

5. Price and Wage Developments

Recent Developments in Inflation

Headline consumer price inflation picked up significantly in the March quarter. The quarterly increase was quite high relative to outcomes over the inflation-targeting period, with significant increases in the prices of fruit, vegetables and fuel.

The consumer price index (CPI) increased by 1.6 per cent in the March quarter, to be 3.3 per cent higher over the year (Graph 5.1, Table 5.1). Prices for fruit and vegetables rose by 15 per cent in the quarter, a consequence of the earlier extreme weather conditions. Automotive fuel prices rose by 9 per cent due to higher global oil prices, partly as a result of geopolitical developments in North Africa and the

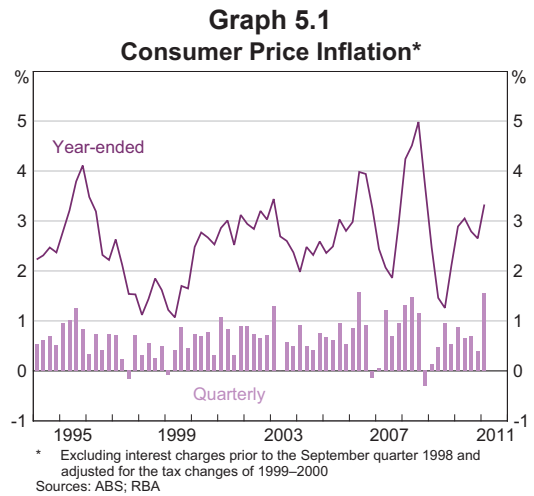


Table 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly		Year-ended	
	December quarter 2010	March quarter 2011	December quarter 2010	March quarter 2011
CPI	0.4	1.6	2.7	3.3
– Tradables	0.3	1.8	1.6	3.3
– Tradables (excl food, fuel and tobacco)	-1.2	-0.6	-2.0	-1.6
– Non-tradables (excl deposit & loan facilities)	0.6	1.1	3.5	3.3
<i>Selected underlying measures</i>				
Trimmed mean	0.3	0.9	2.2	2.3
Weighted median	0.5	0.8	2.2	2.2
CPI excl volatile items ^(a) and deposit & loan facilities	0.1	0.7	2.5	2.6

(a) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

Middle East. There was also a 4½ per cent increase in the estimated price of deposit & loan facilities, a 5 per cent increase in electricity prices, and large seasonal increases in the prices of education and health services. Offsetting these rises, the prices of many imported retail goods continued to decline, although generally by less than in the previous quarter.

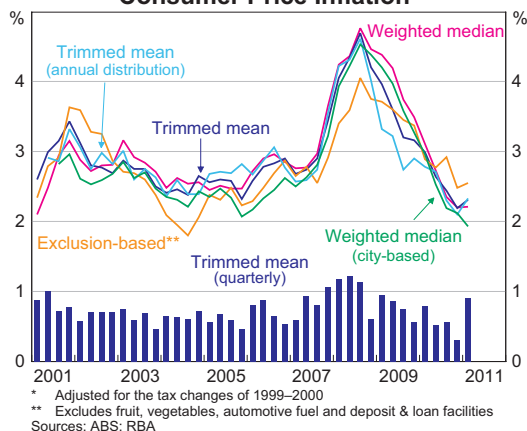
Based on a range of measures, year-ended underlying inflation is estimated to have been around 2¼ per cent, well below the headline rate of inflation (Graph 5.2). Underlying inflation now appears to have troughed in the lower half of the

target range, a significant fall from the peak of a little over 4½ per cent in 2008. Quarterly underlying inflation is estimated to have been around 0.8 per cent in the March quarter. While this was a little higher than expected, it followed an unexpectedly low outcome in the December quarter.

