

1 February 2019

Welcome to 2019. This is our first Economics Weekly for this year.

AUSTRALIAN ECONOMIC DEVELOPMENTS

Australian inflation (the headline consumer price index, CPI) slowed to 1.8% p.a. in the September quarter of 2018 (Q3) from 1.9% p.a. in Q3. This deceleration in the annual rate of CPI occurred despite a slight (and most probably temporary) acceleration in price movements over the quarter in Q4, with price growth of 0.5% q/q in Q4 compared to 0.4% q/q in Q3. 'Core' inflation (a less volatile measure which removes temporary and seasonal price changes) stayed at 0.4% q/q and 1.8% p.a. in Q4. Inflation is now even further below the RBA's target band of 2 to 3% over the cycle, and further away from necessitating a rise in the RBA's cash rate from the current record low rate of 1.50%.

For Australia's businesses, the latest data on producer prices (the ABS' PPI) confirms that input costs continue to rise, on average, more strongly than output prices for producers of Australian goods and services. Price growth in preliminary (+4.3% p.a.) and intermediate (3.8% p.a.) producer inputs strongly outpaced price growth in producer outputs (+2.0% p.a.) in Q4 of 2018. For businesses relying on imported inputs, the lower Australian dollar through 2018 saw prices for imported preliminary products rise by 7.4% p.a. and prices for intermediate products rise by 7.1% p.a. This 'growth gap' between price rises for final products versus preliminary and intermediate inputs indicates that business margins were further compressed in Q4 2018, with an especially big jump in input prices for businesses that utilise imported inputs.

[The Ai Group Australian Performance of Manufacturing Index \(Australian PMI®\)](#) recovered by 2.5 points to 52.5 points in January 2019 (seasonally adjusted) from a revised result of 50.0 points in December 2018 (previously estimated at 49.5 points, seasonally adjusted). Results above 50 points indicate expansion with higher results indicating a stronger expansion. This signals a very mild recovery in manufacturing conditions in January 2019, following a flat month in December 2018. December's result halted 26 months of continuous expansion in the Australian PMI®. Despite this month's improvement, the Australian PMI® continues to decelerate since reaching a recent peak in March 2018. Of the six manufacturing sectors in the Australian PMI®, the large food and beverages sector continues to enjoy better conditions (including better sales, exports and forward orders) than other manufacturing sectors.

Inflation slows to 1.8% p.a. in Q4 2018

The headline consumer price index (CPI) slowed to 1.8% p.a. in the December quarter (Q4) of 2018 (Q3). This was despite inflation in the quarter picking up slightly to 0.5% q/q in Q4 from 0.4% q/q in Q3 of 2018. When volatile items such as fresh food (affected by drought) and petrol (affected by global oil prices and the dollar) are excluded, inflation was slightly higher in Q4 (0.6% q/q) than in Q3 (0.4% q/q) but remained relatively weak over the year, at just 1.6% p.a. This 'ex-volatile' measure of inflation has not exceeded 2.0% since Q4 2015.

Underlying or 'core' inflation (the RBA's preferred method of excluding the temporary effects of overly volatile pricing) came in at 0.4% q/q and 1.8% p.a. in Q4. It was just above the RBA's forecast for Q4 of 1.75% but remains well below the RBA target band of 2-3% over the cycle Core inflation has been below 2.0% since Q4 of 2015 (table 1 and chart 1). These persistently low rates of ex-volatile and underlying inflation are reducing the probability that the RBA will raise the cash rate from the historically low rate of 1.50% in the foreseeable future.

Table 1: Key inflation numbers, Q3 and Q4 2018

<i>Seasonally adjusted</i>	Quarterly % change		Annual % change	
	Sep-18	Dec-18	Sep-18	Dec-18
Headline CPI	0.4	0.5	1.9	1.8
CPI excluding volatile items	0.4	0.6	1.2	1.6
trimmed mean	0.4	0.4	1.8	1.8
weighted median	0.4	0.4	1.7	1.7
Core CPI (average of trimmed mean and weighted median)	0.4	0.4	1.8	1.8
Tradable goods and services	0.2	-0.1	1.4	0.7
Non-tradable goods and services	0.2	0.8	2.2	2.4
<i>Original (not seasonally adjusted)</i>				
Goods	0.5	0.5	2.2	1.7
Services	0.3	0.5	1.6	1.7
Sydney	0.6	0.4	2.0	1.7
Melbourne	0.2	0.5	2.2	2.0
Brisbane	0.4	0.5	1.8	1.5
Adelaide	0.3	0.5	1.8	1.6
Perth	0.5	0.5	1.2	1.3
Hobart	0.6	1.2	2.7	3.0
Darwin	0.6	0.2	1.3	1.2
Canberra	0.6	0.7	2.5	2.5

