

AUSTRALIAN ECONOMIC UPDATE – JULY 2010

EXECUTIVE SUMMARY

Overall, recent official economic forecasts and forward-looking data suggest that the economy will continue to grow solidly during 2010-11 and 2011-12, notwithstanding some short-term patchiness in growth.

Among the positives, the labour market is seeing a sustained lift in full-time employment, boosting consumers' perceptions of job security and incomes growth. Recent partial economic data suggest, however, that retail sales remain soft and housing finance approvals continue to ease under the weight of higher interest rates and uncertainty around the global economy.

The Reserve Bank Board continues to hold the view that the economy will return to trend growth by late 2010 and in early May the RBA Board raised the official cash rate to 4.5%, a level more consistent with longer-term averages. However, it left the cash rate stable at its June and July meetings, indicating concerns over the global outlook.

The key industrial economies remain soft though there are signs of improvement in the United States economy and global economic forecasts have lifted. As yet however, industrial economy growth remains constrained by high unemployment and weak consumer demand and business investment.

Concerns around high levels of public debt in Europe have fuelled fears of rising risk premia and consequently, global long-term interest rates, with the potential to further constrain economic recovery.

Significant growth remains confined to a relatively narrow base of economies, notably the Asian emerging economies driven by stronger growth in China. However, China has recently acted to tighten monetary conditions to forestall inflationary pressure and reduce the potential for destabilising asset price busts. The impact of this development on the region's growth prospects remains uncertain, but signs of slower growth are accumulating.

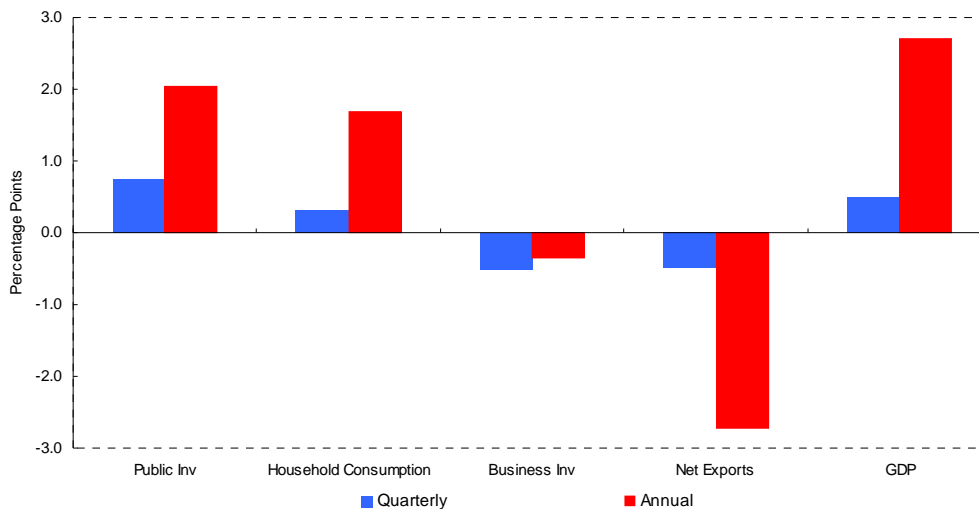
Ai Group's manufacturing and construction indices, in common with the official data, are showing signs of modestly improving activity but activity in the services sector remains weak.

AUSTRALIAN ECONOMIC DATA

The National Accounts for the March quarter 2010 painted a picture of a modest slowing in growth, though the underlying momentum in domestic demand remains solid, if somewhat dependent on public investment.

- Seasonally adjusted, GDP rose by 0.5% in the March quarter 2010 to be up 2.7% in annual terms. The outcome was slightly above market expectations.
- The most significant drivers of growth in the quarter were public sector investment and household consumption. These growth drivers reflect the ongoing impact of public infrastructure stimulus into 2010 and the positive impact of an improved labour market and housing related wealth on consumers' willingness to continue spending. The increase in borrowing rates since October 2009 appears to have slowed consumer demand, however, as it rose at a slower rate than in the December quarter 2009 – consistent with recent retail sales data.
- The main detractors from growth were private sector business investment and net exports.

Chart 1: Key contributors to quarterly and annual GDP growth in March quarter 2010



- In terms of the positive drivers of growth in the March quarter, public investment rose by 11.6% contributing 0.7 percentage points to growth and household consumption grew by 0.6% adding 0.3 percentage points to growth.
- In terms of the key negative contributors to growth in the quarter, private business investment fell by 3.0%, detracting 0.5 percentage points from growth. On the external side of the accounts, exports fell by 0.5% while imports rose by 1.8%, with the net impact a detraction of 0.5 percentage points from GDP growth in the quarter.
- As an important indicator of underlying demand conditions, domestic final demand growth in annual terms continued to accelerate, to 4.4% in the March quarter 2010, up from 3.3% in the previous quarter.

