

Ai GROUP ECONOMICS WEEKLY

Week in Review: 5 – 9 December 2011

- Ai Group's Australian Performance of Construction Index (**Australian PCI®**) rose by 4.9 points to 39.6 in November, signaling a moderation in the rate of contraction for a second consecutive quarter. Readings below 50 indicate a contraction in activity with the distance from 50 indicative of the strength of the decline. The Australian Performance of Services Index (**Australian PSI®**) fell by 1.1 points to 47.7 in November with businesses reporting declining sales levels despite lowering their prices in order to stimulate demand. (<http://www.aigroup.com.au/economicindicators>)
- The ABS **Business Indicators, Australia** survey data showed that company profits increased by a stronger than expected 4.8% in the September quarter 2011, the second consecutive quarter of strong growth. The improvement was driven by solid profit gains in the financial and insurances services (36.1%), other services (35.1%), construction (21.7%), mining (15.2%) and electricity, gas, water and waste services (11.4%) sectors. The mining industry accounted for around 35% of all gross operating profits over the past year to be the most profitable industry sector. Following strong expansion in the June quarter 2011, mining profits rose by 5.0% in the September quarter. On the subdued side, company profits declined in the transport, postal and warehousing (-5.8%), manufacturing (-3.0%) and telecommunications (-2.1%) sectors. The data also revealed that inventories fell by 4.8%, the largest percentage decrease in nine quarters, reflecting a cautious approach by businesses in building stocks amid heightened concerns over the global economic outlook. Declines in inventories were recorded across all sectors with the exception of manufacturing where inventories were flat. The largest fall occurred in accommodation and food services inventories (-3.6%) followed by electricity, gas, water & waste (-2.7%), wholesale trade (-1.8%) and retail trade (-1.6%). Although mining stocks were down by 0.6% in the quarter, this followed a 10.8% increase in the previous quarter in line with the recovery in mining output after the January floods.
- The **ANZ Job Advertisements Index** was unchanged in November 2011 whilst the trend for job advertising declined for an eighth consecutive month. Historically, declining trends in job advertising have been consistent with rising unemployment. Newspaper job advertisements were 0.6% higher in the month, while internet job advertising remained steady. Newspaper job advertising is now 15.9% lower than a year ago, while internet advertising is 1.0% higher over the same period, in part reflecting the continuing trend towards advertising online.
- The **TD Securities – Melbourne Institute Monthly Inflation Gauge** fell by 0.1% in November, following a rise of 0.1% in both October and September. In the twelve months to November, the Inflation Gauge rose by 2.1 %, close to the lower limit of the RBA's two to three per cent target band.
- **ABS Government Finance Statistics** showed that Government spending fell in real terms by 2.5% in the September quarter 2011. Public consumption fell by 1.2% while public investment was down by 6.7%.
- **ABS Balance of Payments** data for the September quarter 2011 showed that Australia's current account deficit improved by a seasonally adjusted \$1.0bn to \$5.6bn. This reflected an increase in the trade surplus by \$583mn to \$6.8bn, driven by a 4.4% increase in the value of exports and a smaller rise of 4.0% in the value of the imports. However, this improvement was mainly due to the influence of prices with export volumes rising by 2.0% in the quarter and import volumes increasing at a higher rate of 4.3%. The rise in import volumes mainly reflected strong growth in capital goods of +10.8%. The volume of

consumption goods imports increased by 6.0% on the back of a rebound in vehicle imports following earlier supply disruptions while import volumes of intermediate & other merchandise goods rose by 1.5%. In terms of export volumes, service exports were hard hit by the strong Australian dollar to be 4.9% down in the quarter and coal exports were 6.6% lower over the year due to flood disruptions to production. The primary income deficit (the other large component of the current account balance) improved modestly by \$0.5bn to \$12.4bn.

