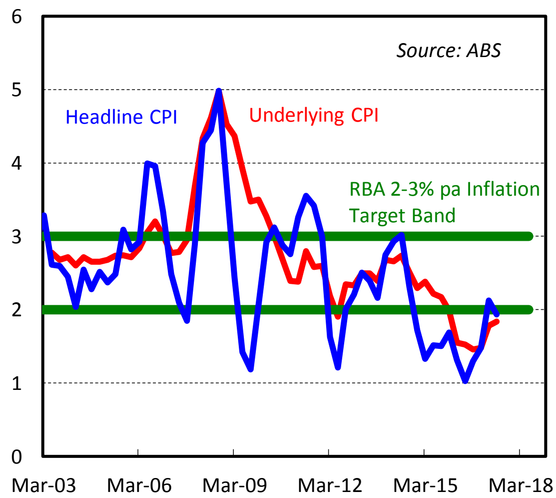
Data Snapshot

Wednesday, 26 July 2017

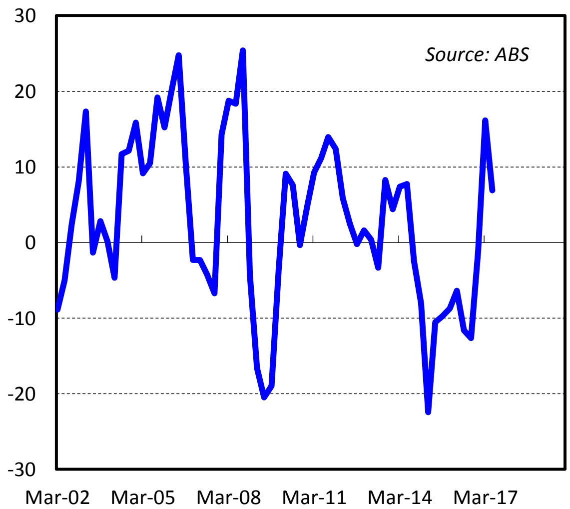
Consumer Price Index
What Inflation?

- **Headline CPI rose just 0.2% in the quarter, in line with our forecasts, but below consensus expectations for a 0.4% increase. The annual rate of headline inflation stepped down from 2.1% in the March quarter to 1.9% in the June quarter.**
- **Today's data is consistent with the broader global trend of subdued inflation. Low wage growth and spare capacity in the labour market also point to low inflation.**
- **Both the headline and underlying rates of inflation sit below the Reserve Bank's (RBA's) 2% to 3% per annum target band, suggesting that talk of a near-term RBA rate hike is still too premature. Importantly, the average of the two measures of underlying inflation (the RBA's preferred inflation measure) has been below the RBA's target band for six consecutive quarters.**
- **Tradables inflation fell for the third consecutive quarter and increased 0.4% in the year to the June quarter. Non-tradables inflation lifted, but at the slowest quarterly pace in a year. Non-tradables inflation lifted at an annual pace of 2.7%, the strongest annual rate in three years.**
- **Today's data should not come as a big surprise for the RBA. At present, the RBA is focusing on developments in the labour market. Wages growth remains subdued and RBA Governor's speech today indicated that there is a risk that wages growth will continue to be soft for some time. The RBA will struggle to get price inflation back to the middle of its target band without an improvement in wage growth.**

Consumer Price Index
(annual % change)



Automotive Fuel Inflation
(annual % change)



Headline CPI rose just 0.2% in the quarter, in line with our forecasts, but below consensus expectations for a 0.4% increase. The annual rate of headline inflation stepped down from 2.1% in the March quarter to 1.9% in the June quarter.

The average of the two measures of underlying inflation, the RBA's preferred inflation measure, was more or less steady coming in at 0.5% in the June quarter, and 1.8% in the year.

There were a few one-off factors which kept inflation low in the quarter, particularly the headline rate. There are not many seasonal impacts in the June quarter to push up inflation. Additionally, the upward impact of Cyclone Debbie on fruit and veggie prices was less than anticipated.

Nonetheless, today's data is consistent with the broader trend seen globally – that inflation remains subdued. Low wage growth and spare capacity in the labour market also point to low inflation.

Both the headline and underlying rates of inflation sit below the RBA's 2% to 3% per annum target band. Importantly, the underlying rate of inflation has been below the RBA's target band for six consecutive quarters.

CPI Groups Analysis

There was limited overall impact from Cyclone Debbie on fruit and vegetable prices. The ABS reports that there were higher prices for tomatoes, beans cucumbers, melons, berries and bananas, reflecting crop damage. However, prices fell for oranges, mandarins and apples. Overall, fruit and veggie prices fell 1.7% in the June quarter, with a 4.4% decline in the price of fruit alone.

