

Ai GROUP ECONOMICS WEEKLY

Week in Review: 24 – 28 October 2011

- **The Australian Industry Group/Australian Constructors Association (ACA) Construction Outlook Survey** revealed that after rising by 6.3% in 2010/11 (current prices), the total value of non-residential construction work (engineering and commercial construction) is forecast to lift by 10.3% in 2011/12, before building to a stronger gain of 12.0% in 2012/13. 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 13.0% in 2011/12 and 14.2% in 2012/13. Based on these forecasts, the total value of engineering construction (by the private sector) is forecast to reach a record high of \$91.5 billion in 2012/13, 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 2011/12 with private investment likely to remain below levels needed to bridge the gap left by the winding back of fiscal stimulus. In 2012/13, growth in commercial construction is expected to step-up to a 6.2% pace reflecting a stronger impetus from turnover generated from private building activity (+7.9%).
[\(<http://www.aigroup.com.au/economicindicators>\)](http://www.aigroup.com.au/economicindicators)
- ABS data on **Producer Prices** showed that the increase in final stage producer prices was slightly lower than expected in the September quarter 2011, with the Final Stage Producer Price Index (FSP) rising by 0.6% against a median market forecast increase of 0.8%. The annual rate of growth in the FSP moderated from 3.4% in the June quarter 2011 to 2.7%, a three-month low. The strength of the dollar has been pivotal in placing downward pressure on prices with import prices flat in the September quarter and down by 6.0% for the year. However, the pace of domestic prices growth was stronger, despite easing to 0.7% in the September quarter from 1.1% previously. The rise in domestic prices was led by a solid increases in the prices paid for electricity, gas and water (+8.2%) pointing to capacity constraints in the economy. Prices at the preliminary and intermediate production stages both rose by 0.1% in the September quarter. However, upstream price pressures were still evident in the annual rates of growth with solid rises over the year of 5.6% (preliminary) and 4.5% (intermediate).
- The **Consumer Price Index (CPI)** showed that annual headline inflation rose by 0.6% in the September quarter 2011, and by 3.5% over the year. The underlying measures of inflation, the trimmed mean and weighted median, remove volatile price items. The average of these two measures surprised on the downside, rising by just 0.3% in the quarter compared to a forecast 0.6% increase. This saw the annual rate of underlying inflation moderate from 2.7% to 2.5%, to be at the mid-point of the Reserve Bank's target annual inflation band of 2-3%. The main driver of inflation in the September quarter was a 1.9% increase in the housing category which includes rents, the cost of building a house and utilities. The other significant contributor was clothing & footwear which rose by 1.5% following a 1.9% increase in the June quarter 2011. The key deflationary influences were pharmaceutical products (-5.0%); fruit and vegetables (-1.8%); automotive fuel (-1.4%); motor vehicles (-1.0%). There was also a notable fall in the prices for audio visual and computing equipment which fell by 3.3% reflecting the impact of cheaper imports (due to the strong AUD) and price discounting by retailers.

How this affects you

Last week's data indicated that the prices that producers pay for their inputs remains relatively contained with the strong Australian dollar having a deflationary effect on the prices of imported goods. In the September quarter 2011, the annual rate of growth in producer prices at the final stage of production stepped down from the two-year high of +3.4% in the June quarter to 2.7%. However, price pressures at the earlier stages of the production process (preliminary and intermediate) are showing greater intensity on an annual basis, suggesting that producers' margins are being squeezed at the final stage as they absorb some of the upstream price increases. Preliminary input prices, in particular, rose strongly in the year to the September quarter (+5.6%) reflecting higher prices for electricity, gas & water charges, coal mining output prices and the prices paid for marketing & management services. Moreover, whereas manufacturing input prices rose at a solid annual pace of 8.7% in the September quarter, growth in manufacturing output prices was slower at 3.4%, underlining the considerable competitive pressures facing manufacturers and the consequential squeeze on margins. This is consistent with the findings of Ai Group's Australian Performance of Manufacturing Index (PMI®) which shows that input cost growth for manufacturers' remains at an elevated level, while the decline in selling prices has persisted throughout much of the past year. While the headline CPI for the September quarter continued its run of moderate price rises, cost-push risks to inflation remain, particularly given the intensification of skill shortages. The Ai Group/ACA Construction Outlook survey indicated that the continued increase in private investment in the infrastructure and resource related construction sectors will further draw on labour, equipment and materials, and maintain the pressure on prices. For this reason, businesses still need to remain mindful of the risks of higher input costs in the year ahead.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0533 ▲
Oil price	USD 90.29 per bbl ▲
Annual growth in GDP	1.4 per cent -
Unemployment rate (%)	5.2 per cent -
Annual growth in headline CPI	3.5 per cent -
Copper price	AUD 7,155.85 ▲
Australian PMI (September)	42.3 -
Australian PSI (September)	50.3 -
Australian PCI (September)	30.0 -

Week in Preview: 31 October – 4 November 2011

- On Tuesday, Ai Group will release its Australian Performance of Manufacturing Index (**Australian PMI®**) for the month of October, followed the Australian Performance of Services Index (**Australian PSI®**) will be released on Thursday.
- Reserve Bank of Australia **Financial Aggregates** for September 2011 and the **RP Data-Rismark** Home Value Index for September 2011 will be released on Monday.
- The Reserve Bank of Australia (RBA) Board meeting and **monetary policy decision**, 2.30pm on Tuesday.
- The ABS will publish **House Price Indexes** for September 2011 on Tuesday.
- On Wednesday, the ABS will release data on **Building Approvals** (a key indicator of the pipeline of residential, apartments and commercial building activity) for September 2011.
- ABS **Retail Trade** data for September 2011 will also be released on Thursday
- The Reserve Bank of Australia's latest **Quarterly Monetary Policy Statement** will be published on Friday.