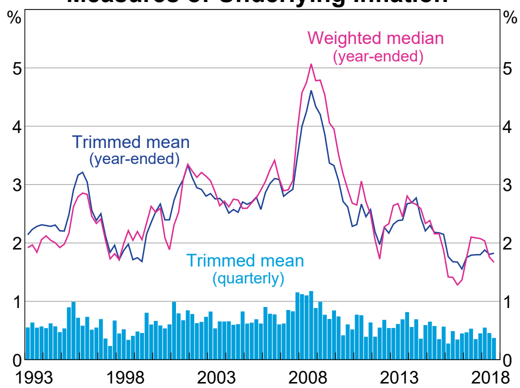
4. Inflation

Inflation remains low

Underlying inflation was a bit under ½ per cent in the September quarter and 1¾ per cent over the year (Table 4.1; Graph 4.1). This was in line with the forecast in the August *Statement on Monetary Policy*. Year-ended underlying inflation has been relatively low and stable between 1¾ per cent and 2 per cent over the past couple of years. This primarily reflects the spare capacity in the economy and the associated low wages growth. As expected, headline inflation declined to 0.1 per cent (seasonally adjusted) in the September quarter to be 1.9 per cent over the year (Graph 4.2). The low quarterly outcome reflected a large decline in the price of child care and a moderation in gas, electricity and new dwelling cost inflation. This step down in headline inflation is expected to be temporary; the Bank's assessment of underlying inflation pressures in the economy is little changed as a result of the latest inflation data.

Graph 4.1
Measures of Underlying Inflation*



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

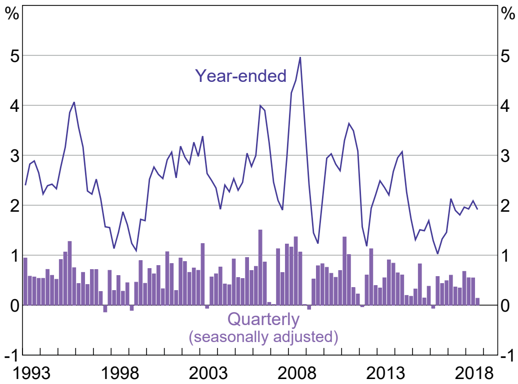
Sources: ABS; RBA

Table 4.1: Measures of Consumer Price Inflation
Per cent

	Quarterly(a)		Year-ended(b)	
	September quarter 2018	June quarter 2018	September quarter 2018	June quarter 2018
Consumer Price Index	0.4	0.4	1.9	2.1
Seasonally adjusted CPI	0.1	0.5	–	–
– Tradables	0.1	0.4	1.4	0.3
– Tradables (excl volatile items)	0.0	-0.2	-0.8	-1.0
– Non-tradables	0.2	0.7	2.2	3.0
Selected Underlying Measures				
Trimmed mean	0.4	0.4	1.8	1.8
Weighted median	0.3	0.4	1.7	1.7
CPI excl volatile items(c)	0.1	0.4	1.2	1.8

(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

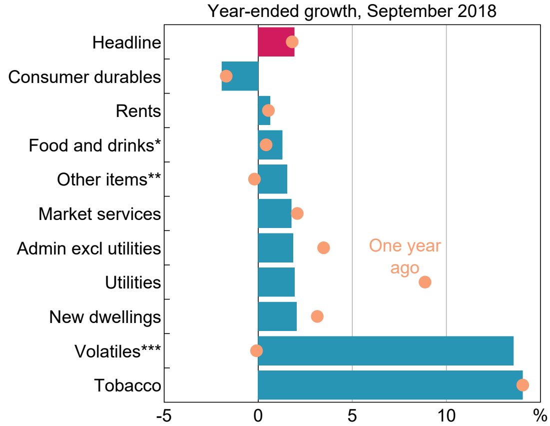
Graph 4.2
Consumer Price Inflation*



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

Sources: ABS; RBA

Graph 4.4
Inflation by Component
Year-ended growth, September 2018



* Excludes fruit, vegetables, meals out and takeaway

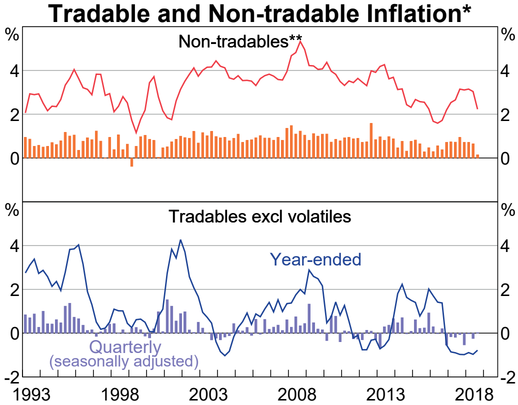
** Includes travel, telecommunications and pet products

