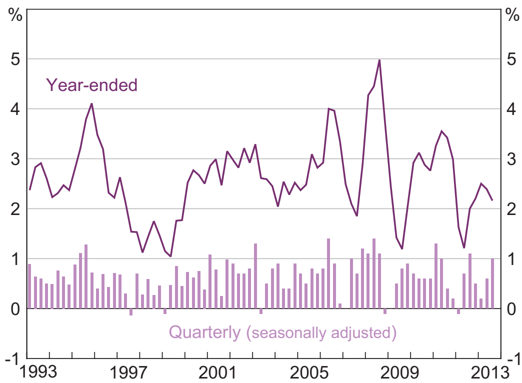
5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation has remained moderate over the past year, notwithstanding a pick-up in the quarterly rate of inflation in the September quarter. On a seasonally adjusted basis, the consumer price index (CPI) rose by 1.0 per cent in the quarter, following an increase of 0.6 per cent in the June quarter (Graph 5.1, Table 5.1). Abstracting from volatile items – which added 0.3 percentage points to headline inflation in the quarter, driven by a rise in fuel prices – there was a small increase in the quarterly pace of inflation in both tradables and non-tradables prices. The year-ended rate of consumer price inflation slowed to 2.2 per cent, as the strong quarterly outcome in the September quarter 2012, which resulted from the introduction of the carbon price and the means testing of the private health insurance rebate, dropped out of the calculation.

Graph 5.1
Consumer Price Inflation*



* Excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999–2000

Sources: ABS; RBA

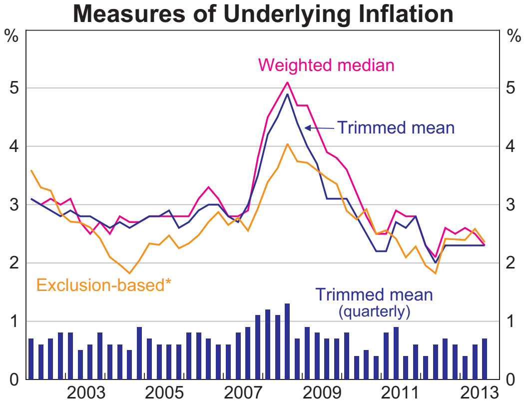
Table 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly(a)		Year-ended(b)	
	September quarter 2013	June quarter 2013	September quarter 2013	June quarter 2013
Consumer Price Index	1.2	0.4	2.2	2.4
Seasonally adjusted CPI	1.0	0.6	–	–
– Tradables	1.0	0.1	–0.1	–0.7
– Tradables (excl volatile items and tobacco)(c)	0.2	0.1	–1.1	–1.3
– Non-tradables	0.9	0.8	3.6	4.3
Selected underlying measures				
Trimmed mean	0.7	0.6	2.3	2.3
Weighted median	0.6	0.6	2.3	2.5
CPI excl volatile items(c)	0.7	0.7	2.4	2.6

(a) Except for the headline CPI, quarterly changes are based on seasonally adjusted data; those not published by the ABS are calculated by the RBA using seasonal factors published by the ABS
(b) Year-ended changes are based on non-seasonally adjusted data, except for the trimmed mean and weighted median measures
(c) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

The various measures of underlying inflation were between ½ and ¾ per cent in the September quarter, slightly higher than expected and similar to the rate of underlying inflation in the previous quarter. In year-ended terms, underlying inflation was a little above 2¼ per cent, a touch lower than the levels of the past year or so, and in the lower half of the inflation target (Graph 5.2). While it is not possible to identify precisely the impact of the introduction of the carbon price in July 2012 on underlying inflation, earlier estimates were that it would boost underlying inflation by a little more than ¼ percentage point, with the pass-through to general prices to occur over several quarters. So underlying inflation over the past year is likely to still include a small contribution from the carbon price, but this will diminish over the next couple of quarters.

