BULLETIN

8 May 2024

Inflation Deeper Insights – revision to forecasts
Upside surprise lifts 2024 forecasts but no change to end 2025.

- In the May 3 Westpac Weekly, we revised our headline inflation forecast to 3.7%yr for June 2024 and 3.2%yr by end 2024; the previous forecasts were 3.1%yr and 3.0%yr respectively. The Trimmed Mean was also revised up to 3.7%yr by June 2024 and 3.5%yr by end 2024. The previous forecasts were 3.5%yr and 3.1% respectively.
- Some of the upgrade is due to base effects from the larger than expected outcome in March, 1.0%qtr vs. forecast of 0.8%qtr for both the CPI and the Trimmed Mean. However, we also note rising fuel prices, a jump in electricity prices as the various government energy rebates unwind (already seen in the Monthly CPI) and ongoing inflationary pressures in financial & insurance services.
- Our end 2024 forecast of 3.2%yr for the CPI and 3.5%yr for the Trimmed Mean are softer that the RBA revised end 2024 forecasts which are 3.8%yr for the CPI and 3.4% for the Trimmed Mean. Our CPI forecast is held back, in part, by the assumption of the return of energy rebates in the September quarter that are only partially unwound in the December quarter.
- Our assumption on the return of the rebates in the second half of 2024, when underlying electricity prices are flat or falling, means utilities fall –7.9% in the September quarter before lifting 5.5% in December and a further 4.1% in March 2025. This holds the increase in the September quarter CPI to just 0.6%.
- For 2025, flat to falling energy prices and moderating rent and dwelling price inflation (as the rate of population growth slows) will be key disinflationary forces while softer wages growth and a rising underemployment should see market services inflation moderate a little.
- By end 2025 our forecast for both the CPI and the Trimmed Mean are back within the band at 2.8%yr which match the RBA's forecasts.
- Despite the upside surprise in March, there were signs that services inflation is moderating. Markets services ex volatile inflation is down to 4.3%yr from 6.8% back in June 2023 with a two-quarter annualised pace of 3.9%yr (seasonally adjusted). We also note that the two quarter annualised pace of inflation for restaurants and take out food was 2.6%yr and 3.2%yr respectively (seasonally adjusted).

Inflation forecasts

		Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
CPI	Index	138.6	139.4	140.5	141.6	142.6
	(%qtr)	0.9	0.6	0.8	0.8	0.7
	(%yr)	3.7	3.0	3.2	3.1	2.9
Trimmed mean	(%qtr)	0.7	0.8	0.8	0.7	0.7
	(%yr)	3.7	3.4	3.5	3.2	3.2

CPI Mar 2024 actual and Jun 2024 forecast

	Mar 2024		Jun 2024 f/c	
Item	**% qtr**	**contrib**	**% qtr**	**contrib**
Food	0.9	0.16	0.6	0.11
of which, fruit & vegetables	2.5	0.05	2.2	0.04
Alcohol & tobacco	0.9	0.06	0.7	0.05
of which, Tobacco	1.2	0.03	0.7	0.02
Clothing & footwear	-1.1	-0.04	0.2	0.01
Housing	0.7	0.16	2.0	0.43
of which, Rents	2.1	0.13	1.7	0.10
of which, House purchases	1.1	0.09	1.0	0.08
of which, Utilities	-1.4	-0.06	5.7	0.23
H/hold contents & services	-0.1	-0.01	1.0	0.08
Health	2.8	0.18	-0.2	-0.01
of which, Pharmaceuticals	7.1	0.07	-1.3	-0.01
Transportation	0.5	0.06	1.5	0.17
of which , car prices	1.0	0.03	-0.2	-0.01
of which, auto fuel	-1.0	-0.04	4.3	0.16
Communication	-0.3	-0.01	-0.7	-0.01
Recreation	-0.1	-0.01	-0.3	-0.03
of which, audio visual & comp.	1.6	0.03	0.2	0.00
of which, holiday travel	-2.0	-0.12	-0.8	-0.05
Education	5.9	0.26	0.0	0.00
Financial & insurance services	2.0	0.11	1.9	0.10
CPI: All groups	**1.0**	–	**0.9**	–
CPI: All groups % year	**3.6**	–	**3.7**	–

Sources: ABS, RBA, Westpac Banking Corporation.

