20 January 2011

Westpac Institutional Bank

Spiked

Q4 CPI 2.3% q/q, 4.0% y/y

- **Quarterly inflation up 2.3% – bang on expectations.**
- **GST hike is largely passed through to consumers.**
- **Nothing new to hurry RBNZ.**

Inflation spiked 2.3% higher in the December quarter, pushing annual inflation to 4%. This was right in line with our expectations – something of a relief given the uncertainty stemming from the 1st of October GST increase.

A quick glance across the details suggests relatively widespread pass-through of the GST hike - as best we can tell. Of course we'll never know for certain exactly what the counter-factual would have been.

Our forecasts assumed the GST increase would add about 1.7% to the headline figure in the December quarter (with the expectation of an eventual full passthrough), and this doesn't look to have been too far off the mark. There would have been a 2.22% increase in any given price if the GST hike was added, while it would have added 2% to the CPI as a whole (since some items included in the CPI are exempt from GST). In the event, a large number of sub-categories recorded price increases in the 2-3% range in the December quarter.

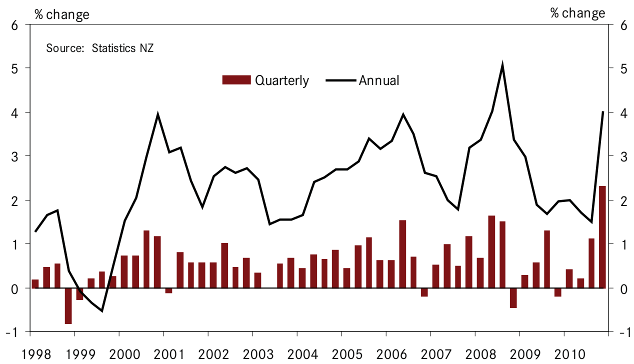
In some categories GST passthrough is less apparent, but it's there - for instance, prices for audio-visual equipment fell 1.8% in Q4, less than the average quarterly change of -3.8% in the last decade. The notable exception was clothing and footwear prices which were flat – perhaps an indication of the importance of price points in this market.

The largest positive contributions in the quarter came from transport (up 4.3%). Petrol prices rose 6.8% on a triple whammy of GST, excise duty, and crude oil price increases. International airfares rose 5.5%, a smaller than usual seasonal increase while in the domestic sector, reduced competition following Pacific Blue's departure from the market saw prices rise 7.1%.

Food prices rose 2.1%, with supermarkets applying the GST hike fully and immediately. Food prices were otherwise slightly softer in Q4, as fresh vegetable prices unwound a Q3 spike resulting from the September storms. We expect upward pressure on food prices in the coming quarters following on from strong increases in world commodity prices and the Australian floods.

Housing-related inflation was a little more subdued than we expected. Rents (which are GST-exempt) rose just 0.2% after

Consumer Price Index



CPI components (quarterly % change)

	Dec-09	Mar-10	Jun	Sep	Dec
Food	−2.4	1.0	−0.9	2.4	2.1
Alcohol & Tobacco	−1.0	1.3	3.5	2.3	1.7
Apparel	1.8	−1.2	0.7	−0.8	0.0
Housing	0.2	0.3	0.5	1.4	1.6
Household Contents	−0.1	−1.3	−0.4	−0.6	1.9
Health	0.6	0.9	0.7	1.0	4.4
Transport	1.5	1.1	0.9	1.0	4.3
Communication	−0.6	−0.8	−0.4	−0.1	0.7
Recreation and Culture	0.4	−1.4	−0.7	0.3	2.9
Education	0.0	4.8	0.0	0.3	0.5
Miscellaneous	0.1	−0.5	0.3	0.5	1.7
Non-tradables	**0.1**	**0.5**	**0.6**	**1.2**	**2.2**
Tradables	**−0.5**	**0.1**	**−0.3**	**0.9**	**2.5**
CPI	**−0.2**	**0.4**	**0.2**	**1.1**	**2.3**
CPI (ann %)	**2.0**	**2.0**	**1.7**	**1.5**	**4.0**

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0.5% increases in each of the previous three quarters; we thought that housing shortages resulting from the Canterbury earthquake might have put a little upward pressure on the national total. On the other hand, the earthquake may have had a hand in pushing property maintenance costs up a hefty 3.8%.

Implications

Quarterly CPI outturns tend to tell us more about idiosyncratic price changes than about the underlying trends in inflation. And in any case, today's release could have been spun positively either way: a complete passthrough would suggest that firms have the pricing power to pass on cost increases; a less-than-complete passthrough would have been a small windfall for consumers (as the vast majority of people received offsetting tax cuts or benefit increases on 1 October).

With today's outturn also in line with the RBNZ's headline inflation forecast (where they estimated that "underlying" inflation, excluding the direct effects of the GST hike and other government charges was 1.4%) it will have done nothing to sway the RBNZ from its plan to gradually increase interest rates from Q3 this year.

The RBNZ remains firmly focused on the inflation outlook over the medium term. As such it will be more concerned about whether the temporary spike in headline inflation starts to influence wage and price expectations (and even then, it's prepared to wait for evidence that those expectations are being turned into action). Surveys to date suggest that people haven't been 'fooled' by an impending GST-related price spike - though the real test may come now that 4%-plus inflation rates are going to be out in the public domain for the next year.

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