On an industry basis:

- The main positive contributors to growth in the March quarter 2010 were the financial & insurance services; transport postal & warehousing; and professional, scientific & technical services sectors (each contributing 0.2 percentage points).
- Mining; construction; administrative & support services; public administration & safety; and ownership of dwellings each contributed 0.1 percentage points to GDP growth.
- The agriculture, forestry & fishing and accommodation & food services sectors each detracted 0.1 percentage points from GDP growth, while statistical discrepancy resulted in a deduction of 0.2 percentage points.
- Manufacturing production grew by just 0.1% in the March quarter 2010, although this followed a revised 5.1% expansion in the previous quarter. Manufacturing production was 5.3% higher over the year.
- The broadly steady state of manufacturing production in the March quarter 2009 reflected a variation in outcomes across the sub-sectors.
- Production grew in the food, beverage & tobacco manufacturing (+5.7%); metal products (+3.1%); petroleum, coal, chemical & rubber products (+2.9%); and wood & paper products (+1.8%) sectors.
- By contrast, production fell strongly in the machinery & equipment (-8.3%); textile, clothing & other manufacturing (7.8%); and non-metallic mineral products (-5.2%) sectors, and more moderately in printing & recorded media (-1.0%).
- The construction sector's output grew by 0.9% in the March quarter 2010, to be 1.1% higher over the year. The quarterly construction growth outcome for the December quarter was revised down from 2.8% to 0.3% in the most recent Accounts.
- The retail trade sector recorded flat growth in the March quarter 2010, following a 0.8% expansion in the previous quarter.

In line with the national accounts data, private new capital spending eased in March quarter 2010, though the expectations data for 2010-11 remained solid.

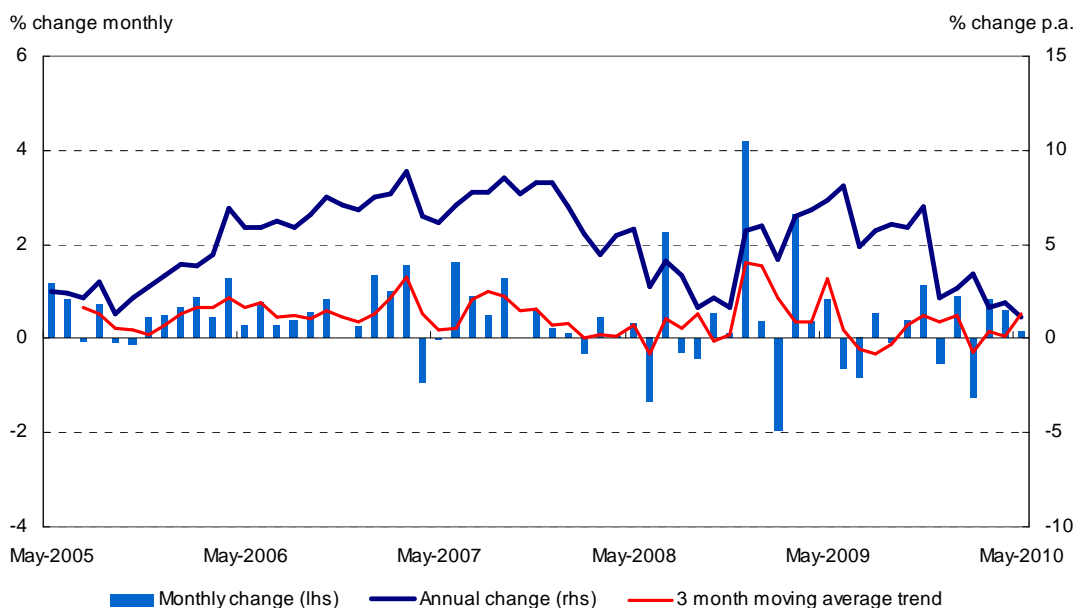
- The volume of private new capital expenditure fell by 0.2% in the March quarter 2010 (seasonally adjusted), following a (revised up) rise of 6.1% in the December quarter 2009.
- The March quarter result was significantly worse than the median market forecast of a rise of 2.5%.
- The annual rate of change improved, from a fall of 2.8% in the December quarter 2009 to a rise of 1.0% in the March quarter 2010.
- Investment in building and structures (volumes) rose by 6.7% in the March quarter, following a 0.6% fall in the previous quarter, to be 1.0% lower over the year.
- Investment in equipment, plant & machinery fell solidly in the March quarter 2010, down 6.0%, following a 12.5% rise in the previous quarter. In the year to the March quarter 2010, investment in equipment, plant & machinery rose by 3.0%.

- Manufacturing capital investment fell by 14.7% in volume terms in the March quarter 2010, to be 12.6% lower than a year ago.
- The seasonally adjusted volume of expenditure by the manufacturing sector on buildings & structures fell by 20.7% in the quarter, while the volume of expenditure on equipment, plant & machinery fell by 11.3%.
- Elsewhere, investment in mining rose by 2.6% in volume terms in the March quarter, following a 0.5% fall in the December quarter 2010. The volume of mining investment in the March quarter was 8.4% lower than a year ago.
- Investment in 'other selected industries' rose by 1.1%, to be 9.6% higher than a year ago.
- Assuming reasonable realisation ratios for investment outcomes, business expectations for investment reported in the March quarter 2010 imply a fall in current price private capital investment of around 4.0% in 2009-10. This is in line with the 2010-11 Budget forecast of a 2.0% fall in business investment in 2009-10 in volume terms.
- Looking further ahead, business expectations data for 2010-11 imply growth in the value of total investment of 14.7% in 2010-11. This compares with a 2010-11 Budget forecast of growth of 7.0% in the volume of business investment in the same year.

Other domestic partial economic data released over May and into June suggest ongoing improvement in the overall economy, though soft spots remain reflecting the impacts of tighter monetary policy and the fading of earlier policy stimulus.

Retail sales growth has been volatile since the second half of 2009, and the first half of 2010 has seen trend growth remain relatively soft as the impact of higher interest rates and still high levels of household indebtedness constrain consumer demand.

