

19 January 2023

## December Quarter CPI Preview

### Electricity, food & holiday travel boosting prices but dwelling price inflation is moderating far faster than we anticipated.

- Westpac is forecasting 1.5% rise in the December quarter boosting the annual pace 0.1ppt to 7.4% which is our forecast peak in the annual pace of inflation for the current cycle.
- We are forecasting the annual pace of headline inflation to ease back to 3.7%yr by end 2023.
- The reasons behind the step down from 1.8%qtr print in Q3 are the ongoing moderation in pace of price increases for food, clothing& footwear, new dwellings and household contents & services.
- The Trimmed Mean is forecast to lift 1.6% in December, a moderation from the 1.8% gain in September which we are forecasting to be the largest quarterly rise this cycle.
- The annual pace for the Trimmed Mean is set to lift to 6.6%yr, from 6.1%yr in September, which again is our forecast peak in core inflation. We are forecasting core inflation to moderate to 3.4%yr by end 2023.
- The Monthly CPI Indicator is a helpful guide to the components of the CPI so we have use the data to November to fine tune our CPI forecasts.
- An important note:** electricity prices are measured in the last month of each quarter and so the Monthly CPI Indicator is not able to provide an update on electricity prices before the release of the Quarterly CPI (when the last month of the quarter Indicator is released). For more information on the Monthly CPI Indicator, and what it does and does not provide in regards to the quarterly CPI, please see "[Australian Monthly CPI Indicator First Release](#)".
- While the energy rebates in NSW and Qld are likely to provide some offset the Victoria rebates will have no impact on the CPI as they are provided as a direct cash payment rather than a bill reduction. In addition, we are expecting a solid bounce back in Perth electricity prices following the 84% decline in the September quarter.
- Dwelling price in the Monthly Indicator continue to moderate far more quickly than we thought they would resulting in a downward revision to our inflation profile.
- The key factors in our forecasts are: ongoing robust gains in food prices, rising fuel prices due to the increase in fuel excise, and a bounce back in holiday travel prices.

### December Quarter CPI forecast

Item	Dec 2022 fc		Sep 2022	
	% qtr	contrib	% qtr	contrib
<b>Food</b>	2.0	0.35	3.2	0.54
of which, fruit & vegetables	0.5	0.01	4.5	0.11
<b>Alcohol &amp; tobacco</b>	1.1	0.10	1.2	0.11
of which, tobacco	1.4	0.06	0.9	0.03
<b>Clothing &amp; footwear</b>	1.2	0.04	-0.2	-0.01
<b>Housing</b>	1.7	0.39	3.2	0.75
of which, rents	1.4	0.09	1.3	0.08
of which, house purchases	1.4	0.12	3.7	0.34
of which, utilities	3.3	0.15	4.8	0.21
<b>H/hold contents &amp; services</b>	1.5	0.13	2.8	0.26
<b>Health</b>	0.4	0.02	0.3	0.02
of which, pharmaceuticals	-0.1	0.00	-1.9	-0.02
<b>Transportation</b>	1.5	0.17	-0.4	-0.04
of which, car prices	1.1	0.03	0.5	0.01
of which, auto fuel	2.6	0.10	-4.3	-0.16
<b>Communication</b>	-0.8	-0.02	1.4	0.03
<b>Recreation</b>	1.8	0.16	1.3	0.11
of which, audio vis & comp	0.9	0.02	0.6	0.01
of which, holiday travel	6.8	0.15	4.0	0.08
<b>Education</b>	0.0	0.00	0.0	0.00
<b>Financial &amp; insurance services</b>	1.8	0.09	1.3	0.08
CPI: All groups	1.5	-	1.8	-
CPI: All groups % year	7.4	-	7.3	-

