

16 April 2015

Australia Q1 CPI preview: fuel, fruit & veg plus seasonality.

Petrol is a significant drag, for now, and the effect of a weaker AUD is only starting to appear.

- Westpac is forecasting a meek 0.1%qtr rise (1.2%yr) in the headline CPI in the March quarter.
- March is historically a seasonally soft quarter, which is interesting given that it is the quarter for the annual repricing of education and health costs (particularly pharmaceuticals). The offsets come from seasonal falls in food, garments & footwear, household textiles & utensils, audio visual & computing and holiday travel.
- The core measures, which are seasonally adjusted, are forecast to rise 0.4%qtr/2.2%yr (on average) and the 6mth annualised pulse is also a benign 2.2%yr.
- The key factors for the very low headline CPI print are: the collapse in petrol prices through late Q4 and early Q1 (a late Q1 surge was not enough to prevent a 12% fall in Q1), falling fruit & vegetable prices (-2.1%), while reports to date suggest that despite the falling AUD, clothing & footwear prices saw their usual post-Christmas discounts.
- Offsetting is a robust 0.7% gain for housing (house purchases up 1.1%), a 1.9% gain for tobacco (seasonal repricing) and a 2.7% lift in health costs (driven mostly by a 7% rise in pharmaceuticals).
- This quarter we make special note of the divergence between the price of Australian automotive fuel and the AUD price of crude oil. The refining spread, or crack, for Singapore 92 RON gasoline blew out in March to the widest we have seen back to 2003. If you just look at crude oil, and don't consider the change refining spread, your estimate for Australian pump prices will be miles off at the moment.

A quick recap on the December quarter CPI

The headline CPI rose 0.2% in Q4 and the annual rate eased back to 1.7% from 2.3% in Q3 and 3.0% in Q2.

For the core measures, both the trimmed mean and weighted median lifted 0.66% and the annual pace of the average of the core inflation measures eased back to 2.2%yr from 2.5%yr in Q3. There has been a meaningful moderation in the pace of core inflation, taking it to the bottom of the RBA's target band.

In the December quarter, the collapse in petrol prices (-6.8%) and fresh fruit & vegetables (-2.2%) more than offset the rise in tobacco (+4.8%). However, a surprising unseasonal rise in clothing & footwear (0.1%) and a stronger than expected rise in household contents (0.5%) limited the fall in traded goods prices to -0.6%, taking the annual rate down to 0.7%yr from 2.0%yr in Q3, and 2.9%yr in Q2. The pace of non-traded inflation remains modest, rising 0.6% in the quarter with the annual rate easing back to 2.3%yr.

Mar quarter 2015 CPI forecast

Item	Q1 2015 forecast		Q4 2014 actual	
	% qtr	contrib	% qtr	contrib
Food	-0.1	-0.01	0.1	0.02
of which, fruit & vegetables	-2.1	-0.06	-2.2	-0.06
Alcohol & tobacco	0.5	0.03	1.7	0.12
of which, Tobacco	1.9	0.04	4.8	0.11
Clothing & footwear	-1.5	-0.06	0.1	0.00
Housing	0.7	0.15	0.5	0.12
of which, Rents	0.4	0.03	0.5	0.03
of which, House purchases	1.1	0.10	1.1	0.10
of which, Utilities	0.5	0.02	-0.3	-0.01
H/hold contents & services	-0.2	-0.02	0.5	0.04
Health	2.7	0.14	-0.9	-0.05
of which, Pharmaceuticals	7.0	0.08	-3.7	-0.04
Transportation	-3.9	-0.44	-2.2	-0.26
of which, car prices	-0.4	-0.01	-1.1	-0.04
of which, auto fuel	-12.0	-0.43	-6.8	-0.24
Communication	0.4	0.01	-0.1	0.00
Recreation	0.2	0.03	1.0	0.12
of which, audio vis & comp	0.5	0.01	-4.6	-0.12
of which, holiday travel	0.0	0.00	3.9	0.18
Education	6.7	0.21	0.0	0.00
Financial & insurance services	0.6	0.03	1.0	0.05
CPI: All groups	0.07	-	0.19	-
CPI: All groups % year	1.21	-	1.72	-
Core inflation	%qtr	%qtr	%yr	%yr
	Mar-15	Dec-14	Mar-15	Dec-14
CPI seasonally adjusted	0.2	0.3	1.2	1.6
CPI ex housing	-0.1	0.1	0.7	1.2
Weighted median	0.42	0.66	2.2	2.3
Trimmed mean	0.47	0.66	2.1	2.2
Average RBA core	0.44	0.66	2.2	2.2
Average RBA core* ex CPM	0.48	0.64	2.3	2.3
Traded good & services	-1.9	-0.6	-1.6	0.7
Non-traded goods & services	1.1	0.6	2.7	2.3

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 has some very significant 'knowns' but, as always, many 'unknowns' remain.