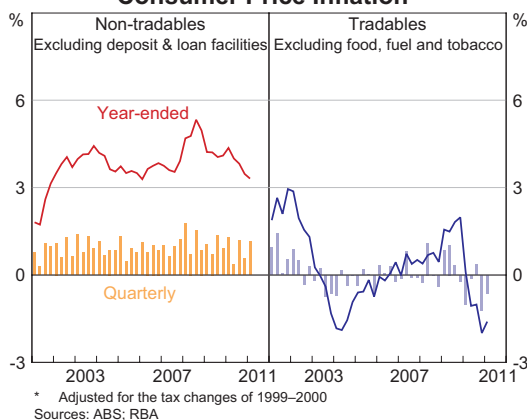
Inflation in non-tradable items (excluding deposit & loan facilities) was 1.1 per cent in the March quarter, partly reflecting seasonal increases in education and some health services prices (Graph 5.3). There were significant increases in housing costs including rents, electricity and house purchase costs in the quarter. These increases were partly offset by falls in domestic tourism prices, where the high exchange rate is resulting in some discounting, and by falls in milk prices due to competition amongst major retailers. The year-ended rate of non-tradables inflation eased further to 3.3 per cent, which is 2 percentage points below its peak in 2008. Looking ahead, recent regulatory announcements on electricity pricing indicate that inflation in utilities prices will remain relatively high over the next year. In addition, there are some early signs of upstream pressures in construction costs which may add to house purchase costs, and rents can be expected to pick up further given the tightness of the rental market. More generally, the gradual tightening in the labour market is expected to contribute to a pick-up in inflation in the prices of various household services.

The prices of many tradable items continued to decline in the March quarter, albeit by somewhat less than in the previous quarter. In aggregate, excluding food, fuel and tobacco, tradables prices fell by 0.6 per cent in the quarter and by 1.6 per cent over the year. There were broad-based price declines across a range of items over the year, especially in audio, visual & computing equipment (-19½ per cent), footwear (-4¼ per cent), major household appliances (-5 per cent) and furniture (-2¾ per cent), as well as clothing and motor vehicles (Graph 5.4). These falls reflect the ongoing pass-through of the exchange rate appreciation and discounting by retailers. While the further appreciation of the

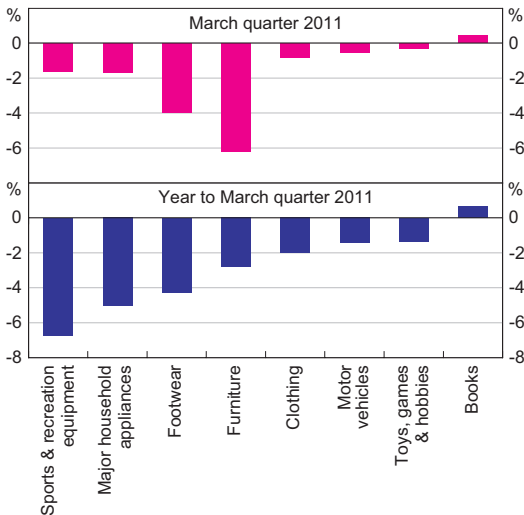
Graph 5.2
Consumer Price Inflation*



Graph 5.3
Consumer Price Inflation*

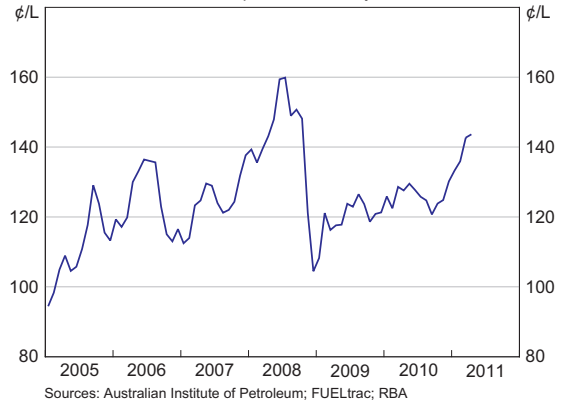


Graph 5.4
Inflation in Consumer Durables



Source: ABS

Graph 5.5
Retail Petrol Prices
Cents per litre, monthly



Sources: Australian Institute of Petroleum; FUELtrac; RBA

exchange rate in recent weeks is likely to continue to exert downward pressure on tradables prices in coming quarters, this will be somewhat offset by rising inflation in global manufactures prices.

