

# Ai GROUP ECONOMICS WEEKLY

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**Week in Review:** 31 October – 4 November 2011

- Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) rose by 5.1 points to 47.4 in October, indicating an easing in the pace of decline in manufacturing. The Australian Performance of Services Index (**Australian PSI®**) declined by 1.5 points to 48.8, with uncertainty about the economic outlook and on-going consumer caution continuing to undermine activity in the sector.  
[\(<http://www.aigroup.com.au/economicindicators>\)](http://www.aigroup.com.au/economicindicators)
- On Tuesday, the **Reserve Bank Board** decided to cut the official cash rate by 25 basis points to 4.50%, the sixth consecutive change in rates on Melbourne Cup day. The dampening influence of the strong Australian dollar on the non-resources sectors, caution by households and tighter than normal financial conditions, appear to be among the major domestic factors underlying the rate cut decision. The global economic outlook is also most likely to have influenced the RBA's decision with the Board noting that economic prospects for Europe remain weak and that the significant slowing in Europe are starting to have an adverse impact on Asia's trade performance. Additionally, the RBA noted that subdued demand and the high exchange rate had contained inflation more recently. On this basis, the Bank concluded that *"a more neutral stance of monetary policy would now be consistent with achieving sustainable growth and 2-3 per cent inflation over time"*.
- The ABS **House Price Index** showed that house prices continued to moderate with the average price for established houses in Australia's eight capital cities falling by 1.2% in the September quarter 2011. In annual terms house prices declined by 2.2%, in line with the annual rate in the June quarter, which was the first annual decline in two years. The state breakdown revealed that Sydney house prices have continued to outperform other capital cities, falling by just 0.2% in the quarter. Brisbane registered the largest decline (-2.5%) followed by Canberra (-2.0%), Melbourne (-1.7%), Perth (-1.3%), Hobart (-1.0%), Adelaide (-0.9%), Canberra (-0.4%) and Darwin (-0.4%).
- Reserve Bank of Australia **Financial Aggregates** data showed that total credit provided to the private sector by financial intermediaries rose by 0.5% in September 2011, its largest monthly gain since March. Despite the rise, the trend in credit growth remains weak. Housing credit increased by 0.5%, although the annual rate remained steady at 5.8%, its equal lowest since 1976. Other personal credit which includes credit cards rose by 0.4%. However, this followed a 1.1% decline in August, the third consecutive monthly fall. Business credit gained 0.5% in the month to be just 0.2% higher over the year.
- The **TD Securities – Melbourne Institute Monthly Inflation Gauge** rose by 0.1% in October, following an identical rise in September. On an annual basis, the Inflation Gauge moderated from 2.8% in September to 2.6%, placing it close to the middle of the RBA's two to three per cent target band for inflation.
- ABS data on **Retail Trade** pointed to tentative signs of an improvement in retail spending with the seasonally adjusted value of retail turnover rising by 0.4%. Annual growth in retail turnover increased from 2.0% in August to 2.3% in September. Nevertheless, the trend remains a weak one with the rate of growth in retail sales having moderated for a third consecutive month in September. The increase in retail sales was led by retailing in household goods (+1.0%) and cafe', restaurants & takeaway food services (+0.9%). However, retailing in clothing, footwear & personal accessories and department stores remained weak, with both categories rising by just 0.1% in the month, a likely reflection of their greater exposure to competition from online buying.

