Markets Research
Economy Watch

CPI Preview – Q2 CPI likely unhelpful but not quite derailing

Summary

- We will finalise our Q2 CPI forecast after the May monthly inflation indicator next week (26 June; this second month having better coverage of services). Our preliminary pick for Q2 Trimmed Mean is 0.9% q/q and 3.9% y/y, one tenth above the RBA's May SoMP forecast. For Headline we expect 0.8% q/q and 3.6% y/y, below the RBA's 1.0% q/q.

- For the May indicator, we pencil in 3.6% y/y, unchanged from April and for ex-volatiles and travel 3.9% from 4.1%. Slower food and takeaway inflation help the underlying measure, while smaller falls in fuel prices than a year ago supports headline and travel adds volatility.

- The RBA has the luxury of waiting for the full Q2 CPI on 31 July before their next meeting in August. Watch for speeches in between that may give a hint to the RBA's interpretation of the May indicator, with Deputy Governor Hauser speaking on 27 June.

- The RBA's comfort tolerating the upside risk inherent in their chosen policy approach is frayed. Our base case remains that slow growth will give them enough confidence in the outlook for further progress on inflation to stay on hold, but near-term risk sits with a hike. NAB has long pencilled in a first cut in November, but an absence of genuine progress across the domestically sensitive prices this quarter would further skew the risk to on hold for longer.

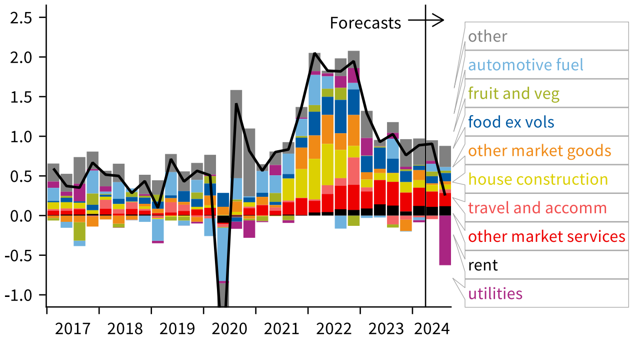
- Looking ahead to Q3 CPI (30 October), watch government rebates. Earlier subsidies unwind but are more than offset by new state and federal subsidies. On our numbers, it's a net 0.5ppt subtraction, leaving our Q3 headline forecast at 0.4%. q/q. This mostly, but not exclusively, weighs on headline, and has only a temporary impact, pushing the y/y rate back above 3% in Q3 2025.

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	0.8	0.4	0.7	0.7
%y/y		6.0	5.4	4.1	3.6	3.6	2.7	2.8	2.5
					RBA May SoMP:	3.8		3.8	
Core Measures									
Trimmed Mean									
%q/q		0.9	1.2	0.8	1.0	0.9	0.8	0.7	0.7
%y/y		5.8	5.1	4.2	4.0	3.9	3.6	3.5	3.2
					RBA May SoMP:	3.8		3.4	

Source: National Australia Bank, ABS

Contributions to quarterly headline CPI (SA)



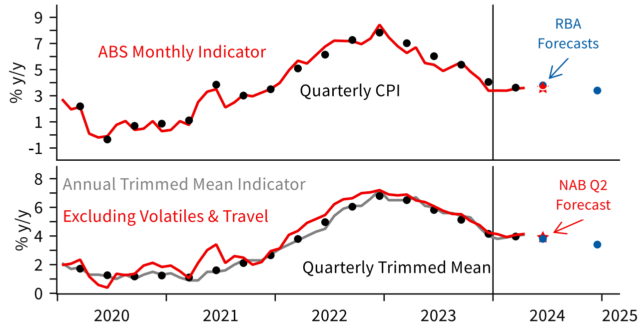
Source: National Australia Bank, Account in-house, Macrobond

Consumer Price Index - Component Expectations (NSA)

