

18 July 2022

June Quarter CPI Preview Housing, food & auto fuel driving the Q2 spike but widespread price pressures continue to push core inflation.

- Westpac is forecasting a solid 1.7% rise in the June quarter CPI. Following on from the 2.1% print in the March quarter this will lift the annual pace from 5.1% to 6.1%. We have also raised the peak in annual inflation to 7.2%yr from 6.6%yr in the December quarter 2022.
- Core inflation is forecast to lift 1.4% in June, matching the lift in March, taking the annual pace to 4.6%yr from 3.7%yr. We have also revised up the peak in trimmed mean annual inflation from 4.8%yr to 5.0%yr in both the September and December.
- Our preliminary forecast for June was 1.5% (see [Energy prices driving an outsized price shock](#)). Driving most of the 0.2ppt revision has been dwelling prices with our forecast lifted 0.9ppt to 5.5% due to ongoing construction input cost inflation which would be pushing CPI dwelling prices higher. The revision to dwelling prices contributed 0.1ppt or half of the revision to our CPI forecast.
- Most of the remaining revision was due to a 2.8ppt increase in our food price forecast to 5.4%. Extreme weather conditions have had a meaningful impact of fresh fruit & vegetable supplies contributing 0.07ppt to the 0.2ppt CPI revision.
- The Ukraine crisis has been a significant shock to fuel prices and in the June quarter even the 22c/ reduction in the fuel excise pump prices gained 4% in the quarter. The recent fall in crude to below US\$100/bbl should provide some offset in the September quarter should it hold this level, or even fall further.
- There is a significant unknown in how much impact supply distributions, and broader upstream price pressure, will have on food, clothing & footwear as well as household goods (both durable and non-durable) this quarter. This presents an upside risk in an economy that is experiencing a recovery in domestic demand.
- The surge in domestic energy prices is set to have a significant impact on retail electricity prices, and thus the CPI, but we don't expect it to appear until the second half of the year and even then, state government rebates will offset this in the September quarter so the full impact will not appear until the December quarter.

June CPI forecast

Item	June 2022 fc		Current Q2 fc	
	% qtr	contrib	% qtr	contrib
Food	1.5	0.26	1.1	0.19
of which, fruit & vegetables	5.4	0.13	2.6	0.06
Alcohol & tobacco	1.3	0.11	1.3	0.11
of which, tobacco	1.9	0.07	1.9	0.07
Clothing & footwear	1.2	0.04	1.2	0.04
Housing	2.6	0.62	2.2	0.53
of which, rents	0.8	0.05	0.6	0.04
of which, house purchases	5.5	0.51	4.6	0.41
of which, utilities	0.9	0.04	0.9	0.04
H/hold contents & services	1.5	0.14	1.3	0.12
Health	2.5	0.16	2.5	0.16
of which, pharmaceuticals	-0.6	-0.01	-0.6	-0.01
Transportation	2.0	0.22	2.0	0.22
of which, car prices	1.0	0.03	1.0	0.03
of which, auto fuel	4.0	0.15	4.4	0.15
Communication	0.1	0.00	0.1	0.00
Recreation	1.1	0.09	0.7	0.06
of which, audio vis & comp	0.7	0.01	0.7	0.01
of which, holiday travel	2.0	0.04	1.0	0.02
Education	0.1	0.01	0.1	0.00
Financial & insurance services	0.5	0.03	0.5	0.03
CPI: All groups	1.7	-	1.5	-
CPI: All groups % year	6.1	-	5.8	-

Sources: ABS, RBA, Westpac Banking Corporation.

Inflation indicators

		Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
AUD/USD	(index)	0.71	0.69	0.74	0.76	0.78
AUD/USD %yr	(%yr)	-7.2	-5.5	1.5	5.4	8.7
TWI	(index)	62.7	64.6	65.2	65.1	65.3
TWI %yr	(%yr)	-1.3	5.5	6.0	6.5	4.1
Brent US\$bbl	(index)	110	107	113	107	102
Brent %yr	(%yr)	60.3	47.0	43.4	11.7	-7.5
Output gap t-3	(index)	1.7	1.5	1.2	0.9	0.6

