

Markets Research Economy Watch



CPI Preview – Trimmed mean at 1.0 a test of RBA strategy

Summary

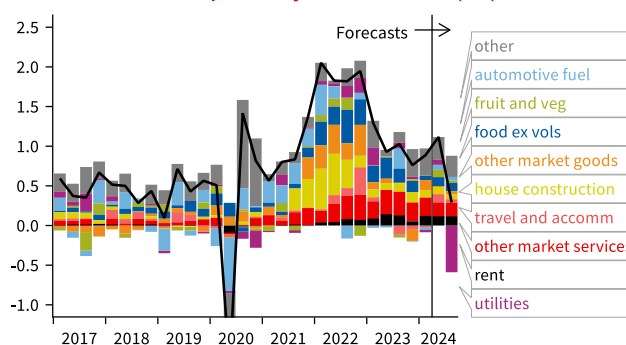
- We expect Q2 trimmed mean of 1.0% q/q and 4.0% y/y. That's two tenths above the RBA's May SoMP forecast of 0.8% and a tenth above our 0.9% preliminary expectation ahead of the May CPI indicator.
- We also pencil in a headline outcome of 1.0% q/q nsa (1.1% sa). That would see headline lift to 3.8% y/y. A surge in international travel prices is the key driver.
- Relative to last quarter, durable goods are more benign but still running ahead of the trend declines prior to the pandemic. A reacceleration in grocery inflation is a key support for the trimmed mean. Housing components remains persistently strong, but elsewhere market services show some improvement.
- The aggregates matter, but this isn't a simple 'sticky service prices' story. A silver lining is that the strength we expect to be confirmed in Q2 CPI is despite progress in still too high market services and non-tradable inflation.
- Uncertainty remains despite the information in the Monthly indicators. New cars, much of health, and financial services have had no coverage so far. Over the past 2 years, trimmed mean has printed on average a tenth away from our forecast and two tenths away from the Bloomberg median, and with little directional bias. With the RBA's strategy having left risks thoroughly unbalanced, Q2 CPI is particularly important.
- NAB's central view is that the RBA will remain on hold – some cooling in market services inflation, wages growth likely passed its peak, and soft activity growth should be enough to keep the low bar of a return to target in 2026 in sight. The consequence is they won't be able to cut for a long time. We pencil in May 2025.
- Still, further tightening as soon as August is a real possibility should the RBA reassess and conclude rates are insufficiently restrictive. At numerous points through this tightening cycle the RBA has slowed or paused hikes earlier than has been warranted by the data backdrop, opting to tolerate upside risks and higher for longer inflation in pursuit of maintaining labour market gains. Their confidence in that approach is frayed.

Table 1: Consumer Price Index Forecasts

	Actual				Forecast				
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Headline CPI									
CPI - NSA									
%q/q	0.8	1.2	0.6	1.0	1.0	0.4	0.7	0.7	0.7
%y/y	6.0	5.4	4.1	3.6	3.8	3.0	3.1	3.1	2.8
					RBA May SoMP:	3.8		3.8	
Core Measures									
Trimmed Mean									
%q/q	0.9	1.2	0.8	1.0	1.0	0.85	0.75	0.70	0.70
%y/y	5.8	5.1	4.2	4.0	4.0	3.7	3.6	3.6	3.3
					RBA May SoMP:	3.8		3.4	

Source: National Australia Bank, ABS

Contributions to quarterly headline CPI (SA)



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

Consumer Price Index - Component Expectations (NSA)

	Mar-24	NAB		in CPI Basket
		Jun-24	Qtr cont.	
Food and non-alcoholic beverages	0.9	1.3	0.2	17.0
<i>Restaurants and takeaway</i>	0.5	0.7	0.0	6.8
Alcohol and tobacco	0.9	1.5	0.1	7.7
Clothing and footwear	-1.1	3.1	0.1	3.2
Housing	0.7	1.1	0.2	22.2
<i>Rents</i>	2.1	2.0	0.1	5.8
<i>New dwellings</i>	1.1	1.0	0.1	8.5
<i>Utilities</i>	-1.4	0.6	0.0	4.2
Household equip and services	-0.1	0.9	0.1	8.8
Health	2.8	2.2	0.1	6.2
Transport	0.5	1.0	0.1	10.7
<i>Automotive fuel</i>	-1.0	1.9	0.1	3.5
Communication	-0.3	-0.8	0.0	2.2
Recreation and culture	-0.1	0.2	0.0	11.9
<i>Domestic travel and accom.</i>	1.3	-5.8	-0.1	2.5
<i>International holiday travel and acc</i>	-5.9	6.3	0.2	2.8
Education	5.9	-0.1	0.0	4.4
Insurance and financial services	2.0	1.6	0.1	5.7
Headline CPI	1.0	1.0	1.0	--
Trimmed Mean, sa	1.0	1.0	--	70

Source: National Australia Bank, ABS

Select forecast detail

Incorporating information from the Monthly Indicators, we expect another quarter demonstrating little to no further progress on overall underlying inflation. Interestingly though, the component level detail should show indicators of domestic inflation pressures look better than the aggregates.

