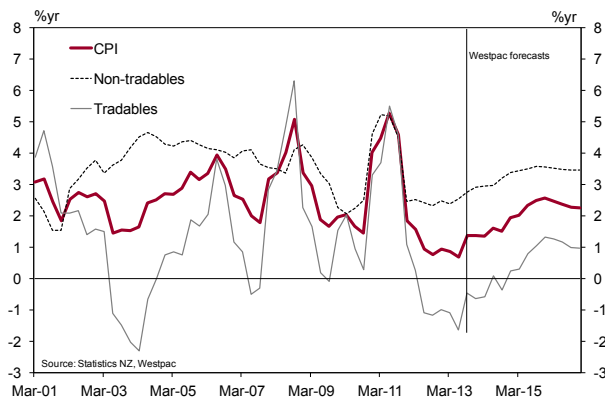


Waiting in the wings

Q4 CPI preview: 21 January, 10:45am

- We expect a 0.2% fall in consumer prices for the December quarter, holding annual inflation at 1.4%.
- Lower fuel prices and a seasonal drop in food prices are the main reasons for the quarterly decline.
- However, the underlying picture is that home-grown inflation pressures are gradually ticking higher.
- Barring a substantial upside surprise next week, we don't expect the CPI figures to push the Reserve Bank towards a January OCR hike.

CPI inflation



We estimate that consumer prices (released next Tuesday) fell 0.2% in the December quarter, a normal seasonal decrease that would keep annual inflation at 1.4%. Our forecast is right in line with the Reserve Bank's most recent projections, and market forecasts are likely to be in a similar range.

With the Reserve Bank having signalled that it's prepared to start raising interest rates soon, there is growing speculation as to whether it could be forced into action as soon as the next OCR review at the end of January. Our view is that the CPI figures alone are unlikely to be the catalyst for an early move. Inflation is below the 2% target, and we share the RBNZ's assessment that it is likely to remain so over the course of 2014. Domestic inflation pressures are gradually re-emerging, but barring a substantial upside surprise in next week's inflation figures, the RBNZ will have time to respond at a measured pace. We expect the first OCR hike to come in the March *Monetary Policy Statement*.

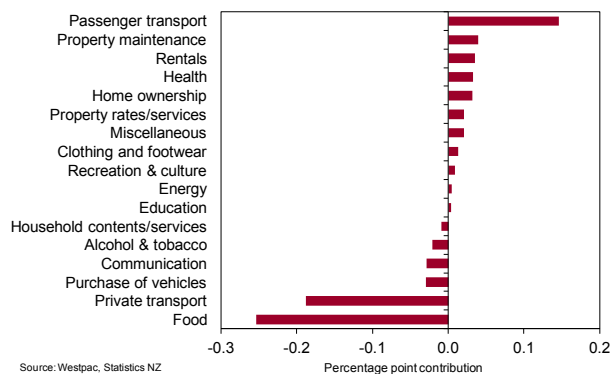
Details

Our forecast of a 0.2% decline in the CPI is fairly typical for a December quarter, when seasonal price effects are at their lowest ebb. In particular, fruit and vegetable prices tend to fall sharply in the December quarter, making them by far the single biggest contributor to the drop in the CPI. That said, it's notable that food price inflation is starting to creep up again on an annual basis, having been more or less flat over the past two years.

The other major negative contributor was a 3.4% fall in petrol prices, largely reversing a short-lived spike in prices during the September quarter. We also expect to see further declines in car prices (a result of the New Zealand dollar's sharp rise against the yen in the last year) and in telecommunications as mobile/broadband pricing continues to improve.

A seasonal increase in international airfares is expected to be the single largest positive contribution to the quarter. It's also the biggest potential source of error in our forecast; airfares tend to rise substantially in the December quarter, but the extent varies a great deal from year to year.

Forecast contributions to quarterly inflation



The subdued headline inflation rate masks a sharp divergence in the price trends for internationally tradable and non-tradable items, something that's more apparent on an annual basis. The ongoing rise in the NZ dollar (the trade-weighted index was up 5% on a year ago) has helped to depress the prices of imported goods, leaving tradables prices down an estimated 0.6% on a year ago. In contrast, non-tradables inflation is expected to accelerate slightly to 2.9%yr. The resurgent property market has played a part in this, with rising prices for new houses, property maintenance and real estate fees (though growth in rents has actually slowed).

Market implications

The CPI is the last official data release before the Reserve Bank's OCR review on 30 January (there's also the REINZ house sales figures for December, due in the next few days). While the RBNZ's most recent statements suggested an OCR increase in March, financial markets are giving about a 40% chance of a hike this month, and are looking to the CPI release as a potential catalyst.

Though we can't at all rule out a January OCR hike, we think that an as-expected CPI outturn, or even a small upside surprise, wouldn't be enough on its own to prompt an early move (though the RBNZ would use the January statement to warn of an impending hike in March). Annual inflation is still below the 2% target midpoint, and with the NZD trade-weighted index flirting with new post-float highs, both we and the RBNZ expect headline inflation to remain subdued over the next year.

However, any evidence that domestically-generated inflation is picking up much faster than expected could prompt the RBNZ to skip the warnings and move straight to an OCR hike in January. Conversely, a softer than expected outturn could give the RBNZ room to delay rate hikes a little longer.

Michael Gordon
Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

For email address changes contact:
WNZResearch@westpac.co.nz

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity.

Disclaimer continued overleaf.

Disclaimer continued

Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “relevant persons”). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Services Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (“WCM”), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.