5. Inflation

Recent consumer price movements have been dominated by the impact of government policy responses to the COVID-19 pandemic, as well as movements in world oil prices. Examples of policy-driven price changes include the temporary introduction of free child care nationwide, free preschool in some states and a number of price freezes for administered services. Further, there have been large declines in rents since March as border closures have contributed to an increase in rental vacancy rates and state governments have required landlords to negotiate rent reductions for tenants in financial difficulty. More broadly, social distancing restrictions have led to substantial changes in consumption patterns – most notably, a shift away from services expenditure in favour of spending on household goods and grocery food – and this has affected pricing decisions. The sharp decline in economic activity and increase in spare capacity has also contributed to subdued underlying inflation over the past two quarters.

Responses to the pandemic have also affected wage movements. Many firms have responded to the effects of the pandemic by freezing wages, and in some cases by imposing temporary wage cuts for some, mostly senior, staff. Some planned wage increases have been deferred or reduced, including as a result of decisions by the Fair Work Commission (FWC) and some government employers. Some measures of wages growth, such as average earnings per hour (AENA), have been temporarily boosted by the JobKeeper wage subsidy as well as large compositional effects due to greater employment losses in lower paid jobs.

The effects on prices and wages of many of these responses to the pandemic are expected to unwind over the coming year. However, elevated spare capacity in the economy means it is likely that wage and price inflation pressures will be subdued for a considerable period.

CPI inflation picked up strongly in the September quarter as some earlier large price falls were unwound

Recent inflation outcomes have been unusually volatile as a result of the pandemic. The seasonally adjusted Consumer Price Index (CPI) rose by 1.5 per cent in the September quarter as a number of large price increases reversed earlier declines that had stemmed from the pandemic and related policy responses (Graph 5.1; Table 5.1). The increase in September was the largest quarterly increase in CPI inflation (excluding interest charges) since 2006, and followed a decline in June that was the largest since 1931. Headline inflation was 0.7 per cent over the year to September.

The main driver of the increase in the September quarter was prices for child care and some preschool services returning to more typical levels, after these had been fully subsidised by governments for much of the June quarter. Automotive fuel prices also rose, retracing some of the sharp decline earlier in 2020. Together, these price increases

Table 5.1: Measures of Consumer Price Inflation

Per cent

	Quarterly(a)		Year-ended(b)	
	September quarter 2020	June quarter 2020	September quarter 2020	June quarter 2020
Consumer Price Index	1.6	–1.9	0.7	–0.3
Seasonally adjusted CPI	1.5	–1.8	--	--
Selected underlying measures				
Trimmed mean	0.4	–0.1	1.2	1.2
Trimmed mean excl. imputed items (c)	0.3	0.1	1.4	1.5
Weighted median	0.3	0.1	1.3	1.3
CPI excl volatile items (d)	1.3	–1.3	1.0	0.4
CPI excl volatile items, child care, preschool & primary education and imputed items (c) (d)	0.2	0.3	1.7	2.0

(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) Imputed items are those that were imputed using headline CPI for all capital cities in the June or September quarter 2020

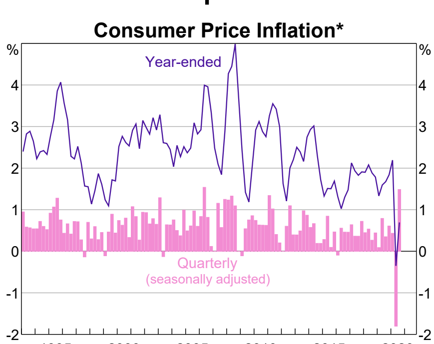
(d) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

contributed 1¼ percentage points to CPI inflation in the quarter (Graph 5.2). Prices continued to rise for a number of retail items, including household goods and motor vehicles, reflecting ongoing strong demand. Housing-related prices (excluding utilities) rose a little in the September quarter, with further falls in rents more than offset by a rise in prices for newly built dwellings.

