

## Electric shock

### Q3 consumer prices up 0.4% q/q, 4.6% y/y

- Consumer prices rose by less than expected in the September quarter. Annual inflation slowed to 4.6% from a 21-year high of 5.3%.
- Increased competition led to unexpected price declines in several industries, while the stronger NZ dollar over the quarter helped to depress prices of imported goods.
- This was an important downside surprise for the Reserve Bank, and supports our call that OCR hikes will be delayed until June next year.

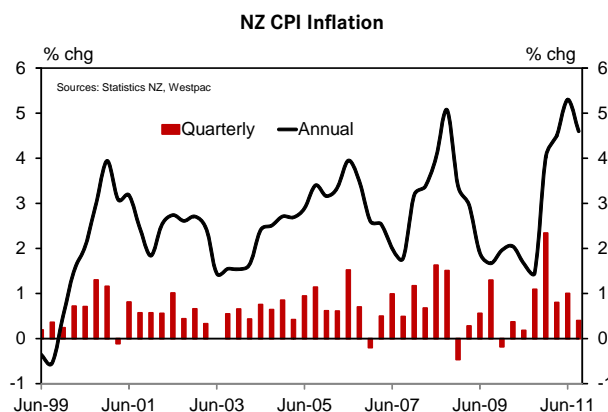
#### Summary

Consumer prices rose 0.4% in the September quarter, substantially below our pick of 0.8% and the Reserve Bank's forecast of 0.7%. The biggest surprise for us was some substantial price drops that can be pinned on increased competition in some industries. This is of course to be welcomed, though it's not necessarily something that will be repeated in the inflation figures from one quarter to the next. This was an important downside surprise, and supports our call that the Reserve Bank will delay the start date for OCR hikes until June next year.

#### Details

The main price increases for the quarter were largely as expected. Food prices rose 1.7%, accounting for 0.3ppts of the total increase for the quarter. There was a larger than usual seasonal increase in vegetable prices that was due to supply constraints after the Queensland floods earlier this year – though that appears to have unwound by the last month of the quarter.

Housing-related costs generally rose, partly reflecting the fallout from the Canterbury earthquakes, as well as the more general housing market squeeze that is emerging in other parts of the country. The annual reset of local authority rates saw a 4.1% increase, comparable with previous years. Rents rose 0.5% and the cost of new homes rose 0.8%, both of which could be quake-related. Insurance premiums rose 12.3% for dwellings and 5.6% for contents, the first of what is likely to be several



rounds of increases as a result of the quakes; however their combined impact on CPI is very low.

The stronger New Zealand dollar over the quarter once again had a dampening effect on the prices of some imported goods. Prices for TVs and computers fell 4.8% and phones fell 9.2% – both of these categories are in a major trend decline in prices due to the continuous changes in technology, but the higher exchange rate helped them towards a relative large quarterly drop. Petrol prices fell 3.3% on a combination of the stronger currency and lower world oil prices.

The biggest downward surprises were in the non-tradables arena. Electricity prices saw a rare quarterly decline (-0.3%), thanks to the recent campaign encouraging people to switch power suppliers. This appears to have spurred suppliers to offer deals such as larger prompt-payment discounts (carded rates actually rose slightly for the quarter). Telecommunication services fell 3.5% reflecting increased data caps for broadband and mobile phone internet packages, which amounts to a quality-adjusted price decline. International airfares fell 3.7% due to increased competition on the routes to Asia. Finally, alcohol prices rose just 1.3% despite a 4.5% increase in excise duty (based on annual inflation in the year to March), suggesting a high degree of discounting.

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### Market implications

Financial markets, which had been positioned for a 0.7% outturn, reacted sharply to the surprise. The NZD was down 40 points, and the 2 year swap rate fell 6 basis points, although much of that drop has since retraced. Interest rates now reflect a 75% chance of an OCR increase by June next year.

Today's result was significantly below the RBNZ's forecast of a 0.7% increase. More importantly, the surprise was almost entirely on the 'stickier' non-tradables side, and in at least one industry (electricity) where limited competition and persistent price increases have long been a bugbear of the RBNZ. It's not obvious that this result can be repeated in coming quarters, though – the pace of switching of electricity providers is apparently slowing, and further downward pressure on airfares depends on more new entrants to the market. In other cases, such as internet services, the downward pressure on prices is likely to continue for some time.

In the September *Monetary Policy Statement* the RBNZ projected annual inflation to fall below 2% by the second half of next year, once last year's GST hike and other government charges (and their apparent impact on inflation expectations) had dropped out of the equation. Today's results will greatly strengthen the RBNZ's confidence in that forecast, and with the global situation a clear negative for the interest rate outlook since September, it's possible that the RBNZ will explicitly signal a slower track for OCR increases in this Thursday's review.

We had already shifted our call for the first OCR hike out to June next year – later than the market median pick of March, reflecting our concerns about the flow-on effects of the rise in overseas funding costs in recent months. Today's result supports our call for an OCR hike towards the later end of market expectations.

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