4. Inflation

Inflation is high and picked up more than expected in the March quarter of 2022. Underlying inflation is also high and stronger than anticipated. Strong demand is enabling firms to pass through increases in input costs, which continued to drive strong inflation outcomes for durable goods and new dwellings in the March quarter. These pressures have now broadened to affect the prices of other items, including groceries. Inflation in the components that are most sensitive to domestic labour market conditions, including some market services, has picked up in recent quarters.

Wages growth picked up slightly in the December quarter but remained in line with the low rates observed in the years leading up to the COVID-19 pandemic. While wages growth was low for most industries, there were signs of the impact of the recent tightening in labour market conditions – for example, broader measures of wages growth that include bonuses and commissions were slightly stronger than base wages. More timely information from the Bank's business liaison program and business surveys suggests that growth in labour costs has picked up further over the course of this year, and that many firms now anticipate wages growth will increase more quickly in the period ahead. This is in line with the outlook for further labour market tightening, an upswing in job mobility and a strong focus by firms on retaining and attracting workers.

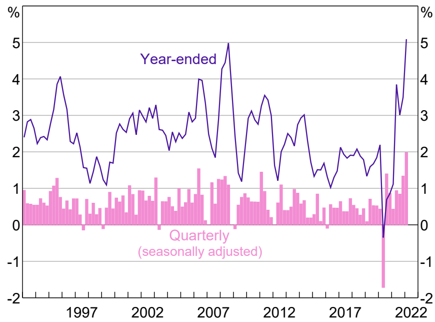
Inflation in the March quarter was very strong

The headline Consumer Price Index (CPI) increased by 2.1 per cent (2 per cent seasonally adjusted) in the March quarter and 5.1 per cent over the year (Graph 4.1; Table 4.1). This outcome was higher than anticipated a few months ago, in part reflecting much higher fuel prices due to Russia's invasion of Ukraine. Price increases for newly constructed dwellings and automotive fuel, which together comprise a little under 15 per cent of the CPI basket, accounted for close to half of the increase in the headline CPI in the quarter (Graph 4.2).

Although a few items continued making outsized contributions to growth in the CPI, inflationary pressures broadened further in the March quarter, with price increases picking up for many grocery items and a number of market services. Around 70 per cent of the CPI basket had an annualised inflation rate above 2.5 per cent in the quarter, which is comparable

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]	
	March quarter 2022	December quarter 2021	March quarter 2022	December quarter 2021
Consumer Price Index	2.1	1.3	5.1	3.5
Seasonally adjusted CPI	2.0	1.3	–	–
– Tradables	2.7	1.8	6.8	4.9
– Tradables (excl volatile items)[c]	1.7	1.4	3.6	2.2
– Non-tradables	1.6	1.2	4.2	2.8
Selected underlying measures				
Trimmed mean	1.4	1.0	3.7	2.6
Weighted median	1.0	0.9	3.2	2.5
CPI excl volatile items[c]	1.6	1.2	4.0	2.6

(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

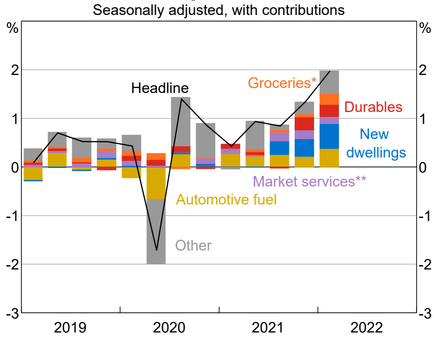
to the levels seen during the period of elevated inflation in Australia prior to the global financial crisis (Graph 4.3).

Measures of underlying inflation were also very strong in the March quarter. Trimmed mean inflation was 3.7 per cent over the year and 1.4 per cent in the quarter – the strongest quarterly outcome since the inflation targeting era began in 1993 (Graph 4.4; Table 4.1).

