

5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation eased in the second half of 2011 following strong outcomes in the earlier part of the year. The seasonally adjusted consumer price index (CPI) rose by 0.2 per cent in the December quarter and the year-ended inflation rate fell to 3.1 per cent (Table 5.1 and Graph 5.1). Fruit and vegetable prices fell sharply in the quarter following large rises associated with supply disruptions in early 2011. CPI inflation is expected to moderate further in year-ended terms in the March quarter as fruit prices continue to fall.

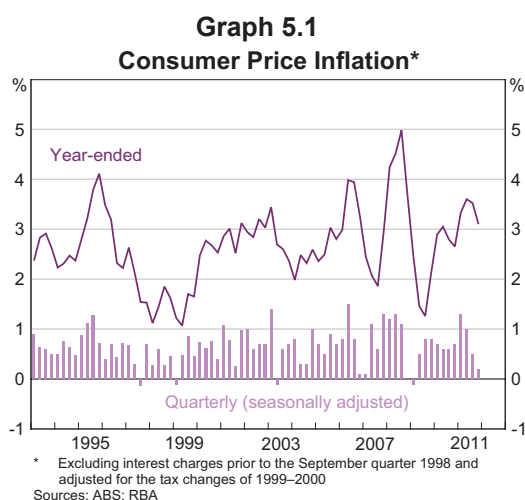


Table 5.1: Measures of Consumer Price Inflation
Per cent

	Quarterly		Year-ended	
	September quarter 2011	December quarter 2011	September quarter 2011	December quarter 2011
Consumer Price Index	0.6	0.0	3.5	3.1
Seasonally adjusted CPI ^(a)	0.5	0.2	3.5	3.1
– Tradables ^(b)	0.0	–0.9	3.3	1.8
– Tradables (excl food, fuel and tobacco) ^(b)	–0.2	–0.6	–1.4	–1.1
– Non-tradables (excl deposit & loan facilities) ^(b)	0.8	0.9	3.5	3.7
<i>Selected underlying measures</i>				
Trimmed mean	0.4	0.6	2.4	2.6
Weighted median	0.4	0.5	2.7	2.6
CPI excl volatile items ^{(b),(c)}	0.5	0.5	2.3	2.5

(a) Year-ended changes are based on non-seasonally adjusted data

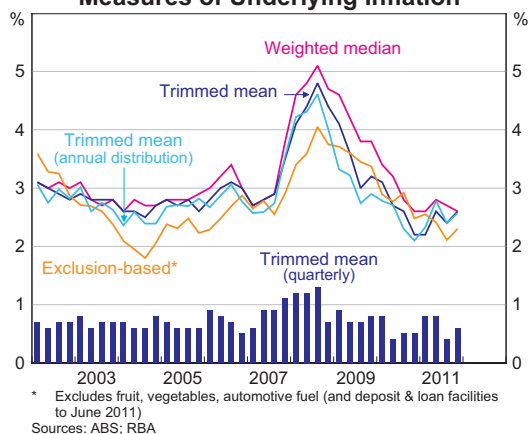
(b) Quarterly data are calculated by the RBA, based on seasonal factors for components from the ABS; year-ended changes are based on non-seasonally adjusted data

(c) Volatile items are fruit, vegetables and automotive fuel

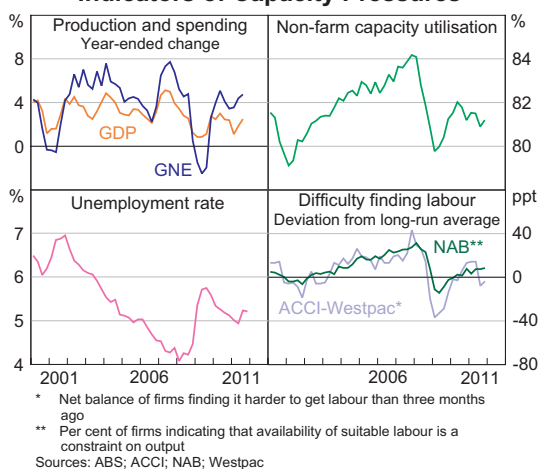
Sources: ABS; RBA

The various measures suggest underlying inflation was around ½ per cent in the December quarter and around 2½ per cent over the year (Graph 5.2); measures of underlying inflation were revised up slightly for the September quarter, reflecting concurrent seasonal adjustment. The latest data indicate that the pace of underlying inflation moderated in the second half of 2011 compared with the solid outcomes in the first half of the year. More broadly, the data suggest that inflation outcomes over the past couple of years have been consistent with the medium-term target, and below the levels seen in 2007 and 2008 when most indicators suggested that capacity in the economy was stretched (Graph 5.3).

