

Ai GROUP ECONOMICS WEEKLY

Week in Review: 18 October to 22 October 2010

- **The Australian Industry Group/Australian Constructors Association (ACA) Construction Outlook Survey** revealed that after rising by a subdued 1.5% in 2009/10 (current prices), the total value of non-residential building work (engineering and commercial construction) is forecast to lift by 5.9% in 2010/11 and by 7.9% in 2011/12. Underlying this improving outlook is the strong pipeline of work in resource-based construction and the significant infrastructure spending plans of Federal and State Governments.
- The minutes of the October **Reserve Bank of Australia Board meeting** revealed that the RBA retains its positive view on the medium term outlook for the domestic economy, with stronger business investment over the next few years expected to offset the scaling back in public investment. The Board indicated that interest rates would need to rise at some point due to an expected tightening in resource utilisation and a subsequent strengthening of inflation pressures. However, the Board noted that the case to wait before tightening monetary policy was that the economy *“was still expected to continue growing at trend in the near term, credit growth had softened somewhat and the rise in the exchange rate would, if it continued, effectively be tightening financial conditions at the margin. Moreover, it was still possible that downside risks to global growth could materialise”*. The Board assessed that these arguments were finely balanced and therefore concluded that *“it would be appropriate to hold the cash rate steady for the time being, pending evaluation of further information at the next meeting”*.
- The **Department of Education, Employment and Workplace Relations Vacancy Report** released on Wednesday revealed only a slight easing in the demand for labour with the skilled vacancy index declining by 0.5% in September 2010 to 45.1. However, at this level the index was 10.3% higher than a year ago.
- The **Westpac-Melbourne Institute Leading Index** (which indicates the likely pace of economic activity three to nine months into the future) registered an annualised growth rate of 5.3% in August 2010. Although this was well above its long term trend of 3.1% it was the fifth consecutive month that the growth of the Index has slowed. However, given that the growth rate of the Index is still high, Westpac has retained its forecast of 3.5% economic growth in 2010 (slightly above trend which is assessed at 3.25%). In 2011, Westpac expects year average growth of 4.0%. This is in line with the Reserve Bank’s current forecast for growth in 2011.
- **ABS International Merchandise Imports** data revealed that imports increased by a seasonally adjusted 2% in September 2010 to \$17.7 billion following a 6.5% decline in the previous month. Capital goods fell by \$167m (4%) and consumption goods fell by \$1m.
- **ABS data on International Trade Prices** for the September quarter 2010 showed that export prices rose strongly by 7.8% while import prices edged up by 0.7%, giving a solid terms of trade (export prices over import prices) gain of 7.1%. There was only a minor offset from the 2.6% quarterly AUD/USD rise. By commodity class, the increase in export prices was driven by strong rises in chemicals (+19.1%); coal (+17.4%); gas (+15.6%); and metalliferous ores and metal scrap (+14.6%). The rise in import prices was led by iron and steel (+9.9%) and inorganic chemicals (+18.3%).

How this affects you

The latest update on the outlook for the non-residential construction industry identifies the two speed split in the outlook for major project investment demand in Australia with resources and infrastructure (engineering construction) expected to be strong, while private commercial construction is forecast to remain subdued. The projected upturn in engineering construction reflects the strong pipeline of work in the mining, oil and gas processing and transport infrastructure sectors. Solid support is also expected from telecommunications, power generation and water supply projects. Nevertheless, the strong projected increase in resources and infrastructure investment is expected to be pushing up against capacity constraints in 2011 and 2012, and as has been noted by the RBA this is likely to have an inflationary impact. This was a clear theme emerging from the Ai Group/ACA Construction Outlook survey. Respondent companies reported worsening skill shortage bottlenecks and increased pressures in the procurement of building materials and equipment, resulting in upward pressure on input costs. There is also the risk that the scale of the proposed investment in the resources sector will inhibit a broader increase in investment as it outbids other industries for labour and capital. The RBA will remain focused on the impact this will have on inflation, particularly wages, but also the prices of other business inputs which can flow through into general consumer prices.

Latest data*

Official cash rate	4.50 per cent -
AUD/USD exchange rate	\$0.9905 ▲
Oil price	USD 81.12 per bbl ▼
Annual growth in GDP	3.3 per cent -
Unemployment rate (%)	5.1 per cent -
Annual growth in headline CPI	3.1 per cent -
Copper price	AUD 8,457.51 ▲
Australian PMI® (September)	47.3 -
Australian PSI® (September)	45.6 -
Australian PCI® (September)	40.8 -

Week in Preview: 25 October – 29 October 2010

- On Monday, the ABS will release data on **Producer Price Indexes** for the September quarter 2010. This will be followed on Wednesday with the latest data on the rate of inflation in Australia, with the ABS releasing the **Consumer Price Index** for the September quarter 2010.
- Data for September on total credit provided to the private sector by financial intermediaries will be made available on Friday with the release of the latest RBA **Financial Aggregates** publication.

* Arrows represent directional movement relative to previous week's issue.