4. Inflation

Inflation was stronger than expected in the September quarter. Headline inflation was 0.8 per cent in the quarter and 3 per cent over the year. About two-thirds of the quarterly increase in the Consumer Price Index (CPI) was accounted for by sharp rises in two components: fuel prices and home-building costs. Growth in construction costs picked up noticeably in the quarter, reflecting both rising input costs globally and the Australia-specific effect of the strong demand induced by the HomeBuilder subsidy and similar state government grants. Although prices of some consumer durable goods picked up as import price pressures persisted and demand remained strong, inflation was fairly subdued in other expenditure components in the September quarter. Underlying inflation was also the strongest for some time, at 0.7 per cent in the quarter and 2.1 per cent over the year.

Wages growth was moderate in the June quarter, with a return to more typical pre-pandemic patterns of growth in some parts of the private sector; this was somewhat offset by ongoing wage freezes elsewhere, as well as soft wages growth in the public sector. Wages growth was subdued in most industries, including those where there had been reports of labour shortages, such as construction, professional services and mining. Reports from the Bank's business liaison program suggest that recently firms have been using measures other than raising base wages in order to attract and retain staff, with wages only rising significantly for selected jobs in very high demand.

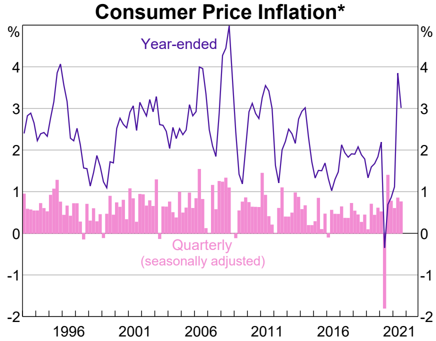
Headline inflation remained elevated and underlying inflation picked up in the September quarter

The CPI increased by 3 per cent over the year to the September quarter (Graph 4.1; Table 4.1). While the peak effect on price movements of earlier government policies (such as temporary subsidies for child care) has passed, their unwinding is still boosting year-ended inflation. The rebound in fuel prices since mid 2020 also continues to add to year-ended inflation. The combination of higher prices for automotive fuel and new dwelling purchase costs contributed about two-thirds of the 0.8 per cent (seasonally adjusted) increase in headline inflation in the September quarter (Graph 4.2).

Measures of underlying inflation attempt to remove the effect of irregular or temporary price changes in the CPI, such as the period of free child care in 2020. Both trimmed mean and weighted median inflation were 2.1 per cent in the year to the September quarter, up from

Graph 4.1

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)]	
	September quarter 2021	June quarter 2021	September quarter 2021	June quarter 2021
Consumer Price Index	0.8	0.8	3.0	3.8
Seasonally adjusted CPI	0.8	0.8	–	–
– Tradables	0.7	1.4	3.1	3.6
– Tradables (excl volatile items)[(c)]	0.0	0.3	0.8	1.2
– Non-tradables	0.7	0.6	3.2	4.0
Selected underlying measures				
Trimmed mean	0.7	0.5	2.1	1.6
Weighted median	0.7	0.5	2.1	1.6
CPI excl volatile items[(c)]	0.5	0.6	2.5	3.1

(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

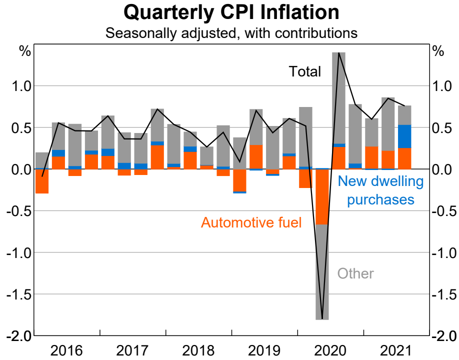
Sources: ABS; RBA

1.6 per cent in the year to the June quarter (Graph 4.3). This was the highest year-ended rate of inflation in these measures since 2015.

New dwelling inflation increased sharply in the quarter, driving much of the increase in aggregate inflation

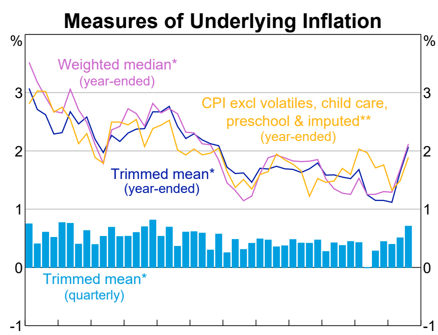
Prices for new dwelling construction, which make up just under one-tenth of the CPI basket, increased significantly – up by 3.3 per cent in the September quarter. This was driven by substantial increases in builders' base prices (exclusive of government subsidies) in most capital cities (Graph 4.4). Sustained strong demand for housing construction, in part boosted by the HomeBuilder subsidy and similar state government grants, enabled builders to

