

# NEW ZEALAND ECONOMICS DATA REVIEW

## CONSUMERS PRICE INDEX – SEPTEMBER 2011 QUARTER

25 October 2011

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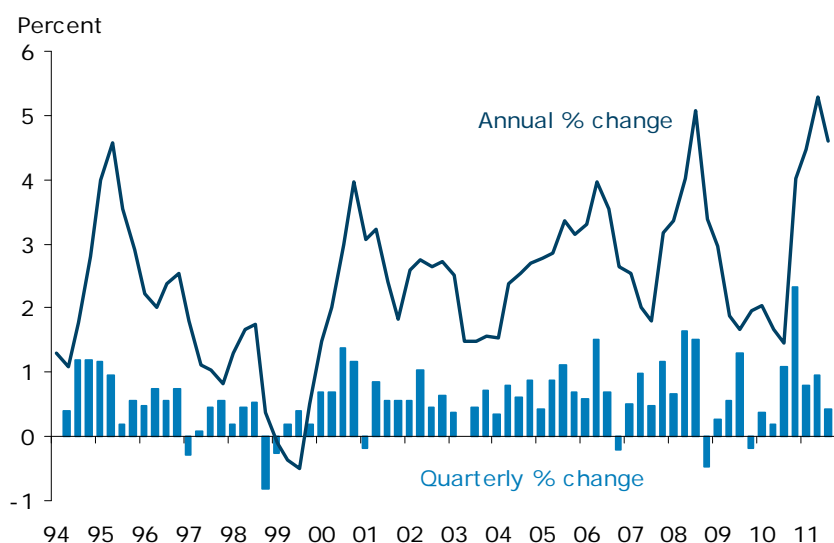
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### LOWER TRANSPORT COSTS RESULT IN MORE BENIGN CPI THAN EXPECTED

- Q3 CPI rose by 0.4 percent, well below both our and the markets expectations. Core measures were subdued, with the weighted median at 0.3 percent and the trimmed mean sitting at 0.2 percent.
- The sources of price increases were as expected, with food the main contributor, followed by housing related prices. But the big downside surprise came from price declines in transport and communication costs. Falls in prices in the recreation and culture group also led to the lower CPI outturn. Some may reverse in Q4 but the better outcome is still encouraging.
- This was a result in line with our monthly inflation gauge (though not our quarterly forecast!) and we are becoming increasingly comfortable with it as a timely inflation indicator.
- The easing in headline inflation to 4.6 percent (2.5 percent if the impact of the GST increase was removed), will be welcomed by the RBNZ.
- Today's CPI result gives the RBNZ continued scope to play a patient waiting game. The next movement for the OCR is still up, but we believe from mid 2012.

**CPI inflation**



Sources: ANZ, National Bank, Statistics NZ

## 2011Q3 CPI REVIEW

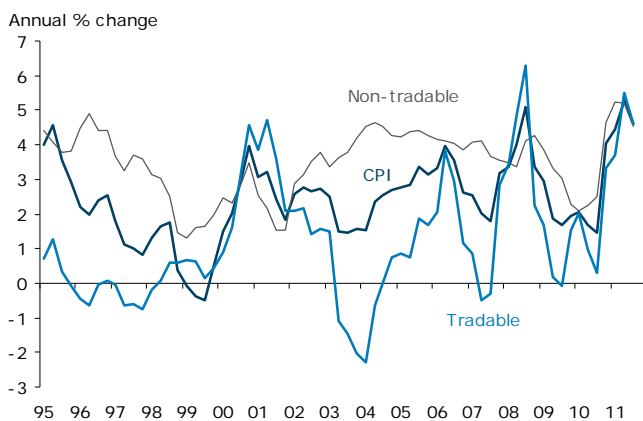
## DATA WRAP

The Consumers Price Index (CPI) rose by 0.4 percent in Q3 2011, taking the annual rate of headline inflation to 4.6 percent. Excluding the direct impact of the GST increase delivered an annual inflation rate of 2.5 percent. The CPI outturn was softer than the median market expectation (0.7 percent), the RBNZ pick of a 0.7 percent quarterly pick, and our 0.8 percent Q3 pick.

