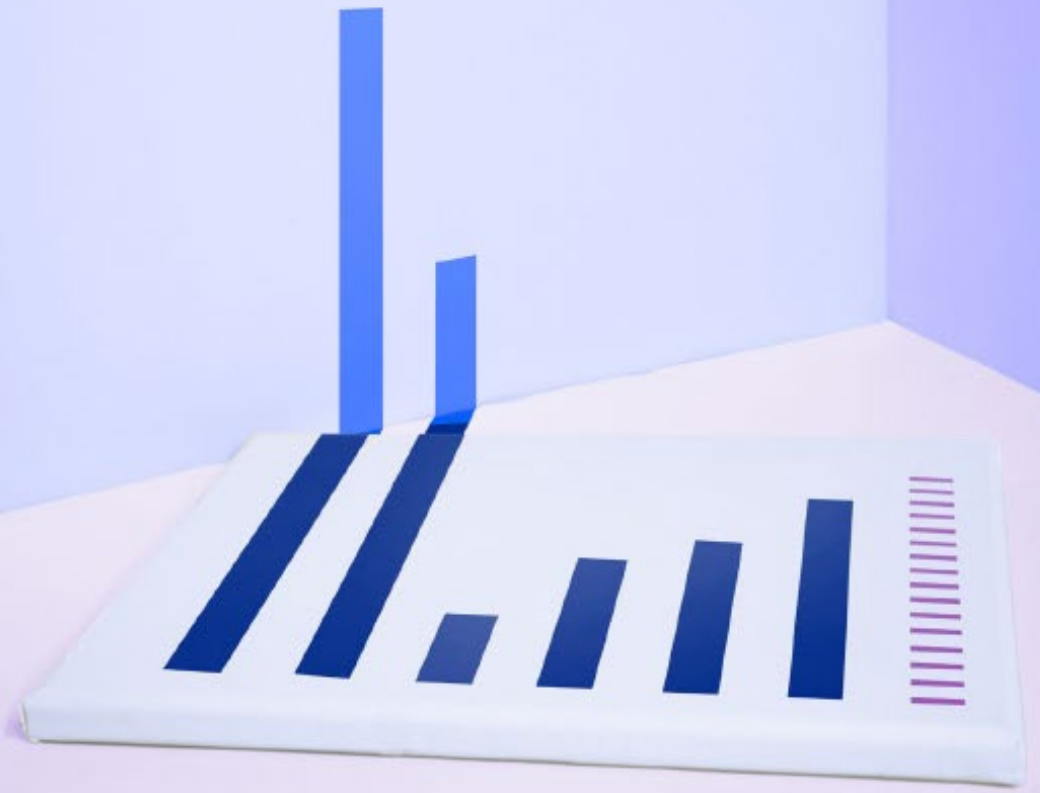
KPMG

Australian Inflation and Cost Dynamics



KPMG Australia

—

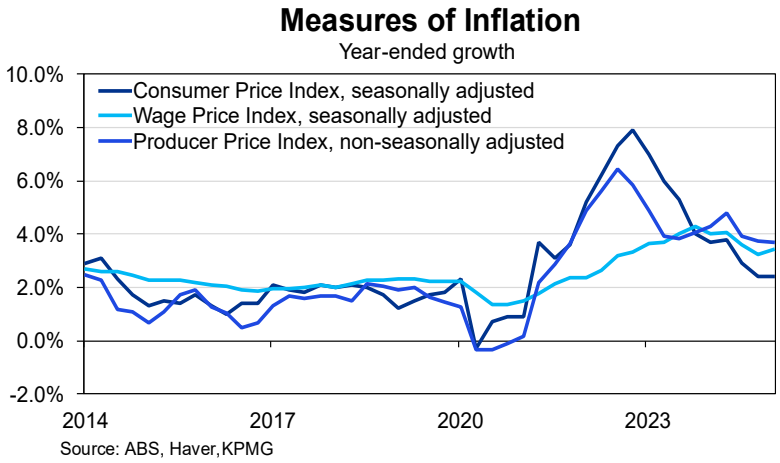
June 2025

Executive Summary

KPMG's biannual *Australian Inflation and Cost Dynamics* report is designed to provide unique and timely insights into the complexities of inflation and its driving forces within the Australian economy. The report investigate trends in international prices, consumer prices, producer prices and wages.

A significant feature of this report is the construction of the KPMG Inflation Pressure Gauge. This analytical tool is designed to offer a clearer understanding of the diverse factors contributing to inflation. Through this gauge, we differentiate the impact of demand-side and supply-side influences on the economy.

By examining these dynamics, this report aims to provide a nuanced perspective of inflationary pressures. Our goal is to equip decision-makers with the insights needed to assist them to navigate and anticipate the implications of inflation trends.



A continued easing of inflationary pressures has allowed the RBA to deliver two rate cuts so far this year, in February and May.

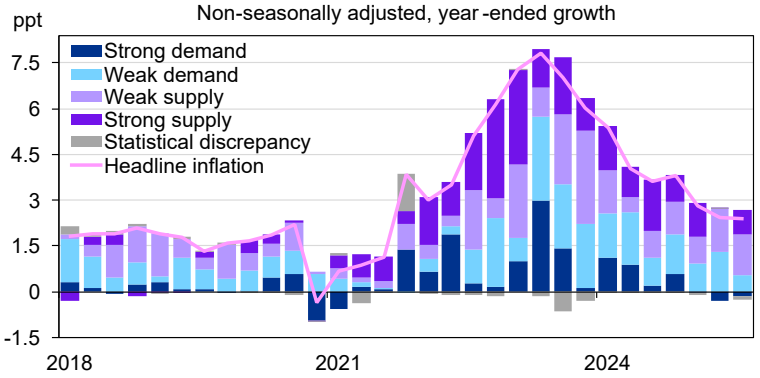
After peaking in late December 2022, headline consumer inflation has been moving in a consistent downwards direction and is now within the 2–3% target band. The RBA's preferred measure of inflation has now returned within the target band, with the trimmed mean measure falling from 3.3% to 2.9% in the March quarter, its lowest rate since the December quarter 2021.

Meanwhile, growth in producer prices (as measured by final demand) was also steady, rising by 3.7% through the year to the March quarter, maintaining its lowest rate of growth in three years.

The pace of wages growth exceeded expectations in the March quarter, rebounding to 3.4% on an annual basis. While representing an uptick from the 3.2% figure in the December quarter, it is still less than the 4.0% seen in the corresponding period a year ago.

Executive Summary (cont.)

Estimated Contribution to Headline Inflation



Source: KPMG, ABS, Haver

Inflation and Wage Forecasts

	2025 Mar*	Jun	Sep	Dec	2026 Mar	Jun
Core Inflation						
Q/Q	0.7	0.7	0.7	0.7	0.7	0.7
Y/Y	2.9	2.8	2.7	2.9	2.9	2.8
Wages						
Q/Q	0.9	0.8	0.8	0.8	0.8	0.7
Y/Y	3.4	3.3	3.3	3.3	3.2	3.1

Source: KPMG *Actual

The contractionary monetary policy regime between mid-2022 to early 2025 has arguably had the intended effects in curbing the demand-sided inflation.

Headline inflation held steady at 2.4% in the March quarter, as measured in seasonally adjusted terms. KPMG estimates that 0.4 pts of this figure can be attributed to demand-dominated pressures, compared to 1.1 pts a year ago.

By contrast, supply-dominated pressures were linked to 2.1 pts of headline inflation according to KPMG estimates, down from 2.6 pts a year ago. This was largely due to the continued normalisation of supply chains, although there has been a recent uptick following severe weather events and global uncertainty surrounding US tariffs.

The escalation in the Middle-East conflict and a likely significant rise in world oil prices will mean temporarily higher inflation. But we believe the RBA will 'look through' this and focus on the negative impact on Australian GDP. This means it is likely to cut rates three times by the end of 2025 to support economic activity

Going forward, the outlook for inflation is already complicated by the ongoing trade war, with uncertainty surrounding the exact extent of tariffs imposed by the US and the retaliatory measures by its trading partners, and the recent geopolitical developments in the Middle East.

