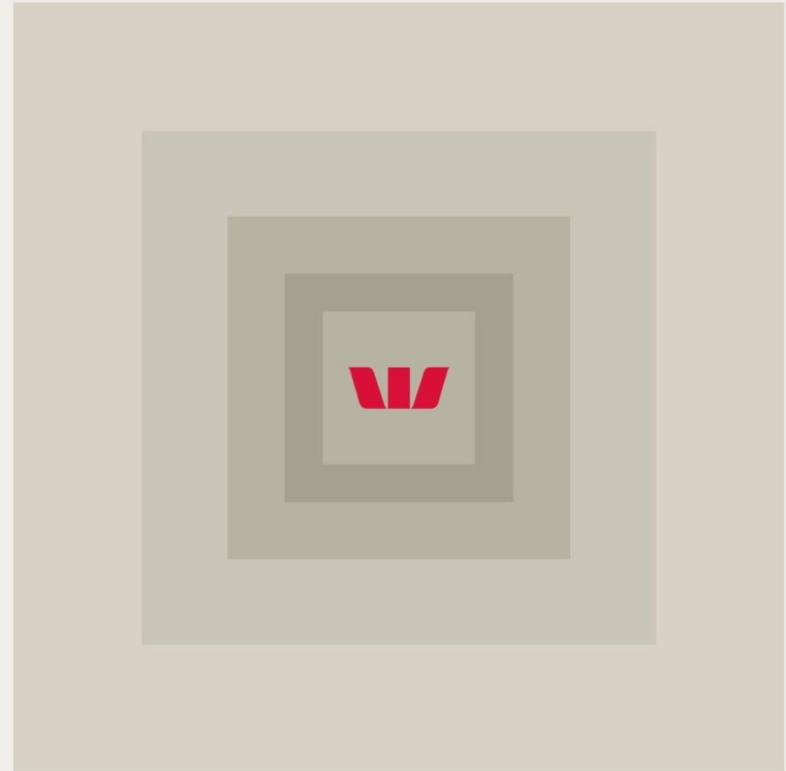


Melbourne Institute Consumer Sentiment

Inflation expectations
chart pack.

July 2014



Melbourne Institute

Consumer inflationary expectations March 2014

- The Melbourne Institute (MI) Inflationary Expectations are now reported as a 30% symmetric trimmed mean utilising all responses except for the ‘don’t know’ responses.
- These changes have added about 2ppt to the level of the index compared to the old trimmed mean ([chart 6](#)). But more importantly, the new series appears to express a greater cyclical amplitude ([chart 7 & 8](#)) which is useful in picking turning points in the inflation cycle.
- The consumer expected inflation rate fell by 0.2ppts to 3.8% in Jul. The trend of the trimmed mean series fell 0.1ppt to 4.0% in Jul; Jun was revised down to 4.1% from 4.2% and May has been revised down from an original estimate of 4.3% to 4.1%.
- The trend series had been narrowing in on the long run average of 4.5% ([chart 10](#)) but this has since reversed. Too early to call a new trend but expectations are still below the long-run average.

Melbourne Institute

Consumer inflationary expectations (cont)

- The underlying distribution, in the last few months, has seen rising clusters of responses around expected price changes of 2% & 3% (within the RBA's target band) and falling clusters of responses around expected price changes of 5% & 10%.
- A closer look at the distribution of responses revealed that the proportion of respondents expecting rising prices fell slightly to 75.2% from 75.9%. The proportion of respondents anticipating falling prices rose to 0.8% from 0.6%.
- Westpac simplifies this into a net balance which had been on a rising trend. But it eased back to 74.3 from 75.3 in Jun and the recent May peak of 79.1. However, the net balance is still well about the long run average of 70.5 suggesting a broadening of expectations for higher prices (Chart 12).
- Expectations from the 0% to 5% group rose a touch, to 2.7% from 2.6% in Jun but the trend was flat at 2.7% (Jun revised from 2.8%).

Melbourne Institute

Consumer inflationary expectations (cont)

