BULLETIN

13 February 2023

Deeper insights on Australian inflation
As goods inflation peaks the strength of services inflation will define the moderation in overall inflation.

- The December quarter CPI rose 1.9% vs. 1.5% forecast; the Trimmed Mean lifted 1.7% vs. 1.6% forecast.
- CPI annual inflation lifted to 7.8%yr from 7.3%yr, the fastest since March 1990. Trimmed Mean inflation lifted to 6.9%yr from 6.1%yr, the fastest pace since December 1988 and above the RBA's forecast of 6.5%yr.
- The most significant contributions came from domestic holiday travel & accommodation (+13.3%), electricity (+8.6%), and international holiday travel & accommodation (+7.6%).
- There was the expected unwinding of WA's $400 electricity credit offset by the Qld's $175 Cost of Living rebate and Tas's $119 Winter Bill Buster electricity discount.
- Given the unusually large 1.7% rise in the Trimmed Mean, it is not surprising that the distribution of seasonally adjusted changes in the components of the CPI were skewed to the high side.
- The inflationary pulse was widespread in December with the share of expenditure classes running faster than 3.0%yr at 90% in December, up from just 31% a year earlier and the highest share since September 1988.
- Goods prices lifted 9.5% in the year to December, basically flat on September and almost twice the pace of services inflation at 5.5%yr. However, the quarterly pace of goods inflation is moderating with goods prices up 1.6% in December compared to an average of 2.5%qtr for the previous three quarters. This was also less than the 2.1%qtr rise in services prices which was the largest quarterly rise since 4.5% in September 2000 (the introduction of the GST).
- Our preliminary forecast for the March quarter is for a 1.3%qtr increase in both the CPI and the Trimmed Mean. Falling auto fuel prices make a -0.2ppt contribution while electricity prices are set to make a smaller contribution as the effect of the rebates fade. Furniture & furnishing prices are moderating while holiday travel prices are forecast to hold at their current high level rather than surge again.
- Our end 2023 forecast for CPI is 3.9%yr while our Trimmed Mean forecast is 3.6%yr, both well above of the top of the RBA's inflation target band but still represent a meaningful moderation from the current pace.
- The December monthly CPI Indicator surged 1.6% suggesting inflationary pressure remain high and broad based with prices up 8.4%yr to December compared to the 7.8%yr reported by the quarterly CPI. Market services, retail items, rents and utilities all lifted but the stand out was the 27% increase in holiday travel & accommodation.

December Quarter 2022 CPI

	Dec 2022 actual		Dec 2022 f/c	
Item	**% qtr**	**contrib**	**% qtr**	**contrib**
Food	0.9	0.15	2.0	0.35
of which, fruit & vegetables	-7.3	-0.18	0.5	0.01
Alcohol & tobacco	1.2	0.11	1.1	0.10
of which, tobacco	1.5	0.05	1.4	0.06
Clothing & footwear	2.6	0.09	1.2	0.04
Housing	1.9	0.45	1.7	0.39
of which, rents	1.2	0.07	1.4	0.09
of which, house purchases	1.7	0.16	1.4	0.12
of which, utilities	4.5	0.19	3.3	0.15
H/hold contents & services	1.8	0.16	1.5	0.13
Health	0.8	0.05	0.4	0.02
of which, pharmaceuticals	0.0	0.00	-0.1	0.00
Transportation	1.7	0.19	1.5	0.17
of which, car prices	2.2	0.07	1.1	0.03
of which, auto fuel	2.2	0.09	2.6	0.10
Communication	-0.5	-0.01	-0.8	-0.02
Recreation	5.4	0.46	1.8	0.16
of which, audio vis & comp	0.1	0.00	0.9	0.02
of which, holiday travel	10.9	0.22	6.8	0.15
Education	0.1	0.00	0.0	0.00
Financial & insurance services	2.0	0.12	1.8	0.09
CPI: All groups	1.87	-	1.48	-
CPI: All groups % year	7.8	-	7.4	-

Sources: ABS, RBA, Westpac Banking Corporation.

