Price and Wage Developments

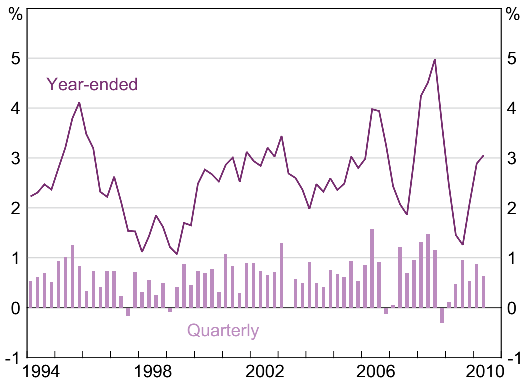
Recent Developments in Inflation

Inflationary pressures have moderated substantially since late 2008, broadly in line with the Bank's expectations. This moderation reflects the significant easing in demand and capacity pressures through 2008 and the first half of 2009, as well as the slowing in wage growth and more recently the effects of the exchange rate appreciation, all of which act over time to dampen inflation. The gradual easing in inflation due to these factors is likely to have largely run its course, with underlying inflation not expected to fall much further over the next year or so.

The consumer price index (CPI) increased by 0.6 per cent in the June quarter, to be 3.1 per cent higher over the year (Table 12, Graph 73). A large rise in tobacco prices contributed 0.4 percentage points

Graph 73

Consumer Price Inflation*



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

Sources: ABS; RBA

Table 12: Measures of Consumer Price Inflation

Per cent

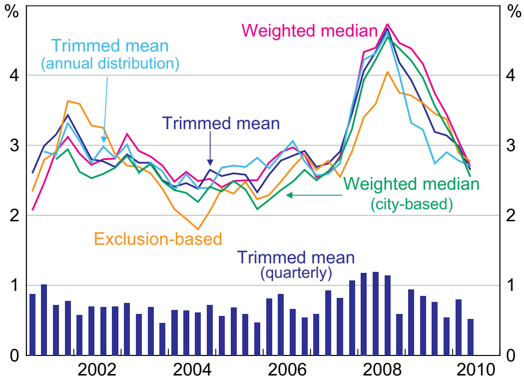
	Quarterly		Year-ended	
	March quarter 2010	June quarter 2010	March quarter 2010	June quarter 2010
CPI	0.9	0.6	2.9	3.1
– Tradables	0.2	1.0	1.1	1.4
– Tradables (excl food, fuel and tobacco)	–1.0	–0.1	0.1	–1.1
– Non-tradables	1.5	0.3	4.2	4.2
Selected underlying measures				
Trimmed mean	0.8	0.5	3.0	2.7
Weighted median	0.8	0.5	3.1	2.7
CPI excl volatile items[(a)] and deposit & loan facilities	0.7	0.7	2.9	2.8

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

Sources: ABS; RBA

Graph 74

Consumer Price Inflation*

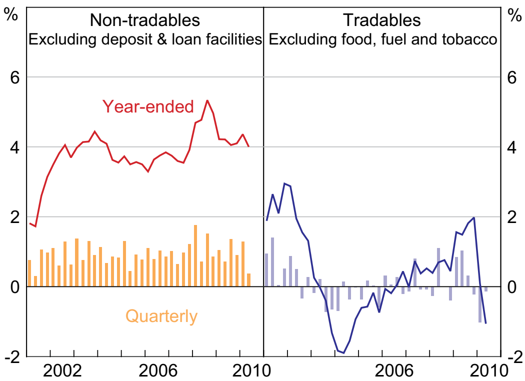


* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 75

Consumer Price Inflation*



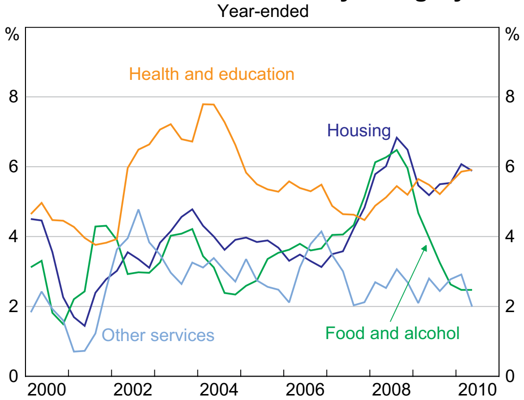
* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 76

