

NEW ZEALAND ECONOMICS

CONSUMERS PRICE INDEX – JUNE 2010 QUARTER

16 July 2010

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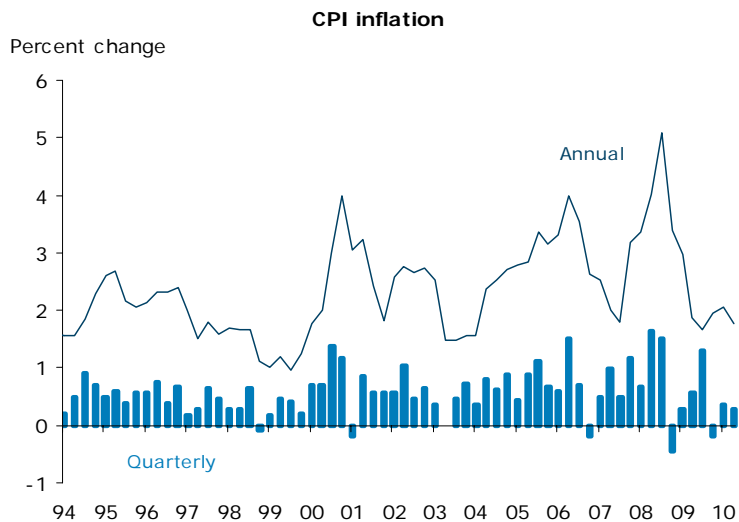
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SUBDUED CPI BUT BIG INCREASES AHEAD

KEY POINTS

- Today's CPI outturn was soft across the board. Excluding the tobacco tax increase, the CPI rose by 0.1 percent in the quarter.
- The core CPI measures were also equally soft, with the trimmed mean and weighted median rising in a 0.3 to 0.4 percent quarterly range. Quarterly non-tradable inflation excluding tobacco increased by 0.2 percent in June.
- The subdued CPI print today will be the last for a while, as various government related policy changes are set to lead to large increases in the CPI over the coming quarters. Nonetheless, the starting point is better than what the RBNZ was expecting.
- We still see another 25bp hike at the end of this month. But today's CPI outturn, alongside recent domestic data suggest some waning in growth momentum, and reinforces our view that the RBNZ will pause in Q4.



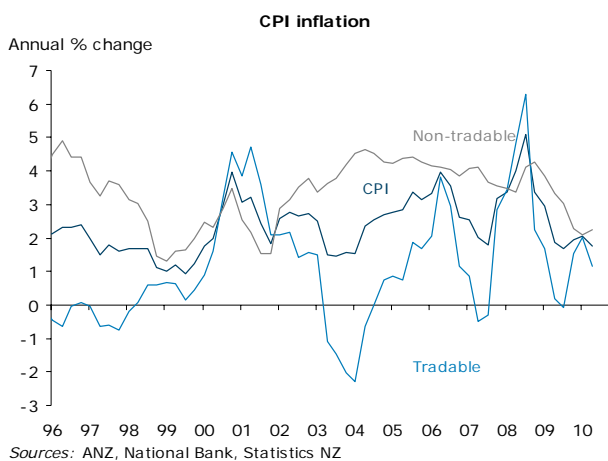
DATA REVIEW

DATA WRAP

The CPI rose by 0.3 percent in the June quarter, taking the annual inflation rate to 1.8 percent. This was weaker than market expectations, and the RBNZ's forecasts from the June *Monetary Policy Statement* which were for a 0.5 percent increase.

	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	2.8	0.7	3.5
Mar-08	0.7	3.4	0.2	3.4	1.1	3.5
Jun-08	1.6	4.0	2.3	4.8	0.9	3.4
Sep-08	1.5	5.1	1.9	6.3	1.3	4.1
Dec-08	-0.5	3.4	-2.1	2.3	0.8	4.3
Mar-09	0.3	3.0	-0.4	1.7	0.7	3.8
Jun-09	0.6	1.9	0.8	0.2	0.5	3.3
Sep-09	1.3	1.7	1.6	-0.1	1.0	3.0
Dec-09	-0.2	2.0	-0.5	1.5	0.1	2.3
Mar-10	0.4	2.0	0.1	2.0	0.5	2.1
Jun-10	0.3	1.8	-0.1	1.1	0.6	2.2
ANZ	0.5	2.0	0.1	1.3	0.9	2.5
RBNZ	0.5	2.0	-	1.8	-	2.2
Market	0.5	2.0	-	-	-	-

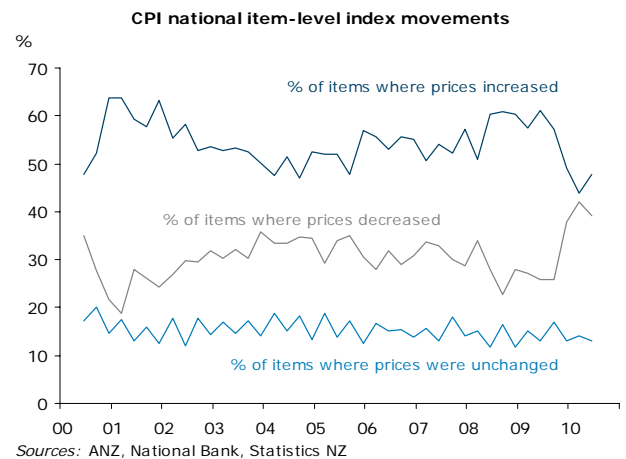
The rise in the CPI in Q2 was dominated by the increase in tobacco excise taxes, with the ex-tobacco and alcohol CPI increasing by 0.1 percent for the quarter. Lower food prices made an offsetting contribution, with the ex-food CPI up by 0.5 percent in the June quarter.