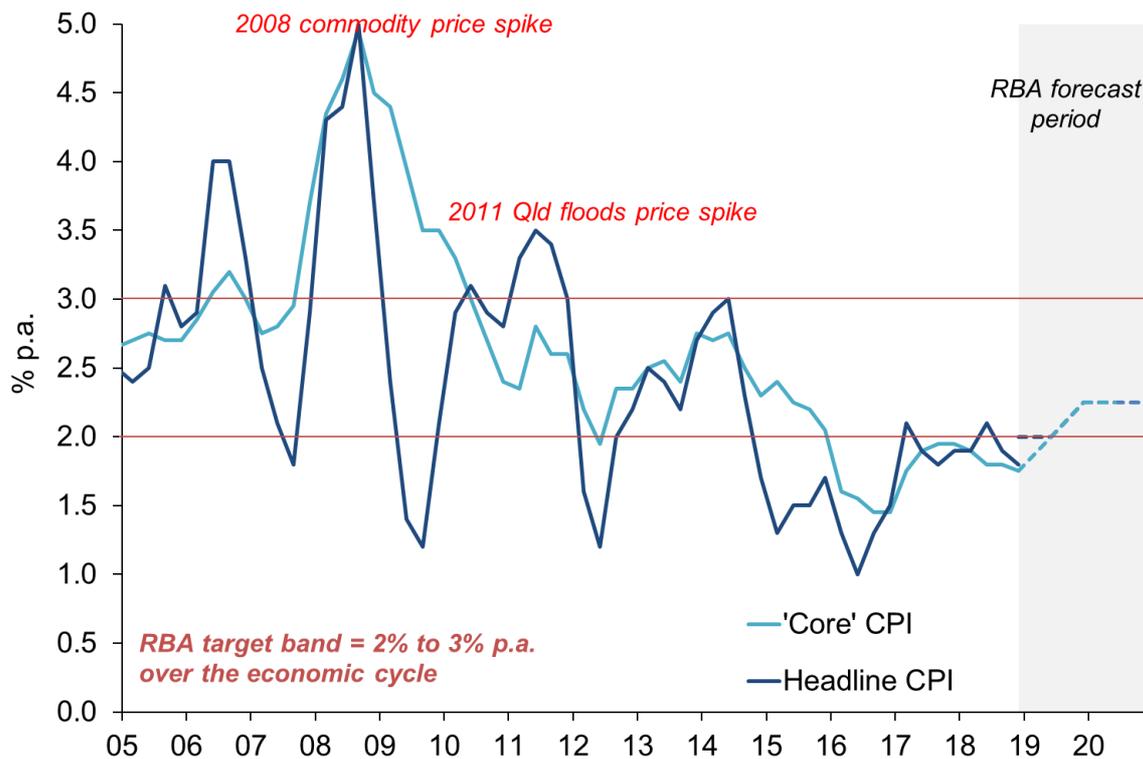
Source: ABS CPI, Dec 2018

Inflation in Q4 of 2018 was affected by:

- **Drought:** stronger price rises for fresh food products including some fruit, vegetables and meat products. Prices spiked for various items through Q3 and Q4 but are expected to be temporary. These price changes have probably prompted product substitution by consumers as they seek cheaper alternatives (swapping between fruits or vegetables). And although fresh food inflation strengthened in Q3 and Q4, it remains low on an annualised basis.

