

## Australia Economic Watch

## CPI review: Faster progress towards target

**CPI eases to 4.1%yoy, well below the RBA's 4.5%yoy**

Headline inflation rose by 0.6%qoq while underlying CPI was up 0.8%qoq in 4Q. This means that annual inflation has eased to 4.1% and 4.2% respectively. While driven by goods and tradables, this is the smallest quarterly rise since March 2021. Most components recorded increases that were offset by declines in the furnishing, transport, and education components. The most significant price rises this quarter were (seasonal) tobacco, new dwellings, domestic holiday travel and accommodation, and medical and hospital services.

**Exhibit 1: Inflation continues to move towards target**

With the monthly measure now running at 3.4%yoy



Source: ABS, Macrobond

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The RBA meets on 5-6 February for the first time this year and is likely to welcome faster than expected progress towards the target. The latter along with low unemployment should be sufficient to keep rates unchanged at 4.35% at this meeting and confirm rates have peaked. We do not expect major changes in guidance as domestic inflation remains elevated and sticky. However, the Bank will need to update its forecasts to reflect lower-than-expected CPI. Today's inflation outcomes support our view that the next RBA move is a cut. We currently see the first cut in 1Q 2025, but risk is for earlier easing.

**FX & Rates: target in sight but no cuts in H1 2024**

A miss on CPI has dragged the AUD down by about 30 pips and prompted a 7-8bps rally in AU rates. These moves make sense given policymakers have achieved noteworthy progress in tackling inflation and the probability of rate cuts in 2024 has increased. Yet we see pricing of cuts in the first half as overdone. Almost 17bps of cuts are priced by June 2024 (+5bps on the day). We decline to add a recommendation given an FOMC announcement is imminent but we are monitoring the next few RBA meeting dates for opportunities to add a short position.

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**Refer to important disclosures on page 4 to 5.**

12653089

Timestamp: 30 January 2024 11:31PM EST

31 January 2024

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## “Good” news

Headline CPI eased to 4.1%yoy from 5.4%yoy on the back of base effects and driven by a 0.6%qoq rise. These outcomes are below consensus, the RBA’s 4.5%yoy assumption and our 4.4%yoy. Core inflation (trimmed-mean) was up 0.8% and 4.2%yoy while the weighted median measure was up 0.9% in the quarter, 4.4%yoy, as we had expected.

We interpret these outcomes as mixed, but enough to confirm a peak cash rate at the current level of 4.35%. The overall breadth of inflation now reflects more components rising at a below-2% pace but the proportion of CPI that remains above target is still high (Exhibit 2)

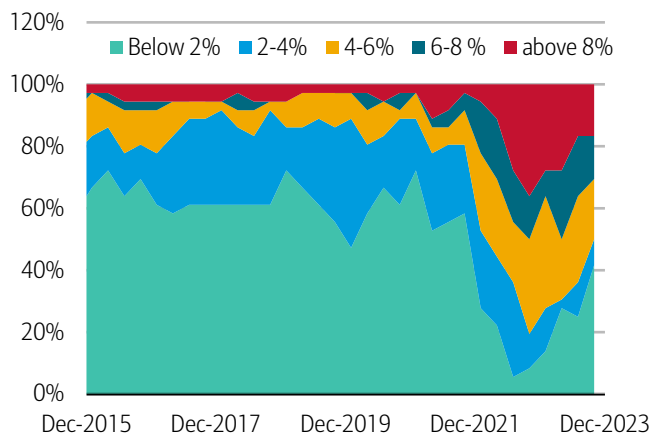
This is the fifth consecutive quarter of lower annual inflation for goods, down from the peak of 9.6% in September 2022 quarter. Annual inflation for most goods eased in the December 2023 quarter, with some goods seeing deflation, where prices are lower compared to 12 months ago, such as clothing, footwear, furniture and household appliances. Annual services inflation eased for the second consecutive quarter, down from the peak of 6.3 per cent in the June 2023 quarter (Exhibit 3).

