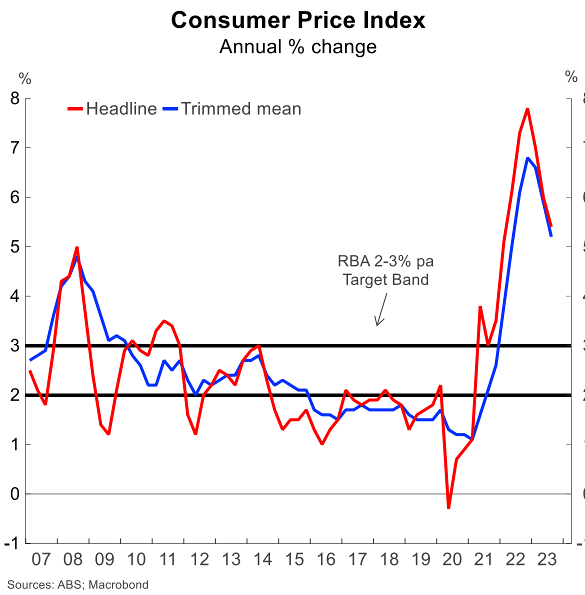
Data snapshot

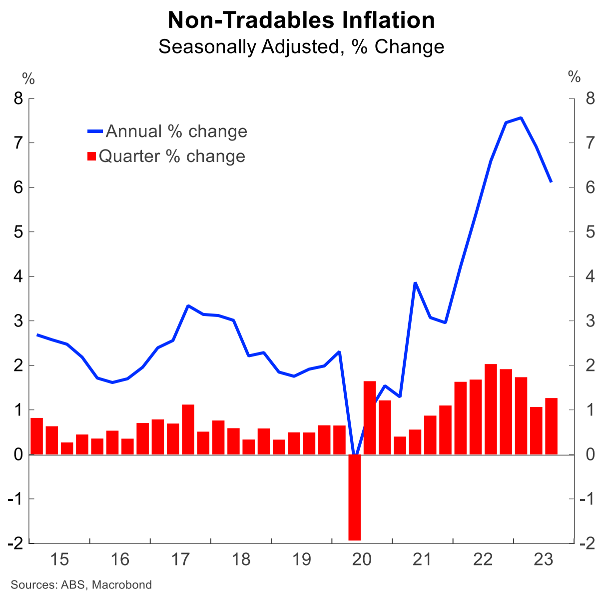
Wednesday, 25 October 2023

# Consumer Price Index

## Brisk Inflation Pulse to Test RBA Tolerance

- **Annual headline inflation slowed to 5.4% in the September quarter. The trimmed mean measure, which excludes the smallest and largest price movements, also improved to 5.2%.**
- **This represents welcome progress on disinflation, but progress was not as significant as expected by the market or by the Reserve Bank (RBA). In fact, the data revealed a concerning resurgence in inflation momentum which could test the RBA's resolve to tame inflation.**
- **Domestic forces contributed strongly to the reinvigorated inflation pulse, while global forces, such as unwinding supply-chain disruptions, largely continued to underpin disinflation.**
- **Housing and food categories remain the largest contributors to headline annual inflation, despite a moderation across both categories. Housing inflation was driven by ongoing strength in rents and a reacceleration in quarterly price growth for new dwelling purchases by owner occupiers. This has been a considerable source of disinflation over recent quarters.**
- **There are emerging signs of stickiness in Australian inflation. Risks to the inflation outlook are also broadening. RBA Governor Bullock noted last night that "the Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation".**
- **Today's inflation data presents such an upside surprise. However, there is a question as to whether the surprise is large enough to trigger a response from the RBA. Reflecting this, the risk that the RBA tightens further has certainly increased.**



## Headline and Underlying Inflation

Annual headline inflation slowed to 5.4% in the September quarter, from 6.0% over the year to the June quarter. The all-important trimmed mean measure, which excludes the smallest and largest price movements, also improved to 5.2% in annual terms, this was down from 5.9% in the June quarter.

