4. Inflation

Movements in aggregate consumer prices and wages over the past year have been dominated by the impact of responses to the COVID-19 pandemic. This has introduced more volatility than usual to measures of prices and wages, with this mostly reflecting temporary or one-off movements. Looking through this volatility, underlying inflationary pressures in the economy remain subdued, consistent with the considerable spare capacity in the economy.

Around half of the increase in Consumer Price Index (CPI) inflation in the March quarter was driven by higher automotive fuel prices; fuel prices have returned to close to their pre-pandemic levels following sharp declines in early 2020. The large and temporary price changes arising from policy responses to the COVID-19 pandemic have mostly dissipated, and are not expected to influence quarterly inflation outcomes much further. However, the year-ended inflation outcome for the June quarter is expected to spike temporarily above 3 per cent as the effects of last year's temporary free childcare program and fuel price declines drop out of the calculation. Other recent pockets of price pressures are abating, or are expected to do so in coming quarters, because heightened demand for some goods over the past year has eased a little and global supply chain disruptions are being worked through. Housing components of the CPI were broadly flat in the March quarter; strong demand for new dwelling construction pushed prices higher, but this was offset by HomeBuilder and similar state government construction grants.

Wages growth picked up a little in the December quarter, boosted by the reversal of some temporary wage cuts in the private sector, which had been implemented in 2020 in response to the economic downturn. Wages growth has also been supported a little by the implementation of award wage increases previously delayed in response to the pandemic. Abstracting from these factors, wage pressures have been subdued across both the private and public sectors.

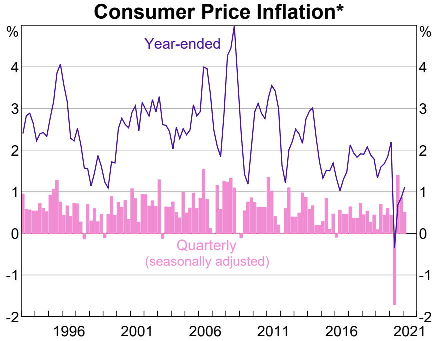
CPI inflation moderated in the March quarter

Headline inflation was 0.5 per cent (seasonally adjusted) in the March quarter, boosted by higher automotive fuel prices, and 1.1 per cent over the year (Table 4.1; Graph 4.1).[1]

Trimmed mean inflation was 0.3 per cent in the March quarter and 1.1 per cent over the year (Graph 4.2). Other measures of underlying inflation were around 1¼ per cent over the year

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]	
	March quarter 2021	December quarter 2020	March quarter 2021	December quarter 2020
Consumer Price Index	0.6	0.9	1.1	0.9
Seasonally adjusted CPI	0.5	0.9	–	–
– Tradables	1.0	–0.1	0.7	–0.6
– Tradables (excl volatile items)[c]	0.4	0.0	1.4	1.4
– Non-tradables	0.3	1.3	1.3	1.5
Selected underlying measures				
Trimmed mean	0.3	0.4	1.1	1.2
Weighted median	0.4	0.5	1.3	1.3
CPI excl volatile items[c]	0.3	1.0	1.4	1.5

(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

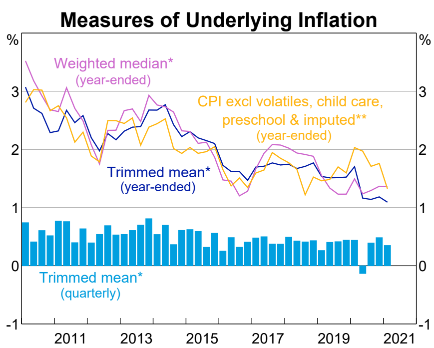
(c) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

to the March quarter. Spare capacity in the economy and associated low wages growth continue to contribute to subdued inflationary pressures.