### Quarterly CPI forecast vs Monthly Indicator

Item	Dec 22	Sep	Oct	Nov
	Qtr % qtr	Mth % mth	Mth % mth	Mth % mth
<b>Food</b>	2.0	-0.7	-0.5	1.4
of which, bread & cereals	2.0	1.9	0.5	0.8
of which, meat & seafood	1.7	0.2	0.0	0.6
of which, dairy & related prod.	2.7	1.4	0.9	1.6
of which, fruit & vegetables	0.5	-6.1	-6.3	2.4
of which, food products nec	1.9	0.6	0.9	0.5
of which, non-alcohol bev,	0.1	0.0	0.8	-0.5
<b>Alcohol &amp; tobacco</b>	1.1	0.5	0.5	-0.1
of which, Alcohol	0.8	0.1	0.5	-0.1
of which, Tobacco	1.4	1.1	0.7	0.0
<b>Clothing &amp; footwear</b>	1.2	1.3	3.0	-2.4
<b>Housing</b>	1.7	1.4	0.4	0.1
of which, Rents	1.4	0.5	0.6	0.2
of which, House purchases	1.4	0.5	0.5	0.1
<b>H/hold contents &amp; services</b>	1.5	0.3	0.2	1.0
<b>Health</b>	0.4	0.3	0.0	1.0
<b>Transportation</b>	1.5	-0.3	2.2	2.2
of which, auto fuel	2.6	-1.7	7.0	5.6
<b>Communication</b>	-0.8	0.7	-0.4	-0.7
<b>Recreation</b>	1.8	2.5	-2.4	2.5
of which, holiday travel	6.8	9.1	-6.4	4.3
<b>Education</b>	0.0	0.0	0.0	0.1
<b>Financial &amp; insurance services</b>	1.8	0.9	0.0	0.6
CPI: All groups %qtr/%mth	1.5	0.6	0.2	0.8
Trimmed Mean %qtr/%mth	1.6	0.4	0.3	0.4

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

### September quarter inflation recap

The 1.8% lift in the September quarter was significantly greater than Westpac's 1.1% forecast and the market's 1.6% forecast. The main difference between our forecast and the print was the +3.2% jump in electricity prices; Westpac had forecast a -17% fall due to the state government rebates. Not only did we overestimate the impact of the rebates but we underestimated the 25% increase in Sydney power bills.

The ABS estimates that excluding the rebates electricity prices would have risen 15.6% in the quarter.

The annual pace lifted from 6.1% to 7.3%, the fastest pace since June 1990 (7.7%yr) and significantly faster than the 5.0%yr pace at the peak of the mining boom (September 2008).

### Food prices remain under pressure

Distribution disruptions may have eased somewhat but yet to see a return to normality with extreme weather events and labour shortages continuing to disrupt farm production. While fruit & vegetable prices are set to ease as supplies improve (0.5%qtr fc) the Monthly Indicator suggested that price pressures also continued for bread & cereals, meat & seafood, dairy products and other food products.

**Food forecast is 2.0% contributing 0.35ppt.**

### Alcohol and tobacco

The tobacco excise rose 1.2% in the month of September and two thirds of this increase was should appear in the December quarter. In the three months to November, tobacco in the Monthly Indicator gained 1.8%. Our current forecast is for a 1.4% rise in the quarter. Our Q4 forecast for alcohol prices is 0.8% and the Monthly Indicator 0.5% in the three months to November.

**Alcohol & tobacco forecast is 1.1% contributing 0.10ppt**

### Seasonal discounting of clothing & footwear prices

The introduction of Black Friday sales in November have started to change seasonality in clothing & footwear prices as seen by the 2.4% decline in the month of November. However, price rose in October and we expect them to do so in December as we head into Christmas.

**Clothing & footwear forecast is 1.2% contributing 0.04ppt.**

### Housing costs moderating

There has been a marked lift in asking rents pointing which will, in time, feed into total average rents in the CPI. The CPI measures all rents paid, not just new contracts, and includes public and defence housing which tend to be more stable. Even then we are surprise by the November moderation in rent inflation and expect a stronger print in December.

**Rents forecast is 1.4% contributing 0.09ppt.**

Through 2021, Commonwealth HomeBuilder grants plus WA and Tasmanian state government grants provided a significant offset for the purchase of a new dwelling, thus suppressing dwelling prices in the CPI as the grants were used. As the use of grant started to fade, this affect was reversed and dwelling prices started to rise more rapidly than underling prices as prices paid lifted back towards contracted prices.

