4. Inflation

Consumer price movements in 2020 were dominated by the impact of responses to the COVID-19 pandemic, as well as large swings in average fuel prices earlier in the year. This introduced more volatility than usual in headline inflation readings. Looking through this volatility, underlying inflation pressures are low.

Over the second half of the year, the unwinding of government support measures such as free child care boosted inflation significantly. Housing inflation also picked up a little in the December quarter on the back of increased demand for detached houses, supported by government grants, while some temporary rent reductions reversed. Offsetting this has been a moderation in retail price inflation; although price movements are still being shaped by increased expenditure on household goods relative to services, the effect of this is easing, as is the effect of earlier global supply chain pressures. There were also some methodological challenges that affected CPI outcomes throughout the year – most notably the need to impute prices for items that were unavailable due to activity restrictions – but these factors were largely resolved by the end of the year.

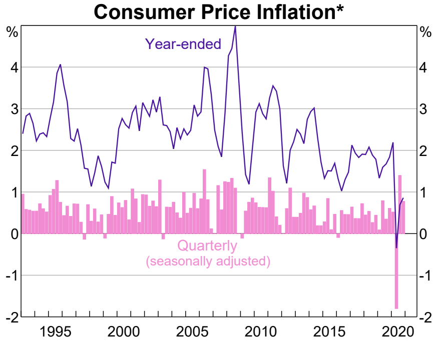
Wages growth has slowed further recently, as employers have responded to the economic challenges of the pandemic by delaying wage increases, imposing freezes and, in some cases, applying temporary wage cuts. Recent lower award wage decisions have also weighed on wage outcomes. While many of these measures are temporary, and will provide some near-term boost to wages as they unwind, forward indicators suggest wages growth will remain soft this year. National accounts measures of wages growth have been temporarily boosted by the JobKeeper wage subsidy, as well as by large compositional effects due to greater employment losses in lower-paid jobs.

CPI inflation moderated in the December quarter

Headline inflation was 0.8 per cent (seasonally adjusted) in the December quarter (Table 4.1; Graph 4.1). Much of this increase was driven by the further unwinding of government support measures such as free child care, as well as the annual increase in the tobacco excise rate. In year-ended terms, headline inflation was 0.9 per cent. This was slightly higher than expected at the time of the November *Statement on Monetary Policy*, mainly because prices of some components that have been affected by pandemic-related policies rose more than expected.

Graph 4.1

Consumer Price Inflation*



* 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)]	
	December quarter 2020	September quarter 2020	December quarter 2020	September quarter 2020
Consumer Price Index	0.9	1.6	0.9	0.7
Seasonally adjusted CPI	0.8	1.4	–	–
– Tradables	–0.2	1.0	–0.6	0.0
– Tradables (excl volatile items)[(c)]	0.0	0.4	1.4	1.1
– Non-tradables	1.2	1.6	1.5	1.0
Selected underlying measures				
Trimmed mean	0.4	0.3	1.2	1.2
Weighted median	0.5	0.2	1.4	1.2
CPI excl volatile items[(c)]	0.9	1.3	1.5	0.9

(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

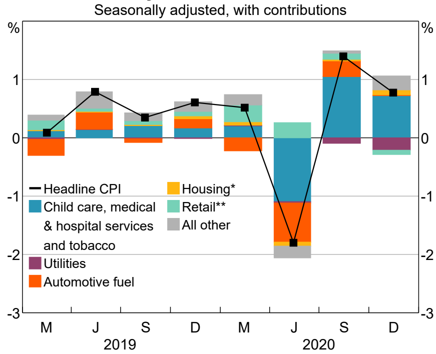
The main drivers of the increase in the headline CPI in the December quarter were the return to full-price child care for the entire quarter and price rises for tobacco and medical & hospital services (Graph 4.2). Together, these price increases contributed 0.8 percentage points to CPI inflation in the quarter. Housing-related prices also increased in aggregate; new dwelling prices rose, driven by strong demand as purchasers sought to utilise the various government incentives on offer, while rents were broadly steady. These increases were offset by price falls for utilities due to government rebates. Prices for retail items also declined modestly as global supply disruptions eased and discounting resumed for food and some consumer durables.

