

# Ai GROUP ECONOMICS WEEKLY

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## Week in Review: 2 May – 6 May 2011

- Ai Group's Australian Performance of Manufacturing Index (**Australian PMI®**) rose by just 0.5 points to 48.4 in April to remain below the 50 point level separating expansion from contraction. The Australian Performance of Services Index (**Australian PSI®**) rose by 5.0 points to 51.5, while the Australian Performance of Construction Index (**Australian PCI®**) fell by 1.5 points to 37.9, amid on-going declines in activity, new orders and employment. (<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 rise in inflation arising from production losses due to the floods and Cyclone Yasi, although it expects that these will represent temporary price shocks and that CPI inflation will be close to target (2-3%) over the year ahead. On this basis, the Bank concluded that *"the current mildly restrictive stance of monetary policy remained appropriate"*, although it stated that it *"will continue to assess carefully the evolving outlook for growth and inflation"*.
- The ABS **House Price Index** showed that the average price for established houses in Australia's eight capital cities fell by 1.7% in the March quarter 2011. In annual terms house prices declined by 0.2%, down from a peak growth rate of 18.8% a year ago, reflecting reduced demand for housing amid higher interest rates and lower affordability. The state breakdown revealed declines in house prices in Melbourne (-2.5%), Sydney (-1.8%), Brisbane (-2.5%), Adelaide (-1.0%), Canberra (-0.4%) and Darwin (-1.0%), with increases confined to Perth (+0.5%) and Hobart (+0.4%).
- ABS data on **Retail Trade** showed that retail sales contracted in March with the seasonally adjusted value of retail turnover falling by 0.5%. Annual growth in retail turnover fell from 3.6% in February to 2.3% in March. The decline in retail sales in March was broadly based with the largest decline recorded in department store sales which fell by 3.0%, the most marked fall in more than a year. Clothing, footwear & personal accessory retailing was the only sector to record growth, although this was very slight at 0.1%. The retail data for March highlighted on-going consumer caution and pointed to the likely impact of the high Australian dollar encouraging greater on-line spending among consumers.
- The ABS **Building Approvals** data showed a 9.1% seasonally adjusted rise in the number of dwelling units approved in March following a 15.4% decline over the first two months of the year. However, on an annual basis, dwelling approvals continued to contract, registering a decline of 18.1%. A 26.1% increase in the volatile high density apartments category (private sector other dwellings) drove the upturn in approvals during March after a sharp fall in this category in the previous month. In contrast, private sector house approvals (a more reliable guide to conditions in the housing sector) fell by 0.8% in the month to be 17.8% down over the year.
- 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 4.3% in March from a weak base while sales of multi-units fell by 10% following a 7.6 per cent decline in February. 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 detached new house sales increased by 13.5% in New South Wales, 11.1% in Queensland, 3.6% in Victoria, and 3.1% in Western Australia. Sales fell by 6.4 per cent in South Australia.

- In the Reserve Bank of Australia's **Statement on Monetary Policy** (May 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 during 2012 and 2013. However, GDP forecasts for the years ending December 2012 and June 2013 at 3.75% have been revised downward (since the previous Statement in February) reflecting the adverse impact of the strong Australian dollar on sectors outside of mining. Year-ended underlying inflation forecasts have been upgraded with growth forecast to be at 2.5% in June 2011, before picking up to a 3.0% pace by December 2012. Highlighting the RBA's inflation challenge, underlying inflation is forecast to be above the target band (2-3%) through the year to December 2013 at 3.25%.

## 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 the intensification of skill shortages. This was particularly evident in Ai Group's Australian Performance of Manufacturing Index (Australian PMI®) which reported falls in new orders during April in nine of the twelve major industry sub-sectors surveyed. Reflecting on-going consumer caution and the substantial erosion of competitiveness due to the surging currency, most sectors reported falls in production with significant decreases in output occurring in the transport equipment, textiles and paper, printing & publishing 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 exhibiting declines in activity in April. This reflected a range of factors including the dampening impact of last year's increases in interest rates, weak buyer confidence and the unwinding of fiscal stimulus. It was also in line with the broad picture coming from declining house prices, the recent slump in finance for the purchase of new dwellings and the underlying weakness in building approvals. Moreover, last week's retail trade data indicates that the cautious mood of consumers has remained dominant during the early months of 2011. 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 mixed services sector activity in April with the sector's overall improvement (on the back of rises in employment and inventories) masking further declines in sales, new orders and deliveries. A tight labour market and strong growth in household incomes suggests that consumers can lift spending, although much will depend on the future direction of interest rates.

## Latest data\*

<b>Official cash rate</b>	<b>4.75 per cent -</b>
<b>AUD/USD exchange rate</b>	<b>\$1.0690 ▼</b>
<b>Oil price</b>	<b>USD 96.75 per bbl ▼</b>
<b>Annual growth in GDP</b>	<b>2.7 per cent -</b>
<b>Unemployment rate (%)</b>	<b>4.9 per cent -</b>
<b>Annual growth in headline CPI</b>	<b>2.8 per cent -</b>
<b>Copper price</b>	<b>AUD 8222.63 ▼</b>
<b>Australian PMI (March)</b>	<b>48.4 ▲ 0.5 points</b>
<b>Australian PSI (March)</b>	<b>51.5 ▲ 5.0 points</b>
<b>Australian PCI (March)</b>	<b>37.9 ▼ 1.5 points</b>

## Week in Preview: 9<sup>th</sup> May – 13<sup>th</sup> May 2011

- On Monday, the **ANZ job advertisements index** for April will be released.
- **Federal Budget** delivered, Tuesday (7.30pm).
- 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 March 2011.
- Tuesday will also see the release of the **National Australia Bank Monthly Business Survey** for March 2011.
- 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 April 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](mailto:economics@aigroup.asn.au).