For the December quarter the Monthly Indicator again highlighted a surprising moderation in dwelling price inflation. The last three months the increase went from 0.5%qtr in

### Quarterly CPI forecast vs Monthly Indicator

	Dec 22	Sep	Oct	Nov
	Qtr % yr	Mth % yr	Mth % yr	Mth % yr
<b>Food</b>	10.5	9.6	8.9	9.4
of which, bread & cereals	10.7	11.8	12.0	12.0
of which, meat & seafood	9.0	7.6	7.9	8.1
of which, dairy & related prod.	13.2	13.6	14.4	15.3
of which, fruit & vegetables	17.6	17.4	9.4	9.5
of which, food products nec	10.1	10.6	10.9	10.9
of which, non-alcohol bev,	9.8	10.4	11.2	11.0
<b>Alcohol &amp; tobacco</b>	4.2	4.6	4.3	4.3
of which, Alcohol	4.0	3.9	3.6	4.2
of which, Tobacco	4.7	5.6	5.4	4.6
<b>Clothing &amp; footwear</b>	3.9	7.1	5.7	4.1
<b>Housing</b>	10.4	10.3	10.5	9.6
of which, Rents	4.1	2.9	3.5	3.6
of which, House purchases	17.5	20.0	20.4	17.9
<b>H/hold contents &amp; services</b>	8.1	7.7	7.8	8.4
<b>Health</b>	3.3	2.8	2.6	3.6
<b>Transportation</b>	7.8	6.8	7.4	9.0
of which, auto fuel	13.6	10.1	11.8	16.6
<b>Communication</b>	1.0	2.0	1.9	0.7
<b>Recreation</b>	5.2	5.3	2.3	5.8
of which, holiday travel	12.9	12.6	3.7	12.8
<b>Education</b>	4.5	4.5	4.5	4.6
<b>Financial &amp; insurance services</b>	4.8	4.2	4.2	4.8
<i>CPI: All groups %qtr/%mth</i>	7.4	7.3	6.9	7.3
<i>Trimmed Mean %qtr/%mth</i>	6.6	5.5	5.4	5.6

### Inflation indicators

		Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
AUD/USD	(index)	0.66	0.68	0.70	0.71	0.73
AUD/USD %yr	(%yr)	-9.7	-5.5	-2.5	4.4	11.5
TWI	(index)	61.6	62.6	62.9	63.6	64.4
TWI %yr	(%yr)	0.2	2.3	0.3	1.5	4.5
Brent US\$bbl	(index)	88	80	80	83	86
Brent %yr	(%yr)	10.9	-15.8	-27.2	-12.7	-1.5
Output gap t-3	(index)	0.93	0.31	-0.13	-0.40	-0.48

### Inflation forecasts

		Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
CPI	(index)	130.4	132.2	133.1	134.5	135.5
	(%qtr)	1.6	1.4	0.7	1.1	0.7
	(%yr)	7.5	6.7	5.6	4.8	3.9
Trimmed mean	(%qtr)	1.7	1.3	0.9	0.7	0.7
	(%yr)	6.7	6.5	5.8	4.6	3.6

September and October to just 0.1% in November. Given there is still some potential lagging boost from the expiring of the construction grants this is a surprising moderation in dwelling price inflation that has happened much sooner than we expected. As such, it has led us to moderate not just our December quarter forecast for dwelling prices but also the forecasts for the first half of 2023.

#### Dwelling forecast is 1.4% contributing 0.12ppt.

As we covered in our report [“Energy prices driving an out-sized 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 plus the demand for further investment in energy storage and distribution. This resulted in a significant increase in the Default Market Offers (DMO) around the country but many states have offset this increase with energy rebates.

There is a fair bit of variation in how the rebates are applied. In WA and Victoria the grants are open to all local residents. WA is offering a \$400 rebate against an annual average bill of \$1,990. The Victorian rebate is a bit less generous, \$250 compared to a \$1,220 annual bill. However, the Victorian rebate is provided as a direct cash payment so it is considered as income by the ABS and will not result in lower electricity prices in the Melbourne CPI. As the WA rebate is provided to the retailer and does reduce power bills directly so has an impact on the Perth CPI.