Graph 4.2



Sources: ABS; RBA

Graph 4.3



* Seasonally adjusted

** Not seasonally adjusted; excludes fruit, vegetables, automotive fuel, child care, preschool & primary education and items that were imputed using headline CPI for all capital cities in the June or September quarter 2020

Sources: ABS; RBA

pass through increased costs for domestic and imported building materials and labour. New dwelling inflation in the September quarter also lifted because fewer government grants were paid out than in the June quarter. Despite applications for HomeBuilder having closed earlier in the year, payments of grants are expected to continue for some time. This will dampen measured prices over that period, although the effect on inflation in a given quarter will vary depending on how many grants are paid out in that quarter.

A key driver of the pick-up in new dwelling inflation has been the strong rise in raw materials costs, which increased 4 per cent in the September quarter and 8 per cent over the year, the fastest pace since the 1980s (Graph 4.5). Domestic and global supply shortages have particularly affected prices of timber and steel inputs. Price increases also reflect a surge in construction activity in response to policy inducements – residential building commencements have been growing at their fastest pace since the early 2000s, and capacity utilisation in the construction industry has been high (see chapter on 'Domestic Economic Conditions').

Rents increased a little in aggregate, although there were large differences across cities

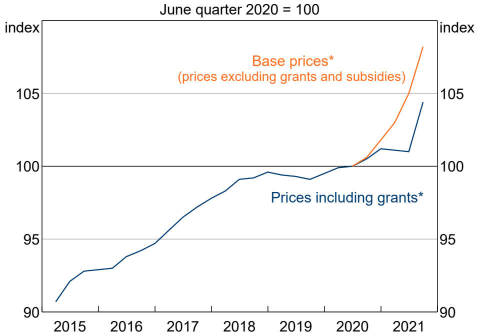
Rents, which account for around 7 per cent of the CPI basket, increased by 0.2 per cent in the September quarter. Although CPI rent inflation remains low relative to aggregate measures of inflation, it has picked up. Advertised rents suggest some further increases in the year ahead, although the pass-through of higher prices in newly rented dwellings to the CPI measure – which covers the entire stock of rental properties – is always gradual.

Rental conditions remain uneven across the country. Rents in Sydney and Melbourne fell further in the quarter due to subdued rental conditions, consistent with high vacancy rates; domestic and international border restrictions, and reduced numbers of short-term visitors and international students, contributed to these falls (Graph 4.6). This weakness somewhat offset continued strength in rents in the other capital cities experiencing low vacancy rates; recent high rent inflation in Perth partly reflects a shortage of rental stock following years of subdued dwelling investment.

Graph 4.4

New Dwelling Prices

June quarter 2020 = 100

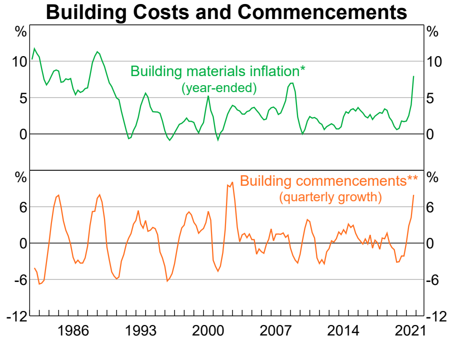


* Government housing construction grants include HomeBuilder and state government grants

Sources: ABS; RBA

Graph 4.5

Building Costs and Commencements



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

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

Sources: ABS; RBA

Retail inflation outcomes were mixed over the quarter

Retail prices, which comprise over a quarter of the CPI, were steady in the September quarter and 0.8 per cent higher than a year ago. However, the outcomes over the quarter varied across components. There were relatively strong price increases for some consumer durable items – including motor vehicles and some household goods – on the back of ongoing supply disruptions at overseas factories and sustained global and domestic demand (Graph 4.7). Liaison reports of input cost pressures among some non-food retailers have increased over recent months – partly because some overseas suppliers have increased prices in response to strong global demand and higher prices for raw materials, and partly because of the spike in shipping costs. By contrast, prices for clothing and footwear declined by 3.5 per cent in the quarter, as retailers increased discounting activity to move excess winter stocks because of weak demand during recent lockdowns.

Liaison information suggests many firms have absorbed upstream cost pressures, supported by earlier hedging of foreign exchange exposures at a favourable rate and improved margins over the past year. However, some household appliances and furnishings retailers have recently started passing higher upstream costs to consumers. Supply chain-related cost pressures and the extent of pass-through to consumers remain an upside risk to tradable goods inflation in the year ahead.

