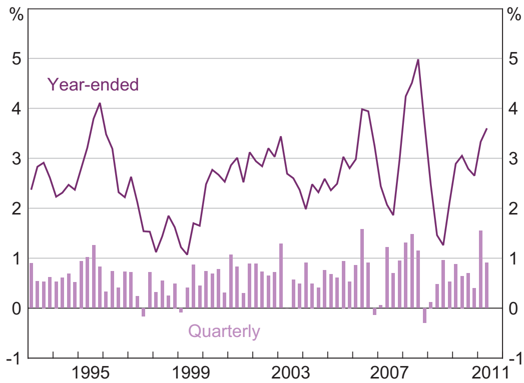
5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation picked up significantly over the first half of 2011, in part due to large increases in fruit and vegetable prices following the flooding and storms early in the year and to higher fuel prices. The consumer price index (CPI) increased by 0.9 per cent in the June quarter, which was a little higher than expected owing to surprisingly large increases in the prices of a range of retail goods (Graph 5.1, Table 5.1). CPI inflation rose to 3.6 per cent over the year. Measures of underlying inflation have also picked up somewhat, with the disinflationary effects of the 2008 slowdown now having waned.

Graph 5.1
Consumer Price Inflation*



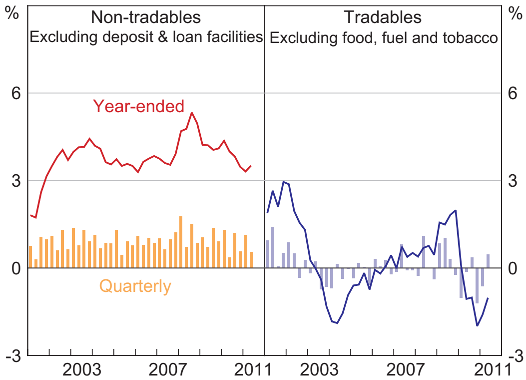
* Excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999–2000
Sources: ABS; RBA

Table 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly		Year-ended	
	March quarter 2011	June quarter 2011	March quarter 2011	June quarter 2011
CPI	1.6	0.9	3.3	3.6
– Tradables	1.8	1.3	3.3	3.6
– Tradables (excl food, fuel and tobacco)	–0.6	0.5	–1.6	–1.0
– Non-tradables (excl deposit & loan facilities)	1.1	0.6	3.3	3.5
Selected underlying measures				
Trimmed mean	0.9	0.9	2.3	2.7
Weighted median	0.8	0.9	2.2	2.7
CPI excl volatile items[(a)] and deposit & loan facilities	0.7	0.5	2.6	2.4

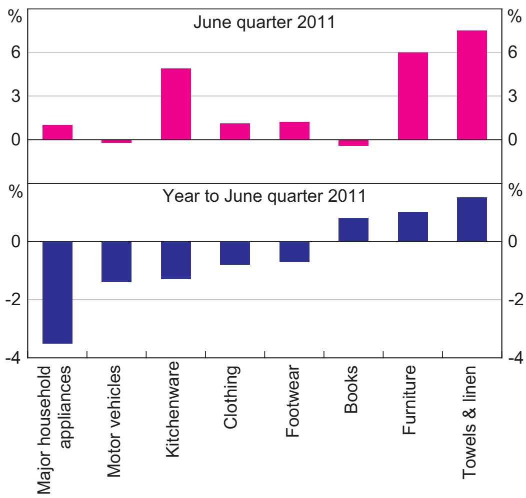
(a) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

Graph 5.2
Consumer Price Inflation*



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

Graph 5.3
Inflation in Consumer Durables



Source: ABS

While quarterly inflation in non-tradable items (excluding deposit & loan facilities) was relatively low, as typically occurs in the June quarter, year-ended inflation for non-tradables picked up slightly to 3.5 per cent (Graph 5.2). The pick-up followed a 2½-year period during which the rate of non-tradables inflation declined significantly from the very high pace seen in the September quarter 2008. Over the most recent year there were significant increases in the prices of utilities, rents, and a range of household services including education, insurance and child care. Housing cost inflation, the largest component of the CPI, has eased over recent quarters, partly owing to soft demand in residential building. Inflation in this component, however, is expected to pick up over coming quarters: the tightening of the rental market is expected to contribute to higher rent inflation and the pass-through of regulatory price increases will see inflation for utilities remain quite high.

