

Fuel tax reduction no game changer for RBNZ

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Impact of fuel tax reduction on inflation

Bottom line

The Government [has announced](#) a temporary reduction in the excise tax charged on fuel in New Zealand. As of tonight, the tax will be reduced by 25 cents/Litre for petrol for three months (with equivalent reductions for diesel vehicles through reduced road user charges, and with a review before the tax cut expires). We estimate the direct impact could reduce CPI inflation in the June quarter by about -0.5% pts, relative to our current forecast of 7.4% y/y. The monetary policy implications are minimal and we continue to expect two 50bp hikes.

Key points

The Government has announced a temporary reduction in the fuel excise tax, road user charges, and a public transport subsidy.

- Due to the Russian invasion of Ukraine, and sanctions that have been imposed in response, WTI oil has risen to around USD110/barrel. Volatility is extreme, with WTI futures trading at or above USD130/barrel at times last week.
- Rising oil prices translate into higher prices at the pump for Kiwis – the [latest estimate](#) from fuel price monitoring company Gaspy puts the average price of unleaded 91 at 306 cents/litre as of today, compared to about 265 cents/litre a month ago.
- Currently, the [national fuel tax](#) for unleaded 91 is set at 77 cents/litre (excluding regional fuel taxes and GST). That's about 30% of the retail price of petrol – although the proportion changes as petrol prices change (see figure 1 on the next page for contributions to the petrol price in NZ).
- This tax will be reduced by 25cents/litre, starting tonight for a period of three months. It's too late for the change to really impact the Q1 CPI figure (which we expect will print at 7.1% y/y), but plugging the change directly into our model implies that headline CPI inflation may now peak at 6.9% y/y in Q2 – a touch lower than our current forecast for 7.4%. As figure 2 shows, the impact is small in the context of the current levels of high inflation we're experiencing – but every little helps.
- We assume that the tax reduction will be gradually unwound over the next 12 months – but that's very much subject to further announcements by the Government. Any unwinding of the tax reduction will mechanically add to CPI inflation when added back in – hence inflation is actually higher in figure 2 at the end of the forecast.
- We will wait for further inflation indicators before formally updating our forecast. Other changes included making public transport half price and cutting road user charges – but policy details there are still being hammered out (and may not have a significant impact on overall inflation, beyond the change to the fuel excise tax).

So what does this policy change mean for inflation trends and for monetary policy? Last week we published a new [inflation forecast](#) showing CPI inflation peaking at 7.4% y/y in Q2 – higher and later than the RBNZ's forecast (finalised before the invasion). That, plus surging inflation expectations, led us to [change our OCR call](#) also last week, and we now expect the RBNZ will lift the OCR by 50bps at *both* the April and May meetings. .

The reduction in fuel excise tax will cause a one-off drop in prices, which we expect could reduce Q2 inflation by 0.5%pts to a still-worrying 6.9% y/y, depending on how much is passed onto consumers. There will be second-round impacts, as most goods and services in the economy rely on fuel somewhere in the supply chain. We'll wait for more data before revising our CPI forecast – today's tax change implies downside risk, but oil price moves or other developments could easily go the other way.

Importantly, this tax tweak doesn't meaningfully alter the picture for core or medium-term inflation. With inflation expectations problematically high even before the oil price surge, and enormous media coverage of inflation since driving awareness, the RBNZ still has a big job ahead of them to get inflation – and expectations thereof – back under control. Illustrating this, Google searches for "inflation" in New Zealand are spiking (figure 3, over). It's the topic du jour. We think the RBNZ will want to get on with things while the going's good, and continue to expect 50bp hikes in both April and May.

Figure 1. Contributions to retail price of petrol in New Zealand

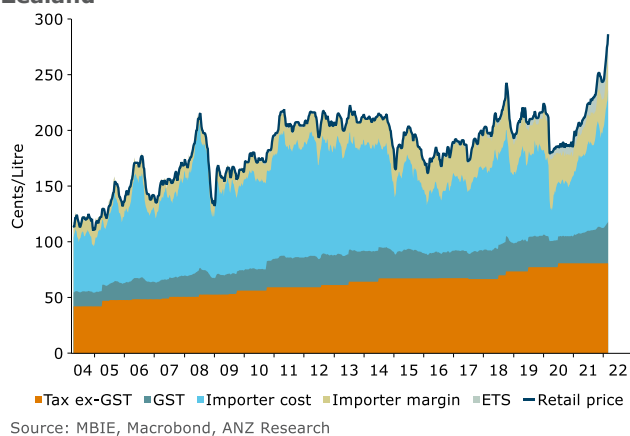


Figure 3. Google searches for "inflation" in New Zealand

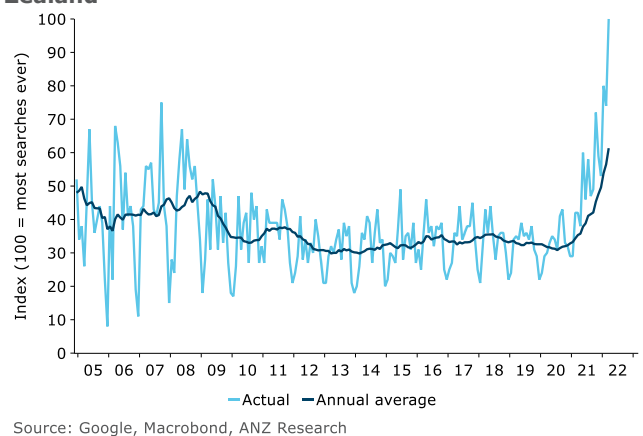
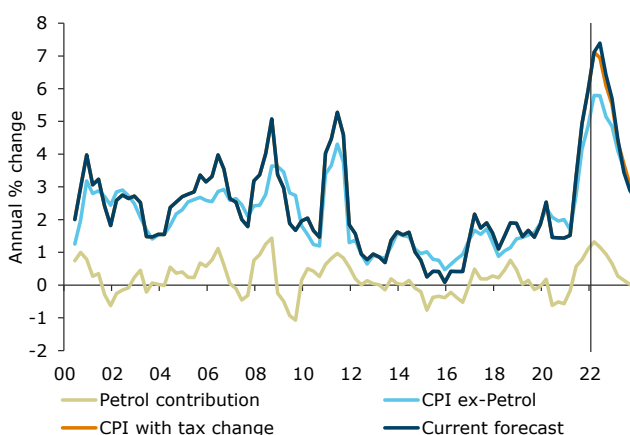


Figure 2. Impact of petrol tax reduction on CPI inflation





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