

Research Economy Watch

17 March 2026

Annual inflation to approach 4.0%

- **February partials broadly on expectation**
- **But petrol lights the inflationary fire**
- **Worst case scenarios need reconsideration**
- **Inflation expectations to rise further**
- **Meanwhile some solace for renters**

We were waiting for today's selected price indexes in case there were any major surprises in the data that might derail the set of inflation forecasts that we were about to publish. As it turns out there were a couple of things that caused us to adjust our view but, in the end, they did little to change the bigger picture which is being driven by rising oil prices.

In terms of those surprises, the biggest one was Statistics New Zealand's announcement that it had miscalculated, through "human error", its January Food Price Index. It turns out food prices increased 2.1% in January not the 2.5% first reported. The error was played down on the basis that it didn't impact any published quarterly CPI outturn. But this overlooks the fact that everyone's Q1 CPI forecast is affected by this number and with food prices accounting for 18.5% of the CPI it matters.

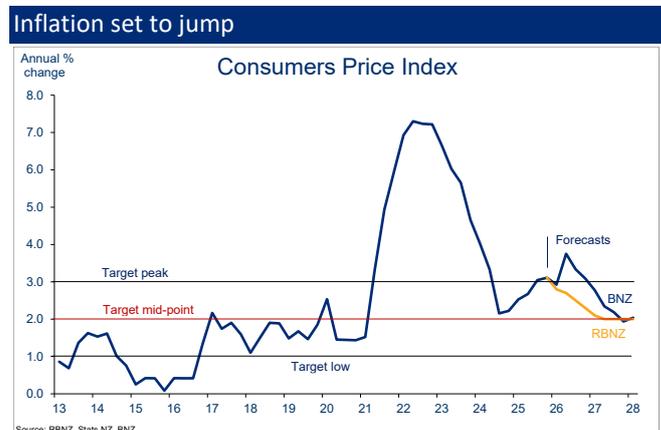
As it turns out, we were surprised by how strong food prices were in the month of February so our broader food price profile remains intact.

The other surprise to us was the 12.8% surge in domestic airfares across the month. This was sufficiently large to mean that, overall, our cumulative partials index was 0.16 higher than we had anticipated. This is significant but not enough to push our Q1 CPI expectations any higher than we had already thought.

Thus, for now we see no reason to change our expectation that the overall CPI rose 0.8% in the first quarter to be up 2.9% for the year. The RBNZ is forecasting 0.6% and 2.8% respectively. The fact that the quarterly difference is wider than the annual is due to rounding. Whatever the case, inflation will again be higher than the RBNZ had expected.

But it's thereafter that things get really interesting. In light of the latest movement in NZ fuel prices, we have now raised our forward inflation track such that annual CPI inflation now peaks at 3.8% in the June quarter of 2026, up

0.2% on our previous forecast. Importantly, it remains above 3.0% in the following two quarters. This will mean inflation will have been predominantly above 3.0% for six consecutive quarters. The prospect of this feeding into inflation expectations, which are already rising, is high. As we have said before, this is nightmare territory for the central bank who had assumed in the February MPS that inflation expectations would fall.



It also seriously questions Treasury's forecasts that annual inflation will only rise to 3.7% under a worst-case scenario. 3.8% is our central view. Because of that there is, of course, around a 50% chance that it doesn't get to 3.8%. But that also means there is an equal chance that it turns out greater than that.

Our forecasts assume that the average price of 91 grade petrol stays, where it is now, at \$3.05 through to the end of April and then falls relatively aggressively. To us that seems a relatively conservative view. We also assume that second round effects are well-contained and that the currency does not depreciate rapidly. These are starting to look like fairly heroic assumptions.

A worst-case scenario in our minds would be a widening of the war in the Middle East accompanied by more disruption to global logistics and a sharply falling New Zealand dollar. The chance of this must be non-negligible and would definitely result in much higher pump prices.

For the record, we also think that Treasury's belief that growth of 2.5% is a worst-case scenario for calendar 2026

is overly optimistic. Based on the economy growing an average of 0.7% per quarter in that year we end up forecasting annual average growth of only 2.4% as our central forecast or 2.9% if we look at December quarter 2026 relative to December 2025. Whatever your point of comparison it seems the worst-case scenario could be a lot worse than Treasury envisages.

If there was one positive piece of news in today's data it was for renters. Rents fell 0.1% in the month, the first negative reported in a series that dates back to January 2007. The 0.9% increase for the year was also the lowest reported. Good for renters but, of course, not great news for landlords.



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