

# Further moderation of Australian inflation

## Economic Research note

27 October 2010

- Australia's headline inflation rose by 0.7%/qtr in Q3 10, with the annual pace of inflation moderating to 2.8% from 3.1%. Headline inflation is now, therefore, back within the RBA's 2%-3% target range.
- More importantly, the pace of underlying inflation rose by just 0.55%/qtr in Q3 10, taking the annual rate to just 2.4% (down from 2.7%).
- Over Q3 10, price pressures from the water, tobacco, electricity and property sectors were partly offset by price declines in fuels, some foods, pharmaceuticals and electronic equipment. Significantly, prices in the trade exposed sectors of the economy rose by just 0.2%/qtr, but with non-traded prices up a sharper 1.1%/qtr.
- Having held monetary policy steady in October in a 'finely balanced' decision, the lower Q3 10 CPI will make it very difficult for the RBA to now lift rates at the November Board meeting.

### Australian underlying inflation moderates further

Australia's headline CPI inflation rate rose by a lower-than-expected 0.7%/qtr in Q3 10 (consensus forecast was 0.8%/qtr). Perhaps more significantly, this took the annual pace of headline inflation down to 2.8% from 3.1% - comfortably within the RBA's 2%-3% target band.

The more important underlying inflation rate rose by an average 0.55%/qtr (with the trimmed mean rate up 0.6%/qtr and the weighted median up 0.5%/qtr). This took the annual pace of underlying inflation down to 2.4% from 2.7% in Q2 10.

The 2.4% pace of underlying inflation is lower than the RBA's forecast for 2.75% underlying inflation as at December 2010. The RBA also expects the underlying inflation rate to average 2.75% over 2011, before increasing to 3.0% in 2012.

For monetary policy, the lower-than-expected Q3 10 CPI has seen the market take out expectations for a rate rise at the November Board meeting next week. Indeed, with underlying inflation just below the middle of the target band, subject to a further significant fall in the unemployment rate or upside surprise on other domestic data, the better inflation outcome likely excludes a monetary policy tightening for the remainder of the calendar year. For 2011, however, the RBA would still be expected to lift the cash rate, helping the economy adjust to the income effects of the rise in the terms of trade and the private sector capex uplift this will bring.

For Q3 10, the biggest price increases came from water (+12.8%/qtr), tobacco (+7%), property rates (+6.2%), electricity (+6%), and rents (+1.1%). On the downside, there were big falls in the prices of auto fuels (-3.7%/qtr), vegetables (-5.4%), pharmaceuticals (-3.9%) and audio, visual and computing equipment (-2.7%).

Perhaps more importantly, tradeables inflation rose by only 0.2%/qtr in Q3, with an annual pace of 1.4%/yr, while in contrast the non-traded sector of the economy saw prices rise 1.1%/qtr and 3.8%/yr. The table below is a more detailed breakdown of the data.

**Stephen Halmarick**  
Head of Investments Research



**Belinda Allen**  
Analyst, Investment Markets Research

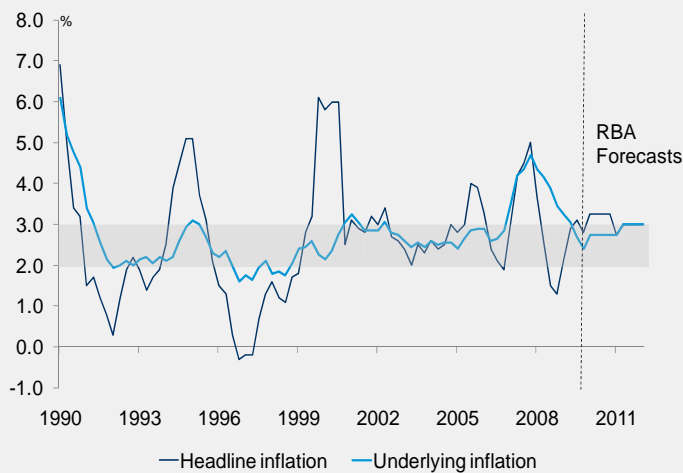
**James White**  
Analyst,  
Investment Markets Research

Sept qtr 2010	% /qtr	% /yr	June qtr 2010	% /qtr	% /yr
Headline CPI	0.7	2.8	Headline CPI	0.6	3.1
Underlying inflation*	0.55	2.4	Underlying inflation	0.5	2.7

\*Average of trimmed mean and weighted median.