	Headline CPI		Tradable		Non-tradable	
	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg	Qtrly % chg	Ann % chg
Mar-10	0.4	2.0	0.1	2.0	0.5	2.1
Jun-10	0.2	1.7	-0.3	1.0	0.6	2.2
Sep-10	1.1	1.5	0.9	0.3	1.2	2.5
Dec-10	2.3	4.0	2.5	3.3	2.2	4.6
Mar-11	0.8	4.5	0.5	3.7	1.1	5.2
Jun-11	1.0	5.3	1.5	5.5	0.6	5.2
Sep-11	0.4	4.6	0.1	4.6	0.6	4.5
ANZ	0.8	5.0	0.8	5.3	0.7	4.5
Market	0.7	4.9	-	-	-	-
RBNZ	0.7	4.9	-	-	-	-

Core inflation measures were also benign, with the trimmed means delivering quarterly increases of 0.2 percent (4.3 percent and 4.2 percent y/y respectively for five and ten percent trims), and the weighted median up only 0.3 percent (3.8 percent y/y). Non-tradable CPI was up 0.6 percent in the quarter, while tradable rose by only 0.1 percent.

CPI inflation

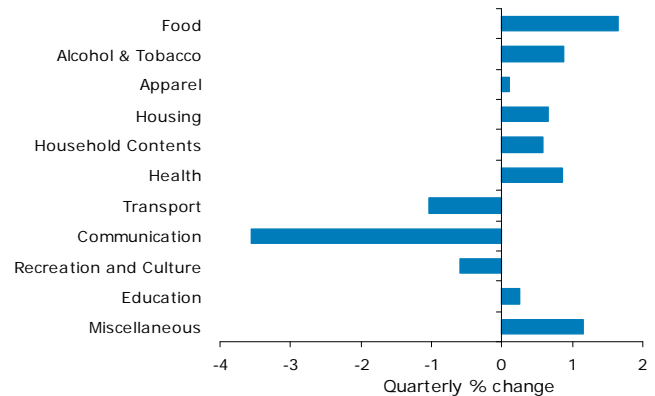


Sources: ANZ, National Bank, Statistics NZ

Sources of price increases were as expected, with food the main contributor (up 1.7 percent q/q), followed by housing-related prices (up 0.7 percent q/q). Cost increases (rather than strengthening demand) were the major culprit, with an adverse weather related spike in vegetables (up 18 percent), and a 4.1 percent increase in local authority rates making the largest positive contributions. The 0.9

percent increase in the tobacco and alcohol group was underpinned by the July 2011 increase in alcohol excise.

CPI groups



Sources: ANZ, National Bank, Statistics NZ

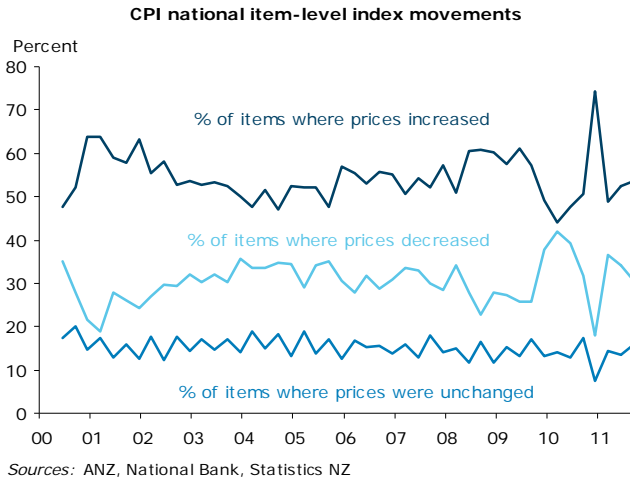
There were some signs of a Canterbury earthquake impact emerging on insurance costs, with dwelling insurance (up 12 percent) and contents insurance (up 5.6 percent q/q) contributing to a 2.4 percent increase in insurance prices. As this sub-group has only a small CPI weight (1.97 percent), the impact on the overall CPI was minor.

Elsewhere, however, the inflation picture was more benign. Encouragingly for the RBNZ, construction costs were up only 0.8 percent in the quarter, not showing much signs of a pick-up at this stage. Property maintenance, which had been strong in the past few quarters, showed a surprising 0.1 percent decline – a sign that increased construction-related work is not being reflected in rising prices at this stage. After a period of sizeable increases, electricity prices managed a small fall, the first since December 2009 and only the third quarterly fall in the past 10 years.

