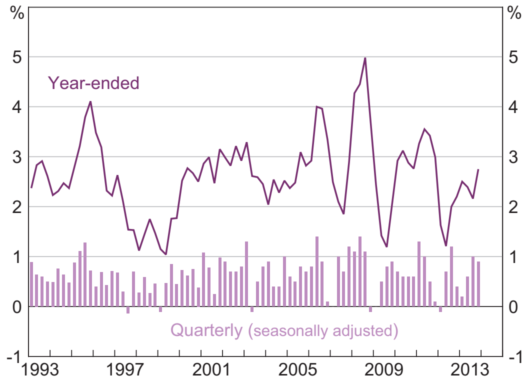
5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation was stronger than expected in the December quarter, and it has picked up somewhat in the past six months. The consumer price index (CPI) rose by 0.9 per cent on a seasonally adjusted basis, following a similar increase in the September quarter, to be 2.7 per cent higher over the year (Graph 5.1; Table 5.1).

Taken together, price movements for volatile items and tobacco had only a small effect on headline inflation in the quarter. Food price inflation (excluding fruit and vegetables) remained relatively low at 0.5 per cent in the December quarter. This was despite the modest pick-up in inflation in the

Graph 5.1
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 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly(a)		Year-ended(b)	
	December quarter 2013	September quarter 2013	December quarter 2013	September quarter 2013
Consumer Price Index	0.8	1.2	2.7	2.2
Seasonally adjusted CPI	0.9	1.0	–	–
– Tradables	0.7	1.1	1.0	–0.1
– Tradables (excl volatile items and tobacco)(c)	0.5	0.3	–0.1	–1.1
– Non-tradables	0.9	0.9	3.7	3.6
Selected underlying measures				
Trimmed mean	0.9	0.7	2.6	2.3
Weighted median	0.9	0.6	2.6	2.4
CPI excl volatile items(c)	0.8	0.8	2.6	2.4
CPI excl volatile items and tobacco(c)	0.8	0.7	2.4	2.2

(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

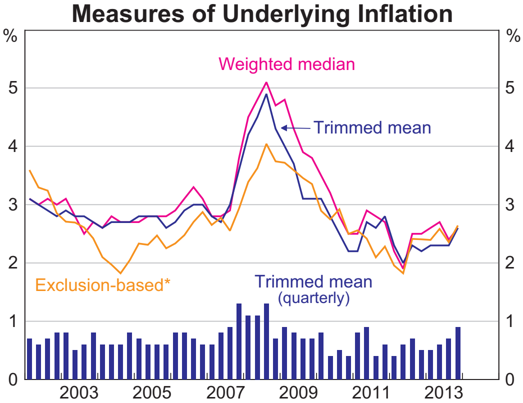
(c) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

prices of meals out and takeaway, and is consistent with reports from the Bank's liaison that supermarket competition continues to constrain increases in many food prices. Tobacco inflation picked up, largely reflecting a 12.5 per cent increase in tobacco excise, which came into effect in December. Vegetable prices rose by 6.5 per cent, reflecting adverse growing conditions in some areas, while fruit prices overall were little changed. Fuel prices declined by 1 per cent in the quarter.

The various measures of underlying inflation were also higher than expected, at between ¾ and 1 per cent in the December quarter. In year-ended terms, underlying inflation was a touch above 2½ per cent, a little higher than has been observed in recent quarters (Graph 5.2).

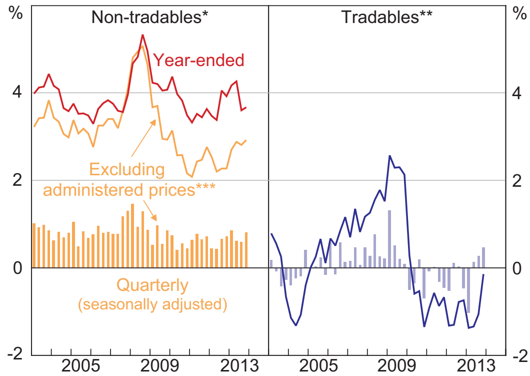
Graph 5.2
Measures of Underlying Inflation



* Excludes fruit, vegetables, automotive fuel (and deposit & loan facilities to June 2011)
Sources: ABS; RBA

