

Markets Research Economy Watch

CPI Preview – Q1 CPI to keep RBA patient

Summary

- We expect Q1 Trimmed Mean CPI of 0.9% q/q and 3.8% y/y, a slight tick up on the 0.8% seen in Q4 2023.
- We see risks as skewed to a 0.8% q/q which is what the RBA forecast back in February (we are at 0.86 unrounded).
- Two reasons Q1 trimmed mean should print higher than Q4 2023 are: the drags from the increase to rent assistance and falling goods prices will not repeat in Q1.
- For headline we expect 0.8% q/q and 3.5% y/y. The data are released on 24 April 2024 and are likely to confirm only gradual progress on domestic price pressures, keeping the RBA on the sidelines until later in the year.

Table 1: Consumer Price Index Forecasts

	Actual					Forecast			
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Headline CPI									
CPI - NSA									
%q/q	1.4	0.8	1.2	0.6		0.8	0.7	0.7	0.8
%y/y	7.0	6.0	5.4	4.1		3.5	3.4	2.9	3.1
			RBA November SoMP:				3.3		3.2
Core Measures									
Trimmed I									
%q/q	1.2	1.0	1.2	0.8		0.9	0.8	0.7	0.7
%y/y	6.5	5.8	5.1	4.2		3.8	3.7	3.2	3.1
			RBA February SoMP:				3.6		3.1

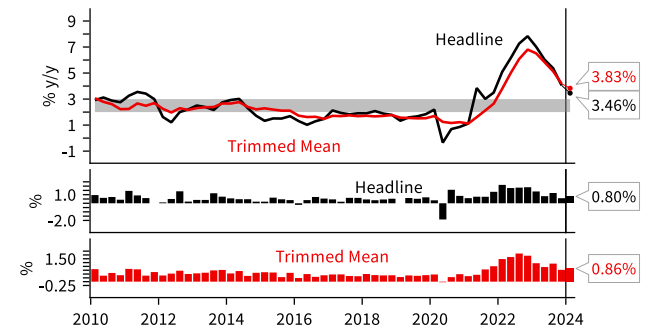
Source: National Australia Bank, ABS

Consumer Price Index - Component Expectations

	Dec-23	NAB Mar-24	NAB Qtr cont.	in CPI Basket
Food and non-alcoholic beverages	0.5	1.0	0.2	17.0
Restaurants and takeaway	0.9	0.5	0.0	6.8
Alcohol and tobacco	2.8	0.9	0.1	7.7
Clothing and footwear	0.5	-1.1	0.0	3.2
Housing	1.0	0.8	0.2	22.2
Rents	0.9	2.3	0.1	5.8
New dwellings	1.5	1.0	0.1	8.5
Utilities	0.6	-1.0	0.0	4.2
Household equip and services	-1.0	-0.5	0.0	8.8
Health	0.6	2.0	0.1	6.2
Transport	-0.2	0.1	0.0	10.7
Automotive fuel	-0.2	-0.9	0.0	3.5
Communication	0.4	0.0	0.0	2.2
Recreation and culture	0.3	-0.2	0.0	11.9
Education	-0.1	5.6	0.3	4.4
Insurance and financial services	1.7	1.6	0.1	5.7
Headline CPI	0.6	0.8	0.8	--
Trimmed Mean, sa	0.8	0.9	--	70

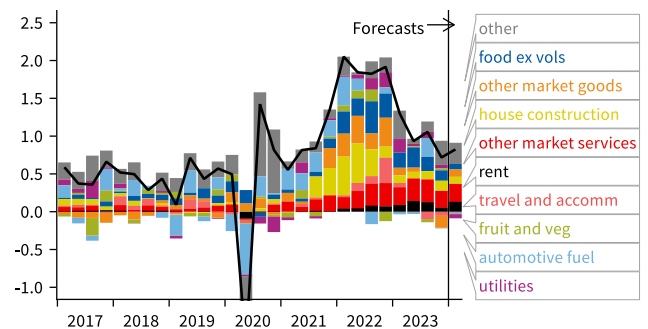
Source: National Australia Bank, ABS

Consumer Price Index Forecast



Source: National Australia Bank, Australian Bureau of Statistics, Macrobond, Account in-house