Annual Inflation Jun 2024 and Dec 2024

	June 2024 f/c		Dec 2024 f/c	
Item	**% yr**	**contrib**	**% yr**	**contrib**
Food	2.7	0.46	2.7	0.47
of which, fruit & vegetables	-0.2	-0.01	0.9	0.02
Alcohol & tobacco	5.8	0.41	3.9	0.28
of which, Tobacco	10.6	0.24	7.5	0.17
Clothing & footwear	0.0	0.00	1.6	0.05
Housing	5.9	1.31	4.3	0.94
of which, Rents	6.8	0.43	6.6	0.41
of which, House purchases	4.9	0.41	4.0	0.33
of which, Utilities	8.5	0.36	1.9	0.05
H/hold contents & services	-0.9	-0.07	2.2	0.19
Health	4.0	0.26	3.0	0.19
of which, Pharmaceuticals	2.8	0.02	2.8	0.02
Transportation	5.1	0.59	0.8	0.10
of which , car prices	0.8	0.03	2.0	0.06
of which, auto fuel	10.3	0.39	-3.8	-0.15
Communication	1.5	0.03	1.0	0.02
Recreation	0.1	0.02	2.8	0.35
of which, audio visual & comp.	1.2	0.02	2.1	0.04
of which, holiday travel	-2.7	-0.16	2.3	0.13
Education	5.4	0.24	5.9	0.26
Financial & insurance services	6.9	0.39	7.3	0.41
CPI: All groups	**3.7**	–	**3.2**	–

Sources: ABS, RBA, Westpac Banking Corporation.

Electricity rebates to have a bigger impact on headline CPI

The QLD Government announced a doubling of their energy rebates, so we have reviewed our electricity forecasts in the CPI. We don't have enough information to correctly estimate the impact of the state rebates on the CPI on a city-by-city basis. The rebates often have a complex structure, some states means test them while others do not, and we do not have access to the base power bills the ABS use. We can nonetheless use the ABS estimate of the impact of the rebates on Monthly CPI Indicator on a national level to build up an electricity price series incorporating the impact of potential rebates over the next 12 months as well as the changes announced in QLD.

For the underlying power bills, this year we have guidance from the Australian Energy Regulator that suggests for most residential customers, Default Market Offers could fall between 0.4% and 7.1% while the remaining residential customers may have increases between 0.9% and 2.7% depending on their region and whether they have controlled load.

From this, we made a simplifying assumption that power bills before rebates will fall an average 2.5% nationally. As we get further information, we will revise our forecasts. The Monthly CPI Indicator will provide critical updates here.

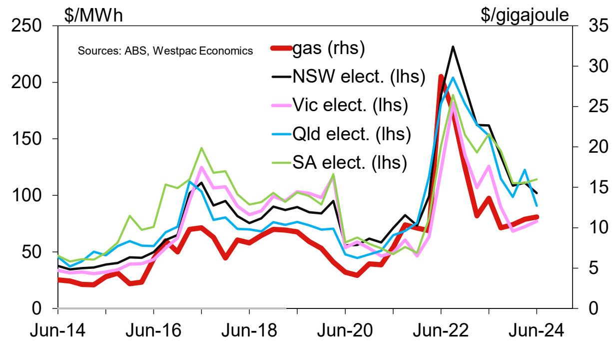
As noted above, the QLD Government announced a doubling of that state's power rebate from $500 to $1,000 (the rebates are not means tested in QLD). We estimate QLD's share of the 2023 rebate based on the ABS CPI weight. According to the ABS, Brisbane represents 9% of total electricity in the CPI. On this basis, Brisbane was responsible for –1.2ppt of the 13.6% fall in electricity prices due to the introduction of the rebates in July 2023. Note that electricity prices in the Monthly CPI rose 6.0% in July as the underlying bills rose 19.6% in the month before the rebates were applied.

