ECONOMIC BULLETIN

CPI preview, December quarter 2024 – Wednesday 22 January, 10:45am.

16 Jan 2025 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

Flirting with 2%

- **We estimate that New Zealand consumer prices rose by 0.5% in the December quarter. That's slightly higher than we previously expected due to a sharp rise in international airfares in December.**
- **The annual inflation rate is expected to slip to 2.1% (down from 2.2% in the year to September). That would be the lowest annual inflation rate since 2021.**
- **Our forecast for annual inflation is in line with the RBNZ's forecast from their November *Monetary Policy Statement*, though quarterly inflation could be slightly stronger than they expected.**
- **The underlying trend in inflation is looking much better contained than it has in a long time, with measures of core inflation drifting back towards the 2% mid-point of the RBNZ's target band.**

Consumer price inflation

	Dec 2024	Forecast	
	Actual	Westpac	RBNZ (Nov MPS)
Headline inflation			
Quarterly	0.6%	0.5%	0.4%
Annual	2.2%	2.1%	2.1%
Non-tradables inflation			
Quarterly	1.3%	0.8%	0.8%
Annual	4.9%	4.7%	4.7%
Tradables inflation			
Quarterly	-0.2%	-0.1%	-0.2%
Annual	-1.6%	-1.4%	-1.5%

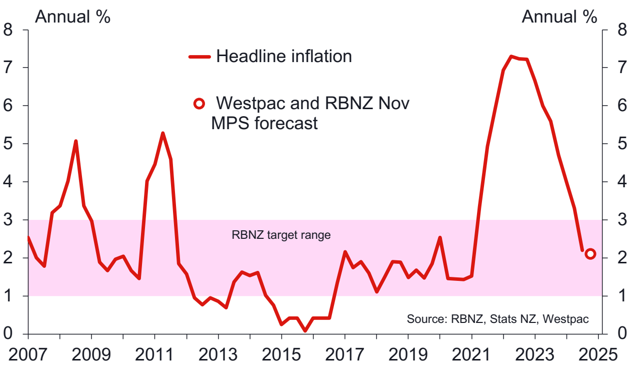
We expect New Zealand's December quarter inflation report (out on 22 January) will show that annual inflation is now tantalising close to the 2% midpoint of the RBNZ's target band.

We estimate that consumer prices rose 0.5% over the past three months. That would see the annual inflation rate nudging down to 2.1% (from 2.2% in the year to September). That would be the lowest annual inflation rate since 2021.

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 up our forecast from our earlier estimate for a 0.4% rise, mainly due to a sharper-than-expected seasonal rise in international airfares in December.

Our forecast for quarterly inflation is slightly stronger then the RBNZ's last published forecast for a 0.4% rise from their November MPS. However, our forecast incorporates today's strong rise in airfares, which the RBNZ may not have been aware of. Swings in the prices of such volatile items are not a key focus for monetary policy. More importantly, our forecast for 2.1% annual inflation is in line with the RBNZ's forecast, as is our forecast for non-tradables inflation. Overall, we don't expect the December quarter inflation report will deliver a big surprise for the RBNZ.

Annual headline inflation



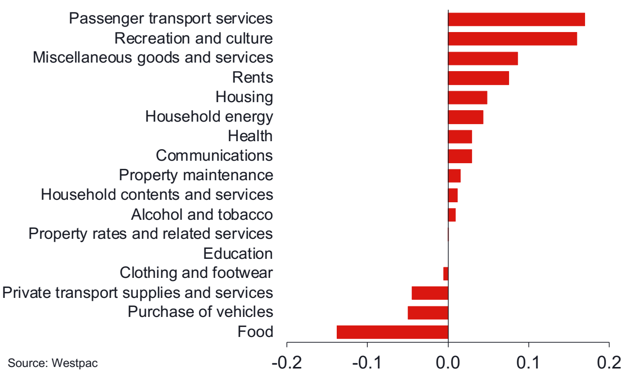
What's underlying our forecasts?

The December quarter is expected to see some large price movements in a few specific areas, mainly due to normal seasonal price swings.

The largest upside contributors to inflation are expected to be domestic and international airfares (up 9% and 7% respectively over the past three months), as well as holiday accommodation costs (up around 3%). Combined, those groups account for around 6% of the CPI and they typically record larger increases over the holiday months.

Insurance premiums (3% of the CPI, included in the 'Miscellaneous goods and services' group) are also expected to a record solid rise of around 3%. But although that is a sizeable increase, it's still a step down from the very large increases we saw over the past year, reflecting that many insurance contracts have already rolled on to higher premiums.

Contributions to December quarter inflation forecast (percentage points)



Balanced against those price rises, food prices (19% of the CPI) fell 0.6% over the quarter as a result of the usual seasonal fall in fresh produce prices. Notwithstanding price increases in the month of December, petrol prices (4% of the CPI) were also down 1.3% over the quarter. We're also expecting a further fall in vehicle prices due to the softness in consumer demand in recent months.

Annual inflation trending back to target.

More important than the quarter-to-quarter swings in specific areas is the underlying trend in consumer prices. On this front, annual consumer price inflation has dropped back sharply over the past year and is set to track close to 2% over the coming quarters.