Non-tradables Inflation by Category*

Year-ended



* Adjusted for the tax changes of 1999–2000; excluding deposit & loan facilities

Sources: ABS; RBA

to the quarterly increase, mostly due to the 25 per cent increase in the tobacco excise in late April. Hospital & medical services prices also recorded a solid quarterly rise following the annual resetting of health insurance premiums, as did automotive fuel prices. These were partly offset by significant price falls for holiday travel & accommodation and fruit & vegetables, and subdued outcomes for a number of tradable items.

Based on a range of measures, underlying inflation is estimated to have moderated to around 0.5 per cent in the June quarter and 2¾ per cent over the year (Graph 74). This is well down from the peak of a little over 4½ per cent in September 2008, and it is the first time underlying inflation has been below 3 per cent since September 2007. Consistent with the moderation in underlying inflation, price pressures were less broad-based in the quarter. The proportion of expenditure classes with prices rising in the quarter at an annualised rate of more than 2.5 per cent (seasonally adjusted) fell to around 40 per cent, which is low relative to outcomes over the past decade.

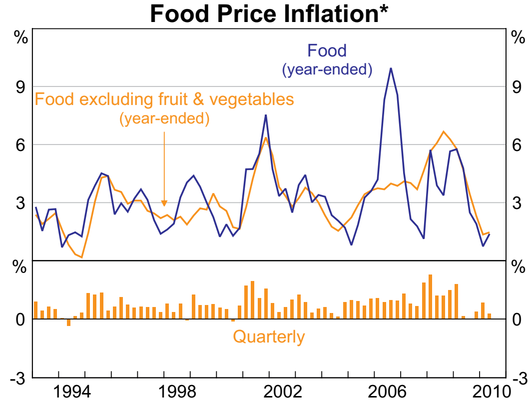
Inflation for non-tradable items has been consistently stronger than inflation for tradable items over a long period (Graph 75). Over the year to the June quarter, non-tradables inflation (excluding deposit & loan facilities) remained firm at 4 per cent, driven by strong price rises for housing, health and education (Graph 76). In the quarter, however, non-tradables inflation slowed to less than ½ per cent, following solid outcomes in previous quarters. This easing was partly due to a 6 per cent fall in the price of domestic holiday travel & accommodation, the largest quarterly decline in a decade, reflecting significant discounting. A slowing in housing-related inflation also contributed to the quarterly easing in non-tradables inflation, although this moderation is likely to be temporary. Inflation in the housing group – which includes house purchase costs, utilities prices and rents – has been strong in recent years and is expected to remain so in the period ahead. While house purchase cost inflation eased in the June quarter, producer price data suggest that the cost of building materials rose solidly in the quarter, which may exert upward pressure on house purchase cost inflation in future. Utilities prices were flat in the quarter, but remained 15 per cent higher over the year, partly reflecting the implementation of large price increases related to ongoing investment in infrastructure. Further significant increases are expected in the September quarter, although some moderation in the year-ended rate of utilities price inflation is expected in the period ahead. Rent inflation remained firm in the June quarter, at a little over 1 per cent, and is expected to pick up over the year ahead, consistent with the tight rental market.

In contrast, inflation for tradable items was subdued over the past year, reflecting the pass-through of the exchange rate appreciation during 2009 and, more recently, the tariff reductions that came into effect in early 2010 and heavy discounting in the retail sector. Excluding tobacco prices – which rose by 15 per cent, mostly due to the excise increase – tradables prices were broadly flat in the quarter. While the prices of some tradable items continued to fall – audio, visual & computing equipment prices declined by more than 6 per cent in the June quarter – there is evidence to suggest that the effects of the exchange rate appreciation may be starting to wane, with producer price data showing that import price inflation has picked up at the earlier stages of production.