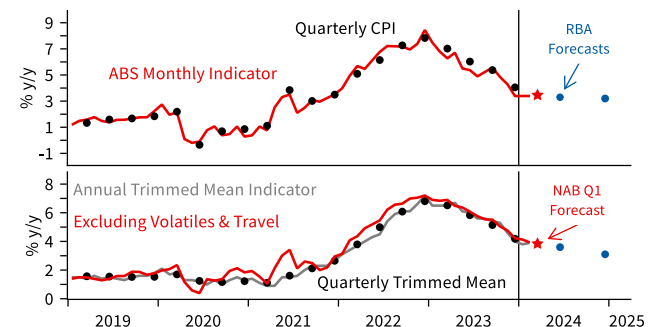
Contributions to quarterly headline CPI (SA)



Source: National Australia Bank, Account in-house, Macrobond

Note: our bottom-up forecast incorporates detail from the January and February monthly CPI indicators as well as forecasts for the large amount of information still to come. Focus should be on the quarterly on 24 April, but for the record our March indicator pick is for headline to remain at 3.4% and for ex volatiles and travel to slide a tenth to 3.8%.

Monthly and Quarterly Inflation



Source: National Australia Bank, Australian Bureau of Statistics

Where is inflation too high?

On our Q1 forecasts, inflation remains much too hot in rents, and too hot across most market services. Food inflation is getting closer to more normal levels consistent with trends seen when inflation last averaged near target for an extended period (we use the 6 years to mid-2015 as a benchmark).

Housing components though remain well above those trends and highlight the challenge rents and new dwelling costs pose in getting inflation back to the mid-point. Services inflation also remains too high, though travel and fuel are not as concerning recently.

Allowing for some components to run a little hotter is that Tobacco and Utilities inflation is running below the rates seen when inflation was last at target – for electricity that could be temporarily derailed in Q3 unless government subsidies are renewed.

Consumer Price Index - Forecast Components					
	weight	annualised % change			benchmark*
		q/q	6m	12m	
Food and Beverage					
grocery ex fruit & veg	8.1	1.3	2.0	3.6	0.7
fruit & veg	2.1	-0.3	2.2	0.1	2.5
Alcohol	5.1	2.5	3.3	3.8	2.3
Meals out and Takeaway	6.9	2.0	2.9	5.3	2.3
Housing					
Rent	5.9	9.2	6.4	8.0	3.5
Home purchase	8.7	4.3	5.3	5.0	3.0
Utilities/rates	5.9	-2.9	0.6	2.9	7.9
Market services					
Ex rent, restaurants & travel	16.2	5.5	5.2	5.7	2.1
travel	4.3	-1.0	-2.9	-3.8	1.6
Market goods					
Other market goods**	17.0	2.3	-0.7	0.0	-1.3
Automotive fuel	3.7	-2.1	-1.5	5.7	2.7
Government-influenced					
Education & Health	10.7	7.4	6.4	3.9	5.1
Tobacco	2.9	5.0	11.9	11.0	11.7
Other government influenced^	2.5	6.2	6.1	1.4	5.2
Trimmed mean					
	70.0	3.6	3.4	3.9	2.5
Headline					
	100.0	3.3	3.1	3.6	2.5

*average change over 6 years to Q2 2015, when headline and trimmed mean averaged 2.5%

**ex houses, tobacco, food, fuel, alcohol | ^public transport, postal, vehicle rego, childcare

Source: National Australia Bank, ABS

By component:

- Food** prices in the monthly CPI indicator are on track for a smaller contribution on a seasonally adjusted quarterly basis and for a continued slowing in y/y inflation. We expect food and non-alcoholic beverage inflation to slow below 4% y/y, from a peak above 9.2%. While there is a general story of goods disinflation, there is some offset from still elevated price increases across snacks and confectionary and water, soft drinks and juice. Higher vegetable prices in the quarter are expected to be somewhat offset by lower fruit prices. As for prepared food, the monthly indicator reveals that meals out and takeaway price increases slowed to just 0.5% q/q in Q1.

