BULLETIN

3 August 2022

Deeper insights from June quarter CPI
Broadening inflationary pressures point to near term upside risks but falling crude prices providing an offset.

- CPI 1.8%qtr vs 1.7% forecast; Trimmed Mean 1.5% vs 1.4% forecast. The CPI came in broadly as expected even with food, clothing & footwear, household furniture, equipment & services surprising to the high side.
- The CPI gained 1.8% in the June quarter splitting the difference between the market median of 1.9% and Westpac's forecast of 1.7%. At two decimal places it was 1.78% so a firm 1.8%. This increase was the second highest since the introduction of the GST and follows on from a 2.1% increase in the March quarter.
- The annual pace lifted from 5.1% to 6.1% the fastest pace since the introduction of the GST (6.1%yr June 2001) and significantly faster than the 5.0%yr pace at the peak of the mining boom in September 2008.
- The most significant price rises were for new dwellings (5.6% vs 5.5% WBC), automotive fuel (4.2% vs 4.0% WBC). What surprised was the strength of the gains for food (2.0% vs 1.5% WBC), clothing & footwear (3.5% vs 1.2% WBC) and household furnishings, equipment & services (2.5% vs 1.5% WBC).
- The price of goods (2.6%) continued to rise more strongly than that of services (0.6%). Main contributors to the rise in food prices included vegetables (7.3% vs 4.8% WBC), meals out and takeaway foods (1.4% vs 0.2% WBC), and fruit (3.7% vs 6.3% WBC). Supply chain disruptions due to flooding, labour shortages, and rising freight costs contributed to higher prices. Furniture prices rose (7.0% vs 3.1% WBC) due to increased transport and material costs as well as stock shortages.
- For services, financial services (1.2% vs 0.4% WBC) and holiday travel & accommodation (2.3% vs 2.0% WBC) were the stand out. Child care (-7.3% vs 1.0% WBC) fell due to additional child care subsidies. Urban transport fares fell (-4.4% vs 0.6% WBC) due to free travel periods in NSW and Tasmanian.
- A broad inflationary pulse was captured by 1.5% gain in the Trimmed Mean; market expectations 1.5%, Westpac 1.4%. The March quarter Trimmed Mean was revised from 1.4% to 1.5%. The annual pace lifted from 3.7%yr to 4.9%yr, the fastest pace since September 1991 (using the RBA's historical estimates).
- How widespread the inflationary pulse is was further emphasised by the rise in the share of components of the CPI running faster than 2.5%yr. The share lifted from 66% to 72.4%, well up from 29% reported back in September 2021 and is the largest share since June 2001 (75.3%, you have to go back to early 1991 to find a larger share).
- Following the June quarter CPI we have updated our inflation profile. It is now to peak at around 7¾%yr at end 2022 before easing back to around 3%yr by end 2023.

June Quarter 2022 CPI

	Jun 2022 actual		Jun 2022 f/c	
Item	**% qtr**	**contrib**	**% qtr**	**contrib**
Food	2.0	0.34	1.5	0.26
of which, fruit & vegetables	5.8	0.14	5.4	0.13
Alcohol & tobacco	0.8	0.07	1.3	0.11
of which, tobacco	1.0	0.04	1.9	0.07
Clothing & footwear	3.5	0.12	1.2	0.04
Housing	2.5	0.58	2.6	0.62
of which, rents	0.7	0.04	0.8	0.05
of which, house purchases	5.6	0.52	5.5	0.51
of which, utilities	-0.2	-0.01	0.9	0.04
H/hold contents & services	2.5	0.22	1.5	0.14
Health	0.4	0.03	2.5	0.16
of which, pharmaceuticals	-1.1	-0.01	-0.6	-0.01
Transportation	2.3	0.25	2.0	0.22
of which , car prices	1.2	0.04	1.0	0.03
of which, auto fuel	4.2	0.16	4.0	0.15
Communication	0.1	0.00	0.1	0.00
Recreation	1.4	0.12	1.1	0.09
of which, audio vis & comp	1.2	0.02	0.7	0.01
of which, holiday travel	2.3	0.05	2.0	0.04
Education	0.0	0.00	0.1	0.01
Financial & insurance services	1.1	0.06	0.5	0.03
CPI: All groups	1.78	–	1.69	–
CPI: All groups % year	6.1	–	6.1	–

Sources: ABS, RBA, Westpac Banking Corporation.