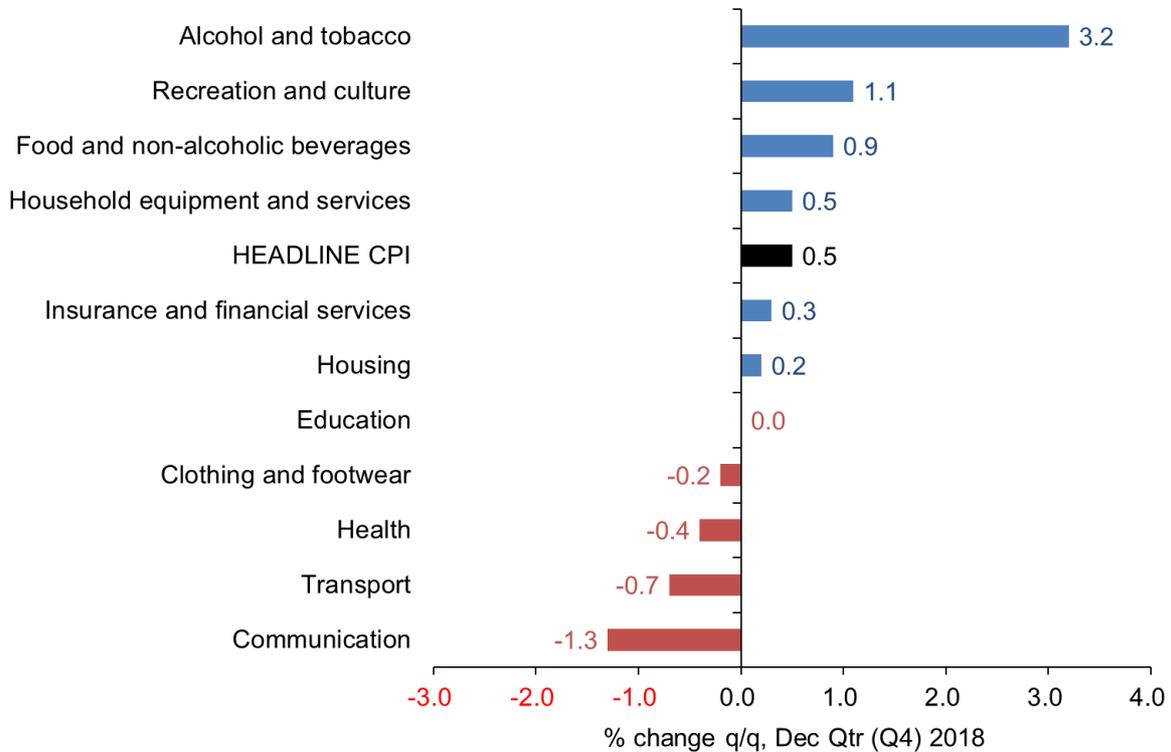
- Government:** stronger price rises (again) in Q4 for ‘government administered’ items (that is, federal or state governments can influence their price) such as tobacco, electricity, gas and childcare. Although gas prices fell from recent peaks in Q4 they remain 3.2% higher than a year earlier. Retail electricity prices increased by a further 0.9% q/q in Q4 (chart 3). Childcare prices increased by 1.4% q/q in Q4 but remained 8.3% lower than one year earlier due to price cuts related to changes to childcare subsidy arrangements earlier in 2018.
- Dollar:** the lower Australian dollar during 2018 is pushing prices higher for some types of tradable goods and services such as travel and household equipment (e.g. televisions). These prices had more often fallen in previous periods (chart 2). Taking the edge off these price rises for some tradeable goods, the retail petrol price fell by 2.5% in Q4. It remained 6.7% higher than one year earlier however, due to big price increases in early 2018.
- Housing market cycle.** Residential property prices are not directly included in the CPI (since purchasing a residence is an asset purchase and not a consumer item), but the effect of decelerating house prices is evident in the CPI indexes for ‘rents’ and ‘new dwelling purchases by owner-occupiers’, which slowed to 0.5% p.a. and 1.8% p.a. respectively in Q4 2018, their slowest in two years. Rents have been rising by less than 1.0% p.a. since Q1 of 2016. Property rates (administered by local councils and based on estimated property values) were flat in Q4, after increasing by an average of 2.3% in Q3. Rates grew by 2.3% p.a. in each of Q3 and Q4, which was the slowest annual growth for this index since at least 2000 (chart 4).

