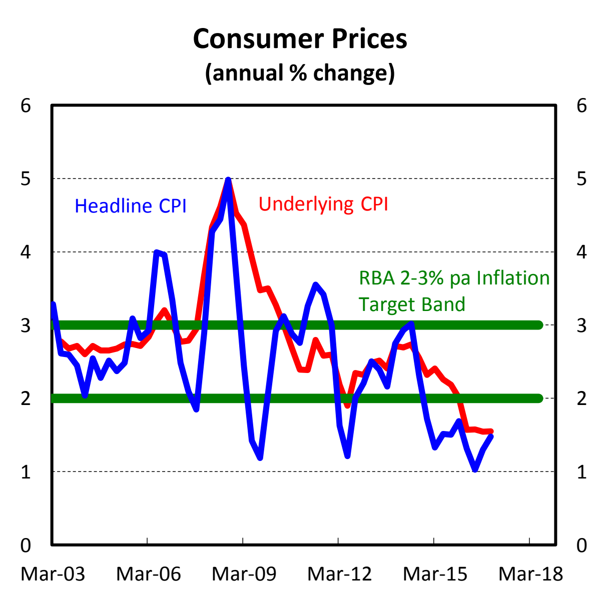
Data Snapshot

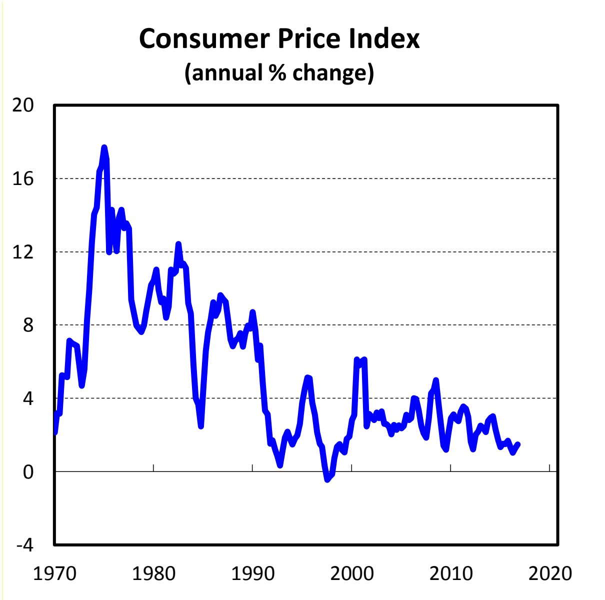
Wednesday, 25 January 2017

Consumer Price Index

Inflation Still Soft

- **Inflation remained weak in the December quarter. Headline inflation rose by 0.5% in the December quarter, which was in line with our expectations. For the year to the December quarter, headline inflation rose to 1.5%, from 1.3% in the year to the September quarter.**
- **Underlying inflation, which strips out the effect of volatile items like petrol and food, remained subdued. The average of the two key measures of underlying inflation rose by 0.4% in the December quarter. For the year to the December quarter, underlying CPI rose by 1.6%, up slightly from a record low in underlying inflation of 1.5% in the year to the September quarter.**
- **Both the headline and underlying rates of inflation remain well below the RBA's 2 to 3% per annum target band.**
- **Non-tradables inflation lifted to its highest in a year, but has been boosted by the inclusion of tobacco prices into the non-tradables component. As rising taxes have been behind the price hikes in tobacco, it is difficult to interpret the pickup as reflective of increasing domestic price pressures.**
- **The RBA's preferred measures of core inflation suggests that broader price pressures remain subdued. Given spare capacity in the economy, underlying inflation is unlikely to pick up to the RBA's 2 to 3 percent target band over the medium term as the RBA is expecting.**





Inflation remained weak in the December quarter. Headline inflation rose by 0.5% in the

December quarter, which was in line with our expectations, but slightly below consensus expectations. For the year to the December quarter, headline inflation rose to 1.5%, from 1.3% in the year to the September quarter.

Underlying inflation, which strips out the effect of volatile items like petrol and food, remained subdued. The average of the two key measures of underlying inflation rose by 0.4% in the December quarter, which was below consensus forecasts for a 0.5% increase but in line with our own forecast. For the year to the December quarter, underlying CPI rose by 1.6%, up slightly from a record low in underlying inflation of 1.5% in the year to the September quarter. Despite the lift, today's data suggests that inflation remains persistently low.

Both measures of inflation continue to sit below the RBA's 2-3% per annum target band.

CPI Groups Analysis

The largest increase was in alcohol and tobacco in the December quarter. Within this group, the increase was driven by tobacco prices, which rose by 7.4% for the quarter, reflecting the continuing impact of the increase in the federal excise tax from 1st September 2016. Over the year to the December quarter, the tobacco price rose by 13.2%.

In keeping with recent quarters, volatility in the oil price was a swing factor for inflation. Automotive fuel prices rose by 6.7% in the December quarter, which was the largest increase since the June quarter 2015. Over the year to the December quarter, automotive fuel prices fell by 1.1%.

