12 January 2012

Westpac Institutional Bank

Prices flat as food falls

Q4 CPI preview: 19 Jan, 10:45am

- **We expect the December quarter CPI to be flat, with annual inflation falling sharply to 2.2% as the previous year's GST hike drops out of the calculation.**
- **Vegetable prices unwound the larger than usual seasonal gains seen through the middle of 2011.**
- **Softer inflation and weak pricing intentions will allow the Reserve Bank to leave interest rates unchanged for the near future.**

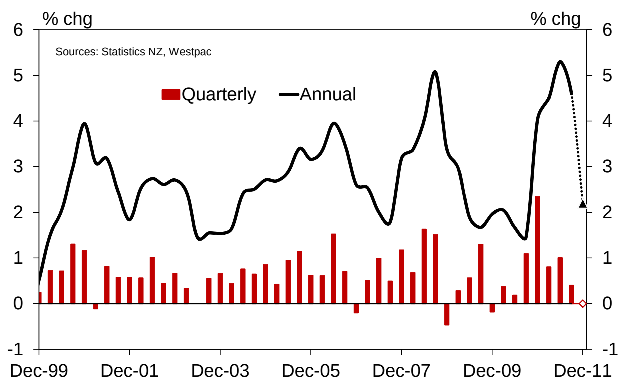
We estimate that the consumer price index was flat in the December quarter, as a large seasonal drop in vegetable prices balanced out modest price gains in most other categories. This would see annual inflation slow from 4.6% to 2.2%, largely due to the October 2010 GST increase finally dropping out of the calculation (this accounts for about 2 percentage points of the fall). Our pick is below the Reserve Bank's estimate of 0.4% qtr, 2.6% annual, and from what we've seen is at the low end of market forecasts.

With business surveys showing a sharp drop in pricing intentions in recent months, inflation pressures are likely to remain subdued in the near term – we expect annual inflation to bottom out at 1.5% in mid-2012. That would give the RBNZ sanction to keep interest rates on hold until later in the year, once the Christchurch rebuild is well underway and some of the uncertainties around global conditions have been resolved.

Details

The biggest drag on the December quarter CPI will be food prices, which we estimate fell by 2% and accounted for 0.4ppts of the fall in the index. In the first half of last year, the seasonal rise in vegetable prices was much greater than usual, due at least in some part to flooding in Australia, which meant that during the winter months, imports of key items such as tomatoes were harder to come by. However, the monthly food price index shows that from August to November, vegetable prices more than fully reversed these gains – some items are now cheaper than they were a year ago. (December food prices will be published on Monday; we've assumed a small rebound for the month, but the outcome isn't crucial for our CPI forecast.)

Consumer Price Index



We also expect another sizeable negative contribution from the communications group (around -0.1ppts). In the September quarter, the data cap for a standard broadband internet package was increased from 30GB to 45GB per month, which was recognised in the CPI as a 33% drop in the per-unit price. This would have been a major factor in the 3.5% fall in the 'telecommunication services' group, by far the largest quarterly drop since 1999. In Q4 the standard broadband package was further increased to 60GB – a 25% price drop – which will again have a meaningful impact on the price index.

Against these two large negatives, we expect small price gains across most of the other major categories. The single largest contributor is likely to be fuel prices (worth +0.1ppts): petrol was up 0.8%, while diesel (which has a much smaller weighting) rose 5%. We've also assumed a +0.1ppt contribution from the usual seasonal increase in international airfares and package holidays, although the size of the increase varies greatly from year to year.

While the Rugby World Cup will have temporarily affected some prices, such as for accommodation, we don't expect this to distort the CPI. Aside from some frequently-purchased items such as food and fuel, most prices are surveyed in the middle of the quarter, so the Q3 and Q4 surveys will have straddled the tournament itself.

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