4. Inflation

Inflation remains low

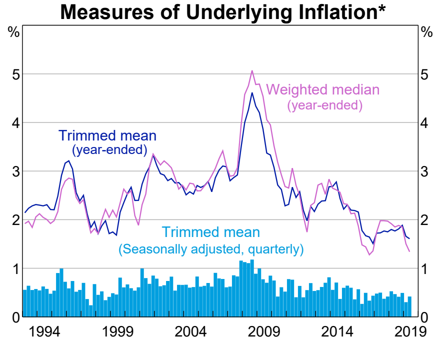
Trimmed mean inflation increased a little to 0.4 per cent in the June quarter but remained at 1.6 per cent over the year (Table 4.1; Graph 4.1). This was in line with the forecast in the May *Statement on Monetary Policy*. There has been some pass-through of the earlier exchange rate depreciation to retail prices, while the ongoing drought has boosted food inflation. However, housing-related inflation was particularly weak in the first half of 2019. Headline inflation increased to 0.7 per cent (seasonally adjusted) in the June quarter and 1.6 per cent over the year (Graph 4.2). Automotive fuel prices rose by 10 per cent in the quarter, while fruit prices declined.

Underlying inflation has been below 2 per cent for around three years. This reflects spare capacity in the economy and associated low wages growth. The slowing in the housing market, a decline in wholesale electricity prices and various government policy decisions have also put downward pressure on inflation over the past year. However, inflation also remains low in many advanced economies where unemployment rates are at multi-decade lows. This suggests there are common global factors also weighing on wage and price inflation. In particular, globalisation and advances in technology have both lowered the cost of production of goods and services, and led to increased competition.

Non-tradable inflation increased in the June quarter, but has slowed notably over the past year (Graph 4.3). The decline in year-ended non-tradable inflation reflects a slowing in inflation in the prices of new dwellings and administered items, including utilities (Graph 4.4). Following several years of deflation, prices of tradable items (excluding volatile items) increased in the June quarter and over the year. This is consistent with some pass-through to retail prices from the

Graph 4.1

Measures of Underlying Inflation*

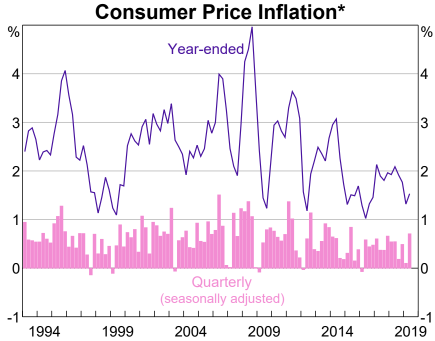


* Excludes interest charges prior to the September quarter 1998; adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 4.2

Consumer Price Inflation*



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

Sources: ABS; RBA

Table 4.1: Measures of Consumer Price Inflation

Per cent

	Quarterly(a)		Year-ended(b)	
	June quarter 2019	March quarter 2019	June quarter 2019	March quarter 2019
Consumer Price Index	0.6	0.0	1.6	1.3
Seasonally adjusted CPI	0.7	0.1	–	–
– Tradables	1.1	–0.2	1.1	0.4
– Tradables (excl volatile items)(c)	0.5	0.2	1.0	0.3
– Non-tradables	0.5	0.2	1.8	1.8
Selected underlying measures				
Trimmed mean	0.4	0.3	1.6	1.6
Weighted median	0.4	0.1	1.2	1.4
CPI excl volatile items(c)	0.5	0.3	1.5	1.3

(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

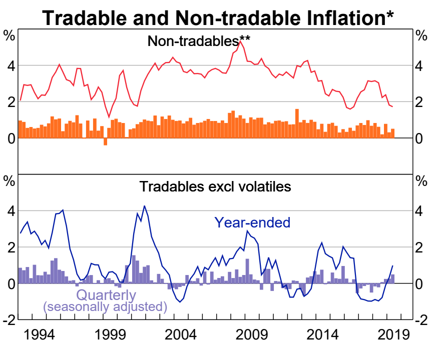
Sources: ABS; RBA

exchange rate depreciation. Grocery food (excluding fruit & vegetables) inflation is higher than a year ago because of the ongoing drought conditions in eastern Australia and adverse weather in some other parts of Australia.