Chart 2: Monthly, annual and trend growth in retail turnover (seasonally adjusted)



- Illustrating the softness in sales, the value of retail turnover in seasonally adjusted terms increased by 0.2% in May 2010, following a rise of 0.6% in April, a 0.8% increase in March 2010, and a 1.2% fall in February.
- Annual growth in retail turnover fell from 1.9% in April to 1.2% in May - a nine-year low.
- Retail turnover increased in only two states: New South Wales (0.9%) and Victoria (0.2%). Sales fell most heavily in South Australia (-0.9%), although this followed a strong increase in the previous month. Turnover also fell in Western Australia (-0.3%); Queensland (-0.2%); and Tasmania (-0.1%).

There is some reason to remain cautious about the strength of retail sales over coming months. The Reserve Bank's aggressive increases in the official interest rate since October 2009 and the potential for further increases may deter consumers who remain in the throes of lifting saving and running down debt. Much will depend on continued improvement in employment prospects supporting consumer willingness to spend.

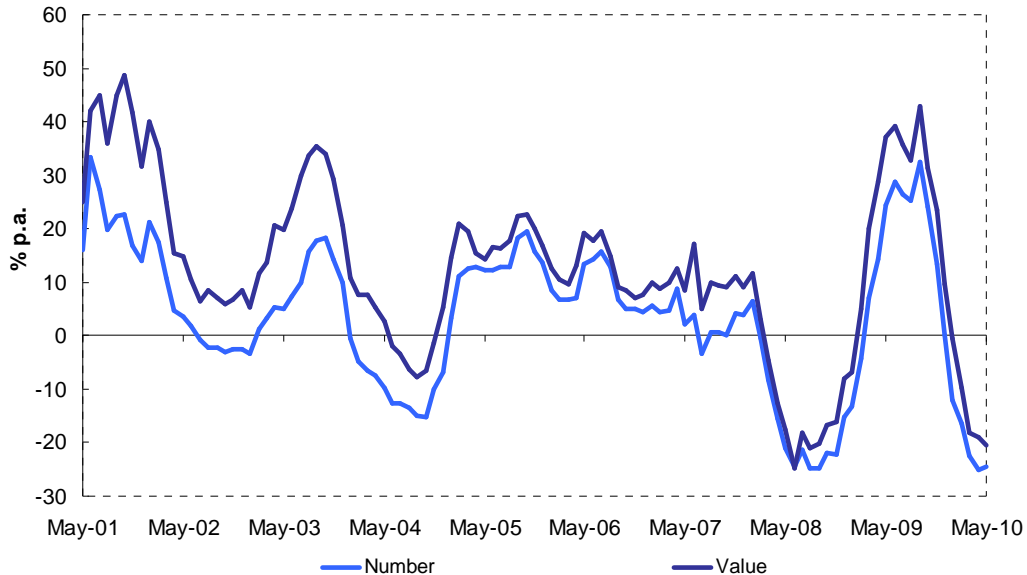
- Suggesting some recent softness in consumers' willingness to spend, other personal credit (essentially consumer borrowings) fell by 0.5 per cent over May, following a rise of 0.2 per cent over April. Over the year to May, other personal credit increased by 3.1 per cent.

Improvements in the housing sector, particularly among first homebuyers, played an important role in early stages of economic recovery. This was largely due to the sharp reductions in home mortgage rates following the RBA's 425 basis point reduction in the official cash rate since September 2008 and the boost to the First Homebuyers' Grant. Australia's long-term deficit of housing stock has also played, and will continue to play a role in supporting underlying housing construction.

However, there have been signs of an easing in demand for housing finance over recent months as interest rates have increased, with expectations of further rises.

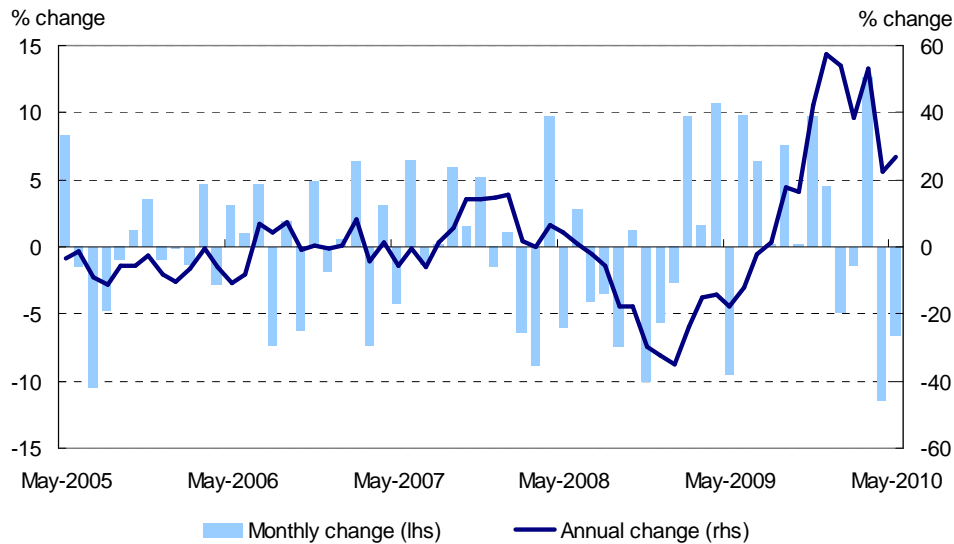
- The value of owner occupied housing commitments fell by 0.3% in May (seasonally adjusted), while the number of owner occupied housing commitments rose by 1.9%.
- The rise in the number of commitments in May was the first in eight months and was better than the flat result anticipated by the markets.
- Reflecting the softening in housing commitments over the past few quarters, the number of owner occupied dwelling commitments in May 2010 was 24.4% lower than at the same time last year.
- The value of owner occupied housing commitments was 20.3% lower than at the same time last year.
- In trend terms, the number of commitments for owner occupied housing finance fell for an eleventh consecutive month, declining by 1.2% in May.

