PSI AUSTRALIAN

PERFORMANCE OF SERVICES INDEX®

AUSTRALIAN INDUSTRY GROUP

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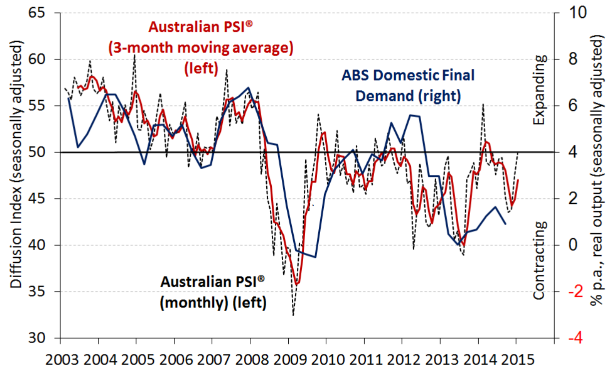
SERVICES SECTOR STABILISES IN THE NEW YEAR

Australian PSI®	USA Flash PSI	Eurozone Flash PSI	UK Markit PSI	Japan Markit PSI	China HSBC PSI
Jan 2015: **49.9** ↑	Jan 2015: **54.0** ↑	Jan 2015: **52.3** ↑	Dec 2014: **55.8** ↓	Dec 2014: **51.7** ↑	Dec 2014: **53.4** ↑

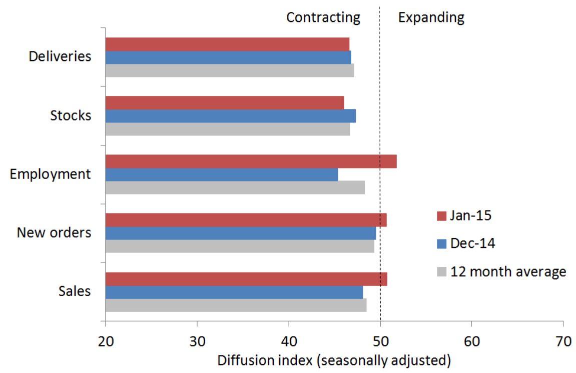
KEY FINDINGS

- After spending most of 2014 in negative territory, conditions in the services industries stabilised in the New Year. The seasonally adjusted Australian Industry Group Australian Performance of Services Index **(Australian PSI®)** improved by 2.4 points to 49.9 points this month, indicating stable conditions across service businesses in January.
- The three-month moving average for the **Australian PSI®** increased to 47.1 points in January. Recent results from the **Australian PSI®** suggest growth in Australian demand for goods and services (as measured by the ABS in the *National Accounts* each quarter as 'domestic final demand') is likely to remain subdued in Q4 2014 and early in 2015.
- Three of the five activity sub-indexes in the **Australian PSI®** returned to expansion (i.e. above 50 points) in January. Pleasingly, the sales, new orders and employment sub-indexes all expanded this month following four months of contraction (three months for employment). However, services businesses reduced their supplier deliveries and stock levels for an eighth consecutive month in January.
- Two of the nine services sub-sectors showed expansion this month, while one – retail trade – was stable (50.0 points). The very large health and community services sub-sector (58.1 points, three-month moving averages) expanded for a third month in January and the finance and insurance services sub-sector also returned to expansion (56.6 points). Conditions in the retail trade sub-sector (50.0 points) stabilised this month after three months of contraction. All other services sub-sectors contracted again in January.
- Respondents to the **Australian PSI®** indicated that the lower Australian dollar has boosted conditions in dollar-exposed sub-sectors such as retail trade and tourism, while a pick-up in residential building activity over the past year has increased demand for related services. However, service sector businesses remain concerned about weak local economic conditions and subdued consumer and business confidence. Some respondents said that state elections in NSW and Queensland, as well as uncertainties around a few large public infrastructure projects (e.g. East-West Link in Melbourne), have dampened demand for business services such as accounting, legal, personnel and administrative services.



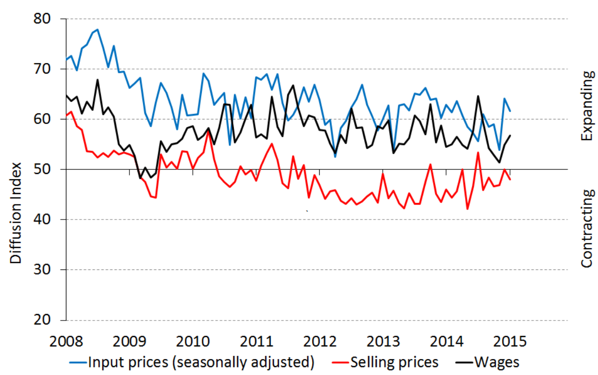
ACTIVITY SUB-INDEXES

- The sales sub-index increased by 2.6 points to 50.7 points in January. This signalled the first expansion (above 50 points) in sales in the **Australian PSI®** since August 2014.
- The new orders sub-index in the **Australian PSI®** also returned to expansion this month, moving up by 1.2 points to 50.7 points. This augurs well for activity over coming months.
- Likely reflecting these improvements in sales and orders, services employment expanded in January after contracting for three months. The employment sub-index increased by 6.4 points to 51.7 points this month.
- On the other hand, both the supplier deliveries (down 0.2 points to 46.6 points) and stocks (down 1.3 points to 46.0 points) sub-indexes remained below 50 points in January and both signalled an eighth month of contraction. They last expanded in May 2014.
- Capacity utilisation across the services industries increased slightly this month to 76.8% (up 1.9 percentage points) of capacity being utilised in January.