Graph 4.2

Quarterly CPI Inflation

Seasonally adjusted, with contributions

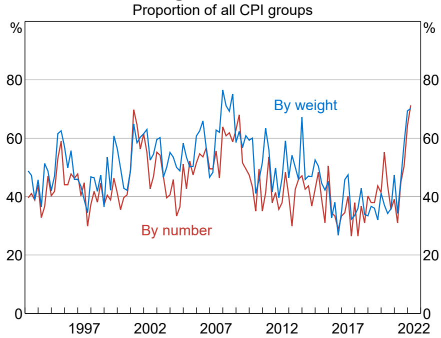


* Excludes fruit and vegetables.
** Excludes domestic travel and telecommunications.
Sources: ABS; RBA

Graph 4.3

CPI Items Rising More than 2.5 Per Cent*

Proportion of all CPI groups



* Based on seasonally adjusted data; adjusted for the tax changes of 1999–2000; CPI items with annualised quarterly growth more than 2.5 per cent.
Sources: ABS; RBA

Fuel prices increased sharply in the quarter, making a large contribution to headline inflation

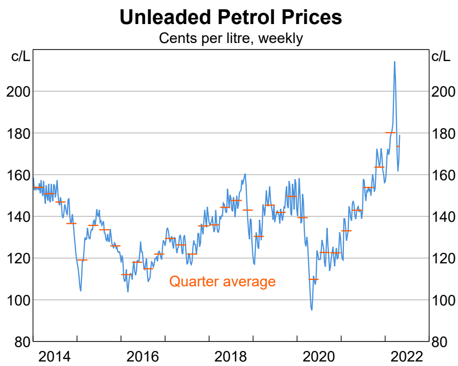
Fuel prices increased by 11 per cent in the March quarter to a record high level, contributing close to 0.4 percentage points to headline inflation in the quarter (Graph 4.5). This was primarily due to the increase in global oil prices following Russia's invasion of Ukraine, alongside strengthening global demand after the easing of COVID-19 restrictions. Fuel prices increased by 35 per cent over the year to the March quarter – the largest annual increase since 1990. However, fuel prices have since decreased due to the reduction in fuel excise and declines in oil prices; if sustained around current levels, fuel will subtract from quarterly headline inflation in the June quarter.

Pass-through of upstream cost pressures continued to drive strong inflation outcomes for new dwellings and durable goods …

The upstream cost pressures that have boosted the prices of new dwellings and durable goods since the latter part of 2021 continued in the March quarter. Prices for new dwelling construction, which make up just under one-tenth of the CPI basket, continued to increase significantly – prices were up by 5.7 per cent in the March quarter to be 13.7 per cent higher over the year. This was driven primarily by further substantial increases in the prices charged by builders in all capital cities, particularly in Perth (which saw a 15.8 per cent increase). 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 4.2 per cent in the March quarter and 15.4 per cent over the year (Graph 4.6).

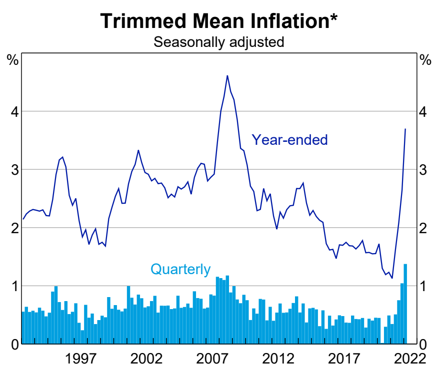
Prices for new dwellings also increased because fewer government grants were paid out in the March quarter than in the December quarter – this accounted for close to one-quarter of the

Graph 4.5



Sources: Australian Institute of Petroleum; RBA

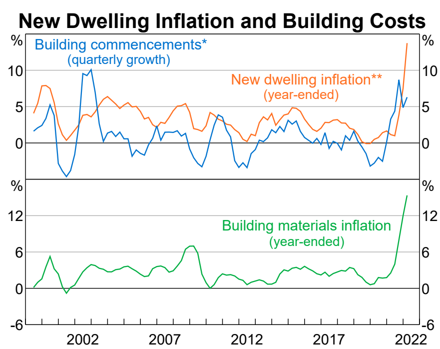
Graph 4.4



* 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 4.6



* Six-quarter average lagged by one quarter.

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

Sources: ABS; RBA

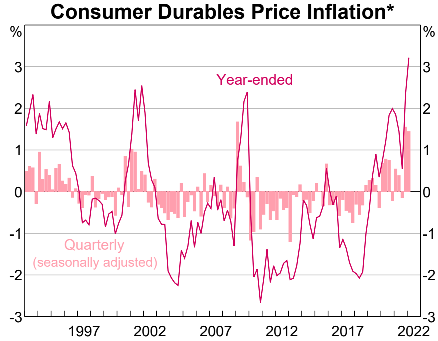
total increase in new dwelling prices (Graph 4.7). The number of grants paid out is expected to decline further over time, which will boost measured inflation as prices measured in the CPI converge to the prices charged by builders. However, the effect on inflation in a given quarter will vary depending on how many grants are paid out during that period.