Chart 3: Annual growth in housing finance approvals by value and number (seasonally adjusted)



In line with the lift in housing finance over most of 2009, building approvals, which lag finance approvals, have strengthened solidly, though the data remains volatile.

- The seasonally adjusted number of dwelling units approved fell by 6.6% to 13,412 in May, following an 11.4% decline in the previous month.
- The annual rate of growth in dwelling approvals increased from 22.6% in April to 26.6% in May. This was however well down on the 53.3% annual growth in March 2010.
- A decrease of 18.8% in private sector other dwellings approvals (largely comprising apartments) drove the decline in total dwelling approvals in May. The number of private sector house approvals rose by a seasonally adjusted 1.7% in the month following a 10.7% decline in April.
- The trend number of total dwelling approvals fell by 2.0% in the month, the fourth consecutive month of decline.

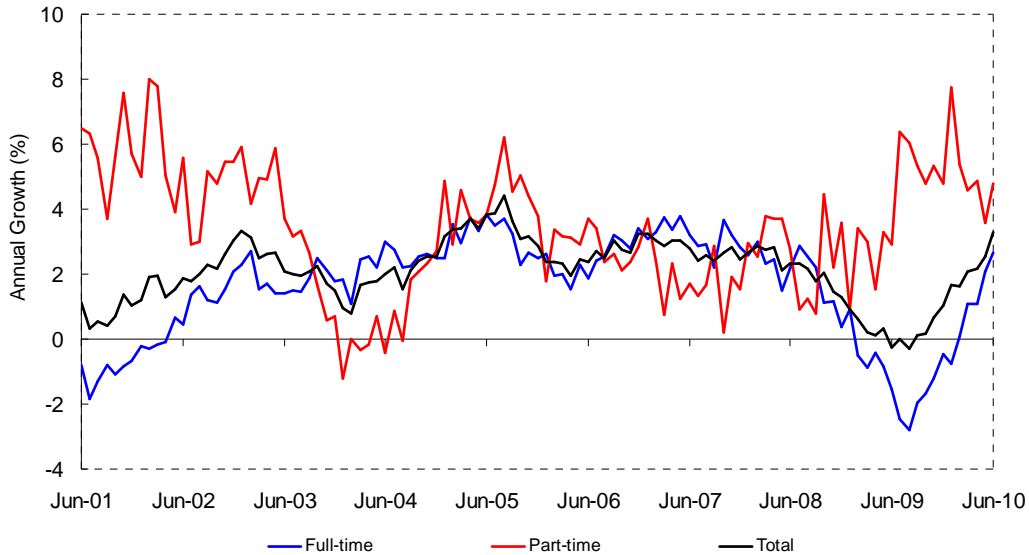
Chart 4: Annual and monthly growth in building approvals by number (seasonally adjusted)


- Looking ahead the easing in finance approvals suggests a further slowing in building approvals over coming quarters.

A key to sustained resilience in consumer demand is the outlook for the labour market. Rising levels of business confidence on the economic outlook appear to be having a positive impact on firms' willingness to lift full-time employment in recent quarters.

- National employment increased by 45,900 (3.3%) to 11,100,700 in June (seasonally adjusted), well above market expectations of a rise of 15,000.
- The rise in total employment was underpinned by a tenth consecutive monthly rise in full-time employment, by 18,400 to 7,794,700, which was complemented by a 27,500 rise in part-time employment, to 3,306,000.
- Annual employment growth accelerated in June, up from 2.5% in May to 3.3% in June (the strongest rate of increase since September 2005).
- Annual growth in full-time employment increased solidly, up from 2.1% in May to 2.7%, while annual growth in part-time employment rose to 4.8% from 3.6% in May.
- The unemployment rate remained steady at 5.1%. The labour force participation rate rose 0.1 percentage points to 65.2% in June.
- Seasonally adjusted, total employment rose in all states - Western Australia (+21,600); New South Wales (+14,800); Queensland (+7,200); Victoria (+4,400); South Australia (+1,400); and Tasmania (+900).
- Unemployment rates ranged from 6.5% in Tasmania; 5.4% in Victoria and South Australia; 5.3% in Queensland; 5.2% in New South Wales; and 4.0% in Western Australia.

Chart 5: Annual growth in employment (seasonally adjusted)