	Mar-24	NAB Jun-24	NAB Qtr cont.	in CPI Basket
Food and non-alcoholic beverages	0.9	1.0	0.2	17.0
Restaurants and takeaway	*0.5*	*0.7*	*0.0*	*6.8*
Alcohol and tobacco	0.9	1.2	0.1	7.7
Clothing and footwear	-1.1	3.1	0.1	3.2
Housing	0.7	0.9	0.2	22.2
Rents	*2.1*	*1.9*	*0.1*	*5.8*
New dwellings	*1.1*	*1.0*	*0.1*	*8.5*
Utilities	*-1.4*	*-0.1*	*0.0*	*4.2*
Household equip and services	-0.1	1.1	0.1	8.8
Health	2.8	2.0	0.1	6.2
Transport	0.5	1.0	0.1	10.7
Automotive fuel	*-1.0*	*2.9*	*0.1*	*3.5*
Communication	-0.3	-0.3	0.0	2.2
Recreation and culture	-0.1	-0.9	-0.1	11.9
Education	5.9	-0.2	0.0	4.4
Insurance and financial services	2.0	1.4	0.1	5.7
Headline CPI	**1.0**	**0.8**	**0.8**	--
Trimmed Mean, sa	1.0	0.9	--	70

Source: National Australia Bank, ABS

Monthly and Quarterly Inflation



Source: National Australia Bank, Australian Bureau of Statistics

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What to look out for in May and Q2 CPI

Ahead of the monthly inflation indicator (26 June), our preliminary Q2 Trimmed Mean CPI is 0.9% q/q, one tenth above the RBA's May SoMP forecast, but anticipates some modest further progress across domestically sensitive and services components. The May indicator will provide a lot of information to firm up Q2 forecasts.

A host of quarterly services outcomes will be published in the May indicator. Services categories that are measured in May include restaurant meals, hairdressing, other household services, recreation and cultural services, parts of sports participation, and insurance:

- Restaurants and takeaway prices were much cooler in Q1, and slower takeaway price rises than a year ago are a key source of downward pressure on y/y rates in the Monthly Indicator. Disinflation has mirrored the moderation in broader food inflation despite still elevated labour and overhead cost pressures in a more challenging demand environment. Restaurants and takeaway are 7% of the basket, and we pencil in a ¾% increase in the 3 months to May. An outcome showing price rises back above 1% would add upside risk to our Q2 trimmed mean forecast.

- Insurance prices have been especially elevated, and don't necessarily reflect the domestic demand and labour cost sensitive narrative ascribed to other components of the services basket. We pencil in a 3m change still above 3% in May, but prices are catching up the earlier price increases in repair and replacement costs for autos and buildings. The May US CPI downside surprise was driven by an abrupt shift in auto insurance. Evidence of relief on insurance increases coming through sooner than we have pencilled in would be very helpful.

- Elsewhere, sporting events and major concerts have been a regular refrain from the ABS as supporting Q1 data. That was evident in inflation as well. Overall, our read from services pricing indicators in the NAB Business survey and other evidence is consistent with some modest cooling in still too-strong services inflation outside of rents, where inflation is unhelpfully both elevated and stable.

A lot will be known in the May monthly, but it won't remove uncertainty completely. Recall Q1 trimmed mean printed 1.0% q/q, above all surveyed economists' forecasts (consensus was 0.8, NAB was 0.9). The reason is some large categories have no partial indicators in the first two months. Among them are new car costs, and other financial services. The added upside surprise in Q1 was from larger price increases across health, which is a bigger March risk than June risk due to timing of annual price increases.

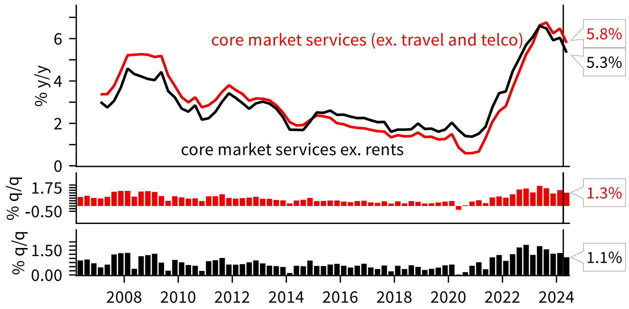
While our preliminary forecast is for trimmed mean a tenth higher than the RBA pencilled in in May, our headline forecast of 0.8% q/q is below their estimate. Domestic travel prices drive our lower headline estimate, and travel prices are, as usual, the key source of uncertainty going into the May monthly print.

