Data Snapshot

Wednesday, 3rd September 2014

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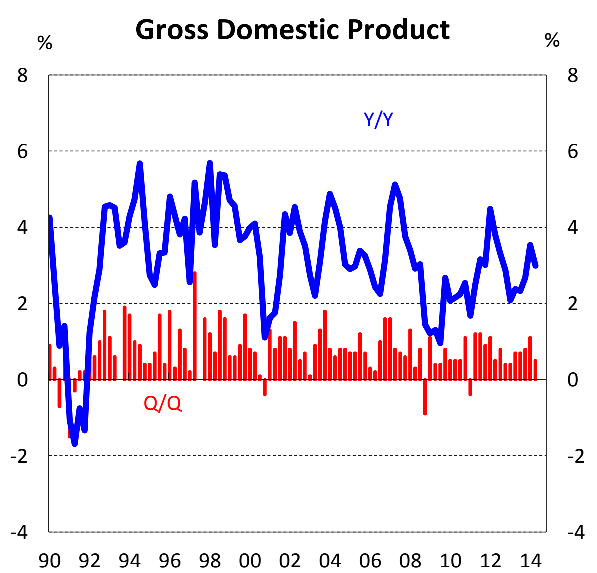
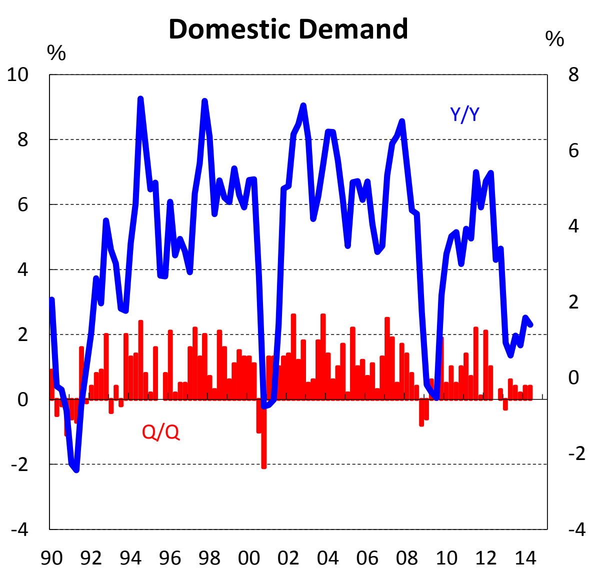
National Accounts - GDP

A Patchwork Quilt

- **The economy grew by 0.5% in the June quarter, after rising 1.1% in the March quarter. This was the slowest quarterly growth in over a year, with the surge in exports in the March quarter partially backtracking in the June quarter. However, businesses rebuilt inventories after running inventories down in previous quarters, which supported economic growth.**
- **Annual growth eased to 3.1% in the year to the June quarter, from 3.4% in the year to the March quarter. It remains, however, above its decade average, and a healthy pace of growth.**
- **Economic growth was slightly above our own and consensus forecasts, at 0.5% in the June quarter. The positive surprise came from business investment which rose 1.0% in the June quarter, contributing 0.2 percentage points to GDP growth.**
- **Annual growth in State final demand reflected the shift in growth drivers from mining to non-mining States. On an annual basis, final demand contracted in Queensland, WA and Northern Territory, where mining investment has been most prominent.**
- **Today's data highlights that the economic recovery remains patchy. However, we continue to expect the annual growth in GDP to have a 'three' in front of it for 2014. This means the next move in interest rates from the Reserve Bank will be up, although not until next year.**





GDP Expenditure Measure:

The GDP data for the June quarter highlights the patchy nature of economic growth in Australia, as the economy transitions away from mining investment led economic growth. Net exports detracted 0.9 percentage points from GDP growth in the June quarter, after making a substantial contribution to GDP growth in the March quarter (1.2 percentage points). Export volumes slipped 0.8% in the June quarter, after a 4.2% surge in the March quarter. Import volumes lifted 3.7% in the June quarter, following three consecutive quarters of declining imports.

