5. Inflation

As expected, there were large temporary price falls in the June quarter …

The Consumer Price Index (CPI) declined by 2 per cent in the June quarter and 0.3 per cent over the year (Graph 5.1; Table 5.1). As anticipated, the fall in the CPI owed to unusually large temporary declines in a few price series. As a result, the June quarter saw the first decline in year-ended CPI inflation (excluding interest charges) since the early 1960s and the largest quarterly decline since 1931. Child care and some pre-school services were free for most of the quarter, and fuel prices also moved sharply lower; together, these price declines subtracted 2 percentage points from CPI inflation in the quarter. Rents also declined in the quarter as tenants have obtained discounts on existing rental agreements and travel restrictions led to increased supply in the longer-term rental market. In contrast, there were strong price increases for some food items and household goods that were in high demand under the social distancing measures. Looking ahead, CPI inflation will increase sharply in the September quarter as child care and pre-school prices progressively return to normal levels, and as fuel prices have rebounded from their May low.

Measurement challenges were prominent in the June quarter CPI. Headline CPI reflected price changes for 91 per cent of the CPI basket, as the remaining prices were unavailable to be collected in the quarter because of various containment measures. For the 9 per cent of items that were unavailable, which included for example domestic and international holiday travel and sports participation, the ABS imputed prices using headline CPI.[1]

The COVID-19 containment measures also led to large changes in consumption expenditure shares. For example, travel restrictions and social distancing requirements resulted in consumers spending more on home entertainment and groceries instead of going on international holidays and dining out (see 'Domestic Economic Conditions' chapter for more detail). However, the CPI measures price changes for a fixed basket of goods and services (representing the things that households typically buy).

Underlying inflation measures were around zero in the June quarter, although they too were affected by the price movements discussed above (Graph 5.2). Price falls for child care and automotive fuel, as well as the imputed price declines for unavailable items, account for much of the slowing in underlying inflation in the quarter. CPI inflation excluding imputed items, child care, pre-school and volatile items was positive but slowed to 0.2 per cent in the quarter. Overall, the large price changes resulting from changes to government policies and the measurement challenges during the quarter, make it more difficult to use the aggregate inflation measures to gauge the inflationary impulse in the economy.

Table 5.1: Measures of Consumer Price Inflation

Per cent

	Quarterly(a)		Year-ended(b)	
	June quarter 2020	March quarter 2020	June quarter 2020	March quarter 2020
Consumer Price Index	−1.9	0.3	−0.3	2.2
Seasonally adjusted CPI	−2.0	0.5	–	–
Selected underlying measures				
Trimmed mean	−0.1	0.5	1.2	1.8
Trimmed mean excl. imputed items	0.1	–	1.5	–
Weighted median	0.1	0.5	1.3	1.6
CPI excl. volatile items (c)	−1.3	0.6	0.4	2.1

(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

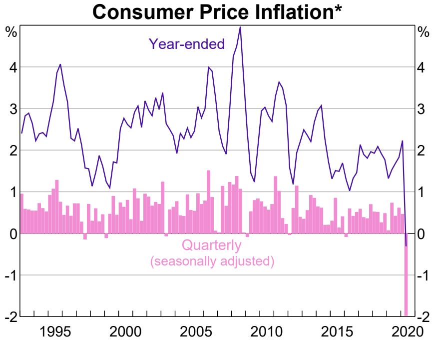
(c) Volatile items are fruit, vegetables and automotive fuel

Sources: ABS; RBA

Government policies reduced administered prices

A number of government policies announced in response to the COVID-19 pandemic affected consumer prices significantly in the June quarter, most notably the introduction of free child care services from 6 April to 12 July 2020. The government subsidy, which also covered before and after school care services, led to a 95 per cent decline in child care prices in the June quarter (Graph 5.3). In addition, pre-school fees were waived for term two in New South Wales, Victoria and Queensland. Together, these policies subtracted 1.2 percentage points from headline inflation in the June quarter (Graph 5.4). Inflation will rebound in the second half of 2020 as these subsidies are progressively removed. Child care fees resumed on 12 July, while pre-school remains free until after term 3 in NSW and Victoria. On 5 August, the Australian Government announced increased funding to allow Victorian child care facilities to re-introduce fee waivers.

