5 Aug 2022

Economics Weekly

This week's economic highlights

- The RBA released its **latest monetary policy decision,** lifting interest rates for the fourth time since November 2010 to 1.85 basis points.
- The RBA's latest **Statement of Monetary Policy** anticipates a further decrease in unemployment to 3.4% by mid-2023, before rising again to 4.0% by the end of 2024.
- **Ai Group's economic indices** show mixed conditions. Manufacturing and construction activity fell in July, while the services sector lifted to modest growth. Input costs, labour shortages, supply chain issues and increased interest rates were major constraints in the month.
- **Residential building approvals** was flat, indicating a pause in the rate of approvals in June 2022 after very high levels in 2021.
- Higher exports prices contributed to a **record trade surplus** in June. Record high gold exports and increased iron ore exports were the principal drivers. Import volumes rose modestly in June 2022.
- Ai Group has launched **new "data interactives"** for our business indicators in manufacturing, services and construction.

Australian economic forecasts

This week the RBA lifted interest rates for the fourth time since November 2010, up 50 basis points to 185 basis points. The RBA also increased the rate on Exchange Settlement balances by 50 basis points to 1.75 per cent.

One prominent source of **ongoing uncertainty** about the economic outlook is the behaviour of household spending. Higher inflation and interest rates are putting pressure on household budgets. Consumer confidence has also fallen, and housing prices are declining in some markets after the large increases in recent years.

The Board believes many households have also built up large financial buffers, and the saving rate remains higher than it was before the pandemic. The Board will be paying close attention to how these various factors balance out as it assesses the appropriate setting of monetary policy.

Further interest rate rises should be expected in future as the extraordinary monetary support put in place to support the economy during the pandemic is withdrawn.

RBA also said:

> *"The increase in interest rates over recent months has been required to bring inflation back to target and to create a more sustainable balance of demand and supply in the Australian economy. The Board expects to take further steps in the process of normalising monetary conditions over the months ahead, but it is not on a pre-set path. The size and timing of future interest rate increases will be guided by the incoming data and the Board's assessment of the outlook for inflation and the labour market. The Board is committed to doing what is necessary to ensure that inflation in Australia returns to target over time."*

The RBA revised its economic forecasts, with the release this week of its latest quarterly *Statement on Monetary Policy*. The RBA expects:

- **GDP to expand at a slower pace than previously anticipated**, with GDP growth of 3.2% p.a. by the end of 2022 and moderating down to 1.8% by the end of 2023.
- **The unemployment rate** has decreased to 3.5% as of June 2022 (an historic low for 5 decades). Labour force participation, the employment-to-population ratio and job mobility are at record high levels. Job vacancies and job ads are also both at very high levels and a further decline in unemployment is expected over the months ahead. Beyond that, an increase in unemployment is expected as economic growth slows. The unemployment rate is expected to fall to 3.4% p.a. by the end of 2022 before rising again to 4.0% by the end of 2024.
- **Inflation in Australia (and globally) has increased**. Inflation is the highest it has been since the early 1990s. In headline terms, inflation was 6.1 per cent over the year to the June quarter; in underlying terms it was 4.9 per cent. Annual headline inflation is expected to rise to 7.8% p.a. by the end of 2022 and fall to 4.3% by 2023 (see chart 1). Fuel prices grew by 4 per cent in the June quarter and 32 per cent over the year to June, contributing around 0.2 percentage points to headline inflation in the June quarter.
- **Wages growth** is expected to rise to 3.6% p.a. by the end of 2023, with growth in other measures of labour costs slightly higher than this.

Latest Australian economic data

The **Ai Group Performance of Manufacturing Index (Australian PMI®)** declined by 1.5 points to 52.5 points in July 2022, (seasonally adjusted). This indicates a weaker rate of expansion across manufacturing in July (see chart 2).

- Manufacturing activity slowed in July. Most subsectors eased but the metal products sectors recovered strongly.
- Labour challenges, supply chain disruptions and high energy prices remain the major structural constraints on manufacturing.
- Input prices declined for the first time since February 2022 but remain at very high levels. Employment declined, reflecting labour shortage pressures on manufacturing businesses.
- Most manufacturing activity indicators declined in July. However, new orders and sales strengthened, despite tight supply chain pressures.

The **Ai Group Performance of Construction Index (Australian PCI®)** fell slightly by 0.9 points to 45.3 points in July (seasonally adjusted) (see chart 3). This indicates contraction in activity across the construction sector for the second month following four months of positive or stable conditions. Results below 50 indicate contraction, with lower numbers indicating a stronger rate of decline.

