4. Inflation

Inflation is high and broadly based. The pass-through of non-labour cost pressures (such as higher materials and transport costs) to consumer prices, enabled by strong demand conditions, continued to drive strong goods price inflation in the June quarter of 2022. Some of these upstream cost pressures are showing signs of easing but it will take some time before this affects prices paid by consumers. Higher input costs and strong demand have also contributed to a pick-up in services inflation in recent quarters. Short-term measures of inflation expectations have increased alongside the rise in inflation outcomes, but most medium- and long-term measures remain anchored to the inflation target and suggest that the current high inflation is expected to be relatively short lived.

Timely information from the Bank's liaison program and business surveys suggest that growth in labour costs has picked up. Firms expect that wages growth will increase over the year ahead, in line with the tight labour market, high inflation and an ongoing focus on retaining and attracting workers. Wage policy announcements by the Fair Work Commission (FWC) and a number of state governments are also expected to support a pick-up in wages growth in the period ahead. The Wage Price Index (WPI) for the March quarter of 2022 confirmed that overall wages growth remained around its pre-pandemic pace earlier in the year. While there were some areas of stronger wage increases, these were not particularly broadly based in the quarter.

Inflation in the June quarter was high

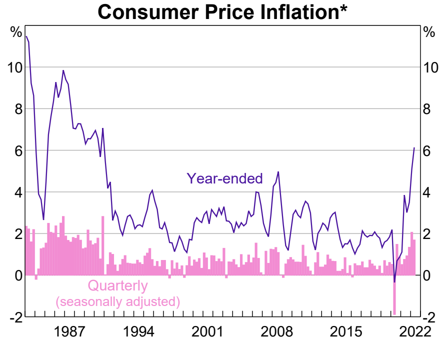
The headline Consumer Price Index (CPI) increased by 1.8 per cent (1.7 per cent seasonally adjusted) in the June quarter and by 6.1 per cent over the year – the highest year-ended CPI inflation since the early 1990s (Graph 4.1; Table 4.1). This outcome was higher than anticipated a few months ago, largely reflecting increases in fuel, fruit and vegetable prices.

Inflation continues to be broadly based. A wide range of items have contributed to the strong inflation outcomes in recent quarters, in contrast to late 2021 when a small number of items were driving overall inflation outcomes (Graph 4.2). Around three-quarters of prices in the CPI basket grew faster than 3 per cent in annualised terms in the June quarter (Graph 4.3).

Measures of inflation that remove the effect of irregular or temporary price changes indicate that underlying inflation was also high in the June quarter. Trimmed mean inflation was

Graph 4.1

Consumer Price Inflation*



* Excludes interest charges prior to the September quarter of 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 2022	March quarter 2022	June quarter 2022	March quarter 2022
Consumer Price Index	1.8	2.1	6.1	5.1
Seasonally adjusted CPI	1.7	2.1	–	–
– Tradables	2.2	2.8	8.0	6.8
– Tradables (excl. volatile items)[c]	1.7	1.8	5.1	3.6
– Non-tradables	1.5	1.6	5.3	4.2
Selected underlying measures				
Trimmed mean	1.5	1.5	4.9	3.7
Weighted median	1.4	1.0	4.2	3.0
CPI excl. volatile items[c]	1.5	1.7	5.3	4.0

(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.

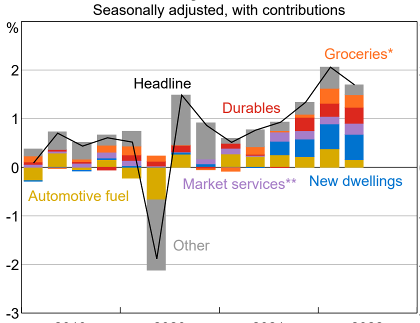
Sources: ABS; RBA

1.5 per cent in the quarter and 4.9 per cent over the year; this is the strongest outcome in year-ended terms since 1991 (Graph 4.4; Table 4.1).

