

4. Inflation

Underlying inflation declined in the March quarter

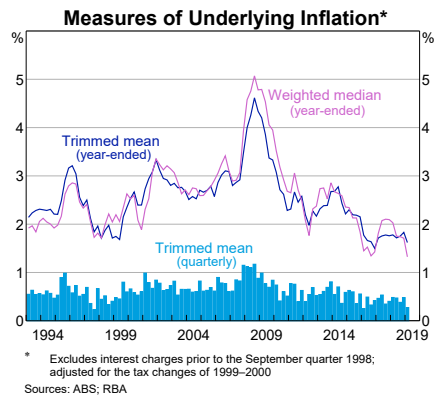
Underlying inflation declined to ¼ per cent in the March quarter and 1½ per cent over the year (Table 4.1; Graph 4.1). This was lower than expected both at the time of the February *Statement on Monetary Policy* and more recently by market forecasters. The deceleration in inflation in the quarter was broad based, but the slowing in the housing market and government cost-of-living initiatives were particularly important factors. The Bank’s assessment is that the March quarter inflation data suggest that domestic price pressures are more subdued than previously thought.

Headline inflation was 0.1 per cent (seasonally adjusted) in the quarter and 1.3 per cent over the year (down from 1.8 per cent) (Graph 4.2). Fuel prices fell by 9 per cent in the quarter. More recently, though, fuel prices have increased sharply and are likely to boost headline inflation in the June quarter.

Non-tradable inflation declined to 0.2 per cent in the quarter to be 1.8 per cent over the year (Graph 4.3). Inflation in the prices of new dwellings and administered items, including utilities, has declined over the past year. In contrast, there has been some upward pressure on inflation as a result of the decline in labour market spare capacity. This is clearest among the components of the Consumer Price Index (CPI) basket that have demonstrated a clear statistical relationship with the unemployment rate during the inflation targeting period; on

average, inflation in these components has increased gradually over the past two years but remains at a low level. The prices of tradable items (excluding volatile items) rose in the quarter, consistent with some pass-through to retail prices from the exchange rate depreciation over the past year. The ongoing drought in eastern Australia and recent floods in northern

Graph 4.1



Graph 4.2

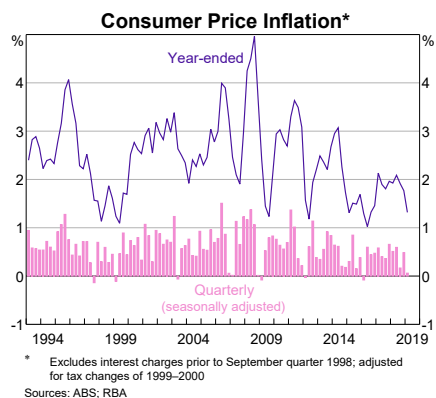


Table 4.1: Measures of Consumer Price Inflation

Per cent

| | Quarterly ^(a) | | Year-ended ^(b) | |
|---|--------------------------|-----------------------|---------------------------|-----------------------|
| | March quarter 2019 | December quarter 2018 | March quarter 2019 | December quarter 2018 |
| Consumer Price Index | 0.0 | 0.5 | 1.3 | 1.8 |
| Seasonally adjusted CPI | 0.1 | 0.4 | – | – |
| – Tradables | –0.4 | 0.0 | 0.4 | 0.6 |
| – Tradables (excl. volatile items) ^(c) | 0.2 | 0.2 | 0.3 | –0.1 |
| – Non-tradables | 0.2 | 0.8 | 1.8 | 2.4 |
| <i>Selected underlying measures</i> | | | | |
| Trimmed mean | 0.3 | 0.5 | 1.6 | 1.8 |
| Weighted median | 0.1 | 0.4 | 1.2 | 1.6 |
| CPI excl. volatile items ^(c) | 0.2 | 0.6 | 1.3 | 1.6 |

(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

Queensland have also boosted food price inflation.

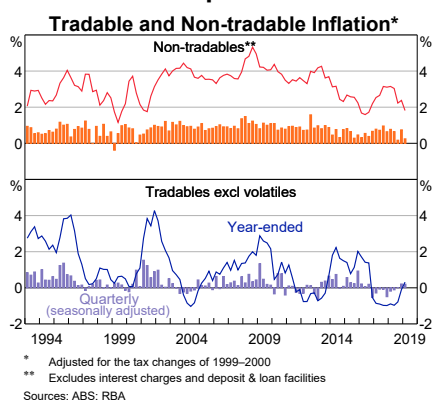
Price pressures related to housing are weak

Weaker conditions in the housing market have exerted downward pressure on inflation (see ‘Box C: Housing in the Consumer Price Index’).