- Rents** inflation remains elevated with no end in sight. Timely data on advertised rents, which reflect dynamics in new rental prices, show still strong growth amid low vacancies rates and strong demand. These flow to CPI rents, which measure the stock of all outstanding rents, with a lag. We expect rents to rise 2.3% q/q in Q1 and there is little scope for relief until into 2025 at least. This is a key ongoing support for the CPI, even though rents account for just 6% of the CPI basket, this category is adding over 0.5ppt to annual inflation. Not that rents were temporarily lower in Q4 because of an increase to commonwealth rent assistance, that subtracted a tenth off headline trimmed mean measures last quarter.
- New Dwellings** is the largest component of the CPI and the main driver of both the initial surge in inflation and the subsequent moderation. Price pressures remain in the residential construction industry, and we pencil in 1% q/q growth in this component in Q1, anticipating a similar increase in March to the 0.3% m/m outcome in February.
- Electricity** prices are being heavily influenced by subsidies. The measured level for electricity is 13% below where it would be without current government rebates. The effect of the second instalment of the WA Energy Bill Relief Fund ends in February, so we expect a 5% increase in electricity prices in March to leave the Q1 q/q change as a small negative. The remainder of the subsidies are set to expire in Q3. If they lapse, upward pressure will be partially offset by lower underlying prices, but they may well be extended in the upcoming federal budget.
- Fuel** prices fell sharply into year end, and have rebounded through Q1. Timelier data suggests fuel prices rose another 2% or so in March after a 5% rise in February, but on a quarter average basis we expect a small decline of a bit under 1% q/q.
- Education** will support with large increases in tertiary (reflecting lags in CPI indexation) and secondary education. Preschool and primary also saw large increases, though these were partially offset by the expansion of QLD government's 'free kindy' program.

RBA implications – watching services

For the RBA, they are marking progress against their forecasts and will be looking for signs of progress on domestically generated inflation pressures that would give them greater confidence in their trajectory for inflation. Their February outlook is for trimmed mean inflation around the 2-3% mid-point by mid-2026.

The RBA's implied forecast for Q1 trimmed mean is for 0.8% q/q. A print of 0.8% would likely give them more confidence in their forecast track, but the RBA continues to assess demand as above supply capacity and the labour market on the tight side of sustainable levels.

Two 0.8% prints still annualise above 3% inflation, so even if

inflation prints at 0.8%, we still think the RBA would wait on the sidelines until later in H2 2024 before cutting rates. It is worth noting in the 1996 cutting cycle the RBA noted that “over the first half of 1996, inflation was running at an annual rate of around 2½ per cent”.

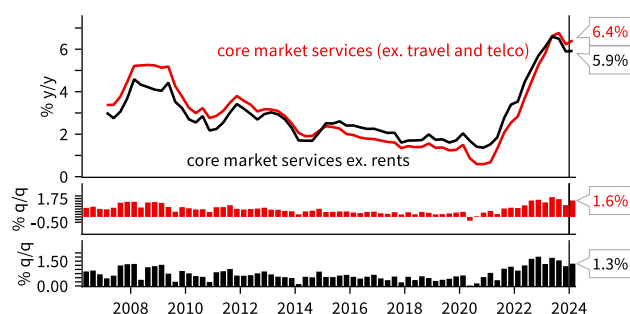
If inflation comes in line with our 0.9% q/q trimmed mean forecast, we expect the RBA would still be able to characterise things as broadly in line with their assessment even as it puts more onus on future data to give them the comfort to cut. We think it would take two further quarterly CPI prints for the RBA to have assurance on their inflation path.

What the details say about domestic pressure, including through services components, will be important.

A couple of different subsets we are watching are market services inflation, non-tradables inflation, and cyclical inflation. Within market services, components that remain most elevated are insurance and rents, which do not reflect labour cost pressures to the same extent as other areas.

