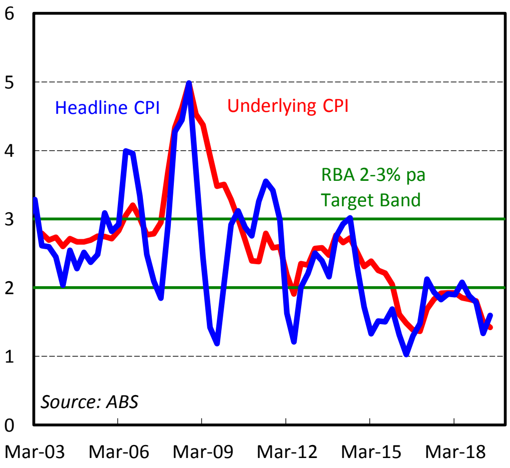
Wednesday, 31 July 2019

Consumer Price Index

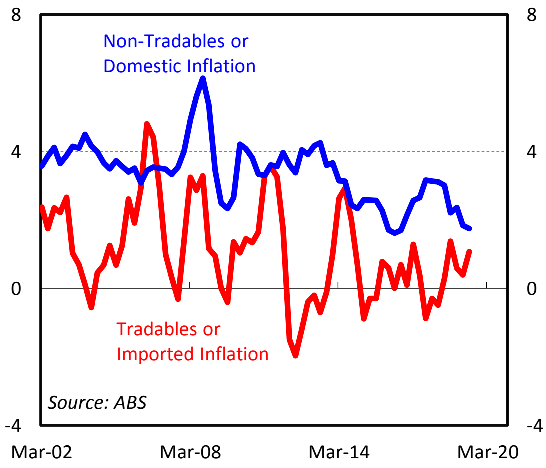
Still Below Target

- **Headline CPI rose 0.6% in the quarter, versus consensus expectations for a 0.5% increase. It was the strongest quarterly lift in headline CPI in 1½ years. The annual rate lifted from 1.3% in the March quarter to 1.6% in the June quarter.**
- **Underlying CPI (trimmed mean) rose 0.4% in the June quarter. This outcome left the annual rate steady at 1.6%, but this was stronger than consensus expectations of 1.5%.**
- **While inflation was a touch stronger than expectations, inflation outcomes were still weak. Both headline and underlying inflation are running below the RBA's 2 to 3 percent per annum target band. Moreover, underlying inflation has been below the RBA's 2 to 3 percent target band for 3½ years, and is still unlikely to return to the RBA's target any time soon.**
- **The stronger-than-expected result mostly reflected higher oil prices – automotive fuel rose 10.2% in the June quarter.**
- **There was also some pass-through of higher prices from the weaker Australian dollar, reflecting higher prices for clothing & footwear, furniture, international travel and tradables inflation.**
- **Nonetheless, domestic price pressures remain very subdued reflecting weakness in the housing market and ongoing spare capacity in the labour market.**
- **The outlook for inflation remaining subdued for some time remains unchanged. Today's data also doesn't change the fact that there continue to be downside risks to the economic outlook and the unemployment rate is at risk of rising. The RBA wants to see further signs of progress towards its inflation and full-employment objectives and has indicated a willingness to provide further monetary easing "if necessary".**

Consumer Price Index
(annual % change)



Consumer Price Index
(annual % change)



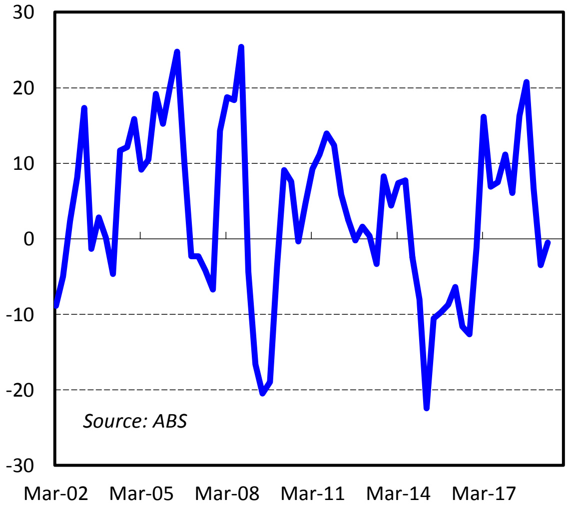
Headline and Underlying CPI

Inflation was a bit above expectations in the June quarter. Headline CPI rose 0.6% in the quarter, versus consensus expectations for a 0.5% increase. It was the strongest quarterly lift in headline CPI in 1½ years. The annual rate lifted from 1.3% in the March quarter to 1.6% in the June quarter.

