

INFLATION

IMPACT OF THE CURRENCY ON AUSTRALIAN PRICES

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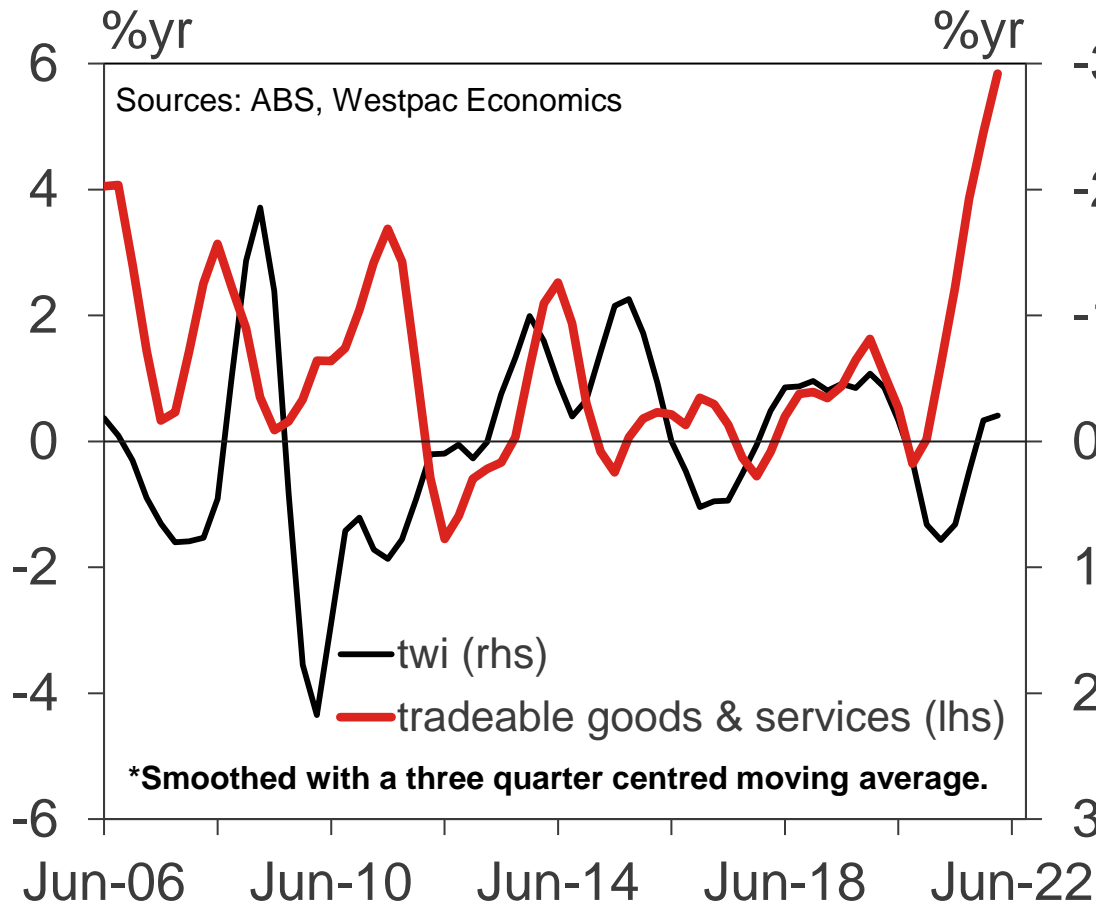
Westpac Institutional Bank