The Middle-East conflict looks set to reignite global inflationary pressures. So far, it has already disrupted global shipping routes, driving up freight and insurance costs. Although Australia does not directly import oil from Iran, domestic fuel prices will likely rise in response to the global increase in oil prices, which will in turn affect domestic transport- and freight-intensive industries.

KPMG expects a mixed picture ahead, and in the near term, we anticipate headline inflation to stay around the mid-point of the target range in the first half of the year. However, escalating trade and geopolitical tensions could see Australian inflation rebound towards the latter half of the year.

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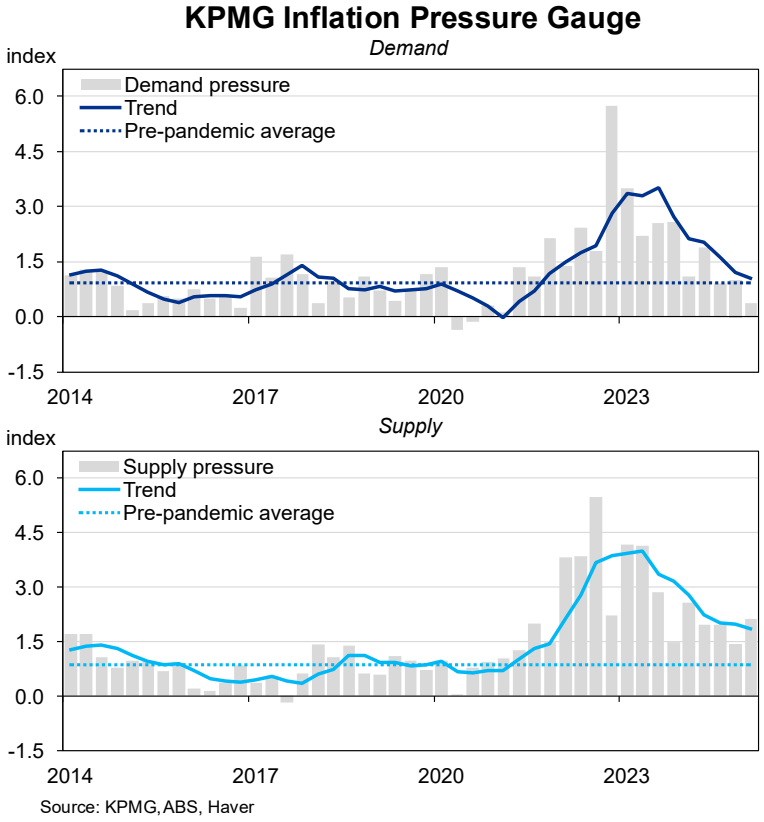
KPMG Inflation Pressure Gauge

KPMG Inflation Pressure Gauge



Source: KPMG, ABS, Haver

The latest analysis shows that inflationary pressures have continued to subside. While demand pressure has returned to pre-pandemic levels, supply pressure has proven to be more persistent.

While it is clear that inflation was mostly supply driven for much of 2020 and 2021 due to supply chain disruptions and labour shortages, by early 2022, the drivers of inflation have been the subject of intense debate.

Our analysis suggests that since mid-2024, demand factors have not been as prevalent in influencing inflation. The latest estimate[1] for the March quarter 2025 shows that demand-driven inflationary pressure has fallen to 1.0 pts in trend terms, compared to 2.1 pts a year prior. This corresponds to a decrease of 0.2 pts from the September quarter, with the index now only 0.1 pts above its pre-pandemic average.

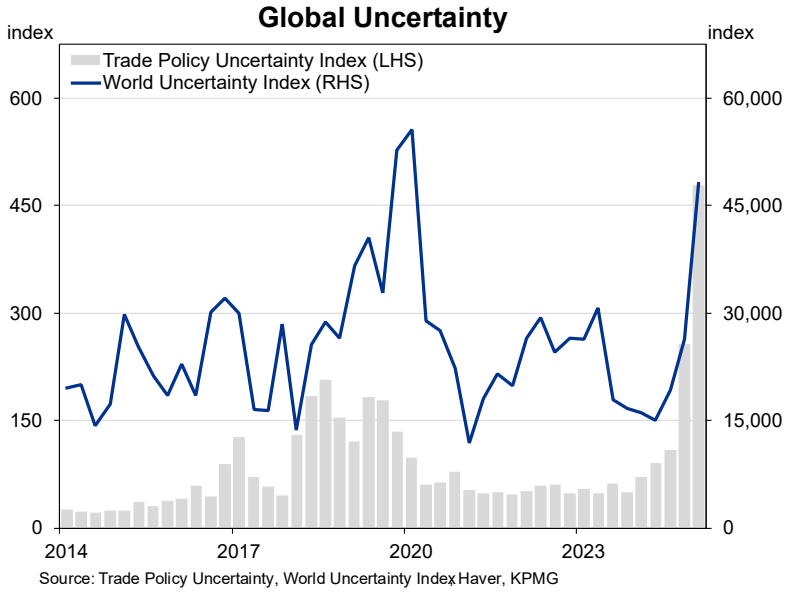
Within this context, the RBA has judged it appropriate to lower the cash rate by 25 basis points in both February and May, bringing the policy rate to 3.85%. It is evident that the high interest rates have had the intended effects in curbing demand-driven inflation.

By contrast, supply-driven inflationary pressures have also eased, but at a slower pace. It is now at 1.9 pts in trend terms, substantially less than the 2.8 pts recorded a year ago, but the index remains 1.0 pts higher than the average prior to the pandemic. However, as supply-side inflationary pressures are less sensitive to interest rates, and with a deteriorated outlook for global and domestic growth in the wake of US tariffs, this is unlikely to pose a significant concern to the RBA.

[1] For further details, refer to Appendix A.

02
International Trends

Trade and Policy Uncertainty

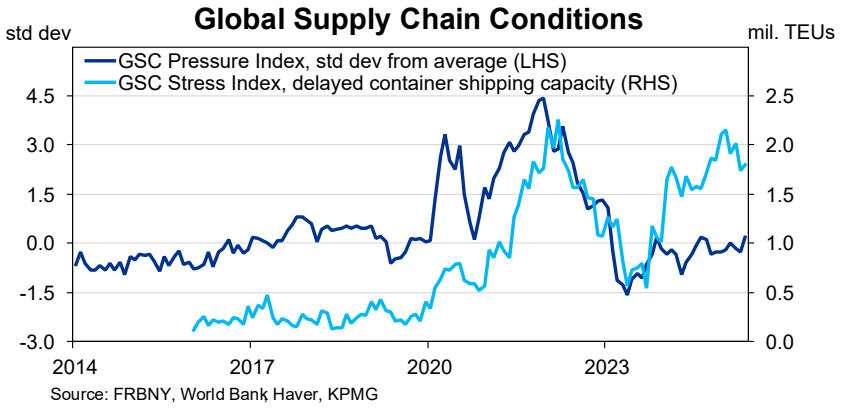


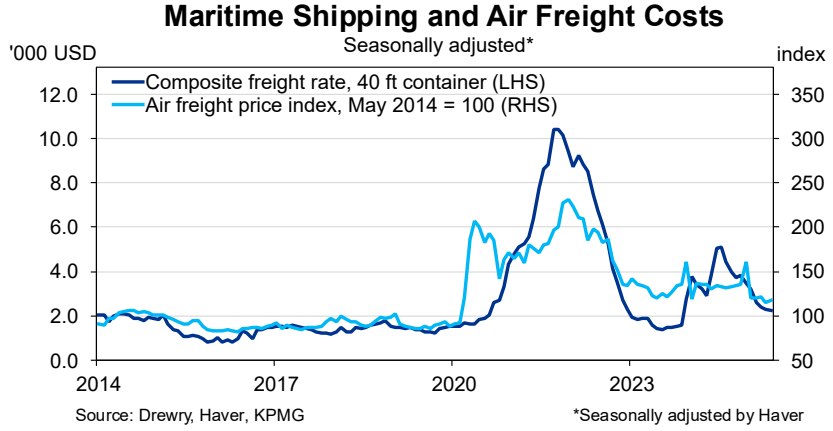
Global uncertainty has skyrocketed following US tariff announcements and has continued to evolve since. High uncertainty will look to complicate the outlook for inflation dynamics.

