

Ai GROUP ECONOMICS WEEKLY

Week in Review: 31 January – 4 February 2011

- The manufacturing industry remained subdued in January amid on-going declines in new orders with Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) registering 46.7 (readings below 50 indicate a contraction in activity). The Australian Performance of Services Index (**Australian PSI®**) fell by 0.9 points to 45.5 to signal a third consecutive month of contraction in service sector activity. (<http://www.aigroup.com.au/economicindicators>)
- On Tuesday, the **Reserve Bank Board** decided to leave the official cash rate unchanged at 4.75 per cent. The RBA noted the temporary adverse impact that the floods are having on economic activity and prices, although it expects that the rebuilding program (while adding to aggregate demand) will not have a major impact on the medium term outlook for inflation. On this basis, the Bank concluded that *"the current stance of monetary policy remained appropriate in view of the general macroeconomic outlook."*
- The **National Australia Bank Monthly Business Survey** showed that business conditions improved modestly in December 2010, although business confidence declined reflecting a severe deterioration in confidence in Queensland following the extensive and damaging floods. The overall business conditions index (a composite index of trading performance, profitability and employment) rose by 2 points to a +6 point index level. Forward orders which give an indication of future demand for goods and services, weakened marginally by 1 point to a weak minus 3 points level. Orders were particularly subdued in the construction, manufacturing, mining and wholesaling sectors. The survey also found that labour costs (a wage bill measure) continued to rise, registering growth of 0.8% in December, although on a 3-month annualised basis, growth moderated to 4.2% from 4.7% in November.
- Reserve Bank of Australia **Financial Aggregates** data showed that total credit provided to the private sector by financial intermediaries rose by 0.2% in December 2010. Housing credit growth remained subdued with growth of just 0.5% reflecting the impact of higher interest rates and weaker lending to investors. Other personal credit which includes credit cards was down by 0.4% while business credit fell by 0.3% consistent with declining business confidence.
- The ABS **House Price Index** revealed that the average price of established houses in Australia's eight capital cities rose by 0.7 in the December quarter 2010 following a 0.3% fall in the previous quarter. In annual terms, house price growth increased at a rate of 5.8%, down from the recent peak of 18.8% in the March quarter 2010 reflecting reduced demand for housing during the year amid higher interest rates and the end to the First Home Owners Boost. By state, strong price gains were recorded in Sydney, Melbourne, Canberra and Hobart during the quarter. In contrast, prices fell sharply in Perth while Brisbane showed very little growth during the quarter.
- The ABS **Building Approvals** data showed a 8.7% seasonally adjusted rise in the number of dwelling units approved in December following a .9% decline in the previous month. A 21.3% decline in the more volatile "other dwellings" segment (which includes apartments, townhouse and units) drove the increase in total building approvals. In contrast, private sector house approvals were flat in December (and down by 16.0% on an annual basis), consistent with the lagged impact of the RBA's November interest rate rise plus the larger increases in bank lending rates. The value of non-residential building approvals rose by a seasonally adjusted 13.1% in December, although over the year were down by 41.2%.

- The latest **HIA - Jeld-Wen New Home Sales Report**, a survey of Australia's major residential builders, confirmed a soft end to house sales in 2010 with the number of new homes sold easing back by 0.6% in December 2010. Detached house sales increased slightly by 0.3% while multi-unit sales fell by 7.3%. In calendar year 2010, new home sales fell by 4.4% and were down 11.0% over the second half of last year. By state, detached new house sales increased by 3% in New South Wales, 5.8% in Queensland, and 4.2% in Western Australia. Sales fell by 3.7% in Victoria and 6.6% in South Australia.
- ABS **International Trade** data showed that Australia's trade surplus in December 2010 was \$1.9 billion, representing only a slight change on November's revised surplus of \$2.1 billion and extending the sequence of surpluses to nine months. The value of exports rose by just 0.3% rise in December as Australian exporters continued to be inhibited by the strong Australian dollar, while the value of imports rose by 0.8%. Imports of capital and consumption goods both declined (down by 3.8% and 1.0% respectively), consistent with recent weakness in business credit and retail volumes. The increase in exports reflected a 1.4 % rise in non-rural exports (largely iron ore and coal) and a 0.9% rise in rural exports.
- Official **VFACTS** data released by the Federal Chamber of Automotive Industries (FCAI) showed that 73,584 passenger cars, SUVs and commercial vehicles were sold in January (down 1.7 %or 1,280 vehicles compared to the same month in 2010).
- In the Reserve Bank of Australia's **Statement on Monetary Policy** (February 2011) released on Friday, the Bank expects the Australian economy to grow at a 4.25% pace in 2011 and to remain at an above average pace of around 3.75 – 4.00% during 2012 and 2013. These forecasts are broadly unchanged since the November 2010 Statement. The RBA noted, however, that the impact of extreme weather events is an important source of short term uncertainty for the forecasts. Overall, year-ended underlying inflation is forecast to be at 2.25% in June 2011, before picking up gradually to 3.0% by December 2012. The near term forecast for inflation has been revised down since the November Statement following the lower than expected December quarter 2010 outcome.

How this affects you

Recent economic developments provide further confirmation of the toughness and fragility of industry conditions in Australia. This was particularly evident in Ai Group's Australian Performance of Manufacturing Index (Australian PMI®) which reported falls in new orders during January in seven of the twelve major industry sub-sectors surveyed. Reflecting on-going subdued demand and business caution, manufacturers drove down stocks during the month rather than ordering new stock with the sharpest falls in new orders occurring in the construction materials; paper, printing & publishing and fabricated metals sub-sectors. The subdued level of private sector house approvals and new home sales in December also highlighted the continued weak state of the housing construction sector with weak demand from first home buyers, higher mortgage rates , falling immigration and lower affordability all impacting negatively on house building demand. Moreover, business credit continued to decline in December, further underlining that businesses remain cautious in their intentions. However, against the backdrop of rising national incomes amid a strong rise in Australia's terms of trade, a strengthening in business credit and expenditure is expected to emerge in coming months. This should help to support stronger economic growth during the year.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0135 ▲
Oil price	USD 87.84 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 9852.98 ▲
Australian PMI (January 2011)	46.7 ▲ 0.4 points
Australian PSI (January 2011)	45.5 ▼ 0.9 points
Australian PCI (December 2010)	43.8 -

Week in Preview: 7-11 February 2011

- On Monday, Ai Group will provide an up to date assessment of conditions across the major sectors of the construction industry with the release of the Australian Performance of Construction Index (**Australian PCI®**) for January 2011.
- The **ANZ job advertisements index** for January will be released on Monday.
- Also on Monday, the ABS will publish estimates on turnover for retail establishments with the release of its **Retail Trade** publication for December 2010.
- The **Westpac – Melbourne Institute Index of Consumer Sentiment** for February 2011 will be released on Wednesday.
- On Thursday, the **ABS Labour Force** publication for January 2011 will be available with an assessment of the latest national and state trends in employment and unemployment.
- RBA Governor Stevens Parliamentary Testimony, 9.30 am Friday 11th February.

* 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.