The Australian Bureau of Statistics (ABS) has been able to return to normal price collection in most capital cities as social distancing restrictions have eased over recent months.[1] Imputed items comprised around 8 per cent of the basket in the quarter (compared with 12 per cent in the June quarter).

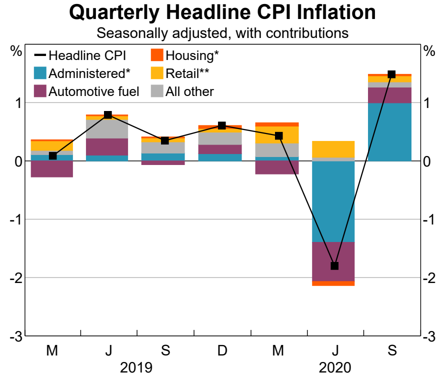
Graph 5.1



* Excludes interest charges prior to the September quarter 1998; adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 5.2



* Excludes utilities

** Includes fruit and vegetables

Sources: ABS; RBA

Trimmed mean inflation increased to 0.4 per cent in the September quarter and was 1.2 per cent over the year (Graph 5.3). Part of this increase was because of the unusual pattern of component-level price movements, as several prices bounced back after sharp falls in the June quarter. In particular, price rises for child care and automotive fuel, as well as the imputed price increases for unavailable items, accounted for much of the increase in trimmed mean inflation in the quarter. Abstracting from these temporary shifts, underlying inflationary pressures in the economy remain subdued; CPI inflation excluding volatile items, child care, preschool and imputed items was around 0.2 per cent in the quarter.

Government policies have driven large movements in some administered prices

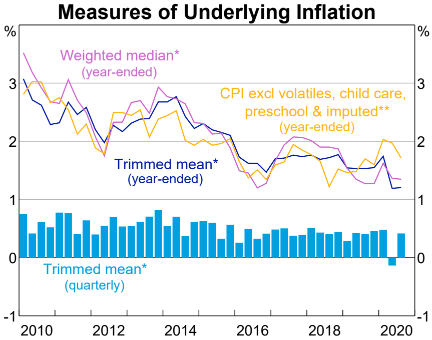
Administered price inflation increased sharply in the September quarter as several government subsidies implemented in response to the COVID-19 pandemic ended. The Australian Government had fully subsidised child care and before- and after-school care services from 6 April to 12 July 2020, which meant prices fell to zero during this period. Prices returned to more normal levels in the September quarter in all cities except Melbourne, where child care centres remained closed for much of the quarter in accordance with public health restrictions. In addition, preschool fees returned to full price in Queensland after being waived for the second term of the school year. The end of these subsidies meant child care prices increased sharply in the quarter, and to a lesser extent preschool & primary education prices. Together, the end of these policies contributed almost 1 percentage point to the increase in headline CPI in the September quarter. However, the price levels for these categories remain well below their pre-COVID-19 levels (Graph 5.4). Preschool fee waivers in New South Wales and Victoria have been extended until the end of the year – headline inflation will be boosted in early 2021 as these waivers are lifted.

Automotive fuel prices increased following earlier falls

Fuel prices increased in the September quarter following a sharp fall over the first half of 2020 (Graph 5.5). The 9 per cent increase in the quarter contributed ¼ percentage point to quarterly headline inflation. Fuel prices declined slightly in the month of October. At current

Graph 5.3

Measures of Underlying Inflation



* Seasonally adjusted

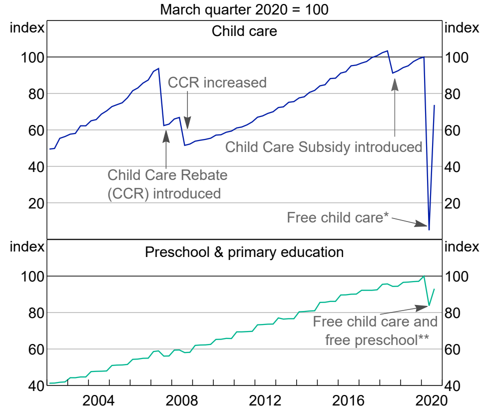
** Not seasonally adjusted; excludes fruit, vegetables, automotive fuel, child care, preschool & primary education and items that were imputed using headline CPI for all capital cities in the June or September quarter 2020