Excluding QLD, if the state and the federal governments repeat the rebate programmes with QLD doubling their rebate the net impact in July 2024 will be –14.8ppt decline in electricity prices added to the –2.5% fall in the base bills. From there, we assume a similar profile for rebates seen in the last 12 months which will see prices rise from September closing the gap with base bills in the March quarter of 2025. Visually our electricity profile, both with and without rebates, is on the right and you can see that electricity rebates will be deflationary in the September quarter before turning inflationary Q4 2024 and Q1 2025.

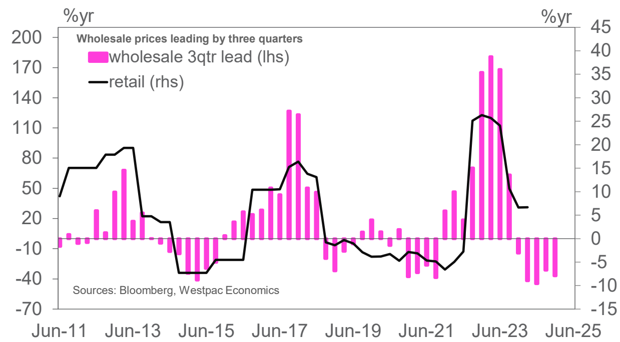
These assumptions will see electricity prices fall almost 17% in the September quarter subtracting –0.38ppt from the CPI before lifting 10% (+0.24ppt) in the December quarter and 8% (0.18ppt) in the March quarter of 2025 as the rebates roll of.

Of course, the rebates may not be implemented as we have assumed. The recent Victorian budget made no announcement in regards to an extension of their rebate programme. We will be closely watching the Federal budget next week and will adjust our forecasts where necessary.

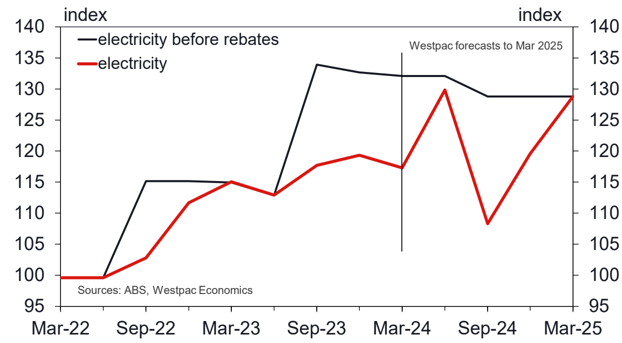
Wholesale gas vs. electricity futures



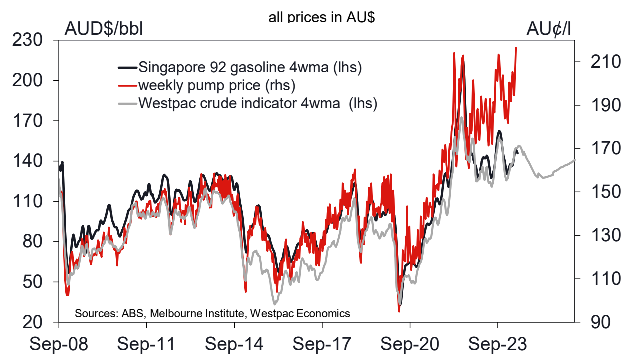
Sydney electricity prices



Rebates to have a bigger net impact in 2024



Australian premium to Singapore gasoline



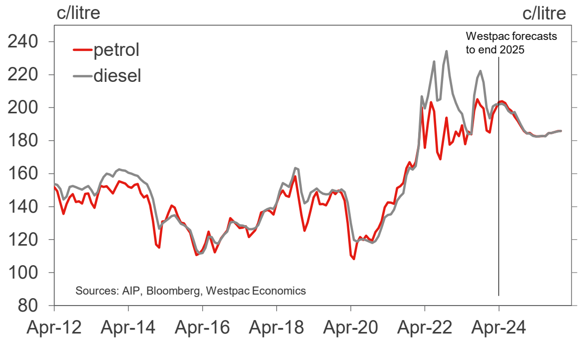
Key fuel price indicators

		Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
AUD/USD	(index)	0.66	0.69	0.70	0.71	0.72
AUD/USD %yr	(%yr)	-1.0	4.7	7.0	7.4	8.2
Brent	US$/bbl	89	87	82	79	79
Brent	(%yr)	15.1	1.6	-0.7	-3.2	-11.3