Consumer Price Index analytical series

		Mar-22	Jun-22	Sep-22	Dec-22
CPI	(index)	123.9	126.1	128.4	130.8
	(%qtr)	2.1	1.8	1.8	1.9
	(%yr)	5.1	6.1	7.3	7.8
CPI sa	(%qtr)	2.1	1.8	1.9	1.8
	(%yr)	5.2	6.1	7.3	7.8
Trimmed mean#	(%qtr)	1.6	1.6	1.9	1.7
	(%ann)	3.8	5.0	6.1	6.9
Weighted median#	(%qtr)	1.18	1.45	1.39	1.65
	(%ann)	3.2	4.2	4.9	5.8
Tradables	(%ann)	6.8	8.0	8.7	8.7
Non-tradables	(%ann)	4.2	5.3	6.5	7.4
Discretionary	(%ann)	6.6	7.6	8.4	8.4
Non-discretionary	(%ann)	2.7	4.0	5.5	7.1

Inflation forecasts

		Mar-23	Jun-23	Sep-23	Dec-23
CPI	(index)	132.5	133.7	134.8	135.9
	(%qtr)	1.3	0.9	0.8	0.8
	(%yr)	6.9	6.0	5.0	3.9
Trimmed mean#	(%qtr)	1.3	0.9	0.6	0.8
	(%yr)	6.6	5.9	4.6	3.6

Core inflation being underpinned by rising services prices

Core inflation continues to run at a faster than expected pace. While it is true that the quarterly pace eased from 1.9% in September (revised up from 1.8%) to 1.7% in December, this was not enough to prevent the six month annualised pace lifting from 7.1%yr to 7.3%yr, the fastest since the 7.4%yr print in September 1988.

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.

With an unusually large 1.7% rise in the Trimmed Mean, it is not surprising that the distribution of seasonally adjusted changes in the components of the CPI are skewed to the high side. The trimming of the bottom 15% starts at a quite high 0.4% so there are no negatives in the core measure. The negatives trimmed are: vegetables fuel (–7.1%), fruit (–3.3%), books (–1.6%), utilities (–1.2%), lamb & goat (–0.6%), audio visual & computing (–0.3%), urban transport (–0.3%), garments for infants & children (–0.2%), telecommunication (–0.1%), tobacco (–0.1%), therapeutic appliances (–0.0%), with the positives trimmed being: beef & veal (0.0%), tertiary education (0.3%), sports participation (0.3%), audio visual & computing (0.4%).

There is a significant clustering of weighted changes between 1.7% and 2.4% with the top of the core sampled at 2.4%.

Trimmed off the top are: garments for men (2.5%), other food production (2.7%), garments for women (2.8%), cakes & biscuits (2.8%), milk (2.9%), fish & seafood (2.9%), carpets & floor coverings (3.0%), newspapers, stationary & magazines (3.3%), bread (3.4%), footwear for women (3.5%), child care (3.9%), glassware & household utensils (4.0%), ice cream & other dairy products (4.2%), cleaning products (5.4%), pet products (5.4%), cheese (6.4%), electricity (6.9%), games, toys & hobbies (7.0%), domestic travel (7.5%) and international travel (9.0%).

Distribution analysis highlights how widespread core inflation pressures are and while you can identify some that might be transitory, such as food prices due seasonal factors and imported household goods that are set to benefit from the significant fall in global freight costs (global container freight rates are down 80% from their January 2022 peak), the strength of price gains we are seeing in household services will help underpin above target inflation in 2024.

A further concern is broad based inflationary pressure in services can have a meaningful impact on inflationary expectations, which may then flow to the wage bargaining process resulting in a higher than expected inflation profile.

Just how widespread the inflationary pulse was in December can been seen in lift in the share of expenditure classes running faster than 3.0%yr. From a low of up from just 31% a year earlier it surged to 90% in December which is the highest share since June 1989 91%.

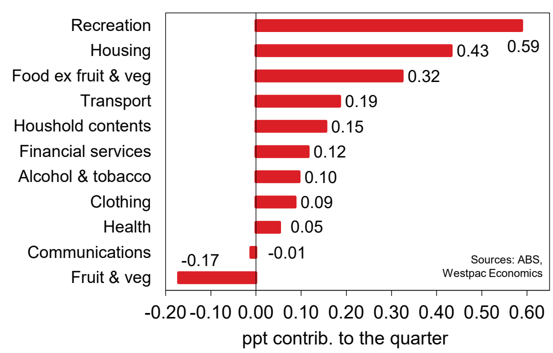
Goods inflation easing as services inflation picks up

In the year to December good prices are up 9.5%, basically flat on the 9.6%yr in September but it is running at almost twice the pace of services inflation at 5.5%yr. However, in the quarter good prices lifted just 1.6%, down on the average of 2.5%qtr for the previous three quarters and was less than the 2.1%qtr rise in services prices which is the largest quarterly rise since the 4.5% rise in September 2000 (introduction of the GST). Market services ex-volatile lifted 2.7%qtr/6.4%yr.