*** Includes fruit, vegetables and automotive fuel

Sources: ABS; RBA

The prices of tradable items (excluding volatile items) have fallen a little over the year, though they were unchanged in the recent quarter (Graph 4.3). Inflation in the prices of non-tradable items moderated in the quarter and over the year, largely due to sizeable declines in the prices of some administered services and utilities and the slowing in new dwelling cost inflation (Graph 4.4). Over the past year, the share of items for which inflation has increased has been similar to the share of items for which inflation has declined.

Graph 4.3
Tradable and Non-tradable Inflation*



* Adjusted for the tax changes of 1999–2000

** Excludes interest charges and deposit & loan facilities

Sources: ABS; RBA

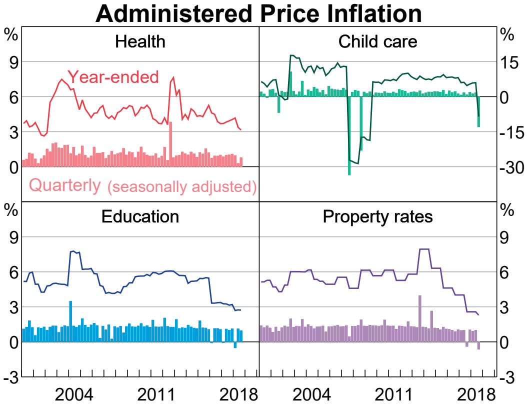
Administered price inflation has slowed

In the CPI basket, administered items have prices that are (at least partly) regulated or are items for which the public sector is a significant provider. These include services, such as health, education and child care, as well as utilities. Price inflation for administered services has generally been higher than aggregate CPI inflation for the past couple of decades, but has slowed since 2012 (Graph 4.5). The slowing has been broad based across administered items, including education and health.[1]

A number of administered prices changed in the September quarter as policies announced in state and federal budgets took effect. Childcare prices fell by 12 per cent (in non-seasonally adjusted terms) following the introduction of the government's childcare subsidy package. The CPI captures changes in the *effective* cost of child care, that is, the gross fees payable by families

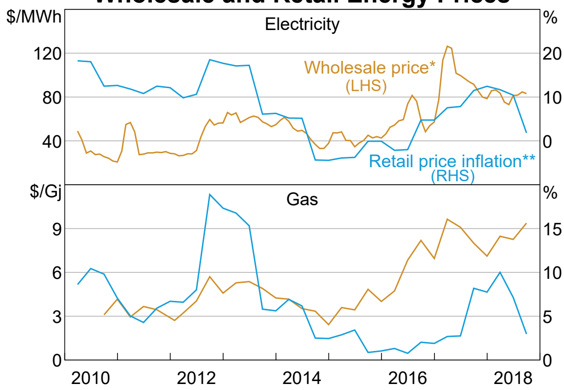
1 Debelle G (2018), 'Low Inflation', Address at the Economic Society of Australia (QLD) Business Lunch, 22 August.

Graph 4.5
Administered Price Inflation



Source: ABS

Graph 4.6
Wholesale and Retail Energy Prices



* State-level wholesale prices weighted by each state's generation capacity

** Year-ended growth

Sources: ABS; AER; Bloomberg; RBA

less any government assistance.[2] Several other administered prices are typically reset annually on 1 July, and these price increases were a little lower this year than in 2017. The introduction of government initiatives to reduce cost-of-living pressures put downward pressure on price inflation of administered services, but also boosted household purchasing power.

