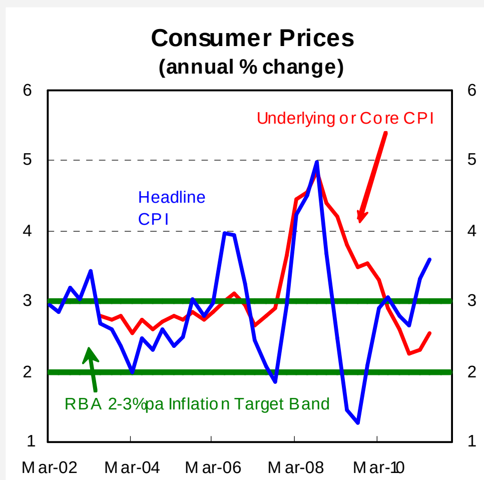
THE CASH RATE OUTLOOK

Inflation Seasonal Adjustment

Wednesday, 14 September 2011

- **The ABS published new seasonal adjustment figures today, which impacted underlying CPI inflation numbers. Core inflation has now been revised down to an increase of 0.6% in the June quarter (for the average of the two core measures), from 0.9% previously reported. However, the new seasonal adjustment will bump up inflation in coming quarters, so that there are no direct implications for monetary policy.**
- **The RBA has recently indicated it remains worried about the uncertainty and volatility in global financial markets and the world economy and how this uncertainty will play out. It had also indicated it was concerned about the medium-term inflation outlook. While inflation concerns remain at the fore for the RBA, the sovereign debt woes present downside risk.**
- **Our central view is that the RBA will leave official interest rates on hold this year, although the risk of a sovereign debt default in the Euro zone and slowing global economic growth present significant risks to this view, and could see the RBA cut interest rates later this year. The timing of such a move would be dependent on the unfolding of sovereign debt woes in Europe.**



The ABS published new seasonal adjustment estimates today, which resulted in revisions to its CPI inflation numbers. It revised down underlying inflation, so that the average of the RBA's two underlying measures fell to 0.6% in the June quarter, from the previously reported 0.9%. This takes the annual rate for core inflation down to 2.55%, from the 2.7% rate previously reported. However, the revised seasonality will bump up inflation later in the year, meaning the end result for annual inflation will be unchanged.

In the statement accompanying its rate decision on 6th September, the RBA described conditions in global financial markets as "very unsettled", a situation that has not improved since, with increased nervousness about the sovereign debt problems in Europe. It noted, however, that at this stage there was "little evidence" that troubles in Europe and the US had had any effect on other regions, noting that prices for key Australian commodities had remained "very high" and that growth in China looked "solid". If the sovereign debt situation in Europe were to deteriorate, it would likely impact other regions. Additionally, a worsening of the sovereign debt situation in Europe or a further moderation in global economic growth would assist in containing inflation in Australia.

In its 6th September statement, the RBA said underlying inflation has been increasing this year and that the RBA remains concerned about the medium term outlook for inflation. Although the historical path of underlying inflation may be altered due to today's revisions, implications for the medium-term inflation remain.

Clearly, the RBA is grappling with the higher than usual uncertainty in the global economy and what it means for the domestic growth and inflation outlook. Our central view is that the RBA will leave official interest rates on hold this year, although the risk of a sovereign debt default in the Euro zone and slowing global economic growth present significant risks to this view, and could see the RBA cut interest rates later this year. The timing of such a move would be dependent on the unfolding of sovereign debt woes in Europe.

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