Economic Review

New Zealand

15 October 2009

Consumers Price Index: September 2009 quarter

Key points

> **Higher food prices, international airfares and increases in government related levies and taxes drove the CPI higher in Q3.**
> **However, even abstracting from those components, today's number was still strong.**
> **It looks to be a case of price increases across the board, as firms seek to rebuild margins.**
> **The risk now is an earlier tightening cycle than the September start we had initially envisaged.**
> **While tempting to shift forward a quarter, the real decision is whether we jump to March.**
> **At this stage we believe there is simply too much news to pass before that possibility becomes our central track.**

Assessment

The CPI index rose by a solid 1.3 percent in the September quarter. This was a stronger rise than we, the market and the RBNZ were expecting – by a wide margin. Higher food prices (up 1.7 percent), a rebound in international airfares from low levels (up 11 percent) and government related charges (local authority rates up 5.6 percent and vehicle re-licensing fees up 16.2 percent) all made large contributions to the quarterly CPI rise. Annual inflation did ease from 1.9 percent to 1.7 percent – the lowest level since the March 2004 quarter. However, this was well above our expectation of a fall to 1.2 percent.

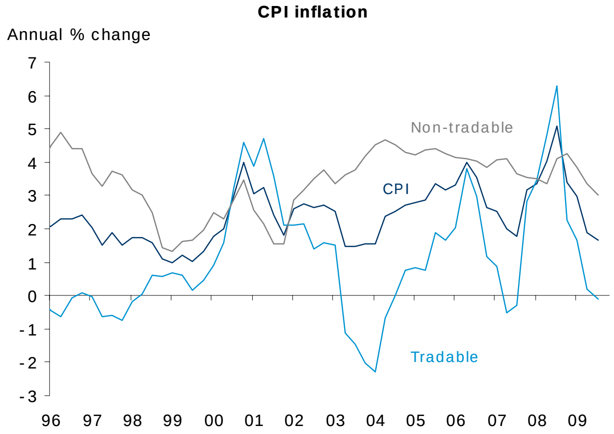
Stronger price increases from one-offs partly accounted for the upside surprise. The rise in vehicle re-licensing fees, in part due to an increase in ACC levies, added 0.1 percentage points to the quarterly CPI increase. A bigger proportion of the usual local authority rate increases (typically split between the September and December quarters) appears to have been factored into the September quarter (90 percent vs 80 percent previously). This added a further 0.1 percentage points. All up, government related charges contributed 0.3 percentage points to the quarterly increase. There were also some factors that partially offset the upside one-offs, with property maintenance prices falling 0.7 percent, influenced by new price subsidies for the installation of insulation and clean heating.

Housing-related inflation appeared well behaved. Construction costs rose a subdued 0.1 percent, while rents rose only 0.2 percent. This fits with notions of a reasonably large negative output gap at present.

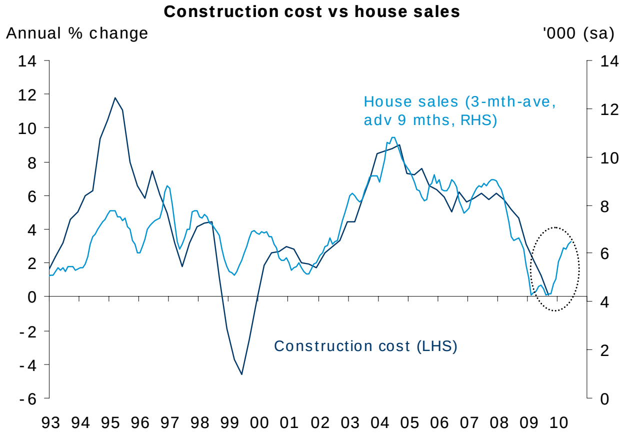
But one-offs, seasonality and housing aside, the strength in today's numbers appears to be spread across the board. Retail related goods prices typically fall in the September quarter (averaging -1.2 percent over the past five years by our estimate). However, retail prices actually rose 0.3 percent, with a strong 3.1 percent increase recorded in used car prices. Services prices rose 1.7 percent in the quarter, with health related services up 1.4 percent, suggesting that weakness in the labour market and subdued wage growth is not filtering through.