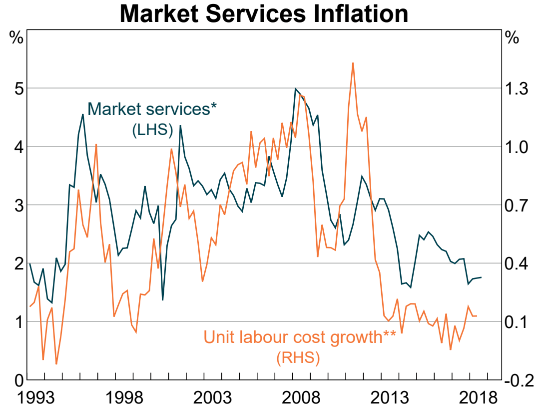
The price of electricity, which represents 2 per cent of household expenditure, was little changed in the quarter, but declined by 2 per cent in seasonally adjusted terms (Graph 4.6). This follows a two-year period where electricity prices rose strongly. Wholesale prices, which account for a large share of the residential electricity bill, have also increased strongly over recent years in response to a reduction in generation capacity, though prices have now declined from their 2017 peak. Gas price inflation has also moderated in recent quarters.

2 On July 2, the Child Care Subsidy replaced the means-tested Child Care Benefit and the non-means tested Child Care Rebate payments. The changes affected several dimensions of the child care payments structure: eligibility requirements, subsidy rates, payment caps, and type of care supported.

Domestic price pressures remain subdued

Apart from administered prices, inflation in the prices of domestic goods and services remains low (Graph 4.7). Low growth in labour costs, which make up a particularly large share of costs for market services, has been a significant factor contributing to the slower pace of inflation in this component.

Graph 4.7
Market Services Inflation



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

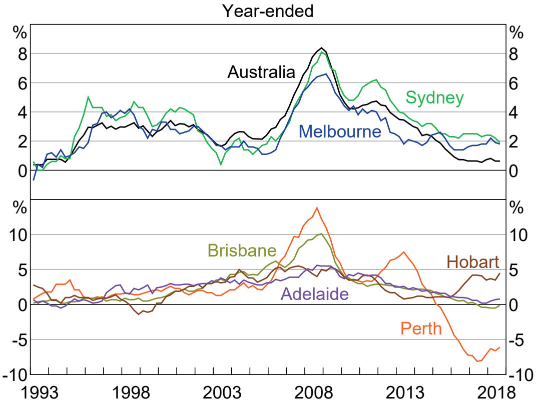
** Quarterly; non-farm; eight-quarter moving average

Sources: ABS; RBA

Rent inflation was 0.6 per cent over the year, which is around its lowest rate since mid 1993 (Graph 4.8). Growth in the housing stock has outstripped population growth since 2014, which has put downward pressure on growth in rents. Conditions continue to vary noticeably across capital cities in line with the divergence in housing market conditions. Rents are 6 per cent lower over the year in Perth, and have been falling since 2015. However, the pace at which rents have been falling has eased more recently as the Perth vacancy rate has started to decline. In Brisbane, where there has been a large increase in the dwelling stock, rents were a little lower over the year. Rent inflation has been relatively steady in Sydney and Melbourne because substantial additions to the housing stock have been absorbed by the relatively fast pace of population growth in these cities; however, newly advertised rents in Sydney have declined of late as the vacancy rate has increased. In contrast, Hobart rents are growing at a solid rate.

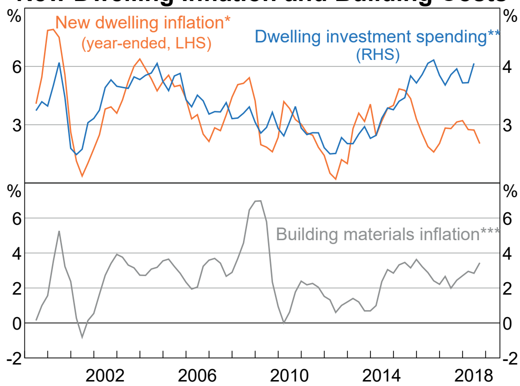
Inflation in the cost of building a new dwelling slowed to only 0.1 per cent in the quarter, and 2 per cent over the year (Graph 4.9). Despite the historically high level of activity in housing construction over recent years, inflation in the costs of constructing new dwellings has been running below its long-run average. Prices of building materials (such as steel, timber and concrete) have increased; information from liaison suggests that strong demand and competition from infrastructure and commercial projects has contributed to higher material prices in the eastern states this year. However, dwelling cost inflation overall has been contained for some time by the implementation of more efficient construction practices and relatively subdued wages growth for most construction workers; in the September quarter there was also increased use of incentives – such as the inclusion of appliances at no charge – by some home builders.

