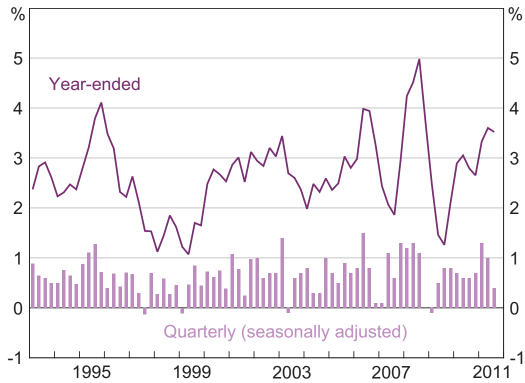
5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation moderated in the September quarter following strong outcomes earlier in the year. The consumer price index (CPI) rose by 0.6 per cent in the quarter. On a seasonally adjusted basis, the CPI increased by 0.4 per cent in the quarter, similar to the various measures of underlying inflation (Graph 5.1 and Table 5.1). On a year-ended basis, headline inflation remained elevated at 3.5 per cent owing to the earlier increases in fruit and fuel prices. It is, however, expected to decline sharply over coming quarters as banana prices return to normal levels.

Graph 5.1
Consumer Price Inflation*



* Excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999–2000
Sources: ABS; RBA

Table 5.1: Measures of Consumer Price Inflation
Per cent

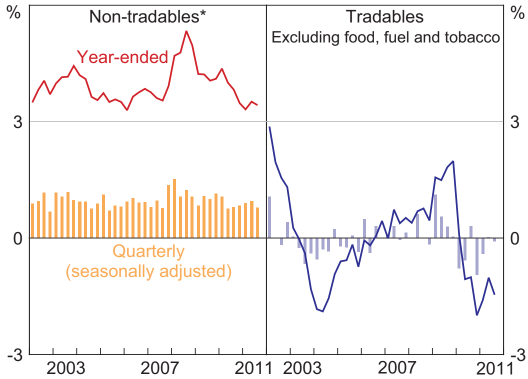
	Quarterly		Year-ended	
	June quarter 2011	September quarter 2011	June quarter 2011	September quarter 2011
CPI	0.9	0.6	3.6	3.5
Seasonally adjusted CPI[(a)]	1.0	0.4	3.6	3.5
– Tradables[(b)]	1.0	0.0	3.6	3.3
– Tradables (excl food, fuel and tobacco)[(b)]	0.0	–0.1	–1.0	–1.3
– Non-tradables (excl deposit & loan facilities)[(b)]	1.0	0.8	3.5	3.4
Selected underlying measures				
Trimmed mean	0.8	0.3	2.6	2.3
Weighted median	0.8	0.3	2.9	2.6
CPI excl volatile items[(b) (c)]	0.7	0.5	2.5	2.3

(a) Year-ended inflation rates are based on non-seasonally adjusted data
(b) Quarterly data are seasonally adjusted by the RBA using ABS seasonal factors for individual components; year-ended inflation rates are based on non-seasonally adjusted data
(c) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

The September quarter marked the introduction of the 16th series CPI, following the CPI Review in 2010 (see 'Box C: The 16th Series Consumer Price Index'). The new CPI includes a reweighting of expenditure items based on the 2009/10 Household Expenditure Survey. Periodic reviews of CPI weights are necessary to ensure that the weights of individual goods and services included in the index reflect evolving consumption patterns. Fixed-quantity price indexes like the CPI are subject to positive 'substitution bias' that can lead to inflation being overstated when the expenditure weights are out of date, as the effective weight of goods with falling (rising) relative prices is likely to be too low (high) on average. As discussed in Box C, alternative calculations of inflation over the year to the June quarter using the updated 16th series weights suggest that headline and underlying inflation over the year to June were running at a somewhat lower rate than indicated by the 15th series data.

