# ECONOMIC BULLETIN

## CPI preview, June quarter 2024 – Wednesday 17 July, 10:45am.

11 Jul 2024 | **Satish Ranchhod**, Senior Economist | +64 9 336 5668 | +64 21 710 852 | satish.ranchhod@westpac.co.nz

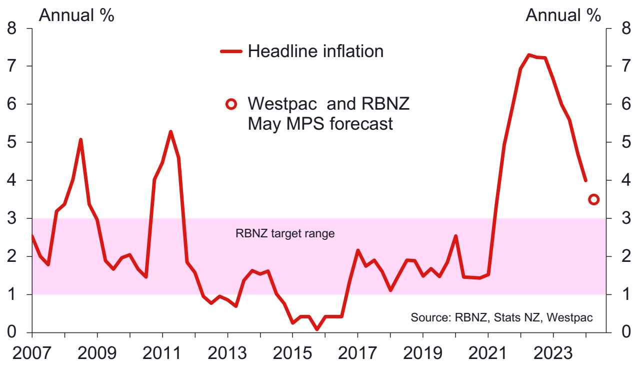
# Inflation's down, but not out.

- **We estimate that New Zealand consumer prices rose by 0.6% in the June quarter. That would see the annual inflation rate dropping to 3.5%, down from 4.0% in the March quarter.**
- **Our forecast is close to the RBNZ's forecast from their May *Monetary Policy Statement*.**
- **While inflation is easing, we expect to see continued strength in domestic inflation.**
- **A key area to watch will be services sector prices which have been rising at a solid pace but are starting to show signs of cooling.**

**Consumer price inflation**

| | Mar 2024 | Jun 2024 forecast | |
|---|---|---|---|
| | Actual | Westpac | RBNZ |
| **Headline inflation** | | | |
| **Quarterly** | 0.6 | 0.6 | 0.6 |
| **Annual** | 4.0 | 3.5 | 3.6 |
| **Non-tradables inflation** | | | |
| **Quarterly** | 1.6 | 0.8 | 0.8 |
| **Annual** | 5.8 | 5.3 | 5.3 |
| **Tradables inflation** | | | |
| **Quarterly** | -0.7 | 0.1 | 0.3 |
| **Annual** | 1.6 | 0.9 | 1.1 |

**Annual headline inflation**

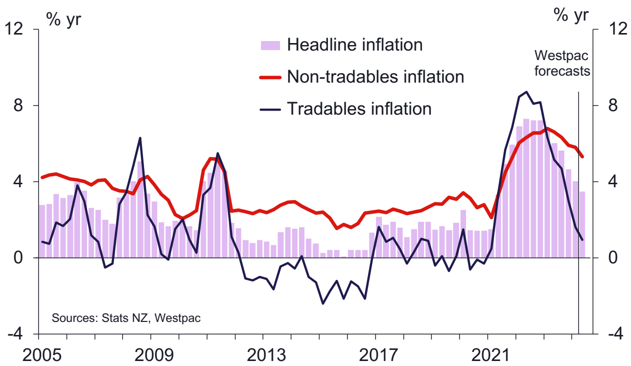



We expect New Zealand's June quarter inflation report (out on 17 July) will show that consumer prices rose 0.6% over the past three months. That would see the annual inflation rate dropping to 3.5%, down from 4.0% in the year to March.

Underlying our forecast for June quarter inflation are some familiar factors. That includes another solid increase in rents and further large increases in insurance costs. We also expect to see a solid rise in the cost of utilities, like electricity.

Balanced against those increases, recent months have seen softness in areas related to travel, including airfares and accommodation costs.

**Inflation components**




Stepping back from the quarter-to-quarter swings in prices, the longer-term trend in inflation is downwards. That's already been reflected in the various measures of core inflation which have been trending down over the past year and which we expect will have continued to ease over the past few months. For instance, inflation excluding the volatile food and fuel categories is expected to have slowed to 3.6% in the year to June, down from 4.1% in the year to March and well down on the rates of 5% to 6% that we saw at the start of last year.

