Australia GDP Preview – Q4 2015

by NAB Economics

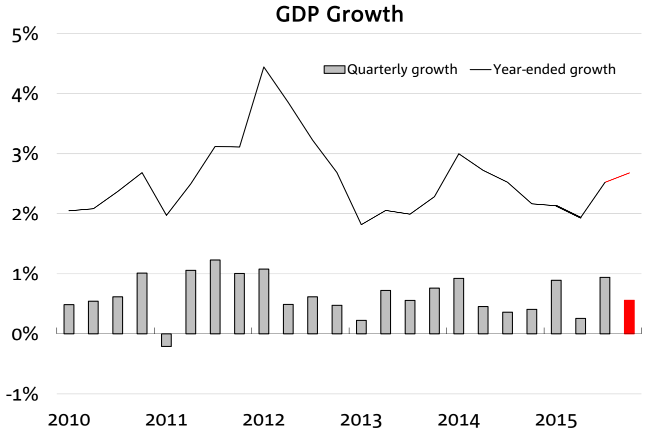
29 February 2016

National Australia Bank

Q4 GDP data will be released on Wednesday 2 March at 11:30 AEDT.

- **Economic partials for Q4 point to moderate real GDP growth of 0.6% in the quarter.** This is down from strong quarterly growth in Q3 of 0.9% q/q which was partly unwinding temporary weakness in Q2. **Looking through the quarterly volatility, year-ended growth is forecast to pick up to 2.7% y/y** – while temperate, this would be the strongest rate of growth since mid-2014 and just above the 5-year average, but below the pre-GFC average of around 3¼%.
- **Measures of national income however will remain depressed,** given another sharp 5% fall in the terms of trade and subdued wages growth (although strong employment will provide some offset).
- **The major themes driving the expenditure measure of GDP are unlikely to surprise.** That is, mining investment will have continued to drag on domestic demand while non-mining investment remained frustratingly tepid. This is likely to have been offset by strong net exports (both from resources and tourism/education exports). Meanwhile, dwelling construction and household consumption are likely to have grown at a solid rate in Q4, supported by the high level of building approvals and strong employment growth. Public expenditure is likely to have been boosted by the commissioning of Landing Helicopter Dock HMAS Adelaide in December 2015.
- **Industry gross value added figures should imply a more entrenched recovery in the non-mining economy, particularly services sectors** as indicated by the NAB measure of business conditions. The shift towards more labour-intensive industries (away from capital-intensive sectors) is consistent with strong employment growth, and frustratingly weak non-mining investment.
- **Our forecasts are slightly above RBA expectations in the latest Statement on Monetary Policy of 2½%.** This may provide some reassurance to the RBA amidst an uncertain global backdrop. **We anticipate no change at the RBA's board meeting on Tuesday.**
- **While GDP is normally an important release for the AUD and short-dated yield reactions, we do not expect this release to have a sustained impact on market pricing given current sentiment is being driven by global factors.**

Year-ended GDP growth to have accelerated in Q4



Source: ABS; NAB Economics

Another mixed result

Australian National Accounts (a)

	Q/Q		Y/Y	Contribution to Q/Q
	Sep-15	Dec-15	Dec-15	Dec-15
Household Consumption	0.7	0.6	2.5	0.3
Dwelling Investment	0.9	2.0	8.2	0.3
Underlying Business Investment	-5.5	-3.0	-14.2	-0.4
Underlying Public Final Demand	-8.2	4.0	3.0	0.1
Domestic Final Demand	**-0.5**	**0.3**	**0.6**	**0.3**
Stocks (a)	-0.1	0.0	-0.1	0.0
GNE	**-0.6**	**0.3**	**0.9**	**n.a.**
Net exports (a)	**1.5**	**0.3**	**1.3**	**0.3**
Exports	4.6	1.7	6.7	0.4
Imports	-2.4	0.2	0.7	0.0
GDP	**0.9**	**0.6**	**2.8**	**n.a.**

(a) Contribution to GDP growth

Source: NAB Economics, ABS

Our detailed forecasts for the expenditure measure of GDP are outlined in the table below:

Household consumption: On the consumption side, solid employment growth is likely to have underpinned solid growth in consumption, despite still very subdued growth in wages. Consumption is expected to have increased 0.6% in Q4 (similar to Q3), contributing 0.3 ppts to GDP and raising annual growth to 2.7%. While retail sales figures so far for the quarter point to a more subdued outcome due to a surprisingly weak read for the month of December, ongoing strength in business conditions for household services suggest strong growth in services spending.

