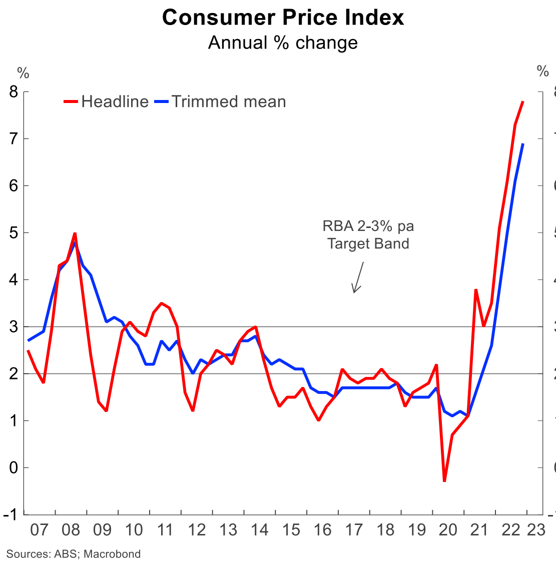
Data snapshot

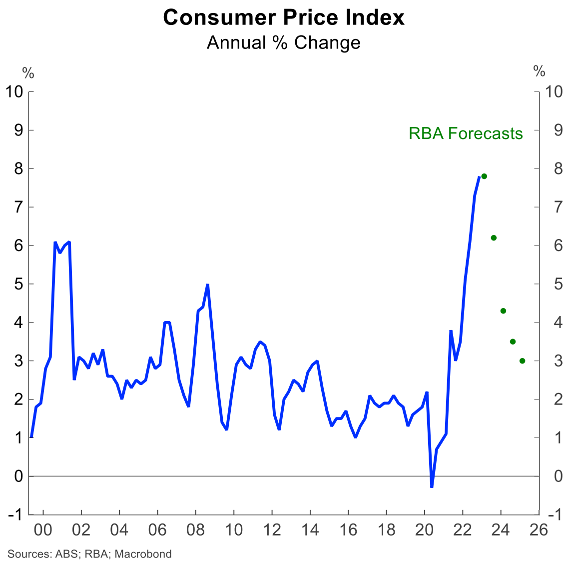
Wednesday, 25 January 2023

Consumer Price Index

Did Hospitality Cash In On Last Hurrah?

- **Headline inflation remained elevated in the December quarter of 2022, increasing by 1.9% in quarterly terms to be 7.8% higher in annual terms. The annual rate is near its highest in nearly 33 years. The underlying measure of inflation increased by 1.7% in quarterly terms, taking the annual rate to a record high of 6.9%.**
- **The headline outcome was just under the Reserve Bank's (RBA) forecast of 8.0%. But the underlying measure was well above the RBA's forecast of 6.5%.**
- **Goods inflation is showing some tentative signs of easing, but this may be happening too slowly for the RBA's liking. Troubling for the RBA is that price pressures have broadened, especially for a wide range of prices in the services industry.**
- **Services inflation accelerated to 5.5% per annum, reaching its highest rate since 2008. This was driven by the hospitality industry with consumers seemingly unfazed by the 10.9% quarterly increase in the price of holiday travel and accommodation.**
- **It's also evident in the broad-based nature of price increases - more than 85% of the Consumer Price Index (CPI) sub categories experienced annual increases of more than 2.5%.**
- **The mounting challenge for the RBA is the longer inflation is elevated, the stickier it becomes and the tougher to tackle. It runs the risk of inflation becoming embedded in wage-setting processes.**
- **The key for the RBA to decipher is whether the increase in inflation is permanent or it reflects the last hurrah before consumers tighten their belts. The RBA next meets in early February. Another rate hike of 25 basis points remains our call.**





Headline and Underlying Inflation

The inflation fight is not over. Annual inflation increased from 7.3% in the September quarter to 7.8% in the December quarter. The latest outcome is close to the Reserve Bank's (RBA) forecast of 8.0%, but above the market consensus forecast of 7.7%. And it's the highest in over 32 years.

In quarterly terms, the headline consumer price index (CPI) lifted 1.9%, a tad higher than the 1.8% increase in the previous quarter.

Troubling for the RBA is that inflationary pressures in the December quarter broadened. There are eleven major categories in the CPI basket and ten of the eleven categories recorded annual growth rates well above the top of the RBA's inflation target band of 3%.

