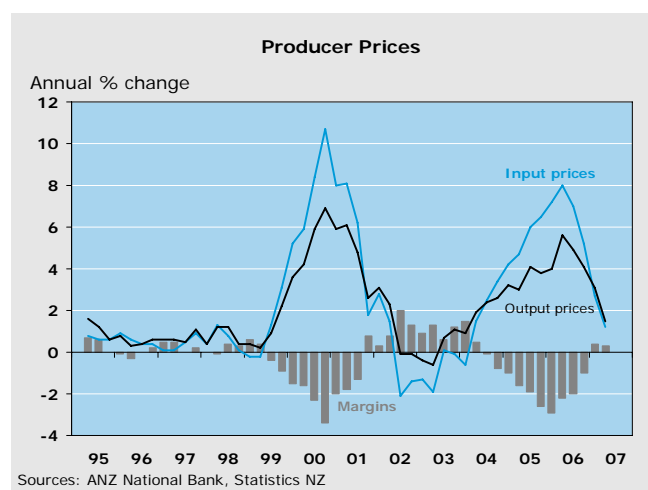


PRODUCERS PRICE INDEX – JUNE QUARTER 2007

Key points

- Both the producers input and output price indices rose by more than expected in the June quarter.
- Higher petroleum refining charges, imported crude oil prices and wholesale electricity prices contributed to the stronger than expected rise in input prices.
- Higher spot prices for electricity and dairy-related prices accounted for most of the output price increases.
- There are limited monetary policy implications for the Reserve Bank from today's release. The lack of margin headroom for businesses points to further pipeline inflation pressure, which the Reserve Bank will remain alert to.

	Input Prices		Output Prices		Margins	
	QoQ	YoY	QoQ	YoY	QoQ	YoY
Jun-05	1.9	4.4	1.2	2.9	-0.8	-1.6
Sep-05	2.8	6.0	1.8	4.0	-1.0	-1.9
Dec-05	1.3	6.4	0.2	3.7	-1.0	-2.6
Mar-06	0.9	7.1	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
ANZ	-0.1	0.0	0.8	1.2	-	-
Market	0.8	0.9	0.9	0.9	-	-

Assessment

Both producer input and output prices rose by more than expected in the June quarter. Input prices were up 1.3 percent (compared with a market expectation of a 0.8 percent increase) while output prices rose 1.2 percent (market expectations were for a 0.9 percent increase). We were expecting softer input prices due to a higher currency over the June quarter. However, higher wholesale trade input prices (up 3.4 percent), due to higher petroleum refining charges and imported crude oil prices, drove overall input prices up. In addition, higher wholesale electricity prices in the spot market drove the electricity generation and supply input prices 14.3 percent higher, contributing to the higher than expected overall input price rise. On the output side, which was closer to expectations, higher spot prices for electricity and dairy-related prices drove most of the output price increases.

Firms' margins remain under pressure despite being up 0.3 percent from a year ago. Over the past two years, output prices have outpaced input prices only once – in the March quarter this year. Margins contracted again in the June quarter, and given the tight labour market and elevated wage growth, further pressure on margins can be expected. With the NZ dollar now lower and oil prices creeping higher recently, there is not much room for businesses to absorb further unexpected increases in input prices. But with domestic demand slowing into the second half of this year, competitive pressures may yet force businesses to absorb price increases further, resulting in reduced profitability.

Today's data has limited monetary policy implications for this Thursday. The lack of margin headroom for businesses points to further potential pipeline inflation pressure, which the Reserve Bank will remain alert to. The Reserve Bank will take some comfort from the fact that construction output price increases continue to ease (up 0.6 percent in June following 0.8 percent increase in March and 1.0 percent in December last year). But it is the threat of broader-based inflation pressure that they will guard against. However, recent global developments, which have increased the uncertainty regarding the outlook, will be the focal point at the Reserve Bank's upcoming *Monetary Policy Statement*.

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