- **Market goods ex food**, fuel and houses, capturing mostly trade-exposed durable goods, is likely to remain elevated relative to pre-pandemic growth, but be more benign than last quarter despite some strength in volatile garments and footwear. Most of these prices are already measured, with the notable exception of new car prices.
- For **motor vehicles**, we pencil in -0.2% q/q (+0.1% q/q sa). Supply has improved, and a range of indicators suggest new car price inflation has moderated sharply, but there has been significant volatility in the quarter-to-quarter outcomes measured by the ABS.
- **Food and non-alcoholic beverages +1.3% q/q**. Prices have moderated materially from their peak above 9% y/y, but grocery inflation reaccelerated a little on a quarterly basis, led by meat and fish. Fruit prices surged, a key support for headline CPI.
- **Rents +2.0% q/q**. Underlying rents growth is annualising around 9%. New rents are still growing strongly, implying little relief for rents until well into 2025 at the soonest. Semiannual rent assistance indexation takes two tenths off rents growth this quarter. More impactfully, The 10% increase in rent assistance in Q4 will subtract 1.1ppt from quarterly rents and 7bp from CPI. Rents growth is adding 50bp to annual inflation.
- **New Dwellings +1.0% q/q**. The largest component of the CPI peaked at 6% in early 2022, the slowdown since then accounts for almost 2ppt of the improvement in annual inflation. It is still running faster than pre-pandemic levels amid ongoing cost pressures in the construction industry
- **Health +2.3% q/q** driven by health insurance premium increases, which are back to their usual April timing.
- **Electricity** subsidies had only a minor impact in Q2. Remaining subsidies unwind but will be more than offset by the introduction of new, larger subsidies in Q3. We detail our estimate of their effect below.
- **Fuel +1.8% q/q**. Timely data suggests a small June rise.
- **Travel** is adding to headline. In seasonally adjusted terms domestic travel looks to have declined in Q2. For headline, that is more than overcome by strength in international travel, but both are expected to be trimmed.

Where is inflation too hot?

Inflation is running faster in most categories than in the 2009-2015 period where inflation averaged 2.5%.

Supporting headline this quarter is strength in travel, fruit & veg and tobacco. Rents continue to run at very elevated levels. That won't resolve quickly and makes progress back to the RBA's target more challenging. Health, education, and other government influenced prices, as well as utilities, are more benign, but importantly that's compared to very elevated inflation in the comparison period.

Unhelpful for the Q2 outcome is a pickup in grocery inflation, while meals out and takeaway (measured quarterly in May) remained relatively benign after moderating through 2023. Indeed, there is some cooling in still too strong inflation across a range of market services (discussed below).

Consumer Price Index - Forecast Components					
	weight	annualised % change			benchmark*
		q/q	6m	12m	
Food and Beverage					
grocery ex fruit & veg	8.0	3.1	2.1	2.5	0.7
fruit & veg	2.2	17.8	9.4	3.7	2.5
Alcohol	5.0	2.9	2.3	3.3	2.3
Meals out and Takeaway	6.8	2.7	2.3	4.2	2.3
Housing					
Rent	5.8	8.2	8.4	7.3	3.5
Home purchase	8.6	4.2	4.3	5.0	3.0
Utilities/rates	5.6	6.0	2.3	3.7	7.9
Market services					
Ex rent, restaurants & travel	16.0	3.6	4.5	5.0	2.1
travel	5.2	8.2	3.1	-1.9	1.6
Market goods					
Other market goods**	17.0	0.3	1.7	0.0	-1.3
Automotive fuel	3.4	7.7	1.7	7.9	2.7
Government-influenced					
Education & Health	10.9	4.8	6.9	6.0	5.1
Tobacco	2.9	16.5	10.7	13.4	11.7
Other government influenced^	2.6	5.0	6.4	2.2	5.2
Trimmed mean	70.0	4.0	4.0	4.0	2.5
Headline	100.0	4.5	4.1	3.8	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

Market Services improved

The RBA has been focussed on services inflation as an indicator of domestic and labour-market sensitive inflation pressure. That framework has only limited usefulness, but interestingly the strength in core inflation measures we expect to be confirmed in Q2 data is despite evident cooling across much of the market services basket. We expect a narrow cut of market services that excludes travel and rent prices to record its lowest outcome in 2 years. That's despite insurance price rises continuing to annualise around 15%.