Source: ABS

**Australian underlying inflation moderates further**



Source: ABS

**Further details**

- The key components of inflation were relatively subdued. There was strength in some areas, particularly housing (+2.3%/qtr), alcohol and tobacco (+3.1%/qtr). Recreation (+0.7%/qtr) and financial services (+0.5%/qtr) were in line, while petrol, food, pharmaceuticals and electronic equipment offset the increases.
- The increase in housing costs were substantial, though well flagged given the expectation of rising utilities costs. There were large rises in water and sewerage (+12.8%/qtr), electricity (+6.0%/qtr), property rates and charges (+6.2%/qtr), while rents (+1.1%/qtr) were more subdued.
- The increases were offset by falling food prices and the strength of the Australian dollar. Vegetable prices fell (-5.4%/qtr) on the back of strong growing conditions, the price of oil in Australian dollars led to a large decline in the cost of automotive fuel (-3.7%/qtr), this was also the case for the prices of pharmaceuticals (-3.9%/qtr) and audio, visual and computing equipment (-2.7%/qtr).
- If there was one concern for the RBA, it is non-tradeable inflation. While tradable prices rose only slightly (0.2%/qtr and 1.4%/yr), 'non-tradables' picked up pace (1.1%/qtr and 3.8%/yr). This does point to more concerning, underlying wage pressures that will remain in place even if the impact of the strong AUD passes somewhat in coming quarters.

- On a city by city basis, and as shown in the table below, price rises showed a considerable range, with the biggest price increase in the September qtr in Darwin (+1.1%/qtr), Brisbane (+1.0%/qtr) and Hobart (+1.0%/qtr), while rises were more subdued elsewhere - with Perth (+0.5%/qtr) and Melbourne (+0.6%/qtr).
- Some of the more interesting price changes were; postal services rose (+6.4%/qtr) domestic travel was up (+1.9%/qtr), suggesting operators are using price to reclaim volume losses. Despite the strong AUD, female footwear rose (+3.5%/qtr), suggesting strong retail margins, while pet food fell (-2.3%/qtr).

Sept qtr 2010	%/qtr	%/yr
Sydney	0.8	2.6
Melbourne	0.6	3.1
Brisbane	1.0	2.9
Adelaide	0.9	2.6
Perth	0.5	3.1
Hobart	1.0	2.8
Darwin	1.1	2.3
Canberra	0.6	2.1
<b>Weighted average</b>	<b>0.7</b>	<b>2.8</b>

For further information

Stephen Halmarick	Head of Investment Markets Research	+61 2 9303 3030	shalmarick@colonialfirststate.com.au
Belinda Allen	Analyst, Investment Markets Research	+61 2 9303 3110	ballen@colonialfirststate.com.au
James White	Analyst, Investment Markets Research	+61 2 9303 2645	jwhite@colonialfirststate.com.au

**Disclaimer**

Product Disclosure Statements (PDS) and Information Memoranda (IM) for the funds issued by Colonial First State Investments Limited ABN 98 002 348 352, Commonwealth Managed Investments Limited ABN 33 084 098 180, and CFS Managed Property Limited ABN 13 006 464 428 (collectively CFS) are available from Colonial First State Global Asset Management. Investors should consider the relevant PDS or IM before making an investment decision. **Past performance should not be taken as an indication of future performance.**

No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of CFS. This material contains or is based upon information that we believe to be accurate and reliable. While every effort has been made to ensure its accuracy we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them. This material has been prepared for the general information of clients and professional associates of CFS. You should not rely on the contents. To the fullest extent allowed by law, CFS excludes all liability (whether arising in contract, from negligence or otherwise) in respect of all and each part of the material, including without limitation, any errors or omissions.

This material is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render specific advice. It is not an offer document, and does not constitute a recommendation of any securities offered by CFS. No person should act on the basis of any matter contained in this material without obtaining specific professional advice. Colonial First State Global Asset Management is the consolidated asset management division of Commonwealth Bank of Australia ABN 48 123 123 124.

Copyright © (2010) Colonial First State Group Limited.  
All rights reserved.