

Economic note

22 July 2009

Inflation: headline down, underlying stubborn

June qtr 2009	%/qtr	%/yr	March qtr 2009	%/qtr	%/yr
Headline CPI	0.5	1.5	Headline CPI	0.1	2.5
Underlying inflation*	0.8	3.9	Underlying inflation	1.1	4.2

*Underlying inflation is the average of the trimmed mean and weighted median inflation measures

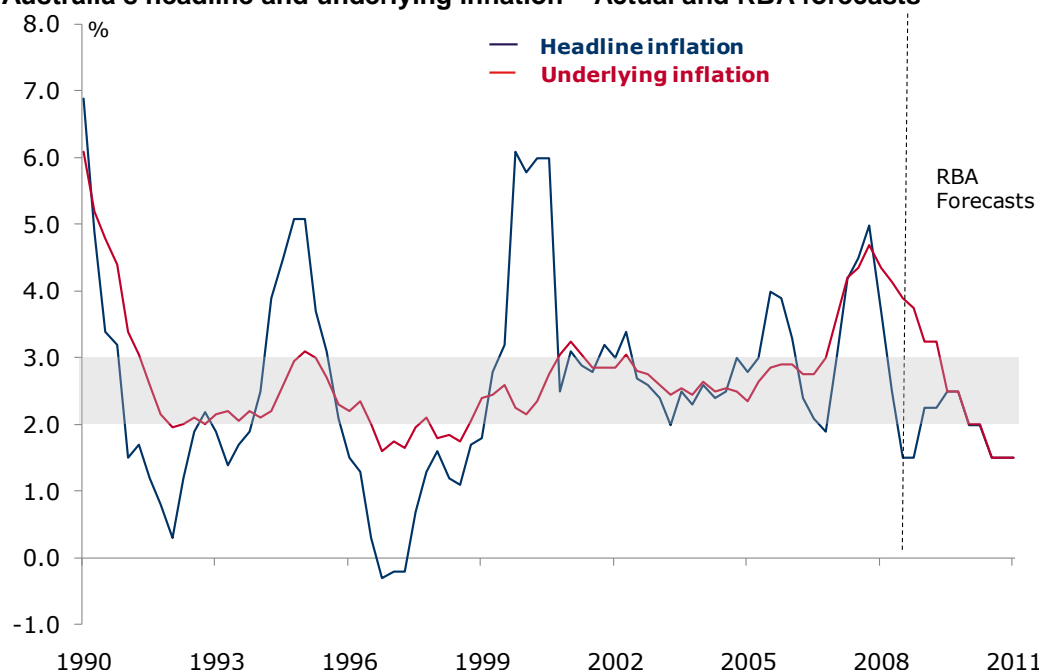
Highlights:

Australia's headline Consumer Price Index (CPI) increased by 0.5%/qtr in the June quarter 2009, right on consensus market expectations. This took the annual rate of inflation down to just 1.5%, from 2.5% in the year to the March quarter 2009. **This is the first time that Australia's headline inflation rate has been below the Reserve Bank of Australia's (RBA) 2%-3% target range since the September quarter 2007.** It is also the lowest annual headline inflation rate since June quarter 1999. With the economy slowing under the weight of the global recession, Australia's headline inflation rate has now fallen from a peak of 5.0% in the September quarter 2008.

The inflation news for the Underlying measures was not, however, as positive. The trimmed mean inflation reading increased by 0.8%/qtr, while the weighted median rate also rose by 0.8%/qtr. The annual underlying inflation rate declined to 3.9%, from 4.2%, but remains above the RBA's 2%-3% target range. The higher increase in the underlying inflation measure comes about due to the skew in price changes, with the largest price movements being falls in deposit and loan facilities (-4.3%), fruit (-7.6%) and vegetables (-6.9%), while the largest rises were less extreme for rents (+3.7%), fuels (+3.6%) and hospital and medical changes (+3.6%). Nevertheless, as shown in Chart 1, RBA expectations are that the underlying inflation rate will fall back to within the target range in mid-2010.

Today's inflation news provides support to the RBA's aggressive monetary policy easing campaign of late 2008/early 2009. It is, however, unlikely to be new news to the RBA and should not alter the RBA's view on the monetary policy outlook. This view was re-stated in Tuesday's Minutes of the July Board meeting, which signalled that while the inflation outlook allowed the RBA to retain an easing bias, with the economic news turning a little more positive, the cash rate was likely to remain at 3.0% for an extended period.

Australia's headline and underlying inflation – Actual and RBA forecasts



Source: ABS and RBA

Some details:

- The most significant price increases in the June quarter 2009 were in petrol and other automotive fuels (+3.6%/qtr), hospital and medical services (+3.6%), rents (+1.4%), furniture (+3.7%) and house purchases (+0.8%). Offsetting these increases were falls in deposit and loan facilities (-4.3%/qtr), vegetables (-6.9%), fruit (-7.6%) and overseas travel (-3.4%).
- For the broad prices categories, the biggest increases on the quarter were in the prices of Health (+2.3%), Household contents and services (+2.2%) and Clothing and footwear (+2.1%). These were offset by Financial and insurance services (-1.7%), Food (-0.9%) and Recreation (-0.1%).
- Over the year to the June quarter 2009 the main increases in prices were for: Housing (+5.2%/yr), Health (+5.2%), Education (+5.1%), Food (+4.8%) and Alcohol and tobacco (+4.7%). This were offset by big falls in the prices of; Financial and insurance services (-6.6%/yr) and Transportation (-5.9%). Other more moderate prices changes were seen for: Household contents and services (+2.4%), Clothing and footwear (+1.3%), Communications (+1.2%) and Recreation (+0.7%).
- It is also interesting to note that the biggest price increases in the June quarter were in 'tradeables', ie. goods and services prices that are largely set on the world market – which accounts for approximately 42% of the CPI. Prices for tradeables rose by 0.7%/qtr, led by gains in auto fuels, furniture and motor vehicles. The price of 'non-tradeables', ie. goods and services prices set in the domestic market, rose by a smaller 0.4% in the June quarter. The biggest price increases for domestically priced items were in health costs, rents and domestic travel, offset by the falls in deposit and loan facilities.
- On a state by state basis, the biggest price increase in the June quarter was in Darwin at 1.1%/qtr (due largely to higher recreation costs), with all other capital cities between 0.3%-0.8%.
- On an annual basis, then highest inflation rates are in Darwin, Canberra and Brisbane. Sydney, Melbourne, Adelaide, Perth and Hobart all have annual inflation rates below the RBA 2%-3% target range. See table for details.

Capital city	%/qtr	%/yr
Sydney	0.4	1.3
Melbourne	0.3	1.2
Brisbane	0.6	2.0
Adelaide	0.6	1.6
Perth	0.8	1.4
Hobart	0.5	1.7
Darwin	1.1	2.5
Canberra	0.6	2.1
Weighted average	0.5	1.5

Source: Australian Bureau of Statistics

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