Graph 4.8
Rent Inflation
Year-ended



Source: ABS

Graph 4.9
New Dwelling Inflation and Building Costs

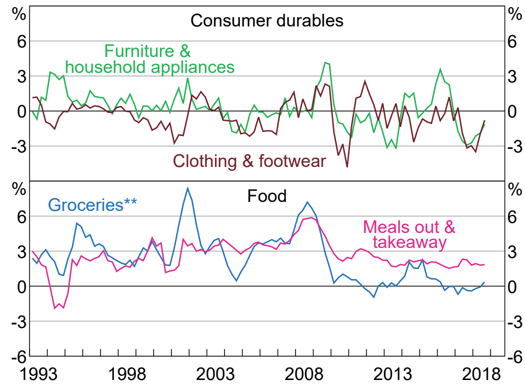


* Adjusted for the tax changes of 1999–2000
** As a share of nominal GDP
*** For houses
Sources: ABS; RBA

Higher import prices have put upward pressure on retail prices

Retail prices were little changed in the September quarter, though retail price deflation continues in year-ended terms. Grocery food inflation (excluding fruit & vegetables) has picked up a little over recent quarters, and deflation in consumer durable prices eased in the quarter (Graph 4.10). Most retail items are

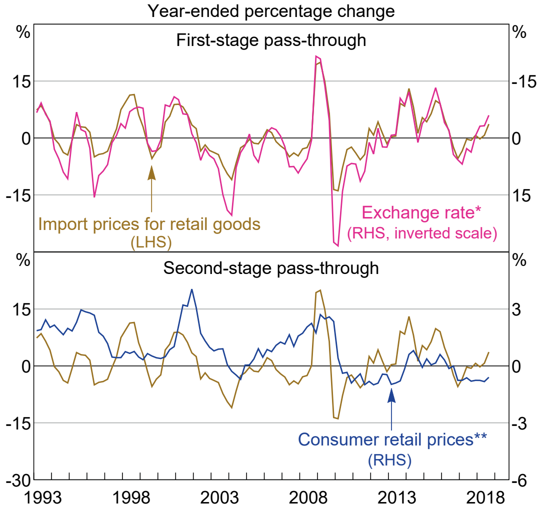
Graph 4.10
Consumer Durables and Food Inflation*
Year-ended



* Adjusted for the tax changes of 1999–2000
** Excludes fruit & vegetables
Sources: ABS; RBA

either fully imported, have imported inputs, or compete with imported products. This means that domestic retail prices are influenced by prices set on world markets and fluctuations in the exchange rate (Graph 4.11). The depreciation in the import-weighted exchange rate over the year has put a little upward pressure on retail price inflation, while growth in other input costs has been subdued. Retail rents have been little changed for some time, and, as noted earlier, growth in labour costs has been slow and wholesale electricity prices have declined. Ongoing competitive pressures in the retail industry have limited the upward adjustment in final consumer prices to date.

Graph 4.11
Retail Prices and the Exchange Rate
Year-ended percentage change

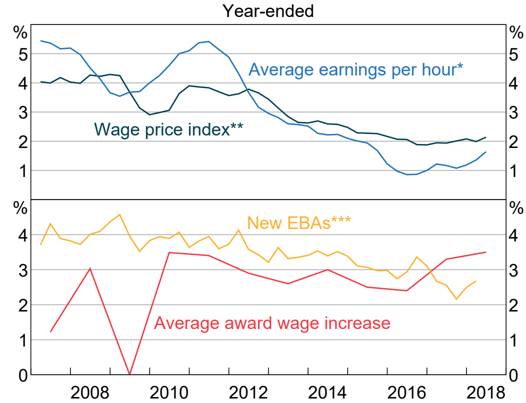


* Import-weighted index; quarter average
** Adjusted for the tax changes of 1999–2000
Sources: ABS; RBA