Moreover, goods inflation remained too high while services inflation accelerated. The lift in services inflation is the more worrying trend because it is slower moving and can be more challenging to correct for central banks.

Goods inflation is expected to moderate through 2023, as supply-chain pressures continue to ease, energy prices stabilise and interest rates slow demand. However, goods inflation only slowed from 9.6% in the year to the September quarter, to 9.5% in the year to the December quarter – possibly suggesting there is a risk the moderation in goods inflation will be slow and gradual.

The RBA and Treasury both forecast that inflation has peaked in the December quarter. However, the acceleration in services inflation and stubbornness of goods inflation suggests there's a risk that the peak in inflation may come later in the March quarter of this year.

Importantly, whilst headline inflation has peaked or nearing a peak, underlying inflation may prove stickier. The RBA's preferred measure of underlying inflation – the trimmed mean – tries to dampen the impact of the more extreme movements in prices. This measure grew by 1.7% in the quarter. In annual terms it stepped up from 6.1% in the September quarter to 6.9% and, critically, pierced the RBA's forecast of 6.5%.

The RBA provides a visual 70% confidence interval, which could be thought of as a range of possible outcomes, and 6.9% appears to be around the top of that interval – suggesting not only did underlying inflation breach the RBA's central forecast but also possibly was at or outside of their range of possible outcomes. It must be causing the RBA's brows to furrow further.

The mounting challenge the RBA faces is the longer inflation is elevated, the stickier it becomes and the tougher to tackle. In an environment of rising and elevated price pressures, it may make it easier for businesses to put up their prices and inflation expectations could become unanchored.

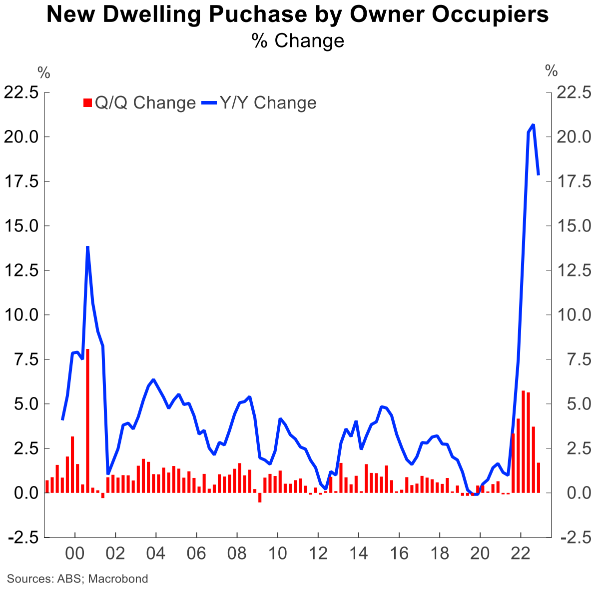
The RBA will almost certainly hike again in February and the odds favour more tightening beyond February.

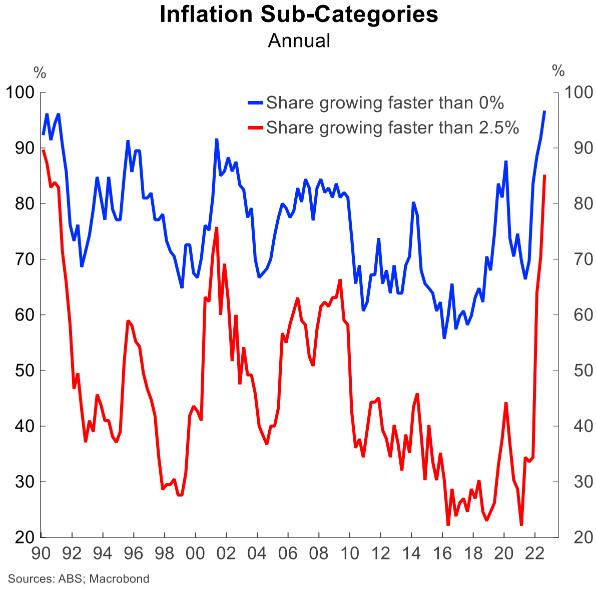
Inflation Categories

The main drivers of inflation in the quarter were increases in the price of hospitality mainly due to the cost of flights and accommodation, housing due to higher electricity prices and rents, and transport as the unwinding of the temporary halving of the fuel excise impacted the quarter.

