

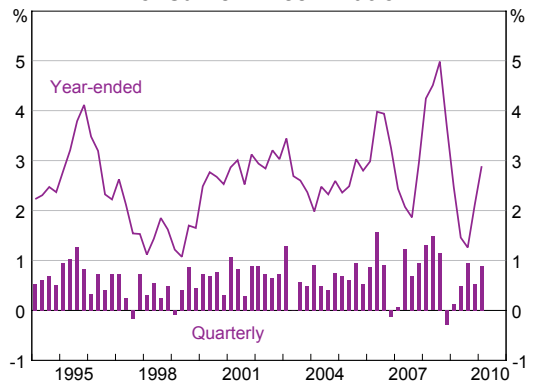
Price and Wage Developments

Recent Developments in Inflation

The consumer price index (CPI) increased by 0.9 per cent in the March quarter, to be 2.9 per cent higher over the year (Table 12, Graph 73). The quarterly outcome was boosted somewhat by seasonal price increases in items such as pharmaceuticals and education, and by increases in automotive fuel and deposit & loan facilities prices. Based on a range of measures, underlying inflation is estimated to have been around 0.8 per cent in the March quarter, which was a little higher than had been expected and above the outcome for the December quarter (Graph 74).¹ In year-ended terms, underlying inflation continued to moderate, to around 3 per cent, well down from the peak of a little above 4½ per cent over the year to September 2008. Accordingly, underlying and CPI inflation were broadly the same over the year to March, following a period since late 2008 when year-ended CPI inflation was considerably lower. The previous gap largely reflected sharp price declines in the volatile automotive fuel and deposit & loan facilities items in 2008/09, which have now largely dropped out of the year-ended calculations.

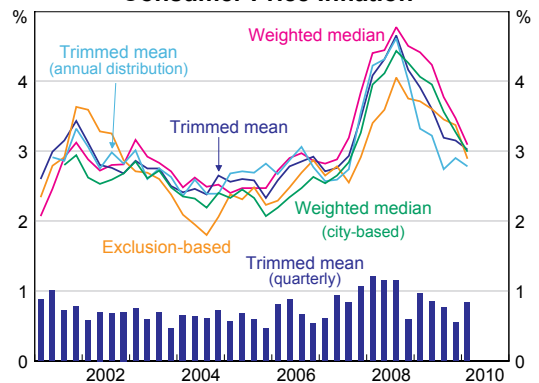
¹ The exclusion-based series is the CPI excluding fruit, vegetables, automotive fuel and deposit & loan facilities. The weighted median (city-based) series is calculated using disaggregated quarterly price change data for each CPI item in each of the eight capital cities, rather than using national average data (i.e. it is based on 720 price changes rather than the 90 national price changes). The trimmed mean (annual distribution) series is the average annual inflation rate after trimming the 15 per cent (by weight) of items with the highest and lowest year-ended inflation rates (rather than calculating trimmed mean inflation using the quarterly price changes of items and then cumulating these quarterly rates to an annual rate).

Graph 73
Consumer Price Inflation*



* Excluding interest charges prior to September quarter 1998 and adjusted for the tax changes of 1999–2000
Sources: ABS; RBA

Graph 74
Consumer Price Inflation*



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

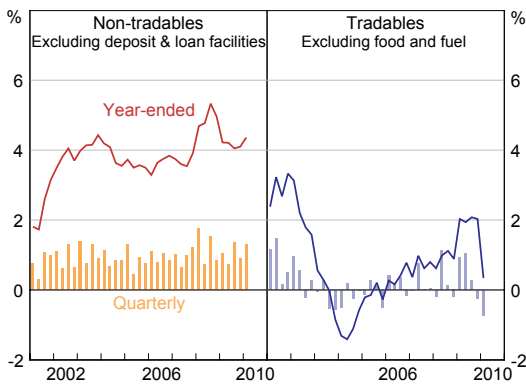
Table 12: Measures of Consumer Price Inflation
Per cent

	Quarterly		Year-ended	
	December quarter 2009	March quarter 2010	December quarter 2009	March quarter 2010
CPI	0.5	0.9	2.1	2.9
– Tradables	0.1	0.2	1.4	1.1
– Tradables (ex food & fuel)	–0.3	–0.7	2.0	0.3
– Non-tradables	0.8	1.5	2.6	4.2
<i>Selected underlying measures</i>				
Trimmed mean	0.5	0.8	3.2	3.0
Weighted median	0.6	0.8	3.5	3.1
CPI ex volatile items ^(a) and deposit & loan facilities	0.5	0.7	3.4	2.9

