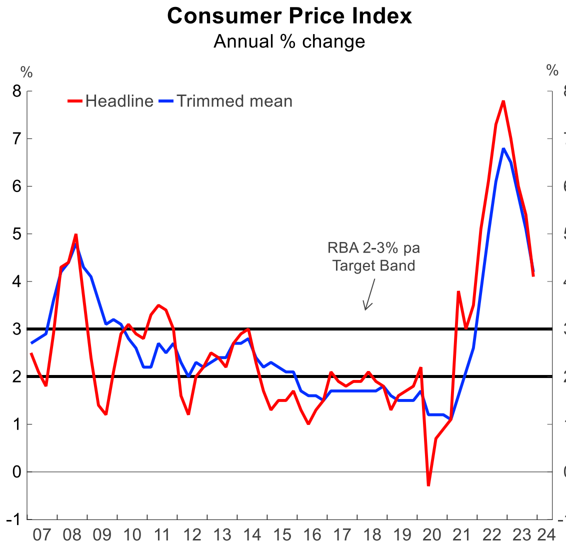
Data snapshot

Wednesday, 31 January 2024

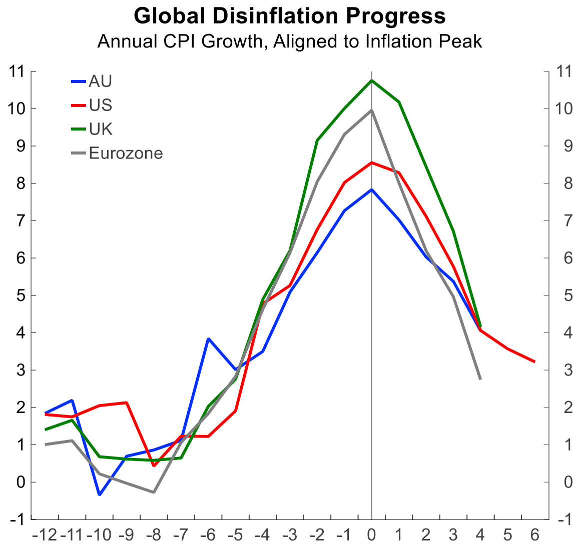
Consumer Price Index

Inflation Dragon May Have Been Tamed

- **The moderation in inflation is occurring more quickly than expected. Headline inflation advanced by 0.6% over the December quarter, the slowest rate in almost three years. In annual terms inflation is running at 4.1%, much lower than the 4.5% the Reserve Bank (RBA) was expecting. The trimmed mean measure, which excludes the smallest and largest price movements, moderated to 4.2%, again lower than the 4.5% the RBA was expecting.**
- **The global disinflationary impulse has arrived. For the first time in three years, the prices of globally traded goods declined. Tradable inflation fell by 0.4% over the quarter, to be 1.3% higher in annual terms. The prices of household goods, fuel, clothing all fell over the quarter.**
- **Growth in some domestic prices continue to remain elevated, including the cost of dwelling construction, rents, and insurance. More broadly we are seeing growth in prices across market services slow. We expect this to continue as growth in the population eases – there will be less pressure on rental markets and the capital stock will catch up to the increase in labour supply, boosting labour productivity, and reducing unit labour costs.**
- **At the same time, recent activity indicators make clear that monetary policy is working and spending is slowing – this will limit the pricing power of businesses.**
- **Today's release also confirmed that Australia's disinflationary journey is on par with that of our global peers. We expect inflation be running at 3.2% over 2024 in both headline and core terms. Today's outcome suggests that there are some downside risks to these forecasts. It also suggests that when the RBA reviews their forecasts, they could even start to tilt the balance of risks for inflation to the downside with the potential for inflation to be back to around the mid-point of the band within their forecast horizon.**