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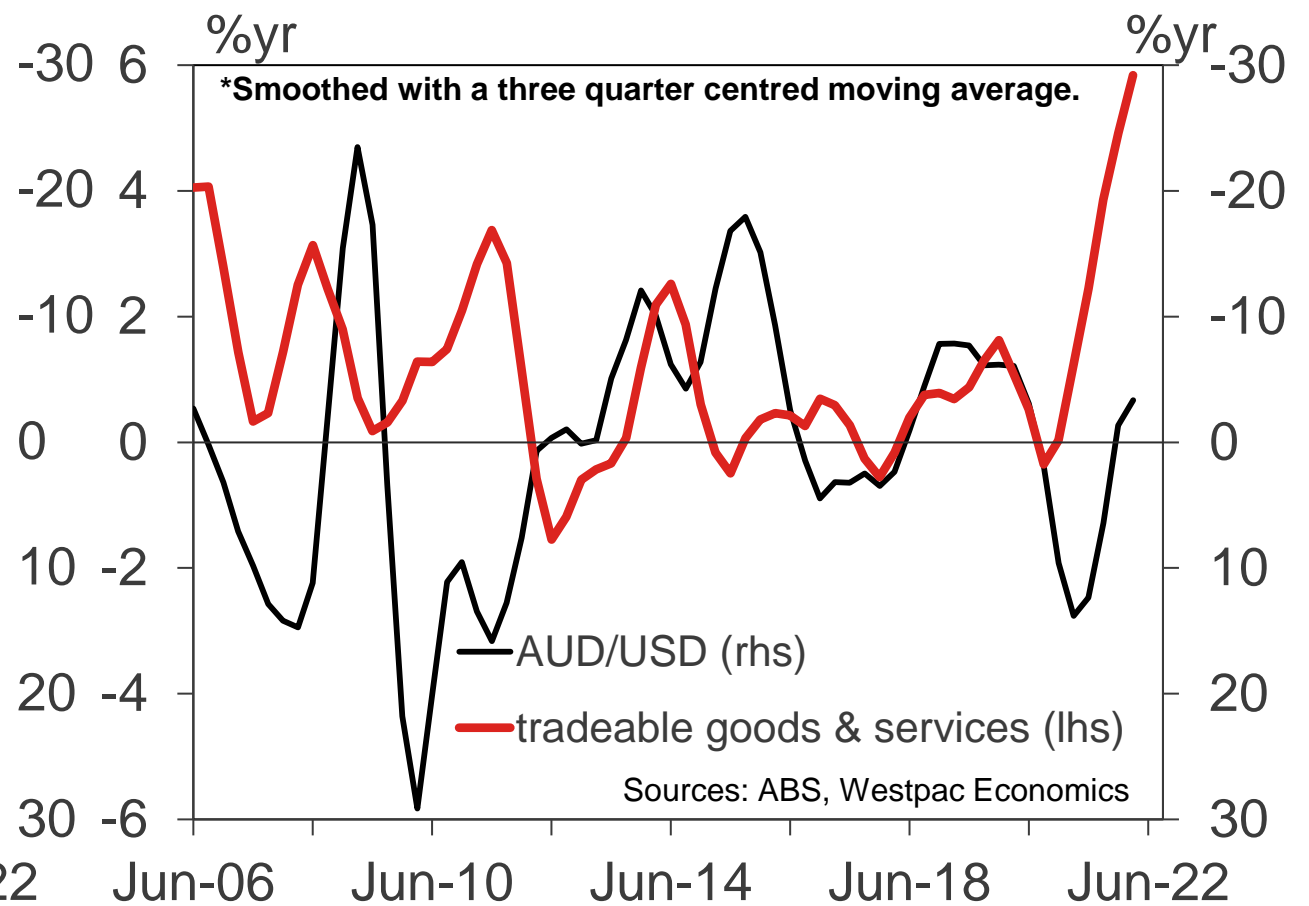


