

Ai GROUP ECONOMICS WEEKLY

Week in Review: 3 – 7 October 2011

- Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) fell by 1.0 point to 42.3 in September to remain below the 50 point level separating expansion from contraction. The Australian Performance of Services Index (**Australian PSI®**) fell by 1.8 points to 50.3, while the Australian Performance of Construction Index (**Australian PCI®**) fell by 2.1 points to 30.0, amid on-going declines in activity, new orders and employment.
[\(<http://www.aigroup.com.au/economicindicators>\)](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 that whilst Australia's terms of trade remained at very high levels and investment in the resources sector was picking up, consumer caution and the strong Australian dollar were exerting a noticeable dampening effect on other sectors. In addition, the RBA indicated that the likely path for inflation was now more consistent with the 2-3 per cent target in 2012 and 2013, and that prospects for a significant increase in labour costs outside of the resources sector had lessened. On this basis, the Bank concluded that *"the current cash rate remained appropriate"*, although it stated that it *"will continue to assess carefully the evolving outlook for growth and inflation"*.
- **ABS International Trade** data showed that Australia recorded a trade surplus of \$3.1bn in August 2011 (an increase of \$1.3bn on the surplus in July) as an 8.0% rise in exports more than offset a 3.3% rise in imports. In terms of imports, intermediate and other merchandise goods increased by a strong 7.0% (driven by an 11.1% rise in fuels and lubricants) while consumption goods imports increased by 3.1% following a 3.6% rise in July. Capital goods imports contracted by 2.5% led by a 15.5% decline in the volatile civil aircraft category. However, machinery and industrial equipment imports which are linked to capital investment rose by 3.3% in the month. On the export side, rural exports rose by 5.9% in August while non-rural exports (largely iron ore and coal) increased by 9.6%, driven by large rises in exports of coal, coke and briquettes (+13.7%), other mineral fuels (+23.7%) and metal ores and minerals (+6.5%).
- **ABS data on Retail Trade** showed that retail sales increased for a second consecutive month in August with the seasonally adjusted value of retail turnover rising by 0.6%. Annual growth in retail turnover rose from 1.5% in July to 2.1% in August. The trend annual growth rate was steady at 1.8% in August, on par with the record-low set in July. Across the retailing sectors, the strongest rise occurred in household goods retailing which rose by 1.7% led by sales of furniture and floor coverings. Spending on cafes, restaurants and takeaway food services was also solid, rising by 1.2%, the second consecutive strong month of growth for this discretionary sales category. However, retail sales in the clothing, footwear & personal accessory retailing and department store retailing remained weak, contracting by 0.3% and 0.8% respectively.
- The **ABS Building Approvals** data showed an 11.4% seasonally adjusted rise in the number of dwelling units approved in August following growth of 1.8% in the previous month. A 35.1% increase in the volatile high density apartments category (private sector other dwellings) drove the upturn in approvals during September following a fall in this category of 20.0% between May and July 2011. In contrast, private sector house approvals (a more reliable guide to conditions in the housing sector) fell by 1.0% in the month to be 9.5% down over the year.

- ABS Engineering Construction Activity** data showed that the value of total engineering construction work done increased by a seasonally adjusted 2.7% to \$23,308.6m in the June quarter 2011, to be 20.0% above the level in the June quarter 2010. Work for the private sector rose by 1.4% in the quarter (+25.6% annually), while work for the public sector increased by 5.3% in the quarter (+10.8% annually). Forward indicators of activity point to solid growth with engineering construction work yet to be done rising by 30.5% in the year to the June quarter 2011 and work in the pipeline valued at 14.6 months, up from 12.4 months a year ago.

How this affects you

Recent economic developments show that large parts of the economy are continuing to face challenging conditions as a result of the high Australian dollar and consumer caution. This was particularly evident in Ai Group’s Australian Performance of Manufacturing Index (Australian PMI®) which reported falls in new orders during September in seven of the twelve major industry sub-sectors surveyed. Reflecting weak consumer confidence and the erosion of competitiveness due to the strong currency, most sectors reported falls in production with significant decreases in output occurring in the food & beverages, wood products & furniture and transport equipment sub-sectors. Ai Group’s Australian Performance of Construction Index (Australian PCI®) highlighted the persistent weakness of the construction industry with all the major building sectors registering declines in activity in September. This reflected a range of factors including high interest rates, consumer and investor caution and project funding constraints. It was also in line with the broad picture coming from the fragile underlying trend in building approvals and the significant step-up in house price weakness through the middle of the year. Last week’s retail trade data was stronger than expected, offering hope that consumer demand may be starting to pick-up. However, annual growth in retail sales at 2.1% still remains well below the long-term growth rate over the past decade of 5.5%. Moreover, it comes against a backdrop of a softening in the labour market and heightened uncertainty about both the prospects for global economic growth and the resolution of sovereign debt and banking problems in Europe. These factors are likely to continue to weigh on consumer sentiment and household spending in coming months.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$0.9769 ▲
Oil price	USD 82.45 per bbl ▲
Annual growth in GDP	1.4 per cent -
Unemployment rate (%)	5.3 per cent -
Annual growth in headline CPI	3.3 per cent -
Copper price	AUD 7,421.44 ▲
Australian PMI (September)	42.3 ▼ 1.0 points
Australian PSI (September)	50.3 ▼ 1.8 points
Australian PCI (September)	30.0 ▼ 2.1 points

Week in Preview: 10 – 14 October 2011

- On Monday, the **ANZ job advertisements index** for September 2011 will be released.
- Tuesday will also see the release of the **National Australia Bank Monthly Business Survey** for September 2011.
- On Wednesday, the ABS will release for August 2011 **Housing Finance** data commitments for owner occupation, commitments for construction or purchase of dwellings for rent or resale, and loans outstanding to individuals/households for housing.
- The **Westpac – Melbourne Institute Index of Consumer Sentiment** for October 2011 will also be released on Wednesday.
- Speech by **Guy Debelle, Assistant Governor, Reserve Bank of Australia (Financial Markets)** – High Frequency Trading in Foreign Exchange Markets – to the ACI Australia High Frequency Trading Conference, Westin Hotel, Sydney, Wednesday at 3.00pm.
- 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 August 2011.
- **Speech by Luci Ellis, Head of Financial Stability Department, Reserve Bank of Australia** – The Platypus Moment: Rents, Risks and the Right Responses – to the Paul Woolley Centre for the Study of Capital Market Dysfunctionalities Annual Conference, University of Technology, Sydney, Thursday at 9.50am.

* 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.