Conditions in housing markets have weighed on inflation …

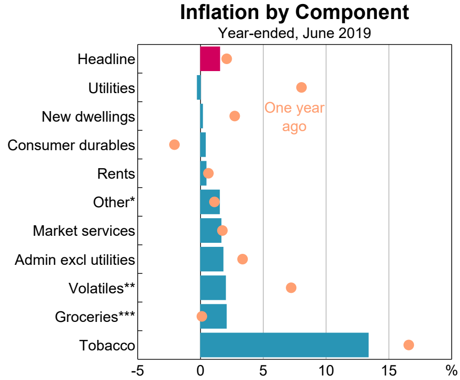
The two largest housing components of the CPI basket are rents and new dwelling purchases by owner-occupiers, which together account for around one-sixth of the CPI basket. Inflation in

Graph 4.3



* Adjusted for the tax changes of 1999–2000
** Excludes interest charges and indirect deposit & loan facilities
Sources: ABS; RBA

Graph 4.4



* Includes alcoholic beverages, travel, telecommunications and pet products
** Includes fruit, vegetables and automotive fuel
*** Excludes alcoholic beverages, fruit, vegetables, meals out and takeaway
Sources: ABS; RBA

these components remains around historical lows (Graph 4.5).

Rent inflation has been low over the past few years because the effect of strong population growth has been offset by large additions to the stock of housing. Rents were unchanged in the June quarter, although conditions in rental markets continue to vary noticeably across capital cities (Graph 4.6). In Sydney, rent inflation has continued to slow, consistent with a sharp increase in the vacancy rate and a decline in newly advertised rents over the past year. Perth rents have fallen by 22 per cent since 2014, although the pace of decline has eased gradually. This is consistent with an increase in Perth's newly advertised rents and a decline in the vacancy rate. Rents have been little changed in Brisbane for some years, while Melbourne rents continue to increase at a modest rate because a substantial increase in new housing supply has been largely absorbed by relatively strong population growth. Hobart rents have increased by more than 5 per cent over the past year.

Prices of newly built dwellings declined again by 0.2 per cent in the quarter. In year-ended terms, new dwelling inflation is at its lowest rate since it was included in the CPI in 1998 (Graph 4.7). Information from liaison suggests that bonus offers and purchase incentives for new detached dwellings were widespread in the June quarter in several cities. These incentives typically take the form of including appliances at no charge or direct 'cash-back' offers, which reduce the measured price of the dwelling. Liaison reports suggest that competition from infrastructure projects has put upward pressure on material prices and construction wages in Sydney, although this pressure has eased somewhat over the past year. Consistent with these reports, new dwelling inflation remains relatively strong in Sydney in contrast to Melbourne, Brisbane and Adelaide, where prices for new dwellings have declined over the past year. New dwelling prices in Perth have steadied in recent quarters following three years of deflation.

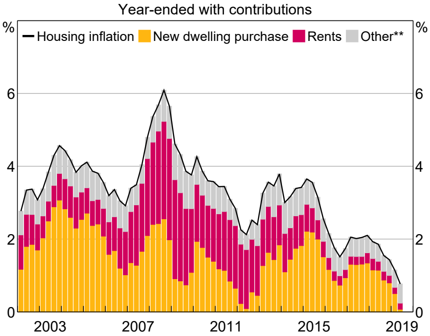
… while government pricing decisions have also lowered inflation

Utilities prices are little changed compared to a year ago (Graph 4.8). In the June quarter, utilities prices declined a little in non-seasonally adjusted terms owing to declines in market offer electricity prices in some capital cities. Gas prices were generally unchanged across all capital cities in the June quarter. More broadly, electricity and gas inflation has eased notably since 2018 as the earlier strong increases in

