

Ai GROUP ECONOMICS WEEKLY

Week in Review: 25 July – 29 July 2011

- ABS data on **Producer Prices** showed that the increase in final stage producer prices was slightly higher than expected in the June quarter 2011, with the Final Stage Producer Price Index (FSP) rising by 0.8% against a median market forecast increase of 0.7%. However, it marked the sixth consecutive quarterly increase in producer prices, resulting in a further pick-up in the annual rate of growth to 2.7% from 3.4% in the March quarter. This indicates that increases in upstream factory gate prices continued in the June quarter and this is likely to add to general inflationary pressures. In the June quarter, the rise in producer prices was mainly due to higher prices received for petroleum (+10.4%) and building construction (+1.2%). Food inflation also remained elevated in the June quarter, rising by 1.0%.
- Preliminary prices rose by 2.8% in the quarter while prices at the intermediate stage rose by 2.1%. In line with trends at the final stage, annual growth increased from 5.5% to 6.8% at the preliminary stage and from 4.4% to 5.6% at the intermediate stage, pointing to upside risk to general inflation in the year ahead. Increases at these levels (compared to the final stage) were mainly due to basic chemical manufacturing; petroleum; iron and steel manufacturing; oil and gas extraction; and coal mining.
- The **National Australia Bank Quarterly Business Survey** showed that business conditions improved slightly in the June quarter 2011, although they remained soft with further weakness expected in the near term. The overall business conditions index (a composite index of trading performance, profitability and employment) rose by 1 point to a +3 index points level. Conditions improved sharply in mining but remained poor in manufacturing, retail and construction. The survey also found that business confidence fell in the June quarter (down by 5 points to +6 index points), reflecting the impact on sentiment of the high Australian dollar, continued cautiousness of households and concerns about the global outlook. Consistent with this, forward orders, which give an indication of future demand for goods and services, remained at a weak minus 1 index points level. Orders recorded the largest deterioration in manufacturing, and remained weak in the construction, wholesale and finance sectors.
- The **Consumer Price Index (CPI)** showed that annual headline inflation rose by 0.9% in the June quarter 2011, taking the annual rate from up from 3.3% in the March quarter 2011 to 3.6%, the highest rate in almost three years. Underlying or core inflation which looks through the volatility of prices (such as the impact on prices from the floods) increased by 0.9% in the quarter (up from 0.85% in the previous quarter), while annual growth in underlying inflation rose from 2.3% in the March quarter to a one-year high of 2.7%. A major driver of inflation in the June quarter was a 1.4% increase in food prices reflecting adverse weather conditions earlier in the year. Other significant contributors were financial and insurance services (+1.6%); household content and services (+1.5%) due to price rises for furniture (+6.0%) and towels and linen (+7.5%) as discounting from the previous quarter was discontinued; clothing and footwear (+2.3%) and; transportation (+1.2%) in line with higher petrol prices. A 2.0% rise in the health category was mainly due to a 3.4% rise in hospital and medical services reflecting increases in private health fund premiums effective from 1 April 2011. All capital cities, with the exception of Melbourne, recorded quarterly inflation increases in excess of 0.9%. In annual terms, Adelaide had the highest inflation rate at 3.9%.

- The **RP Data-Rismark** home value index for all capital cities fell by 0.2 per cent in June 2011 to be 2.0% down over the year to June. The fall recorded in June marked the sixth consecutive month of declining capital city home values.
- Reserve Bank of Australia **Financial Aggregates** data showed that total credit provided to the private sector by financial intermediaries fell by 0.1% in June 2011. Business credit declined by 0.7% in June and was down by 2.4% an annual basis, while other personal credit which includes credit cards was down by 0.4%. Housing credit increased by 0.3% to be 6.0% higher over the year to June.

How this affects you

The economic data over the past week provided 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 wholesaling sectors. The producer prices data also indicated that while the strong Australian dollar is helping to reduce imported inflationary pressures (imports are mainly priced in AUD/USD terms) for producers, the prices that producers pay for their domestically produced inputs are increasing. As a consequence, the annual rate of growth in producer costs has picked up to its highest pace over the past nine quarters, signaling that price pressures in the production chain are building. Preliminary input prices, in particular, rose strongly in the June quarter (+7.2%) reflecting the strength of commodity prices. Moreover, whereas manufacturing input prices rose by a solid 3.7% in the June quarter, manufacturing output prices rose by a subdued 0.9%, indicating that manufacturers' margins are being squeezed as businesses absorb a high proportion of the growth in input costs. This build-up of price pressures in the producer pipeline poses the risk of adding to general domestic inflation in forthcoming quarters. The resources sector is also likely to be a key driver of inflation in the year ahead as worsening skill shortage bottlenecks and intensifying pressures in the procurement of building materials and equipment leads to upward pressure on costs. These developments highlight the need for businesses to be mindful of the risks of further rises in input costs and the potential adverse impact on future earnings and margins.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0988 ▲
Oil price	USD 95.66 per bbl ▼
Annual growth in GDP	1.0 per cent -
Unemployment rate (%)	4.9 per cent -
Annual growth in headline CPI	3.3 per cent -
Copper price	AUD 8856.0 ▼
Australian PMI (June)	52.9 -
Australian PSI (June)	48.5 -
Australian PCI (June)	35.8 -

Week in Preview: 1 August – 5 August 2011

- On Monday, Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI®**) for the month of July, while the Australian Performance of Services Index (**Australian PSI®**) will be released on Wednesday followed by the Australian Performance of Construction Index (**Australian PCI®**) on Friday.
- On Tuesday, the ABS will release data on **Building Approvals** for June 2011.
- The Reserve Bank of Australia (RBA) Board meeting and **monetary policy decision**, 2.30pm on Tuesday.
- On Wednesday, the ABS will release preliminary estimates on **Australia's International Trade in Goods and Services** for June 2011.
- ABS **Retail Trade** data for June 2011 will also be released on Wednesday.
- The Reserve Bank of Australia's latest **Quarterly Monetary Policy Statement** will be published on Friday.