In September Perth electricity prices collapsed -84% due to the rebates there. This fall is larger than what was seen in December 2020 even though the dollar value of the rebate in 2022 was less than the rebate in 2020 suggesting a much more rapid update this time. This has set the scene for a quicker bounce back than in 2020. But a lesson learnt in 2020 is that such a significant fall in prices does have a significant impact on the weights of the components of the CPI. We have had to make an estimate to the changes in the weights the Perth power bills, based on what happened in 2020, lowering the impact of the massive bounce (+345%) in Perth electricity prices.

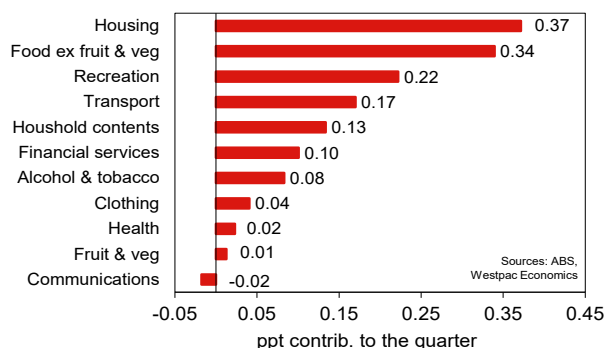
From there it's a bit more confusing. In Qld the rebate is only available to those with social security cards. As such it won't have as dramatic impact on electricity bills. In NSW the rebate is open to first home buyers and those who qualify for Family Tax Benefits so its impact will be more limited. Also the applications are open till 30 June 2023 so their use could be drawn out over a longer period of time.

Given different rules around application of state electricity rebates it is tricky to be definitive on just what impact they will have. Nevertheless, as shown by WA in 2020 and 2022 the rebates impact can be significant. Westpac is forecasting electricity prices lift 5.9% in the quarter due contributing 0.13ppt to the CPI.

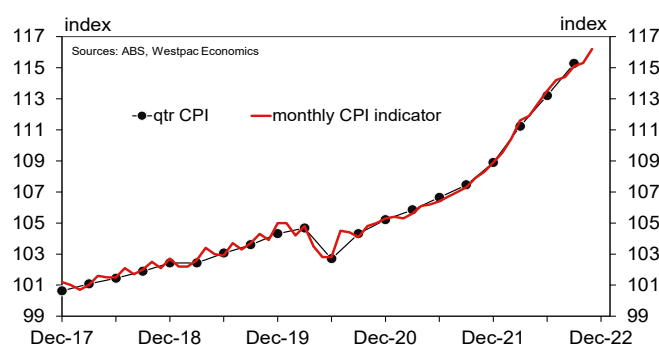
It is important to note that electricity prices are measured in the last month of the quarter so the Monthly CPI Indicator can't provide any guidance for electricity prices in the December quarter.

#### Overall housing forecast is 1.7% contributing 0.39ppt.

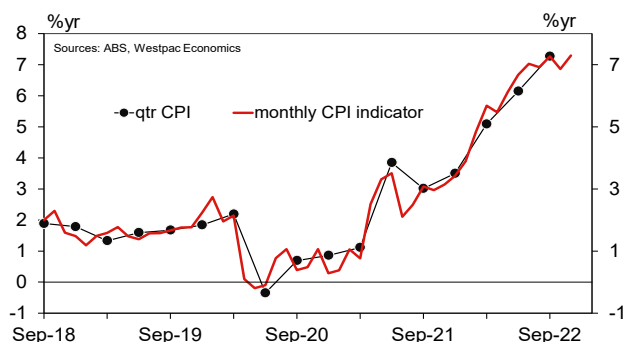
### Contributions 2022Q4 CPI 1.5%qtr forecast



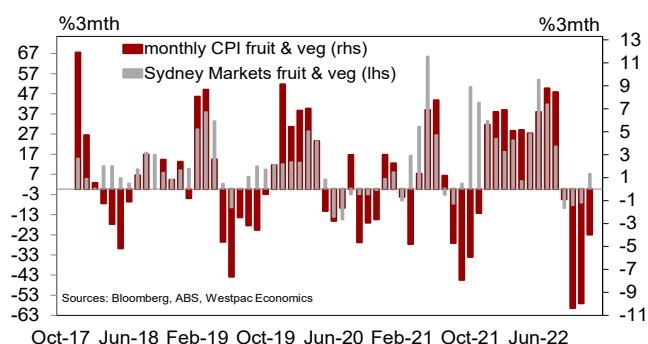
### CPI Monthly Indicator vs. qtr CPI



### CPI Monthly Indicator vs. qtr CPI



### Monthly fruit & veg three month change



### Furnishings, household goods & services prices

Price pressures continue to build household contents & services and while there should also be a Black Friday Sales effect in November, prices lifted 0.3% in September, 0.2% in October then 1.0% in November.