- Three of the four construction sectors – housing, commercial and engineering – were in contraction in July. Activity improved in the apartments and commercial sectors.
- House builders reported higher interest rates constraining new orders, which fell again in July.
- Increased interest rates were the main concern for respondents across all sectors. Labour shortages and delays in supplier deliveries continued to inhibit activity.
- Capacity utilisation moderated slightly to 80.6% the lowest it has been since August 2021.

The **Ai Group Performance of Services Index (Australian PSI®)** rose by 2.9 points to 51.7 points (seasonally adjusted) in July 2022 indicating growth and an improvement on the two previous months of deterioration (see chart 4).

- Uneven dynamics continue to affect the services sector. Business & property, personal services and retail & hospitality were up. Logistics and health & community services were significantly down.
- Services capacity utilisation rose slightly to 80.3%, similar to the June result and above the long-term average.
- Customer demand in some sectors remains robust, but increased input costs, labour shortages and concerns about future demand impacted services businesses in July.

The ABS **Building Approvals, Australia** gives an indication of the additions to the forward pipeline of work for the housing industry. The total number of dwelling approvals was unchanged in June 2022 compared to the previous month. Private sector house building approvals falling by 0.3% m/m and private sector multi-unit approvals rising by 1.0% m/m (trend) (see chart 6).

Australia recorded a record trade surplus of $18 billion in June 2022, an increase of $2.7 billion from the previous month. **Iron ore** rose by 5.5% over the month. **Gold exports** rose by 64% to a record high. **Coal and LNG exports** fell by 0.6% and 2.2% respectively but remained elevated (chart 7). Imports rose by 0.7% in the month due to a rise in travel debits.

The **ABS Lending Indicators** indicates that the value of new loan commitments decreased by 4.4% for housing and 15.2% for personal fixed term loans. The typically volatile new loan commitments for business construction rose by 7.7% while the value of new loan for business purchase of property declined by 19.4%.

New Ai Group interactive data products

Ai Group has launched **new "data interactives"** for our industry performance indicators.

Users can choose from 23 different topics – business activity types, industry subsectors and states – to instantly make custom data visualisations. The interactives allow users to explore Ai Group's rich business data on the manufacturing, construction and services sectors.

You can explore the data interactives at:

Performance of Manufacturing Index: https://www.aigroup.com.au/resourcecentre/research-economics/PMI/

Performance of Construction Index: https://www.aigroup.com.au/resourcecentre/research-economics/PCI/

Performance of Services Index: https://www.aigroup.com.au/resourcecentre/research-economics/PSI/

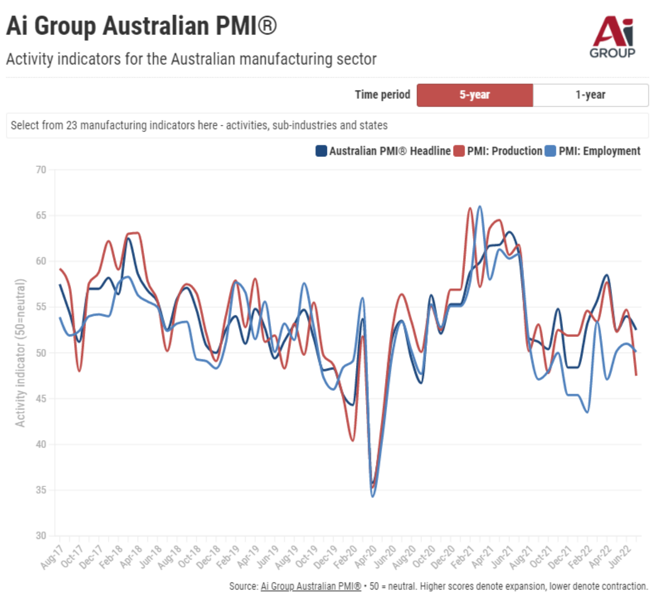
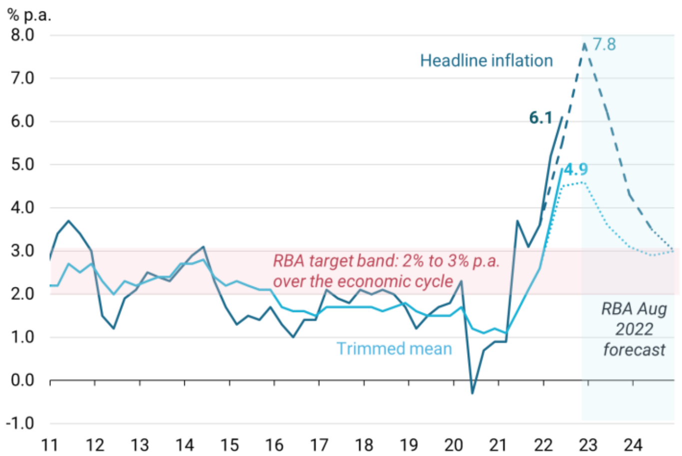


Chart 1: The RBA is increasing interest rates in an attempt to rein in inflation and normalise monetary policy conditions. Annual headline inflation is expected to rise to 7.8% p.a. by the end of 2022 and fall to 4.3% by 2023.

