WESTPAC ECONOMIC BULLETIN

CPI preview, December quarter 2022 – Wednesday 25 January, 10:45am.

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Past the peak, but still red-hot.

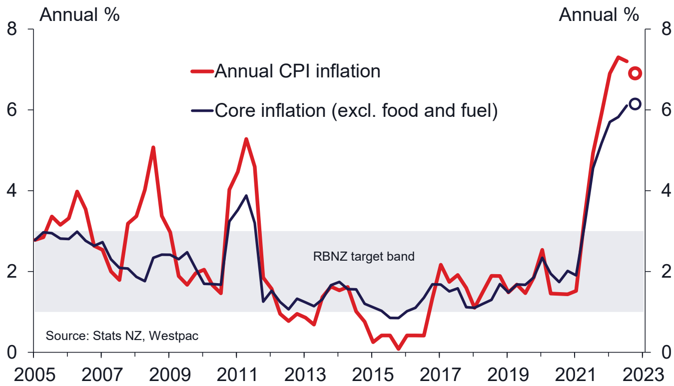
- We estimate that New Zealand consumer prices rose by 1.1% in the December quarter.
- That would see annual inflation slipping to 6.9%, down from 7.2% last quarter. Even so, that would still leave us with a picture of consumer prices that are continuing to charge higher, with annual inflation remaining close to multi-decade highs.
- The December quarter saw continued large increases in food prices and housing related costs. Those increases have been partially offset by falls in fuel prices.
- Our forecast is lower than the RBNZ's last published projection. A result in line with our forecast, while still high, would reduce the case for another jumbo-sized OCR hike next month.

Consumer price inflation

	Sep-22	Dec-22	
	Actual	Westpac forecast	RBNZ forecasts
Quarterly	2.2%	1.1%	1.7%
Annual	7.2%	6.9%	7.5%

Inflation looks like it's peaked. However, it's still running well above the RBNZ's target band. We estimate that consumer prices rose by 1.1% in the three months to December. That would see the annual inflation rate slipping to 6.9%, down from 7.2% in the year to September. But even with the annual inflation rate starting to soften, prices are still rising at an alarming pace. And that means an ongoing squeeze on households' spending power.

Annual inflation (including Westpac forecasts)



Much of the strength in inflation continues to be related to higher food prices and increases in housing related costs, including increases in rents and the continuing rise in building costs. Inflation has also been boosted by the post-Covid recovery in both domestic and international tourism, with prices for many travel and hospitality services pushing higher in recent months.

Providing some offset to those increase has been the sharp fall in petrol prices, with prices at the pump dropping by around 8% during the final months of 2022.

Most of the various measures of core inflation published by Stats NZ and the RBNZ have been running over 6% in recent quarters. We expect that they will have remained around those levels in the December quarter. That would be consistent with recent business surveys which have pointed to continued large increases in operating costs and output prices.

Downside risk for the RBNZ's inflation forecast.

Our forecast for a 1.1% rise in December quarter inflation is lower than the RBNZ's latest published forecast for a 1.7% increase. Some of that difference reflects that the RBNZ's forecast was finalised in November, and since that time petrol prices have continued to ease. But even accounting for lower fuel prices, we expect that inflation will fall short of the central bank's forecast.

Financial markets have been scaling back their expectations for interest rate hikes from the RBNZ in recent weeks. At the time of writing, market pricing was split roughly 50:50 between a 50 bp rise and a 75 bp rise at the February policy meeting (as a comparison, a 75 bp point hike was almost fully priced just before Christmas). That winding back of expectations follows recent signs that domestic activity is cooling, including falls in retail spending and gauges of business activity.

A December quarter inflation result in line with our lower inflation forecast would still leave us with a picture of strong and widespread price pressures. However, with signs domestic demand is now cooling, a downside surprise to the RBNZ's forecast would likely tilt market pricing further towards a 50 bp move in February.

Breakdown of expected price movements.

Housing related costs are expected to be the largest upside contributors to December quarter inflation. For the most part, that's due to the continued rise in the cost of a newly built home. Although the material shortages that dogged the construction sector over the past year have eased, we're still seeing pressure on build costs. That includes higher labour costs and contractor charges.

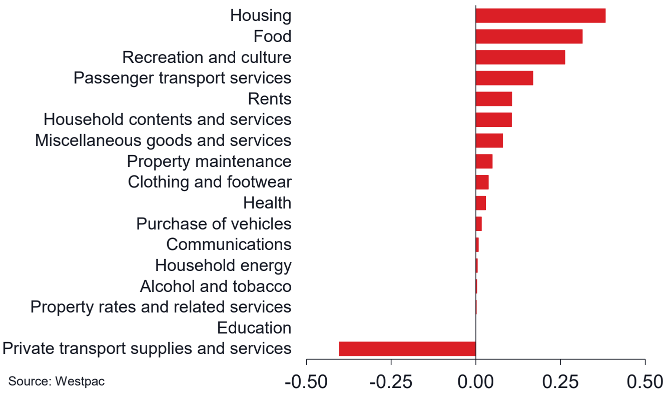
Adding to the pressure on housing costs, rents are estimated to have risen by around 1% in the December quarter. That's similar to the rise seen in recent quarters, continuing the trend of sizeable increases that we've seen over the past year (housing rents are the single largest item in the CPI, accounting for just under 10% of the basket).

Food prices are again set to be a major driver of overall consumer price inflation. Food prices rose by 1.8% over the past three months and are up a massive 11% over the past year. Historically food prices have tended to fall during the December quarter, with seasonal reductions in the price of fresh produce. However, domestic and international supply disruptions (including poor weather) have resulted in higher than usual prices for produce, meat and groceries. In addition, wage costs have been pushing higher, contributing to price rises for some takeaway food and restaurant meals.

December quarter inflation is also likely to be boosted by the post-Covid recovery in both domestic and international tourism. The effects of that resurgence in demand will be seen most clearly in higher international and domestic airfares, with tourist numbers rising rapidly while flight availability is still constrained. We also expect to see higher prices for services like accommodation. Again, staffing shortages and the related rise in wage costs have been key contributors to the rise in output prices.

Providing an offset to the above increases has been the sharp fall in petrol prices. Prices at the pump have fallen by around 8% over the past three months, with the price of 91-octane dropping to around $2.40 ltr.

Contributions to December quarter inflation forecast (percentage points)



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