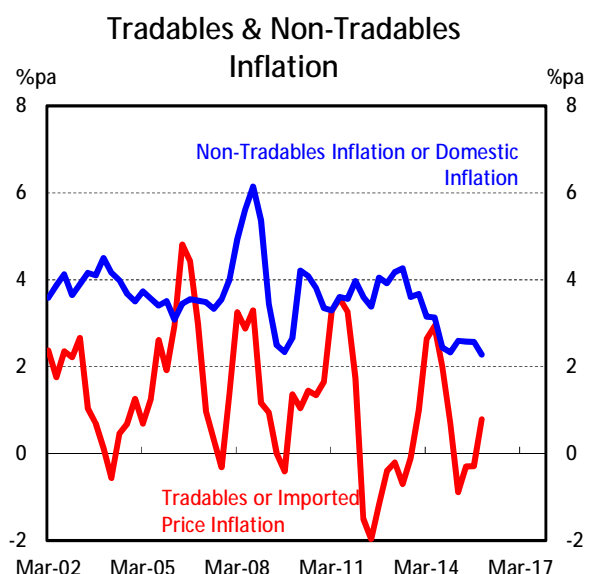
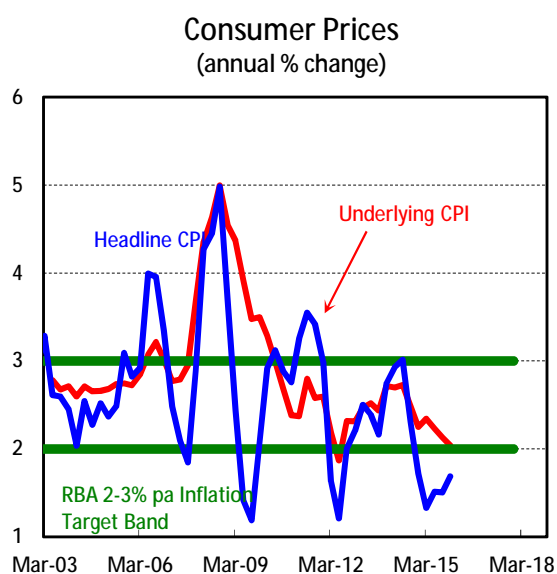


Consumer Price Index Inflation Still Below Target

- Inflation continues to be well-contained. Headline CPI rose 0.4% in the December quarter, while the annual rate lifted from 1.5% to 1.7%, the highest in a year.
- The average of the two underlying inflation measures rose 0.5% in the December quarter. Meanwhile, the annual rate edged down from 2.1% to 2.0% in the year to the December quarter, at the bottom of the RBA's 2-3% annual target band. It reinforces the view that underlying inflation could remain in the bottom half or even fall below the RBA's target band in the near-term.
- Major contributors to inflation for the quarter included alcohol & tobacco (2.7%) and recreation & culture (1.6%). Transport prices were down 1.4% while communication prices fell 2.4% in the quarter.
- In the year to the December quarter, inflation was below the RBA's 2 to 3% target band in all capital cities except Sydney where prices rose 2.0%. The smallest increases over the year were in Darwin (0.5%) and Canberra (0.7%).
- Inflation was very close to the RBA's published November forecasts, suggesting limited implications for the cash rate outlook. Low inflation means that the RBA can leave the door open for lower rates if it sees the need. However, with the unemployment rate possibly having passed a peak and growing signs of improvement in non-mining sectors of the economy, we expect the RBA will remain on hold next week and for the remainder of the year.



Inflation continues to be well-contained. Headline CPI rose 0.4% in the December quarter, while the annual rate lifted from 1.5% to 1.7%, the highest in a year. However, headline inflation has stayed below 2% for over a year.

Underlying inflation, which strips out volatile items such as petrol prices, is the major focus for the RBA. This measure further confirms that upward pressures on inflation are limited. The average of the two underlying inflation measures rose 0.5% in the December quarter. Meanwhile, the annual rate edged down from 2.1% to 2.0% in the year to the December quarter, at the bottom of the RBA's 2-3% annual target band. It reinforces the view that underlying inflation could remain in the bottom half or even fall below the RBA's target band over much of this year.

Despite the subdued outcome, both headline and underlying inflation outcomes were broadly in line with the RBA's forecasts published in November. The headline rate was a touch above consensus and our expectations, but underlying inflation was close to estimates.

CPI Groups Analysis

The largest price increase in the December quarter was for alcohol & tobacco (2.7%). The price of tobacco products rose 7.4% in the quarter due to increases in the federal excise tax effective from 1 September 2015. Also seeing a significant increase were prices in recreation & culture (1.6%). Domestic holiday travel and accommodation prices rose 5.9% while international holiday travel and accommodation prices were up 2.4%, partly due to the October school holiday period and the lead up to the Christmas holidays.

Counteracting the price increases were declines in communications (-2.4%) and transport (-1.4%). The price of automotive fuel fell 5.7% but this was partially offset by a 1.7% increase in the cost of vehicle maintenance and repairs.

Over the last twelve months, prices in the alcohol and tobacco group rose 6.0%. The main contributor to the rise was tobacco which rose 13.3%. The price of education rose 5.5% over the year while health prices rose 5.3%.

Not all categories rose over the year. Communication prices were down 6.3% and transport prices fell 1.4% assisted by an 8.7% fall in automotive fuels prices and a 3.4% decline in urban transport fares.