The Trade Policy Uncertainty Index soared to a record high, averaging 478 pts in the March quarter 2025, reflecting growing concern about the impact of US tariffs on global trade flows. These fears continue to extend, with the latest data showing the index climb further to an unprecedented 1,151 pts in April, before cooling slightly to 723 pts in May. Beyond the disruptive effects of tariffs, the rapidly changing nature of policy announcements has challenged the ability to make decisions with confidence.

Likewise, the World Uncertainty Index has also climbed to 48,146 pts in the March quarter, nearing the peak seen at the beginning of the pandemic. Recent escalations in regional tensions, most notably surrounding conflict between Israel and Iran, have only exacerbated these existing risks.

Supply Chain Conditions





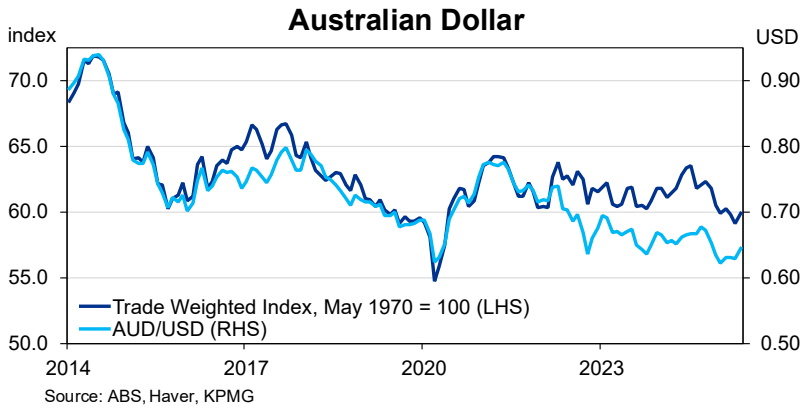
Pressure on supply chains has eased for now, as businesses contend with a quieter outlook for global demand and trade volumes. However, this may be the calm before the storm, as impending tariffs and the Israel–Iran conflict could disrupt established trade and logistics dynamics.

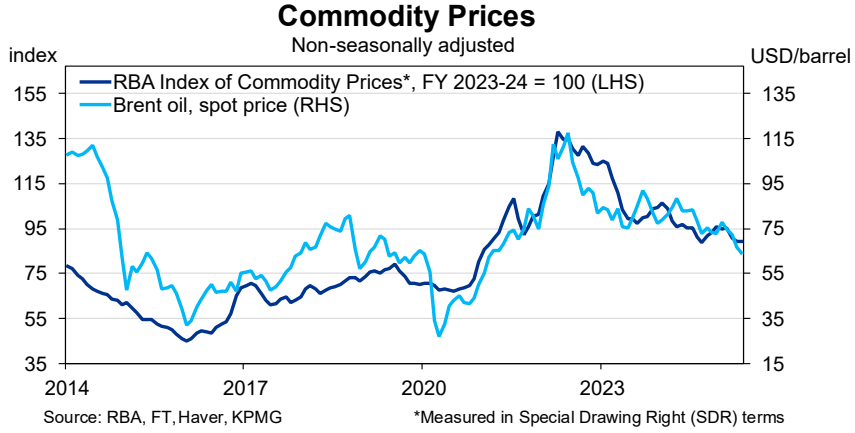
The Global Supply Chain Pressure Index (GSCPI), which integrates transportation costs and manufacturing indicators to assess global supply chain conditions, climbed to a nine-month high of 0.19 pts in May 2025, though it remains near its long run average. A temporary surge in activity has contributed to this uptick, as businesses act to beat upcoming tariffs. However, more depressed medium-term prospects have acted as an opposing force, with a reluctance to make commitments in the face of unresolved trade policies. Excess production capacity, particularly in economies such as China, could contribute to more competitive manufacturing costs moving forward.

Focusing on maritime shipping, the World Bank's Global Supply Chain Stress Index (GSCSI), which measures delayed container shipping capacity due to port congestion and closures, peaked at 2.2 million twenty-foot equivalent units (TEUs) in January 2025 – a standard measure of container capacity and port traffic. This mirrors the previous peak seen in March 2022 during the pandemic, with the Red Sea shipping crisis causing serious disruption to transit times. By May, the index had dropped to 1.8 million TEUs, as the threat of US tariffs caused a slowdown in activity.

This muted demand has been reflected in shipping costs, with both air and ocean freight rates falling sharply in recent months to approach pre-pandemic levels. This provides some welcome relief, although more recent high frequency data suggests a rebound in some shipping costs, associated with a rush to front-load further imports to the US while tariffs remain suspended.

Exchange Rates and Commodities





The value of the Australian dollar slumped in late 2024, weighed down by fears surrounding the effects of tariffs on commodity exports. However, the Australian dollar has been on an upward trend throughout most of 2025.

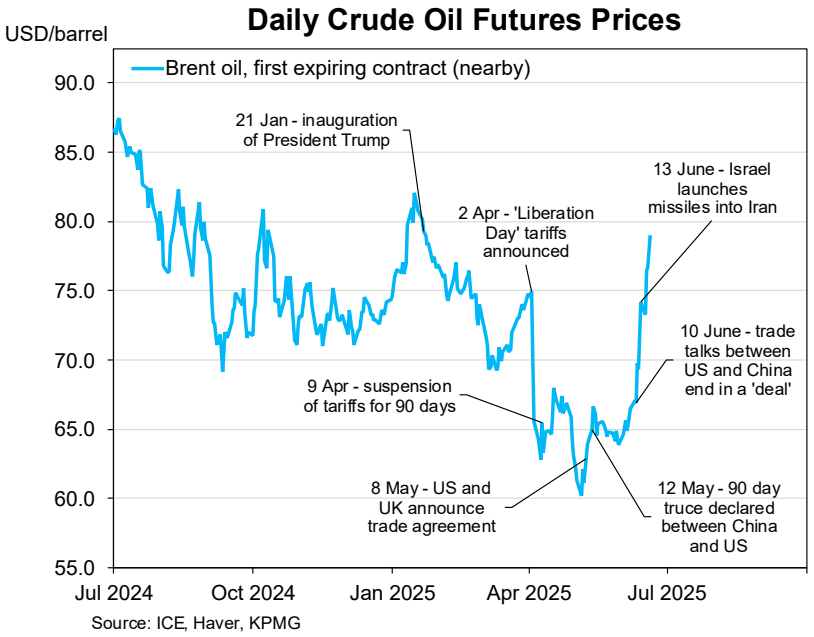
Exchange rates

The Australian dollar has been on an upward trend (with early April being a notable exception, with a sharp dip to below US$0.60 in the wake of 'Liberation Day', followed by a full recovery by the end of the month). As at the end of May, the Australian dollar had climbed back to US$0.64, assisted by a surge in the value of gold and a recovery in iron ore prices. This has also been supported by a weakening of the US dollar, which has depreciated against other major currencies.

Commodity prices

The RBA Index of Commodity Prices lifted by 0.4% in May, but is still down 7.7% over the year, due to depressed iron ore and coking coal prices. This reflects a weaker outlook for steel production, including economic activity in China. Gold prices remain strong, and are projected to remain so, given the ongoing uncertainty. Both the rural commodities and non-rural commodities subindices rose by 0.9% over the month.

Exchange Rates and Commodities (cont.)



Source: ICE, Haver, KPMG

Box A: Oil prices have rebounded amidst elevated risks to supply, potentially adding upward pressure on domestic inflation

In the wake of the pandemic, global oil prices climbed as the recovery in demand outpaced the recovery in supply, with the Russian invasion of Ukraine in February 2022 further pushing prices above US$100/barrel.

Since mid-2022, oil prices have generally been on a downward trend, with muted prospects for global economic growth dampening demand. Notably, lower global oil prices drove substantial falls to *Automotive fuel* in the CPI during the September (-6.7%) and December (-2.0%) quarters of 2024. While this contributed to a fall in measured headline inflation, there was no direct effect on core inflation, as these price movements were 'trimmed' due to their extreme nature. However, there would still be indirect effects; for example, through lower transport and production costs of other goods and services.

