7 May 2025

INFLATION DEEPER INSIGHTS

Inflation will be volatile but core remains within the band

Key points

- At 2.4% per year, the March quarter headline rate of inflation remained in the lower half of the RBA's target band.
- However, this is unlikely to last. The cost-of-living measures that have been suppressing inflation are expiring and are expected to push inflation back above 3% per year by the end of 2025.
- These cost-of-living measures do not significantly impact the Trimmed Mean, so easing into the target band at 2.9% per year is a genuine sign of moderating inflationary pressures.
- More importantly, momentum in core inflation, measured by the two-quarter annualised pace, has decreased to 2.5% per year (2.45% per year to two decimal places), suggesting core inflation is set to decline further.
- The moderation in housing inflation is crucial to this trend, but March also saw a decrease in market services excluding volatile prices.

Breakdown: June Quarter CPI & Apr Monthly CPI

	Jun f/c	Feb	Mar	Apr f/c
	Qtr	Mth	Mth	Mth
Item	% qtr	% mth	% mth	% mth
Food	**1.0**	**0.0**	**0.5**	**0.3**
of which, bread & cereals	0.0	-1.2	0.8	-0.2
of which, meat & seafood	0.5	0.0	0.3	0.3
of which, dairy & related prod.	0.5	-0.7	1.0	0.1
of which, fruit & vegetables	4.8	-0.5	2.7	2.2
of which, food products nec	-0.4	-1.3	0.2	0.2
of which, non–alcohol bev.	1.6	2.1	0.9	-0.2
Alcohol & tobacco	**1.2**	**0.9**	**0.7**	**0.2**
of which, alcohol	0.5	1.0	0.4	-0.1
of which, tobacco	2.4	0.6	1.4	1.0
Clothing & footwear	**1.5**	**1.6**	**-1.4**	**2.5**
of which, garments	1.0	2.8	-2.4	2.6
Housing	**0.9**	**-0.1**	**0.9**	**-0.1**
of which, rents	1.1	0.5	0.3	0.3
of which, house purchases	-0.1	-0.1	-0.1	-0.1
of which, electricity	6.4	-2.5	9.2	-2.0
of which, gas & other fuels	-0.9	0.2	-0.2	-0.1
H/hold contents & services	**0.8**	**0.1**	**0.3**	**0.6**
Health	**1.2**	**0.0**	**2.9**	**0.0**
Transportation	**-1.0**	**0.8**	**-0.2**	**-0.5**
of which, auto fuel	-4.0	1.2	-0.7	-1.9
Communication	**-0.3**	**0.9**	**-0.2**	**-0.2**
Recreation	**1.9**	**-3.6**	**0.9**	**2.0**
of which, holiday travel	4.0	-7.6	1.7	4.3
Education	**0.0**	**5.1**	**0.1**	**0.0**
Financial & insurance services	**0.7**	**0.2**	**0.5**	**0.0**
CPI: All groups	***0.8***	***0.0***	***0.6***	***0.3***

Sources: ABS, Westpac Banking Corporation

"Domestic inflationary pressures continue to ease, holding core inflation within the target band"

Headline inflation bounces as energy rebate expire

Justin Smirk
Senior Economist

Headline inflation to bounce but core remains within the band

Westpac is forecasting the CPI to increase by 0.8% in each of the next three quarters to June 2025. This will see the annual pace ease back to 2.2%yr in June before accelerating 2.8%yr in September then peaking at 3.4%yr in December. As outlined below, the key reason for this kick up in inflation is the unwinding of the cost-of-living assistance measures and so reverse from being brake on inflation to being an accelerate. This will, again, be a temporary effect as we see headline inflation back down to around the mid point of the target band by mid 2027.

The Trimmed Mean, the preferred measure of core inflation, is not impacted by the cost-of-living measures in any material way as the largest 15% of positive and negative price changes are trimmed out. Trimmed Mean inflation is forecast to remain in the upper half of the RBA's target bank though the rest of 2025, finishing at 2.8%yr in December after hitting a low of 2.6%yr in September. As noted below, the moderation in market services and housing inflation is holding down core inflationary pressures.