Chart 1: Headline and core inflation and RBA forecasts



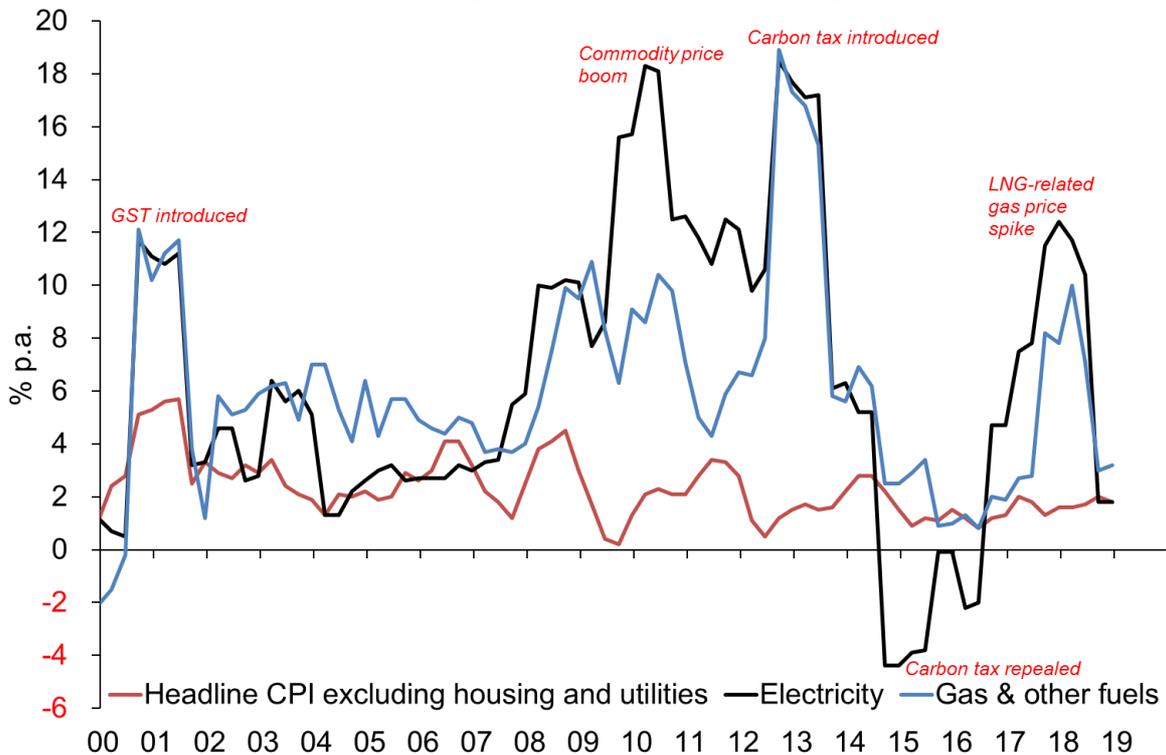
Source: ABS CPI, Sep 2018; and RBA Statement on Monetary Policy, Nov 2018.