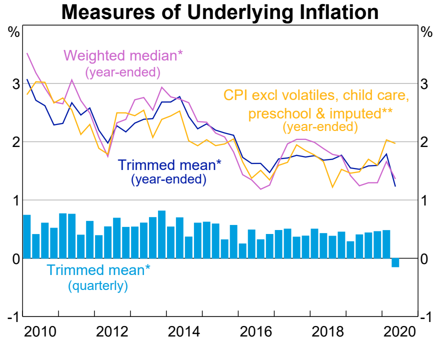
Graph 5.1



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

Sources: ABS; RBA

Graph 5.2



* Seasonally adjusted

** Not seasonally adjusted; excludes fruit, vegetables & automotive fuel, child care, preschool & primary education and imputed items

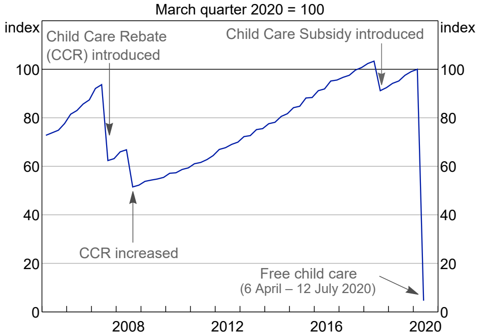
Sources: ABS; RBA

There was also a decline in medical and hospital services prices in the quarter. The government increased bulk billing incentives during the pandemic, which reduced health costs. Private health insurance premiums had been scheduled to increase by 2.9 per cent in April; however, most private health insurers deferred the scheduled increase for at least six months. Scheduled increases in state government fees and charges typically occur at the start of July, but a number of state governments have announced price freezes for state-administered charges until 2021. These freezes, along with delays in the finalisation of government budgets, are likely to hold property rates, motor vehicle-related charges and public transport fares steady throughout most of the year.

Graph 5.3

Child Care Prices

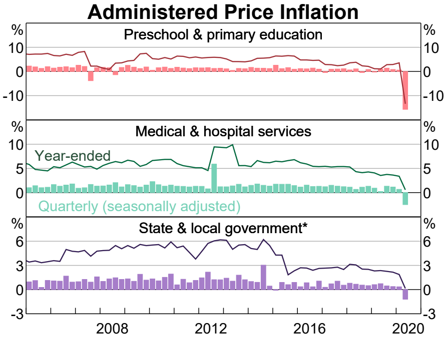
March quarter 2020 = 100



Sources: ABS; RBA

Graph 5.4

Administered Price Inflation



* Includes urban transport fares, property rates & charges and other services in respect of motor vehicles

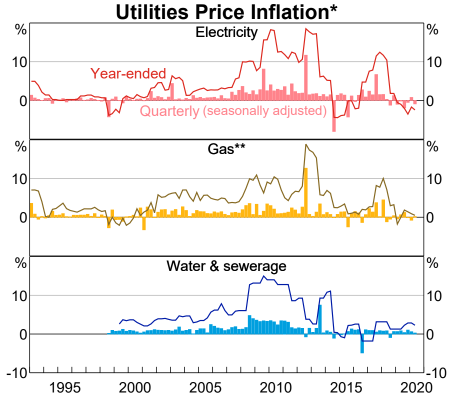
Sources: ABS; RBA

Utilities prices declined in the June quarter, reflecting the introduction of new rebates in several states (Graph 5.5). The Australian Capital Territory and Western Australian governments increased the rebates they offer to concession customers as part of their COVID-19 policy response. The Queensland Government quadrupled the size of the annual electricity asset ownership dividend that is applied to households' electricity bills, which led to a 15 per cent decline in Brisbane electricity prices in the quarter.