Digging into the detail of the pace of growth across each CPI group provides important insight into just how broad inflationary pressures are becoming across the economy.

In fact, of the eleven major CPI groups, all except one grew at an annual pace above 2.5% (the mid-point of the RBA 2-3% band). Breaking this down even further, over 85% of all the categories and sub-categories of spending that are measured by the Australian Bureau of Statistics (ABS) grew at an annual pace of more than 2.5%. This compares with 70% in the June quarter of 2022 and the pandemic low of around 20% in the March quarter of 2021. The last time more than 85% of categories and sub-categories grew at an annual pace of over 2.5% was in 1990.





Across the major categories, the fastest rate of price increases for the quarter occurred in recreation. This category recorded a record jump of 5.4% in the December quarter, driven by price hikes for domestic travel and accommodation.

In contrast, the weakest category in the quarter was communication where the CPI slid 0.5%. It was the only major category to record a fall in the quarter. Food and recreation were two categories that approached double-digit annual rates. Food grew by 9.2% year-on-year and recreation by 9.0%.

Headline Consumer Prices	Quarterly Change (% September)	Quarterly Change (% December)	Annual Change (%)
Recreation and culture	1.3	5.4	9.0
Clothing and footwear	-0.2	2.6	5.3
Insurance and financial services	1.3	2.0	5.0
Housing	3.2	1.9	10.7
Furnishings, household equipment and services	2.8	1.8	8.4
Transport	-0.4	1.7	8.0
Alcohol and tobacco	1.2	1.2	4.4
Food and non-alcoholic beverages	3.2	0.9	9.2
Health	0.3	0.8	3.8
Education	0.0	0.1	4.6
Communication	1.4	-0.5	1.3
Total CPI (Original)	**1.8**	**1.9**	**7.8**
Total CPI (Seasonally adjusted)	**1.9**	**1.8**	**7.8**
Trimmed Mean	**1.9**	**1.7**	**6.9**

Goods and Services Inflation

As we suggested in our Weekly Economic Update, the underlying drivers of inflation are just as important as the headline outcome. This is because services (i.e. rent and travel) inflation is much "stickier" when compared with goods inflation. It is driven by the cost of labour or wages. Where wages growth remains elevated it will become harder to get inflation down without causing significantly higher unemployment.

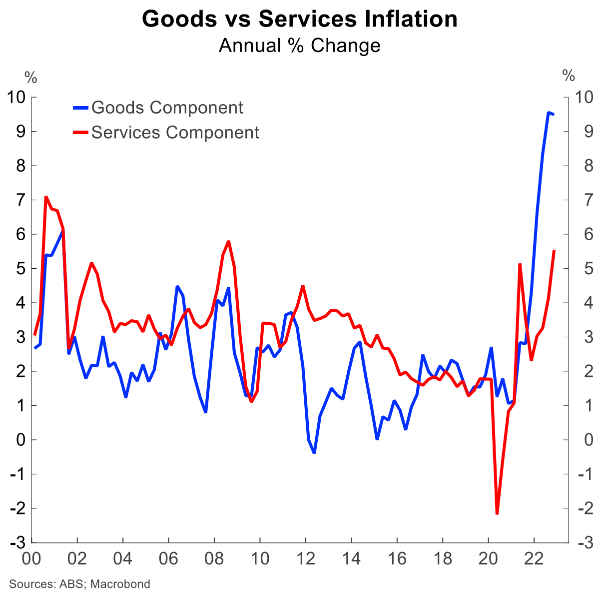
When it comes to today's read, services inflation recorded its largest annual rise since 2008, increasing by 5.5% through the year to the December quarter 2022. This represents a sharp acceleration from the annual growth of 4.1% recorded in the September quarter.