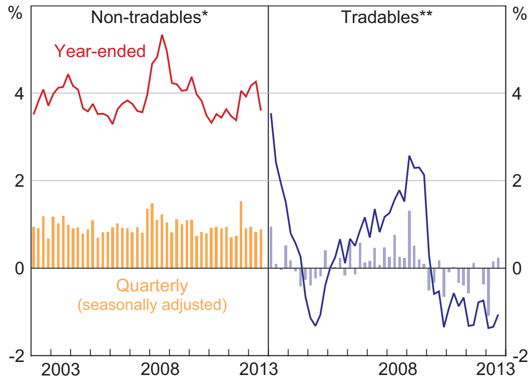
Graph 5.2
Measures of Underlying Inflation



* Excludes fruit, vegetables, automotive fuel (and deposit & loan facilities to June 2011)
Sources: ABS; RBA

Tradables prices (excluding volatile items and tobacco) increased a little in the September quarter, by 0.2 per cent, following a 0.1 per cent increase in the June quarter (Graph 5.3). This increase reflected a pick-up in inflation for food items that are considered tradable (which includes most food items apart from meals out and take-away). The increase in tradables prices over the past two quarters is in contrast to the steady decline in tradables prices over the previous three years. That decline was greater than expected given the relative stability of the exchange rate and import prices over much of that period

Graph 5.3
Non-tradables and Tradables Inflation



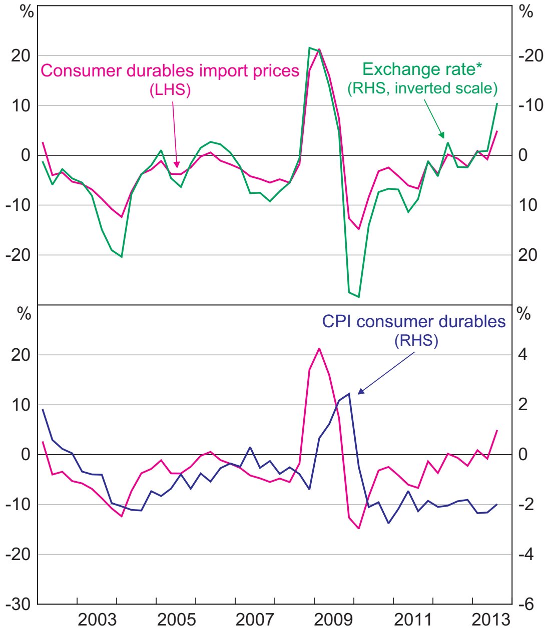
* Excluding deposit & loan facilities to June 2011
** Excluding volatile items (fruit, vegetables and automotive fuel) and tobacco
Sources: ABS; RBA

(Graph 5.4). Instead, it is likely to have reflected pronounced competitive pressures, particularly in the domestic supply chain for consumer durables.[1] Some consumer durables prices appear to have declined at a somewhat slower pace in recent quarters, although the year-ended pace of deflation has remained steady. Based on historical experience, the depreciation of the exchange rate earlier this year is, as yet, unlikely to have had much effect on most tradables prices; that effect would likely begin to show in the next few quarters.

Non-tradables inflation also picked up slightly, to 0.9 per cent in the September quarter. Notwithstanding this, the year-ended pace of non-tradables inflation slowed to 3.6 per cent, as the direct effects of the policy changes in the September quarter last year dropped out of the year-ended rate. Apart from the September quarter 2012, the quarterly pace of non-tradables inflation appears to have been relatively steady over the past couple of years, albeit at below the average pace seen over the past decade. The stability of non-tradables inflation, despite slowing growth in aggregate unit labour costs, could reflect longer than usual lags for the pass-through of labour costs, increased profit margins or noise associated with measurement.

1 See RBA (2013), 'Box B: The Recent Deflation in Consumer Durables Prices', *Statement on Monetary Policy*, May, pp 57–59.

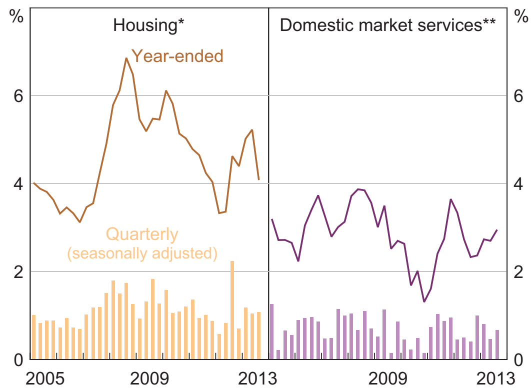
Graph 5.4
Consumer Durables Prices and the Exchange Rate
Year-ended percentage change