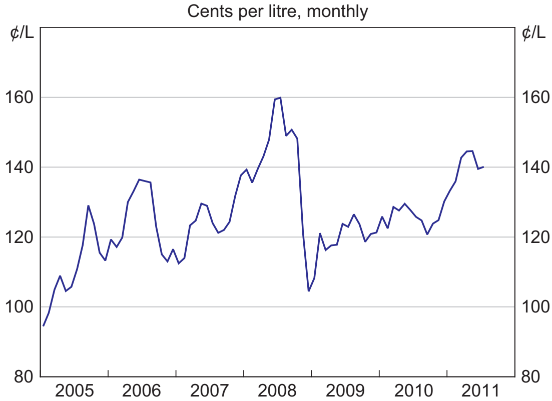
Over the year, there have been notable price falls across a broad range of tradable goods reflecting the large appreciation of the exchange rate and subdued retail trading conditions (Graph 5.3). However, following two quarters of declines, tradables prices (excluding food, fuel and tobacco) rose by 0.5 per cent in the June quarter. Significant increases were reported for the prices of a range of items including furniture, clothing accessories, children's footwear, towels & linen, and kitchenware. While the increases in part reflect the usual seasonal pattern, the extent of price rises was somewhat surprising in light of the currency appreciation over recent quarters and the softness in retail demand. One possible explanation is that there has been some change in the timing of sales, while another is that the price increases reflect increasing upward pressure on the domestic costs of retailers and distributors. In addition, there is some evidence from inflation data in other countries that rising global manufactured goods prices are becoming a source of inflationary pressure.

Food prices rose by 1.4 per cent in the quarter to be 6.1 per cent higher over the year. This reflects the effects of bad weather earlier in the year, although for some affected items prices have declined as growing conditions have improved. Fruit prices rose by 27 per cent in the quarter owing to the ongoing effect of Cyclone Yasi on banana prices (which the ABS estimates were almost five times higher than before the cyclone), while vegetable prices declined by 10 per cent as the supply of crops affected by the floods recovered. Looking ahead, fruit and vegetable prices are expected to reduce headline inflation as the supply of bananas recovers to normal levels. Excluding fruit and vegetables, food prices rose by a modest 0.2 per cent in the quarter, to be 1.4 per cent higher over the year. Inflation in the price of restaurant meals picked up in line with the general strength in non-tradables inflation, while the price of milk and bread continued to decline, with major supermarkets discounting these items heavily.

Following a sharp increase in the March quarter, automotive fuel prices rose by 4 per cent in the June quarter to be 11 per cent higher over the year (Graph 5.4). The appreciation in the Australian dollar has only partly offset the effect of strong global demand and geopolitical tensions on oil prices, which in US dollars were up by more than 50 per cent over the year to the June quarter.

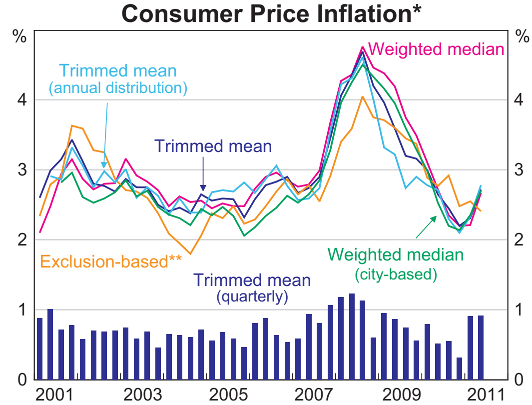
Measures of underlying inflation ranged from 0.5 per cent to 0.9 per cent in the June quarter. On a year-ended basis, measures of underlying inflation were in the range of 2½–2¾ per cent, up from around 2¼ per cent six months earlier (Graph 5.5). While the current rate of underlying inflation is well below the levels of late 2008, it appears that the period of disinflation has passed, with the effect of labour market tightening, solid growth in unit labour costs and strengthening global inflation more than offsetting the disinflationary effects of soft consumer demand and the exchange rate appreciation.

