

Research Economy Watch

22 October 2026

Core inflation pushing higher

- **Core annual inflation around 3%**
- **Headline inflation eases to 3.7% in Q3**
- **It's a head fake, Q4 will be higher**
- **Price increases are broadening**
- **Monetary stimulus removal required**

There was something for everyone in today's inflation figures. For the doves, the headline figure came in a tick under market expectations, the quarterly core measures were well contained, and just two components (international airfares and local authority rates) accounted for two-thirds of the quarterly increase.

For the hawks, the percentage of items rising in price lifted aggressively indicating a broadening in inflationary risk and annual core inflation continues to rise with measures clustered around the 3% mark.

For all, the third quarter data is dated. That is a remarkable statement when the data is released 22 days after the reference period. A sign of the speed of change in today's markets.

Whatever the finer details of today's Q3 data showed, annual inflation is already shaping up to be much stronger in Q4. And that is before the full impact of a lower NZ dollar is felt.

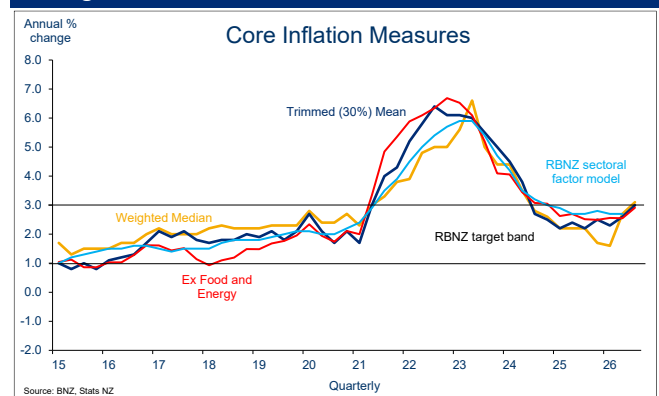
It is the core measures of inflation that worry us most. CPI excluding food and energy rose 2.9% y/y, a decent chunk higher than the 2.5% y/y reading a quarter earlier. The 30% trimmed mean annual inflation rose to 3.0% from 2.6%. And the weighted median rose to 3.1% from 2.7%.

Not all core inflation measures rose. The 10% trimmed mean annual inflation managed to edge down a tick to 3.0% from 3.1%, as did non-tradeable annual inflation which nudged down to 3.3% from 3.4%.

These annual readings are simply too high for comfort. One would imagine the RBNZ's Sectoral Factor model to give a similar message when it is released around 3pm today. It all raises questions around how much spare capacity the economy has been operating with in the face of recent supply shocks.

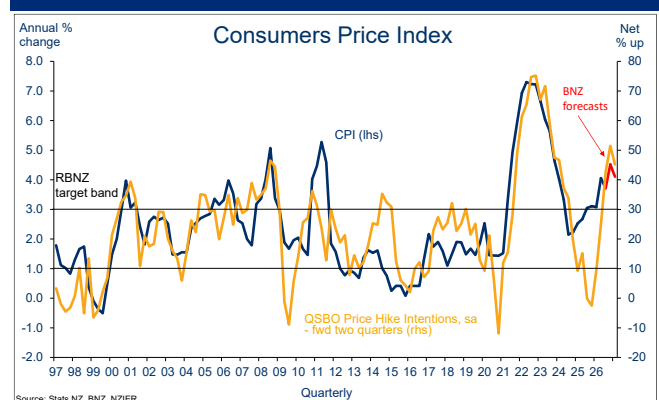
While some may celebrate that annual inflation eased to 3.7% in Q3 from 4.1% in Q2, we continue to warn that annual inflation is likely to push materially higher in Q4. And, of course, at 3.7%, annual inflation is hardly low and is a clear and material headwind to household disposable income.

Too high



We will take a closer look through the details of today's data in due course to finalise our thoughts for Q4, but even with a mild downside surprise in today's Q3 data, annual inflation looks likely to push up into the mid-4's in Q4. This is consistent with pricing intentions from the likes of the Quarterly Survey of Business Opinion.

Well outside the band



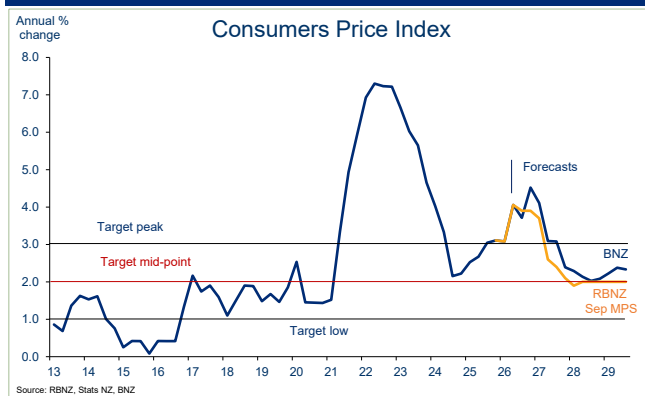
The Q3 CPI inflation outcome of 0.7% q/q and 3.7% y/y was a tick lower than market expectations of 0.8% q/q and 3.8% y/y. We and the RBNZ had +0.8% q/q and +3.9% y/y.

Q3 CPI inflation was a tick lower than the RBNZ's projection for the quarter and two ticks lower for the year. We do not think this will materially alter the Bank's thinking for next week's OCR decision, where we continue to expect a 25 basis point hike.

