

5. Price and Wage Developments

Recent Developments in Inflation

Consumer price inflation has declined significantly over the past couple of years. This has reflected the relatively subdued growth in demand, especially from households, since the slowing in the economy in late 2008 and the associated easing in capacity pressures and wage growth. More recently, the appreciation of the exchange rate has also exerted downward pressure on inflation.

The consumer price index (CPI) increased by 0.4 per cent in the December quarter, to be 2.7 per cent higher over the year (Graph 5.1, Table 5.1). The quarterly outcome was lower than had been expected at the time of the November

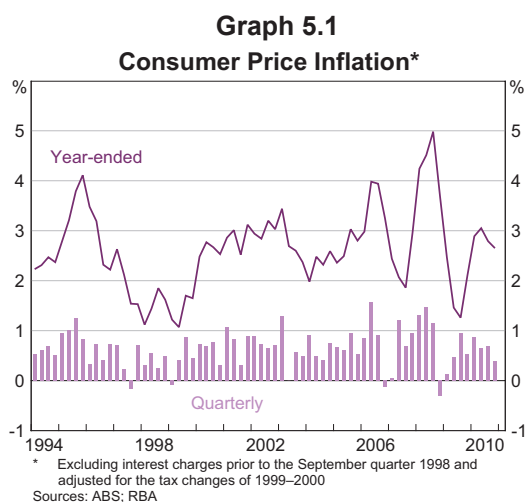
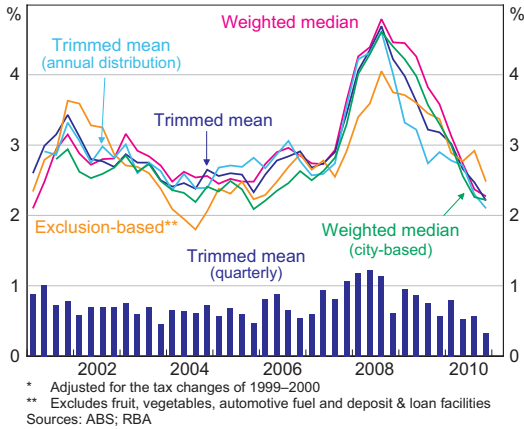


Table 5.1: Measures of Consumer Price Inflation
Per cent

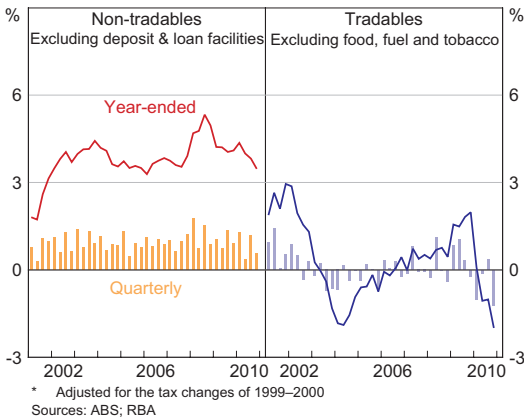
	Quarterly		Year-ended	
	September quarter 2010	December quarter 2010	September quarter 2010	December quarter 2010
CPI	0.7	0.4	2.8	2.7
– Tradables	0.2	0.3	1.4	1.6
– Tradables (excl food, fuel and tobacco)	0.4	–1.2	–1.0	–2.0
– Non-tradables (excl deposit & loan facilities)	1.2	0.6	3.8	3.5
<i>Selected underlying measures</i>				
Trimmed mean	0.6	0.3	2.5	2.2
Weighted median	0.5	0.5	2.4	2.3
CPI excl volatile items ^(a) and deposit & loan facilities	1.1	0.1	2.9	2.5