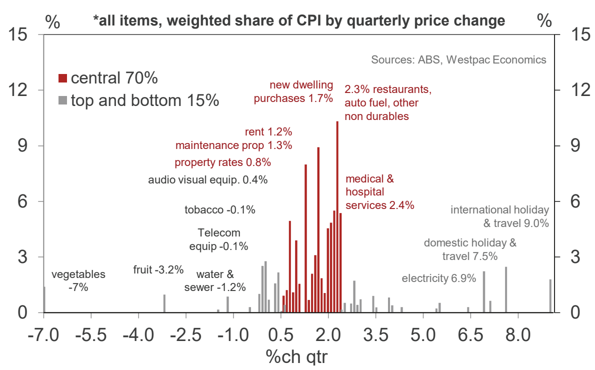
Quarterly CPI actual vs Monthly Indicator

Item	Dec 22 Qtr % qtr	Oct Mth % mth	Nov Mth % mth	Dec Mth % mth
Food	0.9	–0.5	1.4	0.8
of which, bread & cereals	3.4	0.5	0.8	1.6
of which, meat & seafood	1.0	0.0	0.6	0.7
of which, dairy & related prod.	4.2	0.9	1.6	1.9
of which, fruit & vegetables	-7.3	-6.3	2.4	3.0
of which, food products nec	2.7	0.9	0.5	1.5
of which, non-alcohol bev,	0.7	0.8	–0.5	–0.8
Alcohol & tobacco	**1.2**	**0.5**	**-0.1**	**-0.2**
of which, Alcohol	1.0	0.5	-0.1	-0.4
of which, Tobacco	1.5	0.7	0.0	-0.1
Clothing & footwear	**2.6**	**3.0**	**-2.4**	**1.2**
Housing	**1.9**	**0.4**	**0.1**	**1.4**
of which, Rents	1.2	0.6	0.2	0.5
of which, House purchases	1.7	0.5	0.1	0.9
H/hold contents & services	**1.8**	**0.2**	**1.0**	**0.7**
Health	**0.8**	**0.0**	**1.0**	**0.2**
Transportation	**1.7**	**2.2**	**2.2**	**-2.1**
of which, auto fuel	2.2	7.0	5.6	-8.1
Communication	**-0.5**	**-0.4**	**-0.7**	**0.2**
Recreation	**5.4**	**-2.4**	**2.5**	**11.0**
of which, holiday travel	10.9	-6.4	4.3	27.0
Education	**0.1**	**0.0**	**0.1**	**0.0**
Financial & insurance services	**2.0**	**0.0**	**0.6**	**1.4**
CPI: All groups %qtr/%mth	*1.9*	*0.2*	*0.8*	*1.6*

Contributions 2022Q4 CPI 1.9%qtr print



Distribution of seasonally adjusted Q4 CPI



On a two-quarter annualised basis, market goods excluding volatile held at 10.3%yr in the December quarter while market services ex volatile lifted to 6.1%yr from 3.5%yr in September, well up on the recent low of 0.7%yr in September 2021; at the same time market goods ex volatile was 0.9%yr.

Non-discretionary inflation appears to be peaking

At 8.4%yr, non-discretionary inflation continues to run at a faster pace than the CPI (7.8%yr). However, inflationary momentum is shifting with as discretionary inflation lifted from 5.5%yr in September to 7.1%yr in December. Comparing two quarter annualised growth rates provides a stronger view on the shift that is occurring. Non-discretionary inflation dropped from a recent peak of 14.5%yr in September to 10.7%yr in December, the slowest pace since 7.1%yr in December 2021. Two quarters annualised discretionary inflation lifted from 3.8%yr in December 2021 to 4.6%yr in March 2022, 7.7%yr in June, 8.8%yr in September then hitting 12.7%yr in December, a record high for the data that dates back to the second half of 2005.

