Inflation rate edges higher from a 17-year low

Consumer price index

- Inflation rate lifts: The Consumer Price Index – the main measure of inflation in Australia – rose by 0.7 per cent in the September quarter, above expectations for a lift of 0.4-0.5 per cent. In seasonally adjusted terms the CPI rose by 0.4 per cent. The annual rate of inflation rose from a 17-year low of 1.0 per cent to 1.3 per cent (seasonally adjusted 1.4 per cent).
- Underlying measures: The Reserve Bank monitors three measures to derive the underlying inflation rate. The trimmed mean rose by 0.4 per cent in the September quarter (1.7 per cent annual); the weighted median rose by 0.3 per cent (1.3 per cent annual) and the CPI less volatile items rose by 0.5 per cent (1.7 per cent annual). Overall, underlying inflation rose by 0.4 per cent in the quarter and by 1.6 per cent over the year.
- Main changes: Fruit prices rose by 19.5 per cent in the quarter with electricity up by 5.4 per cent, tobacco up by 2.3 per cent, vegetables up 5.9 per cent and property rates and charges up 4.0 per cent. The CPI was dragged lower by a 2.9 per cent fall in petrol prices and a 2.5 per cent fall in telecom equipment and services.
- Notable changes: Prices of beer, wine, cedar and spirits rose by just 0.9 per cent over the year – the smallest rise on record (43 years). Car prices fell 0.6 per cent in the September quarter with the car price index at the lowest levels since 1987.

The inflation measures monitored by the Reserve Bank

	Quarterly		*Year-ended*	
	Sep Qtr 16	Jun Qtr 16	*Sep Qtr 16*	Jun Qtr 16
CPI - unadjusted	*0.7*	0.4	*1.3*	1.0
CPI - seasonally adjusted	*0.4*	0.6	*1.4*	1.0
– Tradables	*1.0*	0.6	*0.7*	0.0
– Tradables (excl volatile items/tobacco)	*na*	-0.3	*na*	0.1
– Non-tradables	*0.5*	0.6	*1.7*	1.6
Selected underlying measures				
Trimmed mean	*0.4*	0.5	*1.7*	1.7
Weighted median	*0.3*	0.4	*1.3*	1.3
CPI excluding volatile items(a)	*0.5*	0.4	*1.7*	1.6

(a) Volatile items are fruit, vegetables and automotive fuel (r) revised
Source: ABS, RBA, CommSec

What does it all mean?

- Inflation has lifted from the canvas, albeit with a lot of help from higher prices for fruit and vegetables. Still, the higher headline rate of inflation will serve to lift key measures of inflation expectations and thus make it more likely that inflation will return to the 2-3 per cent target band in coming quarters.

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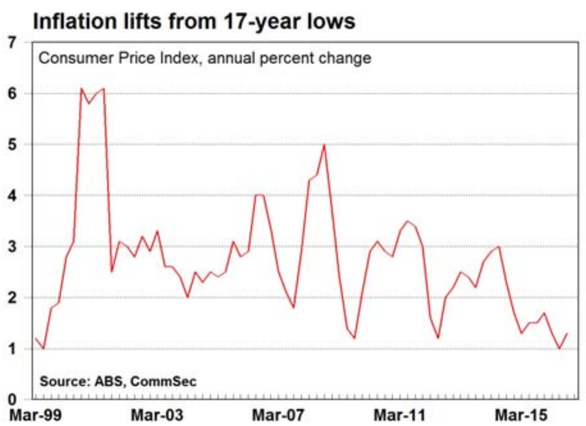
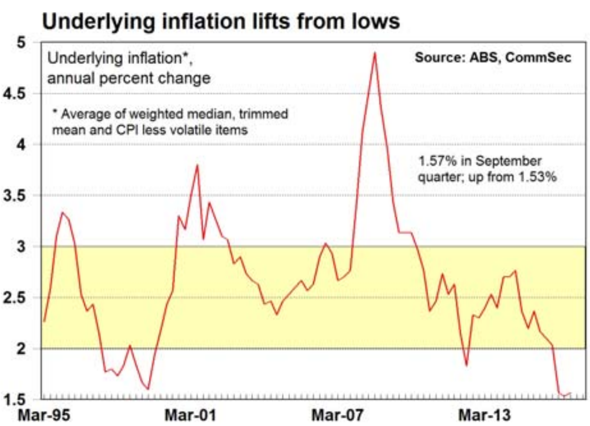
- Underlying inflation remains low: up 0.4 per cent in the quarter to be up 1.6 per cent for the year. But if recent floods cause more food inflation, this will drive headline inflation higher, and in turn, lift underlying price measures.
- It is clear that inflation is still historically low. So, the Reserve Bank can still cut rates if it wants to take out some insurance on a stronger growth/stronger inflation outcome. So a rate can't on November 1 can't be totally ruled out. But financial markets are not betting on it – with pricing suggesting that there is a 6 per cent chance of a rate cut in November. And the Reserve Bank is indeed looking for reasons not to cut rates rather than looking for reasons to reduce rates to new record lows.
- It is clear that interest rates will stay low for an extended period. Global competition ensures that retailers can't lift prices in the current environment.
- The Reserve Bank would also welcome the fact that coal, oil and iron ore prices are rising, the US economy remains in good shape, China is still expanding at a near 7 per cent annual clip and that European economic activity is looking better. Inflation still faces challenges in returning to the 2-3 per cent target band, but prospects of getting back into the band are looking better.