**Household contents & services forecast is 2.4% contributing 0.22ppt.**

### PBS offset seems to be fading

Pharmaceutical prices should experience their usual seasonal fall as families health expenditure starts to exceed the threshold to qualify for support under the Pharmaceutical Benefit Scheme (PBS). However, the monthly indicator is suggesting there has been a pickup in health services inflation with total health costs up 0.3% in September, 0.0% in October then 1.0% in November.

**Health costs forecast 1.5% contributing 0.13ppt.**

### Rising fuel and motor vehicles push transport costs

The Ukraine crisis represented a significant shock to 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. There was also the temporary halving of the fuel excise (worth 22.2 cents a litre) just as crude rallied back up to US\$120/bbl by early June. The temporary cut to the excise ended on the 30th of September so this should have had meaningful impact in the December quarter.

However, crude oil prices fell 8.2% in the December quarter offsetting some of the increase in excise. Auto fuel prices fell 1.7% in September, then lifted 7.0% in October and a further 5.6% in November. Weekly Auto Fuel pump prices fell 9% in December pointing to a further fall in auto fuel in the CPI. We are forecasting a 2.6% rise in auto fuel contributing 0.10ppt to the CPI.

**Transport forecast 0.4% contributing 0.02ppt.**

### Recreation & culture rebounds from lock-downs

State borders reopened in early 2022 with the international borders doing so a bit later. With no further lock downs in any capital city, tourism activity has surged for both the domestic and international sectors. We now have the 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 prices build on the September quarter surge moving higher again in the December quarter. Holiday travel & accommodation lifted 9.1% September, declined 6.4% in October only to lift 4.3% in November. Given the robust best airfare data we are looking for a further solid gain in December.

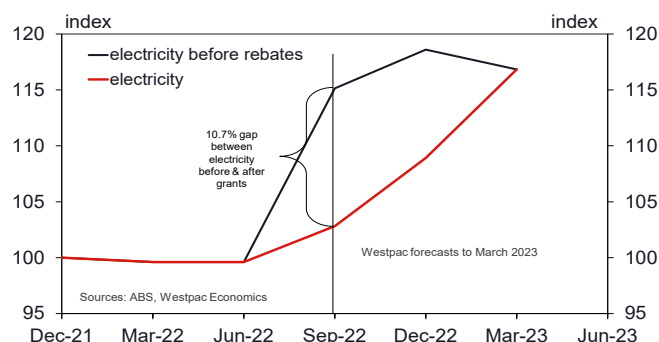
All up we see holiday travel prices lifting 6.8% in the quarter contributing 0.15ppt. The Monthly CPI Indicator for recreation & culture lifted 2.5% in September, fell 2.4% in October then lifted 2.5% in November.

**Recreation & culture forecast is 1.8% contributing 0.16ppt.**

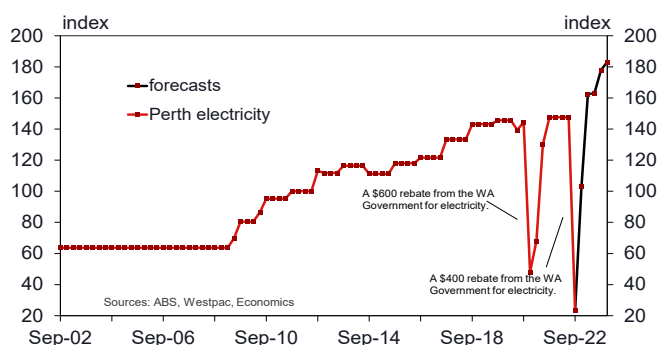
### Widespread inflationary pressures boosting core inflation