Measures of underlying inflation over 2020 were affected by some unusually large component-level price movements and the imputation approach adopted by the Australian Bureau of Statistics (ABS) for missing prices. However, these issues had largely abated by the December quarter, providing a clearer signal of the low underlying inflationary pressures in the economy. Trimmed mean inflation was subdued at 0.4 per cent in the December quarter and 1.2 per cent over the year (Graph 4.3). Spare capacity in the economy and associated low wages growth have contributed to muted

Graph 4.2

Quarterly Headline CPI Inflation

Seasonally adjusted, with contributions



* Excludes utilities

** Includes fruit and vegetables

Sources: ABS; RBA

underlying inflationary pressures for a number of years.

The ABS updates expenditure weights every year in December to ensure that the weights are reflective of spending by Australian households. Due to the COVID-19 pandemic, the changes in the weights were unusually large for some components (see 'Box A: Consumption Patterns and Consumer Price Index Weights'). The new weights were applied to the December quarter 2020 CPI, but they did not affect reported inflation outcomes much.

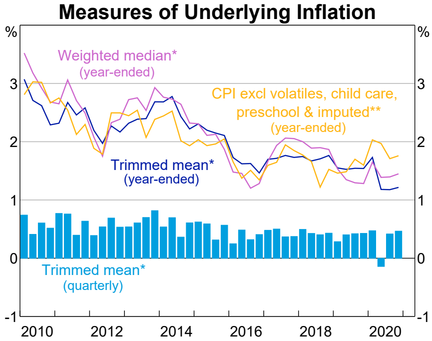
Government policies continued to drive movements in some administered prices

Administered prices, which comprise around 15 per cent of the consumption basket, rebounded further in the December quarter following a sharp decline earlier in the pandemic. Australian Government subsidies for child care services substantially reduced the price of child care in the June quarter and early September quarter (Graph 4.4). The return to full-price child care in early July, alongside broad-based price increases by providers in October, boosted quarter-average CPI child care prices in both the September and December quarters. This resulted in child care prices ending the year a touch above their pre-pandemic levels. The end of the free child care program (which had also covered before- and after-school care services) also boosted preschool & primary education prices. Together, these increases contributed 0.4 percentage points to headline inflation in the December quarter. However, prices for preschool & primary education are likely to remain below their pre-COVID-19 levels for some time as free preschool programs in New South Wales and Victoria have been extended until end 2021.

Other administered prices (excluding utilities) rose a little in the December quarter (Graph 4.5). Medical & hospital services inflation was unusually strong, reflected in the average increase in private health insurance premiums of 2.9 per cent (Graph 4.6). This contributed 0.2 percentage points to headline inflation in the quarter. Premiums typically increase in April each year, but insurers agreed to defer the 2020 increase until October in order to ease pressure on customers during the initial phase of the pandemic. Urban transport fares also increased as discounted off-peak transport prices ended in Sydney. Administered price inflation has trended lower over many years, and

Graph 4.3

Measures of Underlying Inflation



* Seasonally adjusted

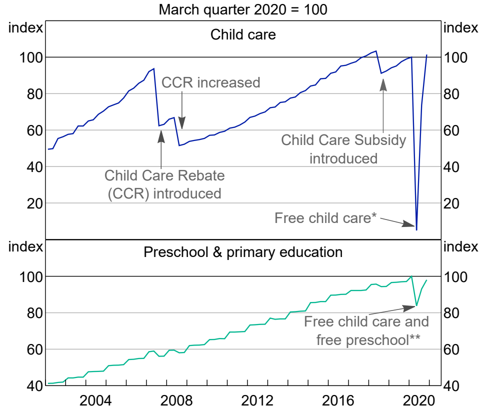
** Not seasonally adjusted; excludes fruit, vegetables, automotive fuel, child care, preschool & primary education and items that were imputed using headline CPI for all capital cities in the June or September quarter 2020

Sources: ABS; RBA

Graph 4.4

Early Education Prices

March quarter 2020 = 100



* Nationwide from 5 April to 12 July 2020

** Nationwide from 5 April to 12 July 2020 for child care; term 2 in Queensland and terms 2 to 4 in New South Wales and Victoria for preschool

Sources: ABS; RBA

this trend is expected to persist for some time partly because of ongoing administered price freezes in a number of states and territories.

Utilities prices decreased further in the quarter

Prices for utilities, which account for around 5 per cent of the consumption basket, declined further by 4.4 per cent in the December quarter, in large part because of special rebates introduced in some states (Graph 4.7). The Western Australian Government provided households with a one-off credit of $600 to reduce their electricity bills from 1 November, which led to a large temporary decline in WA electricity prices in the quarter. The rebate was applied to quarterly electricity bills from November onward and will continue to weigh on prices in early 2021 as additional customers receive the rebate; this will be partly offset by price increases as customers that have already received the rebates return to normal billing over the coming months. The Queensland Government also provided additional rebates that were applied to households' electricity bills in the September and December quarters. Gas prices were generally unchanged across most capital cities in the quarter.