The other key factor which influences the headline inflation rate is the price of petrol. A recent pull back in the price of oil has brought down inflation rates all around the world. In the June quarter, prices of automotive fuel dropped 2.5% in the quarter.

Seasonal factors also kept prices muted. The price of domestic holiday travel and accommodation (-3.2%) fell, reflecting the off-peak season period. The June quarter also lacks some of the seasonal increases that occur in other quarters such as for utilities, education and childcare. The exception was for healthcare, where medical and hospital services rose 4.1%. This reflected the annual lift in private health insurance premiums on 1 April.

Tradables and Non-Tradables Inflation

Softness in inflation in the June quarter was driven by the tradables component. This component fell for the third consecutive quarter, largely reflecting falling oil prices globally. Tradables inflation includes the prices of goods and services that are imported or compete with imported goods and services. It comprises around 35% of the weight of the CPI. Prices of tradables fell by 0.3% in the June quarter. The biggest driver of the decline in tradables inflation was automotive fuel (-2.5%). This was partially offset by increases in prices of household textiles (4.0%) and international holiday travel and accommodation (0.9%).

So far in the September quarter, the average oil price has been lower than in the June quarter. Although its early days, if the lower oil price were maintained, it would weigh on inflation in the current quarter. The fall in tradables inflation in the June quarter occurred, despite the slightly lower Australian dollar over the quarter, which tends to have an inflationary impact. The Aussie dollar has increased in the current quarter and if these currency gains were maintained, it would put downward pressure on prices of tradables.

In annual terms, tradables inflation rose 0.4% in the year to the June quarter, down from an increase of 1.3% in the year to the March quarter.

Non-tradables CPI, which reflects domestic prices not subject to international or import competition, rose by 0.4% in the June quarter. It was the softest quarterly gain in a year. The increase in non-tradables inflation was led by medical and hospital services (4.1%), new dwelling purchase by owner occupiers (0.9%) and tobacco (1.0%).

On an annual basis, non-tradables CPI lifted 2.7% in the year to the June quarter. This was the highest reading since the June quarter 2014 and took non-tradables CPI to the top half of the RBA's 2% to 3% per annum target band.

Inflation By State

Prices increased in Brisbane (0.5%), Sydney (0.4%), Darwin (0.3%), Melbourne (0.1%) and Adelaide (0.1%) in the June quarter. Prices were unchanged in Perth, Canberra and Hobart, for the quarter.

In annual terms, inflation rose in all capital cities, although the pace of increase was slower in many of the capital cities than in the previous quarter. For the year to June, inflation was strongest in Hobart (2.3%), followed by Sydney (2.2%), Melbourne (2.2%), Canberra (2.1%), Brisbane (1.8%), Adelaide (1.6%), Perth (0.7%) and Darwin (0.5%).

Outlook

Today's data confirms that inflation remains subdued and will likely remain low for some time. The phenomenon of low global inflation has been described as a "puzzle" by policymakers of major central banks, which persists despite an improving picture of global demand.

Reserve Bank Governor Lowe provided some reasons for soft wage inflation in his speech delivered today but acknowledged there is no single answer. One of the key reasons was that many workers in the global economy today "perceive" there's greater competition. These workers feel less secure about their jobs and, therefore, are reluctant to ask for higher wages. This perception is being fuelled by greater globalisation and technology advancements. In turn, workers are then adjusting down their future wage expectations and future household spending plans. The adjustment lower in household consumption presumably feeds into subdued price inflation outcomes.

Not surprisingly then, in Australia, ongoing spare capacity in the labour market further points to a low inflation outlook. Additionally, weak global inflation backdrop also suggests inflation will remain low.

Annual rates of both headline and underlying inflation are below the RBA's 2% to 3% target band, and suggest that talk of an RBA rate hike in the near term is still too premature.

There is a chance that underlying inflation will move to within the RBA's target band over the next few quarters, but only just and if so, it will likely remain towards the bottom of the RBA's 2 to 3 per cent band.

That said, today's data should not come as a big surprise for the RBA. The result is close to the RBA's inflation forecasts. Moreover, the RBA maintains that inflation will be consistent with its target over time. At present, the RBA is focusing on developments in the labour market. Wages growth remains subdued and there is a risk that wages growth will continue to be soft for some time, as indicated in by the RBA Governor in a speech today. The RBA will struggle to get price inflation back to the middle of its target band without an improvement in wage growth.

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