Inflation in food prices has also been relatively subdued, with inflation over the past year low relative to outcomes over the past decade (Graph 77). The moderation in food price inflation since early 2009 reflects a number of factors, including an easing in the global prices of some food commodities, the appreciation of the exchange rate, and the broader easing in demand pressures. The Bank's liaison also suggests that there has been significant competition amongst retailers.

Graph 77

Food Price Inflation*



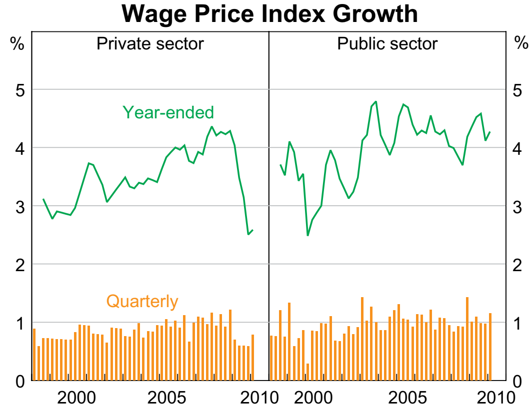
* Adjusted for the tax changes of 1999–2000
Sources: ABS; RBA

Costs

Labour cost growth has been picking up this year, after a period of unusually low outcomes in 2009, particularly in the private sector. The wage price index (WPI) increased by 0.9 per cent in the March quarter, which is around the average quarterly growth rate since the series began in 1997, with the pick-up fairly broad-based across the states. Over the year, the WPI increased by 3.0 per cent, more than ½ percentage point below its decade average, reflecting subdued quarterly outcomes during 2009. Private-sector wages grew at a below-average pace, to be 2.6 per cent higher over the year, while public-sector wage growth remained solid at 4.3 per cent over the year (Graph 78). Wage growth was stronger

Graph 78

Wage Price Index Growth



Source: ABS

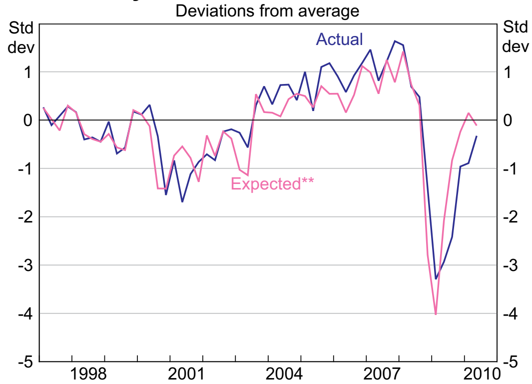
in utilities and public-related industries over the past year, while subdued growth was recorded in manufacturing, wholesale trade and a range of service industries.

Business surveys and the Bank's liaison in recent months also suggest that labour cost growth is picking up (Graph 79), although both indicate that, in general, firms are continuing to have relatively little difficulty finding suitable labour, despite reports of emerging skills shortages by firms exposed to the mining industry.

Graph 79

Surveys of Business Labour Costs*

Deviations from average



* Weighted average of data from various business surveys since 1994, with weights calculated by the RBA using the principal component method