Inflation measures in the March quarter were much less affected by the pandemic than was the case for much of the past year (Graph 4.3). The large policy-driven swings in administered prices, such as for child care, have now unwound, and the price adjustments induced by changed consumption patterns over the past year (which saw increased spending on groceries and consumer durables) have slowed. While policy measures continue to have a small influence on other price components of the CPI, such as housing and utilities, these effects are likely to diminish further over coming quarters.

Graph 4.2



* 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

Housing-related prices were unchanged

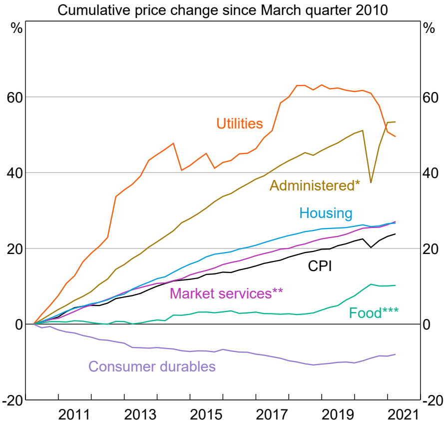
Following two quarters of modest increases, housing-related inflation slowed in the March quarter. New dwelling prices declined slightly due to the impact of government construction incentives. Rents were unchanged in the quarter and rent inflation remained very weak in year-ended terms. These 2 housing-related components together account for around one-sixth of the CPI basket.

Ongoing strength in demand for new detached housing construction has been in part supported by the Australian Government's HomeBuilder program and similar state government grants. Information from liaison suggests that this strong demand, as well as some supply chain disruptions, has contributed to higher material prices and subcontractor rates over the past few quarters (Graph 4.4). Higher input costs have been passed on to consumers through higher base prices. However, these were completely offset by the direct impact of government grants, which are treated by the ABS as price reductions. As a result, CPI prices for newly constructed dwellings fell by 0.1 per cent in the quarter (Graph 4.5). Because HomeBuilder grants are only paid after dwelling construction has commenced, the recent 12-month extension to the HomeBuilder construction commencement deadline will prolong the program's impact on CPI prices. As a result, the HomeBuilder grants are likely to continue to subtract from new dwelling inflation until late 2022.

Graph 4.3

Consumer Price Inflation

Cumulative price change since March quarter 2010



* Excludes utilities

** Includes household services, meals out & takeaway and insurance & financial services

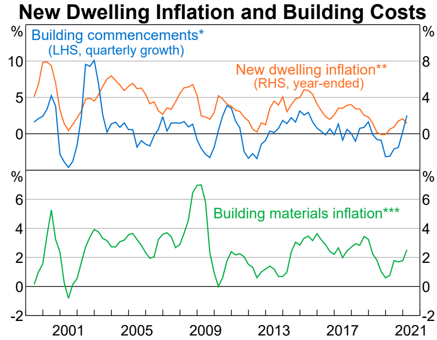
*** Excludes fruit, vegetables and meals out & takeaway

Sources: ABS; RBA

Rents were unchanged in the March quarter and 1.4 per cent lower over the year (Graph 4.6). Advertised rents and available listings suggest rental market conditions have tightened a little over recent months, but this is yet to flow through to the stock of existing rents captured in the CPI. Rents fell further in Sydney in the quarter and were around 3 per cent lower over the year. In Melbourne, declines in the March quarter in rents for some tenants were offset by the unwinding of temporary rent reductions for others. Rents increased in most other cities in the quarter but were particularly strong in Brisbane and Perth. The recent recovery in Perth rents partly reflects a rental stock shortage following years of subdued dwelling investment.

