26 August 2024

PRICES & WAGES DEEPER INSIGHTS

Rebates increase price volatility while wages key to core inflation

Key points

- Rebates set to drive inflation to below the mid-point of the RBA's 2-3% inflation target band.
- We have a softer headline inflation forecast than the RBA for both end 2024 and June 2025. We suspect this is due to a larger assessed impact of cost-of-living measures as well as falling auto fuel prices.
- The RBA will focus on core inflation as it will exclude most of the impact of cost-of-living assistance as well as the usual volatility.
- Our Trimmed Mean forecasts are very similar to the RBA's.
- For the July Monthly CPI indicator our near-cast is -0.2%mth/3.4%yr on the back of a large fall in electricity prices (cost-of-living rebates) and falling auto fuel. The July month will be set the base for the September quarter CPI.
- Wages growth has already tipped over and with a recovery in productivity, we don't see labour costs as a threat to inflation.

Breakdown of CPI: Jun actual, Sep forecast

	Jun 2024		Sep 2024 fcs	
Item	**% qtr**	**contrib**	**% qtr**	**contrib**
Food	**1.2**	**0.21**	**0.7**	**0.11**
of which, Fruit & vegetables	6.3	0.13	0.6	0.01
Alcohol & tobacco	**1.5**	**0.10**	**0.9**	**0.07**
of which, Tobacco	3.0	0.07	1.4	0.03
Clothing & footwear	**3.1**	**0.10**	**0.2**	**0.01**
Housing	**1.1**	**0.25**	**-0.4**	**-0.09**
of which, Rents	2.0	0.12	2.0	0.12
of which, House purchases	1.1	0.09	1.6	0.13
of which, Utilities	0.8	0.03	-10.0	-0.41
H/hold contents & services	**0.8**	**0.07**	**1.1**	**0.09**
Health	**1.5**	**0.10**	**0.5**	**0.03**
of which, Pharmaceuticals	-0.6	-0.01	-1.1	-0.01
Transportation	**0.9**	**0.10**	**-1.7**	**-0.19**
of which, Car prices	-0.3	-0.01	0.1	0.00
of which, Auto fuel	1.7	0.06	-6.4	-0.24
Communication	**-0.8**	**-0.02**	**0.9**	**0.02**
Recreation	**0.5**	**0.06**	**1.2**	**0.14**
of which, Audio visual & comp.	1.0	0.02	-0.3	0.00
of which, Holiday travel	0.9	0.05	1.0	0.06
Education	**0.2**	**0.01**	**0.0**	**0.00**
Financial & insurance services	**1.2**	**0.07**	**1.4**	**0.07**
CPI: All groups	**1.0**	**-**	**0.2**	**-**
CPI: All groups % year	**3.8**	**-**	**2.8**	**-**

Sources: ABS, RBA, Westpac Banking Corporation

Wages are not a threat to the inflation outlook

Justin Smirk
Senior Economist

June quarter CPI as expected

The CPI gained 1.0% in the June quarter, exactly what the markets and Westpac had been expecting. The annual pace lifted a touch from 3.6%yr to 3.8. It was 4.1%yr in December 2023.

The Trimmed Mean printed 0.8% in the quarter for an annual pace of 3.9%yr. The market was looking for a 1.0% increase while Westpac was expecting 0.9%qtr, the core inflation result undershooting both (for note, the Trimmed Mean printed 0.84% to two decimal places while our forecast was 0.94%).

RBA incorporates cost of living assistance

The RBA was forecasting both the CPI and the Trimmed Mean to be 3.8%yr in the June quarter so the result was as expected for the RBA in terms of headline inflation but a touch stronger in terms of core inflation.

However, as our Chief Economist Luci Ellis noted in her weekly note "Skating to where the puck used to be" the June quarter Trimmed Mean print of 3.9%yr was a net zero surprise compared to the RBA's November 2023 Statement on Monetary Policy (SoMP) forecast (see Chart 1). So more recently, inflation has been unfolding broadly as the RBA had been expecting.

