WESTPAC ECONOMIC BULLETIN

CPI preview, June quarter 2023 – Wednesday 19 July, 10:45am.

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Lower inflation, not low inflation.

- We estimate that New Zealand consumer prices rose by 0.9% in the June quarter. That would see annual inflation slipping to 5.9%, down from 6.7% in the year to March.
- But while inflation is dropping back, it is not low by any stretch of the imagination. Importantly, with strong and persistent underlying price pressures, inflation is unlikely to return within the RBNZ's target band any time soon.
- The June quarter saw a further large increase in food prices, as well as continued increases in housing related costs. Those increases have been partially offset by falls in fuel prices.
- Our forecast is lower than the RBNZ's last published projection reflecting a lower forecast for tradable prices.

Consumer price inflation

	Mar-23	Jun-23	
	Actual	Westpac forecast	RBNZ forecast (May MPS)
Headline inflation			
Quarterly	1.2%	0.9%	1.1%
Annual	6.7%	5.9%	6.1%
Non-tradables inflation			
Quarterly	1.7%	0.9%	1.0%
Annual	6.8%	6.2%	6.3%
Tradables inflation			
Quarterly	0.7%	0.9%	1.4%
Annual	6.4%	5.3%	5.8%

The annual inflation rate is past its peak, and we expect it will take a sizeable step down in the June quarter.

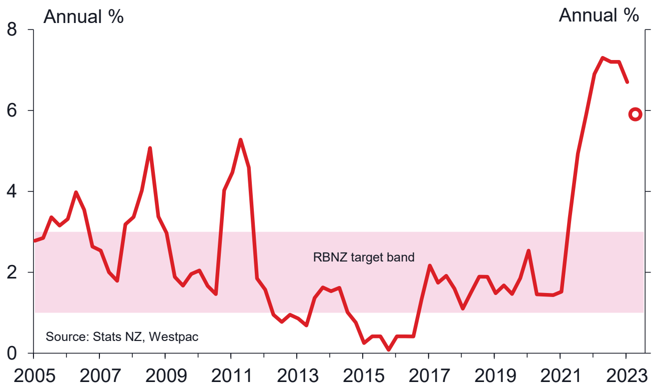
We estimate that consumer prices rose by 0.9% in the June quarter. That would see the annual inflation rate slowing to 5.9%– down from 6.7% last quarter, and well below the peak of 7.3% that we saw last year.

Why is inflation dropping back?

The fall in the annual inflation rate is almost entirely due to petrol prices, which are 16% lower than this time last year. Prices at the pump spiked in early 2022 in response to the Russia-Ukraine conflict. However, since that time, global fuel prices have fallen and local fuel taxes have been temporarily reduced.

Also contributing to the easing in inflation, we're now seeing more moderate increases in the cost of purchasing a new dwelling than we did over the past few years. Construction costs charged higher in the early stages of the pandemic in response to low interest rates and shortages of materials. Now, while build costs remain high, a slowdown in building activity and an easing in supply chain pressures has seen price growth slowing sharply.

Annual inflation (including Westpac forecasts)



It's still a long road back to the RBNZ's target.

While inflation is now turning down, it is not low by any stretch of the imagination.

And although the easing in post-pandemic supply disruptions is pulling down the annual inflation rate, under the surface price pressures remain strong. Despite the recent slowdown in GDP growth, economic activity remains elevated, and the labour market remains stretched. The related firmness in demand and wage growth means that we are continuing to see strong price growth in many parts of the economy.

Consistent with that, most measures of core inflation (which track the underlying trend in prices) are set to linger at levels of around 5% to 6%. That's miles outside the RBNZ's 1% to 3% target band.

Crucially, those 'sticky' underlying price pressures mean that inflation is unlikely return inside the target band until the latter part of 2024.

