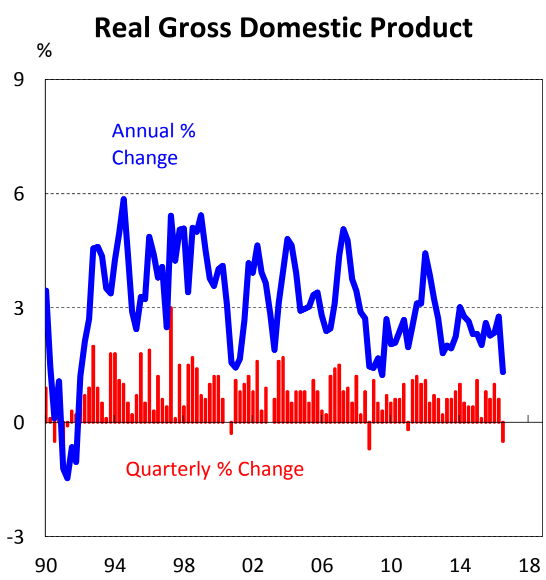
Data Snapshot

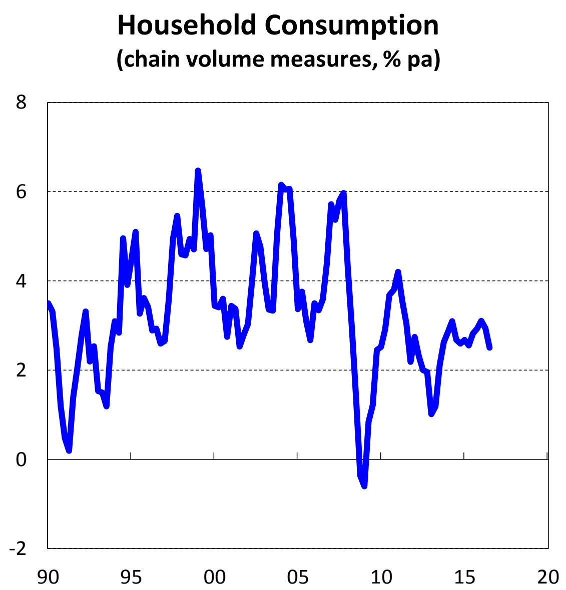
Wednesday, 7 December 2016

National Accounts - GDP

Economy Hits A Pothole

- **GDP was weaker than expected, falling by 0.5% in the September quarter. This was below our own and the consensus forecast for a smaller decline of 0.1%. It was the largest quarterly decline since the GFC.**
- **For the year to the September quarter, GDP rose by just 1.8%, down from a revised pace of 3.1% in the year to June (previously reported as a 3.3% increase). This took annual GDP growth from an above trend pace of growth, to one which is below trend.**
- **Variation across the States and Territories has become the new catchphrase for describing the Australian economy. State final demand rose in four jurisdictions and fell in the remaining four. Only the Northern Territory (4.7%) saw strong growth in the quarter while in Western Australia State final demand declined 3.8%, its fifth consecutive quarter of contraction.**
- **The detail behind the GDP data was mixed with a positive contribution from household spending and a neutral impact from business investment. Government expenditure, dwelling investment and net exports all detracted from growth in the September quarter.**
- **Some of the key areas of weakness in September quarter GDP growth are expected to rebound in the December quarter, suggesting the contraction in the September quarter growth was likely a 'one-off'.**
- **The annual growth profile for this year and next, however, looks much weaker as a result of today's data, highlighting the risk that the RBA is not done cutting interest rates in this cycle.**





GDP was weaker than expected, falling by 0.5% in the September quarter. This was below our own and the consensus forecast for a smaller decline of 0.1%. It was the largest quarterly decline since the December quarter 2008, when the economy was in the throes of the GFC fall-out. This followed an upwardly revised increase of 0.6% in the June quarter (previously reported as a 0.5% increase).