Sources: ABS; RBA

Graph 5.4

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 two in Queensland and terms two to four in New South Wales and Victoria for preschool

Sources: ABS; RBA

levels, automotive fuel prices are expected to have little impact on headline CPI in the December quarter.

Price rises for other administered prices were generally smaller than is typical in the September quarter

A number of other administered prices were reset in July. Property rates & charges increased by less than is typical in the September quarter, largely because of price freezes in Brisbane, Canberra, Darwin and Hobart. This led to a seasonally adjusted price decline for these items (Graph 5.6). Other motor vehicle-related prices, which had declined earlier in the year due to the introduction of temporary free parking offers in some cities, increased a little in the September quarter. The CPI measure of urban transport fares declined further, reflecting the temporary introduction of discounted off-peak transport prices in Sydney.

Prices for utilities, which account for around 5 per cent of the consumption basket, declined in the September quarter. In July, the Australian Energy Regulator's Default Market Offers – which are effectively caps on standing offer electricity prices in New South Wales, South Australia and southeast Queensland – were reduced, and the number of offers covered by the caps was expanded. These price reductions were partly offset by prices normalising in Brisbane, Canberra and Perth as one-off government rebates applied in the previous quarter expired. Gas prices declined, driven by a reduction in distribution charges in Sydney. Water & sewerage prices declined due to changes in water authorities' pricing approaches in Adelaide and Sydney.

Utilities inflation has been subdued for the past two years and is likely to remain low for some time. Wholesale gas prices have fallen in recent months alongside lower international prices. Lower wholesale gas prices and increased generation capacity from renewable energy projects continue to exert downward pressure on wholesale electricity prices (Graph 5.7). Additionally, retail utilities prices in Canberra, Darwin, Hobart and Perth are expected to remain broadly unchanged until 2021 due to state government price freezes.

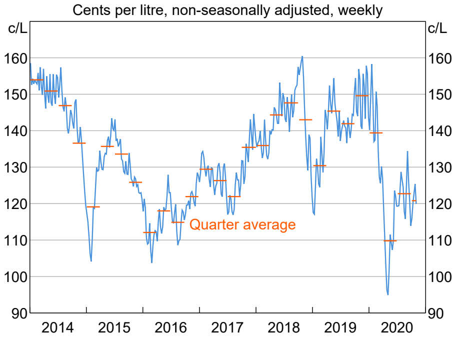
Retail prices increased in the quarter

Retail prices, which comprise just over a quarter of the CPI, rose a little in the September quarter, to be 2.2 per cent higher over the year. Higher prices for consumer durable items accounted for much of this increase. The pick-up in consumer durables inflation was broad based, but was again especially marked for furniture &

Graph 5.5

Unleaded Petrol Prices

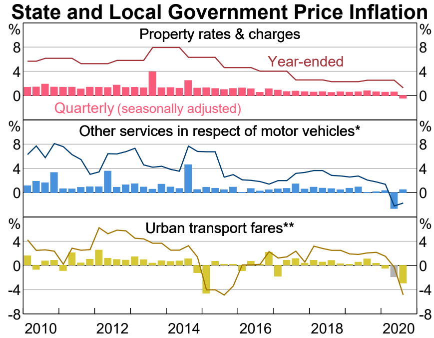
Cents per litre, non-seasonally adjusted, weekly



Sources: Australian Institute of Petroleum; RBA

Graph 5.6

State and Local Government Price Inflation



* Includes motor vehicle registration, roadworthiness tests, driver licence fees, parking fees, driving lessons and toll road charges