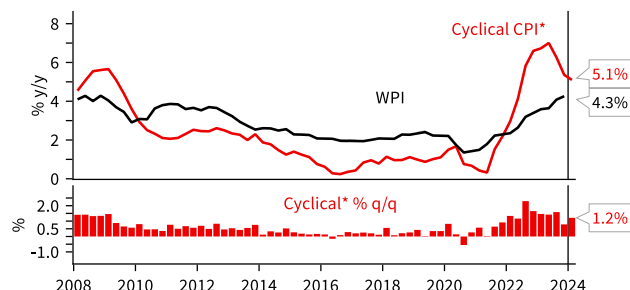
Improvement in categories like restaurant meals could be a glimmer of hope that there is the potential for improvement in the services inflation backdrop to come from easing in non-labour cost pressures. But the broader services picture remains mixed according to the monthly indicator.

Market Services Inflation



*Seasonally adjusted; calculated by NAB from ABS data and NAB forecasts
Source: National Australia Bank, ABS

Cyclical CPI and base wages growth

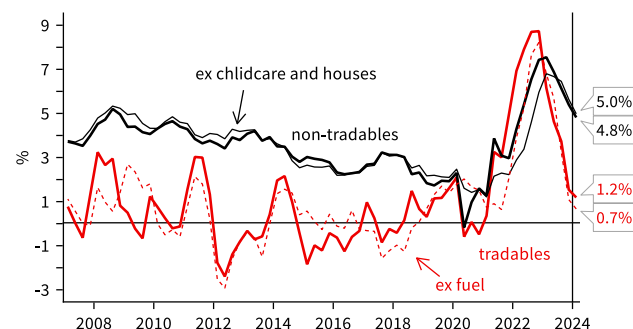


*Cyclical CPI calculated by NAB. Includes about a third of the basket that is historically sensitive to spare capacity in the labour market
Source: National Australia Bank, ABS

The resumption of elevated rents inflation should drive stronger outcomes in Q1 than Q4 in market services and cyclical inflation, but even excluding rents, we expect overall market services inflation to remain elevated.

The same is expected in more gradual progress on non-tradables inflation than tradables inflation.

Tradable and non-tradable inflation



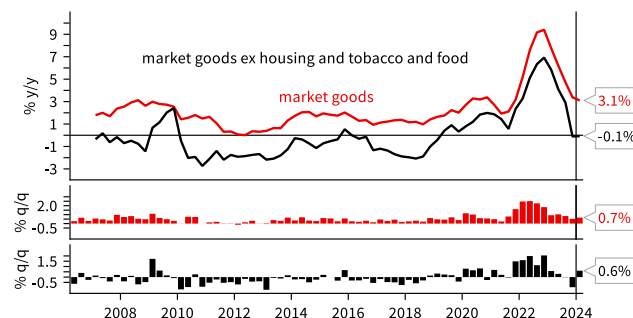
Source: National Australia Bank, ABS

While goods price inflation has been a key driver of the improvement in inflation, on a sequential quarterly basis we do not expect the drag from non-food goods prices evident in Q4 to persist in Q1. While a range of durable consumer goods prices fall seasonally in Q1, the monthly indicator suggests that there will be a return to modest growth in a basket of non-food goods prices in Q1 on a seasonally adjusted basis.

For market goods as a whole, that is offset by cooler food and tobacco inflation, but the drag from falling prices among trade sensitive consumer goods has not continued into 2024. Looking forward, while supply conditions have eased relative to 2022, there have been some more recent local port disruptions and shipping costs are off their lows. Consumer goods import prices have also increased a little in recent quarters.

While much of this dynamic is known, a key uncertainty is new car prices, which are not measured until the March month. Wholesale import prices have returned to growth recently, but volumes are materially improved, and backlogs are being worked through. We pencil in a small fall of around 0.5% q/q.

Market Goods Inflation*



Seasonally adjusted; calculated by NAB from ABS data and NAB forecasts
Source: National Australia Bank, ABS

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