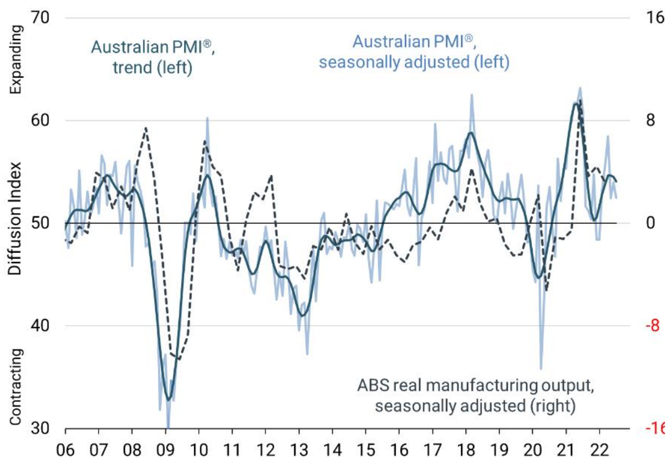
Headline & trimmed mean CPI, June 2022, RBA forecasts of CPI in August 2022



Source: ABS, RBA

Chart 2: **Ai Group-HIA Australian PMI®** declined by 1.5 points to 52.5 points in July 2022 (seasonally adjusted). This indicates a weaker rate of expansion across manufacturing in July. Most subsectors eased but the metal products sectors recovered strongly.

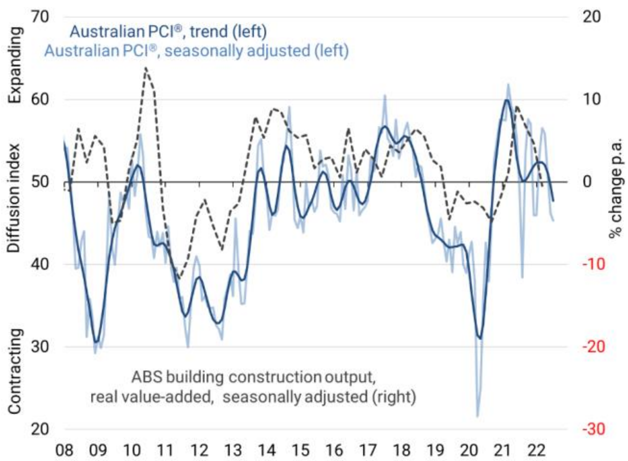
Australian PMI® and ABS construction output



Results above 50 points indicate expansion, with higher results indicating a stronger pace of expansion. Sources: ABS, *National Accounts*, March 2022 and Ai Group-HIA *Australian PCI*, July 2022.

Chart 3: **Ai Group-HIA Australian PCI®** fell slightly by 0.9 points to 45.3 points in July (seasonally adjusted). This indicates contraction in activity across the construction sector for the second month following four months of positive or stable conditions.

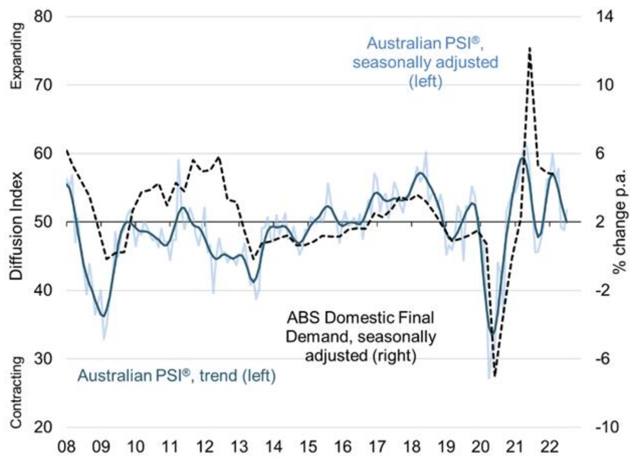
Australian PCI® and ABS construction output



Results above 50 points indicate expansion, with higher results indicating a stronger pace of expansion. Sources: ABS, *National Accounts*, March 2022 and Ai Group-HIA *Australian PCI*, July 2022.

