WESTPAC ECONOMIC BULLETIN

CPI review, June quarter 2023.

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Inflation down, but definitely not out.

- New Zealand consumer prices rose 1.1% in the June quarter, with prices up 6.0% over the past year.
- Inflation has slowed from the eye-watering rates of over 7% that we saw last year. However, while inflation is 'lower', it is not 'low' by any stretch of the imagination.
- Importantly, measures of core inflation are continuing to run at rates of around 6%, and some have actually picked up in the June quarter. That points to lingering strength in underlying price pressures.
- Those simmering underlying price pressures mean that inflation is unlikely to return within the RBNZ's target band any time soon.
- We continue to see the risk that the RBNZ will need to raise the OCR again.

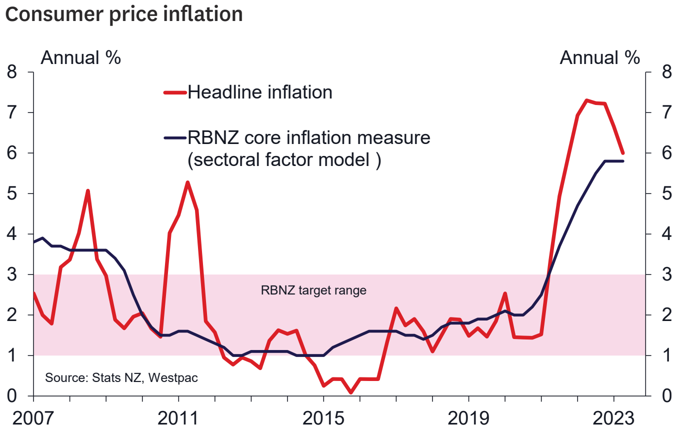
Consumer price inflation

	Jun-23	Forecasts	
	Actual	Westpac	RBNZ May MPS
Headline inflation			
Quarterly	1.1%	0.9%	1.1%
Annual	6.0%	5.9%	6.1%
Non-tradables inflation			
Quarterly	1.3%	0.9%	1.0%
Annual	6.6%	6.2%	6.3%
Tradables inflation			
Quarterly	0.8%	0.9%	1.4%
Annual	5.2%	5.3%	5.8%

Consumer prices rose by 1.1% in the June quarter. That saw the annual inflation rate dropping to 6.0%, down from 6.7% in the year to March and well below the peak of 7.3% that we reached last year.

Today's result was close to our own forecast and the RBNZ's expectations.

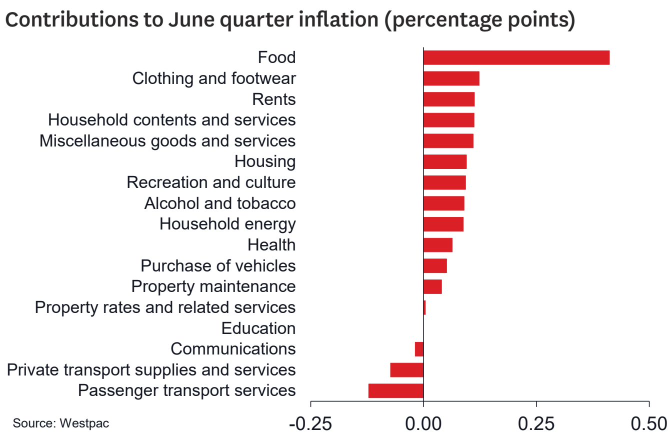
However, while inflation is 'lower', it is not 'low' by any stretch of the imagination. Prices are continuing to rise at an eye-watering pace. Crucially, the underlying details of today's report point to lingering strong price pressures. And that is a big concern for the RBNZ. Eighteen months after the central bank began hiking the Official Cash Rate, inflation pressures are yet to show signs of easing materially. That means inflation is unlikely to be back in the target range for an extended period.



Food and housing costs continuing to climb.

Price movements over the June quarter were largely as expected.

- Food prices were again the major factor that has pushed overall household living costs higher. Food prices rose by 2.2% over the June quarter and are up a massive 12% over the past year.
- Housing costs have also continued to be key contributors to overall inflation. Housing rents rose by an average of 1.1% over the past three months and are up a solid 4.2% over the past year. Rents are the largest single component of the CPI, and they have been rising at a rapid pace for over a year now.
- In addition, the cost of purchasing a new dwelling is continuing to climb, rising by 1.1% over the quarter (though while that was a solid rise, it's much more moderate than the oversized increases we saw over the past few years when low interest rates and shortages of materials saw construction costs surging).
- Providing some offset to those increases was the fall in petrol prices, with prices at the pump dropping by around 1.5% over the June quarter.



Looking at the change in prices over the past twelve months, annual inflation has now slowed to 6.0%, down from rates of over 7% in 2022.

That fall in the annual inflation rate is almost entirely due to petrol prices, which are 15% lower than this time last year.

Also contributing to the easing in the annual inflation rate, we're now seeing more moderate increases in construction costs as building activity has slowed and earlier supply chain pressures have eased. Those conditions have seen annual construction cost inflation more than halve from over 18% last year to 7.8% now.

