

# Economic Review

## New Zealand

20 January 2010

### Consumers Price Index: December 2009 quarter

#### Key points

- > **Headline CPI came in weaker than market expectations.**
- > **All the core measures were soft, with non-tradable weaker than the RBNZ's expectation.**
- > **Overall, today's CPI report is dovish and should douse any expectation of earlier rate hikes.**
- > **We still see June as the start of the tightening cycle.**

#### Assessment

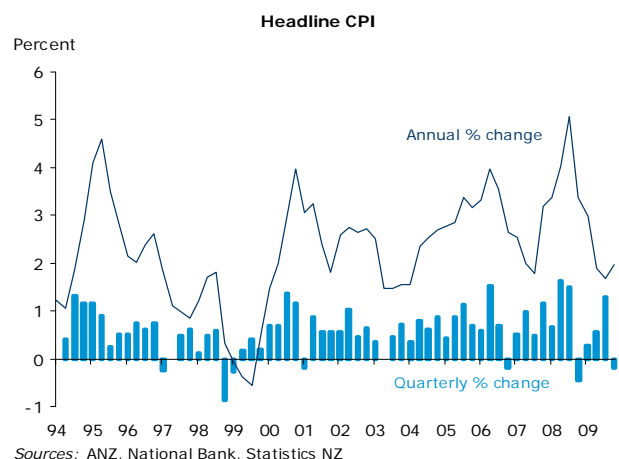
**The CPI index fell 0.2 percent in the December quarter, taking the annual inflation rate to 2.0 percent.** This was weaker than market expectation, though it is in line with what the RBNZ forecast in their December *Monetary Policy Statement*. Lower food prices (down 2.4 percent) were the major driver of the CPI, with other downward contributors coming from alcoholic beverages and tobacco (down 1.0 percent), communication (down 0.6 percent) and household contents and services (down 0.1 percent). Offsetting these was a 1.5 percent increase in the transport group, driven by a 13.9 percent rise in international airfares.

**Relative to our expectations, non-tradable prices came in weaker.** In fact, all the core inflation measures were soft in the December quarter. Non-tradable CPI rose by 0.1 percent in the quarter, taking the annual non-tradable inflation rate from 3.0 percent to 2.3 percent, lower than the 2.5 percent rate the RBNZ forecast. If we exclude housing related components from the non-tradable measure, it came in flat. The trimmed mean measure was flat as well and the weighted median measure rose 0.2 percent. **On balance, there does not appear to be much evidence of broad-based price pressures starting to build.** Inflation has hardly been crushed, but it certainly looks to be contained.

**One area that continues to confound us is the lack of retail discounting in the official CPI data.** There were wide anecdotes of early and more aggressive discounting in the lead-up to the Christmas shopping season last year. Yet, most retail related prices rose, with the clothing and footwear group up a surprisingly strong 1.8 percent, furniture, furnishings and floor coverings up 1 percent, household appliances up 0.6 percent and vehicle prices up 1 percent. There were large price declines for electronic goods recorded, but we continue to be mystified at the lack of broad-based discounting for retail related goods in the CPI.

Perhaps there is a timing issue at play, and given that the March quarter is when there is a seasonal fall in tradable prices, most of the discounting will be picked up then.

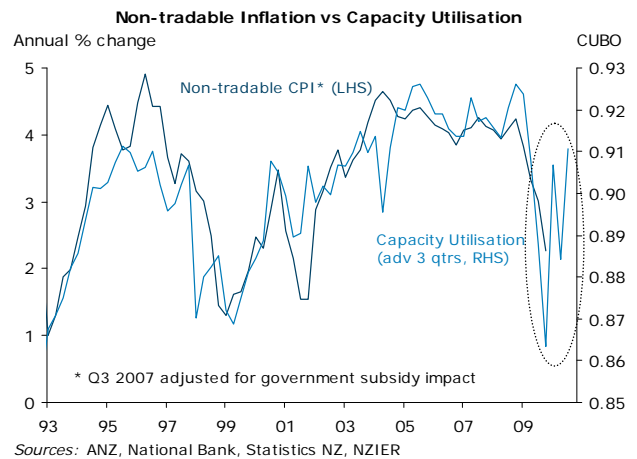
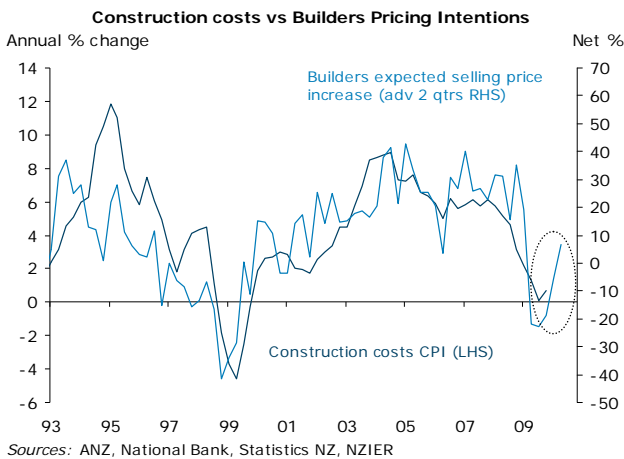
	Headline CPI		Tradable		Non-tradable	
	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg
Sep-07	0.5	1.8	0.5	-0.3	0.6	3.7
Dec-07	1.2	3.2	1.8	2.8	0.7	3.5
Mar-08	0.7	3.4	0.2	3.4	1.1	3.5
Jun-08	1.6	4.0	2.3	4.8	0.9	3.4
Sep-08	1.5	5.1	1.9	6.3	1.3	4.1
Dec-08	-0.5	3.4	-2.1	2.3	0.8	4.3
Mar-09	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
<b>Dec-09</b>	<b>-0.2</b>	<b>2.0</b>	<b>-0.5</b>	<b>1.5</b>	<b>0.1</b>	<b>2.3</b>
<b>ANZ</b>	<b>-0.1</b>	<b>2.1</b>	<b>-0.6</b>	<b>1.4</b>	<b>0.4</b>	<b>2.5</b>
<b>RBNZ</b>	<b>-0.2</b>	<b>2.0</b>	<b>-</b>	<b>1.3</b>	<b>-</b>	<b>2.5</b>
<b>Market</b>	<b>0.0</b>	<b>2.1</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>