Core inflation measures were strong. Non-tradable CPI rose 1.0 percent in the quarter, taking the annual rate to 3.0 percent from 3.3 percent in the previous quarter. The trimmed mean and weighted median rose 0.9 and 0.3 percent respectively in the quarter. The latter certainly suggests little widespread pressure, but we think it is probably more prudent to average across the three measures. This still gives a pretty solid 0.7 percent rise considering the economic backdrop.

	Headline CPI		Tradable		Non-tradable	
	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg
Jun-07	1.0	2.0	0.9	-0.5	1.1	4.1
Sep-07	0.5	1.8	0.5	-0.3	0.6	3.7
Dec-07	1.2	3.2	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**
ANZ	***0.8***	***1.2***	***1.0***	***-0.8***	***0.7***	***2.8***
RBNZ	***0.9***	***1.2***	***-***	***-0.7***	***-***	***2.8***
Market	***0.8***	***1.2***	***-***	***-***	***-***	***-***



Sources: ANZ National, Statistics NZ



Sources: ANZ National, Statistics NZ, REINZ

One interpretation of today's figures is that businesses appear to be rebuilding their margins at an earlier stage than we had envisaged. While this is obviously not apparent in output and demand sensitive pockets such as housing, it looks to be a case of firms rebuilding profitability via the margin lever in some sectors. We'll hold fire on sweeping statements regarding this until we see another quarter's data. Our view of easing price pressure over the next few quarters was based on the assumption that a weak demand environment would prevent firms from pushing through price increases. Today's numbers suggest this may not be the case. If so, then we may not see a full pass-through from the current high NZD into tradable prices later this year and early next year.

At present, it is domestic price increases from non-housing related components that are an area of concern. While annual non-tradable less housing inflation has eased from 4.2 to 3.7 percent, this is still a reasonably elevated level. With the economy building forward momentum and the housing market picking up (with house prices now 5 percent higher than a year ago), the risk is that we could see upward price pressure emerge sooner than expected. One factor we will be watching very closely over the coming six months will be how inflation expectations behave and also whether housing-related inflation begins to rise in line with improving housing market conditions.

Implications

The higher CPI results need to be respected. While CPI inflation remains well within the RBNZ's target band, the higher than expected starting point and the fact the economy now appears to be building forward momentum is something that won't go unnoticed by the RBNZ. Today's data will no doubt continue to underpin the market's current view towards an earlier tightening cycle. This is now a risk that must be acknowledged and sees the bias look towards the first interest rate hike coming earlier than the September 2010 start we had initially envisaged. At this stage, we see little point tweaking between June and September. If there is a big call to be made it is for a March 50 basis points start. At this juncture we simply believe there is too much water to flow under the bridge before that potential becomes reality.

CPI Components	Quarterly % change	*%-point contrib.*	Annual % change
Food	1.7	*0.3*	5.4
Alcohol and Tobacco	1.5	*0.1*	4.3
Clothing and Footwear	-0.1	*0.0*	2.2
Housing and Household Utilities	0.7	*0.2*	2.1
Household Contents and Services	-0.3	*0.0*	1.9
Health	1.4	*0.1*	3.7
Transport	3.1	*0.5*	-5.5
Communication	-0.2	*0.0*	0.0
Recreation and Culture	0.9	*0.1*	0.6
Education	0.0	*0.0*	4.3
Miscellaneous Goods and Services	0.7	*0.1*	3.4
All Groups	**1.3**	***1.3***	**1.7**
Tradables	**1.6**	***0.7***	**-0.1**
Non-tradables	**1.0**	***0.5***	**3.0**
Trimmed Mean	**0.9**		**2.0**
Weighted Median	**0.3**		**2.8**

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