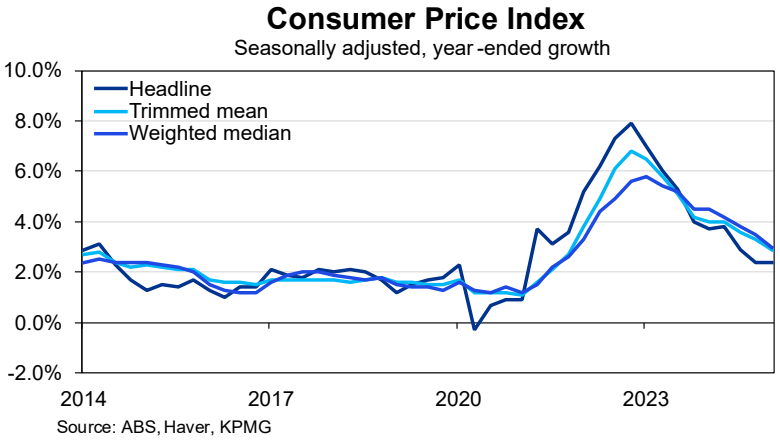
Looking more recently, tariff announcements triggered a sharp decline in oil prices, with fears of weaker global growth dampening demand expectations for oil. However, through May and June, there has been a recovery in the market, as progress in trade negotiations provides some positive news for global trade. Nevertheless, we still expect global demand for oil to be weak, considering muted global growth prospects.

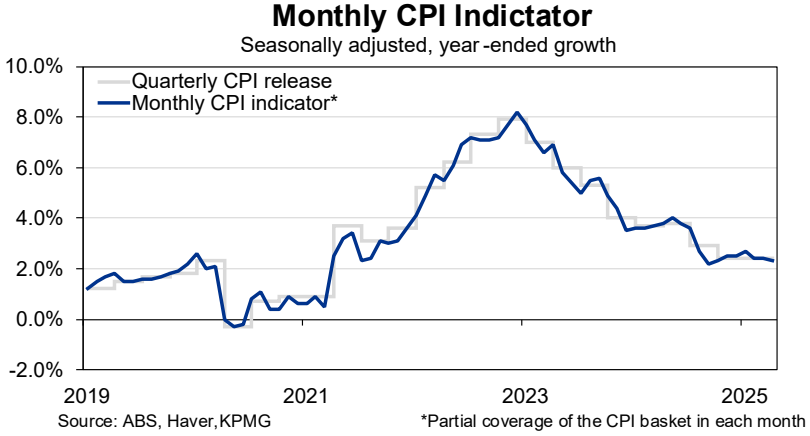
On the supply side, global oil production has remained generally stable. However, the escalating conflict between Israel and Iran in early June has threatened global supply and triggered immediate price increases, in response to Israel striking Iranian oil production facilities, and Iran threatening to close the Strait of Hormuz.

03

Domestic Trends

Consumer Prices: Overview





Quarterly CPI release – March quarter 2025

Growth in consumer prices[2] held steady at 2.4% in the March quarter, as measured by seasonally adjusted annual headline inflation. This was unchanged from the December quarter result, and above the market expectation of 2.2%.

Crucially, the RBA's preferred measure of inflation has now returned within the target band. The trimmed mean measure fell to 2.9% in the March quarter, from 3.3% in the period prior. This was in line with the consensus and represents the lowest rate since the December quarter 2021.

Monthly CPI indicator – April 2025

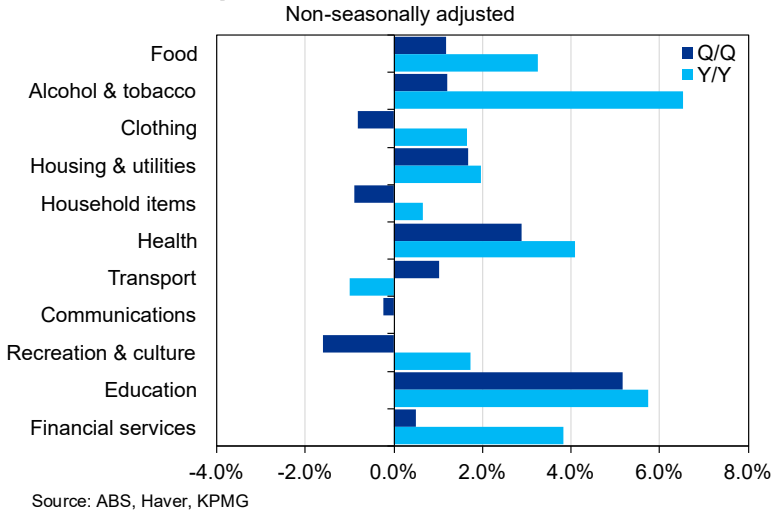
The timelier monthly inflation figures are consistent with this trend, with seasonally adjusted headline inflation falling marginally to 2.3% in April, from 2.4% in March. Although this measure does not update the price movements of the entire CPI basket in each month, it provides a timelier measure of inflation compared to the main quarterly release.

Meanwhile, the trimmed mean picked up slightly to 2.8%, from 2.7% in the month prior. The monthly trimmed mean measure has held between 2.7% and 2.8% since December 2024, providing reassurance that inflation is returning to target in a sustainable manner.

[2] Appendix B describes key measures of inflation in further detail.

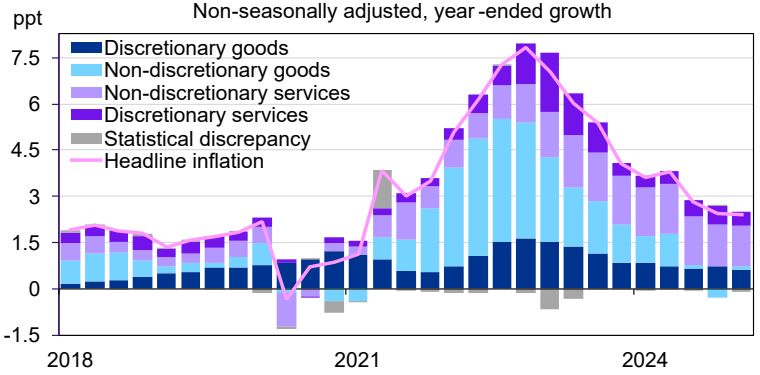
Consumer Prices: Detail

Components of Inflation, Mar 2025



Source: ABS, Haver, KPMG

Contribution to Headline Inflation



Source: KPMG, ABS, Haver

Contributors to quarterly inflation – March quarter 2025

Over the March quarter, prices rose by 0.9%. This compared to 1.0% in the corresponding period of 2024. The most significant contributors to this movement were:

- *Housing* (+1.7%), primarily driven by a 16.3% rise in *Electricity*. This was linked to reduced energy bill relief payments from both state and commonwealth governments. When excluding the impact of rebates, prices would have risen 0.4% in the quarter.
- *Education* (+5.2%), coinciding with the start of the school year.
- *Food and non-alcoholic beverages* (+1.2%), with seasonal factors reducing supply of *Fruit and vegetables*, which saw a 2.8% rise.

This was offset by:

- *Recreation and culture* (-1.6%), led by *International holiday travel and accommodation*, where prices fell 7.6% over the quarter due to lower demand following the peak December holiday period.
- *Furnishings, household equipment and services* (-0.9%), with a 5.5% fall in *Furniture* partially offset by a 2.4% rise in *Child care*.

Goods and services inflation

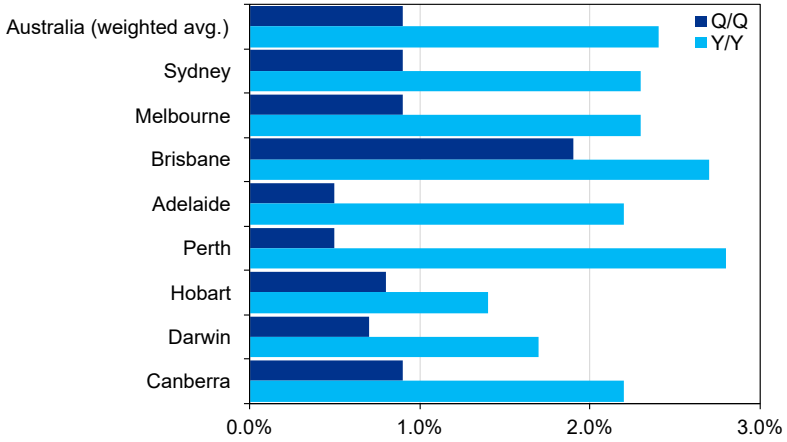
Overall, price growth for services was the primary driver of inflation in the March quarter. Annual services inflation, despite easing to 3.7% in December from 4.3% in the previous quarter, remains at elevated levels. Nevertheless, this was the lowest rate since the June quarter 2022, driven by moderating price growth for *Insurance* and *Rents*.

