

# Ai GROUP ECONOMICS WEEKLY

---

**Week in Review:** 24 January – 28 January 2011

- ABS data on **Producer Prices** showed that the increase in final stage producer prices was lower than expected in the December quarter 2010, with the Final Stage Producer Price Index (FSP) rising by 0.1% against a median market forecast increase of 0.5%. However, it marked the fourth consecutive quarterly increase in producer prices, resulting in a further pick-up in the annual rate of growth to 2.7% from 2.2% in the September quarter. In the December quarter, prices received for other agriculture (+18.1% qtr rise), accommodation (+8.4%) house construction (+0.8%) and building construction (+0.7%) constituted the main sources of cost growth. These gains were largely offset by falls in the prices of industrial machinery and equipment (-3.2%) and electronic equipment and appliances (-7.1%) with the stronger Australian dollar helping to reduce the costs of these mainly imported items.
- The data on producer prices pointed to similar price trends at the preliminary and intermediate stages of production in the December quarter. Preliminary prices rose by 0.1% in the quarter while prices at the intermediate stage were flat. However, the annual growth increased from 2.9% to 3.8% at the preliminary stage and from 2.4% to 3.3% 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 electricity, gas and water (preliminary and intermediate stage); basic non-ferrous metal product manufacturing (preliminary and intermediate stage); other food manufacturing (preliminary and intermediate stage); and metal ore mining (intermediate stage).
- The **Consumer Price Index (CPI)** showed that annual headline inflation was 2.7% in the December quarter 2010, down from 2.8% in the year to the September quarter 2010. This was below the market expectation of a 3.1% rise. The quarterly rate of growth was 0.4% compared with a 0.7% increase in the September quarter. The Reserve Bank of Australia's preferred, 'trimmed mean' measure (an indicator of underlying inflation) increased by 0.3% in the December quarter, while the annual rate for this trimmed mean measure was 2.2%, the lowest rate since the September quarter 1999. A major driver of inflation in the December quarter was a 2.2% increase in food prices reflecting adverse weather conditions and rising global food prices. Other significant contributors were housing (+0.8%) and alcohol and tobacco (+0.8%). Key deflationary influences were clothing and footwear (-1.9%), major household appliances (-3.9%) and audio visual and computing equipment (-4.8%) reflecting the impact of cheaper imports (due to the strong AUD) and widespread price discounting by retailers (due to softer than expected retail sales).
- The **Westpac-Melbourne Institute Leading Index** (which indicates the likely pace of economic activity three to nine months into the future) registered an annualised growth rate of 3.5% in November 2010. Although this was the eighth consecutive month that the growth of the Index has slowed, it remained consistent with reasonably solid economic growth in 2011. However, the growth profile will be distorted by the severe impact of the floods on economic activity. Westpac is forecasting GDP to contract by 0.1% in the March quarter 2011 (downgraded from their previous 1.1% growth forecast). In the June quarter 2011, growth is expected to strengthen to 1.9%, although economic output will be below the level previously expected. Thereafter, the boost from the rebuilding of flood affected areas is forecast to lift annualised growth in the second half of 2011 to 4.8% (upgraded from 3.4%).
- The International Monetary Fund released an update to its **World Economic Outlook** suggesting global output is forecast to expand by about 4½ percent in 2011, a slight upward revision. Nonetheless, global financial stability is still at risk as many nations grapple with debt problems.

## How this affects you

The economic data over the past week indicated that the increase in final stage producer prices was relatively benign in the December quarter 2010 reflecting the deflationary effect of a stronger Australian dollar and subdued domestic demand. Nevertheless, the step up in the annual rate of growth in producer prices from 2.2% to close to a two-year high of 2.7% is consistent with the picture of a modest pick up in inflation in the producer pipeline. While the CPI for the December quarter continued its run of moderate price rises, cost-push risks to inflation remain, particularly given the intensification of skill shortages. The continued increase in private investment in the resources sector, as well as flood reconstruction will further draw on labour, equipment and materials, and maintain the pressure on prices. This pressure will be exacerbated by the impact of the floods on food prices. For this reason, businesses still need to remain mindful of the risks of higher input costs in the year ahead and the potential adverse impact on earnings and margins.

## Latest data\*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$99.28 ▲
Oil price	USD 88.12 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 9659.55 ▲
Australian PMI (December)	46.3 -
Australian PSI (December)	46.4 -
Australian PCI (December)	43.8 -

## Week in Preview: 31 January – 4 February 2011

- On Tuesday, Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI®**) for the month of January, while the Australian Performance of Services Index (**Australian PSI®**) will be released on Thursday.
- The Reserve Bank of Australia (RBA) Board meeting and **monetary policy decision**, 2.30pm on Tuesday. Also on Tuesday, private credit data for December 2010 will be made available with the release of the latest RBA **Financial Aggregates** publication.
- On Thursday the ABS will release data on **Building Approvals** for December 2010 and preliminary estimates on **Australia's International Trade in Goods and Services** for December 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. 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](mailto:economics@aigroup.asn.au).