Weekly Economic Brief

29 November 2024 | Senior Economist's View

Reading the tea leaves of the monthly CPI data

October inflation keeps rate cut steeped in suspense

Despite the importance of inflation in driving monetary policy settings, the October CPI failed to excite markets this week. The monthly headline CPI printed a 2.1% annual increase, unchanged from September and below market forecasts for a 2.3% annual rise. The better-than-expected outcome had no impact on market pricing for monetary policy, which is pricing RBA rate cuts from May next year.

While headline inflation sits near the lower bound of the RBA's target band of 2-3%, it is being supressed by falling fuel and electricity prices, as we outlined here. More important for monetary policy is the underlying, or trimmed mean measure, of inflation and the news on this front was less sanguine. Trimmed mean inflation spiked up to 3.5% in October from 3.2% in the previous month; it remains well above the RBA's target band and is rising rather than falling. But this also failed to shift financial market pricing. Why did markets not push back further the timing of expected RBA rate cuts on such disappointing underlying inflation data?

To be fair, the monthly trimmed mean has proven itself to be an unreliable guide to the quarterly trimmed mean, which remains the RBA's preferred inflation gauge. Back in June, we saw the May CPI data show a similar sized acceleration in trimmed mean inflation to the one witnessed in the October data, from 4.1% to 4.4%, which spooked markets into expecting an imminent RBA rate hike. The monthly data proved misleading, with the quarterly data subsequently confirming no such acceleration in underlying inflation had occurred in the June quarter. Perhaps this explains the lack of market response to the October CPI data. So why do we care about the monthly CPI at all?

The monthly inflation data provides a partial update for the quarterly CPI. Some prices are measured monthly, with the quarterly average of these prices feeding into the quarterly CPI, while others are measured only quarterly or annually. In terms of the price data that are released quarterly, October contains information on goods, some of which showed downside surprises due to early or unseasonal discounting. In contrast, the November data update focuses more on services, with the prices of restaurants and takeaways, hairdressers, streaming services and insurance being measured. Services inflation has been gradually slowing across most categories, and we expect this trend to continue into November as wage growth has continued to ease.

Of the prices that are measured monthly, the most important are food and garments, and housing costs. Food price inflation has been relatively stable this year, running at an annual rate of 3.3% in October. The prices of garments rose by less than expected in October and will likely fall sharply in November due to Black Friday sales.

Developments in the cost of housing inflation have turned more favourable recently, and not just because of the State and Federal government subsidies that have seen electricity prices fall by 35% over the last four months. Rents and new home construction costs make a considerable contribution to the CPI basket, with weights of 6.2% and 8.2% respectively. Excluding the impact of Commonwealth Rent Assistance subsidies which increased in September, rental inflation has eased to an annualised rate of around 6% from close to 10% earlier this year. These data reflect rents on the entire stock of housing which is relatively slow moving. Data for new leases suggests rental growth will slow further over the coming year as vacancy rates have troughed. For new homes too, the inflation news is improving, with prices largely flat over the last two months compared to annual growth of around 5% for most of this year. Of course, while it is worth celebrating the slower rate of inflation in these components of housing costs, the level of rents and new home prices remain extremely elevated and this continues to contribute to cost of living pressures faced by households.

Incorporating the available monthly data and updating our projections for the remaining price categories leads us to forecast a December quarter trimmed mean CPI of 0.6% q/q, which would slow the annual rate of underlying inflation to 3.3%. This is around 10 basis points below the RBA's November forecast and would likely see underlying inflation move within the RBA's target band as early as the March quarter 2025 compared to their current forecast of December 2025. It remains a close call whether or not this is sufficient to prompt a 25bps cut to the cash rate by the RBA in February, as we currently forecast, but the risks are moving in the right direction.

Table 1: Financial market movements: 21 - 28 November 2024

EQUITY INDEX	LEVEL	CHANGE	10-YR GOVERNMENT BOND	YIELD	CHANGE	FOREIGN EXCHANGE	RATE	CHANGE
S&P 500	5,998.7	0.8%	US	4.26%	-15.8 bps	US Dollar Index (DXY)	106.05	-0.9%
Nikkei 225	38,349.1	0.8%	Japan	1.06%	-4.3 bps	USD-JPY	151.55	-1.9%
FTSE 100	8,281.2	1.6%	UK	4.28%	-16.8 bps	GBP-USD	1.269	0.8%
DAX	19,425.7	1.5%	Germany	2.13%	-19.1 bps	EUR-USD	1.055	0.7%
S&P/ASX 200	8,444.3	1.5%	Australia	4.36%	-21.7 bps	AUD-USD	0.650	-0.2%