Consumer durables inflation increased at its fastest pace in more than three decades, at a little over 3 per cent in year-ended terms (Graph 4.8). This reflected ongoing global supply chain disruptions, sustained global and domestic demand, and high shipping costs. Price increases were broadly based across most items within the durables category (Graph 4.9). The exception was clothing and footwear, where firms increased discounting activity by a larger-than-usual amount to reduce excess summer stock. Nonetheless, liaison suggests that some firms have increased base prices for their new winter stock.

Reports of non-labour input cost pressures remain widespread across goods-related firms. These pressures are likely to persist for longer than previously expected, because of the Russian invasion of Ukraine and renewed lockdowns in China. Additional demand for household goods and building materials induced by the flooding along the east coast is also expected to contribute to inflationary pressures in the near term. Most retailers in the Bank's liaison program have increased prices over recent months, or expect to do so over the months ahead, due to the persistence and magnitude of cost increases. To date, many retailers have limited price increases to items where cost pressures have been most pronounced or where demand is relatively inelastic; only a small share of firms have undertaken across-the-board price increases.

Graph 4.8

Consumer Durables Price Inflation*

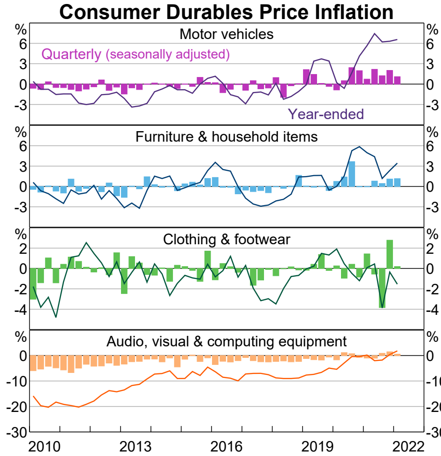


* Adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA

Graph 4.9

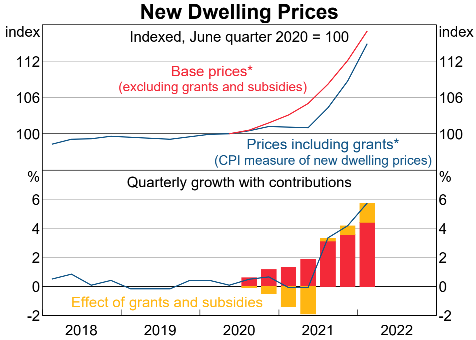
Consumer Durables Price Inflation



Sources: ABS; RBA

Graph 4.7

New Dwelling Prices



* Government housing construction grants include HomeBuilder and state government grants.

Sources: ABS; RBA

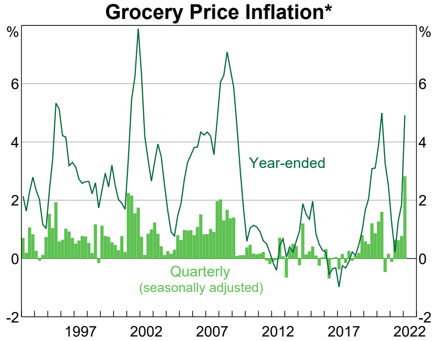
… and broadened to affect the prices of many grocery items

Grocery prices have also picked up strongly over recent months as supermarkets passed through supplier cost increases and reduced discounting activity in response to supply disruptions (Graph 4.10). Grocery prices (excluding fruit & vegetables) increased by 2.8 per cent in the quarter – the strongest quarterly outcome since 1983 – with prices 4.9 per cent higher than a year ago. Retailers in the Bank's liaison program have become more willing to accept price increases from their suppliers due to the broad-based cost increases their suppliers have faced, including for inputs such as fertilisers, chemicals, shipping and packaging. Price increases for most fresh food categories were strong in the quarter, including for meat, which continued to be affected by limited supply as farmers restock herds.

Prices of fruit & vegetables increased by 2.3 per cent in the quarter to be 6¾ per cent higher over the year. This primarily reflected supply chain disruptions and higher input costs, such as for transport and fertiliser. Flooding in production areas of New South Wales and Queensland also disrupted supply in early March, placing additional pressure on vegetable prices late in the quarter.

