

Consumer Price Index (CPI), June quarter (Q2) 2016

Headline annual inflation slowed to 1.0% p.a. in the June quarter of 2016 (Q2), moving further below the RBA's target band of 2 to 3%. In quarterly growth terms, headline CPI grew by +0.4%, after a rare quarter of negative growth in Q1 (-0.2% q/q, which was the slowest quarter and the only negative since December 2008). The main contributors to inflation in Q2 were price increases in health care (+2.6% q/q, +4.5% p.a.), transport (+1.0% q/q, -2.8% p.a.) and housing (+0.4% q/q, +1.3% p.a.).

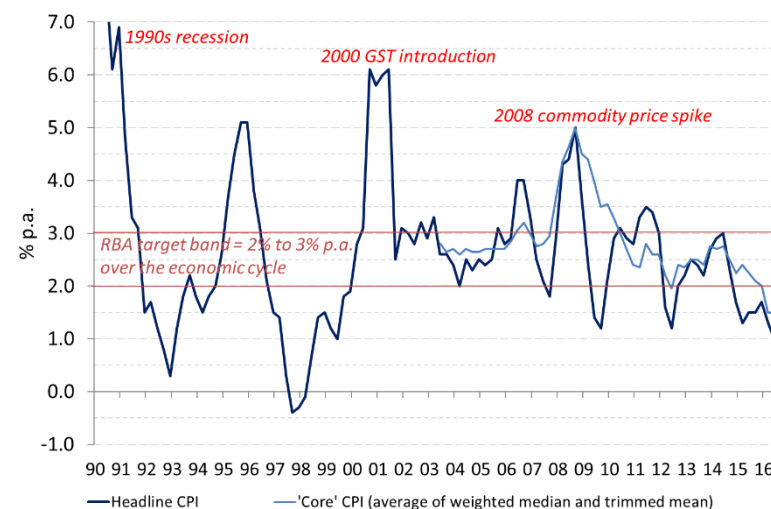
At just +1.0% p.a. in Q2, this is Australia's slowest **headline inflation** rate since June 1999. Headline inflation has now been below the RBA's target band of 2 to 3% p.a. (on average, over the economic cycle) for seven consecutive quarters. This is the longest period that CPI annual growth has stayed below 2% since 1999.

Underlying inflation (the average of the trimmed mean and weighted median measures of inflation, and a less volatile measure than headline CPI) was unchanged in annual terms in Q2, at +1.5% p.a.. This annual rate of core inflation is the lowest level on record in the relevant CPI data series (commencing in 2003) and the only time it has moved below the RBA's target band of 2-3%. In quarterly growth terms however, underlying inflation accelerated slightly, to +0.5% q/q in Q2 from +0.2% q/q in Q1.

This extended period of very subdued inflation may allow the RBA to reduce cash rates further in 2016, should it consider this prudent. The RBA will be looking for signs of a pickup in inflation and will be hoping that the current record low cash rate of 1.75% will help to stimulate local demand and hence to stabilise prices. However, if this does not occur in the near term, the RBA might need to reduce the cash rate further in the coming months. Ongoing weakness in headline and core inflation is also helping to reduce pressure on employers to raise wages for their employees, in order to keep up with real the cost of living.

Across the capital cities, annual inflation in Q2 2016 was slowest in Darwin (0.0% p.a.) and highest in Brisbane (+1.5% p.a.) and Melbourne (+1.4% p.a.). The large eastern capitals have generally experienced stronger price growth, while other capitals had softer inflation. This reflects differences in general economic conditions between states and the shift in economic activity towards the eastern states (see Table 1).

Chart 1: CPI p.a., headline & core



+0.4%

HEADLINE CPI,
QUARTER GROWTH

+1.0%

HEADLINE CPI,
ANNUAL GROWTH

Prices for tradable goods and services (accounting for around 40% of the CPI basket) bounced up by +0.6% q/q in Q2 (up from -1.4% q/q in Q1), but slowed to zero growth (0.0%) in annual terms. Prices for tradable goods and services are largely determined globally and are affected by movements in the exchange rate. The increase in tradable prices in Q2 was driven by higher automotive fuel prices (i.e. petrol and diesel) and higher international holiday, travel & accommodation prices. These prices have been influenced by the relatively lower Australian dollar (compared to the March quarter), with prices for imported goods and services becoming more expensive, in Australian dollar terms.

Prices for non-tradeable goods and services (accounting for around 60% of the CPI basket) increased modestly in the June quarter, at +0.4% q/q and +1.6% p.a. In annual growth terms, this was slightly slower than in the March quarter (+1.7% p.a.). Prices for non-tradeable goods and services are largely determined locally by labour, rent and other local costs. Non-tradeable price increases in Q2 were most evident in prices for new dwellings and for medical & hospital services.