Utilities inflation has been subdued for the past 18 months and is likely to remain low for some time. Wholesale electricity prices have declined in most states since early 2019 because renewable energy projects have increased generation capacity. Wholesale gas prices have also fallen in recent months alongside lower international prices. The Default Market Offer, which places a cap on standing offer electricity prices in New South Wales, South Australia and southeast Queensland, was reduced in July. The Australian Capital Territory, Northern Territory, Tasmanian and Western Australian governments have also announced that they will freeze utilities prices until 2021.

Graph 5.5

Utilities Price Inflation*



* Adjusted for the tax changes of 1999–2000

** Includes other household fuels

Sources: ABS; RBA

Rents also declined in the quarter

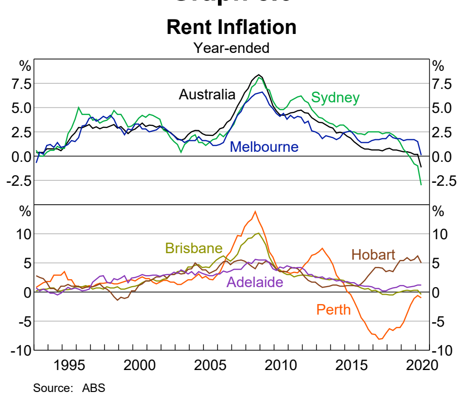
Housing-related inflation slowed sharply in the June quarter. Rents declined for the first time in the 45-year period for which quarterly rents data are available (Graph 5.6). The supply of properties available for long term rental has increased since the outbreak of COVID-19; the introduction of travel restrictions encouraged some landlords that were previously supplying short-term holiday accommodation to instead put their properties on the longer-term rental market. State governments have introduced mechanisms to enable tenants who have become unemployed or lost income due to COVID-19 to negotiate rent reductions. Information from liaison contacts suggests that around 5 per cent of residential tenants have successfully negotiated rent reductions since the end of March. Rent reductions for ongoing tenancies directly affect measured rent inflation because the CPI captures rents paid on the stock of existing rental properties. Rent relief as part of land tax rebate schemes and public housing rent reductions also contributed to rent price falls in some states in the quarter. Rent declines in the June quarter were largest in Sydney and Melbourne where renegotiations were most prevalent and where the international travel restrictions have led to the most pronounced increase in rental stock.

New dwelling price inflation moderated in the June quarter (Graph 5.7). Increased demand for new housing in late 2019 and early 2020 had allowed some builders to raise base prices early in the year, while bonus offers and purchase incentives had become less prevalent. However, demand for new dwellings declined in the June quarter. Future price increases will depend on how fast housing demand recovers following the COVID-19 shock. Information from liaison suggests that the Australian Government's HomeBuilder package is boosting demand in the near term, particularly for new detached housing.

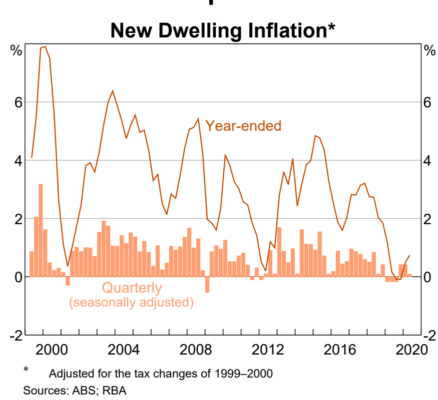
Market services inflation remains subdued

Market services inflation, which includes household services such as hairdressing, as well as financial services and meals out & takeaway, slowed in the June quarter (Graph 5.8). Social distancing measures resulted in a number of household services and their respective prices being unavailable for part or all of the June quarter. The ABS constructed price estimates for unavailable items using the price change for a similar or substitute product; for example, restaurant prices were imputed using takeaway food prices. For domestic and international holiday travel, sports participation and other

Graph 5.6



Graph 5.7



recreational, sporting and cultural services, the ABS imputed prices using headline CPI.

