

NEW ZEALAND ECONOMICS

Consumers Price Index – March 2010 quarter

20 April 2010

CONTRIBUTORS

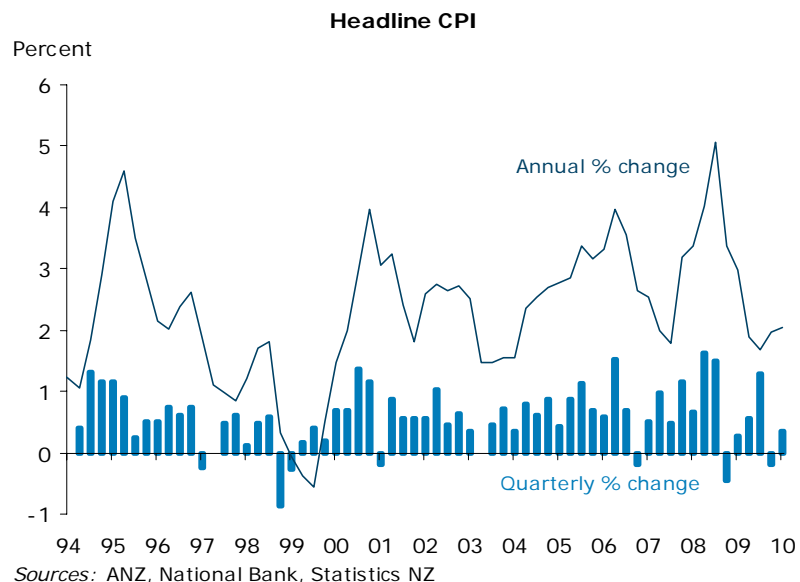
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INFLATION REMAINS CONTAINED

KEY POINTS

- March quarter inflation was much weaker than market expectations. The result was broadly in line with the RBNZ's March view but the mix looks marginally better.
- Higher petrol, food and education prices contributed to the outturn. Inflation outside of these areas was more subdued.
- Core measures of inflation were very contained in the quarter.
- Subdued core inflation should continue to buy the RBNZ time to ensure the recovery takes a firm hold. This looks to be occurring, but gradually with growth set to accelerate from late 2010.
- While we view today's inflation read as constructive towards our later than consensus view as to the start of the tightening cycle, ultimately we believe medium-term drivers such as the labour market and the Budget should be more persuasive.

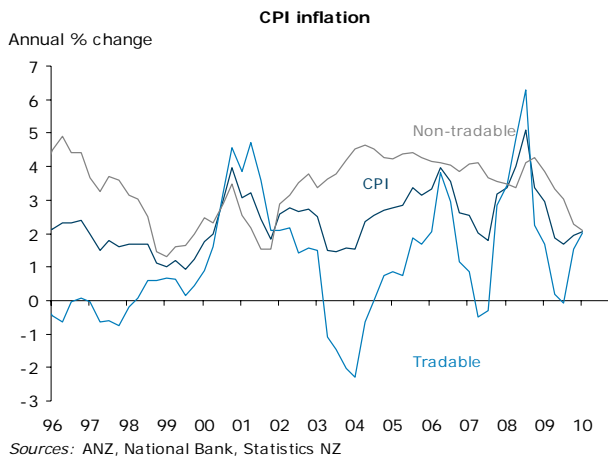


DATA REVIEW

DATA WRAP

The CPI rose by 0.4 percent in the March quarter, taking the annual inflation rate to 2.0 percent. This was much weaker than market expectations, though it is in line with what the RBNZ forecast in their March *Monetary Policy Statement*.

Core measures of inflation were well contained. From the outset we must acknowledge some of the volatility that has been apparent in inflation reads from mid 2009 (which carries the implication we may see some reversal in Q2 2010). But even abstracting from normal volatility core reads all paint a similarly subdued picture. Non-tradable inflation rose 0.5 percent (roughly the same as the average of two volatile quarters in September and December 2009). CPI Inflation ex food was up 0.2 percent. Inflation ex food, energy and utilities was down 0.3 percent. The trimmed mean rose 0.4 percent and weighted median 0.2 percent. Non-tradable ex housing and utilities was up 0.7 percent but some of this reflects a seasonal lift in education charges (although service sector inflation in the likes of health is more prevalent). Service related inflation was flat in the quarter. Inflation less central and local government charges (a non-contestable pocket) was up 0.3 percent. Our readings of today's outturn suggest little evidence of a firming in pricing pressure.



Prices in six of the eleven groups in the CPI registered quarterly increases. Five groups recorded decreases. Of the components, higher petrol (up 6.9 percent) and food (up 1.0 percent) made sizeable upward contributions to the CPI outturn. Education fees registered their usual strong increase in March. Other upward contributions were from alcoholic beverages and

tobacco and health costs. Large downward contributions were evident from lower international airfares, and audio-visual equipment.

Inflation in the housing group remained contained, increasing by 0.3 percent in the quarter. Following the usual seasonal pattern, dwelling rents rose in the March quarter (up 0.5 percent). Of some comfort for the RBNZ will be the benign readings for the homeownership sub-group (which includes the construction cost component). The 0.2 percent increase for March followed a 0.4 percent increase for December, and suggests that weak activity in the residential construction sector is containing price increases.

Food prices rose by 1.0 percent in the quarter. Positive contributions were evident for dairy and meat. **With export commodity prices on a rising trajectory, the likelihood will be a firming in food prices in the coming months and this is something we remain alert to.**

While CPI inflation came in slightly more than the March MPS forecasts, the RBNZ would have been expecting this. The climb in petrol prices after the March MPS forecasts were finalised would have prepared them for a higher number. A rebound from a weak December quarter reading (-0.2 percent) was also a distinct possibility.

