ECONOMIC BULLETIN

Inflation update.

14 Nov 2023 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

NZ First Impressions: Monthly price series, October 2023

- **We've revised our forecast for December quarter inflation to 0.6% (down from 0.9% previously). For the year to December, we now forecast a rise in prices of 4.8% (previously, we expected a rise of 5.1%).**
- **Stats NZ's expanded monthly prices update highlighted softness in the prices for food and air travel. That offset a stronger than expected rise in tobacco prices and continued firmness in rents.**
- **We have not changed our forecast for non-tradables inflation, and still expect high rates of core inflation.**
- **We expect that today's data will also have been a downside surprise for the RBNZ. This reinforces our expectation for an 'on hold' OCR decision in November.**
- **While we currently still have a 25bp rate rise pencilled in for February, the faster decline in headline inflation likely increases the hurdle the RBNZ needs to get over between now and then.**

Stats NZ has begun releasing an expanded suite of monthly price indices. In addition to the information on food prices and housing rents which they have already been providing, Stats NZ now also provides monthly information on alcoholic beverages and tobacco, fuel prices, airfares and accommodation services.

As prices for many of these goods and services can be volatile, they are often excluded when looking at 'core' measures of inflation. However, combined they account for around 45% of household spending. As a result, this information will help provide timely information about some of the items that often drive the quarter-to-quarter swings in the overall CPI.

Today's updates from Stats NZ signal downside risks to our forecast for overall consumer prices in the December quarter. We now expect overall consumer prices to rise by 0.6% in the December quarter, which would leave prices up 4.8% for the year. Previously we forecast a quarterly rise of 0.9% and annual inflation of 5.1%.

Softness in prices in October mainly related to food prices which account for nearly 20% of the CPI, and the cost of air travel (which is 2.6% of the CPI). Those prices can be volatile on a month-to-month basis. Even so, the falls in these prices in October mean that, even if we saw some rise in prices over the next few months, December quarter inflation is still likely to fall short of our earlier expectations.

In the details:

- Food prices fell 0.9% over the month (below our forecast for a 0.5% fall). That included a seasonal fall in fruit and vegetable prices, as well as drops in the prices for grocery items and meat products.
- In terms of air fares, international airfares were down 9.4% in October, and domestic airfares were down 7.5%. The historic seasonal patterns that we saw in

these prices has been disrupted since the pandemic and we could see some unusual swings – up or down – over the next few months. However, with international air capacity on the rise and domestic demand being dampened by tight financial conditions, the risks on this front appear tilted towards smaller price rises or price falls.

- On the upside, rents (which account for 9% of households spending) rose by 0.4% in October and are up 4.2% over the year. However, that is an average of all rents, many of which will not have changed. Just looking at new rents, we've seen a 6% rise over the past year, with larger increases in areas like Auckland with population growth is booming.
- There was also an unexpected 2.7% rise in tobacco prices. Tobacco only accounts for 3% of households spending, but it's unusual to see a rise like this at this time of year – prices usually only change in the March quarter when the excise tax is increased.

We suspect that today's result will also be a downside surprise for the RBNZ. Most of the softness in prices relates to tradable prices (which mainly relates to the prices of imported goods). Tradable prices have been weaker than both we and the RBNZ had expected over the past year. In part that's because global prices for many internationally traded goods have been easing as pandemic related supply chain disruptions have eased. Tighter monetary policy will also be weighing on demand for imported goods locally.

However, we continue to expect non-tradables prices to rise by 0.8% in the December quarter, in line with the RBNZ's last published forecast (released in August). Non-tradables prices relate mainly to the strength of domestic demand and include a wide range of services. Prices on this front have continue to rise at a brisk pace two years after the RBNZ first raised the OCR, consistent with the ongoing tightness in the labour market and strength in wage growth. That strength means that overall inflation is easing only gradually, even as import prices fall.

While we've seen volatility in some specific prices, we're continuing to see underlying strength in inflation. In terms of core inflation, we expect the CPI excluding food and fuel will rise by 5.2% in the year to December – down from 6.1% last quarter, but still red hot.

Overall, today's data will make the RBNZ more comfortable that inflation is continuing to ease. That reinforces our expectations That the OCR will be left on hold in November.

While we currently still have a 25bp rate rise pencilled in for February, the faster decline in headline inflation will help reduce risks to inflation expectations and so likely increases the hurdle the RBNZ needs to get over between now and then. We'll be watching how domestic demand and the labour market are evolving to determine the longer-term outlook for the cash rate. Lingering strength in domestic inflation, strong net migration and the housing market turning upwards remain upside inflation risks.

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