

Aust PPI: < mkt but upstream prices no longer deflationary; CPI f/c unchanged, downside for WM

2010Q2 PPI: 0.3%qtr, 1.0%yr; 0.7% annual core PPI pace rising, despite softer quarter with imports down

- Q2 Final Stage PPI inflation was weaker than expected at 0.3%qtr (consensus 0.8%, Westpac 0.7%). Nevertheless, after falling through 2009, PPI upstream price pressures are no longer a deflationary influence with back to back rises lifting the annual rate to 1.0%yr from -0.1%, the highest since 2009Q2.
- House construction output prices rose 0.7%qtr. We have revised down our CPI house purchase component forecast to +0.7% (from +0.9%) as a result. This leaves our headline CPI and trimmed mean CPI forecasts unchanged at +0.9%qtr, but tips the weighted median to +0.7%qtr (from +0.9%), which would leave the annual weighted median 'high' at 3.0%. With more faith in the trimmed mean forecast, we retain our 0.9%qtr average core forecast, but acknowledge downside risk from the weighted median CPI.
- Non-core items made a net addition to the PPI. Higher food prices (0.3%, +0.05ppt contribution) were reinforced by a rise in petroleum (1.8%, +0.04ppt contribution) giving a net +0.10ppt contribution to the quarterly PPI.
- The 0.3% rise in PPI food components unwound a 0.3% fall previously. CPI food prices are not well correlated with PPI equivalents, but the lack of a strong bounce leaves us comfortable in expecting a weak result in the CPI food group (f/c +0.1%qtr vs +1.1%qtr prev).
- Ex-food and petroleum, the core PPI was more subdued than last quarter, with core import prices lower despite a weaker AUD, a smaller rise in the domestic core PPI ex-construction & utilities, subdued utilities after a strong Q1, and a lesser rise in building construction prices. Still, core PPI pressures were positive again after falls through 2009, at +0.2%qtr and +0.7%yr (vs -0.5%yr prev).
- While a 1.1%qtr fall in the AUD import weighted TWI saw the core MPI rise 1.1%qtr in Q2, the core imports PPI was weaker than this implied, at -0.4%qtr.
- Building construction prices rose 0.3%qtr (vs 0.6%qtr prev). Abstracting from this, and small rise in utilities, domestic core prices were subdued, rising 0.5%qtr. Still, that is their 3rd consecutive rise, to be up 1.7%yr.

The Q2 PPI for Final Stage Prices (FSP) rose 0.3%qtr (vs 1.0% prev), lifting annual growth to 1.0%yr from -0.1%yr previously, the highest since 2009Q2. The headline result was below consensus (0.8%qtr) and our Westpac forecast (0.7%qtr). Nevertheless, while softer than expected, the result marked the second consecutive quarterly increase for the first time since 2008Q4 and

Producer Price Indexes

		Sep 09	Dec 09	Mar 10	Jun 10
PPI prelim stage	% qtrly	-0.5	-0.8	1.0	1.5
	% ann	-7.5	-8.4	-3.0	1.2
PPI final stage (FSP)	% qtrly	0.1	-0.4	1.0	0.3
	% ann	0.2	-1.5	-0.1	1.0
FSP core#	% qtrly	-0.2	-0.4	1.0	0.2
	% ann	1.2	-1.5	-0.5	0.7
FSP core domestic*	% qtrly	-0.5	0.6	1.1	0.5
	% ann	0.8	0.4	1.8	1.7
FSP core import#	% qtrly	-5.7	-5.5	1.4	-0.4
	% ann	8.3	-12.4	-15.2	-10.0
FSP consumer	% qtrly	1.5	-0.7	1.4	0.4
	% ann	1.8	0.0	1.5	2.5
Building construction	% qtrly	0.0	0.3	0.6	0.3
	% ann	-2.5	-1.8	0.4	1.2
House construction	% qtrly	1.2	0.5	0.8	0.7
	% ann	2.4	2.6	4.0	3.3

Westpac estimate ex food and petroleum prices.

* Westpac estimate ex food, petroleum, construction and utilities prices.

Source: ABS 6427, Westpac Economic Research.

the second consecutive increase in the annual rate. PPI upstream price pressures are no longer a deflationary influence after falling through 2009.

While the PPI says more about upstream factory gate price pressures as an influence on CPI inflation over the year ahead (and is signalling an end to this disinflationary influence of 2009), key PPI components results can also influence our CPI forecast for Q2 through their **signals on house construction output prices, and food prices**. While food prices were stronger than we expected, rising 0.3% after a 0.3% fall previously, their correlation with the CPI food group is weak – still, their lack of a strong Q2 rebound after a soft Q1 affirms our forecast for a smaller rise in the CPI food group of +0.1%qtr (vs +1.1%qtr prev). However, **with a lower than forecast rise in house construction output prices (+0.7%), we have revised down our CPI house purchase item forecast to +0.7% (from +0.9%). This change was not enough to alter our headline CPI forecast, which remains at 0.9%qtr and 3.3%yr. The trimmed mean forecast also remains at 0.9%qtr for an unchanged annual rate at 3.0%yr. However, the (less reliably forecast) weighted median forecast has tipped down to 0.7%qtr (from 0.9%). This would still leave the annual weighted median at a 'high' 3.0%yr. With greater confidence in the trimmed mean forecast, we retain our**

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0.9%qtr average underlying CPI forecast, but acknowledge downside risk from the weighted median CPI measure. We also note that even if the trimmed mean is 0.9%qtr and the weighted median is a softer 0.7%qtr, giving an average underlying rate of 0.8%qtr, the average annual rate would still be 3.0%yr – above the RBA's forecast flagged in recent communications of below 3%yr.

