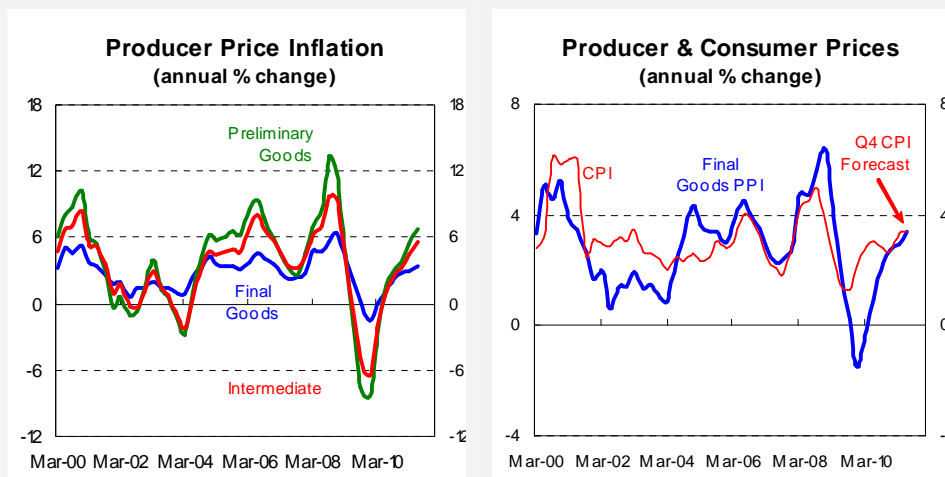


# DATA SNAPSHOT

## Producer Prices – Margins on the Squeeze

Monday, 25 July 2011

- Producer price pressures continued to build in the June quarter, from relatively benign growth last year, as spare capacity in the economy continues to diminish.
- Producer prices remain relatively contained due to the deflationary effect of prices for imported goods. However, the annual rate of producer prices hit a 2-year high in the June quarter.
- Price pressures at the earlier stages of the production process are showing more intense price pressures, indicating producer margins' are being squeezed as they absorb some of the price increases.
- The direct relationship between movements in producer prices and consumer prices on a quarter-by-quarter basis is not overly strong. However, today's result for producer prices leaves us comfortable with our CPI forecast for a modest 0.7% increase in the June quarter. Thus we expect the RBA to leave interest rates on hold when it meets next week.



Producer prices at the final stage posted a solid 0.8% increase in the June quarter, after a large 1.2% rise in the March quarter. The annual rate stepped up from 2.9% to a two-year high of 3.4%.

We expect a further pick up in inflation in the producer pipeline over 2011 as the economy continues to push up against capacity pressures.

The rise in prices at the final stage was due to rises in the prices received for building construction (+1.2% in the quarter), petroleum refining (+10.3%) and other agriculture (+7.9%). Some of these price rises reflect underlying inflation pressures in the economy.

A stronger Australian dollar has helped keep inflationary pressures at bay. The prices for industrial machinery & equipment manufacturing fell by 2.0%. These items are largely imported. The impact of the stronger Australian dollar was also reflected in a 1.4% decrease in final stage import prices, which partly offset the 1.1% increase in prices of domestically produced items.

Price pressures at the earlier stages of the producer pipeline – the preliminary goods stage and the intermediate stage – are showing more intense price pressures. Producer prices at the intermediate stage (or stage 2) rose by 2.1% in the quarter and prices at the preliminary stage (or stage 1) rose 2.8% in the same time period. This indicates producers' margins are being squeezed as they absorb larger price increases at the earlier stages of

production, rather than passing them on to consumers.

On a quarterly basis, there is not an overly strong relationship between PPI and the consumer price index (CPI). Given today's data was in line with our expectations, we are leaving our forecasts for CPI for Q2 unchanged. We are forecasting a 0.7% increase in CPI for the quarter, for both the headline and core measures in Wednesday's data.

The RBA has recently highlighted the importance of the near term inflation position in its monetary policy decision-making process. It would take a very large increase in the CPI on Wednesday to push the RBA closer to raising interest rates, against the deteriorating global economic backdrop. If the CPI rises by 0.7%, as we expect, the RBA will likely leave interest rates unchanged at 4.75% at its meeting next week.

Jo Heffernan, Senior Economist  
Ph: (02) 9320-5751

## Contacts List

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Economics Group		<a href="mailto:economics@stgeorge.com.au">economics@stgeorge.com.au</a>	(02) 9320 5833
Chief Economist	Besa Deda	<a href="mailto:debad@stgeorge.com.au">debad@stgeorge.com.au</a>	(02) 9320 5854
Senior Economist	Josephine Heffernan	<a href="mailto:heffernanj@stgeorge.com.au">heffernanj@stgeorge.com.au</a>	(02) 9320 5751
Economist	Janu Chan	<a href="mailto:chanj@stgeorge.com.au">chanj@stgeorge.com.au</a>	(02) 9320 5892
State Manager SA	Mark Goldsmith	<a href="mailto:goldsmithm@banksa.com.au">goldsmithm@banksa.com.au</a>	(02) 8424 5597

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