- The ABS **Building Approvals** data showed a 13.6% seasonally adjusted decline in the number of dwelling units approved in September following a rise of 10.7% in the previous month. On an annual basis, the pace of decline accelerated to -12.0% compared to -5.3% in the previous month. A 30.7% decrease in the volatile high density apartments category (private sector other dwellings) drove the downturn in approvals during September after a solid rise of 32.8% in this category in the previous month. Private sector house approvals (a more reliable guide to conditions in the housing sector) rose by 1.1% in the month. Despite this growth, housing approvals remain anchored at more than 20.0% below levels of two years ago.
- The latest **HIA - Jeld-Wen New Home Sales Report**, a survey of Australia's major residential builders, confirmed that the volume of new home sales remained subdued and well below their historical average. The number of new homes sold increased by 3.5% in September, to be down by 14.0% over the September quarter. Detached house sales fell by 3.3% in September 2011 while sales of multi-units fell by 5.5%. By state, detached new house sales increased by 5.7% Queensland but fell in each of the other mainland states. Victoria posted the largest monthly fall with sales declining by 6.6 per cent in September, followed by South Australia (-5.9%), New South Wales (-4.7%) and Western Australia (-3.5%).
- In the Reserve Bank of Australia **Statement on Monetary Policy** (October 2011) released on Friday, the Bank expects the Australian economy to grow by 2.75% in 2011, which is a downward revision from the 3.75% forecast in August. This revision reflects a slower than expected recovery in coal production; the loss of momentum in the non-mining economy and; a subsequent softening in labour market conditions in the past six months. There is little change to GDP forecasts for the years ending December 2012 (3-3½%) and December 2013 (3-4%) reflecting the strong medium term outlook for the resources sector. Year-ended underlying inflation, excluding the impact of the introduction of a price on carbon, is forecast to be around or above the (2-3%) target band over the period to 2013. In December 2011, year-ended growth in underlying inflation is expected to be at 2½% and to remain at this pace during 2012. Thereafter, year ended inflation in December 2013 is expected to increase to 2½ -3% as capacity in the domestic economy tightens.

## How this affects you

Recent economic developments provide further confirmation of the range of headwinds that continue to confront large parts of the economy, including the strong Australian dollar and on-going consumer and investor caution. This was particularly evident in Ai Group's Australian Performance of Manufacturing Index (Australian PMI®). Despite an easing in the overall rate of decline in manufacturing, eight of the twelve major industry sub-sectors surveyed recorded falls in activity during October, with the clothing and footwear sector experiencing the most pronounced decline. Substantial weakness also continued in sectors hit by the subdued state of house building and the slowdown in commercial construction work, including wood products and furniture, fabricated metals and construction materials. Indeed, the building approvals data for September confirmed that the underlying trend in housing remains fragile with housing approvals anchored at more than 20.0% below levels of two years ago. Moreover, the value of commercial (non-residential) building approvals fell by 19.9% in September reflecting the diminishing number of fiscal stimulus projects (education and health building) and renewed weakness during the month across a range of private sector building categories, including retail, offices and industrial premises. Last week's retail trade data also indicates that the cautious mood of consumers has remained dominant during 2011, despite tentative signs of retail spending improving. This accords with the challenging conditions that continue to confront the services sector as highlighted in the Ai Group's Australian Performance of Services Index (Australian PSI®) which depicted a reduction in services activity in October amid weaker sales, new orders and employment. On-going European sovereign debt concerns and uncertainty about the global economic outlook continue to weigh on confidence and domestic demand, although the interest rate cut from the RBA last week could help in providing a positive offsetting influence.

## Latest data\*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0373 ▼
Oil price	USD 94.25 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 7,644.85 ▲
Australian PMI (October)	47.4 ▲ 5.1 points
Australian PSI (October)	48.8 ▼ 1.0 points
Australian PCI (September)	30.0 -

## Week in Preview: 7<sup>th</sup> – 11<sup>th</sup> November 2011

- On Monday, Ai Group will release its Australian Performance of Construction Index (**Australian PCI®**) for the month of October.
- Also on Monday, the **ANZ job advertisements index** for October will be released.
- Preliminary international trade estimates on a balance of payments basis will be available on Tuesday with the release of ABS data on Australia's **International Trade in Goods and Services** for September 2011.
- Tuesday will also see the release of the **National Australia Bank Monthly Business Survey** for October 2011.
- On Wednesday, the ABS will release September 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 November 2011 will also be released on Wednesday.
- 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 October 2011.
- Speech by **Reserve Bank Of Australia Assistant Governor (Economic), Philip Lowe**, to the Australian Farm Institute Agriculture Roundtable Conference 2011, The Hotel Windsor, Melbourne, Thursday, 9.30 am.

\* 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).