Inflation tipped to hit 20-year high

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Inflation could blow out to 10 per cent over the next five years, well above the Reserve Bank target of 1 per cent to 3 per cent, according to funds management company NZ Funds.

The firm's chief investment officer Michael Lang made the bold prediction following the Reserve Bank's Survey of Expectations for the June quarter, which points to an annual consumer price index inflation rate of 5.1 per cent for the current year, compared to 4.4 per cent for the March quarter. Currently inflation is 4.5 per cent.

The 75 business managers surveyed also expected inflation increases of 3.12 per cent and 3 per cent in 2012 and 2013, respectively. The previous quarter's survey had expectations at 2.87 per cent and 2.64 per cent.

Mr Lang said the expectations in the June survey were a "20-year high" and the Reserve Bank's inability to curb it "is a precursor to inflation getting out of control".

"If businesses expect inflation to rise next year they will put up their prices in anticipation this year. This in itself creates inflation, validating their concerns and turning inflation expectations into a reality," Mr Lang said.

"Under the current circumstances we are factoring inflation expectations between 5 to 10 per cent between 2013 and 2016." He was the only financial expert spoken to by BusinessDay who expected the rate to go that high.

Tower Investments chief executive Sam Stubbs said "inflation is definitely coming" but would not make a prediction.

"We are highly confident that with many countries printing so much money, that has to flow through inflation in those countries. For example, inflation in China is running close to 10 per cent, and because we import so much from China, we import their inflation."

Westpac chief economist Dominick Stephens said inflation of 10 per cent was "highly unrealistic" for New Zealand and he expected it to be under 3 per cent after two years.

"If people expect higher inflation, their wage and pricing decisions may reflect that expectation and that creates difficulties for the Reserve Bank."

Inflation expectations peaking at 5.1 per cent incorporates hikes in GST and ACC changes as well as the emissions trading scheme, "which are all administrative" in nature. Without them, "inflation is probably at around 2 per cent at present", he said.

New Zealand Institute of Economic Research principal economist Shamubeel Eaqub predicts inflation of between 2 and 3 per cent by 2013, as "the GST will drop out of inflation calculations within the next two quarters".

Both he and Mr Stephens said if high inflation expectations continued the Reserve Bank would have to raise the official cash rate to slow growth. However, that would trigger a rise in the value of the kiwi dollar.

Mr Stubbs said that could be a saving grace because "if we continue to have an extremely high dollar and we are able to export at that dollar value, then imported inflation will stay low".

But Mr Lang argued the Reserve Bank would be unable to "aggressively use interest rates to curb inflation" as it did before the global financial crisis.

"The New Zealand economy is now significantly weaker than prior to the global financial crisis and cannot withstand the meaningfully higher real interest rates needed to dampen future inflation."

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