Fuel prices increased further in the quarter

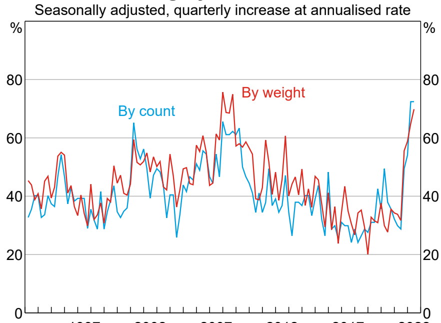
Fuel prices increased by 4 per cent in the June quarter, contributing around 0.2 percentage points to headline inflation (Graph 4.5). This was primarily due to higher global prices and refining margins, reflecting the effects of the Russian invasion of Ukraine and robust global demand. Fuel prices increased by 32 per cent over the year to the June quarter, although prices have declined of late.

Graph 4.2



* Includes fruit and vegetables.
** Excludes domestic travel and telecommunications.
Sources: ABS; RBA

Graph 4.3



* Adjusted for the tax changes of 1999–2000.
Sources: ABS; RBA

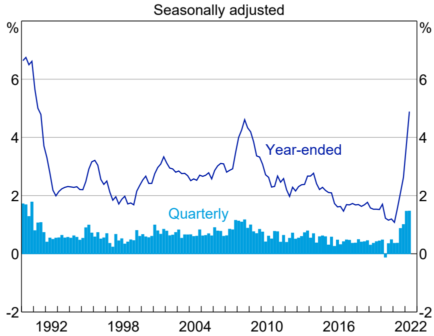
Pass-through of upstream cost pressures continued to drive strong goods price inflation

The pass-through of upstream cost pressures, such as higher materials and transport costs, continued to boost prices across a number of goods-related sectors in the June quarter. Some of these cost pressures are showing signs of easing globally but it will take some time before this affects prices paid by Australian consumers. Additional demand for household goods and building materials induced by the flooding along the east coast is also expected to contribute to inflationary pressure for some goods in the near term.

Graph 4.4

Trimmed Mean Inflation*

Seasonally adjusted



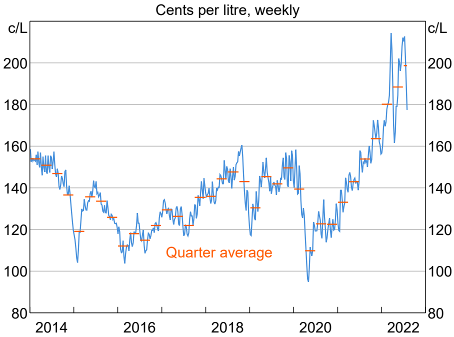
* Excludes interest charges prior to the September quarter of 1998 and deposit & loan facilities; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA

Graph 4.5

Unleaded Petrol Prices

Cents per litre, weekly



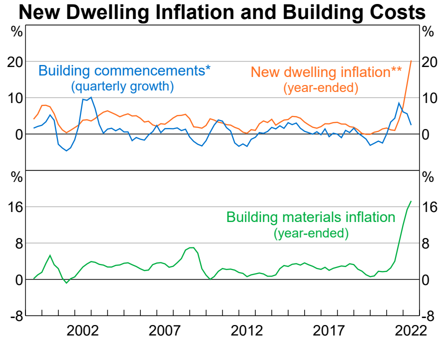
Sources: Australian Institute of Petroleum; RBA

Prices for new dwelling construction – which make up just under one-tenth of the CPI basket – increased by 5½ per cent in the June quarter to be 20 per cent higher over the year. This CPI item has made a large contribution to headline CPI movements, contributing around one-third of the total increase in the June quarter. This was driven primarily by further substantial increases in the prices charged by builders in all capital cities. Sustained strong demand for housing construction has enabled builders to pass through increased costs for labour and building materials; prices for building materials increased by 4.3 per cent in the June quarter and 17.3 per cent over the year (Graph 4.6). Measured prices for new dwellings also increased because fewer government grants for new home building were paid out in the June quarter than in the March quarter, although this accounted for only 0.4 percentage points of the total increase in the quarter.

Consumer durables inflation continued to increase strongly over the quarter to be a little over 5 per cent over the year – the highest annual growth since 1989 (Graph 4.7). This reflected ongoing upstream cost pressures, sustained global and domestic demand, and high transport costs. Price increases were particularly strong for furniture & household items and clothing & footwear (Graph 4.8).

Graph 4.6

New Dwelling Inflation and Building Costs



* Six-quarter average lagged by one quarter.

** Adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA

Grocery prices (excluding fruit & vegetables) increased further in the June quarter as supermarkets continued passing through cost increases from suppliers (Graph 4.9). Prices were around 6½ per cent higher than a year ago – the highest rate of annual increase since 2008. Many food categories recorded strong price increases in the quarter; for example, bread and cereal products increased by 3.1 per cent, reflecting constrained global wheat supply. Food retailers in the Bank's liaison program have become more willing to accept price increases from their suppliers due to the widespread cost increases their suppliers have faced, including for inputs such as fertilisers, chemicals, packaging and transport.

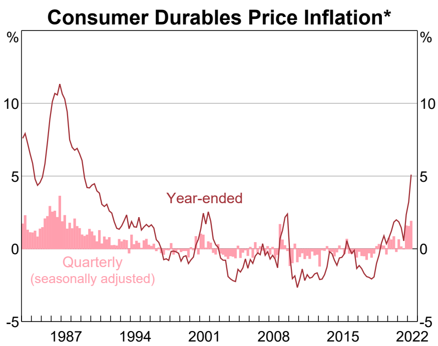
Prices of fruit & vegetables increased by nearly 5 per cent in the quarter to be around 7 per cent higher over the year. This primarily reflected adverse weather conditions, including the east coast flooding, which affected the availability of some items. COVID-19-related supply chain disruptions and higher input costs, such as for transport and fertiliser, also contributed to price rises.

Inflationary pressures increased for many services

Input cost pressures and strong demand have contributed to large price increases for many services in recent quarters. Market services inflation, which covers a little over one-fifth of the CPI basket, picked up strongly in the June quarter to be around 4 per cent higher over the year – the fastest annual increase since 2002 (Graph 4.10). The prices of these services are generally among the most sensitive to domestic labour costs, although increases in non-labour costs have been a factor driving higher prices for some of these services in recent quarters, in particular for cafes and restaurants.

Increased use of state government vouchers such as the New South Wales 'Dine & Discover'

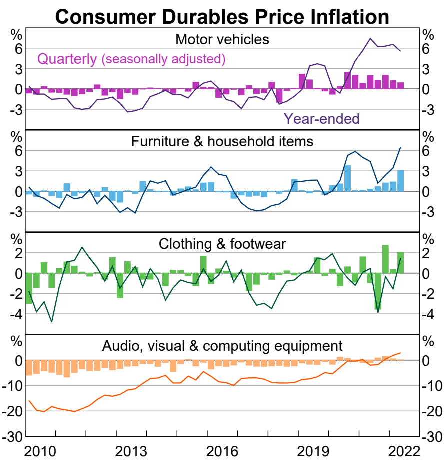
Graph 4.7



* Adjusted for the tax changes of 1999–2000; includes other manufactured household goods such as cleaning and personal care products.

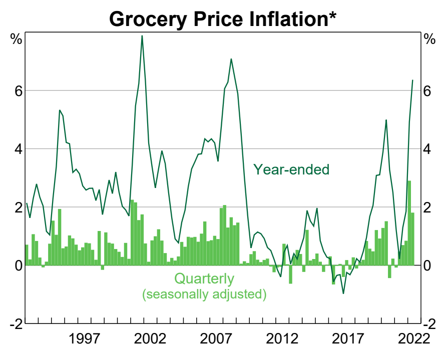
Sources: ABS; RBA

Graph 4.8



Sources: ABS; RBA

Graph 4.9



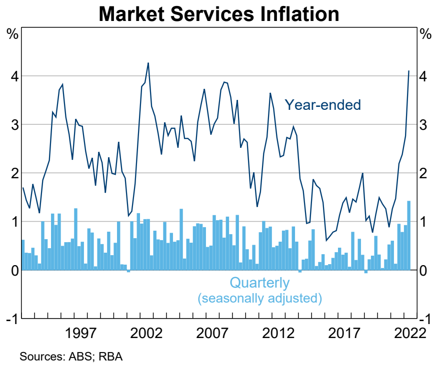
* Excludes fruit & vegetables; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA

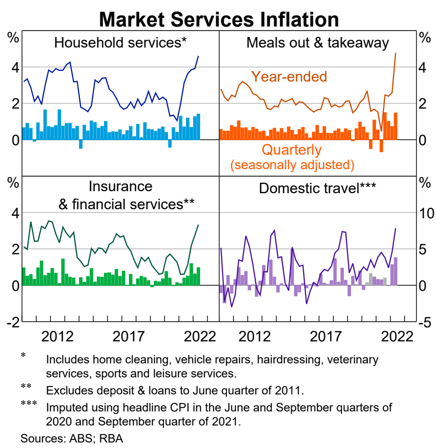
and Melbourne's 'Melbourne Money' reduced the extent of the increases in measured prices of meals out & takeaway and domestic holiday travel & accommodation in the quarter; excluding such vouchers, underlying inflation in these categories was very strong in the quarter (Graph 4.11). These vouchers expired at the end of June and will boost measured market services inflation in the September quarter. Prices for domestic travel & accommodation services increased strongly over the year, reflecting high demand for domestic holidays and the effect of higher jet fuel costs on airfares.

Rents – accounting for around 6 per cent of the CPI basket – increased by 0.7 per cent in the June quarter. Rents in Sydney and Melbourne increased modestly, driven by increases for detached houses (Graph 4.12). Rents across other capital cities continue to record relatively strong rises, reflecting historically low vacancy rates. The gap between CPI rents (covering the entire rental stock) and advertised rents for new tenants remains large by historical standards (see chapter on 'Domestic Economic Conditions'). Stronger advertised rents are expected to contribute to a further pick-up in CPI rent growth in the year ahead, although the timing and extent of this pass-through remains uncertain.

Graph 4.10



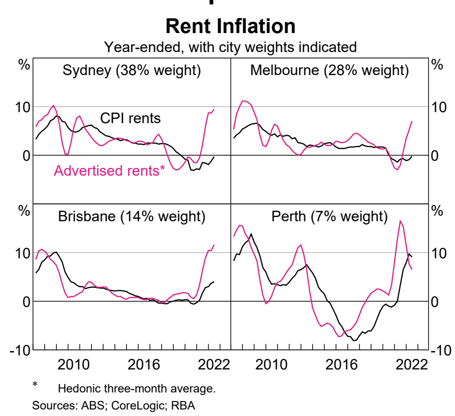
Graph 4.11



Growth in administered prices remained around pre-pandemic rates but is expected to pick up in the second half of the year

Administered inflation (excluding utilities) remains around pre-pandemic trends, as freezes on price increases of some items as well as rebates and other government policies continue to affect prices. Child care prices declined by nearly 7 per cent in the quarter, driven by the increase in the child care subsidy rate for families with more than one child in care and the New South Wales Before and After School Care voucher (Graph 4.13). Prices for medical and hospital services were around 3 per cent higher over the year, slightly below pre-pandemic rates

Graph 4.12



due to freezes in some private health insurance premiums. State and local government fees and charges were little changed in the quarter.

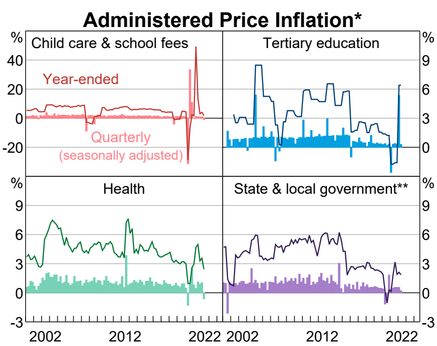
Retail electricity prices increased by around 1 per cent in the June quarter but were little changed over the year (Graph 4.14). Gas prices declined a little in the quarter but were 6½ per cent higher over the year. Wholesale electricity and gas prices have increased sharply over recent months, reflecting a combination of factors, including domestic supply disruptions, increased demand, and higher coal and gas prices (see 'Box A: Recent Developments in Energy Prices'). This will be passed through to retail prices in the September quarter, though the introduction of rebates by some state governments means that most of the effect on measured prices in the CPI will occur in the December quarter.

Short-term inflation expectations have increased further, but longer-term inflation expectations mostly remain consistent with the inflation target

Measures of short-term inflation expectations increased over the past quarter and are at a high level (Graph 4.15). This is consistent with the higher cost of living that households are experiencing, the Reserve Bank's public commentary that inflation will increase further in the near term and general reports in the media of high inflation. The available evidence suggests that longer term inflation expectations remain anchored to the inflation target at this stage (Graph 4.16). Most medium- and long-term measures, including those from financial markets, remain within the inflation target range, suggesting that the current high inflation is expected to be relatively short lived. Long-term expectations of union officials have picked up to around 3½ per cent, the highest level since 2009.

