

## Contraction in service sector activity

Activity in the services sector contracted in June with the Australian Industry Group – Commonwealth Bank **Performance of Services Index (PSI™)** falling 4.3 points to 49.5 on a seasonally adjusted basis.

The drop below the 50 mark that separates expansion from contraction was the first since the PSI commenced in February 2003. The apparent decline follows a sustained period of exceptionally strong growth including a sharp rebound in May.

Of the five components in the index, sales and new orders continued to expand – although at a somewhat slower pace than in May - while there were sub-50 readings in employment, inventories and supplier deliveries.

Rising costs also had an impact on the sector in June. The cost measure collected as part of the PSI survey indicates that the upward pressure on input costs has increased over the past few months.

Activity expanded in five sectors comprising retail trade; accommodation; communications; transport & storage; and health & community services. Activity contracted in four sectors: wholesale trade; finance & insurance; personal & recreational services; and property & business services. Finance & insurance suffered the deepest decline, although after a prolonged period of strong growth.

Commonwealth Bank Chief Economist, Michael Blythe, said the latest PSI™ indicated a general toughening of conditions in some areas of the services sector.

“The key economic drivers remain supportive and the latest PSI™ reading needs to be interpreted in this light. Those service sector segments dependent on the consumer continue to fare well. But it does look like higher input costs are squeezing the business services segment in particular,” Mr Blythe said.

Australian Industry Group Chief Executive, Heather Ridout, said the June PSI™ reflected some volatility across the sectors.

“The June result should be seen in the context of a strong reading in May and a number of factors that are obscuring underlying developments and curbing sales such as especially cold and wet weather in some areas.

“It is also significant that while sales growth slowed, both sales and new orders remain in positive territory above 50. The improvement in these two important areas together with the stimulus from the tax cuts and family payments auger well for continued overall growth in months ahead,” Mrs Ridout said.

---

## The key indicators:

### Sectors

In unadjusted terms, five of the nine sectors reported an expansion of activity in June. The five comprised retail trade; accommodation; communications; transport & storage; and health & community services. Respondents attributed a turnaround in transport & storage to rainfall and improved rural conditions, although growth in communications was down sharply from the previous month. Activity contracted in four sectors - wholesale trade; finance & insurance; personal & recreational; and property & business.

### Sales

Sales fell 2.4 points to 51.3 (sa), more than reversing a 2.2 point jump in May. However, the index still remains 1.3 points above the most recent low of 50.0 recorded in April 2004.

### Orders

New orders tumbled 7.1 points to 50.8 (sa), the lowest level yet recorded in the PSI™. Orders fell in wholesale trade and finance & insurance, but increased particularly strongly in retail trade; accommodation and transport & storage.

### Jobs

The employment index fell 3.7 points to 48.7(sa). The contraction in employment is the first since July 2003. Four sectors recorded contractions, while a further three reported unchanged levels of employment.

### Stocks and input prices

Consistent with the steady moderation in sales and new orders growth, service sector inventories now have been rundown for four consecutive months. The stocks index fell a further 1.1 points in June, and at 47.3 (sa) is the lowest since June 2003.

### Further Comment:

Tony Pensabene – Ai Group	03 9867 0258 or 0417 012 863
Michael Blythe - Commonwealth Bank of Australia	02 9312 4135 or 0414 886 027

### Media Inquiries:

Tony Melville - Ai Group	02 6233 0716 or 0419 190 347
Steve Cookson- Commonwealth Bank of Australia	02 9378 2504

### 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 190 companies.

---