Chart 4: Ai Group's **Australian PSI®** rose by 2.9 points to 51.7 points (seasonally adjusted) in July 2022 indicating growth and an improvement on the two previous months of deterioration (results above 50 points, seasonally adjusted indicate expansion).

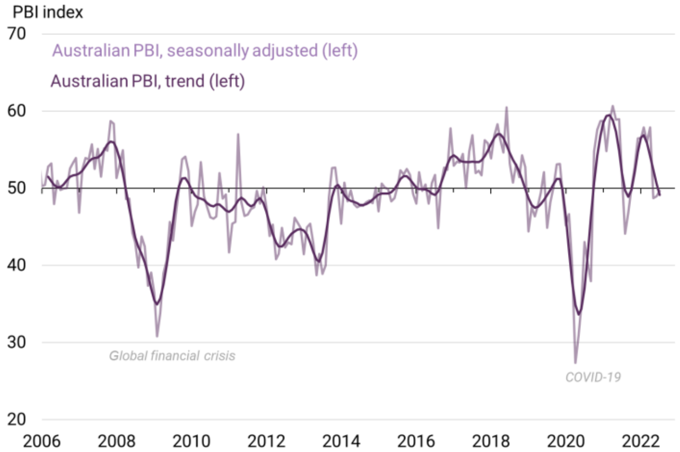
Ai Group Australian PSI® and ABS domestic final demand



Results above 50 points indicate expansion, with higher results indicating a stronger pace of expansion. Sources: ABS, *National Accounts*, March 2022 and Ai Group *Australian PSI*, July 2022.

Chart 5: The Ai Group **performance of business index*** rose by 0.7 points to 49.7 points in July 2022 indicating flat results in July (seasonally adjusted). This reflects weak conditions, with labour and supply chain issues posing constraints.

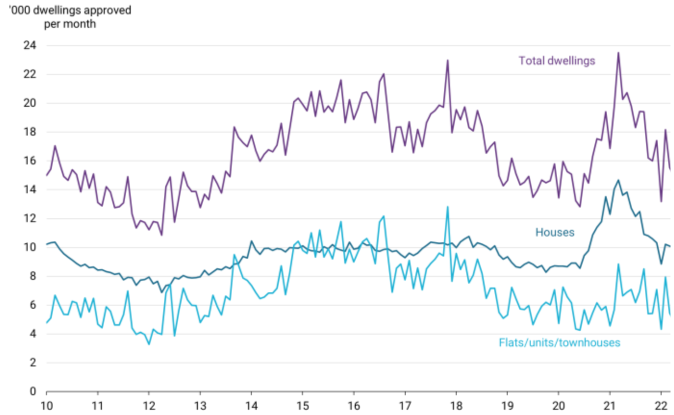
Ai Group performance of business index* (PBI)



* Composite of Ai Group Australian PMI, PCI and PSI. Net balance indexes. 50 = neutral. Sources: Ai Group, July 2022.

Chart 6: The number of **residential building approvals** remained unchanged in June, indicating a pause in the rate of approvals in June 2022 after very high levels in 2021.

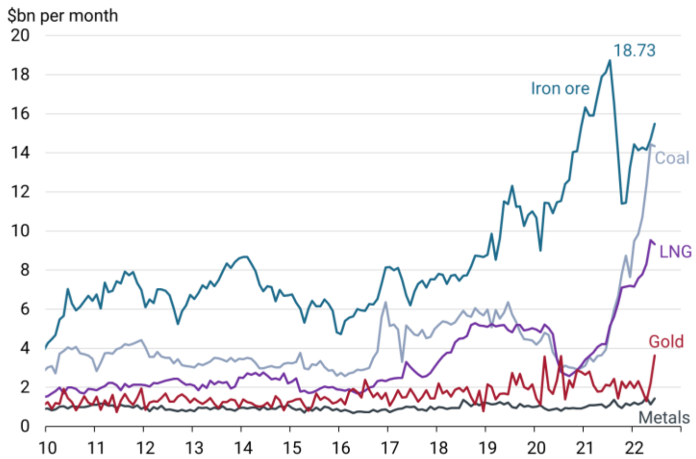
Residential building approvals by type, 2010 to June 2022



Source: ABS, *Building approvals*, June 2022.

Chart 7: The increase in Australia's exports in June was driven by record high gold exports and higher iron ore exports. **Coal and LNG exports** fell by 0.6% and 2.2% respectively but remained elevated.