Impact of the currency on tradeable goods/services inflation

TWI & tradeable inflation

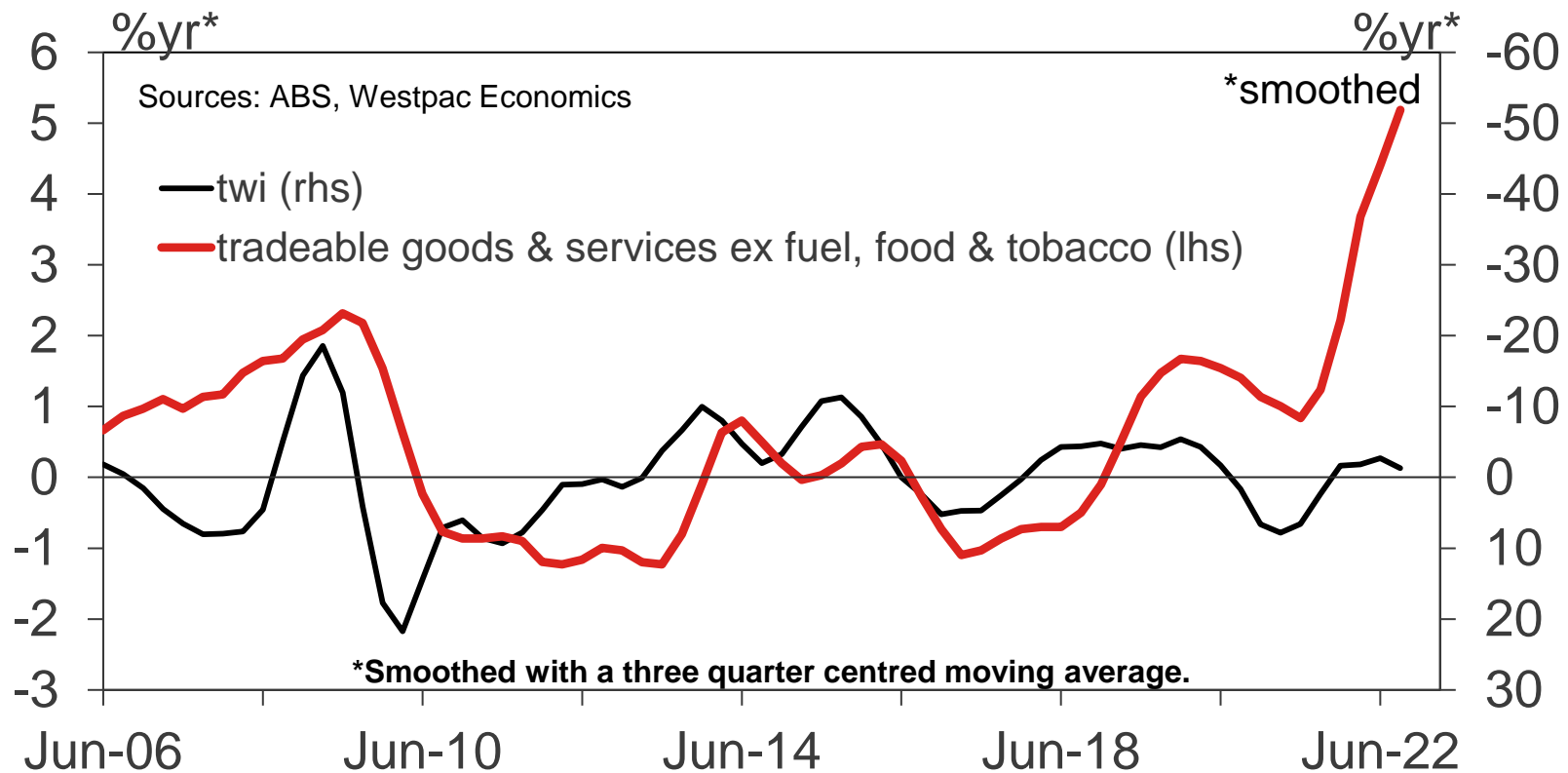


AUD/USD & tradeable inflation



The currency & core tradeable inflation

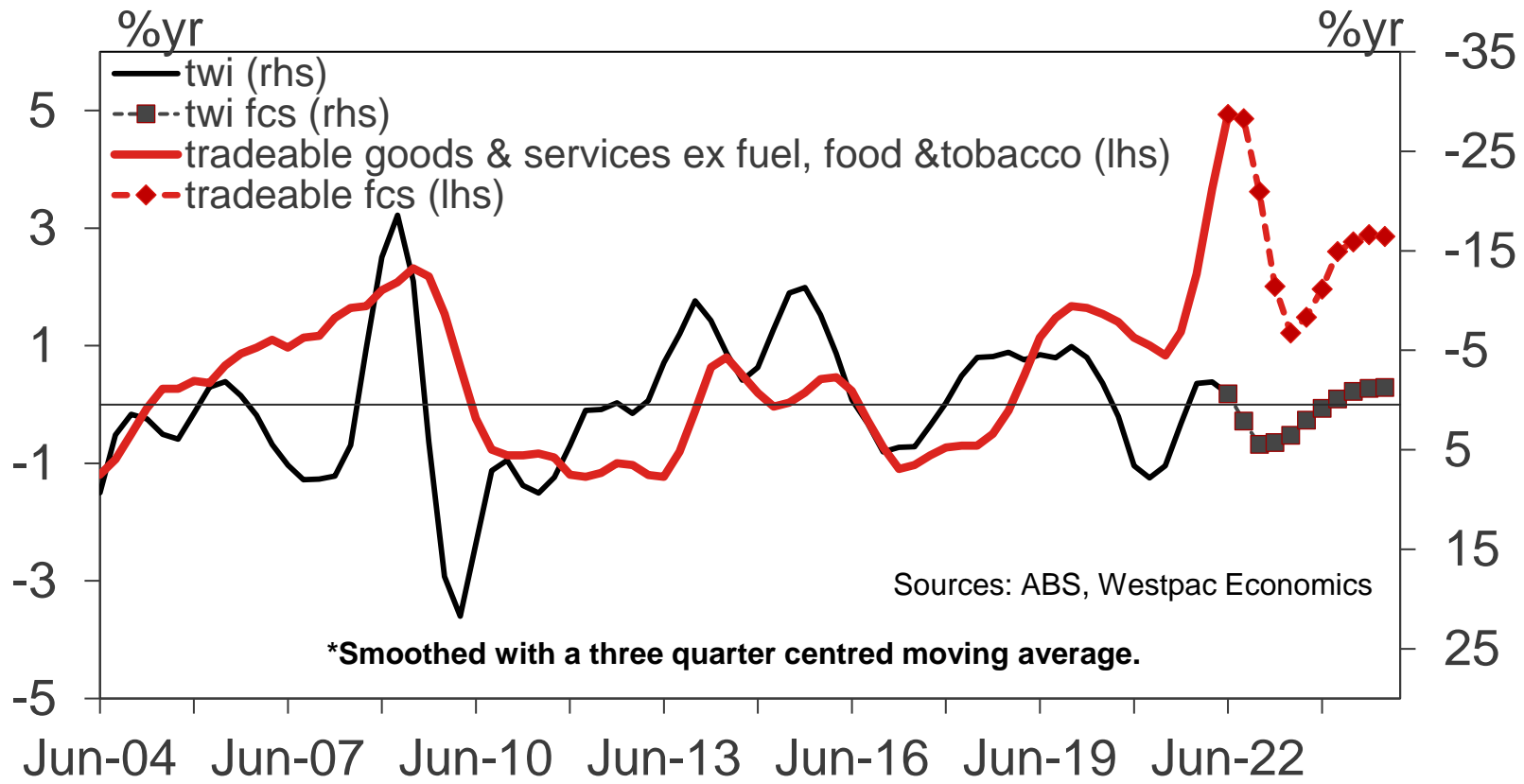
The most recent surge in tradeable inflation has had little to do with the currency



- Rough rule of thumb – a 10% depreciation of the currency will lift the CPI by around 0.3ppt to 0.4ppt though the next six months.
- As well as the currency the consumer price of imported goods and services will also reflect global prices, freight, shipping and warehousing costs plus local margins. As such the effect of the currency can often be masked by these other factors.