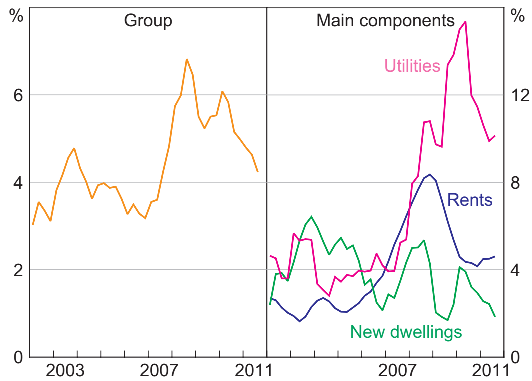
In seasonally adjusted terms, non-tradables prices rose by 0.8 per cent in the September quarter, a smaller increase than in the previous two quarters. In year-ended terms, however, non-tradables inflation has remained around 3½ per cent over the past year, a significant moderation from the pace seen immediately prior to the 2008–09 slowdown (Graph 5.2). Housing costs, the largest expenditure group in the CPI, continued to make a sizeable contribution to non-tradables inflation, although there have been divergent developments within this expenditure group (Graph 5.3). In the September quarter, there was a larger-than-usual seasonal increase in utilities prices, reflecting large increases in electricity charges in Sydney and water charges in Adelaide; utilities prices rose by 10 per cent over the year. Rents also rose solidly in the quarter, with the year-ended pace of rent inflation picking up to 4.6 per cent. However, the cost of purchasing new dwellings, the component with the largest individual weight in the CPI, fell slightly in the quarter with the year-ended rate of inflation moderating to 1.8 per cent. The weakness in residential building activity has seen a sharp slowing in inflation in new dwelling costs over the past year, with price growth particularly soft in Brisbane and Adelaide.

Graph 5.2
Consumer Price Inflation



Sources: ABS; RBA

Graph 5.3
Housing Cost Inflation

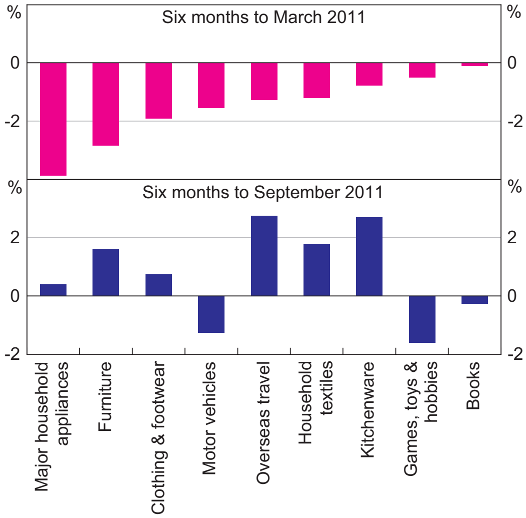


Source: ABS

In seasonally adjusted terms, tradables prices (excluding food, fuel and tobacco) have been broadly flat over the past two quarters. This follows a fall over the previous year associated with the appreciation of the exchange rate in 2009 and 2010, along with the effect of subdued retail trading conditions. However, with little net change in the exchange rate over the past half year, this disinflationary impetus appears to have waned for some items over recent quarters (Graph 5.4). In some cases, most notably textiles and clothing & footwear, the trend to higher inflation appears to be broadly consistent with a pick-up in

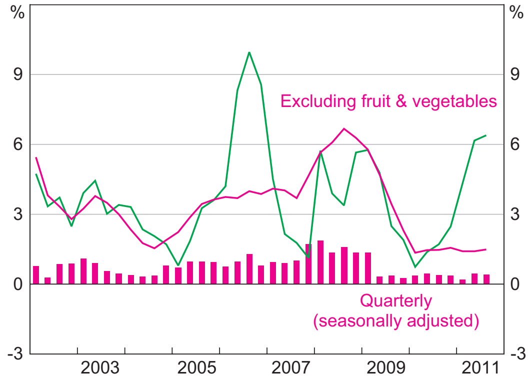
Graph 5.4
Price Inflation in Selected Tradables

Seasonally adjusted



Sources: ABS; RBA

Graph 5.5
Food Price Inflation



Sources: ABS; RBA

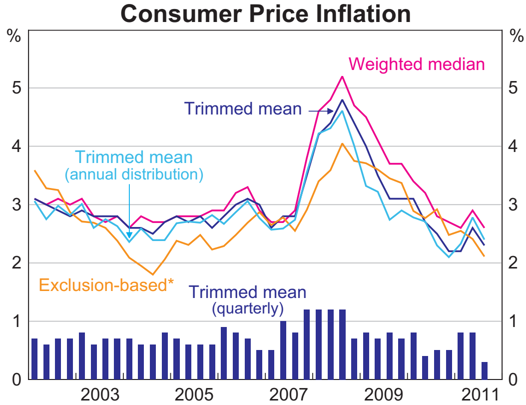
prices evident in data for some other countries. In contrast to earlier quarters, there was also a rise in the price of overseas travel and accommodation in the September quarter, reflecting the effect of higher airfares. Nevertheless, there were continuing price falls in the quarter for a range of other tradable goods, including: audio, visual and computing equipment; games and toys; and motor vehicles.