Annual goods inflation picked up to 1.3%, from 0.8% in the December quarter. This was mainly due to the sharp rebound in the price of *Electricity* due to the timing and impact of government rebates.

Consumer Prices: States and Territories

Headline Inflation in Capital Cities, Mar 2025

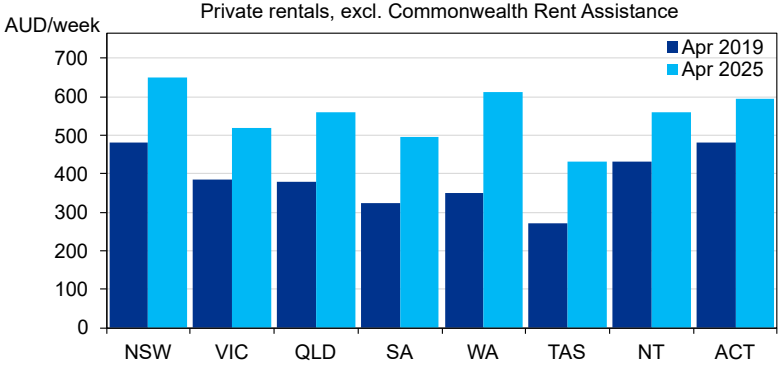
Non-seasonally adjusted



Source: ABS, Haver, KPMG

Median Weekly Rent by State and Territory

Private rentals, excl. Commonwealth Rent Assistance



Source: ABS, KPMG

Prices growth dynamics varied significantly across capital cities.

Looking at annual inflation across the capital cities, the fastest price growth was seen in Perth (+2.8%), followed by Brisbane (+2.7%). The lowest levels of inflation continued to be seen in Hobart (+1.4%) and Darwin (+1.7%).

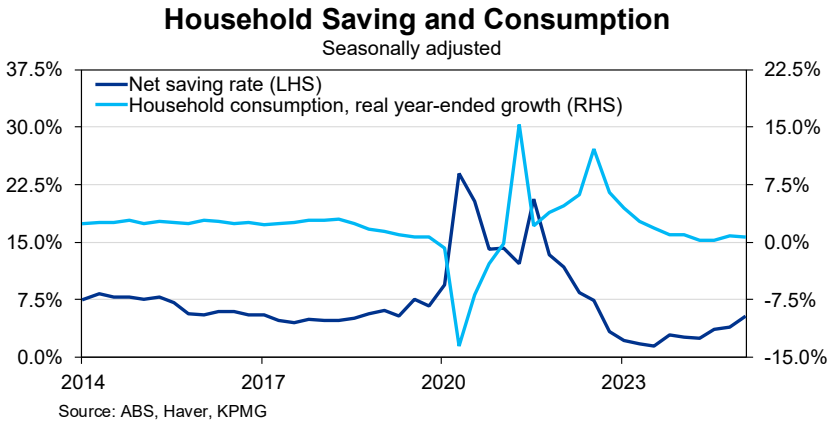
However, it must be noted that the March quarter figure for Brisbane was recorded in the context of Queensland state government electricity rebates being expended, which saw a rebound in out-of-pocket costs for households. This saw the price of *Electricity* rise by 341.4% in the March quarter compared to the December quarter in Brisbane. Other capital cities also saw notable jumps in *Electricity* over the quarter, including Sydney (+11.8%) and Melbourne (+16.2%), while Perth saw a sharp fall (-27.6%). Again, these movements can primarily be attributed to the timing of rebate payments.

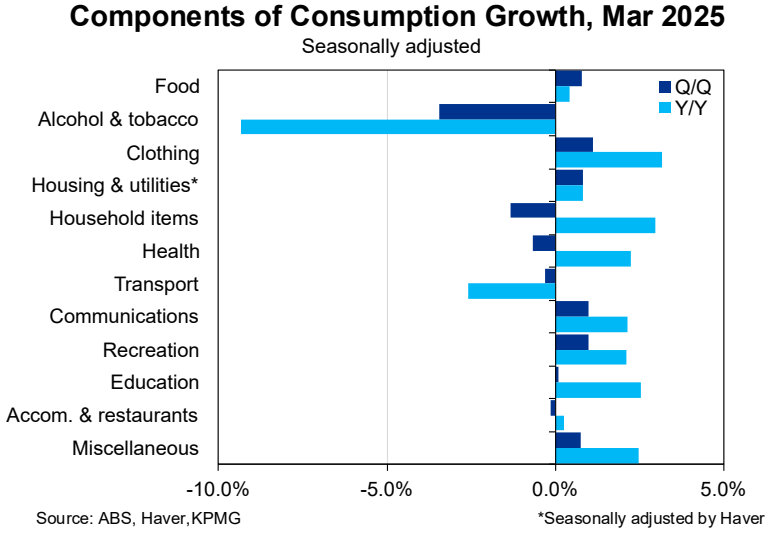
Box B: Additional insights on rental prices

Rental prices rose 5.5% through the year to the March quarter 2025, the weakest annual rise in two years. This easing growth reflects rising vacancy rates in most capital cities. Changes to Commonwealth Rent Assistance also supported this, with an additional 10% increase to the maximum rate available being introduced last September, in addition to the usual biannual indexation. Excluding these changes, rental prices in the CPI would have increased by 7.8%.

The median weekly rent was highest in New South Wales ($650 p/w), followed by Western Australia ($613 p/w) and the Australian Capital Territory ($595 p/w). The lowest median rent was seen in Tasmania ($430 p/w).

Household Consumption





Household consumption recorded modest growth in the March quarter, led by increased spending on essentials.

Consumer demand

Consumer demand lifted for a second consecutive quarter, with Household Final Consumption Expenditure increasing by 0.4% in real terms. This follows a strong December quarter which was boosted by sales events, where household spending lifted by 0.7% (revised up from 0.4%). Through the year, consumption has grown by 0.7%.

Spending on non-discretionary (essential) items lifted by 0.4%. This was led by *Electricity, gas, and other fuel* (+10.2%), due to warmer than average weather in summer, as well as reduced government energy bill relief payments. *Food* rose by 0.8%, with Queenslanders stockpiling in preparation for ex-Tropical Cyclone Alfred.

Discretionary (optional) spending increased by 0.3%, as *Recreation and culture* (+1.0%) saw strong attendance at major sporting and music events, alongside an increase in *Purchase of vehicles* (+2.5%).

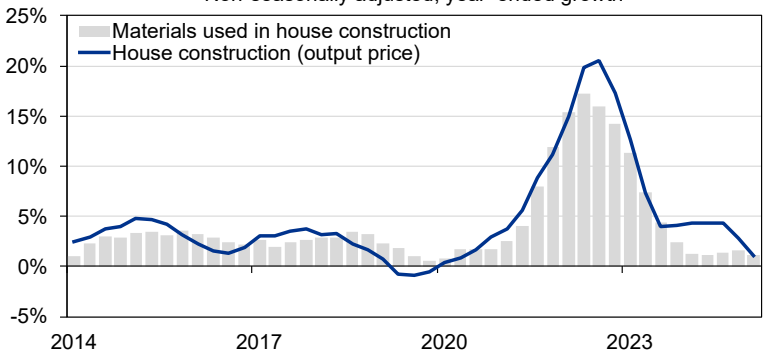
Household saving

The net saving rate jumped to 5.2%, from 3.9% in the December quarter, with gross disposable income (+2.4%) rising faster than nominal spending (+1.0%). Aside from the usual rise in compensation of employees, households also benefited from lower interest payments following the February rate cut, with interest paid on dwellings falling by 0.6%. Overall, this was the highest level of net saving since the September quarter 2023, though it is still 1.4 pts below the pre-pandemic average.