* Import-weighted index
Sources: ABS; RBA

In the September quarter, the small pick-up in non-tradables inflation reflected an increase in market services inflation, while the quarterly pace of housing inflation remained relatively steady (Graph 5.5). Market services inflation was lifted by a strong rise in the prices of domestic holiday travel and accommodation (which tend to be volatile), some of which was attributable to higher jet fuel prices. In contrast, inflation in the prices of most other market services declined. Within the housing group, there were substantial rises in utilities prices, particularly for water and gas, owing to capital investments and network cost increases in some states. These were offset by a surprising decline in new dwelling cost inflation in the quarter, with price reductions observed in Brisbane and Melbourne. The decline could, in part, reflect liaison reports of builders in some cities finding it difficult to raise prices, as well as an increase in the value of first home owner grants (which acted to reduce the cost of new dwellings in Victoria). But the decline was somewhat at odds with the pick-up in indicators of housing market activity. Rents inflation also eased, in line with the slight increase in vacancy rates over the first half of the year.

Graph 5.5
Non-tradables Inflation



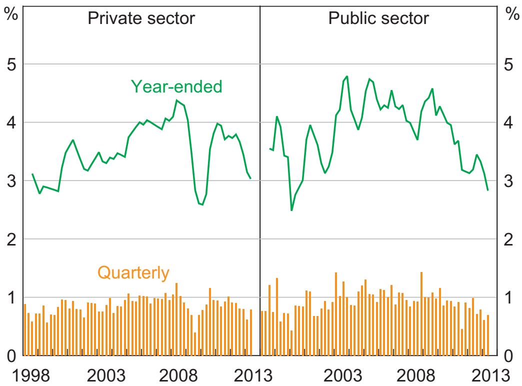
* Includes prices for rents, dwelling repair & maintenance, new dwelling purchases, utilities and property rates & charges
** Excludes deposit & loan facilities to June 2011
Sources: ABS; RBA

Food prices (excluding fruit & vegetables) increased by 0.5 per cent in the quarter, which was more than the 0.2 per cent increase in the June quarter. The pick-up in food price inflation was broad based across a range of items. Even so, food price inflation remains relatively subdued compared with history, consistent with reports from liaison that supermarket competition continues to place downward pressure on prices. Vegetable prices decreased by 4.9 per cent in the September quarter, while there was a modest increase in fruit prices.

Costs

Year-ended wage growth eased further in the June quarter, consistent with the softening in labour market conditions observed over the past year or so. The wage price index rose by 0.7 per cent in the June quarter, to be 2.9 per cent higher over the year (which is ¾ percentage point below the average annual growth of the past decade). Public sector wage growth has been particularly weak in recent quarters, with year-ended growth currently at its slowest pace since 2000 (Graph 5.6). Growth in private sector wages also continued to slow over the year, though it picked up slightly in the quarter. Business surveys and liaison suggest that wage growth remained slow in the September quarter, and firms tended to report that they expect wage growth to slow a little further over the period ahead.

Graph 5.6
Wage Price Index Growth

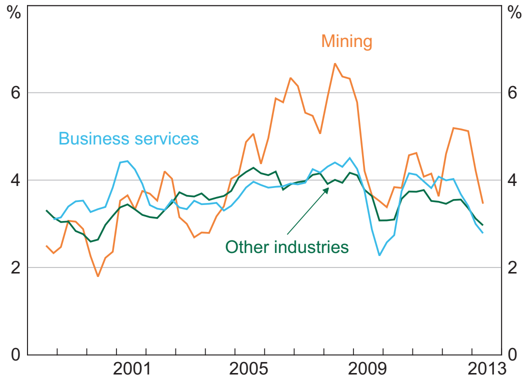


Source: ABS

The slowing in wage growth has been broad based. Over the year to the June quarter, wage growth was below its decade average in all industries and the dispersion in wage growth across industries was at its lowest level since at least 1998. Wage growth in the mining industry has slowed particularly sharply since the beginning of the year, consistent with the decline in the demand for labour in that industry (Graph 5.7). Wage growth in the business services sector (which accounts for around one-fifth of total employment) has also declined markedly, in part reflecting the decline in mining-related demand for business services, and has accounted for a large part of the slowing in aggregate wage growth over the past year.