Utilities inflation has been subdued for the past 2 years and is likely to remain low for some time. Domestic wholesale gas prices have fallen in recent months. Lower wholesale gas prices and increased electricity supply from renewables continue to put downward pressure on utilities prices. Retail utilities prices in Canberra, Darwin, Hobart and Perth are expected to remain broadly unchanged until the second half of 2021 due to state and territory government price freezes.

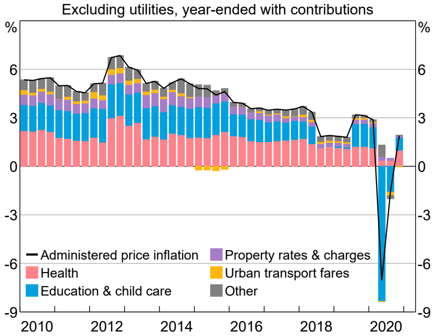
Housing inflation picked up as new dwelling inflation remained relatively strong and rent deflation eased

The 2 largest components of the CPI basket are new dwelling purchases by owner-occupiers

Graph 4.5

Administered Price Inflation

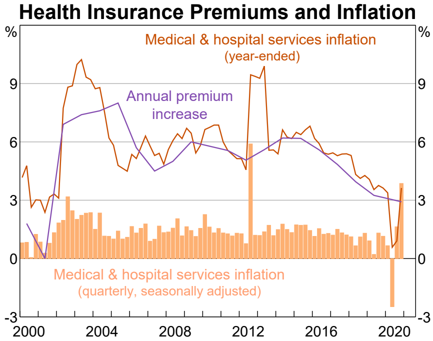
Excluding utilities, year-ended with contributions



Sources: ABS; RBA

Graph 4.6

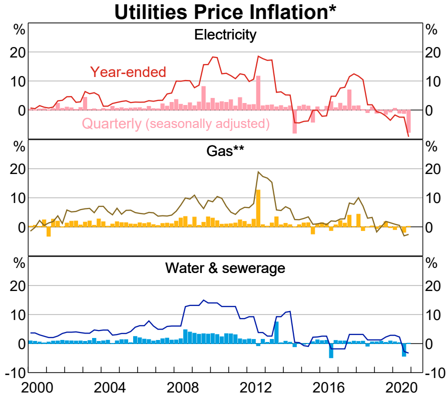
Health Insurance Premiums and Inflation



Sources: ABS; Canstar; RBA

Graph 4.7

Utilities Price Inflation*



* Adjusted for the tax changes of 1999–2000

** Includes other household fuels

Sources: ABS; RBA

and rents; together these account for around one-sixth of the CPI basket. Housing-related inflation rose a little in the December quarter, after slowing sharply in the first half of 2020.

Prices for newly constructed dwellings increased by 0.7 per cent in the quarter and were 1.7 per cent higher over the year, reflecting stronger demand in the detached housing sector (Graph 4.8). This demand has been boosted by the Australian Government's HomeBuilder program and some state government grants. In particular, demand for new detached dwellings surged in the December quarter as purchasers finalised contracts before the scheduled reduction in the value of the HomeBuilder grant on 1 January 2021. Although these grants are reflected as measured price declines in the CPI, increased demand for new housing encouraged some builders to increase base prices or offer fewer discounts to buyers, more than offsetting this effect. Price inflation for new dwellings has been particularly strong in Perth over the past few quarters following a prolonged period of weakness. Despite the recent pick up in new dwelling prices in Sydney and Melbourne, new dwelling inflation there remains low relative to history.

Rents were broadly steady in the December quarter but were 1.3 per cent lower over the year (Graph 4.9). Declines in rental prices over the middle of 2020 in part reflected elevated supply of rental properties and weaker demand because of travel restrictions and lower population growth. Rent reductions for existing tenants continued to weigh on rent inflation in the December quarter, but this decline was offset by renters who had previously negotiated temporary discounts returning to their usual payments. Rents increased notably in Perth in the quarter, partly reflecting tighter rental market conditions following several years of subdued growth in dwelling investment. In contrast, rents were fairly flat in Sydney and Melbourne.