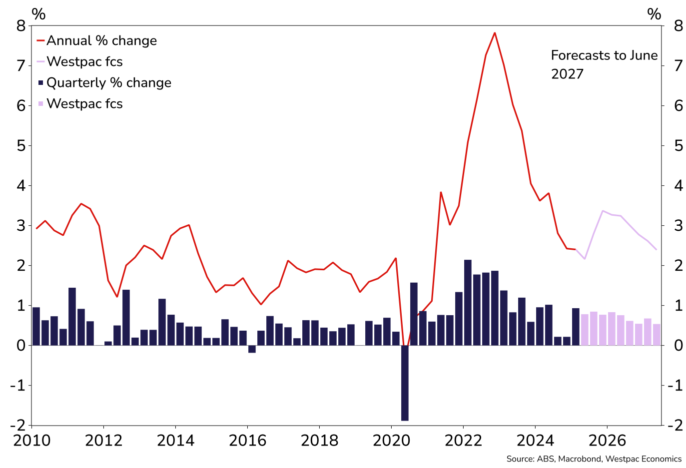
Market services inflation continues to moderate

The Market Services excluding volatile (MSxV) measure of inflation is our preferred measure of domestic inflationary pressures as it has a closer relationship with wages and productivity as measured by unit labour costs. This inflation measure includes:

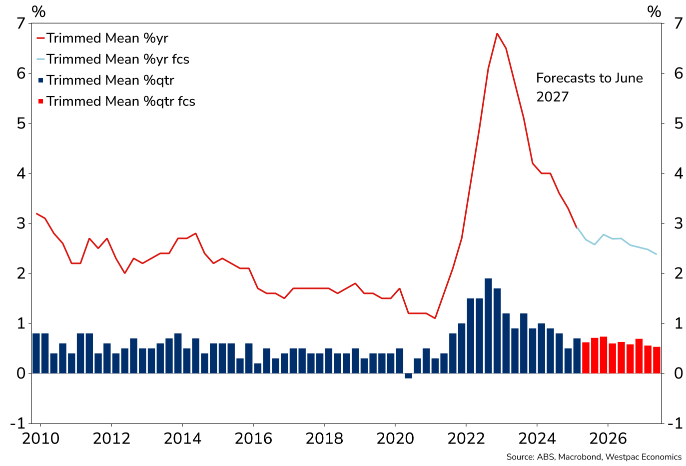
- restaurant meals,
- cleaning, repairs & hire of clothing & footwear,
- rents,
- maintenance & repair of dwelling,
- maintenance & repair of motor vehicles,
- hairdressing & personal grooming services,
- other household services,
- telecommunication equipment & services,
- domestic holiday travel & accommodation and international holiday travel & accommodation,
- veterinary and other services for pets,
- sports participation,
- other recreational, cultural & sporting services, and
- insurance, deposit & loan facilities and other financial services.

MSxV surprised us by declining by –0.1% in the March quarter, the first decline in this series since June 2020, taking the annual pace down from 4.2%yr to 3.3%yr, the slowest pace of MSxV inflation since March 2022. Even more eye catching is that the six month annualised momentum is now down to

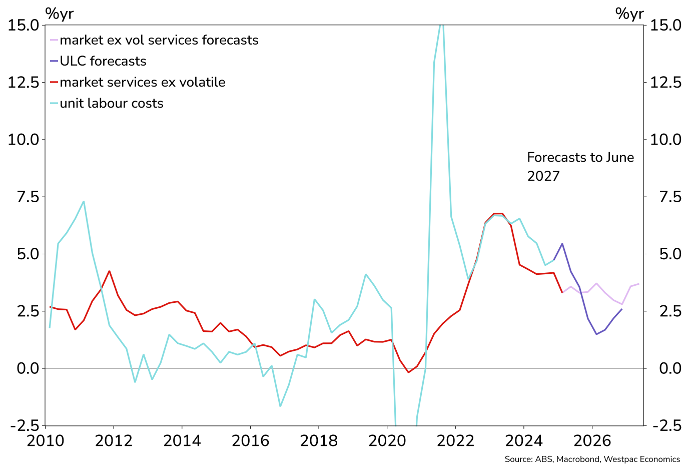
Headline CPI Inflation



Trimmed Mean or core inflation



Domestic inflation & Unit Labour Costs



2.0%yr, at the bottom of the RBA's target band. This outcome is consistent with the under performance of wages observed through 2024 given just how tight the labour market.

