Research

Economy Watch

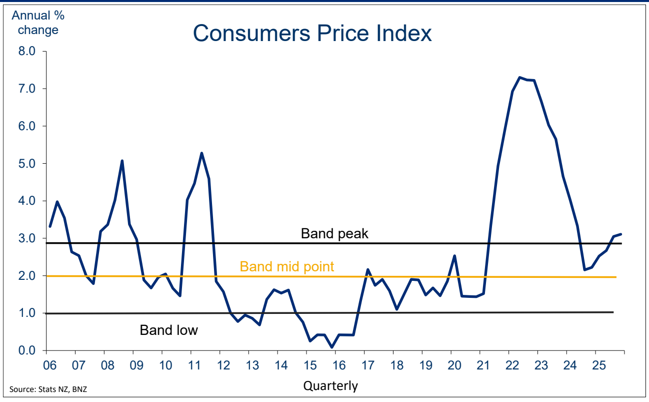
23 January 2026

Inflation worryingly high

- **Q4 CPI well above RBNZ expectations**
- **Growth acceleration under way**
- **Cash rate will soon need to become less stimulatory**
- **Election timing not optimal**
- **We bring forward our forecast first rate hike to September 2026**

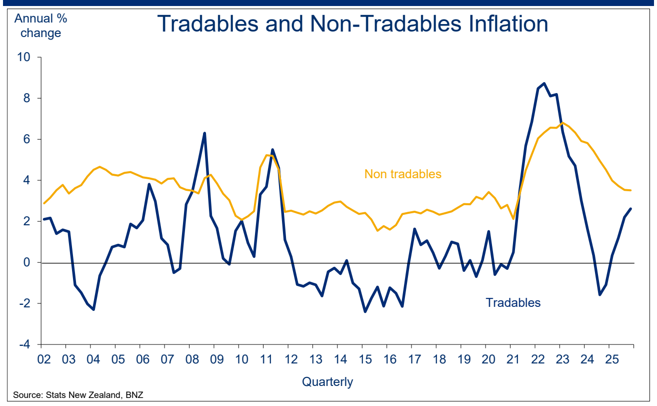
The chances of a 2026 rate hike rose significantly today with annual CPI inflation rising to an eighteen month high of 3.1%. We think our new laser-focussed-on-inflation RBNZ Governor will not be amused.

Unwelcome inflation



To start with, the quarterly increase of 0.6% was a big miss for a central bank that was forecasting 0.2% for the period. The miss was greater on tradables than non-tradables but both came in higher than anticipated. Tradables rose 0.7% against a 0.1% pick and non-tradables 0.6% against a 0.4% prediction.

Both too high?



The miss is one thing but more problematic is the fact that the headline reading has a three in front of it. This risks pushing inflation expectations higher and may encourage the increasing number of businesses who appear to be contemplating price increases to give things a nudge.

There are a number of inflationary factors that probably should be looked through. To start with, we are a bit flummoxed by the 11.3% increase in the price of telecommunications equipment in the quarter. This accounted for around a quarter of the 0.2% difference between our forecast for the CPI increase and the outturn. This is very unlikely to be repeated in the next quarter.

Similarly, the strong contribution from the 7.2% quarterly increase in international airfares could unwind in future quarters, though we are quick to note that this increase and prospective correction were already built into our forecasts.

But, equally, there is a lot going on that can't be discounted.

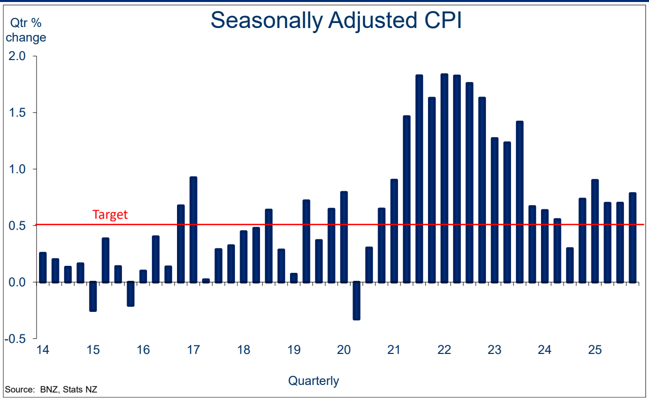
Perhaps the most concerning factor to us is that, in the words of Statistics New Zealand, "more than 80% of the CPI basket increased in price over the past year – the highest proportion of increases recorded in 18 months". This means the breadth of price increases is widening disconcertingly.

This is reflected in the fact that the 10% trimmed mean measure of annual inflation has risen progressively from a low of 2.3% in the year to December 2024 to 2.9% by end 2025.