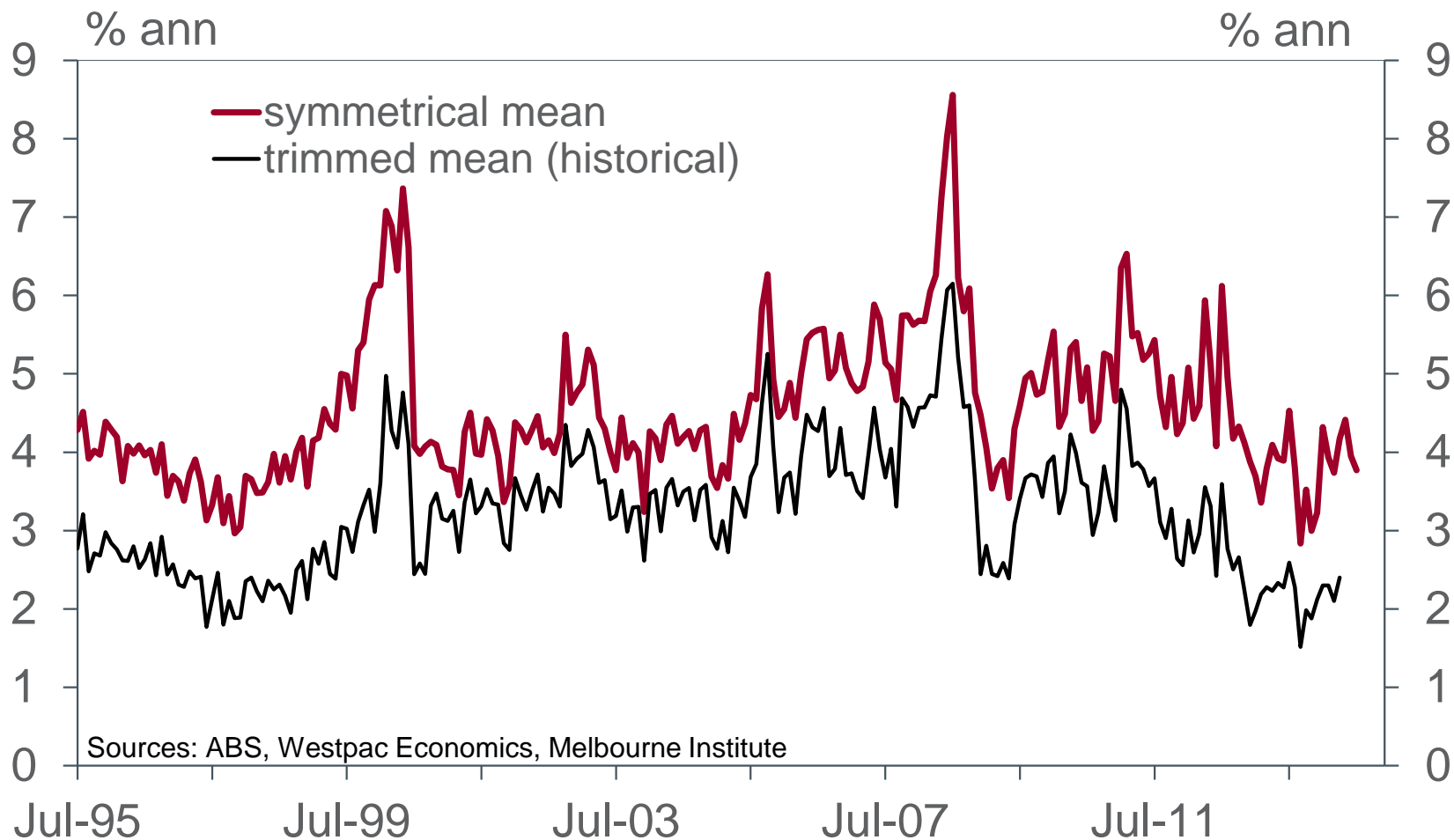
- Westpac has found an inverse relationship between the share of those reporting 0% to 5% expected inflation and actual inflation as reported by the CPI. That is, as the share those expecting inflation to fall within that range declines, it is generally associated with a pick-up in inflation ([chart 13](#)). Very few ever expect prices to fall so a falling share means there is a greater share of extreme expectations.
- The share of the responses within 0% to 5% rose to 77.4 from 74.6 in Jun and 72.8 in May. That is there is a declining share of respondents expecting inflation to be greater than 5%. The trend share has lifted to 74.5% from a recent low of 73.6% in May. This is much greater than the long run average of 68.1% suggesting a much lower than usual share of extreme responses. Despite all you hear in the media about rising prices, households don't appear to be overly concerned about rising inflation.

