Research

Economy Watch

21 July 2026

Inflation demands stimulus removal

- **Price rises stronger than RBNZ projections**
- **Core measures too high**
- **More supply shocks ahead?**
- **Inflation will fall from here**
- **But will need central bank help**

Inflation is a problem in New Zealand. Today's Consumers Price Index is a strong confirmation of this. Yes, we all know fuel prices are currently the main contributor to households' cost of living misery, and this will be the focus of most headline writers. But the worrying aspect of today's data is not the impact of fuel but the depth and breadth of price increases across the economy.

For the central bank, even the headline reading will be disconcerting. Prices rose 1.5% for the June quarter, 4.1% for the year. When releasing its July Monetary Policy Review the RBNZ announced it was lowering its annual inflation forecast for the year ended June to 3.9% with it falling further to 3.3% in September. To get 3.3% for Q3 you would now need only a 0.3% increase in prices for the next quarter. We are looking at something closer to 0.7%, which will deliver annual inflation of 3.8%.

For the Reserve Bank to justify holding its policy rate in September would, in our opinion, have necessitated today's inflation surprising to the low side of its projections. Moreover, with oil prices ascending again there is already heightened risk for Q3 inflation.

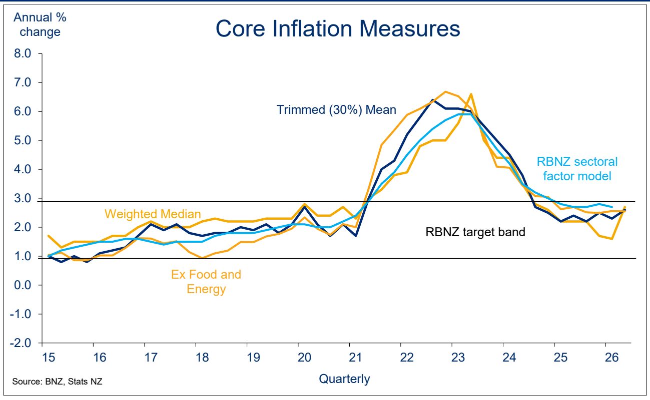
The very fact the annual reading printed with a "4" in front of it is problematic for inflation expectations. Moreover, the extent of the quarter's increase will probably ensure annual inflation stays above 3.0% for the remainder of the year. That too will not help inflation expectations fall.

And all this before one contemplates the possibility of another three potential supply shocks:

- Soaring computer memory costs impacting technology prices.
- El Nino which is already affecting global food prices and could impact domestically grown food prices if we get a drought.
- Bird flu and its potential impact on food prices.

While headline inflation is the focus of the Reserve Bank's legislated target the Bank tends to focus on core measures of inflation as being better measures of "true" inflation. We don't yet know what the RBNZ's sectoral factor model measure is for the June quarter, but we do know that if it doesn't move far from the 2.7% annual reading for the March quarter, that the average of the core measures followed will rise. Moreover, even the lowest core reading, that of CPI ex food and energy, will be 2.5% which is well above the mid-point of the RBNZ's target and at a time when the economy allegedly has a bucket load of spare capacity. As this spare capacity is eroded in line with current growth forecasts that inflationary pressure can only become greater.

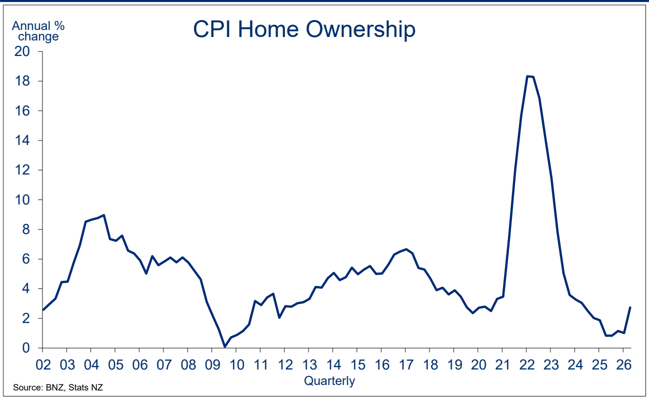
Core inflation too high



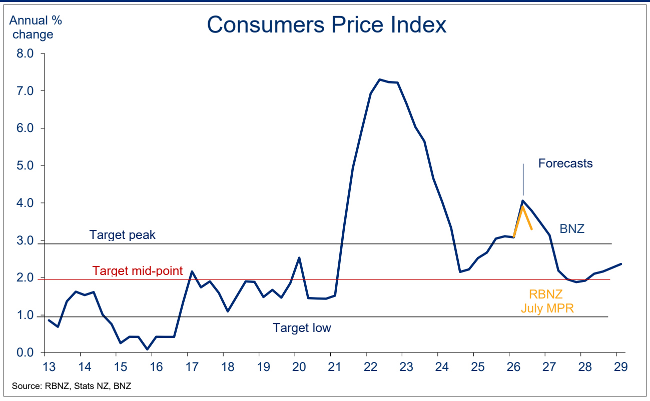
On a similar vein, it is noteworthy that the proportion of goods and services that are rising in price seems to be trending gradually higher. This implies inflationary pressure is expanding across the economy.

There weren't too many surprises in the detail with evidence that fuel, the increase in the minimum wage and the fall in the New Zealand Dollar probably impacted a number of categories. We were, nonetheless, surprised to see that the cost of home ownership (read building) rose 1.6% in the quarter to be up 2.7% from a year earlier. This is the largest annual increase since June 2024. We know the sector is struggling with cost increases but we were surprised to see the extent of the pass through given anecdotal evidence of low demand.

Too early for this?



Going down with help



While we recognise the prevalent inflationary pressures, we are not arguing inflation is about to surge out of control. In fact, we argue quite the opposite. We think inflation in the year ended June will be the peak in the cycle and that it will progressively fall to levels that are consistent with the central bank achieving its target. However, this comes with the huge caveat that such success will be very short-lived if the RBNZ fails to move interest rates back to at least neutral, and probably higher, over the remainder of this year and into next. And don't be fooled into thinking higher interest rates here would be a global aberration. Our current annual inflation rate is above that of Australia, UK, USA and the EU yet our interest rates are lower than all of them except the European Union whose annual inflation rate is 3.3% and annual growth sub 1.0%.

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