Graph 5.4
Retail Petrol Prices
Cents per litre, monthly



Sources: Australian Institute of Petroleum; FUELtrac; RBA

Graph 5.5
Consumer Price Inflation*

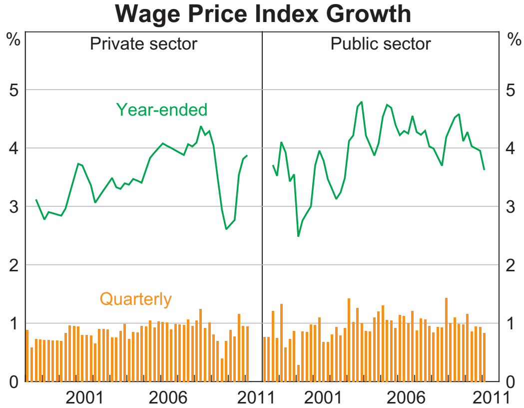


* Adjusted for the tax changes of 1999–2000
** Excludes fruit, vegetables, automotive fuel and deposit & loan facilities
Sources: ABS; RBA

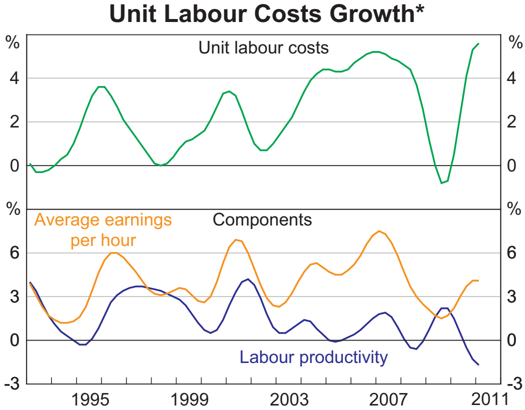
Costs

Labour cost growth remains firm, in line with a relatively tight labour market. The wage price index rose by 0.8 per cent in the March quarter, to be 3.8 per cent higher over the year, leaving the pace of annual wage inflation broadly unchanged. Growth in private-sector wages was 3.9 per cent over the year to March, somewhat above the 3.5 per cent average pace seen since the series began in 1997 (Graph 5.6). Public-sector wage growth has slowed, with recent developments suggesting some prospect of further slowing. Year-ended wage growth was relatively uniform across the states, with Western Australia recording the strongest growth. By industry, growth was strongest in the mining and professional, scientific & technical services industries.

Graph 5.6
Wage Price Index Growth



Graph 5.7
Unit Labour Costs Growth*



Fair Work Australia (FWA) announced the outcome of its annual wage review in June, increasing award wages by a uniform 3.4 per cent from 1 July. The decision to grant a percentage increase, rather than a fixed dollar increase as in earlier years, was intended to preserve relativities in the award classification structure. The increase was toward the upper end of those proposed in submissions by major stakeholders, with FWA noting in its decision the relatively strong performance of the economy over the past year.

Data from the national accounts indicate that non-farm unit labour costs – the average cost of labour per unit of output – rose strongly in the March quarter, although this mostly reflected the temporary fall in GDP associated with the fall in coal and iron ore production stemming from the adverse weather in the quarter. Nevertheless, smoothing through the volatility suggests that there has been a significant pick-up in unit labour costs growth recently, due in part to weak productivity growth outcomes (Graph 5.7). Estimates for both the market sector and the total economy suggest that labour productivity growth since 2003/04 has been around 1½ percentage points below the rate seen over the preceding three decades (Table 5.2). Furthermore, with strong growth in the capital stock and hours worked over the recent period, multifactor productivity in the market sector is estimated to have fallen over this period.

