



25 October 2023

# ECONOMIC UPDATE

Inflation: Down but not by far enough



## Key Points

- The Q3 CPI data surprised on the high side;
- Inflation is declining but not as quickly as the RBA was hoping;
- The cash rate in Australia is about one percentage point below that of peer countries;
- All of this makes it likely that the cash rate will rise by a further quarter percentage point at the November RBA meeting.

### The inflation number was higher than expected

Some economic numbers mean more than others and that was the case with the Q3 CPI data. The RBA had recently made it clear that it was getting uncomfortable that inflation might stay too high for too long. The essence of the message was that if inflation continued to decline in line (or below) the RBA's forecasts then the cash rate may have peaked. But if inflation surprised notably on the high side then another rate hike was likely. The September quarter CPI data surprised on the high side.

The headline CPI rose by 1.2% in the September quarter (5.4% over the year). The RBA also likes to look at alternative gauges of inflation. It's favourite measure of 'underlying' inflation is the Trimmed Mean which also rose 1.2% in the quarter (up 5.2% over the year).

It was not all bad news. The growth in goods prices (removing the volatile items) continues to slow and services inflation might have started to fall. Tradeable goods continues to decline in line with ongoing improvement in global supply-chain problems. on-tradeable goods and service inflation appears to have peaked. All of this suggests that further slowing in the inflation rate in coming quarters is likely. For example, the experience of the US suggests that furniture inflation in Australia is likely to slow further (and could decline) in coming months.

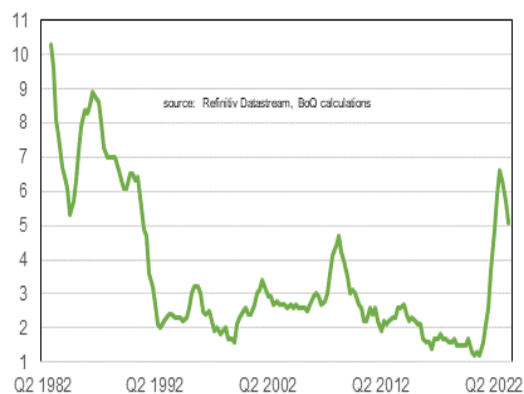
The inflation rate is declining. But it is still too high.

**Headline CPI**  
(annual % change)

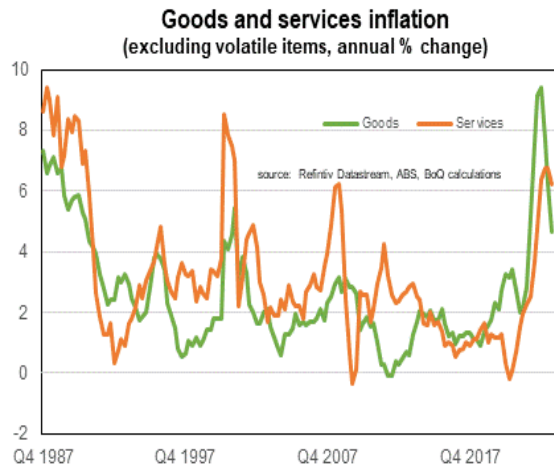


The 'underlying' inflation measures tell a similar story.

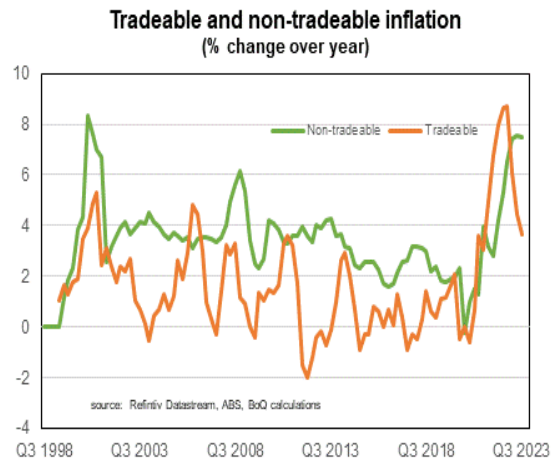
**Trimmed Mean**  
(annual % change)



The moderation of inflation has mainly reflected the slowing in the growth of goods prices.



The improvement in global supply chains has helped moderate tradeable goods prices.