(a) Volatile items are fruit, vegetables and automotive fuel
Sources: ABS; RBA

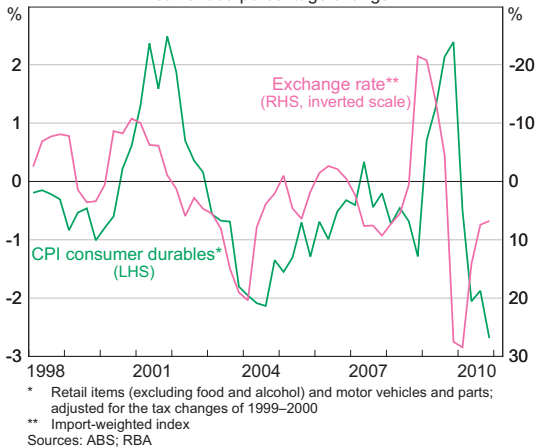
Graph 5.2
Consumer Price Inflation*



Graph 5.3
Consumer Price Inflation*



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



Statement. This reflected larger-than-expected price declines for a range of tradable consumer items and lower outcomes for deposit & loan facilities prices and rents than had been anticipated. In contrast, the price of fruit & vegetables rose sharply, and there was an increase in the price of automotive fuel. The recent floods are expected to have an impact on CPI inflation in coming quarters (see 'Box A: The Impact of the Recent Floods on the Australian Economy').

Based on a range of measures, underlying inflation is estimated to have declined to around 2¼ per cent over the year to December (Graph 5.2). This is significantly below the recent peak of a little over 4½ per cent in September 2008. Most of the difference between the year-ended rates of headline and underlying inflation in the December quarter was due to the large increase in tobacco excise in 2010, which is estimated to have increased CPI inflation by nearly 0.4 percentage points. In the quarter, underlying inflation is estimated to have been a little less than ½ per cent.

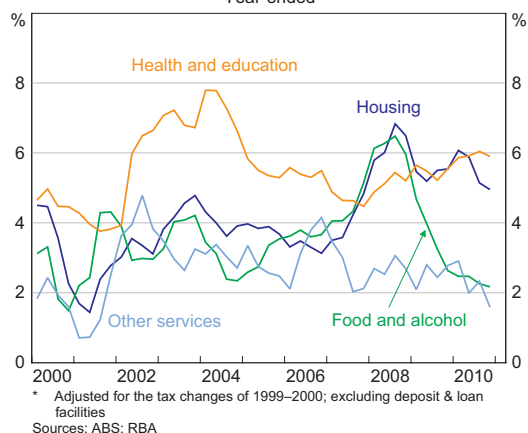
The prices of a wide range of tradable consumer items declined over 2010, including clothing (–6 per cent), major household appliances (–4 per cent), audio, visual & computing equipment (–18 per cent) and motor vehicles (–1½ per cent). In aggregate, tradables prices (excluding food, fuel and tobacco) fell by more than 1 per cent in the December quarter and by 2 per cent over 2010; this was the largest year-ended decline in the three decades for which the series is available (Graph 5.3). This decline reflects the ongoing effects of the exchange rate appreciation since early 2009 (Graph 5.4), the tariff cuts for imported motor vehicles, textiles, clothing and footwear implemented in early 2010, and the subdued growth in household spending. Looking ahead, the appreciation of the exchange rate is likely to exert additional downward pressure on tradables prices in coming quarters.

Non-tradables inflation (excluding deposit & loan facilities) eased to 0.6 per cent in the December quarter and 3.5 per cent over the year. This is the

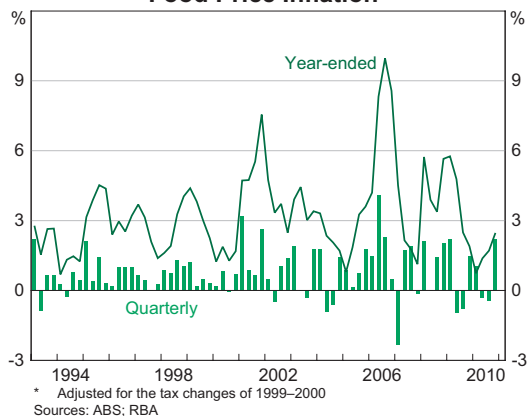
slowest year-ended pace since September 2007, and almost 2 percentage points below the peak in late 2008. The rates of increase in rents, house purchase costs and the price of non-tradable food have declined over the past couple of years (Graph 5.5). Domestic holiday prices declined over 2010, as the domestic tourism industry was affected by the exchange rate appreciation and bad weather later in the year. However, further substantial moderation in non-tradables inflation seems unlikely in the near term. Conditions in the rental market are relatively tight, and the cost of building materials has increased, although liaison continues to point to some underlying weakness in the house construction industry. Inflation remains relatively high for a number of services. Health services and education prices rose by around 6 per cent over 2010, and utilities prices increased by 11½ per cent. More generally, labour market conditions have tightened since mid 2009 and wage growth picked up over 2010.