Post the CPI, the RBA released revised forecasts in their August SoMP. When their previous forecasts were released the RBA did not have the details of the cost of living assistance from either the Commonwealth or various state government and, as such, could not include them in their forecasts. Westpac had the advantage of being able to speculate on what possible assistance would be included in the May budget and so had included an estimate of the impact of such assistance. As such, it is not surprising the RBA had to lower the December 2024 CPI estimate by 0.8ppt to 3.0%yr and the June 2025 forecast by 0.4ppt to 2.8%yr.

The RBA did, however, lift its Trimmed Mean forecast for December by 0.1ppt to 3.5%yr while holding the June 2025 forecast flat at 3.1%yr.

Westpac sees softer headline inflation...

When you combine the impact of the cost of living assistance with the current decline in auto fuel prices, Westpac is forecasting the headline CPI rate of inflation to ease back to 2.6%yr by December 2024 and then to a low of 2.3%yr in June 2025.

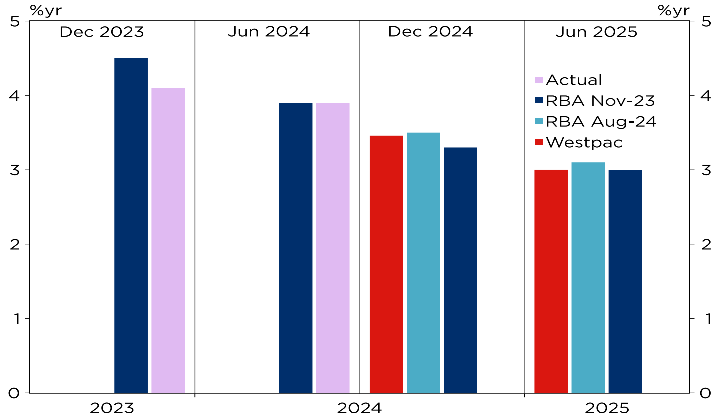
While we cannot be sure of the exact difference between the RBA's forecast and our we can speculate two key possibilities.

The first possibility is that the RBA could have a more conservative view on the impact of the cost of living assistance measures and, in regards to electricity prices, be assuming no change in the underlying prices.

Westpac is forecasting electricity prices before rebates to be down 3% in the year to June 2025 with electricity bills with rebates some 23% lower in the year contributing -0.45ppts to the CPI.

Unlike the Commonwealth assistance, the $1,000 rebate in Queensland is given as a lump sum and so its impact fades as it is used by households. The Commonwealth assistance is a quarterly payment of $75 thus it holds down electricity prices to September 2025. When the rebates were applied in the year to June 2024 underlying electricity prices rose 14.6%yr so with rebates power bills gained a smaller 6.0% in the year to June.

1. RBA core inflation forecasts



Source: ABS, Macrobond, Westpac Economics

The second possible explanation is around auto fuel.

We know that the RBA holds crude oil prices at prevailing levels when it compiles its forecasts so it does not have an undue impact on the inflation path.

Westpac is forecasting Brent to average US$76/bbl in the December 2024 quarter, down from US$84/bbl in the June quarter and while it is expected to firm from there it is still only US$79/bbl by June 2025.

On this basis auto fuels are forecast to be down 13% in the year to December 2024 and in June 2025. At June 2025 auto fuel will make a -0.44ppt contribution to the annual pace of the CPI.

Westpac & RBA very close on the Trimmed Mean

Westpac is forecasting the Trimmed Mean to print 3.4%yr at December 2024, on par with the RBA's forecast, then moderating to 3.0%yr at June 2025, just a touch softer than the RBA's forecast of 3.1%. So despite differences in our headline forecasts our core inflation forecast are very similar.

This suggests that the RBA and ourselves would have very similar market services ex volatile forecasts. This domestic inflation measure peaked at 6.8%yr in June 2023 then moderated to 4.1%yr by June 2024. From there we expect this series to broadly track sideways around a 4.5%yr pace through to June 2025.

We use nominal unit labour costs as a broad guide for market services inflation so it has been a little surprising to see market services inflation moderate somewhat faster than unit labour cost inflation. This could be part of the reason why the RBA is still concerned about potential near term upside risks to core inflation from relatively robust growth in unit labour costs.

