Australia GDP Preview – Q3 2015

by NAB Economics

30 November 2015

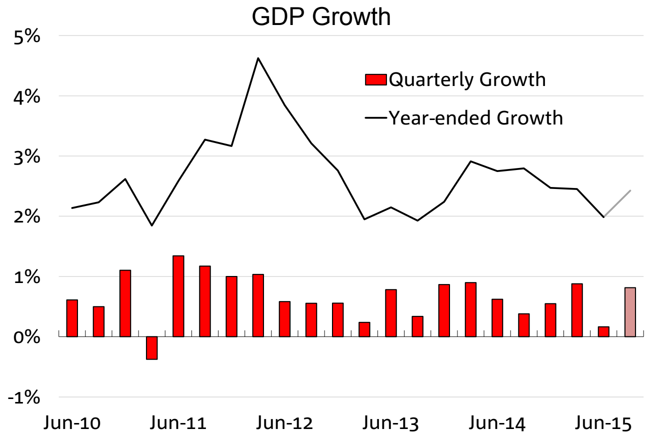
National Australia Bank

- Economic partials for Q3 have been mixed, but point to stronger real GDP growth of 0.8% in the quarter (up from 0.2% in Q2), as a series of one-offs that weighed on Q2 growth recede. Looking through the quarterly volatility, year-ended growth is forecast to remain sub-trend notwithstanding a small bounce to 2.4% y/y.
- Despite the mixed results across the partials, the theme is likely to be consistent with the much anticipated (and ongoing) sharp decline in mining investment, with offsetting strength in export volumes. Consumption and dwelling investment are making a modest positive contribution, while public demand is expected to fall as spending was brought forward to Q2.
- Overall, the National Accounts are still expected to evidence a somewhat more entrenched recovery in the non-mining sector, although non-mining investment remains notably absent.
- Our forecasts are broadly in line with RBA expectations in the latest Statement on Monetary Policy. We expect no change at the December 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 coming just in front of the week's much bigger global risk events (ECB and US payrolls).

Growth accelerating in Q3, but data remain volatile

Q3 GDP data will be released on Wednesday at 11:30 AEDT. Recent partial indicators paint a mixed picture of the Australian economy in the September quarter, and continue to be relatively volatile given the influence of temporary factors. Overall, these indicators point to stronger growth in Q3 as some of the short-term factors underpinning the disappointing growth outcome in Q2 were partially unwound. Growth is expected to accelerate to 0.8% in Q3 (market 0.7%; previous 0.2%), lifting annual growth to a still sub-trend rate of 2.4%.

GDP Growth to accelerate in Q3



Source: ABS; NAB Economics

As expected, the mining sector is continuing to provide a significant drag on domestic demand, contributing to an anticipated 7.1% decline in underlying business investment.

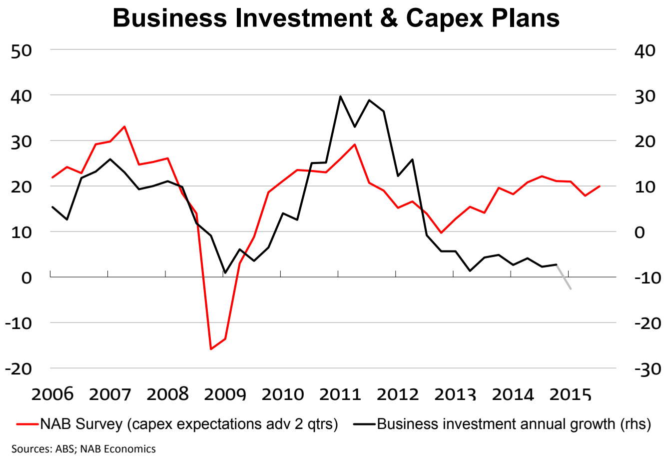
Australian National Accounts (a)

	Q/Q		Y/Y	Contribution to Q/Q
	Jun-15	Sep-15	Sep-15	Sep-15
Household Consumption	0.5	0.7	2.7	0.3
Dwelling Investment	-1.1	1.0	9.7	0.3
Underlying Business Investment	-0.3	-7.1	-12.6	-0.9
Machinery & equipment	**-0.7**	**-8.2**	**-10.4**	**-0.4**
Non-dwelling construction	**-0.1**	**-6.4**	**-13.9**	**-0.5**
New building	**0.9**	**-1.9**	**3.1**	**-0.1**
New engineering	**-0.8**	**-9.2**	**-22.6**	**-0.4**
Underlying Public Final Demand	5.0	-2.0	4.1	-0.1
Domestic Final Demand	**0.8**	**-0.6**	**1.1**	**-0.6**
Stocks (a)	-0.2	0.1	0.0	0.1
GNE	**0.6**	**-0.5**	**0.7**	**n.a.**
Net exports (a)	**-0.6**	**1.3**	**1.6**	**1.3**
Exports	-3.3	4.6	6.3	1.0
Imports	-0.7	-1.8	-1.2	0.4
GDP	0.2	0.8	2.4	n.a.

(a) Contribution to GDP growth

But while lumpy investment projects in the mining industry are driving a sharp decline in engineering construction, other building construction rose in the quarter, supported by ongoing growth in residential building – the latter expected to rise 1% in the quarter and contribute 0.3 ppts to GDP growth. However, signs of a lift in non-mining business investment remains frustratingly absent.

