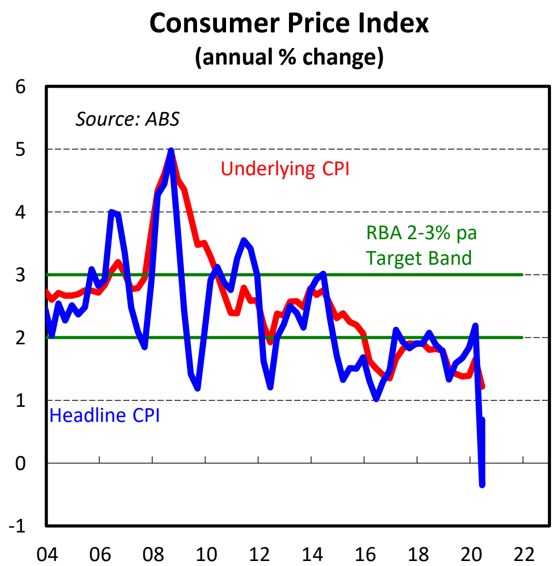
Data Snapshot

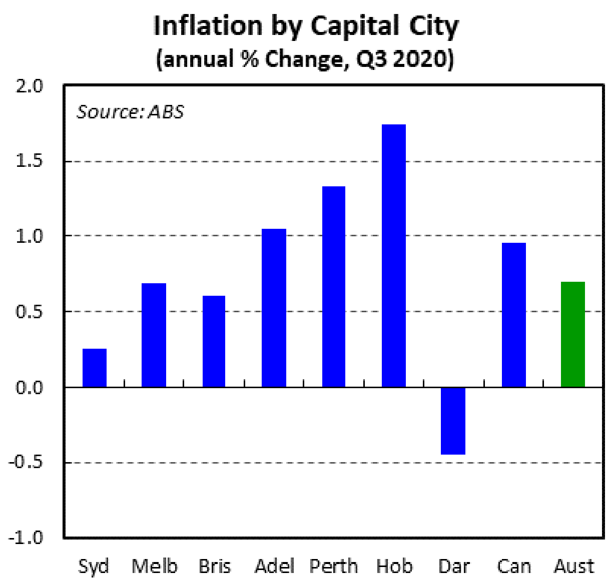
Wednesday, 28 October 2020

Consumer Price Index

Childcare Causes Spike in the CPI

- **Headline CPI rose 1.6% in the September quarter, the largest increase in the series since the June quarter of 2006 when the quarterly CPI rose 1.7%. The annual rate of inflation picked up from -0.3% in the June quarter to 0.7% in the September quarter. Inflation in Australia is subdued.**
- **Costs of childcare rose sharply as the Federal government's free childcare program came to an end. Adding to inflation was an increase in petrol prices flowing from a rise in the global price of oil during the September quarter.**
- **Underlying inflation in the September quarter rose by a less spectacular 0.4% for an annual rate of just 1.2%. Underlying inflation is clearly well below the RBA's 2-3% target band and suggests that monetary policy will be eased when the RBA board meets on 3rd November.**
- **We expect underlying inflation to stay below the 2-3% band for at least three years.**
- **Factors that could put upward pressure on prices would be a strong economic recovery, the opening of international borders and the wide availability of an effective vaccine against COVID-19. Each of these is well down the track. As a result, inflation remains low, interest rates remain low and the government will seek to support the economy.**





Headline and Underlying CPI

Headline CPI rose 1.6% in the September quarter, the largest increase since the June quarter of 2006 when the quarterly CPI rose 1.7%. The annual rate of inflation picked up from -0.3% in the June quarter to 0.7% in the September quarter. Inflation in Australia is subdued.

As with the June quarter 2020 result (-1.9%), the September result has also been distorted by government policy actions. The sharp rise in the CPI was predominantly due to an increase in the cost of childcare and pre-school. During the quarter, the 'Early Childhood Education and Care Relief Package', which made childcare free, came to an end.

Underlying inflation rose by a less spectacular 0.4% for an annual rate of just 1.2%. Underlying inflation removes volatile items and is the measure preferred by the Reserve Bank of Australia (RBA) when deciding monetary policy. Underlying inflation is clearly well below the RBA's 2-3% target band and suggests that monetary policy will be eased when the RBA board meets on November 3.