Rent inflation declined a little to 0.4 per cent over the year to March (Graph 4.4). Rent inflation is at its lowest pace since 1993, although conditions continue to vary noticeably across capital cities in line with the divergence in housing market conditions. Rents are 5 per cent lower over the year in Perth, and have been falling since 2015. However, the pace of these falls has eased since mid 2017 as the Perth rental vacancy rate has declined significantly. Rent inflation has continued to decline in Sydney, reflecting further increases in the vacancy rate and declines in newly advertised rents. In contrast, rent inflation in Melbourne has been fairly stable implying that the substantial additions to the housing stock have been absorbed by the relatively fast pace of population growth in that city. Hobart rents have risen sharply over the past year.

New dwelling inflation slowed to 1.2 per cent over the year to March, its lowest rate since 2012 (Graph 4.5). The slowing in inflation over the past two years has occurred despite the high

Graph 4.3



level of residential construction activity. The cost of a newly built dwelling declined in Melbourne and Brisbane in the quarter because the slowing in housing market activity has led developers to offer larger purchase incentives. These incentives typically take the form of including appliances at no charge or direct ‘cash-back’ offers. In comparison, new dwelling inflation has been higher in Sydney; information from liaison suggests that strong demand and competition from infrastructure projects have contributed to higher material prices and subcontractor rates over the past few quarters.

Inflation in market services is also weak

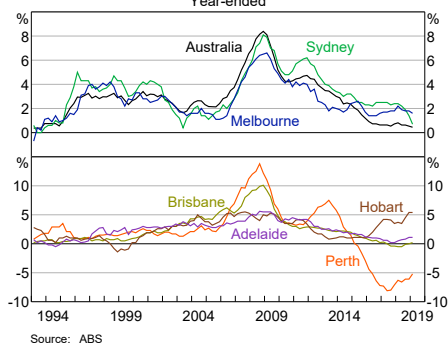
Inflation in the prices of market services, which include household services such as hairdressing, as well as financial services and meals out & takeaway, also declined in the quarter (Graph 4.6). Prices of market services have been growing at or below 2 per cent in recent years. The prices of these services are generally driven by domestic factors such as labour costs and commercial rents, which have experienced slower growth in recent years.

Administered price inflation has slowed over the year

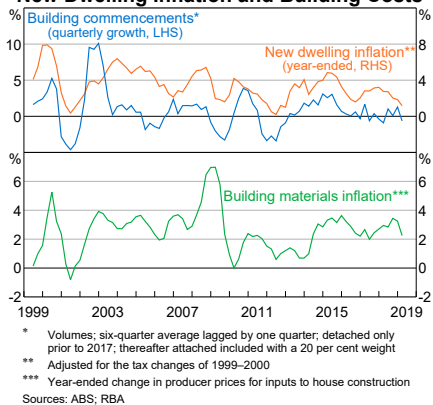
Utilities inflation has slowed considerably over the past year (Graph 4.7). Wholesale gas and electricity prices increased strongly from 2015–17, and the pass-through of these increases to final retail prices is now complete. Utilities prices fell by 0.4 per cent in the March quarter owing to declines in market offer gas and electricity prices in several states, as well as some scheduled reductions in standing offer prices.

Inflation in other administered prices has also declined since early 2018. These declines are the

Graph 4.4
Rent Inflation
Year-ended



Graph 4.5
New Dwelling Inflation and Building Costs

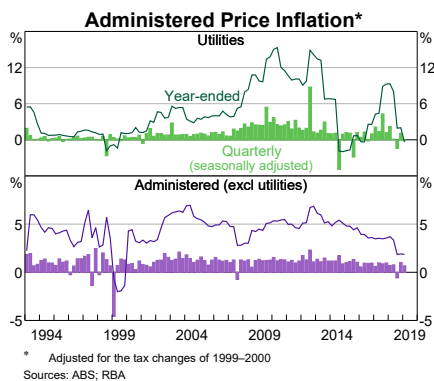


Graph 4.6
Market Services Inflation

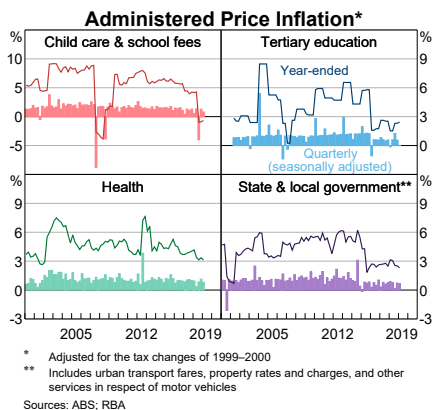


result of several pricing decisions, including below-average increases in state and local government charges and health insurance premiums, and the introduction of the new child care subsidy payment (Graph 4.8). Price increases for items that typically have their prices reset in the March quarter, such as education fees and some state government charges, were a little below average this year. The introduction of free TAFE courses for some students in Victoria and Queensland contributed to a decline in tertiary education inflation in the quarter.