The March quarter saw large known forces tug the CPI in opposite directions. But as always, a large number of unknowns remain. Also we don't have access to the data which the ABS uses potentially causing many small errors along the way.

One of the most obvious events in the quarter was the significant volatility in the pump price of automotive fuels. The national weekly average price for unleaded fuel hit a low of 104¢/litre in the week ended February 1 before surging to 134¢/l by the week ended March 29.

Many commentators point out this price rise can't be justified by the crude oil price (in US\$) and the movement in the AUD. But what has been missed is surge in Singapore 92 RON unleaded gasoline. From a January 25th low of A\$67/bbl, Singapore gasoline surged 42% to A\$95/bbl. The peak to trough move for weekly unleaded fuel prices was a more modest 29%. We have seen some analysis refer to the movement in WTI (+13%) to argue that the rise in Australian gasoline prices were unjustified. Clearly this is not the case.

Westpac's has a crude indicator of Australian petrol prices (based on a 4 week moving average of the A\$ price of Brent and TAPIS plus an estimate for taxes, transport and retail margin). This indicator normally has a close relationship with Australian (and Singapore) petrol prices but in March the error from the indicator widened out to 15.3¢/l, the widest spread we have seen in the history we have back to 2003. So just looking at crude oil prices can give you a misguided perception of where Australian petrol prices are headed in the nearer term if you do consider Singapore refining margins.

Seasonality in fruit & vegies are a negative, but it is a significant positive for pharmaceuticals.

Wholesale vegetable prices rose a solid 16% in Q1 but, as always, we can't be sure just how they were passed through to the retail level. Vegetable prices are much more volatile at the wholesale level than they are at the retail level and the 17% fall in Dec quarter translated into just a 1.7% fall at the retail level. We have pencilled in a 1% fall in Q1 as there is a tendency for retail prices to smooth out some of the volatility in wholesale prices. Again, for fruit some catch up to the smaller drop in retail prices in Q4 relative to wholesale prices is our reasoning behind the 3% fall in fruit prices in the CPI. The ABS seasonal factors point to a robust -4.8% seasonal effect for fruit prices in the March quarter.

It is well understood that pharmaceuticals & health service prices fall in Q2, Q3 and Q4 as more families progressively gain access to the Prescribed Benefits Scheme (PBS); they then rise in Q1 as the threshold of assistance is reset. However, recent changes to this scheme, plus government controls aimed at controlling pharmaceuticals inflation, will reduce this impact. In 2014, the Q1 uplift was smaller than previous March quarters: 6.1% compared to 7.6% in 2013Q1 and 14.0% in 2012Q1. It appears that Big Pharma is pushing back which, along with the fall in the AUD, is behind our forecast for a 7% rise in pharmaceuticals.

We also know of changes to the indexation of tobacco and how, due to the timing of the indexation, its impact has been spread over Q3 and Q4. Our estimate for a 1.9% rise in tobacco prices is more to do with seasonal price resetting by the producers plus some pass-through of the weaker AUD.

Dwelling prices continue their gains but will be mixed by city

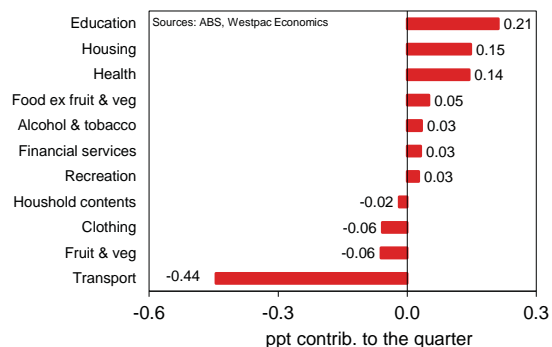
Dwelling prices are on a stronger trend particularly in Sydney with a 3.0% gain through the last half of 2014. Gains were muter in

