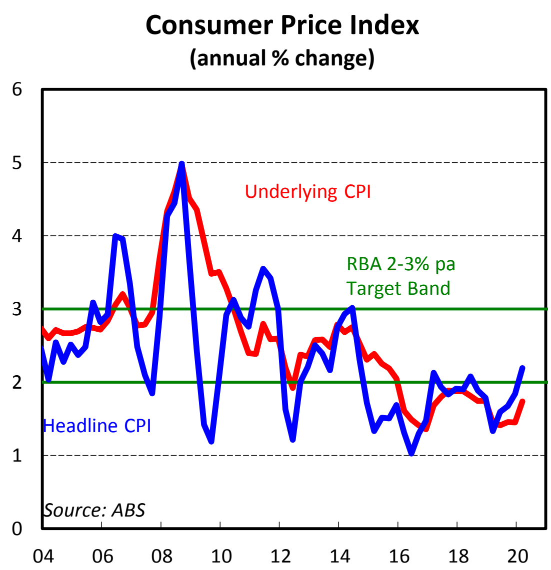
Data snapshot

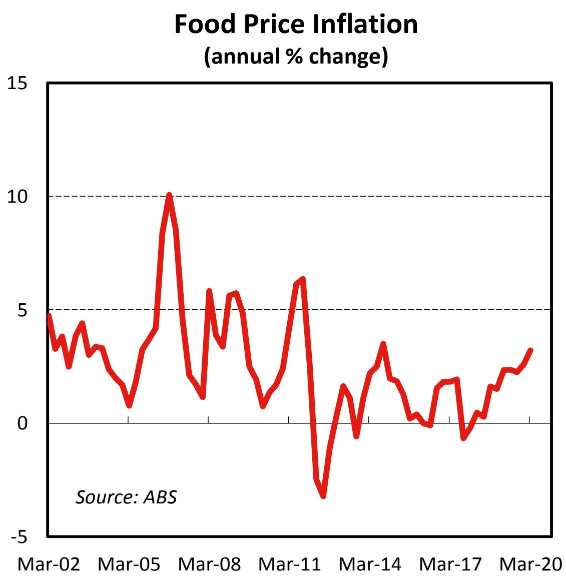
Wednesday, 29 April 2020

Consumer Price Index

False Alarm

- **Annual rates of both headline and underlying inflation edged higher in the March quarter.**
- **Annual headline inflation lifted from 1.8% to 2.2%, landing in the RBA's 2 to 3% per annum target band for the first time since the June quarter of 2018.**
- **Underlying (or trimmed mean) inflation increased from an annual rate of 1.6% to 1.8%. It was the strongest annual rate in over a year, but is below the RBA's target band. Underlying inflation is the preferred measure for the RBA in assessing broad-based price pressures.**
- **The quarterly gain in prices was driven by the impact of the drought and bushfires on prices of some fresh food. Additionally, there were some demand-induced price spikes from stockpiling ahead of COVID-19 restrictions, especially for certain household products such as toilet paper and hand sanitiser. Prices for non-durable household products recorded firm growth.**
- **The impact of COVID-19 also materialised in the tradables inflation measure, which fell for the first time in a year, as the plunge in oil prices caused automotive fuel prices to decline.**
- **We are far from seeing this bounce as an uptick in price pressures. The stark drop in demand over the June quarter is expected to translate into broad-based price weakness. Indeed, a rapid fall in fuel costs, free childcare and a likely decline in rents point to a risk of the headline inflation gauge declining over the June quarter.**





Headline and Underlying CPI

Both headline and underlying inflation were higher than expected in the March quarter.

Headline CPI rose 0.3%, above the consensus estimate for a 0.2% gain. Annual headline inflation edged higher from 1.8% to 2.2%, landing in the RBA's 2 to 3% per annum target band for the first time since the June quarter of 2018.

Underlying (or trimmed mean) inflation rose by 0.5%, while the annual rate edged up from 1.6% to 1.8%. It was the strongest annual rate in over a year, but is below the Reserve Bank's (RBA's) target band.

The stronger-than-expected lift was driven by the impact of the drought and bushfires on prices of some fresh food. Additionally, there was some impact from COVID-19 concerns, reflecting high demand for certain household products, including toilet paper and hand sanitiser, boosting prices for non-durable household products.