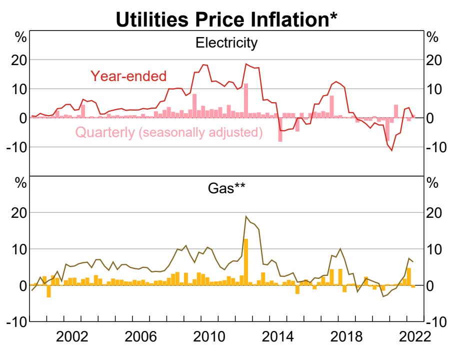
Inflation expectations can influence firms' and households' wage negotiations and price-setting behaviour, and a number of firms in the business liaison program have noted that higher inflation outcomes have been a factor in recent wage negotiations. In general, though, firms expect wages growth over coming quarters to be less than current headline inflation, in part because some of the recent strength in inflation is seen as temporary. Some firms that do expect their base wages to increase by more than in the past also noted that the tight labour market was a major factor driving these wage expectations. A number of firms noted that they intend to look through some of the recent sharp inflation increases – a common practice in the past for wage setting – but are unsure as to how long they will be able to do so.

Graph 4.13



* 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 4.14



* Adjusted for the tax changes of 1999–2000.
** Includes other household fuels.
Sources: ABS; RBA

Reports of firms increasing prices in response to higher wages have so far largely been contained to professional services firms, where labour is the most significant cost and reports of higher wages growth have been more common.

Timely indicators suggest that wages growth has increased and will pick up further in the period ahead

Information from the Bank's liaison program and other business surveys suggests that private sector wages growth has picked up. In liaison, there has been a marked increase in the share of firms reporting realised average wage increases above 3 per cent (Graph 4.17). Many firms have continued to report that recent increases in average wages growth have been driven by larger regular or out-of-cycle increases for specific occupations or skills in high demand; in some cases, firms have reported paying higher increases to staff more broadly in response to elevated voluntary turnover. Reports of larger-than-average wage increases to date have been most common among construction and business services firms.

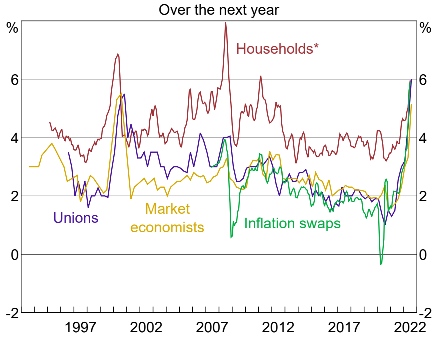
Liaison reports and surveys of wages growth expectations point to a further lift in wages growth over coming quarters (Graph 4.18). Over 60 per cent of firms that reported their expectations in the business liaison program in 2022 so far expect to raise wages by more than 3 per cent over the year ahead. Firms expect the pick-up will be broadly based, rather than limited to specific industries or occupations. The lift in expected wages growth reflects firms responding to higher voluntary turnover and stronger inflation.

In June, the FWC determined an increase of 5.2 per cent in the national minimum wage. Modern award wages will increase by a minimum of 4.6 per cent, with increases of up to 5.2 per cent for lower-paid workers (Graph 4.19). The increase was effective for most awards on

Graph 4.15

Short-term Inflation Expectations

Over the next year

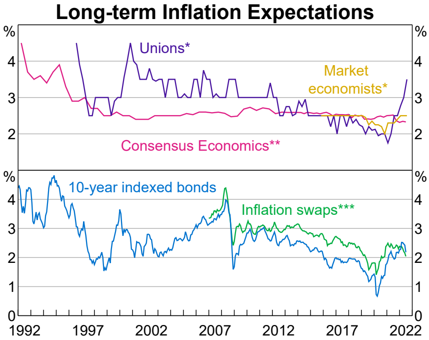


* Smoothed.

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

Graph 4.16

Long-term Inflation Expectations



* Average over the next 5–10 years.