Producer Prices: Construction

Input and Output Prices for House Construction

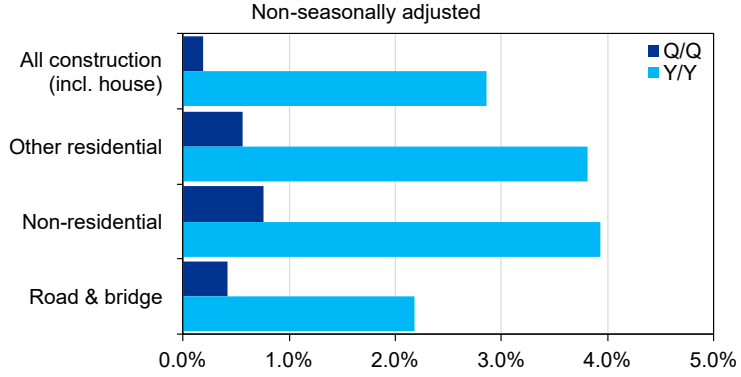
Non-seasonally adjusted, year-ended growth



Source: ABS, Haver, KPMG

Output Prices for Other Construction, Mar 2025

Non-seasonally adjusted



Source: ABS, Haver, KPMG

Ongoing labour market pressures offset falling material costs in the construction sector.

Prices for building materials used in residential house construction fell by 0.1% over the March quarter, the first decrease in 13 years. Low demand, particularly in New South Wales and Victoria, has seen significant discounting for building products such as timber and steel. Over the year, input prices were up 1.1%.

This slowdown in demand saw output prices for *House construction* fall by 0.7% over the quarter, with builders increasing discounting and promotions to entice customers, who have been deterred by high interest rates and elevated construction costs following the pandemic.

Through the year, the output price of *House construction* rose by 1.1%. This was the first time since the September quarter 2023 where the annual growth in the output price of residential building did not outpace the growth in materials costs. Recent price growth in *House construction* has mainly been driven by increased labour costs due to ongoing shortages.

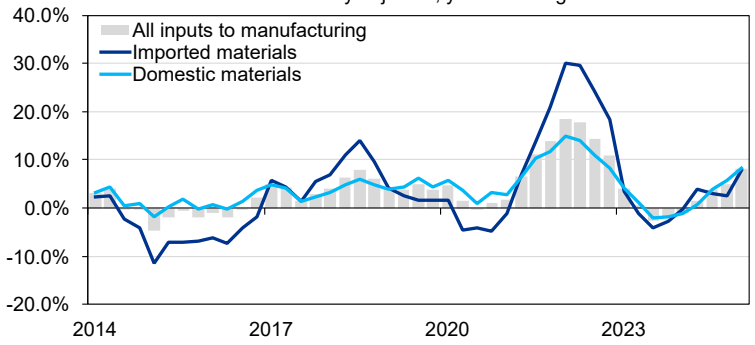
Looking at the rest of the construction sector:

- Output prices lifted by 0.6% during the March quarter for *Other residential building construction*, mainly associated with increased activity on 'build-to-rent' projects in New South Wales. Labour costs continued to experience pressure, with competing demand from non-residential and infrastructure projects.
- Similarly, *Non-residential construction* prices rose by 0.8% in the quarter, supported by demand for government projects for education, health, and infrastructure.

Producer Prices: Manufacturing

Input Prices for Manufacturing

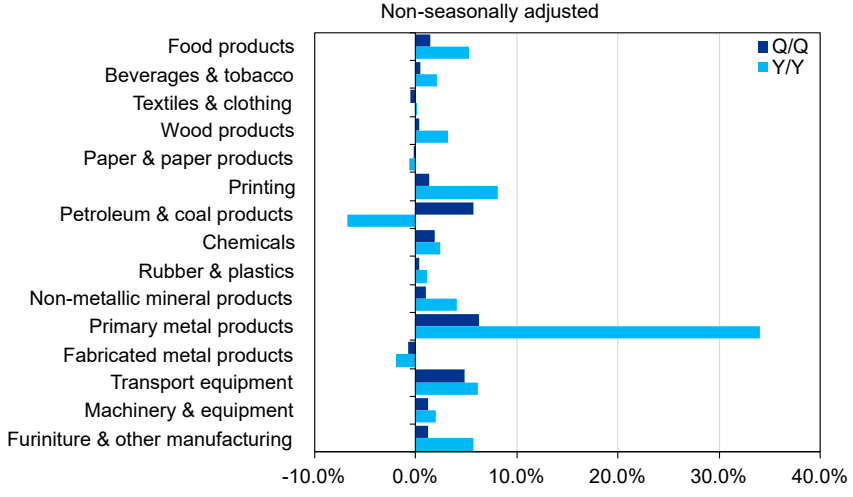
Non-seasonally adjusted, year-ended growth



Source: ABS, Haver, KPMG

Output Prices of Manufacturing, Mar 2025

Non-seasonally adjusted



Source: ABS, Haver, KPMG

Movements in global commodity demand lift manufacturing prices.

Input costs to manufacturing rose by 3.9% over the March quarter, to be up 8.2% through the year. On an annual basis, prices for imported materials were up by 7.7%, while the cost of domestic materials rose by 8.3%. The main factors behind this quarterly rise were:

- *Metal ore mining* (+8.5%), with geopolitical uncertainty continuing to sustain strong demand for gold.
- *Agriculture to manufacturing* (+4.5%), with strong export demand for beef coinciding with limited supply of cattle.
- The depreciation of the Australian dollar, in addition to tightening supply, saw *Oil and gas extraction to manufacturing* (+3.4%) rise. However, this follows four consecutive quarterly falls.

There were no notable price decreases elsewhere to offset these cost increases.

Consequently, output prices for products produced by manufacturing industries lifted by 2.5% in the March quarter, to be up 7.4% over the year. Adding to the quarterly growth were:

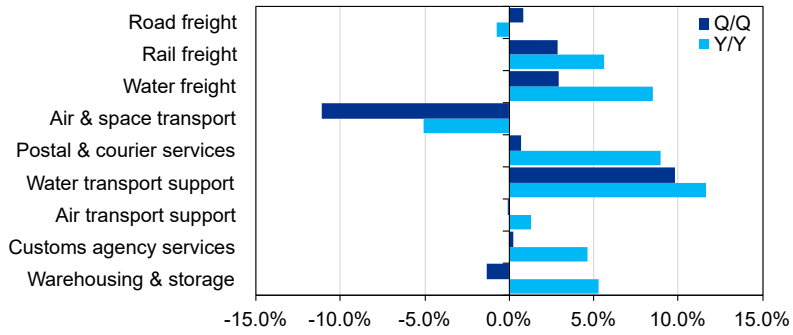
- *Basic non-ferrous metal manufacturing* (+7.4%), supported by strong demand for gold and aluminium.
- A rebound in unleaded and diesel fuel prices, which had been in decline, lifted *Petroleum and coal product manufacturing* (-5.7%).
- Shortages in the US, alongside a weaker Australian dollar, supported export demand for beef. Consequently, *Meat product manufacturing* (+3.5%) experienced a rise.

Again, there were no significant price decreases this quarter to offset some of these rises.

Producer Prices: Transport and Business Services

Output Prices for Transport Services, Mar 2025

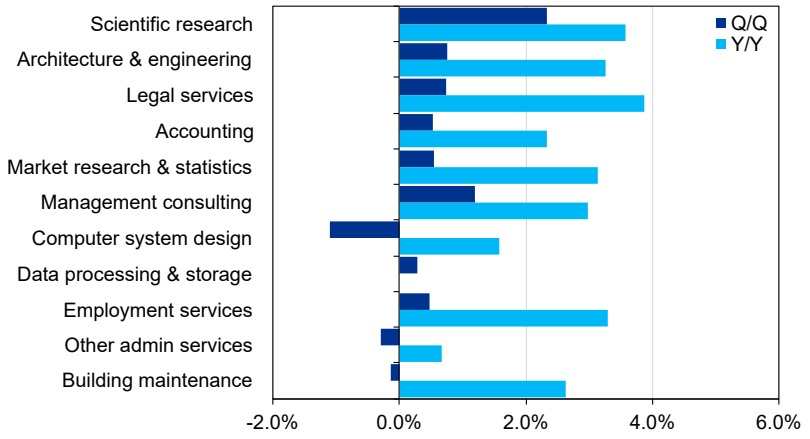
Non-seasonally adjusted



Source: ABS, Haver, KPMG

Output Prices for Business Services, Mar 2025

Non-seasonally adjusted



Source: ABS, Haver, KPMG

Annual port charges and rising input costs have placed upward pressure on prices across the transport sector.