The increase in underlying inflation largely reflected a rise in tradables prices. This followed a substantial decline in tradables prices from 2010 until early 2013 (Graph 5.3). In the December quarter, tradables prices (excluding volatile items and tobacco) rose by 0.5 per cent. While the prices of tradable items, by definition, are relatively sensitive to movements in the exchange rate, the recent increases in tradables prices were greater than might have been expected given the magnitude of the depreciation of the exchange rate over the past year. In part, this reflects changes in consumer durables prices, which increased in the

Graph 5.3
Non-tradables and Tradables Inflation



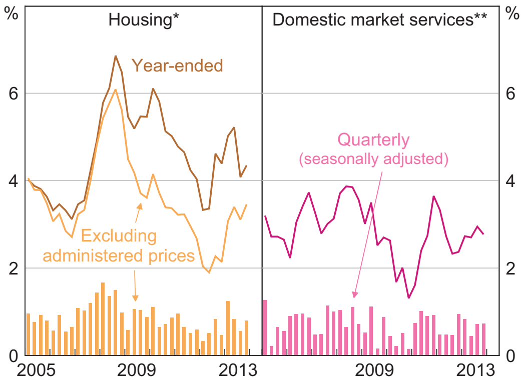
* Excluding deposit & loan facilities to June 2011
** Excluding volatile items (fruit, vegetables and automotive fuel) and tobacco
*** Administered prices include the prices of utilities, education, health services, some motor vehicle services, property rates & charges, pharmaceutical products, child care, urban transport fares and postal services
Sources: ABS; RBA

December quarter for the first time since 2010, driven by large price increases for household appliances and clothing accessories. In contrast, during the past two to three years durable items had experienced a persistent decline in prices, despite the relative stability of the exchange rate over that period. Falling durables prices over this period contributed to relatively muted inflation in retail prices overall and, in turn, the modest outcomes in aggregate inflation (see 'Box C: Recent Developments in Retail Prices and Margins').

The quarterly rate of non-tradables inflation was unchanged in the December quarter, with year-ended inflation picking up slightly to 3.7 per cent. However, abstracting from the effects of administered prices (which had boosted non-tradables inflation in the previous quarter) non-tradables inflation picked up a little in the December quarter. Non-tradables prices tend to be less affected by movements in the exchange rate, and relatively more influenced by domestic labour costs. So it is somewhat surprising that non-tradables price inflation has not eased given that growth in labour costs has been weak in recent quarters.

Over the past year, non-tradables inflation has been buoyed by an increase in the pace of housing inflation (Graph 5.4). This has been partly attributable

Graph 5.4
Non-tradables Inflation



* Includes prices for rents, dwelling repair & maintenance, new dwelling purchases and administered items (utilities and property rates & charges)
** Excludes deposit & loan facilities to June 2011 and housing services
Sources: ABS; RBA

to a strong rise in new dwelling costs, consistent with recent signs of a recovery in housing construction. Overall, market services inflation was unchanged in the December quarter, but remains somewhat stronger than expected given the recent weak growth in wages and unit labour costs. Inflation in domestic travel prices, despite easing in the December quarter, remained relatively strong, consistent with liaison reports that the lower exchange rate is encouraging substitution away from international travel, which might have allowed domestic travel providers to increase their margins. Also, there was higher inflation in the prices of household services and meals out & takeaway.

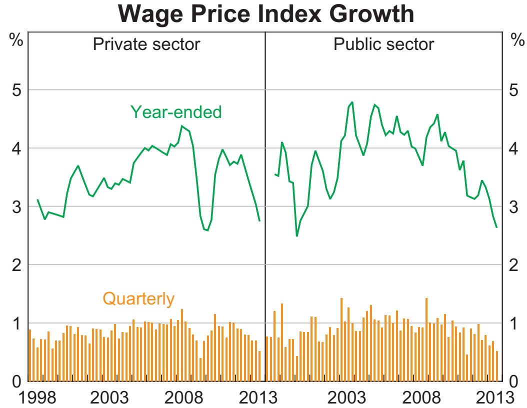
Both tradables and non-tradables inflation were somewhat higher than expected in the quarter. It could be that there was a higher-than-usual degree of noise in the data, which can occasionally occur owing to the difficulties of measurement or the timing of price changes. Alternatively, the higher-than-expected inflation recorded in the quarter might reflect a number of other factors. For tradables prices, it could be that the 'second stage' of exchange rate pass-through – from import prices (across the docks) to the prices facing consumers – has been more rapid than has been the case historically. For non-tradables prices, it could be that slower growth of labour costs is taking longer to pass through to final prices than usual. More generally, margins in both the traded and non-traded sectors may have increased. Such a rise appears to be at odds with the below-trend growth of consumption at least over the year to the September quarter, although more recently there have been tentative signs of improved trading conditions for retail trade, housing construction and domestic travel & leisure.

