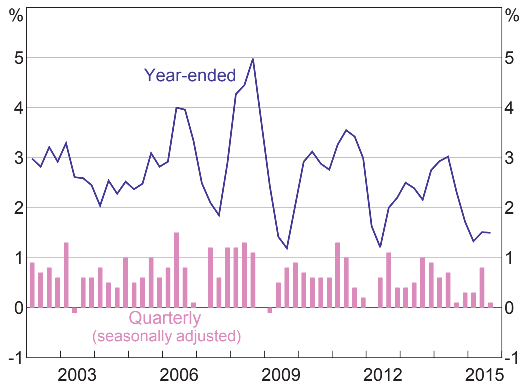
5. Price and Wage Developments

Recent Developments in Inflation

Inflation declined in the September quarter (Graph 5.1; Table 5.1). Indicators of underlying inflation decreased to be a bit above ¼ per cent in the quarter (Graph 5.2). Over the year, various measures suggest that underlying inflation was between 2 and 2¼ per cent. The outcome was lower than forecast in the August *Statement* and reflects weaker-than-expected outcomes across a range of goods and services. Domestic inflationary pressures are subdued, a key exception being the cost of new dwellings. The prices of tradable items were little changed in the September quarter. Import prices

Graph 5.1
Consumer Price Inflation



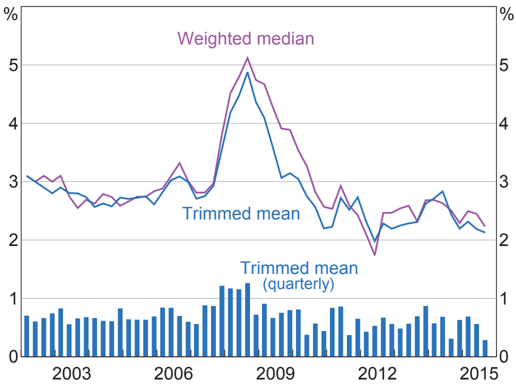
Source: ABS

Table 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly[a]		Year-ended[b]	
	September quarter 2015	June quarter 2015	September quarter 2015	June quarter 2015
Consumer Price Index	0.5	0.7	1.5	1.5
Seasonally adjusted CPI	0.1	0.8	–	–
– Tradables	–0.2	1.1	–0.3	–0.3
– Tradables (excl volatile items and tobacco)[c]	–0.1	–0.2	0.2	–0.2
– Non-tradables	0.4	0.7	2.6	2.6
– Non-tradables (excl utilities)	0.5	0.7	2.7	2.9
Selected underlying measures				
Trimmed mean	0.3	0.6	2.1	2.2
Weighted median	0.3	0.5	2.2	2.4
CPI excl volatile items[c]	0.2	0.5	2.1	2.0

(a) Except for the headline CPI, quarterly changes are based on seasonally adjusted data; those not published by the ABS are calculated by the RBA using seasonal factors published by the ABS
(b) Year-ended changes are based on non-seasonally adjusted data, except for the trimmed mean and weighted median
(c) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

Graph 5.2
Measures of Underlying Inflation
Year-ended



Source: ABS

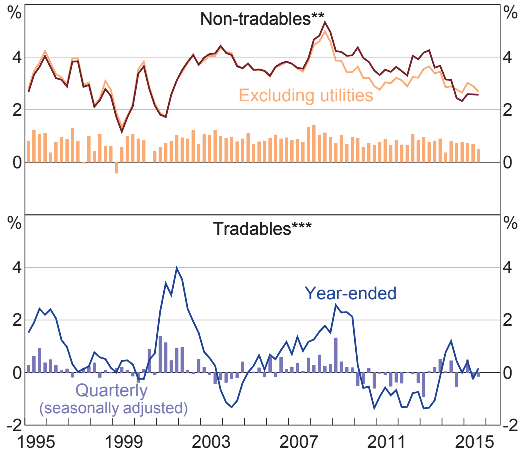
have risen over the year, despite low global inflation, due to upward pressure from the depreciation of the Australian dollar. However, the effect of this on final prices for tradable items appears to have been offset to some extent by competitive pressures and improvements in efficiency along the supply chain.

Headline inflation declined in the September quarter to 0.1 per cent (in seasonally adjusted terms) and was low at 1.5 per cent over the past year. This is partly due to temporary factors, including the fall in fuel prices earlier in the year and a large decline in utility prices in the September quarter.