In addition, given our current activity estimate for Q2, the recent strength in hours worked is pointing to a very weak update on productivity and thus another strong gain in unit labour costs. Based on our current wage, labour market and GDP near-casts we estimate a 1.3%qtr gain in unit labour costs in the June quarter. While this is a robust update, with the 1.7%qtr print from June 2023 rolling out, the annual pace still slows to 5.4%yr from 5.8%yr.

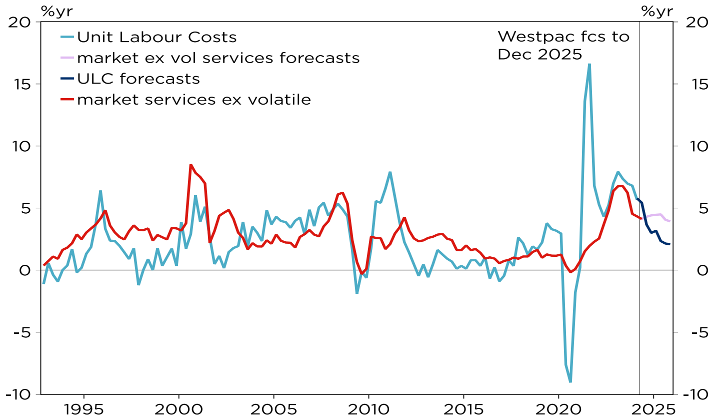
By December 2024 growth in unit labour costs is forecast to slow to 3.0%yr and be down to 2.3%yr by June 2025. This moderation in unit labour cost inflation, if realised, would suggest some downside risk to our current 'market services ex volatile' inflation forecasts. The moderation in unit labour costs through the second half of the year is why we believe we won't see an acceleration in market services inflation and expect it to moderate as we move through 2025.

Rents remain an inflationary pressure

Rents are expected to remain a significant inflationary pressure, holding a pace of at least 7%yr through to June 2025 from where we expect the pace to ease back a touch to around 6%yr by December 2025. The pace of growth for asking rents has already tipped over but with ongoing robust population growth, and the fact the pace of growth in asking rents is still higher than the growth in average rents in the CPI, there is little reason to expect a near term moderation in rental inflation.

Rents growing at 7.6%yr in the year to December will contribute 0.48ppts to the annual pace of inflation while rents at 7.0%yr at June 2025 will contribute 0.45ppts to the annual pace.

2. Core domestic inflation & unit labour costs



Source: ABS, Macrobond, Westpac Economics

Breakdown Sep quarter & Jul Monthly Indicator

	Sep f/c	May	Jun	Jul f/c
	Qtr	Mth	Mth	Mth
Item	% qtr	% mth	% mth	% mth
Food	**0.7**	**0.5**	**-0.1**	**0.0**
of which, bread & cereals	0.2	0.1	-0.5	0.1
of which, meat & seafood	0.2	0.3	-0.6	0.2
of which, dairy & related prod.	1.8	-0.4	0.0	1.7
of which, fruit & vegetables	0.6	2.3	0.3	-1.3
of which, food products nec	0.2	-0.4	0.0	-0.1
of which, non-alcohol bev.	1.0	0.8	0.2	0.9
Alcohol & tobacco	**0.9**	**0.3**	**0.0**	**-0.1**
of which, alcohol	0.7	0.3	-0.1	-0.1
of which, tobacco	1.4	0.2	0.2	0.0
Clothing & footwear	**0.2**	**-1.5**	**-1.0**	**1.5**
of which, garments	-1.2	-2.4	-1.7	1.3
Housing	**-1.6**	**0.4**	**0.6**	**-1.0**
of which, rents	2.0	0.8	0.6	0.7
of which, house purchases	1.6	0.4	0.6	0.5
of which, electricity	-32.0	1.4	0.1	-14.0
of which, gas & other fuels	2.4	-2.5	2.7	0.8
H/hold contents & services	**1.1**	**0.0**	**0.1**	**0.5**
Health	**0.5**	**0.0**	**-0.5**	**0.0**
Transportation	**-1.7**	**-1.3**	**0.3**	**-0.7**
of which, auto fuel	-6.4	-5.1	1.2	-2.3
Communication	**0.9**	**-0.6**	**-0.8**	**0.6**
Recreation	**1.2**	**-1.3**	**3.4**	**0.1**
of which, holiday travel	1.0	-2.7	7.0	0.2
Education	**0.0**	**0.0**	**0.2**	**0.0**
Financial & insurance services	**1.4**	**0.7**	**0.5**	**0.0**
CPI: All groups	***-0.1***	***-0.1***	***0.5***	***-0.2***

Dwelling inflation to ease but remains a risk

New dwelling inflation has eased from the post-COVID surge of 20.7%yr, but has held up recently, running at 5.1%yr as at June 2024.