Graph 4.4

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

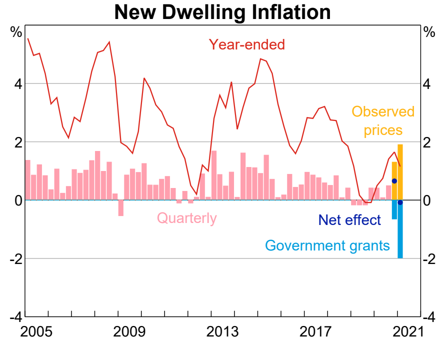
** Adjusted for the tax changes of 1999–2000

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

Sources: ABS; RBA

Graph 4.5

New Dwelling Inflation



Sources: ABS; RBA

Administered price inflation has returned to its pre-pandemic trends

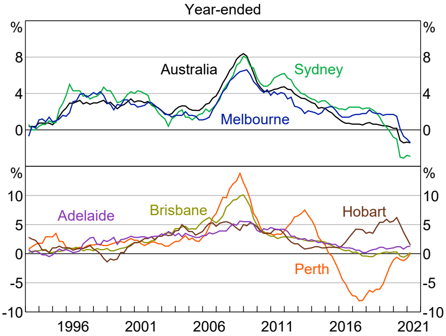
Administered price inflation moderated in the March quarter, returning to the pre-pandemic pattern of subdued price increases. Administered price inflation has trended lower over the past 6 years and this trend is expected to persist for some time, in part due to ongoing administered price freezes in a number of states and territories.

Price rises for preschool & primary education were smaller than is typical in the March quarter, largely because of ongoing preschool fee waivers in New South Wales and Victoria (Graph 4.7). Tertiary education prices declined, driven by university fee changes as part of the government's Job-ready Graduates Package. Price increases for other items that typically have their prices reset in the March quarter, such as secondary education fees and state government charges, were a little below average this year. In contrast, pharmaceutical product price inflation rose a little due to the annual reset of safety net thresholds for the Pharmaceutical Benefits Scheme.

Utilities prices decreased in the quarter

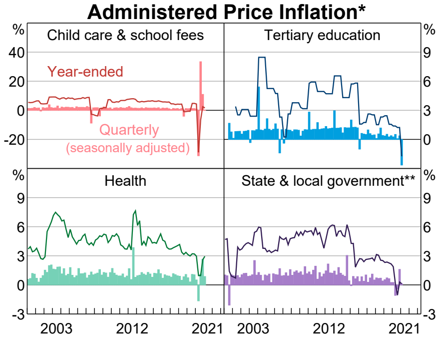
Prices for utilities, which account for around 5 per cent of the consumption basket, fell in the March quarter owing to declines in regulated electricity prices and the provision of government rebates in some states (Graph 4.8). Melbourne electricity prices fell noticeably in the quarter. Market and standing offers declined, consistent with the scheduled reduction in the Victorian Default Offer; a one-off rebate was also provided to concession customers. Partly offsetting this, electricity prices in Western Australia rose as government rebates unwound for some customers. Gas prices increased a little in the quarter, largely driven by scheduled increases in market offer gas prices in Melbourne.

Graph 4.6



Sources: ABS; RBA

Graph 4.7

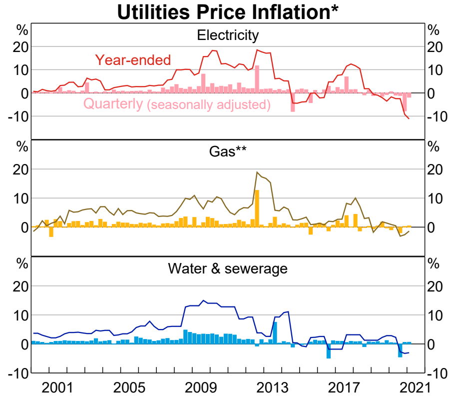


* Adjusted for the tax changes of 1999–2000

** Includes urban transport fares, property rates & charges and other services in respect of motor vehicles

Sources: ABS; RBA

Graph 4.8



* Adjusted for the tax changes of 1999–2000

** Includes other household fuels

Sources: ABS; RBA

Utilities inflation has been subdued for the past 2 years and is likely to remain low for some time. Lower wholesale gas prices and increased electricity supply from renewables continue to put downward pressure on utilities prices. State government price freezes mean that residential utilities prices are expected to remain broadly unchanged until the second half of 2021 in Canberra, Darwin, Hobart and Perth. Electricity prices in Adelaide, Brisbane and Sydney are likely to decline in the September quarter 2021 owing to a scheduled reduction in the Default Market Offer.

