

5. Inflation

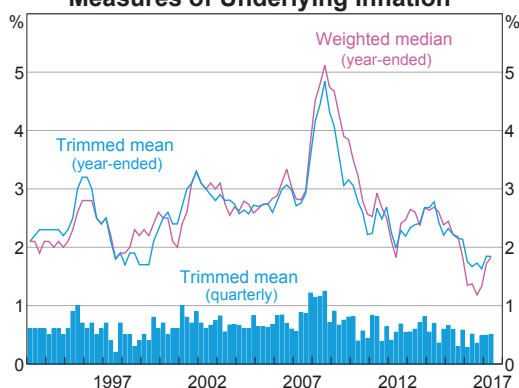
Measures of underlying inflation were steady in the June quarter at 0.5 per cent and 1¾ per cent over the year (Graph 5.1; Table 5.1). This was in line with the forecasts in the *May Statement* and provides further confidence that inflation has increased a little from its 2016 low. Headline inflation was 0.4 per cent in the quarter and 1.9 per cent over the year (Graph 5.2). This was a little lower than expected, in part due to fruit & vegetable inflation being weaker than anticipated in the quarter.

Inflation is low across the economy; over three-quarters of the components of the CPI basket have price growth below their long-run average. In general, this reflects the spare capacity in the economy and low wage growth. Other factors that are weighing on inflation include the low pace of rent growth, and the effect of heightened competition on retail prices. Increases in utilities and fuel inflation and further

increases in the tobacco excise partly offset these downward pressures over the year.

Over the past year, non-tradable inflation increased, while prices of tradable items declined (Graph 5.3). Non-tradable goods and services represent around two thirds of the CPI basket and their prices are mainly driven by domestic developments. A noticeable part of the increase in non-tradable inflation over recent quarters has been due to increases in the tobacco excise. However, inflation in other non-tradable components has also started to pick up (Graph 5.4). Inflation in market services (such as domestic household services, financial services and meals out & takeaway) is higher than it was a year ago. However, it remains low because around half of total costs in market services are labour costs. Wage growth remains low and, with productivity growing at around the same pace, there has been little growth in unit labour costs

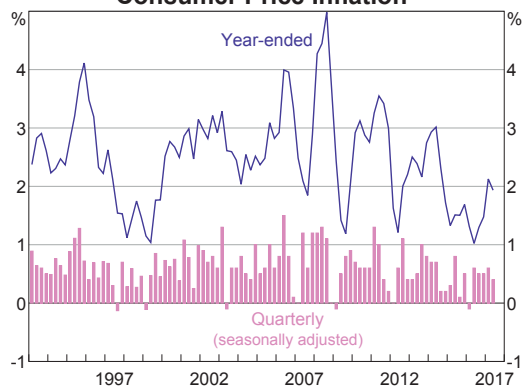
Graph 5.1
Measures of Underlying Inflation*



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

Sources: ABS; RBA

Graph 5.2
Consumer Price Inflation*



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

Sources: ABS; RBA

Table 5.1: Measures of Consumer Price Inflation
Per cent

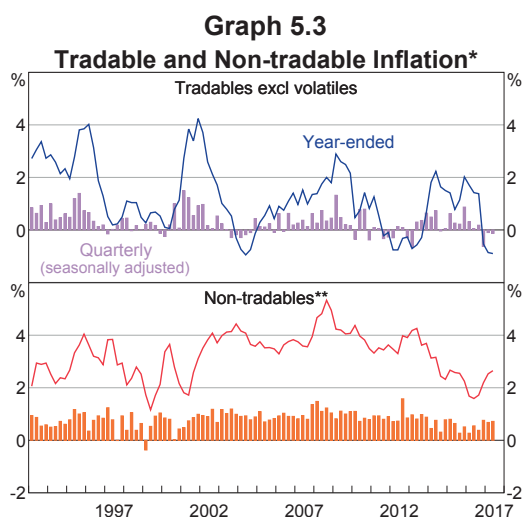
	Quarterly ^(a)		Year-ended ^(b)	
	June quarter 2017	March quarter 2017	June quarter 2017	March quarter 2017
Consumer Price Index	0.2	0.5	1.9	2.1
Seasonally adjusted CPI	0.4	0.6		
– Tradables	–0.3	0.5	0.4	1.3
– Tradables (excl volatile items) ^(c)	–0.1	–0.1	–0.9	–0.9
– Non-tradables	0.7	0.7	2.7	2.6
<i>Selected underlying measures</i>				
Trimmed mean	0.5	0.5	1.8	1.8
Weighted median	0.5	0.5	1.8	1.7
CPI excl volatile items ^(c)	0.5	0.4	1.5	1.5

