

Ai GROUP ECONOMICS WEEKLY

Week in Review: 30 May – 3 June 2011

- Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) fell slightly by 0.7 points to 47.7 in May to remain below the 50-point level separating expansion from contraction for a third consecutive month. The Australian Performance of Services Index (**Australian PSI®**) registered 49.9 in May. This highlighted the on-going weakness in service sector activity with the strong dollar and consumer caution continuing to impact on demand. (<http://www.aigroup.com.au/economicindicators>)
- The ABS **Business Indicators, Australia** survey data showed that company profits declined by 2.0% in the March quarter 2011, the third consecutive quarterly decline. Profits in the mining sector fell by 6.6% (due to the likely negative impact of floods on shipments and production) while profits in the broader economy rose by a subdued 0.6%. The data also revealed that business inventories rose by just 0.4% in the March quarter, down from 0.8% growth in the December quarter 2010. The slower rate of stock building is consistent with production disruptions during the quarter and weak household expenditure. Inventories were lower in the manufacturing (-0.6%), retail (-1.2%) and accommodation & food services (-6.6%) sectors, indicating that businesses in these sectors are drawing down stocks in response to weaker demand.
- **ABS Government Finance Statistics** showed that Australia's net foreign debt liability increased by \$29.8bn to \$677bn in the March quarter 2011. Government spending on consumption rose by 1.4% in the quarter while government spending on investment fell by 0.7%.
- The latest **HIA - Jeld-Wen New Home Sales Report**, a survey of Australia's major residential builders provided a subdued update for new home sales with the number of new private dwellings sold increasing by just 0.2% in April 2011. Detached house sales inched up by 0.4% with increases in New South Wales and Victoria while the sale of multi-units posted a third consecutive decline, falling by 2% during the month.
- The ABS **Building Approvals** data showed a 1.3% seasonally adjusted decline in the number of dwelling units approved in April following an 8.6% rise in the previous month. On an annual basis, dwelling approvals were down by 11.5%, the fourth consecutive month that the annual rate of decline in building approvals has been in double digit territory. The weakness in dwelling approvals reflected a 3.3% decline in private sector housing approvals which was partly offset by a 6.4% rise in the volatile "other dwellings" segment. On a state basis, dwelling approvals decreased in April in New South Wales (-12.9%), Western Australia (-9.6%) and Tasmania (-8.7%) while Queensland (+29.2%), South Australia (+9.9%) and Victoria (+0.3%) recorded increases.
- **ABS Balance of Payments** data for the March quarter 2011 showed that Australia's current account deficit widened by a seasonally adjusted \$2.4bn to \$10.5bn. This reflected a reduction in the trade surplus of \$3.3 billion resulting from a fall in export volumes of 8.7% outweighing a 1.3% increase in import volumes. A 26.8% decline in export volumes of coal, coke & briquettes drove the decline in total export volumes due to weather related disruptions to coal-mine productions during the quarter. The rise in import volumes mainly reflected a 5.0% increase in the volume of capital goods imports consistent with the current upturn in private business investment. In contrast, the volume of consumption goods imports fell by 1.7% in line with on-going consumer caution and weak retail sales in the first quarter of the year. The primary income deficit (the other large component of the current account balance) increased by \$0.9 bn to \$13.2 bn as consequence of a further rise in net equity income outflows due to the high proportion of offshore ownership of the resource sector.

- Reserve Bank of Australia **Financial Aggregates** data showed that credit provided to the private sector by financial intermediaries was flat in April 2011. Business lending, the major driver of overall credit, fell by 0.6% while other personal credit which includes credit cards declined by 0.3%. Although housing credit increased by 0.4 per cent in April, this was down from the 0.5-0.6% growth recorded over the second half of 2010 and the early months of this year.
- ABS **National Accounts** data showed that the Australian economy contracted by 1.2% (seasonally adjusted) in the March quarter 2011 with non-farm GDP falling by 1.0%. Growth through the year moderated from 2.7% in the December quarter 2010 to 1.0%. The main detractors to GDP growth in the quarter were net exports (-2.4 percentage points) and inventories (-0.5 percentage points). Public gross fixed capital formation was the largest positive contributor, adding 0.7 percentage points to GDP growth. Domestic demand rose by a solid 1.3% in the quarter, largely due to strong growth in private investment with new dwellings investment rising by 4.5% and investment in machinery and equipment rising by 6.0%. Household consumption expenditure increased by 0.6% in the March quarter, although growth was slower than the previous quarter (0.7%) highlighting the cautious approach by consumers to spending. Manufacturing declined by 2.4% in the quarter, to be 3.1% down over the year. The income side of the National Accounts showed that total compensation of employees rose by 2.9% in the March quarter and 8.6% on a year ago, the strongest annual rate of growth in more than three years as the tight labour market helped to lift household incomes. GDP per hour worked (a labour productivity measure), however, fell by 1.5% in the quarter and by 1.8% over the year, the weakest outcome in almost six years.
- In terms of State final demand (the closest GDP measure for the States), Western Australia and Victoria made the largest percentage point contributions to growth in the March quarter (0.4ppts) and recorded growth of 3.2% and 1.6% respectively. This was followed by New South Wales (0.1ppts) and growth of 0.4% during the quarter. Queensland and South Australia detracted 0.1ppts with respective declines of by 0.6% and 0.8%.
- ABS data on **Retail Trade** provided signs that cautiousness among consumers may be starting to ease. The seasonally adjusted value of retail turnover expanded by 1.1% in April following a 0.3% decline in March. Annual growth in retail turnover rose from 2.5% in March to 3.3% in April. The rise in April was led by a 3.6% increase in department stores sales with large increases also recorded for clothing, footwear and personal accessories (+1.2%) and other retailing (+2.0%). South Australia was the only state to record a decline in retail sales. Victoria recorded the strongest rise (+2.8%), followed by Queensland (+1.8%).
- ABS **International Trade** data showed that Australia's trade surplus narrowed by \$94 million to \$1.6bn in April, reflecting a sharp slowdown in the growth of exports of goods and services. Exports increased by 0.5% (down from 10.1% growth in March) while imports increased by 1.0% (slightly down from 1.4% growth in March). In terms of imports, consumption goods were 3.1% lower consistent with subdued consumer spending. However, in a positive sign for the business investment outlook, capital goods imports increased by a solid 12.2%. On the export side, rural exports rose by 5.5% whereas non-rural exports rose by 1.1%. Manufacturing exports fell by 11.5% as manufacturers continued to struggle under the headwind of the strong Australian dollar.
- ABS **Industrial Disputes** data showed that there were 19,700 working days lost due to industrial disputation in the March quarter 2011, a decrease of 7,500 on the December quarter 2010. The transport, postal and warehousing industry accounted for 9,200 (47%) of the total number of working days lost in the March quarter. The transport, postal and warehousing industry also had the highest number of working days lost per thousand employees (17.6) for the quarter. This was followed by the construction industry with 11.3 working days lost per thousand employees. During the year ended March 2011, there were 212 disputes (23 fewer than in the year ended March 2010) and 117,500 working days lost compared with 149,900 in the year ended March 2010.