Food price inflation moderated in the September quarter following large increases earlier in the year as a result of the effect of the floods and Cyclone Yasi on fruit and vegetable supplies (Graph 5.5). Fruit and vegetables prices were broadly unchanged in the September quarter and are expected to decline sharply over the December and March quarters as banana supplies and prices return to normal. Excluding fruit and vegetables prices, food inflation has been low over the past 2½ years, most recently owing to strong price competition among retailers in several grocery categories. For some items, including bread, milk and eggs, prices have declined over the past year despite strength in global food commodity prices.

Automotive fuel prices fell modestly in the September quarter but have risen by 14 per cent in the past year. Over the year the appreciation in the Australian dollar has only partly offset the strong rise in global oil prices. Based on information for the December quarter to date, fuel prices are expected to rise slightly in the quarter.

The trimmed mean and weighted median measures of inflation were lower than expected in the September quarter at 0.3 per cent. Taking the available measures together, the published data suggest that over the year to September underlying inflation was running a little below 2½ per cent (Graph 5.6). However, as discussed in Box C, an assessment of

Graph 5.6
Consumer Price Inflation



* Excludes fruit, vegetables, automotive fuel (and deposit & loan facilities to June 2011)

Sources: ABS; RBA

the pace of underlying inflation over the past year is complicated by the effect of substitution bias on the published data up to the June quarter, which means most of the available measures are likely to be slightly overstating underlying inflation over the year to September.

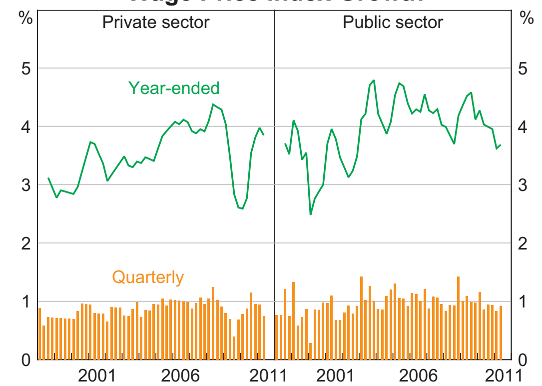
Costs

Labour cost growth remains firm but recent indications suggest the likelihood of a significant acceleration in labour costs has lessened. The wage price index rose by 0.9 per cent in the June quarter, to be 3.8 per cent higher over the year. Private-sector wage growth was relatively soft in the quarter, increasing by 0.7 per cent, the lowest quarterly outcome since late 2009. In year-ended terms private-sector wage growth remains relatively firm at 3.8 per cent, above the average for the series (Graph 5.7). In contrast, year-ended public-sector wage growth remained a little below average despite ticking up slightly in the quarter. Wage growth was strongest over the year in the wholesale trade and finance & insurance industries, both of which had seen a relatively pronounced slowing in wage growth in 2009. Wage growth for the September quarter will include the effect of the increase in award wages that came into effect at the beginning of July.

Consistent with a softening in the labour market, most firms are not reporting significant difficulty finding suitable labour. Nevertheless, there continue to be reports of skills shortages in certain mining-related industries and occupations. Business surveys and the Bank's liaison suggest a decline in momentum in labour costs growth in the September quarter, abstracting from some temporary strength in wage growth due to the award wage increase (Graph 5.8).