The annual pace of growth slowed from a revised 3.1% in the year to the June quarter (previously reported as a 3.3% increase) to 1.8% for the year to September. This took annual GDP growth from an above trend pace of growth, to one which is below trend. It was the slowest annual growth in GDP since the September quarter 2009.

Some of the key areas of weakness in September quarter GDP growth are expected to rebound in the December quarter. This suggests the contraction in the September quarter growth was likely a 'one-off'. The annual growth profile for this year and next, however, looks much weaker as a result of today's data.

In the September quarter, there was little positive news in the composition of the GDP results.

GDP Expenditure Measure:

There was a reasonable contribution to GDP from the household sector, while government consumption, government investment and net exports all weighed on growth.

Household consumption rose by a subdued 0.4% in the September quarter, the slowest pace of growth since the March quarter 2013. Despite being one of the strongest sectors of growth in the quarter, household consumption only contributed 0.3 percentage points to overall quarterly growth, highlighting the broad-based softness in today's data.

Despite the softer growth in consumption, the areas where spending was strongest were discretionary in nature. By sector, the strongest growth in household consumption in the September quarter was in communications (2.7%), hotels, cafes & restaurants (2.2%) and alcoholic beverages (1.8%).

Dwelling investment has been a significant contributor to growth over the past three years. In the September quarter, however, dwelling investment was weak, falling by 1.4%. Dwelling investment detracted 0.1 percentage point from growth in the September quarter, the first detraction since the June quarter 2015. For the year to the September quarter, dwelling investment rose by 7.2%. While growth in dwelling investment is expected to moderate in coming years, a high level of building approvals suggest dwelling investment will rebound in the December quarter.

Business investment took a breather from ongoing declines in the September quarter, lifting by 0.1%, following eight consecutive quarters of declines. In the June quarter there was a transfer of assets from the private sector to the public sector. This caused the largest decline in business investment in the June quarter since the September quarter 2009. This resulted in a flat result in business investment in the September quarter. However, the breakdown suggests that there remains underlying weakness in business investment.

Moreover, the recent Capex intentions survey suggests the weakness is set to resume in coming quarters. For the year to the September quarter, business investment declined by 9.7%.

In a break with recent quarters, government expenditure weighed on economic growth.

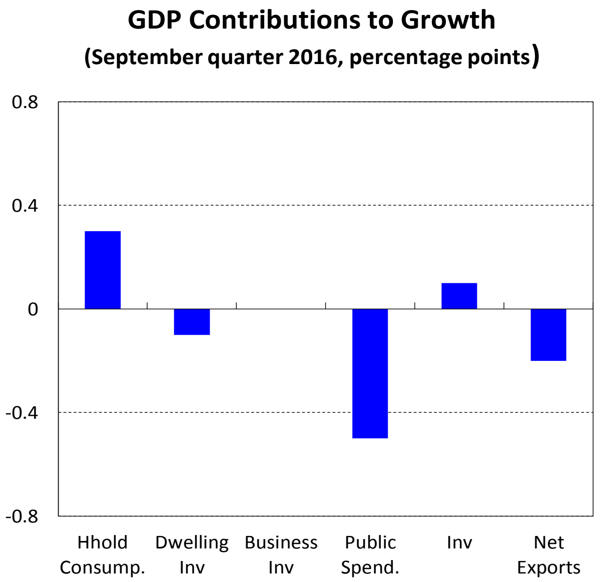
Government investment fell by 10.4% in the September quarter, while government consumption spending slipped 0.2% in the quarter. The declines were 'payback' for strong growth in government investment (21.6%) and consumption (2.0%) in the June quarter. The weakness in government expenditure in the September quarter is unlikely to be sustained in the December quarter.

