7 Product and consumer prices

The shift in the terms of trade affected prosperity and its distribution in another way.

## A wedge between product and consumer prices

Ordinarily, movements in the prices of goods and services produced in Australia are closely aligned with movements in the prices of the goods and services that Australians consume. Movements in the GDP implicit price deflator, representing product prices, and the CPI, representing consumer prices, were closely aligned from 1959-60 to the end of the 20th century (figure 7.1).

Figure 7.1 Product and consumer pricesa, 1959-60 to 2011-12

indexes, 1999-00=100

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| Product and consumer prices, 1959-60 to 2011-12. This figure shows that, while product and consumer prices moved together over the 4 decade from the 1960s to the 1990s, product prices grew faster than consumer prices in the 2000s. |

a GDP implicit price deflator and price deflator for households’ final consumption expenditure.

*Data sources*: ABS (Cat. no. 5204.0); author estimates.

However, product prices rose faster than consumer prices in the first decade of the 2000s. The GDP deflator rose by an annual average of 3.7 per cent, whereas consumer prices rose 2.8 per cent a year on average. The two price series departed after 2002-03, as the terms of trade took off.

The rise in product prices in the 12-industry market sector in the 2000s was quite similar to the rise for the economy as a whole (figure 7.2).[[1]](#footnote-1) According to these estimates, however, the market sector experienced a stronger fall in prices in 2009-10, in the aftermath of the global financial crisis.[[2]](#footnote-2)

Figure 7.2 GDP deflator, market sector prices and the CPI, 1990s and 2000s

indexes, 1999-00=100

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| GDP deflator, market sector prices and the CPI, 1990s and 2000s.This figure shows that market-sector product prices and the implicit GDP deflator moved closely together over the two decades, although there was a little less growth in market-sector prices in the 1990s. |

*Data sources*: ABS (Cat. no. 5204.0); author estimates.

The wedge between movements in product prices and consumer prices was a manifestation of the shift in the terms of trade. Higher export prices, especially for minerals, fuelled strong growth in product prices, as was demonstrated in the previous chapter. However, these would have had little direct effect on domestic consumer prices. Import prices, on the other hand, fell with exchange rate appreciation and lower supply prices for many goods on world markets. Lower import prices helped to keep domestic consumer prices in check.

## A wedge between real consumption wages and real product wages

The wedge between consumer and product prices meant that there was also a wedge between real wages as a cost to producers and real wages as income to labour. While product prices are relevant to producers in determining the real cost of employing labour, consumer prices are relevant to workers in determining the real value of their incomes as wherewithal to purchase goods and services.[[3]](#footnote-3) The nominal wage deflated by an index of consumer prices is referred to as the real consumption wage (RCW).

Whereas real product wage (RPW) growth fell behind labour productivity growth in the 2000s, RCW growth roughly kept pace with productivity growth (figure 7.3). Over the decade, labour productivity (LP) grew at 2.1 per cent a year on average and the RCW grew at 2.0 per cent a year. RPW, on the other hand, only grew at 1.1 per cent a year (table 7.1).

RCW growth and RPW growth diverged after 2003-04, once the terms of trade had started to rise (right panel of figure 7.3).

The implication is that the consumption gain to workers — the increased purchasing power of their incomes — ‘compensated’ in a sense for the lower share of income growth from production (at producer prices) in the 2000s. The labour share of income from production fell over the 2000s as growth in the RPW fell behind LP growth. However, growth in RCW kept up with LP growth over the course of the decade.

It is important to note, from a general living standards point of view, that this consumption gain was available to all residents and for all sources of income.

Figure 7.3 Cumulative growth in labour productivity (LP), the real product wage (RPW) and the real consumption wage (RCW), 1990s and 2000s

per cent

|  |  |
| --- | --- |
| *1990s* | *2000s* |
| Cumulative growth in labour productivity (LP), the real product wage (RPW) and the real consumption wage (RCW), 1990s and 2000s. This figure shows that LP and the RPW grew in close alignment in the 1990s, with less growth in RCW. In the 2000s, Grwoth in LP and RCW were closely aligned, with less growth in RPW | Cumulative growth in labour productivity (LP), the real product wage (RPW) and the real consumption wage (RCW), 1990s and 2000s. This figure shows that LP and the RPW grew in close alignment in the 1990s, with less growth in RCW. In the 2000s, Grwoth in LP and RCW were closely aligned, with less growth in RPW |

*Data source*: Author’s estimates based on ABS (Cat. no. 5204.0; Cat. no. 5260.0550.02).

Table 7.1 Growth in productivity, prices and real wages

per cent per year

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| --- | --- | --- | --- |
| Growth in | 1990s | 2000s | 2002-03 to 2011-12 |
| Labour productivity | 2.9 | 2.1 | 1.8 |
| Product prices | 1.6 | 3.7 | 3.8 |
| Consumer prices | 2.3 | 2.8 | 2.5 |
| Real Product Wage (RPW) | 2.1 | 1.1 | 1.4 |
| Real Consumption Wage (RCW) | 1.5 | 2.0 | 2.6 |

*Source*: Author’s estimates based on ABS (Cat. no. 5204.0; Cat. no. 5260.0550.02).

### The 1990s

There was also a wedge between producer and consumer prices in the 1990s. It was, however, smaller in size and opposite in direction. Consumer prices rose more than producer prices. The left-hand panel in figure 7.3 shows that the RCW grew less than the RPW over the 1990s.

Timing, however, played a more precise role. It appears that the divergence in the real product and real consumption wages arose in the early 1990s recession. From 1992-93, however, they ran in close parallel. A fall in the terms of trade in the early 1990s was associated with an exchange rate depreciation, which in turn was likely influenced by the weakness of the domestic economy during the recession.

Labour productivity, the RCW and the RPW moved closely together (in parallel in figure 7.3) from 1994-95. This was the period of strong productivity growth in the 1990s, outside of the recession and with relatively stable terms of trade.

## Key point summary

* The terms of trade drove a wedge between growth in product prices and consumer prices in the 2000s.
* Higher commodity export prices meant there was more growth in product prices than in consumer prices, which were also held in check by cheaper imports.
* This in turn drove a wedge between growth in the RPW (based on product prices) and the RCW (based on consumption prices).
* There was stronger growth in the RCW than in the RPW.
* While growth in the RPW fell behind growth in labour productivity, growth in the RCW did not.
* Both labour productivity and the RCW grew at an average rate of around 2 per cent a year, whereas the RPW grew at half that rate.
* One way to interpret this is to say that, while labour received a lower share of the income generated, the real value of the income received increased. These effects were offsetting.
* However, the increased value of income was not confined to labour income. It applied to all forms of income.

1. Market sector prices are implicit prices formed from the ratio of current-price to chain-volume gross value added. [↑](#footnote-ref-1)
2. The departure of market sector prices from the GDP deflator in the 1990s is of passing interest. There was much less rise in market sector prices from 1993-94 until the end of the decade. The market sector was the source of strong productivity gains over this period and the smaller rise in MS12 prices suggests that many of the productivity gains were passed on in the form of lower output prices than would otherwise be the case. This supports the conclusion of Parham et al. (2000). [↑](#footnote-ref-2)
3. There is a further wedge between wages as a cost and wages as income and that is the on-costs that add further costs of employing labour beyond the wage payments received by workers. On-costs have not changed a lot as a proportion of total labour costs over the two decades. [↑](#footnote-ref-3)