

Ai GROUP ECONOMICS WEEKLY

Week in Review: 1 August – 5 August 2011

- Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) declined by 9.5 points to 43.4 in July reinforcing the tough trading conditions that continue to restrict growth in the sector (readings below 50 indicate a contraction in activity). The Australian Performance of Construction Index (**Australian PCI®**) rose by 0.3 points to 36.1, while the Australian Performance of Services Index (**Australian PSI®**) rose by 0.3 points to 48.8 with the majority of services businesses experiencing soft trading conditions.
[\(<http://www.aigroup.com.au/economicindicators>\)](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 investment was picking up strongly in the resources sector, cautious household spending and the high level of the exchange rate were having a noticeable dampening effect on other sectors. Whilst the Board remained concerned about the outlook for inflation it judged that "it was prudent to maintain the current setting of monetary policy, particularly in view of the acute sense of uncertainty in global financial markets over recent weeks." However, it stated that it would "continue to assess carefully the evolving outlook for growth and inflation" at future meetings.
- The ABS **House Price Index** showed that the average price for established houses in Australia's eight capital cities fell by 0.1% in the June quarter 2011. In annual terms, house prices declined by 1.9%, down from a peak growth rate of 18.8% in the March quarter 2010. The state breakdown revealed declines in house prices in Perth (-1.0%), Adelaide (-0.8%), Brisbane (-0.3%), Melbourne (-0.1%), Darwin (-1.6%) and Hobart (-0.1%) with increases confined to Canberra (+1.1%) and Sydney (+0.4%).
- ABS data on **Retail Trade** showed that retail sales contracted in June with the seasonally adjusted value of retail turnover falling by 0.1%, the third fall in the past four months. Compared to the same time last year, retail turnover rose 1.4%, slower than the 2.0% annual growth recorded in May. The decline in retail sales in June was largely influenced by falls in discretionary areas of spending, including department stores sales (down by 3.2%), and cafes, restaurants & takeaway food services and household goods retailing which both fell by 0.7%. Across the states, retailing fell in South Australia (-0.8%), New South Wales (-0.5%) and Victoria (-0.1%). Western Australia and Queensland recorded increases of 0.5% and 0.2% respectively, while retail sales were flat in Tasmania.
- The ABS **Building Approvals** data showed a 3.5% seasonally adjusted decline in the number of dwelling units approved in June following a 6.3% decline in the previous month. On an annual basis, the pace of decline was steeper at 15.5% as compared to 13.3% in May. The annual rate has now been in double-digit territory for six consecutive months. June's decline in dwelling approvals reflected a 4.2% fall in the high density apartments category (private sector other dwellings) and a 3.2% decline in private sector houses.
- The latest **HIA - Jeld-Wen New Home Sales Report**, a survey of Australia's major residential builders provided further evidence that the housing sector is faltering under the weight of consumer and investor caution and stretched affordability. The number of new homes sold declined by 8.7% in June, the sharpest monthly decline since May 2006. By state, detached new house sales fell by 1.8% in New South Wales, 10% in Victoria, 17.1% in Queensland, and 6.3% in Western Australia. Sales were flat in South Australia.

- **ABS International Trade** data showed that Australia recorded a trade surplus of \$2.1bn in June 2011 (a fall of \$647m on the surplus in May) as a rise in imports (2.6%) more than offset a decline in exports (-1.0%). In terms of imports, intermediate and other merchandise goods rose by 7.3% (driven by a 10.9% increase in fuels and lubricants) while consumption goods imports fell by 0.6% consistent with continued consumer cautiousness and weak retail sales. In a positive sign for business investment, capital goods imports increased by 7.3%. On the export side, rural exports rose by 3.0% in June while non-rural exports (largely iron ore and coal) rose by 4.0%, boosted by a 4.5% rise in exports of metal ores and minerals as consequence of strong increases in copper and ores and concentrates of base metals.
- Federal Chamber of Automotive Industries (FCAI) official **VFACTS data** showed that 80,991 new vehicles were sold in July, 1.7% (or 1,385) fewer than in the same month in 2010 reflecting continued delays in new vehicle purchases by consumers and supply disruptions of vehicles and components from Japan as a consequence of the earthquake and tsunami in March.
- In the Reserve Bank of Australia's **Statement on Monetary Policy** (August 2011) released on Friday, the Bank expects the Australian economy to grow at a 3.25% pace in 2011, which is a downward revision from 4.25% in May. This revision reflects a slower than expected recovery in coal production and a downward revision to consumer spending as domestic and international concerns weigh on sentiment. There is little change to GDP forecasts for the years ending December 2012 (3.75%) and June 2013 (3.75%) reflecting the strong medium term outlook for the resources sector. Highlighting the RBA's inflation challenge, year-ended underlying inflation 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 3.25% before moderating in the year to June 2012 (3.0%) with subdued retail conditions and the strong dollar exerting some dampening influence. Thereafter, year ended underlying inflation is expected to increase to 3.75% in December 2012 and December 2013 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, sluggish domestic demand and deteriorating business confidence. This was particularly evident in Ai Group's Australian Performance of Manufacturing Index (Australian PMI®) which reported falls in new orders during July in eight of the twelve industry sub-sectors surveyed. Reflecting on-going consumer caution and the substantial erosion of competitiveness due to the strong currency, most sectors reported falls in production with significant decreases in output occurring in the wood, products & furniture and clothing & footwear 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 experiencing declines in activity in July. This reflected a range of factors including the dampening impact of last year's increases in interest rates, weak buyer confidence and a diminishing level of government backed projects. It was also in line with the broad picture coming from softening house prices, lackluster demand for house construction finance and the decline in building approvals in July to their lowest level in two years. The weakness in building approvals was broadly based in June across houses and high density units, with the value of non-residential building approvals also exhibiting a significant downward trend. In addition, last week's retail trade data confirms that the cautious mood of consumers has remained dominant through the first half of 2011. This accords with the tough conditions that continue to confront the services sector as highlighted in the Ai Group's Australian Performance of Services Index (Australian PSI®) which depicted contracting services sector activity in July amid further declines in sales, new orders and deliveries. Against a backdrop of a noticeable lift in downside risks to the world economy, last week's data adds further weight to the case for the RBA to keep interest rates on hold in coming months.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0440 ▼
Oil price	USD 86.87 per bbl ▼
Annual growth in GDP	1.0 per cent -
Unemployment rate (%)	4.9 per cent -
Annual growth in headline CPI	3.3 per cent -
Copper price	AUD 8802.68 ▼
Australian PMI (July)	43.4 ▼ 9.5 points
Australian PSI (July)	48.8 ▲ 0.3 points
Australian PCI (July)	36.1 ▲ 0.3 points

Week in Preview: 8th August – 12th August 2011

- The **TD Securities Melbourne Institute (TDMI) Inflation Gauge** for July will be released on Monday to provide an estimate of consumer inflation pressures.
- Tuesday will see the release of the **National Australia Bank Monthly Business Survey** for June 2011.
- Also on Tuesday, the ABS will release June 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.
- **Lending Finance** data for the month of July 2011 will be published by the ABS on Wednesday. This will provide statistics on finance commitments for secured housing finance for owner occupation, other personal finance, commercial finance and lease finance.
- The **Westpac – Melbourne Institute Index of Consumer Sentiment** for August 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 July 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.