Inflation: No room for complacency

Consumer price index

- **Inflation**: The Consumer Price Index – the main measure of inflation in Australia – rose by 0.5 per cent in the December quarter, above expectations. In seasonally adjusted terms the CPI rose by 0.4 per cent. The annual rate of headline inflation eased from 1.9 per cent to 1.8 per cent. The Aussie dollar rose a quarter of a cent against the greenback in response.

- **Underlying measures**: The Reserve Bank monitors three measures to derive the underlying inflation rate. The trimmed mean rose by 0.4 per cent in the December quarter (1.8 per cent annual); the weighted median rose by 0.4 per cent (1.7 per cent annual) and the CPI less volatile items rose by 0.6 per cent (1.6 per cent annual). Overall, underlying inflation rose by 0.4 per cent in the quarter and by 1.75 per cent over the year. Market goods and services less volatile items was up by 0.7 per cent in the quarter to be up 1.7 per cent on the year.

- **Main changes**: domestic holiday travel and accommodation (+6.2 per cent), fruit (+5.0 per cent), tobacco (+9.4 per cent) and new dwelling purchase by owner-occupiers (+0.4 per cent) The most significant offsetting price falls this quarter are automotive fuel (-2.5 per cent), audio visual and computing equipment (-3.3 per cent), wine (-1.9 per cent) and telecommunications equipment and services (-1.5 per cent).

**What does it all mean?**

- Consumer prices rose a touch higher-than-expected in the December quarter. And while growth rates of 0.4-0.5 per cent for the quarter are still modest outcomes, market goods and services printed at a relatively high growth rate of 0.7 per cent for the quarter. There are no immediate implications other than interest rates remain on hold. But the Reserve Bank will likely stick to its guns, saying the next move in rates is up as a tighter job market manifests in higher wages and prices over time.

- Over the past decade underlying inflation has averaged 2.4 per cent and inflation has averaged 2 per cent over the past five years. The goal of the Reserve Bank is to keep inflation in the 2-3 per cent target band over the medium term. So the Reserve Bank has met its objective. Today’s data confirms that inflation is contained for

### The inflation measures monitored by the Reserve Bank

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<th>Quarterly</th>
<th>Year-ended</th>
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<tbody>
<tr>
<td></td>
<td>Dec Qtr 18</td>
<td>Sep Qtr 18</td>
</tr>
<tr>
<td>CPI - unadjusted</td>
<td>0.5</td>
<td>0.4</td>
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<tr>
<td>CPI - seasonally adjusted</td>
<td>0.4</td>
<td>0.1</td>
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<tr>
<td>– Tradable</td>
<td>-0.3</td>
<td>0.1</td>
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<tr>
<td>– Tradable (excl volatile items)</td>
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<td>0.0</td>
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<tr>
<td>– Non-tradables</td>
<td>0.9</td>
<td>0.2</td>
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<tr>
<td><strong>Selected underlying measures</strong></td>
<td></td>
<td></td>
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<tr>
<td>Trimmed mean</td>
<td>0.4</td>
<td>0.4</td>
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<tr>
<td>Weighted median</td>
<td>0.4</td>
<td>0.3</td>
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<tr>
<td>CPI excluding volatile items</td>
<td>0.6</td>
<td>0.1</td>
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(a) Volatile items are fruit, vegetables and automotive fuel

Source: ABS, RBA, CommSec
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now, so interest rates don’t need to move in any direction. For future interest rate settings it depends on where inflation is headed. And the best guess is that underlying inflation will move modestly higher. The job market is tightening, wages are starting to tick higher and the weaker Aussie dollar has the potential to show up in the prices of imported goods.

- The other factor to watch is the drought. The Bureau of Statistics note “Meat and seafood (+1.6 per cent), have been impacted by drought conditions in the eastern states, impacting supply and prices, particularly for lamb and goat (+6.8 per cent).”

- Before today, the Reserve Bank had expected underlying inflation to be 1.75 per cent in the December quarter and then to hold between 2-2.25 per cent from March 2019 through to the end of the 2020 year. The Bank will revisit these forecasts in the next quarterly Statement on Monetary Policy on February 8. Certainly we aren’t expecting any major changes in forecasts.

- With inflation still low and expected to lift only modestly over time, the Reserve Bank can continue to “push the envelope” by leaving interest rates well below the “neutral” or “normal” level. Monetary conditions – including interest rates and the Aussie dollar – remain stimulatory, and there are few risks in maintaining current settings.