Graph 4.5

Housing Inflation*

Year-ended with contributions



* Excludes utilities

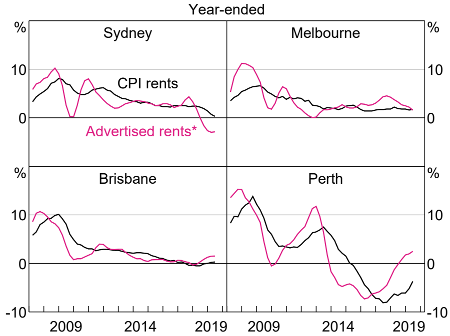
** Includes dwelling maintenance and property rates & charges

Sources: ABS; RBA

Graph 4.6

Rent Inflation

Year-ended



* Hedonic three-month average

Sources: ABS; CoreLogic; RBA

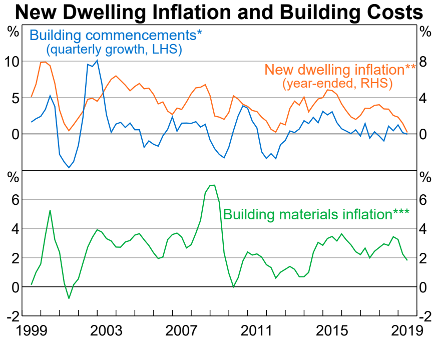
wholesale electricity and gas prices have passed through.

Electricity prices are expected to decline in the September quarter owing to the introduction of the Default Market Offer and the Victorian Default Offer. The Default Market Offer places a cap on standing offer electricity prices in New South Wales, South Australia and southern Queensland. This cap has been set at the mid-point between the median market offer and the median standing offer in each electricity distribution zone. Because market offers are usually cheaper than standing offers, the cap is likely to result in lower average electricity prices in those states. In Victoria, all standing offer electricity customers have been moved onto the Victorian Default Offer, which has been set below the median standing offer price in each zone.

Inflation in the prices of other administered items declined a little in the June quarter and is now at its lowest since 1999 (Graph 4.9). Health inflation declined in the quarter, driven by the smallest increase in private health insurance premiums since 2001. The decline in administered price inflation over the past year reflects several government pricing decisions, including lower-than-average increases in property rates, public transport fares and motor vehicle-related charges, and the 2018 reforms to child care subsidies.

Graph 4.7

New Dwelling Inflation and Building Costs



* Volumes; six-quarter average lagged by one quarter; detached only prior to 2017; thereafter attached included with a 20 per cent weight

** Adjusted for the tax changes of 1999–2000

*** Year-ended change in producer prices for inputs to house construction

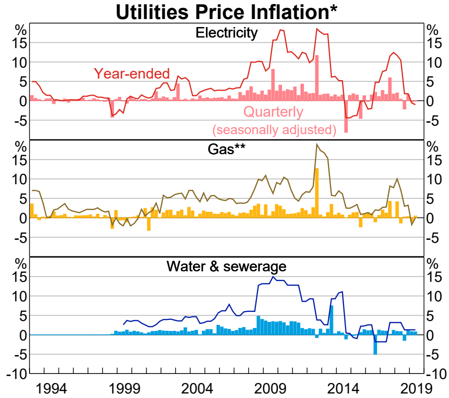
Sources: ABS; RBA

Market services inflation remains stable

Inflation in the prices of market services, which include hairdressing, financial services and meals out & takeaway, remains low (Graph 4.10). The prices of these services are generally driven by domestic factors such as commercial rents and labour costs. Commercial rents have increased relatively slowly over recent years. Labour cost growth has also been relatively low since 2013, but has picked up recently, putting some upward pressure on prices for market services.