It is hard to distinguish among the different explanations because second-stage pass-through, margins, costs or noise in the data cannot be directly observed, and it may be that some combination of these factors is at work.

Costs

Wage growth slowed further in the September quarter. The wage price index increased by 2.7 per cent in year-ended terms, which is around 1 percentage point below its average of the past decade. The pronounced slowing in wage growth over the past year reflects the effect of spare capacity in the labour market, combined with relatively low consumer and union inflation expectations and continuing pressures on firms and public sector employers to contain costs. Private sector wage growth slowed in both quarterly and year-ended terms, with reports from liaison suggesting that labour is readily available and the rate of employee resignations is low (Graph 5.5). The annual award

Graph 5.5
Wage Price Index Growth

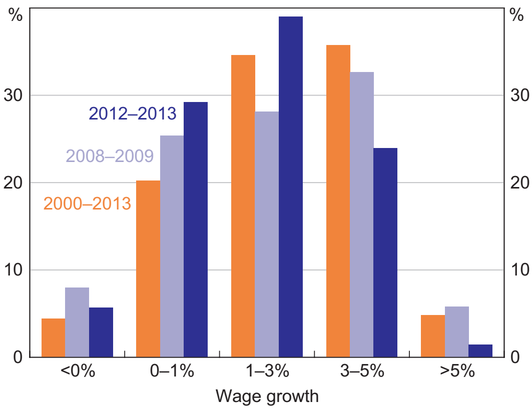


Source: ABS

wage increase, which came into effect in July and was a little less than the increase awarded in 2012, also contributed to the slowing in wage growth. In an environment of ongoing fiscal restraint, wage growth in the public sector eased to its slowest pace in year-ended terms since 2000. Bank liaison and surveys of firms' wage expectations indicate that wage pressures are likely to remain low over the next year.

Slower wage growth has been accompanied by a fall in the proportion of employees receiving relatively large wage increases. Survey data on the distribution of wage growth outcomes suggest that the slowing in wage growth has been more widespread across firms than was the case during the period of slower wage growth in 2008 and 2009 (Graph 5.6). At that time, a higher proportion of firms continued to offer wage increases of 3 per cent or more. In contrast, in the recent episode, wage growth of between 1 and 3 per cent has been more common.

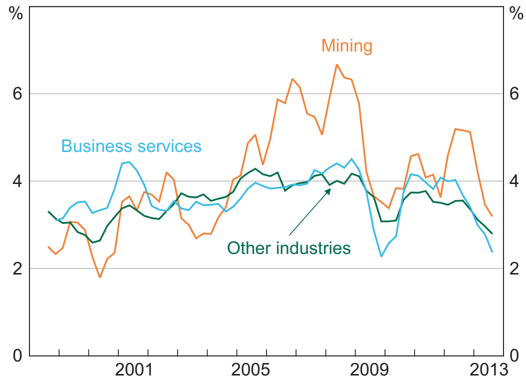
Graph 5.6
Distribution of Wage Growth Outcomes
Per cent of firms



Sources: NAB; RBA

The slowing in wage growth has been broad based across industries, but it has been somewhat more pronounced in mining and business services, reflecting the more noticeable slowing in demand for labour from these industries (Graph 5.7). Wage growth has also slowed across all states over the past year, with year-ended wage growth in New South Wales the slowest in the 15-year history of