- But that is not to say the currency has no impact.
- The trade weighted index, rather than the AUD/USD exchange rate, guides our estimate of the impact of the currency. However, as the AUD/USD exchange rate dominate the TWI the AUD/USD provides a very similar answer.
- The exchange rate has a broad, but far from perfect, relationship with core tradeable good & services (ex food, fuel & tobacco). A 10% rise in the currency will lower the tradeable goods & services (ex food, fuel & tobacco) by 2%.

Tradeable goods & services inflation

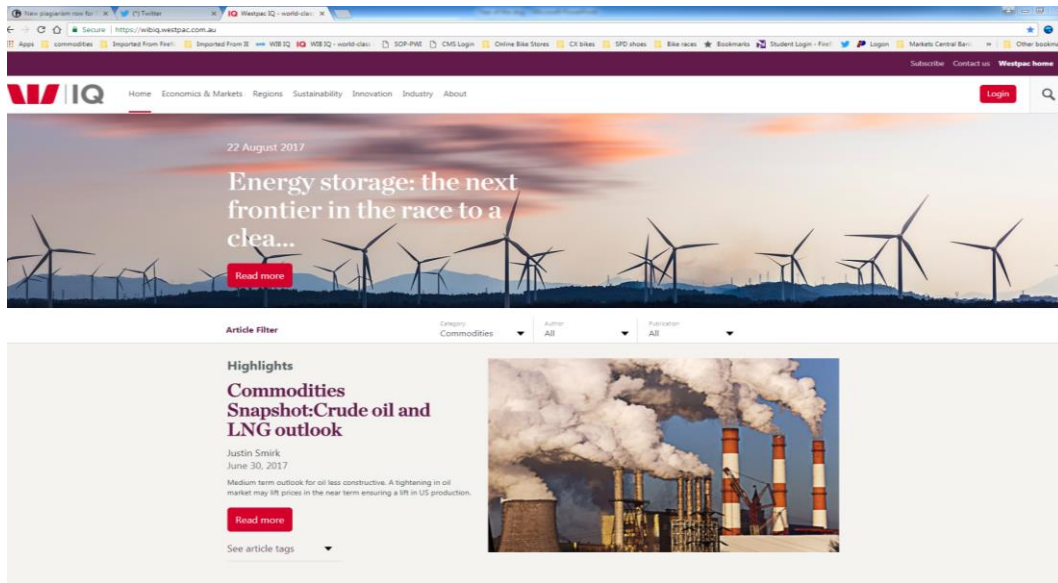
Our forecasts incorporate a currency impact but there is also more going on at a fundamental level