Inflation forecasts

		Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
CPI	(index)	126.0	127.0	130.0	131.4	132.2
	(%qtr)	1.7	0.8	2.4	1.1	0.6
	(%yr)	6.1	6.1	7.2	6.1	4.9
Trimmed mean	(%qtr)	1.4	1.2	1.0	0.8	0.8
	(%yr)	4.6	5.0	5.0	4.5	3.9

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March quarter inflation recap

The March quarter CPI lifted 2.1%, well above the market forecast of 1.7% and even exceeding Westpac’s top of the range forecast of 2.0%. It was the largest quarterly increase in the CPI since the introduction of the GST in 2000 (3.8% at September 2000). The annual pace lifted from 3.5% to 5.1% also the fastest pace of annual inflation since the introduction of the GST. The unwinding of the HomeBuilder grants continued to be part of the story behind the boost in inflation but it was the ongoing shortages of building supplies and labour, heightened freight costs plus strong demand also contributed dwelling price inflation as well as the broader inflationary pulse. A broad spread inflationary pulse was captured by 1.4% gain in the trimmed mean which, if you compare to the RBA historical estimates of the trimmed mean, it is the largest quarterly increase since the 1.8% print in December 1990.

Food prices remain under pressure

Distribution disruptions remain on ongoing complexity adding to seasonal conditions as well as a significant labour shortages that continue to disrupt farm production. This resulted in a significant bounce in fruit & vegetable prices as well as other food products. There is the complexity of the NSW Governments Dine & Discover vouchers which expired on the 30th of June - it is unknown how many were used and what impact it will have a restaurant & take away food.

Food forecast is 1.5% contributing 0.26ppt.

Some rebuilding of clothing & footwear prices

Sales normally occur post Christmas/New Year (impact in March quarter) and post the end of the financial year (June 30 so in the September quarter). The introduction of Black Friday sales in November have started to change seasonality in clothing & footwear prices but the June quarter still appears to be when retailers reset prices post the New Year sales.

Clothing & footwear forecast is 0.2% contributing 0.4ppt.

Housing costs continued to remain a key source of inflationary pressure

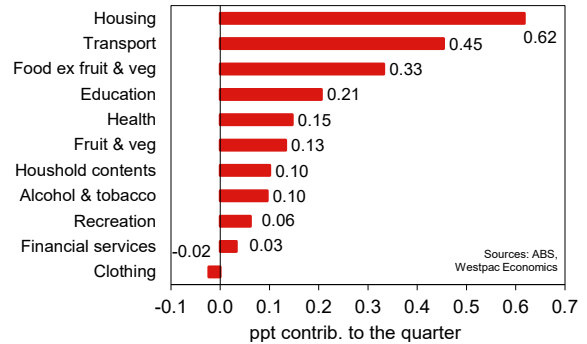
The Covid related government support and grants for rents ended in 2020 and there have been steady reports of rising market rents since the June quarter of 2021. Market data suggests rents are lifting in Sydney and Melbourne. However, the CPI measures all rents paid, not just new contracts, and includes public and defence housing which are more stable. We see rents lifting in NSW and Vic adding to the current momentum seen in Qld and WA.

Westpac has rents rising 0.8% contributing 0.05ppt.

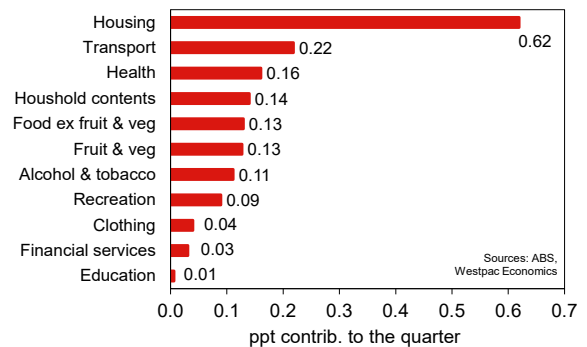
Through 2021 Commonwealth HomeBuilder grants plus WA and Tasmanian state government grants provided a significant offset for new dwelling prices. Dwelling prices fell 0.1% in 2021 Q1 and again in Q2 with an increasing use of HomeBuilder grants. Grants were still being used through the rest of 2021 but by a lesser amount as robust gains in prices paid saw the CPI report dwelling prices lifting 3.3% in the September quarter, 4.2% in the December quarter and 5.7% in the March quarter.