Encouragingly, 0.6%qoq rise was the smallest quarterly rise since the March 2021 quarter. While prices continued to rise for most goods and services, annual CPI inflation has fallen from a peak of 7.8% in December 2022 to 4.1% in December 2023

The most significant contributors to the December quarter rise were Housing (+1% ), Alcohol and tobacco (+2.8%), Insurance and financial services (+1.7%), and Food and non-alcoholic beverages (+0.5%). Furnishing, and household equipment declined in the quarter to reflect heavy discounts and sales as well as slower housing activity. Transport prices also fell 0.2% on the back of volatile petrol prices.

### Exhibit 2: Inflation breadth also shows progress

The proportion of items rising below target is larger

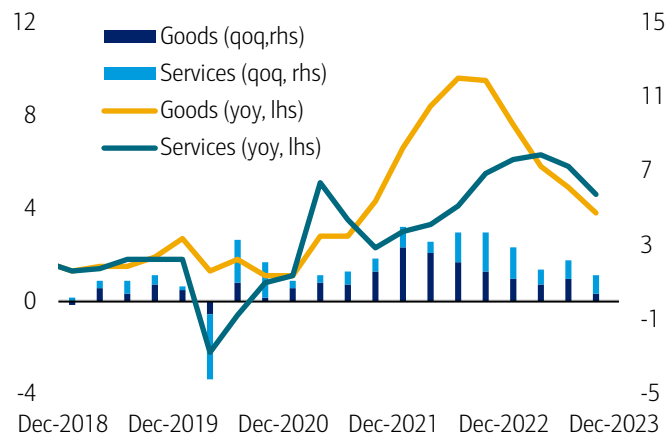


Source: ABS, Macrobond

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### Exhibit 3: A softer pace of growth for both goods and services CPI

Yet some more progress will be needed



Source: ABS Macrobond

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Insurance prices rose 16.6% in the 12 months to the December 2023 quarter, which is the strongest annual rise since March 2001. Higher reinsurance, natural disaster and claims costs contributed to higher premiums for house, home contents and motor vehicle insurance. Our insurance analysts believe insurance premiums increases have peaked. See: [Australia Economic Watch: CPI eases in 4Q, but risks remain 18 January 2024](#).

Annual growth in new dwelling prices remained steady at 5.1% in the December 2023 quarter, however, is significantly down from the peak of 20.7 per cent in September 2022. The moderation in annual price growth over the past 12 months reflects subdued

new demand and building materials cost increases easing. The latter reflects traction from high interest rates.

Annual food inflation eased to 4.5%yoy. Price rises have been lower across all food categories, while fruit and vegetable prices fell 0.2% compared to 12 months ago. Meat and seafood prices showed no change compared to 12 months ago, with price falls in lamb and goat of 15% and beef and veal of 4.5% offsetting price rises in chicken, pork and seafood. This is consistent with recent outcomes in New Zealand. See: [New Zealand Economic Watch: CPI review: Food for thought 24 January 2024](#)

## **Fiscal policy remains key**

Overall, the data reflects progress on the inflation front though driven by volatile and goods components. Non-tradables remains elevated at 5.4% due to price rises for new dwellings, rents, insurance, and electricity. Notably, there are government subsidies on electricity and rents. Excluding the changes to rent assistance, rental prices would have increased by 2.2% in 4Q. Ahead of the Budget due in May we would expect focus to shift to fiscal measures to continue to address high living costs. The government could provide further relief on rents and power bills. See: [BofA Australia Household Consumption Tracker: Tax cuts to the rescue 25 January 2024](#)

From 20 September 2023, the maximum rate available for Commonwealth Rent Assistance (CRA) increased by 15% in addition to the biannual CPI indexation that applies in March and September each year. In the December 2023 quarter, rents rose 0.9% with the increase moderated by changes to Commonwealth Rent Assistance.

Electricity prices rose 1.4% in the December 2023 quarter. The introduction of the Energy Bill Relief Fund rebates from July 2023 has moderated the increase in electricity bills for households. Electricity prices have risen 5.7% since the June 2023 quarter. Excluding the Energy Bill Relief rebates, electricity prices would have increased 17.6% over this period.

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