

The September quarter will also see the annual increase in the alcohol excise duty. That increase is based on the rise in the CPI for the 12 months to March 2022, which was 6.9%. That's more than double the average increase we saw in the years leading up to the pandemic. In addition, we're likely to see some producers passing on other cost increases at the same time as prices are adjusted for the excise tax.

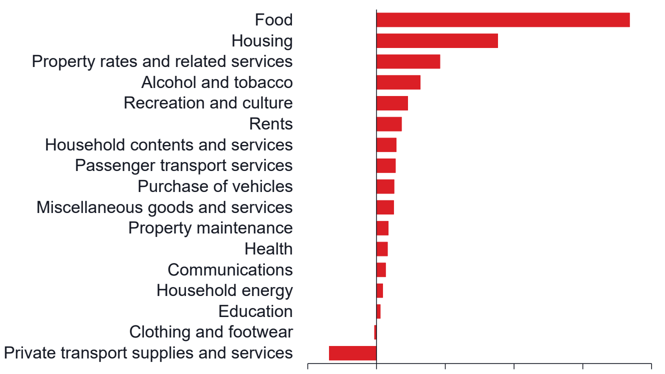
Housing related costs will again be a big driver of the overall rise in the CPI, with increases coming on several fronts. First are the continued large increases in the cost of a newly built home. We've pencilled in a 3.5% increase in building costs this quarter, following similarly large rises over the past year. Although earlier shortages of materials have started to ease, building firms have continued to face strong pressure on their margins. Notably, construction firms are continuing to face difficulties sourcing staff, and labour costs are rising rapidly.

Adding to the pressure on housing costs this quarter is the annual increase in local authority rates, which we estimate were up around 6% this year.

Finally, housing rents rose by around 0.8% in the September quarter. That's a larger increase than we typically see at this time of year (housing rents are the single largest item in the CPI, accounting for just under 10% of the basket.

Providing some offset to the above increases have been lower petrol prices. Prices at the pump have fallen by around 3.4% over the past three months as the price of international oil has fallen. That seen the price of 91-octane dropping to around $2.57 ltr.

Contributions to Q3 CPI forecast (percentage points)



Source: Westpac

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