Some retail prices increased strongly in the quarter

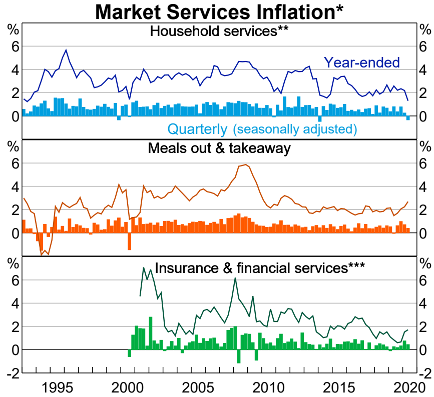
Retail prices increased in the June quarter. Prices for non-durable household goods such as personal hygiene and cleaning products rose as some supermarkets stopped discounting on the back of increased demand for these items. Strong demand alongside the introduction of lockdowns and working from home measures caused price rises for furniture and household appliances (Graph 5.9). In contrast, prices for clothing and footwear declined sharply as retailers offered significant discounts early in the quarter in an attempt to drive sales.

Food prices also increased strongly in the June quarter on the back of sustained demand. Some supermarkets stopped discounting in late March because of increased demand as households prepared for an anticipated period of social distancing. Strong demand for food items continued for the first half of the June quarter but, by the end of the quarter, discounting behaviour for some products had returned to normal. Price pressures were most evident for longer-life supermarket items, such as pasta, tinned food and frozen meals (Graph 5.10). Meat prices increased further as improved rainfall conditions in Eastern Australia induced some farmers to restock, reducing the supply of meat.

Fuel prices declined sharply over the first half of 2020 as activity restrictions suppressed global demand for oil (Graph 5.11). The 19 per cent decline in the June quarter subtracted 0.7 percentage points from quarterly headline CPI. Fuel prices rose a little in the month of June and the increase has been sustained throughout the first month of the September quarter; at current levels, automotive fuel prices are expected to boost headline CPI by close to ½ percentage points in the September quarter.

Graph 5.8

Market Services Inflation*



* Adjusted for the tax changes of 1999–2000

** Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services

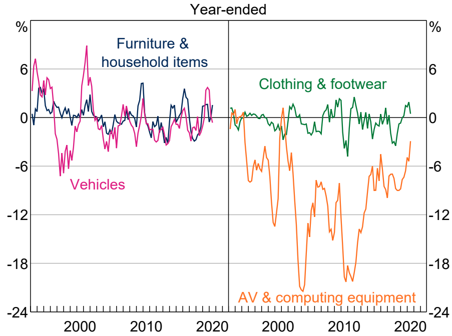
*** Excludes deposit & loans to June quarter 2011

Sources: ABS; RBA

Graph 5.9

Consumer Durables Price Inflation*

Year-ended



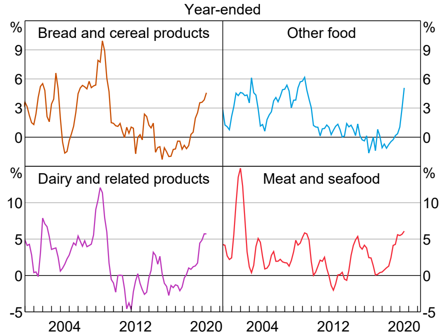
* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Graph 5.10

Food Price Inflation*

Year-ended



* Adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

Inflation expectations have declined since the outbreak of COVID-19

Wage- and price-setting behaviour can be affected by expectations about the future rate of inflation. Market economists have revised up their inflation expectations for the year ahead, likely due to the recovery in fuel prices and the rebound in child care prices over the remainder of 2020 (Graph 5.12). Unions expect inflation to remain well below 2 per cent in June 2021. Households' inflation expectations have also declined over the past six months; the share of households expecting prices to rise over the next year is now at a historical low. Long-term survey-based measures of inflation expectations are little changed at around 2–2½ per cent and remain consistent with the Bank's medium-term inflation target (Graph 5.13).