** Average over 6–10 years in the future.

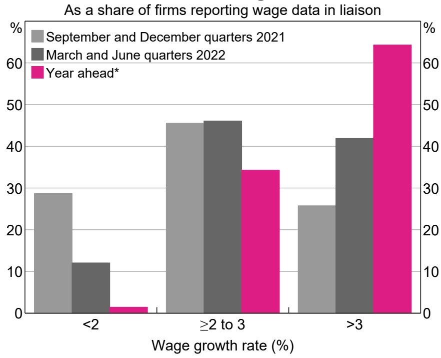
*** 5-years to 10-years forward.

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

Graph 4.17

Distribution of Wages Growth

As a share of firms reporting wage data in liaison



* Expectations for the year ahead for firms reporting in the March and June quarters of 2022.

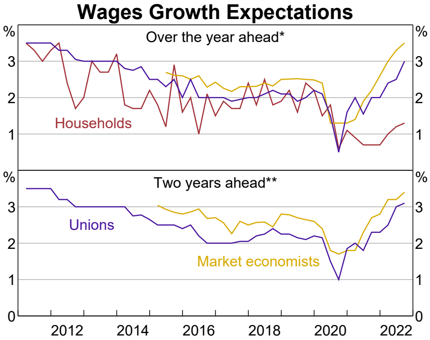
Source: RBA

1 July; a few industries that are still being impacted by the pandemic will have increases from 1 October, including aviation, tourism and hospitality. It is estimated that around one-third of all employees' wages are directly or indirectly linked to the decision.

Public sector wage announcements by a number of state governments are also expected to support wages growth over the next year. The New South Wales Government (Australia's largest employer) announced that it would raise its current (superannuation-inclusive) employee wage cap from 2.5 per cent to 3 per cent for 2022/23 and to 3.5 per cent in 2023/24 (conditional on productivity improvements). The Western Australian Government raised its wage policy for 2022/23 and 2023/24 from around 2.5 per cent to 3 per cent per year. The Tasmanian Government raised its expectation for wages growth in new industrial agreements from 2 per cent in 2021/22 to 2.5 per cent in 2022/23. The Queensland Government announced a new wages policy, under which future wage increases for workers on expiring collective agreements will be determined in individual enterprise negotiations rather than at a whole-of-government level (where wage increases had previously been set at 2.5 per cent). A number of state governments have also offered lump-sum payments to some of their public sector employees in 2022/23, in part to offset higher living costs.

Graph 4.18

Wages Growth Expectations



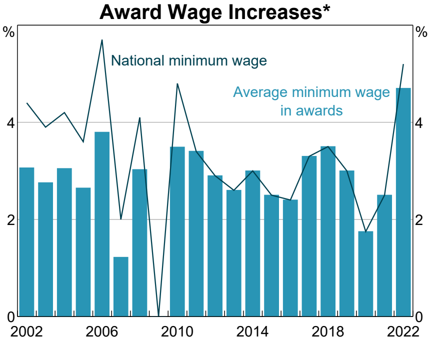
* The current calendar year for union expectations.

** 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

Graph 4.19

Award Wage Increases*



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

Sources: AFPC; AIRC; FWC; RBA

The superannuation guarantee increased from 10 per cent to 10.5 per cent of ordinary time earnings on 1 July 2022. Additional increases in the superannuation guarantee of 0.5 per cent are legislated to come into effect each year until 2025.

Wages growth increased in the March quarter but remained around its pre-pandemic pace

The WPI grew by 0.7 per cent in the March quarter and 2.4 per cent in year-ended terms. Private sector wages growth was 2.4 per cent for the third consecutive quarter (Graph 4.20). Public sector wages grew by 0.6 per cent in the March quarter and 2.4 per cent in year-ended terms; relatively few large enterprise agreements had increases scheduled in the quarter.

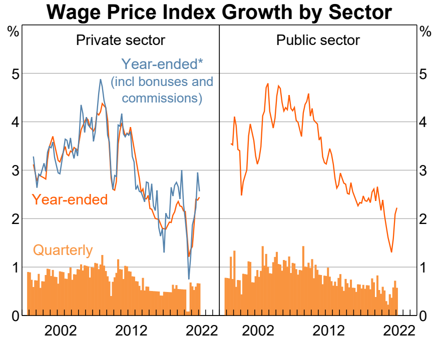
The share of industries with year-ended wages growth above 2.5 per cent increased in the March quarter, led by rental & real estate services, professional services, information media & telecommunications and manufacturing. Bonuses and commissions boosted growth in pay over the year; wages growth including bonuses and commissions increased at a slightly faster pace than the WPI in year-ended terms. Wages growth was between 2 and 3 per cent in year-ended terms in most states and territories (Graph 4.21); there has been little evidence in recent quarters that wages growth has been faster in states where the labour market tightened earlier.