Looking at the logistics sector, annual increases to port fees and charges for vessels saw output prices for *Water transport support services* rise by 9.8% over the March quarter, to be up 11.6% through the year.

Similarly, annual price rises in *Road freight transport* also contributed to a 0.8% quarterly rise, in addition to rising labour costs and a rebound in diesel fuel prices. However, output prices are still down 0.7% through the year, owing to a longer-term decline in global oil prices. Rising labour and fuel costs also pushed up output prices for *Rail freight transport* by 2.9% in the March quarter, contributing to an annual rise of 5.6%.

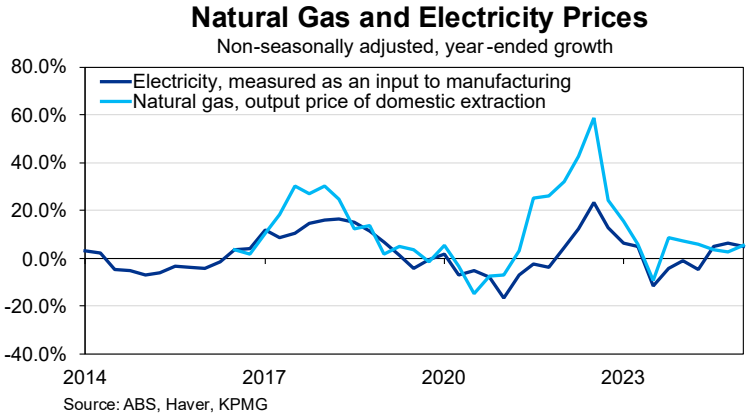
These increases were offset by *Air and space transport*, which fell 11.1% in the quarter with weaker demand following the peak December holiday period. Over the year, prices have fallen by 5.1%.

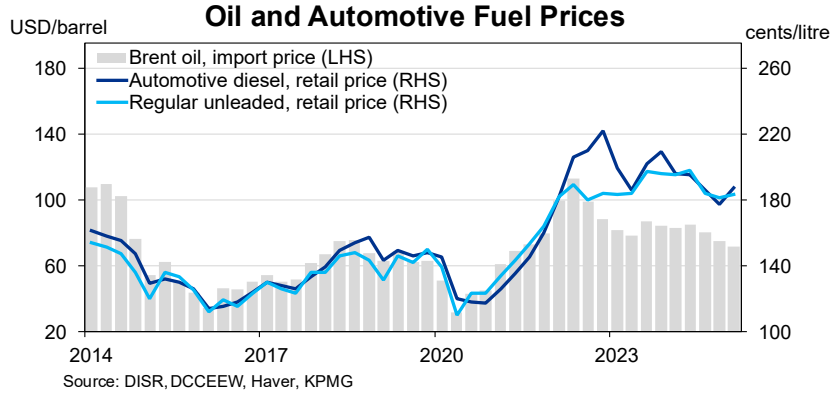
Price movements for business services were mixed, reflecting a variety of operating conditions.

Looking across the various business services, the most significant price rises were seen in *Scientific research*, up 2.3% over the quarter and corresponding to a 3.6% annual rise. This was followed by *Management consulting*, with a 1.2% quarterly increase to be up 3.0% through the year.

Meanwhile, quarterly price decreases were seen in *Computer system design* (-1.1%), *Other administrative services* (-0.3%), and *Building maintenance* (-0.1%).

Energy Prices





Weakened international conditions have driven a moderation in global energy price growth.

Natural gas (extracted for domestic use)

The price received for domestic gas extraction rose by 3.1% in the March quarter, following a 2.2% decrease in the period prior. Price rises were seen in both short-term contracts (linked to dated Brent oil) and long-term contracts (linked to the Consumer Price Index). This was led by a 3.6% rise in the east coast market, with the west coast market recording a 1.1% rise.

Through the year, domestic gas extraction prices rose by 5.2%, comprising a 5.7% increase in the east coast market and a 2.7% rise in the west coast market.

Electricity (as an input to domestic manufacturing)

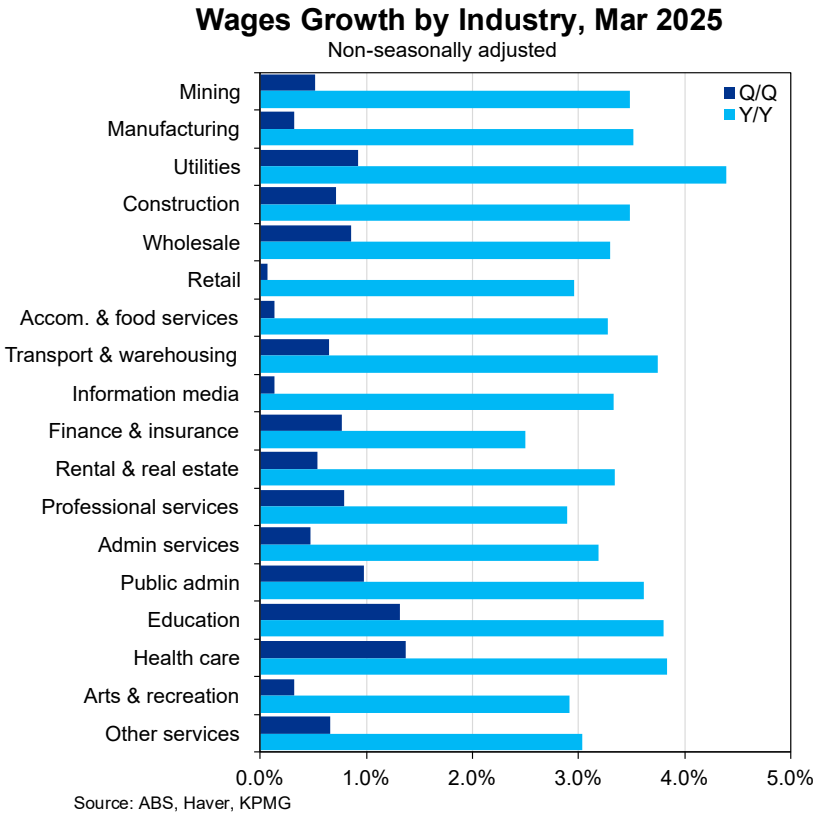
Prices for electricity (measured as an input to manufacturing) rose by 0.9% in the March quarter, to be up 4.9% through the year. Although 7.1% higher compared to the recent trough in the December quarter 2023, prices are still 6.9% lower than the peak which was seen in the September quarter 2022.

Oil and automotive fuel

Global oil prices continue to trend downwards, in line with a weakened economic outlook following US tariff announcements. The import price of Brent crude oil fell to an average of US$71.8/barrel in the March quarter (preliminary estimate), from US$74.7/barrel in the December quarter. This is a price level not seen since the June quarter 2021.

The average price for regular unleaded (91 RON) in the March quarter was 183 cents/litre. This represents a 1.1% rise compared to the December quarter, but is still down 6.2% through the year, and falls short of the peak seen in the June quarter 2024 of 198 cents/litre.

Wage Prices



Source: ABS, Haver, KPMG

According to the latest data, annual wage growth accelerated for the first time since the June quarter 2024.

Quarterly WPI release – March quarter 2025

Figures from the March quarter release of the Wage Price Index show that annual wages growth rebounded to 3.4%, compared to 3.2% in the previous quarter. Nevertheless, this is still slower than the 4.0% growth recorded for the corresponding period a year ago. Over the quarter, wages lifted by 0.9%.

Annual wages growth in the private sector held steady at 3.3%, maintaining its slowest pace of growth since the June quarter 2022. By contrast, wages growth in the public sector lifted back to 3.6%, from 2.9% in the December quarter, though this figure is still in line with other recent data points. Nevertheless, this was just the third time in four years where wages growth in the public sector has outpaced the private sector.

Over the March quarter, wage rises in the private sector were influenced by administrative adjustments associated with the Stage 3 Aged Care Work Value Case, and the Early Childhood Education and Care Worker Retention Payment. In the public sector, wages growth was affected by state government enterprise agreements, as well as increases paid to workers in aged care.

