

Headline act

Q2 CPI preview: 18/07 10:45am NZT

- We estimate that the Consumer Price Index (CPI) rose by 0.9% in the June quarter, lifting annual inflation to 5.2%.
- Strength in world commodity prices is expected to show through in fuel, food, airfares and building costs.
- The RBNZ is already braced for a '5' handle on annual inflation, but the potential effects on already-high inflation expectations should be a concern.

CPI expectations

	% qtr	%yr
Q1 actual	0.8%	4.5%
Q2 Westpac forecasts	0.9%	5.2%
Q2 RBNZ forecasts	0.7%	5.0%

We expect another sizeable quarterly increase in next Monday's CPI release, lifting the annual inflation rate to a 21-year high of 5.2%. The headline rate is still being boosted by one-off administrative changes – mostly the GST increase last October – but the underlying picture is that the recessionary lull in inflation pressures is now well past.

We expect the biggest positive contributions to come from:

Private transport (0.3ppts): Petrol prices have eased from record highs since early May, but were still 4.7% higher on average for the quarter.

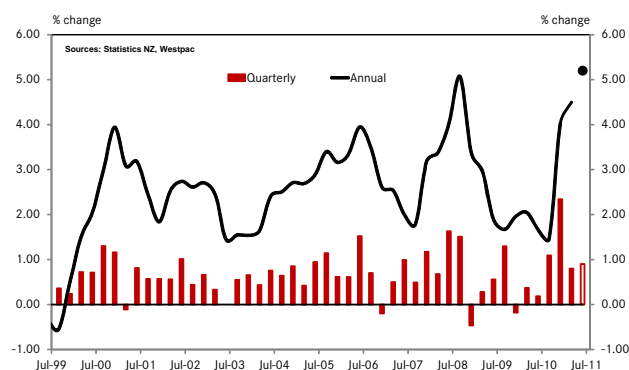
Food (0.2ppts): High world commodity prices reflected in local prices for meat, and increasingly for processed foods.

Energy (0.1ppts): A seasonal increase in electricity line charges.

Passenger transport (0.1ppts): Several international airlines increased their fuel surcharges between February and April in response to soaring oil prices.

We also expect small positive contributions from the housing-related components of the CPI – an area that proved to be a stubbornly persistent source of inflation during much of the last decade. Prices of building materials have been rising sharply since last September, driven by increases in world commodity prices. Rentals have also been rising at a faster clip recently

Consumer Price Index



compared to the 2009 slowdown. We suspect only a small fraction of these increases can be put down to the effects of the Canterbury earthquakes.

Implications

The Reserve Bank is expecting a 0.7% rise in the June quarter CPI, leaving annual inflation at 5.0%. A push above the 5% mark – the second time in the last three years – will not in itself alarm the RBNZ, given that this time the headline rate has been boosted (to the tune of around 2.5ppts) by the earlier increases in GST and tobacco excise and the introduction of the emissions trading scheme.

However, we are concerned that these kinds of outcomes will steadily erode the RBNZ's wiggle room on inflation. Inflation expectations are already at or above 3% on various surveys. There is little visible passthrough from the persistently high exchange rate of the last two years. And the RBNZ acknowledges that it is making a major assumption that cost pressures arising from the rebuild of Christchurch can be well-contained. We are now forecasting annual inflation to remain above 3% at the end of this year – that is, once the GST hike has dropped out – compared to the RBNZ's current forecast of a drop to 2.5%.

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