Most wage increases were between 2 and 3 per cent over the year to the March quarter (Graph 4.22); the share of jobs experiencing wage increases above 3 per cent remains much lower than was seen in the 2000s, although this has picked up a bit recently. Wages growth has been led by a pick-up for jobs where wages are set by individual arrangement (Graph 4.23); the average size of wage increases for these jobs (conditional on a wage change having occurred) increased noticeably in the March quarter. By contrast, wages growth in public and private enterprise agreements was around 2 per cent in year-ended terms, which is below the rates that prevailed prior to the pandemic. Growth in award wages declined to 2.4 per cent in the March quarter, after being boosted recently by some jobs that received two award increases in 2021.

Real (inflation-adjusted) wages continued to decline in the March quarter, as consumer price inflation rose faster than wages growth (Graph 4.24). Cost-of-living pressures are likely to fall unevenly across households, as those with lower incomes spend a greater proportion on essential items and have relatively limited

Graph 4.20

Wage Price Index Growth by Sector

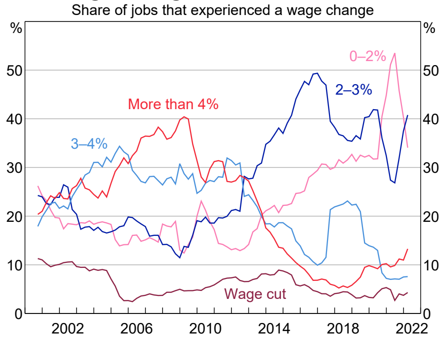


* Non-seasonally adjusted.
Source: ABS

Graph 4.22

Wage Changes of Different Sizes*

Share of jobs that experienced a wage change

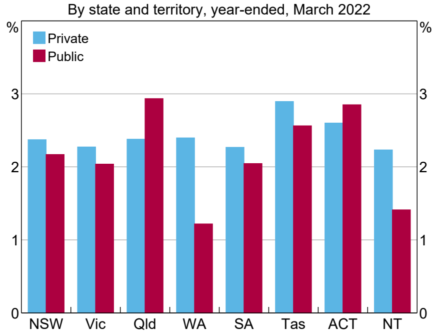


* Smoothed using a four-quarter trailing average.
Sources: ABS; RBA

Graph 4.21

Wage Price Index Growth*

By state and territory, year-ended, March 2022

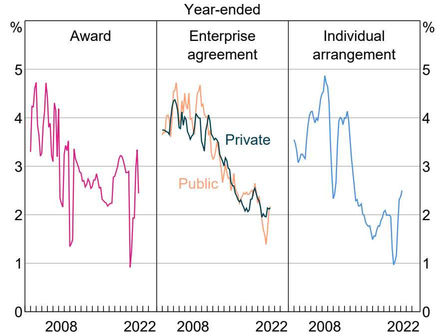


* Non-seasonally adjusted; excluding bonuses and commissions.
Source: ABS

Graph 4.23

Wages Growth by Pay-setting Method*

Year-ended



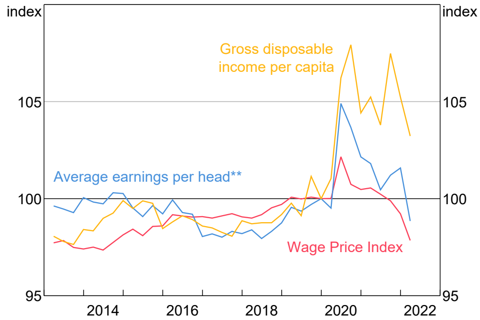
* Excludes bonuses and commissions.
Sources: ABS; RBA

savings buffers to draw upon. However, some of these households will have their real income supported by the FWC decision and by increases in employment. Further, growth in total household income (which includes items like financial income and social assistance receipts) has recently been stronger than labour income growth; this is supporting household purchasing power in the higher inflation environment.

Graph 4.24

Real Labour and Household Income*

December 2019 = 100



* Deflated using the headline Consumer Price Index.

** Non-farm.

Sources: ABS; RBA