Consumer Prices	December quarter 2015, %	
	Quarterly change	Annual change
Food and non-alcoholic beverages	0.3	0.4
Alcohol and tobacco	2.7	6.0
Clothing and footwear	1.6	0.5
Housing	0.1	2.2
Furnishings, household equipment and services	0.6	1.9
Health	-0.4	5.3
Transport	-1.4	-1.4
Communication	-2.4	-6.3
Recreation and culture	1.6	1.7
Education	0.0	5.5
Insurance and Financial Services	0.8	1.8
Total CPI	0.4	1.7

Tradables and Non-Tradables Inflation

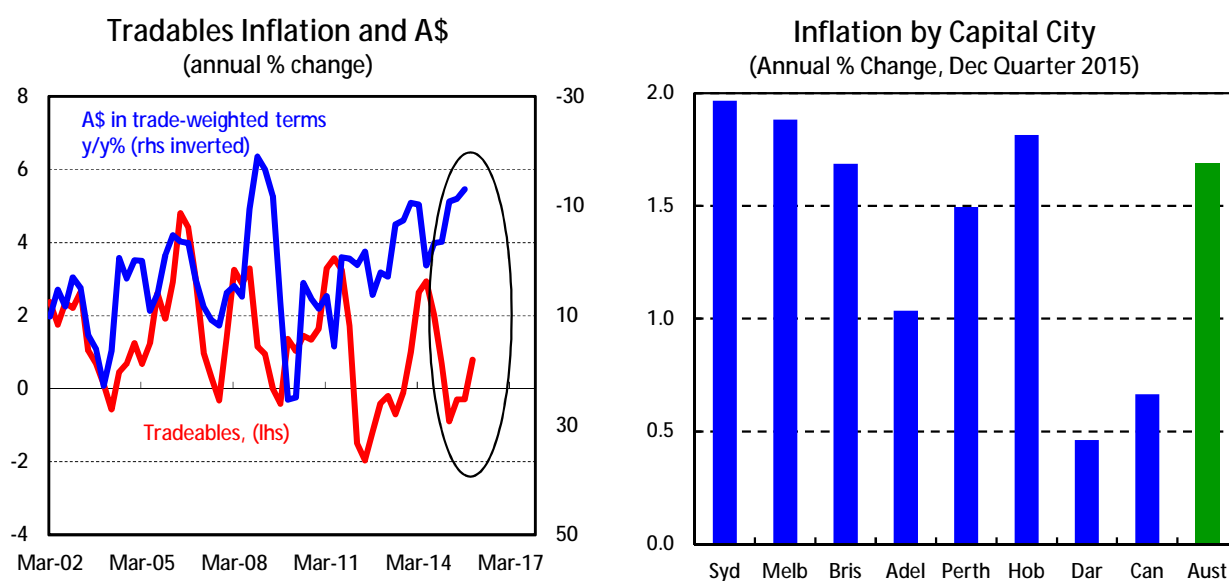
Tradables inflation includes the prices of goods and services which are imported or compete with imported goods and services and, as such, tend to be influenced by currency movements. Tradeables have a weighting of approximately 40% in the headline CPI. Tradables CPI rose 0.5% in the December quarter, for an annual rate of 0.8%. While tradables inflation remains subdued, the annual rate is the strongest in over a year. This could provide some evidence of the lower Australian dollar feeding in to higher prices, although tradables inflation is being kept down by lower petrol prices. Nonetheless, there continues to be limited impact from the depreciation in the Australian dollar over the year to December.

Non-tradables inflation grew at just 0.4% in the quarter, the second consecutive quarter at this pace. The annual rate stepped down from 2.6% in the September quarter to 2.3% in the December quarter, and was the weakest in a year. Non-tradables inflation is largely reflective of domestic cost pressures. Low wage growth continues to limit growth in domestic inflation. We would need to see further momentum in the economy and wage growth before non-tradables inflation picks up.

States Results

For the December quarter, inflation was mixed across the capital cities, ranging between 0.2% in Adelaide and Canberra up to 0.9% in Hobart. Between the 'extremes' sat Melbourne (0.7%), Perth (0.5%), Brisbane (0.4%), Sydney (0.3%) and Darwin (0.3%).

In the year to the December quarter, inflation in most of the capital cities was below the RBA's 2-3% target band. The largest increase in prices was yet again Sydney where prices rose 2.0%. This was followed by Melbourne at 1.9% and Hobart at 1.8%. Brisbane saw prices rise 1.7% over the year while they were up 1.5% in Perth. At the lower end of the range were Adelaide (1.0%), Canberra (0.7%) and Darwin (0.5%)



Outlook

The 2.0% annual rate in underlying inflation was in line with RBA's published forecasts in November. Headline inflation was also very close to the RBA's forecasts at 1.75% for the year ending December. This suggests that today's data has limited implications for the RBA.

That said, CPI remains low and well-contained and inflation could stay in the bottom half of the RBA's 2 to 3 per cent target band over much of 2016, or even fall below. Therefore the RBA can leave the door open for lower rates if it sees the need.

Whether it wants to walk through that door is another question, and will depend on the outlook for growth. With the unemployment rate possibly passed a peak and growing signs of non-mining activity picking up, the RBA is unlikely to see a need to lower rates anytime soon.

We expect the RBA will remain on hold next week and for the remainder of the year. Nonetheless, downside risks to the global economy keep open the possibility of another cut. Low inflation would not be an impediment to a rate cut, if needed.

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