**Housing related inflation is still subdued, but forward indicators are pointing to a pick-up later this year.** The cost of building materials has been rising and building consents are recovering. The QSBO survey showed a rise in expected selling prices by builders. These suggest we have reached the trough in terms of construction cost inflation, though we do not expect a return to the strong

increases seen during the last housing boom. But this area will need to be closely monitored.

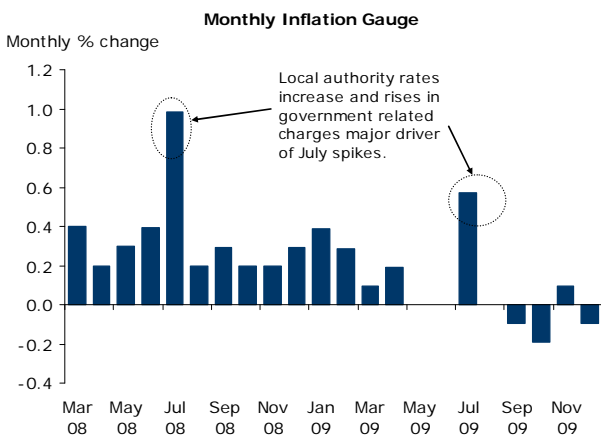
recovery starts to gather momentum. This will be something the RBNZ will be wary of.



**Today's CPI report gives the RBNZ time to continue assessing how the economy evolves.** And while the soft non-tradable print will be welcomed, this comes after a very strong print in the previous quarter. Volatility in the non-tradable reads from quarter to quarter is somewhat perplexing. But averaging it out over H2 2009 gives 0.5 percent per quarter. Perhaps the real message in such volatility is to highlight the dangers in chasing intra-quarterly movements. This can be seen by our monthly inflation gauge, which has been volatile over the second half of last year, though it has clearly shown a downward movement. Government related charges look set to cause more volatility in the non-tradable reads over coming quarters. For this reason, the focus should be on the inputs into the medium-term inflation drivers.

**Implications**

**The CPI data today should douse any expectation of an earlier rate hike.** Judging from the rally in rates and selloff in the currency following the data release, this is indeed occurring. We suspect market pricing will start to back off March but still have April fully priced. We have a strong bias towards the tightening cycle starting on a *Monetary Policy Statement* date (i.e. in June) as opposed to an OCR Review (i.e. April). Hiking during the latter just looks like being too reactive to CPI prints.



CPI Components	Quarterly % change	%-point contrib.	Annual % change
Food	-2.4	-0.4	1.4
Alcohol and Tobacco	-1.0	-0.1	2.9
Clothing and Footwear	1.8	0.1	3.1
Housing and Household Utilities	0.2	0.0	1.6
Household Contents and Services	-0.1	0.0	1.3
Health	0.6	0.0	3.7
Transport	1.5	0.2	3.7
Communication	-0.6	0.0	-0.2
Recreation and Culture	0.4	0.0	-0.5
Education	0.0	0.0	4.2
Miscellaneous Goods and Services	0.1	0.0	2.8
<b>All Groups</b>	<b>-0.2</b>	<b>-0.1</b>	<b>2.0</b>
<b>Tradables</b>	<b>-0.5</b>	<b>-0.2</b>	<b>1.5</b>
<b>Non-tradables</b>	<b>0.1</b>	<b>0.0</b>	<b>2.3</b>
<b>Trimmed Mean</b>	<b>0.0</b>		<b>2.2</b>
<b>Weighted Median</b>	<b>0.2</b>		<b>2.2</b>

**In that regard we'll be paying particular attention to the labour market data out in early February.** With wage pressures subdued and the unemployment rate still set to move higher, there should not be much cost-push inflation pressure. But last week's QSBO capacity utilisation reading is a reminder that inflation pressure could quickly return if the economic

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