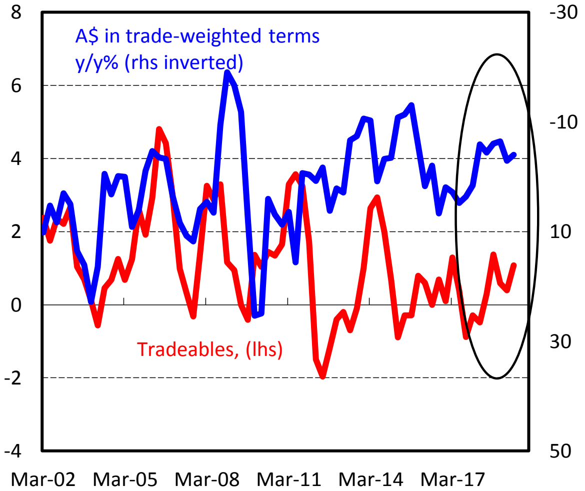
Underlying CPI (trimmed mean) rose 0.4% in the June quarter. This outcome left the annual rate of underlying inflation steady at 1.6%, but this was stronger than expectations of 1.5%.

However, it is important to note, that while inflation was a touch stronger than expectations, inflation outcomes were still weak. Both headline and underlying inflation are running below the RBA's 2 to 3 per cent per annum target band. Moreover, underlying inflation has been below the RBA's 2 to 3 per cent target band for 3½ years, and is still unlikely to return to the RBA's target any time soon. The RBA tends to focus on underlying inflation as it strips out volatile prices.

Automotive Fuel Inflation
(annual % change)



Tradables Inflation and A$
(annual % change)



Groups Analysis

The largest contributor to the lift in CPI was a 10.2% increase in prices of automotive fuel in the June quarter, as oil prices rebounded further from their lows in December 2018. This lift resulted in a 3.4% rise in transport prices over the quarter. Given oil prices have partly retreated amid concerns about global demand, this boost to prices is unlikely to be repeated in the coming quarter.

Another key contribution to higher prices was medical & hospital services (2.6%), reflecting the seasonal increase in private health insurance premiums on 1 April. This drove prices in the health group 1.8% higher in the quarter.

Clothing & footwear prices rose 1.6% in the June quarter, which was the strongest quarterly increase in three years. This increase likely reflects the impact of the weaker Australian dollar over the past year.

Prices in the furnishings, household equipment & services group also gained, lifting 0.7% in the quarter. This was the strongest increase in two years and was driven by a 1.6% gain in prices of furniture.

On a year ago, price growth in both these categories remain subdued, at 0.2% and -0.4%, respectively, suggesting that strong competition is preventing retailers from passing on the higher cost of weaker Australian dollar. Nonetheless, the annual increase in clothing & footwear prices was the strongest since the March quarter 2017.

In the June quarter, areas of weakness included the housing category, which fell 0.2% in the June quarter. It was the first decline since the March quarter 1998. It not only reflected subdued conditions in the housing market, but also lower electricity & gas prices and subdued growth in rents due to rising vacancies in some capital cities.

Communications (-1.1%) and food & non-alcoholic beverages (-0.4%) were the other two groups which recorded price declines.

Fruit & veggie prices fell 2.8%, as the supply of bananas recovered after adverse weather conditions and increased supply of apples, citrus fruits and winter vegetables.

Tradables and Non-Tradables Inflation

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.

Tradables inflation rose 1.2% in the June quarter, the strongest quarterly increase in four years. While the gain reflected higher fuel costs, it also provides some evidence that the lower Australian dollar is having some impact in pushing up prices. Tradables inflation was also driven higher by a 2.7% increase in international holiday, travel & accommodation prices.

The Australian dollar in trade-weighted terms fell 1.3% in the June quarter, but is currently down 6.3% from a recent peak on August 9 of last year. The sustained depreciation in the Australian dollar is beginning to pass through to consumer prices.

On an annual basis, tradables inflation remains weak, at 1.1%.

Non-tradables consumer prices reflect domestic prices not subject to international or import competition. This measure lifted by just 0.2% in the June quarter, the softest quarterly increase since the March quarter 2009. On an annual basis, non-tradables inflation was steady, but remained at a subdued rate of 1.8%.

