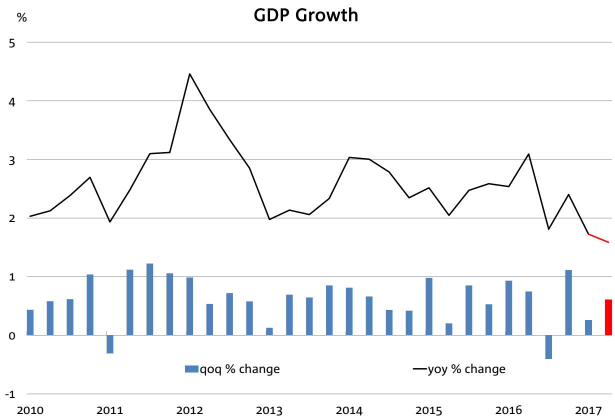
AUSTRALIAN GDP PREVIEW – Q2 2017

NAB Australian Economics 4 September 2017

Q2 GDP data will be released on Wednesday 6 September at 11:30am AEST. Additional partials will be available tomorrow and may alter our forecast.

- **Economic partials point to reasonable GDP growth in Q2 of 0.6% q/q.** This follows a particularly weak Q1 in which exports and construction were affected by weather events, although growth this quarter has also been affected by the impact of Cyclone Debbie on coal exports in particular (although surging LNG exports have masked this to some extent). **As a result of disruptions this year and in Q3 last year, the year-ended growth rate actually drops further to 1.6% y/y, the weakest rate since Q3 2009.**
- **Headline figures will thus not give an accurate picture of underlying growth momentum in the economy**. Looking beneath the aggregate, there are likely to be some positive signals to take note of. In particular, **private business investment looks to have increased for the second consecutive quarter**, with a further apparent strengthening in non-mining investment particularly encouraging (particularly in machinery & equipment this quarter). (Note that we are not forecasting as strong a surge in mining investment as evident in Wednesday's construction work done figures from the import of the Icthys central processing facility given the methodology in the national accounts which spreads projects over multiple quarters by including progress payments). Meanwhile, **government investment looks to have increased strongly,** as infrastructure programs continue to ramp up.
- Stronger employment growth this year also appears to have supported **strong consumer spending in Q2, particularly retail volumes.** However this may prove to have been temporary, as there was a notable slowing in retail trade in the last month of the quarter, and leading indicators including the NAB cashless retail indicator suggest further slowing in July, while consumer confidence has taken a beating amidst higher energy prices and geopolitical risk and retail conditions in the NAB business survey have fallen back. It appears that some of the strength in retail sales was unexpected this quarter, with wholesale stocks falling sharply and likely subtracting from growth.
- **More problematic this quarter was the poor performance of dwelling construction,** which is likely to have been broadly flat in the quarter following a sharp (4.4%) fall in Q1. This raises the possibility that dwelling construction has already peaked, as opposed to peaking sometime in 2018 as most had forecast. While this likely suggests a more elongated cycle with dwelling construction likely to hold at a high level for some time (and there is some evidence of rotation towards non-dwelling construction), an earlier drop back in housing construction would signal downside risks to the broader economy and employment given strong multipliers.
- **Net exports meanwhile look to have been neutral to growth.** Despite the impact of Cyclone Debbie on coal exports early in the quarter, the rebound in May was stronger than expected, while there was a surge in LNG exports in the quarter. Import growth also remained solid, with capital imports particularly strong in Q2.
- **Income growth is likely to be mixed in Q2** with the ~5% drop in the terms of trade (as iron ore prices dropped back after the surge in Q1) weighing on corporate profits, but labour income supported by higher employment. Compensation of employees however is likely to have been stronger given the pace of employment growth in the quarter (even if wages growth remained low), and an improvement in the wages share of income is likely after it hit an 8-year low of 51.5% last quarter.



Australian National Accounts (a)

	qoq % ch		yoy % ch	Contribution to qoq % ch
	Mar-17	Jun-17	Jun-17	Jun-17
Household Consumption	0.5	1.0	2.9	0.5
Dwelling Investment	-4.4	0.3	-3.6	0.0
Underlying Business Investment	0.4	0.7	-2.5	0.1
Underlying Public Final Demand	0.5	1.2	2.4	0.3
Domestic Final Demand	**0.3**	**1.0**	**1.9**	**1.0**
Stocks (a)	0.4	-0.6	0.2	-0.6
GNE	**0.8**	**0.4**	**1.6**	**0.4**
Net exports (a)	**-0.7**	**0.0**	**-0.2**	**0.0**
Exports	-1.6	2.1	5.6	0.4
Imports	1.6	2.2	6.7	-0.5
GDP	**0.3**	**0.6**	**1.6**	**n.a.**

(a) Contribution to GDP growth

Source: NAB Economics, ABS

Monetary Policy and Market Implications

Our forecasts appear slightly below those published in the RBA's latest Statement on Monetary Policy of around 1¾% y/y. Like us, the RBA is likely to look through the volatility and soft year-ended growth rates, and take solace in particular from the improvements in non-mining and government investment. The RBA will also be watching inflation, wages and unit labour cost measures closely for any evidence of a pickup. At this stage however, we expect the RBA to sit on its hands for some time – watching for any evidence that stronger employment this year will translate into stronger wages/inflation outcomes, while also scrutinising housing market data (both in terms of prices and construction) closely. The RBA retains a more optimistic view about the economic outlook than NAB Economics, expecting a strong recovery in household consumption – we see downside risks to this view amidst low wages growth, and remain more concerned about how the economy will fare as commodity prices, LNG exports and particularly dwelling construction turns down (be it this year or next year).

Rates

Against a bullish global bond backdrop, the Aussie market has been a notable underperformer across the curve over the last month, particularly against the US. OIS rates are fully pricing a 25bp rate hike by the end of 2018, the 3y yield is in the middle of a relatively tight one month range and the curve has flattened notably. Given the relative cheapening of Aussie front end rates, it will take a strong GDP print to add to this underperformance, in our view. NAB's +0.6% q/q, 1.6% y/y GDP forecast is below consensus for a 0.8% q/q,1.8% y/y outcome and if realised could add modest downward pressure to front end rates (although the market median may be revised down somewhat following weak inventories data today).

Currency

On the AUD, with market expectations for GDP currently ranged between 0.5% and 1.0%, it will likely take an outcome close to one or other of the range extremes to elicit much reaction. Thus our 0.6% forecast versus the 0.8% current consensus would, if correct, be expected to produce at least a modest intra-day negative reaction, with modest upside reaction on a 0.9-1.0% print. A sustained move higher or lower will likely require a print outside the 0.5-1.0% market range. Given current money market pricing, we'd judge there should be more AUD downside on weak numbers that challenge confidence in a 2018 RBA rate rise, than upside on strong data.

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