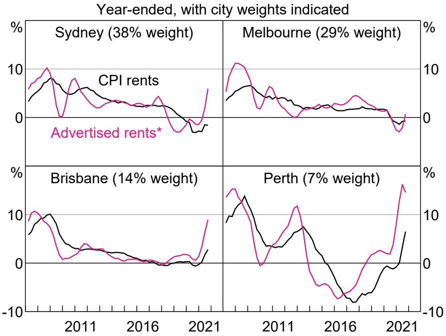
Grocery inflation has remained subdued in recent quarters (Graph 4.8). While lockdowns in 2020 and the sharp increase in 'at home' food consumption contributed to a marked rise in groceries inflation a year ago, prices did not respond similarly in the most recent lockdowns. Liaison information suggests that recent supermarket discounting behaviour has been in line with pre-pandemic patterns. Meat prices increased further as producers continued restocking following the end of the drought in eastern Australia; prices for other fresh food categories were little changed.

Prices of fruit & vegetables declined by 1.8 per cent in the quarter, subtracting a little from CPI inflation. Liaison suggests that favourable growing conditions have supported lower prices, and that concerns about labour shortages have not meaningfully affected fresh produce prices to date; fruit & vegetables prices are around 1 per cent lower than a year ago.

Graph 4.6

Rent Inflation

Year-ended, with city weights indicated

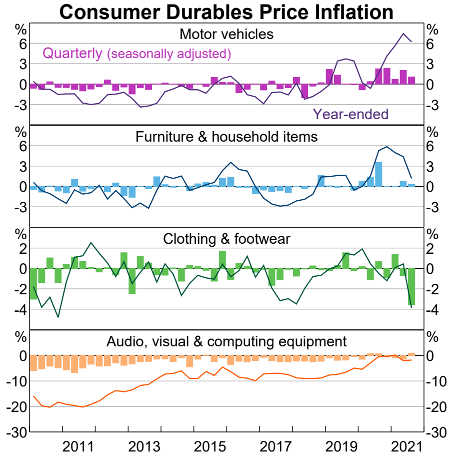


* Hedonic three-month average

Sources: ABS; CoreLogic; RBA

Graph 4.7

Consumer Durables Price Inflation



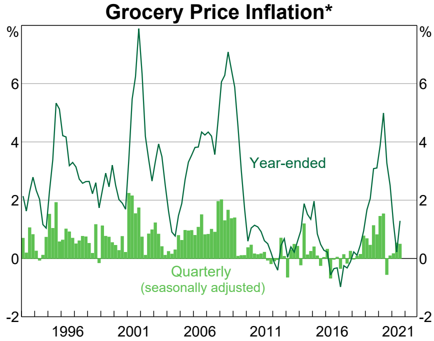
Sources: ABS; RBA

Fuel prices have increased strongly, making a large contribution to headline inflation

Fuel prices increased by just over 7 per cent in the September quarter, contributing 0.3 percentage points to headline inflation in the quarter (Graph 4.9). This lifted fuel prices in the CPI to their highest quarter average ever recorded (a little above prices in 2014). Fuel prices have increased even further since then, and at current levels would contribute ⅓ percentage point to quarterly headline inflation in the December quarter.

Graph 4.8

Grocery Price Inflation*



* Excludes fruit and vegetables; adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Administered prices increased only slightly as the effects of government policies faded further

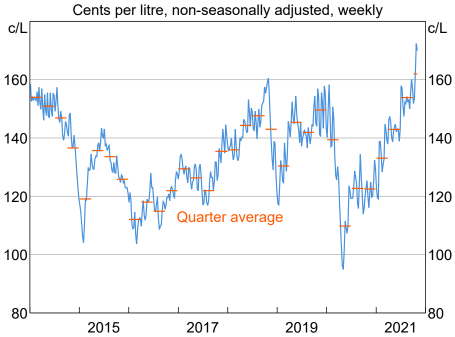
Administered prices (excluding utilities) rose by 0.8 per cent in the September quarter. Growth was stronger over the year at 6 per cent, largely because of the effects of freezes and rebates that were in place this time last year (Graph 4.10). Child care prices increased by 1.4 per cent in the September quarter and look to be returning to their pre-pandemic trend, after a period of very large movements in 2020 due to the effect of temporary large subsidies. Most state and local government fees and charges also increased in the September quarter, after a range of freezes and discounts imposed over the past year were ended; in aggregate they increased by around ½ per cent, primarily driven by a 1.2 per cent increase in property rates and charges.

