bankSA

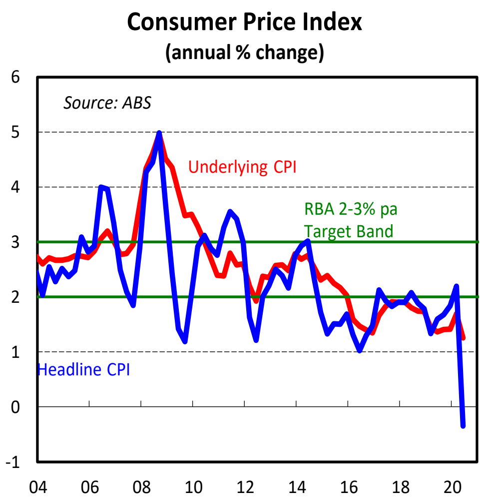
Data Snapshot

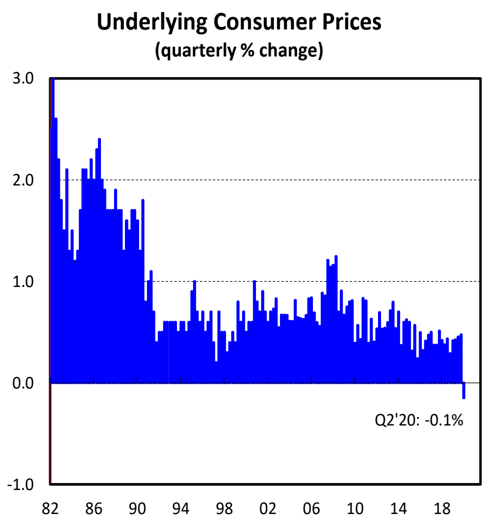
Wednesday, 29 July 2020

Consumer Price Index

COVID-19 Brings Deflation

- **Headline CPI fell 1.9% in the June quarter, the largest drop in the series history which dates back to 1948. The annual rate of headline inflation eased to -0.3%, turning negative for the first time since 1998. There has only been two periods previously that the annual rate of inflation turned negative.**
- **The spectacular drop in prices in the June quarter did not come as a surprise. The sharp drop was influenced heavily by the impact of COVID-19 on consumer behaviour and the measures aimed to curb its spread.**
- **Costs of childcare fell sharply as it became free across the country and pre-school was also made free in NSW, Victoria and Queensland. The limitations on the movement of people around the world also weighed heavily on oil prices, and led to a sharp drop in fuel costs.**
- **Underlying inflation was also very weak. The trimmed mean inflation measure fell 0.1% in the June quarter, declining for the first time ever in the series calculation, beginning in 1982. On an annual basis, trimmed mean inflation eased to 1.2% in the June quarter, also the lowest on record. Underlying inflation has moved further away from the RBA's 2 to 3 per cent target band and has not been within this band since 2015.**
- **Some of the major price declines that occurred over the June quarter are likely to be reversed in the September quarter. However, the decline in underlying inflation suggests that price weakness is more broad based. The bumpy recovery and the likelihood that there will be spare capacity within the economy for some time points to inflation remaining very weak.**





Headline and Underlying CPI

Headline CPI fell 1.9% in the June quarter, the largest drop in the series history which dates back to 1948. The big decline resulted in the annual rate of headline inflation easing to -0.3%, turning negative for the first time since 1998. There has only been two periods previously that the annual rate of inflation turned negative in the series history.

The spectacular drop in prices in the June quarter did not come as a surprise. The sharp drop was influenced heavily by the impact of COVID-19 on consumer behaviour and the measures aimed to curb its spread.

Costs of childcare fell sharply as it became free across the country and pre-school was also made free in NSW, Victoria and Queensland. The limitations on the movement of people around the world also weighed heavily on oil prices, and led to a sharp drop in fuel costs.

Excluding these three components (excluded childcare, automotive fuel and preschool & primary education), CPI would have risen 0.1% in the June quarter.

Underlying inflation was also very weak, reflecting the sharp fall in demand over the quarter. The Reserve Bank (RBA) prefers to assess price pressures with underlying inflation as it strips out volatile items. The trimmed mean inflation measure fell 0.1% in the June quarter, declining for the first time ever in the series calculation, beginning in 1982. On an annual basis, trimmed mean inflation eased from 1.8% in the March quarter to 1.2% in the June quarter, also the lowest in available published data. Underlying inflation has moved further away from the RBA's 2 to 3 per cent target band and has not been within this band since 2015.