Graph 5.2
Measures of Underlying Inflation



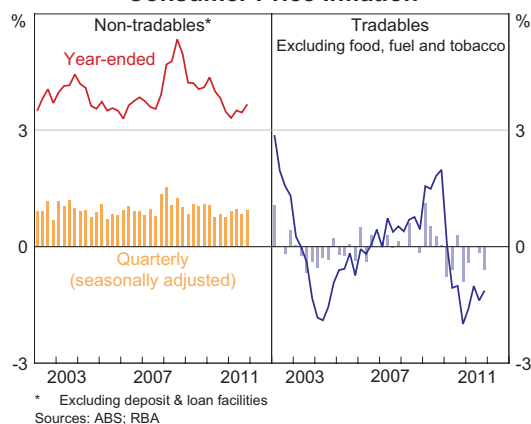
Graph 5.3
Indicators of Capacity Pressures



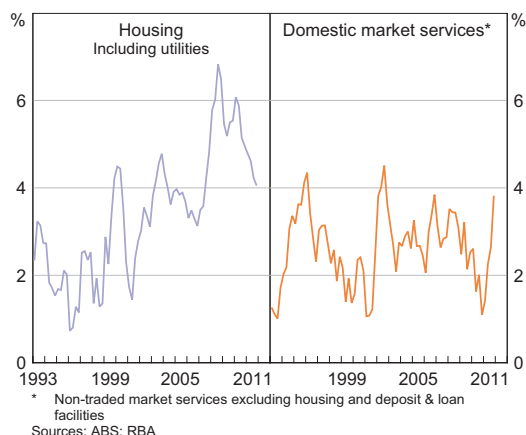
Inflation in non-tradables prices, which includes housing and a large range of domestic services prices, and accounts for around 60 per cent of the CPI basket, picked up slightly in the December quarter. In seasonally adjusted terms, non-tradables prices rose by 0.9 per cent to be 3.7 per cent higher over the year – around ¼ percentage point higher than the trough in non-tradables inflation in early 2011 (Graph 5.4). Housing costs made a sizable contribution to inflation in the December quarter, although there are divergent inflationary pressures within the group. Inflation in rents remained firm in the quarter. In contrast, inflation in the prices of new dwellings remained low and in year-ended terms was around its lowest level in over a decade, reflecting soft demand conditions in the residential construction industry. Inflation in the prices of several administered services, including hospital & medical and childcare, as well as a range of market services, such as domestic travel, telecommunication, insurance and restaurant meals, was relatively strong in the quarter. The pace of year-ended inflation in market services has returned to around the average of the years prior to the slowdown in inflation in 2008 (Graph 5.5).

Declines in the prices of tradable items continued to hold down overall consumer price inflation. In seasonally adjusted terms, tradables prices (excluding food, fuel and tobacco) fell by 0.6 per cent in the quarter and by 1.1 per cent over the year.

Graph 5.4
Consumer Price Inflation



Graph 5.5
Non-tradables Inflation

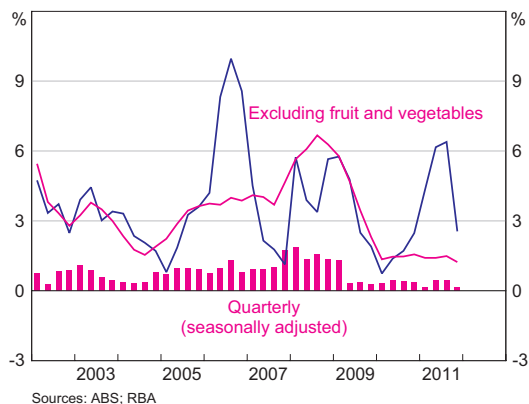


The fall in the quarter was driven by lower prices for overseas travel, audio visual & computing equipment and motor vehicles. The decline in motor vehicle retail prices reflected a small fall in import prices and some additional discounting by distributors. Outside of these items, however, tradables prices were broadly flat in the quarter and over the year, in contrast to the sizable falls which occurred in 2010 associated with the earlier large appreciation in the Australian dollar.