Construction costs peaking with dwelling inflation easing

New dwelling price inflation eased to 1.5% in the December quarter, a meaningful moderation from the greater than 5% increases seen through the first half of the year. In the year to December dwelling price are up 17.8%. This moderation in dwelling price inflation reflects an improvement in the supply of building materials and weaker demand following the lift in interest rates and the unwinding of construction grants. Construction input costs rose 2.2%qtr/11.8%yr in December, the smallest quarterly increase since March 2021 while prices fell for timber, steel products and electrical cable. The moderation in dwelling construction cost has been matched by the moderation measured dwelling prices.

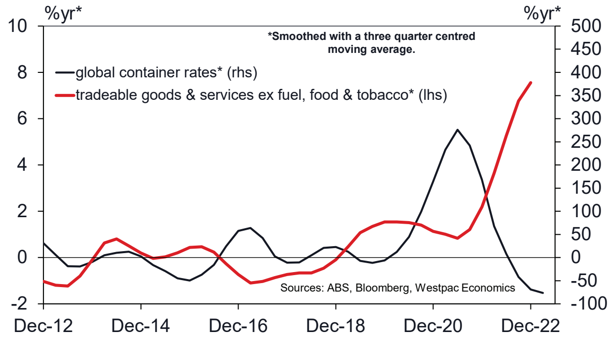
We are, however, surprised to that see that the grants are still holding the level of CPI dwelling prices below measured prices but it is now down to a gap of just 1% which we expect to close by the June quarter adding 0.5% to dwelling prices over the next two quarters.

We expect dwellings price increases to continue moderating as we move through 2023 as contracting home sales and falling established home prices point to softer demand for new dwellings and thus a compression of developers margins. We are, however, closely watching dwelling prices in the Monthly CPI Indicator which was revealing a moderation in the rate of increase. After rising 0.5% in October the pace moderated to 0.2% in November only to surge 0.9% in December. Was this due to the a rise in the measured price or the expiry of construction grants? We don't have the data to answer that question.

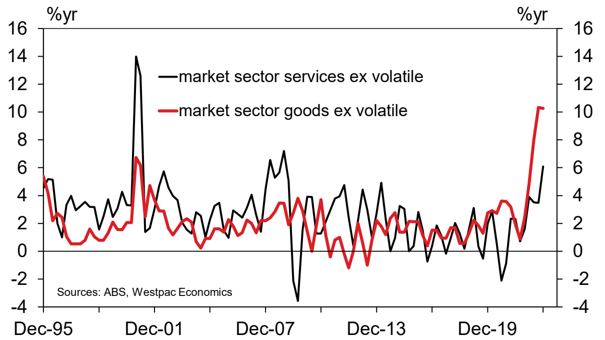
Rentals under pressure as vacancy rates fall

Rents increased by 1.2% in December to be up 4.0% in the year. This reflects a tight rental market across the country. There was an offset from the regular indexation of rent subsidy payments and in the absence of this offset, rents would have increased by 1.5%, a little stronger than the previous quarterly outcome. In monthly terms, rent inflation had a similar pattern to dwelling prices rising 0.6%, 0.2% and 0.5% respectively in October, November and December. Rents were strong in all cities, with increases in Sydney and Brisbane particularly large (1.5% and 1.6% respectively) while the smallest increase was reported in Hobart (0.3%). With rental market conditions continuing to tighten across the country, rising advertised rents and historically low vacancy rates, we expect to see a pick-up in rent inflation through 2023.

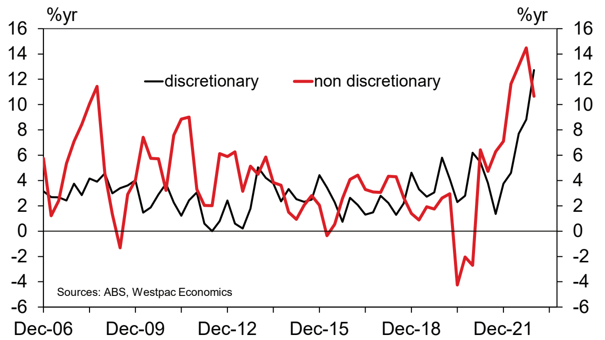
Global shipping and traded goods inflation