Graph 4.7



Graph 4.8



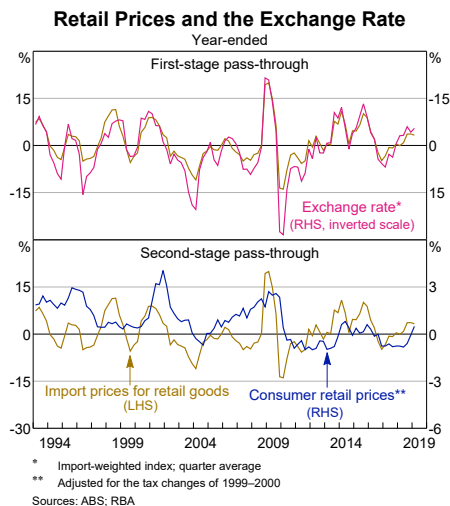
The earlier exchange rate depreciation is flowing into higher retail prices

Retail prices rose a little in the March quarter, to be 0.5 per cent higher over the year. This was the second consecutive quarter of price rises following a number of years of retail price deflation. The recent increase in retail inflation is consistent with the small depreciation of the exchange rate over the past two years (Graph 4.9). Retail price increases have been most noticeable for consumer durable items such as furniture, clothing and household appliances. Nonetheless, retail inflation remains low because an environment of elevated competition continues to place downward pressure on prices in the industry.

Unfavourable weather has led to higher grocery prices

Food prices have increased noticeably in the past couple of quarters (Graph 4.10). Fruit and vegetable price inflation increased in the March quarter because of supply shortages associated with flooding in northern Queensland and

Graph 4.9



heatwaves in Victoria. The ongoing drought in eastern Australia has also contributed to rising retail meat prices, particularly for beef and lamb, while the drought-related increase in grain input costs has put upward pressure on final prices for bread. Milk prices were also higher over the year following the introduction of drought-relief levies on supermarket milk in late 2018. Reports from liaison suggest that the once-off deflationary impact of the transition to ‘every day low price’ strategies on grocery prices may be abating.

Inflation expectations have declined a little, in line with other advanced economies

Short-term and long-term market-based measures of inflation expectations have declined in recent months (Graph 4.11; Graph 4.12). The recent declines have also occurred in other advanced economies, and appear to reflect a decline in expectations for global growth and hence inflation. While the initial decline in market-based measures of inflation expectations coincided with a sharp fall in oil prices, expectations have continued to drift lower as oil prices have increased more recently. Some survey-based measures of long-

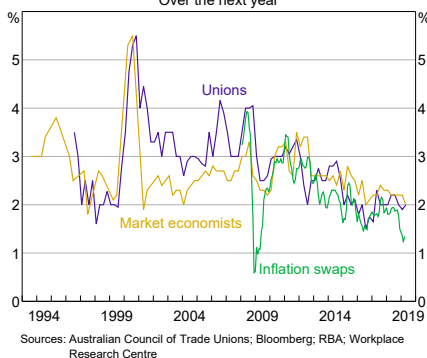
term inflation expectations for Australia have also declined a little recently.

Wages growth has picked up, but remains low

Growth in the Wage Price Index (WPI) was 0.5 per cent in the December quarter and remained steady at 2.3 per cent over the year. The pick-up in growth is stronger in the private sector, and when bonuses and commissions are included (Graph 4.13). Analysis of highly disaggregated WPI data on wage changes in individual jobs suggests that the recent strength in bonuses and commissions has been limited