Automotive fuel prices remain below their pre-COVID-19 levels

Fuel prices were fairly steady over the September and December quarters, after falling sharply and only partially recovering over the first half of 2020 (Graph 4.10). There was a notable rise in fuel prices in the month of January – at current levels, automotive fuel is expected to contribute around ¼ percentage point to headline CPI in the March quarter.

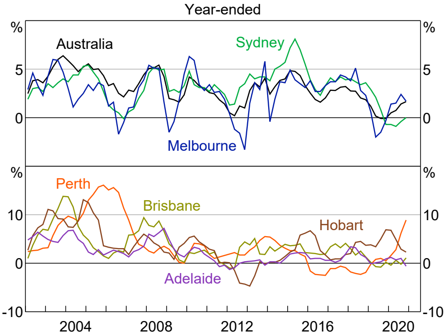
Tobacco prices rose due to a scheduled increase in the tobacco excise

Higher tobacco prices contributed 0.2 percentage points to headline CPI in the

Graph 4.8

New Dwelling Inflation

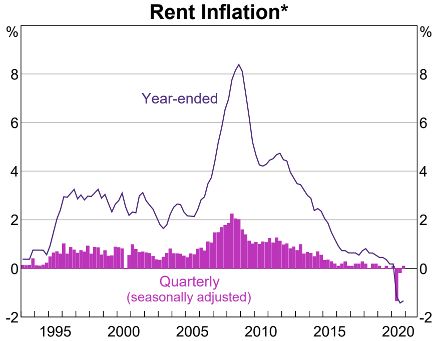
Year-ended



Source: ABS

Graph 4.9

Rent Inflation*



* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

December quarter (Graph 4.11). In addition to regular indexation, since 2013 tobacco prices have incorporated excise increases of 12½ per cent in September each year. The boost to headline inflation from these increases is expected to subside in 2021 as the tobacco excise returns to regular indexation.

Retail inflation moderated in the quarter as inventory-related price pressures eased

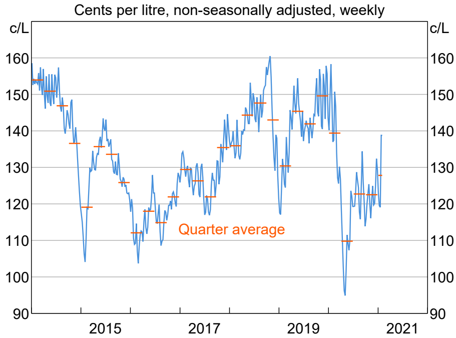
Retail prices, which comprise just over a quarter of the CPI, declined a little in the December quarter, but remained higher than they were a year ago. During 2020, sustained demand for many consumer durable items had driven retail prices higher as a large share of people spent more time at home during the initial COVID-19 outbreak. Reduced stock availability owing to global supply chain pressures also put upward pressure on prices for some retail items. As these pressures started easing, price increases slowed in the December quarter, particularly for furniture & household appliances (Graph 4.12). Part of this reflected the resumption of discounting by some retailers, as well as increased retailer participation in Black Friday sales events. Prices for clothing & footwear fell alongside subdued demand and increased discounting during sales periods in November and December. In contrast, motor vehicle price inflation remains elevated due to continued price pressures from strong demand and reduced domestic inventory.

Grocery prices (excluding fruit & vegetables) increased a little in the December quarter (Graph 4.13). Liaison reports suggest that supermarket discounting behaviour has returned to pre-pandemic patterns, following a reduction in discounting as demand increased strongly during the early stages of the pandemic. Price increases were notable for beef & veal, as better seasonal conditions have led some farmers to rebuild herds, reducing the supply of meat.

Graph 4.10

Unleaded Petrol Prices

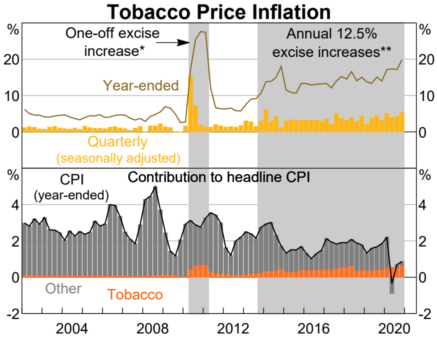
Cents per litre, non-seasonally adjusted, weekly



Sources: Australian Institute of Petroleum; RBA

Graph 4.11

Tobacco Price Inflation



* In 2010, the Commonwealth Government increased the excise and excise-equivalent customs duty rate applying to tobacco products by 25 per cent