Spare capacity in the labour market and declines in the cost of business inputs, such as fuel and utilities, have kept domestic inflationary pressures well contained. Non-tradables inflation declined in the September quarter (Graph 5.3). While the decline was relatively broad based, falls in regulated utility prices in some states made a large contribution. Over the year, non-tradables inflation remained at 2.6 per cent, below its average over the inflation targeting period. Excluding utility prices, year-ended non-tradables inflation declined and also remains below its historical average.

Market services inflation (excluding domestic travel & accommodation) remains low (Graph 5.4). The prices of these services are continuing to respond to low growth in labour costs as they

Graph 5.3
Non-tradables and Tradables Inflation*



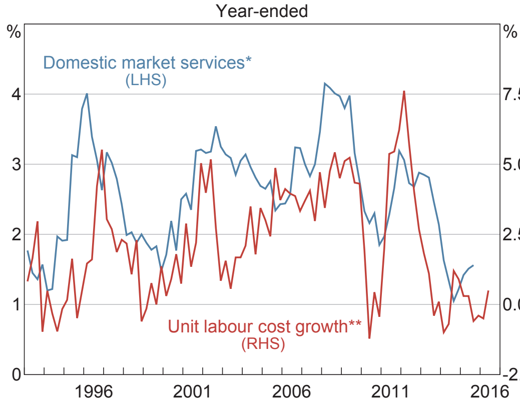
* Adjusted for the tax changes of 1999–2000

** Excluding interest charges prior to the September quarter 1998 and deposit & loan facilities to June quarter 2011

*** Excluding volatile items (fruit, vegetables and automotive fuel) and tobacco

Sources: ABS; RBA

Graph 5.4
Market Services Inflation
Year-ended



* Excludes deposit & loan facilities to June quarter 2011, housing services and domestic travel

** Moved forward by four quarters, non-farm

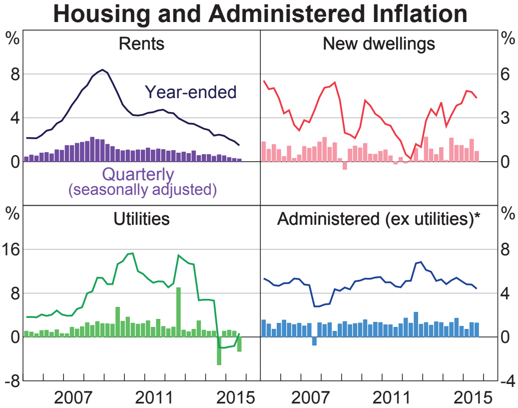
Sources: ABS; RBA

contain a relatively high labour content and have few administered components. Year-ended rent inflation was around its lowest pace in two decades, and is a little lower than would be expected given the current level of the vacancy rate. The recent low headline inflation outcomes, the decline in population growth and an increase in supply may be contributing to the broad weakness in rents inflation across capital cities; rents in Perth have declined in response to weak economic conditions in Western Australia. In contrast, inflation in new dwelling costs continues to support non-tradables inflation, remaining relatively high at 4.3 per cent over the year, consistent with the ongoing high level of activity in the residential construction sector.

The prices of administered items are less affected by labour market conditions than other non-tradable items. Declines in electricity and gas prices dampened administered price inflation in the September quarter (Graph 5.5). These declines are principally the result of regulatory and policy decisions (beginning 1 July 2015). The Australian Energy Regulator lowered network charges, placing downward pressure on retail prices in New South Wales, the Australian Capital Territory and South Australia. At the same time, the New South Wales government introduced a gas rebate for a range of eligible households. Excluding utilities, inflation for administered prices remains around its inflation-targeting average.

The prices of tradable items (excluding volatile items and tobacco) were little changed both in the September quarter and over the past year. The prices of tradable items such as consumer durables tend to be heavily influenced by movements in the exchange rate, as they are either imported or more exposed to international competition than prices for non-tradable items. For much of the past few years, the outcomes for consumer durables inflation have been lower than implied by movements in the exchange rate (Graph 5.6).[1] The prices of consumer durables declined again in the September quarter. A strong inflation outcome for motor vehicles was more than offset by weakness in a range of other items such as clothing and footwear. The relatively low outcomes for inflation of tradable items may suggest that exchange rate pass-through has been tempered by heightened competitive pressures associated with spare capacity in many product markets. This spare capacity is likely to reflect a combination of increases in supply, particularly in some parts of the retail sector, and subdued growth of demand in a number of markets. Even so, tradables inflation remains higher than it was between 2010 and 2013 and the lower exchange rate is expected to continue to place gradual upward pressure on the prices of tradable items over the next few years.