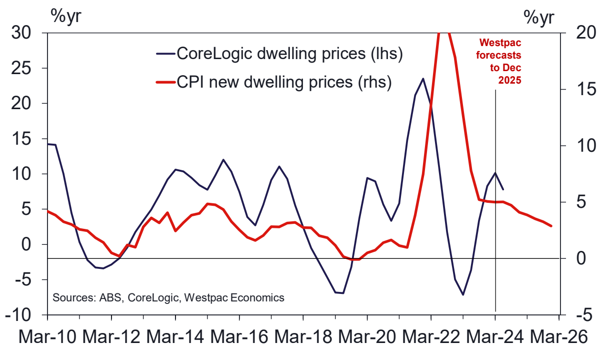
Auto fuel boosting the June forecast

Rising crude oil prices and a weak Australian dollar have boosted fuel pump prices in Australia. The decline in global diesel prices did take out some of the sting, but not by enough to prevent our forecast 4.3% rise in auto fuel in the June quarter (0.16ppt contribution). From there we expect a combination of weaker global crude oil prices, down from around US$90/bbl in June quarter to US$82/bbl in the December quarter, and a stronger Australian dollar will see fuel prices falling from late 2024 and into the first half of 2025.

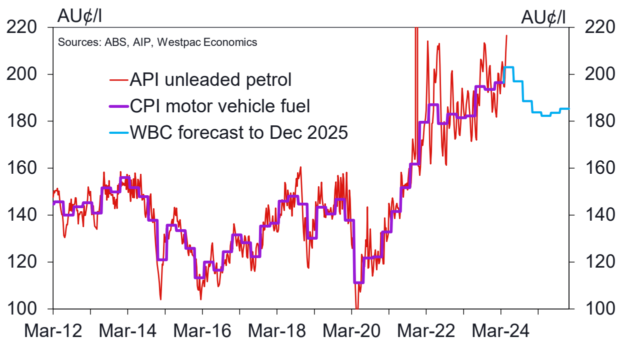
Australian fuels pump prices



House prices vs CPI new dwelling prices



Weekly bowser price & CPI auto fuel

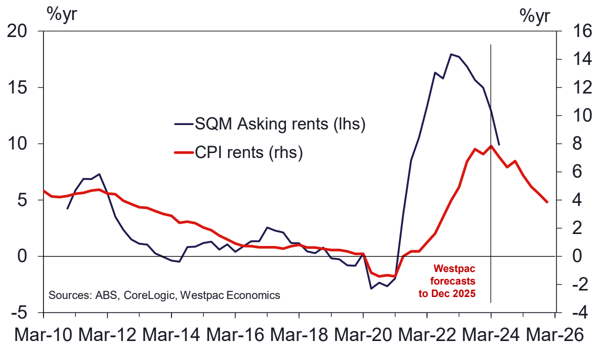


Housing inflation to peak in 2024

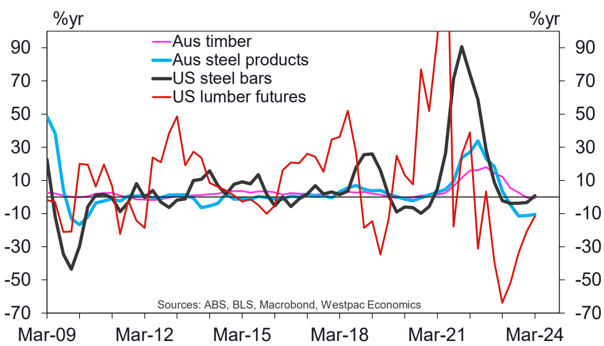
Outside of policy induced volatility in electricity prices, housing is set to remain a source of domestic inflationary pressure. As the boost from the COVID Home Builder grants faded, new dwelling price inflation eased back from more than 30%yr to around 5%yr. We are expecting new dwelling price inflation to continue to moderate from here but while we have seen a moderation in construction inputs inflation input prices remain elevated keeping margins tight as so any moderation dwelling prices will be slow.