With wage inflation expected to continue to moderate through 2025, and productivity expected to improve, the moderation in unit labour cost inflation should continue to hold down MSxV inflation. Westpac is forecasting MSxV inflation to hold under 4%yr through 2025 before dropping down to around the mid point of the target band in 2026.

Moderating housing dragging down core inflation

Housing inflation moderated significantly from 10.7%yr at December 2022 to just 1%yr by March 2025. For sure, energy rebates have played an important role in helping to hold down electricity prices with prices falling –11.5% in the year to March 2025. The underlying electricity price before rebates was almost flat down just –0.8%yr to March. As noted in more detail below, as the rebates expire they will boost both housing and headline inflation.

More critical for core inflation has been the moderation in rents and dwellings inflation. Rental inflation peaked at 7.8%yr in March 2024 and has since moderated to 5.5%yr in March 2025. Rental inflation has been moderated by changes to Commonwealth Rent Assistance (CRA). The maximum CRA rate increased by 10% on 20 September 2024, in addition to the usual biannual CPI indexation on 20 March and 20 September each year. The ABS noted that excluding the changes to CRA, rents would have increased by 6.8%yr in the March quarter, compared to 7.8%yr in the December quarter. Given the moderation in population growth, we expect rental inflation to drift below 5%yr in 2025 and then drift down below 4%yr through 2026.

The turn around in dwelling price inflation has been even more dramatic, from peaking at 20.7%yr in September 2022 falling down to around 5%yr in December 2023, 2.9%yr at December 2024 and printing 1.4%yr at March 2025. Our current projections have dwelling price inflation hitting a low of –0.2%yr in September 2025 before recovering modestly to 0.7%yr in December 2025 then to 2.9%yr in December 2026.

Crude oil prices

The fall in crude oil prices below US$60/bbl has been surprising and that, along with the recovery in the Australian dollar, is supportive of lower pump prices for Australian auto fuel. For our inflation forecasts, we have pencilled in crude oil US$55/bbl for Brent in June 2025, US$57/bbl in September 2025 and US$60/bbl in December. This will see the annual pace of auto fuel inflation dip further down from –5.1%yr in March to –10.5%yr in June and while easing still deflationary in December 2025 at –4.7%yr. We don't see a positive annual pace of auto fuel inflation until it hits a 2.6%yr pace in September 2026.

Cost-of-living measures turning inflationary

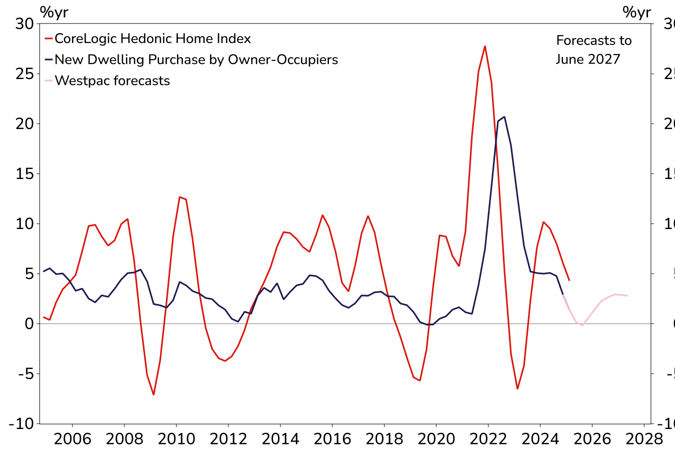
As noted earlier as energy rebates roll off they are set to boost the CPI. From a deflationary –11.5%yr pace in March 2025 we see electricity prices surging 48.7%yr at December 2025 and due to delays in the timing of the rebates in various capital cities, this momentum continues into 2026 with