** Imputed using headline CPI in the June quarter 2020

Sources: ABS; RBA

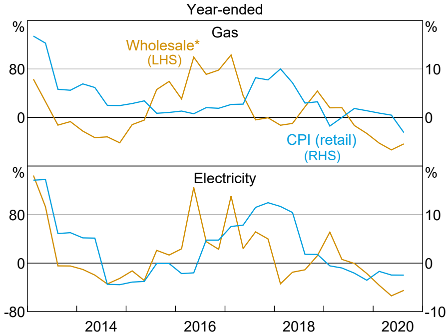
household appliances, which have seen strong demand related to a large share of people spending more time at home (Graph 5.8). Global supply disruptions affecting stock levels have also tended to boost prices for consumer durables. Motor vehicle price inflation also picked up due to price pressures from reduced domestic inventory and the introduction of new models at higher price points. These increases were partly offset by price declines for clothing & footwear, as demand for clothing has been weak and supply chain disruptions have affected clothing less than other consumer durables.

Food prices fell in the September quarter, but were 3.3 per cent higher over the year

Graph 5.7

Energy Price Inflation

Year-ended



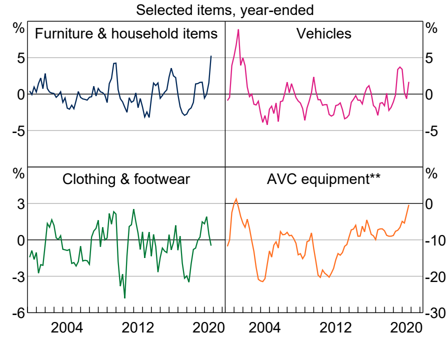
* Quarter-average spot prices weighted according to state generation capacity

Sources: ABS; AEMO; AER; RBA

Graph 5.8

Consumer Durables Price Inflation*

Selected items, year-ended



* Adjusted for the tax changes of 1999–2000

** Audio, visual & computing equipment

Sources: ABS; RBA

(Graph 5.9). Liaison reports suggest that supermarket discounting behaviour has returned to pre-pandemic patterns, following a reduction in discounting during periods of heightened demand earlier in the year. Price declines were most notable for packaged foods and bread & cereal products. In contrast, meat prices increased further as recent rainfall has induced some farmers to rebuild herds and flocks, reducing the supply of meat.

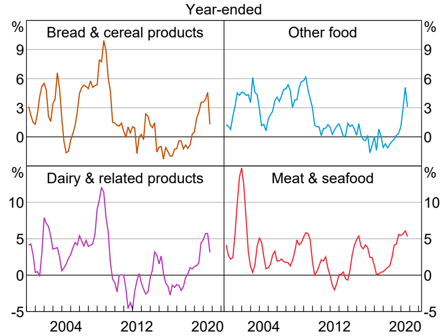
Housing inflation remains subdued as rents continue to fall

Housing-related inflation rose slightly in the September quarter, after slowing sharply in the first half of 2020 mainly because of declines in rental prices. As a result, housing-related prices, which comprise around one-sixth of the CPI basket, contributed only a little to headline CPI in the quarter. Prices for newly constructed dwellings increased by 0.5 per cent in the September quarter. Strong price rises in Perth drove this increase as state government grants supported demand for dwellings in the September quarter and led builders to reduce bonus offers (Graph 5.10). In contrast, prices for new dwellings fell in all other capital cities except Melbourne and Canberra. Future price increases will depend on the outlook for

Graph 5.9

Food Price Inflation*

Year-ended



* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

dwelling construction and how quickly housing demand recovers following the COVID-19 shock.