Consumer Price Index analytical series

		Sep-21	Dec-21	Mar-22	Jun-22
CPI	(index)	119.7	121.3	123.9	126.1
	(%qtr)	0.8	1.3	2.1	1.8
	(%yr)	3.0	3.5	5.1	6.1
CPI sa	(%qtr)	0.9	1.3	2.1	1.7
	(%yr)	3.1	3.6	5.2	6.1
Trimmed mean#	(%qtr)	0.9	1.0	1.5	1.5
	(%ann)	2.1	2.6	3.7	4.9
Weighted median#	(%qtr)	0.9	0.9	1.0	1.4
	(%ann)	2.1	2.4	3.0	4.2
Tradables	(%ann)	3.1	4.9	6.8	8.0
Non-tradables	(%ann)	3.2	2.8	4.2	5.3

Inflation forecasts

		Sep-22	Dec-22	Mar-23	Jun-23
CPI	(index)	127.3	130.5	131.8	132.7
	(%qtr)	1.0	2.5	1.0	0.7
	(%yr)	6.3	7.6	6.4	5.2
Trimmed mean#	(%qtr)	1.5	1.2	0.8	0.7
	(%yr)	5.5	5.8	5.0	4.2

The acceleration in inflation continues to widen

With revisions we now know that core inflation has been accelerating faster than we first thought. The March quarter print for the Trimmed Mean was revised up from 1.4%qtr to 1.5%qtr (due to seasonal reanalysis of the individual components) then matched by a 1.5%qtr rise in June. Given the details outlined below we have revised up our September forecast to 1.5%qtr (was 1.2%qtr) taking the peak rate at end 2022 from 5.0%yr to 5.8%yr.

The ABS reports the 1.5% gain as the largest quarterly rise in the Trimmed Mean since they started calculating it in 2002. Before then the RBA was estimating the trimmed mean and compared to this historical series March was the largest quarterly rise in the trimmed mean since March 1991 (1.8%). The annual pace lifted from 3.7%yr to 4.9%yr, the fastest pace since September 1991 (5.0%yr).

At two decimal places the trimmed mean rose 1.46% so a solid 1.5%; for completeness the weighted median gained 1.4% for 4.1%yr.

Readers will remember that the core measures use seasonally adjusted inputs so the percentage changes reported in the following analysis could vary significantly from what is reported in the headline CPI. In addition, as noted earlier seasonal reanalysis can lead to revisions to the quarterly estimates of the core measures of inflation.

As you can see in the chart over, the distribution of seasonally adjusted change in the components of the CPI is skewed to the high side. The trimming of the bottom 15% starts at a quite high 0.27% and there are not a lot of negatives. The negatives trimmed are; child care (-6.8%), urban transport fares (-4.1%), footwear for infants (-3.6%), deposit & loan facilities (-1.6%), medical & hospital services (-1.0%), gas & other household fuels (-0.6%), pharmaceutical products (-0.1%), audio, visual, & computing equipment (0%), postal services (0.1%), water & sewerage (0.1%), books (0.1%), insurance (0.2%), other recreational, sporting & cultural services (0.2%) and telecommunication equipment & services (0.3%). While there is a significant weighted clustering of changes from 0.8% to 1.5% the sample does have a long tail to the high side with the top 15% trimming not starting till 4.15%. Trimmed off the top are; tertiary eduction (5.4%), coffee, tea & cocoa (5.6%), automotive fuel (4.2%), small electric appliances (4.2%), bread (4.4%), oils & fats (5.1%), spare parts & accessories for motor vehicles (5.1%), breakfast cereals (5.4%), dwellings (5.6%), vegetables (6.2%) and international holiday travel & accommodation (19.3%).

