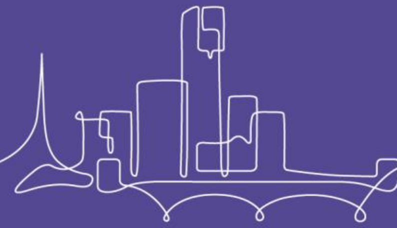
Data snapshot



Wednesday, 27 October 2021

Consumer Price Index

Inflation Surprise Increases Pressure on RBA

- **Inflation numbers released today showed that Australia isn't immune to growing inflationary pressures that have impacted other economies around the world.**
- **The headline consumer price index (CPI) rose by 0.8% in the September quarter 2021, in line with consensus expectations, to be 3.0% higher over the year.**
- **But here is where it gets interesting. Trimmed mean inflation, the Reserve Bank's (RBA) preferred measure of underlying inflation, rose 0.7% in the quarter, to the 2.1% higher over the year. This was notably stronger than the 0.5% rise that was expected and marks the first time annual underlying inflation was within the RBA's 2–3% target band since 2015. The RBA expected underlying inflation to reach the band much later in 2023.**
- **Indeed, swap and bond rates jumped markedly higher in today's trading session, reflecting investors' growing expectation that the RBA will be forced to lift the cash rate sooner than the central bank has flagged.**
- **The housing boom, fuel costs and global supply-chain disruptions contributed to inflationary pressures in the quarter. However, some of the strength in headline inflation reflects base effects due to the unwinding of pandemic-related price reductions from 2020.**
- **We expect the headline rate to continue to drop in the period ahead, while we expect the underlying inflation rate to move into the upper end of the RBA's target band by the end of next year, in turn spurring the RBA to lift the cash rate in 2023.**

Headline and underlying inflation

Inflation numbers released today showed that Australia isn't immune to growing inflationary pressures that have impacted other economies around the world.

The headline consumer price index (CPI) rose by 0.8% in the September quarter 2021, to be 3.0% higher over the year to the September quarter. The was in line with consensus expectations.

But here is where it gets interesting. The trimmed mean measure, the RBA's preferred measure of underlying inflation, rose 0.7% in the quarter, to be 2.1% higher over the year. This was the strongest quarterly growth since June 2014. It was also notably stronger than the 0.5% rise that was expected by consensus.

Importantly, this marks the first time annual underlying inflation was within the RBA's target band of 2–3% since the December quarter of 2015. Measures of underlying inflation, including the trimmed mean, seek to reduce the impact of short-term volatile components. This helps policy makers look through temporary impacts and better understand underlying inflationary trends. In its most recent forecasts, published on 6 August, the RBA did not expect trimmed mean inflation to be within the target band until 2023.

The housing boom, rising fuel costs and global supply-chain disruptions all contributed to inflationary pressures in the quarter. However, some of strength in the headline inflation figures reflects base effects due to the continued unwinding of pandemic-related price reductions from 2020. These factors are temporary and their impacts are expected to dissipate over time. Reflecting this process, we expect annual headline inflation to fall below 3% over coming quarters.

Groups Analysis

Prices increased in seven out of the eleven CPI groups and were unchanged in one group.

The key driver of the increase was the housing group, up 1.7%, with new dwelling purchases by owner-occupiers up 3.3% – the largest quarterly rise since the introduction of the GST in 2000. Continued strong demand for housing construction has allowed material and labour cost increases to be passed onto consumers. At the same time, the unwinding of the HomeBuilder program is putting upward pressure on prices. Effectively, the Australian Bureau of Statistics (ABS) adjusts consumer prices by the value of government grants, meaning that the HomeBuilder program depressed readings of new housing inflation. But as the impact of the program unwinds, this effect will reverse, pushing up new housing inflation. Separately, rents also increased across most of the country.

Another key driver of the increase was transport costs, as was the case in the previous quarter. The 3.2% increase in transport costs in the quarter was underpinned by a 7.1% rise in automotive fuel prices following the increase in global oil prices. Motor vehicle prices also rose 1.4% alongside strong demand, while the global semiconductor shortage, COVID-related restrictions on factory operations and shipping costs hampered supply.

There was also a 1.6% increase in the furnishing, household equipment & services group. Furniture prices were up 3.8%, as consumers purchased household items through lockdowns alongside supply shortages. Childcare prices were also up as a rise in fees increased the cost borne by households.