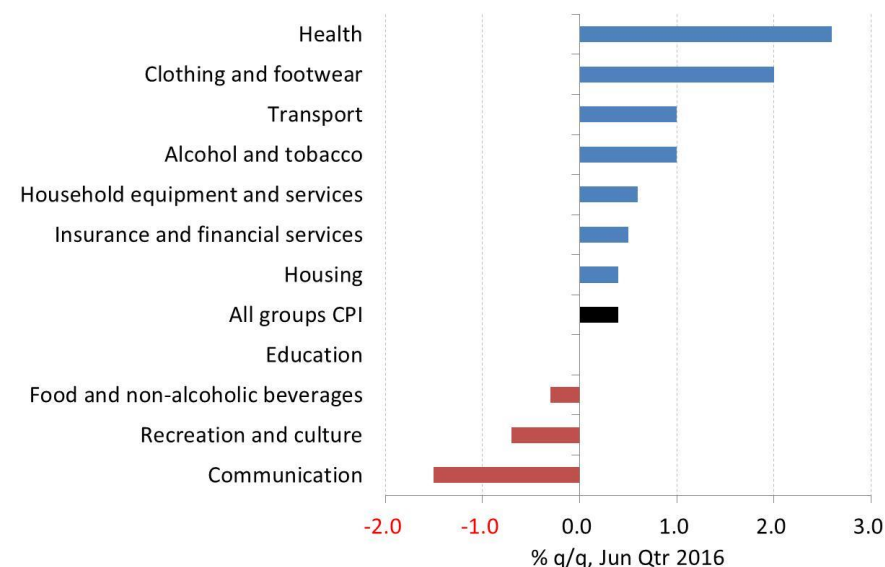
Health services were the main driver of increases in CPI in Q2 (+2.6% q/q and +4.5% p.a.). Specifically, prices for medical and hospital services increased by +3.8% q/q and +5.4% p.a. in Q2, mainly due to increases in private health insurance premiums as of 1 April 2016.

Transport prices also added upward pressure to the CPI in Q2 (+1.0% q/q), but detracted from it over the year to Q2 (-2.8% p.a.). In particular, automotive fuel prices increased by +5.9% q/q in Q2, but remained 11.6% lower than a year earlier.

Also contributing to the upward CPI movement in Q2 were housing costs (+0.4% q/q and +1.3% p.a.), including the cost of new dwelling purchases by owner occupiers (+0.9% q/q and +1.9% p.a.). The ABS attributed this to rising prices for building materials in some major cities.

Some downward pressure on CPI arose from declines in recreation and culture prices in Q2 (-0.7% q/q but +0.8% p.a.). This was due mainly to declines in domestic holiday travel and accommodation prices (-3.7% q/q and -0.8% p.a.), with the June quarter typically the off season for domestic tourism.

Chart 2: Quarterly price rises, Q2 2016



Key numbers: Australian core CPI, June quarter 2016

+0.5%

CORE CPI,
QUARTER GROWTH

+1.5%

CORE CPI,
ANNUAL GROWTH

Table 1: Key CPI Numbers, June quarter (Q2) 2016

	Quarterly change (% q/q)		Annual change (% p.a.)	
	Jun-16	Mar-16	Jun-16	Mar-16
Headline CPI	0.4	-0.2	1.0	1.3
Trimmed mean	0.5	0.2	1.7	1.7
Weighted median	0.4	0.1	1.3	1.3
Core CPI <i>(average of trimmed & weighted)</i>	0.5	0.2	1.5	1.5
Tradable goods and services	0.6	-1.4	0.0	0.6
Non-tradable goods and services	0.4	0.4	1.6	1.7
Goods	0.6	-0.7	0.3	0.9
Services	0.3	0.4	2.0	1.9
Capital cities				
Sydney	0.6	-0.2	0.9	1.3
Melbourne	0.4	-0.1	1.4	1.7
Brisbane	0.5	0.0	1.5	1.7
Adelaide	0.5	-0.3	0.7	0.7
Perth	0.3	-0.6	0.5	0.7
Hobart	0.0	-0.2	1.2	1.3
Darwin	0.3	-0.9	0.0	-0.3
Canberra	0.2	0.2	0.8	1.0

What is the CPI?

The Consumer Price Index (CPI) measures changes in the price of a 'basket' of goods and services which account for a high proportion of expenditure by metropolitan households. CPI data is collected by the Australian Bureau of Statistics (ABS) and released each quarter in January, April, July and October.

Headline CPI is the most commonly referenced CPI figure. It is not adjusted for the seasonality of volatile movements in prices.

Underlying CPI (or Core CPI) is a less volatile measure, as it removes the effects of items that tend to fluctuate frequently in price. Core CPI is the average of the trimmed mean CPI and the weighted mean CPI.

For more information from the ABS, or for information from the ABS on how to use the CPI in contracts, see:

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/6401.o?opendocument#from-banner=LN>

Next CPI release date:

September Quarter (Q3) 2016 due for release on 26 October 2016

Ai Group Economics and Research Team

Julie Toth	Chief Economist
David Richardson	Senior Economist
Jesse Oliver	Economist
Colleen Dowling	Senior Economics Research Coordinator
Elle Spyropoulos	Economics Research Assistant

economics@aigroup.com.au

T: 03 9867 0111