As expected, food prices fell sharply in the December quarter, primarily due to the unwinding of the effects of Cyclone Yasi on banana supplies and prices (Graph 5.6). The ABS indicated that banana prices fell by nearly 50 per cent in the quarter, which is estimated to have subtracted around 0.3 percentage points from headline CPI inflation. Inflation in food prices, excluding fruit and vegetables, moderated further in the quarter to 1¼ per cent in year-ended terms, the slowest pace since 1994. The prices of milk, bread and several meat categories fell over the year. The underlying softness in food price inflation in part reflects ongoing competition among retailers which is limiting price rises in the grocery supply chain.

Automotive fuel prices rose by over 5 per cent in seasonally adjusted terms in the December quarter. Over the year, fuel prices rose by 12½ per cent with the strong rise in global oil prices outweighing the effects of the exchange rate appreciation.

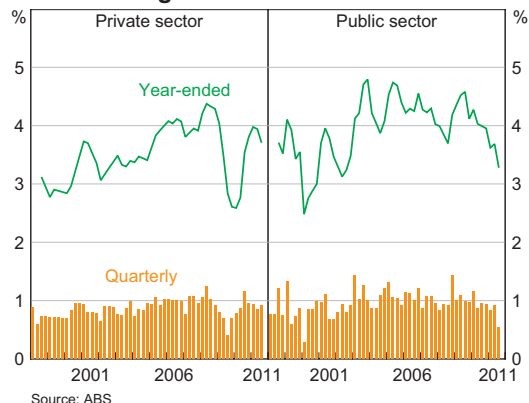
Graph 5.6
Food Price Inflation



Costs

Although growth in wage costs remains firm, the moderation in labour market conditions over the past year has lessened the likelihood of a pick-up in wage inflation. The wage price index (WPI) rose by 0.7 per cent in the September quarter, after rising by 0.9 per cent in the previous quarter. Private sector wage growth remained firm, with growth of 0.9 per cent in the quarter (Graph 5.7). Although the WPI data indicate there is currently relatively little dispersion in the growth of wage rates across states and industries, the national accounts measures indicate that total labour income is rising strongly in Western Australia, consistent with rapid growth

Graph 5.7
Wage Price Index Growth



in high-wage employment in the resources sector in that state. The annual award wage increase came into effect at the beginning of July, increasing award wages by 3.4 per cent.

Public sector wage growth was unusually soft in the September quarter, owing to delays in finalising new enterprise agreements in a number of states and Commonwealth agencies. It is likely there will be some catch-up in public sector wages as outstanding agreements are finalised over the December and March quarters.

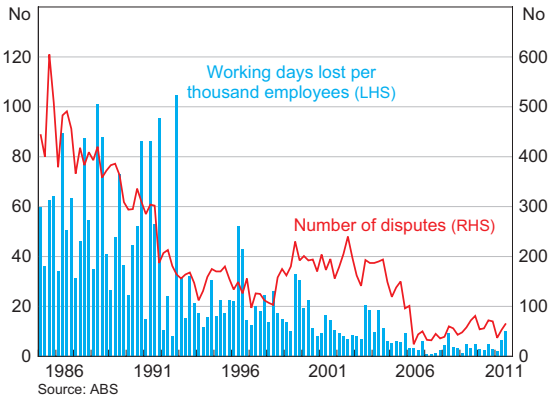
Overall, the official data suggest that wage growth is currently running around the average rate seen since 1997, having moderated slightly over the past year. Consistent with this, business surveys and the Bank's liaison suggest that wage pressures have remained firm, although there is little evidence of upward pressure on wage inflation.