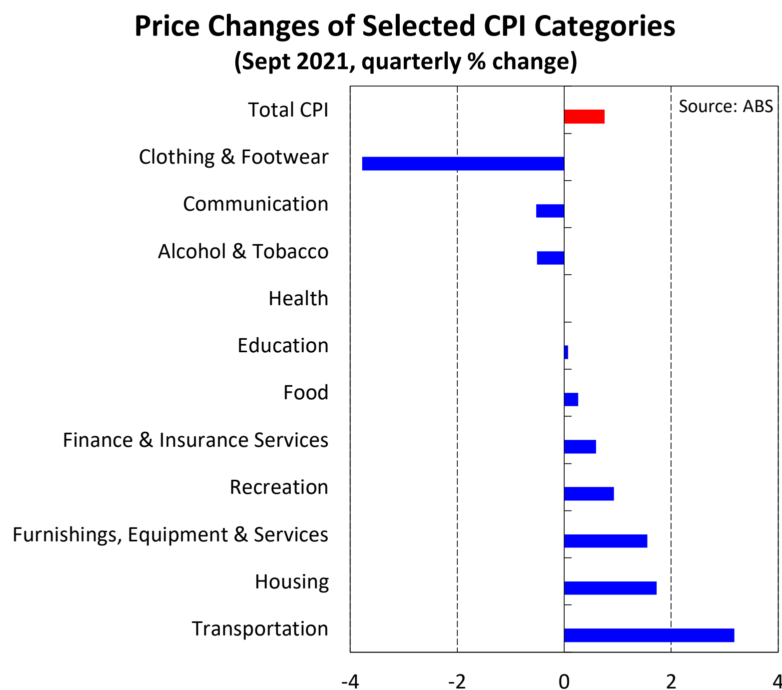
At the other end of the scale, the clothing & footwear group fell 3.8% as retailers looked to get rid of excess winter stock alongside low demand during lockdowns.

Recreation and culture surprisingly increased 0.9%, despite lockdowns in our two largest cities during the quarter. The increase partly reflected a rise in audio, visual and computing equipment,

as the global chip shortage was combined with elevated household demand.

The food & non-alcoholic beverages category increased a more modest 0.3%. Restaurant meals and takeaway both rose alongside the decline in the use of voucher schemes (‘Dine & Discover’ in NSW and ‘Melbourne Money’ in Victoria). The vouchers reduced the out-of-pocket expenses for households in the previous quarter, so the unwind of this effect saw higher prices. These increases were partly offset by a sharp decline in fruit prices, alongside favourable growing conditions, while demand from the food service industry also softened through lockdowns.

Elsewhere, the insurance & financial services group rose 0.6% and the education group edged up 0.1% while health was flat. The alcohol & tobacco and communication groups both edged down 0.5%.



Tradables and non-tradables inflation

Tradables and non-tradables inflation grew at a similar rate in the September quarter. Tradables inflation measures the prices of imported goods and services and is influenced by global factors, including movements in the currency and oil. Non-tradables inflation is a measure of the prices of domestically produced goods and services.

Tradables inflation grew by 0.8% in the quarter, to be 3.1% higher over the year. Growth was driven by increases in the price of automotive fuel. This was partly offset by a fall in the price of tradable services.

Non-tradables inflation grew by 0.9% in the quarter, to be 3.2% higher over the year. Increases in the price of new dwellings purchased by owner-occupiers and restaurant meals drove the increase.

Inflation by capital cities

By capital city, inflation in the September quarter increased the most in Darwin (1.5%), Brisbane (1.3%), and Canberra (1.3%). All other capital cities reported increases of less than 1.0% for the quarter. Inflation was the weakest in Hobart (0.3%), followed by Sydney and Adelaide (both 0.7%).

