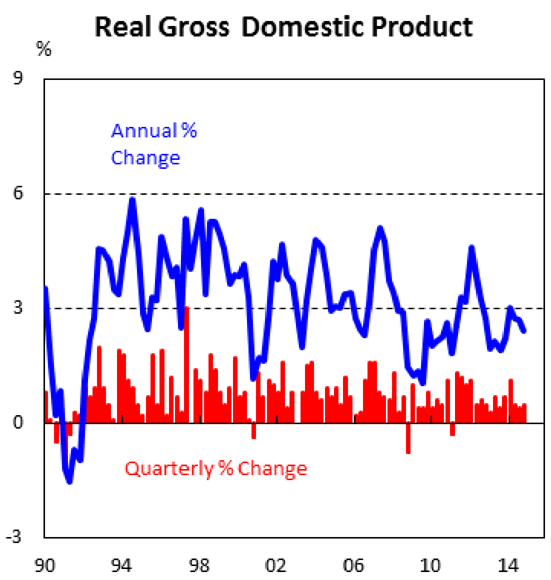
Data Snapshot

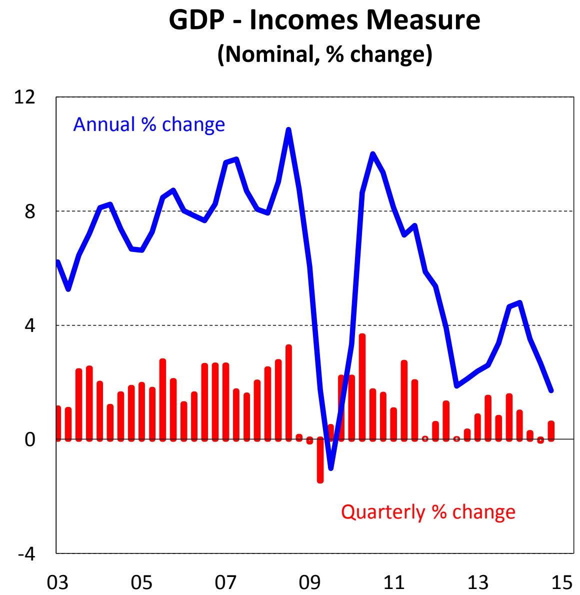
Wednesday, 4th March 2015

National Accounts - GDP

Weak Undercurrents

- **GDP expanded by 0.5% in the December quarter, for annual growth of 2.5%. Annual growth was in line with the RBA's growth forecasts published in February, but the overall picture of the economy remains soft. The annual pace of growth remains below trend, and is likely to remain so for some time.**
- **Household consumption, dwelling investment and net exports were the main drivers of growth, while inventories and business investment detracted from growth.**
- **Some of the detail in today's report was encouraging. Domestic demand rebounded, after contracting in the September quarter. Household consumption was also stronger than expected.**
- **Income growth was soft. Softer commodity prices weighed on national incomes, although the weaker Australian dollar should provide some relief. Wages growth was weak, reflecting the subdued labour market.**
- **Final demand was mixed across the States, growing in Western Australia, Victoria, Northern Territory, New South Wales and South Australia in the December quarter.**
- **There remain risks on the horizon, given weak income growth and an uncertain outlook for non-mining investment. The RBA cut official interest rates in February and these risks suggest it is likely it will cut rates again in coming months.**





GDP Expenditure Measure:

GDP expanded by 0.5% in the December quarter, just a touch below consensus and our own expectations for 0.6%. However, thanks to a slight upward revision to September quarter growth of 0.1 percentage points to 0.4%, the annual pace of growth met expectations at 2.5%. The result was in line with the RBA's growth forecasts published in February, but the overall picture of the economy remains soft. The annual pace of growth remains below trend, and is likely to continue to well into 2015.

Some of the detail in today's report was encouraging. Notably, domestic demand rebounded 0.6% in the December quarter. It was the strongest quarterly growth in 2½ years, but followed a 0.4% contraction in the September quarter. Domestic final demand better represents total spending within the domestic economy. The annual growth rate of domestic demand remained weak at 1.2%, and remains well below the long-run average of 3.3%. Domestic demand would need to strengthen much further for the unemployment rate to start declining in a meaningful way.

The main surprise from the release was the strength of household spending for the quarter. Along with household consumption, the main growth drivers of the economy continued to be dwelling investment and net exports. Inventories were the largest drag on the economy, detracting 0.6 percentage points from growth. Business investment detracted 0.1 percentage point, while public spending contributed 0.1 percentage point.