(a) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

Graph 75

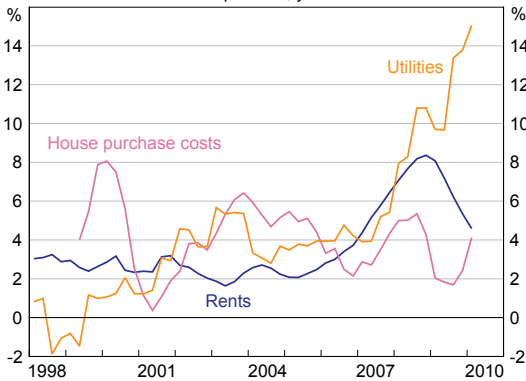
Consumer Price Inflation*



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

Graph 76

Housing Cost Inflation*
Main components, year-ended



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

Inflation in tradable and non-tradable items diverged further in the March quarter (Graph 75). Non-tradables inflation (excluding deposit & loan facilities) picked up to 1.3 per cent in the quarter, and 4.4 per cent in year-ended terms. Housing-related prices continued to make a significant contribution (Graph 76). Utilities prices continued to increase strongly in the quarter, largely driven by increases in Melbourne electricity and gas prices. More broadly, utilities prices have increased strongly in a number of states over the past year, or are expected to in coming quarters, partly reflecting the implementation of large price increases to help fund the upgrade of infrastructure. Inflation in house purchase costs has increased since mid 2009, partly due to the fall in the Federal Government's first-home buyer grant back to its earlier level. Rent inflation remained firm at 1 per cent in the quarter, consistent with the tight rental market.

In contrast, tradables prices (excluding food & fuel) fell by 0.7 per cent in the quarter, following a small decline in the December quarter, to be little changed over the year. The quarterly decline was due to fairly broad-based falls in retail goods prices, reflecting discounting by retailers, the appreciation

of the exchange rate through 2009, and the reduction in tariffs on motor vehicles (and parts) and a range of textile, clothing and footwear products, which took effect in January. The largest declines over the past year were recorded for audio, visual & computing prices, which declined by more than 6 per cent, and clothing & footwear prices, which fell by around 2 per cent.

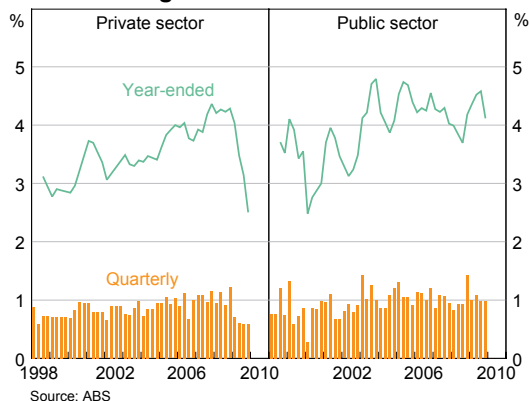
Overall, as expected, inflationary pressures have moderated substantially since late 2008, reflecting the significant easing in demand and capacity pressures and in wage growth, which act over time to dampen inflation. A further modest decline in year-ended underlying inflation is expected in the near term, although inflation is now forecast to fall by less than at the time of the February *Statement*.

Costs

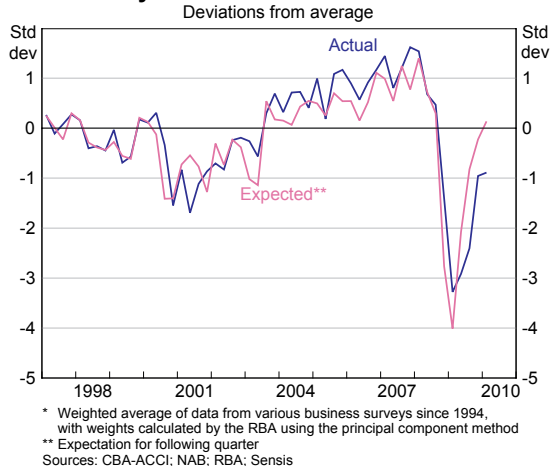
Labour costs have continued to grow at a below-average pace, due to the earlier easing in labour market conditions. The wage price index (WPI) increased by 0.6 per cent in the December quarter, half the pace recorded a year earlier. In year-ended terms, WPI growth moderated to 2.9 per cent, nearly 1½ percentage points below the peak in late 2008. This was largely due to an easing in private-sector wage growth to 2.5 per cent over the year to December, the slowest pace in the 12-year history of the series (Graph 77). Growth in public-sector wages remained solid, at 4.1 per cent over 2009. The moderation in wage growth was broad-based across states and industries, although it was particularly pronounced in Western Australia and South Australia.

