ECONOMIC BULLETIN

CPI preview, September quarter 2024 – Wednesday 16 October, 10:45am.

11 Oct 2024 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Back in the band!

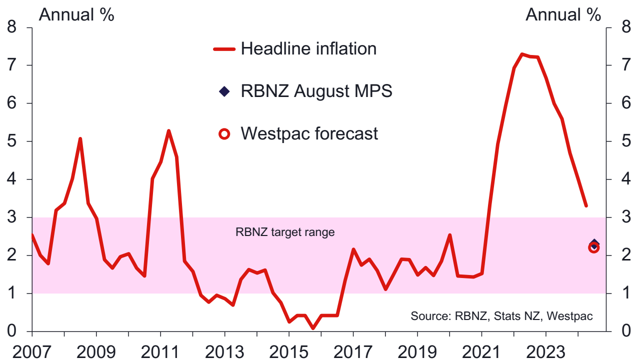
- **We estimate that New Zealand consumer prices rose by 0.7% in the September quarter.**
- **Annual inflation rate is expected to drop below 3% for the first time since 2021 and print at 2.2%.**
- **Our forecast is slightly below the RBNZ's forecast from their August Monetary Policy Statement reflecting weaker fuel prices in recent months as the oil price has fallen.**
- **There are risks on both sides for inflation. On the downside, the downturn in consumer spending could be an even larger drag on the prices of retail goods and some services. However, there is also a chance we see continued strength in the prices of items like insurance and rates, which have contributed to stronger than expected non-tradable inflation over the past two years.**

Consumer price inflation

	Jun 2024	Sep 2024 forecast	
	Actual	Westpac	RBNZ
Headline inflation			
Quarterly	0.4	0.7	0.8
Annual	3.3	2.2	2.3
Non-tradables inflation			
Quarterly	0.9	1.3	1.4
Annual	5.4	5.0	5.1
Tradables inflation			
Quarterly	-0.5	-0.1	-0.2
Annual	0.3	-1.5	-1.6

We expect New Zealand's September quarter inflation report (out on 16 October) will show that annual inflation has dropped below 3% for the first time since 2021. We estimate that consumer prices rose 0.7% over the past three months. That would see the annual inflation rate dropping to 2.2%, down from 3.3% in the year to June. That will be welcome news for households and businesses, and especially for the Reserve Bank.

Annual headline inflation



Our updated forecast incorporates information from Stats NZ's latest monthly Selected Price Index (SPI), which provides a timely gauge on 45% of the CPI, including some of the more volatile prices. The information in the SPI has prompted us to revised down our forecast from our earlier estimate for a 0.9% rise, mainly due to softness in fuel prices.

Our updated forecast for overall consumer prices is a little below the RBNZ's last published forecast for a 0.8% rise which was finalised back in August. However, with large drops in non-core items like petrol in recent months, the RBNZ is likely braced for a softer result.

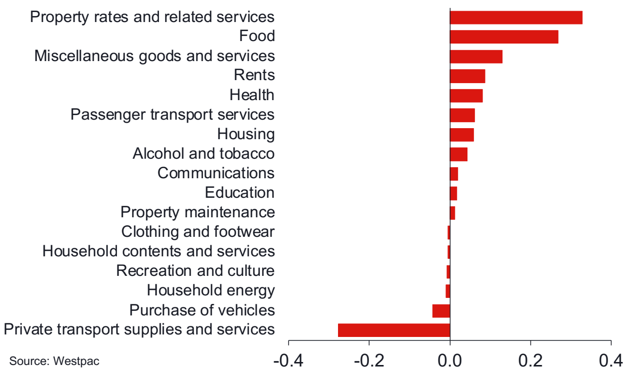
What's underlying our forecasts?

Underpinning our forecast for a 0.7% rise in consumer prices are big movements in some specific areas.

On the upside:

- Annual increases in local council rates (3% of the CPI) are expected to be the largest contributor to the rise in consumer prices. We estimate that rates have risen by an average of 10% over the past year, with large increases spread right across the nation.
- Food prices (19% of the CPI) will also be a large contributor to quarterly inflation, with Stats NZ's monthly prices data pointing to a 1.2% rise over the past three months. That includes a seasonal increase in the cost of fresh vegetables.
- Insurance costs (3% of the CPI, included in the 'Miscellaneous goods and services' group) are also expected to post another large rise of 4.2%. While still elevated, that's a bit more modest than the increases seen in recent quarters, reflecting that many insurance contracts have already rolled on to higher premiums over the past year.

Contributions to September quarter inflation forecast (percentage points)



On the downside:

- Petrol prices (4% of the CPI) have trended down over the past few months and are estimated to have fallen 6.5%.
- We're also expecting softness in the prices of many imported durable consumer goods. Of note, weakness in demand is expected to see prices for new and used cars falling by 1% and 1.5% respectively.

Annual inflation trending back to target.

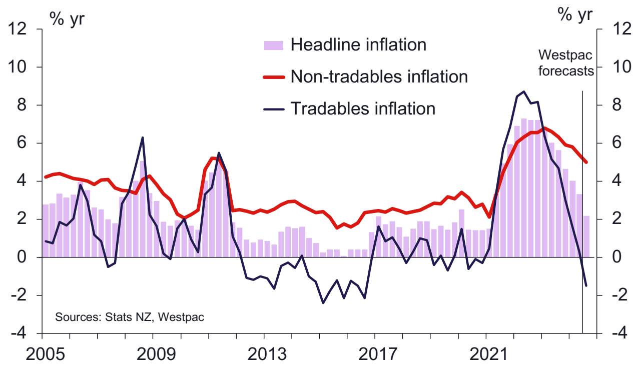
Of more note than the quarter-to-quarter swings in prices is the continued downtrend in annual inflation, which has been steadily falling for around two years now.