Without the government grants, new dwelling prices would have risen 1.2% in December 2020, 1.3% in March 2021 then 1.8% in June, 3.0% in September and 3.6% in the December quarter underpinned by rising material and labour costs with demand supercharged by the grants. This has continued into 2022 with dwelling prices before grants lifting 4.4% in the March quarter. As such, grants held the effective price of dwellings 1.7% below

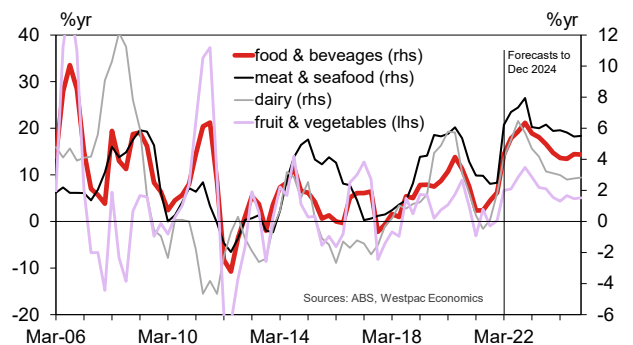
Contributions 2022Q1 CPI 2.1%qtr print



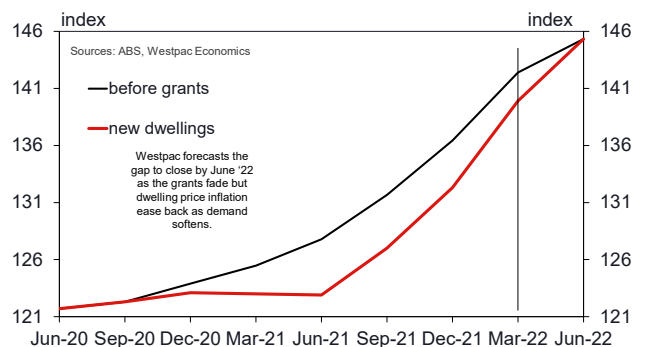
Contributions 2022Q2 CPI 1.7%qtr forecast



Food inflation to remain elevated



As grants fade dwelling prices lift



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the list price at the March quarter. As the grants are used up dwelling prices will rise to close that gap; we expect this gap to occur in the June quarter.

For the June quarter we expect to see dwelling prices before grants to rise 3.7% due to ongoing cost pressure while the lack of grants being used will add a further 1.7%.

We have dwelling purchase prices rising 5.5% contributing 0.51ppt.

As we covered in our report “[Energy prices driving an outsized price shock](#)” the Australian energy market has been hit by a perfect storm of rising demand, less output from coal fired base load generation plus record high coal and gas prices. There has been a surge in low cost renewable energy but it has not been enough to offset the loss of coal fired generation nor the rise in gas and coal prices. This has resulted in a significant increase in the Default Market Offers around the country with many state offsetting this with energy rebates. This increase in DMO, and temporary energy rebates, is set to add significant volatility to our CPI forecast through 2022. However, this all occurs in Q3 and Q4 and not in Q2

Electricity prices are forecast to rise 1.0% contributing 0.02ppt.

Overall housing forecast is 2.6% contributing 0.62ppt.

Furnishings, household contents & services prices

Price pressure in continues to build in domestic & housing services (childcare, hairdressing and other household services). The June quarter is also when the post New Year Sales price reset occurs.

Household contents & services forecast is 1.5% contributing 0.14ppt.

PBS starts to offset rising health costs

Pharmaceutical prices are to have their usual seasonal fall as families health expenditure starts to exceed the threshold to qualify for support under the Pharmaceutical Benefit Scheme (PBS). We are forecasting a 0.5% fall in medical products, appliances & equipment.

Health costs forecast 2.5% contributing 0.16ppt.