Sources: ABS; Macrobond



Sources: ABS, Eurostat, BLS, ONS, Macrobond

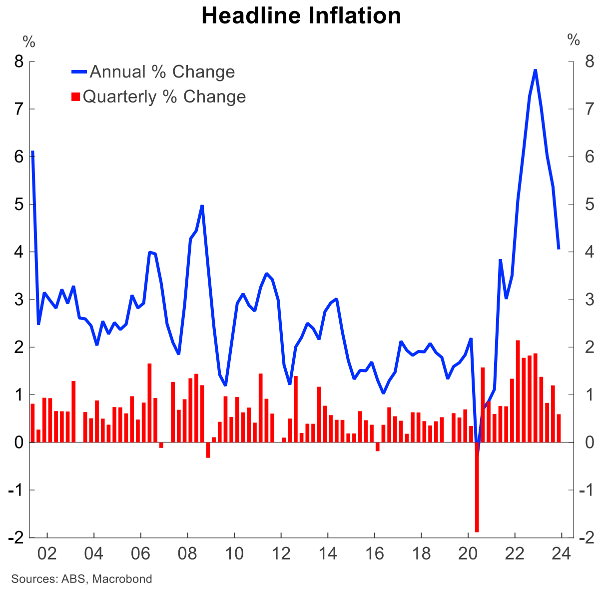
Headline and Underlying Inflation

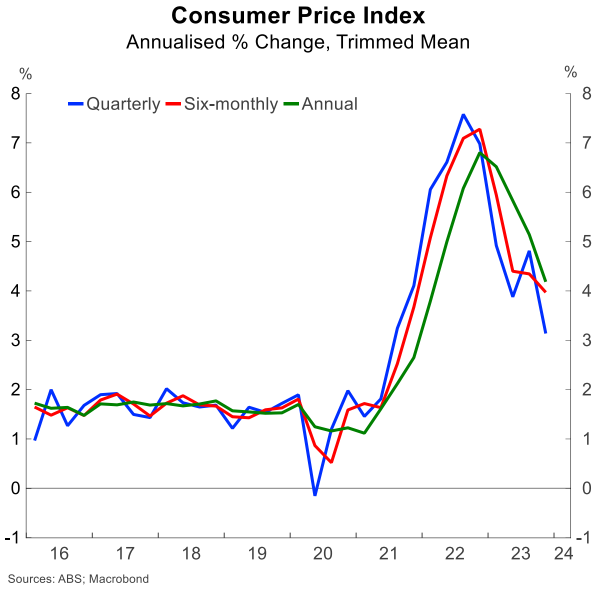
The moderation in inflation is occurring more quickly than expected. Annual headline inflation slowed to 4.1% in the December quarter, from 5.4% over the year to the September quarter. The all-important trimmed mean measure, which excludes the smallest and largest price movements, also improved to 4.2% in annual terms, this was down from 5.1% last quarter.

While today's outcome was softer than the market was expecting, more importantly, it was softer than the RBA's forecasts – and significantly so. One of the reasons is that the global disinflationary impulse has arrived, and we saw the price of tradables fall over the quarter for the first time in three years.

Today's outcome also shows that we are on par with the disinflationary journey in other developed countries, helping to dismiss the view that inflation has become more persistent in Australia because interest rates are lower.

In quarterly terms, the headline Consumer Price Index (CPI) moderated to grow by 0.6% over the December quarter, the slowest rate in almost three years.