To cap things off, the seasonally adjusted move in prices was 0.8% q/q. Indeed, the seasonally adjusted figures have been relatively steady between 07-0.9% over the past five quarters, challenging any argument of disinflationary forces prevailing in the economy over the past year or so.

Also difficult to discount is the news that inflation in the price groups associated with house building, maintenance and furnishing appear to no longer be on a falling trend. Home ownership costs rose 0.6% in the quarter, property maintenance 0.7% and furnishing, flooring and floor coverings an eye-watering 4.4%. The increases in these groups explain around half of our forecast miss. Notably these are interest rate sensitive sectors.

Above target for a while?



Putting all this together one has to conclude that the chances of a rate hike in 2026 have gone up considerably. The balance of risk to an earlier hike also has been pushed higher by an economy that appears to be building a head of steam faster than had been forecast. And then there's the labour market. It still looks weak, but we are concerned that, as the economy grows, the mismatch in skills between those unemployed and those needed will put upward pressure on wage rates especially if weak net immigration continues to limit the supply of labour.

Developments in Australia are also unhelpful from an inflation perspective. A strengthening labour market means financial markets now expect a rate hike in Australia relatively soon. The relative shift in monetary policy has been a theme over the last six months driving the weaker NZDAUD cross rate over that timeframe, which adds to our domestic inflation. More importantly, though, the strengthening Australian economy will exacerbate New Zealand's skill shortages.

To cap things off, financial market pricing needs to be taken into consideration. A first rate hike is almost fully priced for the September RBNZ meeting with two rate hikes priced by year's end. This pricing is already affecting lending and borrowing rates but doesn't seem to be causing any major bother. And note that today's CPI outturn was already largely priced.

We have been saying for some time now that our pick for a first rate hike in February 2027 was looking too late. Today's numbers certainly support that view.

The problem we are faced with is: if we are to bring forward our rate hike track when exactly do we move it to?

One thing that needs to be taken into consideration is the General Election on November 7. The RBNZ is operationally independent so it can broadly do what it wants when it wants but central banks are not keen to become embroiled in election campaigns if it can be avoided. In our opinion, this means the 28 October Monetary Policy Review would be far from optimal for a first rate hike. Moreover, it's always easier to tell the full story with a complete Monetary Policy Statement when a hiking cycle (or cutting) begins.

So the question is, would it make more sense to go in December or September? December is the easy go to option for forecasters. It brings the first hike into 2026 and avoids the election. But, frankly, if our logic about what is going on is right then December would be almost as tardy as February 2027.

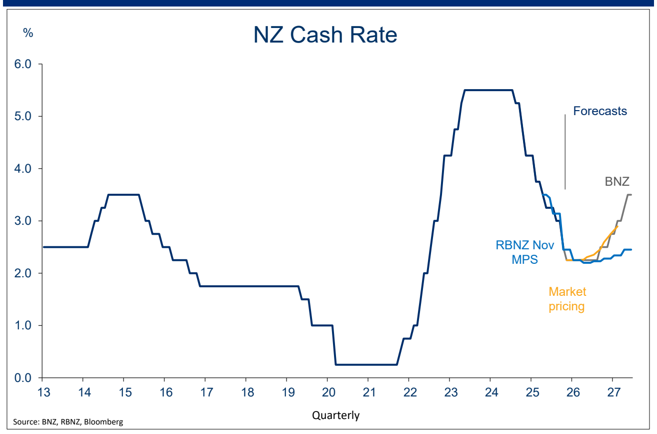
So is September too ambitious? We think not. In short:

- Growth is bouncing strongly
- Labour market tensions could grow quickly
- Inflation is stronger and stickier than anticipated
- The market is already a long way toward pricing it so following through in September should not cause too much grief for the election
- The cash rate will still have been at its low for almost twelve months, which is about the normal length of time for a low to be sustained
- Even with a series of rate hikes it will take some time before interest rates become contractionary.

We are thus formally shifting our expected first rate hike to September of this year. We have a pause in October and then rate hikes in each of the next meetings, restarting in December, through to a peak of 4.0% by September 2027. Our October pause is simply doffing our hat to the election. In reality that may be being a bit cute and unnecessary.

Naturally, there are innumerable events that could, and probably will, change our view on the exact track. As is always the case there is a risk that the first moves are more extreme than what we have forecast and that pauses get longer towards the end of the cycle. Additionally there is substantial risk around the terminal rate. For now, though, we feel that moving our view to September of this year is a better "central" view than leaving the first rate hike to February 2027 where the risks seem increasingly one-sided.

Market's got it right



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