Wage growth slowed in all states over the year to the June quarter. In New South Wales, Queensland and Tasmania, wage growth is now at its slowest pace since the early 2000s, reflecting slow growth in both the public and private sectors. In Western Australia, private sector wage growth has slowed sharply, most notably in mining and mining-related industries, and

Graph 5.7
Wage Growth by Industry
Year-ended



Sources: ABS; RBA

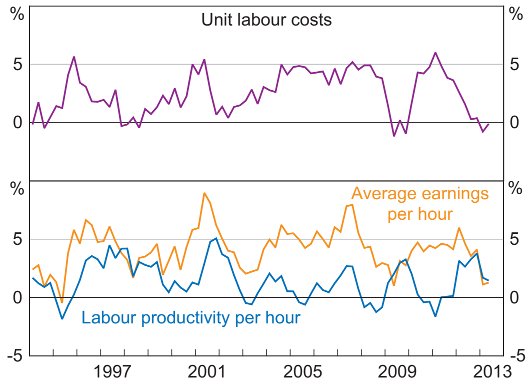
is now only slightly above the national average. In contrast, public sector wage growth in that state has remained relatively strong.

Average earnings as measured in the national accounts increased by 1.3 per cent over the year to June, which was low relative to history. At the same time, measured growth in labour productivity has slowed somewhat from the pace seen last year, to be around its 20-year average over the year to the June quarter. With average earnings and productivity having grown at around the same pace, aggregate unit labour costs are estimated to have been unchanged over the past year (Graph 5.8).

Producer price data point to a pick-up in inflation in the September quarter across all stages of production, mainly due to a rise in import prices. Nevertheless, producer price inflation remained relatively modest at around 2 per cent in year-ended terms.

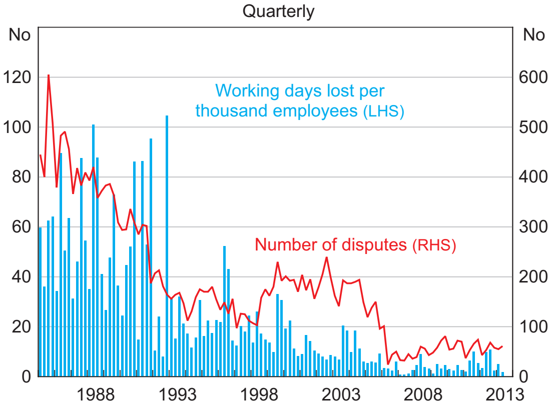
ABS data indicate that the number of working days lost as a result of industrial disputes declined in the June quarter, to be well below the decade average (Graph 5.9). This decline was driven by a fall in the average number of employees involved per dispute, which more than offset slight increases in the average duration and number of disputes.

Graph 5.8
Unit Labour Costs Growth
Non-farm, year-ended



Sources: ABS; RBA

Graph 5.9
Industrial Disputes
Quarterly

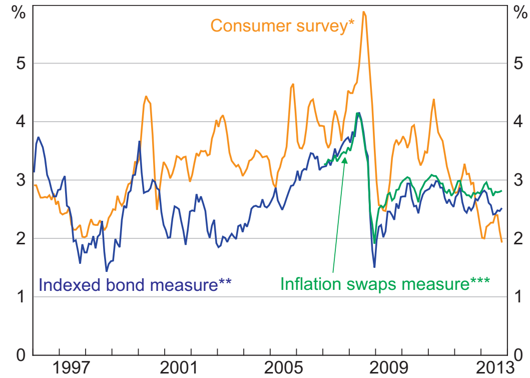


Source: ABS

Inflation Expectations

Measures of inflation expectations remain within the inflation target range, and are generally below their long-term average levels (Graph 5.10, Table 5.2). Following the higher-than-expected September quarter outcome, market economists' expectations for inflation over the year to June 2014 increased a bit, although expectations for the year to June 2015 have been revised slightly lower. Union officials' forecasts for inflation are little changed, as are financial market measures of inflation expectations, which remain below their historical average levels. The Melbourne Institute's measure of consumer inflation expectations is around its lowest level in the history of the series. ✠

Graph 5.10
Indicators of Inflation Expectations



* Three-month moving average of the trimmed mean expectation of inflation over the next year
** Break-even 10-year inflation rate on indexed bonds
*** Expectation of average annual inflation over the next 10 years
Sources: Bloomberg; Melbourne Institute of Applied Economic and Social Research; RBA

Table 5.2: Median Inflation Expectations
Per cent

	Year to June 2014			Year to June 2015	
	May 2013	August 2013	November 2013	August 2013	November 2013
Market economists	2.6	2.6	2.8	2.6	2.5
Union officials	2.8	2.5	2.5	2.5	2.5

Sources: RBA; Workplace Research Centre