Australia: Some welcome news on inflation

Headline CPI inflation for October dropped below 5%, and there should be further declines in the coming months, increasing (but not guaranteeing) the chances that rates in Australia have peaked

Source: Shutterstock

4.9%

October CPI inflation

Down from 5.6%

Lower than expected

Size of the decline beats expectations

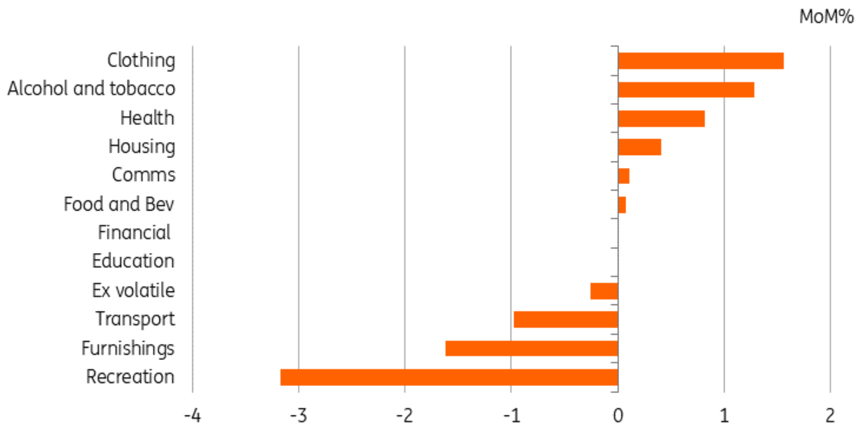
The October CPI inflation print of 4.9% YoY was a fair bit lower than the consensus expectation which only had inflation dropping to 5.2% (ING f 5.0%) from 5.6% in September.

If you pore through the month-on-month data, the main contribution apart from lower transport costs, which were mainly due to lower motor fuel prices (more of that to come next month given what is happening to crude oil prices) was from housing.

- The main housing component slowed from 0.8% MoM to 0.4% MoM
- This was mainly because rents went from a 0.3% MoM increase in September to a 0.4% decline in October - is RBA rate policy finally beginning to bite even against industry data that points to a still robust property market (at least as far as purchases go)?
- Home furnishings fell in MoM terms for a second month - not a sign of health in the property sector, surely?

There was also some volatility in things like recreation and holiday prices - which are extremely seasonal. So this probably doesn't represent more than the usual monthly noise at this time of year. Financials also slowed to zero after a couple of months of higher readings, which will also have helped. Tobacco prices continued to rise at a reasonable pace - probably lagged effects of earlier bi-annual excise duty adjustments. This should not extend into next month.

October CPI inflation MoM% by component



Source: CEIC, ING

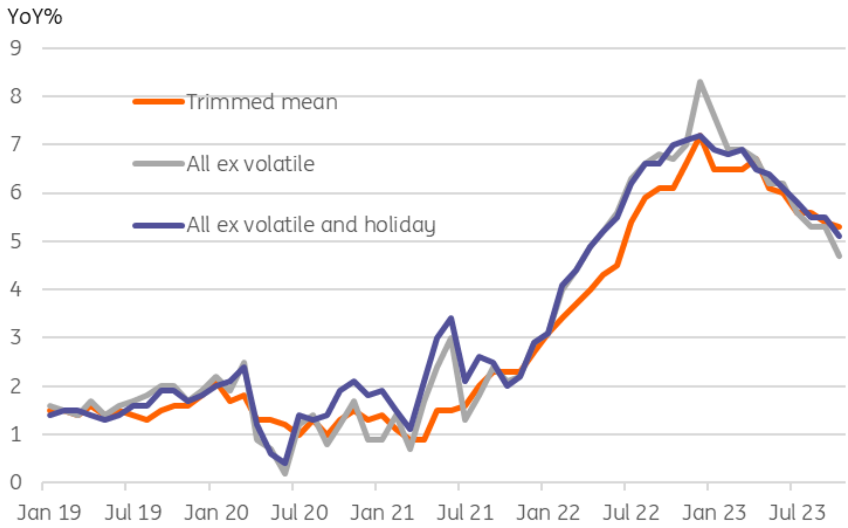
Inflation still strong across the board

Despite a softer reading for October, annual inflation rates for most components are still much higher than the Reserve Bank's (RBA) 2-3% inflation target. Of the main sub-groups, only communications, recreation, furnishings and clothing were within or below the 2-3% YoY range. Two-thirds of the main sub-components were higher, and in some cases a lot higher than the target.

