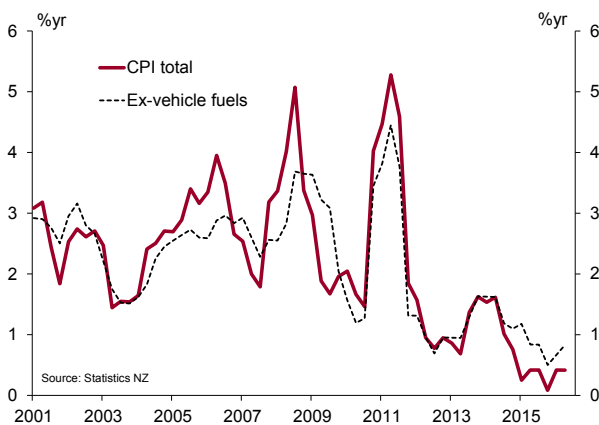


Petered out

June quarter consumer prices rose 0.4%, annual inflation 0.4%

- The Consumer Price Index (CPI) rose 0.4% in the June quarter, less than market forecasts. Annual inflation remained at 0.4%.
- Price pressures are intensifying on new home building, but remain muted in the rest of the economy.
- The boost to inflation from last year's fall in the New Zealand dollar appears to have run its course.
- The result was softer than the Reserve Bank expected, and strengthens the case for another OCR cut next month.

CPI inflation



Consumer prices rose 0.4% in the June quarter, a result that left the annual inflation rate unchanged at 0.4% as well. The result was slightly weaker than our forecast of a 0.5% increase, and below the Reserve Bank's forecast of a 0.6% rise.

Today's result is a challenge for the Reserve Bank on several fronts. First, near-term inflation remains well below the 1-3% medium-term target. It's now marginal as to whether it will be back within the target range by the end of this year, as the RBNZ had been predicting.

Second, domestic inflation pressures remain largely absent outside of housing. Newly-built home prices are rising strongly, for understandable reasons. But those pressures have been contained within that sector.

Third, the boost to tradables inflation from last year's fall in the New Zealand dollar appears to have petered out. If the currency sustains its recent gains, it will switch to being a drag on the already-low inflation rate over the coming year.

Market pricing for an OCR cut at the August Monetary Policy Statement rose to 80% after today's release, and the New Zealand dollar fell accordingly to 0.7080. We agree with that pricing. The RBNZ had already signalled in its last statement that it was likely to cut in August, and developments since then have added to the case for a rate cut on balance.

Details

The rise in the June quarter CPI came largely from two sources. First, petrol prices rose 5.3% over the quarter, reversing some of the steep fall that occurred early this year. (The rise in fuel prices was smaller than at the same time last year, so it was actually a drag on annual inflation.) We note, however, that fuel prices were already falling again by the end of the June quarter, and are currently shaping up to be a negative again for the September quarter.

The second factor was a strong rise in the housing categories, especially new dwelling construction, which was up 2.1% for the quarter and up 5.6% on a year ago. Statistics NZ cited new health and safety legislation, as well as rising labour and material costs, as a factor behind the unusually large quarterly increase, which suggests that prices won't necessarily keep rising at that pace. But it's clear that the construction industry is under severe capacity constraints at the moment.

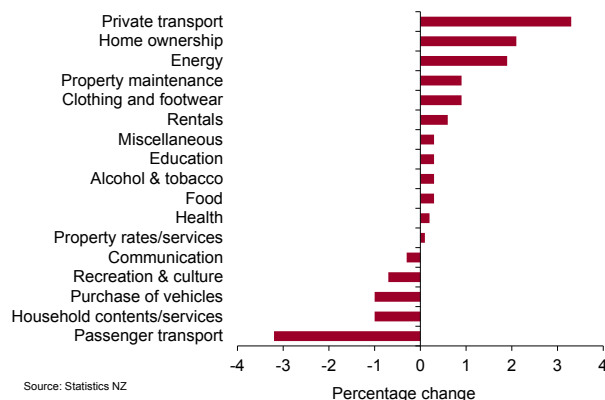
There was also an acceleration in rents in Auckland (up to 3.5%yr), in keeping with the city's burgeoning population and shortage of housing. But rents were subdued elsewhere, and are now falling outright in Canterbury as more houses are repaired or rebuilt. At a national level, rental growth was steady at 2.3%yr.

The main downside surprise for us was that prices were weaker in many of the import-heavy categories, such as household contents, recreational goods and vehicles. The fall in the New Zealand dollar last year had put some upward pressure on these prices in recent quarters, though much less than we would have expected given the size of the fall in the currency. The latest results suggest that that effect has now run its course, without ever leading to a meaningful pickup in overall inflation.

The other major price movements in the June quarter were mostly seasonal. Electricity prices are typically reviewed once a year; the 1.8% increase this year was more than last year but still small relative to history. Domestic airfares fell almost 10% on a combination of cheaper fuel and a seasonal downturn, while accommodation services also unwound most of their summer strength.

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Components of quarterly inflation



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