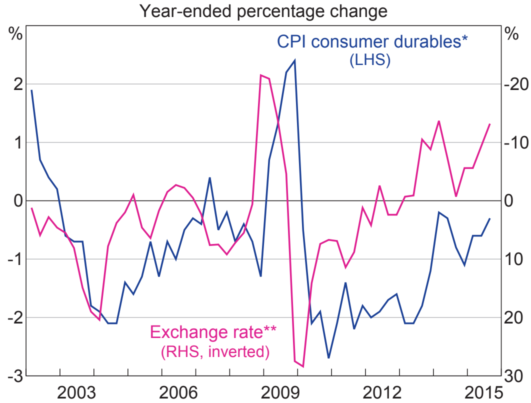
Graph 5.5
Housing and Administered Inflation



* Includes education, child care, health services, property rates, urban transport fares, postal services, some motor vehicle services and pharmaceutical products

Sources: ABS; RBA

Graph 5.6
Consumer Prices and the Exchange Rate
Year-ended percentage change



* Retail items (excluding food and alcohol) and motor vehicles and parts

** Import-weighted index, quarter average

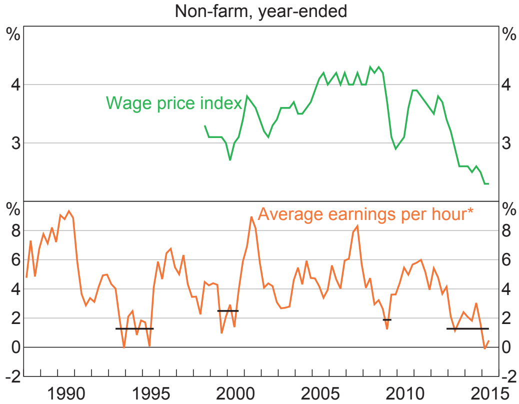
Sources: ABS; RBA

1 See RBA (2013), 'Box B: The Recent Deflation in Consumer Durables Prices', *Statement on Monetary Policy*, May, pp 57–59.

Labour Costs

Labour cost pressures remain weak (Graph 5.7). The wage price index (WPI) increased by 0.6 per cent in the June quarter and by 2.3 per cent over the year – the lowest annual outcome since the index was first published in the late 1990s. Average earnings per hour, which incorporates a wider range of labour income payments and captures changes in the composition of employment, have been little changed over the year. The recent period has been the most protracted episode of low earnings growth since the early 1990s.

Graph 5.7
Wage Growth
Non-farm, year-ended

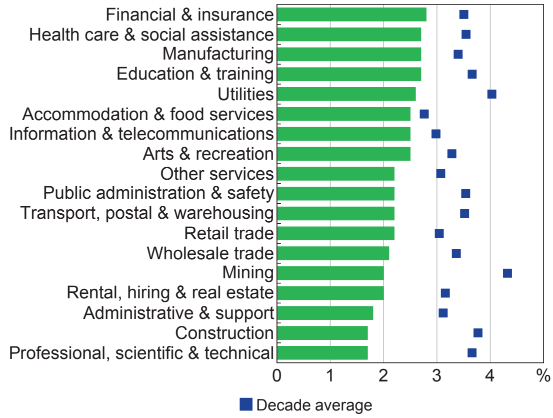


* The black lines represent the average over the period
Sources: ABS; RBA

Low wage growth has been broad based across public and private sectors, industries and states. All industries have experienced wage growth below their decade averages (Graph 5.8). Over the past year, wage growth has generally declined further in industries where employment outcomes have been weaker and has been little changed in industries where employment has increased (see 'Box C: Developments by Sector'). Dispersion in year-ended wage growth across the states remains low. Unions and firms expect wage growth to remain low for some time (Graph 5.9).

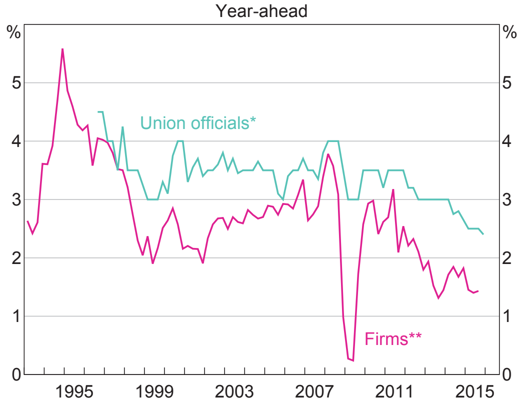
The weakness in wage growth is consistent with spare capacity in the labour market. However, the decline has been more pronounced than