Food prices rose by 2.9 per cent in the March quarter and by 4.3 per cent over the year. The pick-up in food price inflation, from less than 1 per cent a year ago, mostly reflects large increases in the prices of fruit and vegetables: excluding the latter, year-ended food price inflation was 1.5 per cent, with falls in the prices of some general grocery items, including milk. The pick-up in fruit and vegetable prices, which rose by 15 per cent in the March quarter, following an increase of 13 per cent in the December quarter, is the result of the Queensland and Victorian floods and Cyclone Yasi. Bananas were particularly affected, with prices doubling in the quarter and likely to have increased further in the June quarter. However, the increases in fruit and vegetable prices are likely to be temporary and are expected to be largely unwound as supply returns to normal over coming quarters. There is some evidence in wholesale price data that the prices of some crops affected by the floods, such as potatoes and broccoli, have already declined significantly

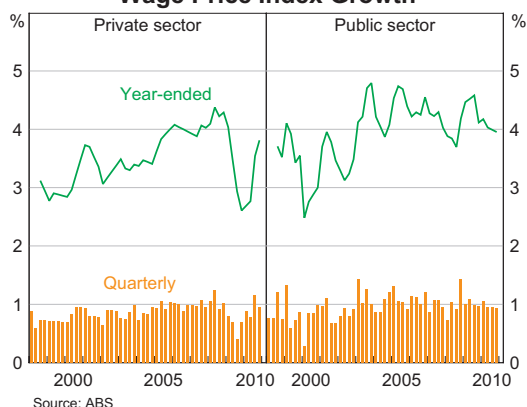
(see 'Box B: An Update on the Impact of the Natural Disasters in Queensland').

Automotive fuel prices rose by nearly 9 per cent in the quarter – the largest quarterly increase since June 2007 – and contributed 0.3 percentage points to headline inflation (Graph 5.5). As noted in 'Box A: Commodity Prices and Global Inflation', fuel prices in Australia have risen by less than in many other countries, with the appreciation of the exchange rate partly offsetting the significant increase in world oil prices.

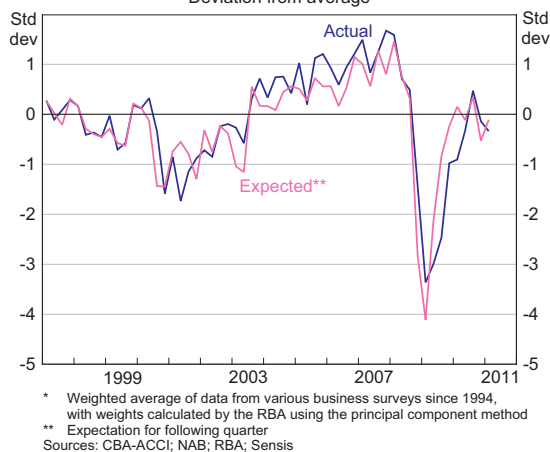
Costs

Growth in average labour costs has picked up from the low outcomes seen in 2009, in line with the tightening in the labour market. The wage price index rose by 1 per cent in the December quarter, to be 3.9 per cent higher over 2010; this was a little above the average rate since the series began in 1997. The rise in wage growth reflects a pick-up in private-sector wage growth, with public-sector wage growth – which was relatively unaffected by the economic slowdown – moderating slightly over

