

Ai GROUP ECONOMICS WEEKLY

Week in Review: 16 May – 20 May 2011

- **The Australian Industry Group/Australian Constructors Association (ACA) Construction Outlook Survey** revealed that after rising by a 4.4% in 2010 (current prices), the total value of non-residential building work (engineering and commercial construction) is forecast to lift by 9.1% (current dollars) in 2011 before increasing at a stronger rate of 11.0% in 2012. Engineering construction is expected to underpin growth reflecting the strong project pipeline in the mining, oil and gas processing, transport infrastructure and telecommunications sectors. Total turnover from engineering construction is expected to increase by 12.5% in 2011 and 13.1% in 2012. Based on these forecasts, the total value of engineering construction (by the private sector) is forecast to reach a record high of \$82.5 billion in 2012, which is more than double the level of six years ago. However, reflecting the two speed split in the demand for major investment projects in Australia, the commercial construction sector is expected to remain subdued in 2011 with private investment likely to remain below levels needed to bridge the gap left by the winding back of fiscal stimulus. In 2012, commercial construction is expected to recover modestly with growth of 6.0% reflecting a stronger impetus from turnover generated from private building activity (+8.4%). (<http://www.aigroup.com.au/economicindicators>)
- ABS data on **Lending Finance** showed that total finance commitments (which include housing, personal, commercial and lease finance) increased by 7.7% (seasonally adjusted) in March 2011. The increase was mainly driven by a solid rise in the value of commercial finance commitments (+13.3%), the largest monthly rise in this category since September 2009. Offsetting this strength in commercial lending was continued weakness in owner occupied housing finance commitments which fell by 1.1% while personal finance commitments remained broadly unchanged rising by 0.1% in the month.
- ABS **Housing Finance** data also signaled a further deterioration in finance for occupied housing in March 2011 with a decline of 1.5% registered in the month. Finance for the purchase of established dwellings fell by 1.8% while finance for the construction of new dwellings was down by 1.5%, reversing a 1.0% rise in February. In annual terms finance for the construction of new dwellings was down by 17.2% on a year ago, underlining the extent to which this component continues to weigh on housing demand.
- The minutes of the May 2011 **Reserve Bank of Australia Board meeting** indicated that, notwithstanding the significant short term effects of the recent floods and Cyclone Yasi, the RBA's outlook for the domestic economy remained largely unchanged. The Board noted that economic growth was expected to be relatively strong over the next few years, although forecasts had been lowered due to the further appreciation of the Australian dollar and its effect on trade-exposed sectors. It was also observed by members of the Board that conditions in the housing market remained subdued and that the reduction in coal production in the March quarter was likely to be larger than initially expected. In terms of inflation, it was noted that, notwithstanding the strong exchange rate and the relatively high saving ratio of households which would help to contain inflationary pressures, underlying inflation was expected to be at the top end of the (2-3 per cent) target band over the next two years. On the basis of these considerations, the Board judged the current "mildly restrictive stance of monetary policy as remaining appropriate" and as a result decided to leave the official cash rate steady at 4.75%. However, it judged that if economic conditions evolved as expected, "higher interest rates were likely to be required at some point if inflation was to remain consistent with the medium-term target."
- ABS data based on the VFACTS series produced by the Federal Chamber of Automotive Industries showed that **New Motor Vehicle Sales** decreased by a seasonally adjusted 3.5% (or 3,032) in April 2011,

following growth over the previous two months. Falls in sales were recorded for sports utility vehicles (-9.6%) and other vehicles (-5.5%) while sales of passenger vehicles remained largely unchanged during the month. Total vehicle sales in April were also 8.4% lower than a year ago, well below the 29.1% annual growth rate in April 2010.

- The **Westpac-Melbourne Institute Consumer Sentiment Index** fell by 1.3% to 103.9 in May, the lowest reading since June 2010. The component of the Index measuring views on “finances relative to a year ago” fell by 4.1% while expectations for family finances over the next 12 months fell by 6%. This was consistent with a special question in the survey which found that 36% of respondents expected that the May Federal Budget would worsen their family finances over the next year. Factors that were supportive of consumer sentiment included a 1.7% increase in the index tracking views on “whether now is a good time to purchase a major household item”; and a 3.5% increase on consumers’ assessment of “economic conditions over the next five years”.
- The **Department of Education, Employment and Workplace Relations Vacancy Report** revealed a decline in job vacancies advertised on-line during April with the Internet Vacancy Index decreasing by 8.4% in seasonally adjusted terms. Despite this fall, the demand for labour remains strong with the internet vacancy index up by 12.4% over the year to April. The demand for labour was shown to be strongest for high skill jobs with Advanced Diploma or Diploma skill levels recording the largest increase over the past year (19.0%). The DEEWR report also revealed that the newspaper-based Skilled Vacancy Index decreased by 0.4% in May 2011 (one month ahead in data collection) with this trend likely to continue as employers move away from newspaper advertising to online advertising.
- The ABS **Labour Cost Index (LCI)** which measures total hourly rates of pay excluding bonuses, rose by 0.8% (seasonally adjusted) in the March quarter 2011, following a 1.0% increase in the December quarter 2010. In addition, annual wages growth moderated to 3.8%. This was still well below the 4.5% limit that the RBA sees as consistent with its inflation target, although it was up from 3.0% a year ago. The professional scientific & technical services (+4.7%) and mining sectors (+4.6%) recorded the largest annual increase in wages, closely followed by wholesale trade (4.4%), financial and insurance services (+4.3%) and the construction sector (+4.3%). The ABS **Average Weekly Earnings** data showed that average weekly ordinary time earnings grew by a seasonally adjusted 1.0% in February 2011 after a rise of 1.4% in November 2010. Annual growth remained steady at 4.1%.

How this affects you

Last week’s data revealed lower than expected wage cost pressures in the first quarter of the year. Nevertheless, there are signs that the tightness in the labour market is starting to flow through to wages inflation in the private sector. Over the year to the March quarter 2011 private sector wages increased by 3.8% while public sector wages were up by 3.6%. This follows the softer gains in private sector versus public sector wages over the previous two years and indicates that the disinflationary influence of private sector wages growth has passed. Moreover, with unemployment expected to fall further this year and with skill shortages set to intensify, stronger wages growth is likely over coming quarters. Broader economic data indicates that a range of factors including the fall in motor vehicle sales, lower consumer sentiment, recent weakness in building approvals and housing finance are weighing on domestic growth. This suggests that the RBA will keep interest rates on hold in the short term but will be closely monitoring developments in wages inflation given the on-going strength of the labour market and the projected pick-up in mining investment and resource-related construction during the year. These are significant risk factors for inflation given their potential to exert upward pressure on wages and other input costs.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0656 ▲
Oil price	USD 99.03 per bbl ▼
Annual growth in GDP	2.9 per cent -
Unemployment rate (%)	4.9 per cent -
Annual growth in headline CPI	2.8 per cent -
Copper price	AUD 8428.52 ▲
Australian PMI (April)	48.4 -
Australian PSI (April)	51.5 -
Australian PCI (April)	37.9 -

Week in Preview: 23-27 May 2011

- On Wednesday, the ABS will release preliminary statistics for the value of **Construction Work Done, Australia** for the March quarter 2011.
- The **Westpac – Melbourne Institute Leading Index** for March 2011 (which indicates the likely pace of economic activity three to nine months into the future) will also be released on Wednesday.
- Preliminary estimates for actual and expected new capital expenditure will be made available by the ABS on Thursday with the release of its March quarter 2011 **Private New Capital Expenditure, Australia** publication.
- **RBA Deputy Governor Battellino Speech**, 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.