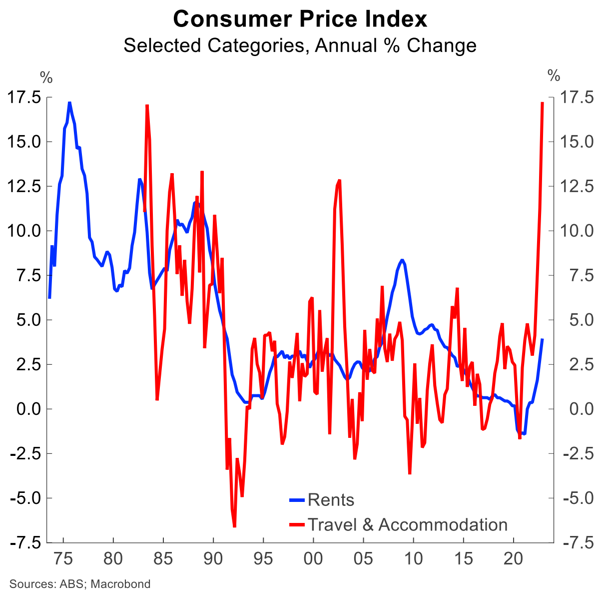
Hospitality (holiday travel and accommodation) underpinned the strong outcome. This was the first Christmas and holiday period where domestic and international boarders were fully open. Households were eager to take full advantage, even when facing skyrocketing costs. With demand increasing and operating flights in some parts still operating below pre COVID-19 capacity, there were sharp increases in the price of both travel and accommodation.

The cost of domestic holiday travel and accommodation prices increased by a massive 19.8% through the year to the December quarter 2022. This was particularly evident during the December holiday period which increased the price of both airfares and accommodation. The cost of international holiday travel and accommodation increased by 15.9% in annual terms due to strong demand and flights still below pre-COVID levels.

Going forward, price increases at this rate are unlikely. Household budgets are likely to be weighed down by higher interest rates and cost of living pressures.

Rents also contributed to the increase in services inflation, growing by 4.0% in annual terms. Given the increase in demand from net overseas arrivals and the extremely low vacancy rates, this is one category which is likely to continue to increase going forward. In addition, the high interest rates are leading to sharp falls in approvals and building activity, which will put further upward pressure on rents.





Goods (i.e. electronics and clothing) inflation has been the main driver of the recent inflationary spike. This has been driven in part by global supply-chain disruptions and elevated shipping and freight costs. As these disruptions dissipate, we expect the prices of goods to also ease.

But this may be happening too slowly. Goods inflation edged slightly lower, up by 9.5% over the year to the December quarter 2022, compared with the 9.6% recorded in September. Goods inflation continues to be driven by the cost of new dwellings, which was 17.8% in annual terms in the December quarter, down from the 20.7% recorded in the September quarter. High labour and materials costs continue to drive increases in prices for new dwellings.

In addition, electricity prices increased 11.7% in annual terms in the December quarter. This strong outcome was due to the unwinding of electricity rebates this quarter. Last quarter electricity costs fell in Perth and Canberra following the introduction of the Western Australian Government's $400 household electricity credit, and the ACT Government's $50 rebate for concession households. The higher electricity prices were partially offset by the ongoing impact of the Queensland Government's $175 Cost of Living rebate, and the introduction of the Tasmanian Government's $119 Winter Bill Buster electricity discount for concession households.

Going forward, the Federal Governments announced a $3 billion fund to provide certain households and small businesses with support to meet rising electricity bills is likely to impact the June quarter outcome.

Finally, transportation also contributed to higher goods inflation. The restoration of the fuel excise on 30 September flowed through to fuel prices early in the quarter. Motor vehicles prices also increased as manufacturers continued to pass on higher costs to consumers. In annual terms, automotive fuel was up 13.2% in the December quarter, while motor vehicles were up 5.0% in annual terms.

Inflation by Capital Cities

Inflation continues to be elevated across the country. While we did see a deceleration in the quarterly inflation outcome across all capital cities except for Perth, inflation remains elevated. This is visible in the annual outcomes where the annual rate of inflation ranged from a low of 7.1% in Darwin and Canberra, to a high of 8.6% in Adelaide.

Headline Consumer Prices	Quarterly Change (% September)	Quarterly Change (% December)	Annual Change (%)
Sydney	2.3	1.8	7.6
Melbourne	2.1	1.6	8.0
Brisbane	1.8	1.5	7.7
Adelaide	2.6	1.7	8.6
Perth	-0.5	3.6	8.3
Hobart	2.3	1.5	7.7
Darwin	1.9	0.9	7.1
Canberra	1.9	1.2	7.1
Total CPI	**1.8**	**1.9**	**7.8**

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