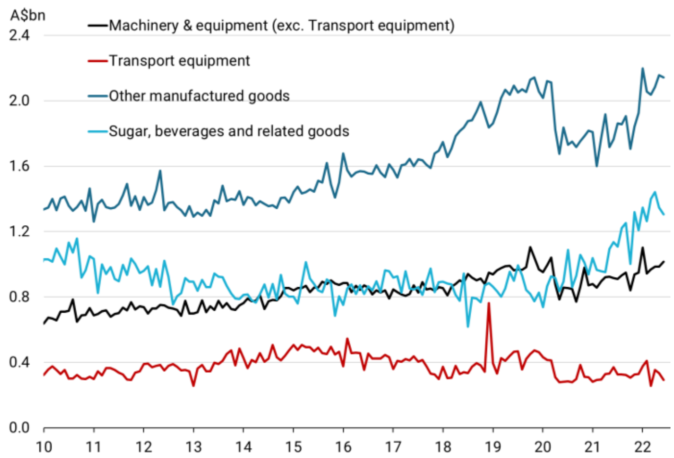
Exports of resources 2010 to 2022



Source: ABS, *International trade*, June 2022.

Chart 8: Australia's exports of manufactured goods in value terms continue to recover to monthly pre-COVID-19 levels, with other manufactured goods reaching record high volumes.

Exports of manufactured goods 2010 to 2022



Source: ABS, *International trade*, June 2022.

This week's data and events 01 August – 05 August 2022

Day	Date	Data/event	Data period
Mon	01 Aug	Ai Group, Performance of Manufacturing	July 2022
Tue	02 Aug	ABS, Building Approvals	June 2022
Tue	02 Aug	ABS, Lending Indicators	June 2022
Wed	03 Aug	Ai Group, Performance of Construction	July 2022
Thu	04 Aug	ABS, International Trade in Goods and Services	June 2022
Thu	05 Aug	Ai Group, Performance of Services	July 2022

Next week's data and events 08 August – 12 August 2022

Day	Date	Data/event	Data period
Tue	09 Aug	ABS, Monthly Business Turnover Indicator	June 2022
Tue	09 Aug	NAB, Monthly Business Survey	July 2022
Tue	09 Aug	ANZ-Roy Morgan, Australian Consumer Confidence	August 1-7 2022
Thu	11 Aug	ABS, Weekly Payroll Jobs and Wages	Week ending 16 July 2022

Ai Group Industry Performance Indicators

Australian Performance of Manufacturing Index®	July 2022	52.5 ▼
Australian Performance of Construction Index®	July 2022	45.3 ▼
Australian Performance of Services Index®	July 2022	51.7 ▲

Seasonally adjusted. Arrows represent direction of movement relative to last observation. Source: Ai Group.

Australian economy: latest annual growth rates and RBA forecasts (as of Aug 2022)

% change over the year	Dec 2021	Jun 2022	Dec 2022	Jun 2023	Dec 2023	Jun 2024	Dec 2024
Gross domestic product (GDP)	**4.2**	3.5	3.2	2.3	1.8	1.8	1.7
Household consumption	3.5	4.6	4.9	2.8	2.4	2.3	2.2
Dwelling investment	5.3	−1.7	1.7	2.5	−0.1	−2.6	−4.8
Business investment	6.4	1.6	4.9	5.9	6.6	5.7	4.6
Public demand	5.1	6.3	3.6	−0.5	−0.7	0.8	1.8
Gross national expenditure	5.0	4.1	3.7	1.5	1.5	1.8	1.9
Imports	1.0	5.0	11.4	6.2	4.0	3.0	2.9
Exports	−2.6	2.3	8.6	9.8	5.1	2.8	2.2
Terms of trade	10.3	6.8	2.6	−14.6	−8.9	−4.4	−1.6
Real household disposable income	3.7	3.9	−0.9	−3.1	−0.9	0.9	1.5
Unemployment rate (qtr average, %)	**4.2**	3.8	3.4	3.4	3.5	3.7	4.0
Employment	2.1	3.2	4.4	2.2	1.4	1.1	0.9
Average wage rates (WPI)	**2.3**	2.6	3.0	3.4	3.6	3.8	3.9
Trimmed mean inflation (CPI)	**2.6**	4.9	6.0	5.0	3.8	3.3	3.0
Headline inflation (CPI)	3.5	6.1	7.8	6.2	4.3	3.5	3.0

= actual. = forecast. Sources: ABS, various data; RBA 'baseline scenario' in *Statement on Monetary Policy*, August 2022.

Forecasts 3 August. Forecasts are conditioned on a path for the cash rate broadly in line with expectations derived from surveys of professional economists and financial market pricing. Other forecast assumptions: TWI at 63, A$ at US$0.69 and Brent crude oil price at US$94bbl. Assumed rate of population growth is broadly in line with the profile set out in the Aus Gov 2022/23 Budget.

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