

7 February 2023

## Inflation Deeper Insights – revision to forecasts We are past the peak but it is going to be a bit of a grind getting inflation back to the mid point of the target band.

- Westpac has revised down its inflation forecast profile to now have annual growth at 3.0%yr by end 2024. The Trimmed Mean has also been revised down to 3.1%yr by end 2024. The previous forecasts were for end 2024 were 3.2%yr for both.
- Our forecast for the March quarter CPI is 0.7% while for the Trimmed Mean it is 0.8%. The annual pace of the CPI is forecast to moderate from 4.1%yr to 3.4%yr while the annual pace of the Trimmed mean is forecast to slow to 3.8%yr from 4.2%yr.
- Our January Monthly CPI Indicator near-cast, which being the first month of the quarter includes durable goods prices (many of which are forecast to fall) but few services prices, is 0.1%<sup>mth</sup>. Due to base effects this will see the annual pace lift from 3.4%yr to 3.9%yr.

### Inflation forecasts

		Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
CPI	Index	137.1	137.9	139.1	140.2	141.1
	(%qtr)	0.7	0.6	0.9	0.8	0.6
	(%yr)	3.4	3.1	2.8	3.0	2.9
Trimmed mean	(%qtr)	0.8	0.6	0.9	0.7	0.7
	(%yr)	3.8	3.5	3.2	3.1	3.0

### CPI Dec 2023 actual and Mar 2024 forecast

Item	Dec 2023		Mar 2024 f/c	
	% qtr	contrib	% qtr	contrib
<b>Food</b>	0.5	0.09	0.8	0.14
of which, fruit & vegetables	-1.2	-0.03	1.9	0.04
<b>Alcohol &amp; tobacco</b>	2.8	0.22	0.7	0.06
of which, Tobacco	7.0	0.19	0.5	0.01
<b>Clothing &amp; footwear</b>	0.5	0.02	-2.5	-0.08
<b>Housing</b>	1.0	0.23	2.0	0.45
of which, Rents	0.9	0.05	2.2	0.13
of which, House purchases	1.5	0.13	1.4	0.12
of which, Utilities	0.6	0.03	4.3	0.18
<b>H/hold contents &amp; services</b>	-1.0	-0.08	-1.3	-0.11
<b>Health</b>	0.6	0.04	2.3	0.14
of which, Pharmaceuticals	-1.7	-0.02	5.0	0.05
<b>Transportation</b>	-0.2	-0.02	-1.4	-0.16
of which, car prices	-0.5	-0.02	-0.6	-0.02
of which, auto fuel	-0.2	-0.01	-4.5	-0.16
<b>Communication</b>	0.4	0.01	0.7	0.01
<b>Recreation</b>	0.3	0.04	-0.2	-0.03
of which, audio visual & comp.	-0.4	-0.01	0.0	0.00
of which, holiday travel	1.0	0.06	-1.0	-0.05
<b>Education</b>	-0.1	0.00	4.9	0.21
<b>Financial &amp; insurance services</b>	1.7	0.09	1.2	0.07
<b>CPI: All groups</b>	<b>0.6</b>	<b>-</b>	<b>0.7</b>	<b>-</b>
<b>CPI: All groups % year</b>	<b>4.1</b>	<b>-</b>	<b>3.4</b>	<b>-</b>

Sources: ABS, RBA, Westpac Banking Corporation.

- Housing remains the most significant inflationary force in the March quarter as electricity rebates come to an end and the impact of increases in rental assistance on September 20 fades.
- There will also be the usual annual price increase for education and jump in health costs as families see their expenditure thresholds for government assistance reset.
- Offsetting this in the March quarter will be falling clothing & footwear, household durable goods, car prices, auto fuel and holiday travel & accommodation.
- A factor for lower inflation in 2024 will be the moderation in energy prices with utilities rising 5.9%yr (8.2%yr in 2023) and auto fuel falling -3.2%yr (5.5%yr in 2023). We also expect a to see a moderation in food inflation, down to 1.9%yr from 4.4%yr in 2023.
- Global disinflationary forces will still be in play, at least for the first half of 2024, which in the face of a weak consumer, is likely to see prices fall for items such as clothing & footwear, furniture, electronic goods and automotive spare parts.
- Near-term inflationary expectations have eased from their late 2022 peak and as headline inflation continues to moderate, so too should inflationary expectations.

