

## **Australian PSI®: Services sector growth stalls - Something worrying going on in the Australian economy**

Services sector growth appears to have stalled in early 2005. The **Australian Industry Group – Commonwealth Bank Performance of Services Index (PSI®)** dipped below the 50 point mark that separates expansion from contraction in February.

The PSI reading for February fell by 4.8 points to 48.7. The drop follows an earlier sharp slowdown in January.

The decline in services sector activity in February was largely due to sharp contractions in supplier deliveries and inventories, mainly in the retail and wholesale trade sectors. The PSI® sales sub-index also contracted slightly and the input price index eased to the lowest level since April 2004.

The employment and new orders components of the overall PSI®, however, are still in expansion territory. These components remain consistent with further jobs growth and some lift in sales activity over the next few months, albeit at a markedly slower pace.

Four sectors reported strengthening growth in February, led by accommodation, cafes & restaurants and business & property services. The wholesale and retail trade sectors reported the sharpest contractions in activity, while the health & community services sector recorded only its second ever contraction in activity.

Commonwealth Bank Chief Economist, Michael Blythe, said the dropping away of service sector momentum in the early part of 2005 highlighted the fine judgement required when raising interest rates to address longer-run inflation concerns.

“The sharp contraction in the delivery and inventory components stand in contrast to the more resilient readings on orders and employment. This mix is consistent with an economy pushing up against capacity constraints. Rising business capex is one way of easing these constraints. But another outcome could be higher prices – a lift in interest rates is one way to insure against that risk,” Mr Blythe said.

Ai Group Chief Executive, Heather Ridout, said the February PSI® provided further evidence of the weakening trends emerging in the economy.

“Something worrying is going on in the Australian economy. That something is that the economy is weakening. Consumers are becoming cautious and this is consistent with a slowing in domestic demand, which has been the mainstay of Australian economic growth in recent times,” Mrs Ridout said.

### **The key indicators:**

#### **Sectors**

Unadjusted, five sectors reported expanding activity in February and of those, four sectors enjoyed a strengthening in growth relative to January (accommodation, cafes & restaurants; transport & storage; finance & insurance; and property & business services). Growth slowed in personal & recreational services. By contrast, the readings for retail trade and health & community services were the lowest yet recorded, while activity in both wholesale trade and communications has now fallen for two consecutive months.

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## Sales

The seasonally adjusted sales sub-index fell 5.9 points to 48.6, the second consecutive easing and the first contraction in sales yet recorded. In unadjusted terms, only three sectors reported higher sales – accommodation & restaurants; property & business services and personal & recreational services (and which partly reflects seasonal influences). However, growth in personal & recreational services moderated from levels reported in January. Elsewhere, sales again fell sharply in wholesale trade, and declined also in retail trade. The level of sales was unchanged in the remaining four sectors.

## Orders

After seasonal adjustment, the new orders component fell 5.7 points to 50.2. The decline follows a similarly sharp decline in January, leaving the index at the lowest level yet reported. Unadjusted new orders grew in five sectors, with growth strengthening from January in finance & insurance; and property & business services. New orders grew at an unchanged pace in accommodation, cafes & restaurants, and slowed in health & community services and personal & recreational services. Orders were unchanged in communications, but fell in wholesale and retail trade and communications.

## Jobs

The seasonally adjusted employment component eased 1.4 points to 51.2. It was the third consecutive month in which the index has moderated, and the lowest reading since June 2004. Employment rose in only four sectors, comprising accommodation, cafes & restaurants, transport & storage, finance & insurance and property & business services. Employment contracted in the remaining five sectors, although the rate of job shedding slowed slightly in wholesale trade and personal & recreational services.

## Stocks

The unadjusted stocks sub-index fell 6.2 points to 44.9, again the lowest reading yet recorded. Inventories rose in transport & storage and in communication services. Stock levels were unchanged in accommodation & restaurants and property & business services, but fell sharply in wholesale and retail trade, and also in finance & insurance; health & community & personal & recreational services.

## Supplier deliveries and input prices

The seasonally adjusted sub-index fell 6.0 points to 44.9, the third consecutive month of moderating growth and again the lowest reading recorded. Deliveries contracted sharply in both wholesale and retail trade, and to a lesser extent in health & community services. Only accommodation, cafes & restaurants; and transport & storage reported increases, with the other sectors unchanged. The seasonally adjusted input price sub-index eased 0.7 points to 62.1, more than reversing an earlier rise in January.

## 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 approximately 190 companies.

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