

16 July 2014

Australian Q2 CPI preview: f/c 0.6%/3.2%yr; core 0.7%/2.8%yr

Food, housing & health boosting Q2 CPI

- Our Q2 headline CPI forecast is 0.6%qtr/3.2%yr. Core inflation, as measured by the average of the trimmed mean and weighted median, is forecast to rise by 0.7%qtr/2.8%yr.
- We estimate that the 6 month annualised pace of core inflation eased back to 2.5%yr in Q2 from 2.8%yr in Q1 and 3.0%yr in 2013Q4. The pulse of core inflation has eased back from the top of the RBA's 2-3% target band and the lack of wage inflation, well anchored low inflation expectations and a robust AUD suggests that the most likely outcome is for this moderation to continue.
- June is seasonally a softer quarter (pharmaceuticals, holiday travel, rates & taxes and education lower, offset to a degree by the annual health insurance premium hike) with the ABS estimating a historical net contribution of about -0.14ppts. This seasonality is helping to hold down the pace of inflation despite a robust contribution from food, housing and health costs. The seasonally adjusted CPI is forecast to rise 0.8%qtr.
- Housing, with a weight of 22.3% in the CPI, is key to understanding headline, core and non-traded inflation. We expect a bounce in house purchase prices. Rents, however, are holding their pace at 0.8% in Q2 from 0.7% in Q1. That mix lifts housing 0.7%qtr for a 0.16ppt contribution. Ex-housing, the CPI is forecast to rise 0.5%qtr. Utilities inflation has moderated and is likely to ease further over the coming year with the removal of the carbon tax.
- The most direct impact from the stronger AUD (up 4.1%qtr against the USD, 3.7% in TWI terms) in Q1 is seen in lower petrol prices. While very volatile week to week, surveys suggest the quarterly average pump price fell 1.4%qtr.
- Wholesale fruit prices rose in the quarter (7.0%) offset somewhat by a fall in vegetable prices (-3.0%) but meat prices have been rising helping to boost food inflation.
- Alcohol and tobacco are expected to make a steady contribution in Q2, but less so than following the tobacco excise boost in Q1.
- Clothing & footwear has a seasonal boost in Q1 as prices are reset post the New Year sales and prior to June 30 sales. But with a more robust AUD, and disappointing retail sales reports, we have gone for a below seasonal par rise of 1.8%.
- Domestic holidays have a seasonal correction in Q2, confirmed by airfares data, and international holidays also tend to be softer in this quarter.
- Traded goods are forecast to rise 0.5%qtr/2.9%yr while non-traded goods are forecast to rise 0.7%qtr/3.4%yr.

June quarter 2014 CPI forecast

Item	Q2 2014 forecast		Q1 2014 actual	
	% qtr	contrib	% qtr	contrib
Food	0.9	0.15	0.3	0.05
of which, fruit & vegetables	2.4	0.07	0.7	0.02
Alcohol & tobacco	1.1	0.08	2.9	0.20
of which, Tobacco	2.1	0.05	6.7	0.16
Clothing & footwear	1.8	0.07	-2.1	-0.08
Housing	0.7	0.16	0.6	0.12
of which, Rents	0.8	0.05	0.7	0.04
of which, House purchases	1.1	0.10	0.1	0.01
of which, Utilities	0.0	0.00	1.4	0.05
H/hold contents & services	1.2	0.11	-1.5	-0.13
Health	2.2	0.12	2.6	0.14
of which, Pharmaceuticals	-1.4	-0.02	6.1	0.07
Transportation	-0.1	-0.01	1.1	0.12
of which, car prices	0.2	0.01	0.4	0.01
of which, auto fuel	-1.4	-0.05	4.1	0.15
Communication	0.6	0.02	0.2	0.01
Recreation	-0.7	-0.08	-0.5	-0.06
of which, audio vis & comp	-0.6	-0.02	-0.8	-0.02
of which, holiday travel	-1.9	-0.09	-2.4	-0.11
Education	0.0	0.00	5.1	0.16
Financial & insurance services	0.7	0.04	0.4	0.02
CPI: All groups	0.64	-	0.57	-
CPI: All groups % year	3.19	-	2.93	-
Core inflation	%qtr	%qtr	%yr	%yr
	Jun-14	Mar-14	Jun-14	Mar-14
CPI seasonally adjusted	0.78	0.48	3.1	2.9
CPI ex housing	0.50	0.46	2.4	2.2
Weighted median	0.70	0.57	2.7	2.7
Trimmed mean	0.71	0.48	2.8	2.6
Average RBA core	0.70	0.52	2.8	2.7
Average RBA core* ex CPM	0.7	0.5	2.8	2.5
Traded good & services	0.6	0.4	2.9	2.6
Non-traded goods & services	0.7	0.7	3.4	3.1