Automotive fuel prices have rebounded

Fuel prices rose strongly in the March quarter, after remaining fairly steady over the second half of 2020 (Graph 4.9). The 8.7 per cent increase in the quarter contributed ¼ percentage point to quarterly headline CPI (half the total increase in the CPI). Fuel prices continued to rise in the month of April – at current levels automotive fuel is expected to again contribute to headline CPI in the June quarter, although less so than in the March quarter.

Retail inflation outcomes were mixed

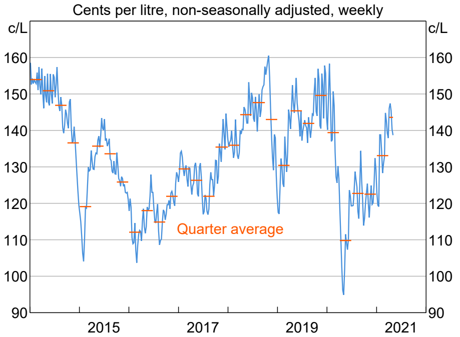
Retail prices, which comprise over a quarter of the CPI, rose a little in the March quarter to be 1.7 per cent higher over the year. During 2020, sustained demand for many consumer durable items – particularly household items and motor vehicles – had driven retail prices higher as a large share of people spent more time at home during the initial COVID-19 outbreak. These pressures had been exacerbated by the difficulties faced by retailers in managing inventories during the pandemic. Some retailers opted to cancel orders early in the pandemic in response to uncertainty over the outlook for demand. Retail inventories then continued to decline over 2020 as strong demand outpaced retailers' ability to restock, in part due to global supply chain pressures. However, these supply pressures have now eased a little and the appreciation of the exchange rate has provided some offset by reducing prices for imported inputs. Prices for motor vehicles continued to rise in the March quarter, but at a slower pace, while prices for furniture & household items declined (Graph 4.10). In contrast, prices for clothing & footwear rose in the quarter, driven by higher prices for accessories, particularly jewellery.

Grocery prices (excluding fruit & vegetables) were little changed in the March quarter. Price declines for dairy and some packaged foods were offset by price rises for meat products;

Graph 4.9

Unleaded Petrol Prices

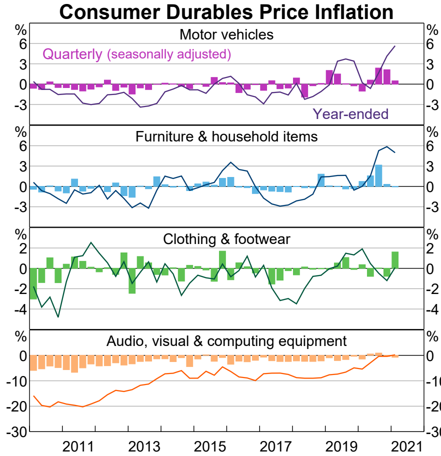
Cents per litre, non-seasonally adjusted, weekly



Sources: Australian Institute of Petroleum; RBA

Graph 4.10

Consumer Durables Price Inflation



Sources: ABS; RBA

better seasonal conditions have led some farmers to rebuild stock numbers, reducing the supply of meat (Graph 4.11). Prices for most other grocery items are now around their levels of a year ago, consistent with business liaison reports that supermarkets have returned to normal discounting strategies following some changes in discounting behaviour during periods of strong demand early in the pandemic.

Prices for fruit & vegetables, which can be volatile, decreased in the March quarter as favourable weather conditions and a fall in fruit exports led to strong supply in supermarkets. Despite recent reports of labour shortages for some produce harvesting, these do not appear to have led to widespread price pressures to date.