Groups Analysis

Of the eleven key CPI groups, seven categories saw prices decline.

Free childcare was a major contributor to weaker prices in the quarter. Prices fell 95% in the quarter. The Government provided free childcare services for families from April 6 until July 12.

Additionally, free pre-schooling in NSW, Victoria and Queensland brought down pre school and primary education costs by 16.2%.

These falls brought down prices in the groups, furnishings, household equipment & services (-11.2%) and education (-3.7%).

The other key contribution to weaker prices was a 19.3% fall in automotive fuel, which brought down transport costs 6.8%.

There were other significant impacts from COVID-19.

Re-negotiations of rent and rising vacancies led to a fall in rents of 1.3% in the June quarter. It was the first fall ever recorded in the series history, which dates back to 1972.

Prices of domestic holiday travel and accommodation and international holiday travel accommodation fell 2.0% in the June quarter, although these estimations would have been affected by difficulties in collection (ie. international travel has not been readily available).

Strong demand for certain consumer goods drove price increases for various items as a result of changes to hygiene practices and working-from-home arrangements.

Prices in the furnishings, household equipment & services group rose 2.3% when excluding the impact of childcare. Demand for home office furniture, and household appliances resulted in a 3.8% increase in the price of furniture and 3.0% increase in major household appliances. Prices also increased for non-durable household products (4.5%) and cleaning & maintenance products.(4.5%).

Audio-visual & computing equipment also witnessed strong demand. Prices increased 1.8% in the June quarter, and was the strongest quarterly rise since 2015.

Within the food & non-alcoholic beverages group, prices rose 0.5% in the quarter. Better seasonal conditions resulted in a fall in prices of vegetables (-1.4%) and beef & veal (-1.1%) after drought and bushfire pushed up the price of seasonal produce earlier in the year.

June quarter, 2020

Headline Consumer Prices	Quarterly % Change
Alcohol & Tobacco	1.5
Food	0.5
Financial & Insurance Services	0.3
Clothing & footwear	0.1
Health	-0.2
Housing	-0.7
Recreation	-1.0
Communication	-1.3
Education	-3.7
Transportation	-6.8
Furnishings, household equipment and services	-11.2
Total CPI	**-1.9**

Source: ABS

Tradables and Non-Tradables Inflation

Both tradables and non-tradables inflation weakened in the June quarter as large price declines affected both series.

Global factors impacted tradables inflation, particularly the sharp fall in the oil price. Tradables inflation fell 1.3% in the June quarter, the largest fall in just over four years.

Meanwhile non-tradables inflation fell 2.3% in the quarter, the largest drop recorded, with the series beginning in 1998. The 95% drop in childcare prices was the major factor behind the decline.

Inflation by Capital Cities

Lower fuel costs and childcare brought down prices across the capital cities. In particular, the free preschooling for term 2 in NSW, Victoria and Queensland brought down prices in these States.

Housing fell in most capital cities, reflecting lower rents – the largest fall in rents were in Sydney (-2.0%) where vacancy rates have risen the most.

The largest declines in the capital city CPI measures were in Darwin (-2.5%), followed by Sydney (-2.3%), Canberra (-2.3%) and then Brisbane (-2.2%). A sizeable decline was still recorded in Melbourne (-1.8%) and to a lesser extent in Hobart (-1.4%), Perth (-1.2%) and Adelaide (-1.0%).

On an annual basis, inflation was in decline in Darwin (-1.8%), Sydney (-1.0%), Brisbane (-1.0%) and Canberra (-0.6%). Hobart (1.3%), Adelaide (0.8%), Melbourne (0.3%) and Perth (0.1%) had positive rates of inflation, but very low and further away from the RBA's 2 to 3 per cent target band.

Outlook

Some of the major price declines that occurred over the June quarter are likely to be reversed in the September quarter. Free childcare ended on July 12 and oil prices have rebounded substantially from their lows. Brent oil prices fell to a low of US$27.05 a barrel on April 28 and has since risen 60% to above $40 a barrel.

The June quarter's deflation outcome is not likely to be repeated, and inflation is likely to turn positive again in the September quarter.

However, the decline in underlying inflation suggests that price weakness is broad-based. While demand has recovered somewhat as lockdown restrictions have eased, that recovery remains uneven. The bumpy recovery and the likelihood that there will be spare capacity within the economy for some time points to inflation remaining very weak.

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