



Consumer Price Index Rate Cut Gathers Urgency

- Headline CPI was flat in the March quarter, which is the weakest result in 3 years and below the consensus forecast of 0.2% growth. The annual rate slid to 1.3% in the March quarter – the slowest annual pace since the September quarter 2016.
- The average of the two underlying measures of inflation rose just 0.19% in the March quarter. A lower quarterly rate has not been recorded since the data series started in Q2 of 1982.
- In annual terms, the average of the underlying measures grew by 1.4% in the March quarter, down from 1.7% in the December quarter.
- The six-month annualised growth rate in core inflation is now just 1.2%, well below the bottom of the RBA's target band of 2-3% per annum, and the slowest pace since December 1997.
- The prices of tradable goods and services fell by 0.6% in the March quarter, dragged down by a sharp drop in fuel prices. Falls in the prices of international holiday, travel & accommodation was also a key contributor.
- Consumer prices fell across 4 of the 8 capital cities in the March quarter – Sydney, Perth, Hobart and Darwin. In annual terms, all capital cities grew at a pace below 2% except Hobart.
- Six of the eleven sub categories recorded declines in the March quarter. The biggest decline was recorded in transportation, down 1.7% in the quarter, the biggest fall in 3 years. There was also a hefty decline of 1.5% in the recreation category; this decline was led by falls in holiday travel (both domestic and overseas) and audio, visual, computing media & services.
- The category that registered the sharpest rise in prices in Q1 was education, up 2.7%, followed by health, up 1.9% in the same period. Both these categories reflect seasonality. The food category rose by 1.3% in the March quarter, the largest quarterly gain in 2½ years, due to the drought and other adverse weather conditions impacting food prices.
- The latest policy minutes from the RBA revealed an inclination towards cutting rates, but no real urgency to do so. However, today's inflation numbers puts the cat among the pigeons and suggests some greater urgency towards cutting rates.
- The inflation result was unequivocally weak and the inflation target is the RBA's guiding principle in changing the cash rate. The annual rate of underlying inflation has now been under the RBA's 2-3% per annum target band for 13 consecutive quarters. We do not see this underlying rate returning to the band any time soon.
- Interest-rate markets moved swiftly to shorten the odds of a rate cut from the RBA; a 25 basis point rate cut from the RBA is now fully priced in by July.

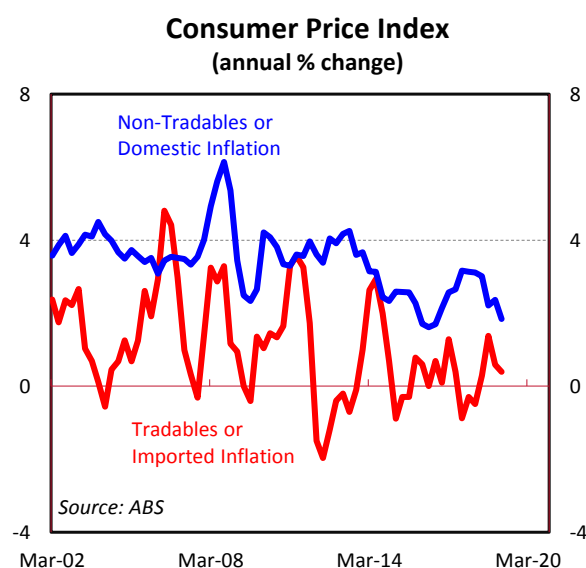
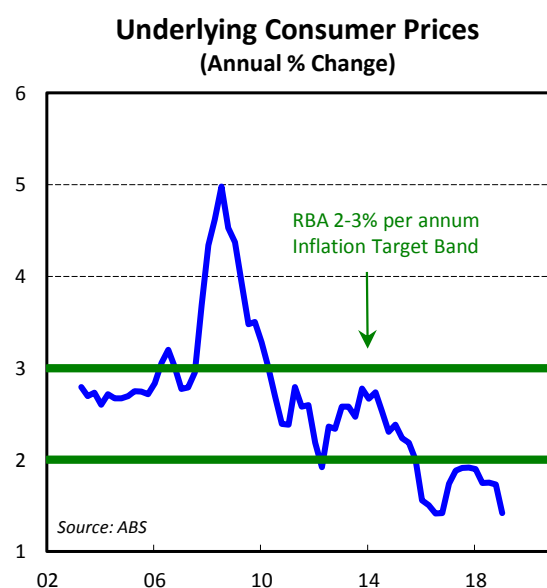
Headline and Underlying CPI

The headline consumer price index (CPI) was flat in the March quarter, which is the weakest result in 3 years and below the consensus forecast of 0.2% growth. The annual rate slid from 1.8% in the December quarter to 1.3% in the March quarter – the slowest annual pace since the September quarter 2016.

