bankSA
Weekly Economic Outlook
Monday, 25 January 2021

Inflation: This Week's Key Metric.

The Australian Bureau of Statistics (ABS) will release the December quarter 2020 Consumer Price Index (CPI) on Wednesday. It's a fairly big deal.

Amid last year's flurry of COVID-19 policy changes, the RBA changed the way it would think about setting the cash rate. It announced that actual inflation, rather than the Reserve Bank's forecasts of inflation, would guide the RBA Board's policy making. It said that it will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent per annum target range.

On Wednesday, the ABS will release the actual inflation results. We expect the CPI rose by 0.7% in the December quarter, leaving the annual rate of inflation steady at 0.7%.

Inflation, like life, can be complicated. There are several ways of measuring and reporting inflation.

In addition to the headline (All Groups) measure of inflation, the ABS also provide trimmed mean and weighted median measures. These measures remove volatile items and provide a guide to underlying or core inflation.

Our 0.7% forecast, for both the December quarter and the annual rate, is for headline inflation.

We expect both the trimmed mean and the weighted median rose by 0.3% in the December quarter, giving an annual rate 1.1% and 1.2%, respectively. A 1.1% annual rate for the trimmed mean would be its lowest on record.

When the RBA talks about actual inflation, it means underlying or core inflation. Given that the underlying measures of inflation are well below 2%, it is reasonable to expect that the RBA will not increase the cash rate for quite some time, at least not before 2023

Behind our forecasts: Like many recent statistics, Wednesday's CPI results will be distorted by COVID-19 related events. This quarter, we note that the cessation of free childcare in Victoria will push the CPI up but, working in the opposite direction, supplements to the Federal Homebuilder grants in WA and Tasmania will push the CPI down. The various policies, this quarter, seem likely to balance each other out.

This quarter, we forecast that food, health costs and education costs have risen, while prices in the areas of clothing and footwear, rents, petrol and communications have fallen.

For inflation to move sustainably into the RBA's 2 to 3 per cent target range, wages will need to rise, as wages are a major component of prices. With unemployment still above 6%, spare capacity in the labour market is working against wage increases. This could change as the unemployment rate declines during 2021, but it would still take time to flow through to wages. The opening of borders and the rollout of vaccines should assist in that process.

Apart from Wednesday's CPI result, new numbers on private sector credit will be released by the RBA on Friday. Credit growth remains subdued except in the area of home lending. We expect private sector credit eked out a 0.1% increase in December.

Contact Listing

Chief Economist
Besa Deda
dedab@banksa.com.au
(02) 8254 3251

Senior Economist
Hans Kunnen
hans.kunnen@banksa.com.au
(02) 8254 1316