

Back on track

Q3 CPI preview: 16 October, 10:45am

- We expect a 0.9% rise in consumer prices for the September quarter, lifting annual inflation back above 1% for the first time in over a year.
- A spike in fuel prices is the main contributor to the lift in the annual inflation rate. Elsewhere, the economy's spare capacity and a still-high New Zealand dollar have kept price pressures subdued.
- Our forecast is similar to market and Reserve Bank forecasts, and shouldn't cause a stir on the day.

We estimate that consumer prices (published next Wednesday) rose 0.9% in the September quarter. With a soft September 2012 quarter dropping out of the calculation, that would lift the annual inflation rate from 0.7% to 1.3%, bringing it back within the Reserve Bank's 1-3% target band for the first time since June 2012.

A return to within the target band will give the RBNZ more confidence that monetary policy is on the right track. However, the expected near-doubling of the inflation rate in one go probably overstates the degree to which inflation pressures are picking up. With the economy still operating with some slack, and the New Zealand dollar remaining high (though no longer trending upward), we don't expect that annual inflation to be back at the RBNZ's target midpoint of 2% until the end of next year.

Details

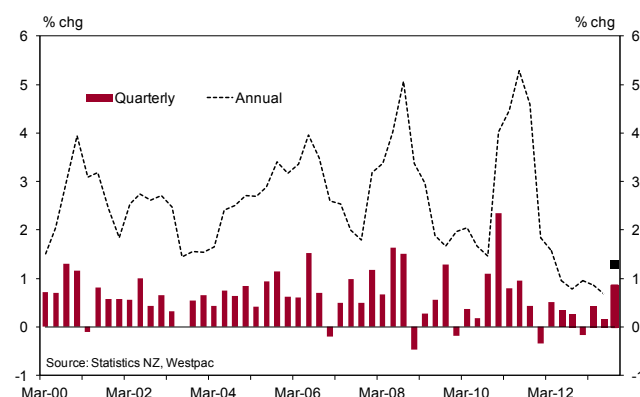
The main contribution to the lift in the September quarter CPI was the cost of running a vehicle. Petrol prices rose 5% over the quarter (including an increase in fuel excise that raised prices by 1.4%), diesel prices rose by a similar amount, and road user charges for diesel vehicles were hiked by about 10%. Given that fuel prices fell in the same period last year, this is also the main factor behind the rise in the annual inflation rate.

Many of the price increases for the September quarter are seasonal in nature. Food prices rose 1.7%, led by fruit and vegetables – a fairly normal increase for this time of year. Alcohol excise was increased by 0.9% on 1 July (and brewers often pass along other cost increases at the same time). And local body rates were increased by an average of 3.3% for the current year, most of which will be captured in the September quarter.

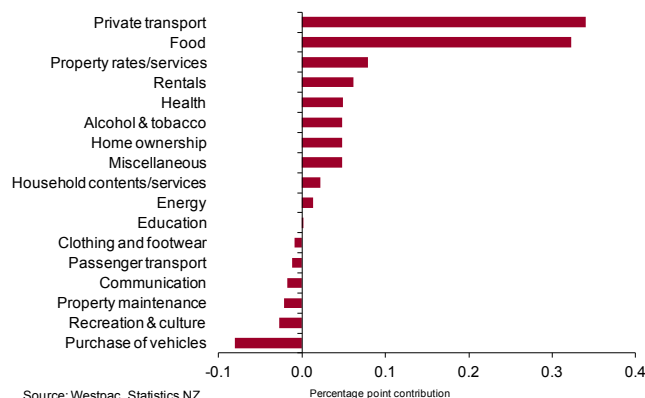
With house prices accelerating and construction activity picking up, we'll be watching for further evidence of rising housing-related costs – new house prices, rents, maintenance and selling fees. The June quarter CPI showed a sharp jump in new house prices nationwide, but we're waiting to see evidence of this happening consistently outside of the Canterbury region.

On the downside, the legacy of the strong New Zealand dollar is likely to have had a depressing effect on prices in a range of

NZ CPI inflation



Forecast contributions to quarterly inflation



categories such as clothing, furnishing and electronics. While the NZD was slightly lower over the September quarter, its impact on the prices of imported goods tends to come with a lag of as much as a year – and the trade-weighted index was still up 3.6% on a year ago. Used car prices could be especially soft, with the NZD up by 24% against the yen in the last year.

Market implications

Our forecast is similar to the RBNZ's estimate of a 0.8% quarterly increase (1.2% annual); market forecasts look to be around the same mark. Any annual inflation rate with a 1 in front of it should leave the RBNZ more confident in stating its rhetoric that inflation is tracking higher and that higher interest rates will be warranted next year. But with the market already pricing OCR hikes from around March, such an outcome is unlikely to elicit much of a response.

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