This is partly the result of the unwinding of government assistance for new home construction which had been suppressing dwelling prices in the CPI in the face of surging demand and rising cost of dwelling construction.

We are expecting the moderation to continue to 4.8%yr by December 2024 (contributing 0.39ppts to the annual pace) and then to 4.2%yr at June 2025 (contributing 0.34ppts to the annual pace).

The rate of growth in established homes prices has already rolled over, as has the cost of materials used in constructing new dwellings, suggesting the pressure on the cost of building new homes and dwelling prices in the CPI should also continue to ease from here.

However, we note the significant level of insolvencies in the construction sector and the ongoing demand pressure for housing from robust rates of immigration. As such, dwelling prices present an upside risk our inflation forecasts.

Monthly CPI Indicator set for a drop in July

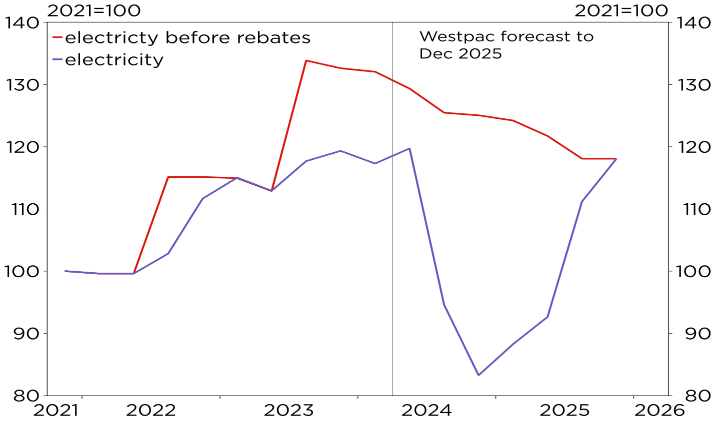
The Commonwealth and Western Australian governments' energy rebates do not became available until July 31st so they won't have an impact in the July Monthly CPI Indicator. However, as they are paid to energy distributors, and thus lower the electricity bills for households, they are set to have a significant impact on the CPI in August and September.

The Commonwealth is providing a $300 rebate that will be paid in $75 quarterly instalments. Western Australia is providing a further $400 but as two payments of $200 in the September quarter and again in the June quarter. The Queensland government is providing a $1,000 as a lump sum that will be paid from July 1.

Due to the rebates, Westpac is forecasting electricity prices to fall -14% in July. There is a lot of uncertainty in regards to how the rebates will impact on prices. We have been surprised by how enduring the previous rebates have been in holding down electricity prices (we expect to see this again as households in WA have to apply for the state rebates) but we do know it will be very significant.

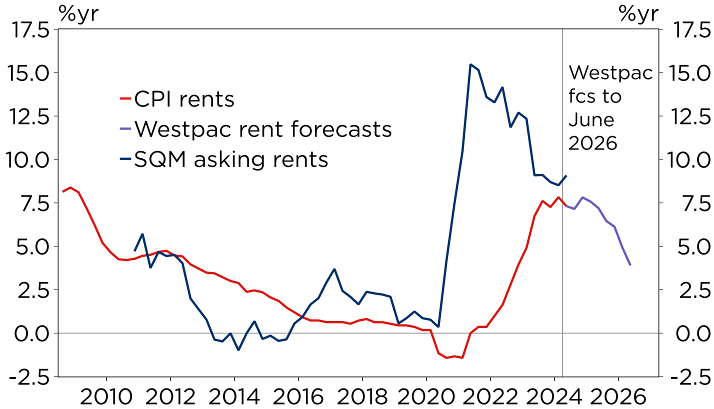
When combined with a -2.3%mth fall in auto fuel and flat food prices, Westpac is forecasting a -0.2%mth decline in the July Monthly CPI Indicator which will see the annual pace dip from 3.8%yr to 3.4%yr, the slowest pace since August 2021 (2.5%yr). A more detailed breakdown of our monthly July forecast, compared with the previous two months and Westpac's September quarter forecast is on the previous page. The table on the next page provides the same breakdown but on a through the year basis.