The downtrend in headline inflation is mainly due to the low level of tradables prices (mainly imported retail goods). We estimate that's tradable prices fell by 0.1% this quarter, leaving them down 1.5% over the past year. That in part due to falls in global prices as international supply conditions have improved over the past couple of years. The downward pressure on prices has been amplified by the pressures on household budgets and the related falls in discretionary spending.

Domestic price pressures have also been easing, but much more gradually. We estimate that non-tradable prices rose 1.3% in the September quarter, with the annual rate slowing to 5.0% September. While that would be down from 5.4% last quarter, it's still well above long-run averages. Although we have seen softness in some domestic prices, like construction costs, services inflation more generally remains elevated. We're also seeing continued large increases in many non-discretionary expenses, like the costs of insurance and local council rates.

The RBNZ places a lot of weight on non-tradable prices in their policy deliberations. And the 'stickiness' in non-tradables prices over the past year has meant that, even though imported inflation has fallen, overall consumer price inflation has been easing only gradually. Consistent with that, we expect that the various measures of core inflation (which smooth through volatile quarter-to-quarter price movements, and instead track the underlying trend in prices) will continue to trend down, but most are likely to remain above 3%. For instance, we estimate that inflation excluding food, fuel and energy costs will ease to 3.2% from 3.4% previously. However, some core inflation measures, like trimmed mean inflation could fall below 3%.

Inflation components



Key areas to watch and where could we be surprised?

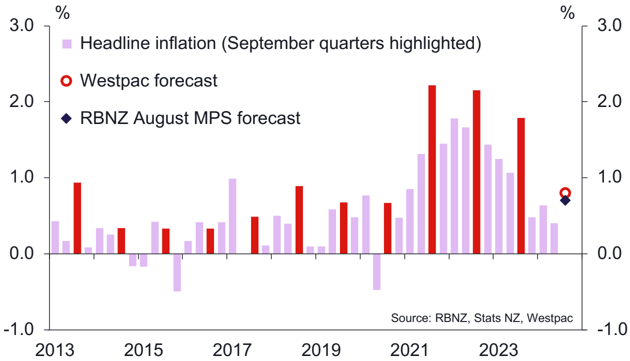
Even with the lingering strength in non-tradables prices, the drop in overall inflation means that the RBNZ is now feeling much more comfortable about the inflation. However, there are some key areas to watch that could be important for the stance of policy over the year ahead, with risks on both sides.

On the tradables front, we could see even greater weakness in the prices of imported consumer goods than we have allowed for. Financial pressures have been a big drag on households' discretionary spending, and a number of businesses have told us of poor sales in sectors like motor vehicles and household furnishings in recent months. With tradable prices heavily influenced by offshore conditions, the RBNZ often tends to deemphasise surprises on this front in their policy deliberations. However, continued downside surprises in tradable prices would raise the risk of inflation falling below 2% next year.

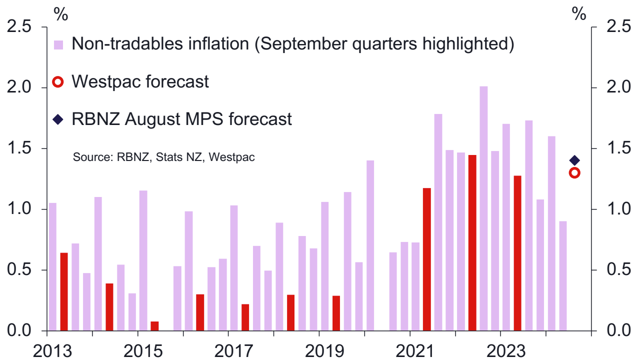
Of particular importance for the RBNZ will be the evolution of domestic prices, and the risks on this front are two-sided. Despite high borrowing costs in recent years, domestic inflation has continued to run hot. And while much of that strength has been related to items like insurance and local council rates, the strength in inflation has been widespread. As we have seen for the past few years, we could find that domestic price pressures have remained sticky. That would be important for how comfortable the RBNZ is feeling when it comes time to next review interest rates.

However, there is the potential for a faster easing in domestic prices in some interest rate sensitive areas. Recent months have seen a softening in the labour market and wages, and our own discussions with businesses have pointed to some easing cost pressures. We'll be watching to see how quickly those developments are being reflected in services pricing.

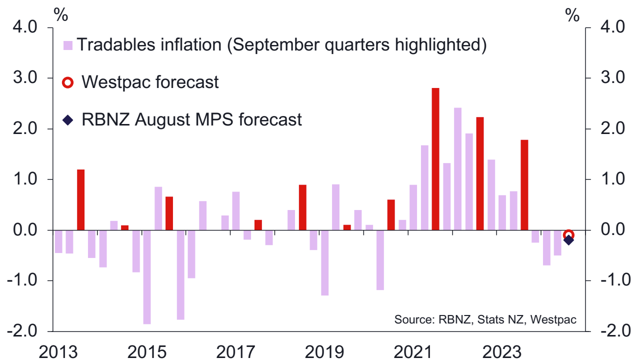
Quarterly CPI inflation



Quarterly non-tradables inflation



Quarterly tradables inflation



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