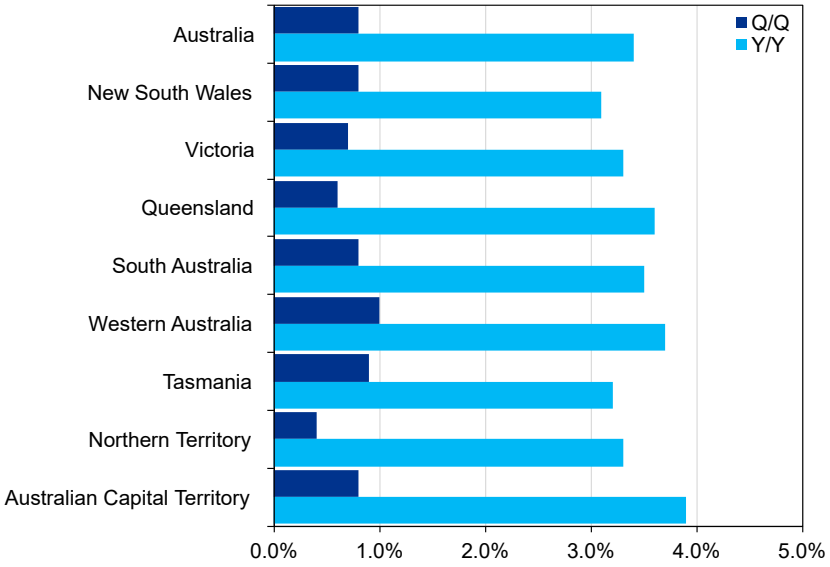
Consequently, quarterly wages growth was fastest in *Health care and social assistance* (+1.4%), followed by *Education and training* (+1.3%), and *Public administration and safety* (+1.0%).

When factoring the relative size of industries, *Health care and social assistance* (+0.20 pts) remained the most significant contributor to the quarterly wage movement. This was followed by *Education and training* (+0.12 pts), and *Professional, scientific and technical services* (+0.09 pts).

Wage Prices (cont.)

Wages Growth by State and Territory, Mar 2025

Non-seasonally adjusted



Source: ABS, Haver, KPMG

Across the states and territories, annual wages growth was fastest in the Australian Capital Territory (+3.9%), Western Australia (+3.7%) and Queensland (+3.6%). The weakest growth was seen in New South Wales (+3.1%) and Tasmania (+3.2%).

Real wages and productivity

With headline inflation holding steady and nominal wages growth rising, real wages growth has accelerated. Through the year to March, real wages lifted by 1.0%, recording its sixth consecutive quarter of growth following a prolonged period of decline between 2021 to 2023. This was the strongest rise since the March quarter 2019.

Looking ahead, it is crucial that productivity growth recovers to keep up with this rise in real wages. If current trends continue, there is the risk for labour cost pressures to reignite inflationary risks in the economy.

Box C: Fair Work Commission minimum wage decision

This is particularly important as the Fair Work Commission has determined that the minimum wage is to rise by 3.5% from 1 July 2025, a touch below the increase last year of 3.75%. This will directly affect workers on award wages, who represented 23.2% of the workforce according to the latest estimates for May 2023. These workers tend to be concentrated in lower-paid, part-time or casual roles, with the largest groups seen in *Health care and social assistance*, *Accommodation and food services*, and *Retail trade*.

It is important to note that beyond its direct effects, this news can have broad impacts on the labour market; for example, through other enterprise agreements which are linked to this decision. This change in labour market conditions can also indirectly affect the size and timing of increases paid to those under individual agreements, as employers undertake wage and salary reviews.

04
Appendices

Appendix A: KPMG Inflation Pressure Gauge

KPMG has developed a methodology to decompose headline inflation in Australia that allows us to identify how much of inflation is being driven by demand-side and supply-side factors.

Broadly, inflation can be categorised into two primary drivers. Demand-pull inflation occurs when aggregate demand in an economy exceeds its productive capacity, while cost-push inflation arises when production costs, such as labour or raw material prices, rise and are passed on to consumers in the form of higher prices.

Understanding these underlying forces serves as a useful guide for the conduct of monetary policy. When inflation is driven by excess demand, central banks can raise interest rates to reduce consumer spending, business investment, and borrowing, thereby cooling the economy and bringing inflation back to target. Conversely, when inflation is driven by supply-side factors, interest rate adjustments may have a more limited effect on controlling prices, since the underlying problem is not excessive demand but rather constrained supply.

This analysis is derived using Consumer Price Index data combined with information from the National Accounts, Construction Activity and Overseas Arrivals and Departures, and follows similar methodologies associated with decomposing the drivers of headline inflation undertaken by the San Francisco Federal Reserve, Reserve Bank of Australia, and Norges Bank.[a,b,c]

The methodology is based on the idea that:

- Demand-driven categories are identified as those where unexpected changes in price move in the same direction as changes in quantity. Using a positive demand shock as an example, when consumers have increased willingness to make purchases, then *both* prices and quantities should now be higher than expectations.
- Supply-driven categories are identified as those where unexpected changes in price and quantity move in opposite directions. For instance, in a negative supply shock where producers experience constraints on their ability to supply, prices should be higher than expected while quantities should be less than expectations.

The contributions to inflation can then be developed by extracting the unexpected component of the quarterly changes in price and quantity for each of the expenditure category. However, it is also important to acknowledge some limitations of the classification methodology, which include:

- Both demand and supply shocks can be present at the same time, so this approach identifies which is more dominant (which depends on the size of the shock and the sensitivity of demand and supply to price movements). Substitution between goods and services can also make it challenging to identify the root cause of inflation.[d]
- It is challenging to identify global spillover effects. As an example, a surge in demand overseas may reduce supply to Australia and would therefore be classified as a supply shock.

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[a] See the original paper for further details. A. Shapiro, Decomposing Supply and Demand Driven Inflation, Federal Reserve Bank of San Francisco, 13 February 2024

[b] Evaluates this approach in the Australian context. B. Beckers et al, Estimating the Relative Contributions of Supply and Demand Drivers to Inflation in Australia, RBA Bulletin, June 2023

[c] In line with Section 6, the data is demeaned before estimation. D. Bergholt et al, What drives the recent surge in inflation? The historical decomposition roller coaster, Norges Bank, April 2024

[d] For instance, suppose poor weather causes a decrease in the supply of apples – the price of apples would go up, and be recorded as supply pressure. If consumers substitute with pears, the price of pears will go up due to higher demand. Therefore, the substitution effect attributes some inflationary pressures to be demand-driven, but the root cause is a supply shock.

Appendix B: Measures of Inflation

Key inflationary measures in the economy include the Producer Price Index (PPI), the Consumer Price Index (CPI), and the Wage Price Index (WPI).

Producer prices

The PPI is a measure of inflation from the perspective of producers. It measures prices as they enter (input costs) or exit (output costs) the production process.

A key output of the PPI is called *Final demand,* which measures the price changes of products consumed with no further processing. For example, sugar cane is a preliminary product and used as an input into the production of raw sugar (an intermediate good). In turn, raw sugar is then used to produce refined sugar, which is destined for final consumption.

As the PPI generally excludes distribution costs, taxes and subsidies, it can provide a better picture of the underlying costs of items. It also contains detailed input costs and output costs for specific industries, including construction, manufacturing, mining and services.

Overall, the PPI is seen as a good pre-indicator of inflationary pressures as it measures the costs of producing consumer goods, and commodity and food prices which tend to flow through to retail pricing.

Consumer prices

The CPI focuses on a basket of goods and services consumers have bought in each of the capital cities. It tends to be the key inflationary indicator for the conduct of monetary policy in Australia as the Reserve Bank of Australia aims to keep consumer price inflation between 2% and 3%.

The CPI covers 87 ‘expenditure classes’, which are a collection of like items. They are arranged into 11 broad categories as follows:

- *Food and non-alcoholic beverages*
- *Alcohol and tobacco*
- *Clothing and footwear*
- *Housing*
- *Furnishings, household equipment and services*
- *Health*
- *Transport*
- *Communication*
- *Recreation and culture*
- *Education*
- *Insurance and financial services*.

Wage prices

The WPI measures the changes in wages and salaries paid by employers for a unit of labour (i.e. one hour) over time that arise from market factors. Wage inflation affects the cost of labour for businesses, who can pass on these costs to consumers.

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