Melbourne Institute

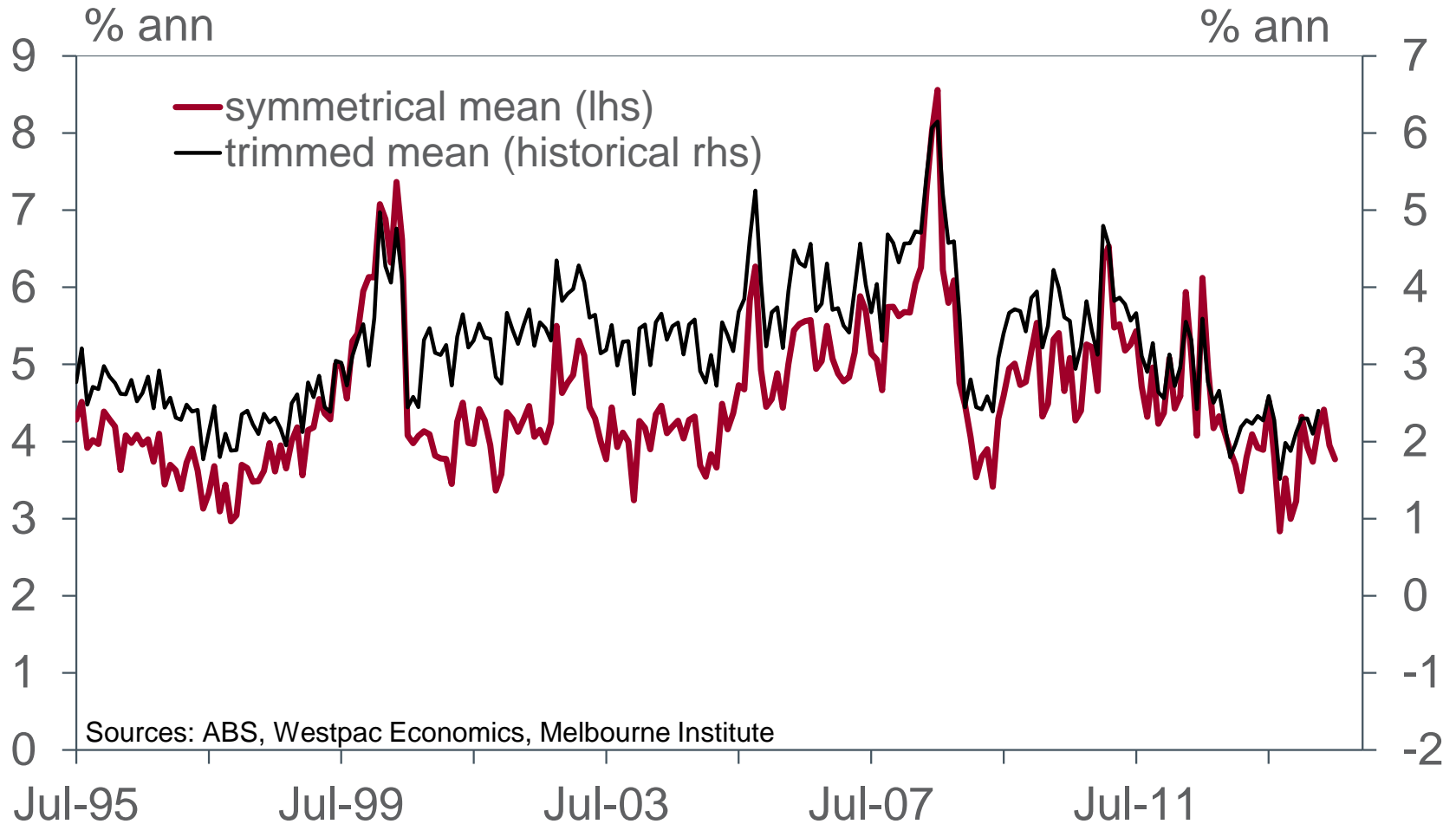
Consumer inflationary expectations (cont)

- **Inflation expectations have may lifted from the lows of 2013 but they have failed to accelerate. In fact they may be easing as both the level and distribution of responses are drifting lower away from the longer run averages.**
- **True, the lift in the net balance of expectations is something we are watching closely. But overall this appears to be the least convincing indicator and the overall picture remains quite benign for inflation.**
- **For now, with low wage outcomes and a stronger AUD we would not be surprised to see expectations to stabilise around current levels.**

