Economics | April 28 2021

Underlying inflation at record lows

Consumer Price Index

- **Inflation: The Consumer Price Index (CPI) – the main measure of inflation in Australia – rose by just 0.6 per cent in the March quarter (consensus: +0.9 per cent).**
- **Annual rate of inflation: In the year to March, the CPI rose by 1.1 per cent after rising by 0.9 per cent in the year to December (consensus: +1.4 per cent).**
- **Main changes: The Australian Bureau of Statistics said the most significant CPI price rise in the March quarter was petrol (+8.7 per cent) while the most significant price fall was furniture (down 3.0 per cent).**
- **Underlying measures: The Reserve Bank focuses on the trimmed mean as the key underlying price measure. The trimmed mean rose by 0.3 per cent in the quarter (survey: +0.5 per cent) to be up 1.1 per cent on the year – the slowest rate in 38 years of records (survey: +1.2 per cent).**

The inflation data is pivotal in Reserve Bank interest rate deliberations.

What does it all mean?

- It's been more than five years since annual underlying inflation (as measured by the trimmed mean measure) has been in the Reserve Bank 2-3 per cent target zone. And courtesy of just a modest lift in prices in the March quarter, annual inflation is still well short of the goal. In fact the trimmed mean recorded a slower annual increase, down from 1.2 per cent to 1.1 per cent – the slowest rate in 38 years of records. And annual headline inflation is also just 1.1 per cent. Bottom line: the Reserve Bank will maintain its resolve and keep the cash rate at record lows until 2024.
- While the annual headline rate of inflation continues to lift, it is from significant lows. The Reserve Bank has anticipated the lift in prices, but it has fallen short of even its forecasts. The economy is growing at a faster rate, and that translates to higher prices. The lift in prices caused by higher raw material prices and consumer demand won't be sustained however unless there is also a lift in wage pressures. And that

The inflation measures monitored by the Reserve Bank

	Quarterly %		Year-ended %	
	Mar Qtr 21	*Dec Qtr 20*	Mar Qtr 21	*Dec Qtr 20*
CPI - unadjusted	0.6	*0.9*	1.1	*0.9*
CPI - seasonally adjusted	0.5	*0.8*	1.0	*0.9*
- Tradables	1.1	*-0.4r*	0.7	*-0.6*
- Tradables excl volatile items (a)	na	*0.0*	na	*1.4*
- Non-Tradables	0.4	*1.2*	1.3	*1.5*
Selected underlying measures				
Trimmed mean	0.3	*0.4*	1.1	*1.2*
Weighted median	0.4	*0.5*	1.3	*1.3r*
CPI excluding volatile items (a)	0.3	*0.9*	1.4	*1.5*

(a) Volatile items are fruit, vegetables and automotive fuel
Source: ABS, RBA, CommSec

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depends on a tighter job market, leading to higher labour costs, and, in turn, a generalised lift in consumer prices across the economy.

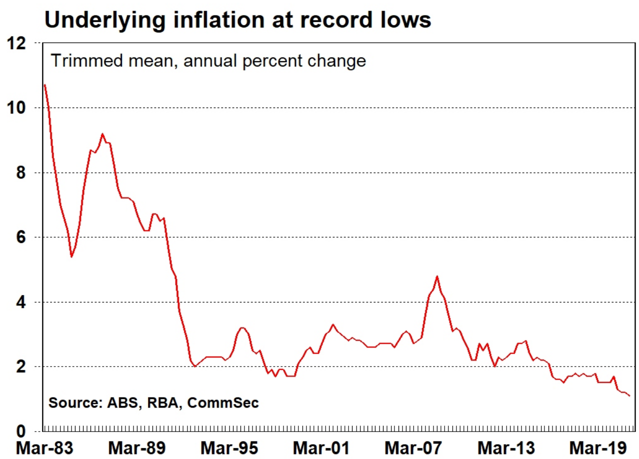
- Remember the Reserve Bank expects a temporary lift in headline inflation to 3 per cent in the June quarter, but underlying inflation is tipped to remain near 1.25 per cent.
- There is still spare capacity in the job market, so there is no sign as yet of generalised wage pressures. Higher wages are more confined to certain regions and industries, notably in the home building trades. The Reserve Bank doesn't expect generalised wage pressures to emerge until the jobless rate is closer to 4 per cent – clearly still some way off.
- Inflation is a watching brief. The economy is recovering much quicker than initially expected and that could mean higher-than-expected price increases and a tighter job market. Currently, the main lift in prices is at a producer level – such as record copper and iron ore prices. The question is how quickly and how extensive will be the pass-through from higher producer prices to higher consumer prices.
- But just as in the previous quarter, the message is the same: 'move on, move on, nothing to see here'.