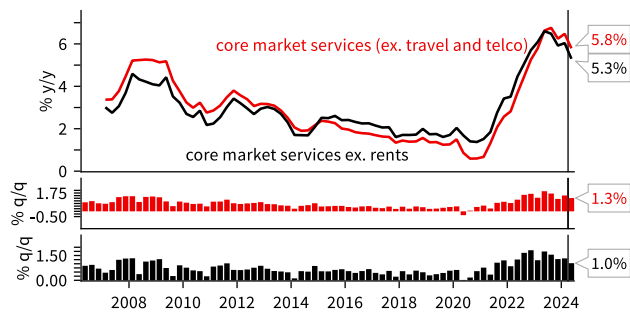
The RBA's concern has been that poor productivity and elevated unit labour costs growth would drive persistence in market services inflation. As we outlined in [Thematic – The RBA's productivity red herring](#), industries upstream from market consumer prices have not been the driver of poor

productivity outcomes, and some cooling in market services inflation was possible even ahead of more material slowing in base wages growth. Although there has been little overall progress on disinflation in recent quarters, that is not because of a narrow conception of ‘sticky services prices.’

Contrasting the ‘market services’ story is in health, where governments have a larger role in price setting. Still, upstream cost pressures through health overlap significantly with those in market services, but they have been slower to transmit to end prices. They will be a source of upward pressure for some time yet with catch up growth likely.

Aggregate services indices will pick up in Q2, but given the acceleration is driven by overseas holiday prices it shouldn’t be seen as evidence of persistence.

Market Services Inflation

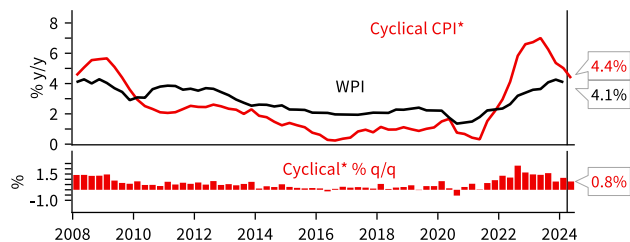


*Seasonally adjusted; calculated by NAB from ABS data and NAB forecasts
Source: National Australia Bank, ABS

Other domestic cuts

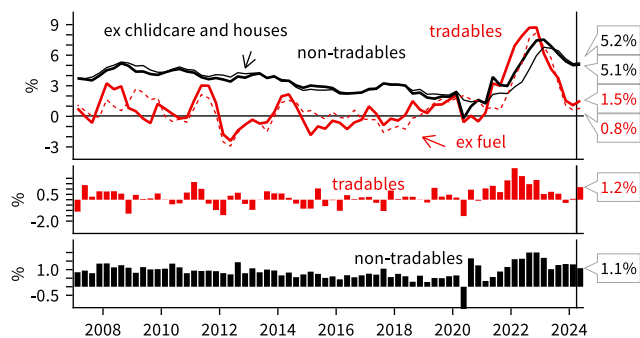
Other lenses on domestic pressure also look like they will suggest modest improvement, or at least not reacceleration. Our forecasts imply cyclical (a subset of the basket most sensitive to the labour market) and non-tradable inflation at still elevated levels, but modestly improved from Q1 and comfortably below earlier peaks.

Cyclical CPI



*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

Tradable and non-tradable inflation



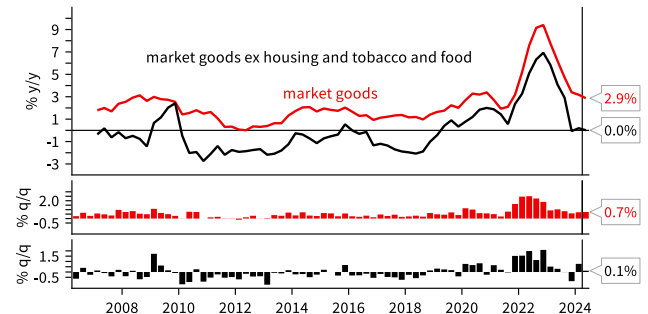
Source: National Australia Bank, ABS

Goods prices

New house prices have stabilised annualising a little under 5% after driving much of the earlier disinflation. Some further moderation would be useful and further easing of capacity constraints in the construction industry suggest there is scope for some further slowdown looking forward, but in the near term cost pressures and price rises are proving stubborn.