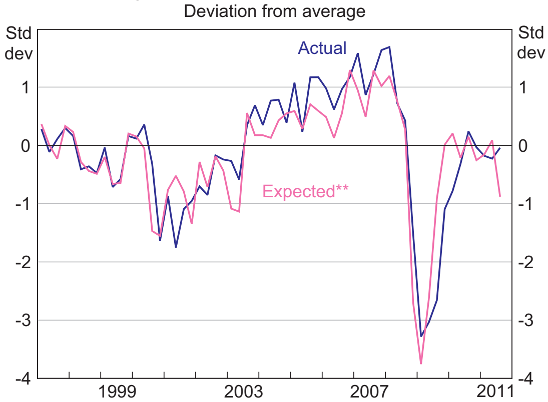
National accounts measures of unit labour costs – the average cost of labour per unit of output – have been affected by volatility in labour productivity over the first half of 2011, owing to the temporary decline in GDP associated with the effect on coal

Graph 5.7
Wage Price Index Growth



Source: ABS

Graph 5.8
Surveys of Business Labour Costs*
Deviation from average

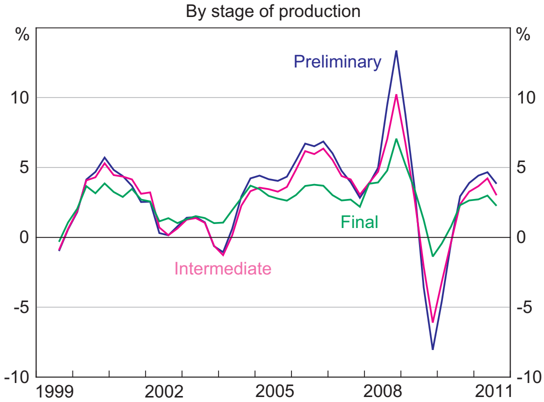


* Weighted average of data from various business surveys since 1994, with weights calculated by the RBA using the principal component method
** Expectation for following quarter
Sources: ACCI; NAB; RBA; Sensis

production of adverse weather events last summer. Nevertheless, given current rates of wage growth, the weak growth in trend labour productivity over recent years suggests that growth in unit labour costs remains relatively firm.

The September quarter producer price data point to some moderation in upstream inflation pressures (Graph 5.9). At the final stage of production (excluding oil), the year-ended rate of producer price inflation of 2.3 per cent was around the average pace seen over the past 12 years. There was a 0.7 per cent increase in final-stage prices in the quarter, with a seasonal increase in utilities prices and some evidence that the disinflationary effect of the earlier exchange rate appreciation is waning. Some easing in inflationary pressures was more apparent at the earlier stages of production, especially in the domestic component. Prices in the manufacturing and construction industries were particularly weak in the quarter.

Graph 5.9
Producer Price Inflation*
By stage of production

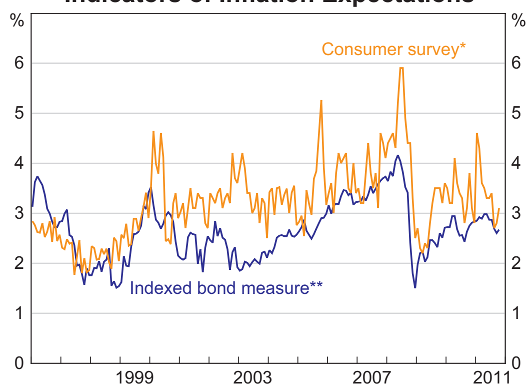


* Excluding oil
Sources: ABS; RBA

Inflation Expectations

Most measures of inflation expectations have fallen over the past six months. The Melbourne Institute's measure of consumer inflation expectations has returned to its inflation-targeting average, after increasing sharply at the start of the year (Graph 5.10). Financial market measures of medium- to long-term inflation expectations have also fallen, with the indexed-bond measure now slightly below its inflation-targeting average. Market economists' near-term inflation forecasts are a little lower than three months ago, but expectations for inflation in 2013 have ticked up (Table 5.2). Market economists generally expect the carbon price to add 0.7 percentage points to inflation when it comes into effect on 1 Ju1y 2012. Union officials' inflation expectations for 2012 and 2013 have picked up slightly since the previous *Statement*. Business survey measures suggest that selling price inflation is likely to remain below average in the near term.

Graph 5.10
Indicators of Inflation Expectations



* Median expectation of average annual inflation over the next year
** Break-even 10-year inflation rate on indexed bonds
Sources: Melbourne Institute of Applied Economic and Social Research; RBA

Table 5.2: Median Inflation Expectations
Per cent

	Year to June 2012			Year to June 2013[(a)]	
	May 2011	August 2011	November 2011	August 2011	November 2011
Market economists	2.7	2.6	2.5	2.7	2.8
Union officials	3.1	3.2	3.4	3.2	3.4

(a) Excluding carbon price
Sources: RBA; Workplace Research Centre