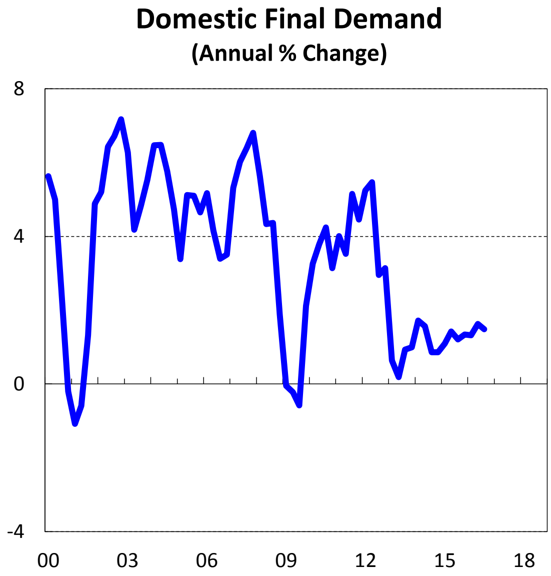
Reflecting the weakness in most domestic sectors of the economy, domestic final demand fell by 0.5% in the September quarter. This was the largest decline since the March quarter 2009, following the GFC.

Net exports have been a major 'swing factor' in GDP growth in recent years. In the September quarter, net exports again detracted 0.2 percentage points from growth, following 0.2 percentage points of detraction in the June quarter and a 1.1 percentage point contribution in the March quarter. Exports rose by 0.3% in the September quarter, although imports were up by a larger 1.3%. Increased resource production capacity following the resource investment boom, together with solid services exports should support export growth in coming quarters. We expect net exports to regain their footing in the December quarter and contribute to growth in the year ahead.

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	0.4
Public Consumption	-0.2
Dwelling Investment	-1.4
Business Investment	0.1
Public Investment	-10.4
	Contribution to GDP, ppt
Inventories	0.1
Net Exports	-0.2





GDP Income Measure:

GDP growth based on incomes was only modest, and was a bit disappointing given that there was a solid increase in commodity prices in the quarter. Nominal incomes rose just 0.5% in the September quarter, which saw annual growth step down to 3.0% in the year.

This measure largely comprises wages and profits.

- **Gross Operating Surplus**

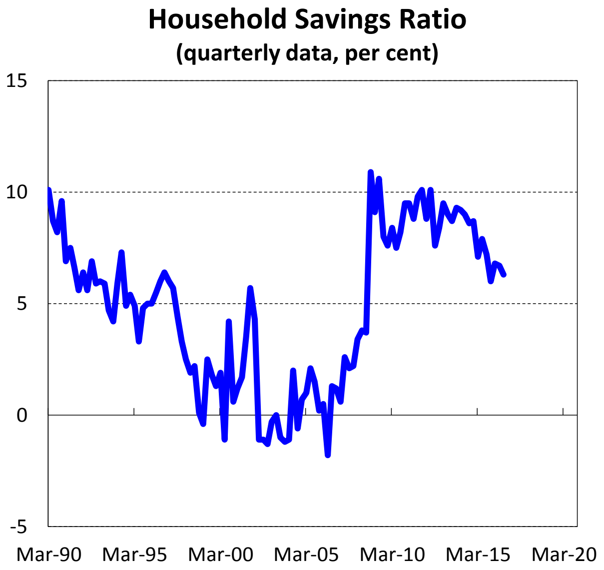
Profits (gross operating surplus) for total corporations rose 1.1% in the September quarter following a 1.2% increase in the previous quarter. The rebound in commodity prices in recent months has provided support to corporate earnings, particularly among resource firms.

