WESTPAC ECONOMIC BULLETIN

CPI preview, June quarter 2022 – Monday 18 July, 10:45am.

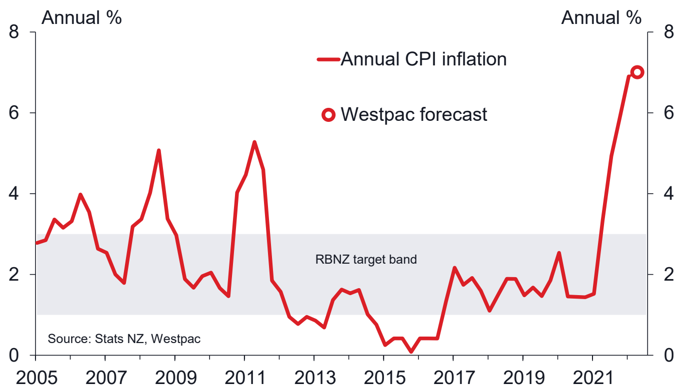
14 July 2022

Satish Ranchhod, Senior Economist
+64 9 336 5668 | +64 21 131 3433
satish.ranchhod@westpac.co.nz

The not-so magnificent seven.

- We expect the upcoming Consumers Price Index will show that New Zealand consumer prices rose by 1.4% in the June quarter.
- That would take annual inflation to 7.0%, up from 6.9% last quarter and the highest annual inflation rate in more than three decades.
- There have been particularly large increases in the prices of food, fuel and housing related costs. However, price pressures are bubbling over in every corner of the economy.
- Businesses are continuing to grapple with shortages of staff and supplies. But what has really lit a fire under consumer prices has been the strength of demand.
- Our forecast is in line with the RBNZ's last set of published forecasts.

Annual inflation forecast



There's been no relief from the intense price pressures that have been buffeting New Zealand households. We're forecasting a 1.4% rise in consumer prices in the three months to June. Coming on the back of the strong price rises in previous months, that would take the annual inflation rate to 7.0% - up from 6.9% last quarter and the highest annual rate in more than three decades.

As discussed below, much of the rise in consumer prices over the past three months (and over the past year) relates to three key areas – fuel, food and housing costs. However, the strength in inflation isn't limited to a few areas. Rather, price pressures are bubbling over in every corner of the economy, boosted by a cocktail of supply-side cost increases and strong consumer demand.

On the cost side of the ledger, businesses continue to grapple with disruptions to global supply chains and the related difficulties sourcing both consumer goods and raw materials. Operating costs have also been boosted by elevated global prices for commodities such as oil. And on top of those factors, wage costs have been pushing higher as businesses have struggled to attract and retain staff.

But while shortages of staff and materials have boosted inflation, what's really lit a fire under consumer prices has been the strength of demand. Indeed, if we look at the areas where businesses are reporting significant shortages of supplies, they're predominantly in areas where demand has been strong, like the retail and construction sectors. In other words, the economy's productive capacity hasn't been able to keep up with the lift in demand since health restrictions were eased, and that's resulted in prices ratchetting higher.

That strength in demand is important for two reasons. First, it's given many businesses greater scope to pass on cost increases into output prices, rather than just taking a hit on margins.

Second, if demand is strong, inflation is likely to remain elevated even when the current pressure on operating costs (eventually) eases off. And that's a big concern for the RBNZ, as a key factor underpinning the strength of household demand has been stimulus from low interest rates. In fact, that's a key reason why the RBNZ has been raising the Official Cash Rate at such a rapid pace in recent months.

Consistent with that broad-based strength in inflation pressures, we expect the range of core inflation measures published by Stats NZ and the RBNZ will continue to run hot at levels well above the RBNZ's 2% target.

Our forecast for June quarter inflation is in line with the RBNZ's latest published forecast for a 1.4% rise (finalised in May). Earlier this week the RBNZ signalled that further rate increases are on the cards over the coming months, and a result close to our forecast would confirm that stance.

Details.

While inflation pressures are widespread, there are a few categories where we expect to see particularly large increases in the June quarter.

First up are housing and construction costs. We've pencilled in a 3.5% increase in building costs for the quarter, following similarly large quarterly rises over the past year. Building firms have continued to face intense pressure on costs as they grapple with acute shortages of materials and staff. Combined, those factors have seen the cost of purchasing a newly built home rising by close to 20% over the past year.

Adding to the pressure on housing costs, rents have been rising rapidly, with an increase of around 1.1% in the June quarter.

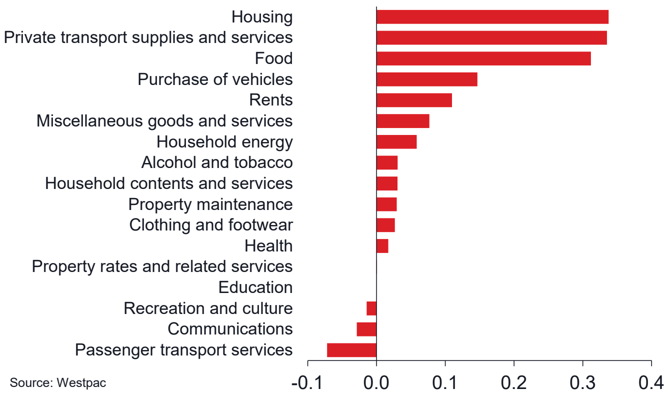
Fuel prices have also risen strongly, with prices at the pump hitting record levels in recent months. Across the country, the price of 91-octane is still running at over $3/ltr (despite the 25 cent reduction in the petrol excise tax!). That's flowing straight through to consumers wallets, and the related increases in transport and production costs are adding to the prices for all manner of goods and services.

Increases in food prices are again set to be a major driver of the rise in overall inflation. Prices have risen by 1.6% in the past three months and are up by 6.9% over the past year. That includes sizeable increases in the prices for groceries and fresh vegetables. Contributing to those increases have been earlier poor weather and staffing shortages here in New Zealand. Those pressures have been compounded by strong international demand for commodities, continued disruptions to global supply chains, and the ongoing disruptions stemming from the war in Ukraine.

Lastly, June quarter inflation will also be boosted by the Government's 'Clean Car' program and the related fees on higher emitting vehicles.

Providing some offset to the above price increases are the reduction in road user charges and the halving of public transport fares that the Government introduced earlier this year.

Contributions to Q2 CPI forecast (percentage points)



Source: Westpac

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment recommendations disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;
(ii) physical separation of various Business/Support Units;
(iii) and well defined wall/cell crossing procedures;
(iv) a "need to know" policy;
(v) documented and well defined procedures for dealing with conflicts of interest;
(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.