Stripping away volatile items also shows that there is still work to be done by the RBA.

Trimmed mean inflation fell this month from 5.4% to only 5.3%. There was a larger decline in the CPI ex-volatile items inflation rate to 4.7% from 5.3%, and the CPI-ex volatile items and holidays inflation rate fell from 5.5% to 5.1%.

Australian core measures of inflation



Source: CEIC, ING

Further declines in inflation over the next 2 months barring accidents

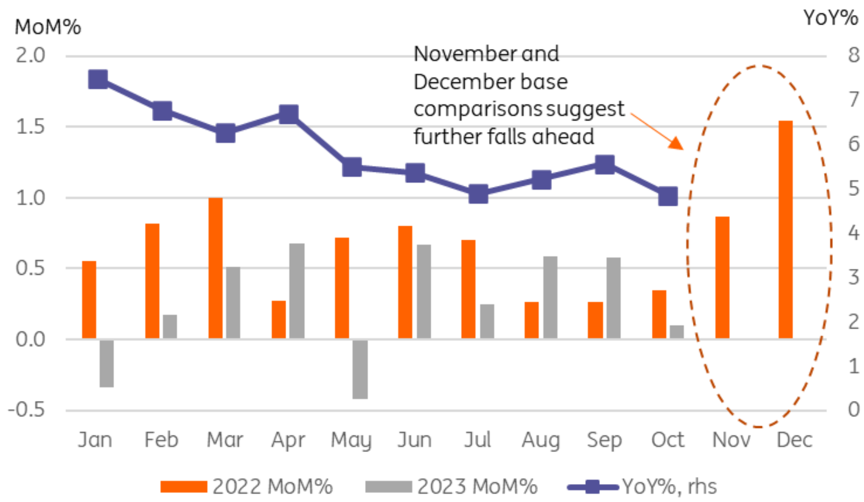
The outlook for the next two months is that we should see further, and perhaps rapid falls in inflation. Indeed, it is only thanks to upward rounding from two decimal places that inflation in October registered as 4.9%, not 4.8%, so we are already well on the way to a further reduction just on rounding.

Last year's weather-induced food and energy price spikes, plus outsize post-Covid re-opening surges in holiday-related costs around December will hopefully not be repeated, at least not as substantially as last year. That said, we are still in an El Nino weather pattern, so freak cold or wet weather and the ensuing impacts on prices cannot be ruled out, though will hopefully be less disruptive and damaging than in 2022.

If so, then we could well see some further substantial reductions in headline inflation taking us into the New Year of 2024 and delivering a much more benign inflation backdrop in early 2024 than we had in early 2023. If so, that could well temper any lingering thoughts of further RBA hikes.

We still think that RBA rate-policy has peaked, but the main risk will come later on in 2024, in February and March, when the base effects (from Jan and Feb inflation) turn much less favourable. And so unless we see the month-on-month run rate for Australian inflation dropping more convincingly by then, there is still, in our view, a slight risk of a final 25bp rate hike around then. If we get past that point, it will look increasingly likely that the peak came with the last hike in November.

Monthly inflation progression and base effects



Source: CEIC, ING

Markets move to price in more cuts in 2024

The market response following this inflation data was to price in a greater chance of a rate cut in 2024 than had been assumed. Yesterday, only 0.148 of a 25bp rate cut was priced into the December 2024 cash rate contract. Today, that has risen to 0.733. The AUD monetarily dipped on the news, but then recovered, overshot and settled down to roughly where it was. Clearly, USD weakness is the dominant currency theme right now, not the local rate story.

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