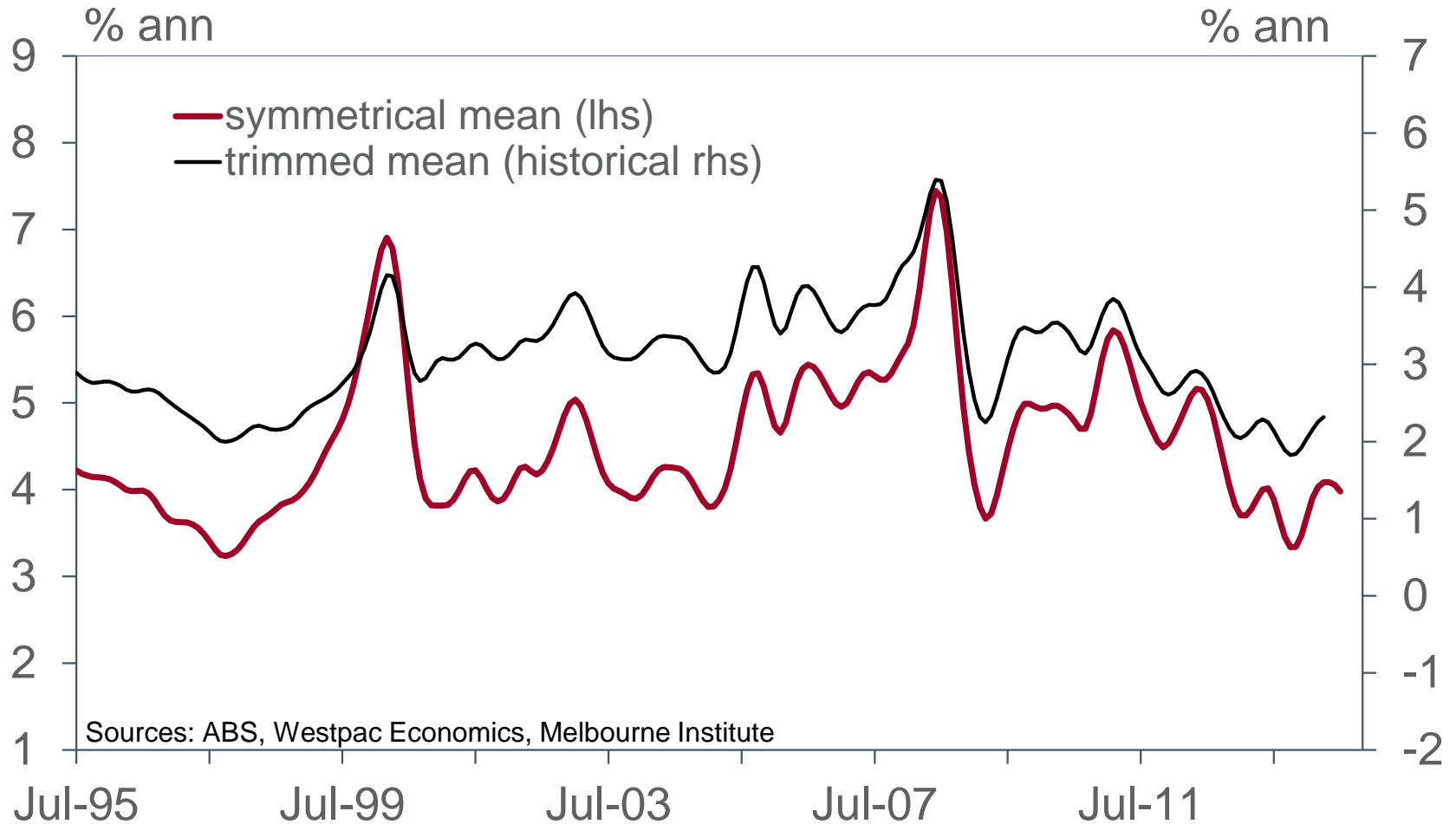
Symmetrical trimming adds 2ppts



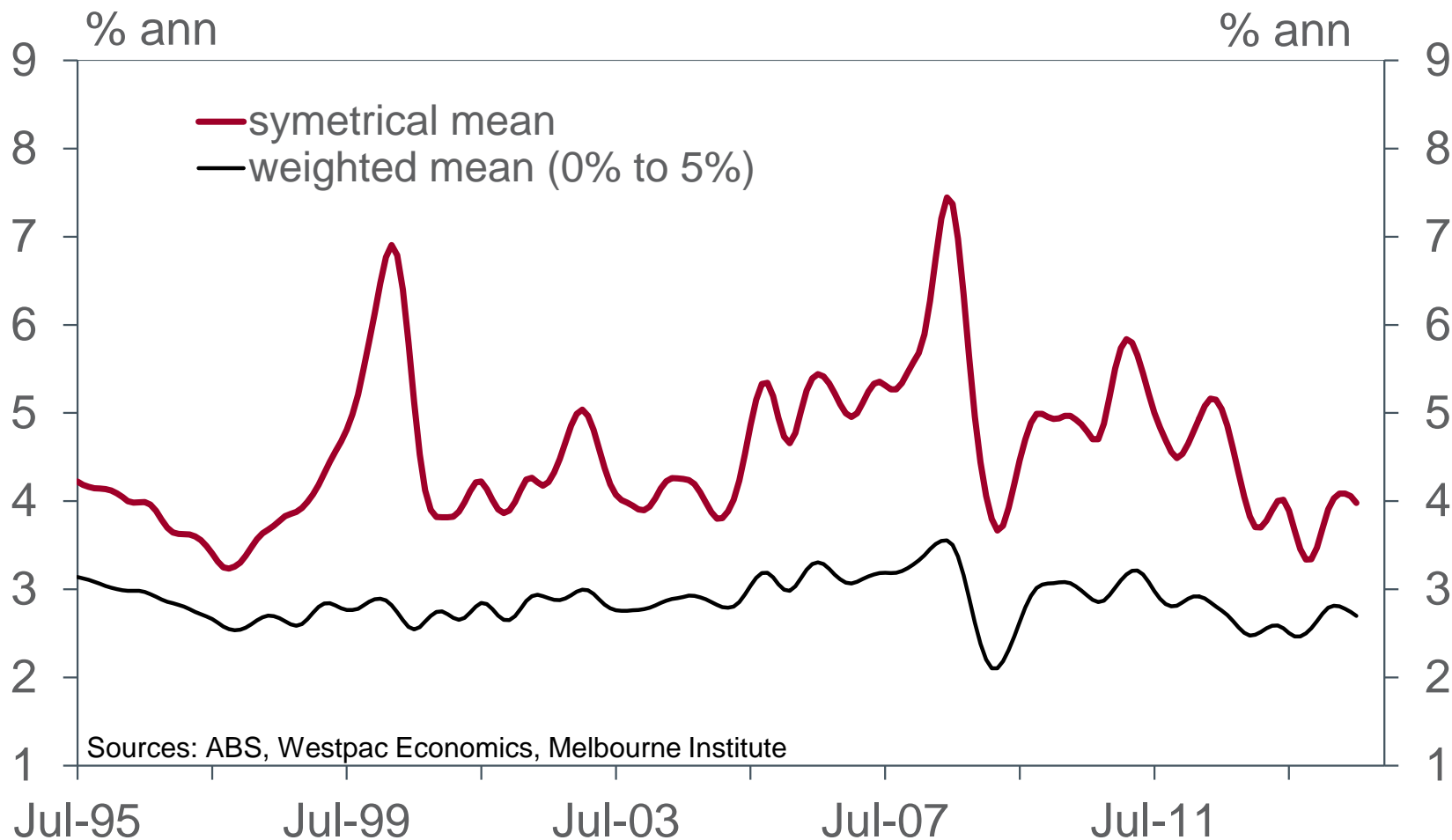
Symmetrical trimming increases cyclicity...