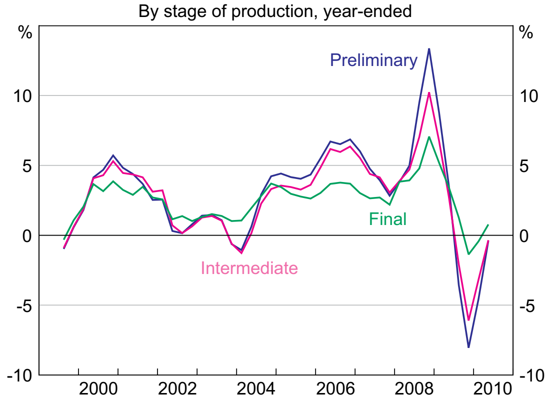
** Expectation for following quarter

Sources: CBA-ACCI; NAB; RBA; Sensis

Graph 80

Producer Price Inflation*

By stage of production, year-ended



* Excluding oil

Sources: ABS; RBA

Fair Work Australia (FWA) handed down its first minimum wage decision in June, increasing the federal minimum wage by around $26 per week, or 4.8 per cent, to $569.90. This was the first increase since late 2008 and followed the Australian Fair Pay Commission's decision to leave the federal minimum wage and basic award rates unchanged in 2009. The increase was towards the upper end of submissions by major stakeholders, which ranged from 2 per cent to 5 per cent, with FWA noting that better-than-expected economic conditions warranted a significant increase in the minimum wage. The $26 increase applies to all federal award wages and came into effect in July. This implies an estimated average increase of around 3½ per cent for award-reliant workers, who account for a little less than a fifth of all employees.

Estimated labour productivity growth appears to have been relatively weak in recent quarters, following strong outcomes over the first half of 2009 (see the 'Domestic Economic Conditions' chapter). The combination of weaker productivity growth and the pick-up in wage growth implies that growth in labour costs per unit of output has increased recently, following significant weakness over 2009.

Producer price data showed that inflation at the final stage of production was quite soft in the June quarter. Final-stage producer prices (excluding oil) rose by 0.3 per cent in the quarter, to be 0.8 per cent higher over the year (Graph 80). At the sectoral level, construction and manufacturing output price inflation eased in the quarter, despite a pick-up in input cost inflation. The data point to emerging price pressures at the early stages of production, following significant declines over 2009. At the preliminary stage, domestic inflation remained firm in the quarter and the disinflationary effects of the exchange rate appreciation in 2009 on import prices appear to have mostly passed. Preliminary prices have risen at an annualised pace of around 5 per cent over the first half of 2010 after declining by 8 per cent over 2009.

Table 13: Median Inflation Expectations
Per cent

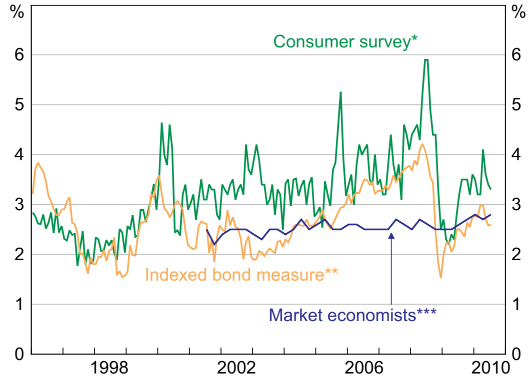
	Year to December 2010			Year to December 2011		
	February 2010	May 2010	August 2010	February 2010	May 2010	August 2010
Market economists[a]	2.3	3.1	3.2	2.9	3.0	3.0
Union officials[b]	3.0	3.1	3.1	3.0	3.0	3.2

(a) RBA survey
(b) Workplace Research Centre

Inflation Expectations

Measures of inflation expectations have provided mixed signals in recent months. Market economists' inflation forecasts are little changed from three months ago, with inflation expected to be slightly above 3 per cent over 2010, before declining to around 2¾ per cent in 2012 (Graph 81, Table 13). Union officials' inflation forecasts remain slightly below the average of the past decade. The Melbourne Institute's survey measure of consumer inflation expectations has eased in recent months to be slightly above its inflation-targeting average, while financial market indicators of longer-term inflation expectations have also moderated; the indexed bond measure is a little below the average for the inflation-targeting period. Business surveys suggest that expected selling price growth in the near term has picked up to around average levels. ✠

Graph 81
Indicators of Inflation Expectations



* Median expectation of average annual inflation over the next year
** Break-even 10-year inflation rate on indexed bonds
*** Median expectation of annual inflation 2 years ahead
Sources: Melbourne Institute of Applied Economic and Social Research; RBA