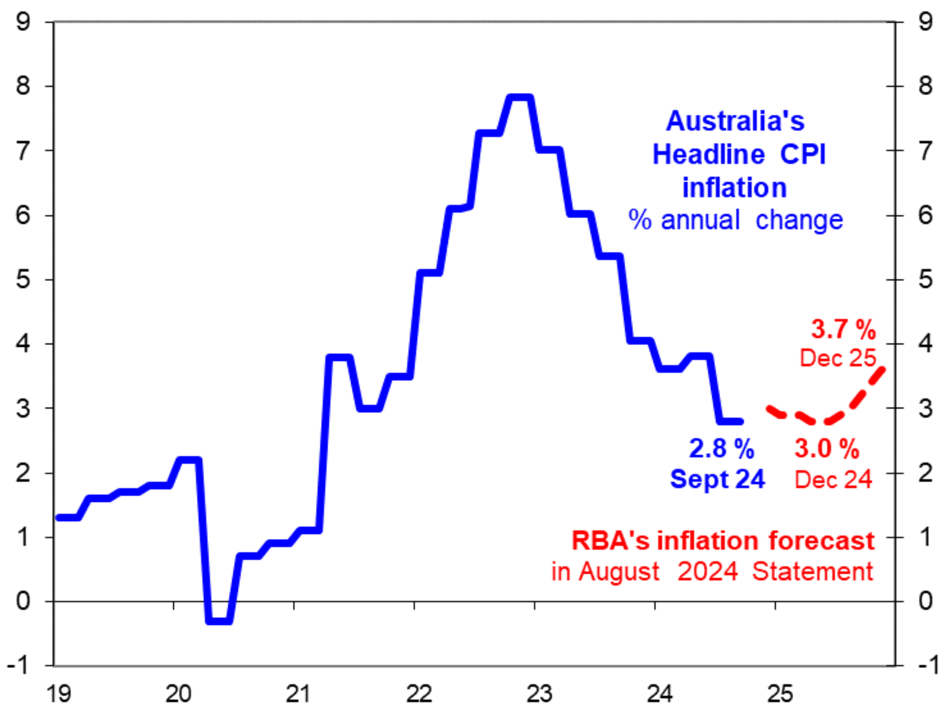
Australia's lower inflation is yet to convince the Reserve Bank of Australia

Bob Cunneen, Senior Economist and Portfolio Specialist
October 2024

Australia's inflation moderates but the central bank castigates

In welcome news, Australia's annual consumer inflation rate has finally fallen below 3% for the first time since 2021. For the year to September 2024, inflation came in at 2.8% (Chart 1). After the peak of 7.8% in December 2022, Australia's inflation has been gradually falling. Yet the Reserve Bank of Australia (RBA) appears less than impressed even with inflation now back to the central bank's 2% to 3% target range. The RBA is adamant that inflation is still a threat. Indeed, the RBA is forecasting that inflation will rise back to 3.7% by the end of 2025.

Chart 1: Australian consumer inflation



Sources: Australian Bureau of Statistics and Reserve Bank of Australia.

,

Why has Australia's inflation rate declined in the past year?

Australian consumers can find some solace from lower electricity prices through various government programs. As noted by the Australian Bureau of Statistics (ABS):