What do the figures show?

- **Overall result:** The Consumer Price Index (CPI) rose by 0.6 per cent in the March quarter after rising 0.9 per cent in the December quarter. In the year to March, the CPI rose 1.1 per cent after rising 0.9 per cent in the December quarter.
- **Underlying measures:** The Reserve Bank focuses on the trimmed mean as the key underlying price measure. The trimmed mean rose 0.3 per cent to be up 1.1 per cent on the year. The weighted median rose by 0.4 per cent (+1.3 per cent annual). The CPI less volatile items rose by 0.3 per cent (+1.4 per cent annual). Market goods and services less volatile items rose by 0.2 per cent in the quarter to be up 1.9 per cent on the year.
- **Capital cities**: Sydney +0.4 per cent in the quarter (annual +0.9 per cent); Melbourne +0.3 per cent (+1.8 per cent); Brisbane +0.6 per cent (1.7 per cent); Adelaide +0.6 per cent (+1.2 per cent); Perth +1.4 per cent (+1.0 per cent); Hobart +0.8 per cent (+1.1 per cent); Darwin +2.6 per cent (+2.3 per cent); Canberra +0.9 per cent (+1.6 per cent).

Main Contributors: The notable price changes in the March quarter were:

- **Food:** "Beef and veal (+3.7 per cent) which rose as favourable weather saw farmers re-building herds after prolonged drought conditions, reducing meat supply. Takeaway foods (+0.6 per cent) and Restaurant meals (+0.5 per cent) which rose as the continued easing of lock-down restrictions saw more consumers dining at restaurants, allowing restaurants to pass through input cost increases. Fruit (-1.6 per cent) and Other cereal products (-2.7 per cent) which fell, partially offsetting the rise, due to favourable growing conditions leading to increased supply."
- **Alcohol and tobacco:** "Alcohol rose 1.0 per cent as prices returned from festive season specials alongside the pass through of the excise tax increase for beer and spirits. Tobacco fell 0.6 per cent, due to a small amount of discounting. The Average Weekly Ordinary Time Earnings (AWOTE) fell in November, therefore there was no increase in the tobacco excise, which typically rises on 1 March and 1 September each year."
- **Clothing:** "Accessories rose 7.3 per cent as elevated consumer confidence and demand enabled jewellers to pass through high precious metal prices."
- **Housing:** "Maintenance and repair of dwellings which rose 1.1 per cent as prices returned to previous levels following the completion of the Northern Territory Government's Home Improvement Scheme. Electricity fell 0.9 per cent, partially offsetting the rise. An annual review of Victorian electricity prices drove a fall in Melbourne. Perth rose 41.6 per cent, as electricity costs returned to more normal levels following the introduction of the $600 household electricity credit by the Western Australian (WA) Government in the December 2020 quarter. New dwelling purchase by owner occupiers fell 0.1 per cent."
- **Furnishings, Household equipment & services:** "Furniture which fell 3.0 per cent as prices fell due to post-Christmas discounting. Child care (+2.2 per cent) and Other household services (+1.2 per cent) partially offset the fall, due to increases in child care fees and price rises for gardening and house cleaning services."
- **Health:** "Medical and hospital services (+1.5 per cent) and Pharmaceutical products (+5.3 per



cent) rose as a result of the cyclical reduction in the proportion of consumers who qualify for subsidies under the Medicare safety net and Pharmaceutical Benefits Scheme (PBS). The safety net thresholds for both the PBS and Medicare are reset on 1 January each year."