Short- and long-term market-based measures of inflation expectations have both declined since the outbreak of COVID-19 in early 2020. However, these measures have been significantly affected by dysfunction in these markets in the months following the initial COVID-19 shock. Since May, market functioning has improved and market-based measures have increased.

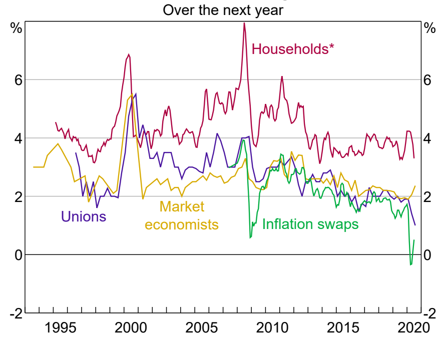
Liaison suggests there have been widespread wage freezes

The ABS payrolls data show that the wage bill has fallen 5 per cent between mid March and mid July (Graph 5.14). Employee earnings declined over April and May, as employment and average hours worked fell sharply, but have recovered a little since then. The JobKeeper wage subsidy program has provided substantive support for wages. Around one-quarter of JobKeeper-supported employees effectively received an increase in earnings as a result of the flat JobKeeper payment of $1,500 per fortnight. In addition, job losses were more prevalent in lower-earnings industries and age groups, which

Graph 5.12

Short-term Inflation Expectations

Over the next year



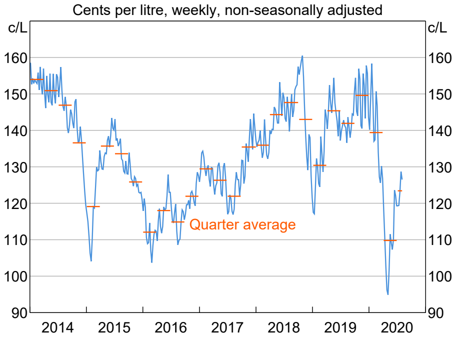
* Smoothed

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

Graph 5.11

Unleaded Petrol Prices

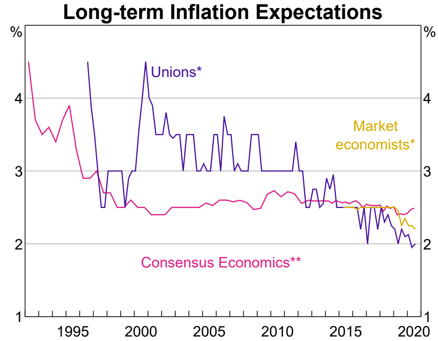
Cents per litre, weekly, non-seasonally adjusted



Sources: Australian Institute of Petroleum; RBA

Graph 5.13

Long-term Inflation Expectations



* Average over the next five to ten years

** Average over six to ten years in the future

Sources: Australian Council of Trade Unions; Consensus Economics; RBA; Workplace Research Centre helps explain why the decline in jobs has been larger than the decline in the wage bill.

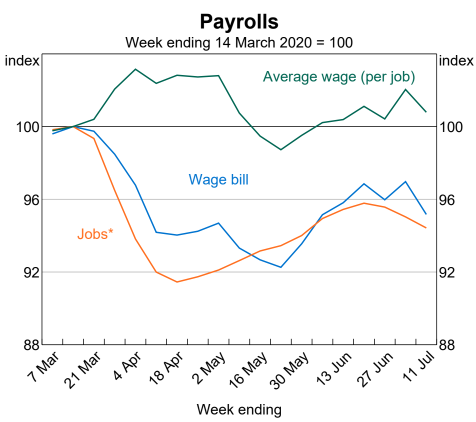
Information from liaison suggests that a sizeable share of employees had remuneration reviews delayed, wages frozen, or had wage cuts in recent months. More than 10 per cent of liaison contacts have reported COVID-related wage cuts; the wage cuts have typically been targeted towards senior management, but broader wage cuts for all staff have also been implemented by some firms. The vast majority of wage cuts are expected to be unwound as business conditions recover. The proportion of liaison contacts implementing wage cuts is significantly higher than during the Global Financial Crisis. Wage freezes have also been implemented for some employees in the public sector, notably Commonwealth and Queensland government employees. Under current policies, previously agreed wage increases have been deferred for up to 12 months.

