BofA SECURITIES

Australia Economic Watch

CPI eases in 4Q, but risks remain

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Economics
Australasia

Micaela Fuchila
Economist
Merrill Lynch (Australia)
+61 2 9226 5337
micaela.fuchila@bofa.com

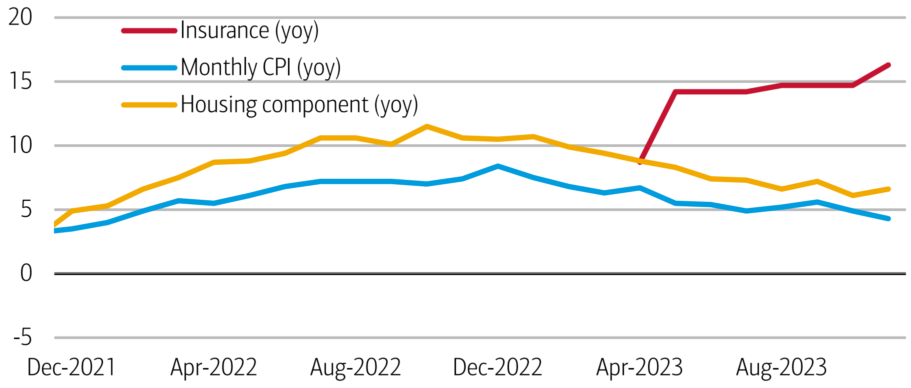
Christiane Holstein >>
Research Analyst
Merrill Lynch (Australia)
christiane.holstein@bofa.com

CPI to rise by 0.9% in 4Q, annual inflation eases to 4.4%

Inflation data for the December quarter will be released on Jan 31 and we look for a 0.9%qoq rise in headline and core that would push CPI down to 4.4%yoy respectively. These outcomes are slightly below the RBA's 4.5% assumption and reflect further progress towards the inflation target. Should our forecast materialise, inflation would ease to the lowest level since early 2022. These outcomes should be enough for the RBA to stay on hold in February, but the composition of CPI remains concerning with domestic pressures easing very slowly.

Housing costs remain elevated despite government support measures and insurance premiums still rising well above CPI due to climate events. Transitory increases in CPI due to flooding on the east coast along with supply chain disruptions due to the geopolitical conflict in the Red Sea should be looked through by the RBA.

Exhibit 1: Insurance premiums continue to rise above CPI
The housing component is yet to materially slow despite government support measures



Source: ABS, Macrobond

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East coast weather events not to add pricing pressure

ICA reported c38,000 claims received by insurers as at 3-Jan, which relate to the Christmas and New Year storms impacting Queensland, New South Wales and Victoria. SUN reported Queensland to be the "hardest hit", with claims largely relating to home insurance. SUN and IAG both stated that it is too early to determine the total expected cost, however, both insurers expect costs to be below their 1H24E catastrophe allowance of $680m and c$574m, respectively. Insurer premiums are not expected to see additional pressure from the recent weather event, with inflationary pressures expected to ease, catastrophes tracking below allowance, and support from reinsurance.

Glossary

ICA: Insurance Council of Australia

SUN: Suncorp Group Ltd

IAG: Insurance Australia Group

GWP: Gross Written Premium

CPI is on its way down, but slowly

Inflation data for the December quarter will be released on Jan 31 and we look for a 0.9%qoq rise in headline and core that would push CPI down to 4.4%yoy respectively. These outcomes are slightly below the RBA's 4.5% assumption and reflect further progress towards the inflation target.

While we think easing inflation pressure will be enough for the RBA to stay on hold on its first monetary policy meeting of the year on February 6, the composition of CPI remains concerning with domestic pressures easing very slowly. See: Australia Economic Viewpoint: Year Ahead 2024: No landing down under 22 November 2023

Consumer confidence remained weak in January, suggesting households continue to feel the pressure from higher interest rates and high inflation. The latest monthly CPI data for November reflected an expected decline in food and energy prices but also high domestic pressures, with the housing component running at 6.6%yoy, despite rent relief and other government measures to support households' cost of living (Exhibit 2)

An expected increase to phone bills will be reflected in the communications component and food prices could be transitorily impacted by the climate events in north Queensland in late December. Indeed, climate events have boosted the insurance and financial services component over 2023.

This component remains elevated at 8.8%yoy in November. Insurance prices rose 16.3% in November, up from 14.7% in October 2023. This is the highest annual price movement since the beginning of the monthly CPI indicator. Higher reinsurance and natural disaster costs contributed to higher premiums for house, home contents and motor vehicle insurance.

Exhibit 2: Monthly CPI yoy by component
Not very close to target yet

	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23
Total	4.3	4.9	5.6	5.2	4.9	5.4
Food & Non-Alcoholic Beverages	4.6	5.3	4.7	4.4	5.6	7
Meat & Seafoods	0.2	1.8	1.7	2.6	2.4	2.7
Fruit & Vegetables	0.7	1	-5.4	-8.3	-5.4	1
Alcoholic Beverages & Tobacco	6.4	6.6	5.8	4.4	4.5	4.6
Alcoholic beverages	4.2	4.5	5	4.7	5	5.1
Tobacco	10.5	10.4	7.5	3.7	3.6	3.8
Clothing & Footwear	-0.9	-1.5	-0.1	1.5	1.5	-0.7
Housing	6.6	6.1	7.2	6.6	7.3	7.4
Rents	7.1	6.6	7.6	7.8	7.6	7.3
New Dwelling Purchase by Owner-Occupiers	5.5	4.7	4.9	4.8	5.9	6.6
Furniture, Furnishings & Household Equipment & Services	-0.3	0.4	2.3	4	4.3	6.3
Health	5.2	6.3	5.4	5.2	5.2	5.2
Transport	3.6	5.9	9.4	7.4	0.3	-0.9
Automotive Fuel	2.3	8.6	19.7	13.9	-7.6	-10.6
Communication	2.4	1.8	1.2	1.6	0.3	0.6
Recreation	1.2	2.7	3.5	3.9	4.1	6.8
Travel & Accommodation	-0.3	1.3	1.9	6.6	5.3	12.9
Education	4.8	4.8	4.8	5.5	5.2	5.2
Finance & Insurance	8.8	8.6	8.6	8.8	8.5	8.5

