

One-hit wonder

- We expect the CPI to print at 0.9% qoq, taking annual inflation up sharply to 2.1%.
- Capacity pressures in construction and tourism sectors are being compounded by a number of temporary price rises.
- We continue to expect the RBNZ to leave the OCR on hold until late 2018, given the lack of broad inflation pressures.

We expect the CPI to print at 0.9% qoq in Q1, substantially stronger than the RBNZ’s 0.3% qoq forecast in February’s Monetary Policy Statement (MPS). **Q1’s lift in prices largely reflects a continuation of Q4’s key trends, exacerbated by a number of temporary price increases. Tight capacity pressures in the construction and services (tourism) sectors, combined with a further lift in petrol prices, remain key drivers of inflation over Q1. In addition, a 10% tobacco tax increase and a lift in food prices will combine to push annual inflation above 2% for the first time in over 5 years.**

Despite annual inflation returning to the RBNZ’s 2% target, **we caution that part of this lift in inflation is temporary.** Higher petrol, food (largely fruit and vegetables) and tobacco prices are transitory and, as a result, we expect inflation to dip again before grinding back up to the midpoint of the inflation target over the medium term. **The RBNZ itself noted in March’s OCR statement that inflation is likely to be volatile over the near term.** With broader inflation pressures still muted, **we expect the RBNZ to leave OCR unchanged until late 2018.**

Our qoq forecast is stronger than the RBNZ’s forecast published in the February MPS. The majority of this divergence lies in our tradable inflation forecasts. However, given the recent strength in food and petrol prices since the RBNZ published the February MPS, the RBNZ is likely to have revised its inflation forecast higher since then. See the table below for our more detailed forecasts.

Key drivers of the Q1 result include:

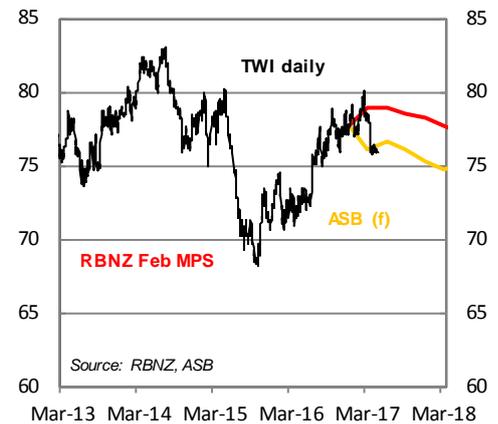
- **A 6.0% lift in petrol prices over Q4.**
- **A 7.2% rise in fruit and vegetable prices.**
- **A 10% tobacco tax increase levied from the 1st of January.**

Despite the strong price gains in petrol, fruit and vegetable and tobacco prices, we expect the RBNZ to look through this strength. The RBNZ is more focussed on underlying inflation pressures, rather than temporary price movements.

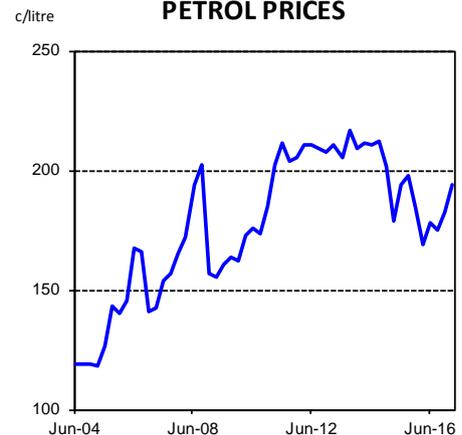
On the other hand, the RBNZ will be relieved to see capacity pressures are picking up, though they are largely confined to the construction and tourism industries. Sustained levels of high net migration are supporting demand for construction. And, the recent tourism boom NZ has been enjoying is placing pressure on the accommodation sector. We expect these pressures to continue driving inflation for some time yet. Further, in Q4, we saw some evidence of pricing power returning to retailers and the RBNZ will likely look for more evidence of this.

On balance, the NZ inflation outlook has undoubtedly lifted in recent months. Further, the recent fall in the NZD will reduce some of the drag from tradable inflation going forward. However, with inflation likely to be volatile in the near term and the ongoing downside risks stemming from global uncertainty, the RBNZ is likely to remain cautious. As a result, we continue to expect the RBNZ to leave the OCR on hold until late 2018, by which broad capacity pressures will be more evident.

NZ TWI FORECAST



PETROL PRICES



CPI breakdown Q%	Sep-16	Dec-16	Mar-17
Food	0.4	-1.2	2.2
Alcohol & tobacco	-0.1	-0.3	3.6
Clothing & footwear	-0.2	1.0	-0.8
Housing & h/h utilities	1.1	0.6	0.6
H/h contents & services	2.3	-1.4	-0.2
Health	1.3	0.7	-0.1
Transport	-1.9	3.7	1.0
Communication	-0.5	-1.2	0.0
Recreation and culture	0.7	0.8	-1.4
Education	0.1	0.1	3.0
Misc.goods & services	0.5	0.3	0.6
CPI	0.3	0.4	0.9
Tradable	0.0	0.3	0.6
Non-tradable	0.5	0.6	1.1
CPI Annual	0.4	1.3	2.1

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