(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



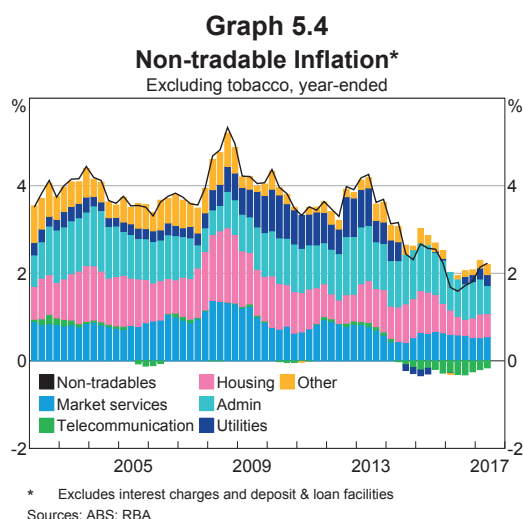
* Adjusted for the tax changes of 1999–2000

** Excludes interest charges and deposit & loan facilities

Sources: ABS; RBA

over recent years. Prices of telecommunication equipment & services have declined in recent years as a result of increased competition between service providers and technology-driven quality improvements.

Inflation in prices of utilities has picked up considerably in recent quarters (Graph 5.5). This is



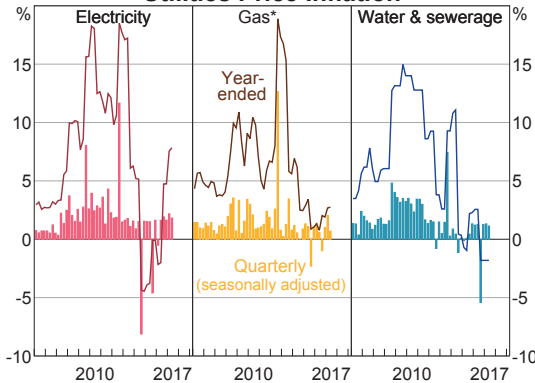
* Excludes interest charges and deposit & loan facilities

Sources: ABS; RBA

primarily due to a sharp rise in wholesale prices for gas and electricity in recent years, reflecting supply constraints following the closure of coal-powered electricity plants and a lack of industry investment widely attributed to uncertainty over electricity and environmental policies. Gas demand has also increased from the production of LNG for export. The announcement of price increases by a number of electricity and gas providers points to a

Graph 5.5

Utilities Price Inflation



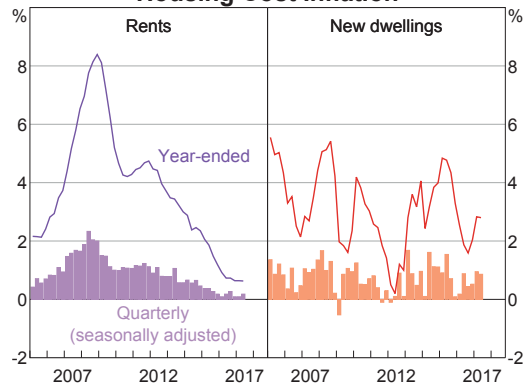
* Includes other household fuels
Sources: ABS; RBA

significant pick-up in utilities inflation in both the September quarter 2017 and the March quarter 2018. Along with the direct effects on household utility bills, there will also be indirect effects on inflation as a result of rising business input costs. Given the small size of utilities in business input costs, these indirect effects are estimated to be fairly small. However, this will vary by industry and there is uncertainty around the extent of the pass-through of higher costs to final prices.

Inflation in the cost of building a new dwelling continued to rise over the year (Graph 5.6). The high level of residential investment, in particular for the construction of apartments, has put upward pressure on the cost of some construction materials. While wage pressures remain fairly contained in the construction industry as a whole, information from the liaison program suggests there are labour shortages for some construction workers in the eastern state capital cities. Rent inflation has stabilised in the last few quarters but remains low. Conditions in rental markets vary considerably across capital cities, reflecting differences in vacancy rates, which in turn depend on housing supply and population growth; rent inflation is around its inflation-targeting average in Sydney and Melbourne, while rents have fallen markedly over the past year in Perth.