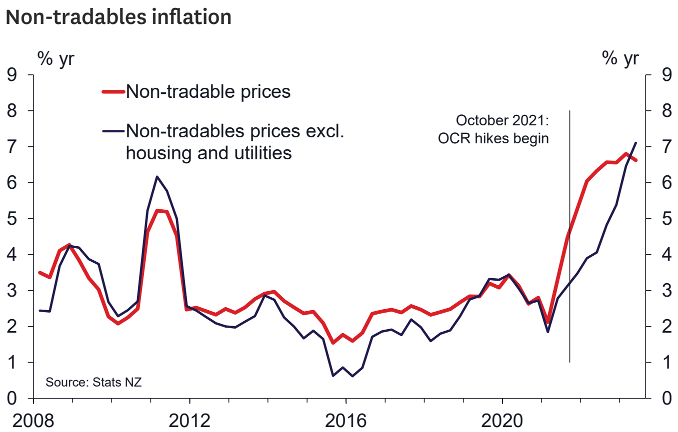
Underlying inflation pressures strong and 'sticky'.

Quarter-to-quarter swings in prices are not the focus of monetary policy. The RBNZ is much more concerned with the longer-term trend in inflation. On this front, we have seen inflation dropping back as some of the cost increases we saw in the wake of the pandemic have eased. However, under the surface, the news for the RBNZ is looking more worrying.

Most measures of core inflation (which smooth through the quarter-to-quarter swings in prices and track the underlying trend in inflation) are continuing to track at levels of around 6% – well outside the RBNZ's 1% to 3% target band. Notably, several core measures have pushed higher over the past few months, highlighting the continued strength in pricing pressures.

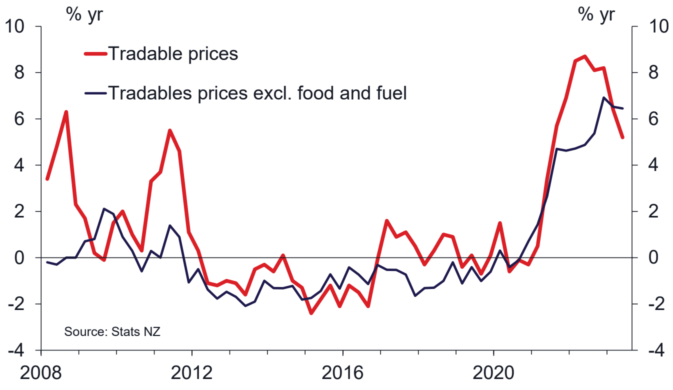
Looking across the broad product groups, domestic (aka. non-tradable) prices were up 1.3% in the June quarter and have risen by 6.6% over the past year. The RBNZ pays particular attention to non-tradables inflation given its close connection to the strength of domestic economic conditions. The central bank had expected to see annual non-tradables inflation easing in the year to June. Instead, it has lingered at high levels, and has only nudged back slightly in the 18 months since the RBNZ began raising the OCR.

There has been particular strength in the prices of services, up 6.1% over the past year. That's consistent with the ongoing tightness in the labour market and related strength in wage pressures. With the labour market still tight and wages climbing at a brisk pace, we expect such pressures will linger for some time. That will underpin continued strength in domestic inflation well into the new year.



Prices for imported goods (sometimes referred to as tradables) rose by 0.8% over the past three months and are up 5.3% over the past year. That's a slowdown from the rates we saw last year. However, that decline has mainly been due to the fall in fuel prices. The prices of tradable goods excl. food and fuel cost are continuing to rise at a rapid pace, increasing 6.5% over the past 12 months. That's despite an easing in supply chain pressures over the past year, and points to ongoing firmness in households' spending appetites.

Tradables inflation



What does today's result mean for the RBNZ?

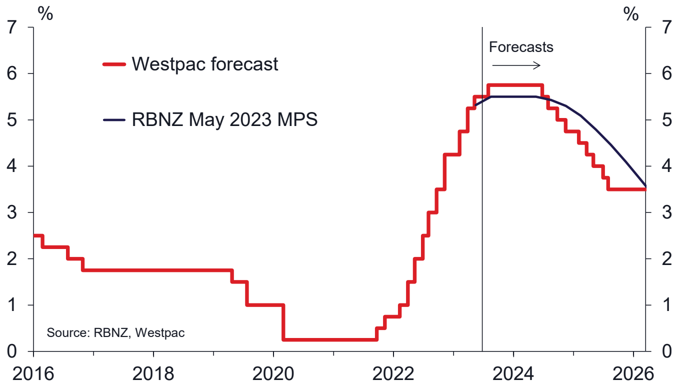
While today's outturn was in line with the RBNZ's forecast, we suspect the persistence in underlying inflation pressures was actually more worrying than the central bank anticipated. Most notably, non-tradables inflation was stronger than the RBNZ expected, and is yet to show material signs of cooling. In fact, excluding building costs, non-tradables inflation picked up to 7.1% in the year to June (vs 6.5% in the year to March), with the cost of services continuing to push higher.

In its recent policy updates, the RBNZ signalled that it expected to keep the OCR at the current level of 5.50% for some time yet. However, with underlying price and wage pressures remaining firm, the RBNZ still has a rocky road ahead. Inflation looks unlikely to be back within the target band before the latter part of next year.

It's also a mixed picture on the activity front. We are seeing signs that demand is cooling, such as the easing in business activity indicators like the PMI and PSI. Even so, economic activity remains elevated, and the labour market is still stretched. In addition, we are seeing signs that the economic cycle may still have some legs (such as the turnaround in net migration, and signs that the housing market may be heating up again).

Putting this all together, we continue to forecast that the RBNZ will need to raise the OCR again.

Official Cash Rate forecasts



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