Table 5.2: Productivity Growth

Annual average, per cent

	1975/76–2003/04	2004/05–2010/11 [a]
Market sector industries [b]		
Labour productivity	2.2	0.9
Multifactor productivity	1.0	–0.8
All industries		
Labour productivity	2.0	0.6
Multifactor productivity	1.1	–0.1

(a) Labour productivity includes estimates for 2010/11; multifactor productivity is calculated to 2009/10

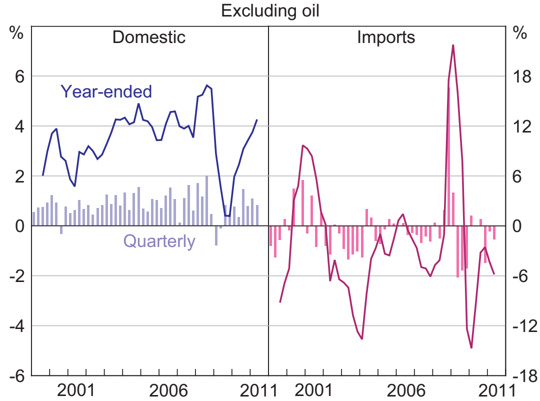
(b) Market sector estimates of productivity are more reliable as industries for which productivity is most difficult to estimate are excluded. Data prior to 1994/95 are for 'selected industries', which is a slightly narrower definition of the market sector than the current ABS definition.

Sources: ABS; RBA

Producer prices rose solidly over the first half of 2011, with a pick-up in year-ended inflation across all stages of production but most notably in the earlier stages. Final stage producer prices (excluding oil, which rose strongly) rose by 3.0 per cent over the year to June, while preliminary prices (excluding oil) rose by 4.7 per cent over the year. The domestic component of the index drove the pick-up, with sizeable increases recorded over the year for construction, food-related items and utilities prices (Graph 5.8). Import prices continued to subtract from final-stage producer price inflation. However, at the preliminary stage, import prices rose modestly for the second consecutive quarter in June, indicating that stronger global prices for commodities and manufactured goods outweighed the disinflationary effect of the exchange rate appreciation.

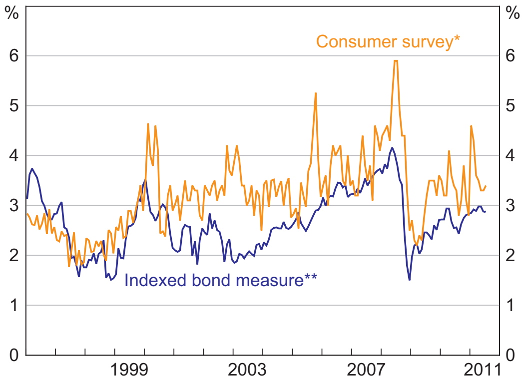
Graph 5.8
Final Stage Producer Price Inflation

Excluding oil



Sources: ABS; RBA

Graph 5.9
Indicators of Inflation Expectations



* Median expectation of average annual inflation over the next year
** Break-even 10-year inflation rate on indexed bonds
Sources: Melbourne Institute of Applied Economic and Social Research; RBA

Inflation Expectations

Most measures of inflation expectations are broadly unchanged since the May *Statement*, remaining at, or a little above, their inflation-targeting averages. The Melbourne Institute's measure of consumer inflation expectations, which spiked in January following the floods, was broadly unchanged over the quarter at around the average level of the past two years (Graph 5.9). Financial market measures of medium- to long-term inflation expectations are also broadly unchanged, with the indexed-bond measure of inflation expectations around its inflation-targeting average. The inflation expectations of market economists for 2011 are unchanged from three months ago, but expectations for CPI inflation in 2012 have picked up reflecting the expected impact of the carbon price (Table 5.3). The survey measure of union officials' inflation expectations for 2011 and 2012 are broadly unchanged since the May *Statement*. Somewhat in contrast, business survey measures suggest that selling price inflation is likely to remain a little below average in the near term.

Table 5.3: Median Inflation Expectations
Per cent

	Year to December 2011			Year to December 2012	
	February 2011	May 2011	August 2011	May 2011	August 2011
Market economists[(a)]	3.3	3.4	3.4	3.0	3.7
Union officials[(b)]	3.2	3.3	3.4	3.1	3.1

(a) RBA survey
(b) Workplace Research Centre