Graph 4.10

Grocery Price Inflation*



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

Sources: ABS; RBA

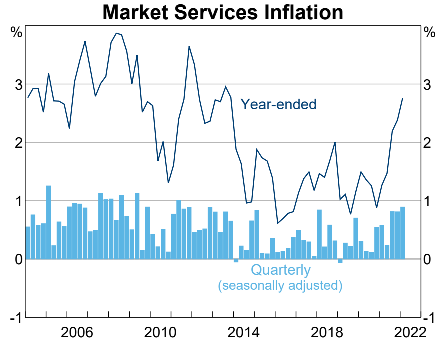
Domestic inflationary pressures have started to pick up

Inflation in the prices of market services, which account for a little over one-fifth of the CPI basket, picked up further in the March quarter to be 2.8 per cent higher over the year – the fastest annual increase since 2013 (Graph 4.11). The prices of these services are generally among the most sensitive to domestic labour costs, although increases in non-labour costs have driven the price increases for some of these services in recent quarters. Price increases were particularly strong for household services that have been experiencing acute labour shortages such as hairdressing and vehicle repair, and for domestic travel and accommodation.

Prices of meals out & takeaway increased by 0.7 per cent in the quarter as firms passed through increases in both labour and non-labour costs (Graph 4.12). Underlying price increases were partly offset by greater use of state government vouchers such as the NSW 'Dine & Discover' and Melbourne's 'Melbourne Money' vouchers. Many of these vouchers are yet to be redeemed and will continue to weigh on measured market services inflation in the June quarter. Prices for domestic travel and accommodation services increased by 2.5 per cent in the quarter in seasonally adjusted terms, reflecting strength in demand for domestic holidays.

Graph 4.11

Market Services Inflation



Sources: ABS; RBA

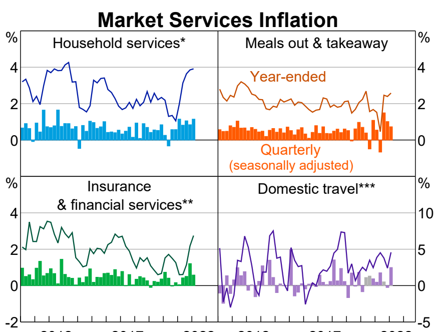
Rents – accounting for around 6 per cent of the CPI basket – increased by 0.6 per cent in the March quarter, after increasing by 0.1 per cent in the previous quarter. This is the strongest quarterly outcome since the September quarter of 2014. Rents in Sydney and Melbourne increased modestly, driven by increases for detached houses; in Sydney, this is the first quarterly increase in CPI rents since 2018 (Graph 4.13). 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.

Growth in administered prices remains around pre-pandemic rates

Administered prices (excluding utilities) rose by around 1.3 per cent in the March quarter and 3.7 per cent over the year, broadly in line with pre-pandemic trends. The effects of freezes and rebates implemented early in the pandemic have mostly faded but changes to other government policies continue to affect prices. Tertiary education prices increased by more than 5 per cent in the quarter in seasonally adjusted terms, driven by the changes in the federal government's contribution scheme for university courses (Graph 4.14). Prices for preschool and primary education also increased strongly in the quarter following the commencement of the new school year and the end of a two-year free preschool period in Victoria. Child care prices increased only slightly, with underlying price increases partially offset by the increase in the child care subsidy rate for families with more than one child and the NSW Before and After School Care voucher; these changes will continue to weigh on child care prices in the June quarter. Price increases for medical and hospital services were broadly in line with pre-pandemic rates.

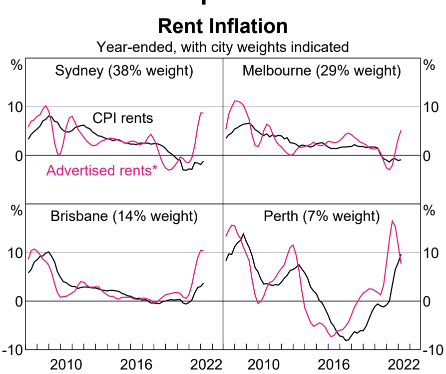
Retail electricity prices declined by 1.6 per cent in the March quarter, continuing the downward trend of recent years; prices are now over 11 per cent lower than their peak at the end of 2018, in part reflecting increased supply of renewable energy (Graph 4.15). While wholesale electricity prices have picked up strongly in recent months, information from liaison suggests that wholesale prices typically comprise only around one-third of retail

Graph 4.12



* Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.
** Excludes deposit & loans to June quarter of 2011.
*** Imputed using headline CPI in the June and September quarters of 2020 and September quarter of 2021.
Sources: ABS; RBA

Graph 4.13



* Hedonic three-month average.
Sources: ABS; CoreLogic; RBA

electricity bills and that pass-through is gradual. Retail gas prices increased by 4.4 per cent in the quarter, driven by a 10.9 per cent rise in Melbourne (largely due to the annual price reviews that factored in rising wholesale and network costs). The sharp increase in wholesale energy prices observed in recent quarters suggests that retail energy prices could increase in the period ahead.