Graph 4.8

Utilities Price Inflation*



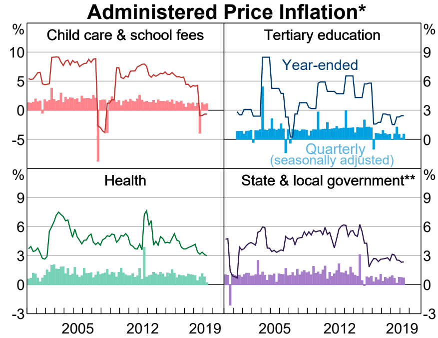
* Adjusted for the tax changes of 1999–2000

** Includes other household fuels

Sources: ABS; RBA

Graph 4.9

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

Higher import prices have put upward pressure on retail prices

Retail prices had been declining for a sustained period as a result of strong competition for market share among retailers. Liaison reports suggest that this competition is continuing to put downward pressure on most retail prices. In recent quarters, however, retail prices have increased modestly and are now 0.9 per cent higher over the year. This reflects the pass-through of the exchange rate depreciation to higher import prices (Graph 4.11). Within the category of consumer durable goods, year-ended motor vehicles inflation has increased to its highest level since 2002, and higher import prices have been passed through to consumer prices for clothing & footwear and several household goods. The timing of the effect of the depreciation on consumer prices is uncertain; liaison reports suggest that most large retailers hedge their exchange rate exposure around 6–12 months in advance.

Grocery price inflation remains elevated due to adverse weather

Grocery price inflation moderated in the June quarter but remains higher than one year ago (Graph 4.12). Drought-related supply disruptions have put upward pressure on food prices over the past year, particularly bread (through higher grain input costs) and meat (through higher wholesale prices). Strong international demand, particularly for lamb and beef, has also put upward pressure on meat prices over the past year. Milk prices increased in the June quarter following decisions by major supermarkets to raise private-label milk prices.

Some measures of inflation expectations have declined a little

Wage- and price-setting behaviour can be affected by expectations about the future rate of

Graph 4.10

Market Services Inflation

* Year-ended; includes household services, meals out & takeaway and insurance & financial services; adjusted for the tax changes of 1999–2000

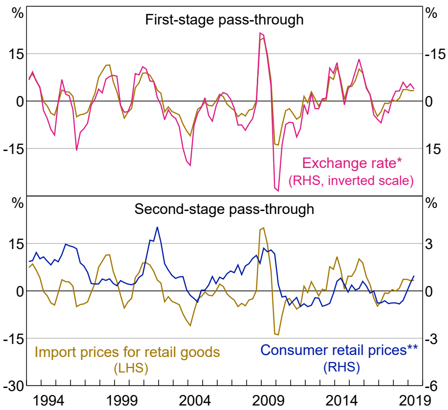
** Two-year-ended annualised growth

Sources: ABS; RBA

Graph 4.11

Retail Prices and the Exchange Rate

Year-ended



* Import-weighted index; quarter average

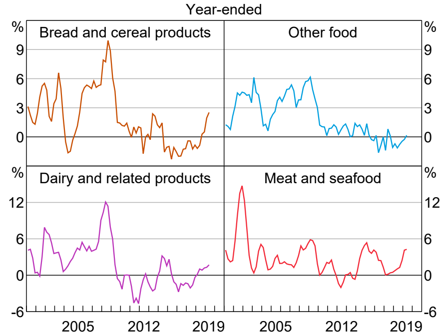
** Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 4.12

Grocery Price Inflation*

Year-ended



* Adjusted for the tax changes of 1999–2000

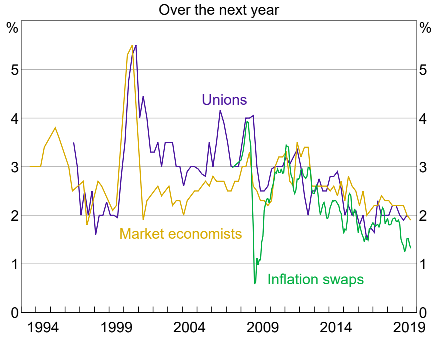
Sources: ABS; RBA

inflation. Short-term market-based measures of inflation expectations remain low (Graph 4.13). Long-term market-based measures of inflation expectations have continued to decline and are now at their lowest since 1992 (Graph 4.14). Similar declines have also occurred in other advanced economies this year and reflect unusually low perceived uncertainty about future inflation outcomes. Survey-based measures of inflation expectations have eased slightly or been little changed over recent months. However, they remain consistent with the Bank's medium-term inflation target.