Market services inflation remains subdued

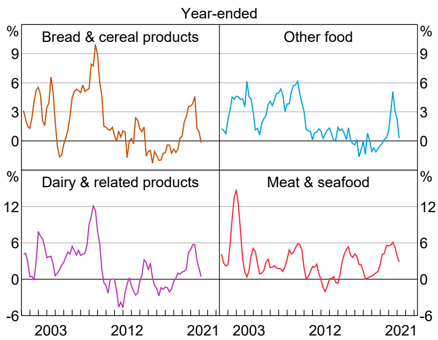
Inflation remains low for market services, which include household services, financial services, meals out & takeaway and domestic travel, and comprise a little under one-quarter of the consumption basket (Graph 4.12). Within domestic travel, price increases stemming from strong demand for holiday accommodation in the March quarter were partly offset by lower airfares. Domestic travel prices are likely to fall in the coming quarters due to the Australian Government's half-price airfare scheme.

Inflation expectations have increased a little

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 picked up a little and become less volatile over recent months (Graph 4.13). In part this is because large changes in some price components (such as the effects of oil price changes and child care subsidies that occurred during 2020) are no longer influencing year-ahead expectations. Despite the pickup, short-term inflation expectations remain relatively subdued. Survey measures of long-term inflation expectations have increased a little of late and are around 2–2½ per cent (Graph 4.14). Long-term market-based measures of inflation expectations have also picked up from the very low levels seen in early 2020. The pandemic-related market dysfunction observed at times over the past year is no longer affecting market measures of inflation expectations.

Graph 4.11

Food Price Inflation*

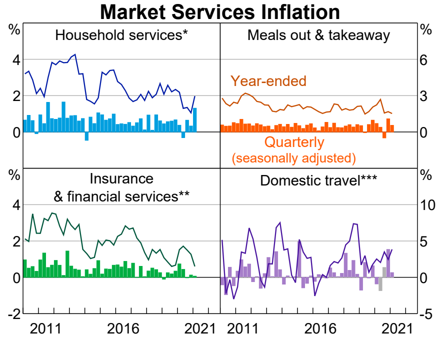


* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 4.12

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

Wages growth increased in the December quarter as earlier wage cuts were unwound …

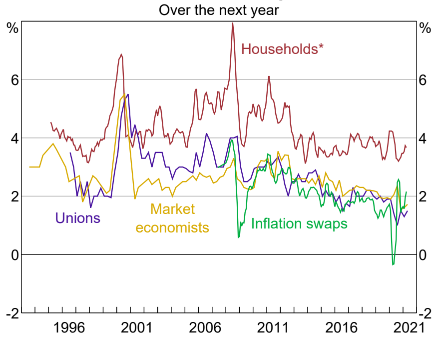
Growth in the Wage Price Index increased to 0.6 per cent in the December quarter, but year-ended growth remained subdued at 1.4 per cent. Private sector wages increased by 0.7 per cent, primarily reflecting the reversal of a number of large temporary wage cuts implemented in the June and September quarters across mostly senior executive and higher paid jobs in response to the pandemic (Graph 4.15). There was also a small contribution to growth from award wage increases in construction, manufacturing and a range of other industries that had previously been delayed from July to November by the Fair Work Commission. Public sector wages rose by 0.3 per cent in the quarter, as wage freezes across the sector continued to weigh on outcomes.

The reversals of the large private sector wage cuts in December were broad-based across industries, but had the biggest impact on wages growth in business services. Looking through the impacts of wage cuts imposed and then reversed over 2020, underlying wage pressures remained weak across all industries.

