

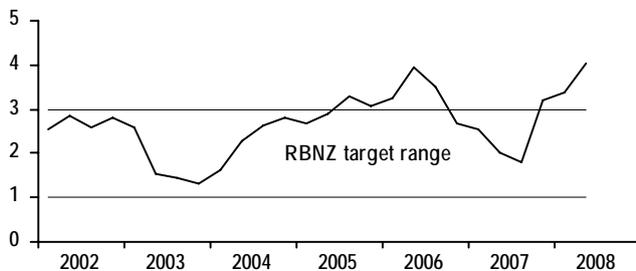
New Zealand economic update

2Q CPI

Headline inflation in New Zealand accelerated to an 18-year high of 4.0% oya in 2Q (JPMorgan and consensus 3.8%) from 3.4% in 1Q, remaining well above the central bank's 1-3% target range for the third straight quarter. The quarterly rise was unexpectedly large at 1.6% q/q, up from 0.7% previously.

New Zealand: CPI

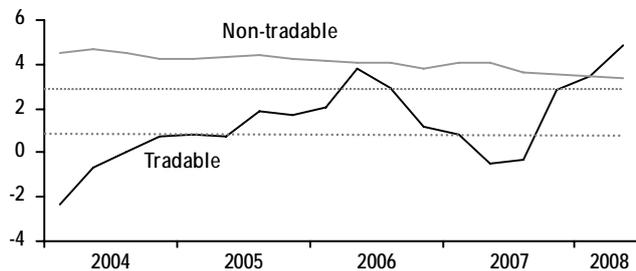
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The annual rate of inflation again was driven higher by rising petrol prices. Higher prices for petrol (+25.9%) made the most significant individual contribution to the increase in the 2Q CPI. If petrol prices had remained constant, annual inflation would have risen to 2.7% in 2Q.

New Zealand: non-tradable and tradable inflation

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More importantly, though, non-tradable inflation, a key point of focus for RBNZ policy-makers, slowed only moderately to 3.4% oya in the June quarter, from 3.5% in the two prior quarters, and remains above the RBNZ's target range. We suspect that the RBNZ would have been more comfortable with a sharper slowdown in non-tradable inflation, which is generated domestically

and not influenced by exchange rate fluctuations. Non-tradable inflation remains persistently high, however, despite the recent downturn in domestic demand, and raises the risk that wage and price setting behaviour may soon start to change. Workers, for example, may demand higher wages to compensate for the rising cost of living.

The 2Q CPI data was certainly an important milestone on the road to the next policy rate decision by the RBNZ. Despite the forecast slowdown in economic momentum, widespread inflation pressures, particularly the elevated level of non-tradable inflation, mean that the RBNZ likely will delay cutting the OCR until September. Recent weak data has dragged forward market expectations for a July rate cut, but we believe RBNZ officials will be looking for further evidence of sustained weakness in employment; in particular, whether earlier softness in the labour market in 1Q continued through the second quarter. Any further loosening of the labour market would take some upside pressure on wages, providing some relief on the inflation front. The employment release is due on August 7.

The details:

- From a year ago, consumer prices rose 4.0%. Making large positive contributions were transport supply (+18.1%), groceries (+11.4%), transportation (+9.6%), and energy (+7.1%).
- From the previous quarter, consumer prices rose 1.6%. Making large positive contributions were transport supply (+8.9%), transportation (+4.9%), newspapers (+2.5%), healthcare (+1.0%), and household appliances (+1.0%).

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