Inflation forecasts

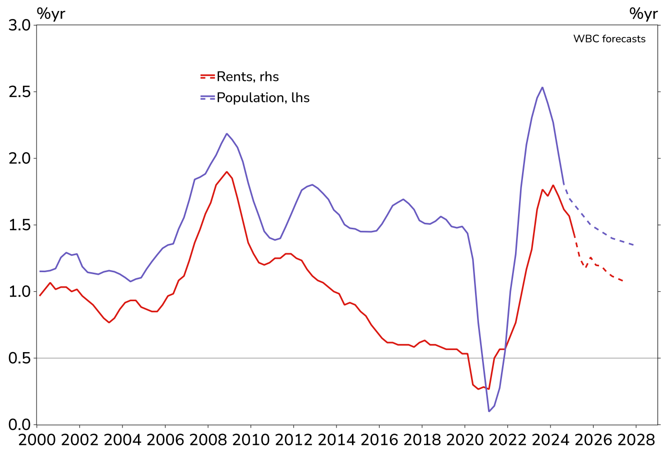
		Jun–25	Sep–25	Dec–25	Mar–26
CPI	Index	141.8	143.0	144.1	145.3
	(%qtr)	0.8	0.8	0.8	0.8
	(%yr)	2.2	2.8	3.4	3.3
Trimmed mean	(%qtr)	0.6	0.7	0.7	0.6
	(%yr)	2.7	2.6	2.8	2.7
	(6mth ann'd)	2.6	2.7	2.9	2.7

Source: ABS, Westpac Economics.

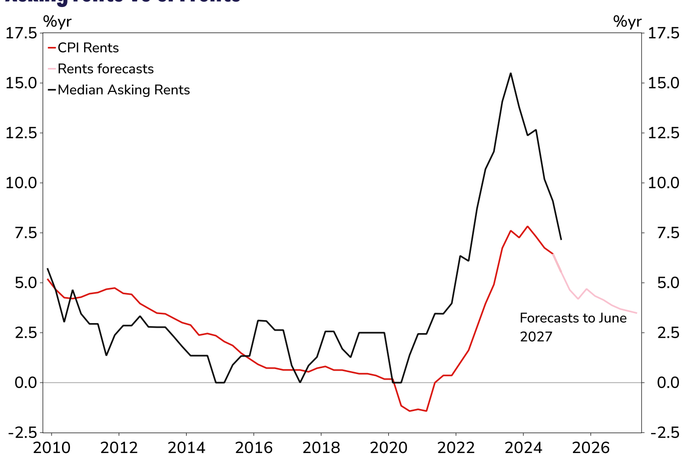
CPI New Dwellings vs Established Homes



Growth in Population and Rents



Asking rents vs CPI rents



Source: ABS, CoreLogic Australia, Macrobond, Westpac Economics electricity inflation running at a 26.7%yr pace at June 2026. If we exclude the energy rebates from the calculation then electricity inflation lifts from –0.8% in March 2025 to 6.1%yr by December 2025 to a 6.2%yr pace in June 2026.

If we exclude the impact of the cost-of-living assistance (energy rebates plus additional rental relief and subsidies for public transport), headline CPI inflation prints 2.9%yr in March compared to the ABS estimate of 2.4%yr. The cost of living measures have shaved 0.5ppt off inflation. Looking forward, if we exclude the close of living measures CPI inflation is running at 2.6%yr in December 2025 compared to our current headline forecast of 3.4%yr. As such, the unwinding of the cost of living measure is adding 0.8ppt to the CPI in the year to December 2025. Is there a chance the Federal Government could continue the cost-of-living measures into 2026? Yes, but as you can see without a significant fall in underlying electricity prices, then they would just be delaying the inevitable boost to electricity prices and inflation.

As we have noted in previous research notes, the impact of cost-of-living measures on core inflation is marginal at best. Our estimate of the Trimmed Mean excluding the cost of living measures was 3.0%yr at March 2025 compared to the 2.9%yr reported by the ABS. At two decimal places, the difference is just 0.06ppt so it only just rounds up to a 0.1ppt difference. For December 2025 we have the Trimmed Mean without the cost of living measures rising 2.7%yr compared to our current estimate with of 2.8%yr, again a difference of just 0.1ppt.