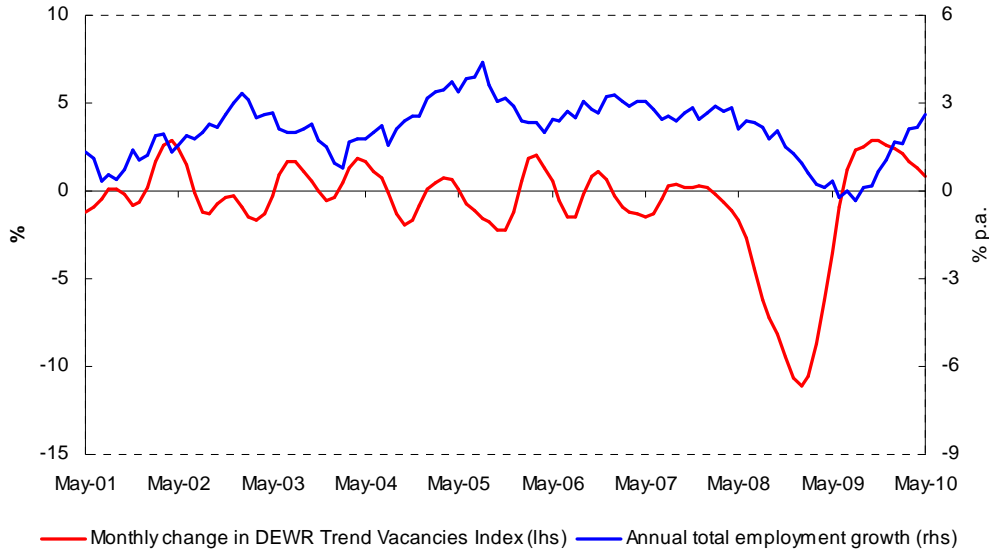


The lagged effect of recent improvement in economic activity is being reflected in the strengthening in the labour market data, reflecting the lag between changes in activity and employment, which is generally around two quarters.

However, despite recent improvements, the tightening of monetary policy carried out by the Reserve Bank since October 2009 is likely to have its most significant impact in the second half of this year and this may cause some softening of employment growth.

Job vacancies data suggest that labour market conditions will continue to improve but at a slower rate as monthly vacancy growth has slowed in recent months.

- The Department of Education, Employment and Workplace Relation's Skilled Vacancy Index (SVI) (trend) increased by 1.0% in May 2010 to 46.8 (2007 = 100).
- In annual terms, the SVI is 24.4% higher than in May 2009.

Chart 6: Monthly change in job vacancies and annual employment growth


The net effects of the recent improvement in labour market outcomes and the impact of the tightening of monetary policy will drive consumers' willingness to spend over coming quarters. Overall, consumers are likely to remain relatively cautious given some uncertainty around the timing and extent of further increases in borrowing rates.

Reserve Bank economic forecasts

Table 1 sets out the Reserve Bank's most recent economic forecasts, which were released as part of its May 2010 Statement on Monetary Policy.

Table 1: RBA economic forecasts (percentage changes over year to quarter)

| April 2010 Statement | Dec-09 | Jun-10 | Dec-10 | Jun-11 | Dec-11 | Jun-12 | Dec-12 |
|---|--------|------------|------------|------------|------------|------------|--------|
| GDP growth | 2.7 | 2.5 | 3.25 | 3.75 | 3.75 | 3.75 | 4 |
| Non-farm GDP | 2.5 | 2.5 | 3.25 | 3.75 | 3.75 | 3.75 | 4 |
| Underlying CPI | 3.25 | 2.75 | 2.75 | 2.75 | 2.75 | 3.0 | 3.0 |
| Difference from February 2010 forecasts | Dec-09 | Jun-10 | Dec-10 | Jun-11 | Dec-11 | Jun-12 | Dec-12 |
| GDP growth | actual | 0 | 0 | +0.25% pts | +0.25% pts | +0.25% pts | na |
| Non-farm GDP | actual | 0 | 0 | +0.25% pts | +0.25% pts | +0.25% pts | na |
| Underlying CPI | actual | +0.25% pts | +0.25% pts | +0.25% pts | 0 | +0.25% pts | na |

(a) For the forecast period, the RBA's technical assumptions include A\$ at US\$0.91, TWI at 71, WTI crude oil price at US\$87 per barrel and Tapis crude oil price at US\$90 per barrel.

Source: RBA Statement on Monetary Policy May 2010

The key elements underpinning the RBA's May forecasts are:

- The central forecast is for GDP to grow by around 3¼ % over 2010, a similar outcome to that forecast three months ago. Growth in public demand is expected to slow as fiscal measures run their course, with this being offset by a pick-up in private-sector demand.
- Beyond this year, growth is expected to increase to be in the 3¼–4 % range, with investment strengthening further. This outlook is underpinned by the positive outlook for the resources sector – including a sharp lift in the terms of trade – with the resources-related parts of the economy expected to record stronger growth, particularly in investment, than other sectors. This forecast assumes that a greater share of the boost to national income due to higher commodity prices will be saved than was the case in the boom in the second half of the 2000s, as households rebuild balance sheets.
- Some easing in the annual rate of underlying inflation is still expected in the short term. However, due to relatively limited amount of spare capacity and current services and utilities price pressures, the trough in inflation later this year now looks likely to be in the top half of the target band, rather than in the middle of the band as previously forecast. A gradual rise in inflation is then expected, as capacity utilisation gradually increases and the effect of the earlier appreciation on the prices of imported goods diminishes.
- There are risks to this central case forecast. Global growth could continue to surprise on the upside and the expansionary impact of the terms of trade could be greater than currently anticipated, particularly if the prospect of future income gains leads to an upgrading of current spending plans. On the downside, a significant slowing in growth in Asia could have a significant impact on the Australian economy, in particular changing the outlook for commodity prices and the resources sector. It is also possible that the fiscal problems in Europe could intensify, prompting a retreat from risk-taking by investors and a sharp slowing in the world economy, although, to date, the impact has been largely confined to Europe.

The key monetary policy message of the Statement was that “the Board will continue to assess prospects for demand and inflation and set monetary policy as needed to achieve an average inflation rate of 2–3 % over time.”