Sources: ABS, RBA, Westpac Banking Corporation.

*Westpac's estimate. The ABS is not providing an estimate of impact of the carbon tax.

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The March quarter surprised with a modest print.

The March quarter headline CPI rose 0.6%, softer than the market expectation of a 0.8% rise and Westpac's 0.9% forecast. The ABS estimated that seasonality was worth 0.1ppts in that quarter with the seasonally adjusted CPI rising 0.5%qtr. The core measures, which are seasonally adjusted, rose 0.48%qtr for the trimmed mean and 0.57%qtr for the weighted median, for an average of 0.52%qtr. The annual pace of the average of the core inflation measures is now 2.7%yr. Westpac had been expecting a 0.7%qtr in core inflation (average of the two) while the market was expecting a 0.6%qtr rise.

There are a number of surprises in any CPI release but for the March quarter we noted that the surprises were broadly based across multiple categories in a consistent direction – most coming in on the low side.

Seasonality is reversed in Q2 and holds down inflation.

The June is a seasonally softer quarter with pharmaceuticals and holiday travel key here but the ABS has also identified negative seasonality in fresh fruit & vegetables, other foods, property rates, utilities and education. On the other hand, annual health insurance premium hikes feed through in this quarter. The ABS has estimated that net seasonality contributes about -0.14ppts to the June quarter CPI. This seasonality would offer something of an offset to the robust contribution from housing and health costs but in this quarter our partials suggest that food prices are seasonally much stronger than usual. Our estimate of the seasonally adjusted CPI, using ABS seasonal factors, rises 0.8%qtr in Q2.

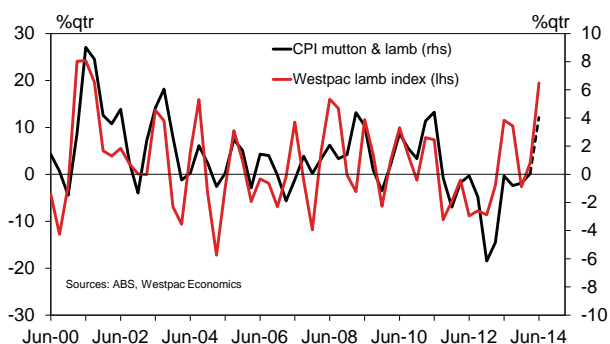
It is important to note that the ABS conducts concurrent seasonal adjustment so the seasonal factors, the seasonally adjusted CPI and the core measures of inflation are all subject to revisions with each new release.

Bottom up information on fruit, veggies and meat.

Wholesale fruit prices rose in the quarter (7.0%) pointing to another bounce in fresh fruit prices in the CPI which goes against the seasonal norm. This is offset, somewhat, by the ongoing fall in wholesale vegetable prices (-3.0%). But the relationship between wholesale and retail vegetable prices is not as clear cut with wholesale prices having almost double the volatility of retail prices.

We also get some broad indicators of wholesale meat prices, from live cattle markets and meat export prices. These are pointing to a robust rise in meat and seafood prices driven by gains in beef & veal and lamb, mutton & goat, which is only partially offset by a seasonal fall in pork. Wholesale dairy prices have also eased, in part due the stronger AUD crimping export prices, while rising global grain prices will be boosting prices for bread and cereal products.