Chart 2: Quarterly inflation for major product categories, Q4 2018



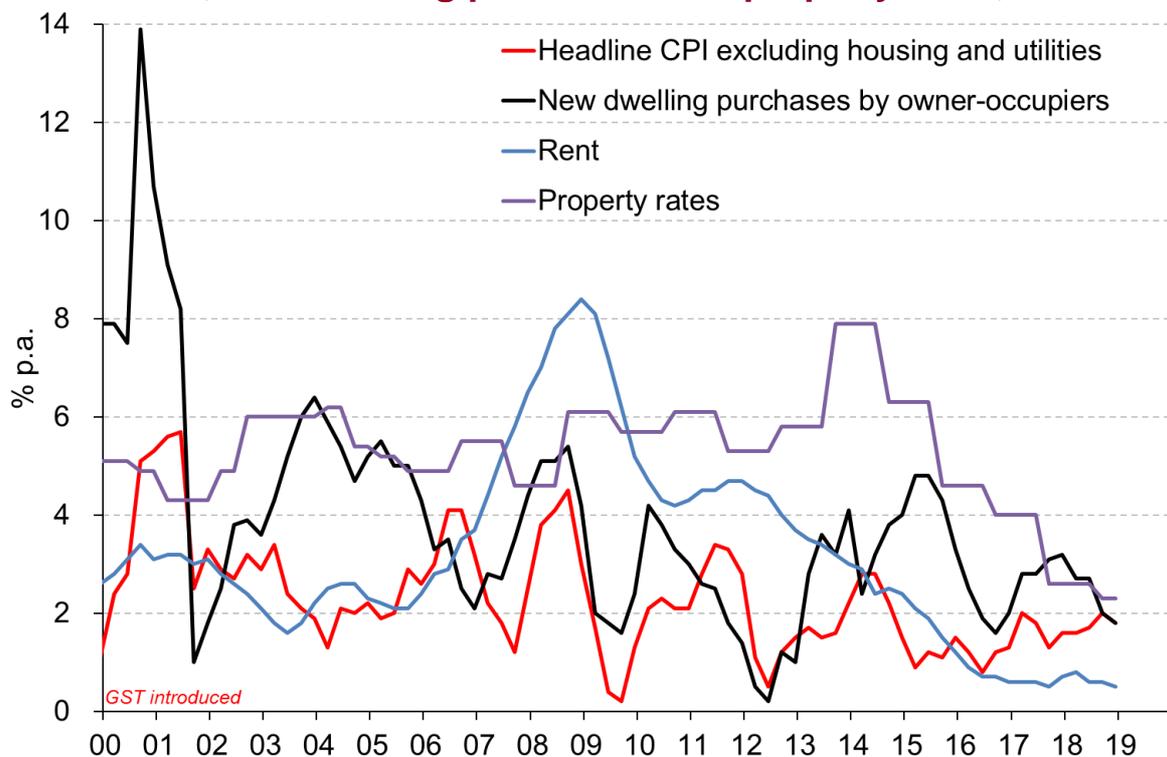
Source: ABS CPI, Dec 2018.

Chart 3: Electricity and gas retail price changes, 2000 to 2018



Source: ABS CPI, Dec 2018.

Chart 4: Rents, new dwelling purchases and property rates, 2000 to 2018



Source: ABS CPI, Dec 2018.

Business margins further compressed in Q4 2018

For Australia’s businesses, the latest data on producer prices (the ABS’ PPI) confirms that input costs continue to rise, on average, more strongly than output prices for all producers of Australian goods and services. Price growth in preliminary (+4.3% p.a.) and intermediate (3.8% p.a.) producer inputs strongly outpaced price growth in producer outputs (+2.0% p.a.) in Q4 of 2018 (table 2). For businesses relying on imported inputs, the lower Australian dollar through 2018 saw prices for imported preliminary products rise by 7.4% p.a. and prices for intermediate products rise by 7.1% p.a. This ‘growth gap’ between price rises for final products versus preliminary and intermediate inputs indicates that business margins were further compressed in Q4 2018, with an especially big jump in input prices for businesses that utilise imported inputs.

For manufacturers, the gap between input price increases and output (selling prices) price increases was especially large in Q4 2018, probably reflecting their relatively high share of imported inputs. Over the year to Q4 2018, manufacturing input prices rose by 6.2% p.a., with prices for imported inputs up by 9.7% p.a. In contrast, average output prices were up by 5.4% p.a. (chart 5). This was due to a combination of a lower Australian dollar during 2018 and price rises for key commodities utilised as inputs by many manufacturers. The drought appears to have pushed up input prices for some agricultural inputs also.

Input price rises for manufacturers in 2018 included particularly steep input price rises for: sheep and beef cattle (+13.3% p.a.); oil and gas extraction (+21.7% p.a.); coal mining (+12.5% p.a.);

petroleum and coal products (+12.3% p.a.); basic ferrous metals (+14.8% p.a.); basic ferrous metal products (+24.9% p.a.); natural gas (+5.4% p.a.); and electricity (+11.3% p.a.).