Other components that contributed significantly to the increase in CPI for the quarter included higher prices for domestic holiday travel and accommodation (5.5%) and new dwelling purchase by owner-occupiers (0.5%). Prices for domestic holiday travel tend to rise in the December quarter, reflecting both the October school holidays and the lead-up to the peak summer holiday period.

There was also seasonal impact from a fall in the price of pharmaceutical products (-2.6%), reflecting the annual pattern where subsidies kick in for the Pharmaceutical Benefits Scheme (PBS) safety net as a greater proportion of consumers reach the threshold.

	December quarter 2016, %	
Consumer Prices	**Quarterly change**	**Annual change**
Food and non-alcoholic beverages	0.6	1.8
Alcohol and tobacco	2.8	5.9
Clothing and footwear	-0.5	-0.9
Housing	0.3	1.9
Furnishings, household equipment and services	-0.8	0.6
Health	-0.6	3.7
Transport	1.7	-0.3
Communication	-0.8	-5.9
Recreation and culture	0.6	-0.5
Education	0.0	3.3
Insurance and Financial Services	0.6	2.7
Total CPI	**0.5**	**1.5**

Over the last twelve months, softness in inflation was driven by ongoing price declines in communication (-5.9%), reflecting lower prices for telecommunication equipment & services and audio, visual & computing equipment and clothing and footwear (-0.9%), driven by a decline in accessories prices (-3.3%).

Annual price growth was strongest for alcohol & tobacco (5.9%), which was driven by a lift in the excise on tobacco from 1st September. This was followed by health (3.7%, reflecting higher prices for medical & hospital services) and education (3.3%).

Tradables and Non-Tradables Inflation

Tradables CPI edged 0.1% lower in the December quarter, after increasing 1.0% in the September quarter. Tradables inflation includes the prices of goods and services that are imported or compete with imported goods and services, and comprises around 35% of the weight of the CPI. The biggest positive contributor to the tradable goods component, was automotive fuel which rose 6.7%. This was partially offset by a 5.1% decline in accessories. A 2.6% decline in international holiday travel and accommodation also drove the decline in the quarter.

On an annual basis, tradables inflation was at just 0.1% in the December quarter. It appears that the inflationary impact of the earlier depreciation in the Australian dollar over 2013 through to 2015 has largely passed.

Non-tradables CPI, which reflects domestic prices which are not subject to international or import competition, rose 0.8% in the December quarter, the strongest quarterly gain since the March quarter 2015. Non-tradables inflation has been an important means of gauging price pressures in the domestic economy. However, the December quarter data now includes tobacco (previously under tradables) and would have exacerbated the increase in non-tradable prices for the quarter. Given much of the price increases in tobacco reflect rising taxes, we cannot interpret today's data as a pickup in underlying domestic price pressures.

Indeed, the price of tobacco rose 7.4% in the quarter, and was the most significant contributor to the lift in the prices of non-tradable goods. Domestic holiday travel and accommodation, which tends to increase significantly in the December quarter, rose 5.5%. Pharmaceutical products (-2.6%) provided an offsetting decline.

On an annual basis, non-tradables CPI lifted 2.1% in the year to the December quarter. Although non-tradables inflation was the highest in a year, it remains subdued and well below the RBA's 2 to 3% per annum target band. Soft wage growth, ongoing spare capacity within the economy suggests that domestic inflation will remain low for some time.

Inflation By State

Prices increased in all capital cities in the December quarter, with the exception of Darwin, where prices slipped 0.1%. For the quarter, the strongest gains in CPI were in Hobart (0.8%), followed by Melbourne (0.7%), Canberra (0.6%), Brisbane and Sydney (both 0.5%), Perth (0.4%), Adelaide (0.3%).

In annual terms, inflation increased in all capital cities, except Darwin, where prices fell 0.4%. Price increases were strongest in Sydney and Canberra (both 1.8%), followed by Brisbane (1.6%), Melbourne (1.5%) and Adelaide and Hobart (both 1.3%) and at a slower pace, Perth (0.4%).

Outlook

The underlying picture of inflation remained weak in the December quarter. The RBA's preferred measures of core inflation suggests that broader price pressures remain subdued. The low pace of inflation reflects strong competition and excess capacity within the global and local economies.

The Australian economy is growing at a reasonable pace, but not sufficient to result in a substantial reduction in spare capacity and there remains a degree of slack in the labour market. That would suggest that inflation is unlikely to pick up to the RBA's 2 to 3 percent target band over the medium term as the RBA is expecting. If inflation remains subdued, there is a risk the RBA will ease monetary policy further.

Contact Listing

Chief Economist

Besa Deda
dedab@stgeorge.com.au
(02) 8254 3251

Senior Economist

Josephine Horton
hortonj@stgeorge.com.au
(02) 8253 6696

Senior Economist

Janu Chan
chanj@stgeorge.com.au
(02) 8253 0898