Graph 4.13

Short-term Inflation Expectations

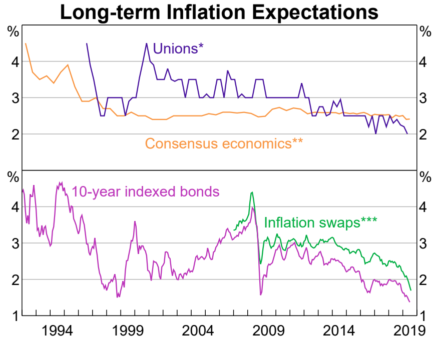
Over the next year



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

Graph 4.14

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

Wages growth remains low

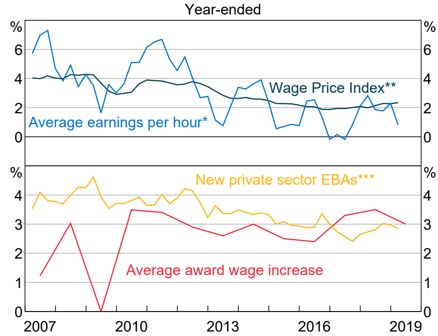
Growth in wages has picked up a little, but remains modest (Graph 4.15). The low rate of wages growth reflects a number of factors. There is still considerable spare capacity in the labour market despite strong employment growth over the past year or so. The adjustment to the end of the mining investment boom has led to a prolonged period of relatively weak wages growth in mining-exposed states and industries, although this effect has largely dissipated. Government policies have also kept public sector wages growth stable at around 2½ per cent over the past few years. There are a number of other potential explanations for low wages growth, both in Australia and globally, including low productivity growth, and the effect of technological change and globalisation on workers' perceived bargaining power.[1] It is difficult to know how persistent or important these structural factors are, although wages growth has increased over the past year in other advanced economies, where labour markets are very tight.

Growth in the Wage Price Index (WPI) was broadly steady in the March quarter at 0.5 per cent to be 2.3 per cent higher over the year. Year-ended wages growth in the private sector increased to 2.4 per cent, which is its

Graph 4.15

Wages Growth

Year-ended



* Non-farm
** Excluding bonuses and commissions
*** Average annualised wage increase; federally registered

Sources: ABS; Attorney-General's Department; FWC; RBA fastest pace in four years. There has been a more noticeable pick-up in wages growth in industries where wages are more sensitive to labour market conditions and where workers tend to be on individual agreements.[2] This includes the professional, scientific & technical services and mining industries (Graph 4.16)

The Fair Work Commission increased federal awards and the national minimum wage by 3 per cent on 1 July, which followed an increase of 3.5 per cent in the previous year. These recent increases have supported wages growth at the lower end of the skill distribution and for those that are employed on a casual basis, given the prevalence of award-reliant jobs in these parts of the labour market. The share of employees that are award-reliant is around 20 per cent, although there will also be some pass-through to wage decisions that are in some way linked to awards.

Wages growth in enterprise bargaining agreements (EBAs) has been relatively steady at a low level in recent years. This reflects that public sector workers account for around two-thirds of EBA employees and government policies have been in place in many jurisdictions to keep public sector wages growth steady at around 2½ per cent in recent years. There are some clear differences across the public sector (Graph 4.17). Wages growth for the Western Australian public sector has generally been the lowest across state governments in recent years following a period of above-average growth during the mining boom, while Victorian public sector wages growth has been relatively strong in recent years with many workers receiving wage increases of around 3 per cent. Average wages growth for Commonwealth Government jobs has increased following a period where protracted EBA negotiations led to widespread wage freezes. Within the private sector, several large retailers have recently signed new EBAs after a lengthy period of renegotiation, during which employee wages were frozen. This should boost average wages growth in the retail industry in the near term.