Consumer Price Index - Forecast Components

		annualised % change			
	weight	q/q	6m	12m	benchmark*
Food and Beverage					
grocery ex fruit & veg	8.0	2.3	1.7	2.3	0.7
fruit & veg	2.2	11.1	6.2	2.2	2.5
Alcohol	5.0	1.8	1.8	3.0	2.3
Meals out and Takeaway	6.8	3.1	2.5	4.3	2.3
Housing					
Rent	5.8	7.7	8.2	7.2	3.5
Home purchase	8.6	3.9	4.2	5.0	3.0
Utilities/rates	5.6	3.8	1.3	3.2	7.9
Market services					
Ex rent, restaurants & travel	16.0	4.2	4.8	5.1	2.1
travel	5.2	-3.4	-2.5	-4.6	1.6
Market goods					
*Other market goods***	17.0	0.5	1.7	0.1	-1.3
Automotive fuel	3.4	12.3	3.8	9.0	2.7
Government-influenced					
Education & Health	10.9	4.1	6.6	5.8	5.1
Tobacco	2.9	15.2	10.1	13.1	11.7
*Other government influenced^*	2.6	5.1	6.5	2.2	5.2
Trimmed mean	70.0	3.6	3.8	3.9	2.5
Headline	100.0	3.7	3.6	3.6	2.5

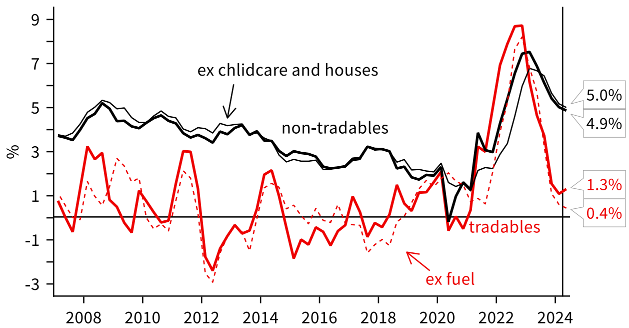
**average change over 6 years to Q2 2015, when headline and trimmed mean averaged 2.5%*
***ex houses, tobacco, food, fuel, alcohol | ^public transport, postal, vehicle rego, childcare*
Source: National Australia Bank, ABS

Market Services Inflation



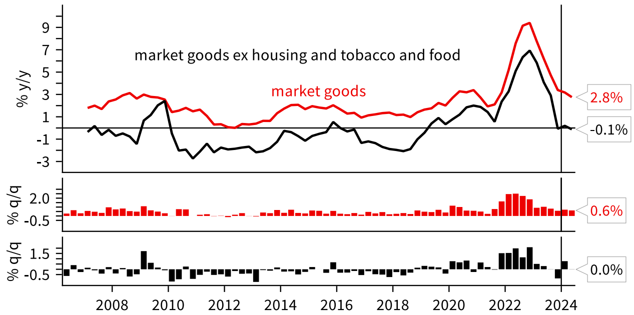
*Seasonally adjusted; calculated by NAB from ABS data and NAB forecasts
Source: National Australia Bank, ABS

Tradable and non-tradable inflation



Source: National Australia Bank, ABS

Market Goods Inflation*



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

Some component detail

- **Food and non-alcoholic beverages +1.0% q/q**. Prices have moderated materially from their peak above 9% y/y over 2022 to what we expect to be near 3% y/y in Q1.

- **Rents +1.9% q/q**, consistent with 0.7% m/m in May). New rents are still growing strongly, implying little relief for rents until well into 2025 at the soonest. Rents are about 6% of the basket but are adding over 4 tenths to annual inflation. A 10% increase in rent assistance in Q4 will subtract 1.1ppt from quarterly rents and 7bp from CPI.

- **New Dwellings +1.0% q/q** (0.3% m/m in May). 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 with cost pressures remaining in the construction industry.

- **Health +2% q/q** driven by health insurance premium increases, which are back to their usual April timing.

- **Electricity** subsides are largely a Q3 story though there is some minor boost expected in May from Victoria. A full explanation of the impact from Q3 is below. It is large.

- **Fuel** +2.8% q/q. Timely data point to a fall of 3.3% in May before a small increase in June. Note fuel prices fell almost 7% in May 2023, so even with the monthly fall are set to support y/y growth in the monthly indicator.

- **Travel** is a key uncertainty for both May monthly and quarterly headline inflation. Prices seasonally fall sharply in May and rebound in June, and we pencil in a 9% m/m fall in May, led by domestic travel.

RBA implications – fearing persistence

Progress on disinflation has slowed. Slower construction cost increases and a shift to flat to falling trade-sensitive goods prices drove the early progress, but further improvement relies on slowing domestic inflation pressures.

