

Ai GROUP ECONOMICS WEEKLY

Week in Review: 21 February – 28 February 2011

- The **National Australia Bank Quarterly Business Survey** showed that business conditions softened noticeably in the December quarter 2010 under the weight of weaker profitability. The overall business conditions index (a composite index of trading performance, profitability and employment) fell by 3 points to a +2 point index level. Conditions were strongest in recreation and mining and weakest in retail and agribusiness. Forward orders which give an indication of future demand for goods and services, remained in negative territory, posting a weak minus 2 points index reading. Business confidence and expectations also fell back in the December quarter.
- The ABS **Labour Cost Index (LCI)** which measures total hourly rates of pay excluding bonuses, rose by 1.0% (seasonally adjusted) in the December quarter 2010, following a 1.1% increase in the September quarter 2010. Annual wages growth increased to a 3.9% pace from 3.5% in the previous quarter, a level which represented the highest rate of growth since the March quarter 2009. Annual growth in private sector wages lifted from 3.4% in the September quarter 2010 to 3.9% in the December quarter 2010. The mining sector recorded the largest annual growth in wages (up by 4.6%), closely followed by the financial and insurance (+4.4%) and professional, scientific and technical services sectors (+4.4%).
- The ABS **Average Weekly Earnings** data showed that average weekly ordinary time earnings grew by a seasonally adjusted 1.1% in November 2010 after a rise of 0.6% in August 2010. Annual growth moderated from 5.9% in August to 4.3%.
- ABS construction industry data showed that the total value of **Construction Work Done** rose by a softer than expected 0.8% (seasonally adjusted) in the December quarter 2010 following a 1.5% decline in the previous quarter. Underlying this on-going weakness in construction activity were declines in both non-residential construction (-9.9%) and residential construction (-1.1%). However, engineering construction work was a positive, rising by 7.3% or \$1.5bn in the quarter with growth driven by a 10.2% rise in the value of infrastructure work done by the private sector. On a state basis, NSW recorded the strongest growth in construction work in the December quarter (+9.4%), followed by Western Australia (+4.1%) while Victoria was largely unchanged (-0.5%). In contrast, Queensland fell by 2.5% and South Australia was down by 2.2%.
- ABS investment data showed that the volume of **Private New Capital Expenditure** rose by 1.3% (seasonally adjusted) in the December quarter 2010, a result which was below the median market forecast of a rise of 2.3%. Investment in buildings and structures contracted by 2.8%, although this follows a 14.4% increase in the previous quarter with investment over the year up by 20.8%. Investment in plant and equipment increased by 6.1% in the December quarter but remained down over the year by 7.1%. The data continued to provide an upbeat assessment for the investment outlook. The estimate for total private capital expenditure in 2010/11 was \$128.9 billion which implies solid growth through 2010/11 of 23%, up from 21% implied three months ago. By industry sector, mining investment is expected to lead the way with implied growth of 46.8%. Manufacturing investment plans imply growth of 10.1% while services sector implied investment growth is 13.6%. For 2011/12, capital expenditure plans are also strongly positive, with implied growth of 32.2%.

How this affects you

Last week's data reveals that wages inflation is edging higher as the labour market continues to tighten. Private sector wages growth is also picking up, rising at a faster rate than public sector wages in the December quarter for only the second time since the early stages of the global financial crisis (September quarter 2008). However, annual wages growth at 3.9% is still below the 4.5% limit that the RBA sees as consistent with its inflation target. Further upward pressure on wages is likely in 2011, particularly as the tightening in the jobs market leads to skill shortages becoming more intense and widespread across the economy. Broader economic data confirms that large parts of the economy continue to face a range of headwinds, including a strong Australian dollar, weak domestic demand and higher interest rates. This was evident in the fall in business conditions and confidence (NAB quarterly business survey) and the on-going reductions in building work done (residential and non-residential) in the December quarter 2010. Non-residential (commercial construction) remains particularly subdued with the private sector yet to step up to bridge the gap left by the unwinding of the Federal Government's school building program. Nevertheless, the outlook for business investment and infrastructure construction remains positive. The upward revisions to business investment plans are consistent with the high level of resource based projects in the pipeline and the ramping up of the \$43 bn Gorgon LNG project in WA. Private infrastructure activity will also be supported by the significant infrastructure plans of Federal and State governments and the rebuilding works in regions impacted by the recent floods and cyclones. However, there is the risk that worsening skill shortage bottlenecks and materials and equipment supply constraints, could limit the extent of the potential upside.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0180 ▲
Oil price	USD 96.47 per bbl ▲
Annual growth in GDP	2.7 per cent -
Unemployment rate (%)	5.0 per cent -
Annual growth in headline CPI	2.8 per cent -
Copper price	AUD 9528.48 ▼
Australian PMI (January)	46.7 -
Australian PSI (January)	49.5 -
Australian PCI (January)	40.2 -

* 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.

Week in Preview: 28 February – 4 March 2011

- On Monday, the ABS will publish the latest edition of **Business Indicators, Australia**. This will provide estimates of production, income from the sale of goods and services, wages and salaries and the book value of inventories for the December quarter 2010.
 - RBA Financial Aggregates data for January 2011 providing an update on total credit provided to the private sector by financial intermediaries will also be released on Monday.
 - On Tuesday, Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI®**) for the month of November, while the Australian Performance of Services Index (**Australian PSI®**) will be released on Thursday.
 - On Tuesday, the ABS will release data on Australia's **Balance of Payments and International Investment Position** for the December quarter 2010.
 - Also on Tuesday, the ABS will release **Retail Trade** data for January 2011 data on) and **Government Finance Statistics** for the December quarter 2010.
 - The latest reading on Australia's economic growth will be available on Wednesday with the release of **Australian National Accounts** data for the December quarter 2010.
 - **Building Approvals** for January 2011 (a key indicator of the pipeline of residential, apartments and commercial building activity will be published by the ABS on Thursday. Also on Thursday, the ABS will release preliminary estimates on Australia's **International Trade in Goods and Services** for January.
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