Short-term inflation expectations have increased further in recent months, but long-term expectations remain consistent with the inflation target

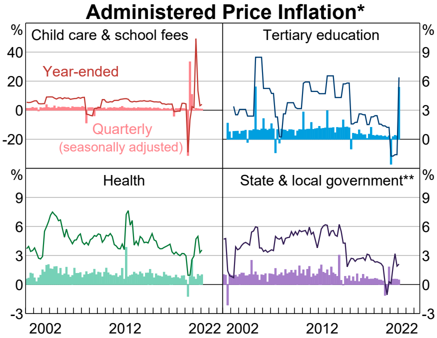
Survey-based measures of short-term inflation expectations have increased further over recent months to be around their highest levels in many years (Graph 4.16). Most measures of long term inflation expectations remain around 2½ per cent, although expectations of union officials have picked up to around 3 per cent, the highest level since 2012 (Graph 4.17).

Wages growth remained around its pre-pandemic pace in the December quarter …

The Wage Price Index (WPI) grew by 0.7 per cent in the December quarter, and 2.3 per cent in year-ended terms. Private sector wages growth remained at 2.4 per cent over the year, with

Graph 4.14

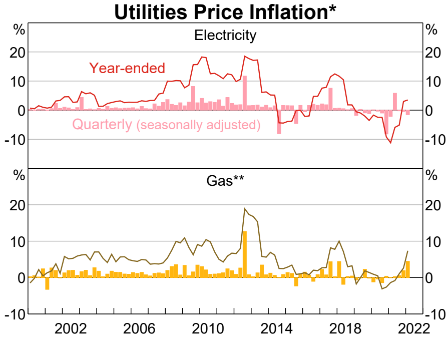
Administered Price Inflation*



* 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 4.15

Utilities Price Inflation*

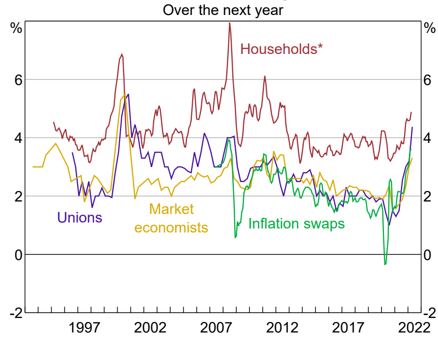


* Adjusted for the tax changes of 1999–2000.
** Includes other household fuels.
Sources: ABS; RBA

Graph 4.16

Short-term Inflation Expectations

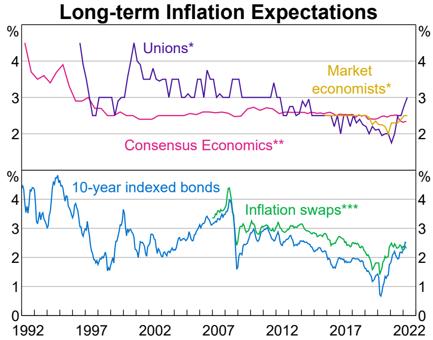
Over the next year



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

Graph 4.17

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

wages growth for jobs covered by enterprise agreements showing little sign of picking up above recent low rates (Graph 4.18). Wages growth in most industries was around pre-pandemic norms of 2–2.5 per cent (Graph 4.19). Exceptions to this included accommodation & food and retail trade, where stronger growth was largely due to some workers on modern awards receiving two wage increases in 2021 following the delay to some modern award implementations in 2020. Consistent with a tightening in labour market conditions, measures of private sector wages growth that include bonuses and commissions have grown faster than base wages in recent quarters, with growth averaging around 3 per cent in the December quarter in year-ended terms.

Public sector wages grew by 0.7 per cent in the quarter and 2.1 per cent in year-ended terms, as public sector wages policies continued to weigh on outcomes. The pick-up in quarterly growth was driven by scheduled increases in enterprise agreements for several large state employers, following a period of wage freezes.

