

4. Inflation

Underlying inflation remained subdued in the September quarter

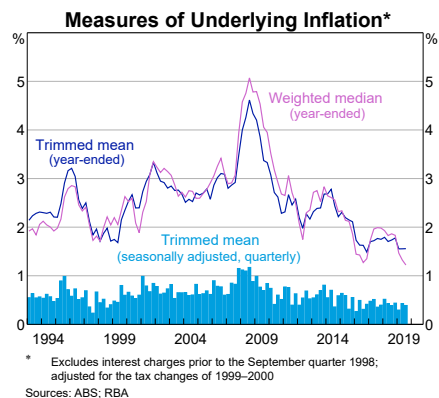
Trimmed mean inflation was unchanged at 0.4 per cent in the September quarter and 1.6 per cent over the year (Table 4.1; Graph 4.1). This was in line with expectations at the time of the *August Statement on Monetary Policy*. Headline inflation declined to 0.3 per cent (seasonally adjusted) in the quarter as the prices of fruit, vegetables and automotive fuel fell, to be 1.7 per cent over the year (Graph 4.2).

Underlying inflation has been below 2 per cent for over three years. Weak housing market conditions have weighed on recent inflation outcomes, as have continued spare capacity in the labour market and associated low wages growth, various government price and wage decisions and declines in utilities price inflation. Working in the other direction, the pass-through of the earlier exchange rate depreciation and drought-related grocery price increases have put some upward pressure on inflation.

Non-tradable inflation was unchanged in the September quarter at 0.5 per cent, to be 1.9 per cent over the year (Graph 4.3). The slowing in non-tradable inflation over the past year has been particularly notable for the prices of new dwellings and electricity (Graph 4.4). Tobacco prices rose strongly in the quarter due to an increase in the tobacco excise. In contrast, inflation in the prices of tradable items (excluding volatile items) has trended higher since mid 2018 and was 1.8 per cent over the year to September. This is the fastest pace of tradable inflation since 2015, and reflects some

pass-through to retail prices from the earlier depreciation of the exchange rate. In addition, grocery food (excluding fruit & vegetables) prices continued to rise in the quarter because the ongoing drought has put upward pressure on prices for meat, bread and dairy products.

Graph 4.1



Graph 4.2

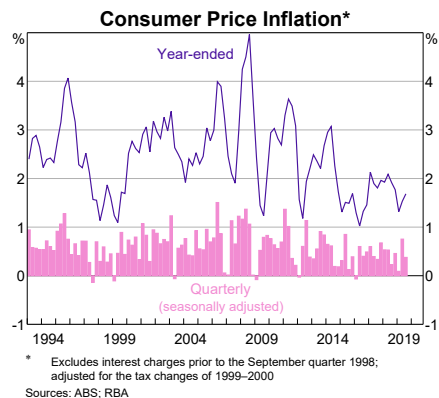


Table 4.1: Measures of Consumer Price Inflation

Per cent

	Quarterly ^(a)		Year-ended ^(b)	
	September quarter 2019	June quarter 2019	September quarter 2019	June quarter 2019
Consumer Price Index	0.5	0.6	1.7	1.6
Seasonally adjusted CPI	0.3	0.8	–	–
– Tradables	0.3	1.2	1.2	1.1
– Tradables (excl volatile items) ^(c)	0.7	0.5	1.8	1.0
– Non-tradables	0.5	0.5	1.9	1.8
Selected underlying measures				
Trimmed mean	0.4	0.4	1.6	1.6
Weighted median	0.3	0.4	1.2	1.3
CPI excl volatile items ^(c)	0.5	0.5	1.9	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

