WESTPAC ECONOMIC BULLETIN

CPI preview, March quarter 2022 – Thursday 21 April, 10:45am.

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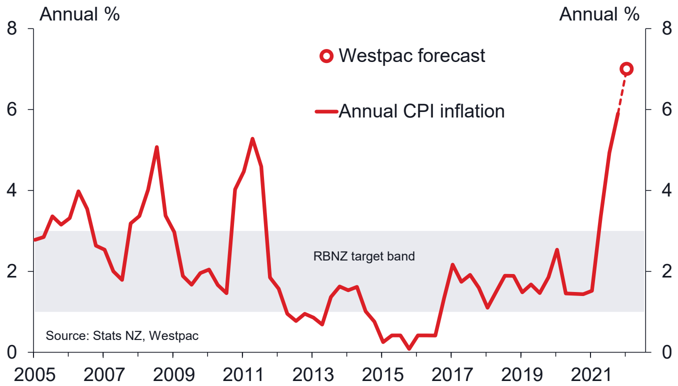
It's gonna be a monster.

- Price pressures are bubbling over in every corner of the New Zealand economy, boosted by a potent cocktail of supply-side cost pressures (including rising wages) and firm consumer demand.
- We expect the upcoming Consumers Price Index will show that New Zealand consumer prices rose by 1.9% in the March quarter.
- That would take annual inflation to 7%, up from 5.9% at the end of last year and the highest annual inflation rate in more than three decades.
- Our forecast is stronger than the RBNZ assumed in their last set of published forecasts. However, those forecasts were finalised several months ago, and we expect the RBNZ is already braced for a stronger result.

The March quarter inflation result is set to be another monster. We're forecasting that consumer prices rose by 1.9% in the three months to March. Coming on top of the large price increases that we saw last year, that would take the annual inflation rate to 7.0%, up from 5.9% at the end of last year and the highest annual inflation rate since the GST related spike in 1990.

Annual inflation forecast



Much of the rise in consumer prices seen in recent months is a result of high international oil prices. There have also been large increases in the prices for fresh produce and other food products.

But the high level of inflation isn't just due to a few specific items. Price pressures are bubbling over in every corner of the economy, boosted by a potent cocktail of supply-side cost pressures and firm consumer demand.

On the cost side of the ledger, we've seen continued shortages of many consumer goods and production inputs, with much of that a result of the ongoing disruptions to global manufacturing and supply chains.

Closer to home, domestic cost pressures have also been on the rise. Most notably, wages have been pushing higher as businesses are struggling to attract and retain staff. Those pressures have been exacerbated in recent months by the Omicron outbreak and related rise in worker absenteeism.

However, the increase in inflation isn't just a result of higher operating costs. Demand has also been running hot in some key parts of the domestic economy. That's important for two key reasons.

First, strong demand in some sectors has meant that businesses have had greater scope to pass on cost increases into output prices, rather than taking a hit on margins. That's been seen particularly clearly in the construction sector, which has been a key driver of the overall rise in consumer prices.

Second, if demand is strong, inflation is likely to remain elevated even when the current pressure on operating costs eventually eases off. That's especially important for the RBNZ, as a key factor underpinning the strength of household demand has been stimulus from low interest rates.

Our forecast for March quarter inflation is higher than the RBNZ's latest published forecast for a 1.4% rise. However, the RBNZ's forecast was finalised back in February, before the spike in global energy prices. It's likely that the RBNZ will be braced for a higher result on the day. Consequently, a result in line with our forecast isn't likely to prompt a change in the RBNZ's policy stance. Indeed, the RBNZ has already become increasingly hawkish in recent months. Earlier this week they hiked the cash rate by 50bps to 1.50% and signalled that further rate increases are coming. Westpac is forecasting a series of OCR hikes over the coming year, with the cash rate expected to peak at 3%.

Since the initial Covid outbreak, we have seen some large swings in the prices of many consumer goods and services, and we could see further sharp swings (both up and down) this quarter. Such movements could be exacerbated by the Omicron outbreak which has dampened demand in sectors like hospitality, while also compounding disruptions to business operations.

Despite such quarter-to-quarter volatility, underlying inflation pressure are set to remain strong. Businesses across the economy are reporting large increases in operating costs and output prices. Consistent with that, we expect the range of core inflation measures published by Stats NZ and the RBNZ will continue to run hot at levels well above the RBNZ's 2% target.

Details.

While inflation pressures are widespread, there are a few categories which we expect will post particularly large increases.

First up are food prices which have risen by 3.0% over the March quarter. That's the largest quarterly rise in more than a decade. Recent months have seen strong increases in the prices of fresh produce and meat, as well as larger than usual increases in the prices of many groceries.

Housing and construction costs are again set to be major drivers of the rise in overall inflation. We've pencilled in a 4.0% increase in building costs for the quarter, following similarly large quarterly rises last year. Building activity has been charging higher. At the same time, acute shortages of materials and staff have seen input costs climbing rapidly. Combined, those factors have seen the cost of purchasing a newly built home rising by close to 20% over the past year.

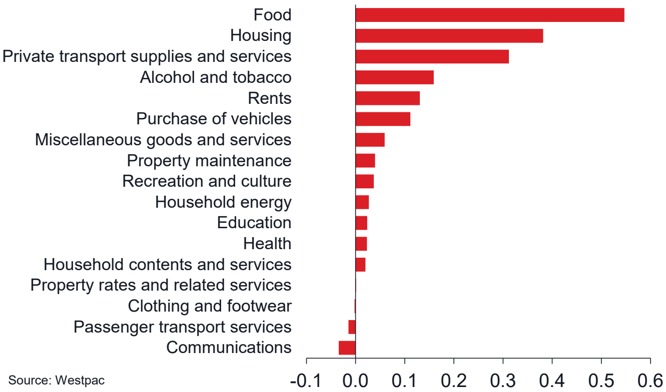
Adding to the pressure on housing costs, rents have been rising rapidly, with an increase of around 1.3% in the March quarter.

Petrol prices have also risen strongly in recent months as the conflict in Ukraine has intensified. That saw local pump prices hitting record highs in March. And while the reduction in fuel taxes may have blunted some of the pain, prices over the March quarter as a whole were still around 6% higher than at the end of 2021. That's also adding to inflation more generally due to the related rise in transport and operating costs.

Finally, March quarter inflation will also be boosted by the annual increase in tobacco excise taxes. That rise will be based on the CPI for the twelve months to September 2021, during which time consumer prices rose by 4.9%.

While the aforementioned factors are expected to account for the lion's share of this quarter's rise, inflation pressures are broad-based. We expect to see continued firmness in the prices for a range of consumer goods, including prices for many durable household items like recreational equipment and used cars.

Contributions to Q1 CPI forecast (percentage points)



Source: Westpac

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