The largest contribution to growth for the quarter came from businesses rebuilding inventories (adding 0.9 percentage points).

Household consumption and business investment helped to underpin growth in the quarter. Household consumption added 0.3 percentage points to growth, while business investment added 0.2 percentage points to growth. Non-dwelling construction added 0.2 percentage points to growth. Residential construction added 0.1 percentage points to growth for the June quarter, after adding 0.2 percentage points in the March quarter.

Aside from net exports, the other major detractor from growth was government investment, which detracted 0.2 percentage points from growth in the June quarter, following a 0.3 percentage point detraction in the March quarter.

If we exclude the biggest contributor and drag to GDP growth in the quarter - inventories and net exports – we are left with domestic final demand. It gives us a better guide to underlying strength in the domestic economy. Domestic final demand rose by 0.4% in the June quarter, after rising 0.4% in the March quarter. For the year to the June quarter, domestic final demand rose 1.4%, after rising 1.6% in the year to the March quarter. This remains well below the 10-year average of 3.5%.

The annual GDP growth rate (including net exports and inventories) edged down to 3.1% in the year to the June quarter, from 3.4% in the year to the March quarter. It remains, however, above the average annual growth rate through 2013 (of 2.3%) and above the decade-average of 2.9%.

Selected Expenditure Items on GDP
Chain Volume Measures

	Contribution to GDP, ppt
Household Consumption	0.3
Dwelling Investment	0.1
Business Investment	0.2
Public	-0.2
Inventories	0.9
Net Exports	-0.9

Outlook:

We expect annual growth in GDP to have a 'three' in front of it for 2014. The increased production capacity which has flowed from the mining investment boom should boost net exports in coming quarters. While net exports should drive growth, the outlook for domestic final demand is likely to remain patchy. However, low interest rates have supported interest rate sensitive sectors of the economy and consumption and dwelling investment should support domestic final demand this year. Additionally, there is growing evidence that non-mining investment is recovering.

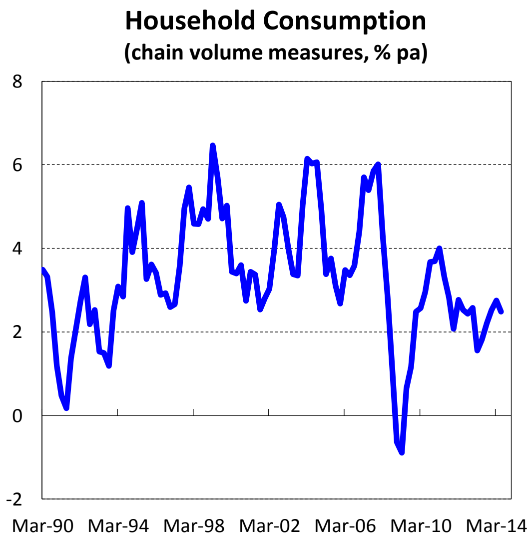
The Reserve Bank has suggested interest rates will remain unchanged for some time, with its continued "period of stability in interest rates" rhetoric. Our view is that interest rates will remain on hold this year, before lifting next year, once evidence of a strengthening economic recovery firms.

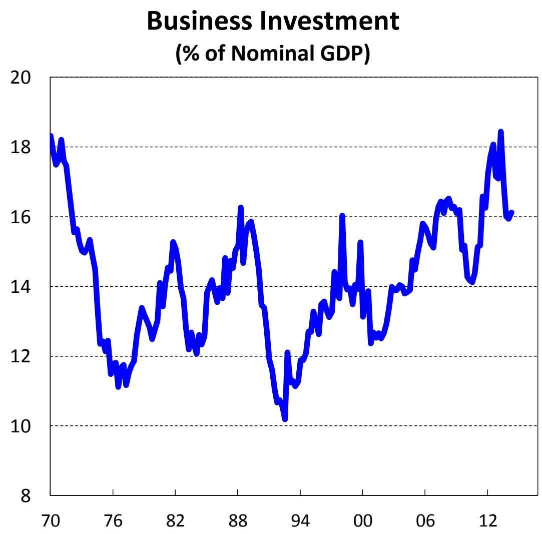
GDP Expenditure Measure Breakdown:

- **Household Consumption**

Spending by households rose by 0.5% in the June quarter, after rising 0.5% in the March quarter. However, it is somewhat disappointing given it remains below the 0.7-0.8% increases seen in the last three quarters of 2013, despite the ongoing low interest rate environment.

Household spending on electricity, gas and other fuel had the largest decline for the June quarter (-3.9%), followed by spending on clothing and footwear (-1.0%). The largest increase in spending for the June quarter was on communications (2.0%). However, the largest contribution came from spending on rent and other dwelling services, which rose 0.6%, but makes up a large proportion of household spending (more than 20%).





- **Dwelling Investment**

New dwelling investment rose 5.7% in the June quarter, which was the eighth consecutive quarterly increase and followed a 6.4% jump in the March quarter. For the year to the June quarter, new dwelling investment rose 14.6% the strongest annual growth rate since December 2002. Residential construction activity should remain strong over the coming year, helping to boost domestic economic activity.

- **Business Investment**

Business investment rose 1.0% in the June quarter, after rising by an upwardly revised increase of 0.3% in the March quarter (previously reported as a decline of 0.3%). For the year to the June quarter, however, business investment has declined 10.9% reflecting weakness in mining investment.

Recent data from the capex survey indicates mining investment will drop sharply in the coming year. However, it showed an encouraging upgrade in plans for capital spending in the non-mining sectors, confirming non-mining investment will lift gradually. Indeed, in today's data there was a strong increase in intellectual property products, which contributed 0.1 percentage points to growth.

- **Trade Sector**

Net exports detracted 0.9 percentage points from GDP growth in the June quarter. Export volumes fell 0.8% in the June quarter. Export volumes were unusually large in the March quarter (rising 4.2%) and some of those gains retraced in the June quarter. Import volumes jumped 3.7% in the June quarter, but are down 1.1% over the year.

The decline in June quarter net exports defies the broader trend, of rising export volumes due to an increase in production capacity within the mining industry. As mining production continues to lift we expect the trend of strong net exports to resume in coming quarters. Over the year to the June quarter, net exports have provided a large contribution to growth, despite the detraction in the June quarter.

- **Inventories**

Inventories were rebuilt in the June quarter, after businesses had run down their inventories over the past year.

GDP Income Measure:

Real GDP - using the income measure – rose by 0.6% in the June quarter and by 3.5% in the year to the June quarter. However, in nominal terms (not adjusted for inflation) the income measure of GDP was flat and was the weakest in nearly two years. Weak incomes largely reflect the impact from falling commodity prices and the resilient Australian dollar.

The income measure largely comprises wages and profits. For the quarter, it was a drop in corporate profits which drove the decline in incomes.

- **Gross Operating Surplus**

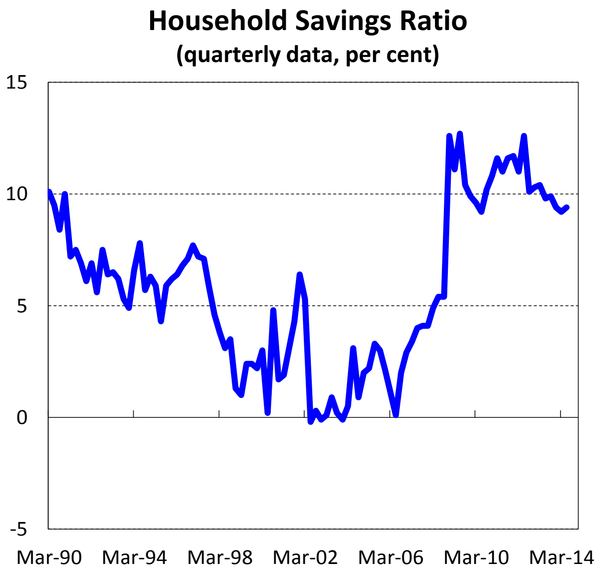
Profits (gross operating surplus) for total corporations fell 3.0% in the June quarter. Mining profits were impacted by the fall in commodity prices and a stronger Australian dollar. A temporary pullback in export volumes for the quarter was also a likely factor. Annual growth however, eased to a moderate pace of 2.8%, and reflects the healthy gains in production capacity that has occurred over the past year.