Selected Expenditure Items on GDP
Chain Volume Measures

	Contribution to GDP, ppt
Household Consumption	0.5
Dwelling Investment	0.1
Business Investment	-0.1
Public	0.1
Inventories	-0.6
Net Exports	0.7

- **Household Consumption**

Household consumption grew at 0.9%, the strongest quarterly growth in nearly three years. The healthy result came despite depressed levels of consumer confidence towards the end of 2014. Consumers might be less anxious about their finances than previously thought. Rising asset prices and low interest rates may indeed be having a positive impact on consumer spending. That being said, there is probably some payback from relatively weak spending earlier in the year. Soft growth in wages is also likely to limit growth in household spending. On a year ago, household spending grew at an annual pace of 2.8%, in line with the long-run average.

- **Dwelling Investment**

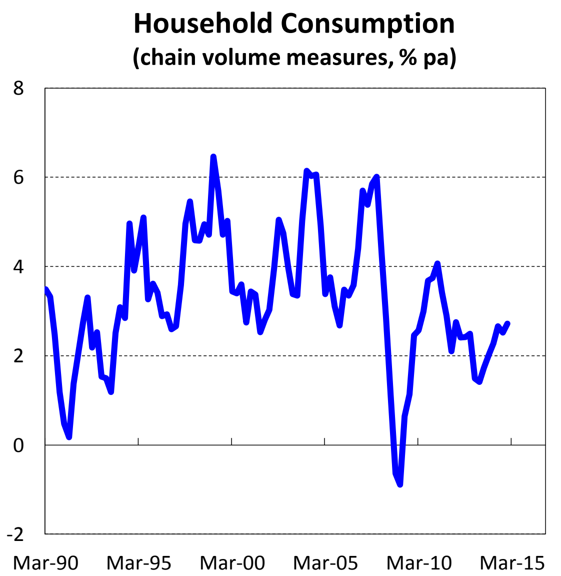
Residential dwelling investment continued to strengthen, growing at 2.5% in the quarter. Annual growth stepped up to a solid 8.1%. A lift in building approvals to an all-time high early this year, suggests that dwelling construction should continue to contribute to growth this year. Rising house prices and low interest rates continue to provide a favourable environment for activity within residential construction.

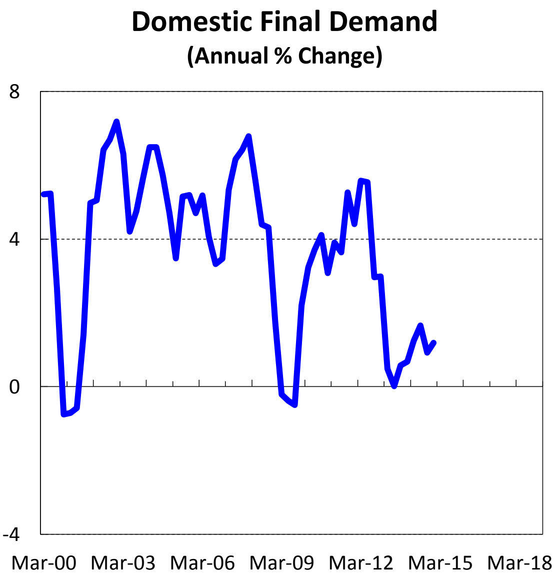
- **Business Investment**

Business investment fell 0.4% in the December quarter, and detracted 0.1 percentage points from growth. The size of the drop in the quarter is relatively modest given the downturn in mining investment underway. To some extent, non-mining sectors are helping to fill the void. However, there is a risk that business investment will deteriorate further as mining investment declines, while the outlook for non-mining investment appears less positive.

- **Net Exports**

Exports continued to be the other major growth driver in the economy. They grew 1.0% in the quarter helping to deliver a contribution to growth in the quarter from net exports of 0.7 percentage points. Exports are being supported by the strong boost to production brought about by mining investment over the years. Meanwhile, as mining investment slows, demand for capital imports is weakening. Imports fell 2.5% in the December quarter, and have declined in five of the last six quarters. We expect this trend of strengthening exports and weak imports to continue as mining transitions away from investment to production. Net exports will provide a significant contribution to growth in coming years.





GDP Income Measure:

Real GDP - using the income measure – grew 0.5% in the December quarter and 2.4% in the year.

GDP in nominal terms (i.e. not adjusted for inflation) is the income measure of economic activity and it rose 0.6% in the quarter, after declining 0.1% in the September quarter.

The income measure largely comprises wages and profits. For the quarter, profits rose following two quarters of decline and wages were also stronger.

- **Gross Operating Surplus**

Profits (gross operating surplus) for all corporations rose 0.9% in the December quarter, however, this followed declines in September and June quarters (of 1.1% and 2.4% respectively). Annual growth in corporate profits fell into negative territory, down 1.4% in the year to the December quarter.