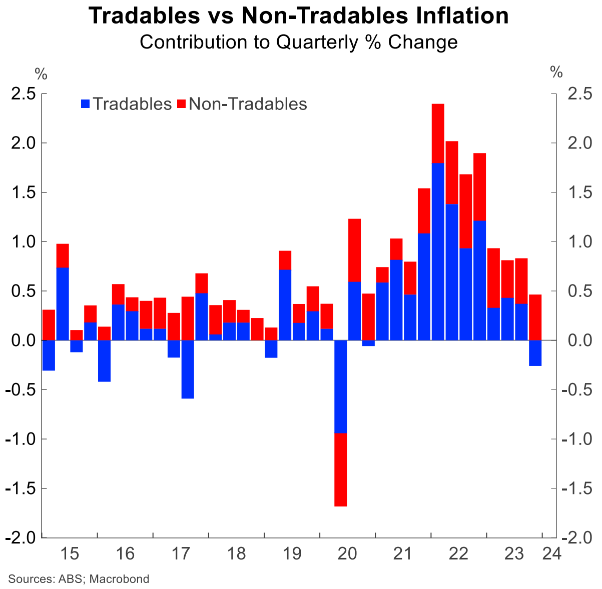
Tradable and Non-tradable Inflation

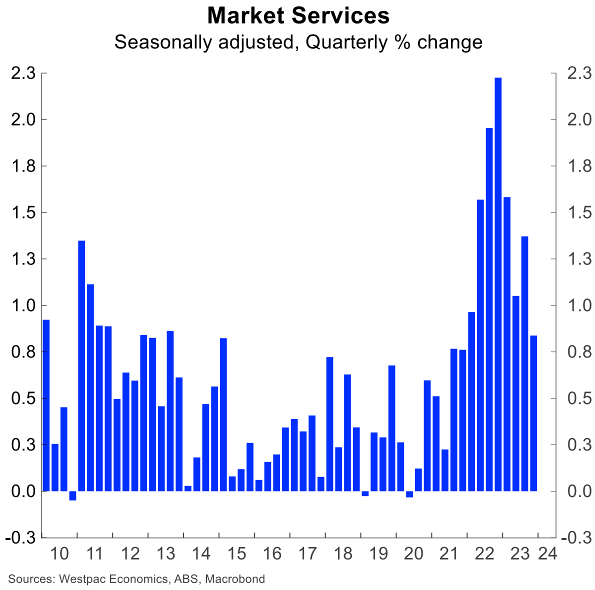
For the first time in three years, the prices of globally traded goods declined by 0.4% over the quarter to be to 1.3% higher over the year to the December quarter.

Today's outcome is further evidence that global supply chain disruptions continued to iron out over 2023 and this is contributing strongly to the fall in headline inflation rates across the globe. This disinflationary force is expected to persist for some time, however, its magnitude of will wane over time, putting less downward pressure on headline inflation.

Domestic drivers of inflation, as proxied by non-tradable inflation, remain elevated at 5.4% in annual terms. This represents progress compared to a peak of 7.6% in the March quarter, and the 6.1% recorded last quarter. Growth in housing costs, particularly the cost of constructing new dwellings, and insurance costs, continue to remain elevated. This will improve as global supply chains continue to revert to normal, the labour market comes into better balance, and population growth slow as net migration numbers ease back.

Encouragingly, growth in the price of market services continue to show signs of moderating – this includes the prices of haircuts, sporting activities, medical services for pets etc. After accelerating last quarter on the back of the Fair Work Commission 2023-24 minimum and award wage increase, price growth moderated. We expect this to continue as unit labour costs ease on the back of improved productivity.





Inflation Categories

Housing plus alcohol & tobacco were largest contributors to headline annual inflation in the quarter. Housing costs lifted 1.0% in the quarter to be up 4.1% in the year. A large share of this rise was due to the 1.5% increase in the cost of building a new home but even with the offset of the increase in Federal Government rental assistance rents rose a solid 0.9% in the quarter. Excluding the changes to rental assistance, rents would have increased by 2.2% in the December 2023 quarter on par with the September quarter increase. The ABS noted that higher labour and material costs contributed to dwelling price rises this quarter.

For housing, the momentum in both dwelling prices and rents (excluding rental assistance) is likely to continue at around their current pace at least into mid-2024.The recent surge in population growth is likely to see the strong contribution from rents continue, while a sustained turn in new dwelling purchases by owner occupiers could pose a significant upside risk to the outlook for dwelling prices. This could potentially be fuelled by ambitious housing investment goals pushing up against constrained supply as the construction industry continues to grapple with labour shortages and a raft of insolvencies. However, these pressures are likely to ease through the second half of the year and population growth slows and dwelling construction activity lifts.