Aggregate PPI contributions from non-core elements (food and petroleum) were slightly higher than forecast (+0.10ppts vs f/c +0.03ppts). Food prices rose 0.3% (+0.05ppt contribution) after a 0.3% fall previously, higher than we expected. However, this upside was partially offset by a lesser rise in petroleum refining prices than implied by Friday's import price index data on mineral fuels, rising 1.8% (+0.04ppt contribution) after a 8.2% rise previously.

Abstracting from the non-core PPI net addition, the core PPI was more subdued in Q2 than in Q1, with core import prices lower despite a weaker AUD, a smaller rise in the domestic core PPI ex-construction & utilities, subdued utilities after a strong Q1, and a lesser rise in building construction prices. Still, core PPI pressures were positive again after falls through 2009, at +0.2%qtr and +0.7%yr (vs +1.0%qtr and -0.5%yr prev). That's the highest annual core PPI rate since 2009Q3. Most of the downside surprise on the quarterly core PPI stemmed from an unexpected fall in the core imports PPI. While the AUD import weighted TWI fell 1.1%qtr and core import prices in the MPI rose 1.1%qtr, the core imports PPI subset actually fell 0.4%qtr. Still, this lessened the annual fall to -10.0%yr from -15.2%yr previously.

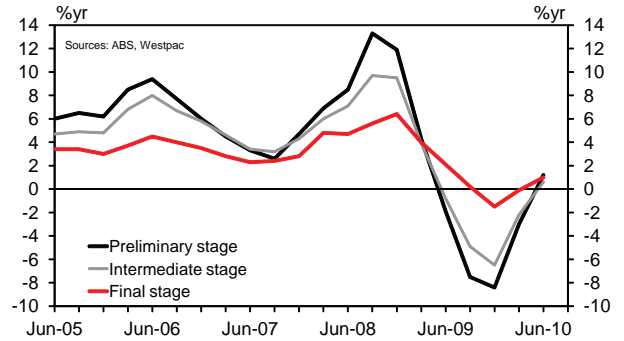
Overall building construction price pressures eased a notch at 0.3%qtr after a 0.6% rise previously, still their third consecutive rise, lifting the annual rate to 1.2%yr from 0.4%yr, the highest since 2009Q1.

As expected, utilities were seasonally subdued in Q2, rising 0.2%qtr after a strong 3.2%qtr jump previously. No CPI implications here.

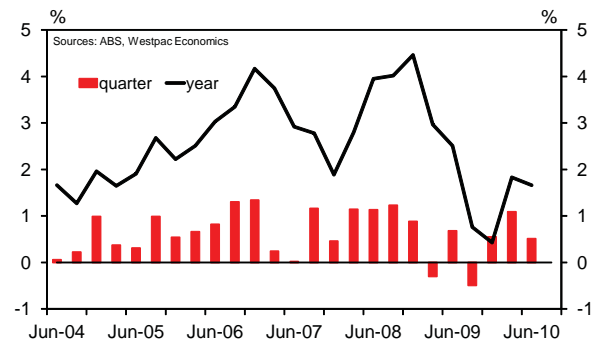
Abstracting from the weakness in core import prices, the lesser rise in building construction prices, and seasonally subdued utilities, **the domestic core PPI saw less pressure in Q2 than in Q1, but nonetheless recorded its third consecutive rise after falls in 2009Q1 and 2009Q3.** The domestic core PPI ex-construction and utilities was +0.5%qtr and +1.7%yr (vs +1.1%qtr and +1.8%yr prev). This domestic core subset rise was less broad based in Q2 than Q1, with increases in 11 of the 32 items (still, second highest since 2009Q3, vs 16 prev) but falls in only 6 items (lowest since 2008Q4, vs 7 prev). The items recording price increases were tobacco products; publishing; plastic product manufacturing; other transport equipment manufacturing; electrical equipment and appliance manufacturing; industrial machinery and equipment manufacturing; non-building construction; road freight transport; services to transport; real estate agents; and technical services.

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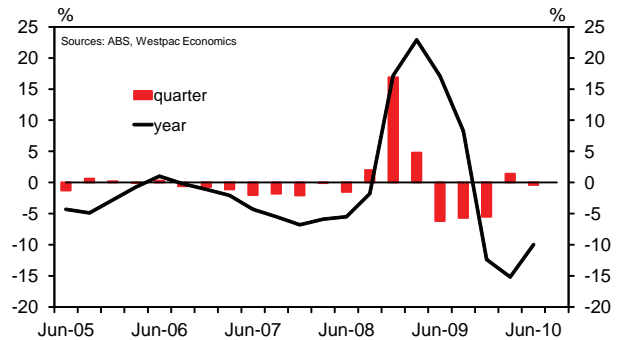
PPI inflation: upstream deflation finished



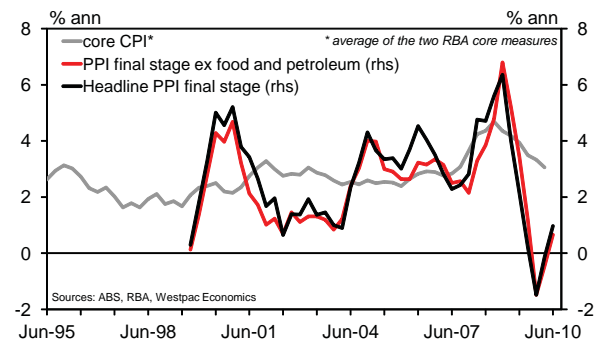
Core domestic PPI ex-construct'n & utilities



PPI core import prices: fell despite AUD dip



Core producer prices vs consumer prices



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.