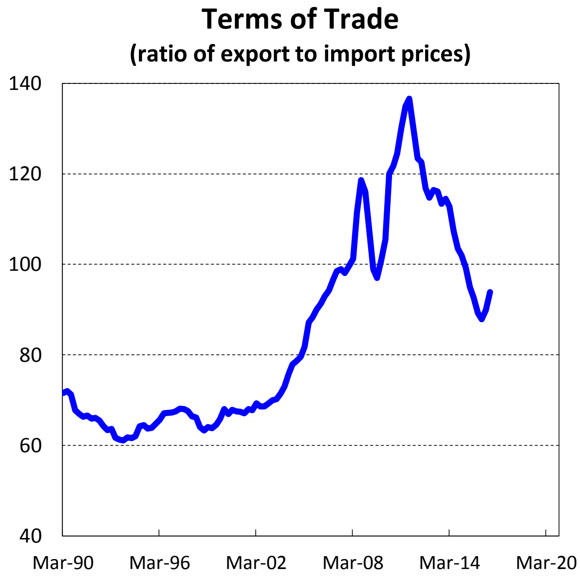
However, profits among small businesses (gross mixed income) took a hit in the September quarter, falling 5.8%. The drop in small business profits detracted 0.5 percentage points from income growth in the quarter.

- **Wages**

Wages (including employer's social contributions) jumped 1.3% in the September quarter, the strongest quarterly growth in 4½ years. The annual pace of growth edged up from 2.9% in the June quarter to 3.1% in the September quarter, and remains a modest pace of growth. A further pickup in wages would likely require a greater tightening in labour market conditions, although the lift in the terms of trade will provide a boost to incomes.

Household disposable income, which includes non-wage income, was a weaker than growth in wages income, rising by 0.4% in the September quarter. For the year to the September quarter, household disposable income rose 2.8%, an unchanged pace from the June quarter.





- **Household Saving Ratio**

The household saving ratio edged down from 6.7% in the June quarter to 6.3% in the September quarter. Regardless, household spending was weak in the quarter. Although wage growth was relatively firm in the quarter, the reduction in small business profits weighed on overall incomes.

The fall in small business profits should be temporary. Low interest rates and rising household wealth should continue to provide support to spending. There remains further scope for the household savings ratio to fall further, if consumers are confident about their finances.

Terms of Trade

The terms of trade (ratio of export to import prices) rose 4.4% in the September quarter, reflecting a further increase in commodity prices in the quarter. This quarter's increase was the second in a row after nine quarters of decline that began in the March quarter 2014. It was the first annual increase in the terms of trade since the December quarter 2013. The terms of trade has now risen 1.4% over the year to the September quarter.

Despite two quarters of improvement, the terms of trade are still 31.3% below the peak reached in the September quarter 2011. However, at 93.9 it is above the 20 year average of 90.7.

Industry Break Down:

Industry Gross Value Added, Chain Volume Measures

By Industry Sector	Quarterly % Change	Annual % Change
Agriculture, forestry & Fishing	7.5	2.6
Information media & telecommunications	1.6	4.8
Accommodation & food services	1.0	2.2
Wholesale Trade	0.8	3.8
Financial & insurance services	0.7	5.1
Professional, scientific & technical services	0.6	3.4
Healthcare	0.6	3.5
Transport,postal & warehousing	0.5	0.2
Education & training	0.3	2.3
Public Admin & safety	0.1	4.4
Arts & recreation services	0.0	2.2
Manufacturing	-0.1	-2.4
Electricity gas, water & waste services	-0.6	-0.1
Mining	-0.8	2.1
Retail Trade	-0.8	0.9
Administrative & support services	-1.4	-1.4
Rental, hiring & real estate services	-2.4	3.1
Construction	-3.6	-3.8
Other services	-4.6	-3.5

State Final Demand:

Variation across the States and Territories has become the new catchphrase for describing the Australian economy. State final demand rose in four jurisdictions and fell in the remaining four.