### Annual Inflation Dec 2023 and Dec 2024

Item	Dec 2023		Dec 2024 f/c	
	% yr	contrib	% yr	contrib
<b>Food</b>	4.4	0.76	1.9	0.33
of which, fruit & vegetables	-0.1	-0.01	-0.7	-0.02
<b>Alcohol &amp; tobacco</b>	6.4	0.51	3.8	0.31
of which, Tobacco	10.3	0.29	6.2	0.19
<b>Clothing &amp; footwear</b>	-1.1	-0.04	-1.5	-0.05
<b>Housing</b>	6.0	1.36	4.9	1.12
of which, Rents	7.1	0.42	6.6	0.40
of which, House purchases	5.0	0.43	4.5	0.39
of which, Utilities	8.2	0.36	5.0	0.22
<b>H/hold contents &amp; services</b>	-0.2	-0.02	0.2	0.02
<b>Health</b>	5.1	0.32	4.2	0.27
of which, Pharmaceuticals	0.6	0.00	1.4	0.01
<b>Transportation</b>	3.6	0.40	0.1	0.02
of which, car prices	1.2	0.04	0.2	0.01
of which, auto fuel	5.5	0.20	-3.2	-0.11
<b>Communication</b>	2.2	0.05	1.4	0.03
<b>Recreation</b>	0.5	0.06	3.0	0.35
of which, audio visual & comp.	0.7	0.01	0.7	0.02
of which, holiday travel	-2.6	-0.13	4.3	0.22
<b>Education</b>	4.7	0.20	4.9	0.22
<b>Financial &amp; insurance services</b>	7.9	0.46	7.0	0.42
<b>CPI: All groups</b>	<b>4.1</b>	<b>-</b>	<b>3.0</b>	<b>-</b>

Sources: ABS, RBA, Westpac Banking Corporation.

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.

### CPI vs Monthly Indicator %yr

Item	Dec 23	Oct	Nov	Dec
	Qtr % yr	Mth % yr	Mth % yr	Mth % yr
<b>Food</b>	<b>4.5</b>	<b>5.3</b>	<b>4.6</b>	<b>4.0</b>
of which, bread & cereals	8.2	8.5	8.3	7.7
of which, meat & seafood	0.0	1.8	0.2	-1.9
of which, dairy & related prod.	6.4	7.8	6.1	5.2
of which, fruit & vegetables	-0.2	1.0	0.7	-2.2
of which, food products nec	6.5	6.2	6.6	6.8
of which, non-alcohol bev.	5.3	3.4	5.4	7.1
<b>Alcohol &amp; tobacco</b>	<b>6.6</b>	<b>6.6</b>	<b>6.4</b>	<b>6.8</b>
of which, Alcohol	4.5	4.5	4.2	4.6
of which, Tobacco	10.6	10.4	10.5	10.8
<b>Clothing &amp; footwear</b>	<b>-1.1</b>	<b>-1.5</b>	<b>-0.9</b>	<b>-0.8</b>
of which, garments	-0.8	-1.7	-0.4	-0.4
<b>Housing</b>	<b>6.1</b>	<b>6.1</b>	<b>6.6</b>	<b>5.2</b>
of which, Rents	7.3	6.6	7.1	7.4
of which, House purchases	5.1	4.7	5.5	5.1
of which, Electricity	6.9	10.1	10.7	0.4
of which, Gas & other fuels	13.4	13.0	12.9	8.5
<b>H/hold contents &amp; services</b>	<b>-0.2</b>	<b>0.4</b>	<b>-0.3</b>	<b>-0.3</b>
<b>Health</b>	<b>5.1</b>	<b>6.3</b>	<b>5.2</b>	<b>4.7</b>
<b>Transportation</b>	<b>3.7</b>	<b>5.9</b>	<b>3.6</b>	<b>3.6</b>
of which, auto fuel	5.4	8.6	2.3	5.3
<b>Communication</b>	<b>2.2</b>	<b>1.8</b>	<b>2.4</b>	<b>2.0</b>
<b>Recreation</b>	<b>0.5</b>	<b>2.7</b>	<b>1.2</b>	<b>-2.4</b>
of which, holiday travel	-2.6	1.3	-0.3	-9.1
<b>Education</b>	<b>4.7</b>	<b>4.8</b>	<b>4.8</b>	<b>4.7</b>
<b>Financial &amp; insurance services</b>	<b>8.1</b>	<b>8.6</b>	<b>8.8</b>	<b>8.2</b>
<b>CPI: All groups</b>	<b>4.1</b>	<b>4.9</b>	<b>4.3</b>	<b>3.4</b>

