

# Inflation Outlook

October 2024

Arculus Funds Management Pty Ltd  
Phone: 0432 815 534  
ABN 68 140 364 576 | AFSL No. 346034  
[arculus.com.au](http://arculus.com.au)



## Inflation Outlook

Despite the narrative that inflation at a headline CPI level will fall to the RBA 2.5% target and force an official interest rate cut this year, we still see a higher probability of another interest rate increase in this cycle and more importantly the RBA holding rates at a higher level than expected for a considerable period. Media reporting on economic data releases continues to be disappointing, but far more concerning is the way the banks switch between a statistical and economic approach to analysis of the data, to interpret the data in a way favourable to their agenda. So, we will do both a statistical approach and then an economic one.

## Statistical Review

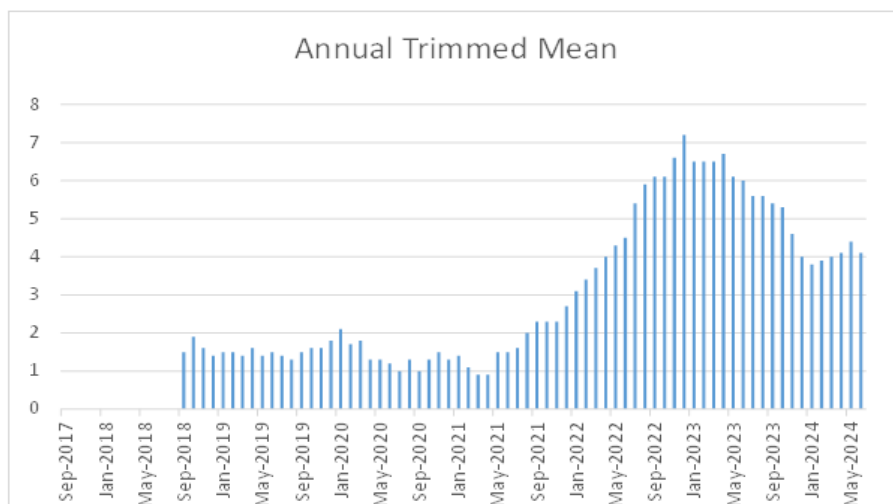
The following tables were assembled with the data provided by the ABS. [Monthly Consumer Price Index Indicator, July 2024 | Australian Bureau of Statistics \(abs.gov.au\)](https://www.abs.gov.au/australian-bureau-of-statistics/publications/mcpi)

Weighted average of eight capital cities, annual movement	May 23 to May 24 % change	Jun 23 to Jun 24 % change	Jul 23 to Jul 24 24 % change
All groups monthly CPI	4.0	3.8	3.5
Food and non-alcoholic beverages	3.3	3.3	3.8
Alcohol and tobacco	6.7	6.9	7.2
Clothing and footwear	2.8	3.6	1.9
Housing	5.2	5.5	4.0
Furnishings, household equipment and services	-1.1	-1.1	-0.9
Health	6.1	5.3	5.3
Education	5.2	5.6	5.6
Insurance and financial services	7.8	6.4	6.4

The headline CPI shows a declining pattern from 4% in May to the current July reading of 3.5%. A great deal of caution needs to be used when relying on the monthly data because the ABS does not yet consistently survey all the CPI basket every month but does only over an entire quarter.