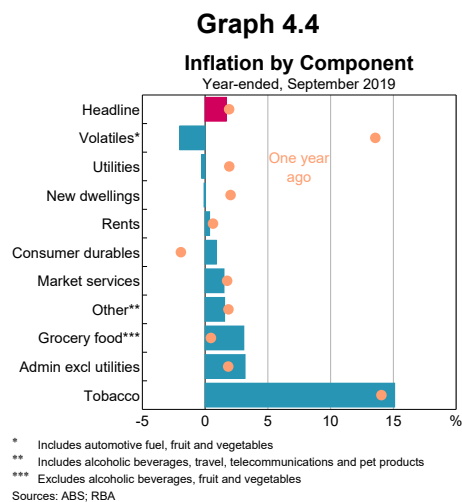
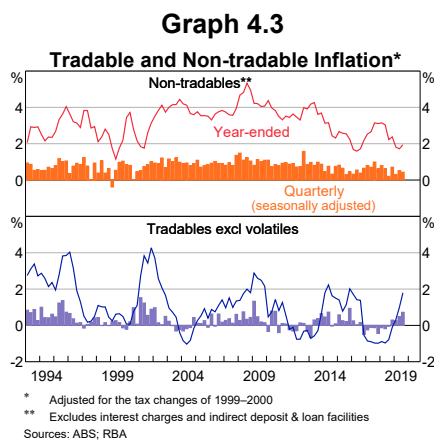
(c) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

Housing inflation is at historical lows

Inflation in housing-related parts of the CPI basket continued to decline in the September quarter to reach a new low (Graph 4.5). The two largest housing-related components, rents and new dwelling purchases by owner-occupiers, together account for around one-sixth of the CPI basket. Both are at historically low rates of inflation.

The new dwelling purchase component of the CPI captures the cost of adding to the housing stock – newly built dwellings and major renovations. After three consecutive quarterly declines, new dwelling prices were 0.1 per cent lower over the year to September (Graph 4.6). This was the first annual price decline since new



dwellings were included in the CPI in 1998. A decline in building activity over the year has led to weaker demand from developers for building materials, resulting in lower price inflation. Developers have also used discounts and bonus offers (which reduce the measured price of a dwelling) in response to weaker demand for new housing. Liaison reports suggest that purchase incentives for new houses have been widespread in several cities. New dwelling prices have declined over the past year in Melbourne and Brisbane, while new dwelling inflation has eased noticeably in Sydney and Adelaide. Following several years of deflation, new dwelling prices in Perth increased a little over the past year.

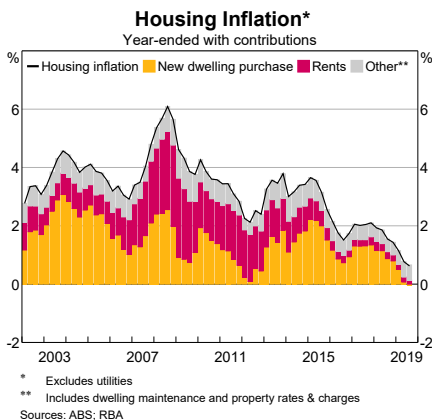
Rent inflation has been low over the past few years, reflecting a mix of supply- and demand-side developments. Growth in the housing stock has outpaced population growth, putting downward pressure on rents. Rents can also be indexed to CPI inflation, while lower household disposable income growth may also be weighing on rental outcomes. In recent quarters, the contribution of rents to CPI inflation has been less than one-fifth of its average over the inflation-targeting period. Newly advertised rents, which are a leading indicator of CPI rents, have been broadly unchanged over the past

year. Although new rents account for only a portion of the existing rental stock and pass-through to CPI rents is gradual, this suggests that rent inflation is likely to remain subdued over the year ahead. Conditions in rental markets continue to vary across capital cities (Graph 4.7). Rents have declined in Sydney over the year, consistent with the earlier decline in advertised rents and an elevated vacancy rate. Rent deflation has continued to moderate in Perth, though rents remain around 22 per cent lower than in 2014. Growth in rents in Melbourne and Brisbane has been relatively stable for some time, while in Hobart, rents have increased by more than 5 per cent over the past year.