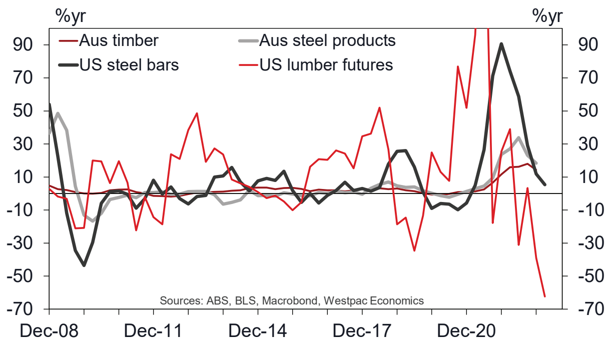
Two quarter annualised inflation



Two quarter annualised inflation



Construction inputs in Aust. dollars



Electricity prices boosted as rebate affect fades

Electricity prices increased 8.6% in December (7% seasonally adjusted) due to the unwinding of rebates in WA and the ACT with only a modest offset from QLD and Tas rebates. Gas prices, which were not affected by government rebates, increased 0.8% (around 2% seasonally adjusted) to be up 17.4% in the year. Electricity and gas prices are expected to increase further through this year due to higher wholesale prices seen through 2022.

However, the Australian Government introduced the Energy Price Relief Plan which included price caps for thermal coal ($125/t) and natural gas ($12/gigajoule). From this, Treasury revised its forecast for household energy bills to +47.6% over the two years for electricity (20% in 2022/23 and 23% in 2023/24) and 22.6% for gas (18% in 2022/23 and 4% 2023/24). On the back of this wholesale gas prices have fallen back to around $12/gigajoule while wholesale electricity prices have also moved lower with prices in Victoria almost back to where they were before the most recent spike higher. This is why we feel more confident that the energy inflationary pulse will fade as we move towards 2024.

Consumer durable inflation was particularly strong

There was a broad based pick up in consumer durables inflation in December which was particularly strong for clothing & footwear (2.6%qtr/5.3%yr despite Black Friday and Cyber Monday sales) and motor vehicles (2.2%qtr/5.0%yr due to price rises for luxury vehicles). Price pressures appeared to ease for furniture & furnishings which rose just 0.6% in the quarter compared to more than a 6% rise in each of the preceding two quarters to be up 10.8% in the year. Audio, visual & computing equipment fell 0.2% in the quarter to be up just 0.4% in the year.

Given the correction we have seen in global freight rates, the improvement in global supply chains and the expected moderation in consumer demand though 2023, we believe we have seen the peak in durable consumer goods inflation and expect it to moderate from here.

Groceries continue to surge

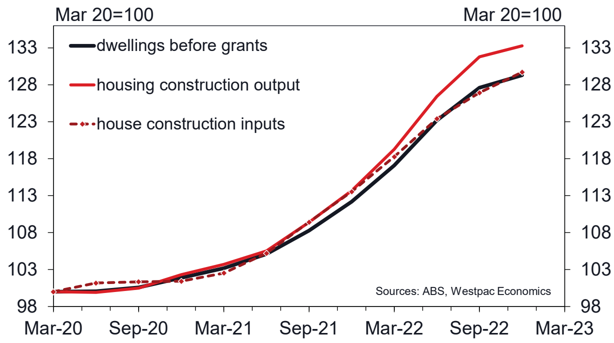
Grocery prices (food excluding fruit & vegetables and restaurant meals & take out) increased by 2.2%qtr/10.8%yr as supermarkets continued passing through supplier cost increases. The close to 11%yr increase is the fastest annual pace since 1983. Prices of most food items increased strongly in the quarter, with the largest increases seen in dairy and related products due to higher wholesale costs. It is likely that grocery prices will increase further in the near term but we do expect the pace to moderate compared to recent history.

In seasonally adjusted terms, this group lifted 1.1% in the quarter. Meals out and takeaway foods (up 2.1%) provided the main contribution. The prices of fruit & vegetables fell 6% in the quarter in seasonally adjusted terms to be up around 8½% in the year. The decline in the quarter reflects an easing of unfavourable weather conditions. The late 2022 flooding in parts of Vic and NSW had a smaller than expected impact on fresh produce supply.