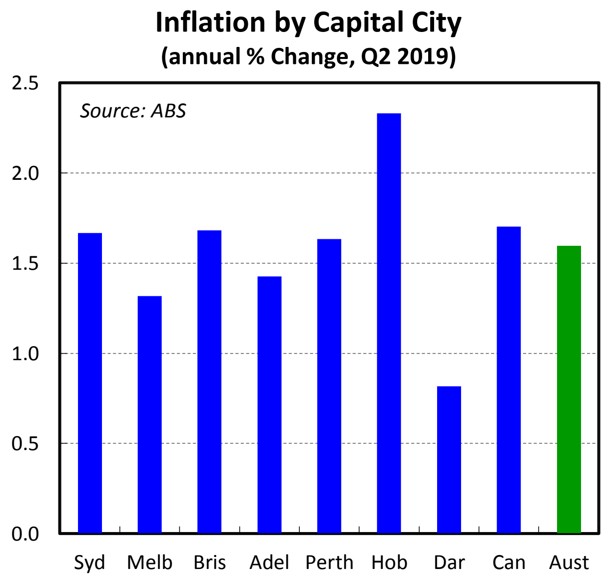
The weak pace of non-tradables inflation reflects soft growth in the domestic economy and suggests domestic underlying price pressures remain very subdued.

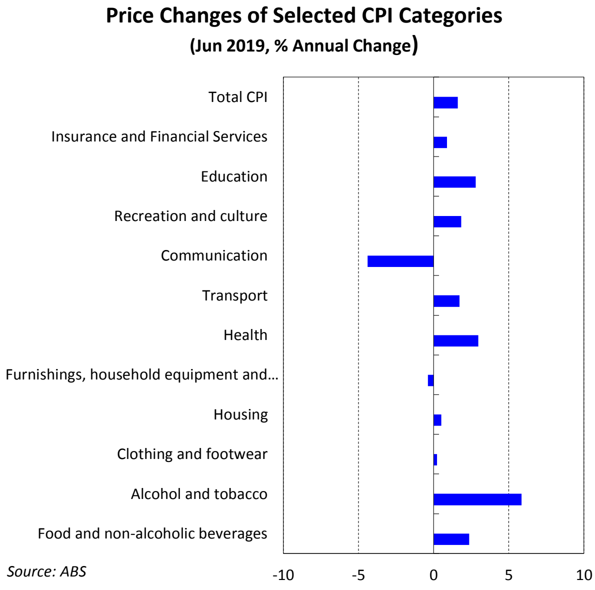
Inflation by Capital Cities

Higher fuel prices and the lift in private health insurance premiums had the impact of driving up prices across all capital cities in the June quarter.

The quarterly increase in consumer prices ranged from 0.5% to 0.7% across Sydney, Melbourne, Brisbane, Adelaide, Perth and Hobart. CPI in Darwin jumped 0.8% in the June quarter, although this followed a 0.8% fall in the March quarter. Canberra CPI rose just 0.3%.

Annual headline inflation was below 2% across all capital cities, with the exception of Hobart (2.3%).





Outlook

Today's data doesn't change the fact that there continue to be downside risks to the economy and the unemployment rate is at risk of rising.

Moreover, the breakdown of inflation suggests that it has been international factors providing upward pressure on prices in the quarter. Domestic price pressures remain very subdued reflecting weakness in the housing market and ongoing spare capacity in the labour market.

Weaker momentum in the global economy suggests limited scope for firmer increases in international oil prices. A further depreciation in the Australian dollar should provide upward pressure on inflation. However, scope for policy easing in central banks other than the RBA around the world and resilient commodity prices could prevent the AUD from depreciating significantly.

The RBA wants to see further signs of progress towards its inflation and full-employment objectives and has indicated a willingness to provide further monetary easing "if necessary".

Today's data also confirms that inflation remains below the RBA's 2 to 3 percent target. Trimmed mean inflation, at an annual rate of 1.6%, is a little above the RBA's May forecast of 1.5% in June quarter. Nonetheless, the outlook for inflation remaining subdued for some time remains unchanged.

Greater attention will be on growth and employment to gauge whether the economy is headed in the right direction for the RBA. Given that downside risks to the domestic economy remain, we continue to expect the RBA will lower interest rates further.

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