Lamb prices jumped in the June qtr

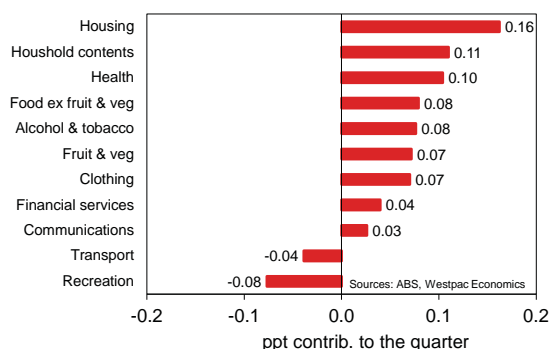


Key forecasting indicators of the CPI

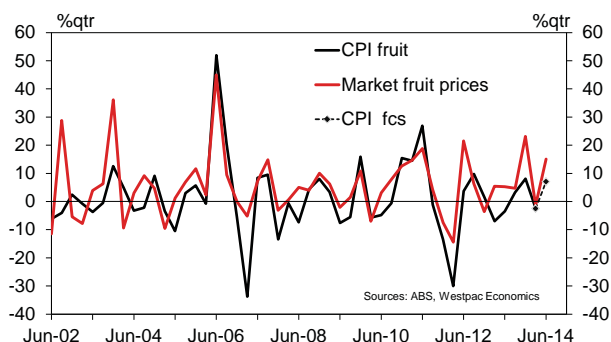
	Sep-13	Dec-13	Mar-14	Jun-14
CPI %qtr	1.2	0.8	0.6	0.6(f)
CPI %yr	2.2	2.7	2.9	3.2(f)
RBA core %yr	2.3	2.6	2.7	2.8(f)
AUD/USD	0.92	0.93	0.90	0.93
AUD/USD %yr	-11.9	-10.7	-13.7	-5.9
TWI	70.5	71.0	69.0	71.6
TWI %yr	-9.1	-7.5	-11.6	-5.3
Crude oil, Brent US\$bbl	119	117	120	117
Crude oil, Brent %yr	13.6	11.7	11.6	12.1
Output gap, adv. 3qtrs	-0.3	-0.5	-0.6	-0.5

Sources: ABS, RBA, Bloomberg, Westpac Economics

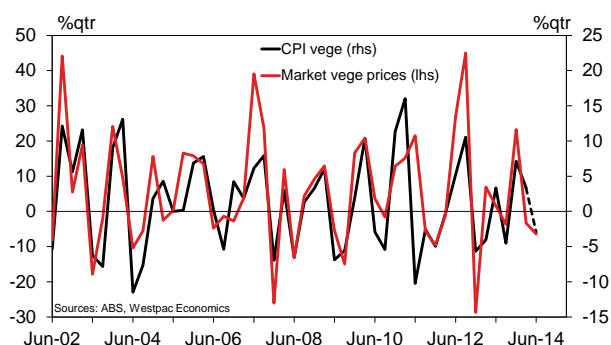
Contributions to 0.6%qtr 2014Q2 forecast



Wholesale fruit prices bounce in Q2



Correction to vege prices continued into Q2



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Modest rise in alcohol and tobacco.

Following tobacco's large 6.8%qtr rise in Q1, due to a lift in tobacco excise, prices will return to a more normal 2.1%qtr in Q2 while alcoholic beverages rise a seasonal 0.6%qtr.

Clothing & footwear more muted than normal.

Clothing & footwear normally rises around 2% in the June quarter as retailers reset prices post the Boxing Day/New Year sales and pre the post June 30 sales. However, this year retail sales were particularly slow though this quarter while the rising AUD would be lowering the price of imported products. As such, we have estimated a more modest 1.8% rise for this quarter as we suspect some discounting may have started earlier this year (intuition that is backed by our liaison work).

Dwelling purchase price to bounce in Q2.

Housing costs rose a very modest 0.6%qtr in Q1 led by a surprisingly soft 0.1%qtr rise in new dwelling purchase costs. The Q1 rise was well below the longer-run average rise of 0.8%qtr and was due in part to a -1.4%qtr contraction from Melbourne. We note that dwelling purchase prices have been quite volatile from this city of late and would expect the negative to be reversed by a positive print in the June quarter CPI hence our forecast for a 1.1%qtr forecast for new dwelling purchases. We are assuming a 0.8% for rents, a step down from an above trend 1.1% in Q1. Overall, housing costs are forecast to rise 0.7%qtr contributing 0.16ppt to the CPI.

