ECONOMIC BULLETIN

CPI preview, September quarter 2023 – Wednesday 17 October, 10:45am.

6 Oct 2023 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

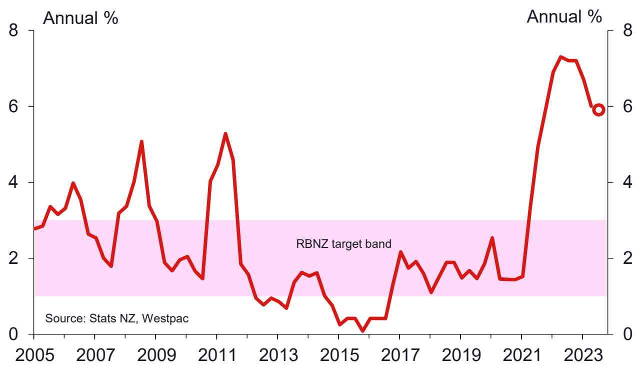
Sticky core

- **Given the likely importance of the upcoming CPI report for the decision that the RBNZ will make at the November Monetary Policy Statement, we thought it would be useful to set out our current expectations based on the indicators we have to hand.**
- **We currently expect that the upcoming CPI report (due for release on 17 October) will show consumer prices rose by 2.0% in the September quarter. That would see the annual rate edging back just slightly to 5.9%, down from 6.0% in the year to June.**
- **Our forecast is slightly below the RBNZ's forecast for a 2.1% rise. However, we don't think this signals any let up in the strong price and cost pressures that have been rife throughout the economy over the past year. In fact, core inflation is expected to remain red-hot.**

Consumer price inflation

	Jun 2023	Sep 23	
	Actual	Westpac f'cast	RBNZ f'cast (Aug MPS)
Headline inflation			
Quarterly	1.1%	2.0%	2.1%
Annual	6.0%	5.9%	6.0%
Non-tradables inflation			
Quarterly	1.3%	1.7%	1.7%
Annual	6.6%	6.3%	6.2%
Tradables inflation			
Quarterly	0.8%	2.4%	2.9%
Annual	5.2%	5.3%	5.8%
Core inflation (excl food and energy)			
Annual	6.1%	5.6%	-

Annual inflation (including Westpac forecasts)



Drivers of September quarter inflation – all gassed up and ready to go.

We'll finalise our forecast for September quarter inflation next week when Stats NZ releases updates on food prices and rents (which together account for about 30% of household spending). However, we've already got data on several key components of the CPI.

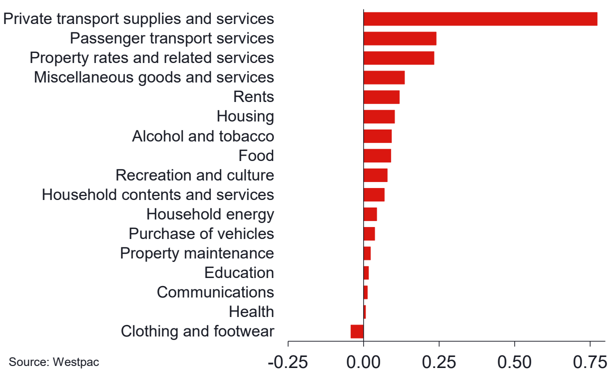
Underpinning our forecast for a large 2% rise in consumer prices in the September quarter are some special factors:

- First is the nearly 17% rise in fuel prices over the past few months. That's in part due to the reversal of last year's fuel tax reduction which added 25 cents/ltr to prices at the pump from 1 July. On top of that, recent months saw global oil prices pushing higher, while the New Zealand dollar dropped back. Combined, those conditions have seen petrol prices in many parts of the country rising back over $3 ltr – the highest they've been in more than a year. Note - Stats NZ has updated the weights of items in the CPI, and the weight on petrol has fallen from 4.9% in June 2022 to 3.9% now.
- This year also saw larger than usual increases in local council rates, which we estimate rose by an average of 7.7% across the country.
- Lastly, the September quarter also sees the annual increase in alcohol taxes.

On the downside, the past few months have seen a smaller than usual rise in vegetable prices than we usually see at this time of year. That's because supply conditions are gradually improving after earlier severe weather.

We've also seen a sharp slowdown in construction cost inflation over the past few quarters (albeit to what are still firm levels). Increases in construction costs were a major factor that pushed inflation over 7% last year. However, inflation in the sector has now taken a sizeable step down following the downturn in the housing market and as earlier supply chain disruptions have eased.

