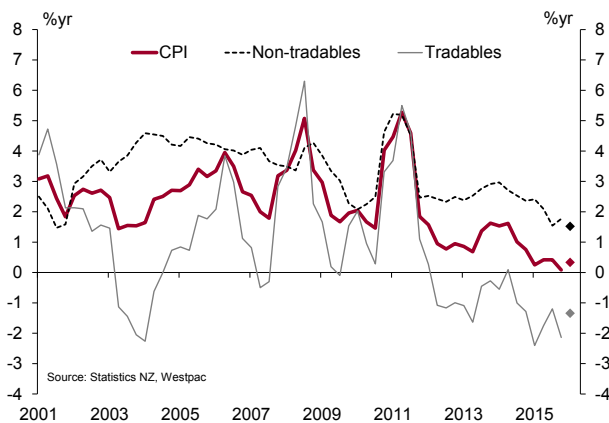


Oil be back

March quarter CPI preview: 18 April, 10:45am

- We expect a 0.1% increase in the Consumer Price Index (CPI) for the March quarter, which would see annual inflation tick up to 0.3%.
- The plunge in world oil prices will again have a major impact on the CPI, particularly through lower petrol prices and airfares.
- The fall in the New Zealand dollar over the last year is expected to have a modest impact on retail prices.
- Our forecast is only slightly below the Reserve Bank's, and in our view would not be enough on its own to warrant an OCR cut as early as this month.

CPI inflation



The March quarter CPI will continue the recent run of very soft inflation readings, due in part to the renewed plunge in oil prices early in the year. We expect a mild 0.1% rise in the CPI for the quarter, reflecting a balance between lower transport costs, the delayed effects of the fall in the New Zealand dollar, and scheduled annual increases for some items. This would see the annual inflation rate pick up from 0.1% to 0.3%, as a very weak outturn from the previous March quarter drops out of the calculation.

The CPI is the most significant data release ahead of the 28 April OCR review. The Reserve Bank is back into easing mode, with its most recent projections suggesting one further rate cut this year. So the market is naturally testing the idea that a weak CPI outturn could force the RBNZ to deliver that cut as early as this month.

Our forecast of a 0.3% annual increase is slightly below the RBNZ's forecast of 0.4%. But the difference is entirely on the tradables side, where the RBNZ has more scope to look through temporary price movements. Our sense is that inflation would have to be substantially below our forecast to prompt the RBNZ into action before the full *Monetary Policy Statement* in June. We'll set out our thinking in more detail in our OCR preview next week.

Details

The plunge in world oil prices will have the most significant impact on the March quarter CPI (and will likely depress the annual inflation rate for the rest of the year as well). We estimate that lower fuel prices alone will knock around 0.4 percentage points off the CPI, although that compares to a -0.6ppt hit in the same quarter last year.

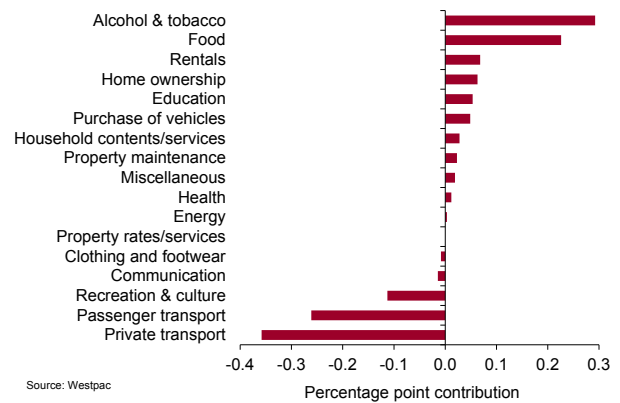
Cheaper fuel is also set to have an impact on airfares, both international and domestic. In the case of domestic airfares, the March quarter will see further downward pressures from Jetstar's entry into some regional routes (itself a product of falling fuel costs).

The New Zealand dollar fell substantially during 2015, but to date we have seen only a small impact on the prices of imported and import-competing goods. This may be due to offsetting forces such as falling transport costs or heightened competition, or it may simply be a matter of timing – for instance, importers may have had currency hedges in place which will eventually run out. The March *Quarterly Survey of Business Opinion* certainly showed a rise in the number of firms reporting higher costs, but with little evidence that they have successfully passed on these cost increases. We’ve assumed some modest price rises in import-heavy areas such as cars and home furnishings, but the impact of the lower exchange rate could go either side of our forecast.

The main price increases that we expect for the March quarter are largely regular features, including a 10.3% hike in tobacco excise (the last scheduled annual increase), a seasonal rise in food prices, and annual changes in education fees (though less than usual as tertiary fee increases have now been capped at 3% a year, from 4% previously). Meanwhile, prices in the housing-related categories, such as rents and newly-built homes, are likely to have continued their persistent climb.

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Components of quarterly inflation



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