Household furnishings and services get a seasonal bounce.

We tend to see Q2 price resetting for furnishing, household equipment and services. We expect to see this again in 2014 but as with clothing, softer retail sales and a strong AUD means we do expect the rise to be more muted than usual.

Health costs rising despite falling pharmaceutical prices.

Pharmaceutical prices fall in Q2 as households cross the threshold for medical expenditure which makes them eligible for the Pharmaceutical Benefits Scheme's (PBS) rebate for prescription drugs. The annual health insurance premium hike out-weighs this impact in Q2 though, which feeds through in the medical and hospital services category. The 2014 increase of 6.2% is up from 5.6% in 2013, 5.06% in 2012 and 5.56% in 2011. In addition, changes to the arrangement of the PBS has reduced the magnitude of both the Q1 rise and the corresponding fall in the following three quarters. Overall, health will contribute 0.10ppt to the Q2 CPI.

Rising AUD helps to lower fuel prices.

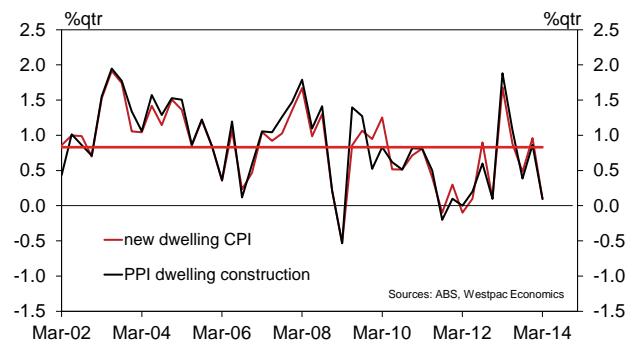
API petrol pump prices have been more volatile than usual this year but the average for Q2 is 1.4% lower than Q1. This more than offset the seasonally modest 0.2% rise in motor vehicle prices driving a 0.1% fall in transport costs.

Seasonal fall in holiday travel prices.

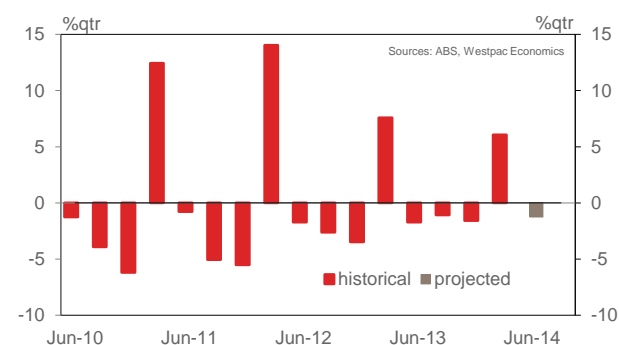
The best price airfare data from BITRE suggests we will see the normal seasonal fall in domestic holiday travel and accommodation. We also expect that the stronger AUD will also help to continue to mute international holiday travel and accommodation prices. All up we expect recreation and culture prices to fall 0.6%qtr contributing -0.08ppt to the CPI.

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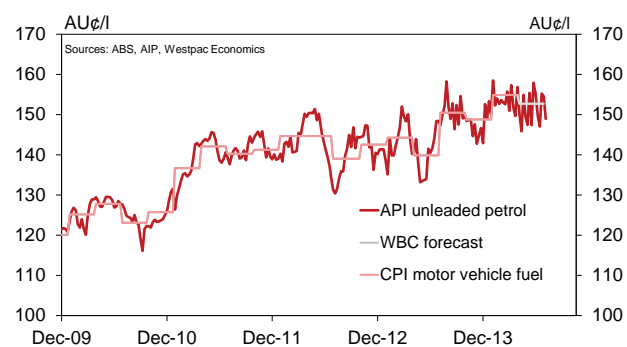
Dwelling PPI vs CPI dwellings



Clear seasonality in pharmaceuticals



Weekly bowser price & CPI auto fuel index



Domestic holiday & travel





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