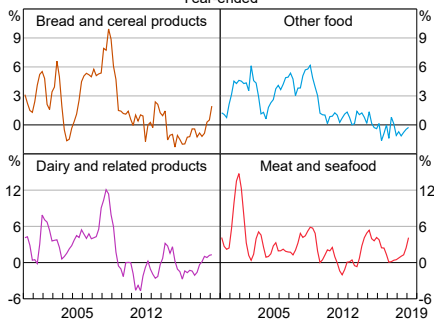
Graph 4.11

Short-term Inflation Expectations
Over the next year



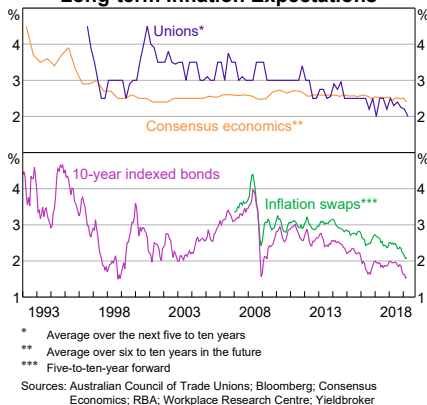
Graph 4.10

Grocery Price Inflation*
Year-ended



Graph 4.12

Long-term Inflation Expectations



to a very small fraction of jobs, although the share of workers receiving bonuses has increased. Wages growth is higher than it was a year ago in most industries (Graph 4.14). It remains highest in the healthcare & social assistance industry and relatively low in the mining and retail trade industries. The small pick-up in wages growth since 2016 is consistent with the gradual tightening of the labour market over that period. Real wages growth increased a little over 2018, but remains well below average.

Growth in average earnings per hour in the national accounts (AENA) had been low for some time, but over 2018 it increased to a

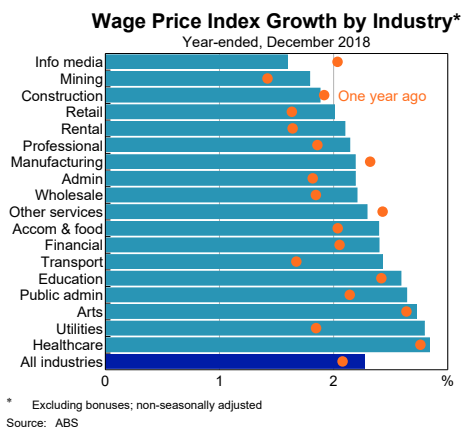
similar pace as growth in the WPI (Graph 4.15). AENA is a more volatile but broader measure of labour costs than the WPI because it captures non-wage payments such as allowances, superannuation and redundancy payments, as well as changes in the composition of employment. This includes employees who had moved from high-wage jobs in mining-exposed industries to lower-wage jobs in other industries. Both the rate of voluntary job turnover and employees' expectations of switching jobs have remained fairly stable despite relatively strong labour market conditions over the past year. As workers tend to receive an increase in pay when transferring jobs, the low level of voluntary job turnover in recent years is likely to have also contributed to subdued growth in AENA. At the same time, the rate of promotions within firms has remained fairly stable at a lower level since the global financial crisis.

The pick-up in wages growth since 2016 has been most evident for employees covered by awards and individual agreements. Meanwhile, wages growth for the average worker on an enterprise bargaining agreement (EBA) has remained fairly stable at low levels (see 'Box D: Trends in Wages Growth by Pay-setting Method'). While wage 'freezes' (no change in

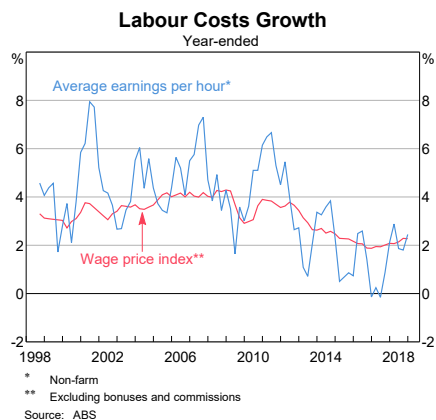
Graph 4.13



Graph 4.14



Graph 4.15



wages for one year or more) have become less common, the share of EBA-reliant employees receiving no change in wages remains elevated in industries such as construction and retail trade. Government policies have kept average wages growth in public sector EBAs stable at around 2½ per cent in recent years (Graph 4.16). There has been some pick-up in average wages growth in new federally registered private sector EBAs to around 3 per cent; however this will take some time to flow through to an increase in average EBA wages growth.

Expectations continue to point to a modest increase in wages growth

Information from the Bank’s business liaison program continues to point to a modest increase in private sector wages growth in the near term. More than three-quarters of firms surveyed expect wages growth at their firm to remain broadly stable over the year ahead, which is a little higher than a year ago. Other surveys of consumer and firm wage expectations are broadly consistent with liaison information; all have increased gradually over the past few years but remain subdued. This may in part reflect the low and stable price inflation recorded in recent years. ✎

