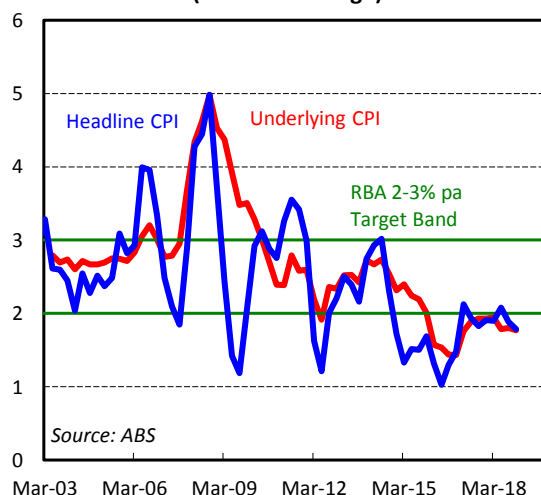


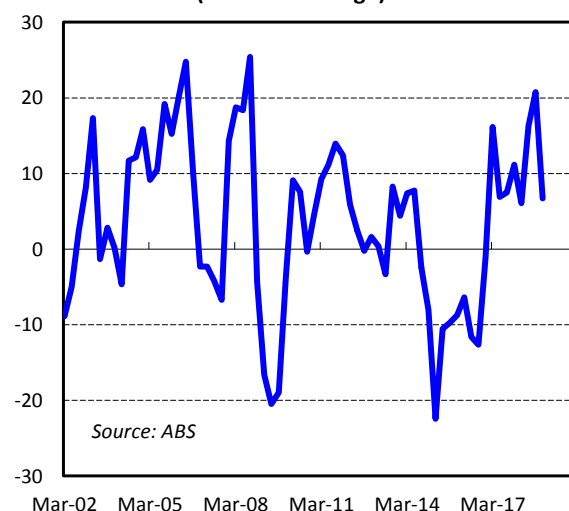
Consumer Price Index Inflation Tethered

- Headline CPI rose 0.5% in the December quarter, which was slightly above consensus expectations for a 0.4% increase. Nonetheless, it indicates that inflation remains subdued. The annual pace of headline inflation slowed to 1.8% in the December quarter, from 1.9% in the previous quarter.
- The Reserve Bank of Australia (RBA) focuses on underlying inflation. The average of the two underlying inflation measures rose 0.4% in the December quarter, after rising 0.4% in the September quarter.
- The annual pace of underlying inflation held at 1.8% for the third consecutive quarter. It remains below the RBA's 2-3% per annum target inflation band.
- The low inflation environment is reflective of conditions in the labour market and retail sector. Wage growth is low and although the unemployment rate has declined over the past year, there remains spare capacity within the labour market. The retail sector also continues to be plagued by cost-cutting competitive pressures.
- In the December quarter, price increases were driven by tobacco (9.4%), domestic holiday travel & accommodation (6.2%) and fruit (5.0%). The rise in CPI inflation was moderated by declining prices for automotive fuels (-2.5%) and audio visual & computing equipment (-3.3%).
- Underlying inflation remains below the RBA's 2 to 3 % per annum target band, indicating inflation remains contained. We do not expect inflation to move to within the RBA's band before 2020. Our inflation forecast profile leaves the RBA on the sidelines this year and next.

Consumer Price Index
(annual % change)



Automotive Fuel Inflation
(annual % change)



Headline CPI rose 0.5% in the December quarter, which was slightly above consensus expectations for a 0.4% increase. Nonetheless, it indicates that inflation remains low. The annual pace of headline inflation slowed to 1.8% in the December quarter, from 1.9% in the previous quarter.

The Reserve Bank of Australia (RBA) focuses on the underlying rates of inflation, the trimmed mean and the weighted median. The average of these two underlying measures rose 0.4% in the December quarter, after rising 0.4% in the September quarter. The annual pace of underlying inflation held at 1.8% for the third consecutive quarter. It remains below the RBA's 2-3% per annum target inflation band.

Today's inflation numbers indicate inflation pressures remain subdued in Australia. The low inflation environment is reflective of conditions in the labour market and retail sector. Wage growth is low and although the unemployment rate has declined over the past year, there remains spare capacity within the labour market. The retail sector also continues to be plagued by cost-cutting competitive pressures.

CPI Groups Analysis

In the December quarter, price increases were driven by tobacco (9.4%), domestic holiday travel & accommodation (6.2%) and fruit (5.0%). Tobacco prices were impacted by a 12.5% increase in the Federal excise tax and a further increase based on earnings, from September 2018. Prices for domestic holiday travel & accommodation tend to rise in the December quarter, reflecting both the October school holidays and the lead-up to the peak summer holiday period.

Despite large increases in some areas, overall inflation was muted in the December quarter. The rise in CPI inflation was moderated by declining prices for automotive fuels (-2.5%), audio visual & computing equipment (-3.3%) and wine (-1.9%). The fall in automotive fuel prices reflects a decline in oil prices in the December quarter feeding through to petrol prices, although over the year to the December quarter, automotive fuel prices have increased by 6.7%.