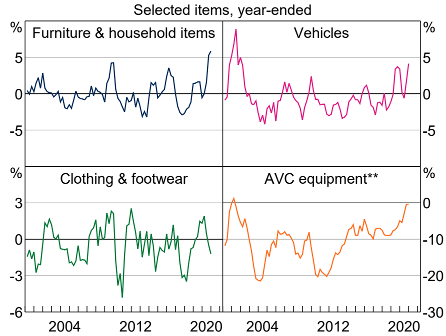
** In 2013, a new regime came into force that saw the tobacco excise increase by 12.5 per cent annually in addition to regular indexation; the regime ended in 2020

Sources: ABS; RBA

Graph 4.12

Consumer Durables Price Inflation*

Selected items, year-ended



* Adjusted for the tax changes of 1999–2000

** Audio, visual & computing equipment

Sources: ABS; RBA

Prices for fruit & vegetables, which can be volatile, declined in the December quarter. Despite recent reports of labour shortages for some produce harvesting, potential supply disruptions do not appear to have led to widespread price pressures.

Market services inflation picked up in the quarter but remains subdued

Inflation remains low for market services, which includes hairdressing, financial services, meals out & takeaway and domestic travel, and comprises a little under one-quarter of the consumption basket (Graph 4.14). The ABS has been able to return to normal price collection for domestic travel, which recorded a 3.8 per cent price increase in the December quarter. The only item that was still imputed (using headline CPI) in the quarter was international holiday travel & accommodation. Price inflation for household services slowed in the quarter, as demand moderated a little from the high levels seen immediately after restrictions were eased in many parts of the country in the previous quarter. In contrast, prices increased for meals out & takeaway.

Survey-based measures of inflation expectations remain low

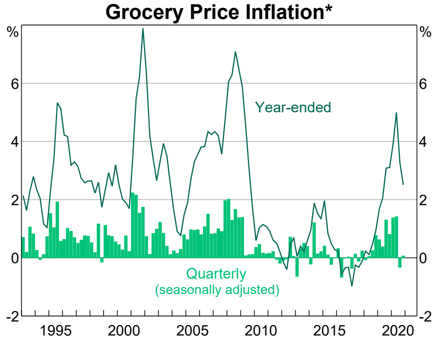
Price- and wage-setting behaviour can be affected by expectations about the future rate of inflation. Market economists' year-ahead inflation expectations have remained broadly steady following some volatility over the second half of 2020. In part this is because recent large anticipated changes in some price components (such as the effects of oil prices and child care subsidies) are no longer influencing year-ahead expectations (Graph 4.15). Unions' inflation expectations remain relatively subdued. Consensus and market economists' long-term inflation expectations are around 2–2½ per cent and remain consistent with the Bank's medium-term inflation target.

Wages growth declined further in the September quarter

Growth in the Wage Price Index (WPI) slowed to 0.1 per cent in the September quarter, to be 1.4 per cent in year-ended terms. This is the lowest reading since this series began 2 decades ago. Private sector wages growth remained at 0.1 per cent in the quarter, as many employers responded to the pandemic by delaying financial year-end wage reviews and enterprise bargaining agreement (EBA) increases

Graph 4.13

Grocery Price Inflation*

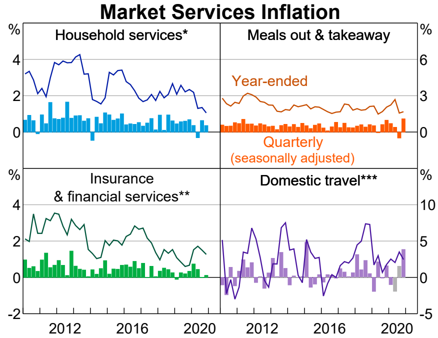


* Excludes alcoholic beverages, fruit, vegetables and meals out & takeaway

Sources: ABS; RBA

Graph 4.14

Market Services Inflation



* Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services

** Excludes deposit & loans to June quarter 2011

*** Imputed using headline CPI in the June and September quarters 2020

Sources: ABS; RBA

(Graph 4.16). Public sector wages growth declined to 0.2 per cent, reflecting deferred wage increases for Commonwealth employees, delays in negotiating the Victorian public service EBA and delays and reductions in wage increases for New South Wales state government employees.

Wages growth has been weakest in industries most reliant on award wage increases, including accommodation & food services and retail trade. Annual increases in award wages usually occur in the September quarter, but the Fair Work Commission decided in June to delay effective increases for most awards to November or February. These delayed awards are expected to provide some support to wages growth in affected industries in coming quarters, although the increase in award wages will be smaller than it has been in recent years in light of the current economic environment.