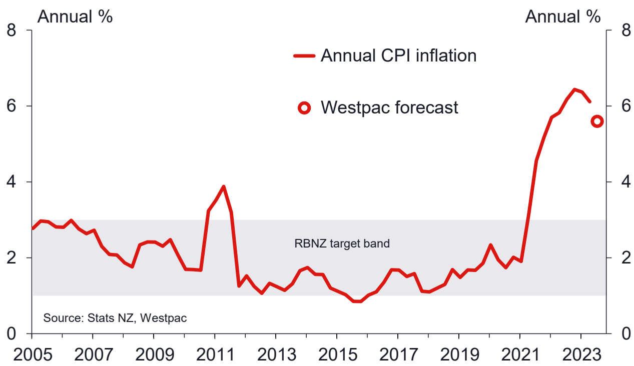
Contributions to September quarter inflation forecast (percentage points)



Core inflation pressures persist.

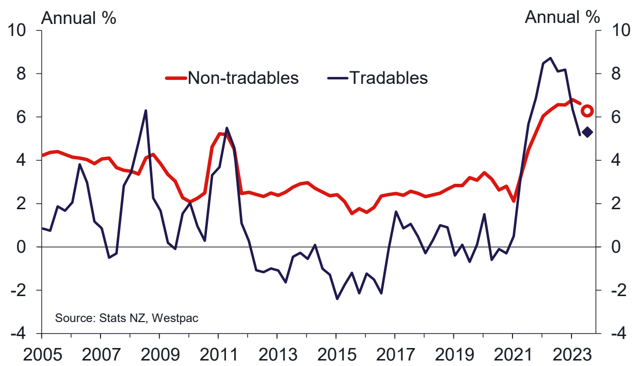
Monetary policy isn't focused on quarter-to-quarter swings in the prices of volatile items like petrol. Instead, the bigger concern for the RBNZ is what's happening to the underlying trend in prices. On this front, we expect most measures of core inflation (which track the underlying trend in prices) will again come in at levels of around 5% to 6%. In terms of specifics, we're forecasting that inflation excluding food and fuel will come in at 5.6%. That would be down from a rate of 6.1% last quarter, but would still be miles outside the RBNZ's comfort zone.

Core inflation (excl. food and petrol)



Importantly, we expect that domestic inflation (a.k.a. non-tradables) will remain elevated. We're forecasting a 1.7% increase in non-tradable prices over the September quarter, leaving them up 6.3% over the past year. That lingering strength in domestic inflation pressures is a particular concern for the RBNZ as it's domestic prices that changes in monetary policy have the biggest impact on. However, despite the 525 bp rise in the OCR over the past two years, non-tradables inflation is only easing gradually, at least at this stage.

Tradables and non-tradables inflation (incl. Westpac forecasts)



September quarter inflation unlikely to assuage the RBNZ concerns.

Our forecast for September quarter inflation is slightly below the RBNZ's forecast for a 2.1% rise. While our forecast for non-tradables is the same as the RBNZ, our forecast for tradables prices is lower. Although we have seen strong increases in fuel prices in recent months, food prices have been softer.

Surprises to the RBNZ's forecasts on either the up or downside which are related to volatile items like food or fuel would not have a big impact on their thinking. The key focus for the RBNZ will continue to be domestic and core inflation pressures, which are set to remain strong.

Where could we be surprised?

On balance, the risks to our forecasts are tilted slightly to the upside (which would push us closer to the RBNZ). However, there are some key areas of uncertainty that could throw around the September quarter inflation result.

First are the prices for services associated with travel and hospitality, such as airfares and accommodation. The normal seasonal patterns that we saw in these sectors have been disrupted since the pandemic. We're expecting some strong price increases in these areas, in part due to the FIFA world cup events. However, we could see send larger increases than expected.

Construction costs could also deliver an unexpected result, with demand softening but many operators still reporting pressure on margins.

Lastly, we could see large moves in the prices of many durable goods. Retailers have reported softening demand for items like appliances and furnishings. At the same time, shipping costs have continued to ease. Demand for motor vehicles may also have been impacted by consumer rushing to beat change in rebates/emissions charges.

In the previous quarter, non-tradables inflation was stronger than we or the Reserve Bank expected. The surprise to our forecast was broad based across sectors, highlighting the ongoing strength in domestic inflation pressures. We've incorporated that persistence in our updated forecast. Another similar surprise this quarter would be important information for markets and the RBNZ, reinforcing the upside risk for the OCR.

CONTACT

Westpac Economics Team | **westpac.co.nz/economics** | nzeconomics@westpac.co.nz

Kelly Eckhold, Chief Economist | +64 9 348 9382 | +64 21 786 758 | kelly.eckhold@westpac.co.nz

Satish Ranchhod, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Darren Gibbs, Senior Economist | +64 9 367 3368 | +64 21 794 292 | darren.gibbs@westpac.co.nz

Nathan Penny, Senior Agri Economist | +64 9 348 9114 | +64 21 743 579 | nathan.penny@westpac.co.nz

Paul Clark, Industry Economist | +64 9 336 5656 | +64 21 713 704 | paul.clark@westpac.co.nz

Shania Bonenkamp, Graduate | +64 21 796 895 | shania.bonenkamp@westpac.co.nz

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