Rents were 1.4 per cent lower over the year to September, the largest year-ended decline in the 47 years since the quarterly series began (Graph 5.11). In part this is because of an increase in the stock of properties available for long-term rental, as some short-term holiday rental properties have been converted to long-term rentals following the introduction of travel restrictions. Declines in rental prices have also followed the introduction of state government policies that enable tenants to negotiate rent reductions if they are experiencing financial stress due to COVID-19. Information from liaison contacts suggests that, nationally, up to 8 per cent of residential tenants have successfully negotiated rent reductions since the end of March, although some of these were only temporary and have already been reversed. Rent reductions for ongoing tenancies directly affect measured rent inflation because the CPI captures rents paid on the stock of existing rental properties. Public housing rent reductions and rent relief as part of land tax rebate schemes have also contributed to rent price falls in some states.

Market services inflation remains weak

Prices for market services were unchanged in the September quarter (Graph 5.12). These prices include household services such as hairdressing and house cleaning, as well as financial services and meals out & takeaway, and comprise a little under a quarter of the CPI. The activity restrictions in Melbourne during much of the September quarter resulted in the ABS imputing prices for a number of items in that city. Elsewhere, the easing of restrictions allowed the ABS to return to normal price collection for most items, after imputed prices were used in the June quarter for a number of categories. This resulted in a measured increase in recreation, sport & culture prices, as the return to normal price collection unwound the imputed June quarter price decline for the sports participation and other sporting & cultural services expenditure classes. Offsetting this, strong competition between restaurants and takeaway food businesses led to lower prices for meals out & takeaway.

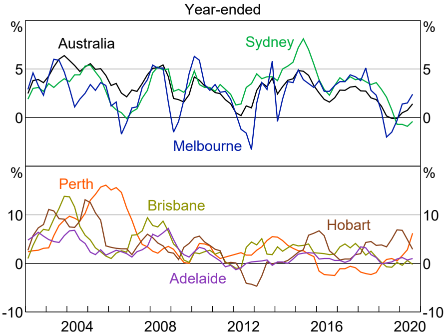
Survey-based measures of inflation expectations remain low

Wage- and price-setting behaviour can be affected by expectations about the future rate of inflation. Market economists' year-ahead inflation expectations have been revised down a

Graph 5.10

New Dwelling Inflation

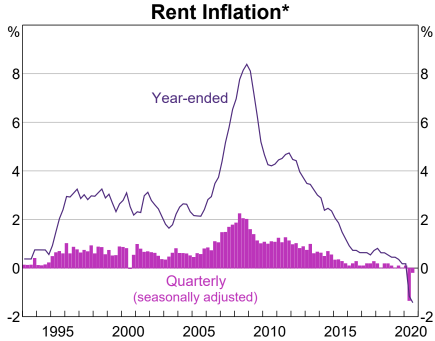
Year-ended



Source: ABS

Graph 5.11

Rent Inflation*



* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

little recently. In part this is because recent large anticipated changes in some price components (such as the effects of oil prices and government subsidies) are no longer influencing year-ahead expectations (Graph 5.13). In contrast, unions' short-term inflation expectations have picked up a little but remain relatively subdued. Long-term survey-based measures of inflation expectations are around 2–2½ per cent and remain consistent with the Bank's medium-term inflation target.

Wages growth declined in the June quarter

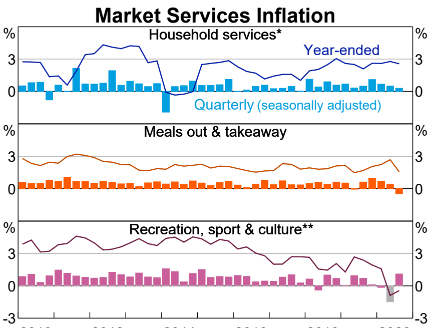
Growth in the Wage Price Index (WPI) slowed to 0.2 per cent in the June quarter, to be 1.8 per cent higher in year-ended terms (Graph 5.14). These quarterly and year-ended growth rates were the slowest in the history of the series. Private sector wages growth slowed to 0.1 per cent in the quarter as employers made significant adjustments to wages in response to the effects of COVID-19. In contrast, public sector wages growth was stable at 0.6 per cent in the quarter.