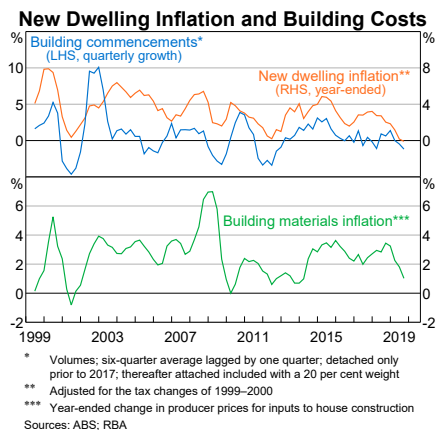
Electricity prices declined in the September quarter but other administered prices rose

As anticipated, electricity prices declined in the September quarter as a result of regulatory changes (Graph 4.8). On 1 July, the federal government introduced the Default Market Offer, which places a region-specific cap on standing offer electricity prices in New South Wales, southern Queensland and South Australia. This default price, determined by the Australian Energy Regulator, was set at the

Graph 4.5



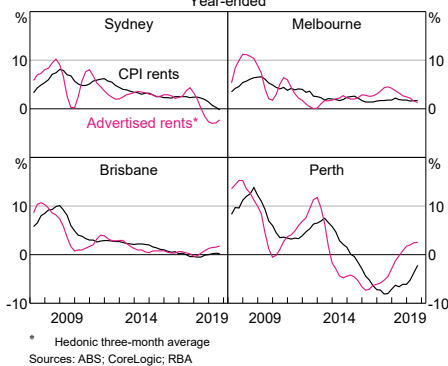
Graph 4.6



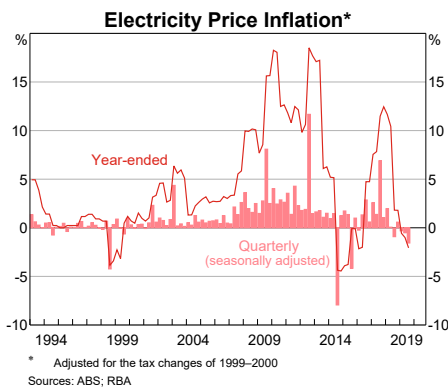
midpoint between the median market offer (non-standard contracts agreed to between a household and an energy retailer) and the median standing offer (electricity contracts characterised by infrequent but regular price changes) in each region. As a result, households previously on more expensive standing offers were automatically switched to their retailer's new, lower, default price. Similarly, standing offer prices fell in Melbourne following the introduction of the Victorian Market Offer. The Victorian Market Offer was set below the previous median standing offer and has replaced all other standing offers. The decline in standing offer electricity prices was partly offset by retailers removing some discounts on market offer prices.

A number of other administered prices changed on 1 July as policies announced in state and federal budgets took effect (Graph 4.9). Public transport fares and property rates & charges increased by a little more than in 2018, while motor vehicle-related charges increased by a little less than in 2018. Child care prices increased relatively strongly over the year. This follows a sharp decline in child care prices in late 2018 with the introduction of the government's child care subsidy package.

Graph 4.7
Rent Inflation
Year-ended



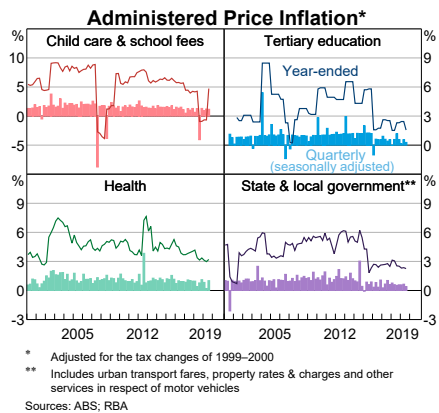
Graph 4.8



Inflation in market services remains low

Year-ended inflation in the prices of market services has been at or below 2 per cent in recent years. This is mainly because labour cost growth has been subdued; labour costs account for around two-fifths of final prices for market services. More recently, growth in unit labour costs has picked up. If sustained, this would put some upward pressure on prices for market services. Inflation in meals out & takeaway increased in the quarter, which reflects some pass-through of higher food prices and increases in the award and minimum wage rate (Graph 4.10). Commercial rents, another factor affecting market services prices, continue to increase at a relatively slow rate.