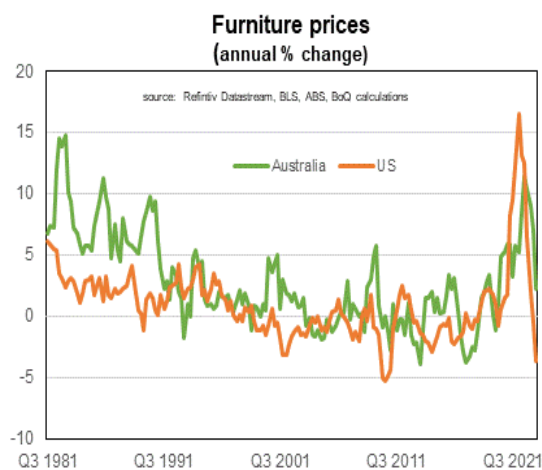


Mainly the rise and fall that has taken place in inflation has been due to global factors (COVID, Russia-Ukraine War). Movements in Australian inflation largely mirror that of peer countries (such as Canada and New Zealand). The data overseas is also consistent with a further moderation of inflation in coming quarters.

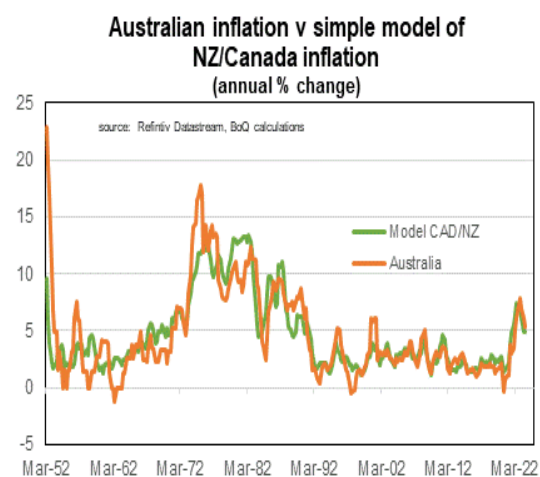
Nonetheless there have been reasons to get worried about inflation. The economy has slowed, mainly because of a step-down in consumer spending. This has led to some rise in the unemployment rate and some decline in capacity utilisation. But the level of both suggests that there is still little spare capacity in the Australian economy.

There has been improvement in supply-chain problems in Australia however this improvement has not been as marked as what has happened globally. The domestic rate of improvement in supply-chain problems as reported by firms has slowed over the past couple of quarters. There has been a big increase in the number of workers and a modest decline in the demand for workers. Nonetheless, a shortage of workers remains many firms' greatest problem. And that is likely to remain the case for at least another six months.

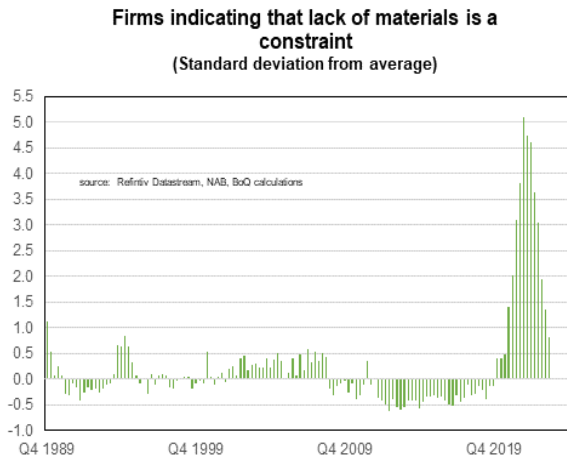
Judging by the US experience, further slowing of furniture prices in Australia is likely.



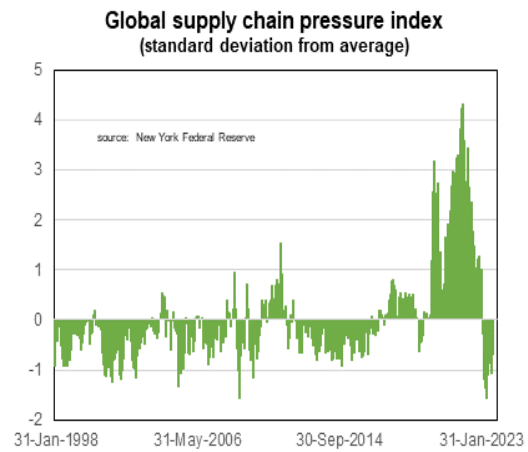
The decline of Australian inflation has largely mirrored what has happened in NZ and Canada.