The rest of the non-food goods basket looks very different. Prices were modestly declining in the pre-pandemic period. They have been broadly stable over the past year, but quarter to quarter volatility was a huge factor in the materially uglier Q1 CPI than the Q4 outcome. Looking through that volatility, we see only limited scope for meaningful further disinflation pressure to come from goods. A lot of domestic logistics cost remain elevated, and freight costs have risen sharply. That is an offset to improved supply and higher pressure on margins in a cooler demand environment.

Market Goods Inflation*

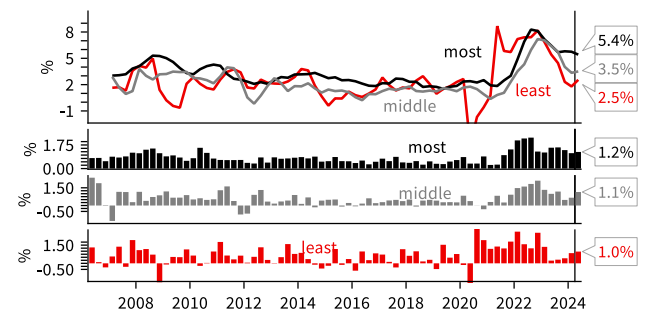


Seasonally adjusted; calculated by NAB from ABS data and NAB forecasts
Source: National Australia Bank, ABS

Persistence

Another way to size up the implications of hotter inflation outcomes in Q2 is to split inflation components by their persistence. That is, whether one quarter’s outcome is a good guide to the next. Inflation has been most stubborn in the most persistent third of the basket where the pace of growth is slower moving. No surprise there, with rents and insurance the two most persistent components and both running hot. The rest of the basket had been showing more improvement. Encouragingly, a lot of the reacceleration in H1 was in components where price rises are a poor predictor of future rises, like travel and clothing and footwear. Those in the middle also look to have driven a lot of inflation in Q2, largely reflecting strength through grocery components.

Inflation by persistence*



*basket split into thirds by weight according to coefficient from an AR1 model for each EC, SA
Source: National Australia Bank, ABS

RBA – do they hold their nerve?

Progress on disinflation has slowed. Slower construction cost increases and a shift to flat to falling trade-sensitive goods prices drove the early progress. The optimistic lens on what we expect to be shown in the full Q2 data is that hot international travel prices and a temporary reacceleration in food prices has masked what is ongoing underlying progress.

The RBA in June noted “*limited information about market services price inflation since the May meeting.*” On that narrower front, the Q2 outcome is not expected to show bad news. The June Minutes noted “*collective data received since the May meeting had not been sufficient to change their assessment that inflation would return to target by 2026.*” NAB’s view is that evidence of modest cooling in domestic inflation pressure, wages growth likely passed its peak, and soft activity growth will be enough to keep the RBA’s low bar of a return to target in 2026 in sight. The consequence is they won’t be able to cut for a long time. We pencil in May 2025.

Even if the Board concludes that they were insufficiently proactive in balancing risks and should have raised the cash rate higher sooner, it does not necessarily follow they should raise the cash rate now. Monetary policy works with a lag. The tightening cycle is over 2 years old, and there has been only a single 25bp increase in the past year. Growth has moderated, and while the labour market remains tighter than the RBA had earlier expected, it has not outperformed their recent forecasts and continues to cool. Wages growth developments do not suggest it is materially out of balance.

Still, further tightening from August is a real possibility should the RBA conclude policy is insufficiently restrictive. At numerous points through this tightening cycle the RBA has slowed or paused hikes earlier than has been warranted by the data backdrop, opting for a strategy of tolerating upside risks and higher for longer inflation, assessing it would make it possible to maintain more gains in the labour market. Their confidence in that approach is frayed.

The Minutes assess “*it was still possible to achieve the Board’s strategy of returning inflation to target in a reasonable timeframe without moving away significantly from full employment*” but that this ‘narrow path’ was becoming narrower. They also flagged the August forecast round provided an “*opportunity for the staff to carefully review the extent of spare capacity*” and that raising the cash rate “*could be appropriate if members formed the view that policy settings were not sufficiently restrictive to return inflation to target within a reasonable timeframe.*”

Q2 inflation will be assessed through the lens of what it means for the outlook. They can’t and shouldn’t ignore the aggregate picture, but areas of the basket they have been pointing to as an indicator of domestic pressures provide some silver lining. If they hold onto their assessment inflation pressure is moderating a surprise in Q2 needn’t have a large impact on medium-term forecasts. However, the May forecasts were already conditioned on a cash rate unchanged well into 2025. There is little room to absorb further bad news with a flat for longer, rather than higher, cash rate.