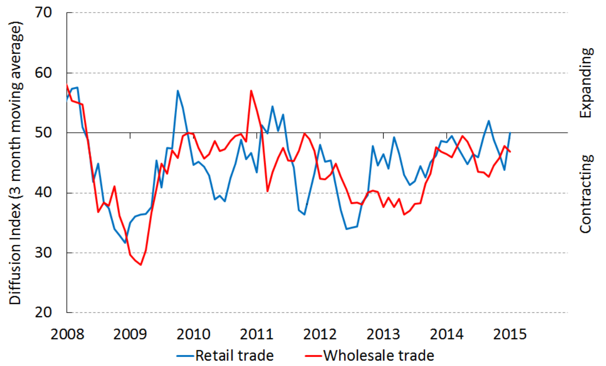
PRICES SUB-INDEXES

- The input prices sub-index in the **Australian PSI®** declined slightly to 61.6 points (down 2.6 points) in January. This followed a sharp rise of 10.2 points in December, likely reflecting higher prices for imports due to the further depreciation of the Australian dollar since September 2014. In general, growth in input prices has been relatively contained over the past year, due to relatively weak consumer demand and soft global background inflation.
- The average wages sub-index in the **Australian PSI®** increased by 1.9 points to 56.8 points in January. This suggests annual wage growth in the services industries is likely to remain weak in the near term. It reflects the weak national labour market, with employment growth of just 1.4% in the year to the end of December 2014 and the unemployment rate near a 12-year high of 6.2%, as well as weaker consumer inflation (1.7% in December).
- Selling prices in the services industries contracted again in January following a brief stabilisation last month. The selling prices sub-index decreased by 1.9 points to 48.1 points this month. This puts services businesses' margins under further pressure amid ongoing increases in wages and other input costs and headwinds in raising prices to cover them.



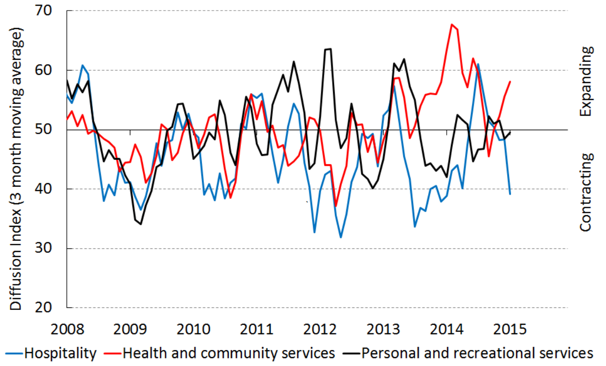
RETAIL TRADE; WHOLESALE TRADE *

- The **retail trade** sub-sector in the **Australian PSI®** returned to stable conditions in January following three months of contraction. The sub-sector's index rebounded by 6.2 points to 50.0 points this month (three-month moving average). The further depreciation of the Australian dollar since September 2014 appears to have assisted local retailers, with both sales and new orders expanding over the past three months.
- The **wholesale trade** sub-sector's index, on the other hand, decreased marginally by 0.9 points to 46.9 points in January (three-month moving average). This sub-sector has been in continuous contraction since a brief stabilisation in October 2011.
- Despite the lower Australian dollar and stable activity levels in the retail trade industry over the past month, respondents from both the retail and wholesale trade sub-sectors continued to raise concerns about the lingering effects of fragile consumer confidence, the economic outlook, and uncertainties surrounding various household-related Federal and state government policies that might affect household spending and investment decisions.