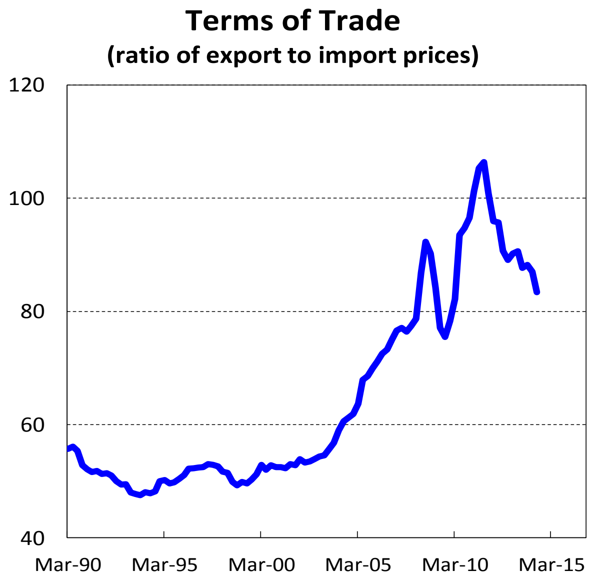
Profits over all sectors (including government and dwellings owned by persons) declined 1.9% in the June quarter and rose 3.4% in the year to the June quarter.

Today's data highlights the important role the Australian dollar plays for corporate incomes, and the domestic economy. The resilience of the Australian dollar is limiting profit gains, and at the same time, falling commodity prices have also put incomes under pressure. It increases the importance of productivity growth to drive income gains. Nonetheless, this slower pace of income growth is the most likely scenario in the coming years.

- **Wages**

Total wages (including employer's social contributions) rose a modest 0.8% in the June quarter, while annual growth lifted from 2.8% to 3.1%. The annual pace of growth sits well below the long run average of 6.4%, and corresponds with soft labour market conditions. While there are signs that the job market will improve, the elevated unemployment rate suggests that the pace of growth in wages will only be modest for some time. A softer pace of wage growth could limit any pickup in household consumption. However, the household savings ratio is another factor that will drive household consumption growth (see below).





- **Terms of Trade**

The terms of trade (ratio of export to import prices) fell 4.1% in the June quarter, the largest quarterly decline in nearly two years. In the year to the June quarter, the terms of trade is down 7.9%, and is down 21.6% from its peak in the September quarter 2011. The terms of trade however, remains well above its long-run average.

Bulk commodity prices (iron ore and coal) have come under a bit more pressure recently, so there is a risk that the terms of trade could fall further. The more it falls, the harder Australia will need to work for income gains. It corresponds with RBA's frustration with the elevated Australian dollar, as a weaker currency would help cushion this impact.

- **Household Saving Ratio**

The household savings ratio rose from 9.2% to 9.4% in the June quarter, recovering its fall in the March quarter. Uncertainty among households stepped up in the quarter, as reflected in a sharp fall in consumer sentiment in May. Encouragingly, a rebound in confidence in more recent months could suggest that households are more willing to reduce their savings, and support consumption growth.

While the household savings ratio is down from a recent peak of 12.6% in the June quarter 2012, it remains above the 10-year average. This suggests that there plenty of scope for households to tap into savings, particularly when interest rates remain low and household wealth levels are rising.