### Falling wholesale prices and another round of energy rebates to hold down utilities inflation in 2024

Wholesale gas prices peaked back in the June quarter of 2022 with electricity prices following soon after, peaking in the September quarter. On average across the east coast, electricity futures were 65% lower in the December quarter compared to their September 2022 peak; Victoria has seen the largest fall of 78% while SA saw the smallest fall of 47%.

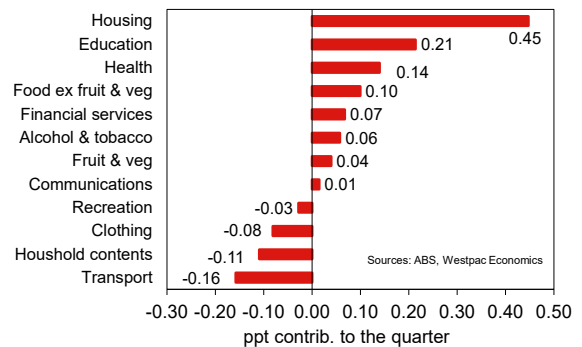
While the relationship is far from perfect, we have found that direction of electricity futures lead the direction in electricity prices by around three quarters. This suggests we should have seen the peak in wholesale electricity prices and it is possible that retail prices could drift lower from here. But we are cautious as electricity futures can fall much further this year. Natural gas prices seem to be anchored around the \$12/gigajoule price cap that has been imposed by the Commonwealth Government and the expansion of renewables seems to have slowed a bit. Additionally, it appears the recent increase in power bills fell short of the spike in wholesale electricity prices.

There is also an additional complexity: as electricity prices surged, both state and the federal governments offered a series of energy rebates to offset the increase in power bills. As these were provided to the distributors, rather than a cash transfer to households, they reduced power bills which was then reflected in lower electricity prices in the CPI compared to power bills without the rebates. (see chart over). These rebates were introduced in 2022, and again in 2023, temporarily holding down electricity prices in the CPI even though electricity prices were rising in the retail market. This is why in late 2022 and early 2023, electricity prices in the CPI snapped higher