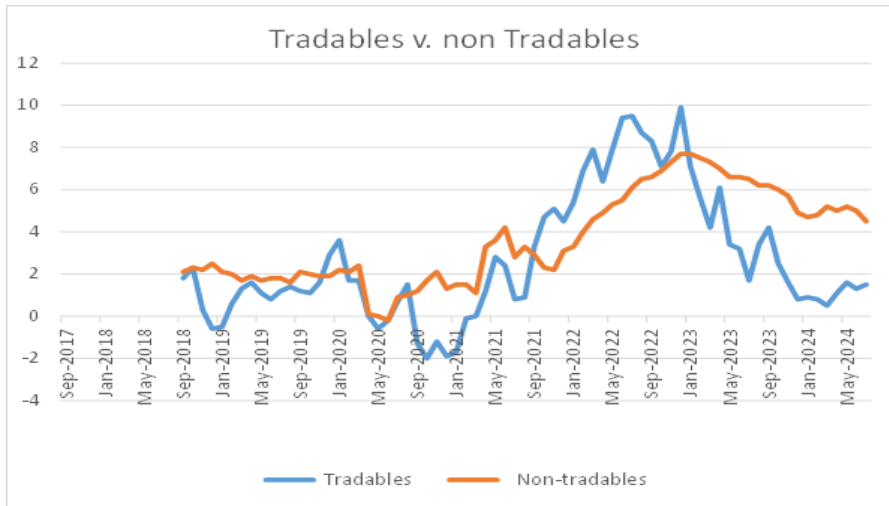
Weighted average of eight capital cities, annual movement	May 23 to May 24 % change	Jun 23 to Jun 24 % change	Jul 23 to Jul 24 24 % change
Seasonally adjusted CPI excluding volatile items** and holiday travel	4.1	3.8	3.6
Annual Trimmed mean	4.4	4.1	3.8

There has also been a pattern of falling inflation in the seasonally adjusted, CPI excluding volatile items and the all-important Trimmed Mean which is the data the RBA uses to measure inflation.



**There are then several ways to interpret this CPI data provided by the ABS.**

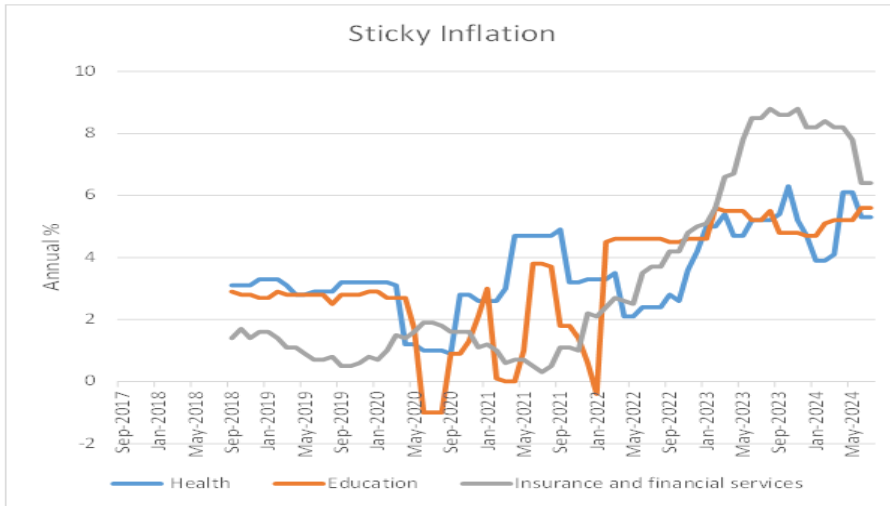
1. Tradables inflation includes Household furnishings & clothing, footwear that have been consistently declining since the pandemic restrictions were lifted and the global supply chains were restored. Non-Tradables inflation remains at a high level.



2. Goods & Services inflation shows a divergence with Goods price increases back to long term levels and Services prices still at a high level and importantly beginning to rise again.



3. Inflation remains elevated due to 'sticky' prices such as Insurance, Health and Education still increasing. It would be reasonable to expect that insurance costs will begin to rise again in the months ahead because Health insurance premiums need to increase to fund the increased costs of private hospitals following the large wages increases in the industry sector. Pleasingly, the fall depicted in the chart below appears to be due to increased competition - after strong price increases over several years- for directors and officers liability insurance that has seen a 20% decline in the first half of 2024.



