

Ai GROUP ECONOMICS WEEKLY

Week in Review: 18 April – 21 April 2011

- **ABS Building Activity** data revealed a fall of 4.3% in the value of building work done (residential and non-residential) in the December quarter 2010. The reduction was driven by an 8.7% decline in non-residential building (commercial) work done. Residential building work (new houses and other residential building) remained subdued falling by 0.6% in the quarter, despite a growing pipeline of residential work outstanding. The winding back of the Federal Government's fiscal stimulus package saw the value of public building work done decline by 7.7% while private building work was also lower, falling by 3.2% after a reduction of similar magnitude in the previous quarter.
- The minutes of the 5th April **Reserve Bank of Australia Board meeting** made reference to the negative impact of recent natural disasters on domestic production including the slower than expected recovery in coal production due to delays in removing water from the coal mines. The Board noted that household spending remained subdued and that consumer sentiment was only modestly above long term average levels. The Board also highlighted the unevenness of conditions across the economy with the appreciation of the exchange rate continuing to weigh on the trade-exposed sectors such as tourism and manufacturing. However given the overall positive outlook for the economy, and in particular the high level of the terms of trade and the strong outlook for investment in the resources sector, the Board considered that the current (mildly restrictive) stance of monetary policy remained appropriate so as to ensure that the medium-term inflation outlook was consistent with the (2-3 per cent) target range. As a result, the Board decided to leave the cash rate steady at 4.75%.
- **ABS International Merchandise Imports** data revealed that imports decreased by 12% in March to \$18.5 billion (original terms). Capital goods imports increased by 19.4% while consumption goods imports increased by 5.4%.
- ABS data on **International Trade Prices** for the December quarter 2010 showed that export prices increased by 5.2% (reflecting sustained global demand for commodities) while import prices increased by 1.4% with the dampening influence on import prices of the strong Australian dollar offset primarily by higher prices for petroleum and petroleum products. The terms of trade increased by 3.8% in the quarter, to be up by 22.1% over the year.
- ABS data on **Producer Prices** showed that the increase in final stage producer prices was slightly higher than expected in the March quarter 2011, with the Final Stage Producer Price Index (FSP) rising by 1.2% against a median market forecast increase of 1.0%. It also marked the third consecutive quarterly increase in producer prices, resulting in a pick-up in the annual rate of growth to 2.9% from +2.7% in the December quarter and the low of -0.1% touched a year ago. The rise in producer prices was mainly due to rises in the prices received for petroleum refining (+13.0%), other agriculture (+13.7%) and electricity, gas and water (+2.7%).
- The **Westpac – Melbourne Institute Leading Index** which indicates the likely pace of economic activity three to nine months into the future was 4.7% in February, well above its long term trend of 3.3%. While the growth rate of the leading index has stabilised over the last six months, it remains indicative of solid economic growth in 2011.

How this affects you

Last week's data indicates that producer prices posted a modestly stronger gain in the March quarter 2011. The high value of the Australian dollar helped to contain imported inflationary pressures (imports are mainly priced in AUD/USD terms), and limit the influence of rising oil and food prices, and on-going pressure from increasing utility costs. Nevertheless, the step up in the annual rate of growth in producer prices to 2.9%, the highest pace of growth over the past eight quarters, is consistent with the picture of a pick-up in inflation in the producer pipeline. This is in line with the findings of Ai Group's Australian PMI[®] which shows that input cost growth for manufacturers has remained at an elevated level during recent months. Over coming quarters, the resources sector is likely to be a key driver of inflation as the expected build-up of supply constraints leads to upward pressure on input costs, including labour, equipment and materials. This stems from the high in the terms of trade and the projections of a large investment build up in the resource sector. For this reason, businesses need to be mindful of the risks of higher input costs and the potential adverse impact on earnings and margins.

Latest data*

Official cash rate	4.75 per cent -
AUD/USD exchange rate	\$1.0784 ▲
Oil price	USD 112.21 per bbl ▲
Annual growth in GDP	2.7 per cent -
Unemployment rate (%)	4.9 per cent -
Annual growth in headline CPI	2.8 per cent -
Copper price	AUD 9455.50 ▲
Australian PMI (March)	47.9 -
Australian PSI (March)	46.5 -
Australian PCI (March)	39.4 -

Week in Preview: 27th April – 29th April 2011

- The latest reading on the rate of inflation in Australia will be available on Tuesday, with the ABS releasing the **Consumer Price Index** for the March quarter 2011.
- On Friday, private credit data for March 2011 will be made available with the release of the latest RBA **Financial Aggregates** publication.

* 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.