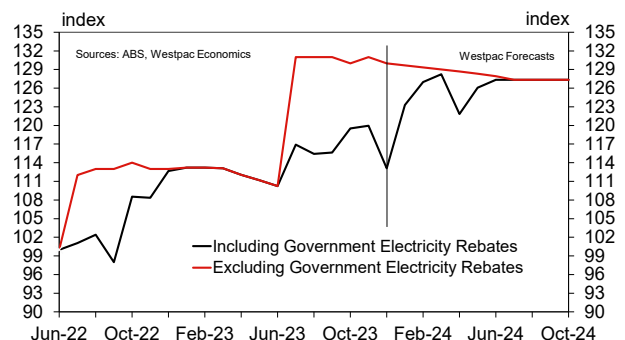
### CPI vs Monthly Indicator %qtr/%mth

Item	Dec 23	Oct	Nov	Dec
	Qtr % qtr	Mth % mth	Mth % mth	Mth % mth
<b>Food</b>	<b>0.5</b>	<b>0.1</b>	<b>0.8</b>	<b>0.2</b>
of which, bread & cereals	1.9	0.2	0.6	1.1
of which, meat & seafood	-1.2	0.1	-0.9	-1.4
of which, dairy & related prod.	0.6	0.7	-0.1	1.0
of which, fruit & vegetables	-1.2	-0.1	2.1	0.1
of which, food products nec	1.9	0.2	1.0	1.7
of which, non-alcohol bev.	0.5	-0.6	1.4	0.8
<b>Alcohol &amp; tobacco</b>	<b>2.8</b>	<b>1.3</b>	<b>-0.3</b>	<b>0.1</b>
of which, Alcohol	0.5	0.0	-0.4	0.1
of which, Tobacco	7.0	3.4	0.1	0.2
<b>Clothing &amp; footwear</b>	<b>0.5</b>	<b>1.6</b>	<b>-1.7</b>	<b>1.3</b>
of which, garments	1.9	3.4	-2.9	2.1
<b>Housing</b>	<b>1.0</b>	<b>0.4</b>	<b>0.7</b>	<b>-0.3</b>
of which, Rents	0.9	-0.4	0.7	0.7
of which, House purchases	1.5	0.2	0.9	0.5
of which, Electricity	1.4	3.4	0.4	-5.7
of which, Gas & other fuels	-1.0	-2.5	2.3	-0.4
<b>H/hold contents &amp; services</b>	<b>-1.0</b>	<b>-1.6</b>	<b>0.3</b>	<b>0.8</b>
<b>Health</b>	<b>0.6</b>	<b>0.8</b>	<b>0.0</b>	<b>-0.3</b>
<b>Transportation</b>	<b>-0.2</b>	<b>-1.0</b>	<b>-0.1</b>	<b>-2.1</b>
of which, auto fuel	-0.2	-2.9	-0.5	-5.5
<b>Communication</b>	<b>0.4</b>	<b>0.1</b>	<b>-0.1</b>	<b>-0.1</b>
<b>Recreation</b>	<b>0.3</b>	<b>-3.2</b>	<b>1.0</b>	<b>7.0</b>
of which, holiday travel	1.0	-7.0	2.7	15.8
<b>Education</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>-0.1</b>
<b>Financial &amp; insurance services</b>	<b>1.7</b>	<b>0.0</b>	<b>0.8</b>	<b>0.8</b>
<b>CPI: All groups</b>	<b>0.6</b>	<b>-0.3</b>	<b>0.3</b>	<b>0.7</b>

### Contributions 2024Q1 CPI 0.7%qtr forecast



### Monthly electricity prices



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**Monthly CPI Indicator & Jan forecasts (%yr)**

Item	Oct	Nov	Dec	Jan fcs
	Mth % yr	Mth % yr	Mth % yr	Mth % yr
<b>Food</b>	<b>5.3</b>	<b>4.6</b>	<b>4.0</b>	<b>4.4</b>
of which, bread & cereals	8.5	8.3	7.7	7.7
of which, meat & seafood	1.8	0.2	-1.9	-1.3
of which, dairy & related prod.	7.8	6.1	5.2	5.7
of which, fruit & vegetables	1.0	0.7	-2.2	1.2
of which, food products nec	6.2	6.6	6.8	6.0
of which, non-alcohol bev.	3.4	5.4	7.1	4.5
<b>Alcohol &amp; tobacco</b>	<b>6.6</b>	<b>6.4</b>	<b>6.8</b>	<b>6.3</b>
of which, Alcohol	4.5	4.2	4.6	3.7
of which, Tobacco	10.4	10.5	10.8	10.8
<b>Clothing &amp; footwear</b>	<b>-1.5</b>	<b>-0.9</b>	<b>-0.8</b>	<b>-0.9</b>
of which, garments	-1.7	-0.4	-0.4	-0.8
<b>Housing</b>	<b>6.1</b>	<b>6.6</b>	<b>5.2</b>	<b>5.8</b>
of which, Rents	6.6	7.1	7.4	7.4
of which, House purchases	4.7	5.5	5.1	5.0
of which, Electricity	10.1	10.7	0.4	8.9
of which, Gas & other fuels	13.0	12.9	8.5	0.7
<b>H/hold contents &amp; services</b>	<b>0.4</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.3</b>
<b>Health</b>	<b>6.3</b>	<b>5.2</b>	<b>4.7</b>	<b>3.9</b>
<b>Transportation</b>	<b>5.9</b>	<b>3.6</b>	<b>3.6</b>	<b>3.0</b>
of which, auto fuel	8.6	2.3	5.3	3.1
<b>Communication</b>	<b>1.8</b>	<b>2.4</b>	<b>2.0</b>	<b>2.1</b>
<b>Recreation</b>	<b>2.7</b>	<b>1.2</b>	<b>-2.4</b>	<b>1.4</b>
of which, holiday travel	1.3	-0.3	-9.1	0.3
<b>Education</b>	<b>4.8</b>	<b>4.8</b>	<b>4.7</b>	<b>4.7</b>
<b>Financial &amp; insurance services</b>	<b>8.6</b>	<b>8.8</b>	<b>8.2</b>	<b>8.2</b>
<b>CPI: All groups %qtr/%mth</b>	<b>4.9</b>	<b>4.3</b>	<b>3.4</b>	<b>3.9</b>

