4. Inflation

Underlying price and wage pressures in the economy remain subdued. Headline inflation has continued to be affected by government subsidies and rebates as well as other one-off effects, and increased by 3.8 per cent over the year to the June quarter. Fuel prices increased further in the quarter, having now fully rebounded from the global demand shock in the first half of 2020. Goods inflation has picked up over the year, in part reflecting stronger demand and some global price pressures; however, this has been offset by subdued inflation in rents and services. Trimmed mean inflation was 0.5 per cent in the June quarter and 1.6 per cent over the year.

Wages growth in the March quarter continued to recover from the mid-2020 trough, and is returning to pre-pandemic rates. In the private sector, temporary wage cuts implemented in response to the pandemic have been mostly unwound, and some firms resumed wage reviews that were put on hold over the last year. Wages growth in the public sector remained soft, reflecting deferrals of increases and caps on wage growth in many states.

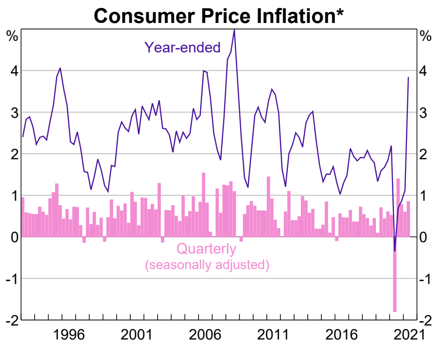
Headline inflation spiked as temporary government policies unwound, but underlying inflation remains subdued

Inflation spiked over the year to June as government subsidies for some services were removed, alongside a recovery in fuel prices from the low levels seen a year ago. The headline Consumer Price Index (CPI) increased by 0.8 per cent (seasonally adjusted) in the quarter and by 3.8 per cent over the year (Graph 4.1; Table 4.1).

Several one-off price increases over recent quarters have boosted year-ended headline inflation temporarily (Graph 4.2). The earlier unwinding of subsidies for child care and after school care, together with medical & hospital services inflation, contributed around 1¾ percentage points to the increase; health insurance premiums increased twice over the past year, after the scheduled annual premium increase in 2020 was delayed from April to October. The recovery in fuel prices and the final scheduled increase in the tobacco excise in September made smaller, but still material, contributions to inflation over the year.

Measures of underlying inflation, which largely exclude these temporary pandemic-related effects, have steadied in recent quarters but remained subdued, reflecting the extent of spare capacity in the economy and associated low wages growth. Trimmed mean inflation was 0.5 per cent in the June quarter and 1.6 per cent over the year (Graph 4.3).

Graph 4.1



* Excludes interest charges prior to the September quarter 1998; adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Table 4.1: Measures of Consumer Price Inflation

Per cent

	Quarterly[a]		Year-ended[b]	
	June quarter 2021	March quarter 2021	June quarter 2021	March quarter 2021
Consumer Price Index	0.8	0.6	3.8	1.1
Seasonally adjusted CPI	0.8	0.6	–	–
– Tradables	1.4	1.2	3.6	0.7
– Tradables (excl volatile items)[c]	0.3	0.5	1.2	1.4
– Non-tradables	0.6	0.3	4.0	1.3
Selected underlying measures				
Trimmed mean	0.5	0.4	1.6	1.1
Weighted median	0.5	0.4	1.7	1.3
CPI excl volatile items[c]	0.5	0.4	3.1	1.4

(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

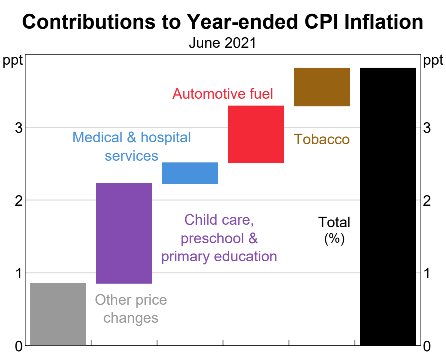
(c) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