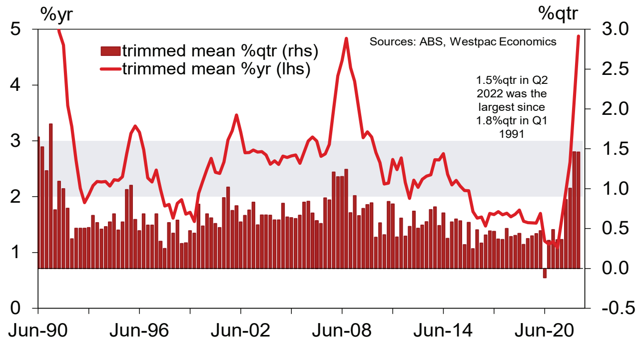
Distribution analysis highlights just how widespread core inflation pressure is and while you can identify some that might be transitory, such as flood effective food, the fact these pressure are broad spread raises the possibility it could have a meaningful impact on inflationary expectations, flowing though to wages, thus setting in train a much higher inflationary profile.

How widespread the inflationary pulse is was further emphasised by the rise in the share of components of the CPI running faster than 2.5%yr. The share lifted from 66% to 72.4%, well up from 29% reported back in September 2021 and is the largest share since June 2001 (75.3%, you have to go back to early 1991 to find a larger share).

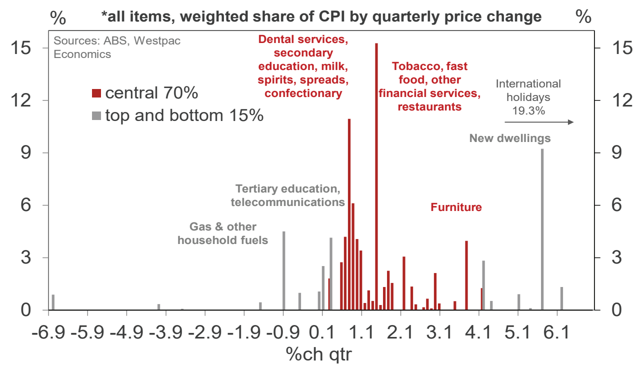
Surging construction costs pushing dwelling prices higher

Since June 2021 the unwinding of the grants has been a significant part of, but not the main story, behind the burst in dwelling price inflation. The impact of HomeBuilder grants was again in June but it is less significant than it has been. The ABS esti-

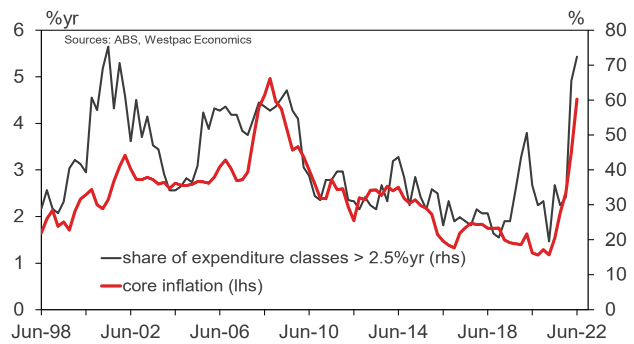
Core inflation accelerates to 31yr high



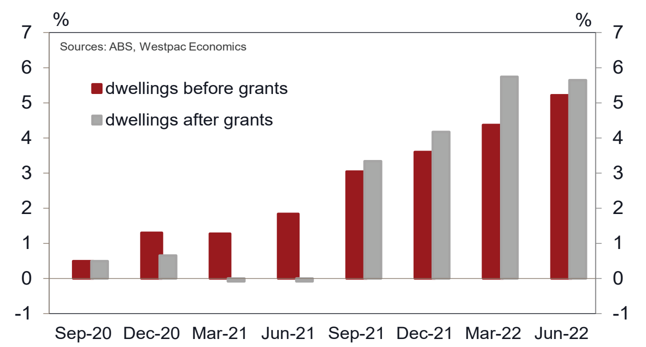
Distribution of seasonally adjusted Q2 CPI



Inflationary pressures are broadening



Grants were disinflationary, now inflationary



mates that the impact of the unwinding of the grants was worth just 0.3ppt of the 5.6% rise in dwelling prices. The more important story now is the shortages of building supplies and labour, high freight costs and ongoing high levels of construction activity. The ABS also noted that the largest rises were recorded in Brisbane (7.0%), Melbourne (6.9%) and Adelaide (6.0%).