Source: Bloomberg

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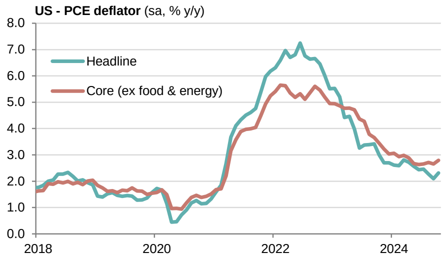
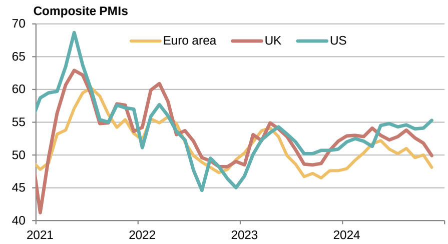
Economic update by region

United States

US October PCE prints as expected

- The October PCE inflation print reinforced the message from the CPI print a few weeks ago that the last mile of inflation moderation will be a slow process. The monthly rate of PCE headline and core inflation was unchanged from September at 0.2% and 0.3% respectively. The annual rate of headline PCE inflation ticked up over the month from 2.1% in September to 2.3% in October. Underlying inflation also rose over the month, with the annual rate of core PCE inflation ticking up from 2.7% to 2.8%.
- The flash S&P PMI release for November indicated that the US's strong economic momentum has continued into the December quarter. The composite PMI improved by 1.2 points to an index level of 55.3, a 31-month high. The services sector's PMI improved further over the month and continues to indicate strong growth in business activity. While the manufacturing PMI improved over the month it continues to indicate a contraction in business activity.
- The second estimate of US GDP for the September quarter confirmed real GDP growth at 2.8% on a quarterly annualised basis.

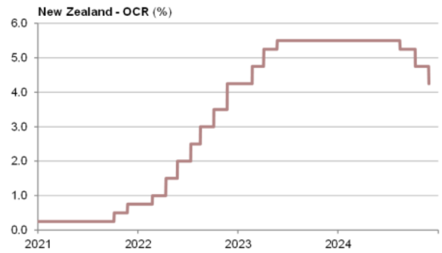




Euro area/United Kingdom

PMIs indicate a slowing in UK and Euro economic momentum

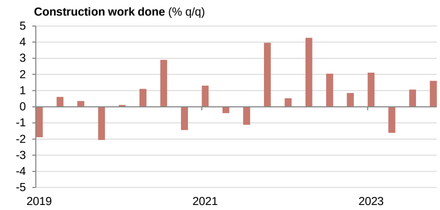
- The UK's composite PMI fell over November with the index level declining from 51.8 in October to 49.9. The fall was seen in both the services and manufacturing sector with business confidence falling in the wake of the recent Autumn Budget
- Euro area PMIs for November indicated a weakening in economic momentum as the services PMI fell 2.4 points to 49.2, pointing to negative growth in activity in the sector for the first time since January. The manufacturing PMI remained solidly within contractionary territory.
- The volume of retail sales in the UK fell by 0.7% in October, with the ONS attributing the fall in part to consumer uncertainty in the lead up to the recent Autumn Budget. Despite the fall, sales were still 2.4% higher than a year earlier.

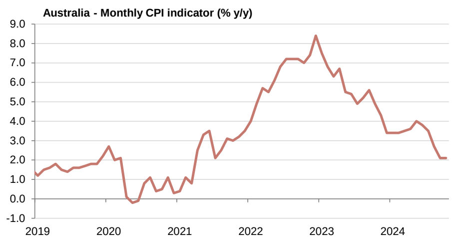


Australia/New Zealand

RBNZ cuts rate by 50bps for the second consecutive time

- At its November meeting the monetary policy committee of the RBNZ chose to cut the overnight cash rate by 50bps to 4.25%. In the post meeting press conference Governor of the RBNZ Adrian Orr noted that core inflation was converging on the middle of the RBNZ's target band of 1-3%. The RBNZ's new projections for the path of the overnight cash rate were steeper than their prior August projections with an additional 50bps worth of cuts expected by the middle of 2025. Their projections remain above market expectations however with the market pricing in 77bps worth of cuts by the middle of 2025.
- Construction work done rose by a stronger than expected 1.6% over the September quarter, driven by public building and engineering work. Adding to the solid result, was an upward revision to growth in the June quarter, which was revised up 1ppt to 1.1%.
- Australia's annual rate of headline inflation remained unchanged from September at 2.1% in October. Government energy rebates continued to supress inflation.
- Real private capital expenditure rose by 1.1% in the September quarter, with investment rising solidly across categories. However, the outlook for spending over the remainder of the financial year is soft, with the latest estimate of expected nominal spending for FY25 up only 4.4% compared to the equivalent estimate for FY24.





Sources: ABS, Refinitiv, QIC