The RBA Board's view of monetary policy

The RBA Board left the official cash rate at 4.50 per cent at its July 2010 meeting. The key reasons behind the decision, as outlined in the RBA's related media release, were as follows:

- The global economy has grown at around trend over recent months, but the expansion remains uneven. The major advanced economies have seen only modest growth overall, while growth in Asia and Latin America has been very strong. Indicators suggest that growth in China is moderating to a more sustainable pace. In Europe, though output has been improving recently in some major economies, next year's outlook is more uncertain given the budgetary constraints governments face and the pressure on euro area banks. US growth has strengthened in the first half of 2010 though the labour market remains soft.
- Financial markets have remained cautious in the past couple of months, reflecting concerns about European sovereigns and banks but also uncertainty around the outlook for global growth.

- Some tightness in funding markets is evident, though not on the scale seen in late 2008. Global commodity prices have eased from their recent peaks but Australia's key commodity prices remain at very high levels. The terms of trade are approaching their peak of two years ago.
- The high level of the terms of trade is expected to add to incomes and demand, and output growth in Australia over 2010 11 is likely to be about trend, despite diminishing support from past policy stimulus. Consumer spending is rising modestly currently, reflecting households' caution, but most indicators suggest business investment will increase over the coming year.
- Business credit appears to have stabilised, though credit conditions for some sectors remain difficult. Housing credit continues to expand at a solid pace.
- The labour market continues to firm gradually and wages growth has picked up a little. Underlying inflation is likely to be in the upper half of the target zone over the next year, while the rate of CPI increase is likely to be a little above 3 per cent in the near term, reflecting higher tobacco taxes and significant increases in utilities prices.
- Current monetary policy is resulting in borrowing rates at around average levels over the past decade. "Pending further information about international and local conditions for demand and prices, the Board views this setting of monetary policy as appropriate."

The RBA Board's decision to leave the cash rate at 4.5% in June and July follows one of the more aggressive phases of monetary tightening since the cash rate became the official tool of monetary policy in the early 1990s.

The RBA tightened policy largely on the basis that rates were pushed aggressively to historical lows in the wake of the Lehman Bros collapse. Given that current and forecast levels of activity and inflation are now at higher levels relative to full employment levels than in the wake of past slowdowns, there is less room for output and employment to increase before inflationary pressures begin to build, particularly in light of persistent skills shortages. In the RBA's view, this has required early action to return the official cash rate to 'normal' levels relatively quickly.

Economic data has supported a move back towards more neutral levels of lending rates over recent months, given the uptick in underlying inflation seen in the March quarter 2010, strong improvements in the terms of trade driven by stellar increases in iron ore and coal prices and the improving outlook for full-time employment which will support consumer demand.

However, the question now is, how far on the tightening side of a neutral cash rate, and how quickly, should the RBA Board move, if at all.

As discussed earlier there remain some soft spots in the economy, notably retail trade and housing finance and we have yet to see the full impact of recent increases in lending rates on employment. Risks to the international economy remain, particularly if global financial markets tighten as a result of rising risk aversion emanating from European sovereign debt markets. China is also in the early stages of tightening policy to arrest inflationary and asset price pressures and the impact of these on the real economy there is, as yet, uncertain.

Given the strength of the RBA's tightening to date, there is now time for the Board to assess the impact of past increases in the cash rate.

International Monetary Fund Forecasts for the World Economy

The International Monetary Fund released an update of its World Economic Outlook and associated forecasts in July 2010.

Table 2: International Monetary Fund (IMF) Growth Forecasts

| | OUTCOME | PROJECTIONS | |
|--------------------------------------|---------|-------------|------|
| | 2009 | 2010 | 2011 |
| World Output | -0.6 | 4.6 | 4.3 |
| Advanced Economies | -3.2 | 2.6 | 2.4 |
| United States | -2.4 | 3.3 | 2.9 |
| Euro Area | -4.1 | 1.0 | 1.3 |
| Germany | -4.9 | 1.4 | 1.6 |
| France | -2.5 | 1.4 | 1.6 |
| Italy | -5.0 | 0.9 | 1.1 |
| Spain | -3.6 | -0.4 | 0.6 |
| Japan | -5.2 | 2.4 | 1.8 |
| United Kingdom | -4.9 | 1.2 | 2.1 |
| Canada | -2.5 | 3.6 | 2.8 |
| Other Advanced Economies | -1.2 | 4.6 | 3.7 |
| Newly Industrialized Asian Economies | -0.9 | 6.7 | 4.7 |
| Australia | 1.3 | 3.0 | 3.5 |

The key points of the update were:

- The world economy grew at over 5 per cent in annual terms during the first quarter of 2010, better than expected previously, largely due to robust growth in the Asian economies.
- There were encouraging signs of growth in private sector demand overall, with global indicators of real economic activity strong through April and stabilising at high levels in May. Reflecting this, industrial production and trade posted double-digit growth and consumer confidence continued to improve. Employment growth resumed in the advanced economies.
- Overall, macroeconomic developments during much of the first quarter of 2010 confirmed a modest but steady recovery in most advanced economies and strong growth in many emerging and developing economies.
- However, turbulence in financial markets over recent months, which reflected a drop in market confidence about fiscal policy sustainability, associated policy responses, and future growth prospects, has emerged as a significant risk for the global economic outlook.
- In terms of outlook, the impact on growth of recent financial volatility remains highly uncertain. However, at this stage, global growth does not appear to have been affected significantly and is expected to be around 4.6% in 2010 and 4.3% in 2011.
- Overall, advanced economy growth is now expected to be 2½ percent in 2010, a small revision higher of ¼ percentage points from April 2010 forecasts, reflecting stronger-than-expected growth during the first quarter, especially in Asia.

