

Service Sector Growth Steadies

The Australian Industry Group – Commonwealth Bank **Performance of Services Index (PSI™)** rose by 2.4 points to 53.8 in May - the first increase since December 2003.

The May **PSI™** result suggests that growth in service sector activity may be steadying – after slowing rapidly in early 2004 - and moving into line with generally favourable broader economic trends.

The rise in May comprised increases in all components other than stocks. Sales increased for the second consecutive month, while new orders rose to the highest level since January 2004. Input costs also rose for the third month in a row – and to the highest level since March 2004 – reflecting the impact of higher energy costs.

Commonwealth Bank Chief Economist, Michael Blythe, said that there are encouraging signs that the decline in service sector growth from its October peak is ending.

“The pick up in sales activity evident in the April survey has continued and this lift is now having positive knock-on effects on orders and employment. The improvement has continued despite some early signs that higher oil prices are starting to bite,” Mr Blythe said.

Australian Industry Group Chief Executive, Heather Ridout, noted that there were some mixed influences in the May **PSI™**.

“Doubts about the timing of the next Federal election emerged for the first time in the May **PSI™** as one of the conflicting currents at work in the services sector.

“The election timing, together with import competition, rising oil prices and renewed rainfall deficiencies in some areas was a balance to the optimism associated with the impact of the tax cuts announced in the Federal Budget.

“A number of sectors are, however, still enjoying strong underlying demand as the threat of interest rate rises recedes,” Mrs Ridout said.

The key indicators:

Sectors

In raw terms, readings improved in six out of the nine sectors. Seven sectors also continued to report positive growth in May (up from six in April). Activity strengthened notably in the communications and property & business services sectors. By contrast, activity contracted sharply in the transport and storage sector, most likely reflecting the impact of higher energy costs.

Sales

The (seasonally adjusted) sales index increased for the second consecutive month, rising 2.2 points to 53.7. The major positive contributions were from the communications and property & business service sectors.

Orders

Seasonally adjusted new orders rebounded 3.0 points to 57.9 in May, and to the highest level since January 2004 (but still well below the most recent cyclical peak of 70.7 in October 2003).

Jobs

After a flat April, employment appears to have grown modestly in May. The (seasonally adjusted) employment index rose 2.4 points in the month, to 52.4.

Stocks and input prices

Service sector inventories have now been depleted for three consecutive months, with the pace of drawdown gradually quickening. The (seasonally adjusted) stocks component fell a further 0.5 points in May, to a level of 48.4.

Input prices also strengthened appreciably in May, to the highest level since March 2003, and most likely reflecting higher energy costs.

Further Comment:

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Background

The **Australian Performance of Services Index (PSI™)** is a leading indicator of Services activity in the Australian economy. The PSI™ is a seasonally adjusted national composite index based on the diffusion indexes for sales, orders/new business, deliveries, inventories and employment with varying weights. An **Australian PSI™** reading above 50 points indicates that services activity is generally expanding; below 50, that it is declining. The distance from 50 is indicative of the strength of the expansion or decline. Results are based on a sample of over 210 companies.
