

# Take the plunge

Q4 CPI preview: 20/1 10:45am NZT

- We expect Q4 CPI to fall 0.5%.
- Annual inflation to pull back to 3.4%.
- Inflation outlook considerably softer on weaker economy.
- Green light for more aggressive interest rate cuts.

Inflation hit an 18 year high of 5.1% in Q3 2008. Now prepare for the fall. We think annual inflation will plunge through 2009 getting close to zero by the third quarter. Such are the powerful downward forces from very weak economic activity both globally and domestically. Substantially lower fuel prices will be prominent in the short term data, while a very weak economy will pull down general inflation later in the year.

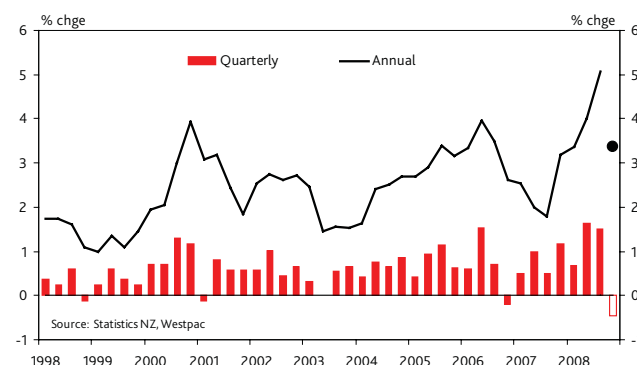
The rapid disinflation will start with the release of the CPI for Q4 2008 next Tuesday with annual inflation reducing to 3.4%. Lower fuel prices are a large part of our expectation that the CPI will fall by 0.5% in the quarter (coincidentally the same initial stab we have in for Q1 2009). The RBNZ had -0.3% for the quarter and 3.6% for the year in their December *Monetary Policy Statement*.

## Transport to drive CPI lower; food and housing inflation sticky for now

Major movers in the CPI over the quarter are expected to be:

- Transport prices. A range of influences summing to a 1.14 percentage point (ppt) negative contribution. A 23% plunge in petrol prices will be the most striking feature of the transport group. The introduction of free off-peak public transport for the elderly will also push down prices. International airfares will show a seasonal increase, although we suspect it will not be as much as usual given the massive retreat in fuel costs. The wild card in transport is vehicle prices. There is upward price pressure from a lower exchange rate, but downward pressure from high stocks, weak demand and tight credit. We have opted for another decline in vehicle prices in Q4.

Consumer Price Index



- Food prices. The food group is expected to make the strongest positive contribution (0.29 ppt) to inflation in Q4. Food prices are expected to rise 1.6% in the quarter, led by groceries, meat and poultry prices and the cost of eating out.
- Housing-related prices. We expect a 0.18 percentage point contribution to the CPI driven by higher household energy prices and the final wash up of the annual increase in local authority rates. We expect rent, purchase and maintenance of housing inflation to be more muted.

The huge drop in petrol prices is a key component behind our forecast 1.8% drop in tradeables inflation. Non-tradeable inflation is expected to come in at 0.7% for the quarter, keeping annual non-tradeable inflation at a pesky 4.1%. Still a 4.1% print would come as a downside surprise to the RBNZ, given the 4.4% forecast in their December *Monetary Policy Statement*.

## Implications

Our focus will be on the non-tradeable sector and on looking for evidence of the widespread anecdotes of hefty discounting by retailers. Still, these numbers relate to last year. The more important new inflation information came from this week's QSBO, where indicators of extremely weak activity, increasing spare capacity and plunging firms' pricing intentions all point to

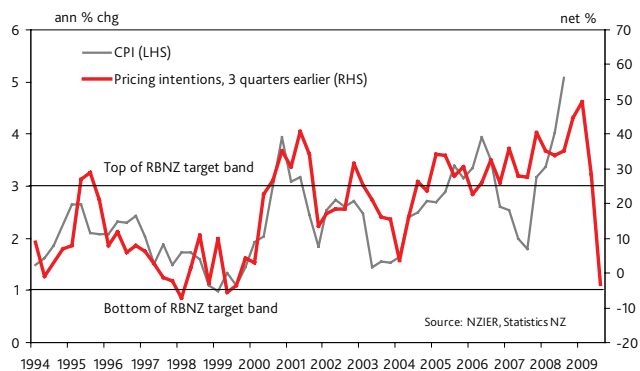
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a weak inflation environment ahead (including non-tradeable inflation). The results of that survey give the RBNZ a green light to continue their aggressive monetary easing. We expect a 100 bps cut in the OCR on January 29.

**Pricing intentions vs CPI**



Despite forecasting two consecutive 0.5% quarterly declines in the CPI, we are not overly concerned about deflation in a general sense. Sure the CPI is expected to decline in the short term, but it will be clear to most that it is hardly a general or widespread decline in prices! Rather we are forecasting disinflation. That is, a slowdown in the rate that general prices are rising. Still, this year will make a change to the recent past as we talk later about breaching the bottom of the RBNZ's target band rather than the top.

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