Food prices rose by 2.2 per cent in the December quarter, following subdued inflation since early 2009, to be 2½ per cent higher over the year (Graph 5.6). Fruit & vegetable prices increased by 13 per cent in the quarter – contributing 0.3 percentage points to CPI inflation – which was the largest increase since mid 2006, when banana prices temporarily spiked following Cyclone Larry. Seasonal strength in fruit & vegetable prices in the quarter was exacerbated by heavy rainfall in several states which damaged crops and reduced supply. Abstracting from fruit & vegetables, food price inflation picked up to 0.5 per cent in the quarter, although the year-ended rate remained low relative to history at 1.6 per cent. Looking ahead, the recent wet weather (including the Queensland and Victorian floods), Cyclone Yasi and elevated commodity prices will place upward pressure on food prices, particularly for fruit & vegetables, although this will be partly offset to the extent that alternative sources of supply become available (see Box A).

Graph 5.5
Non-tradables Inflation by Category*
Year-ended

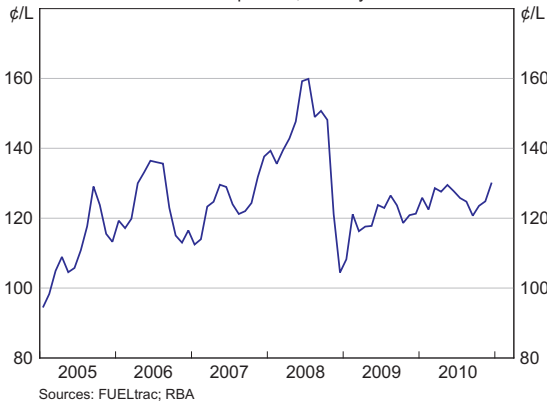


Graph 5.6
Food Price Inflation*

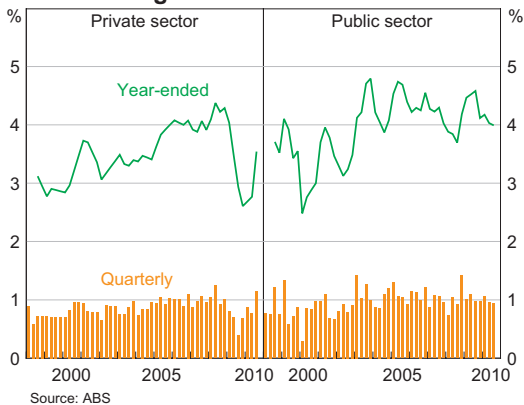


Automotive fuel prices have risen since late 2008, following the sharp decline over the previous year. As noted in the 'International Economic Developments' chapter, global oil prices have continued to rise in recent months. The price increase has been significant for Tapis oil, the relevant benchmark for Australian petrol prices, which has risen by more than 15 per cent since October 2010. The impact on petrol prices of rising oil prices has more than outweighed the effects of the exchange rate appreciation (Graph 5.7).

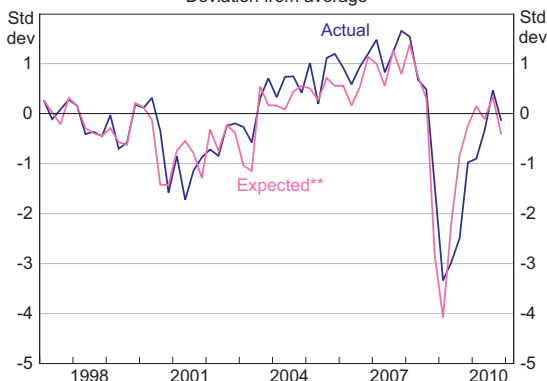
Graph 5.7
Retail Petrol Prices
Cents per litre, monthly



Graph 5.8
Wage Price Index Growth



Graph 5.9
Surveys of Business Labour Costs*
Deviation from average



* Weighted average of data from various business surveys since 1994, with weights calculated by the RBA using the principal component method
** Expectation for following quarter
Sources: CBA-ACCI; NAB; RBA; Sensis

Costs

Labour cost growth picked up during 2010, broadly in line with the Bank's expectations, following low outcomes in the private sector over 2009. This pick-up is consistent with the strengthening in labour market conditions, and a further gradual increase in wage growth is expected as the labour market continues to tighten.