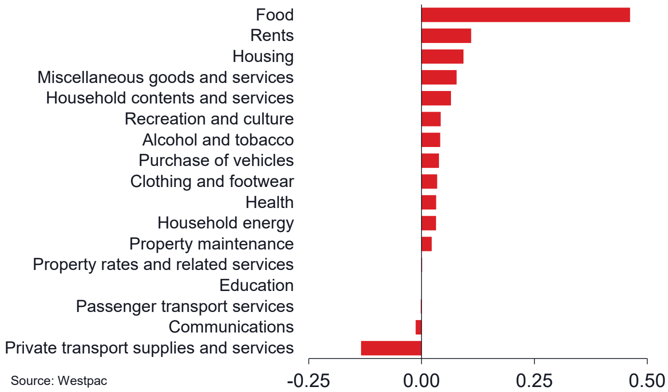
Key drivers of June quarter inflation.

Food prices are set to be the largest upside contributor to inflation in the June quarter. Prices rose by 2.2% over the past three months and are up an eyewatering 12% over the past year. Price increases have been widespread, including sizeable increases in the prices of groceries and takeaway foods (the latter has been boosted by increased spending in the hospitality sector). Poor weather conditions have also added to the prices for some fresh produce.

Housing costs will also continue to be key contributors to overall inflation. Rents have risen by 1.1% over the past three months and are up a solid 4.3% over the past year. In addition, as discussed above, the cost of purchasing a new dwelling is continuing to rise, albeit at a slower rate than over the past couple of years – we're forecasting a rise of 0.9% over the quarter. Combined, these two groups account for close to 20% of the CPI.

Providing an offset to those increases has been a continued easing in petrol prices. Prices at the pump fell by 2.5% through the June quarter and are 16% lower than this time last year.

Contributions to June quarter inflation forecast (percentage points)

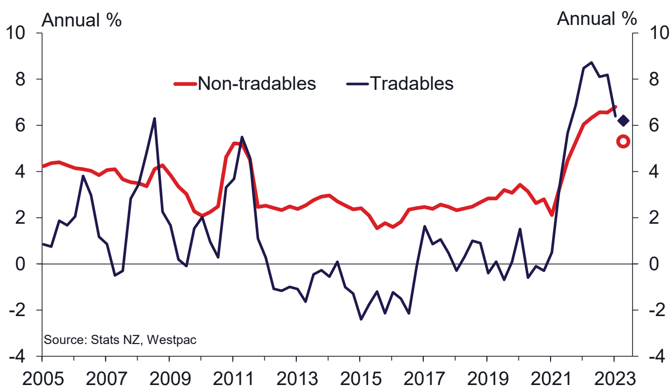


Downside risk for the RBNZ's forecast, but inflation pressures still lingering.

Our forecast for 0.9% inflation in the June quarter is lower than the RBNZ's last published forecast of 1.1% (the RBNZ's forecast for annual inflation is 6.1%).

The main reason for our lower forecast is that we expect lower tradables inflation (sometimes referred to as imported inflation) than the RBNZ has assumed. We're forecasting that tradable prices rose by 0.9% over the past three months, compared to the RBNZ's forecast for a 1.4% increase. The RBNZ's forecast was released back in May, and since that time petrol prices have pushed downwards. We also expect that softening consumer demand for items like household durables will weigh on tradables inflation.

Tradables and non-tradables inflation (including Westpac forecasts)



In contrast, our forecast for a 0.9% rise in domestic (non-tradables) prices is close to the RBNZ's forecast for a 1% rise.

A June quarter inflation result in line with our forecast would still leave the RBNZ with a picture of strong underlying price pressures. However, it would be the third consecutive quarter that inflation has fallen short of the RBNZ's forecasts.

Where could we be surprised?

There are some key areas of uncertainty that could throw around the June quarter inflation result.

First are the prices for services associated with travel and hospitality, such as airfares and accommodation. With pandemic-related disruptions continuing to fade, the seasonal patterns we previously saw in the tourism sector are gradually returning. Even so, we could see unexpected swings in these prices for some time yet.

We could also see sizeable falls in the prices of some durable goods. Retailers have reported softening demand for items like appliances and furnishings. At the same time, shipping costs have continued to ease.

On the upside, demand for motor vehicles may have been boosted by consumers rushing to beat the change in rebates / emissions charges.

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