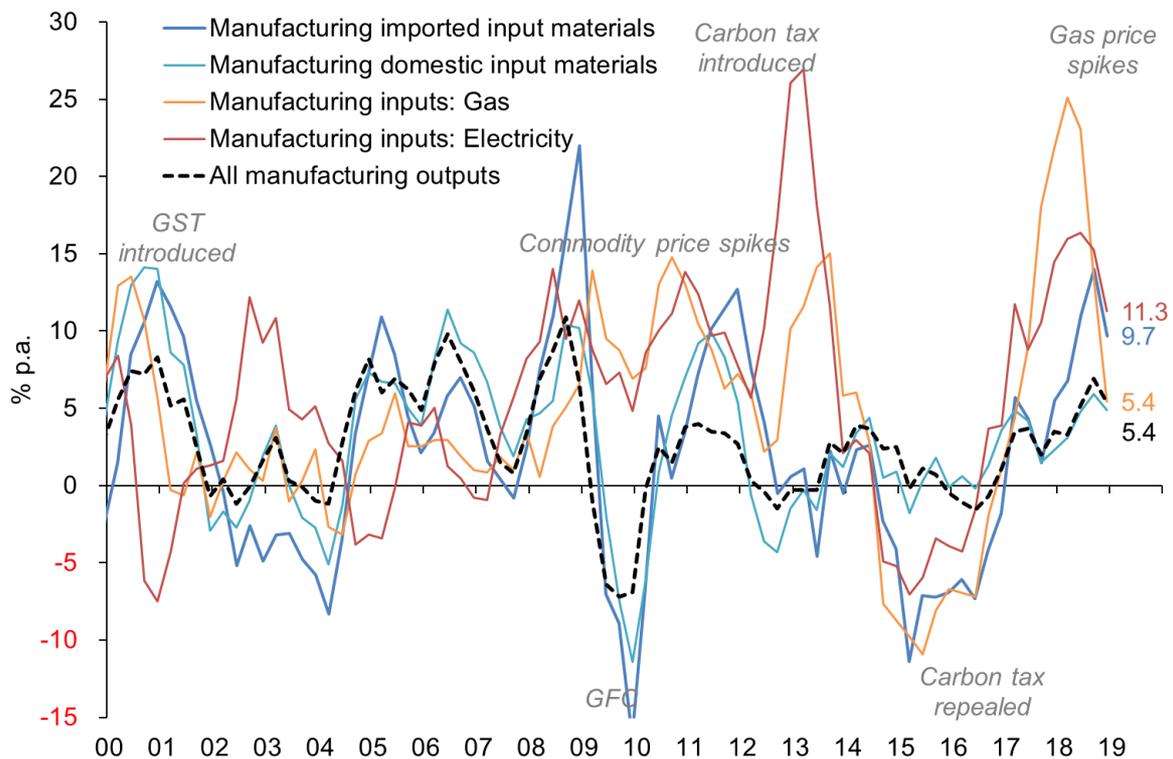
In the case of gas and electricity, the latest round of price increases came on top of mounting costs over the past decade. As of Q4 2018, input prices for electricity for manufacturing businesses were 84% higher than they had been in 2010, while gas input prices were 48% higher than they had been in 2010. This compares to price increases for all manufacturing inputs of 21% over the same period, and price rises for manufacturing outputs (i.e. their selling prices) of 19% over the same period (chart 6). This demonstrates a substantial degree of margin compression due to rising energy input costs, for manufacturing businesses operating across Australia.

Table 2: Producer price index (PPI) changes for all industries, Q4 2018

<i>Seasonally adjusted</i>	Quarterly % change	Annual % change
Preliminary producer prices	0.4	4.3
Domestic	0.4	3.8
Imported	0.5	7.4
Intermediate producer prices	0.4	3.8
Domestic	0.4	3.4
Imported	0.7	7.1
Final producer prices	0.5	2.0
Domestic	0.4	1.8
Imported	0.6	4.0