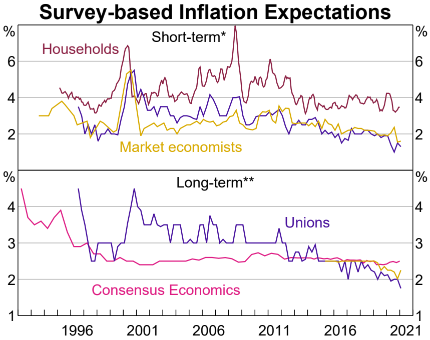
Other measures of earnings continued to be supported by JobKeeper

The national accounts measure of average earnings per hour declined a little in the September quarter, as hours worked in lower-paid jobs rebounded, bringing the composition of hours worked closer to its pre-pandemic mix (Graph 4.17). The JobKeeper wage subsidy continued to affect this measure of earnings; employees' average hourly earnings are boosted above their ordinary earnings in cases where employees would otherwise have earned less per fortnight than the minimum JobKeeper payment (which was $1,500 throughout most of the September quarter).

The further recovery in activity and changes to JobKeeper eligibility requirements in the December quarter are expected to have reduced the number of employers using the program, although payments to firms in industries most impacted by pandemic-related restrictions are likely to have remained elevated. With JobKeeper due to expire at the end of March, some further declines in measured

Graph 4.15

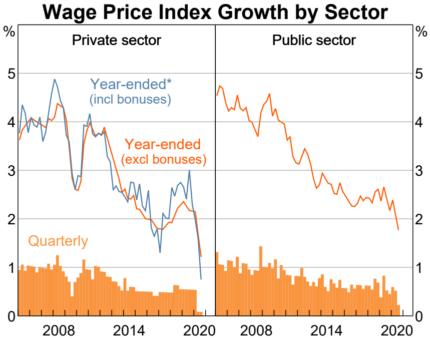
Survey-based Inflation Expectations



* Over the year ahead
** Average over the next 5 to 10 years for market economists and unions; average over 6 to 10 years in the future for Consensus
Sources: Australian Council of Trade Unions; Consensus Economics; RBA; Workplace Research Centre

Graph 4.16

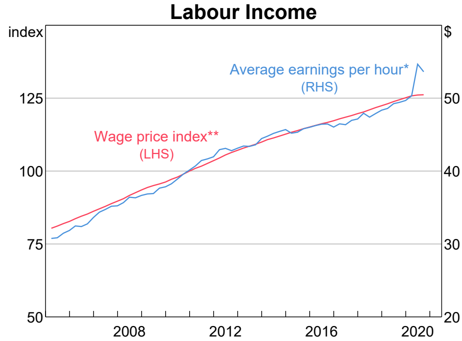
Wage Price Index Growth by Sector



* Non-seasonally adjusted; bonuses include commissions
Source: ABS

Graph 4.17

Labour Income



* Non-farm
** Excluding bonuses and commissions; December 2010 = 100
Source: ABS

average earnings are expected in coming quarters.

Wage freezes will continue weighing on wages growth this year

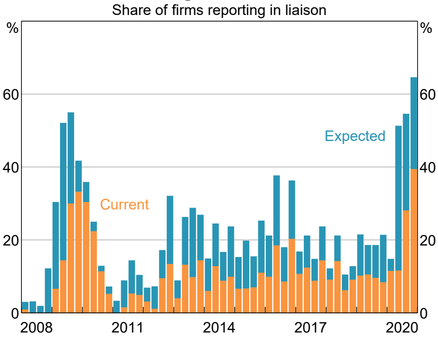
Liaison reports suggest that wages growth will remain weak for some time. The proportion of firms reporting they had wage freezes in place or intended to implement wage freezes this year increased further in the December quarter (Graph 4.18). Some firms also reported that bonuses would be reduced or withheld in coming quarters. However, in most cases these measures are expected to be temporary, with some unwinding of freezes and delays expected over the course of 2021.

Government wage policies announced in recent months have softened the outlook for public sector wages. The Australian Government has announced a wages policy that ties wage adjustments in future EBAs for Commonwealth public servants to private sector WPI outcomes. Some state governments have also announced measures to delay wage increases or cap wages growth at lower rates than had applied in recent years. ✠

Graph 4.18

Wage Freezes

Share of firms reporting in liaison



Source: RBA