But while inflation is dropping back, it remains stubbornly above the RBNZ's target band. That's because although imported inflation has fallen sharply, domestic prices have continued to rise at a rapid pace. We estimate that prices for tradable items (mainly imported goods) were up 0.1% over the June quarter and are up just 1.0% over the past year. In contrast, prices for the domestically focused non-tradable parts of the CPI are estimated to have risen 0.8% in the June quarter, leaving them up 5.3% over the past year. Even though that's down from the highs reached in 2023, it would still be well above average and much higher than the RBNZ will be comfortable with.

## How do our forecasts compare to the RBNZ's assumption?

Our forecast for June quarter inflation is in line with the RBNZ's last published forecast. However, the RBNZ's forecast was finalised back in May, and their policy statement this week hinted that they are now braced for a slightly lower result (reflecting the tone of monthly updates on consumer prices since the May MPS).

We think the composition of inflation will be a little different than the RBNZ has assumed. While we have the same forecasts for non-tradables inflation, we expect tradable prices will be softer than the RBNZ's forecast for a 0.3% quarterly rise. However, that lower forecast for tradables prices isn't large enough to cause a difference in our forecast for overall inflation.

Surprises on import prices tend to have less of an influence on the RBNZ's thinking. Instead, they tend to be more focused on the strength of domestic price pressures and core inflation.

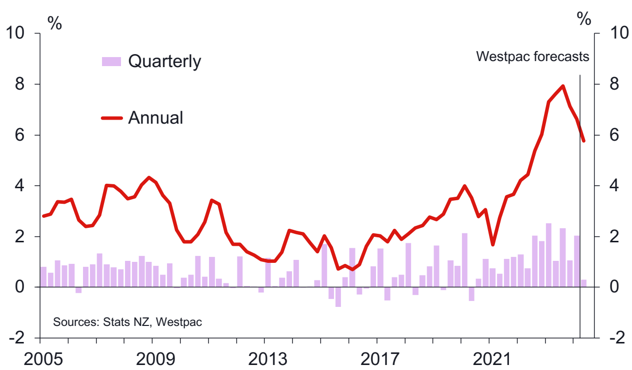
## Key area to watch - domestic inflation.

The lingering strength in domestic inflation has been a key focus for the RBNZ. Much of that strength has been related to items like insurance and utilities. We're forecasting continued large increases in those areas in the June quarter, with further strength likely over the year ahead. Although those sorts of costs respond only gradually to increases in interest rates, the RBNZ does not look through price rises in these areas, especially as they can influence inflation expectations and feed into businesses' costs more generally.

However, the strength in inflation hasn't been limited to those areas. The past few years have seen large and widespread price increases in a range of discretionary spending areas, including the costs of many domestic services like cultural and entertainment services. Those are areas which tend to be more responsive to changes in interest rates. Their continued strength over the past year in spite of the rise in borrowing costs highlights the strength of the inflation pressures that the RBNZ has been leaning against.

We expect continued strength in services prices in the June quarter. However, with a deepening downturn in domestic spending and signs of cooling in the labour market, we're now seeing tentative signs that price pressures on this front are cooling. Stats NZ's monthly price gauges have already recorded softer prices for services like restaurant and takeaway food, as well as a big drop in holiday accommodation costs. On top of that, business surveys in the retail and services sector have reported a fall in the number firms who have increased their prices in recent months. Softness on this front would be an important development for the RBNZ, signalling that tight policy is having the desired impact.

**Non-tradables excluding housing, government charges and insurance costs**



## In the detail: What's underpinning inflation in the June quarter?

Our forecast for June quarter CPI incorporates information from Stats NZ's monthly Selected Price Indicators. That data provides a timely source of information covering 45% of prices in the CPI basket.

Housing rents (9% of the CPI) are set to be the largest contributor to inflation in the June quarter. Stats NZ's monthly data point to a 1.2% rise in rents in the June quarter, which would leave them up 4.8% over the past year.

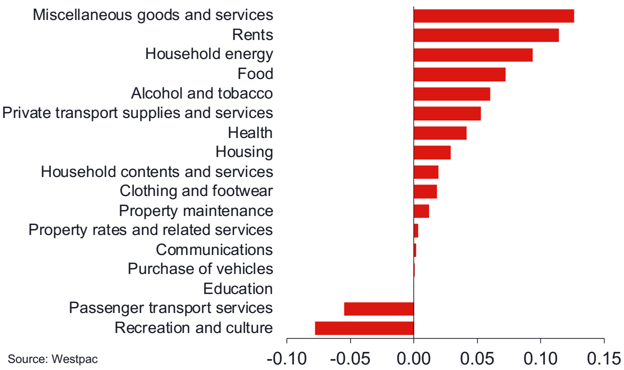
Insurance costs (3% of the CPI, included in the 'Miscellaneous goods and services' group) are likely to post another large rise of 4%. That's a bit more modest than the increases seen in recent quarters, reflecting that many insurance contracts have already rolled on to higher premiums over the past year.