The wage price index (WPI) rose by 1.1 per cent in the September quarter, after rising by 0.8 per cent in the previous quarter. The quarterly outcome partly reflected the effects of the relatively large minimum wage increase in 2010 – which came into effect in July, and followed the minimum wage freeze in 2009 – as well as the broader pick-up in wage growth due to the strengthening in labour market conditions. Over the year to September, the WPI increased by 3.5 per cent, which is slightly below the average since 1997. Private-sector wage growth picked up to 3.5 per cent over the year to September, following subdued growth over 2009 (Graph 5.8). In contrast, public sector wages have grown at a consistently solid pace in recent years, and were 4.0 per cent higher over the year to September. Wage growth has been highest in the utilities and education industries, while Queensland and Western Australia recorded the fastest pace of wage growth across the states over the year to September.

Business surveys and the Bank's liaison suggest that labour cost growth has remained around its average pace (Graph 5.9). Firms are generally not experiencing significant difficulty finding suitable labour at present, although the labour market has tightened and labour shortages have been reported in mining-related industries and for some skilled occupations.

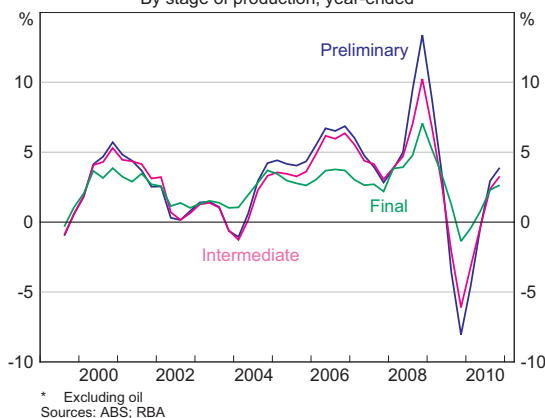
Estimated labour productivity growth has been relatively low for several years. The combination of weak productivity growth and the pick-up in wage growth implies that growth in labour costs per unit of output was relatively high in 2010, following low growth over 2009.

Producer prices rose by around 3–4 per cent at the different stages of production over 2010, after falling over 2009 (Graph 5.10). In the December quarter, however, producer prices were broadly flat at all stages of production, with rising domestic prices offset by falling import prices. Imported producer prices fell by around 3–4 per cent in the quarter at each stage of production, with the exchange rate appreciation more than offsetting upward pressure stemming from rising commodity prices.

Inflation Expectations

There was a sharp increase in consumer inflation expectations in the Melbourne Institute's January survey, which may reflect expectations of large increases in fruit and vegetable prices following the floods (Graph 5.11). Medium-term inflation expectations derived from financial markets have risen more modestly over recent months, with the indexed bond measure around its average over the inflation-targeting period. Union officials have raised their near-term inflation expectations slightly, but their medium-term expectations are unchanged (Table 5.2). Market economists surveyed by the Bank are forecasting headline inflation to remain at, or a little above, the top of the medium-term target over the next couple of years, before declining to around 2¾ per cent. In contrast, business survey measures of expected selling prices in the near term remain below average levels. ✎

Graph 5.10
Producer Price Inflation*
By stage of production, year-ended



Graph 5.11
Indicators of Inflation Expectations

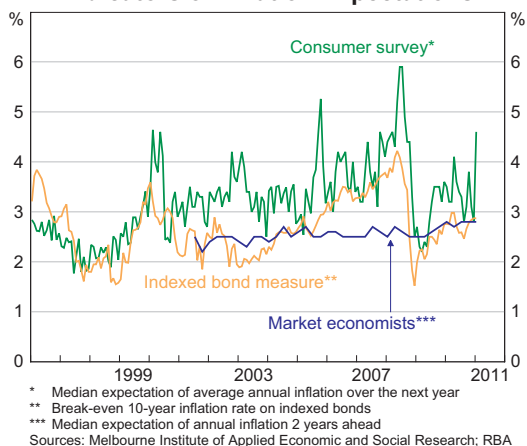


Table 5.2: Median Inflation Expectations
Per cent

	Year to December 2011			Year to December 2012	
	August 2010	November 2010	February 2011	November 2010	February 2011
Market economists ^(a)	3.0	3.2	3.3	2.8	3.1
Union officials ^(b)	3.2	3.0	3.2	na	3.2

(a) RBA survey

(b) Workplace Research Centre