- On Tuesday, the **Reserve Bank Board** decided to cut the official cash rate by 25 basis points to 4.25%, effective 7th December 2011. The dampening influence of the strong Australian dollar on the non-resources sectors, caution by businesses and households and subdued credit growth appear to be among the major domestic factors underlying the rate cut decision. The global economic outlook is also most likely to have influenced the RBA's decision with the Board noting that the likelihood of a further material slowing in global growth has increased. The RBA also highlighted that trade in Asia is seeing some effects of a significant slowing in economic activity in Europe. Additionally, the RBA noted that with softer labour market conditions, the likelihood of a near term acceleration in labour costs outside of the resources sector had lessened. As a consequence, the Bank concluded that *"the inflation outlook afforded scope for modest reduction in the cash rate"*.
- **ABS National Accounts** data showed that the Australian economy expanded by a seasonally adjusted 1.0% in the September quarter of 2011 following an increase of 1.4% in the June quarter. Growth through the year to the September quarter reached 2.5%, from the 1.9% previously. The main contributors to GDP growth were private business investment (+2.0 percentage points) and final consumption expenditure (+2.3 percentage points). However, net exports (which subtracted 0.6 percentage points from GDP growth), inventories (-0.8 percentage points) and public spending (-0.6 percentage points) were a drag on growth. Domestic demand picked-up solidly to a 2.1% pace in the September quarter in response to a spike in total private engineering construction investment which rose by 31.0% in the quarter. Household consumption expenditure increased by 1.2%, the fastest pace in five quarters with many discretionary areas of household consumption recording robust growth (although price discounting is likely to have accounted for some of the increase in volumes). Manufacturing rose by 1.9% in the quarter, to be 2.2% higher over the year. GDP per hour worked (a labour productivity measure), rose by 0.2% and by 0.5% in the year, the first annual growth outcome in one and a half years.
- **ABS Labour Force** data revealed that national employment declined by a seasonally adjusted 6,300 in November 2011, well below market expectations which pointed to growth of 10,000. The seasonally adjusted Australian unemployment rate increased 0.1 percentage points to 5.3 per cent in November. The decrease in employment was driven by a 0.5% (39,900) fall in full-time employment, the largest decline in seven months. This was partially offset by a 1.0% (33,600) increase in part-time employment. This indicates that jobs in this component may be picking-up after exhibiting weakness in previous months. Reflecting the weakening in full-time employment, the number of hours worked in the month fell by 11.3 million to 1.6 billion. On a State basis, jobs growth weakness was broad based with the exception of Western Australia where employment rose by 11,600. The unemployment rate in November increased in Queensland and Victoria. In contrast, the unemployment rate declined in New South Wales and remained unchanged in Western Australia and South Australia. However, at 4.3%, Western Australia's jobless rate remained well below the other states.

How this affects you

Last week's data reveals that the Australian economy expanded at a solid rate in the September quarter 2011, reflecting strong growth in business investment and consumer spending. By industry sector, mining was a strong GDP contributor in the September quarter, adding 0.3 percentage points to growth. This reflected solid rises in coal mining and exploration & mining support services. Construction also continued to benefit from the resources boom with new engineering construction, covering mining infrastructure and resource based investment projects, growing by 31.0% in the September quarter and 51.0% over the year. The contribution of engineering construction to GDP growth was 1.3 percentage points in the quarter. Manufacturing added 1.9 percentage points to growth. Nevertheless, the performance of the manufacturing industry remains mixed with growth in the September quarter coming from a weak base. This is illustrated by the full year National Accounts data which shows that seven of the eight major manufacturing sub-sectors recorded negative growth twice in the past year, with two (textiles & clothing and food & beverages) contracting in three of the four quarters. Despite the strong GDP outcome, headwinds to growth are evident. Housing construction remains weak while inventories, net exports and government spending all detracted from growth in the quarter. On a state basis, the impact of the resources boom and the resulting multispeed economy is also highlighted. Western Australia was the strongest performer for the quarter with state final demand rising by 8.4%. Economic activity also increased strongly in Queensland, where growth of 3.5% was recorded. This compares to weaker growth in the non-mining states, including NSW (+0.5%), Victoria (-0.1%) and South Australia (-1.6%). Overall, the Australian economy is expected to expand further through 2011/12 as the private investment upturn is maintained and coal exports continue to recover from the weather affected disruptions to production at the start of the year. However, the significant downside risks to the global economic outlook and on-going turbulence in financial markets may undermine the size of the recovery.

Latest data*

Official cash rate	4.25 per cent ▼
AUD/USD exchange rate	\$1.0211 ▲
Oil price	USD 99.38 per bbl ▼
Annual growth in GDP	2.5 per cent ▲
Unemployment rate (%)	5.3 per cent ▲
Annual growth in headline CPI	3.5 per cent -
Copper price	AUD 7,637.81 ▲
Australian PMI (November)	47.8 -
Australian PSI (November)	47.7 ▼ 1.1 points -
Australian PCI (November)	39.6 ▲ 4.9 points -

Week in Preview: 12 to 16 December 2011

- On Monday preliminary international trade estimates on a balance of payments basis will be available with the release of ABS data on Australia's **International Trade in Goods and Services** for October 2011.
- **Housing Finance** data for October 2011 will be published by the ABS on Monday. This will provide statistics on finance commitments for secured housing finance for owner occupation, other personal finance, commercial finance and lease finance.
- Tuesday will see the release of the **National Australia Bank Monthly Business Survey** for November 2011.
- Also on Tuesday, preliminary estimates of **Dwelling Unit Commencements** for the September quarter 2011 (new houses, new other residential and conversions) will be published by the ABS.
- The **Westpac – Melbourne Institute Index of Consumer Sentiment** for December 2011 will be released on Wednesday.
- The **Department of Education, Employment and Workplace Relations Vacancy Report** assessing skilled job vacancies in November 2011 will be released on Wednesday.
- Speech by **Ric Battellino, Deputy Governor, Reserve Bank of Australia** to the 24th Australasian Finance & Banking Conference, Shangri-La Hotel, Sydney, Wednesday, 12.30 pm AEDT
- On Thursday, the ABS will release **Sales of New Motor Vehicles** data for November 2011 in each state/territory sourced from the Federal Chamber of Automotive Industries.
- The **Reserve Bank of Australia** monthly bulletin will also be published on Thursday.

* 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.