Retail electricity prices declined slightly in the September quarter, and have been trending down for a number of years; prices are now 10 per cent lower than their recent peak at the end of 2018 (Graph 4.11). Retail gas prices increased only slightly in the quarter despite a spike in wholesale gas prices around the middle of the year, which was in part due to constrained supply.

Graph 4.9

Unleaded Petrol Prices

Cents per litre, non-seasonally adjusted, weekly

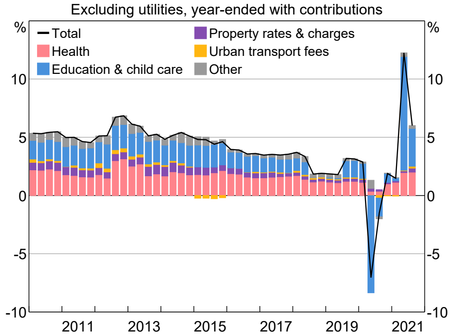


Sources: Australian Institute of Petroleum; RBA

Graph 4.10

Administered Price Inflation

Excluding utilities, year-ended with contributions



Sources: ABS; RBA

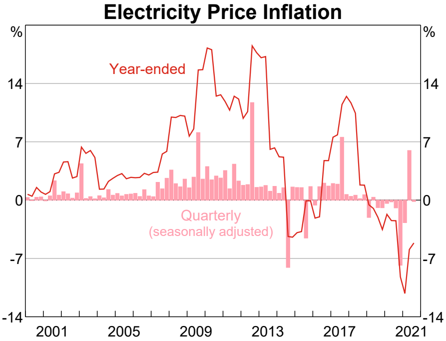
Restrictions in Sydney and Melbourne affected measured market services inflation in the quarter

Market services inflation, which accounts for a little over one-fifth of the CPI basket, was 0.8 per cent in the September quarter. However, price measurement was affected by recent lockdowns and state government vouchers. In particular, while the use of NSW 'Dine & Discover' vouchers in the June quarter had weighed on measured hospitality prices in that quarter, activity restrictions in the September quarter meant less use of vouchers and therefore measured prices increased. Since many of these vouchers are yet to be used, and additional similar vouchers have been announced by the NSW and some other state governments, this is expected to weigh on measured market services prices as they are used in future quarters.

Because of measurement difficulties caused by activity restrictions in a number of capital cities, prices for some market services as well as all domestic travel and accommodation services were imputed using headline inflation in the September quarter.

Graph 4.11

Electricity Price Inflation



Source: ABS

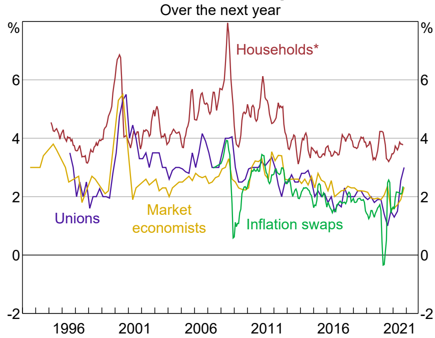
Inflation expectations have increased in recent months

Survey-based measures of short-term inflation expectations have increased over recent months, in particular for unions (Graph 4.12). Survey measures of long-term inflation expectations increased to around 2½ per cent, similar to levels seen in 2019 and consistent with the Bank's medium-term inflation target (Graph 4.13). Long-term market-based measures of inflation expectations also increased recently.

Graph 4.12

Short-term Inflation Expectations

Over the next year

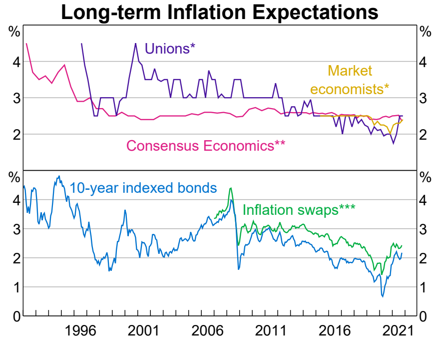


* Smoothed

Sources: Australian Council of Trade Unions; Bloomberg; Melbourne Institute of Applied Economic and Social Research; RBA; Workplace Research Centre

Graph 4.13

Long-term Inflation Expectations



* Average over the next 5 to 10 years

** Average over 6 to 10 years in the future

*** 5- to 10-years forward

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

Wages growth was subdued across most industries in the June quarter

The Wage Price Index (WPI) grew by 0.4 per cent in the June quarter, and 1.7 per cent in year-ended terms (Graph 4.14). Private sector wages increased by 0.5 per cent, with soft growth across most industries. Public sector wages growth was more subdued, at 0.4 per cent, reflecting the prevalence of wage caps and freezes across the sector, as well as ongoing negotiations of new enterprise agreements, some of which were delayed due to the pandemic.

