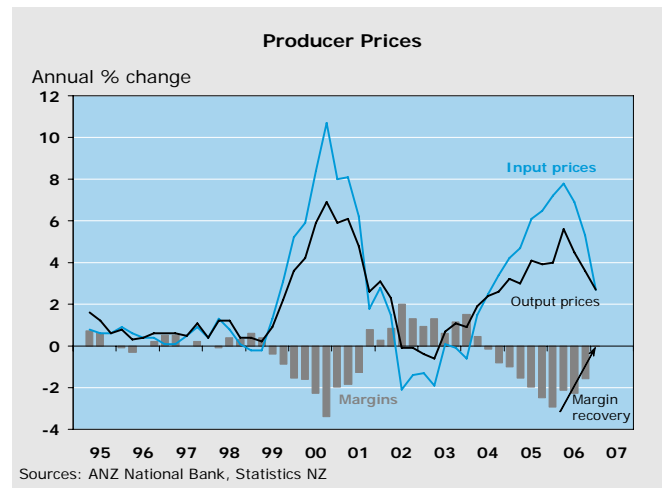


PRODUCERS PRICE INDEX – MARCH QUARTER 2007

Key points

- A stronger currency and lower fuel costs suppressed input and output price increase.
- Firms' margin recovery continues despite falls in both producer input and output prices.
- Further claw back in margins can be expected going forward, particularly when looking at the upward trend in firms' pricing intentions and elevated wage growth, suggesting further pipeline inflation pressure.
- There are limited monetary policy implications from this release. However, the underlying level of inflation pressure still evident within the economy will continue to keep the Reserve Bank on alert.

	Input Prices		Output Prices		Margins	
	QoQ	YoY	QoQ	YoY	QoQ	YoY
Mar-05	0.3	4.2	0.5	3.2	0.3	-1.0
Jun-05	2.0	4.7	1.2	3.0	-0.8	-1.6
Sep-05	2.9	6.1	1.8	4.1	-1.1	-2.0
Dec-05	1.2	6.5	0.3	3.9	-0.9	-2.5
Mar-06	0.9	7.2	0.7	4.0	-0.2	-2.9
Jun-06	2.7	7.8	2.7	5.6	0.0	-2.1
Sep-06	2.0	6.9	0.7	4.5	-1.2	-2.3
Dec-06	-0.3	5.3	-0.5	3.6	-0.2	-1.6
Mar-07	-1.6	2.7	-0.2	2.7	1.4	0.0
ANZ	-0.2	4.2	0.2	3.2		
Market	1.0	5.4	0.8	3.8		



Assessment and implications

Producer input and output prices both recorded falls in the March quarter. Input prices fell 1.6 percent (compared with a market expectation of a 1.0 percent increase), while output prices fell 0.2 percent (market expectations were for an 0.8 percent increase). The higher NZD and lower cost of fuel were reasons behind the falls in input prices, which pushed the wholesale trade input prices down by 8.0 percent, the largest fall since the series began in June 1994. The lower output prices were driven by falls in livestock and cropping farming prices (-9.3 percent), as well as electricity generation and supply prices (-3.1 percent). Construction output prices rose by 0.8 percent, but this is the smallest increase since September 2003.

Firms were able to regain some lost margins in the quarter, despite the falls in output prices. Margins rose by 1.4 percent in the March quarter, the biggest quarterly gain since the series began. However, this is coming after a period of significant contraction in margin growth with quarterly falls recorded in the last nine out of 11 previous quarters. In annual terms, margins are now flat.

We expect firms to attempt to recover their margins further going forward. Pricing intentions surveys reveal a greater proportion of firms intending to increase their prices in future as a result of rising costs. Anecdotally, we are hearing similar nuances from our travels across the country. However, the current competitive economic environment coupled with a high NZD may make it difficult to fully pass on previous cost increases. But the message we take from the last CPI report is that price increases are starting to become more broad-based.

Today's data has limited monetary policy implications. The NZD and oil prices were key contributors to the weak outturn. With world oil prices higher in Q2, part of the price decline will reverse in the June quarter. The Reserve Bank will take some comfort from the fact that construction output prices at least are not accelerating. But with wage inflation still elevated and firms continuing to look for margin recovery, there is still an element of pipeline inflation pressure to come, which will keep the Reserve Bank on alert.

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