A small number of wage reductions weighed on growth in the June quarter. These were largest in professional, scientific & technical services, other services and construction; liaison evidence suggests that these cuts were largely temporary. Although wage increases are typically less common in the June quarter than in other quarters, the ABS noted that wage increases in the June quarter 2020 were even less common than usual.

Other measures of earnings have been boosted by JobKeeper, but this effect will fade over coming quarters

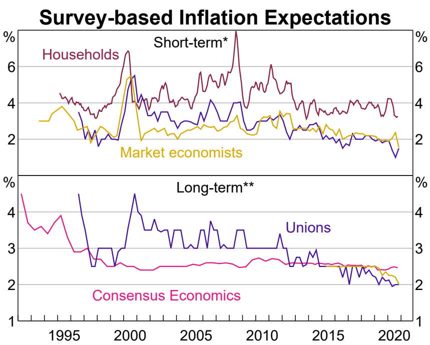
In contrast to the very low growth in the WPI in June, average earnings per hour were 8.2 per cent higher in the quarter (Graph 5.15). This spike was driven by the effects of the JobKeeper program on this measure of earnings, as well as compositional changes in the labour market in the quarter.

Graph 5.12



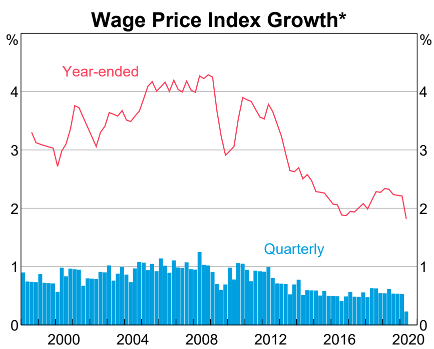
* Includes house cleaning, vehicle and home repairs, hairdressing and veterinary services
** Partly imputed using headline CPI in the June quarter 2020
Sources: ABS; RBA

Graph 5.13



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

Graph 5.14



* Total hourly rates of pay excluding bonuses and commissions
Source: ABS

- The JobKeeper program increased employees' average hourly earnings above their ordinary payments in cases where employees would otherwise have earned less per fortnight than the minimum JobKeeper payment of $1,500.
- The overall composition of jobs worked also shifted significantly in the June quarter; responses to the pandemic resulted in relatively more job losses in lower paid jobs. This compositional change lifted the average level of hourly earnings in the quarter. (In contrast, compositional change did not affect the WPI, which measures ordinary time rates of pay for a sample of jobs that is held fixed from quarter to quarter.)

The spike in measured average earnings per hour is expected to be reversed over coming quarters as the JobKeeper program tapers and as employment in lower paid occupations continues to recover.

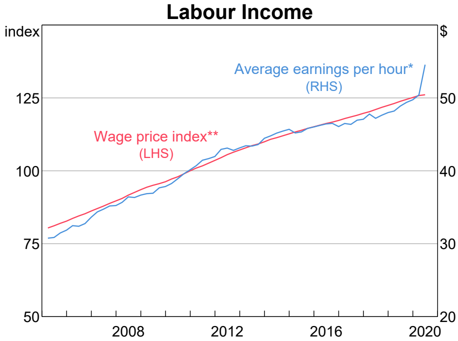
The changes to the JobKeeper program effective from 28 September are likely to see business eligibility decrease and fewer employees benefit from the minimum payment. In addition, the minimum fortnightly payment was reduced from $1,500 to either $1,200, or $750 for workers who had worked fewer than 20 hours per week prior to the pandemic. The lower payment rates that apply over the December quarter would fully cover wages costs for around 10 per cent of employees if they are eligible (Graph 5.16). This coverage is lower than that provided by the initial JobKeeper program; the original – higher – payment was a larger amount than that earned by around one-fifth of employees prior to the effects of COVID-19 (for instance, including some part-time workers). Although the changes from late September will reduce the boost to average earnings received by employees, JobKeeper will continue to provide a substantial subsidy to labour costs until the program's scheduled expiry in March 2021.[2]

Government decisions have affected the timing and size of some wage increases

The FWC awarded a 1.75 per cent increase to award wages this year. This was lower than in recent years, and the increase was delayed for most affected employees from July to November or February. The deferred increase has also affected many employees covered by enterprise bargaining agreements given a growing number of these agreements have pay increases linked to the award wage outcome.

