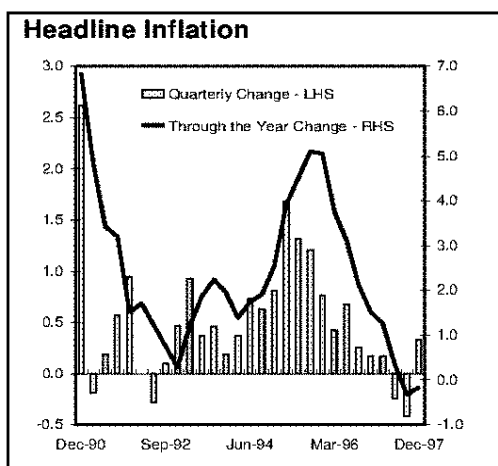


# Data Flash

## CONSUMER PRICE INDEX - DECEMBER QUARTER 1997



### Headlines:

	Dec	Sep
Headline CPI q/q	0.3%	-0.4%
Headline CPI y/y	-0.2%	-0.3%
Treasury Underlying Inflation q/q	0.3%	0.3%
Treasury Underlying Inflation y/y	1.4%	1.5%

- The headline CPI increased by 0.3% over the December quarter, bringing the year ended inflation rate to -0.2%
- The Treasury underlying rate increased by 0.3% over the December quarter, seeing the year ended underlying inflation rate drop to 1.4%.
- Mortgage interest charges continue to underpin moderate CPI outcomes, contributing -26.1% to the 0.2% annual decrease in the headline CPI

### Comment:

*We are confident that the low in inflation for the current cycle has now been seen.*

The surprise of today's release was that the underlying rate has now departed further from the RBA's target range for the business cycle. Whilst three to six months ago, this would be seen as heralding another monetary easing, circumstances have changed considerably since then. *The Asian induced depreciation of the AUD, the strength of domestic demand and the magnitude of increases in the upstream price indicators to date do not point to as benign inflation outcomes over 1998.*

The upstream price indicators point to a gradual acceleration in inflation over 1998, and we expect the underlying rate to approach 2.6% by year end. Given that the RBA rhetoric has changed towards suggesting a 2.0%-2.5% range, an outcome of this magnitude does raise the possibility of a monetary tightening late in 1998. We are still inclined to view 1998 as a year in which monetary policy will be on hold.

Key to this scenario will be the continuing behaviour of AUD-USD. Just as the large improvement in inflation over 1997 was due to the strength of the exchange rate in late 1996, much of the deterioration in inflation performance over 1998 will be due to the weakness of the exchange rate in late 1997 and early 1998. The longer AUD-USD stays weak, the greater that deterioration will be.

### Market Impact:

The Australian dollar continued to enjoy more positive sentiment in overnight trading and into today's inflation report. The lower than expected outturn on the underlying figure saw some slight losses for the Australian currency unit, which pre-data was trading at 0.6769, softening to 0.6755 immediately after the release.

Bond prices were higher although the move was limited to a few basis points. Whilst the year ended inflation rate has now moved further below the RBA's target zone, we are inclined to view this result as keeping monetary policy on hold for longer.

