12 April 2013

Westpac Institutional Bank

# Low and slow

## Q1 CPI preview: 17 April, 10:45am

- **We estimate that consumer prices rose 0.4% in the March quarter, leaving annual inflation at 0.9%.**
- **The high New Zealand dollar has played a major role in depressing the prices of internationally-traded goods.**
- **But stronger GDP growth, an accelerating housing market and the Christchurch rebuild all point to higher inflation over the Reserve Bank's medium-term horizon.**

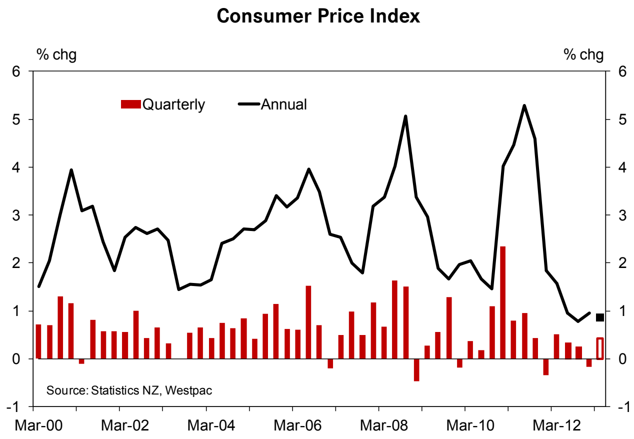
We expect annual inflation to hold steady at 0.9% for the March quarter, a view shared by the Reserve Bank in its March Monetary Policy Statement. Inflation has slowed by a lot more than expected over the last year and a half, in large part due to the stronger than expected New Zealand dollar – something that will clearly be an issue for upcoming inflation prints as well. However, the RBNZ's focus should remain on the medium-term outlook for inflation, where the buoyant housing market and the Christchurch rebuild are starting to generate some home-grown inflation pressures.

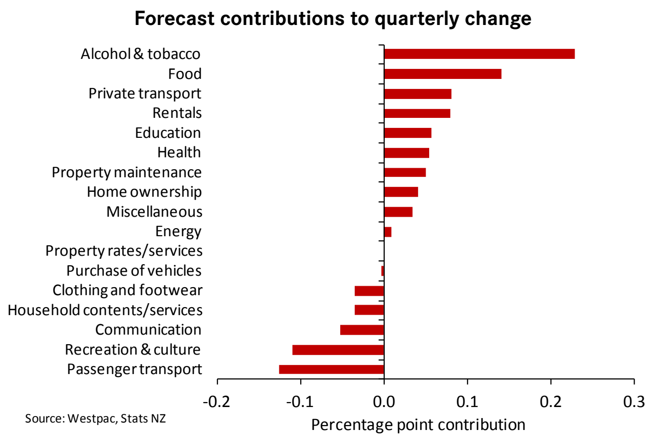
### Details

The major price increases in the March quarter were:

- Annual increases in tobacco excise duty (10% plus inflation) and education fees (university fees were set 4% higher this year, the same as last year).
- A seasonal 0.7% rise in food prices.
- Petrol prices averaged 1.7% higher over the quarter.
- Prescription charges were increased from $3 to $5.
- Ongoing price rises for housing-related items such as rents, new dwellings, property maintenance and real estate agents' fees.

These should be partly offset by seasonal declines in clothing, stationery, international airfares and package holidays, and the steady downward trend in prices for many electronic goods. The recent improvements in pricing for phone and broadband plans probably continued in the March quarter.




Quarterly movements in the CPI are typically more about idiosyncratic factors than broader inflation trends. The more relevant gauge is the annual change: if our forecast is correct, annual inflation will print slightly below 1% for the third time in a row. The strong – and stronger than expected – NZ dollar has played a major part in this, depressing the prices of tradable (imported and import-competing) goods, which have fallen by 1% in the last year. In contrast, non-tradables inflation (which is more a product of domestic forces) has been consistently ticking along at around 2.5%yr.

## Market implications

Our forecast is close to the RBNZ's view and the range of market forecasts, so the implications for markets revolve around the risk of a substantial 'miss'. Inflation has fallen short of the RBNZ's forecasts in each of the last six quarters, largely on the tradables side, raising the possibility that the exchange rate is having an stronger than usual effect on local prices. We've gone through our forecast with a fine-toothed comb to guard against that risk. Nevertheless, another undershoot would seriously strengthen the case for an easier monetary policy stance – definitely later OCR hikes, and even the possibility of cuts in the near term.

On the other hand, an upside surprise would see annual inflation back within the RBNZ's 1-3% target band – not a concern in itself, but it's one of the last remaining hurdles to our call for OCR hikes. Near-term growth is running stronger than the RBNZ expected, the housing market is heating up, and the massive Christchurch rebuild is clearly well under way. All of those factors suggest greater price pressures over the RBNZ's medium-term policy horizon.

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