We are already seeing the seeds being sown for a moderation in rental inflation. As working age population growth peaked in the September quarter of 2023, the rate of growth in asking rents slowed. We expect the annual pace of working age population growth to be closer to the pre-COVID trend of around 1.7%yr by the first half of 2026 and this should further help to moderate rent inflation.

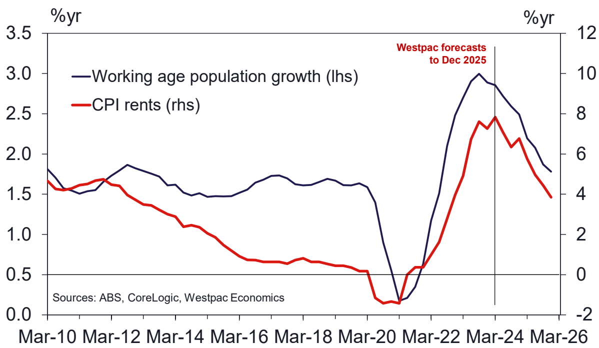
Asking rents vs CPI rents



Construction inputs in Aust. dollars



Population growth vs CPI rents



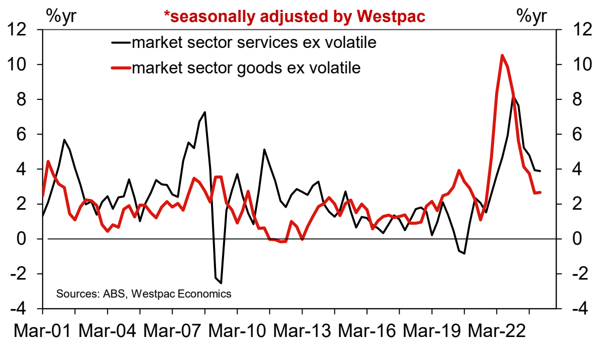
Market services inflation has peaked but remains sticky

Market services excluding "volatile items" inflation peaked at 6.8%yr in March 2023 then moderated to 4.5%yr by December 2023 before slowing further to 4.3%yr to in March 2024. We also highlight that the two-quarter annualised pace in March was 3.9%yr (seasonally adjusted), well down from the peak of 82%yr in December 2022. We also note that the two quarter annualise pace of inflation for restaurants and take out food was 2.6%yr and 3.2%yr respectively (seasonally adjusted).

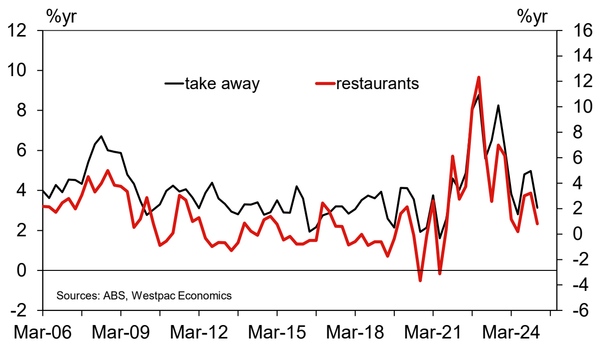
Our current forecasts have market services excluding "volatile items" inflation slowing to 4.0%yr in the June quarter from where we expect it to be sticky around 4%. Given our forecasts for a moderation in wage inflation plus improving productivity, we expect the pace of growth in unit labour costs to slow to a bit more than 2%yr by June 2025. Given that market services inflation has generally runs a touch faster than unit labour costs inflation, we feel our forecasts are a logical central tendency.