Household energy costs (3% of the CPI) are expected to have risen by 3% this quarter, underpinned by the increases in electricity costs.

Food prices (19% of the CPI) were up 0.2% over the past three months (based on Stats NZ's monthly data).

On the downside, passenger transport costs (3% of the CPI) are expected to have fallen 2% in the June quarter, with seasonal drops in both domestic and international airfares. Similarly, prices in the recreational and culture group (10% of the CPI) are expected to be down 0.6%, mainly as a result of lower holiday accommodation costs.

**Contributions to June quarter inflation forecast (percentage points)**



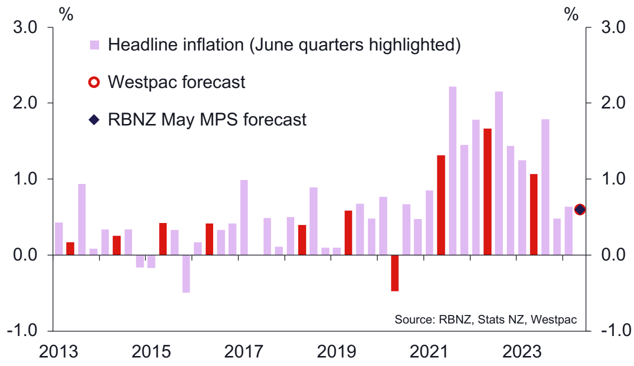

## Risks.

On the domestic front, the main area of uncertainty is insurance costs. With many insurance policies having already rolled onto higher premiums, we've factored in a more moderate (though still sizeable) increase in costs this quarter than we saw over the past year. There is a risk that the rise in premiums is larger than we've allowed for.

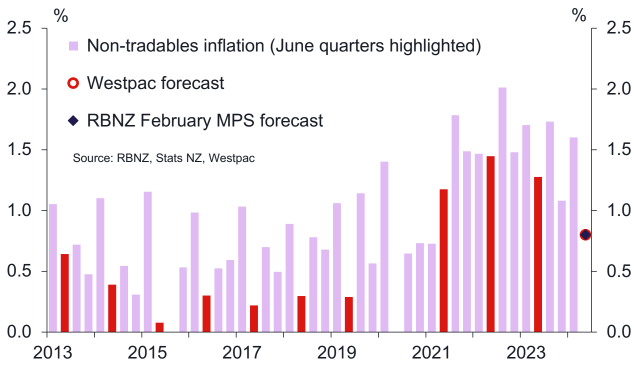
There is also a question mark around the cost of purchasing a new home. Construction cost inflation has already fallen to low levels has building activity has turned down. However, feedback from builders has highlighted ongoing pressure on margins and competitive tendering processes. That could mean an even smaller increase than we've factored in, or even a small decline.

On the imported front, softening consumer spending could be a larger drag on tradables prices than we have assumed, especially for durable items like new and used cars. Increasing competition from direct imports could also be a factor here.

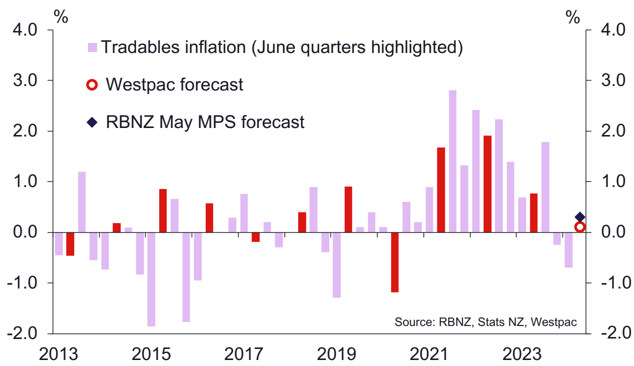
**Quarterly CPI inflation**




**Quarterly non-tradables inflation**




**Quarterly tradables inflation**



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