...suggesting that expectations are easing.

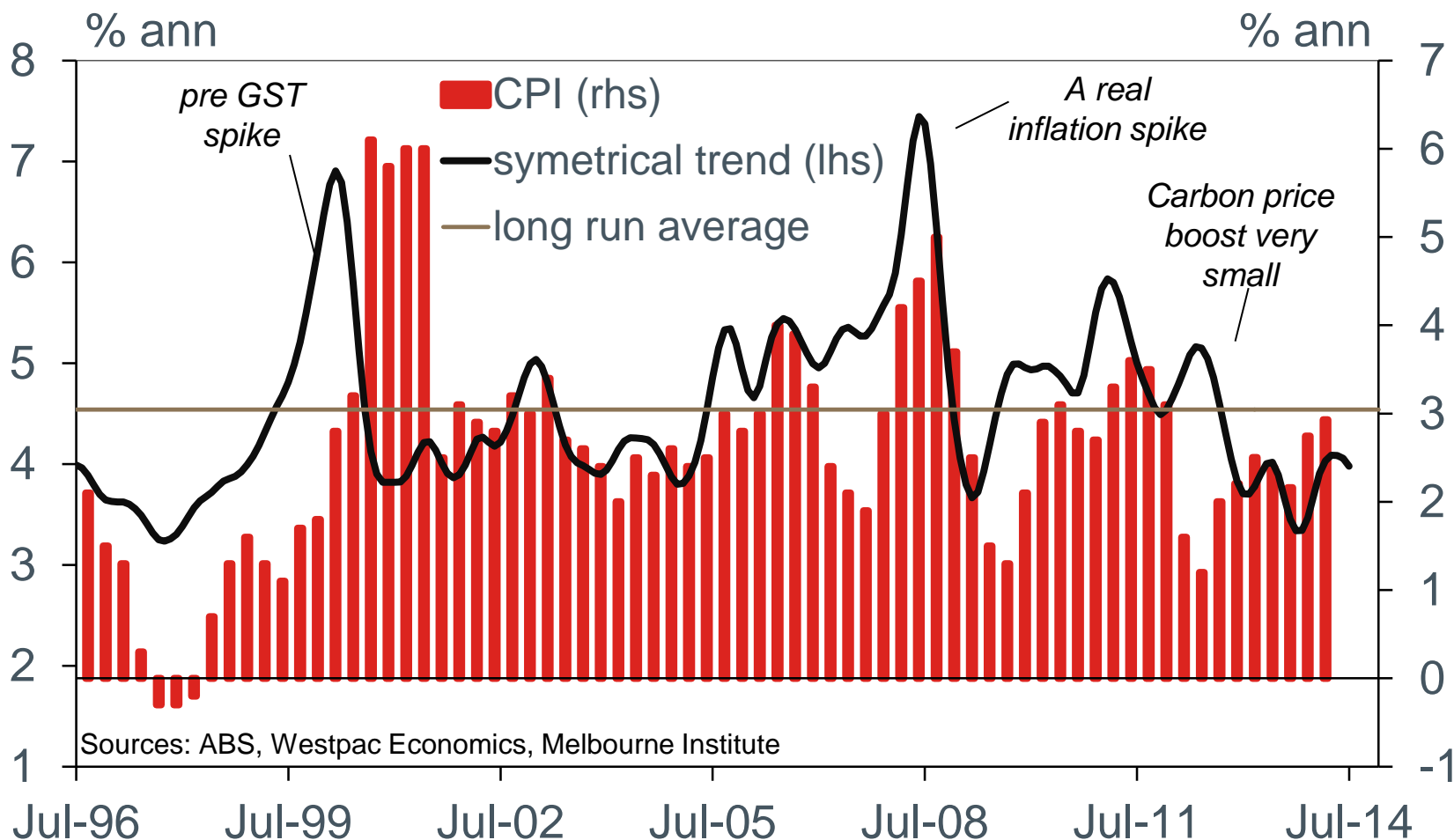


Taking out extremes lowers the level & volatility