Graph 4.13

Short-term Inflation Expectations

Over the next year

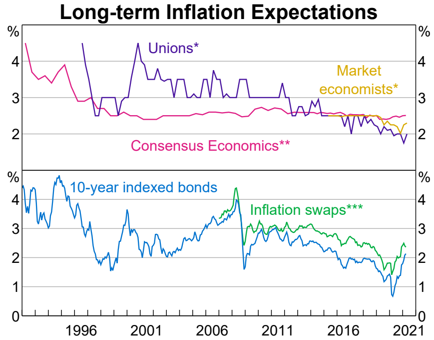


* Smoothed

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

Graph 4.14

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

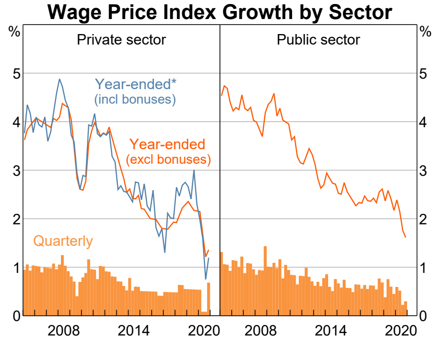
Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; RBA; Workplace Research Centre; Yieldbroker

… but subdued wages growth is likely to persist for some time

Information from the Bank's business liaison program indicates that more temporary wage cuts have been unwound since December. However, wage freezes remain fairly widespread across industries, with over a quarter of firms in the Bank's business liaison program reporting that a freeze was in place in April (Graph 4.16). The near-term outlook has strengthened a little, though, with fewer firms expecting to have wage freezes in place in coming months. Consistent with this, more firms also report expecting stronger wages growth in the year ahead (Graph 4.17).

Graph 4.15

Wage Price Index Growth by Sector



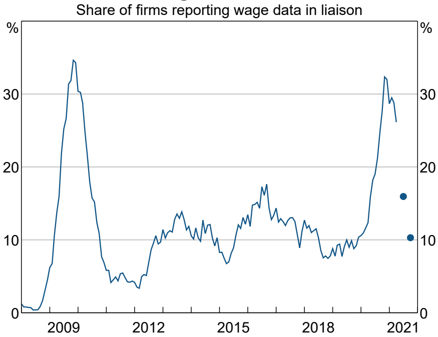
* Non-seasonally adjusted; bonuses include commissions

Source: ABS

Graph 4.16

Wage Freezes*

Share of firms reporting wage data in liaison



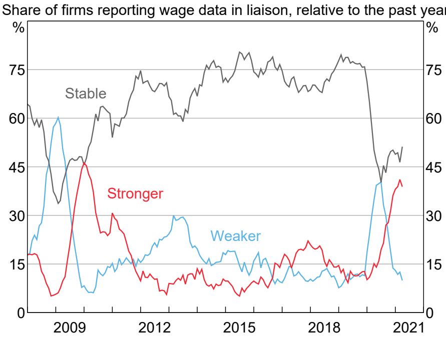
* Smoothed; dots represent expected freezes 3 and 6 months ahead

Source: RBA

Graph 4.17

Expectations for Wages Growth*

Share of firms reporting wage data in liaison, relative to the past year



* 7-month centred moving average

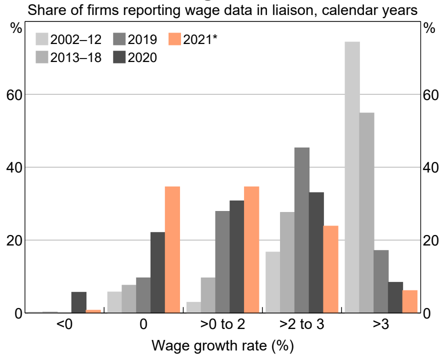
Source: RBA

Despite the likelihood that wages growth may be past its recent trough, overall wages growth is still expected to remain subdued. Information from the Bank's business liaison program indicates that average wages growth has been below 3 per cent for the majority of firms in recent years (Graph 4.18). This pattern appears to have remained in place in 2021 to date, and stands in contrast to outcomes over much of the previous 2 decades, when a large share of firms reported average wage increases of more than 3 per cent. ✢

Graph 4.18

Distribution of Wages Growth Outcomes

Share of firms reporting wage data in liaison, calendar years



* Year to date

Source: RBA

Endnotes

[1] The only item that was still imputed (using headline CPI) in the quarter was international holiday travel & accommodation, which now accounts for less than 1 per cent of the CPI basket following the 2020 update to the CPI weights.