Graph 4.9



Higher import prices and the drought continue to put upward pressure on retail prices

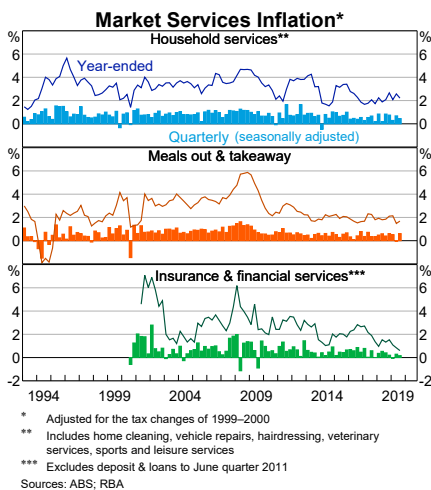
Retail prices have increased in recent quarters to be 1.5 per cent higher over the year. This is the highest rate of retail inflation in around a decade, and is consistent with the pass-through of the earlier exchange rate depreciation to higher import and consumer retail prices (Graph 4.11). The timing and speed of exchange rate pass-through is highly uncertain, though it is estimated that most occurs within a year. This is consistent with liaison reports that most large retailers hedge their exchange rate exposure around 6–12 months in advance. The increase in consumer durables inflation in the quarter was broad based, with price increases across motor vehicles, clothing & footwear and some household goods.

Over a longer period of some years, retail inflation has been very low as a result of heightened competition from new foreign entrants, technology and changing business models. Even though prices have risen recently, retailers continue to cite strong competition as putting downward pressure on prices, along with weaker household demand, especially for

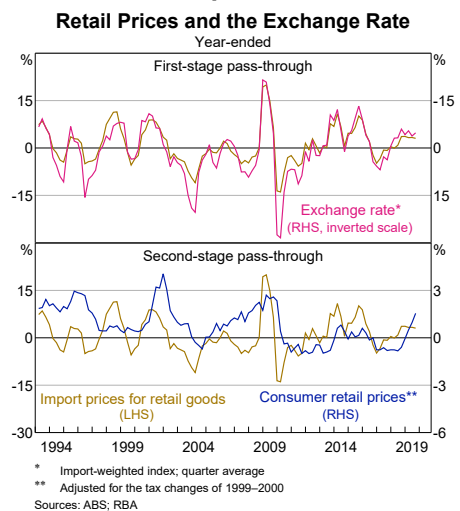
consumer durables. Liaison reports suggest that retailers have made changes to their discounting behaviour in recent months to offset the effect of cost pressures on margins. For example, firms are reportedly being more proactive in their stock management (for example, discounting stock earlier in the season) and being more targeted in their promotions.

Grocery prices increased in the September quarter and year-ended grocery price inflation is now at its highest rate since 2009. Drought-related supply disruptions have put upward pressure on food prices over the past year, particularly bread & cereal products (through higher grain input costs) and meat (through higher wholesale prices) (Graph 4.12). Strong international demand, especially for lamb and beef, has also put upward pressure on meat prices recently. Following similar increases earlier in the year, milk prices increased again in the September quarter as major supermarkets raised private-label prices. Inflation in the prices of other food items has also picked up a little recently but remains fairly subdued.

Graph 4.10



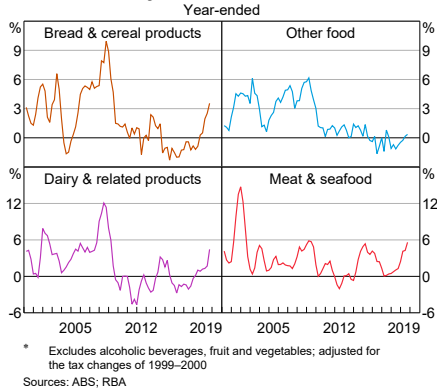
Graph 4.11



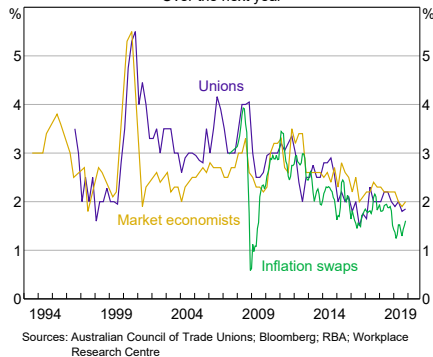
Market-based measures of inflation expectations remain low

