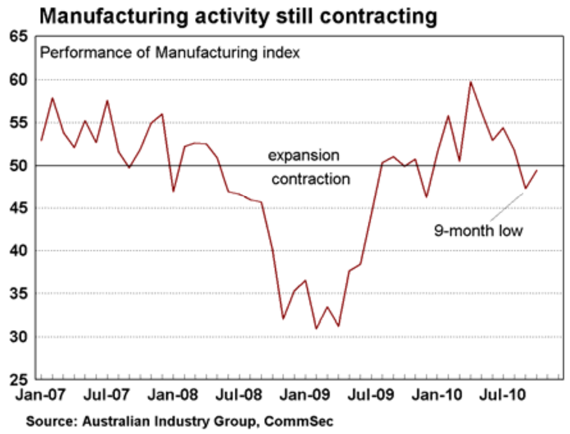
Tame inflation; Manufacturing orders sink

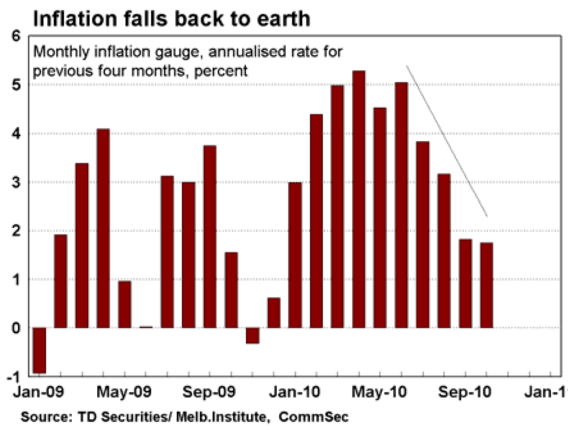
Inflation gauge; Weekly Petrol Price, PMI, House Price Index

- **The TD Securities-Melbourne Institute monthly inflation gauge rose by 0.3 per cent in October after lifting 0.1 per cent in September, and 0.2 per cent in August.**
- **Importantly other underlying rates of inflation were relatively tame in October. The trimmed mean rose by 0.2 per cent and the inflation measure that excludes volatile items was flat in October.**
- **The Performance of Manufacturing index rose from nine-month lows, up by 2.1 points in October to 49.4. Any reading below 50 means the manufacturing sector is contracting. Across the sub indices, production rose from nine-month lows, however new orders slumped to a 16 month low, while exports tracked to the weakest levels in 11-months.**
- **According to the Australian Institute of Petroleum the national average retail pump price fell 0.3 cents a litre last week to 123.6 cents a litre. Over the next fortnight CommSec expects pump prices to trend sideways as the strengthening Australian dollar largely negates any increase in regional oil prices.**
- **The Bureau of Statistics house price index rose by 0.1 per cent in the September quarter to stand 11.5 per cent higher than a year ago. The data is consistent with the RP Data-Rismark index that is tracked by the Reserve Bank.**
- **HSBC's China Purchasing Managers' Index rose from 52.9 to 54.8 in October – a six month high. The measure of prices is at a 27-month high.**

What does it all mean?

- The latest TD inflation gauge shows that inflationary pressures are non-existent. Headline inflation recorded a modest increase, but once you dig beneath the surface it is well and truly apparent that price pressures are contained. Both the trimmed mean and the inflation measure that excludes volatile items, have lifted just 0.2 per cent in the space of three months. In fact once volatile items are excluded, the three month annualised rate of inflation is just 0.9 per cent.
- The improvement in the latest manufacturing gauge is hardly worth getting excited about – especially given that the sector is still contracting and the latest improvement is from nine month lows. In fact the key sub indices of new orders and exports personify just how tough times are for the sector. New orders are holding at the weakest





Savanth Sebastian – Economist (Author)
(02) 8223 7130 (work), 0414 188 161 (mobile) | savanth.sebastian@cba.com.au

levels in 16 months while exports have crumbled to near one year lows. And given the forward looking aspect of these indicators it is unlikely that the manufacturing sector will record any significant improvement anytime soon.

- The recent strength of the Australian dollar has had a profound impact on the manufacturing sector, making exports less competitive, keeping selling prices depressed but also ensuring that input costs are falling. Overall weakness in the manufacturing sector is another reason why inflation is likely to remain well contained in the near term.
- When the contraction in the manufacturing sector is combined with a tame inflation environment and the rather sluggish growth in house prices, the Reserve Bank would be hard pressed to justify a near term rate hike. This is especially the case given that consumers and businesses remain relatively cautious when it comes to investment and spending decisions. Certainly there is a case to be made for delaying a rate hike for at least a month or possibly until the New Year.
- Petrol prices have eased modestly from two-month highs over the past week and are unlikely to alter too dramatically in the coming fortnight. In the near term it is looking more likely that pump prices will largely track sideways, especially given that the strength in the Australian dollar should offset the increase in regional oil prices that have occurred in the past week.

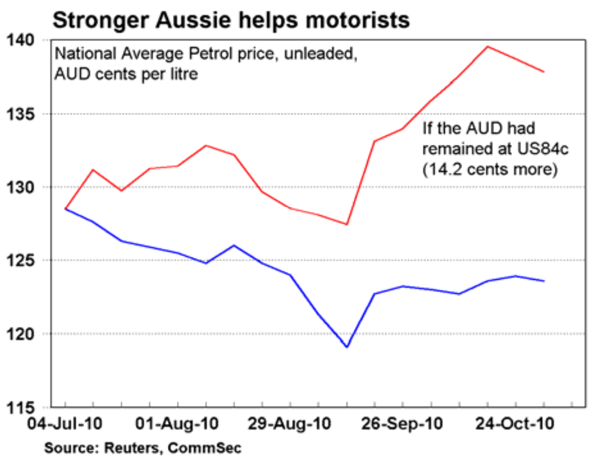
What do the figures show?