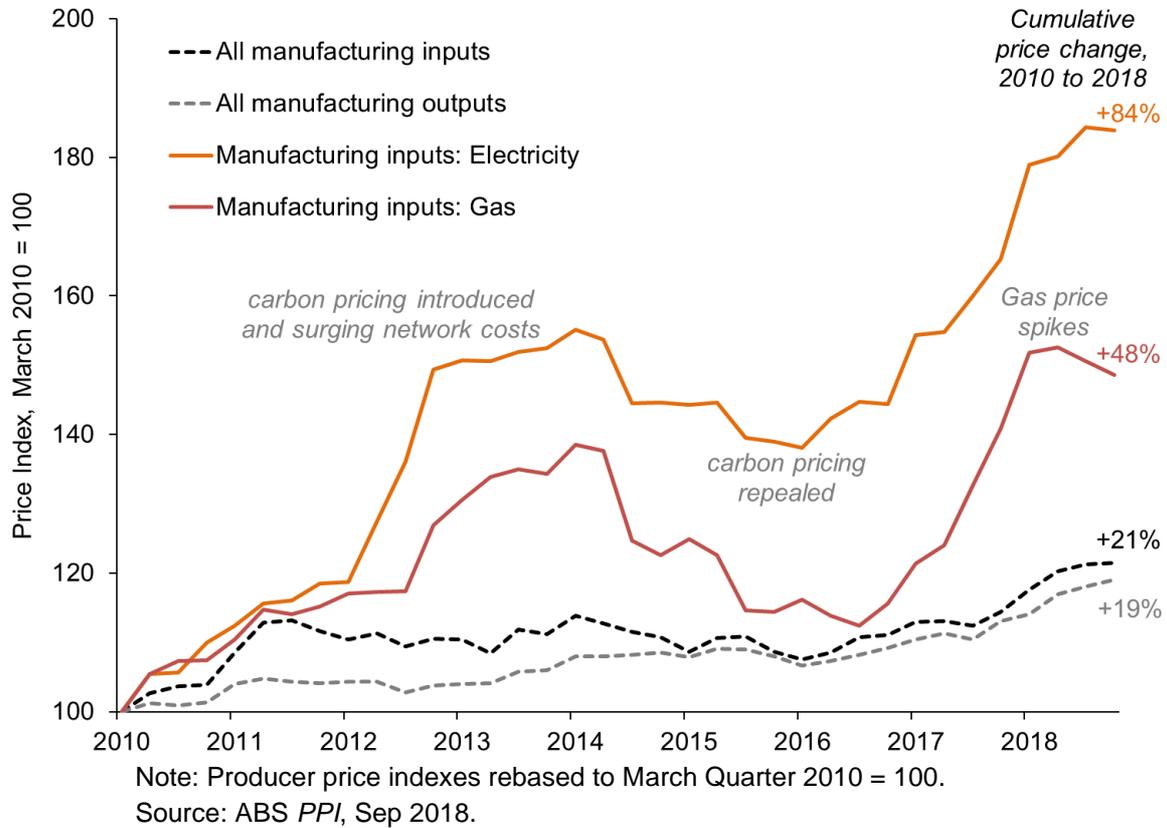
Source: ABS PPI, Dec 2018

Chart 5: Input and output price indexes for manufacturing, annual change



Source: ABS PPI, Dec 2018.

Chart 6: electricity and gas input price indexes for manufacturing, cumulative change from 2010 to 2018



This week's data and events, 28 Jan – 1 Feb 2019

Day	Date	Data/event	Data period	Result
Mon	28 Jan	Australia Day public holiday	-	-
Wed	30 Jan	ABS Consumer Price Index (CPI)	Dec (Q)	Headline CPI +1.8% p.a. Core CPI +1.8% p.a.
Thur	31 Jan	ABS International Trade Price Indexes	Dec (Q)	Import prices +7.8% p.a. Export prices +15.7% p.a.
		RBA private sector credit	Dec (M)	Total credit outstanding: +0.2% m/m, +4.3% p.a.
Fri	1 Nov	Ai Group Australian PMI®	Jan (M)	52.5 points
		ABS Producer Price Index	Dec (Q)	Preliminary prices +4.3% p.a.. Intermediate prices +3.8% p.a.. Final prices +2.0% p.a.

M = monthly. Q = quarterly. H = half-yearly. A = annual. All data are seasonally adjusted unless otherwise noted.