Wage- and price-setting behaviour can be affected by expectations about the future rate of inflation. Short-term market-based measures of inflation expectations have picked up a little in recent months (although these measures can be affected by oil prices) as have long-term market-based measures of inflation expectations. However, both measures remain low (Graph 4.13 and Graph 4.14). Short-term survey-based measures of inflation expectations have increased a little in recent months. Long-term survey-based measures remain consistent with the Bank's medium-term inflation target.

Graph 4.12
Grocery Food Price Inflation*



Graph 4.13
Short-term Inflation Expectations
Over the next year

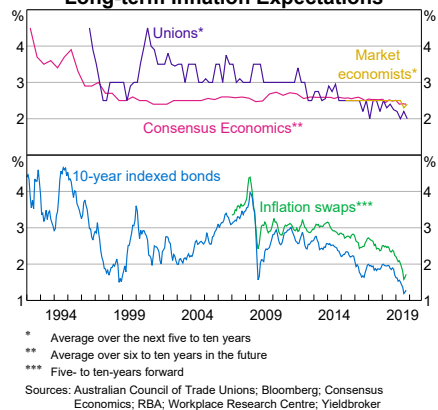


Wages growth remains subdued

Growth in the wage price index (WPI) increased to 0.6 per cent in the June quarter, to remain at 2.3 per cent over the year. As anticipated at the time of the *August Statement*, growth in the quarter was boosted by a large wage increase in one particular enterprise bargaining agreement (EBA). However, wages growth remains subdued across the economy and across all measures (Graph 4.15). Despite strong employment growth over recent years, there is still considerable spare capacity in the labour market. It is possible that wage expectations have become anchored at low levels, as a result of a prolonged period of low wage and inflation outcomes.

Growth in the public sector WPI increased to 0.8 per cent in the quarter and 2.6 per cent over the year, boosted by a large wage increase for Victorian nurses and midwives that brought their wage level into line with those in New South Wales. Over recent years, public sector wages growth has been higher in Victoria than in other states (Graph 4.16). However, the Victorian Government has recently lowered their wage policy cap in new public sector EBAs. Governments in Queensland and New South Wales have had wages caps of 2½ per cent for some time. Growth in Tasmanian and Western

Graph 4.14
Long-term Inflation Expectations



Australian public sector wages is at or around the lowest rate since the WPI series began in 1997. In Tasmania, public sector wages growth has been affected by delays in EBA negotiations.

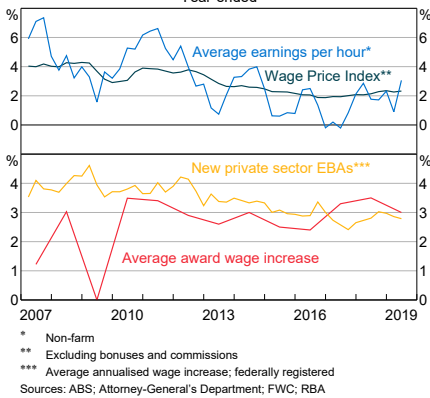
The private sector WPI grew by 2.3 per cent over the year to June. Wages growth is a little higher than it was in most industries a year ago (Graph 4.17). Over that period, there has been a noticeable pick-up in wages growth in industries such as professional, scientific & technical services and mining. Wages growth in these industries had fallen sharply after the mining boom, in part due to wage freezes. More recently, liaison reports that many of these wage freezes have been lifted as labour market

conditions have improved in the mining industry.