3. Electricity rebates a drag on the CPI



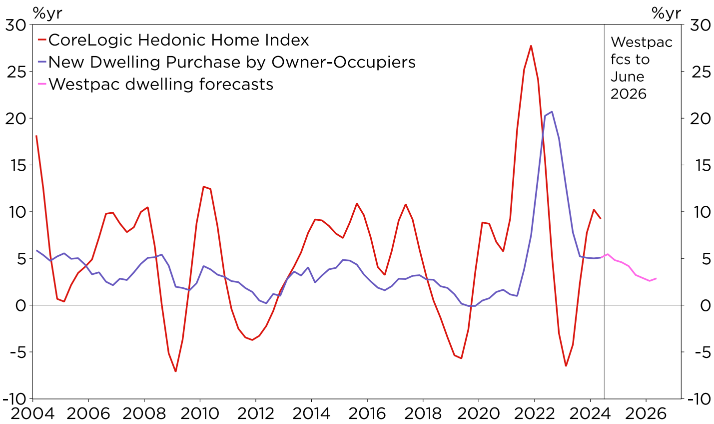
Source: , Macrobond, Westpac Economics

4. CPI rents vs asking rents



Source: ABS, SQM, Macrobond, Westpac Economics

5. CPI dwellings & CoreLogic home index



Source: CoreLogic Australia, ABS, Macrobond, Westpac Economics

“Wages are not a threat given just how tight the labour market is.”

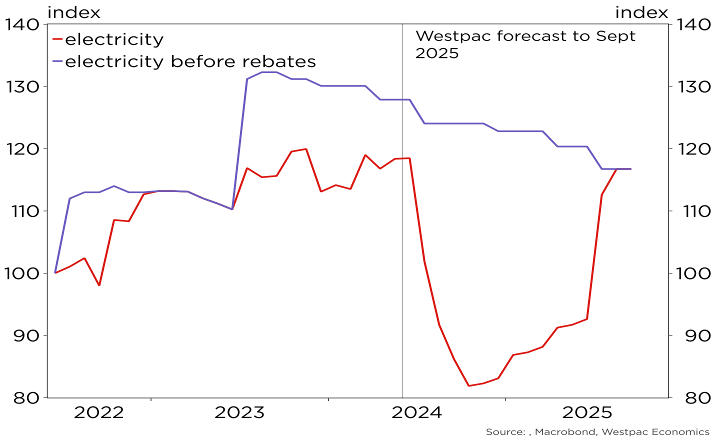
Wage inflation is already moderating

The Wage Price Index (WPI) rose 0.8% in the June quarter, on par with Westpac’s forecast of a 0.8% and weaker than market consensus of 0.9%. On an annual basis, wages held flat at 4.1%yr due to changes in seasonality but are still down from the peak of 4.2%yr in December. Wage inflation has moderated in the first half of the year with the six-month annualised pace dipping from 4.7%yr in December to 3.4%yr in June.

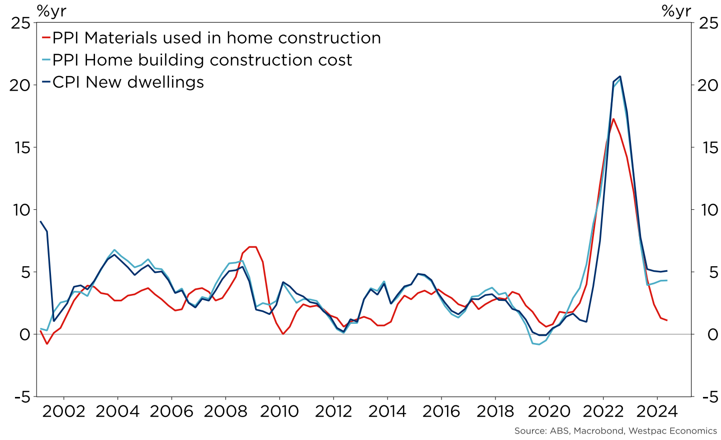
It is true that public sector had stronger wage gains, a 0.9% lift in the June quarter, up from the 0.6% gain in March 2024. The ABS did highlight that all Australian Public Service employees received pay increases effective 14 March 2024. This led to a larger increase in the contribution Commonwealth jobs made to public sector wage growth as these jobs had previously been reporting wage rises across multiple quarters, reflecting the timing of individual agency agreements. Overall, the annual pace of public sector wages growth has moderated from 4.2%yr in December 2023 to 3.8%yr in March 2024 with a slight tick up to 3.9%yr in June.