The Bank, like all of us, can see the upward pressure on inflation still to come through from higher fuel prices and a lower NZ dollar. All along we thought the precise Q3 outcome was of secondary importance to what is shaping up in Q4, which, looks to be a long way north of the 3.9% that the RBNZ projected in its September MPS.

The market looks to have drawn a similar conclusion judging by the reaction to today's data. Short-end interest knee-jerked a point or two lower on the headline figures but bounced back soon after to be marginally higher than pre-data as the core measure was absorbed.

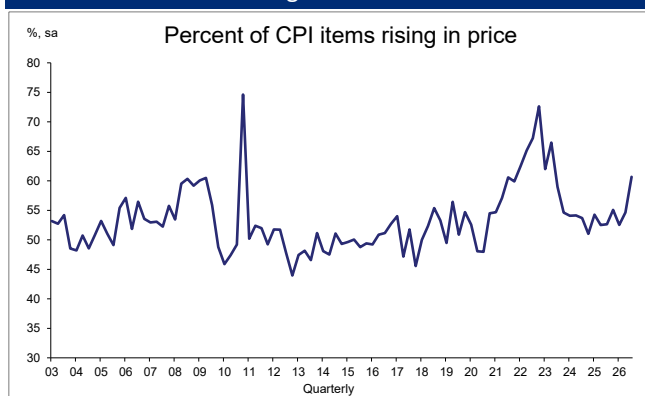
Q4 looks like being further above RBNZ than Q3 was under



Higher headline inflation into year's end and with core annual inflation pushing north, there remain upside risks to inflation expectations and firms price setting behaviour.

There were clear signs of price increases becoming more widespread in today's data. In Q3, the proportion of items that rose in price increased to 59.7%. This was 56.2% in Q2.

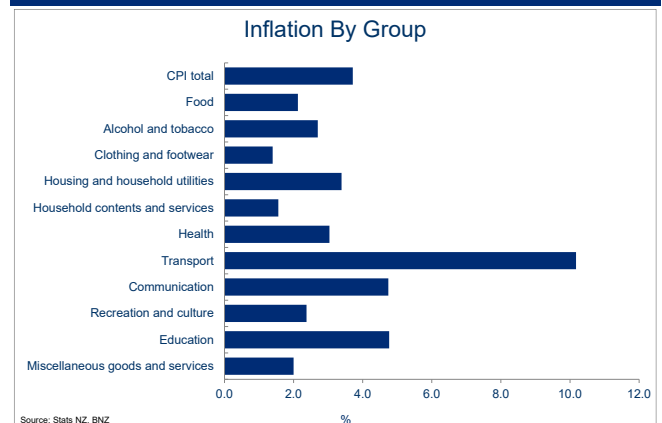
Price increases broadening



Disturbingly, this percentage usually falls between the second and third quarters, so the increase was even greater on a seasonally adjusted basis. The percentage of items going up in price is at its highest since June 2023 and, if you excluded the Covid period and the lift in GST in 2010, it is its highest since June 2009.

Amid a lot of moving parts, all major CPI groups saw prices rise over the year. Across the major groups, clothing and footwear saw the lowest annual inflation at 1.4% while transport saw the highest at 10.2%.

All rise



A lot of the price movements were close to our expectations, as you would expect given the already published monthly indicators.

Food prices rose 1.0% q/q, airfares rose sharply, and electricity and gas prices rose 0.8% q/q. Fuel prices fell sharply in the quarter, as indicated by the monthly data.

Downside surprises for us were concentrated in house construction costs, local authority rates, and some selected tradeable items.

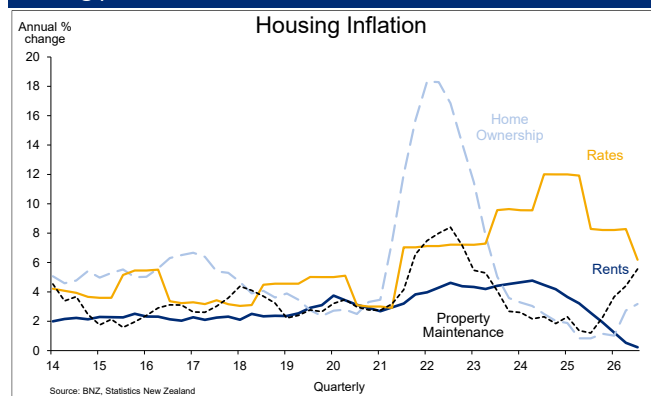
Housing-related inflation was a bit lower than we had pencilled in. Local authority rates rose 6.1% q/q, roughly a percent and a half lower than we had assumed. And, while construction costs rose 0.5% q/q, it was well less than indicated by business surveys and industry estimates. Flat rents in the quarter matched our expectations.

Clothing and footwear prices fell 0.5% q/q and -1.0% q/q respectively, against our assumptions of small gains, and telecommunication equipment prices fell more than we assumed, plunging 12.8% q/q.

Despite the latter, there were some signs of the global computer chip and memory pressures coming through. Audio-visual and computer equipment prices rose 8.3% q/q to record its first annual price lift since the current data series started back in June 2000.

Beyond clothing and footwear, some other tradeable prices pushed higher than expected. It is not clear whether this reflects a lower NZD or movement in underlying global prices. A lower currency can take many quarters to be fully felt domestically and is one factor that threatens to keep inflation elevated for some time yet.

Moving parts



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