The Reserve Bank (RBA) focuses on the underlying rates of inflation, the trimmed mean and the weighted median. The average of these two underlying inflation measures rose by just 0.2% in the March quarter – a lower quarterly rate (when taking it to the second decimal place) has not been recorded since the data commenced in the June quarter of 1982 (the March quarter of 2016 also saw growth of 0.19% in the quarter).

In annual terms, the average of the underlying inflation measures grew by 1.4% in the March quarter, down from 1.7% in the December quarter. And the six-month annualised growth rate in core inflation is now just 1.2%, well below the bottom of the RBA's target band of 2-3% per annum and the slowest pace since December 1997.

Today's inflation numbers indicate inflation pressures remain very subdued in Australia. The low inflation environment is reflective of conditions in the labour market, retail and housing sectors. Wage growth is low and although the unemployment rate has declined over the past year, there remains spare capacity within the labour market. The retail sector also continues to be plagued by cost-cutting competitive pressures. Furthermore, the softening housing cycle is pushing down on prices related to the housing sector.



Tradables and Non-Tradables Inflation

Tradables inflation measures the prices of goods and services that are imported, or those which compete with imported goods, and is heavily influenced by movements in the Australian dollar and other global factors over time.

The prices of tradable goods and services fell by 0.6% in the March quarter, representing the second consecutive quarterly decline. The annual growth rate eased to 0.4% in the March quarter, from 1.6% in the previous quarter, as a sharp drop in fuel prices dragged prices lower in this category. Falls in the prices of international holiday, travel & accommodation was also a key contributor.

The Australian dollar in trade-weighted terms depreciated 0.3% over the quarter and by 2.9% over the year. This decline in the currency tends to place upward pressure on prices. But it can take time for a pass-through effect from the currency to occur. Moreover, it should also be noted that global inflationary pressures are not strong and world oil prices fell significantly in the March quarter. The West Texas Intermediate benchmark oil prices dropped an average of 7.5% over the quarter, heavily influencing transportation prices and overall tradables inflation. It follows an average drop of 14.8% in the previous quarter. However, oil prices have risen sharply higher in recent weeks, so there's a risk that next quarter these falls may reverse.

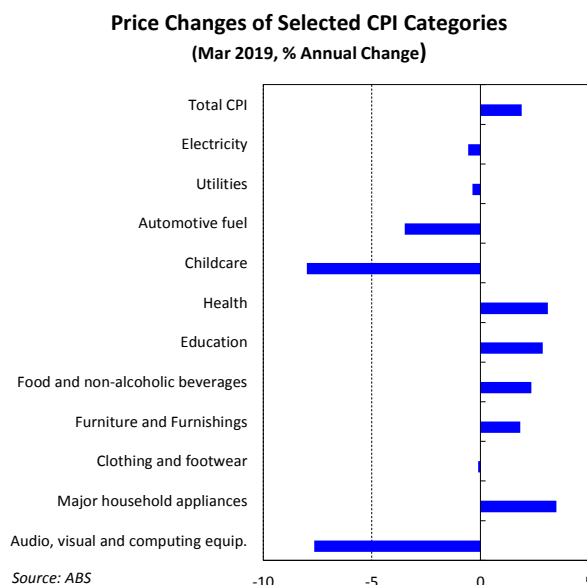
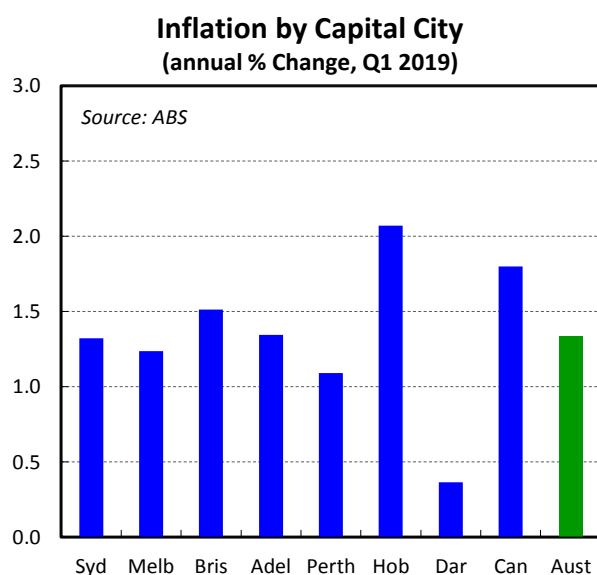
The weakness in tradables inflation growth also reflects the intense competition that is prevailing in the retailing sector.