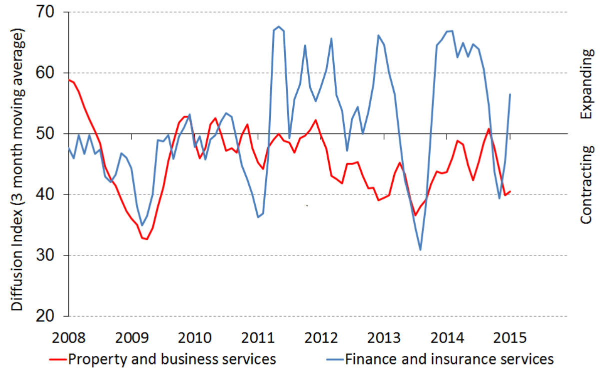
HOSPITALITY; HEALTH SERVICES; RECREATIONAL SERVICES *

- The **accommodation, cafes and restaurants** ('hospitality') sub-sector contracted for a third month in January, after expanding between June and October 2014. The sub-sector's index fell by 9.2 points to 39.2 points (three-month moving average), indicating the fastest pace of contraction in a year. This suggests consumer caution has continued into 2015.
- The **personal and recreational services** sub-sector contracted for a second month in January after three months of mild expansion. The sub-sector index increased by 1.1 points to 49.5 points this month (three-month moving average), signalling a marginal contraction. Concerns about the local economy and uncertainties around both Federal and state policies are still affecting consumer spending on discretionary recreational services.
- The giant **health and community services** sub-sector expanded for a third month in January. The sub-sector's index increased by another 2.5 points to 58.1 points this month (three-month moving average). The health and community sub-sector has experienced the strongest growth among all the **Australian PSI®** sub-sectors over the past two years.



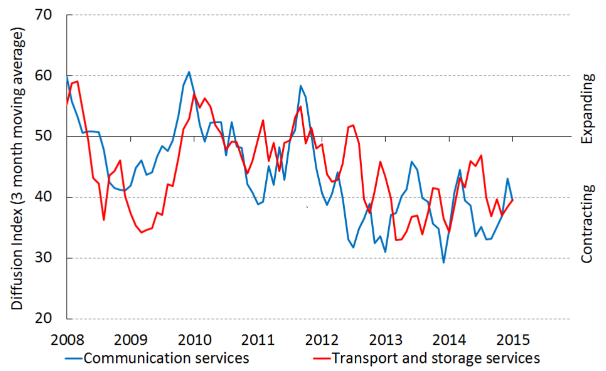
PROPERTY AND BUSINESS SERVICES; FINANCE SERVICES *

- The **property and business services** sub-sector's index was almost unchanged in January, at 40.6 points (up by 0.6 points; three-month moving average). This signalled a fourth month of serious contraction. This large business-oriented industry expanded briefly in September 2014, after a protracted period of contraction since January 2012.
- Respondents from the property and business services sub-sector expressed ongoing concern about weak economic conditions, soft business confidence and continuing decline in investment from the mining and manufacturing industries. Furthermore, uncertainties around some key large public infrastructure projects (e.g. the East-West link in Melbourne) and state elections in NSW and Queensland are also said to have affected demand for business-to-business services such as accounting, legal, design, consulting, personnel and administrative services.
- The giant **finance and insurance** sub-sector returned to expansion in January, following three months of contraction. The sub-sector's index rose by 11.2 points to 56.6 points this month (three-month moving average). Conditions in this sub-sector are affected by performance and volatility in financial markets, investment trends (e.g. the popularity of real estate over other assets at present), and legislative changes affecting the financial services and superannuation industries (such as the change from 1 January 2015 that account-based pensions are treated the same as all other financial assets under the Centrelink Income Test, which could reduce retirees' entitlements to the aged pension).



COMMUNICATION SERVICES; TRANSPORT SERVICES *

- The **communications** sub-sector's index declined by 3.6 points to 39.4 points in January (three-month moving average). This sub-sector has been in contraction since December 2011 (i.e. below 50 points). There are few signs of improved conditions in the communications sub-sector, with all of its activity sub-indexes below 50 points (i.e. in contraction). Fragile global and national economic conditions, weak business appetite for investment, as well as general telecommunications investment uncertainties, continue to weigh on demand for communications, IT and related services.
- The **transport and storage services** sub-sector's index increased by 1.1 points to 39.5 points in January (three-month moving average). This indicated the 30th consecutive month of contraction since this sub-sector last expanded in July 2012. Although the transport and storage sub-sector has benefitted from increased residential building activity over the past year and somewhat better retail conditions over the Christmas trading period, an ongoing lack of confidence, slower mining construction activity and the decline in local automotive assembly are likely to be affecting demand and prices for local freight transport services.



Seasonally adjusted index	Index this month	Change from last month	12 month average	Seasonally adjusted index	Index this month	Change from last month	12 month average
Australian PSI®	**49.9**	**2.4**	**48.3**	**Supplier Deliveries**	46.6	-0.2	47.1
Sales	50.7	2.6	48.5	**Input Prices**	61.6	-2.6	59.6
New Orders	50.7	1.2	49.3	**Selling Prices** **	48.1	-1.9	47.3
Employment	51.7	6.4	48.3	**Average Wages** **	56.8	1.9	56.0
Stocks	46.0	-1.3	46.6	**Capacity utilisation** **	76.8	1.9	76.1

* All sub-sector indexes in the **Australian PSI®** are reported as three month moving averages (3mma), so as to better identify the trends in these volatile monthly data. ** Unadjusted.

What is the Australian PSI®? The Australian Industry Group Australian Performance of Services Index (Australian 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 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. For further economic analysis and information from the Australian Industry Group, visit **http://www.aigroup.com.au/economics**. *For further information on international PMI data, visit http://www.markiteconomics.com or http://www.cipsa.com.au.