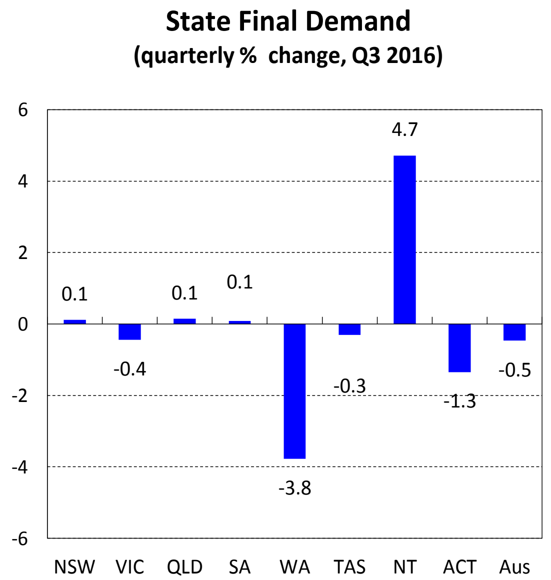
None of the positive quarterly State final demand outcomes were robust, except for the Northern Territory (4.7%) where business investment was the key driver of growth. All the other State quarterly results were lacklustre. NSW, Queensland and South Australia all saw State final demand rise by a very modest 0.1%.

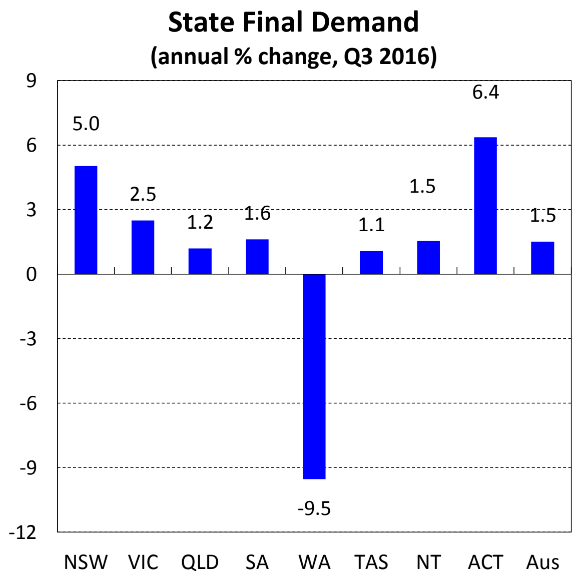
Growth in private business investment kept State final demand positive in NSW, Queensland and the Northern Territory, while in South Australia; the main contributor towards its growth was household consumption. Holding South Australia back from stronger growth was a decline in both government and private capital expenditure.

Western Australia (-3.8%), the ACT (-1.3%), Victoria (-0.4%) and Tasmania (-0.3%) all saw State final demand contract. Western Australia has seen its State final demand contract for five straight quarters. In the September quarter, the largest detractor from growth in WA was weakness in private investment in dwellings, non-dwelling construction and machinery & equipment. The hangover from WA's mining investment boom continues.

In the ACT, Victoria and Tasmania, softer government spending contributed to the negative outcomes. In each of the jurisdictions where State final demand was negative, the decline was cushioned by growth in household consumption expenditure.

On an annual basis, final demand was strongest in the ACT (6.4%), followed by New South Wales (5.0%) and Victoria (2.5%). South Australia (1.6%), the Northern Territory (1.5%), Queensland (1.2%) and Tasmania (1.1%) experienced more subdued growth while Western Australia (-9.5%) continues to contract in annual terms. There is indeed variation across the jurisdictions!





Outlook

Household consumption was the main contributor to growth in the September quarter, despite being lacklustre. Overall, domestic demand remains modest. Some of the key areas of weakness in September quarter GDP growth are expected to rebound in the December quarter. This suggests the contraction in the September quarter growth was likely a 'one-off' and that GDP growth should move back into positive territory in the December quarter. The annual growth profile for this year and next, however, looks much weaker as a result of today's data.

Over the coming year there will be a few factors which could pose a risk to the growth outlook. Dwelling investment is approaching a peak, non-mining investment remains subdued and household consumption does not appear likely to witness a sustained pick-up. However, the economy should benefit from a rising terms of trade and the ending drag from mining investment.

On balance, we are concerned that economic growth will not reach trend or potential growth during 2017 and as such we do not believe that the RBA is done cutting rates in this cycle.

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