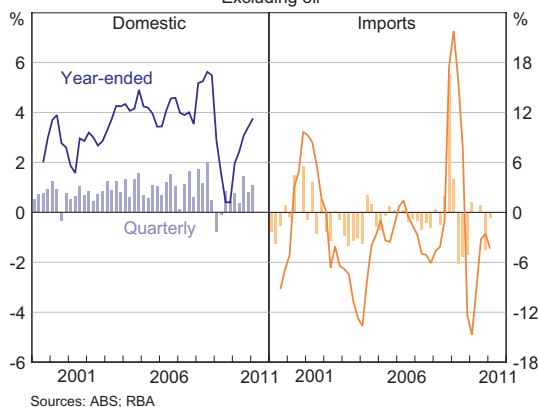
Graph 5.6
Wage Price Index Growth



Graph 5.7
Surveys of Business Labour Costs*
Deviation from average



Graph 5.8
Final Stage Producer Price Inflation
Excluding oil



2010 (Graph 5.6). Growth over 2010 was strongest in Queensland and Western Australia. The highest outcomes were recorded in the utilities industry, followed by the mining and professional, scientific & technical services industries, with the strength in these industries partly related to the growth of the resources sector. More broadly, liaison points to variation in wage outcomes, with quite large increases in specialised occupations in some industries and reasonably subdued growth for lower-skilled employees in other industries.

As discussed in the 'Domestic Economic Conditions' chapter, there has been a gradual tightening in the labour market, with half of the 2008–2009 increase in the unemployment rate having been unwound and the ABS measure of the vacancy rate back to high levels. In general, however, most firms are not reporting significant difficulties finding suitable labour, with the exception of a few skilled professions and occupations, typically linked to the mining sector. Business surveys and the Bank's liaison suggest that labour cost pressures remained around average in the March quarter (Graph 5.7).

Estimated labour productivity growth was weak over 2010, following fairly strong growth over 2009. In combination with rising wage growth, this weakness in productivity implies that growth in labour costs per unit of output was relatively high over 2010, following low growth over 2009.

Producer price data suggest some strengthening in upstream price pressures in the March quarter, particularly in the earlier stages of production. Final-stage producer prices (excluding oil) rose by 2.7 per cent over the year to March, while preliminary prices (excluding oil) rose by 4.4 per cent over the year (Graph 5.8). The pick-up in producer price inflation was driven by solid rises in domestically produced goods and services, most notably food and utilities. Import prices continued to subtract from final stage producer price inflation.

Inflation Expectations

Developments in inflation expectations over recent months have been influenced by the anticipated effects of the floods and Cyclone Yasi. The Melbourne Institute's measure of consumer inflation expectations, which rose sharply in January following the floods, has eased in the past couple of months to be a little above its inflation-targeting period average (Graph 5.9). Financial market indicators of longer-term inflation expectations have risen modestly over recent months, with the indexed bond measure also slightly above the average for the inflation-targeting period. The inflation expectations of market economists and union officials for 2011 and 2012 are broadly unchanged from three months ago at around the top of the target range, with a slight moderation expected in 2012 (Table 5.2). Somewhat in contrast, business survey measures of expected selling prices in the near term remain around or below average levels; this may partly reflect the deflationary influence of the high exchange rate on many manufactured goods prices. ↗

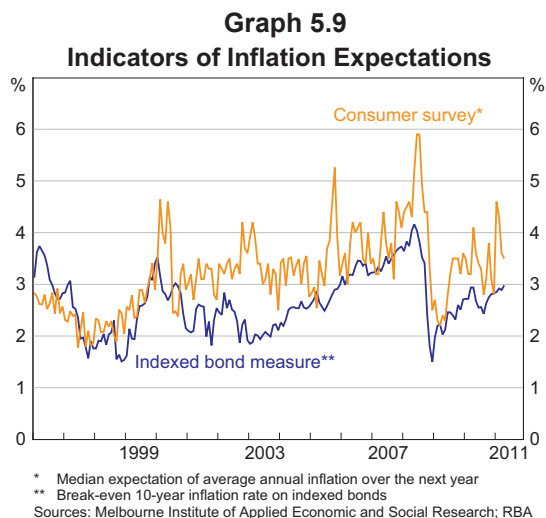


Table 5.2: Median Inflation Expectations
Per cent

	Year to December 2011			Year to December 2012	
	November 2010	February 2011	May 2011	February 2011	May 2011
Market economists ^(a)	3.2	3.3	3.3	3.1	3.1
Union officials ^(b)	3.0	3.2	3.3	3.2	3.1

(a) RBA survey

(b) Workplace Research Centre

