ASB

Economic Note

Q3 CPI Preview

12 October 2018

Costs pushing prices up in Q3

- We expect the CPI to lift 0.7% qoq in Q3, to be 1.7% higher on an annual basis.
- Fuel and housing-related costs are expected to continue driving much of the increase in inflation.
- However, over the medium term, the risks remain skewed to the downside. As a result, we expect the RBNZ to largely look through the Q3 lift. We expect the OCR to remain on hold until early 2020.

Summary & implications

We expect the CPI to lift to 1.7% yoy (+0.7% qoq) in Q3. Our forecast is stronger than that published in the RBNZ's August Monetary Policy Statement (+0.4% qoq, 1.4% yoy). However, the RBNZ's forecast is unlikely to capture the more recent lift in fuel prices. A weaker NZD, high global oil prices and the Auckland regional petrol tax have combined to push fuel prices higher again in Q3. Outside of this, we also expect housing-related costs to have increased further in Q3. **However, with near-term costs pressures still largely contained and downside risks to the medium-term outlook, we expect the RBNZ to largely look through the headline figure.** We continue to expect the RBNZ to leave the OCR on hold until early 2020.

CPI breakdown Q%	Mar-18	Jun-18	Sep-18
Food	0.5	0.8	0.7
Alcohol & tobacco	4.3	1.1	0.1
Clothing & footwear	-0.2	0.5	0.4
Housing & h/h utilities	0.6	0.9	1.1
H/h contents & services	0.7	0.0	-0.5
Health	0.5	-0.3	0.0
Transport	-0.2	0.2	1.7
Communication	-0.1	-2.1	-1.0
Recreation and culture	0.1	-1.4	0.1
Education	-5.6	0.1	0.0
Misc.goods & services	0.8	0.7	0.5
CPI	**0.5**	**0.4**	**0.7**
Tradable	**-0.1**	**0.3**	**0.6**
Non-tradable	**0.9**	**0.4**	**0.7**
CPI Annual	**1.1**	**1.5**	**1.7**

Cost pressures building

We expect prices will have increased again in Q3 as measured by the Consumer Price Index (CPI). The combination of higher fuel prices and still-firm housing-related costs is expected to see the CPI rise 0.7% qoq, the highest quarterly lift since March 2017. **Consumers have been hit by a fuel price triple whammy in Q3.** The NZD fell (lifting import costs), global oil prices rose and Auckland implemented an 11.5 cent regional fuel tax on July 1st. This combination has seen fuel prices jump over the quarter with our forecasts suggesting petrol prices rose over 4% in Q3, with diesel prices up nearly 8%. **Fuel prices look set to rise even further in Q4 following the 3.5 cent lift in the nationwide petrol excise tax that came into effect at the start of the quarter, as well as higher import costs.**

Additionally, motor fuel is a major input cost for businesses across the country (particularly as NZ has substantial transport requirements). As a result, many firms will also be feeling the squeeze on their margins at the moment. We will be watching for signs of businesses passing on these higher costs to consumers.

Housing-related costs are also expected to be a key contributor to price pressures in Q3. From the 1st July every year the annual rates rise is implemented, making Q3 a seasonally-strong quarter for CPI. This year, the rates increase

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appears to have been higher than average in a number of regions. We also expect increases for rent, construction (the cost of building) and property maintenance to boost housing-related prices in Q3.

In what is becoming a rather familiar story, cost pressures outside of housing and petrol are expected to remain rather benign. However, many consumers will be starting to feel the impact of rising fuel and household-related costs on their wallets, despite still-subdued inflation elsewhere. Transport and housing include a high proportion of necessities and therefore it is harder for consumers to substitute away from these goods or delay their spending as prices rise. There is a risk that this weighs on demand in other sectors of the economy. This also has implications for a business's ability to pass through higher transport-related costs to the consumer.

RBNZ to focus on the medium-term inflation outlook

The short-term inflation outlook has firmed, with headline CPI likely to lift back above 2% yoy in Q4. Cost pressures are driving much of the lift, with higher fuel prices impacting both businesses and consumers. However, the lift does not represent a broad-based increase in underlying inflation pressures and, therefore, we expect the RBNZ to largely look through these moves. However, there will be added scrutiny on the core inflation measures, including the RBNZ's sectoral factor model (currently 1.7% yoy) which will be released at 3pm on the 16th of October.

Over the medium term, the risks to the inflation outlook remain skewed to the downside. Soft business confidence suggests that the NZ economy lost momentum over the second half of the year. Below-trend economic growth creates additional spare capacity in the economy and could see medium-term inflation fall. **With risks to the growth outlook still skewed to the downside we expect the RBNZ to look through the near-term jump in inflation and continue to wait for evidence of a sustained lift in underlying inflation. We believe this is still some time away and do not expect the RBNZ to raise the OCR until early 2020.** There remains the risk that the OCR could be lowered if the trend in inflation weakens.

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