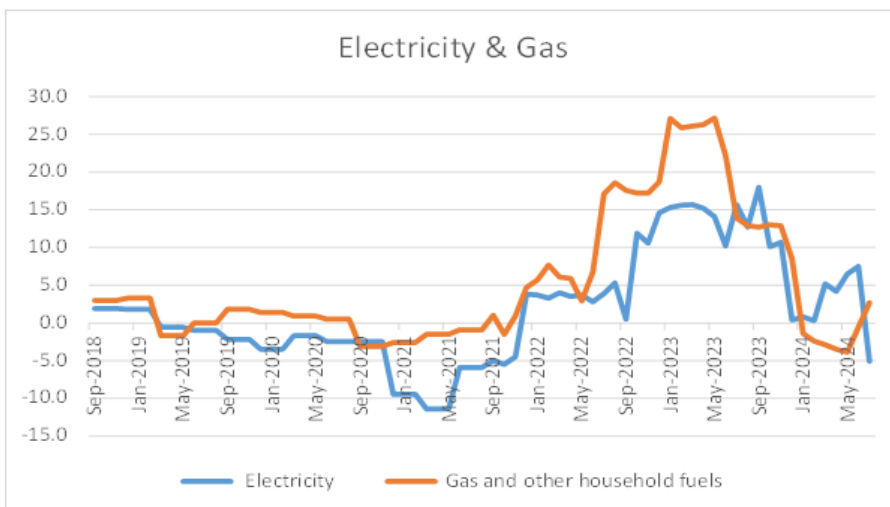
4. The Housing category has a large weighting in the CPI basket and has been targeted by both State and Federal government with several subsidies.

Weighted average of eight capital cities, annual movement	May 23 to May 24 % change	Jun 23 to Jun 24 % change	Jul 23 to Jul 24 % change
Housing	5.2	5.5	4.0
Rents	7.4	7.1	6.9
New dwelling purchases by owner-occupiers	4.9	5.4	5.0
Electricity	6.5	7.5	-5.1
Gas and other household fuels	-3.9	-0.6	2.7

**The Housing category can be then broken down into two groups:**

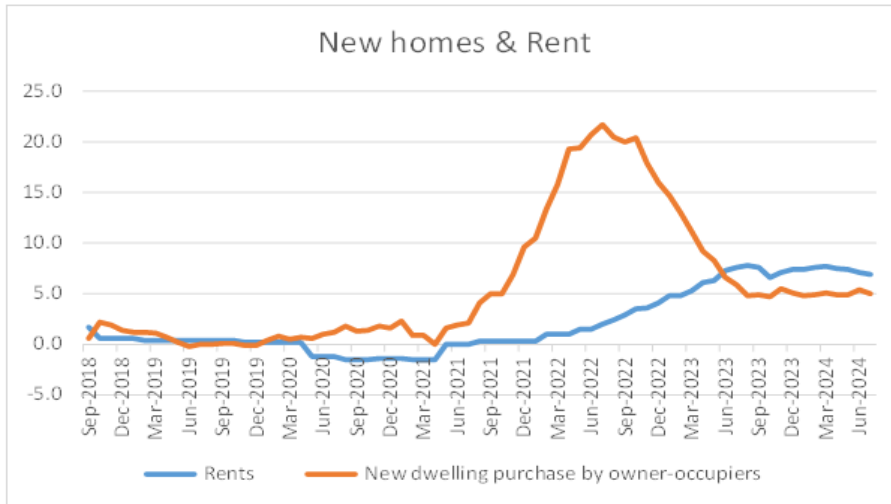
**1. Electricity and Gas**

The spike in electricity and gas prices in 2021-2023 period ended in December 2023 abruptly. While gas prices continued into 2024 electricity prices began to increase again before the Federal and State subsidies brought a sharp drop in June and July. To some extent the rise in gas prices will be now offsetting the electricity subsidy benefit.



## 2. New home prices and Rent costs

The price growth in the cost of building a new home and the reflected rent cost appears to have stabilised at a higher than historical level.

