

ECONOMICS: AUSTRALASIAN PERSPECTIVES—JANUARY 20, 2012

Inflation Surprises on the Downside, but We Don't Expect the RBNZ to Ease

■ **Guy Bruten**
 Global Economist—Asia Pacific

A surprisingly low inflation outcome in the wake of patchy domestic data and global uncertainties has given the Reserve Bank of New Zealand (RBNZ) more time to survey the landscape. We think it unlikely, however, that the RBNZ will move towards an easing bias at its policy review next week.

Positive Inflation Surprises...

New Zealand's fourth-quarter CPI reading came in much lower than expected, with the price level falling by 0.3%. Food prices (fruit and vegetables) fell sharply—down 2.2%—and were a big contributor to the decline. The annual inflation rate fell sharply too, from 4.6% in the third quarter to 1.8%, as the impact of the increase in the Goods and Services Tax faded from the figures. This added to the impression of a very low result. While these factors were important, measures of underlying inflation—trimmed mean, weighted median, CPI ex food and energy—were also surprisingly low. The result, in other words, was caused not only by one-off factors. The average of the three measures shows that core inflation ran at 1.5% over the last year (**Display 1**) and around only 1% annualized over the last six months—that is, right at the bottom of the RBNZ's 1%–3% inflation target range.

The relatively low result partly reflects downward pressure on tradable goods prices—a range of categories that covers

clothing, household furnishings and appliances, and autos. These declined in 2011 as the strength of the New Zealand dollar over the past couple of years continued to flow through to final prices.

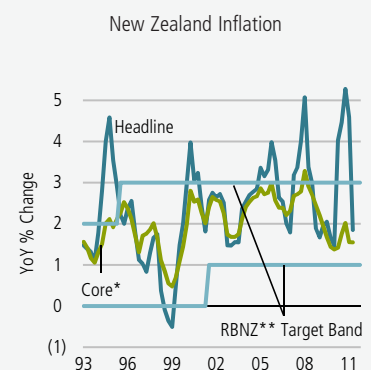
But prices in the non-tradable sector were also relatively subdued. While there were some special factors here, too, the softness also indicated weak domestic demand.

...Still Subdued Growth...

That can clearly be seen in the GDP and labor market data. Despite the boost to the economy from the Rugby World Cup, GDP is struggling to grow much faster than 2% (**Display 2**). As a result, unemployment has been tracking sideways at 6.5%–7% for the past two years.

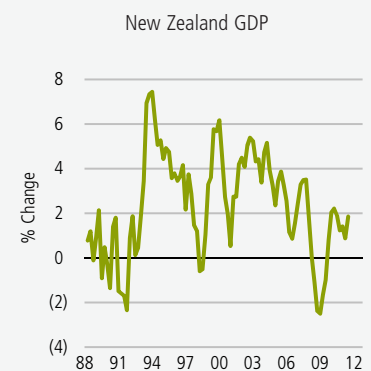
That is not to say that all is doom and gloom: confidence readings in the business and consumer sectors, for example, are not far from their long-run averages (**Display 3, next page**). But a combination of factors—earthquake reconstruction in the Canterbury region is running well

Display 1
Inflation Eases to Lower Half of Target Range



As of 4Q:2012
 *Average of trimmed mean, weighted median. CPI excluding food and energy.
 **Reserve Bank of New Zealand
 Source: Reserve Bank of New Zealand and Statistics New Zealand

Display 2
Growth Stays Weak, Despite World Cup Boost



As of 3Q:2011
 Source: Statistics New Zealand and Thomson Datastream

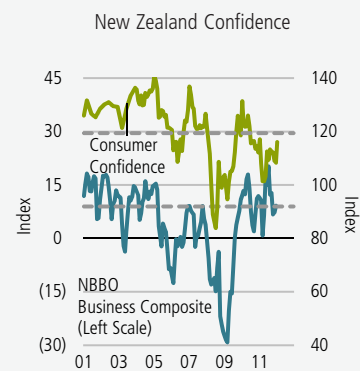
behind expectations (because of continuing aftershocks, among other things), and (global) uncertainty has intensified—has left the NZ economy struggling to find a higher gear.

...Leaves RBNZ Sitting Pat Again

Where does this leave the RBNZ? Having previously pointed to the need for cash rate increases, the central bank in its December Monetary Policy Statement adopted a more neutral stance, saying that it remained “prudent for now to keep the OCR [official cash rate] on hold.” We doubt whether the fourth-quarter inflation result will, in and of itself, provide

adequate reason for the RBNZ to make further substantial changes to this policy bias at its next policy review on January 26. Yes, inflation is low, but the RBNZ remains uncomfortable with what it sees as a very low interest-rate structure, and continues to see upside risks to inflation from reconstruction activity. Market pricing is starting to toy with an easing; we think that is wide of the mark. More likely, in our view, is that—over the next six months, as some of the global uncertainties are resolved—the RBNZ will reinstitute a tightening bias, again along the lines that the “insurance” easing, put in place after the earthquake, is no longer warranted. ■

Display 3
Confidence Indicators Are Muted



As of January 2012 for consumer confidence and December 2011 for business confidence
Source: Bloomberg, CEIC Data and National Bank of New Zealand

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