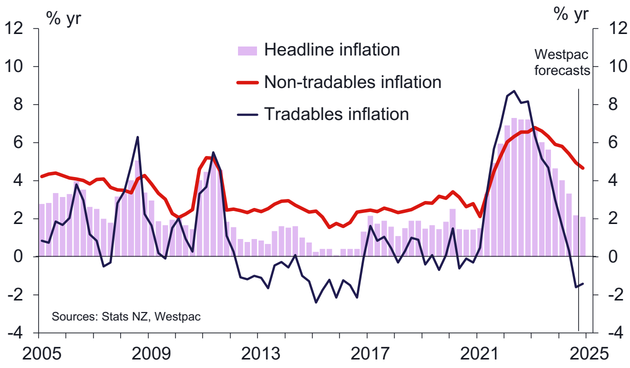
The downtrend in overall inflation is in large part due to the low level of tradables inflation (which mainly relates to imported retail goods). We estimate that tradable prices fell by 0.1% in the December quarter, leaving them down 1.4% over the past year. That's in part due to falls in global prices 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.

On the domestic front, we estimate that non-tradable prices rose 0.8% in the December quarter, which would see annual non-tradables inflation slowing to a still-elevated rate of 4.7%. But that firmness masks some important detail under the surface. Price and cost pressures have been cooling in some sectors of the domestic economy that are sensitive to the high level of interest rates in recent years. For instance, weak demand over the past year has contributed to a marked slowdown in construction cost inflation and has also restrained price increase in the hospitality sector. Continued softness in such areas will be an important signal for the RBNZ.

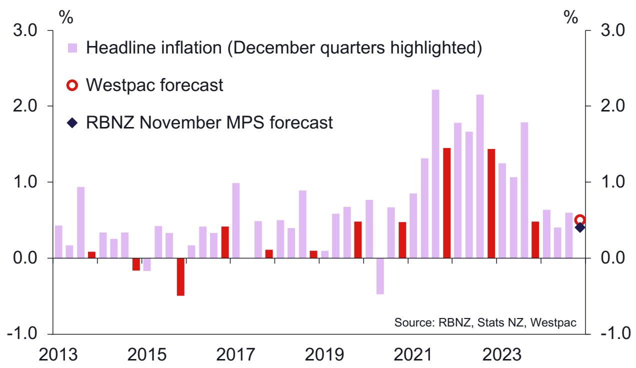
In contrast, we're still seeing solid increases in cost such as local council rates and insurance premiums, which tend to be less sensitive to the level of interest rates. The strength in those costs means that overall domestic inflation remains elevated despite the softness in domestic demand.

But even with the 'stickiness' in costs like insurance premiums, the overall trend in inflation is now looking much more benign than it has for a long time. That should be evident in a further easing in the various measures of core inflation which have been trending down to levels consistent with the RBNZ's target band in recent months. In terms of specifics, we estimate that inflation excluding food, fuel and energy costs will ease to 3.0% from 3.1% previously, while trimmed mean inflation is likely to fall to around 2.3%. (Note: 'Core' inflation measures smooth through volatile quarter-to-quarter price movements and instead track the underlying trend in prices.)

Inflation components



Quarterly CPI inflation



Where could we be surprised?

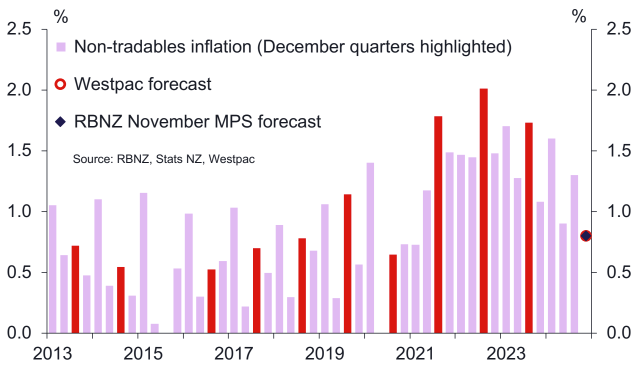
The risks around our inflation forecast are two-sided.

- On the downside, with weak household demand in recent months we could see greater than expected softness in the price of imported goods, such as household furnishings and apparel.
- On the upside, charges for services like insurance could remain stronger for longer than we have assumed.
- Particular areas of uncertainty include construction costs (10% of the CPI) and the cost of vehicles (4% of the CPI), both of which were softer than expected last quarter and can be volatile on a quarter-to-quarter basis.

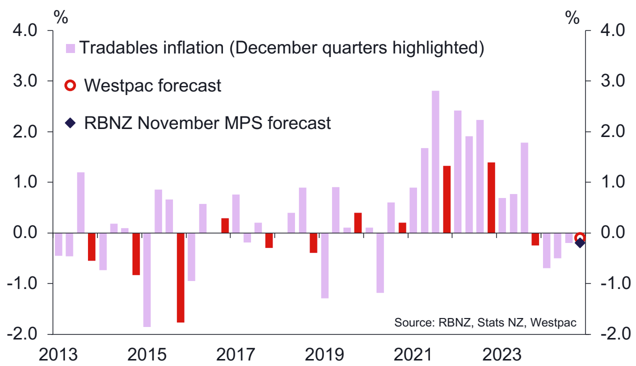
Given the risk of such volatility, the RBNZ is likely to be more focused on the underlying trend in inflation, which as noted above is now looking much better contained than it has in a long time.

One area that we're keeping a close eye on is the New Zealand dollar, which has fallen to its lowest level since 2022. Over time, that decline could push up the cost of some imported goods, such as petrol. This will be an important area to watch over the coming year and will likely be a consideration for the RBNZ's policy stance. However, the impact of the lower New Zealand dollar on next week's December quarter inflation report is expected to be modest. Soft consumer spending in recent months has continued to constrain price increases. In addition, many importers will have had foreign exchange cover in place or will have purchased goods ahead of the NZ dollar's recent fall.

Quarterly non-tradables inflation



Quarterly tradables inflation



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