Rising fuel and motor vehicles push transport costs

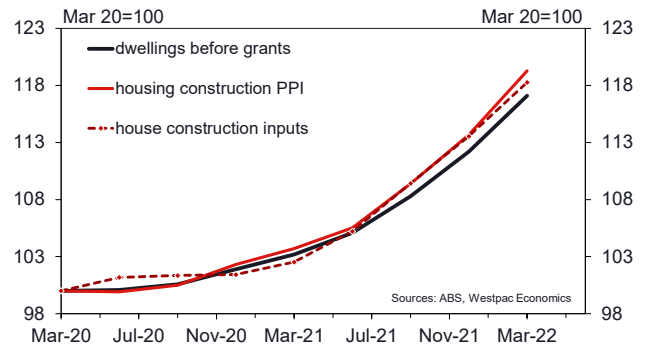
The Ukraine crisis represented a significant shock to the global energy markets with crude prices peaking just under US\$125/bbl in early March before prices have stabilised around US\$100/bbl by the end of the month. In the March quarter there was the offsetting temporary halving of the fuel excise (worth 22 cents a litre) but there was a rally in crude back up to US\$120/bbl by early June. With market starting to focus on rising interest rates, stronger US dollar and risks of a recession crude prices have recently fallen back below US\$100/bbl. Pump price data is pointing to a 4% increase in fuel prices while ongoing shortage of new cars suggest new vehicle prices remain well supported.

Transport forecast 2.0% contributing 0.22ppt.

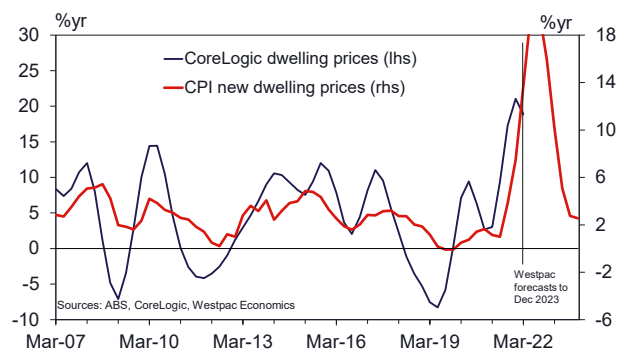
Recreation & culture rebounds from lockdowns

State borders reopened in early 2022 with no further lock downs in any capital city. In the March quarter will see the return of normal price gathering for both domestic and international travel & holidays following a period where the ABS had imputed price changes for this sector based on the overall CPI. Best air fare data suggests there was increased discounting

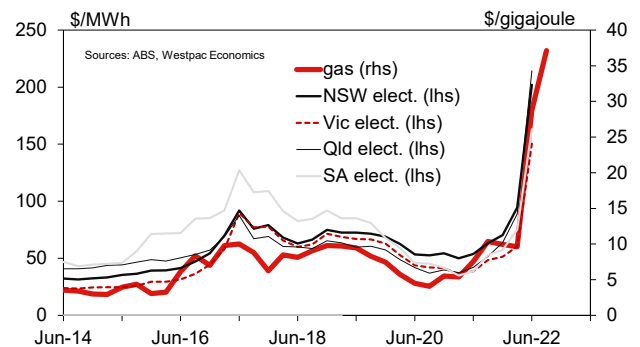
Cost inflation dragging dwelling prices higher



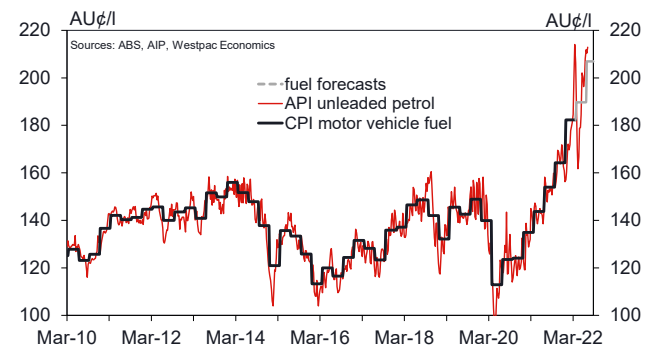
House prices vs CPI new dwelling prices



Wholesale gas vs. electricity prices



Weekly bowser price & CPI auto fuel



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in the March quarter but given the ongoing opening of domestic tourism and robust demand compared to tight supply conditions we expect to see sound increase in the quarter for domestic travel.

The weight for international travel is 0.07% of the CPI reflecting the lack of international travel through the Covid period. As such it has does not impact the CPI but we expect this change through 2022 with the return of international travel.

Recreation & culture forecast is 1.1% contributing 0.09ppt.