Next week's data and events, 4 Feb Nov – 8 Feb 2019

Day	Date	Data/event	Data period due for release	Result of previous release
Mon	4 Feb	ABS building approvals	Dec (M)	Nov (M): -9.1% m/m
		Westpac-MI inflation gauge	Jan (M)	Dec (M): 0.4% m/m
		ANZ job advertisements	Jan (M)	Dec (M): 0.0% m/m
Tues	5 Feb	Ai Group Australian PSI®	Jan (M)	Dec (M): 52.1 points
		RBA Board Meeting	Feb (M)	Dec (M): Cash rate 1.50%
		ABS International trade in goods and services	Dec (M)	Nov (M): trade balance +\$1.9bn
		ABS retail trade	Dec (M) (Q)	Nov (M) nominal sales: + 0.4% m/m Sep (Q) real sales: +0.2% q/q
Wed	6 Feb	ABS Selected Living Cost Indexes	Dec (Q)	Sep (Q): Employee LCI +2.0% p.a.
		RBA Governor Lowe, Speech at the National Press Club, Sydney	-	-
Thur	7 Feb	Ai Group Australian PCI®	Jan (M)	Dec (M): 42.6 points
		ABS Schools Australia	2018 (A)	-
Fri	8 Feb	RBA Statement on Monetary Policy	Feb (Q)	-

M = monthly. Q = quarterly. H = half-yearly. A = annual. B= Biennial. All data are seasonally adjusted unless otherwise noted.

Australian economy: latest full-year growth rates and government forecasts

RBA SoMP (Nov 2018)	Jun 17 e	Jun 18 e	Jun 19 f	Jun 20 f	Dec 20 f	
GDP, % change p.a., year end	1.8	3.1	3.25	3.25	3.0	
Unemployment rate, %, year end	5.6	5.4	5.0	4.75	4.75	
Inflation (CPI), % change p.a., year end	1.9	2.1	2.0	2.25	2.25	
Treasury MYEFO 2018-19 (Dec 2018)	2016-17 e	2017-18 e	18-19 f	19-20 f	20-21 p	21-22 p
GDP, % change p.a., year average	2.1	2.8	2.75	3.0	3.0	3.0
Household consumption, % p.a., year average	2.6	2.8	2.5	3.0		
Dwelling investment, % p.a., year average	2.8	0.1	1.0	-4.0		
Business investment, % p.a., year average	-4.0	6.0	1.0	5.0		
Employment growth, % p.a., year end	1.9	2.7	1.75	1.75	1.5	1.5
Unemployment rate, %, year end	5.6	5.4	5.0	5.0	5.0	5.0
Inflation (CPI), % change p.a., year end	1.9	2.1	2.0	2.25	2.5	2.5
Wages (WPI), % change p.a., year end	1.9	2.1	2.5	3.0	3.5	3.5
Terms of trade, % change p.a., year end	14.4	1.9	1.25	-6.0		

e = estimate f = forecast p = projection

Sources: ABS various data; RBA *Statement on Monetary Policy* (SoMP), latest quarter; Australian Treasury, *MYEFO 2018-19* (Dec 2018).

Australian economy: latest indicators

Economy				FX and commodity prices (Friday morning)		
RBA official cash rate, %	Dec (M)	1.50	-	AUD/USD exchange rate	US\$0.7244	▲
Real GDP, % change p.a.	Sep (Q)	2.8%	▼	Oil price (WTI light crude, USD/BBL)	US\$53.72	▼
Headline CPI, % change p.a.	Dec (Q)	1.8%	▼	Gold price (USD/OZ)	US\$1,318.11	▲
Unemployment rate, % trend	Dec (M)	5.0%	▼	Copper price (USD/tonne, LME spot)	US\$6076.00	▲

Australian Industry Group monthly performance of industry indices

Australian PMI®	Jan (M)	52.5	▲
Australian PSI®	Dec (M)	52.1	▼
Australian PCI®	Dec (M)	42.6	▼

M = monthly, Q = quarterly. All data are seasonally adjusted unless otherwise noted.

Arrows represent direction of movement relative to last week for prices, and last observation for growth rates and indices.

Sources: ABS various data; Ai Group; Australian Financial Review market prices (as of Fri); London Metals Exchange market prices (as of Fri).

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