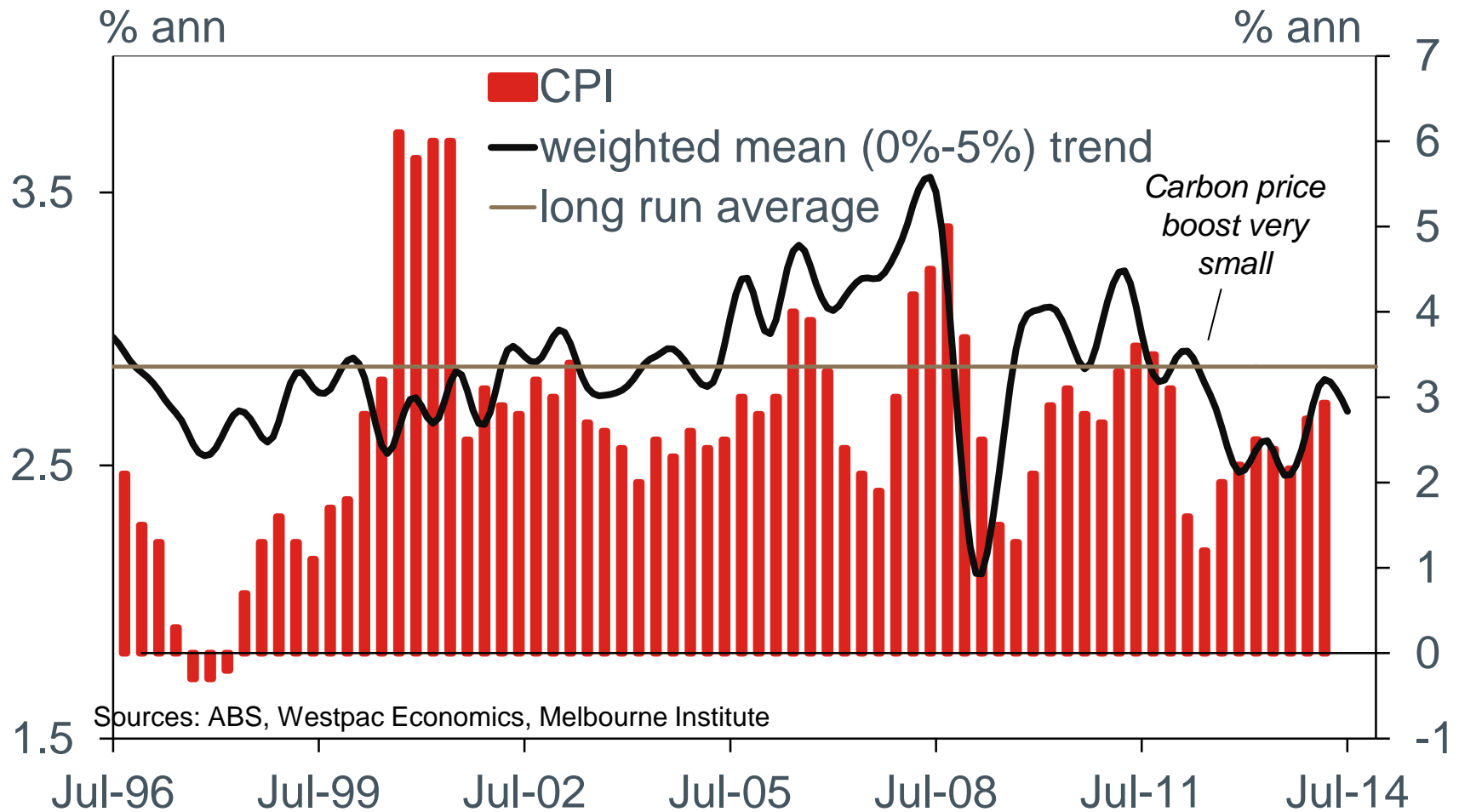


Sources: ABS, Westpac Economics, Melbourne Institute

Expectations are easing back again...