Graph 5.8
Wage Growth by Industry*
Year-ended June 2015



* Wage price index
Sources: ABS; RBA

Graph 5.9
Wage Growth Expectations
Year-ahead



* RBA survey; median expectation
** NAB survey; next three months; annualised
Sources: Australian Council of Trade Unions; NAB; RBA; Workplace Research Centre

historical experience would suggest based on the unemployment rate. Several factors can help to reconcile the difference, including the decline in inflation expectations, the lower terms of trade and the need for the real exchange rate to adjust to improve international competitiveness.[2] Further, increased labour market flexibility is likely to have provided firms with greater scope to adjust wages

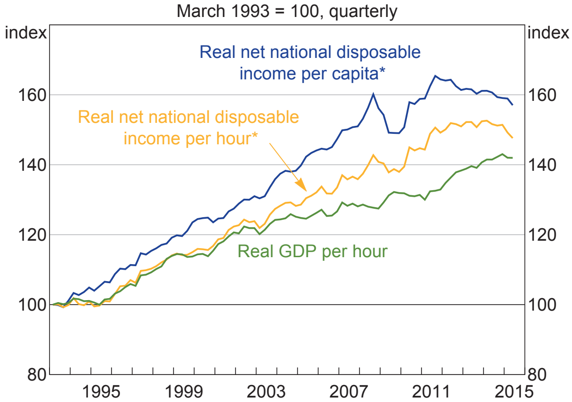
2 For a more detailed discussion see Jacobs D and A Rush (2015), 'Why is Wage Growth So Low?', RBA *Bulletin*, June Quarter, pp 9–18.

in response to a given change in demand for their goods and services. This low wage growth may have encouraged firms to employ more people than would otherwise have been the case.

Labour productivity (GDP per hour worked) has been little changed over the past year. However, measures of productivity growth are volatile and subject to revision. Unit labour costs have been little changed for around four years, because labour productivity has grown at broadly the same pace as average earnings. Together with the depreciation of the exchange rate over recent years, this is helping to restore the competiveness of Australia's labour compared with other countries, following a period of relatively strong growth in unit labour costs.

However, labour productivity does not capture all the factors that influence changes in living standards. A broader measure is net national disposable income (NNDI) per hour worked, which adjusts GDP per hour worked for the purchasing power effects of changes in the terms of trade, the depreciation of the capital stock and net income transfers to the rest of the world (Graph 5.10). Growth of NNDI per hour worked was high through the mid 2000s, even though labour productivity growth was low, due to the boost in incomes from the rapid rise in the terms of trade. During this period, growth of income was even higher on a per capita basis as employment rose by more than the population. More recently, the terms of trade have declined and the labour force participation rate remains below its peak of a few years ago. This has more than offset the slight improvement in productivity growth and so NNDI per capita has declined somewhat.

Graph 5.10
Productivity and Income
March 1993 = 100, quarterly



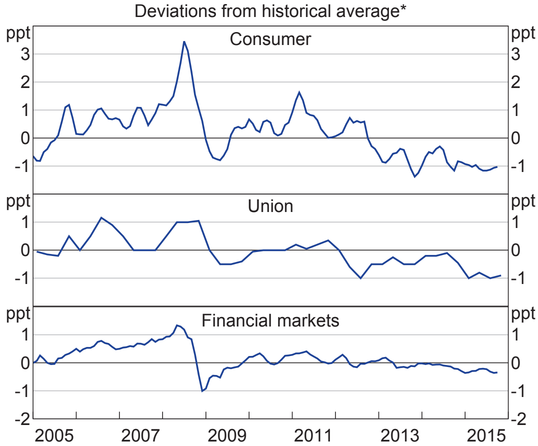
* Real net national disposable income adjusts real GDP for the purchasing power effects of changes to the terms of trade, depreciation of the capital stock and net income transfers to the rest of the world

Sources: ABS; RBA

Inflation Expectations

Measures of inflation expectations – for market economists, union officials, consumers and financial markets – have been little changed in recent quarters and remain below average (Graph 5.11).[3] Longer-run expectations remain well anchored.

Graph 5.11
Measures of Inflation Expectations
Deviations from historical average*



* Since July 1996; see footnote 3 for details

Sources: Australian Council of Trade Unions; Melbourne Institute of Applied Economic and Social Research; RBA; Workplace Research Centre; Yieldbroker

3 The series for consumer expectations is the three-month moving average of the trimmed mean of inflation expectations over the next year; union expectations are the median of union officials' expectations of inflation over the next year; financial market expectations are the break-even 10-year inflation rate between indexed and nominal bonds (with interpolation used to match exact maturity).