The core measures were all subdued with the trimmed mean and weighted average measures increasing by a 0.3 to 0.4 percent per quarter range. Non-tradable inflation increased by 0.6 percent in the June quarter, but the rise was 0.2 percent after allowing for the impact of the tobacco excise tax.

Prices in six of the eleven groups in the CPI registered quarterly increases. Three groups recorded decreases. Of the individual components, higher tobacco (up 8.7 percent) and used cars prices (up 2.4 percent) made the highest individual positive contributions. Large falls for computing and visual equipment (down 4.6 percent) and domestic airfares (down 1.8 percent) provided an offset.

Viewing the distribution of movements at the item level indicated that pricing pressures remain contained. While slightly more items increased in price relative to the March quarter, it was the second lowest proportion in the decade. The proportion of items recording price falls remain close to a decade high. Similarly, the weighted average price decline rose in June (to 3.2 percent), suggesting that retail discounting remains prevalent.



Inflation from the troublesome housing group remained contained. Rents remain well behaved, rising by 0.5 percent in the quarter to be up 1.4 percent for the year. If there were indeed a housing shortage in the country, rents would be up strongly by now. Construction costs also remain well contained, rising by 0.4 percent. Given rising prices for building materials, this suggests that construction firms are absorbing some of those increases in their margins.

While today's release was weak, there are large CPI increases ahead. Q3 and Q4 CPI will be pushed higher due to government policy changes (ETS, vehicle licensing fees, GST increase), and headline inflation is still set to surpass 5 percent. Moreover, high food commodity prices suggest that food prices are likely to make a sizeable positive contribution to CPI inflation over the coming months. While the details of today's

DATA REVIEW

CPI suggest that firms lack pricing power, the RBNZ will remain wary about firms seeking to claw back margins by increasing prices by a greater amount than the GST rise. Whether demand is sufficiently firm enough for this to occur remains to be seen. But the RBNZ will be alert for any signs of this sort of spill over into pricing (as well as wage bargaining) behaviour.

CPI Components	Quarterly % change	%-point contrib.	Annual % change
Food	-0.9	-0.2	-0.7
Alcohol and Tobacco	3.5	0.2	5.3
Clothing and Footwear	0.7	0.0	1.2
Housing and Household Utilities	0.5	0.1	1.7
Household Contents and Service	-0.4	0.0	-2.0
Health	0.7	0.0	3.7
Transport	0.9	0.1	6.6
Communication	-0.4	0.0	-2.0
Recreation and Culture	-0.7	-0.1	-0.8
Education	0.0	0.0	4.8
Miscellaneous Goods and Service	0.3	0.0	0.6
All Groups	0.3	0.3	1.8
Tradables	-0.1	0.0	1.1
Non-tradables	0.6	0.3	2.2
Trimmed Mean	0.3		1.9
Weighted Median	0.4		1.3

Implications

Relative to our expectations, pretty much all the CPI components came in weaker.

Aggressive retail price discounting was evident in the numbers, with the household contents and services group falling 0.4 percent when it usually records a seasonal increase in prices.

Data outturns following the June MPS have tended to be weaker than market (and most probably the RBNZ's) expectations. Whilst the CPI result highlighted the possibility of more intense retail discounting (which implies retail volumes will hold up), the dataflow is suggesting a weaker Q2 GDP outturn than the 1.1 percent forecast by the RBNZ. The softness of leading indicators also suggests a weaker growth outlook relative to the RBNZ forecasts. Nevertheless, the RBNZ will be mindful of the risks to medium-term inflation from one-offs.

The RBNZ detailed three critical judgements in the June MPS, **namely (a) the extent to which the economy continues to deleverage, (b) the impact of the spike in inflation on wage setting and price setting behaviour and (c) developments in Europe and the global scene.** When seen in the context of these themes and the medium-term outlook, today's CPI figures don't

really alter the picture in terms of an inevitable trend upwards for the OCR over the coming years. But clearly the backdrop has also changed in terms of how the economy is tracking, with momentum levelling out as opposed to accelerating. In this environment we continue to favour a somewhat staggered tightening cycle with another 25bp hike at the end of the month and probably another in September before the RBNZ pauses in Q4.

We concur with the consensus that the OCR will move up but we simply doubt that it will be in a straight line fashion.

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- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

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