However, the pick up in the annual inflation rate is unlikely to be sustained. We are far from seeing this bounce as an uptick in price pressures. The stark drop in demand over the June quarter is expected to result in broad-based price weakness. Indeed, a rapid fall in fuel costs, free childcare and a likely decline in rents point to a risk of price declines over the June quarter.

Moreover, the RBA prefers to assess underlying inflation as it strips out one-off factors that may have only a transient effect on prices. While the annual rate of underlying inflation lifted in the quarter, it remains below the RBA's target band.

Groups Analysis

The drought, bushfires and COVID-19 were major events which impacted prices in the quarter, particularly for a range of food products.

A 6.0% lift in fruit and vegetable prices and a 2.0% increase in meat and seafood prices were the key drivers. The drought had a part to play, as well as the bushfires increasing transport costs for fresh produce. Furthermore, strong export demand also boosted prices for meat.

Later in the quarter, prices were also supported by stockpiling amid COVID-19 restrictions, which led to less discounting.

On an annual basis, food prices rose 3.2%, the strongest gain in 5½ years.

Notable March quarter events impacting prices on food categories

Sub-Group	Drought	Bushfire	International demand	COVID-19
Bread and cereal products	X			X
Meat and seafoods	X	X	X	X
Dairy and related products	X			X
Fruit and vegetables	X	X		X
Food products n.e.c.	X	X		X
Non-alcoholic beverages				X
Meals out & takeaway	X	X		

Source: ABS

COVID-19 also impacted prices in the furnishings, household equipment and services group. Other non-durable household products which includes toilet paper, rose 3.4%, the strongest quarterly increase in the series history, which dates back to 1989.

March quarter, 2020

Headline Consumer Prices	Quarterly % Change
Education	2.6
Food and non-alcoholic beverages	1.9
Health	1.7
Alchohol and tobacco	1.6
Furnishings, household equipment and services	0.8
Insurance and financial services	0.7
Housing	0.3
Communication	-0.3
Clothing and footwear	-0.7
Recreation and culture	-1.7
Transport	-1.9
Total CPI	**0.3**

Source: ABS

Education also contributed to the lift in prices, rising 2.6% in the quarter. Rising prices for education is typical at the commencement of the new school year.

Of the other sub-groups, the largest declines was for transport (-1.9%), as automotive fuel costs dropped 6.0% in the quarter. It reflects the drop in global oil prices, which have continued to come under significant downward pressure this month.

Weaker prices for recreation & culture (-1.7%) were driven by a 3.1% fall in prices of domestic holiday & travel accommodation and a 3.0% decline in international travel. It suggests that demand for travel was weakening as cases of COVID-19 escalated in China and across the world. Moreover, this period was the winter-off peak season for travel in Europe and America.

With little to no international travel spending during the June quarter, the ABS will either adjust (so this series does not contribute to CPI for the quarter) or estimate a typical seasonal pattern of prices if restrictions were not in place.

Rents, which comprise over 7% weighting in the CPI basket, edged up a subdued 0.1%. Growth has held at between 0.0-0.1% for five consecutive quarters, and points to a weak starting point ahead of a sharp drop in underlying demand for housing.

Tradables and Non-Tradables Inflation

Non-tradables inflation rose by 0.6% in the March quarter. On a year ago, this measure rose to 2.3% in the March quarter, from 2.0% in the December quarter of last year. Food prices in particular were pressured up in the March quarter by a combination of the drought and bushfires. Food prices spiked 1.9% in the March quarter – a higher quarterly outcome has not been posted in nine years.

In contrast, tradables inflation (i.e. the prices of imported goods and services) fell by 0.2% in the March quarter, which is the first quarterly decline in a year. The substantial decline in world oil prices played a very significant role in the decline in tradables inflation in the quarter. Indeed, automotive fuel declined by 6.0% in the March quarter. The West Texas Intermediate quote for oil declined nearly 67% in the March quarter and has dropped even further into the June quarter.

The annual growth rate of tradable inflation still rose in the March quarter, to 2.1%, from 1.7% in the December quarter of last year, reflecting the depreciation of the Australian dollar since the middle of 2017. The Australian dollar also depreciated sharply during the March quarter, of around 9.3% in trade-weighted terms, but this is likely to feed through to retail prices with some lag.