Private sector wages, which have a more significant share of the wages bill so have a much higher weight in the WPI, rose 0.7% in June 2024, representing an ongoing moderation in quarterly gains from September 2023 (1.4%), December 2023 (1.0%) and March 2024 (0.9%). It is notable that private sector wages growth has also moved off its peak and that trend moderation continues.

7. Rebates to fade as lump sums used



6. Dwelling construction costs



Breakdown Sep quarter & Jul Monthly Indicator

	Sep f/c	May	Jun	Jul f/c
	Qtr	Mth	Mth	Mth
Item	% yr	% yr	% yr	% yr
Food	**3.4**	**3.3**	**3.3**	**3.5**
of which, bread & cereals	2.4	3.4	3.4	3.5
of which, meat & seafood	-0.4	-0.6	-0.2	-0.6
of which, dairy & related prod.	1.9	2.4	1.6	1.5
of which, fruit & vegetables	8.2	4.4	3.6	5.3
of which, food products nec	4.0	4.0	3.7	3.8
of which, non-alcohol bev.	6.0	3.8	6.1	6.1
Alcohol & tobacco	**6.2**	**6.7**	**6.9**	**6.8**
of which, alcohol	2.7	3.4	3.4	3.1
of which, tobacco	13.1	13.4	13.8	13.8
Clothing & footwear	**2.7**	**2.8**	**3.6**	**2.6**
of which, garments	2.8	2.9	4.4	3.0
Housing	**1.3**	**5.2**	**5.5**	**3.1**
of which, rents	7.2	7.4	7.1	7.1
of which, house purchases	5.5	4.9	5.4	5.2
of which, electricity	-30.8	6.5	7.5	-12.8
of which, gas & other fuels	-1.7	-3.9	-0.6	-2.1
H/hold contents & services	**0.9**	**-1.1**	**-1.1**	**-0.7**
Health	**5.4**	**6.1**	**5.3**	**5.4**
Transportation	**-0.5**	**4.9**	**4.2**	**3.5**
of which, auto fuel	-5.9	9.3	6.6	4.4
Communication	**0.3**	**0.7**	**1.0**	**0.8**
Recreation	**1.9**	**2.0**	**0.6**	**2.3**
of which, holiday travel	1.0	2.9	-0.7	2.9
Education	**6.0**	**5.2**	**5.6**	**5.6**
Financial & insurance services	**6.4**	**7.8**	**6.4**	**6.5**
CPI: All groups	***2.4***	***4.0***	***3.8***	***3.4***

Individual Arrangements wages already moderating

We can look deeper into wage bargaining dynamics as the ABS helpfully provides (in non-seasonally adjusted terms) the contributions to the quarterly increase in the WPI from Awards, Enterprise Bargaining and Individual Arrangements. Comparing June 2023 to June 2024, the contribution from Enterprise Bargaining continues to moderate in line with the dynamics in the public sector outlined above, but just not as quickly they did in March (0.35ppts vs. 0.32ppts). Individual Arrangements were flat compared to June 2023 (0.22ppts to 0.23ppts). Just about all the Awards/Minimum Wage Increases are applied in September, so they have a minimal impact in any other quarter.

Westpac estimates Individual Arrangements wage inflation eased from around 4.2%yr at June 2023 to 3.9%yr in June 2024. This moderation in wage inflation, from the wage bargaining stream that is most sensitive to the dynamics of the labour market, gives us confidence that we have seen the peak in wages inflation and that it will continue to moderate as the underemployment rate drifts higher and employment growth softens.