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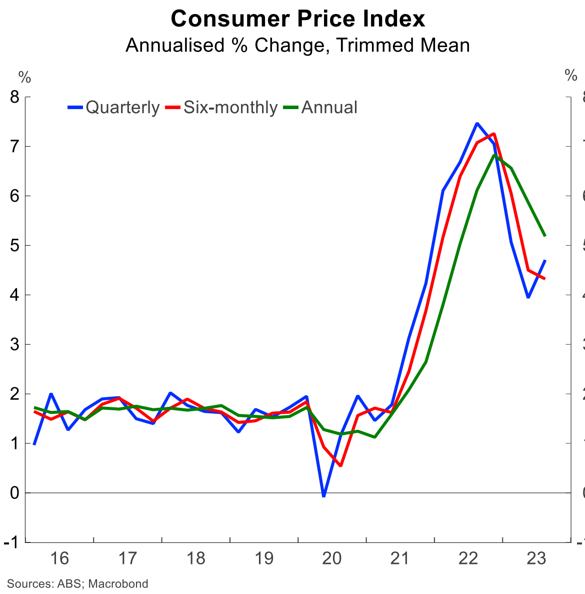
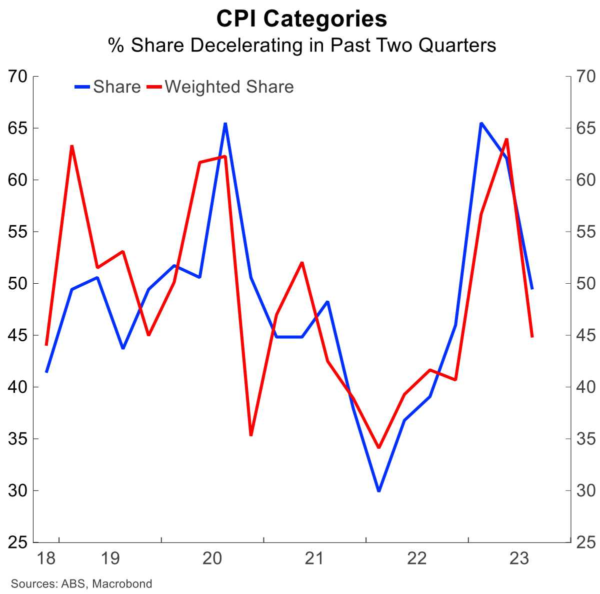
In quarterly terms, the consumer price index (CPI) accelerated in the quarter, rising 1.2% compared to a 0.8% gain in the June quarter. The trimmed mean measure also stepped up a gear in quarterly terms, rising 1.2% compared to a 1.0% increase in the June quarter The RBA's latest forecasts in the August Statement on Monetary Policy implied around a 0.9% quarterly increase in headline inflation.

Importantly, domestic forces contributed strongly to the reinvigorated inflation pulse, while global forces largely continued to underpin disinflation – the exception being fuel prices which remain volatile. This will be of particular interest to the RBA who has clearly telegraphed the importance of domestic services inflation.




## Tradable and Non-tradable Inflation

Global supply chain disruptions have continued to iron out over 2023 and this is contributing strongly to the fall in headline inflation rates across the globe. Australia is no exception, tradable inflation, which can be thought of as a proxy for international drivers of inflation, slowed to 3.7% over the year to the September quarter. This was the slowest pace in two years and comes despite a sharp rise in fuel prices over the quarter. 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 numbers. This will increase the relative importance of domestic inflationary forces.

Domestic drivers of inflation, as proxied by non-tradable inflation, remains elevated at 6.2%. This represents progress compared to a peak of 7.5% in the March quarter, but this progress has been slow. Additionally, a reacceleration in the quarterly pace of non-tradable inflation in the quarter suggests that domestic inflation could prove sticky, as has been the case overseas.

## Goods and Services Inflation

Similarly, goods prices have been the driver of disinflation momentum in recent quarters, and this persisted through the September quarter. However, there are early signs that the disinflation pulse from goods may be waning. Goods inflation slowed to 4.9% in annual terms, the lowest level since December 2021. This was despite a pick-up in quarterly price growth. Goods inflation rose 1.2% in quarterly terms, up from 0.9% in the June quarter.