Graph 5.7
Wage Growth by Industry
Year-ended

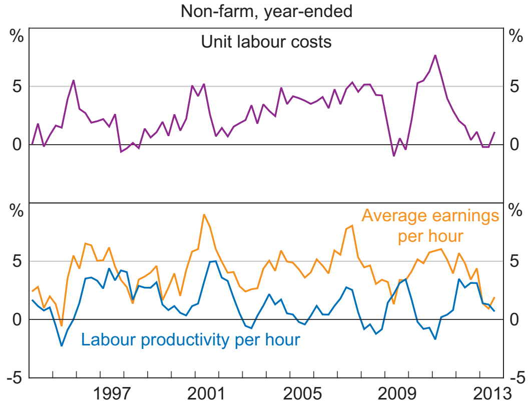


Sources: ABS; RBA

the wage price index. Consistent with the decline in demand for labour in the mining and mining-related industries, private sector wage growth in Western Australia and Queensland has also slowed sharply.

The national accounts measure of average earnings rose only modestly in the September quarter, after being little changed in the first half of 2013. Measured growth in labour productivity has slowed from its relatively fast pace in 2012. With average earnings growing only slightly faster than labour productivity, year-ended growth in unit labour costs is estimated to have remained low (Graph 5.8).

Graph 5.8
Unit Labour Costs Growth
Non-farm, year-ended



Sources: ABS; RBA

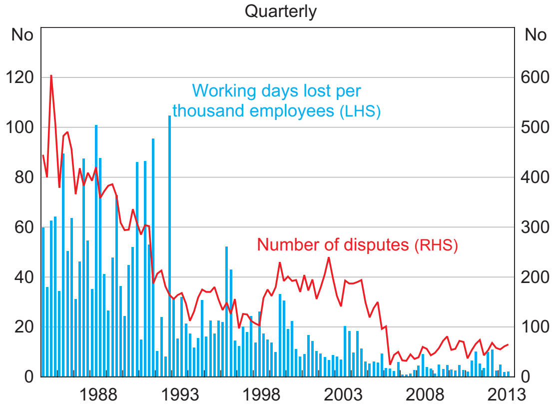
Producer price data suggest that domestic inflation pressures at the producer level were subdued across all stages of production over the year to the December quarter. Producer prices for imported goods declined slightly in the quarter after rising sharply in the previous quarter as a result of the depreciation of the exchange rate.

The number of working days lost per employee as a result of industrial disputes was little changed in the September quarter, remaining well below its decade average (Graph 5.9). There were slight increases in the number of industrial disputes and the average number of employees involved per dispute, but these were offset by a decline in the average duration of disputes.

Inflation Expectations

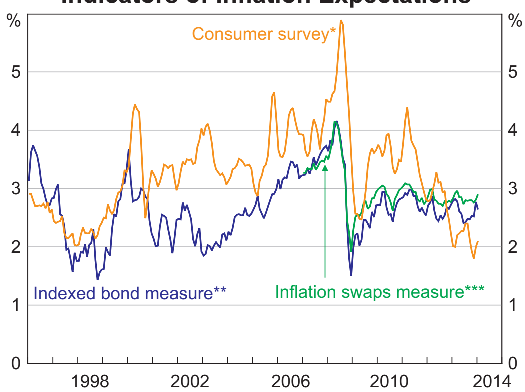
Measures of inflation expectations remain consistent with the inflation target, and are generally around or a little below their long-term averages (Graph 5.10; Table 5.2). Since the November *Statement*, market economists have revised down their expectations for inflation over 2014 slightly, while expectations for 2015 have remained steady. Union officials' forecasts for inflation over 2014 have increased somewhat. Financial market measures of inflation expectations have ticked up over the quarter to be around their average levels. The Melbourne Institute measure of consumers' inflation expectations for the year ahead has also increased modestly but remains low relative to its history.

Graph 5.9
Industrial Disputes
Quarterly



Source: ABS

Graph 5.10
Indicators of Inflation Expectations



* Three-month moving average of the trimmed mean expectation of inflation over the next year
** Break-even 10-year inflation rate on indexed bonds
*** Expectation of average annual inflation over the next 10 years
Sources: Bloomberg; Melbourne Institute of Applied Economic and Social Research; RBA

Table 5.2: Median Inflation Expectations
Per cent

	Year to December 2014			Year to December 2015	
	August 2013	November 2013	February 2014	November 2013	February 2014
Market economists	2.6	2.6	2.5	2.6	2.6
Union officials	2.6	2.5	2.8	–	2.8

Sources: RBA; Workplace Research Centre