Data from the national accounts indicate that unit labour costs – the average cost of labour per unit of output – grew at a rapid pace in early 2011 owing to weak labour productivity growth. However, unit labour costs growth moderated in the September quarter in line with a pick-up in labour productivity, which reflected strong growth in GDP and softer employment growth; a continuation of these trends is expected to see the national accounts measure of unit labour costs moderate further in coming quarters.

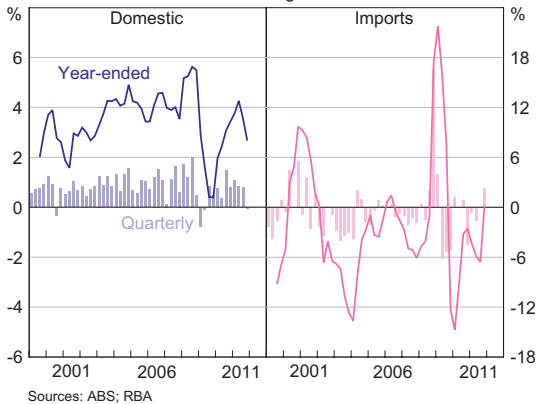
ABS data on working time lost in industrial disputes – which capture stop-work meetings, strikes and employer lockouts – indicate an increase in industrial action in the June and September quarters, partly reflecting a large public sector dispute (Graph 5.8). Nevertheless, the number of disputes and level of working days lost remains low relative to history.

The December quarter producer price data also point to an easing in upstream price pressures in the second half of 2011. Final stage producer prices rose modestly in the quarter to be 2.9 per cent higher over the year. Although part of this easing was due to the large fall in banana prices in the quarter, abstracting from this, domestic price pressures appear to have slowed across all stages of production (Graph 5.9). In contrast, with the effects of the 2009 and 2010 exchange rate appreciation largely passed, and a modest depreciation having occurred in the second half of 2011, import prices picked up across all stages of production in the December quarter.

Graph 5.8
Industrial Disputes
Quarterly



Graph 5.9
Final Stage Producer Price Inflation
Excluding oil



Inflation Expectations

Most measures of inflation expectations are a little lower since the time of the November *Statement* and remain consistent with the medium-term target (Graph 5.10). The Melbourne Institute's measure of consumer inflation expectations has decreased slightly, to be a little below its average over the inflation-targeting period. Financial market measures of medium- to long-term inflation expectations are little changed, with the indexed bond measure remaining around its inflation-targeting average. Market economists have revised down their forecasts for inflation in 2012 over the past three months, while expectations for inflation over 2013 were unchanged (Table 5.2). Union officials have also revised down their expectations throughout the forecast horizon. Consistent with near-term inflation expectations, survey measures suggest that business expectations for near-term selling price inflation remain below average. ↗

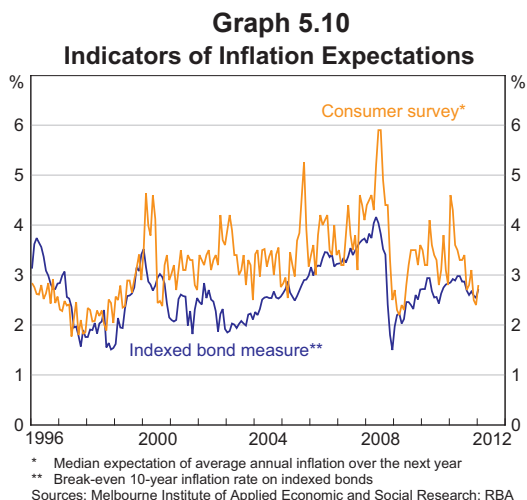


Table 5.2: Median Inflation Expectations^(a)
Per cent

	Year to December 2012			Year to December 2013	
	August 2011	November 2011	February 2012	November 2011	February 2012
Market economists	3.0	2.9	2.5	2.7	2.7
Union officials	3.1	3.4	3.0	3.4	3.0

(a) Excluding carbon price effect

Sources: RBA; Workplace Research Centre