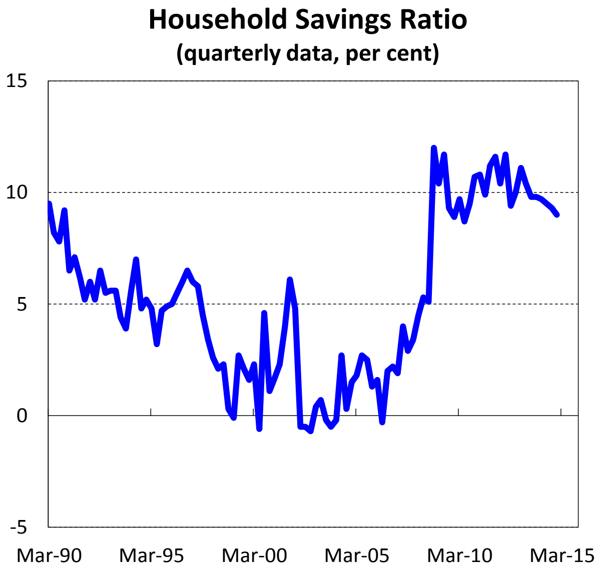
Profits over all sectors (including government and dwellings owned by persons) rose 1.1% in the December quarter and are up 0.6% in the year to the December quarter.

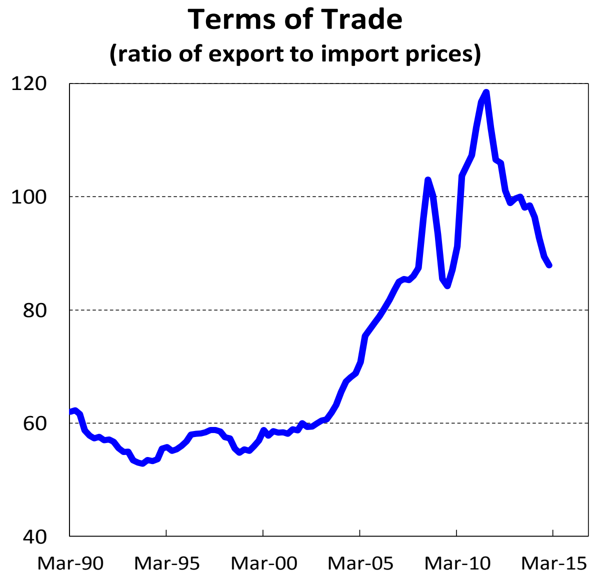
Over the past decade, profit gains have been driven by the strong terms of trade when commodity prices were high, however, this situation has reversed in recent years. A further drop in commodity prices will continue to put incomes under pressure. The weaker Australian dollar, however, will assist in providing some relief. The Australian dollar has fallen by around 4% since the end of December and could fall further. Productivity growth is becoming increasingly important to drive income gains. Productivity is running at around 1.6% year-on-year (based on GDP per hour worked).

- **Wages**

Total wages (including employer's social contributions) rose a lacklustre 0.2% in the December quarter. This saw the annual pace of wages growth slow to 2.3% in the year to December, from 3.1% in the year to September. The unemployment rate rose to a 12½ year high in January, reflecting the softness in the labour market. The slow pace of wage growth is a concerning sign for household consumption, although record low interest rates appear to have increased consumers' willingness to dip into their savings.

Household disposable income, which includes non-wage income was stronger, gaining 1.0% for the December quarter and 3.6% for the year to December.





- **Terms of Trade**

The terms of trade (ratio of export to import prices) fell 1.7% in the December quarter, the fourth consecutive quarterly decline. Over the year to the December quarter, the terms of trade has slumped 10.8% and is down 25.8% from its peak in the September quarter 2011. It remains above its long-run average.

The recent drop in commodity prices suggests that the terms of trade have even further to fall.

The more it falls, the harder Australia will need to work for income gains, although the recent decline in the Aussie dollar will help to cushion the impact of the falling terms of trade.

- **Household Saving Ratio**

With wages growth barely keeping up with inflation, households appear to be dipping into their savings to continue spending.

The household savings ratio fell from 9.3% to 9.0% in the December quarter, the lowest in four and a half years. The low interest rate environment is supporting household spending, despite soft growth in incomes.

The household savings ratio remains above the 10-year average, and suggests that there is further scope among households to draw on their savings, particularly while interest rates remain low and household wealth levels are rising.

