# Ai GROUP ECONOMICS WEEKLY

## **Week in Review:** 1 November – 5 November 2010

- The manufacturing industry remained subdued in October with Ai Group's Australian Performance of Manufacturing Index **(Australian PMI®)** registering 49.4 (readings below 50 indicate a contraction in activity). However, the latest reading was 2.4 points above September's 47.3 to indicate a moderation in the pace of decline during the month. The Australian Performance of Services Index **(Australian PSI®)** increased by 5.1 points to 50.7, while the Australian Performance of Construction Index **(Australian PCI®)** rose by 3.2 points to 44.0, to indicate a less marked rate of decline than in the previous month. (*http://www.aigroup.com.au/economicindicators*)

- On Tuesday, the **Reserve Bank Board** decided to raise the official cash rate by 25 basis points to 4.75 per cent. The RBA expects that private expenditure, particularly business investment, will strengthen in the year ahead and lead to a pick-up in inflationary pressures. On this basis, and given the relatively modest levels of spare capacity in the economy, the Bank concluded that *"the balance of risks had shifted to a point where an early, modest tightening of monetary policy was prudent."*

- The ABS **Building Approvals** data showed a 6.6% seasonally adjusted fall in the number of dwelling units approved in September following a 4.8% decline in the previous month. A 15.7% decline in the more volatile "other dwellings" segment (which includes apartments, townhouse and units) was the main driver of the fall in total building approvals. Private sector house approvals fell by 2.3%. In annual terms, dwelling approvals contracted for the first time since July 2009, falling by 11.6% in the year to September.

- ABS data on **Retail Trade** showed that retail sales remained subdued in September 2010 with the seasonally adjusted value of retail turnover rising by a modest 0.3% following an identical rise in August. Annual growth in retail turnover edged up slightly from 3.8% in August to 3.9% in September. The soft retail sales data reflects the impact of ongoing consumer caution, increases in utility charges and recent interest rate rises.

- ABS **International Trade** data showed that Australia's trade balance narrowed by $686 million in September to $1.8 billion, a 30% reduction from the surplus recorded in August. The narrowing was due to a fall in exports of 1.5% (the third consecutive month of decline) while imports rose by 1.4%. The decline in exports was underpinned by weaker rural (-8.0%) and non-rural exports (-2.9%). Imports rose due to an increased demand for intermediate and other merchandise imports. However, imports of capital and consumption goods declined consistent with recent weakness in business credit and retail sales.

- Official **VFACTS** data released by the Federal Chamber of Automotive Industries (FCAI) showed that 80,925 passenger cars, SUVs and commercial vehicles were sold in October, up 0.1 per cent (or 112 vehicles) on the same month in 2009.

- In the Reserve Bank of Australia's **Statement on Monetary Policy** (November 2010) released on Friday, the Bank depicts the economy as currently growing at around its "trend pace" and expects growth at a 3.5% pace in 2010 before strengthening to 3.75% in 2011 and 4.00% in 2012. These forecasts are broadly unchanged since the August Statement. In year-ended terms, underlying inflation is forecast to remain at 2.5% through December 2010 until mid 2011, before picking up to 3.0% by late 2012. The near term forecast for inflation is slightly lower than at the time of the August Statement due to the recent appreciation off the Australian dollar and the lower than expected September quarter CPI outcome. The RBA notes that significant risks to the medium term outlook include the expansionary shock from sharply elevated terms of trade, uncertainty about the timing and pace of resources investment, capacity pressures, tightening labour market conditions and rising wages and inflationary expectations.

## How this affects you

Recent economic developments indicate that the Australian economy continues to face a range of headwinds including the strengthening of the Australian dollar, sluggish domestic demand and an intensification of skill shortages. Ai Group's **Australian PMI®** showed that manufacturing sector weakness was underpinned by falls in activity in the textiles, food and beverages and wood products and furniture sub-sectors. On the positive side, the clothing and footwear sector experienced a rebound in activity while companies operating in the construction materials, machinery & equipment and basic metal products sub-sectors all lifted their production in anticipation of stronger demand in the mining, infrastructure and transport /logistics end-markets. Nevertheless, the high exchange rate is having a significant constraining influence on activity with exports falling in September and with local industry likely to be further squeezed by an increase in cheaper imports in the lead up to Christmas. The combined impacts of high input cost growth and a lack of pricing freedom are exerting considerable pressure on profit margins, while many businesses will be vulnerable to the risk of weaker demand arising from last week's interest rate increase.

## Latest data*

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| **Official cash rate** | 4.75 per cent ▲ |
| **AUD/USD exchange rate** | $101.60 ▲ |
| **Oil price** | **USD 86.83 per bbl ▲** |
| **Annual growth in GDP** | 3.3 per cent - |
| **Unemployment rate (%)** | 5.1 per cent - |
| **Annual growth in headline CPI** | 2.8 per cent - |
| **Copper price** | AUD 8562.99 ▲ |
| **Australian PMI (October)** | **49.4 ▲ 2.4 points** |
| **Australian PSI (October)** | **50.7 ▲ 5.1 points** |
| **Australian PCI (October)** | **44.0 ▲ 3.2 points** |

## Week in Preview: 8-12 November 2010

- On Monday, the **ANZ job advertisements index** for October will be released.
- On Wednesday, the ABS will release **Housing Finance** data for secured and unsecured housing finance commitments. The **Westpac – Melbourne Institute Index of Consumer Sentiment** for November 2010 will also be released on Wednesday.
- An up to date assessment of labour market conditions in Australia, including the national unemployment rate, will be available on Thursday with the release of ABS **Labour Force** data for October 2010.

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

For further assistance from Ai Group's Economics & Research Unit or for any suggestions for economic information you would like to be included in the report, please email economics@aigroup.asn.au.