Wages growth has picked up a little, but remains low

Wages growth remains low, though it has picked up slightly over the past two years across a range of measures (Graph 4.12). The low level of wages growth reflects a number of factors, including spare capacity in the labour market and low inflation expectations. However, wages growth has been persistently lower than what the usual relationships with these factors would typically imply. The process of adjustment to the end of the mining investment boom can account for some of this, but the common experience of low wages growth in a number of other advanced economies suggests a role for common factors, such as a decline in labour's relative bargaining power, and the effects of technological change

Graph 4.12
Wages Growth
Year-ended

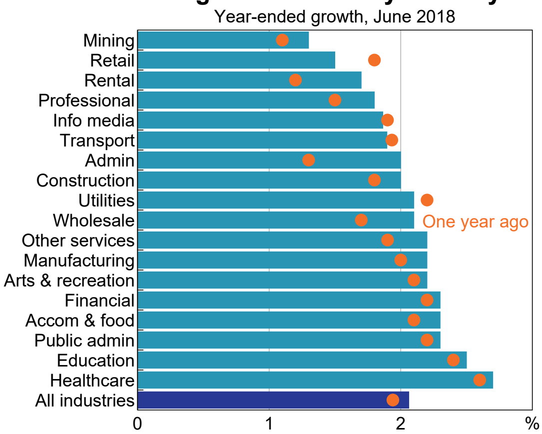


* 9-quarter centred moving average, non-farm
** Excluding bonuses
*** Average annualised wage increase, federally registered
Sources: ABS; Department of Jobs and Small Business; FWC; RBA

and globalisation. Labour costs adjusted for productivity have been little changed over recent years. Given that labour costs are the largest component of business costs, this has contributed to low inflation outcomes.

The wage price index (WPI) increased by 0.6 per cent in the June quarter to be 2.1 per cent higher over the year. The small increase in wages growth over the past two years has occurred in most states. Year-ended WPI growth was higher than it was one year ago in about three-quarters of industries, though the increases have been modest (Graph 4.13).

Graph 4.13
Wage Price Index by Industry*



* Excluding bonuses; not seasonally adjusted
Sources: ABS; RBA

Growth in the national accounts measure of average earnings per hour (AENA) has risen a little recently in trend terms, but remains below growth in the WPI. AENA captures a broader range of labour costs borne by businesses than the WPI. AENA is also affected by changes in the composition of employment. As workers tend to receive higher income when transferring jobs, the low level of voluntary job turnover in recent years is likely to be contributing to subdued growth in AENA. The flow of employees from higher-paid mining-related jobs to lower-paid jobs in other sectors, as well as strong growth in household services occupations that pay below-average rates of pay are also likely to have been factors.

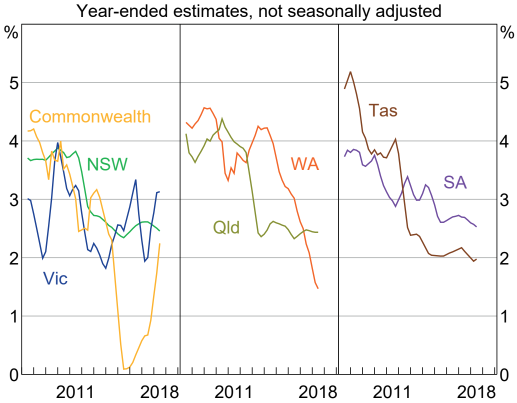
There are small differences in wages growth across industries

Over the past two years, wages growth has been strongest in the education & training and health care & social assistance industries. This is consistent with relatively strong employment gains in these industries over recent years and also reflects that the majority of these employees are on collective agreements. Wages growth in collective agreements across all industries has adjusted relatively slowly to reflect the period of spare capacity in the labour market, in large part because the typical agreement is only renegotiated every three years. Although wages growth in new agreements has picked up more recently, average wages growth for employees on enterprise bargaining agreements (EBAs) is likely to continue to slow in the short term.