What we are looking out for

There are a number of risks to our inflation profile but we think the key issues we are keeping an eye one are whether:

- The Commonwealth government extending cost-of-living measures, in particular the energy rebates. While we see a small risk of this happening, doing so could shave up to 0.5ppt off the annual inflation rate in December 2025. We believe that given the size of the government's mandate, they should have confidence to end the subsides and look at longer term, more sustainable ways to reduce the cost-of-living squeeze on households.
- Dwelling and rent inflation finds a second wind and price inflation accelerates for this group. Given where we are in the economic cycle, we put a low risk on this.
- A deeper than expected decline in durable goods prices as we see increased trade diversion of Chinese goods into the Australian market. We are already noting the higher number of new Chinese brand entering the Australian car market and suspect a price war is a risk later this year or in 2026.
- Wages lift more strongly, based on an outsized increase in the 2025 Minimum Wage Decision that could spread out to the informal wage bargaining stream, boosting market sector services inflation. Given where we are in the cycle, and the fact headline CPI inflation is now down, limits the risk of a larger rise in the minimum wage while our expectation for a softening labour market reduces the pressure on informal wage bargaining.

Rebates have little impact on core inflation

	TM	TM	TM	TM
	ex rebates	ex rebates	with rebates	with rebates
	% qtr	% yr	% qtr	% yr
Jun-23	0.9	5.8	0.9	5.8
Sep-23	1.3	5.2	1.2	5.1
Dec-23	0.9	4.4	0.9	4.2
Mar-24	1.1	4.3	1.0	4.0
Jun-24	0.8	4.2	0.9	4.0
Sep-24	0.8	3.7	0.8	3.6
Dec-24	0.6	3.3	0.5	3.3
Mar-25	0.8	3.0	0.7	2.9
Jun-25 (f)	0.5	2.7	0.6	2.7
Sep-25 (f)	0.7	2.6	0.7	2.6
Dec-25 (f)	0.6	2.7	0.7	2.8

Sources: ABS, Westpac Banking Corporation

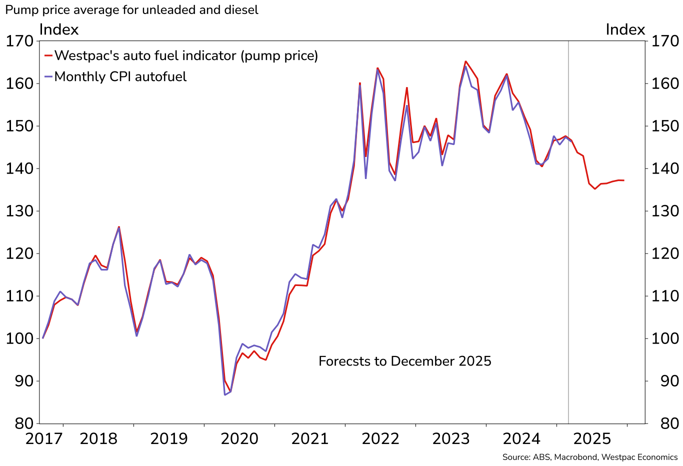
Impact of rebates on CPI inflation

	CPI	CPI	CPI	CPI
	ex rebates	ex rebates	with rebates	with rebates
	% qtr	% yr	% qtr	% yr
Jun-23	0.8	6.0	0.8	6.0
Sep-23	1.6	5.4	1.2	5.4
Dec-23	0.7	4.7	0.6	4.1
Mar-24	1.1	4.3	1.0	3.6
Jun-24	0.9	4.3	1.0	3.8
Sep-24	0.6	3.4	0.2	2.8
Dec-24	0.5	3.1	0.2	2.4
Mar-25	0.9	2.9	0.9	2.4
Jun-25 (f)	0.4	2.4	0.8	2.2
Sep-25 (f)	0.8	2.6	0.8	2.8
Dec-25 (f)	0.6	2.6	0.8	3.4

Sources: ABS, Westpac Banking Corporation

Auto fuel prices

Pump price average for unleaded and diesel



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