2024 minimum wage increase, smallest in 3 years

There is significant seasonality in Australia wages with the largest share of jobs getting a pay rise in the September quarter, the start of the Australian financial year. Boosting this seasonality is the fact the increase in the minimum wage/award wage, outside the COVID period when increase were distributed through the year by industry awards, are also generally paid in the September quarter.

In Chart 9 you can see the significant impact that the increase in the Federal Minimum Wage has on both the size of the wage incresae and the share of workers getting a pay rise in the September quarter. From a low of 1.75% in 2020 the minimum wage was increased by 2.5% in 2021, 4.7% in 2022, 5.9% in 2023 then by the smallest increase in three years in 2024 at 3.75%.

Enterprise bargaining not a risk

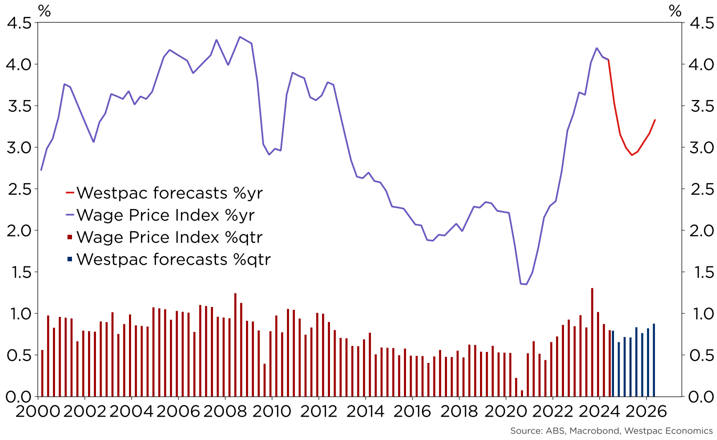
The average annual wage increase for new approved agreements peaked at 4.4% in the December quarter of 2023 then moderated to 3.9% in the first quarter of 2024. We are surprised that given just how tight the labour market has been that we have not seen a larger gain in wage increases through 2023. And since late 2024 we have seen a further moderation in Enterprise Bargaining Wage outcomes as the weekly new approvals average wage increases continues to trend down suggesting we are past the peak and we should not be expecting to see a pick up in wage rises from this wage negotiation stream through 2024.

Inflation forecasts

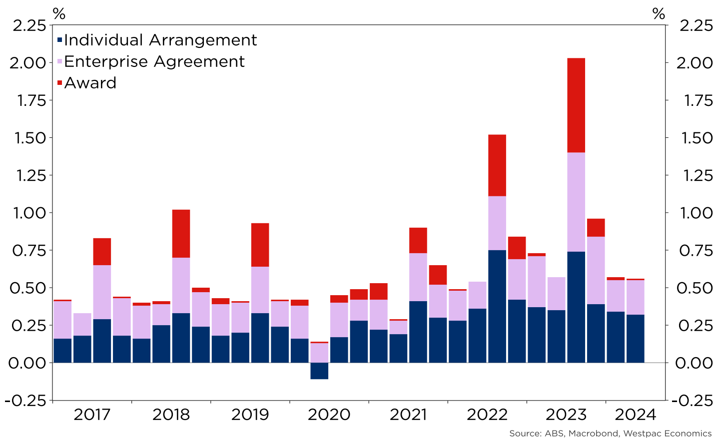
		Sep-24	Dec-24	Mar-25	Jun-25
CPI	Index	138.6	139.7	140.7	142.0
	(%qtr)	-0.1	0.8	0.7	0.9
	(%yr)	2.4	2.6	2.4	2.3
Trimmed mean	(%qtr)	0.8	0.7	0.7	0.7
	(%yr)	3.5	3.5	3.1	3.0
	(6mth ann)	3.3	3.0	2.9	3.0

Source: ABS, Westpac Economics.

8. Wages have already moderated...



9. ...as Individual Arrangements ease.