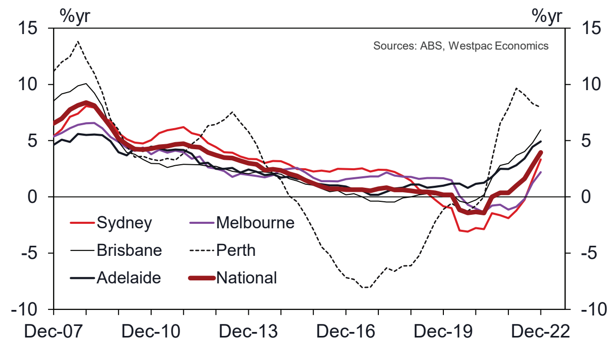
Services are now the key inflationary risk

Rising cost pressures combined with robust demand have contributed to large price increases for many services. As noted earlier, market services inflation (which covers a little over 20% of the CPI basket) lifted more than 2%qtr/7%yr – the strongest outcome since 1990. This group has become increasingly important in the current inflationary cycle as they are generally the prices most sensitive to domestic labour costs. However, it is worth noting that non-labour costs, such as materials and transport, have been an important factor driving higher prices in recent quarters, in particular for cafés & restaurants.

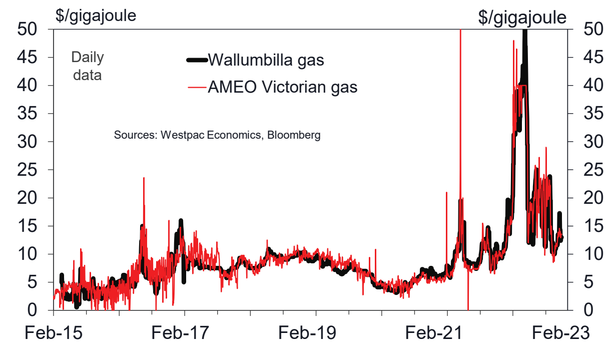
Dwelling prices matching input costs



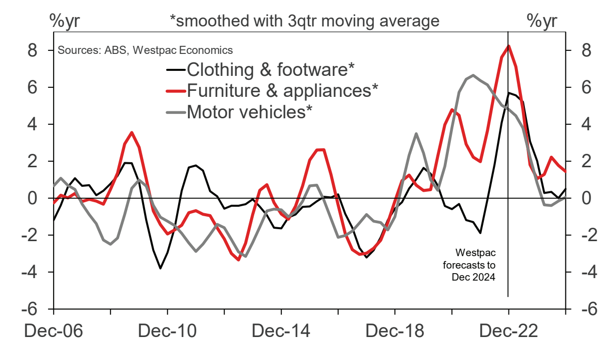
Rental inflation



Gas surged then fell back to around $12



Durable inflation has some strength



The Monthly CPI reveals how volatile prices have been for domestic & international holiday travel. This group saw prices surge 27% in the month of December, a sharp increase reflecting incredibly strong demand as we experienced the first "real" summer holiday in a number of years. Airfares drove a large portion of the increase, reflecting high fuel prices and reduced capacity, while accommodation prices also lifted substantially.

The three month average of holiday travel & accommodation has been a very good guide for the quarterly estimate of holiday & accommodation in the CPI once you adjust for December 2020 diversion when the ABS indexed holiday travel to the overall CPI as the sector had no activity to record prices as it was closed during the COVID-19 lock down.

Seasonally, December and January report the strongest prices in a year suggesting holiday & travel prices should remain elevated in the January Monthly CPI Indicator. This suggests an upside risk to our 5.0% forecasting for holiday travel & accommodation prices in the March quarter.

Meals out & takeaway increased 2% in the December quarter as restaurants & cafés passed on higher input costs including the larger than usual increase in minimum and award wages in 2022. Prices for insurance and financial services also rose strongly in the December quarter.

Our forecasts has a modest slow down in the pace of market services (excluding holiday travel & accommodation) inflation by the end of 2023; from a contribution to annual CPI inflation of 1.3ppt at the end of 2022 to a still considerable 1.1ppt at the end of 2023. Our forecast peak contributions are 1.5ppt in both the March and June quarters of 2023.