Non-tradables consumer prices reflect domestic prices not subject to international or import competition; this measure lifted by only 0.3% in the March quarter, taking annual growth to 1.8%, which is the softest result in 2½ years.

Inflation by Capital Cities

Consumer prices fell across 4 of the 8 capital cities in the March quarter – Darwin (-0.8%), Hobart (-0.2%), Sydney (-0.1%) and Perth (-0.1%). All other capital cities each recorded 0.1% growth in the quarter.

In annual terms, all capital cities grew at a pace below the 2% threshold with the exception of Hobart (2.1%).



Groups Analysis

Six of the eleven sub categories recorded declines in the March quarter.

The biggest decline was recorded in the prices of transportation, down 1.7% in the quarter, the biggest fall in 3 years. This group was dragged lower by a drop of 8.7% in fuel prices, the biggest drop since Q1 2016. Fuel costs fell in all capital cities in Q1, ranging from Adelaide (-7.8%) to Darwin (-14.3%).

There was also a hefty decline of 1.5% in the recreation category; this decline was led by falls holiday travel (both domestic and overseas) and audio, visual, computing media & services. The fall in international holiday, travel & accommodation is due to the winter off-peak seasons in

Europe and America.

Clothing & footwear also posted a large fall of 1.4% in the quarter. The biggest fall in this category was garment prices for women, down 2.9% in the March quarter. Ongoing competition and discounting activity continues to impact retailing.

Four of the eleven categories recorded rises in the March quarter. The category that registered the sharpest rise was education, up 2.7% in the quarter (especially secondary education), followed by health, up 1.9% in the same period. Both these categories reflect seasonality – the start of the school year and the reset of the safety net threshold for the MBS and PBS every 1 January.

The food category rose by 1.3% in the March quarter, the largest quarterly gain in 2½ years. The main contributors to the rise in the food and non-alcoholic beverages group this quarter are vegetables (+7.7%), takeaway & fast foods (+0.9%), poultry (+2.9%), bread (+1.8%) and fruit (+1.8%). Drought and adverse weather conditions continue to reduce the supply of a selection of fruits and vegetables and higher input costs are putting upward pressure on prices for other food items such as poultry and bread.

The only category to be flat in the March quarter was housing. Rises in maintenance and repair of the dwelling (+0.7%), gas and other household fuels (+0.8%) and rents (+0.1%) were offset by falls in new dwelling purchase by owner occupiers (-0.2%) and electricity (-0.6%). The falls in new dwelling purchases was driven by a significant fall in Victoria. There remains the risk of further falls in this sub-category, especially in regards to NSW.

Outlook

The latest policy minutes from the RBA revealed an inclination towards cutting rates, but no real urgency to do so, especially while jobs growth remained solid. However, today's inflation numbers puts the cat among the pigeons and must suggest some greater urgency towards giving more weight to the rate-cut case.

The inflation result was unequivocally weak and it is the inflation target that is the RBA's guiding principle in changing the cash rate. The RBA aims to keep inflation in a 2-3% per annum band over time. The annual rate of underlying inflation has now been under this band for 13 consecutive quarters. We do not see this underlying rate returning to the band any time soon.

Inflationary pressures are likely to remain modest. We might see the fall in fuel prices reversed in Q2 and price pressures from the drought should also fade over time, but the housing downturn is extending. Housing represents a substantial weighting in the CPI, so we would expect the housing category to weigh on price pressures. Furthermore, tough retailing conditions are likely to continue to restrain prices among a range of consumer goods.

Interest-rate markets moved swiftly to shorten the odds of a rate cut from the RBA; a 25 basis point rate cut from the RBA is now fully priced in by July.

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