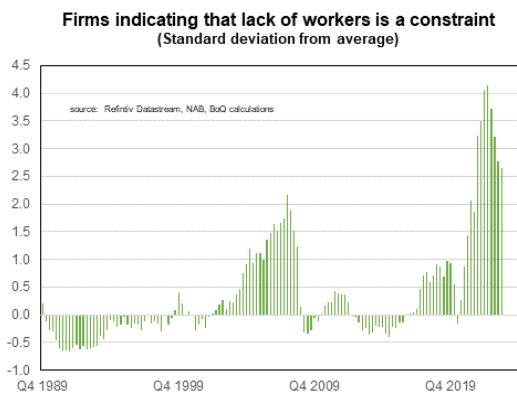
Supply-chain problems have eased in Australia.



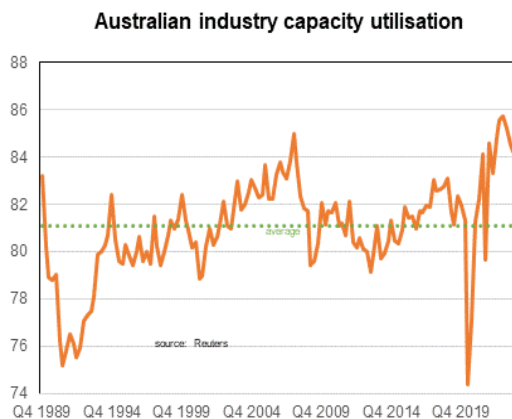
But not as much as what has occurred globally.



Worker shortages remains the major issue for most firms.

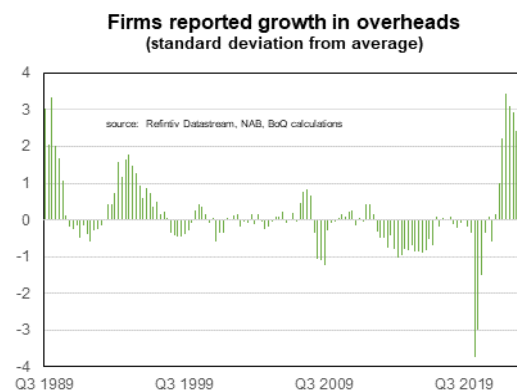


Capacity use remains high.

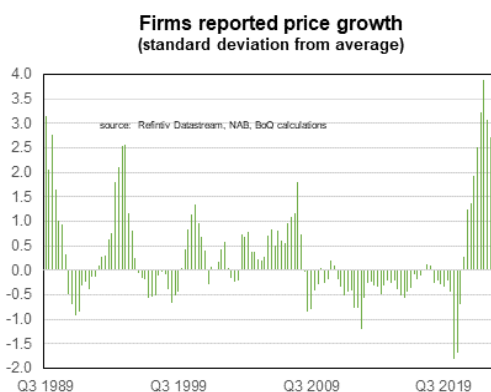


Firms' cost growth has remained elevated and has meant that many businesses have had to pass on decent price rises to their customers. Inflation having been above the RBA's 2-3% target for 10 quarters has led to consumer inflation expectations stabilising at a level inconsistent with price growth returning to the RBA's target. And the extended period of high inflation has led to financial market medium-term inflation expectations rising to their highest level in around 10 years.

The growth in costs remains an issue for most firms.



And is the reason why they have been increasing prices.



This has meant the consumer inflation expectations have remain elevated.



And why there has been a rise in financial market inflation expectations.



The bottom line is that economic growth over the past couple of quarters has been a little better than what most analysts had predicted. The jobs market has weakened, but a substantial rise in the unemployment rate is some way into the distance. Inflation remains too high, with the latest CPI number surprising many analysts on the high side.

All of this suggests that another rate hike is imminent, particularly given that Australia's cash rate is about one percentage point below that of peer countries. To me this make a move at the November Board meeting look likely. We will soon find out whether RBA views about the inflation outlook have changed post the Q3 data. And therefore, any potential interest rate implications.

We really do live in interesting times.

Regards

**Peter Munckton**  
**Chief Economist**  
**Bank of Queensland**

BOQ | 255 George Street Sydney NSW 2000

Twitter: @petermunckton

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