However, given the cost-of-living pressures on households and restricted growth in per capita spending, as well as wage inflation moderating to around 3%yr by end 2025, we do see possible downside risks to this forecast.

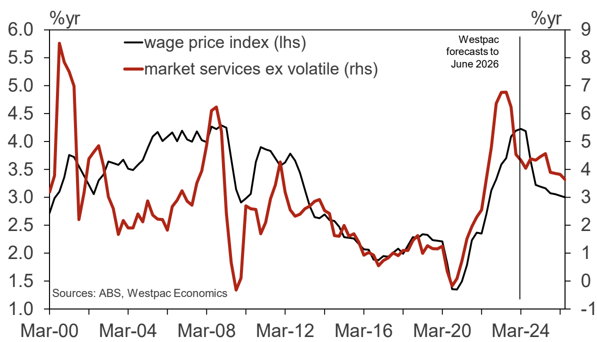
Two quarter annualised inflation*



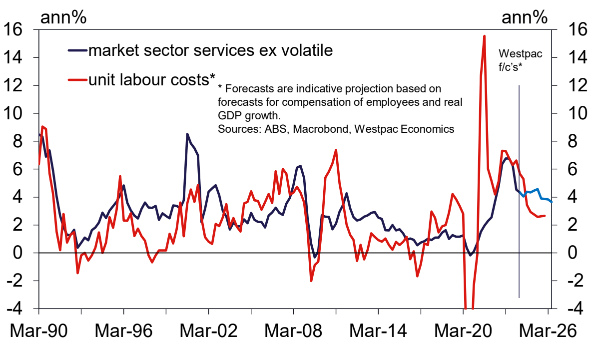
Two quarter annualised inflation



Wages and market services inflation



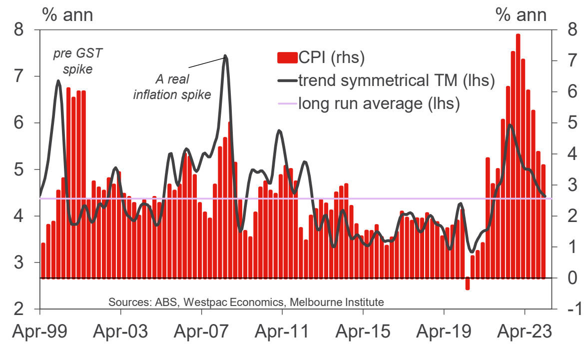
Unit labour costs vs services inflation



Inflationary expectations have eased but still elevated

The trend in the Melbourne Institute symmetrical inflationary expectations has moderated from a peak of 6.0%yr in July 2022 but at 4.4%yr in April they are only just back to the long run average. As such, expectations are still a touch higher than the pre-COVID average of 3.7%yr (2015 to 2019). So while inflation-ary expectations do not pose a risk, given they remain higher than the pre-COVID period they will remain on the RBA's radar.

MI symmetrical trend expectations



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April Monthly CPI will see a fuel and electricity boost

Our preliminary forecast for the April Monthly CPI Indicator is 0.7%mth/3.5%yr. Driving this forecast is a solid lift in auto fuel while electricity prices are set to rise as the various government rebates roll off. Electricity price rose 4.8% in March as the rebates started to expire. The ABS estimates that the gap between the base power bills and electricity prices as reported in the Monthly CPI Indicator was 9.4% in March. We expect this gap to close by June. Adding to the rise in the Monthly Indicator will be a solid gain in holiday travel & accommodation.