Monthly CPI presents upside risk to our March 2023 forecast

In December the monthly CPI lifted a large 1.6% suggesting that not only does inflationary pressure remain high but that it continues to be broad based. It reported prices up 8.4% in the year to December compared to the 7.8%yr reported by the quarterly CPI. The monthly data was quite mixed through the December quarter with inflation moderating noticeably in October and November only to see a very strong print in December. Movements in the monthly CPI indicator over October to December were driven by price increases across many CPI components, including market services, retail items, rents and utilities but the stand out is the 27% increase in holiday travel & accommodation.

March 2023 CPI forecast 1.3%qtr/6.9%yr

Westpac is forecasting a 1.3%qtr rise in the CPI for the March quarter, the softest print since December 2021. This will take the annual pace down to 6.9%yr from 7.8%yr. The Trimmed Mean is forecast to rise 1.3% in the quarter seeing the annual pace ease back to 6.5%yr from 6.9%yr.

The correction in crude oil prices is a major factor in this moderation in inflationary pressure with falling auto fuel making a -0.2ppt contribution in March. While still rising, higher electricity prices are set to make a smaller contribution as the effect of the rebates fade while furniture & furnishing prices are moderating. Holiday travel prices are forecast to hold their current very high level, rather than surge again, thus making a smaller contribution than they did in December.

Our end 2023 forecast for CPI is 3.9%yr while our Trimmed Mean forecast is 3.6%yr, both still well clear of the top of the RBA's inflation target band but a meaningful moderation from the current pace.

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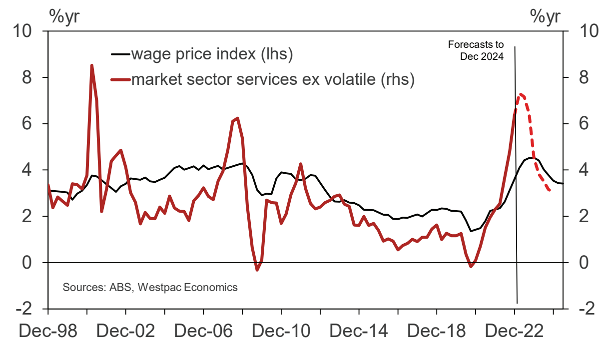
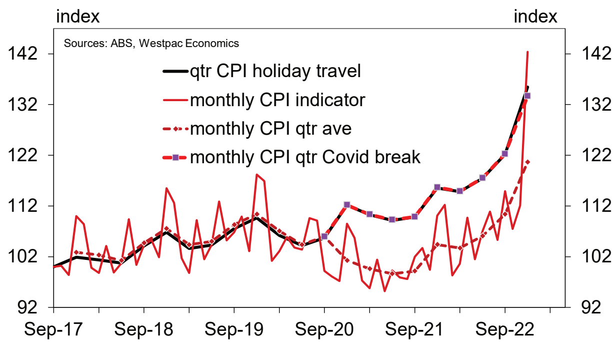
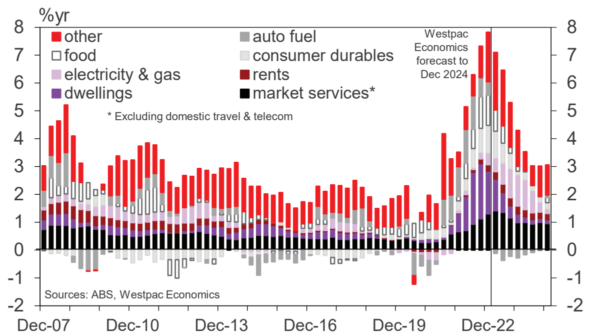
Domestic inflationary pressures



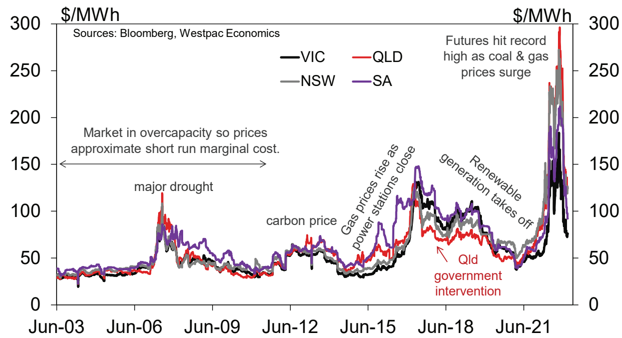
Monthly travel & accom vs. qtr CPI



Contributions to annual inflation



Electricity futures



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