18 October 2011

Westpac Institutional Bank

Looking through

Q3 CPI preview

- **We expect a 0.8% rise in the September quarter CPI, which would see annual inflation ease to 5.0%.**
- **Seasonal increases in food, local body rates and alcohol to be the main contributors.**
- **The RBNZ will continue to look through this year's spike in headline inflation and focus on global developments.**

Summary

We estimate that consumer prices rose 0.8% in the September quarter, led by seasonal increase in food prices and housing costs, slightly offset by lower fuel prices. This would see annual inflation fall to 5.0%, from a 21-year high of 5.3% in June. Our pick is similar to the Reserve Bank's estimate of 0.7% qtr, 4.9% annual.

We suspect the CPI will have little influence on the tone of next Thursday's OCR review, which will focus more on global uncertainties. The high headline inflation rate won't rattle the RBNZ – its preferred measure of 'core' inflation sat at 2.3% in June, though that may rise in September. The RBNZ has also taken the view that inflation expectations will moderate once the spike in annual inflation passes. That assumption won't be put to the test until early next year, once last year's GST hike (which added around 2 percentage points to annual inflation) has dropped out.

Details

We expect the largest quarterly contributions to come from:

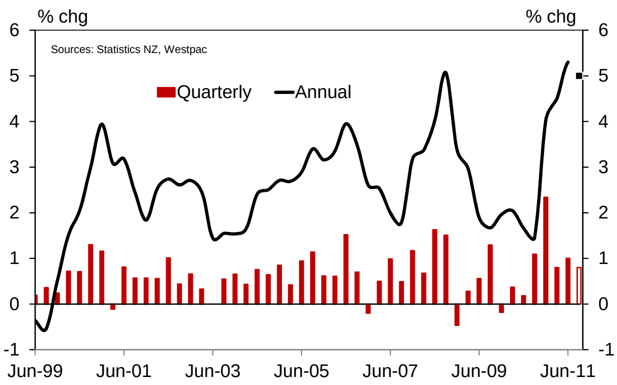
Food (+0.4ppts): A relatively large seasonal increase in fresh produce, although prices eased back in the September month.

Housing and utilities (+0.3ppts): Mostly due to the annual changes in local body rates, with some moderate increases in rents and building costs as well.

Alcohol and tobacco (+0.2ppts): The annual increase in alcohol excise, which is indexed to headline inflation.

Private transport (-0.2ppts): Petrol prices were 3% lower on average over the quarter.

Consumer Price Index



The effects of the Canterbury earthquakes may be apparent in some of the details, though perhaps not large enough to stand out at the aggregate level. The most likely impact will be through building materials, where global forces have already been pushing prices higher over the last year. Rents have risen slightly faster in the last two quarters, with a quake-induced reduction in supply in Christchurch coming on top of an emerging housing shortage elsewhere. Some councils have announced large rates increases for the next year, citing higher insurance costs, although the average increase looks comparable to previous years. Dwelling insurance has a weight of just 0.2% in the index, so even a 50% hike in premiums as some have suggested would only add 0.1ppts to inflation, possibly spread over several quarters.

This release will incorporate the three-yearly update of the CPI weights, to account for changes in household spending patterns. The most notable change is an increase in the weighting of food, with prices rising by more than the broader CPI basket over the last few years (and limited substitution effects). Since food prices are highly seasonal, this will make the quarterly CPI slightly more volatile, and accounts for 0.1ppts of the 0.8% increase that we expect for the September quarter.

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