Other government policies also continue to affect price outcomes

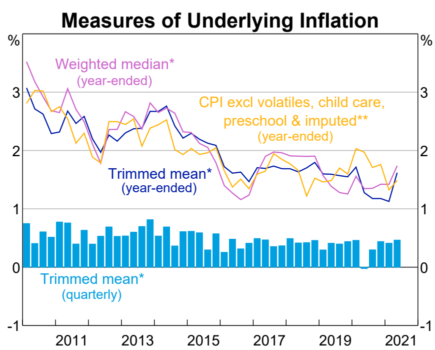
Inflation outcomes over recent quarters have been heavily shaped by the effects of government policies. Observed prices for newly constructed dwellings rose materially in the quarter, in part reflecting strong demand induced by government subsidies such as HomeBuilder; however, the statistical treatment of these subsidies offset the effect of observed price increases in the CPI. Utilities prices rose in the June quarter as a household electricity rebate in Western Australia ended. Government subsidy and voucher programs also affected demand and prices as measured in the CPI for items such as domestic travel, dining and recreation.

Graph 4.2



Sources: ABS; RBA

Graph 4.3



* Seasonally adjusted

** Not seasonally adjusted; excludes fruit, vegetables, automotive fuel, child care, preschool & primary education and items that were imputed using headline CPI for all capital cities in the June or September quarter 2020

Sources: ABS; RBA

New dwelling inflation

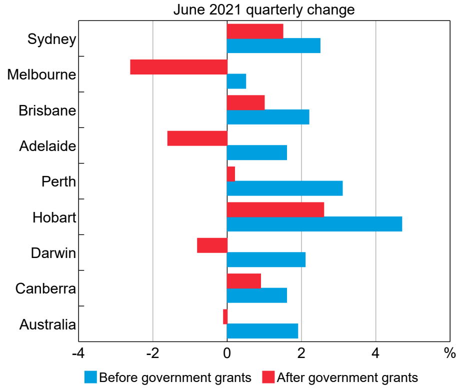
New dwelling prices, which make up just under one-tenth of the CPI basket, declined a further 0.1 per cent in the June quarter; this is because HomeBuilder grants and similar state government programs are treated by the ABS as price reductions (Graph 4.4). Although applications for these grants had closed by the end of March, their effects are incorporated into the CPI as they are paid out, and so affect inflation with a lag. HomeBuilder grants are expected to weigh on new dwelling inflation until late 2022, by which time construction is required to have commenced on all eligible dwellings.

These government construction incentives have boosted demand for new dwellings significantly. Information from liaison contacts indicates that strong demand has in turn contributed to higher material prices and subcontractor rates in recent quarters, as have supply chain disruptions for some imported materials (Graph 4.5). These higher input costs are being passed on to consumers through higher base prices; without the offset from the statistical treatment of government grants, new dwelling prices would have risen by 1.9 per cent in the June quarter.

Graph 4.4

New Dwelling Price Inflation

June 2021 quarterly change



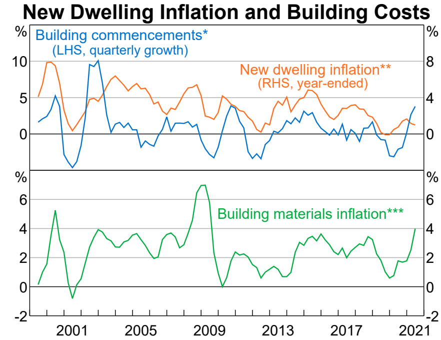
Source: ABS

Utilities

Government rebates have driven large movements in electricity prices in Perth in recent quarters. A rebate was introduced in the December quarter of 2020, which effectively made electricity free for around 4 months; most households used up the last of the available rebate in the June quarter. The return of Perth electricity bills to more normal levels led to a 6 per cent increase in aggregate electricity prices, contributing around ¼ percentage point to quarterly headline CPI (Graph 4.6). Electricity prices declined or remained frozen in all other capital cities in the quarter.