Strongest wages growth in administered sectors

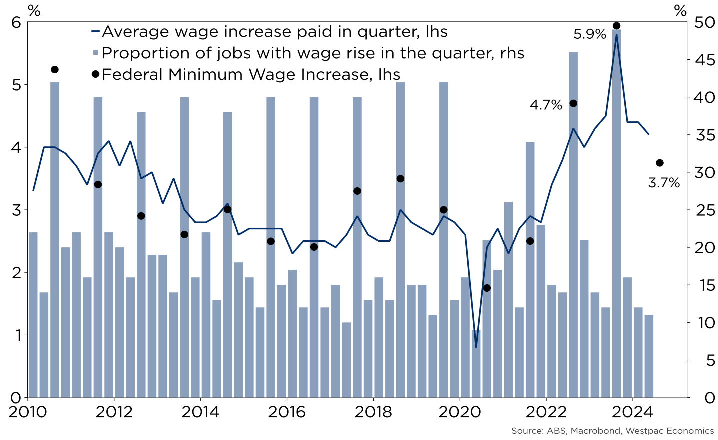
Seen in Chart 12, the largest wage rises are found in the administered industries (those industries were prices are set by government administration) which are currently running around a 4.5%yr pace. By contrast services wages are growing around a 3.5%yr pace while the remainder (tradeable industries and construction) are a running at just under a 4%yr pace. Again we are seeing those sectors most responsive to labour market dynamics revealing a moderation in wage inflation.

Wage inflation forecast to fall to 3.2%yr

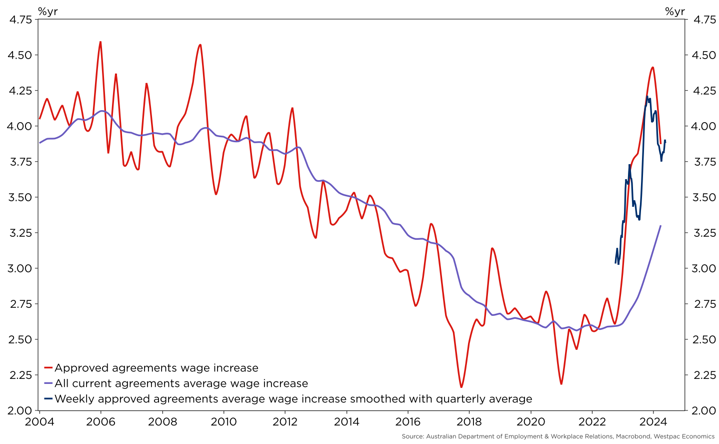
The significantly smaller increase in the minimum wage, along with the moderation in wages negotiated by Individual Arrangements and the surprisingly modest wage gains from Enterprise Bargaining are behind our forecast for a much smaller average wage increase to those who get a wage rise this September. Those that received a pay rise last September were paid a 5.8% increase. Overall we are forecasting a seasonally adjusted average increase of 0.8% with the annual pace dipping to 3.5%yr. This is followed by a 0.7% increase in the December taking the annual pace down to 3.2%yr.

The RBA are forecasting a 3.6%yr pace at end 2024 which would be consistent with a 1.0% rise in September and a 0.9% increase in December. We find it hard to reconcile the RBA's WPI profile with the labour market dynamics outlined above which is pointing to a peak in wage inflation as the labour market softens from me. There is some meaningful wage pressures in the construction sector due to a shortage in labour but elsewhere it is getting easier to find labour and wage pressures are easing.

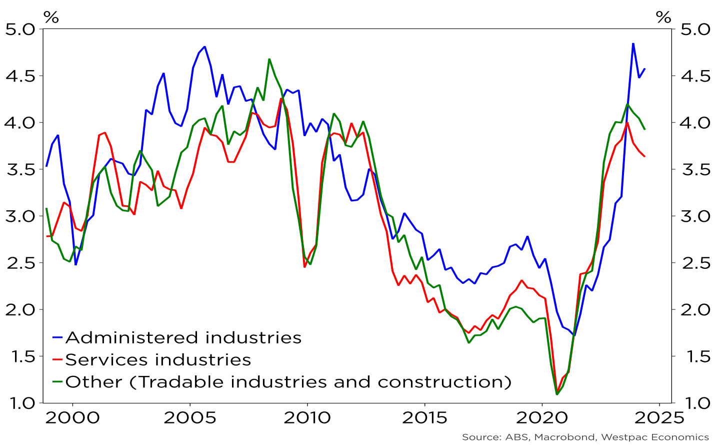
10. Private wage increase & share of jobs



11. Enterprise bargaining wages have peaked



12. Wage pressure in administered industries



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