Dwelling prices excluding grants lifted 5.2% in June following 4.4% in March, 3.6% in December 2021, 3.0% in September and a 1.8% rise in June. There is still 1.3% wedge between dwelling prices in the CPI and dwelling prices before the grants and we expect this wedge to close in the September quarter.

Dwelling prices inflation continues to accelerate as input costs surge even as the demand boost from the government grants fades. June was another robust update on the dwelling price inflation pointing to upside risk from dwelling cost push inflation and the Producer Price Index (PPI) has shown both continuing rising input costs and even fast growth in housing construction output costs (the wholesale price new dwellings and usually tightly correlated to CPI new dwelling prices). Total input costs are up 15.4%yr on the back of a 27.1%yr gain in steel, 16.0%yr gain in timber, 11.7%yr gain in other metal products and a 0.3%yr gain in electrical equipment.

As such, we have lifted our profile for dwelling prices through the second half of 2022. We expect dwelling price increases to ease through 2023 as contracting home sales, and falling prices, point to softer demand for new dwellings and thus a compression of developers margins.

Dwellings lifted 5.6% vs. WBC forecast 5.5%

The ABS also noted that maintenance & repair of dwellings rose 1.3%, due to supply disruptions and higher material, labour and freight costs. We would expect these price pressures to remain at least through to the end of 2022.

The ABS report the ending of the two-speed rental market in Australia. Rents rose 0.7%, the largest rise since the September 2014 with all capital cities contributed to the rise. Sydney and Melbourne recording rises for their second consecutive quarter driven by both houses and other dwellings which includes flats and townhouses. Rents across the remaining capital cities continue to record stronger rises compared to Sydney and Melbourne, reflecting historically low vacancy rates and a competitive rental market.

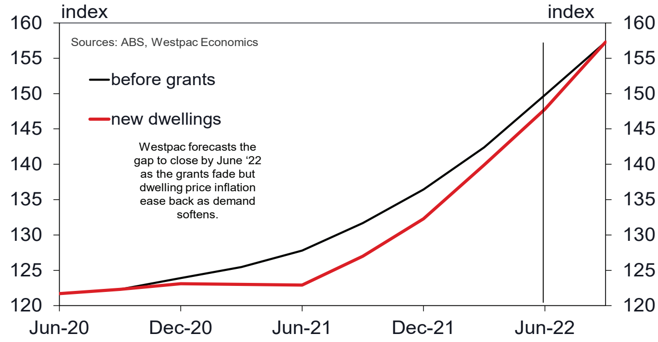
Rents lifted 0.7% vs. WBC forecast 0.8%.

Non-discretionary inflation running hot but discretionary is catching up

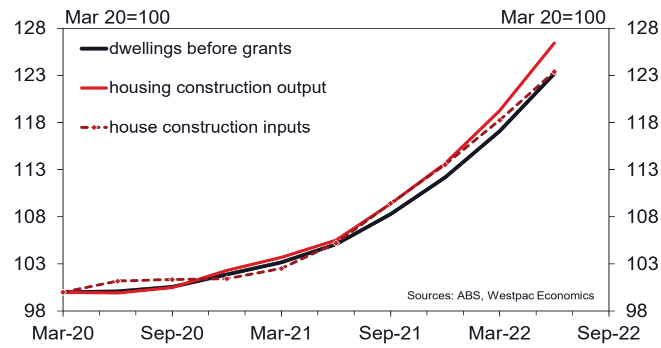
At 7.6%yr non-discretionary inflation is running at a faster pace than the 6.1%r pace by the CPI and is almost twice the rate of discretionary inflation at 4.0%yr though it should be noted that the rate of increase for non-discretionary inflation is moderating lifting just 1.8%qtr compared to a 3.0%qtr gain in March. Compare that to discretionary inflation which lifted 1.7%qtr in June, up from 0.8% in March, and was the strongest quarterly rise in the history of the series back to September 2005.