Widespread inflationary pressures boosting core inflation

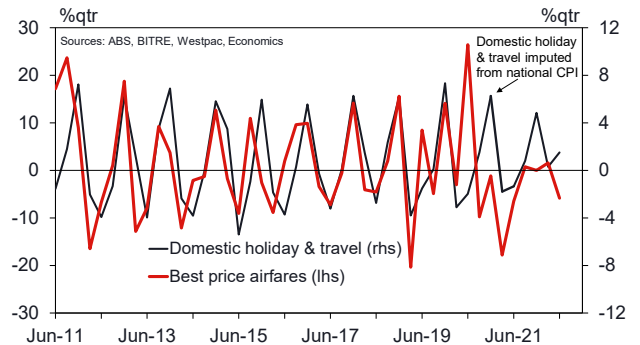
The trimmed mean is forecast to rise 1.4% matching the rise in March quarter, which compared to the RBA historical estimates, is the largest quarterly rise since the 1.8% print in December 1990.

Remembering that prices are seasonally adjusted in the core measures trimmed off the top are; auto fuel, new dwellings, fruit & vegetables as well as international & domestic holidays. The top of the range that is still in the trimmed mean is 3.6%. Trimmed off the bottom; footwear, household utensils, Accessories, Telecommunication equipment & services, household textiles, therapeutic appliances & equipment, audio, visual & computing equipment, sports participation, take away & fast food, spare parts & accessories for motor vehicles and tertiary education. The bottom trim starts at a quite high 0.3%. There are no negative quarterly changes in the June quarter trimmed mean.

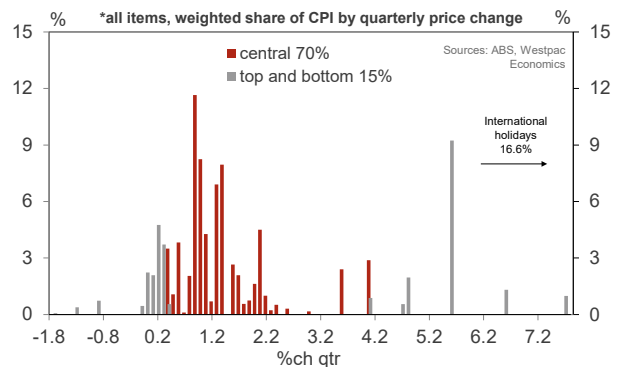
A 1.4% rise in the trimmed mean will see the annual pace lift from 3.7%yr to 4.6%yr; the two quarter annualised pace lifts from 4.9%yr to 5.6%yr. Our expectations are that the annual pace of core inflation is likely to peak at around 5%yr in the second half of 2022, the fastest annual pace since early 1990s.

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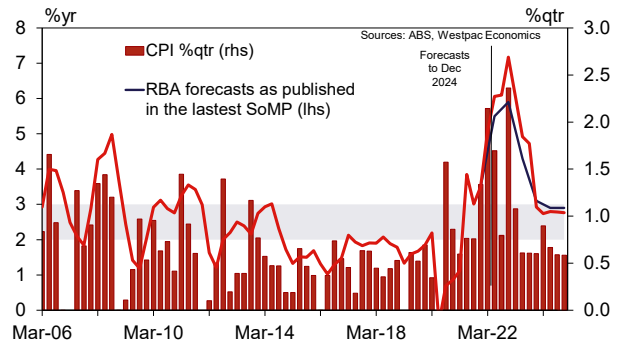
Domestic holidays & travel



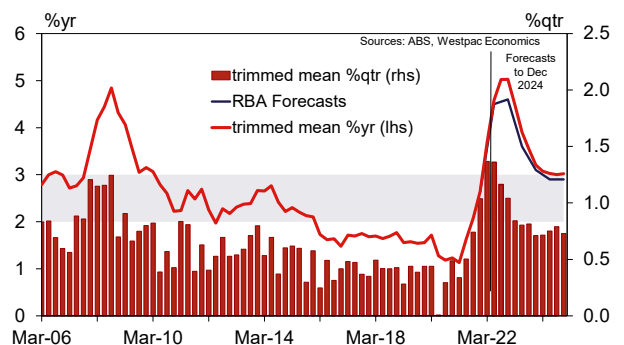
Distribution of seasonally adjusted Q2 CPI fcs



Westpac vs. RBA CPI forecasts



Westpac vs. RBA core inflation forecasts



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