There was also a seasonal impact from a fall in the price of pharmaceutical products (-1.9%), 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.

Tradables and Non-Tradables Inflation

The prices of tradable goods and services fell by 0.3% in the December quarter. It is the first drop in three quarters and takes the annual pace of change to 0.6%, which is down from 1.4% growth in the September quarter.

Tradables inflation measures the prices of goods and services that are imported, or those which compete with imported goods, and is heavily influenced by movements in the Australian dollar and other global factors over time. The Australian dollar in trade-weighted terms depreciated 2.4% over the quarter and by 6.5% over the year. This decline in the currency should be inflationary. But it can take time for a pass-through effect from the currency to occur. Moreover, it should also be noted that global inflationary pressures are not strong and world oil prices fell significantly in the December quarter. The West Texas Intermediate quote for oil dropped 38% over the quarter, heavily influencing transportation prices and overall tradables inflation.

The weakness in tradables inflation growth also reflects the intense competition that is prevailing in the retailing sector, excluding volatile fruit, vegetables and fuel products.

Non-tradables consumer prices reflect domestic prices not subject to international or import competition; this measure lifted by 0.9% in the December quarter. It is the largest quarterly gain in

five quarters and led the annual growth rate to move up from 2.2% to 2.4%. The non-tradables consumer inflation outcome is notable in that the annual rate has been sitting in the RBA's 2-3% band for the past nine quarters. The softness in tradables inflation is helping contain overall price pressures in the Australian economy.

The biggest increase in the quarter came from tobacco, which jumped 9.4% to record its biggest jump since the June quarter of 2010. Recreation posted the next biggest quarterly gain of 1.1%, led by a sharp rise in domestic holiday travel & accommodation (up 6.2% in the December quarter).

Inflation by States

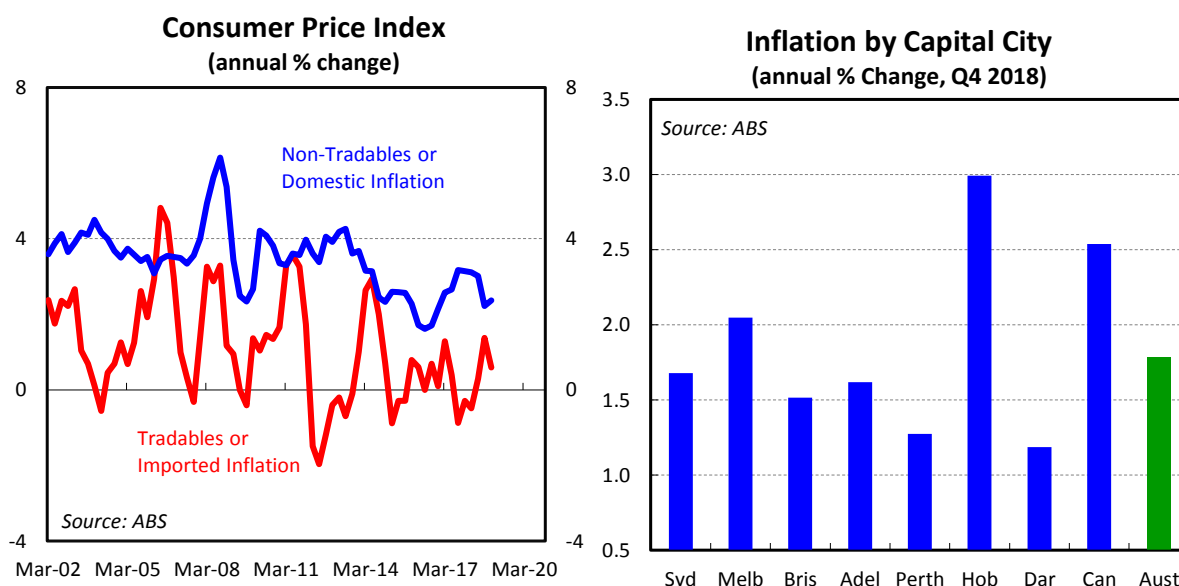
Inflation was moderate across most capital cities. Consumer prices rose by 0.4-0.5% in the December quarter for all capital cities but three. Hobart, Darwin and Canberra were the notable exceptions.

Hobart inflation jumped 1.2% in the December quarter, which is the sharpest quarterly growth outcome in nearly 8 years.

Inflation in Canberra rose 0.7% in the quarter, also a firm result. Both of the inflation results in Hobart and Canberra reflect strong rates of economic activity in their respective economies.

Darwin also recorded an inflation result outside of the range of most capital cities, but the result was at the low end. Darwin consumer prices rise by 0.2%, reflecting a downturn in the Northern Territory economy now that the mining investment construction boom has concluded.

In terms of the annual growth rates in the capital cities, only two capital cities recorded an outcome that was not below the RBA's band. Melbourne's annual rate was 2.0% and Hobart's annual rate was 3.0%.



Outlook

Underlying inflation remains below the RBA's 2 to 3 % per annum target band, indicating inflation remains contained. We do not expect inflation to move to within the RBA's band before 2020. Our inflation forecast profile leaves the RBA on the sidelines this year and next.

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