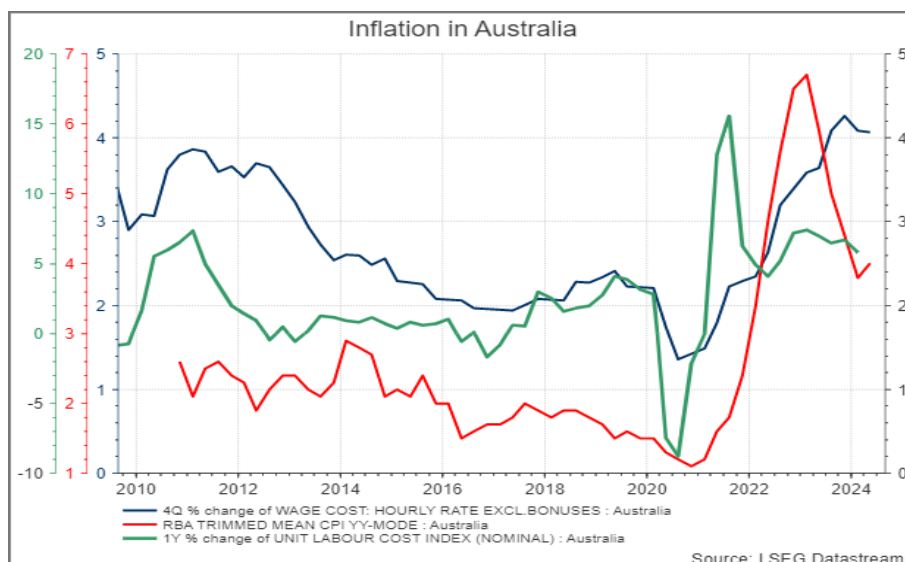


## Economic Outlook and Review

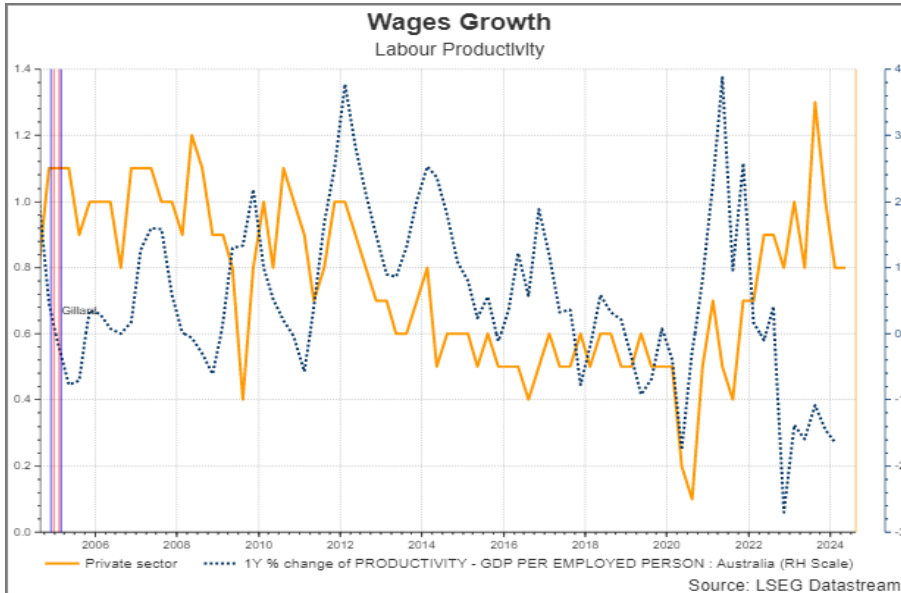
The following should be read in conjunction with our recent paper on Monetary Policy.

- [Monetary Policy – April 2024 – Arculus Funds Management](#)