Wages growth is expected to slow in the year ahead

Looking ahead, wages growth is likely to remain weak. Around 35 per cent of firms in the liaison program expect to implement a wage freeze in the year ahead (Graph 5.15). Overall, around half of the surveyed firms expect wages growth to be lower in the year ahead than the current rate of growth, as a result of wage freezes and smaller wage increases.

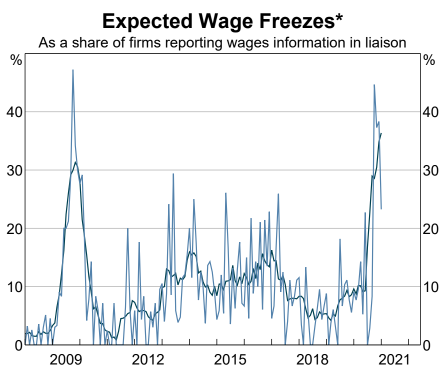
The Fair Work Commission (FWC) determined that the National Minimum Wage and all award wages will increase by 1.75 per cent, which is lower than the outcomes in recent years (Graph 5.16). The timing of the increase will be staggered across the economy in recognition of the uneven effects of the containment measures. From 1 July, around 25 per cent of award-reliant employees in areas like health care and primary and secondary education received the wage increase. Award rates covering a further 40 per cent of award-reliant employees in areas including construction and manufacturing, which have faced some adverse effects from the pandemic, will increase from 1 November. The remainder, including awards in accommodation & food services, arts & recreation, and aviation, were deemed to be the most affected by the pandemic and related restrictions, and award rate increases have been delayed until 1 February. The FWC decision directly affects around 13 per cent of the wage bill, while another 12–20 per cent of employees on collective or individual agreements have their pay set with reference to the decision or the relevant award.

Graph 5.14



* Number of jobs where a payment was made during the reference week
Source: ABS

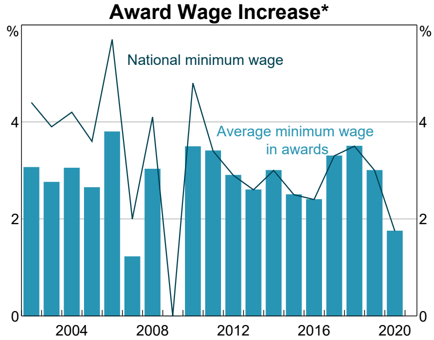
Graph 5.15



* Six-months forward; smoothed line is a seven-month centred moving average
Source: RBA

Graph 5.16

Award Wage Increase*



* RBA calculations; the time period over which each increase applies varies

Sources: AFPC; AIRC; FWC; RBA

The ABS has indicated that the JobKeeper payment will have no direct impact on the wage price index (WPI) as it is a wage subsidy. However, they will publish additional series to capture hourly income growth including the JobKeeper subsidy.[2] It will be important to consider all measures of income growth in an assessment of changes to employee earnings over this period.

Endnotes

[1] The ABS released a paper which sets out its approach to imputation of unavailable prices:<abs.gov.au/ausstats/abs@.nsf/Latestproducts/1359.0Main%20Features3Jun%202020?opendocument&tabname=Summary&prodno=1359.0&issue=Jun%202020&num=&view=>

[2] The ABS released a paper which sets out its approach to measuring the WPI during the COVID-19 pandemic: <abs.gov.au/ausstats/abs@.nsf/Latestproducts/1359.0Main%20Features15Jun%202020?opendocument&tabname=Summary&prodno=1359.0&issue=Jun%202020&num=&view=>