The low annual rates for headline CPI (0.7%) and for underlying inflation (1.2%) reflect general weakness in the economy. Lockdowns, a high level of unemployment, job insecurity and feeble wage growth keep demand and prices subdued. The Federal Budget and the expected cut in official interest rates aim to stimulate demand. It could be several years before inflation sits sustainably in the RBA's inflation target band. Until then, interest rates will stay low and the government plans to continue supporting the economy.

Groups Analysis

Of the eleven key CPI groups, eight categories saw prices increase.

Childcare was a major contributor to stronger price increases in the quarter as fees returned to pre-COVID levels. Prices soared 1,382% in the September quarter. The Government provided free childcare services for families from April 6 until July 12.

Additionally, free pre-schooling in NSW, Victoria and Queensland were also phased down and costs rose by 11.1%.

These increases lifted prices, furnishings, household equipment & services (12.0%) and education (2.1%). Without the influence of childcare fees, furnishings, household equipment and services would have risen by only 1.3%.

The other key contribution to higher prices was the 9.4% rise in automotive fuel following the partial recovery in world demand for oil and reductions in world production. Transport costs increased 3.4% as a result, even after the 3.5% reduction in urban transport fares due to the off-peak discounts in Sydney.

The main influence for the 1.6% increase in alcohol and tobacco group was tobacco. Its price rose 3.2% in the quarter due to the 12.5% annual excise indexation and bi-annual AWOTE increase on September 1.

Only two groups, communications and health, reported reductions in prices in the September quarter. Telecommunication equipment and services fell 0.8% leading to the same reduction in communications. Pharmaceutical products fell by 2.1% and was the main contributor to the 0.1% fall in the health group.

September quarter, 2020

Headline Consumer Prices	Quarterly % Change
Furnishings, household equipment and services	12.0
Transport	3.4
Education	2.1
Alchohol and tobacco	1.6
Recreation and culture	1.1
Clothing and footwear	0.4
Insurance and financial services	0.1
Housing	0.0
Health	-0.1
Food and non-alcoholic beverages	-0.4
Communication	-0.8
Total CPI	**1.6**

Source: ABS

Tradables and Non-Tradables Inflation

Both tradables and non-tradables inflation strengthened in the September quarter as large price increases affected both series.

Global factors impacted tradables inflation, particularly the recovery oil prices. Tradables inflation rose 1.4% in the September quarter, the largest increase in fourteen years.

Meanwhile non-tradables inflation rose 1.6% in the quarter, the largest increase since early 2008. The strong increases in childcare prices was the major factor.

Inflation by Capital Cities

The largest increases in the capital city CPI measures for the September quarter were in Canberra and Brisbane (each at 2.3%), followed by Sydney and Perth (each at 1.8%), Darwin (1.7%) , Hobart and Adelaide (each at 1.0%) and then Melbourne (0.9%).

Higher costs for fuel, tobacco and childcare lifted prices across all capital cities. The differences across capital cities were mainly due to the weight placed on childcare. Canberra and Sydney have the largest weights while Adelaide and Hobart have the smallest.

Transport rose across the board mainly due to increases in fuel prices. Hobart was the only city to record a fall (-1.5%), while Melbourne recorded the highest (11.1%).

On an annual basis, inflation increased in all capital cities except in Darwin (-0.4%). Hobart experienced the largest increase (1.7%), followed by Perth (1.3%), Adelaide and Canberra (each 1.0%), Melbourne (0.7%), Brisbane (0.6%) and Sydney (0.3%). The nation-wide annual print was 0.7%.

Outlook

Weak economic conditions have contributed to weak inflation outcomes. While we expect the economy to pick up in the later part of 2020 and into 2021, we do not expect this to have a substantial impact on the CPI.

Elevated unemployment levels tell us that spare capacity exists in the labour market. Under these conditions there is less scope for wages growth. With wages forming a large part of the costs of production, it further tells us that prices are not set to rise rapidly in the near term.

We expect underlying inflation to stay below the 2-3% band for at least three years.

Factors that could put upward pressure on prices would be a strong economic recovery, the opening of international borders and the wide availability of an effective vaccine against COVID-19. Each of these is well down the track. As a result, inflation remains low, interest rates remain low and the government will seek to support the economy.

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