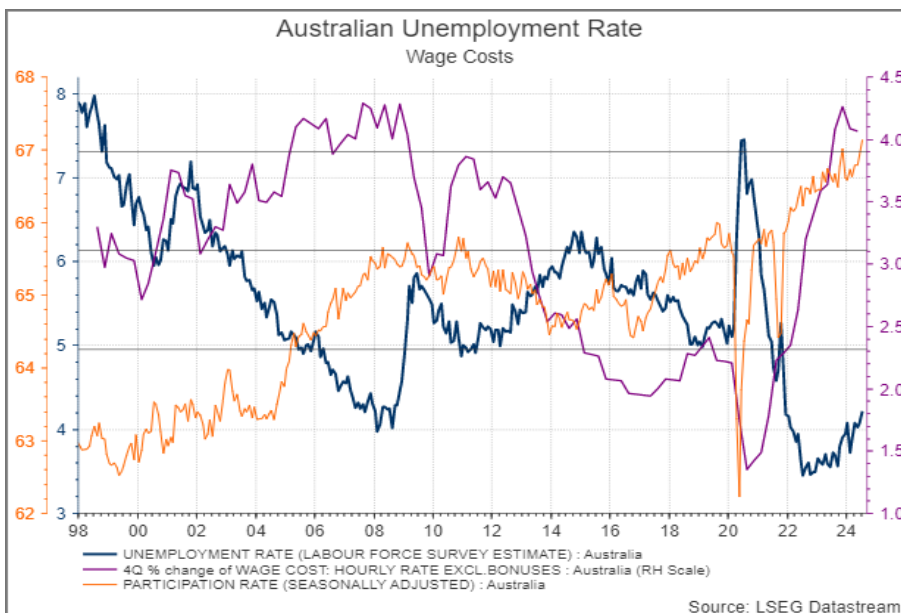
When measuring inflation from an economics standpoint it is best to focus on the RBA Trimmed Mean as that is how the RBA measures inflation. In the following chart there is also Wages Growth and the change in the unit labour cost index (wages with productivity). The RBA has said on many occasions previously, that wages growth of no more than 3% is consistent with achieving a sustainable inflation outcome at the target 2.5%. It is worth observing the spike in the unit labour cost index and then the lagged impact on inflation.



The rise in labour costs and its impact on inflation is central to Phillips Curve Theory, however, labour costs must be considered alongside labour productivity. In the US the strong level of labour productivity has historically made Phillip Curve Theory irrelevant (see our Monetary Policy paper). In Australia where labour productivity is actually declining, we have a real problem. The RBA when it said that wages growth of no more than 3% was consistent with its inflation target, did so with an assumption that labour productivity would be 1%. Today labour productivity is negative and so we need a much lower level of wages growth to see inflation falling (something like 1.5% with labour productivity at negative 1.5%).



Historically and according to economic theory we will need to now see a large rise in unemployment to get an actual material fall in inflation from the current levels. We currently have wages growth above 4% with the highest level of labour participation ever recorded in Australia. The slight rise in unemployment last month is only a reflection of the rise in the labour participation rate. Looking forward we have seen numerous examples of EBA's locking in annual wage gains of 4-5% over 3-4 years. These wage gains are in response to the historical and current level of inflation (and fair enough) but what they do is entrench inflation at a level at or above 4%pa.



## Disclaimer

Important Information: The information provided is intended for general information only. It has been prepared and issued by Arculus Funds Management Pty Ltd which operates under the GCI Australia AFSL as a CAR – GCI Australia Pty Ltd ABN 68 140 364 576 Australian Financial Services Licence No 346034.

Arculus Funds Management Pty Ltd is a specialist Australian asset manager of wholesale discretionary mandates, both corporate and private. We act for clients who need to have a wholesale, sophisticated or professional accreditation.

In preparing this material, Arculus Funds Management nor GCI Australia Pty Ltd has not considered your objectives, financial situation or needs. You should consider the appropriateness of any advice before acting on it. You should consider the relevant Product Disclosure Statement terms and conditions, Financial Service Guide, customer information brochure and Guide to Fees and Charges for the product before making any decisions about whether to make an investment in one of the offered products. Before making an investment decision based on any documents the investor needs to consider whether the advice is appropriate in light of the particular investment needs, objectives and financial circumstances.

Recommendations or opinions expressed may change without notice. Do not act without first consulting your investment adviser to determine whether the investment is appropriate for your investment objectives, financial situation, and particular needs. Any prices or quotations contained herein are indicative only and do not constitute an offer to buy or sell any securities at any given price. No representation or warranty, express or implied, is provided in relation to the accuracy, completeness, reliability or appropriateness of the information, methodology and any derived price contained within this material.

Warning: Past performance is not a reliable indicator of future performance. Derivatives are leveraged products, which means gains and losses are magnified and you may lose substantially more than your initial investment. Opinions, ratings, and recommendations may change without notice. We do not endorse any information from “third-party” research providers that we provide to you unless we specifically say so.

Note: The information contained in this message is intended only for the named addressee and may contain privileged and confidential information. If you are not the named addressee, any dissemination distribution or copying of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by replying to the message and deleting it from your computer.