Non-discretionary inflation includes goods and services that households are less likely to reduce their consumption of, such as food, auto fuel, housing and health costs which have all experienced price rises through the year. In the quarter non-discretionary items lifted 3.0% driven by housing (2.5%qtr vs. WBC forecast 2.6%), auto fuel (4.2%qtr vs. WBC forecast 4.0%qtr) and food (2.0%qtr vs. WBC forecast 1.5%qtr).

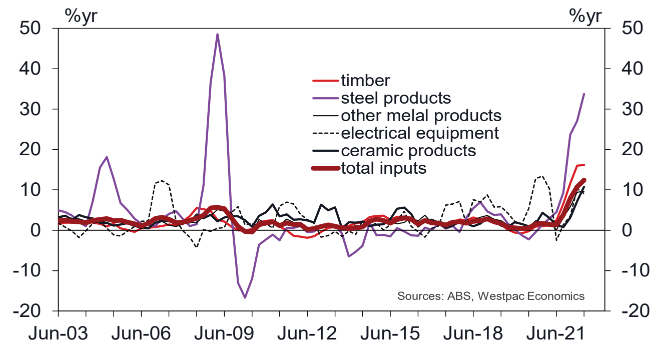
As grants fade dwelling prices lift



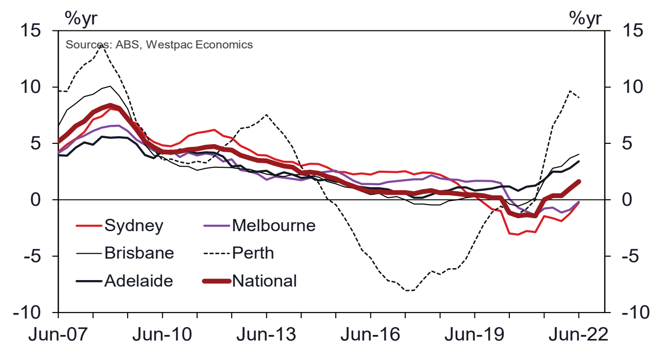
Dwelling prices rising with input costs



Housing construction inputs inflation



Rental inflation



Pressure of food prices greater than we thought

There were price gains across all food products (excluding pork) reflecting a range of price pressures including supply chain disruptions and increased transport/input costs.

Fruit & vegetables rose 5.8% (WBC 5.4%) due to heavy rainfall and flooding in key production areas of NSW and Qld disrupting supply. COVID-related supply chain disruptions and high transport and fertiliser costs also contributed to the rise.

Meals out & take away foods rose 1.4% (WBC 0.8%) due to rising input costs and ongoing supply and labour shortages. Dining vouchers offered by the NSW and Vic Governments and the Melbourne City Council partially offset the rise. These voucher schemes have the effect of reducing out of pocket costs for consumers. Excluding the impact of these voucher schemes, Meals out & takeaway foods rose 2.1%.

Bread and cereal products rose 3.1% (WBC 0.9%) due to constrained global wheat supply. Meat & seafood lifted 0.8% (WBC 1.4%), dairy & related products rose 1.3% (WBC 1.2%) while food products n.e.c gained 1.1% (WBC 0.3%).

All up food lifted 2.0% compared to our 1.5% forecast. This upside surprise in food prices has lead us to upgrade our food price inflation profile through to the end of 2022.

Global crude prices have corrected faster than anticipated

Automotive fuel prices rose for the eighth consecutive quarter. Price pressures continued to flow through following an oil price shock caused by the February Russian invasion of Ukraine, coupled with ongoing easing of COVID-19 restrictions strengthening global demand. A cut in the fuel excise of 22 cents per litre on 30 March 2022 did see fuel price fall in April (-13.8%), price rises were seen in May (1.1%) and June (6.8%) due to rising global crude prices and the widening of refining margins. The average unleaded fuel price in the month of June surpassed the previous record high monthly average seen in March.

The recent moderation in crude prices, and expectation it will fall further though 2023, will be meaningful disinflationary pulse. But before we get there we have to weather the 22c lift in the fuel excise in the December quarter.

