



Surging inflation means interest rates could rise next week, as cost of living jumps most since GST

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Consumer prices have surged by the most in more than 20 years, with the cost of living up 5.1 per cent over the past year. The last time inflation was this high was in June 2001, when prices rose 6.1 per cent largely from the effect of the recently introduced 10 per cent Goods and Services Tax. You have to go back to December 1995 to find an equally high reading (5.1 per cent) that was not affected by the GST introduction.

Australian consumer prices jumped 2.1 per cent in just the first quarter of this year, according to the latest data from the Bureau of Statistics (ABS).

Critically, the Reserve Bank's preferred measure of inflation, which strips out the most extreme price moves, came in at 3.7 per cent, which is well above its 2-3 per cent target and adds to pressure for interest rates to start rising as soon as next week.

This was the highest annual level of so-called underlying inflation since March 2009, just before the Reserve Bank started its last cycle of interest rate increases between October 2009 and November 2010.

Which prices increased most?

The ABS said the biggest contributors to the 2.1 per cent price increase over the quarter were a 5.7 per cent surge in building costs for new homes, an 11 per cent jump in fuel prices and a 6.3 per cent increase in tertiary education fees.

The rise in new dwelling prices came from a combination of rising building material and labour costs in the construction sector, and the wind-down of the government's HomeBuilder subsidy that had previously been shielding customers from that increase in costs.

Fuel prices rose for the seventh consecutive quarter, with the biggest annual increase since 1990. Petrol prices have eased slightly in the current quarter due to a temporary six-month halving of the government's fuel excise, saving motorists about 22 cents a litre.

Food prices also rose substantially, which the ABS said was due to a combination of rising transport, fertiliser, packaging and ingredient costs as well as COVID disruptions and restocking of animals amid favourable weather. The biggest contributors to a 2.8 per cent quarterly jump in food prices were vegetables (up 6.6 per cent), soft drinks and juices (up 5.6 per cent), fruit (up 4.9 per cent) and beef (up 7.6 per cent). Overall, grocery prices surged 4 per cent over the first three months of the year, with state government 'Dine and discover' type vouchers resulting in smaller price rises for restaurants and takeaway food.





Many other grocery items, such as toilet paper and paper towels, also recorded steep price increases over the quarter.

While the surging cost of goods (up 6.6 per cent) drove most of the price increases over the past year, the cost of services also rose 3 per cent, which will be of some concern to the RBA as it indicates strong domestic price pressures and not just supply bottlenecks.

Source: <https://www.abc.net.au/news/2022-04-27/cost-of-living-surge-inflation-interest-rates/101018200>

ACTIVITIES:

1. Define the Reserve Bank's target range for inflation.
2. Outline the main contributors to the increase in the CPI in Australia in the March 2022 quarter.
3. Define underlying inflation and outline why this is the RBA's preferred measure.
4. Explain why the RBA might commence its next cycle of interest rate increases in response to the rise in inflation over recent quarters.
5. Explain the impact of 'surging inflation' on the following:
 - a. The level of savings
 - b. Business investment
 - c. Australia's international competitiveness
 - d. The exchange rate (the Australian Dollar)
 - e. The distribution of income in an economy





Teacher Notes

Purpose

This 'bite' aims to examine the impact of rising inflation on the Australian economy. It presents the concept and measurement of inflation, the main sources of inflation and asks students to examine both the impact and policy options to combat inflationary pressures.

Prior knowledge

From the Year 11 Economics ATAR Syllabus

Knowledge and Understanding

- the concept, and measurement, of inflation
- the distinction between headline and underlying inflation
- the costs of inflation and the benefits of low inflation

From the Year 12 Economics ATAR Syllabus

Knowledge and Understanding

- factors affecting each of the components of aggregate expenditure
- the economic objectives of the Australian Government, including sustainable economic growth, low inflation (price stability), low unemployment (full employment), a more equitable distribution of income, the efficient allocation of resources
- the economic policy objectives of the Reserve Bank of Australia (RBA)
- circumstances under which the RBA may change the cash rate