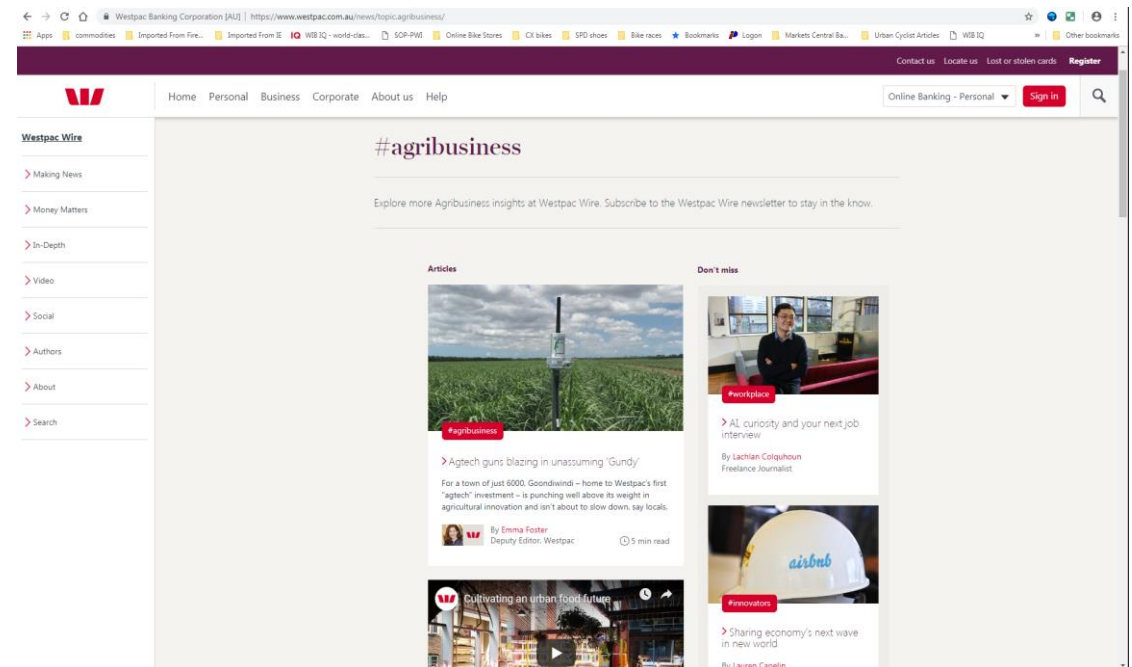
- As core tradeable has a weight of 12.4% in the CPI -10% on the currency will lower the CPI by 0.25ppt.
- A rough rule of thumb is that a 10% fall in the currency will lift auto fuel prices by around 1.3% through next month. Fuel has a weight of 3.6% in the CPI so a 10% fall in the currency boosts the CP 0.05ppt.
- A 10% fall in the currency has a +0.05ppt impact via fuel and +0.25ppt via tradeable goods & services;
- **In total a 10% fall in the currency will result in a 0.26ppt boost to the CPI.**
- For total tradeable goods & services a 10% fall in the exchange rate will raise prices for this group by around 1% - being 37% in the CPI this will generate a 0.37ppt increase in the CPI.
- Our near-term forecasts are generated from a bottom-up approach so we tend to look at the currency impact via fuel, food, clothing & footwear, household goods and international travel crossed checked with top-down estimates.

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