Business surveys and the Bank's liaison suggest that wage growth remained below average in early 2010 (Graph 78). Firms are continuing to report relatively little difficulty finding suitable labour, although conditions have tightened somewhat over the past year (Graph 79). Consistent with the tightening in the labour market, growth in labour

Graph 77
Wage Price Index Growth

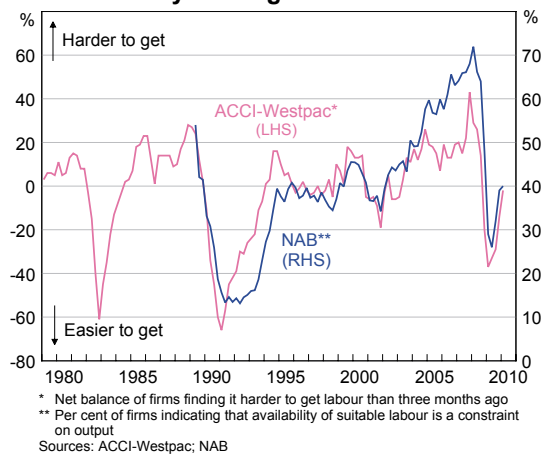


Graph 78
Surveys of Business Labour Costs*



* 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 79
Difficulty Finding Suitable Labour



* Net balance of firms finding it harder to get labour than three months ago
** Per cent of firms indicating that availability of suitable labour is a constraint on output
Sources: ACCI-Westpac; NAB

costs is expected to pick up over the next year, although not to pre-downturn levels.

Estimated labour productivity growth was relatively strong over 2009, which is not unusual during the early stages of an economic recovery. This followed fairly weak productivity growth in the years prior to the downturn. The combination of solid productivity growth and weak average earnings growth over 2009 – the national accounts measure of average earnings per hour was broadly unchanged – implied a significant moderation in labour costs per unit of output.

Upstream price pressures picked up in the March quarter, after pronounced weakness over 2009. Final-stage producer prices (excluding oil) rose by 0.8 per cent in the quarter, after falling through 2009 (Graph 80). This turnaround reflected developments in the prices of imported goods,

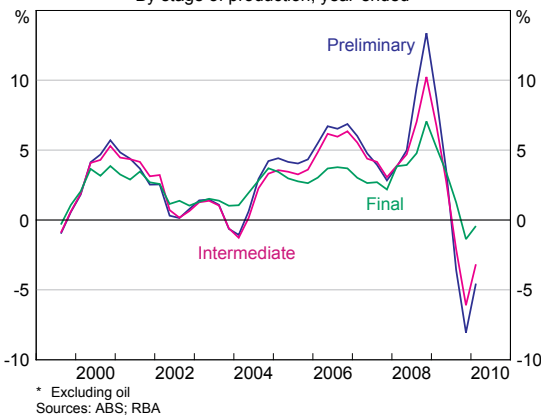
with final-stage import prices (excluding oil) increasing by 1.2 per cent in the quarter, after declining by more than 12 per cent over 2009 as the exchange rate appreciated significantly. Domestic upstream price pressures were relatively firm in the March quarter, driven by increases in construction and utilities prices. Manufacturing output prices (excluding oil) rose by nearly 2 per cent in the quarter, after declining over 2009.

Inflation Expectations

Measures of inflation expectations have generally drifted up through 2009 and early 2010, following the sharp declines in 2008, with most measures now around, or a little above, average levels. Market economists' and union officials' inflation forecasts for 2010 and 2011 are around the top of the medium-term inflation target (Table 13),

Graph 80

Producer Price Inflation*
By stage of production, year-ended



Graph 81

Indicators of Inflation Expectations

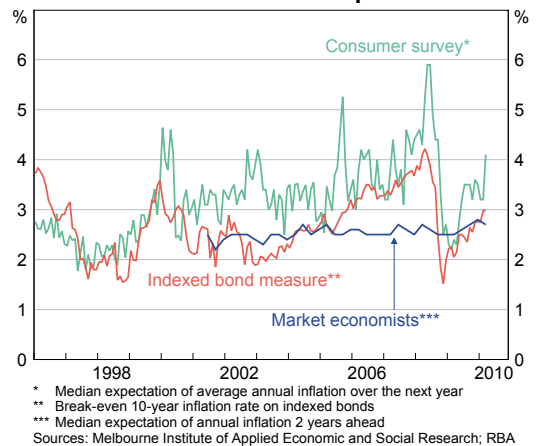


Table 13: Median Inflation Expectations
Per cent

	Year to December 2010			Year to December 2011	
	November 2009	February 2010	May 2010	February 2010	May 2010
Market economists ^(a)	2.2	2.3	3.1	2.9	3.0
Union officials ^(b)	2.6	3.0	3.1	3.0	3.0

(a) RBA survey

(b) Workplace Research Centre

although market economists expect inflation to moderate in 2012 (Graph 81). Measures of inflation expectations derived from financial markets have drifted upwards in recent months, with the measure derived from indexed bonds now slightly above its average over the inflation-targeting period. The Melbourne Institute's survey measure of consumer inflation expectations rose noticeably in April, but this series can be volatile at times. Business survey measures of expected selling price growth in the near term remain at below-average levels, despite some increase recently.