In addition, wholesale electricity prices are well down from their mid 2022 to early 2023 highs and if they can hold around these levels then they could be pointing to lower power bills in the second half of 2024 even if the government energy rebates are not extended. Electricity prices fell 5.7% in the month of December 2023 compared to a 0.4% increase in November. The fall was driven by the introduction of the second instalment of the Energy Bill Relief Fund rebates for all households in Perth but even excluding the rebates power bills fell -0.8% in the month highlighting we may have seen the peak in underlying power bills.

Alcohol & tobacco lifted 2.8% in the quarter. The main contributor to the rise was a 7.0% rise in tobacco which increased due to the flow on effects of the introduction of a 5% annual excise indexation and the usual bi-annual AWOTE indexation applied on 1st September 2023. Alcoholic beverages recorded a small quarterly rise of 0.5%.

Food inflation continues to moderate even if there are still some price pressures in meals out & take away food (+0.9%qtr), food products n.e.c. (+1.9%) and bread & cereal products (+1.9%). Prices are now falling in the fresh food category with meat & seafood down -1.2% and fruit & vegetables down -1.2%. Meat & seafood prices fell this quarter due to increased supply leading to price drops for lamb & goat of –12.1% and beef & veal of –1.5%

As the tourism sector recovers from the COVID lockdown prices for holidays travel &accommodation continue to rise with domestic holiday travel & accommodation lifting +3.9% while insurance premiums continue to rise up 3.8% following the 2.8% gain in September. The increase in insurance was due to higher premiums across motor vehicle, house and home contents insurance. Over the past year insurance costs are up 16.2% making it the largest annual rise since March 2001.

CPI forecasts	Dec-23 Actual		Sep-23 Forecast	
Item	% qtr	contrib	% qtr	contrib
Food	0.5	0.09	0.6	0.11
of which, fruit & vegetables	-1.2	-0.03	-3.7	-0.08
Alcohol & tobacco	2.8	0.22	1.4	0.11
of which, Tobacco	7.0	0.19	1.7	0.05
Clothing & footwear	0.5	0.02	0.4	0.01
Housing	1.0	0.23	2.2	0.49
of which, Rents	0.9	0.05	2.2	0.12
of which, House purchases	1.5	0.13	1.3	0.11
of which, Utilities	0.6	0.02	3.6	0.16
H/hold contents & services	-1.0	-0.09	-0.8	-0.07
Health	0.6	0.04	0.8	0.05
of which, Pharmaceuticals	-1.7	-0.02	-1.2	-0.01
Transportation	-0.2	-0.02	3.2	0.35
of which , car prices	-0.5	-0.02	0.5	0.02
of which, auto fuel	-0.2	-0.01	7.2	0.26
Communication	0.4	0.01	2.1	0.05
Recreation	0.3	0.04	0.2	0.02
of which, audio visual & computing	-0.4	-0.01	-0.1	0.00
of which, holiday travel	1.0	0.06	-0.9	-0.04
Education	-0.1	0.00	-0.4	-0.02
Financial & insurance services	1.7	0.09	1.4	0.08
CPI: All groups	**0.6**	–	**1.2**	–
CPI: All groups % year	**4.1**	–	**5.4**	–

Behind the softer number in the quarter was the fall in household contents & services (–1.0%) on the back of a –4.3% fall in furniture, a –5.1% fall in household textiles partially offset by a 3.2% increase in childcare and a 1.7% increase in personal grooming services.

It is also worth noting the fall in transportation (–0.5%) was aided by a –0.5% fall in car prices as well as a –3.4% fall in spare parts & accessories. Falling global price and freight rates are now flowing through to Australian traded durable goods prices.

Outlook

There are clear signs that global disinflationary forces have landed in Australia while domestic inflationary pressures, particularly for market services, are not as strong as first though. As such, while our inflation forecast for end 2024 remain 3.2%yr for headline inflation and the trimmed mean measure, the risks to those forecast now lie to the downside.

Pat Bustamante, Senior Economist
Ph: +61 468 573 786
&
Justin Smirk, Senior Economist
Ph: +61 459 844 788

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 573 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789