Graph 5.15

Labour Income

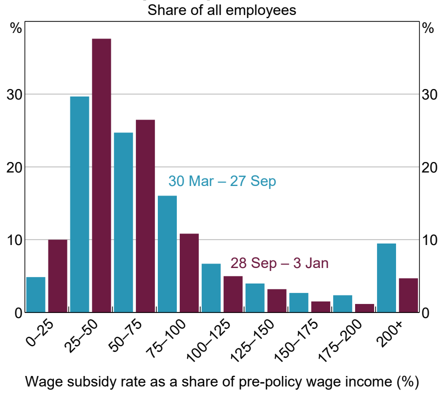


* Non-farm
** Excludes bonuses and commissions; December 2010 = 100
Source: ABS

Graph 5.16

JobKeeper Replacement Rates*

Share of all employees

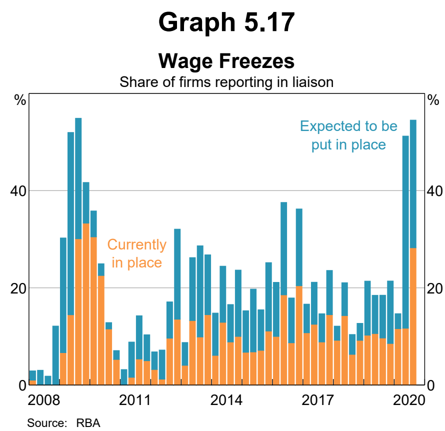


* Based on the distribution of wages in 2018, grossed up to 2020 by average earnings growth; data are replacement rates of the prevailing JobKeeper amount given weekly hours worked for all employees; JobKeeper eligibility is not taken into account
Sources: ABS; HILDA 18; RBA

Public sector wages growth was little changed in the June quarter, but wage freezes and deferrals will weigh on wages growth for the next few quarters. Some previously agreed wage increases have been deferred for up to 12 months, notably for Commonwealth and Queensland government employees. The NSW Industrial Relations Commission recently decided that pay rises in the current financial year for NSW government employees would be 0.3 per cent. The NSW Government has also announced plans to cap future wage increases to 1.5 per cent, lower than the 2.5 per cent increases applying in recent years.

Liaison suggests wage freezes became more widespread in the September quarter

Evidence from the Bank's liaison program suggests that wage freezes have been a common response by firms to the impact of the pandemic on business conditions. In the September quarter, more than half of reporting firms in this program indicated they either had a wage freeze in place or expected to implement one in the year ahead (Graph 5.17). Many firms have delayed remuneration reviews, which will weigh on wages growth in the near term, but may provide some catch up if delayed increases subsequently occur. In addition, most reported wage cuts put in place earlier in the year remain in place, although most firms expect these to be temporary.



Endnotes

[1] The only items that continued to be imputed using headline CPI in the September quarter for all capital cities were domestic and international holiday travel. However, activity restrictions in Melbourne during much of the September quarter meant that the ABS had to impute prices for a number of items in the Melbourne CPI. The ABS released a note setting out its approach to imputation of unavailable prices in the September quarter 2020, available at <abs.gov.au/articles/methods-changes-during-covid-19-period#measuring-the-consumer-price-index-september-quarter-update>.

[2] To assist with understanding the impacts on employing businesses' labour costs of the JobKeeper subsidy (and from payroll tax changes) the ABS reconstructed the previously discontinued Labour Price Index (LPI) for the March and June quarter 2020, available at <abs.gov.au/statistics/economy/price-indexes-and-inflation/wage-price-index-australia/jun-2020#spotlight-labour-price-index>.