Graph 4.5

New Dwelling Inflation and Building Costs



* Volumes; 6-quarter average lagged by one quarter; detached only prior to 2017; thereafter attached included with a 20 per cent weight

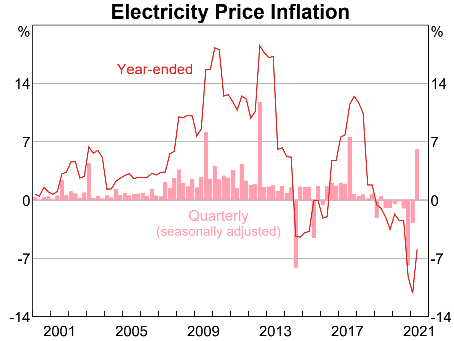
** Adjusted for the tax changes of 1999–2000

*** Year-ended change in producer prices for inputs to house construction

Sources: ABS; RBA

Graph 4.6

Electricity Price Inflation



Source: ABS

Other government initiatives

A number of state governments have implemented voucher programs to support intrastate travel, dining and recreational activities. These programs subtracted from price inflation for takeaway, restaurant meals and other recreational activities in the quarter (Graph 4.7). Prices for domestic travel have also been affected by government subsidies, most notably the Australian Government's half-price airfares program. Accommodation prices rose in the quarter, reflecting buoyant demand for domestic holiday travel. However, this increase was offset by a substantial fall in airfare prices, driven by the half-price airfare program and increased price competition on major domestic airline routes. While most of these subsidy and discount schemes have now ended, the New South Wales 'Dine & Discover' scheme has been extended to the end of August. Measured prices are expected to normalise as these programs unwind, which will support services inflation in the September and December quarters.

Fuel prices have recovered to pre-pandemic levels

Automotive fuel prices have risen further and are now back to their 2019 levels (Graph 4.8). The 6.5 per cent increase in the June quarter contributed ¼ percentage point to headline inflation. Fuel prices continued to rise in the month of July; at current levels, automotive fuel prices are expected to again contribute to headline CPI in the September quarter.

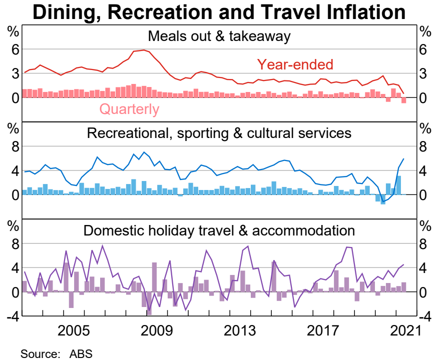
Some imported price pressures have continued for internationally traded goods

Liaison information suggests that retailers of tradable goods continue to face input cost pressures – partly because some overseas suppliers have increased prices in response to strong global demand, and partly because shipping costs are elevated. But firms have also reported that, to date, these costs have been mostly absorbed into margins.

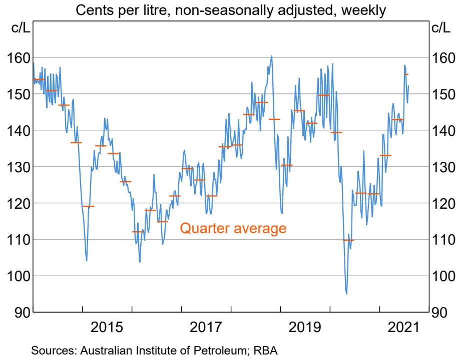
Prices for motor vehicles rose further in the June quarter, reflecting elevated demand as well as continued supply constraints such as semiconductor shortages; motor vehicle prices are 7.4 per cent higher than they were a year ago. Inflation in furniture & household items was also strong at 4.4 per cent over the year, reflecting increased domestic and global demand and constrained supply of timber (Graph 4.9). In contrast, demand for clothing & footwear has been subdued, leaving prices only a little higher than they were a year ago.

Prices for audio, visual & computing equipment declined in the June quarter and were a little lower over the year. Prices for these items have

Graph 4.7



Graph 4.8



fallen consistently over the past decade, although supply disruptions and strong demand for home entertainment-related goods have supported prices for these items over the past 12 months.