Industry Break Down:

Industry Gross Value Added, Chain Volume Measures

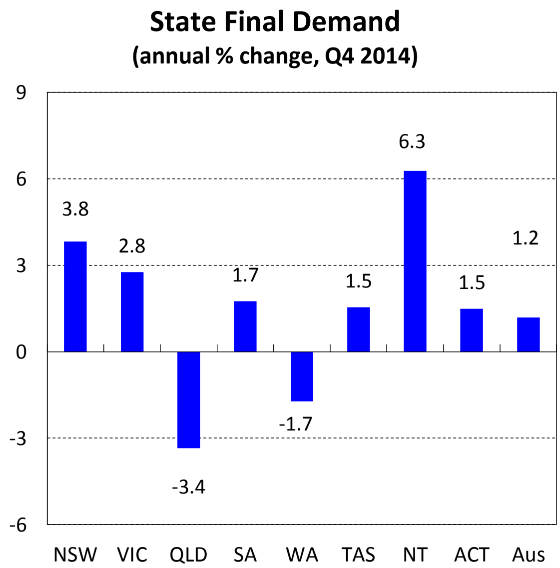
By Industry Sector	Quarterly % Change	Annual % Change
Arts & recreation services	2.6	6.0
Information media & telecommunications	2.1	9.0
Wholesale Trade	1.6	2.3
Healthcare	1.5	5.3
Public Admin & safety	1.2	-0.4
Electricity gas, water & waste services	1.1	0.6
Construction	1.1	1.5
Retail Trade	1.1	2.1
Financial & insurance services	0.7	6.1
Education & training	0.6	2.6
Manufacturing	0.2	-2.1
Mining	0.1	8.9
Administrative & support services	-0.3	0.5
Accomodation & food services	-0.6	8.0
Transport,postal & warehousing	-0.7	-3.7
Agriculture, forestry & Fishing	-0.9	-4.3
Rental, hiring & real estate services	-1.5	2.9
Professional, scientific & technical services	-1.5	-7.2
Other services	-1.8	2.6

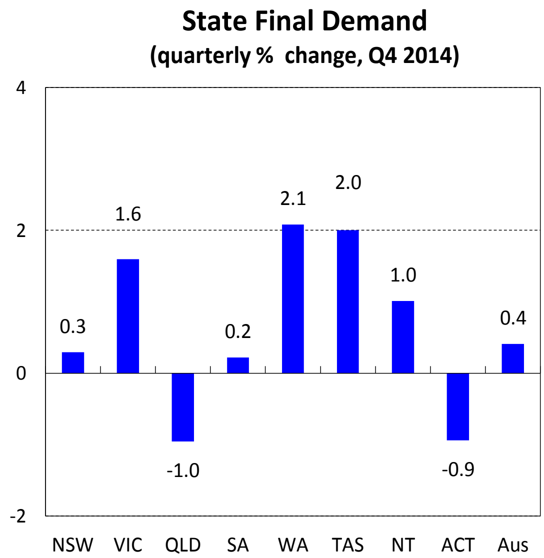
State Final Demand:

For the December quarter, State final demand rose in Western Australia (2.1%), Victoria (1.6%), Northern Territory (1.0%), New South Wales (0.3%) and South Australia (0.2%). There were declines in Queensland (-1.0%), the ACT (-0.9%) and Tasmania (-0.1%).

Despite subdued growth in NSW in the quarter, for the year to the December quarter, annual growth was the strongest of all the States at 3.8%. Including the territories, annual growth was strongest in the Northern Territory (6.3%), followed by Victoria (2.8%), Tasmania (1.6%), South Australia (1.7%) and the ACT (1.5%). For the year to December, annual State final demand fell in Queensland (-3.4%) and Western Australia (-1.7%), reflecting weaker mining investment.

Note that State final demand does not include net exports and therefore does not take into account the positive impact of higher resource exports on economic growth in the resource States, including Western Australia and Queensland.





Outlook:

Today's GDP data was broadly in line with expectations, however, it indicated that economic growth is running at a below-trend rate and is likely to remain so for some time. Mining investment has slumped and the outlook for investment in the non-mining sector is less than positive. While household spending was solid in the December quarter, soft wages growth suggests consumers will need to dip further into their savings to maintain spending growth.

These risks suggest the RBA will likely cut rates again in coming months. We continue to favour May as the most likely timing for the next cut in the cash rate but we cannot rule out a cut in April.

Janu Chan, Senior Economist
Ph: 02-8253-0898

Jo Horton, Senior Economist
Ph: 02-8253-6696

Contact Listing

Chief Economist	Senior Economist	Senior Economist	Senior Economist
Besa Deda	Hans Kunnen	Josephine Horton	Janu Chan
dedab@stgeorge.com.au	kunnenh@stgeorge.com.au	hortonj@stgeorge.com.au	chanj@stgeorge.com.au
(02) 8254 3251	(02) 8254 8322	(02) 8253 6696	(02) 8253 0898