We had factored in a degree of retail discounting, but relative to our expectations, the downside surprise came from transport and communication prices. Increased data caps for broadband plans and cheaper international calling rates contributed to a 3.5 percent fall in telecommunication services. As expected, the 3.3 percent fall in petrol prices contributed -0.1 percent to CPI inflation. These falls were partly offset by higher used car prices (up 2.7 percent q/q) as a shortage of available stock starts to impact at the retail level. Relative to our expectations, however, most of the downside surprise came from falls in transport. International airfares fell 3.7 percent due to lower airfares to Asia. We had

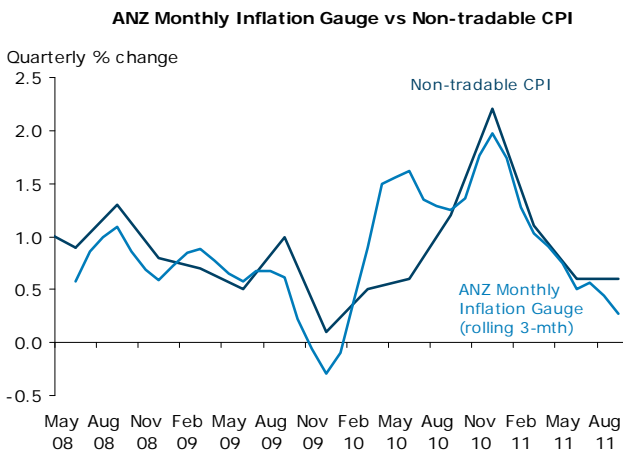
## 2011Q3 CPI REVIEW

expected a “Rugby World Cup premium” to be evident.



Viewing the distribution of price increases shows a small pick-up in the proportion of items registering price increases, but this remains quite modest in relation to historical experience. **Certainly nothing to suggest that a broadening of price increases is emerging.**

**The short-term inflation outlook is looking encouraging for the RBNZ.** Our Monthly Inflation Gauge, which has proved to be adept at picking quarterly turning points in non-tradable inflation, continues to suggest a benign profile that will not cause the RBNZ any sleepless nights. With Statistics New Zealand reporting that around 92 percent of local authority rate increases have been captured in the Q3 CPI, the upshot will be a small flow-through in Q4. Going forward, the close linkage between our monthly inflation gauge and non-tradable gives us greater confidence to be reporting on our monthly measure as a timely gauge of inflationary pressure.



**The Q3 CPI was the first release to be based on the new CPI regimen weights.** The relative importance of health, apparel, communications and recreation and culture have increased, whereas the importance of food, transport, housing and household contents have marginally reduced in importance. **The rebase has delivered the RBNZ an early Christmas present** by reducing the weight on CPI construction costs (to 4 percent from 5.5 percent), thereby mitigating a key source of upside medium-term inflation risk. Weights on dwelling rents increased (to 8.8 versus vs. 7.9 percent), but with the Statistics New Zealand methodology having contributed to reasonably muted historical movements in CPI rents (which have averaged 2.2 percent per annum since 2005), the impact for non-tradable inflation may not be large. If dwelling rents remain within modest historical range of late (up 0.5 percent q/q, 1.8 percent y/y), they may also act as a stabilising force for non-tradable outturns.

### ASSESSMENT

**A benign inflation picture will provide the RBNZ with scope to continue kicking OCR increases into touch.** CPI Inflation looks to be easing faster than the RBNZ (or ourselves) have thought though things like international airfares can swing sharply from quarter to quarter. However, it appears unlikely quarterly inflation will surprise on the downside in Q4 considering the Q4 September MPS pick (+0.1 percent q/q). The Q3 CPI release also showed some pockets of pricing pressure (e.g. health) that have not been completely vanquished.

**Today's comforting CPI release makes Thursday's OCR Review relatively easy to craft, with a very cautious assessment expected.** We expect Thursday's OCR review to allude to the worsening European economic outlook as a reason for kicking OCR increases into tough. A benign inflation outturn for Q3 – though concurrent, simply gives the RBNZ even greater flexibility to take a patient stance.

**We continue to expect a June 2012 start to the tightening cycle, but reiterate that future OCR moves will be gradual and depend on the global scene improving.**

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