Services inflation also accelerated in quarterly terms, rising 1.0% in the quarter following a 0.8% gain in the June quarter. Despite the quarterly gain, annual growth in services inflation slowed for the first time since the December quarter of 2021. Annual services inflation slowed to 5.8% from 6.3% previously – the peak so far in this cycle. This will be an encouraging development for the RBA, though any euphoria will be dampened by the quarterly acceleration.

## Inflation Categories

Housing and food categories remain the largest contributors to headline annual inflation, despite a moderation in annual price increases across both categories. Food inflation continues to moderate, rising 0.6% in the quarter and 4.8% in annual terms and this trend will likely continue.

While housing inflation is also moderating in annual terms, there is a widely different dynamic at play which could slow the disinflation process. Housing inflation accelerated in quarterly terms in the September quarter, rising 2.2% compared to a 0.8% rise in the June quarter. This was driven by ongoing strength in rents (2.2%) and a reacceleration in prices for new dwelling purchases by owner occupiers (1.3%) which have been a considerable source of disinflation over recent quarters. Additionally, a 4.2% increase in electricity prices in the quarter also supported the acceleration in housing inflation.

Large government rebates played a big part in electricity prices, which would have risen by a whopping 18.6% in the quarter if it wasn't for the rebates. A 15% increase in the maximum rate of rental assistance, applied from 20 September, also impacted the rent series, which would have risen by more had it not been for the increase.

Surging 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 inflation outlook. 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.

| Headline Consumer Prices | Quarterly Change (% June Qtr) | Quarterly Change (% September Qtr) | Annual Change (%) |
|---|---|---|---|
| Food & Non-alcoholic Beverages | 1.6 | 0.6 | 4.8 |
| Alcohol & Tobacco | 1.0 | 1.4 | 4.9 |
| Clothing & Footwear | 0.6 | 0.4 | 0.9 |
| Housing | 0.8 | 2.2 | 7.0 |
| Furnishings, Household Equipment & Services | 2.1 | -0.8 | 2.5 |
| Health | -0.1 | 0.8 | 5.4 |
| Transport | -0.1 | 3.2 | 5.6 |
| Communication | -0.4 | 2.1 | 1.3 |
| Recreation & Culture | -0.2 | 0.2 | 5.6 |
| Education | -0.2 | -0.4 | 4.8 |
| Insurance & Financial Services | 3.0 | 1.4 | 8.6 |
| **Total CPI (Original)** | **0.8** | **1.2** | **5.4** |
| **Total CPI (Seasonally Adjusted)** | **1.0** | **1.0** | **5.3** |
| **Trimmed Mean** | **1.0** | **1.2** | **5.2** |

Another important driver of inflation in the September quarter was transport. In particular, automotive fuel. Fuel prices increased 7.2% in the September quarter to be 7.9% higher in annual terms. Much of this was underpinned by an increase in oil prices over the same period as major global producers, including Saudi Arabia and Russia, announced an extension of production cuts. Prices at the pump have since retraced but persistent pressure on inflation from higher oil prices remains a risk especially given the ongoing Israel-Gaza conflict and a weak Aussie dollar.

## Outlook

There are emerging signs of stickiness in Australian inflation. This is being reflected in a resurgence in inflation momentum in the September quarter. Risks to the inflation outlook are also broadening. Housing inflation and the impact of the Israel-Hamas war are particular risks which could see inflation moderate less rapidly.

RBA Governor Michele Bullock noted last night that “the Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation” and that they have a “low tolerance for allowing inflation to return to target more slowly than currently expected”. Today’s inflation data presents such an upside surprise. However, there is a question as to whether the surprise is large enough to trigger a response from the RBA. Additionally, we do not know what today’s data will mean for the RBA’s inflation forecasts which will be refreshed at the next meeting. There is, however, little doubt that the inflation result has shortened the odds of the RBA tightening rates further.

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