

Ai GROUP ECONOMICS WEEKLY

Week in Review: 25 October to 29 October 2010

- ABS data on **Producer Prices** showed that the increase in final stage producer prices was higher than expected in the September quarter 2010, with the Final Stage Producer Price Index (FSP) rising by 1.3% against a median market forecast increase of 0.5%. It also marked the third consecutive quarterly increase in producer prices, resulting in a further pick-up in the annual rate of growth to 2.2% from +1.0% in the June quarter. This indicates that increases in upstream factory gate prices continued in the September quarter and this is likely to add to general inflationary pressures.
- The rise in producer prices was mainly due to price increases in building construction (+1.0%) and in electricity, gas and water (+8.9%). Compared to the June quarter 2010, producer prices at the preliminary and intermediate stages increased at a similar or larger extent in the September quarter. Preliminary prices rose by 1.2% (2.9% y/y) while intermediate prices rose by 1.1% (2.4%y/y). Increases at these levels (compared to the final stage) were mainly due to coal mining (preliminary and intermediate stage); electricity gas and water (preliminary stage); and grain, sheep, beef and dairy cattle farming (preliminary and intermediate stage).
- The **National Australia Bank Quarterly Business Survey** showed that business conditions eased marginally in the September quarter 2010, although business confidence improved to pre-GFC levels. The overall business conditions index (a composite index of trading performance, profitability and employment) fell by 1 point to a +5 point index level. Despite an increase in the business confidence index of 6 points (to a +9 index points level), forward orders, which give a indication of future demand for goods and services, fell by 5 points to a weak minus 3 points level. Orders were particularly subdued in the retail, construction, manufacturing and wholesaling sectors. The survey also found that labour costs (a wage bill measure) continued to rise, registering growth of 1% in the September quarter and 2.7% on a year ended basis
- The **Consumer Price Index (CPI)** released by the ABS on Wednesday showed that annual headline inflation was 2.8% in the September quarter 2010, down from 3.1% in the year to the June quarter 2010. This was below the market expectation of a 3.0% rise. The quarterly rate of growth was 0.7% compared with a 0.6% increase in the June quarter. The Reserve Bank of Australia's preferred, 'trimmed mean' measure (an indicator of underlying inflation) increased by 0.6% in the September quarter, while the annual rate for this trimmed mean measure was 2.5%, the lowest rate in almost five years. A major driver of inflation in the September quarter was the increase in tobacco prices reflecting the impact of the 25% increase in excise tax in April and the increase in the Federal excise in August. Other significant contributors were water and sewerage (+12.8%); electricity (+6.0%); and property rates and charges (+6.2%). An increase in rents also drove the CPI higher.
- The HIA - Jeld-Wen **New Home Sales Report**, a survey of Australia's major residential builders, revealed that the number of new homes sold increased by just 0.6% in September 2010. Sales were down by 14 per cent over the three months to September to be 15 per cent lower when compared to the same period in 2009.
- Reserve Bank of Australia **Financial Aggregates** data showed that total credit provided to the private sector by financial intermediaries rose by 0.1% in September 2010. This was slightly below the market forecast of a 0.2% increase. Housing credit increased by 0.6% in September and other personal credit which includes credit cards was up by 0.3%. However, business credit fell by 0.9% in September and was down by 3.7% an annual basis, reflecting the impediments of weak demand, higher interest rates and the stronger Australian dollar.

How this affects you

The economic data over the past week provides further evidence of the on-going toughness and fragility of industry conditions in Australia with weak updates on business conditions across the manufacturing, construction, retail and wholesale sectors. The data also indicates that pressures on the prices manufacturers pay for their inputs are increasing. While the stronger Australian dollar is helping to contain imported inflationary pressures (imports are mainly priced in AUD/USD terms), annual growth in domestic prices is strengthening at the preliminary, intermediate and final stages of production. This is consistent with the findings of Ai Group's Australian PMI[®] which shows that input cost growth for manufacturers has remained at an elevated level during recent months. This build up of price pressures in the production chain poses the risk of adding to general domestic inflation in future quarters. The resources sector is also likely to be a key driver of inflation in coming quarters as the expected build-up of supply constraints leads to upward pressure on input costs, including labour, equipment and materials. These developments highlight the need for businesses to be mindful of the risks of higher input costs and the potential adverse impact on earnings and margins.

Latest data*

Official cash rate	4.50 per cent -
AUD/USD exchange rate	\$0.9761 ▼
Oil price	USD 81.43 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 8,225.0 ▼
Australian PMI [®] (October)	49.4 ▲
Australian PSI [®] (September)	45.6 -
Australian PCI [®] (September)	40.8 -

Week in Preview: 1 November – 5 November 2010

- On Monday, Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI[®]**) for the month of October, while the Australian Performance of Services Index (**Australian PSI[®]**) and the Australian Performance of Construction Index (**Australian PCI[®]**) will be released on Wednesday and Friday respectively.
- The Reserve Bank of Australia (RBA) Board meeting and **monetary policy decision**, 2.30pm on Tuesday.
- On Wednesday, the ABS will release data on **Building Approvals** for September 2010 followed by **Retail Trade** data for September on Thursday. Also on Thursday, the ABS will release preliminary estimates on **Australia's International Trade in Goods and Services** for September 2010.
- The Reserve Bank of Australia's latest **Quarterly Monetary Policy Statement** will be published on Friday.

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