- **Recreation & culture:** "Domestic holiday travel and accommodation fell 1.8 per cent due to airfares. The entrance of a new competitor into the capital city market has led to significant discounting between domestic carriers, with prices falling across routes including to major city destinations. Domestic accommodation partially offset the fall, with a number of accommodation operators increasing prices following increased demand for intrastate travel. Other recreational, sporting and cultural services rose 3.7 per cent, partially offsetting the fall. Entertainment venues are now allowed to operate at 100 per cent seated capacity, which saw cinemas and live theatre companies increase prices to pre-COVID-19 or higher levels."
- **Transport: "**Automotive fuel which rose 8.7 per cent as a result of a further recovery in world oil prices from large price falls in early 2020 due to COVID-19 related global lockdowns."
- **Communication:** "Telecommunication equipment and services rose 0.4 per cent with new phones coming into the sample and replacing discounted older models. NBN plan prices also increased this quarter."
- **Education:** "Secondary education which rose 1.8 per cent following increases in fees at the commencement of the new school year. Tertiary education fell 1.7 per cent, offsetting the rise."

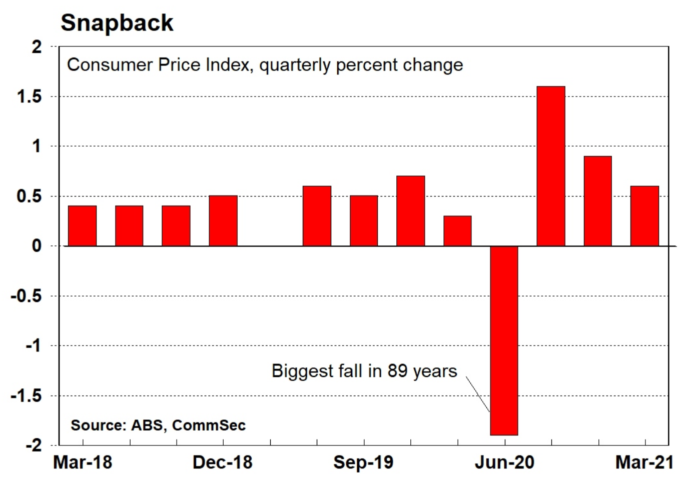
- **Prices of tradables**: The tradables component of the 'All groups CPI' rose by 1.1 per cent to be 0.7 per cent higher over the year.
- **Prices of non-tradables:** The non-tradables component of the 'All groups CPI' rose by 0.4 per cent to be up 1.3 per cent over the year.
- Tradable goods are those items whose prices are largely determined on the world market. Non-tradable prices are more affected by domestic economic conditions.

What is the importance of the economic data?

- 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 (RBA) 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 RBA may elect to raise interest rates in order to constrain price pressures. Conversely, if inflation is low and expected to remain low, the RBA may elect to cut interest rates if it believes the growth pace of the economy is in need of strengthening.

What are the implications for interest rates and investors?

- The Reserve Bank sets interest rates with a view of keeping inflation between 2-3 per cent over an economic cycle. Inflation is well below the lower bound of the range at present. The expectation is that inflation will remain contained for some time. As a result, interest rates will spend an extended period at generational lows.
- There was an eclectic mix of price rises and price falls in the quarter. Cleaning services were more expensive as was holiday accommodation, beef, alcohol and jewellery. But there was price discounting in furniture and – bizarrely – tobacco in the quarter. A lift in high school fees was offset by lower university fees. Higher prices for restaurant and fast food meals was offset by cheaper fruit and cereal products. And increased competition in major routes drove down domestic airfares. For each area of price weakness or fall there were price increases. The economy is still clearly some way from 'normal'.
- Is the 2-3 per cent inflation goal still relevant? Perhaps now is the time for some detailed analysis of the target. A shift in the lower bound to 1 per cent wouldn't water down the goal of keeping inflation low, but acknowledge the greater role of globalisation in influencing prices.



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