- In 2011, advanced economy growth expectations remain broadly unchanged from the April 2010 forecasts, at 2½ percent. Higher than projected growth in the United States (owing to gathering momentum in private sector demand) is offset by slightly weaker projected growth in the euro area (due to financial market turbulence). Overall, the forecast is consistent with a modest recovery in advanced economies, albeit with substantial differentiation among them. Constraining the recovery in these economies are high levels of public debt, unemployment, and in some cases, constrained bank lending.
- For 2011, output growth in emerging and developing economies is expected to edge down to 6½ percent on an annual basis. This forecast is broadly unchanged from April 2010.
- Forecasts for Australia, suggest growth of 3.0% in 2010 and 3.5% in 2011, with still-robust commodity prices boosting private domestic demand.

Ai Group's economic forecasts – 2010

Table 3: Australian Industry Group Forecasts

| | 2010 |
|------------------------|-------|
| GDP Growth - Australia | 2.75% |
| GDP Growth - China | 9.5% |
| GDP Growth - US | 2.75% |
| GDP Growth - World | 4.0% |
| CPI | 3.0% |
| Unemployment Rate (a) | 5.0% |
| Official cash rate (a) | 4.5% |

(a) as at end of year.

Recent Ai Group Data on industry activity

Overall, Ai Group's monthly sectoral performance indicators suggest an improvement in activity in the manufacturing and construction sectors, however the services sector, particularly consumer related sub-sectors, remains weak.

Manufacturing

The pace of growth in manufacturing activity slowed in June from the strong performances in April and May. The seasonally adjusted Australian Industry Group-PricewaterhouseCoopers Australian PMI® fell by 3.4 points to 52.9, but remained above the 50 point level separating expansion from contraction.

Growth in overall manufacturing eased, largely due to slower growth in manufacturing production, new orders, employment and supplier deliveries. Inventories rose moderately in June.

Growth rates in all components of the index were moderate.

The consumer-related sectors food & beverages; textiles; and wood, wood products & furniture saw positive growth outcomes suggesting some resilience in consumer demand, though the clothing & footwear sector contracted for a sixth consecutive month.

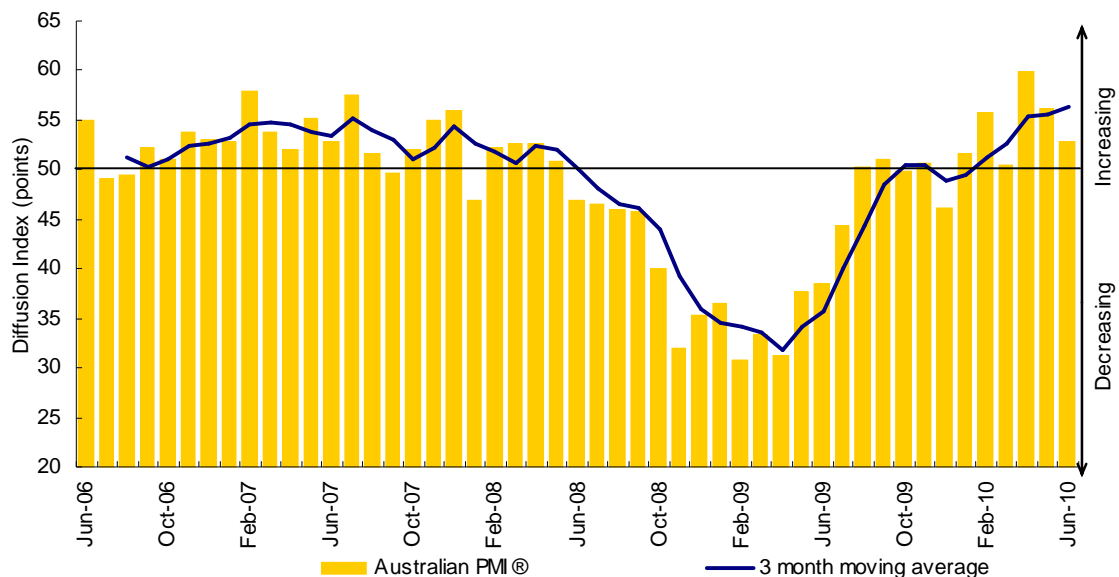
Elsewhere, the lagged effects of stronger housing construction have seen activity in the construction materials sector accelerate in the past quarter.

Wages and input cost growth picked up in June while selling prices fell, strengthening the squeeze on manufacturers' profit margins.

Manufactured exports rose modestly and for the fourth consecutive month.

Activity rose in Victoria, Queensland and Western Australia but fell in the other states.

Chart 7: Australian PMI®



Services

The services sector contracted in June, although the rate of decline was slower than in May.