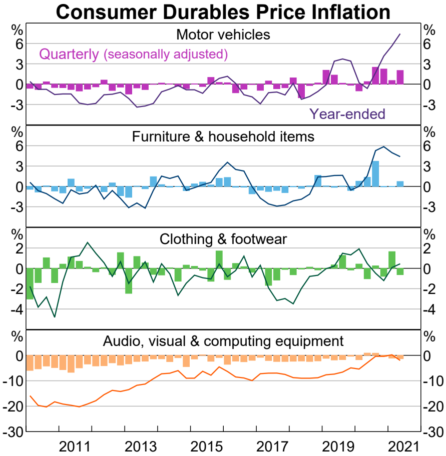
Weather events contributed to food inflation in the quarter

Food prices increased in the June quarter, driven by a 6 per cent increase in prices for fresh fruit and vegetables. This price increase reflected the impact of weather events, including floods in New South Wales and Cyclone Niran in Queensland; liaison information suggests labour shortages have not meaningfully affected fresh produce prices to date. Despite the recent increase, food prices were only a little higher over the year to June.

Grocery prices (excluding fruit and vegetables) increased by 0.4 per cent in the quarter, and supermarket discounting behaviour has returned to pre-pandemic patterns. Meat prices increased strongly in the quarter alongside reduced supply as producers aimed to restock following the end of the drought in eastern Australia; prices for other groceries were little changed.

Graph 4.9

Consumer Durables Price Inflation



Sources: ABS; RBA

Inflationary pressures have been lower for rents and services more broadly

Rents, which account for 7 per cent of the CPI basket, rose slightly in the June quarter, to be little changed over the year. Subdued CPI rent inflation reflects broadly slow growth in advertised rents over recent years, and ongoing weak rental market conditions in Sydney and Melbourne (Graph 4.10). Vacancy rates are high in those cities, most notably for apartments and other attached dwellings, partly because border closures have meant there are fewer international students and other visitors in the country. Elsewhere, advertised rents and available listings suggest rental markets have tightened a little over recent months.

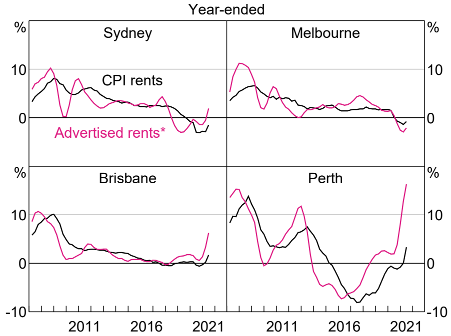
Market services prices were little changed in the June quarter, abstracting from the effects of government policies (discussed above). While demand for financial services has remained relatively steady over the past year, demand for many other market services has been more disrupted by activity restrictions, which has weighed on prices.

Administered prices (excluding utilities) rose a little in the June quarter. This increase was largely due to the annual private health insurance premium increase, with most other administered prices unchanged in the quarter. Over the year, medical & hospital services prices

Graph 4.10

Rent Inflation

Year-ended



* Hedonic 3-month average

Sources: ABS; CoreLogic; RBA

increased by 6.7 per cent, capturing both the 2021 and 2020 premium increases – the 2020 increase was deferred from April to October due to the pandemic and the 2021 increase took effect in May this year (Graph 4.11). Child care prices also rose a little further in the quarter as centres continue to adjust prices after these had been frozen in 2020 while pandemic-related subsidies were in place.

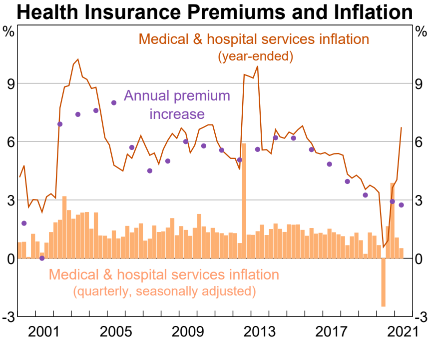
Price inflation for state & local government services has been unusually volatile over the past year, reflecting a combination of rebates, price freezes in some states and the imputation of prices during lockdown periods. These effects have now largely unwound, leaving prices a little higher than they were a year ago. Administered price inflation had trended gradually lower over the 5 years preceding the pandemic and this trend is likely to resume over the coming year, with recent state government budgets announcing below-average price increases for many government services.