Industry Break Down:

Industry Gross Value Added, Chain Volume Measures

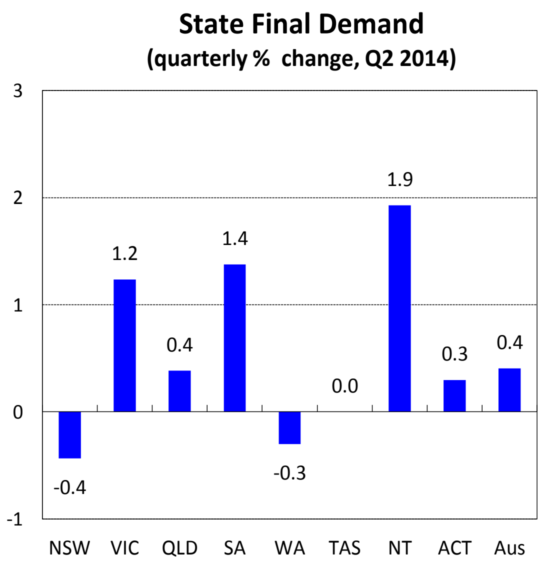
By Industry Sector	Quarterly % Change	Annual % Change
Accomodation & food services	4.5	4.8
Other services	3.1	2.2
Rental, hiring & real estate services	2.7	12.0
Information media & telecommunications	2.5	4.6
Manufacturing	2.1	-0.5
Administrative & support services	2.0	3.7
Construction	1.4	6.7
Healthcare	1.0	4.8
Education & training	0.6	2.2
Wholesale Trade	0.4	-1.9
Financial & insurance services	0.2	6.2
Retail Trade	-0.2	1.6
Transport,postal & warehousing	-0.2	-2.0
Agriculture, forestry & Fishing	-0.4	-5.6
Arts & recreation services	-0.4	2.1
Professional, scientific & technical services	-0.8	-4.1
Public Admin & safety	-1.0	0.9
Mining	-1.4	10.2
Electricity gas, water & waste services	-2.2	-3.3

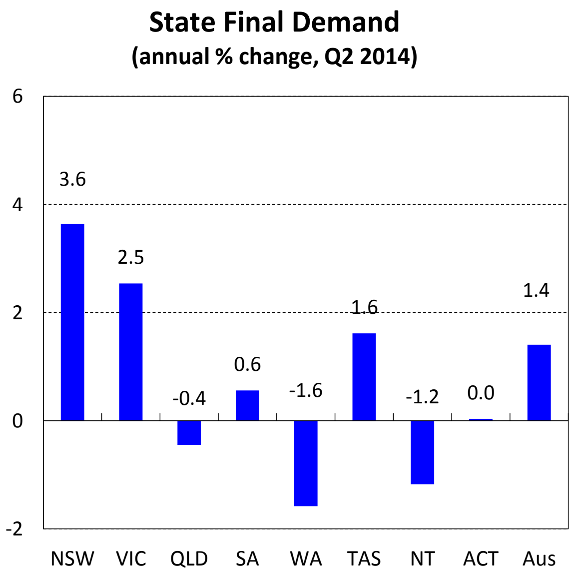
State Final Demand:

Final demand was mixed across States in the June quarter. It was encouraging to see solid quarterly growth in Victoria and South Australia, given their relatively large manufacturing sectors have been struggling in recent years with the high Australian dollar.

Annual growth in State final demand reflected the shift in growth drivers from mining to non-mining States. On an annual basis, final demand contracted in Queensland, WA and Northern Territory, where mining investment has been most prominent. In all other States or territories, demand has turned positive, but remains subdued in most. NSW was the only State or territory to record annual growth in final demand stronger than the long-run average.

These State final demand figures do not include net exports and therefore do not take into account the positive impact of higher resource exports on economic growth in the resource States, including Western Australia and Queensland. The impact of net exports will be available in Gross State Product data but is only available on an annual basis, and should be released in late November.





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