What do the figures show?

- The All Groups Consumer Price Index (CPI) rose by 0.7 per cent in the September quarter, above expectations for a lift of 0.4-0.5 per cent. In seasonally adjusted terms the CPI rose by 0.4 per cent. The annual rate of inflation rose from a 17-year low of 1.0 per cent to 1.3 per cent (seasonally adjusted 1.4 per cent).
- Underlying measures of inflation were generally in line with forecasts in the September quarter. The **trimmed mean** rose by 0.4 per cent in the September quarter (1.7 per cent annual); the **weighted median** rose by 0.3 per cent (1.3 per cent annual) and the **CPI less volatile items** rose by 0.5 per cent (1.7 per cent annual). Overall, underlying inflation rose by 0.4 per cent in the quarter and by 1.6 per cent over the year. So to two decimal places underlying inflation rose from a record low of 1.53 per cent to 1.57 per cent.
- The Bureau of Statistics noted: *"The most significant price rises this quarter are fruit (+19.5 per cent), electricity (+5.4 per cent), vegetables (+5.9 per cent), tobacco (+2.3 per cent) and property rates and charges (+4.0 per cent). „ The most significant offsetting price falls this quarter are automotive fuel (-2.9 per cent) and telecommunication equipment and services (-2.5 per cent)."*
- **Prices of tradables** rose by 1.0 per cent in the September quarter with higher fruit prices offsetting lower petrol prices.
- **Prices of non-tradables** rose by 0.5 per cent in the September quarter. The most significant contributor to the 0.8 per cent rise in the non-tradable goods component was electricity (+5.4 per cent). The rise in the non-tradable services component of 0.4 per cent was driven by property rates and charges (+4.0 per cent). The most significant offsetting fall in the non-tradable services component was telecommunication equipment and services (-2.5 per cent).
- **Tradable goods** are those items whose prices are largely determined on the world market. **Non-tradable prices** are more affected by domestic economic conditions.
- Over the last twelve months, the tradables component rose 0.7 per cent, while the non-tradables component rose 1.7 per cent. This compares to no movement and a rise of 1.6 per cent respectively over year to June.
- **Capital cities**: Sydney +1.0 per cent in the quarter (annual +1.7 per cent); Melbourne +0.5 per cent (+1.4 per cent); Brisbane +0.6 per cent (+1.5 per cent); Adelaide +0.8 per cent (+1.2 per cent); Perth +0.4 per cent (+0.5 per cent); Hobart +0.7 per cent (+1.3 per cent); Darwin +0.4 per cent (0.0 per cent); Canberra +0.8 per cent (+1.4 per cent).





Why is the data important?

- The **Consumer Price Index (CPI)** is regarded as Australia's premier measure of inflation. The CPI is published quarterly and measures price changes for a 'basket' of goods and services that dominate expenditure of metropolitan households. The "All Groups" index is the main focus, but other inflation measures are also published such as so-called 'underlying' measures. These include measures that abstract from price changes in volatile price items such as fresh food and petrol.
- The Reserve Bank aims to keep the headline inflation rate between 2-3 per cent over an economic cycle. If inflation is high and expected to rise, the Reserve Bank may elect to raise interest rates in order to constrain price pressures. Conversely, if inflation is low and expected to remain low, the Reserve Bank may elect to cut interest rates if it believes the growth pace of the economy is in need of strengthening.

What are the implications?

- Financial markets are pricing in a 6 per cent chance of a rate cut in November.
- A November rate cut can't be completely ruled out as inflation is still well below the 2-3 per cent target band. But higher food prices and higher commodity prices have the potential to lift headline inflation, inflation expectations and thus underlying inflation.
- For all businesses the key message is that competition is global rather than local. So non-price inducements will be more common-place this Christmas to attract people into stores and to websites.

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