Key forecasting indicators of the CPI

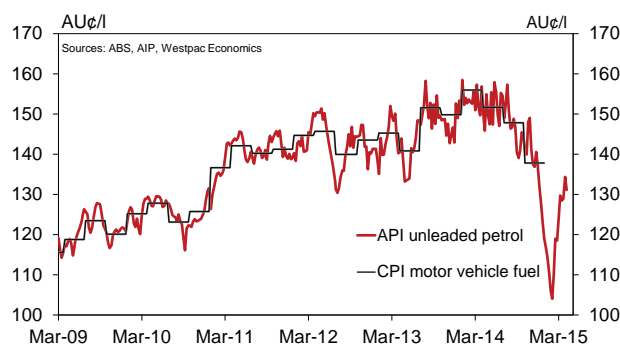
	Jun-14	Sep-14	Dec-14	Mar-15
CPI %qtr	0.5	0.5	0.2	0.1 (f)
CPI %yr	3.0	2.3	1.7	1.2 (f)
RBA core %yr	2.8	2.5	2.2	2.2 (f)
AUD/USD	0.93	0.93	0.86	0.79
AUD/USD %yr	-6.0	1.0	-7.8	-12.2
TWI	71.6	71.3	67.8	64.4
TWI %yr	-5.3	1.1	-4.5	-6.8
Crude oil, Brent US\$bbl	109	104	77	56
Crude oil, Brent %yr	5.9	-4.5	-29.3	-47.8
Output gap, adv. 3qtrs	-0.3	-0.4	-0.4	-0.4

Sources: ABS, RBA, Bloomberg, Westpac Economics. *Actual from 3 quarters prior.

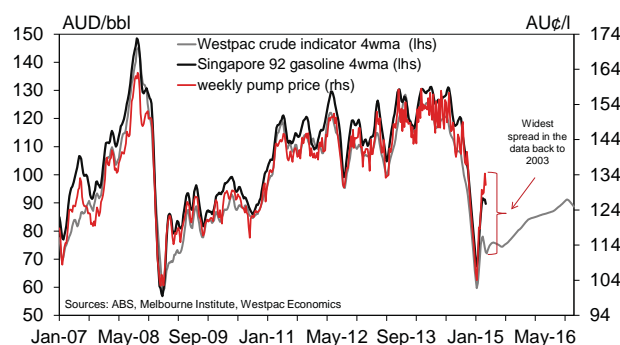
Contributions to 0.1%qtr 2015Q1 print



Weekly bowser price & CPI auto fuel index



Petrol prices, the spread to crude has widened



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Brisbane and Melbourne, 2.0 and 2.1% respectively, while the gains were weaker in Perth (1.2% through 6 months) and Adelaide (1.2%). We are looking for a 1.1% gain in Q1, a continuation from the 1.1% gain in Q4.

Seasonality holds in clothing and holidays despite the weaker Australian dollar

We know about the usual seasonal discounting in holiday travel and from airfare pricing data we can get a good guide as to how much domestic holiday travel costs fell quarter on quarter. But we are uncertain as to how the falling Australian dollar has impacted on international holiday travel costs.

There are also the normal post-Christmas sales for clothing, footwear and accessories. However, this year we do expect that some of the pass-through from the weaker AUD has started, so we have pencilled in a -1.5% compared to -2.1% in 2014Q1 and -3.9% in 2013Q1.

Overall seasonality is a small negative in Q1

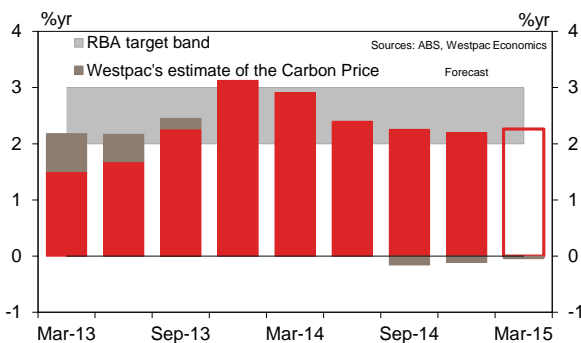
The ABS estimates a negative seasonality in the March quarter of 0.1ppts. That is, on average, prices in the March quarter tend to rise 0.1ppts less than the underlying, or trend, pace suggests they should. So our estimate of the seasonally adjusted CPI is a 0.2%qtr rise. There is an important caveat however; the ABS conducts concurrent seasonal re-analysis and the revisions to the seasonal factors can sometimes be quite significant. We note that in 2013 the seasonal factor was flat in Q1 while it rose 0.1% in 2012Q1. As such, we caution we can't be sure what the ABS will define as the seasonal impact in Q1. This matters as the core measures are seasonally adjusted, revisions to the seasonal factors do impact on the core estimates.