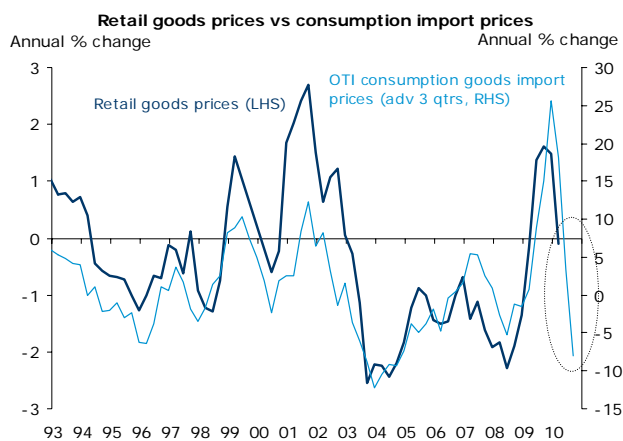
However, the RBNZ should be reassured by the inflation mix. The weaker than expected increase in non-tradable inflation and subdued readings for pretty well all core measures are an indication that inflationary pressures remain contained. **While the information is historical it nonetheless gives the RBNZ continued flexibility**

	Headline CPI		Tradable		Non-tradable	
	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg
Dec-07	1.2	3.4	1.8	3.4	0.7	3.5
Mar-08	0.7	3.4	0.2	4.8	1.1	3.4
Jun-08	1.6	4.0	2.3	6.3	0.9	4.1
Sep-08	1.5	5.1	1.9	2.3	1.3	4.3
Dec-08	-0.5	3.4	-2.1	1.7	0.8	3.8
Mar-09	0.3	3.0	-0.4	0.2	0.7	3.3
Jun-09	0.6	1.9	0.8	-0.1	0.5	3.0
Sep-09	1.3	1.7	1.6	1.5	1.0	2.3
Dec-09	-0.2	2.0	-0.5	2.0	0.1	2.1
Mar-10	0.4	2.0	0.1	2.0	0.5	2.1
ANZ	0.5	2.2	0.3	2.2	0.7	2.2
RBNZ	0.3	2.0	-	1.8	-	2.2
Market	0.6	2.2	-	-	-	-

DATA REVIEW

We have finally seen the aggressive retail discounting flow through into the CPI. For some time now, we had been wondering at the absence of the discounting in the official data that was apparent anecdotally. These came through in the Q1 numbers, helping keep tradable CPI contained, despite the strong contribution from petrol price increases (+6.9 percent). Tradable inflation excluding petrol fell by 0.6 percent for the quarter. By our calculation, retail related prices (including motor vehicles) fell 1.4 percent in the quarter, following 5 consecutive quarters of increases.

This suggests consumption volumes are likely to hold up by more than we expect in Q1 (a positive for GDP) given weakness across aggregate retail spending. With import prices remaining weak, we can expect a bit more retail discounting potentially to flow through in the near-term and potentially Q2 inflation read.



CPI Components	Quarterly % change	%-point contrib.	Annual % change
Food	1.0	0.18	1.2
Alcohol and Tobacco	1.3	0.08	2.3
Clothing and Footwear	-1.2	-0.05	2.3
Housing and Household Utilities	0.3	0.06	1.6
Household Contents and Services	-1.3	-0.07	-0.2
Health	0.9	0.05	3.9
Transport	1.1	0.17	6.4
Communication	-0.8	-0.03	-0.9
Recreation and Culture	-1.3	-0.12	-1.3
Education	4.2	0.07	4.8
Miscellaneous Goods and Services	1.2	0.09	1.4
All Groups	0.4	0.44	2.0
Tradables	0.1	0.04	2.0
Non-tradables	0.5	0.29	2.1
Trimmed Mean	0.4		2.2
Weighted Median	0.2		1.7

If there is a note of caution we noted in terms of today's tame CPI figures it is simply that we must not overplay such numbers too far - despite them obviously supporting our later than consensus view of the tightening cycle. For sure they tell us that inflation pressure is contained, and this gives the RBNZ considerable flexibility to assess how the real economy is evolving to ensure the recovery becomes self-sustaining. But the RBNZ's view will (and should) remain on the medium-term outlook. This is where the upcoming HLFS report will be critical and likewise the May 20 Budget. We expect both to produce outcomes consistent with the medium-term outlook for inflation remaining comfortably within the policy band.

However, somewhat of a sticking point will remain an array of one-offs that will lift the headline inflation rate to 3 percent by early 2011. While one-off in nature, we remain alert to the risk of second-round effects. And we must remember that while better than market expectations the inflation outturn was broadly consistent with the RBNZ's forecasts so the "new news" component is limited. However, the market reaction clearly tells us that the market was looking for a trigger to force a hike earlier as opposed to later. **But net-on-net the spirit of today's numbers - and the medium-term outlook in our mind - remains consistent with allowing the scope for patience.**

Implications

The CPI data today is historical so we are coy about getting overly excited. The market reaction on the day (currency down 30 points and rates market rallying sharply) tells us that the market was looking for a smoking gun to force a rate hike in June. Today's figures didn't deliver it, although the figures are still broadly consistent with the RBNZ's March projections. But beyond key releases over the coming months including the labour market and Budget, the June decision is increasingly shaping up as one of whether the RBNZ will back its bullish 2010 economic assessment despite generally mixed economic signals so far (i.e. sub-trend growth as opposed to the RBNZ's above trend view). We concur with the bullishness, but ours refers to 2011, and it's critically dependent on policy conditions remaining supportive for a wee while yet. **We continue to prefer Q3 over June for the start of the tightening cycle.**

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IMPORTANT NOTICE

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