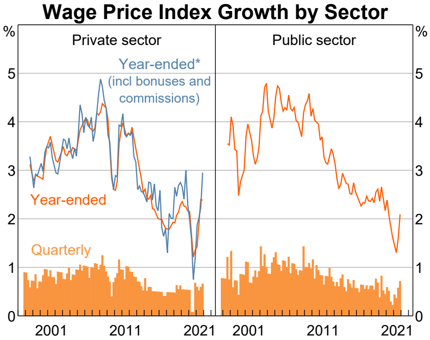
Real (inflation-adjusted) wages have declined since mid-2021 because consumer price inflation has picked up faster than wages growth; however, this decline has been less pronounced than in many other advanced economies. Households whose spending is concentrated in the categories where prices have risen the fastest – such as fuel, food, some durables and dwelling construction – have experienced a larger decline in real purchasing power; that said, the range of items in the CPI basket subject to larger-than-average price rises has broadened in recent quarters, implying that the share of households exposed to reductions in purchasing power has increased. Cost-of-living pressures from rising food and fuel costs are likely to fall unevenly across households, as lower-income households spend a greater proportion of their income on food and fuel and have relatively limited buffers of savings to draw upon. That said, growth in households' real incomes has recently been supported by increases in non-labour sources of income. Broad measures of growth in average earnings have remained highly volatile in recent quarters, due to large compositional changes in the workforce caused by the pandemic.

… though more timely indicators suggest that wages growth has increased recently 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 the past

Graph 4.18

Wage Price Index Growth by Sector

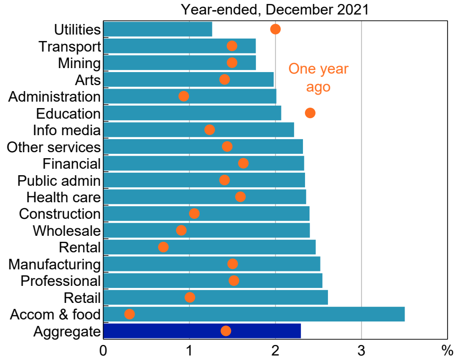


* Non-seasonally adjusted.
Source: ABS

Graph 4.19

Wage Price Index Growth by Industry*

Year-ended, December 2021



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

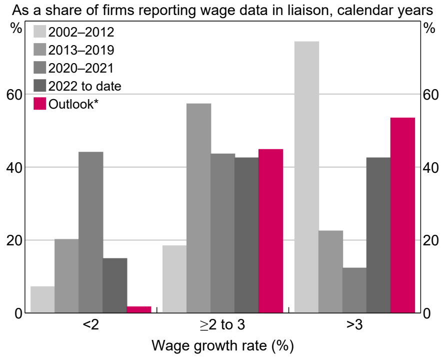
couple of months. While the majority of liaison contacts continue to report annual wages growth of 3 per cent or less, there has recently been a marked increase in the share of firms reporting average wage increases already above 3 per cent (Graph 4.20). Higher average wages growth at many firms is being driven by larger increases for specific occupations and skill sets in high demand, with these firms otherwise looking to non-base-wage measures to retain and attract staff. However, there have been a growing number of firms reporting more broad-based salary increases for all staff.

Liaison reports suggest that wages growth will pick up further over coming quarters. More than half of firms expect to pay wage increases above 3 per cent over the year ahead, consistent with further tightening in the labour market and a greater focus on attracting and retaining workers. By contrast, only a small share of firms expect to pay wage increases below 2 per cent; the share expecting to keep wages frozen has fallen to a very low level. In line with messages from liaison, surveys of wages growth expectations have also risen recently (Graph 4.21).

Graph 4.20

Distribution of Wages Growth

As a share of firms reporting wage data in liaison, calendar years

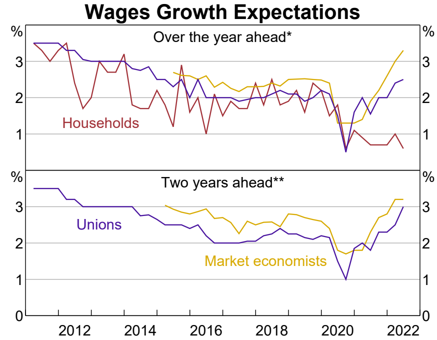


* Expectations for the year ahead for firms reporting in the March and June quarters of 2022.

Source: RBA

Graph 4.21

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