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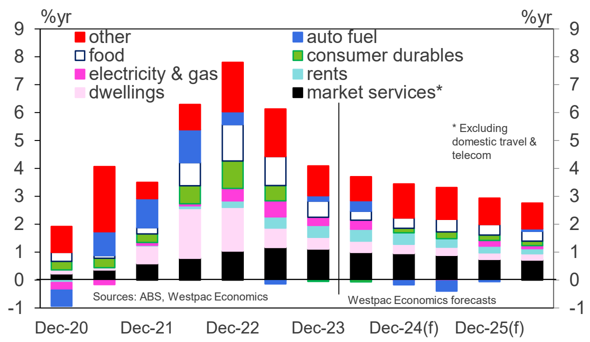
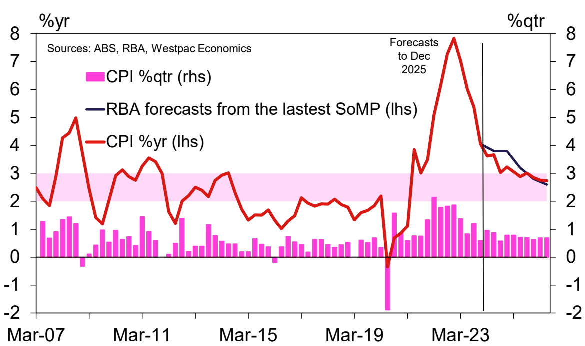
Monthly CPI Indicator & Apr forecasts (%yr)

Item	Jan Mth % yr	Feb Mth % yr	Mar Mth % yr	Apr fcs Mth % yr
Food	**4.4**	**3.6**	**3.5**	**3.4**
of which, bread & cereals	7.4	7.0	7.3	5.9
of which, meat & seafood	-2.0	-2.0	-0.9	-1.0
of which, dairy & related prod.	5.0	4.2	2.9	3.1
of which, fruit & vegetables	1.6	-0.5	-1.2	0.3
of which, food products nec	6.9	4.9	4.0	3.5
of which, non-alcohol bev.	5.7	4.9	5.5	3.1
Alcohol & tobacco	**6.7**	**6.1**	**6.1**	**6.1**
of which, Alcohol	4.5	3.6	2.7	3.0
of which, Tobacco	10.7	10.7	12.4	11.9
Clothing & footwear	**0.4**	**0.8**	**0.3**	**-1.7**
of which, garments	1.9	2.3	1.7	-1.6
Housing	**4.6**	**4.6**	**5.2**	**5.8**
of which, Rents	7.4	7.6	7.7	7.7
of which, House purchases	4.8	4.9	5.1	5.1
of which, Electricity	0.8	0.3	5.2	11.5
of which, Gas & other fuels	-1.4	-2.4	-2.9	-3.4
H/hold contents & services	**0.3**	**-0.3**	**0.1**	**-0.7**
Health	**3.9**	**3.9**	**4.1**	**4.0**
Transportation	**3.0**	**3.4**	**4.5**	**4.1**
of which, auto fuel	3.1	4.1	8.1	6.8
Communication	**2.0**	**1.7**	**1.6**	**2.0**
Recreation	**-1.7**	**0.4**	**-0.6**	**-0.2**
of which, holiday travel	-7.1	-1.3	-3.9	-3.2
Education	**4.7**	**5.1**	**5.2**	**5.2**
Financial & insurance services	**8.2**	**8.4**	**8.2**	**8.2**
CPI: All groups %qtr/%mth	***3.4***	***3.4***	***3.5***	***3.5***

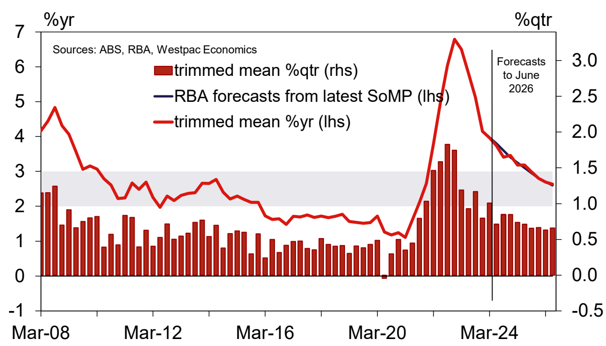
Contributions to annual inflation



Westpac vs. RBA CPI forecasts



Westpac vs. RBA core inflation forecasts



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