

Australia's core inflation falls into target zone, opening room for a rate cut

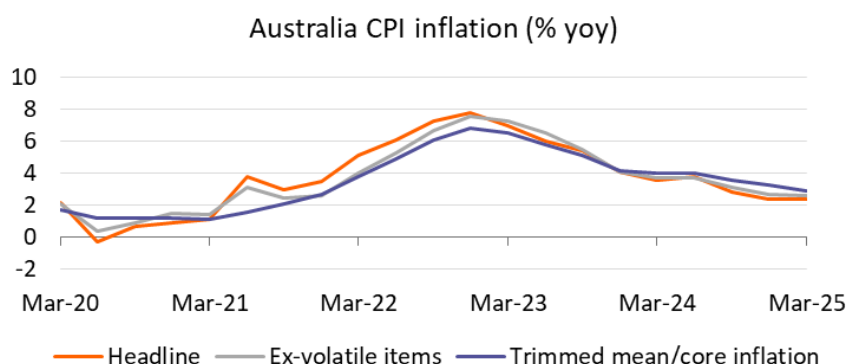
Australia's consumer price index inflation readings exceeded expectations in the first quarter, but year-on-year core prices fell within the Reserve Bank of Australia's target range for the first time since 2021. We maintain our call for a rate cut in May



Lower core on YoY basis changes RBA calculations

At 2.4% year on year, Australia's headline inflation rate in the first quarter was in line with our expectations and remained unchanged compared to the last quarter. Inflation readings across most metrics exceeded consensus expectations on both a year-on-year and quarter-on-quarter basis. Despite this, core inflation, which the Reserve Bank of Australia likely prioritizes over headline rates, fell to 2.9% YoY. This marks the first time since 2021 core inflation fell within the RBA's target range.

Trimmed mean fell 40bps to 2.9% in 1Q vs last quarter



Food and seasonal factors behind higher QoQ inflation

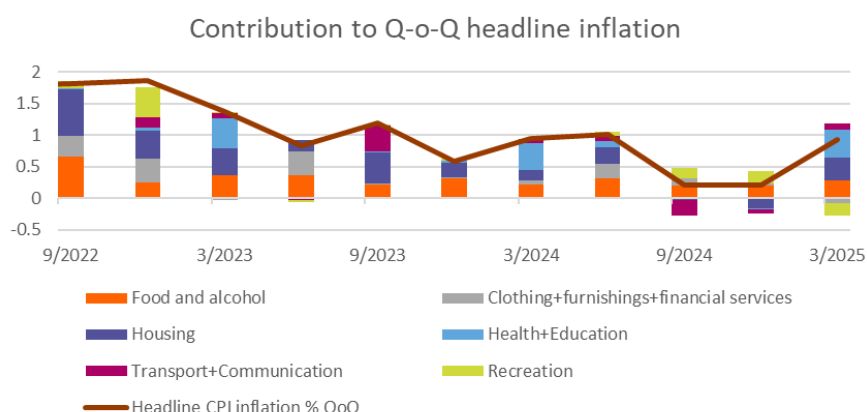
There were three key sources of higher inflationary pressures. Firstly, as we previously noted, a strong uptick in food and electricity prices is reflected in the 1Q numbers. The reversal of cost-of-living electricity subsidies continues to have a large impact on headline inflation, through the housing price index. Electricity prices rose 16.3% QoQ largely driven by waning government subsidies in Brisbane. However, with an expected new round of government energy rebates, electricity's influence on the headline CPI should turn favourable in the second half of the year.

Secondly, while overall food and beverages inflation was modest at 3.4% YoY, gains in two items -- tobacco and fruits and vegetables -- contributed 25% to the headline inflation. Australia's cigarette prices rank among the highest in the world and have been rising because of higher excise duty. It's unlikely that we'll see a meaningful correction in prices in this segment.

Thirdly, putting the impact of food and fuel aside, core inflation on a seasonally adjusted basis edged higher to 0.7% QoQ. This was driven by non-discretionary items such as health, education and house prices. While health and education price increases are more seasonal, they remain large contributors to headline inflation, totalling 60bps in the past year with no signs of cooling off.

Lastly, while the CPI measure of rents shows a slight decrease in the annual inflation rate, it's still running above 5% YoY. The marginal impact on inflation now is probably only quite limited. It will be interesting, though, to see how this turns out over the next few months.

Administered and seasonal price changes drove QoQ higher



Source: CEIC

Lower services and transportation prices were the key offsets

After falling mildly for the last three months, the motor fuel component fell a significant 7.6% YoY in March 2025. Over the coming months, we expect this to continue to be less of a drag on headline inflation, too.

Looking at other components of services inflation, many, such as furnishings, clothing, and communications, are looking far more respectable with close to zero contribution to YoY headline inflation. They remain within levels consistent with the RBA's inflation target. This is also an improvement compared with a year ago, when some of these readings remained outside of RBA's target range.

Bolsters our call for a May rate cut

The upshot of all of this is that the inflation picture remains mixed. But the drop in core inflation to within RBA's target range opens room for a rate cut in the May policy review. We continue to expect the RBA to cut cash rate by 25bps to 3.85%

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