Conclusion

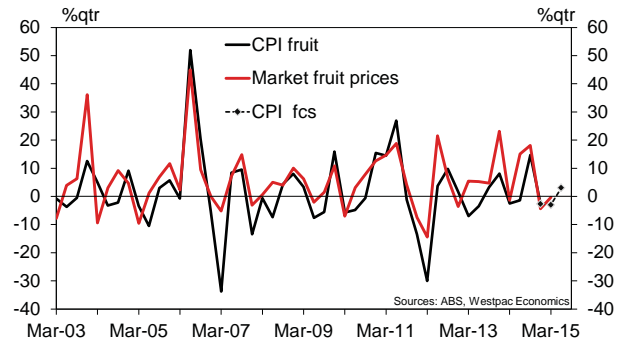
In summary, we expect a meek headline outcome in Q1; declining tradable prices (which are set to reverse in Q2); and a reasonably robust increase in non-traded goods and services. As for the core, policy sensitive measures, we anticipate that the 6mth pulse will lift slightly from 2.1%yr in Q4 to 2.2% in Q1, a benign print - if you exclude the two 2.1%yr prints in the last half of 2014, you have to go back to June 2013 to find a print of 2.2% or lower.

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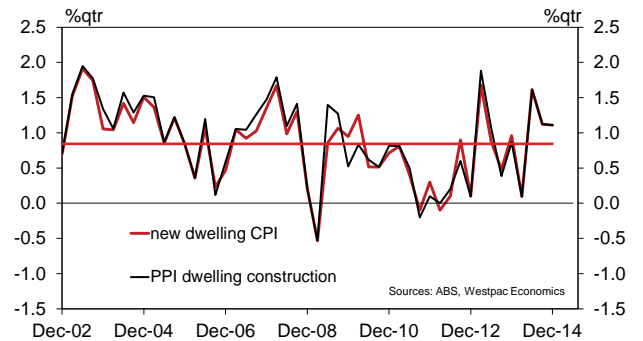
Six month annualised pace of core inflation



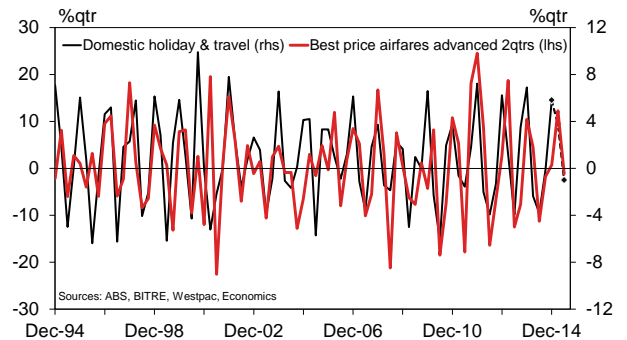
Fruit prices, wholesale & CPI



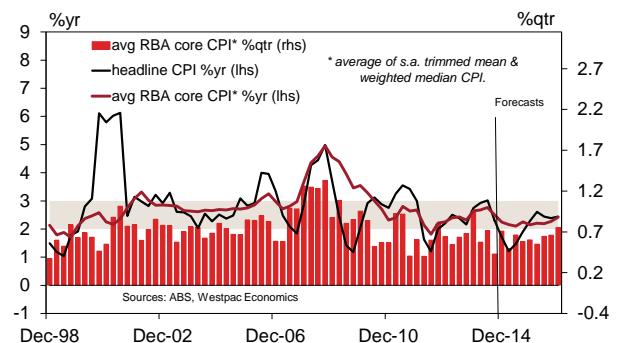
Dwelling PPI vs CPI dwellings



Domestic holiday & travel



Inflationary pressures are to ease from here



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