Inflation expectations have increased a little over recent months

Price- and wage-setting behaviour can be affected by expectations about the future rate of inflation. Survey-based measures of short-term inflation expectations have increased a little over recent months (Graph 4.12). Survey measures of long-term inflation expectations also increased to around 2½ per cent, similar to levels seen in 2019 (Graph 4.13). Long-term market-based measures of inflation expectations have declined slightly in recent months but remain well above the low levels seen in early 2020. The pandemic-related market dysfunction observed at times over the past 18 months is no longer affecting market measures of inflation expectations.

Graph 4.11

Health Insurance Premiums and Inflation

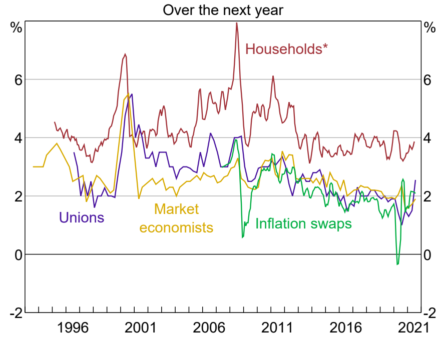


Sources: ABS; Canstar; RBA

Graph 4.12

Short-term Inflation Expectations

Over the next year

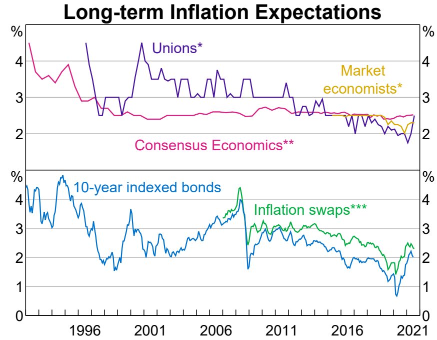


* Smoothed

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

Graph 4.13

Long-term Inflation Expectations



* Average over the next 5 to 10 years

** Average over 6 to 10 years in the future

*** 5- to 10-years forward

Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; RBA; Workplace Research Centre; Yieldbroker

Wages growth continued to recover in the March quarter

The Wage Price Index grew by 0.6 per cent in the March quarter, and 1.5 per cent in year-ended terms. Private sector wages increased by 0.6 per cent, driven primarily by regular scheduled enterprise agreement increases and the resumption of some firms' wage reviews that had been postponed at the height of the pandemic (Graph 4.14). Growth was also supported by award wage increases in a range of industries, after these had been delayed from July 2020 to February 2021 by the Fair Work Commission (FWC).

Private sector wages inclusive of bonuses and commissions have picked up faster than base wage measures in recent quarters, in part reflecting higher commissions on the back of strong spending on consumer goods. Firms in the Bank's business liaison program have increasingly reported using a range of non-base wage remuneration strategies, such as bonuses or increased work flexibility, in order to attract and retain staff. While the reported use of bonuses has been reasonably widespread across industries, it has been most prevalent where labour shortages have been most pronounced, such as in construction and resource-related industries.

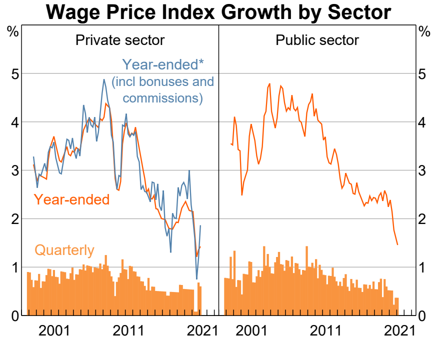
Public sector wages increased by 0.4 per cent in the quarter, as deferrals of increases and wage caps weighed on outcomes in many states. At 1.5 per cent in year-ended terms, growth in public sector wages in the March quarter was the lowest since the WPI measure was introduced in the late 1990s.

Although the pace of wages growth picked up in a number of industries in the March quarter, in most cases the annual pace of wages growth remained well below that seen a year earlier (Graph 4.15). Growth generally remains lower in industries more adversely affected by pandemic-related restrictions on activity. Wage increases in the healthcare & social assistance and education & training industries contributed the most to aggregate wage growth over the past year; outcomes in these industries reflected regularly scheduled increases in enterprise agreements, as well as initial increases paid under newly ratified enterprise agreements.