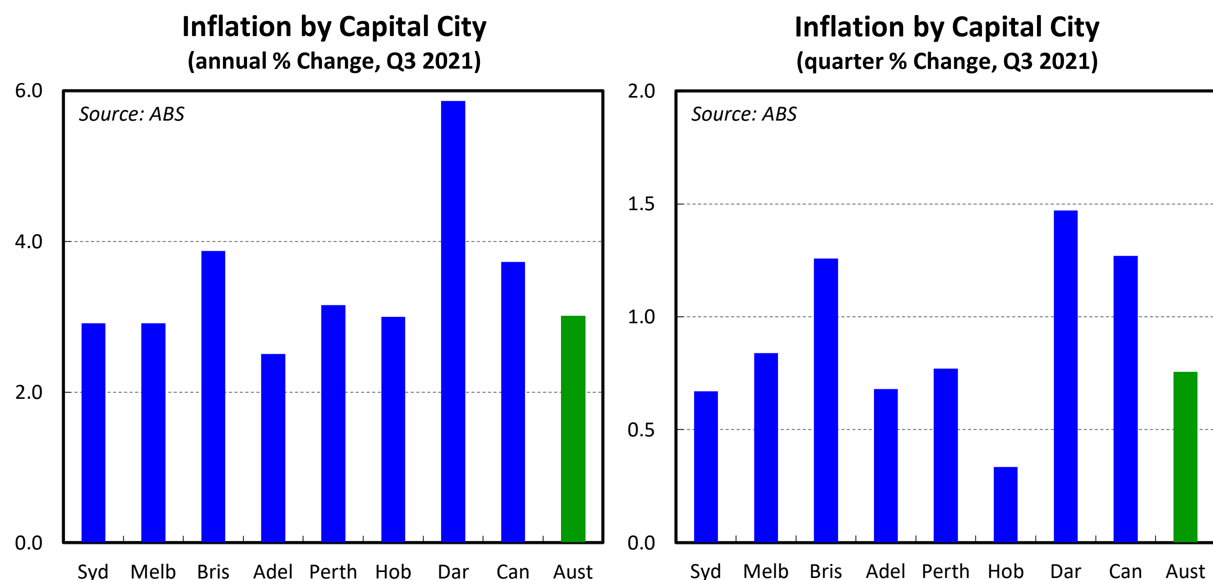
Fuel prices increased across all capital cities by more than 6.3% in the quarter. Prices hit record

highs in Sydney and Melbourne, and approached record highs in Brisbane. Across the country, prices hit record highs of $1.65 per litre. Other categories that increased across all cities included furniture, and property rates and charges. The price of new dwellings purchased by owner-occupiers increased across all cities except Perth. Fruit prices fell across all capital cities, following a bumper crop.

Rents rose across all capital cities except Sydney (-0.5%) and Melbourne (-0.3%). Low vacancy rates in the smaller capital cities continue to drive increases in rents. Rents have now risen by 5.5% in Perth and 4.9% in Hobart since the start of the pandemic (March quarter 2020). However, rents have fallen across the two largest cities. Rents are now 3.9% lower than pre-pandemic levels in Sydney and 2.1% below pre-pandemic levels in Melbourne. High vacancy rates, particularly in inner city areas, continue to drive falls in rents across these cities. As a result of the weakness in Sydney and Melbourne, rents across Australia are still down 1.2% on pre-pandemic levels.

On an annual basis, inflation was highest in Darwin (5.9%), followed by Brisbane (3.9%) and Canberra (3.7%). Annual inflation was weakest in Adelaide (2.5%), and Sydney and Melbourne (both 2.9%).

Like the overall CPI series, annual growth rates continue to be impacted by the unwinding of COVID-19-related disruptions a year ago. Annual growth rates are not expected to remain at these elevated levels going forward.



Outlook

The battle between interest-rate markets and central banks over whether the pickup in inflation will be transitory or persistent has intensified in recent weeks. Central banks have to date largely considered these price pressures as transitory and expect them to unwind as supply constraints ease. However, financial markets remain unconvinced and have brought forward expectations of interest rate hikes.

Today's data shows that these pressures are beginning to flow through into prices in Australia. The question on everyone's lips will be how this will impact the RBA's views on the economic outlook and inflation. Indeed, bond and swap rates jumped up in the wake of today's data. This reflects the market's growing expectation that the RBA will be forced to lift the cash rate sooner than the central bank has indicated.

We believe markets are correct to challenge the RBA's guidance that the cash rate won't increase

until 2024. But, with current pricing suggesting the cash rate could lift by around the middle of 2022, we believe there is a risk financial markets have gone too far in the other direction. We continue to expect trimmed mean inflation will approach the upper half of the 2–3% target band by the end of next year, in turn spurring the RBA to lift the cash rate in 2023. It will come down to how quickly the economy rebounds, and in particular, how fast wages growth picks up.

Jarek Kowcza and Matthew Bunny

Ph: 0481 476 436

Contact Listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Economist
Matthew Bunny
Matthew.bunny@bankofmelbourne.com.au
(02) 8254 1316

Senior Economist
Jarek Kowcza
Jarek.kowcza@bankofmelbourne.com.au
0481 476 436

Research Assistant (Secondment)
Sonali Patel
sonali.patel@bankofmelbourne.com.au
(02) 8254 0030

The Detail

The information contained in this report ("the Information") is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom Bank of Melbourne has a contract to supply Information, the supply of the Information is made under that contract and Bank of Melbourne's agreed terms of supply apply. Bank of Melbourne does not represent or guarantee that the Information is accurate or free from errors or omissions and Bank of Melbourne disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to Bank of Melbourne products and details are available. Bank of Melbourne or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. Bank of Melbourne owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of Bank of Melbourne.

Any unauthorised use or dissemination is prohibited. Neither Bank of Melbourne- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.