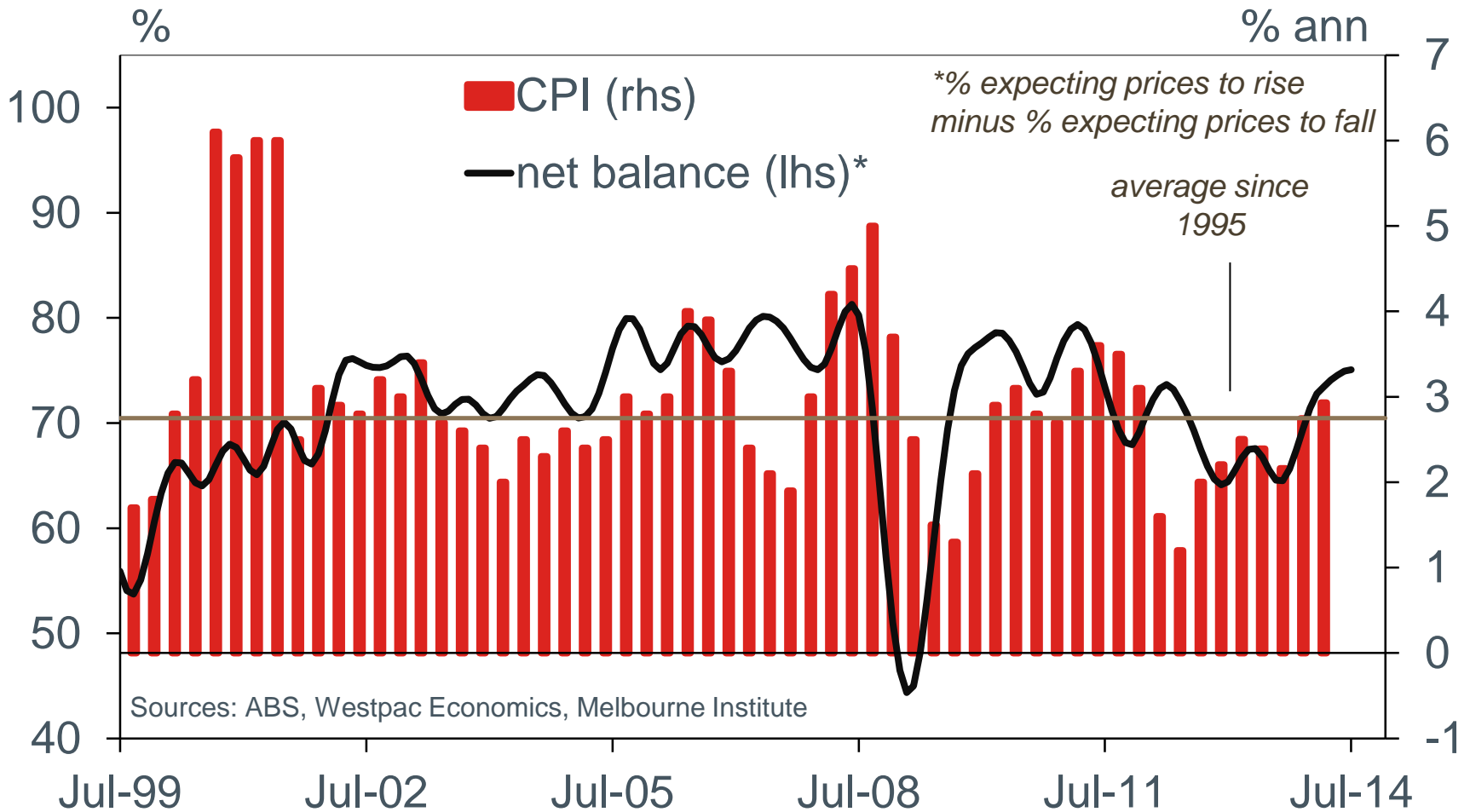


...& even within just the 0%-5% range.