**Monthly CPI Indicator & Jan forecasts (%mth)**

Item	Oct	Nov	Dec	Jan
	Qtr % mth	Mth % mth	Mth % mth	Mth % mth
<b>Food</b>	<b>0.1</b>	<b>0.8</b>	<b>0.2</b>	<b>0.3</b>
of which, bread & cereals	0.2	0.6	1.1	0.2
of which, meat & seafood	0.1	-0.9	-1.4	0.6
of which, dairy & related prod.	0.7	-0.1	1.0	0.0
of which, fruit & vegetables	-0.1	2.1	0.1	0.6
of which, food products nec	0.2	1.0	1.7	0.3
of which, non-alcohol bev.	-0.6	1.4	0.8	0.4
<b>Alcohol &amp; tobacco</b>	<b>1.3</b>	<b>-0.3</b>	<b>0.1</b>	<b>-0.2</b>
of which, Alcohol	0.0	-0.4	0.1	-0.5
of which, Tobacco	3.4	0.1	0.2	0.2
<b>Clothing &amp; footwear</b>	<b>1.6</b>	<b>-1.7</b>	<b>1.3</b>	<b>-3.8</b>
of which, garments	3.4	-2.9	2.1	-5.4
<b>Housing</b>	<b>0.4</b>	<b>0.7</b>	<b>-0.3</b>	<b>1.4</b>
of which, Rents	-0.4	0.7	0.7	0.7
of which, House purchases	0.2	0.9	0.5	0.4
of which, Electricity	3.4	0.4	-5.7	9.0
of which, Gas & other fuels	-2.5	2.3	-0.4	0.3
<b>H/hold contents &amp; services</b>	<b>-1.6</b>	<b>0.3</b>	<b>0.8</b>	<b>-1.7</b>
<b>Health</b>	<b>0.8</b>	<b>0.0</b>	<b>-0.3</b>	<b>0.0</b>
<b>Transportation</b>	<b>-1.0</b>	<b>-0.1</b>	<b>-2.1</b>	<b>-0.3</b>
of which, auto fuel	-2.9	-0.5	-5.5	-1.0
<b>Communication</b>	<b>0.1</b>	<b>-0.1</b>	<b>-0.1</b>	<b>0.1</b>
<b>Recreation</b>	<b>-3.2</b>	<b>1.0</b>	<b>7.0</b>	<b>0.6</b>
of which, holiday travel	-7.0	2.7	15.8	2.4
<b>Education</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Financial &amp; insurance services</b>	<b>0.0</b>	<b>0.8</b>	<b>0.8</b>	<b>0.0</b>
<b>CPI: All groups %qtr/%mth</b>	<b>-0.3</b>	<b>0.3</b>	<b>0.7</b>	<b>0.1</b>

to be level of prices quoted in bills without rebates. Rebates were applied again through 2023, holding down another surge power bill price inflation. However, as we saw in 2022 we expect electricity prices in the CPI to snap back bill prices without rebates through early 2024. However, through 2024 we are not expecting to see an increase in power bill prices but given their extreme level it is possible the government will offer another round of rebates through the second quarter of 2024 holding CPI electricity prices below bill prices through the middle of the year.