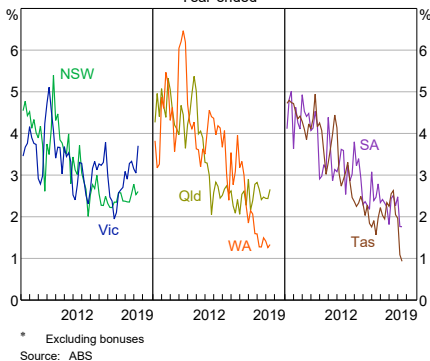
Wages growth continues to be highest in industries where a larger share of workers are on EBAs, such as health care and utilities. Over recent years, EBAs have tended to provide for a smaller wage increase than the agreements they replaced. This has been less evident in the agreements signed over the first half of 2019. The average duration of EBAs is also steadily increasing. The share of new EBAs with a term of three or more years has increased from around one-quarter in 2016 to around two-thirds in 2018. The average annualised wage growth in these longer-term EBAs is around 2½ per cent. This suggests that the effect of changing labour market conditions could take longer to flow through to the base pay of workers covered by these agreements.

Wages growth in the retail industry remains around 2 per cent. While some retail workers are award-reliant and have received annual wages growth over 3 per cent in recent years, others on EBAs experienced a prolonged period of wage freezes. This was due to a number of large retail EBAs that had expired and were either being renegotiated or awaiting Fair Work Commission (FWC) approval. Some new EBAs have been approved by the FWC over the past year, so retail

Graph 4.15
Wages Growth
Year-ended

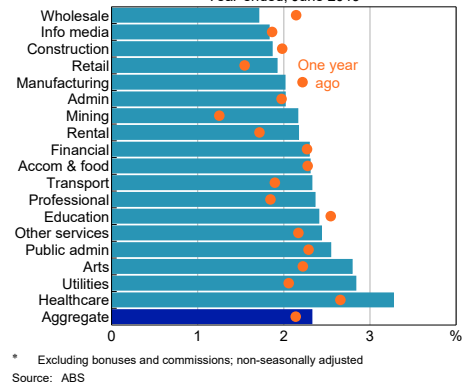


Graph 4.16
Public Sector WPI Growth*
Year-ended



Graph 4.17

Wage Price Index Growth by Industry*
Year-ended, June 2019



wages growth should pick up a little from the September quarter.

The FWC increased federal awards and the national minimum wage by 3 per cent on 1 July, which will provide a small boost to wages growth in the September quarter. This will increase wages of the 20 per cent of employees that are reliant on the award, and it will also, either directly or indirectly, affect other employees that have their wages tied to the award in some way.

Growth in average earnings per hour in the national accounts (AENA) was a little higher than WPI growth over the past year. AENA is a broader, but more volatile, measure of labour costs because it captures non-wage payments as well as changes in the composition of employment. Real average earnings grew at a much stronger pace than labour productivity over the investment phase of the mining boom (Graph 4.18). Since around 2012, the pace of productivity growth, while subdued, has outpaced growth in real average earnings (see Box B: Industry Insights into Productivity Growth).

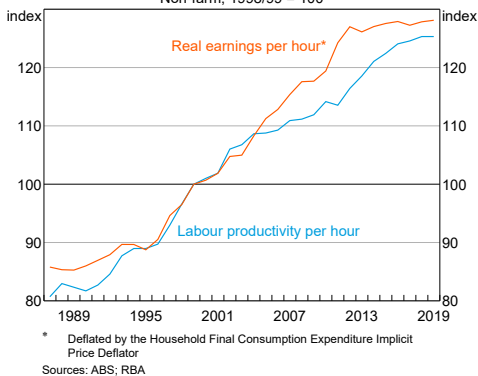
Stable wages growth is expected over the year ahead

As has been the case for some time, the majority of firms that are surveyed in the RBA's liaison program anticipate steady wages growth over the year ahead (Graph 4.19). Over the past year, there had been a small decline in the share of firms expecting an increase in wages growth (relative to the previous year). Consistent with this, unions' expectations for wages growth have declined a little recently and do not suggest a pick-up in wages growth over the year ahead. ✖

Graph 4.18

Productivity and Real Earnings

Non-farm, 1998/99 = 100



Graph 4.19

Expectations for Wages Growth*

Share of firms, relative to the past year