Dwelling investment: Construction work done figures suggest a 2.0% increase in dwelling investment in the quarter, despite a fall in alterations and additions expenditure. This is consistent with the pick up in building approvals through much of 2015, largely driven by high-density apartment approvals.

Business investment: Overall, underlying business investment is expected to have declined 3% in the quarter. But while lumpy investment projects in the mining industry are driving a sharp decline in engineering construction, other private non-residential building construction rose strongly in the quarter (4.6% q/q) according to Wednesday's construction work done data, while machinery and equipment investment was broadly flat in Thursday's capex release.

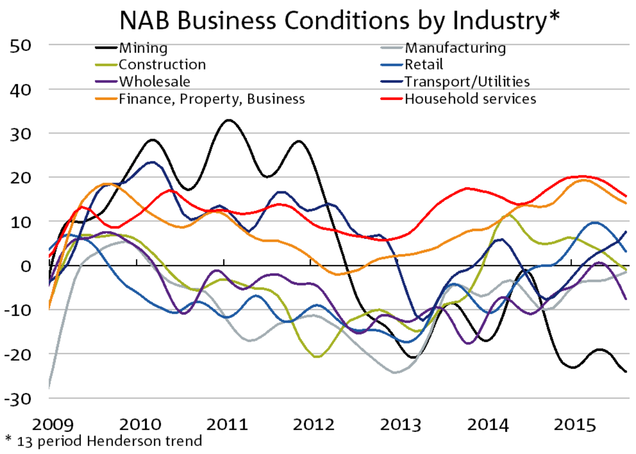
Government spending: In contrast, government investment is likely to have contributed strongly to growth due to the commissioning of HMAS Adelaide (defence acquisitions boosted the Q2 GDP figures and a subsequent fall in Q3). Growth in government consumption (largely the public sector wage bill) is likely to have been moderately positive given subdued public sector wages growth in the quarter.

Net exports: The external sector will again have made a large contribution to growth. Monthly data suggests strong export volume growth for LNG, services (including tourism and education exports), and rural exports. In contrast, relative stability of the exchange rate in the second half of 2015 is consistent with a flat outcome for import volumes. Overall, net exports are expected to have contributed 0.3 ppts to GDP growth in the December quarter.

Non-mining economy picking up

While we don't explicitly forecast economic output on an industry basis, partial indicators of both employment data and results from the NAB Business Survey suggest that the transition towards non-mining sectors of the economy continued into Q4. Services sectors (both professional and personal) appear to outperforming, retail business conditions remained strong while residential activity is helping to offset lower mining investment for the construction industry. In addition, business conditions for manufacturing are looking less negative in a trend sense.

Service industries expected to outperform



Source: NAB Economics

Implications for the RBA's cash rate

For the quarter, the RBA's February Statement on Monetary Policy (SoMP) forecasts year-ended GDP growth of around 2½%, and would imply quarterly growth of around 0.4-0.5%, similar to the market consensus of 0.5%.

We think the GDP release is unlikely to significantly influence the RBA's read on the economy. The mining investment unwind, which is having its peak impact on GDP growth this year, along with slower population growth, is making it difficult to assess conditions in the non-mining economy and hence prospects for growth.

While GDP growth has been below average, employment growth has in fact been at above average rates along with business conditions. The RBA has been siding with a pick-up in the non-mining economy to help reconcile the divergence stating the "relatively labour-intensive nature of this growth suggested that composition change may help to reconcile". We posit the labour market will be the key for the RBA in the period ahead.

The missing piece in the transition story remains a pick-up in non-mining investment. Despite the lack of a lift in non-mining investment, the RBA assess the preconditions for a pick-up in investment are in place, including employment growth picking up, survey measures of business sentiment and capacity utilisation being around or above average levels, non-mining business profits increasing, and the exchange rate providing more support to demand and investment in export-orientated industries.

Market implications

Rates

As with other recent Aussie data releases, we think the ability of local economic data to have a big impact on the rates market is limited. The moves in oil, equities and the global rates market are more critical at this point. But an outsized surprise on GDP in either direction could still push the market around. We suspect the downside surprise would need to be bigger to move the market much, with the front end of the AUD rates curve already priced for 40bp of easing by year-end and a full 25bp rate cut by August.

Currency

As for potential currency reaction, we suspect it will take a print of 0.7% or higher, or 0.4% or lower, to provoke any reaction. Given prevailing money market pricing, we'd judge there to be more upside risk to AUD from an upside surprise on the data than downside risk from a negative surprise, unless of course the latter occurs and is way below expectations.

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