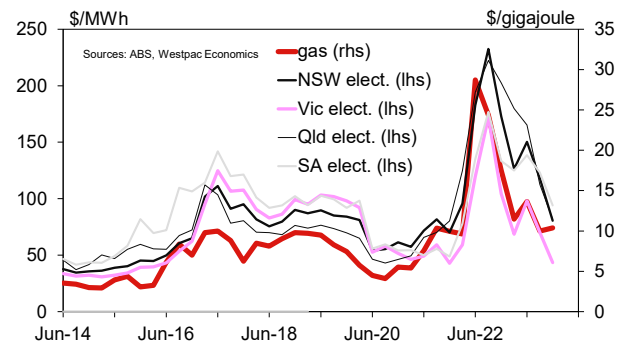
**Dwellings and rents inflation to moderate**

While the housing market remains tight, it does appear that the worst for dwelling/rent inflation, as measured in the CPI, has passed, at least for now. Established home prices are picking up again but this is offsetting falling prices through 2023 and, as such, is likely to mean that dwelling price inflation should stabilise around current levels rather than pick up further in 2024. Asking rents are still rising but at a slower pace than they were a year ago, and again, this will most likely lead to a stabilisation in rent inflation rather than drive a significant moderation. It is important to remember that CPI rents includes all rents, both public and private, and are net of any government assistance. On that front, we also need to remember that Federal Government Rental Assistance is indexed to the CPI in March and September.

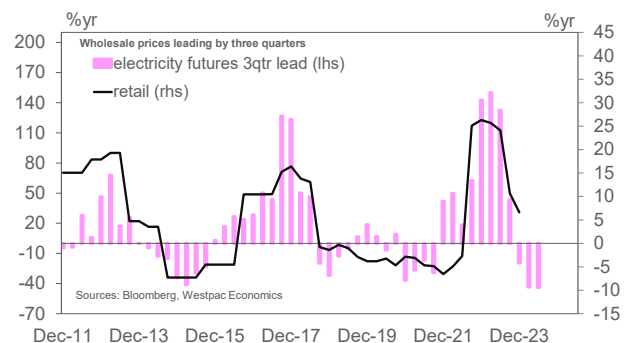
**Fuel prices to track broadly sideways through 2024**

We are expecting Brent crude prices to broadly track sideways through the first half of 2024, if in a somewhat volatile manner, before they firm to US\$85 by the end of the year. At the same

**Wholesale gas vs. electricity futures**



**Sydney electricity prices**



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time we have the Australian dollar holding around current levels in early 2024 before appreciating from the June quarter. On this basis we expect auto fuel prices to also hold around current levels through most of 2024.

**Market services inflation has peaked**

Market services excluding “volatile items” inflation peaked at 6.8%yr in March 2023 before moderating to 4.5%yr by December 2023. Given the current pace of wages growth, we are expecting this group’s inflation rate to moderate only modestly from here. However, we also find it hard to see how there would be a re-acceleration in inflation from this group given our expectation for a meaningful moderation in unit labour costs due to a recovery in productivity.

**Consumer durable goods remain disinflationary**

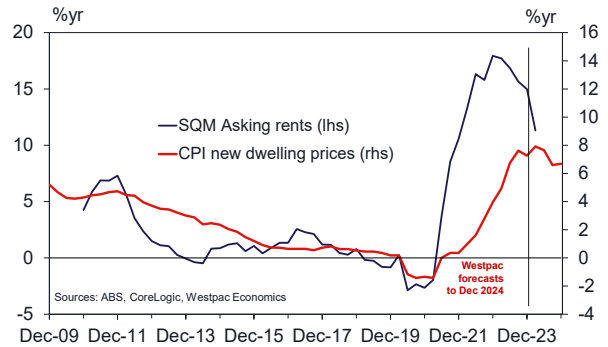
Global disinflationary forces will still be in play, at least for the first half of 2024, which in the face of a weak consumer, is likely to see prices fall for items such as clothing & footwear, furniture, electronic goods and automotive spare parts.