RBA governor Bullock said this week that the April Monthly indicator was a little stronger than they had expected, but that "*there's been limited information about services inflation since the May board meeting.*" She noted services had been driving recent strength and "*we need to get more comprehensive readings on inflation before we can get a handle on the momentum of services inflation.*"

The RBA gets both the May indicator next week and the full Q2 data on 31 July before their August SoMP update and meeting, but the May outcome will fill out the risks for Q2 more completely

Governor Bullock's press conference suggests the RBA is (rightly) already assessing the risk to the upside of their May trimmed mean forecast. Evident signs of cooling across the services indicators in May would go a long way to removing the lingering hike risk but absent that the backdrop heading into the August meeting rhymes with the lead up to the November 2024 meeting. A day before Q3 2023 CPI and 2 weeks out from the November 2023 hike, Bullock said:

> *Our focus remains on bringing inflation back to target within a reasonable timeframe, while keeping employment growing. It is possible that this can be done with the cash rate at its current level but there are risks that could see inflation return to target more slowly than currently forecast. The Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation.*

Any upward surprise would be assessed through the lens of what it means for the outlook. We think there is a higher bar to hiking now than last year. It has been longer since the last increase, growth is slow, and while the labour market has proven resilient, it is not outperforming the RBA's most recent forecasts. Among the big swing factors for our CPI forecast, the RBA would be more willing to absorb an upside surprise driven by say, cars or international travel prices, than it would on more persistent domestically sensitive prices.

Even so, the risk of the RBA being pushed to hike should not be discounted completely. The level of the cash rate is an outcome of the RBA's high tolerance for above target inflation, not the data backdrop in isolation, and 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. A trimmed mean print of 1.0% would be hard for the RBA to ignore and could mean the RBA feels compelled to offset some of the reacceleration in growth baked into forecasts through H2 2024.

NAB's call remains that the RBA will be on hold before a first cut in November, though the clear risk is that the data flow pushes this into 2025.

Governments distorting price changes

Looking further ahead, federal and state government policies will change the price facing consumers for CPI purposes. That can be a permanent change, like the 10% increase in rent assistance, or a temporary change, 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

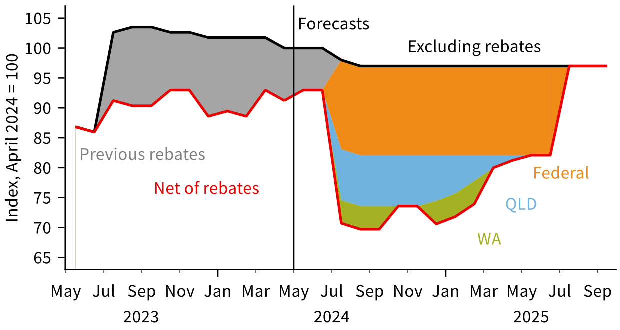
Payments to households via electricity bills have by far the biggest impact of the announced policies. The timing of these policies varies and the exact measurement timing in the CPI carries some additional uncertainty. Three major policies are:

- The federal government will give households $300. The federal rebate is paid quarterly and so 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 weigh on the price level for 3 months before unwinding.

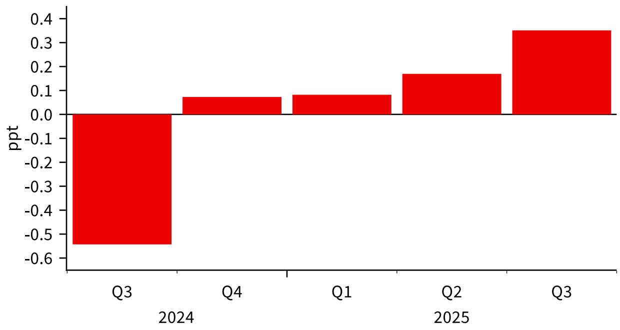
The impact on Electricity CPI of these subsidies is in the below chart, assuming little change to underlying prices beyond some reduction alongside lower market offers from 1 July. The net of the unwind of last year's subsidies and the addition of the new subsidies is an approximately 26% reduction in electricity prices in Q3, or a 0.5ppt drag on overall inflation.

Monthly Electricity CPI



Source: National Australia Bank

Electricity Net Quarterly Contributions to Headline CPI



Source: National Australia Bank

Beyond electricity, higher rent assistance has a once off effect of lowering rents inflation, nearly all measured in Q4 CPI and subtracting 7bp from headline and will likely weigh on the trim as well given rents are usually in or near the trim. Other policies including cheaper car registration and near-free public transport in QLD also weigh on inflation temporarily.

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