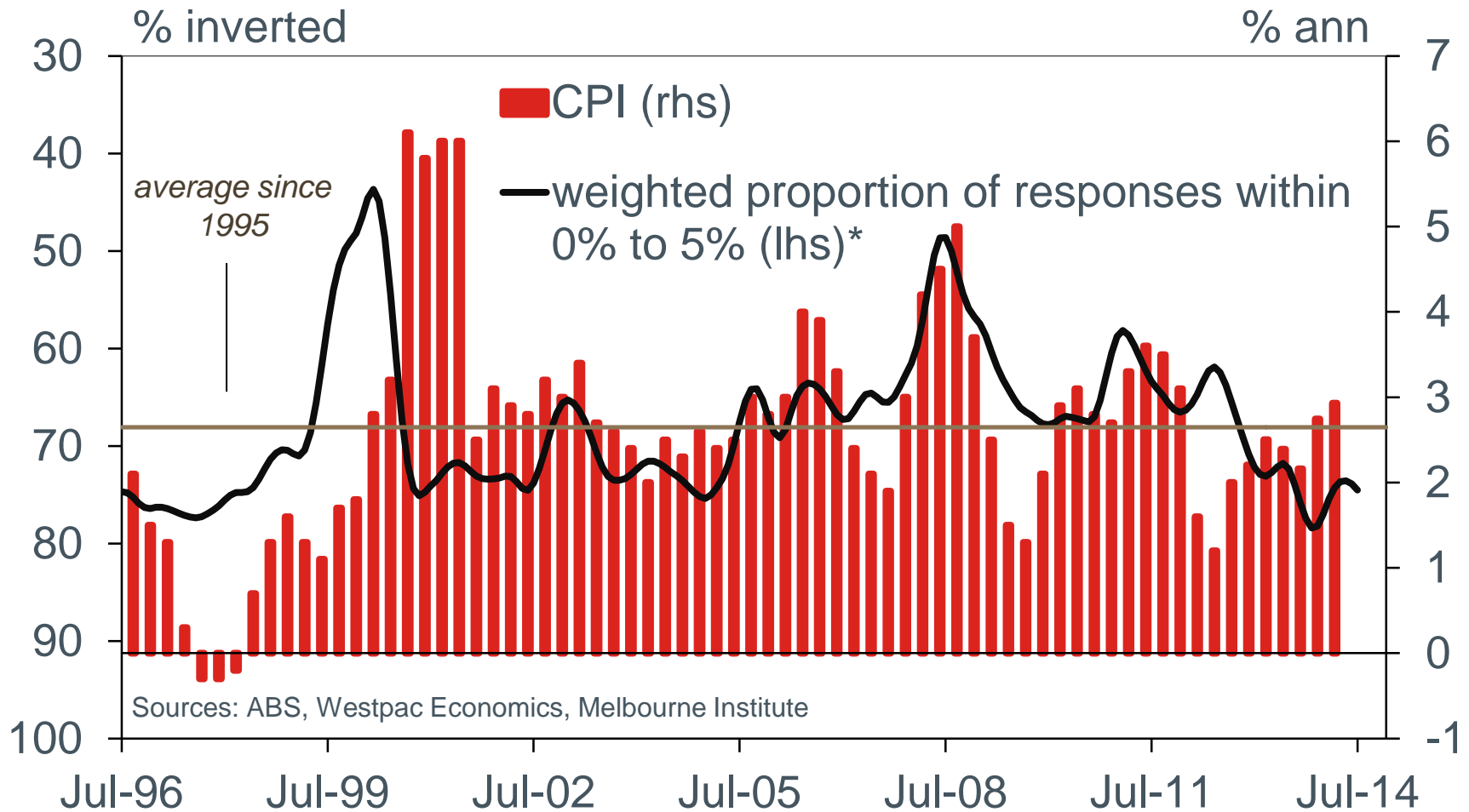


Sources: ABS, Westpac Economics, Melbourne Institute

The net balance continues to rise...



...but rising share of 0%-5% lowers inflations risks.



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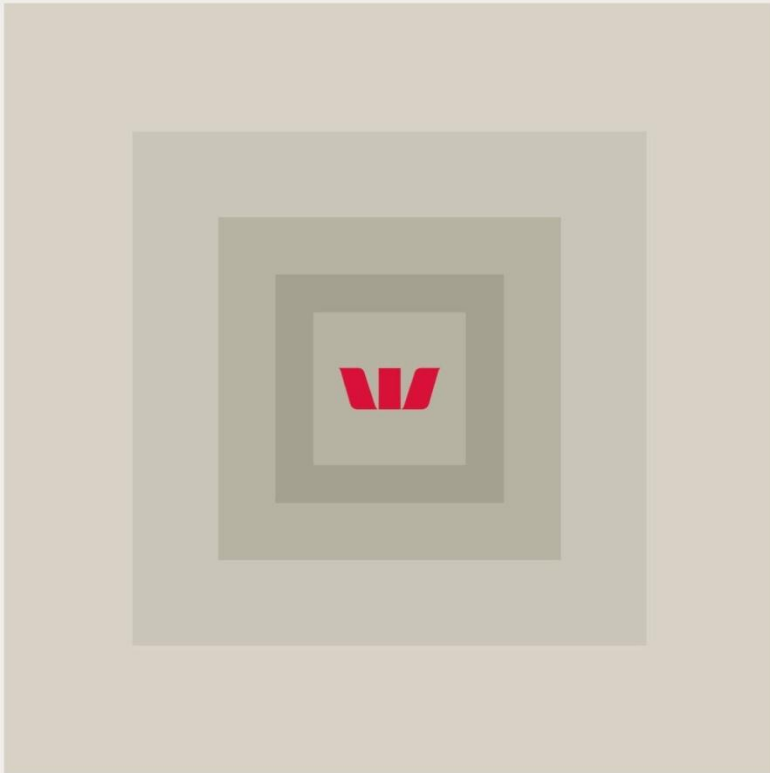
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