The Trimmed Mean is forecast to rise 1.6% moderating from the 1.8% gain in the September quarter which we think is likely to be the peak in quarterly pace this cycle. Due to base effect the annual pace is forecast to accelerate to 6.6%yr from 6.1%yr

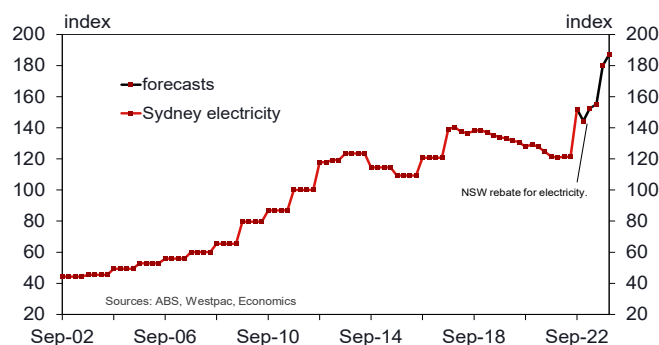
### Grants to supercharge electricity in Q4



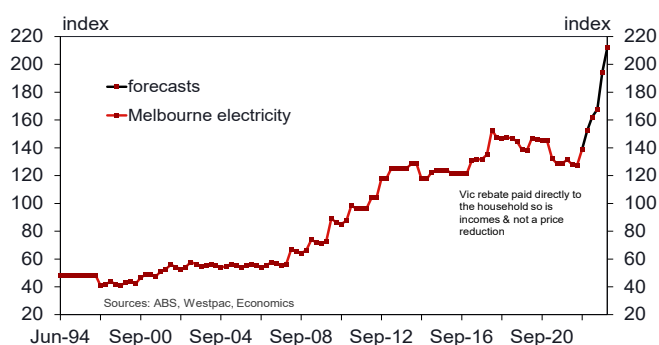
### WA electricity rebates return with force



### NSW rebate to have a modest impact



### Vic rebate will not have an impact on prices



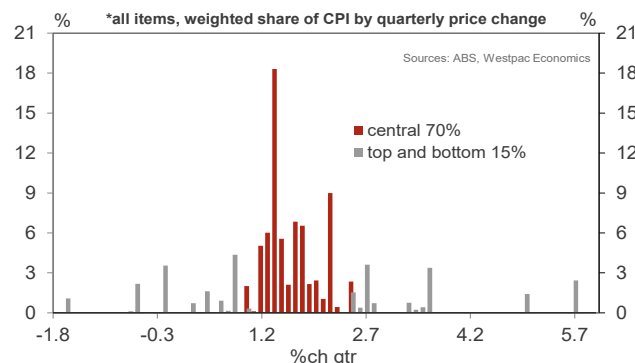
Recall that the prices that are seasonally adjusted in the core measures and trimmed off the top are; household textiles (2.4%), other non-durable household products (2.4%), glassware, tableware & household utensils (2.6%), auto fuel (2.6%), cheese (2.8%), other meats (2.8%), other household services (3.3%), cleaning & maintenance products (3.3%), milk (3.5%), restaurant meals (3.6%), vegetables (4.9%), electricity (5.6%) and international holiday travel & accommodation (8.9%). The top of the range Trimmed Mean estimate is 2.4%.

Trimmed off the bottom are; property rates & taxes (0.8%), secondary education (0.8%), personal care products (0.7%), therapeutic appliances (0.6%), water & sewerage (0.6%), tertiary education (0.4%), spare parts & accessories for motor vehicles (0.2%), tobacco (-0.2%), telecommunication equipment & services (-0.7%), postal services (-0.8%) and fruit (-1.6%). The bottom trim starts at a high 0.8%.

