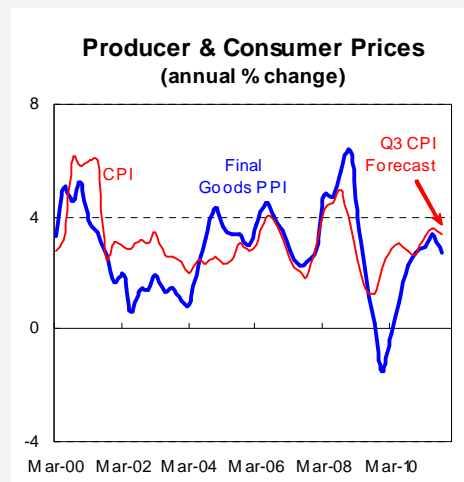
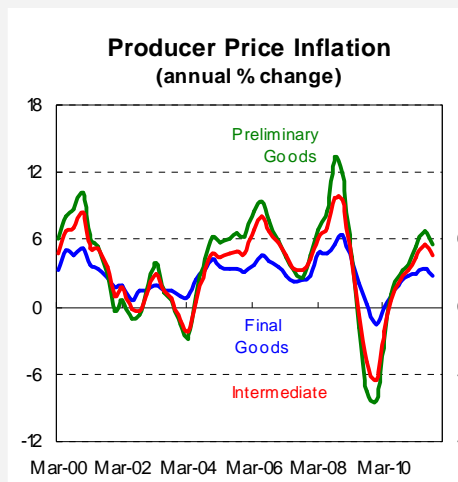


DATA SNAPSHOT

Producer Price Growth Stepping down a Notch

Monday, 24 October 2011

- Growth in producer prices at the final stage stepped down a notch in the September quarter, rising by 0.6% after a solid 0.8% rise in the June quarter. The annual rate eased from 3.4% in the June quarter to 2.7% in the September quarter, a three-month low.
- The strength of the Australian dollar continued to keep down producer prices – import prices were flat in Q3. Price pressures continued to be led by domestic prices, which had quite a solid increase, although they eased to 0.7% from 1.1% previously.
- The solid increase in domestic prices, particularly for electricity, gas and water likely reflect ongoing capacity constraints in the economy and suggests there is still evidence of inflation pressures. However, softer increases in the earlier stages of production and easing in commodity prices in recent months should see price pressures ease. A weaker Aussie, however, is likely to place upward pressure on inflation.
- Given today's data was quite close our expectations, we remain comfortable to leave our forecast for Q3 CPI unchanged at 0.6% for the quarter and 2.6% for the year. The annual outcome would remain in the RBA's comfort zone, giving the RBA a little breathing space to cut rates if needed. However, the RBA is likely to also take into account the improvement in domestic data in recent weeks. On balance, we expect the RBA to leave interest rates on hold when it meets next week, but it might be a close decision.



Growth in producer prices at the final stage stepped down a notch in the September quarter, rising by 0.6% after a solid 0.8% rise in the June quarter. The annual rate stepped down from 3.4% in the June quarter to 2.7% in the September quarter, a three-month low.

The quarterly rise in prices at the final stage was driven by rises in the prices received for electricity, gas and water (8.2%), commercial fishing (14.1%) and other agriculture (3.7%).

The strength of the Australian dollar continued to keep down producer prices – import prices at the final stage were flat in Q3. Although the Aussie has weakened 2.1% in trade-weighted terms in the September quarter, this will likely take some time to flow through to producer prices. Price pressures continued to be led by domestic prices, which rose quite a solid 0.7% in the quarter, although they eased from 1.1% previously.

Price pressures at the earlier stages of the producer pipeline, the preliminary goods stage

and the intermediate stage, were subdued in the September quarter. Producer prices at the intermediate stage (or stage 2) and the preliminary stage (or stage 1) both rose by just 0.1% in the quarter. These soft outcomes taken together with stronger increase in the final stage, suggests that producers' margins improved in Q3. Producers have likely passed on price increases at the final stage of production, to make up for lower margins earlier this year. This could reflect some recent improved confidence by businesses in being able to pass on higher prices.

The solid increase in domestic prices, particularly for electricity, gas and water likely reflect ongoing capacity constraints in the economy and suggests there is still evidence of inflation pressures. However, softer increases in the earlier stages of production and easing in commodity prices in recent months should see price pressures ease. A weaker Aussie, however, is likely to place upward pressure on inflation. Although the Australian dollar remains at high levels, it is likely to have peaked.

Given today's data was roughly inline our expectations of 0.7%; we are leaving our forecasts for CPI for Q2 unchanged (released Wednesday 26 October). We are forecasting a 0.6% increase in underlying CPI for the quarter, implying a 2.6% increase over the year to September quarter, assuming no back revisions. Meanwhile, we are expecting a 0.5% increase in the headline rate for the quarter. Note that the ABS is implementing a number of changes to the next Q3 CPI release. New weightings will be applied and there will be an addition of other inflation measures including a seasonally adjusted headline rate.

The Reserve Bank of Australia (RBA) has highlighted in the minutes of the October board meeting that a benign underlying inflation reading for Q3 was an important precondition for cutting rates. Although our expected outcome of 0.6% of underlying inflation should be within the RBA's comfort zone, the RBA is likely to also take into account the improvement in domestic data in recent weeks. Retail sales, building approvals and employment data have all improved which suggests to us that domestic economic activity has held up relatively well. Meanwhile, financial market sentiment, consumer and business confidence have also partially recovered. On balance, we expect the RBA will likely leave interest rates unchanged at 4.75% at its meeting next week (on Tuesday 1 November), but it might be a close decision.

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