Disaggregated WPI data shows that the share of jobs subject to wage freezes remained elevated in the June quarter, and was particularly high for jobs where wages are set by individual agreement (Graph 4.15).

Based on job-level WPI data, most wage increases remained below 3 per cent over the year to the June quarter; the share of jobs experiencing wage increases above 3 per cent remains much lower than was seen in the 2000s (Graph 4.16). Information from the Bank's business liaison program suggests that – rather than raise base wages – many firms experiencing difficulties finding labour have been using other strategies to retain and attract employees. These strategies include paying targeted sign-on and retention bonuses, offering increased workplace flexibility, providing more internal training and relying more on less-experienced staff. Liaison reports suggest that, recently, wages growth has been strong for specific jobs where labour shortages are acute (such as some types of IT professionals, tradespersons and chefs).

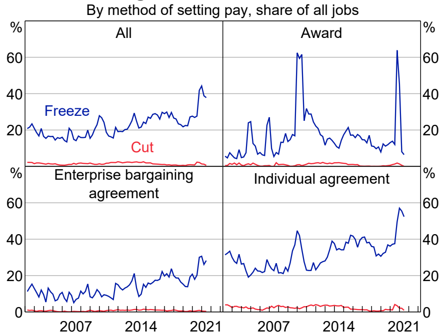
Leading indicators suggest wages growth is returning to pre-pandemic norms

Based on information from the Bank's liaison program, firms report that the prevalence of wage freezes declined in the September quarter and would decline further in the December

Graph 4.15

Wage Freezes and Cuts*

By method of setting pay, share of all jobs

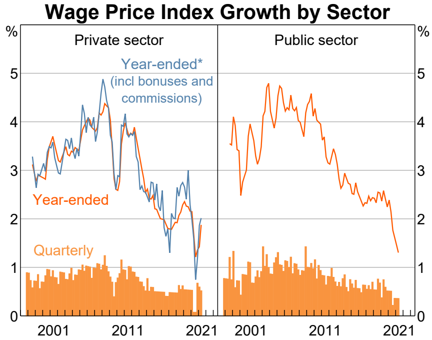


* A 'freeze' is identified when there has been no change in the level of a wage for a given job compared with 12 months earlier; a 'cut' is when the wage level for a given job is lower compared with 12 months earlier

Sources: ABS; RBA

Graph 4.14

Wage Price Index Growth by Sector



* Non-seasonally adjusted

Source: ABS

Graph 4.16

Wage Changes of Different Sizes*

Share of jobs that experienced a wage change

* Smoothed using a four-quarter trailing average

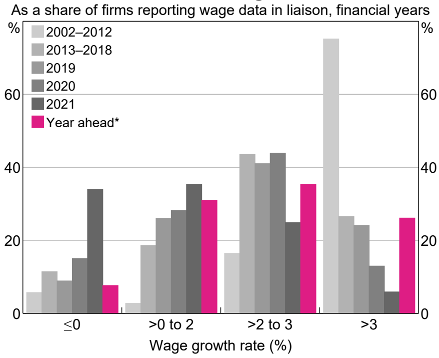
Sources: ABS; RBA

quarter. Firms are generally reporting an expected return to annual wage rises of 2–2½ per cent over the next year. The distribution of firms' wages growth expectations is broadly similar to the pre-pandemic pattern, with only around a quarter of firms expecting wages growth to be greater than 3 per cent (Graph 4.17). Other surveys of wages growth expectations are also consistent with wages growth picking up to around 2–2½ per cent over the year ahead (Graph 4.18). ✠

Graph 4.17

Distribution of Wages Growth

As a share of firms reporting wage data in liaison, financial years



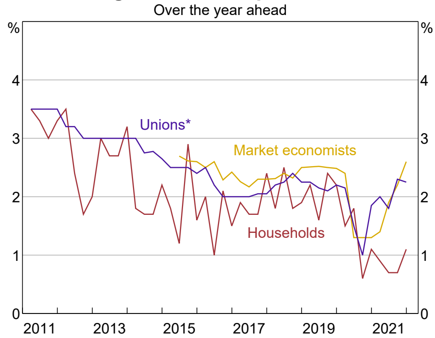
* Expectations for the year ahead for firms reporting in the September quarter of 2021

Source: RBA

Graph 4.18

Wages Growth Expectations

Over the year ahead



* Union expectations are for the next calendar year

Sources: Australian Council of Trade Unions; Melbourne Institute of Applied Economic and Social Research; RBA; Workplace Research Centre