Graph 5.6

Housing Cost Inflation



Sources: ABS; RBA

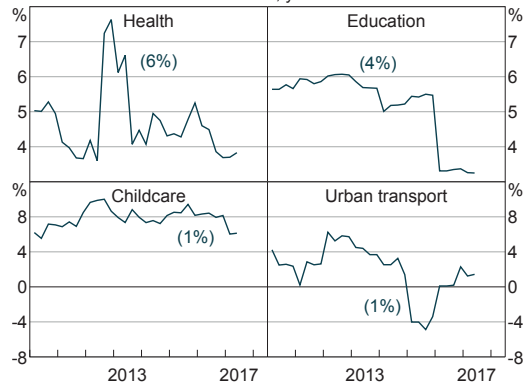
Apart from utilities, inflation in administered prices has declined in the past few quarters due to smaller-than-usual increases in childcare fees and private health insurance premia (Graph 5.7). Policy changes in New South Wales have also limited increases in preschool and primary education fees.

The prices of tradable items (excluding volatile items) have declined over the year. The 3 per cent appreciation of the exchange rate over the year to the June quarter led to a small decline in import prices in Australian dollar terms over the period. Prices of consumer durables have been

Graph 5.7

Administered Inflation*

Selected items, year-ended

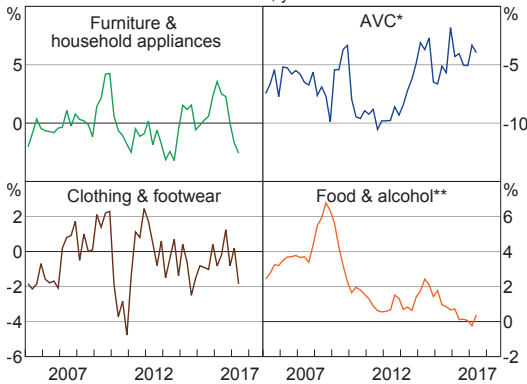


* Numbers in brackets represent the current effective weight in the CPI basket
Sources: ABS; RBA

flat or declined over recent years, as a result of increased competition from new foreign retailers, low wage growth and technological advances (Graph 5.8). The arrival of further new foreign retailers will be an important influence on consumer durable prices over the next few years. Inflation for the food & alcohol component (excluding fruit and vegetables) has declined over recent years as supermarkets have sought to gain market share by competing on prices.

Graph 5.8
Retail Inflation

Selected items, year-ended



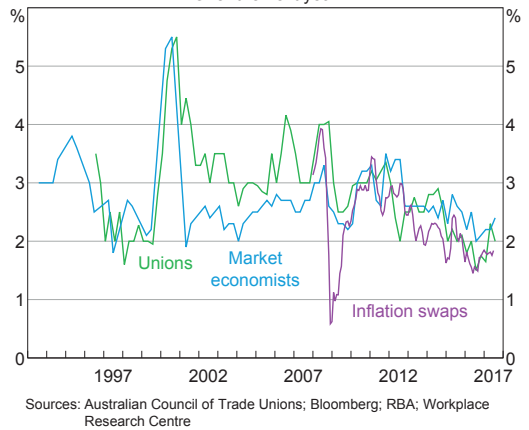
* Includes audio, visual and computing equipment & services
** Excludes fruit and vegetables
Sources: ABS; RBA

Fruit & vegetable prices were largely unchanged in the June quarter, with the boost to certain fruit and vegetable prices as a result of Cyclone Debbie offset by a decline in other vegetable prices. Cyclone-related supply disruptions are not expected to persist after the September quarter. Fuel prices declined in the June quarter, but contributed around 0.2 percentage points to headline inflation over the past year.

Measures of inflation expectations remain low, though most are a bit higher than in 2016. Both short-term and long-term financial market measures of inflation expectations have fallen slightly since the *May Statement*, however, these measures remain at higher levels than a year ago

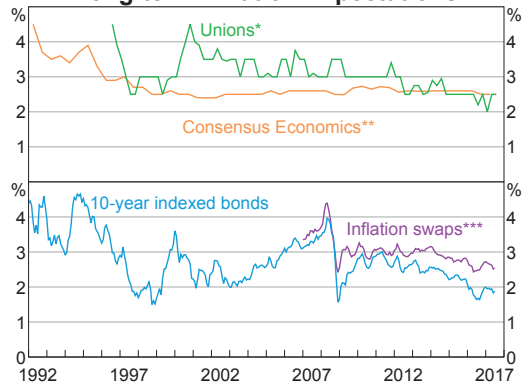
(Graph 5.9; Graph 5.10). Movements in short-term survey-based measures have been mixed. Market economist expectations for inflation over the year ahead have increased, while union expectations have declined. Long-term survey measures have been stable at around 2.5 per cent. ↗

Graph 5.9
Short-term Inflation Expectations
Over the next year



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

Graph 5.10
Long-term Inflation Expectations



* Average over the next five to ten years
** Average over six to ten years in the future
*** Five-to-ten-year forward
Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; RBA; Workplace Research Centre; Yieldbroker