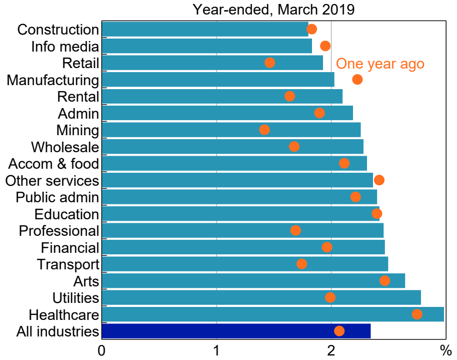
Firms' expectations of wages growth have stabilised

Union and consumer expectations of wages growth over the next year have declined (Graph 4.18). An increasing share of firms in the RBA's liaison program expect wages growth to be broadly stable at current levels over the next year. The share of firms expecting stronger growth in the year ahead is similar to the share of firms expecting weaker wages growth. Around 60 per cent of firms in the NAB quarterly survey report that the availability of labour is

Graph 4.16

Wage Price Index Growth by Industry*

Year-ended, March 2019



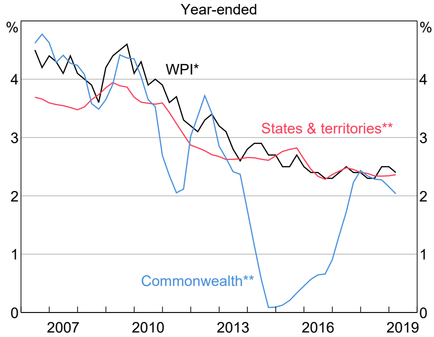
* Excluding bonuses and commissions; non-seasonally adjusted

Source: ABS

Graph 4.17

Wages Growth by Level of Government

Year-ended



* Public; excluding bonuses

** RBA estimates based on publicly available EBA data; states and territories weighted by number of employees

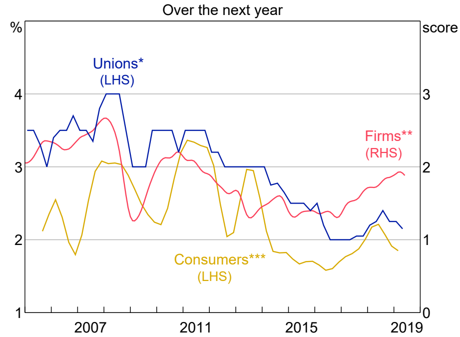
Sources: ABS; RBA

either a minor or major constraint on their business, while job vacancies remain at a very high share of the labour force. However, there is little evidence that these perceived shortages have translated into broader wage pressures, with reports from liaison that businesses are using non-wage incentives such as flexible work arrangements to attract and retain staff. ✠

Graph 4.18

Short-term Wages Growth Expectations

Over the next year



* Median

** Average Likert score; quarterly average; trend; score of two can be interpreted as average growth and zero for no growth

*** Average; trend

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

Endnotes

[1] These potential explanations were discussed at the recent RBA conference on 'Low Wage Growth'. For more information, see RBA (2019), *Low Wage Growth*, Proceeding of a Conference, Reserve Bank of Australia. Available at <https://www.rba.gov.au/publications/confs/2019/>

[2] For more information on how wages growth dynamics can differ across different pay-setting methods, see Bishop J and N Cassidy (2019), 'Wages Growth by Pay-setting Method', RBA *Bulletin*, June. Available at <https://www.rba.gov.au/publications/bulletin/2019/jun/wages-growth-by-pay-setting-method.html>