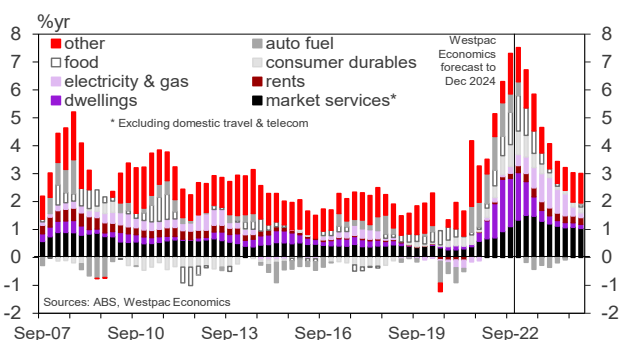
A 1.6% rise in the Trimmed Mean will see the annual pace lift from 6.1%yr to 6.6%yr; the two quarter annualised pace lifts from 6.2%yr to 6.9%yr and if forecast to peak at 7.0%yr in the March quarter of 2023. Our expectations are that the annual pace of core inflation is likely to peak at around 6.6%yr in the December quarter of 2022, the fastest annual pace since early 1990s.

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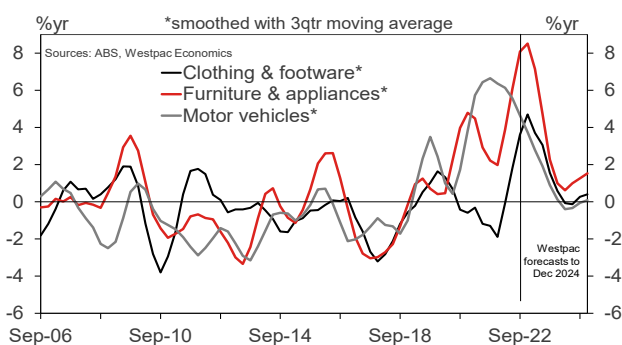
## Distribution of seasonally adjusted Q4 CPI fcs



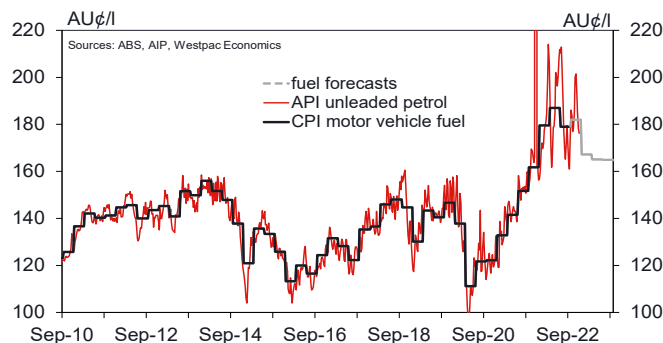
## Contributions to annual inflation



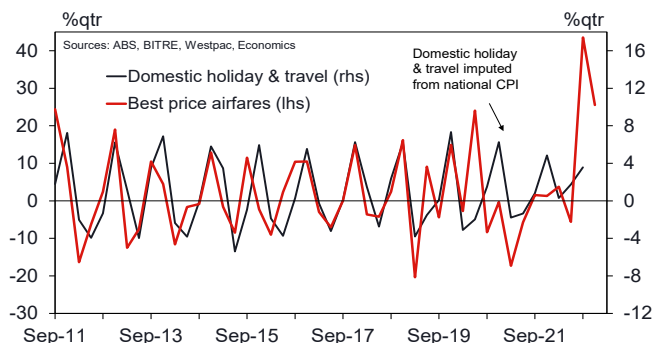
## Durable inflation has some strength



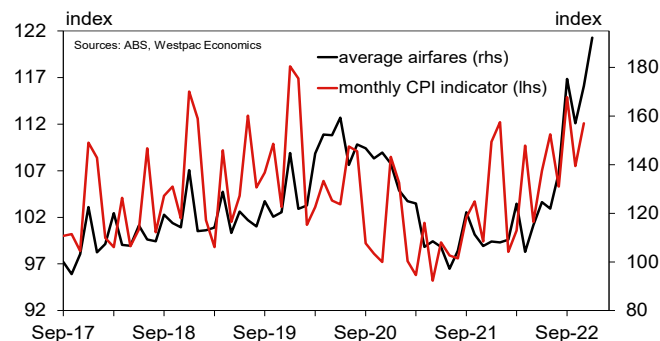
## Weekly bowser price & CPI auto fuel



## Domestic holidays & travel



## Monthly travel & accom vs. airfares



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### Disclaimer continued overleaf

## Disclaimer continued

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