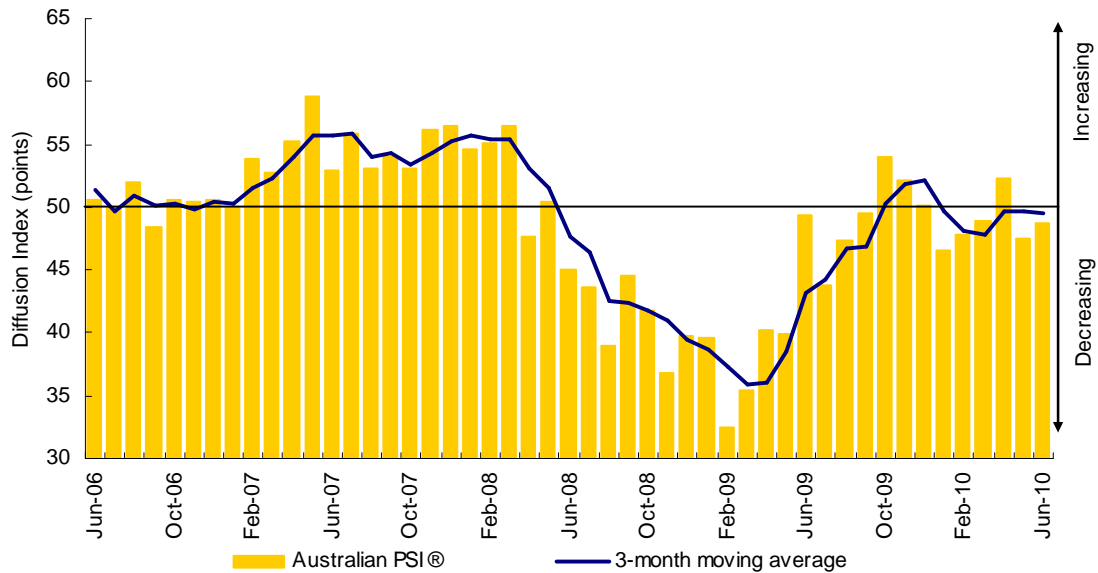
The seasonally adjusted Australian Industry Group/Commonwealth Bank Performance of Services Index (Australian PSI®) rose 1.3 points to 48.8, below the 50.0 level separating expansion from contraction. The June result continues the subdued service sector conditions in 2010.

The main negative influences on the sector's performance were a faster rate of contraction in new orders and a shift from expansion to contraction for inventories and selling prices. These were partially offset by a slower pace of contraction in sales and expanding employment.

Reflecting consumer caution, weakness was mainly centred on the consumer-based sectors, most notably retail trade and accommodation, cafes & restaurants.

Tasmania was the only state to record an expansion in services sector activity in June. This compares with expansions in both Victoria and Western Australia last month.

Chart 8: Australian PSI®



Construction

The national construction industry declined in June following three consecutive months of growth. This weaker result was driven by a reduction in new orders and activity and consequential falls in employment and deliveries from suppliers.

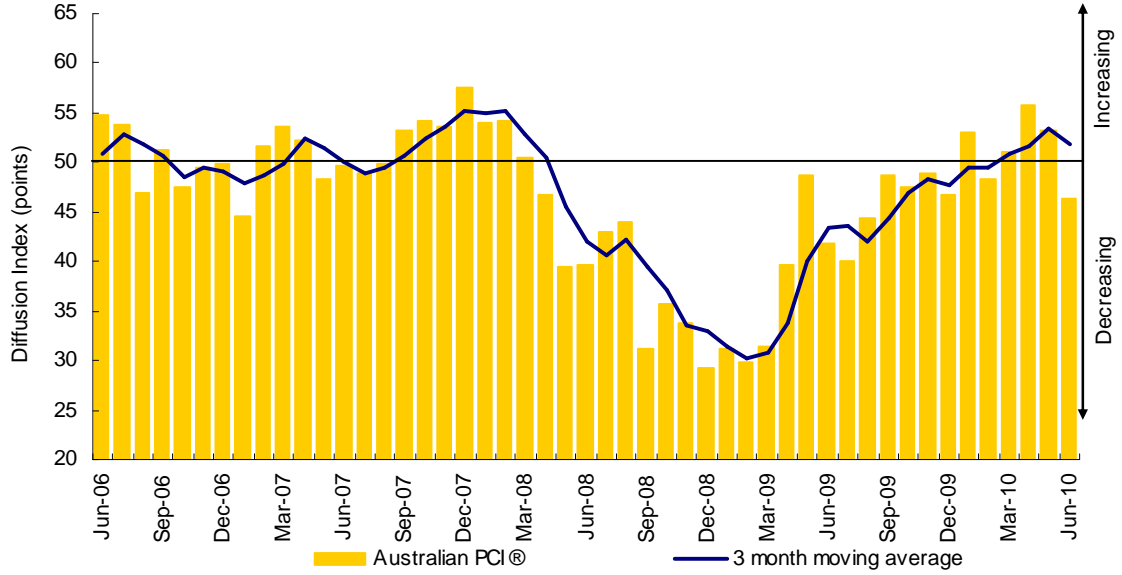
The seasonally adjusted Australian Industry Group/ Housing Industry Association Performance of Construction Index (Australian PCI®) fell by 6.8 points to 46.4 in June, placing it below the critical 50 points level separating expansion from contraction.

There were mixed performances by the major industry sectors with house building falling for the first time in 10 months amid weaker demand conditions, and activity in the apartment building sector registering a second consecutive month of decline. In contrast, work on engineering construction projects expanded after the marked fall of the previous month, while commercial construction activity exhibited continued growth, albeit at a subdued rate.

Reports from survey respondents indicated that tight credit conditions, uncertainty surrounding the economic outlook and subdued client demand had largely contributed to the decline in activity and new orders in June. For companies engaged in house building, higher interest rates and weaker demand from first home buyers were seen as the principal causes of reduced work levels.

On an aggregate industry basis, the activity sub-index declined for a second straight month in June (although at a slightly slower rate than the previous month), while reduced incoming new business across most sectors saw the new orders sub-index fall to its lowest level in seven months.

Chart 9: Australian PCI®



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