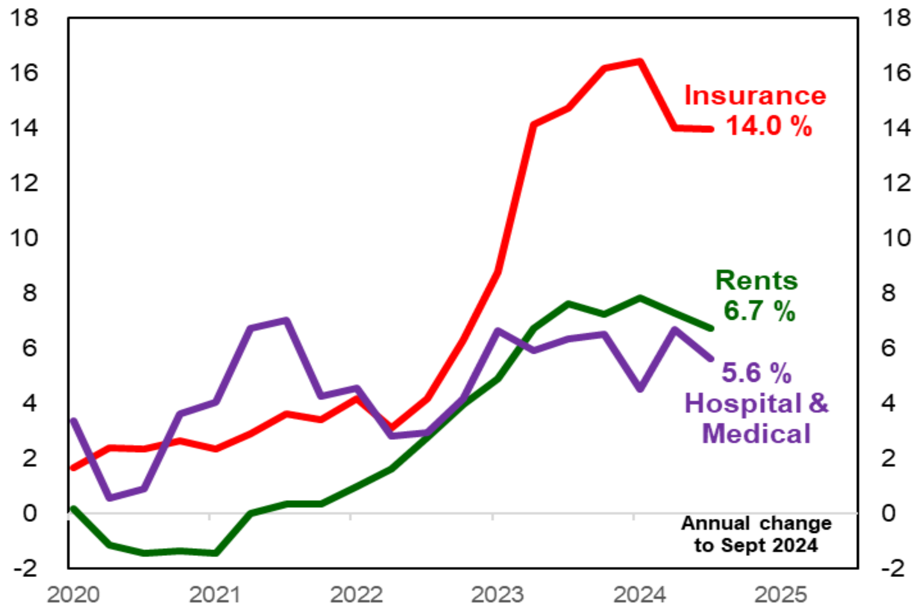
"Electricity prices fell 17.3 per cent in the September quarter and 15.8 per cent in the past 12 months. The introduction of the 2024-25 Commonwealth Energy Bill Relief Fund (EBRF) rebates and State government rebates in Queensland, Western Australian and Tasmania from July drove the fall this quarter."

There have also been falls in consumer prices for automotive fuel (-6.2% over the year to September), furniture (-5.3%), major household appliances (-1.7%), footwear (-1.3%) and even cheese (-2.2%).

A “cost of living” crisis is still evident in the “essentials”

There are more persistent price pressures in health care, insurance and rents that remain troubling for consumers. In the year to September 2024, hospital and medical costs have risen by 5.6%, rents by 6.7% and insurance by 14%. (Chart 2). These services prices have been consistently rising over the past three years. Indeed, these price pressures are resistant to both consumer angst and the ‘painful squeeze’ on weekly budgets. The key problem for consumers is that medical, rents and insurance are effectively ‘essentials’ in which the consumer has little choice but to pay the price. For the RBA, the problem is that these ‘essentials’ are **not** responsive to higher interest rates reducing demand and thereby prices. The persistent inflation results in these “essentials” reflects a mix of specific challenges. These challenges include that Australia’s ageing population have more complex and costly medical needs, a lack of new housing construction over the past decade to meet a growing population and for insurance, a profound lack of competition and transparency.

Chart 2: Australia’s sticky price pressures



Source: Australian Bureau of Statistics.

Why is the RBA forecasting inflation to rise next year?

The RBA’s judgement is that electricity and rent subsidy measures are only temporary. Effectively, governments support measures have a ‘use by date.’ The primary illustration of this is the Federal Government’s $300 annual household electricity rebate is due to end in June 2025. For the RBA, their conclusion is that *“the legislated unwinding of some policies in 2025 will push headline inflation to back above the target range*” of 2% to 3%.

These are bold assumptions by the RBA on two counts. Firstly, that governments will readily take back from consumers these subsidies that are mitigating the “cost of living” crisis. Secondly that inflation pressures beyond the essentials (medical, insurance, rents) will continue to be troubling even when Australia’s economic prospects appear lacklustre. The RBA is optimistically assuming that with the benefit of “Stage 3” income tax cuts from July 2024 and solid income growth from wages, the Australian consumer is eager to spend.

Australia’s inflation is more likely to fall further rather than to climb again in 2025

Yet the RBA Board’s assessment from their last policy meeting in September was that Australia’s “*household consumption had been notably weaker than expected.”* Consumers are struggling to keep food on the table and the roof over their heads. Indeed, the RBA conceded that the forecast that “*consumption growth would pick up”* is at *“risk”* of being *“delayed.”*

Given the more likely prospect is for a subdued Australian economy with consumers still struggling in 2025, the threat of rising inflation in 2025 appears overstated. The RBA needs to be more realistic. Australian consumers require more assistance through continued government support measures and lower interest rates rather than the RBA’s warning of the “upside risks” in inflation.

Sources:

Australian Bureau of Statistics (ABS), Consumer Price Index, Australia for the September Quarter 2024 (released 30/10/2024).

Statement on Monetary Policy, August 2024, Reserve Bank of Australia, Forecasts (page 8).

Minutes of the Monetary Policy Meeting of the Reserve Bank Board – 23 and 24 September 2024.