Wages growth in the public sector remains steady at around 2.5 per cent over the year. Policies to limit public sector wages growth have been in place in most jurisdictions in recent years. While aggregate public sector wages growth has been low and stable, there are some clear differences in outcomes across jurisdictions (Graph 4.14). Commonwealth government wages growth has picked up recently, following a period in which there were widespread wage freezes due to protracted negotiations over new EBAs. In contrast, Western Australian government wages growth has declined to be the lowest across the state governments, following a period around five years ago when it had been well above public sector wages growth elsewhere in the country.

The Fair Work Commission's decision to raise the national minimum and award wages by 3.5 per cent from 1 July 2018, will boost measures of

Graph 4.14
Wages Growth by Government
Year-ended estimates, not seasonally adjusted



Source: RBA

wages growth in the forthcoming September quarter data. The increase was a little larger than last year's increase of 3.3 per cent. Nearly one-quarter of all employees, accounting for around 15 per cent of the national wage bill, are covered by awards. Award coverage is particularly high in the accommodation & food, administrative & support, and retail trade industries. Although about one-third of retail employees are covered by awards, a similar share of employees have their wages determined by EBAs. Over the past three years, there have been lengthy delays in the negotiation of new EBAs at many large retailers during which many employees have experienced wage freezes. This has caused average wages growth in the retail trade industry to decline in the past year. As some of these EBA negotiations are now completed, or getting closer to completion, more retail employees will be returning to positive wages growth and this should boost aggregate retail wages growth.

Wages growth has increased a little across a range of industries in the business services and goods-related sectors, including in construction and professional, scientific & technical services. Wages growth has also picked up a little in the mining industry, with the removal of a number of wage freezes that had been in place for several years. A large share of employees in these industries are on individual arrangements, for which wages growth is typically most responsive to prevailing labour market conditions.

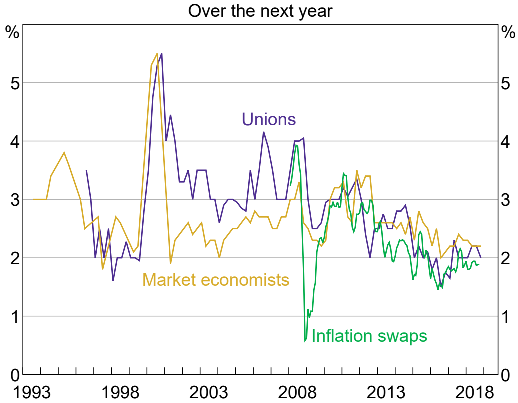
Wages growth expectations have picked up, but remain low

Information from the Bank's liaison program continues to point to a modest increase in private sector wages growth in the near term in line with a tightening labour market. The share of firms reporting wage outcomes above 3 per cent in the liaison program has increased a little this year, but the majority of these reports are concentrated in construction and IT-related business services. Firms also report that they are using a range of strategies to both contain labour costs and retain employees amid tightening labour markets. These include performance bonuses and non-wage incentives such as flexible work arrangements and additional annual leave. About three-quarters of firms expect private sector wages growth to remain stable over the year ahead, although an increasing minority expect wages growth to strengthen. Other measures of short-term wage expectations have also picked up recently.

Inflation expectations are unchanged

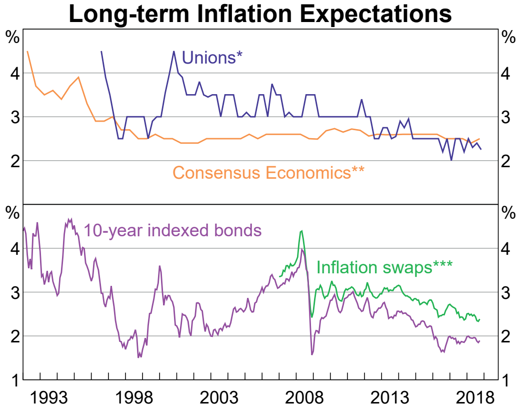
Inflation expectations are generally consistent with the inflation target (Graph 4.15 and Graph 4.16). Measures of short-term inflation expectations are around 2 per cent, while survey-based measures of longer-run inflation expectations measures remain around 2½ per cent. ✥

Graph 4.15
Short-term Inflation Expectations
Over the next year



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

Graph 4.16
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