In June, the FWC determined an increase of 2.5 per cent in the National Minimum Wage and all award wages (Graph 4.16). Employees in most award-reliant industries received the increase on 1 July, while increases have been delayed for a few industries most impacted by the pandemic: to 1 September for the general retail award; and to 1 November for aviation, tourism, hospitality and several other industries. The FWC decision is

Graph 4.14

Wage Price Index Growth by Sector



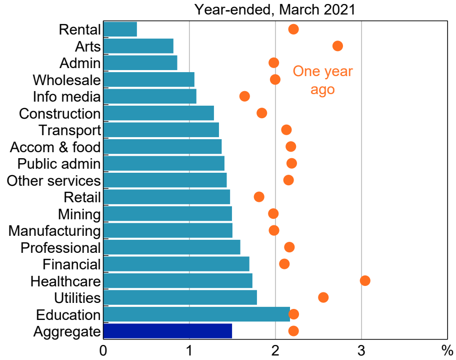
* Non-seasonally adjusted

Source: ABS

Graph 4.15

Wage Price Index Growth by Industry*

Year-ended, March 2021



* Non-seasonally adjusted; excluding bonuses and commissions

Source: ABS

estimated to directly affect around 20 per cent of all jobs (representing around 13 per cent of the national wage bill); a significant share of employees on collective or individual agreements also have their pay set with reference to the decision or relevant award.

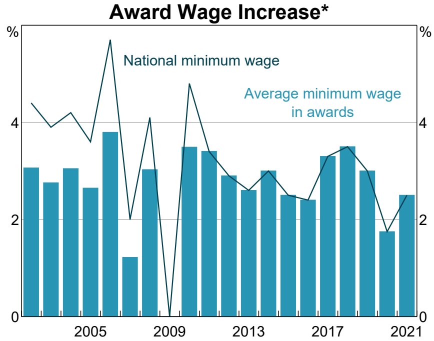
The superannuation guarantee increased from 9.5 per cent to 10 per cent of ordinary time earnings on 1 July 2021. Additional increases in the superannuation guarantee of 0.5 per cent are legislated to come into effect each year until 2025. These increases are expected to weigh a little on base wages growth, although the scale and timing of pass through is somewhat uncertain (see 'Economic Outlook' chapter).

Leading indicators suggest wages growth will remain moderate in the near term

Information from the Bank's business liaison program suggests that year-ended wages growth will return to around its pre- pandemic average of 2–2½ per cent by the end of 2021; most firms with wage freezes still in place expect to have unwound these by the end of the year (Graph 4.17). Only a small number of firms looking to lift wage freezes expect to pay 'catch up' wage increases, with most instead anticipating that wages will grow at around the average rates seen immediately prior to the pandemic. Other surveys of wages growth expectations are also broadly consistent with a recovery to around pre-pandemic rates, but with little acceleration beyond that in the next year or so (Graph 4.18). ✠

Graph 4.16

Award Wage Increase*



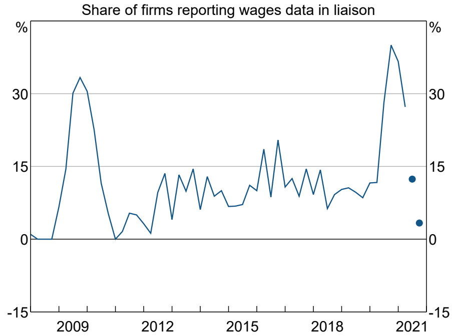
* RBA calculations; the time period over which each increase applies varies

Sources: AFPC; AIRC; FWC; RBA

Graph 4.17

Wage Freezes*

Share of firms reporting wages data in liaison

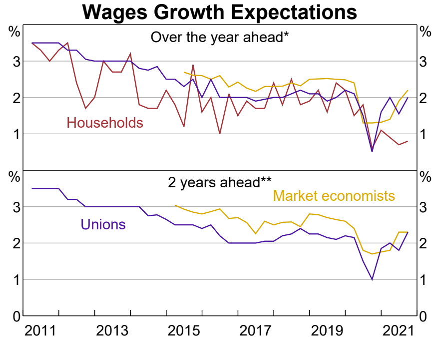


* Dots represent expected freezes in the September and December quarters

Source: RBA

Graph 4.18

Wages Growth Expectations



* The current calendar year for union expectations

** The next calendar year for union expectations

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