Inflation by Capital Cities

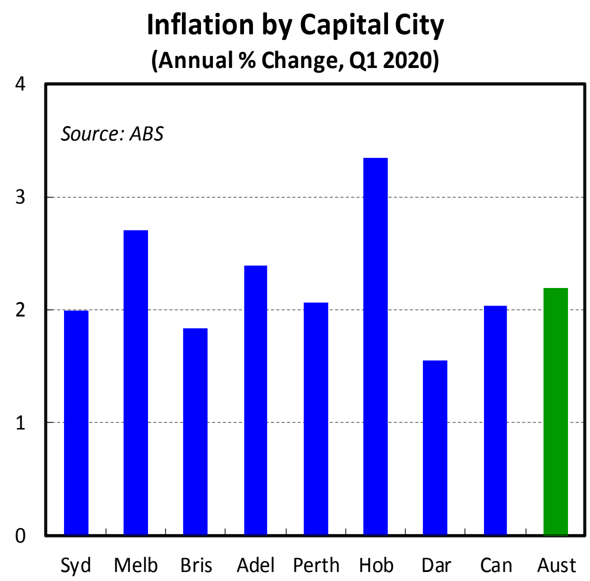
Variation emerged between capital cities in the March quarter, but most capital cities recorded growth of 0.3-0.4% in the quarter. The annual growth rates of most capital cities were above the 2% per annum mark in the March quarter, but this is likely to unravel over coming quarters, as the impact of COVID-19 causes inflation to decompress.

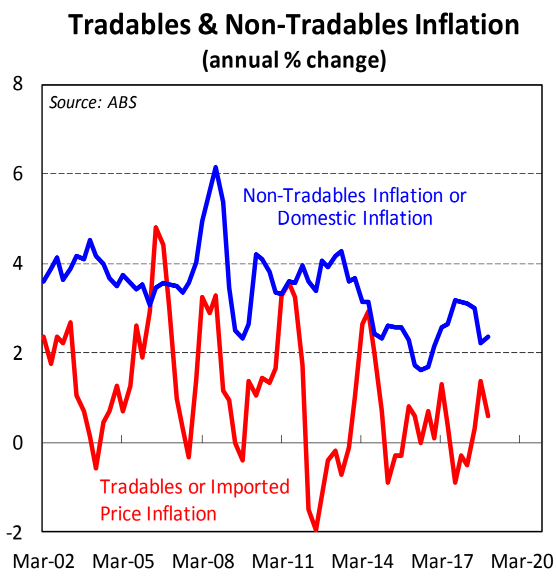
The weakest inflation outcome in the quarter across the capital cities was registered in Brisbane; indeed, Queensland and NSW were the hardest hit States during the bushfire season and the drought impacted QLD very adversely also. Inflation declined by 0.1% in Brisbane, which was the first quarterly decline since the December quarter of 2011. On a year ago, inflation was 1.8%.

The strongest inflation outcome was recorded in Melbourne in the quarter. Inflation jumped by 0.8% in the March quarter and accelerated to 2.7% in the year to the March quarter, which is the sharpest annual growth rate in nearly six years. Higher electricity costs drove the relatively stronger increase in Melbourne.

In the capital cities of Sydney, Adelaide and Hobart, inflation rose by 0.3% in the quarter – matching the national outcome. In the capital cities of Perth, Hobart and Canberra, inflation lifted by 0.4% in the quarter.

The annual pace of inflation grew to a 1½-year high of 2.6% in Sydney, to a near 2-year high of 2.4% in Adelaide and a near 9-year high of 3.4% in Hobart. The annual growth rates was at a near 6-year high of 2.1% in Perth, a 5½-year high of 3.4% in Hobart and at a 1½-year high of 2.0% in Canberra.





Outlook

The recent lift in inflation reflects some one-off supply constraints from the drought and the bushfires. Further, the demand-induced price spike from stockpiling ahead of COVID-19 restrictions is also unlikely to be continued.

As spending and incomes fall due to the large scale of deterioration in the labour market and the cessation of many services, prices are likely to come under downward pressure. Some key components of the CPI will contribute to a fall in prices in the June quarter, including fuel costs, childcare (as it became free) and rents as vacancies rise and as tenants affected by COVID-19 renegotiate lower terms.

In a speech last week, the RBA Governor said that he expects a "significant decline" in inflation in the June quarter and that it was quite likely that annual headline inflation would turn negative. If the RBA's forecast proves to be correct, it would be the first time since the 1960s that year-ended inflation would have declined.

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