Governments distorting price changes

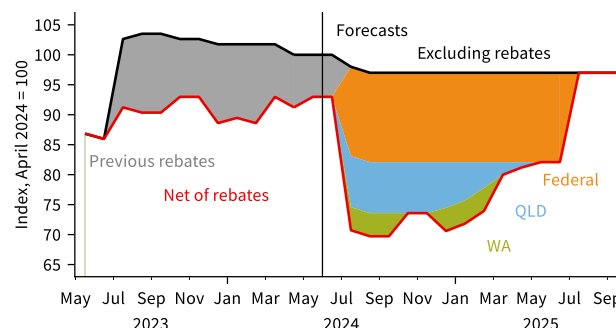
Looking further ahead, federal and state government policies change the prices facing consumers for CPI purposes. That can be permanent, like the 10% increase in rent assistance, or temporary, like the handouts to households via electricity bills. We covered these issues in detail here: [AUS: Budget to impact CPI, but RBA should look through](#)

Electricity rebates have by far the biggest impact of the announced policies. The timing of these policies varies and the exact measurement timing in the CPI carries some additional uncertainty. Three major policies are:

- The federal government will give households \$300. The rebate is paid quarterly and we expect it lowers the price level in each quarter between Q3 2024 and Q2 2025.
- The QLD government \$1000. Credited as a one off from July and will reduce bills to near zero until exhausted. For the average household, that will be sometime in Q1 2025.
- The WA government \$400. Paid in two equal instalments in July and December, on last year’s precedent, we expect each to last 3 months before unwinding.

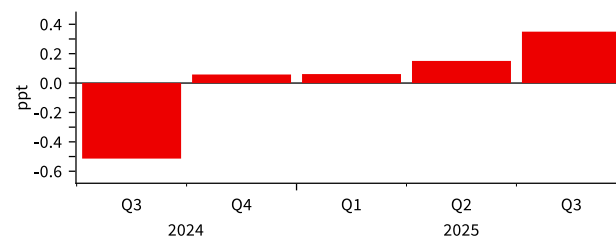
The impact on Electricity CPI of these subsidies is in the below chart, assuming little change to underlying prices beyond some reduction alongside lower market offers from 1 July. In July, last year’s subsidies unwind and the new subsidies take effect. The net is an approximately 24% reduction in electricity prices in Q3, or a 0.5ppt drag on overall inflation.

Monthly Electricity CPI



Source: National Australia Bank

Quarterly Contributions to Headline CPI



Source: National Australia Bank

Beyond electricity, higher rent assistance permanently lowers the rents price level and has a one-off effect on inflation. That’s nearly all measured in Q4 CPI and subtracts 7bp from headline. It will likely weigh on the trim as well given rents are usually in or near the trim. Other policies weighing on inflation temporarily include cheaper car registration and near-free public transport in QLD.

Contacts

Markets Research

Skye Masters

Head of Research, Markets
+61 2 9295 1196
skye.masters@nab.com.au

Markets Economics

Tapas Strickland

Head of Market Economics
+61 2 9237 1986
tapas.strickland@nab.com.au

Taylor Nugent

Senior Economist
+61 2 9237 2190
taylor.nugent@nab.com.au

Foreign Exchange

Ray Attrill

Head of FX Strategy
+61 2 9293 7170
ray.attrill@nab.com.au

Rodrigo Catril

Senior FX Strategist
+61 2 9293 7109
rodrigo.h.catril@nab.com.au

Fixed Income

Kenneth Crompton

Senior Interest Rate Strategist
+61 2 9293 7132
Kenneth.crompton@nab.com.au

Michael Bush

Head of Credit Research
+61 3 8641 0575
michael.d.bush@nab.com.au

Evy Noble

Analyst, Credit Research
+61 2 7226 7336
evy.noble@nab.com.au

London/Europe

Gavin Friend

Senior Markets Strategist
+44 207 710 1588
gavin.friend@eu.nabgroup.com

Group Economics

Alan Oster

Group Chief Economist
+61 414 444 652
alan.oster@nab.com.au

Gareth Spence

Head of Australian Economics
+61 436 606 175
gareth.spence@nab.com.au

Tony Kelly

Senior International Economist
+61 477 746 237
antony.kelly@nab.com.au

Brody Viney

Senior Economist
+ 61 452 673 400
brody.viney@nab.com.au

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