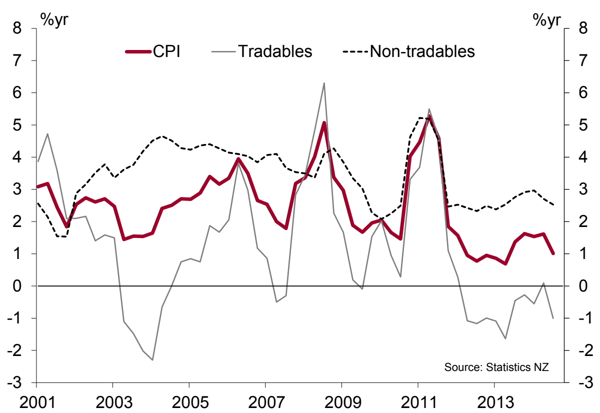
Back to square one

Sep quarter consumer prices rise 0.3%, annual inflation 1.0%

- The Consumer Price Index rose 0.3% in the September quarter, taking annual inflation down from 1.6% to 1.0%.
- Food prices were unusually subdued over the quarter, though some of this may prove temporary.
- But more generally, the legacy of a rising New Zealand dollar has continued to depress prices, and outside of construction there is little evidence that the strong economy has led to home-grown inflation pressures so far.
- The Reserve Bank will need more solid evidence of a pickup in inflation pressures before resuming interest rate hikes. We now expect the next OCR increase to be delayed until September next year.

CPI inflation



Consumer prices rose by 0.3% in the September quarter, once again undershooting market expectations of a 0.5% increase, and below even our bottom of the range forecast of a 0.4% rise. The Reserve Bank had predicted a 0.7% increase in the September *Monetary Policy Statement*, although subsequent details on food and fuel prices would have likely prompted it to lower its forecast since then.

With prices subdued in the latest quarter, and some large price increases last year dropping out of the calculation, inflation slowed from 1.6% to 1.0% in the year to September. That's the slowest pace of annual inflation since it dropped as low as 0.7% in June last year.

Today's release will only heighten the RBNZ's discomfort with the persistently low inflation outturns in recent times. The pickup in annual inflation that gave the green light for this year's OCR hikes has now largely unwound. Inflation is once again scraping along the bottom of the RBNZ's medium-term target band, and we expect it to remain there for at least another quarter.

A rapidly growing domestic economy, surging net immigration and booming construction activity mean that it's still reasonable to forecast a pickup in inflation over the medium term. But we suspect the RBNZ will need some hard evidence of this before it resumes hiking interest rates. Consequently, we've pushed out our forecast of the next OCR hike from June to September next year.

Details

The key factor behind the subdued September quarter result was food prices, which were effectively flat. Food prices have a strong seasonal pattern (particularly for fresh produce), with increases over the September quarter typically well in excess of 1%. Some of the shortfall this year will have been due to favourable growing conditions over winter, something that won't necessarily carry through into summer. But there were other factors that are likely to persist for longer, such as the supermarkets' price war on bread, and lower world prices for dairy products.

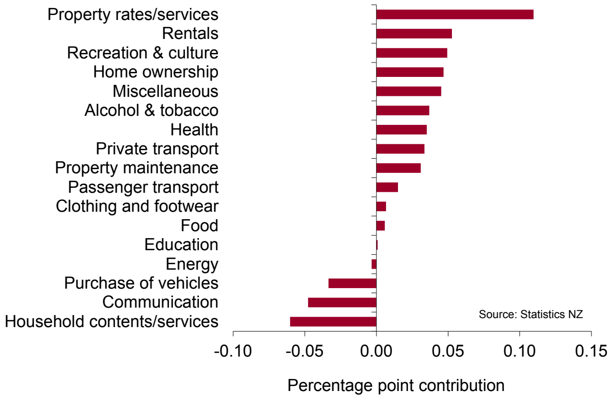
The other items that had a major impact on annual inflation were travel-related. Petrol prices rose 1% in the September quarter this year – but that compares to a 5.6% rise the same time last year. Domestic airfares, package holidays and accommodation were also more subdued compared to the same time last year.

Stepping back from the specific details, the story on inflation pressures was an increasingly familiar one. Prices for tradable items were down 1% on a year ago, as the legacy of a strong New Zealand dollar continued to depress prices of imported or import-competing goods and services. Exchange rate movements tend to flow through to consumer prices with a lag of several quarters, so the recent fall in the NZ dollar – if sustained – is more likely to have an impact on inflation next year.

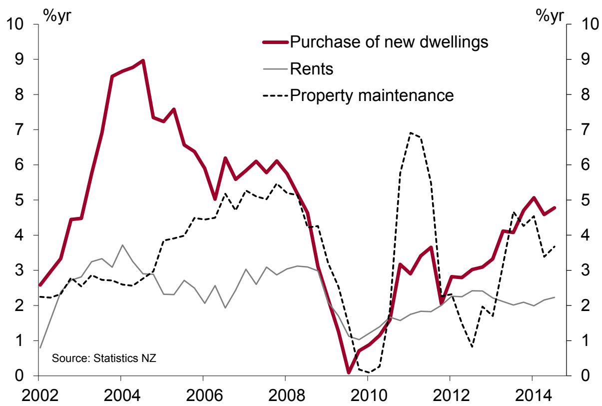
Housing remains a prominent, and unsurprising, source of price increases. New dwelling prices rose 4.8%yr, an acceleration from the 4.6%yr pace in June, and the regional breakdown again showed that this is no longer an isolated Christchurch story. Property maintenance costs also picked up the pace this quarter, and the 3.8% annual increase in local authority rates was in line with last year's increase. Note, however, that rental inflation was unchanged at 2.2%yr, once again supporting our view that a shortage of roofs over heads cannot explain the rate of increase in house prices.

But the pressure on construction costs has yet to spread to domestic price pressures more generally. In fact, non-tradables inflation slowed for the second quarter in a row, to 2.5%yr. Given that housing is included in this category, the remainder must have been particularly soft. Admittedly some of that softness is due to welcome sector-specific developments, such as the ongoing competition driving down mobile phone and broadband prices, and the change from six-monthly to once-yearly warrants of fitness for cars (effectively a price cut). But you would struggle to find any areas other than housing where a booming economy and growing capacity constraints are acting to squeeze prices higher.

Contributions to quarterly inflation



Housing-related inflation



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