- Wages are growing at a 2.3 per cent annual rate (2.7 per cent including bonuses) so the real winners in the current environment are Aussie consumers. A raft of goods has become more affordable with wages outpacing prices.

What do the figures show?

- The Consumer Price Index – the main measure of inflation in Australia – rose by 0.5 per cent in the December quarter, above expectations. In seasonally adjusted terms the CPI rose by 0.4 per cent. The annual rate of headline inflation eased from 1.9 per cent to 1.8 per cent.

- The Reserve Bank monitors three measures to derive the underlying inflation rate. The trimmed mean rose by 0.4 per cent in the December quarter (1.8 per cent annual); the weighted median rose by 0.4 per cent (1.7 per cent annual) and the CPI less volatile items rose by 0.6 per cent (1.6 per cent annual). Overall, underlying inflation rose by 0.4 per cent in the quarter and by 1.75 per cent over the year. Market goods and services less volatile items was up by 0.7 per cent in the quarter to be up 1.7 per cent on the year.

- Most notable price rises: domestic holiday travel and accommodation (+6.2 per cent), fruit (+5.0 per cent), tobacco (+9.4 per cent) and new dwelling purchase by owner-occupiers (+0.4 per cent).

- Most notable price declines: automotive fuel (-2.5 per cent), audio visual and computing equipment (-3.3 per cent), wine (-1.9 per cent) and telecommunications equipment and services (-1.5 per cent).

- Prices of tradables: The tradables component of the All groups CPI fell 0.3 per cent in the December quarter 2018. The tradable goods component fell 0.1 per cent due to automotive fuel (-2.5 per cent), audio, visual and comp equipment (-3.3 per cent) and wine (-1.9 per cent). The tradable services component fell 0.7 per cent due to international holiday travel and accommodation (-0.8 per cent).

- Prices of non-tradables: The non-tradables component of the All groups CPI rose 0.9 per cent in the December quarter 2018. The non-tradable goods component rose 1.5 per cent, due to the excise tax increase for tobacco (+9.4 per cent). The non-tradable services component rose 0.6 per cent, due to domestic holiday travel and accommodation (+6.2 per cent).

- Over the twelve months to the December quarter 2018, the tradables component rose 0.6 per cent and the non-tradables component rose 2.4 per cent.

- Tradable goods are those items whose prices are largely determined on the world market. Non-tradable prices are more affected by domestic economic conditions.

- Capital cities: Sydney +0.4 per cent in the quarter (annual +1.7 per cent); Melbourne +0.5 per cent (+2.0 per cent); Brisbane +0.5 per cent (+1.5 per cent); Adelaide +0.5 per cent (+1.6 per cent); Perth +0.5 per cent (+1.3 per cent); Hobart +1.2 per cent (+3.0 per cent); Darwin +0.2 per cent (+1.2 per cent); Canberra +0.7 per cent (+2.5 per cent).
- **Tobacco drove inflation over most capital cities:** “The rise in tobacco is due to the effects of the 12.5 per cent increase in the federal excise tax and the further increase based on Average Weekly Ordinary Time Earnings (AWOTE), effective from 1 September 2018.”

**Why is the data important?**
- The **Consumer Price Index (CPI)** is regarded as Australia’s premier measure of inflation. The CPI is published quarterly and measures price changes for a ‘basket’ of goods and services that dominate expenditure of metropolitan households. The “All Groups” index is the main focus, but other inflation measures are also published such as so-called ‘underlying’ measures. These include measures that abstract from price changes in volatile price items such as fresh food and petrol.
- The Reserve Bank aims to keep the headline inflation rate between 2-3 per cent over an economic cycle. If inflation is high and expected to rise, the Reserve Bank may elect to raise interest rates in order to constrain price pressures. Conversely, if inflation is low and expected to remain low, the Reserve Bank may elect to cut interest rates if it believes the growth pace of the economy is in need of strengthening.

**What are the implications?**
- Cars, televisions, phones and women’s shoes continue to get cheaper – at the lowest prices for over 30 years. But the cost of domestic holidays has lifted 7.3 per cent over the year with hairdressing up 3.2 per cent, milk up 2 per cent (biggest rise in almost a decade), seafood up 3.2 per cent, takeaway food up 2.7 per cent and both major and small electric household items have lifted around 2 per cent in the quarter in response to a lower Aussie dollar.
- If interest rates are to rise over the next year months it will require a tighter job market to continue to push up wages and therefore prices. So the job market will remain a focus of attention in coming months. There are certainly more reports of businesses finding harder to attract and retain staff. CommSec expects official interest rates to remain stable until late 2019.

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_Twitter: @CommSec_