Source: ABS, Macrobond

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Current climate events unlikely to boost CPI in 2024

Cyclone Jasper has hit north Queensland over December and the South-East Queensland region continues to experience severe storms and flooding. These events have impacted the State's agriculture (crops, including sugarcane, mangoes and bananas), small businesses in regional areas and tourism. While there is uncertainty around the economic impact, the Federal Government expects impact on the Budget and GDP in 4Q 2023/1Q 2024. Damage to public infrastructure means government support (equivalent to 0.02%

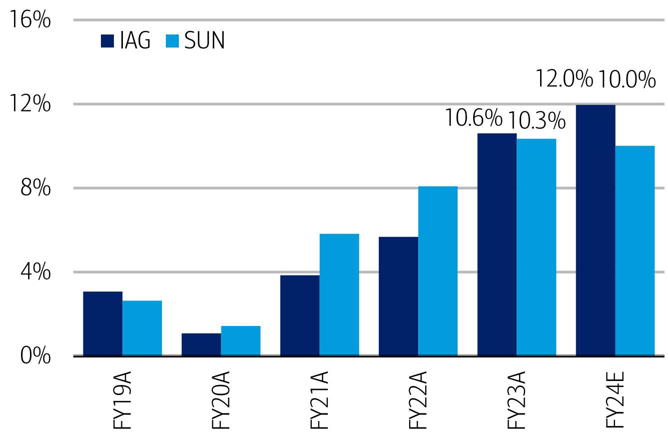
of quarterly GDP so far) would very modestly boost demand in 1Q 2024 due to rebuild and repair works.

The Government has provided a A$108m support package. Notably, as a point of comparison, the floods that followed cyclone Yasi in 2011 had cost the government around A$4.4bn. High construction costs including high wages for the construction sector in the current economic cycle mean reconstruction task may not be accommodated by the Queensland construction industry as easily, given existing limited spare capacity and large infrastructure spending programs across the States.

The Insurance Council of Australia (ICA) reported c38,000 claims received by insurers at 3-Jan, which related to the Christmas and New Year storms impacting Queensland, New South Wales and Victoria. SUN received c19,000 claims at 3-Jan, including 12,500 claims based within Queensland and 13,000 relating to home claims. Management highlighted that it is "too early to provide a total forecast cost", however, costs are expected to be within the $680m 1H24 natural hazard allowance. IAG reported c17,000 claims, with costs similarly still being determined and tracking below their catastrophe allowance (BofAE 1H24 $574m). Insurer premiums are not expected to see additional pressure from the recent weather event, with inflationary pressures expected to ease, catastrophes tracking below allowance and support from reinsurance programs. (Exhibit 3 & Exhibit 4)

Historically, weather events in these regions have led to a temporary increase in food prices particularly on some fruit and vegetable crops.

Exhibit 3: IAG & SUN GWP growth Y/Y
SUN GWP growth expected at 10% and IAG at 12%, in line with guidance



Source: BofA Global Research estimates, company report

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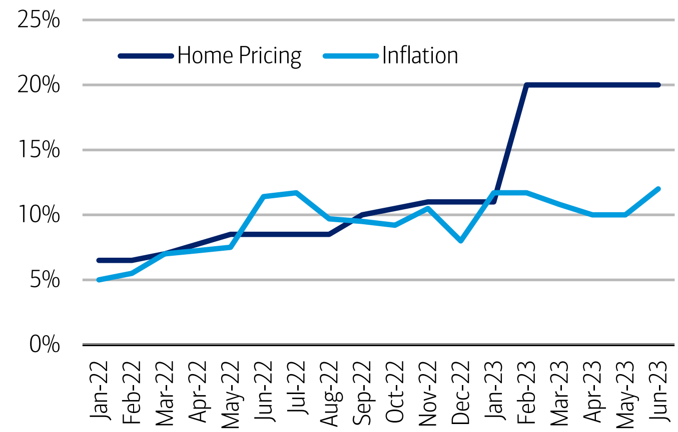
Exhibit 4: IAG Home pricing increases vs inflation
IAG Home insurance premiums c20% at FY23



Source: company report

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Easing of tradables at risk due to geopolitical issues

Tradables inflation has eased at a faster pace than non-tradables during 2023 (see the report: China Watch: Will China export deflation to the world? 16 January 2024). Global shipping costs had normalized following the reopening of the borders, but the current geopolitical conflict in the Red Sea has increased risks for higher tradables inflation into 2024

We estimate the current disruptions could push inflation by 0.2% in the US and 0.6% in Europe over a quarter, but its impact on the Asian region is limited (see the report: Global Economic Viewpoint: Global rate cuts lost at (Red) Sea? 12 January 2024). While the RBA is likely to look through these shocks, it will pay attention to its impact on inflation expectations as CPI remains well above target. We continue to see the RBA on hold in 2024.

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