**Markets have priced out near term inflationary risks**

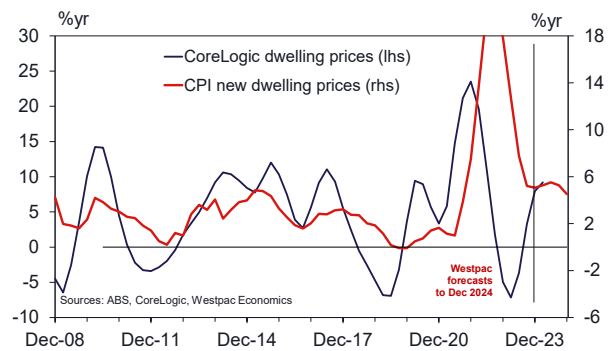
Market inflationary expectations, as measured by the 1yr swap rate, peaked in early 2023 at a bit more than 5% and are now back around 3% to be only a touch higher than 2yr, 5yr and 10yr expectations. While this is still at the top of the RBA’s target band, we would expect the 1yr to 5yr rate to drift down below the 10yr rate through 2024 pointing to inflation being at the mid point for the target band sometime in 2025 if not sooner.

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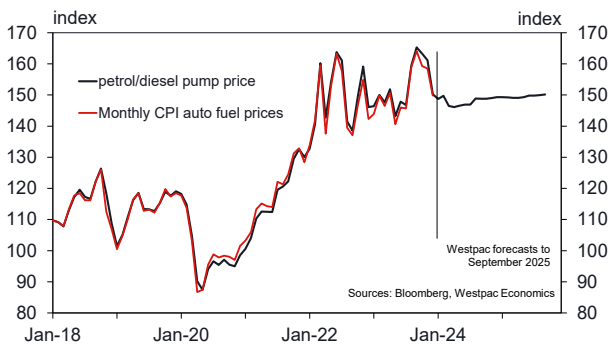
**Asking rents vs CPI rents**



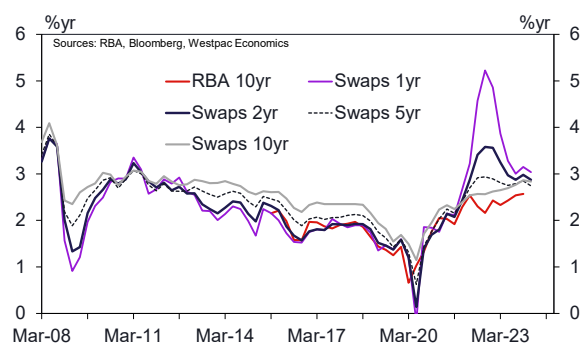
**House prices vs CPI new dwelling prices**



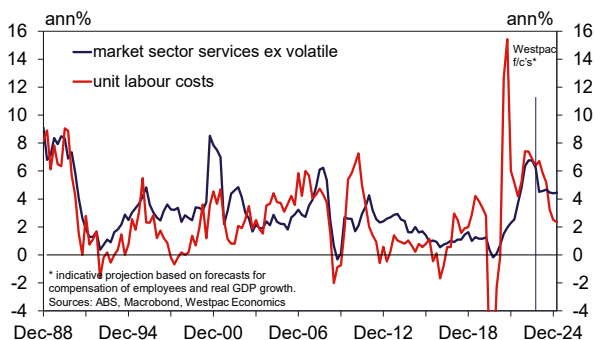
**Petrol/diesel prices vs monthly CPI auto fuel**



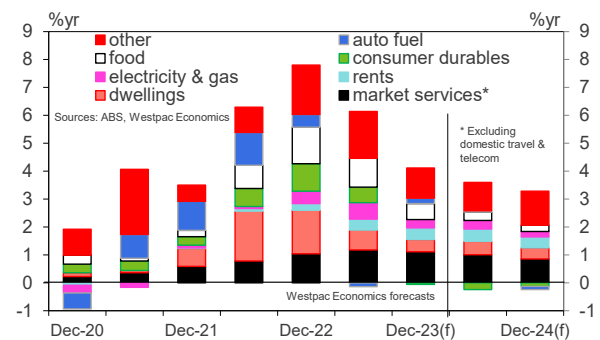
**Financial markets inflation expectations**



**Unit labour costs vs services inflation**



**Contributions to annual inflation**



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## Disclaimer continued

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