Inflation gauge:

- The monthly inflation gauge rose by 0.3 per cent in October after lifting by 0.1 per cent in September. The annual rate of inflation rose from 3.2 per cent to 3.8 per cent. The three-month annualised rate held at a more sedate 2.4 per cent.
- Excluding volatile items like petrol and fruit & vegetables, the inflation gauge rose was unchanged in October after a 0.1 per cent rise in September. The three-month annualised rate of inflation eased from 2.5 per cent to 0.9 per cent.
- The trimmed mean inflation measure rose by 0.2 per cent in October. The trimmed mean measure is up 3.1 per cent on a year ago while the three-month annualised rate rose from 1.1 per cent to 1.3 per cent.
- TD Securities noted that "*Contributing most to the overall change in October were price rises for automotive fuel, fruit and vegetables, and insurance services. These were offset by falls in prices for audio, visual and computing, non-alcoholic drinks and snack food, and alcoholic drinks. The price of automotive fuel increased by 4.6 per cent in October, reversing the 4.4 per cent price fall recorded in September*."

Performance of Manufacturing index

- The Performance of Manufacturing index rose from nine month lows in October, rising by 2.1 points to 49.4. A reading below 50 suggests that the manufacturing sector is contracting.
- Key activity components of the PMI were mostly weaker in October. Production recorded a modest improvement (despite still contracting), while exports fell to an 11-month low and new orders fell to the lowest levels in 16-months.
- The production sub index rose 3.2 points to 49.4; new orders fell by 3.4 points to 43.1; the employment index rose 5.4 points to 50.2; exports fell by 5.3 points to 45.9; the index of selling prices eased modestly to 46.6 while input prices and wages fell sharply.
- In seasonally adjusted terms five of the 12 sectors recorded a decline in activity in October.



House Prices

- The Bureau of Statistics house price index rose by just 0.1 per cent in the September quarter and 11.5 per cent over the past year.

Petrol prices:

- According to the Australian Institute of Petroleum, the national average Australian price of unleaded petrol fell by 0.3 cents per litre to 123.6 cents a litre in the week to October 31. The metropolitan price fell by 0.5c/l to 123.3 c/l, while the regional average price fell by 0.1 c/l to 124.1 c/l.
- Petrol prices across states in the past week were: Sydney (down 0.5 cents to 123.3 c/l), Melbourne (down 0.6 cents to 123.6 c/l), Brisbane (up 0.3 cents to 125.4 c/l), Adelaide (down 1.0 cents to 121.5 c/l), Perth (down 0.9 cents to 120.6 c/l), Darwin (down 2.7 cents to 127.6 c/l), Canberra (down 0.5 cents to 123.0 c/l) and Hobart (up 0.1 cents to 128.5 c/l).
- The national average wholesale (terminal gate) hit an 11-month low of 111.6 cents a litre on October 1. After hitting two month highs of 115.3 cents a fortnight ago, the terminal gate price has fallen by 0.3 cents to 114.7 cents today. The key Singapore unleaded petrol price rose by US$1.20 (1.4 per cent) to US$89.80 last week. And in Australian dollar terms Singapore gasoline rose by $1.97 (2.2 per cent) over the week to $92.06 a barrel.

What is the importance of the economic data?

- The TD Securities/Melbourne Institute **Monthly Inflation Gauge** is designed to "provide a timely and accurate monthly measure of inflation in Australia". The Bureau of Statistics only releases the Consumer Price Index on a quarterly basis.
- The monthly **Performance of Manufacturing Index** is the Australian equivalent of the US ISM manufacturing gauge. The PMI is one of the timeliest economic indicators released in Australia. The PMI is useful not just in showing how the manufacturing sector is performing but in providing some sense about where it is heading. The key 'forward looking' components are orders and employment.
- **Weekly figures on petrol prices** are compiled by ORIMA Research on behalf of the Australian Institute of Petroleum. National average retail prices are calculated as the weighted average of each State/Territory's metropolitan and non-metropolitan retail petrol prices, with the weights based on the number of registered petrol vehicles in each of these regions.
- The Australian Bureau of Statistics publishes **House Price Indexes** each quarter. Price indexes are provided for each of the eight capital cities with a weighted average estimate for Australia. The ABS uses regional stratification to control for the 'quality' effect and compositional change. Data on house prices is useful in looking at issues such as housing demand, affordability and wealth.

What are the implications for interest rates and investors?

- Not only is manufacturing activity contracting, but the key sub indices such as new orders and exports have turned sharply lower – a worrisome trend that does not bode well for coming months. Even selling prices are still falling, adding to the low inflation environment.
- Consumers are refusing to spend unless goods are on sale and retailers have no choice but to continue trimming prices. As long as this situation continues to exist then inflation will remain under control. Certainly the strong Australian dollar and benign petrol prices are further serving to keep downward pressure on local inflation.
- As we have highlighted in recent times, there are clear signs that the economy has lost momentum and looking forward activity is likely to be less robust – especially given that the strength of the Australian dollar will continue to make Aussie exports less competitive. The strong Aussie is likely to depress not just the manufacturing sector but tourism, and agricultural exports.

Savanth Sebastian, Economist, CommSec
Work: (02) 8223 7130; Mobile: 0414 188 161