Forecast revisions post the update

We have updated our forecasts post the June CPI adjusting our dwelling price forecasts to account for a larger than expected rise in the underlying series before grants, the ongoing construction cost pressure plus an unexpected, if modest, further boost from the ongoing gap between dwelling prices in the CPI and actual prices paid before grants. We have also lifted our food, clothing & footwear plus household furnishing, equipment & services forecasts. For the September quarter the forecast has been lifted to 1.0% from 0.8% while the December quarter forecast was lifted modestly to 2.5% from 2.4%. Our peak in the annual pace is now 7.6%yr in December 2022 compared to 7.2%yr prior to the release of the June CPI.

For the trimmed mean our September forecast has been lifted to 1.5%qtr from 1.2%qtr and our December forecast is now 1.2%qtr from 1.0%qtr. This has lifted our peak annual pace at December 2022 to 5.8%yr from 5.0%yr. For the near term the risk remain to the upside but with commodity prices fall, global growth facing a recession risk and our forecast for rising unemployment/underemployment in 2023 we see clear sign of moderating inflationary pressure.

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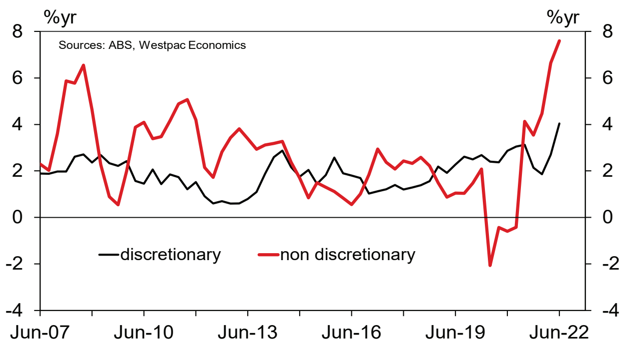
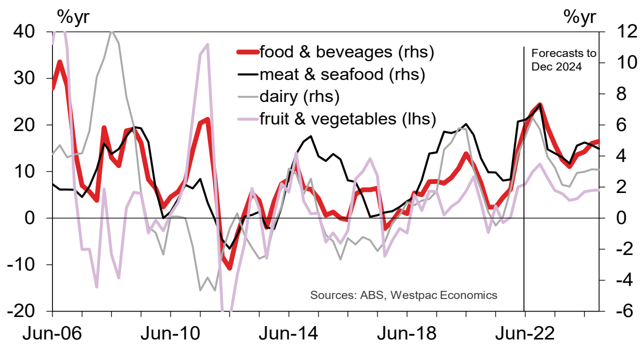
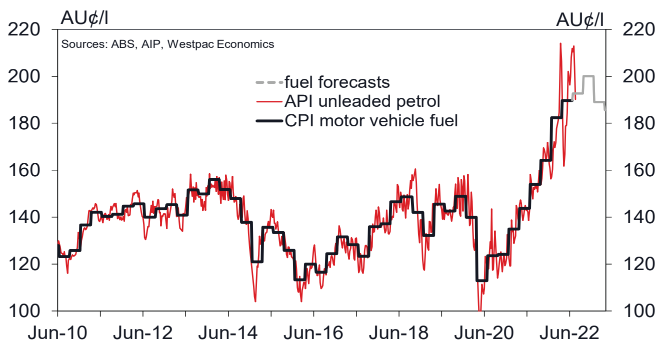
Non discretionary inflation accelerating



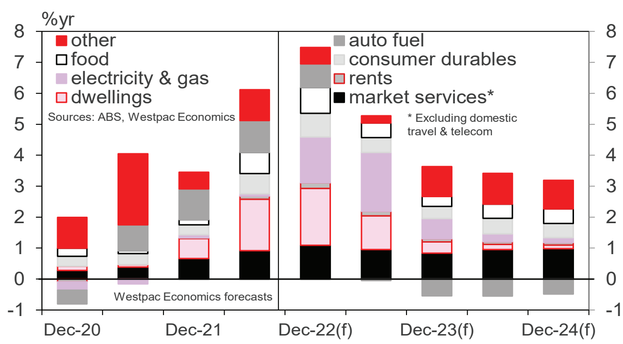
Food inflation to remain elevated



Weekly bowser price & CPI auto fuel



Contributions to annual inflation



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