

New Zealand Economic Update

Producer price index

- Rise in producer input and output prices eased in 3Q from previous quarter ...
- ... but were sharply higher from a year ago, rising 13.6% and 9.8%, respectively
- PPI report has few implications for monetary policy outlook

Pipeline price pressures eased in New Zealand in the third quarter. Producer input prices grew 3.7%q/q, compared to 5.6% in 2Q (which marked the largest rise since 1980). Output prices also grew at a much slower rate, rising 2.8%q/q after a 3.5% rise in 2Q, which was the largest rise since 1985. For both input and output price rises, the major contribution to the price rise came from the fuel wholesaling sector, owing to a rise in crude oil prices.

Although pipeline pressures eased, input prices continue to grow at a significantly faster rate than output prices, suggesting that producers continued finding it difficult in the third quarter to pass on still-high costs to consumers, leaving profit margins squeezed. This is not surprising given the sharp slowdown in domestic demand, which has diminished pricing power.

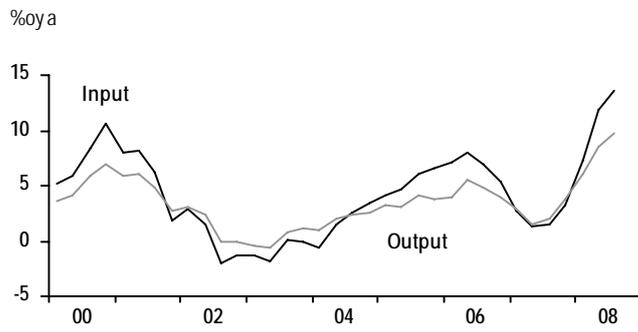
All components of the producer price index rose, excluding the electricity component, where input prices slumped 29%q/q and output prices fell 14%; these sharp falls failed, however, to fully offset the rises in the previous quarter. Wholesale prices for fuel drove up the wholesale trade component significantly. Wholesale trade input prices rose 8.1%q/q, with higher imported crude oil prices being the major driver, and output prices rose 4.3%. From a year ago, both wholesale trade indexes recorded their largest annual increase since the series began.

In addition, according to the Statistics New Zealand, the input and output costs faced by dairy companies rose 20%q/q and 24%, respectively. These were the second largest contributors to the two indexes, but are only reported in the third quarter of every year.

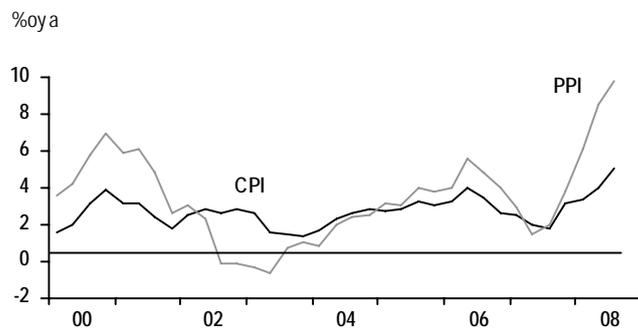
The PPI print has few implications for the monetary policy outlook, however. Our forecast still calls for a 100bp rate cut in December—a move fully priced by the futures market—and a terminal cash rate of 3.25% by end-2009, exactly half the prevailing rate of 6.5%.

The prolonged recession we expect in New Zealand—including five quarters of negative growth—coupled with the rising prospect that inflation will return to the RBNZ's target range more quickly than under our earlier forecasts, points to more assertive policy easing. We expect that inflation will ease significantly in coming quarters, with our forecast calling for headline CPI growth to be beneath the RBNZ's target range of 1-3%oya by 4Q09.

New Zealand: producer prices



New Zealand: CPI and PPI



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