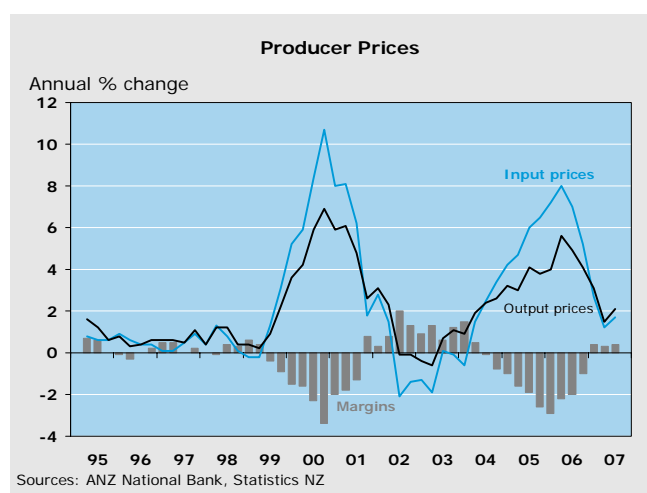


PRODUCERS PRICE INDEX – SEPTEMBER QUARTER 2007

Key points

- Both the producers input and output price indices rose by more than expected in the September quarter.
- Dairy led the surge, although other areas show there is still a persistent inflationary theme.
- Collectively, we feel today's data reinforces the vigilance required by the RBNZ, although we believe it will take a significantly stronger trigger to force a resumption of the tightening cycle in an environment where housing is soggy and credit unease remains.

	Input Prices		Output Prices		Margins	
	QoQ	YoY	QoQ	YoY	QoQ	YoY
Sep-05	2.8	6.0	1.8	4.1	-1.0	-1.9
Dec-05	1.3	6.5	0.2	3.8	-1.0	-2.6
Mar-06	0.9	7.2	0.7	4.0	-0.1	-2.9
Jun-06	2.8	8.0	2.8	5.6	0.0	-2.2
Sep-06	1.8	7.0	1.0	4.9	-0.8	-2.0
Dec-06	-0.4	5.2	-0.5	4.1	-0.1	-1.0
Mar-07	-1.5	2.7	-0.2	3.1	1.3	0.4
Jun-07	1.3	1.2	1.2	1.5	-0.1	0.3
Sep-07	2.3	1.7	1.6	2.1	-0.7	0.4
ANZ	1.1	0.5	1.3	1.8	-	-
Market	0.9	0.3	1.0	1.5	-	-

Assessment

Both producer input and output prices rose by more than expected in the September quarter. Input prices were up 2.3 percent (compared with expectations of a 0.9 percent increase) while output prices rose 1.6 percent (market expectations were for a 1.0 percent increase). Dairy led the surge in both input and output prices. Output prices for dairy cattle farming rose 28.8 percent in the quarter, while input prices for dairy product manufacturing rose 26.5 percent. Other significant upward contributions to the PPI outputs index came from the livestock and cropping farming index (up 6.8 percent) and the meat and meat product manufacturing index (up 5.5 percent). A 1.7 percent increase in the construction index and 4.0 percent increase in the air transport index were other significant contributions to the inputs index. The only significant downward contribution to input prices was from the electricity generation and supply index, which fell 5.8 percent.

The correlation between the PPI and the CPI is contemporaneous at best, and so we are wary about making sweeping assessments. Nevertheless, it reinforces three key themes:

- Strong pending commodity and food-related inflation. Dairy made a significant contribution to today's result. Given the surge in world dairy prices over the past 12 months, we expect this to continue and also to filter into further food-related inflation.
- Pipeline cost-push pressure. Cost pressures remain strong across both labour and non-labour inputs, thereby placing pressure on the bottom line.
- Pressure on margins is resuming. Margins were squeezed further in the quarter, although this comes after a period of rebuild over the first half of the year. Looking at the broad trend in margins since 2004 shows they have contracted by close to 4 percent. Demand conditions will likely need to be very weak if such pressure is to continue to be absorbed.

Today's data reinforces the need for inflation vigilance. The Reserve Bank has very little inflation head room and therefore remains concerned with the upside risks to the inflation outlook. Although today's data reinforces these inflationary risks, particularly from commodity prices, we believe it will take a significantly stronger trigger to force a resumption of the tightening cycle in an environment where housing is soggy and credit unease remains.

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