How this affects you

Last week's data reveals that the Australian economy contracted in the March quarter 2011 for the first time in two years driven by the negative impact from natural disasters. Despite this setback, leading indicators continue to point to a recovery through the remainder of 2011 on the back of the high terms of trade (prices of exports relative to imports) which should flow through to stronger investment and support growth in national income. Indeed, the recently released ABS capital expenditure survey indicates strong growth in private investment during the next financial year as the government's large fiscal stimulus of the past two years continues to taper off. Nevertheless, the current picture of the Australian economy is one of patchiness across industries and sectors. Exports declined by 8.7% in the quarter, subtracting 3.4 percentage points from GDP reflecting the strengthening of the Australian dollar and disruptions to coal production and shipments as a result of the recent floods. In addition, a slower rate of stock accumulation in the quarter as businesses sought to closely manage stocks and control costs, led to inventories subtracting 0.5 percentage points off GDP growth. Private investment expenditure strengthened, with growth increasing to 3.1% in the March quarter, from 1.3% in the December quarter 2010. However, public investment fell by 0.7% and household consumption growth moderated to a 0.6% pace from 0.7% in the previous quarter with higher interest rates and expectations of more to come weighing on consumer spending. The household savings ratio increased to 11.5% from 9.7% in the previous quarter, highlighting the rise in consumer caution during the first months of the year. Across industries, the National Accounts showed that construction (with infrastructure project activity a key source of strength), wholesale trade, healthcare & social assistance and ownership of dwellings all made positive contributions to growth of 0.1 percentage points. In contrast, the agriculture (-0.2ppts), mining (-0.6 ppts) and manufacturing (-0.2 ppts) sectors made strong negative contributions. Mining and agriculture were both adversely impacted by severe weather events. Despite the contraction in GDP during the March quarter, the increase in domestic demand was strong. Moreover, the solid April retail sales data indicates that the retail sector could finally be picking up in line with the on-going strength of the labour market and growth in household incomes. As a consequence, the Reserve Bank of Australia will remain concerned about the upside risk to the inflation outlook, raising the possibility that the RBA could move to increase interest rates in the September quarter.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0715 ▲
Oil price	USD 100.26 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 8414.48 ▼
Australian PMI (May)	47.7 ▼ 0.7 points
Australian PSI (May)	49.9 ▼ 1.6 points
Australian PCI (April)	37.9 -

Week in Preview: 6 June to 10 June 2011

- The **ANZ Job Advertisements Index** for May 2011 will be released on Monday.
- The **TD Securities Melbourne Institute (TDMI) Inflation Gauge** for May will also be released on Monday to provide an estimate of consumer inflation pressures ahead of this week's RBA Board meeting.
- Ai Group will release its Australian Performance of Construction Index (**Australian PCI®**) for May 2011 on Tuesday, the leading indicator of activity in the house building, apartment, engineering and commercial construction sectors.
- The Reserve Bank of Australia (RBA) Board meeting, and **monetary policy decision**, 2.30pm on Tuesday.
- Tuesday will also see the release of the **National Australia Bank Monthly Business Survey** for May 2011.
- The **Westpac – Melbourne Institute Index of Consumer Sentiment** for June 2011 will be released on Wednesday.
- On Wednesday, the ABS will release April 2011 **Housing Finance** data for secured and unsecured housing finance commitments for owner occupation, commitments for construction or purchase of dwellings for rent or resale, and loans outstanding to individuals/households for housing.
- An up to date assessment of labour market conditions in Australia, including the national unemployment rate, will be available on Thursday with the release of ABS **Labour Force** data for May 2011.

* 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.