Non-residential construction work done fell notably in the quarter, and the ABS Capital Expenditure Survey suggested that in addition to mining, investment within 'other selected industries' declined significantly as well in the September quarter. Nevertheless, we remain hopeful that non-mining investment will soon improve. The NAB Survey shows that firms (mainly non-mining) are facing less spare capacity and are considering greater capital expenditure in the near to medium-term.

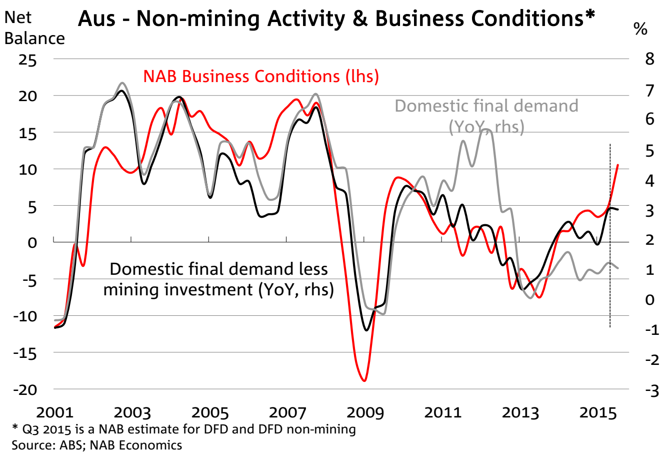


On the consumption side, solid employment growth and higher house prices appear to be underpinning modest growth in consumption, despite still very subdued growth in wages. Consumption is expected to increase 0.7% in Q3 (up slightly from Q2), contributing 0.3 ppts to GDP and keeping annual growth steady at around 2.6%. In contrast, following a strong contribution in Q2, public final demand is expected to partially unwind as temporary spending measures subside (falling 2% Q/Q).

The main contribution to growth in the quarter will come from the external sector. A bounce back in supply affected commodity export volumes (and a ramping up of energy exports) are a major driver behind an anticipated 4.6% rise in exports, although the lower AUD has also been supportive of other exports (including tourism). In contrast, the lower AUD has likely weighed on import volumes, which are expected to decline almost 2% in the quarter. Overall, net exports are expected to contribute 1.3 ppts to GDP growth in the September quarter.

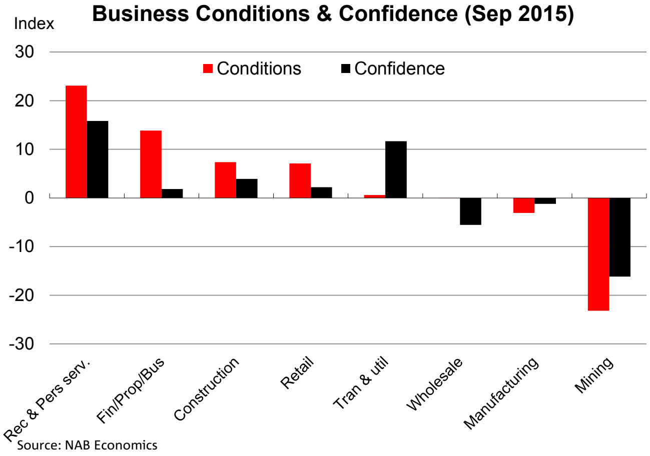
Consistent with growth in consumption and dwelling investment, the NAB Business Survey has been suggesting a more entrenched recovery in non-mining demand during the September quarter. Although it is difficult to calculate official measures of non-mining demand, our measure suggests non-mining demand is still expected to remain at reasonably positive levels.

Non-mining domestic demand growth holding up



Similarly, although partial indicators of Industry GVA are relatively limited, both employment data and results from the NAB Business Survey would suggest that the transition towards non-mining sectors of the economy should have continued in Q3. Services sectors (both professional and personal) appear to outperforming, while residential activity is helping to offset lower mining investment for the construction industry.

Service industries expected to outperform



Implications for the RBA's cash rate

For the quarter, the RBA's November Statement on Monetary Policy (SoMP) forecasts year-ended GDP growth of around 2.3%, and would imply quarterly growth of around 0.7% and this is exactly in the middle of the market range.

With the strong net export contribution already known, the result is unlikely to significantly influence the RBA's read on the economy. The key forces shaping the economy continue, with below-trend growth in the near term from the unwinding of mining investment being offset by continued growth in resource exports (notwithstanding some volatility in the volumes from ports which may affect each quarter's net export contribution to GDP). 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

The GDP release has been an important data release for the AUD and short-dated yield reactions. However, given the events later in the week (ECB meeting Thursday and US Payrolls Friday) it is hard to see the AU market move too much against global market sentiment where investors are anticipating the ECB providing more stimulus while the Fed starts its tightening cycle.

Rates

Australian GDP ranks within the top 5 indicators to have moved bond yields over the past year. The market and NAB are expecting a strong rebound in Q3 following the soft Q2 print. A result nearer 0.9% could put some pressure on the front of the curve. Whether such a move is sustained is questionable. In addition, given the events for later in the week it is hard to see the AU market move too much against global bond market sentiment.

Currency

Currency risk surrounding the release looks to be fairly symmetric for either an upside or downside surprise, though coming just in front of the week's much bigger global risk events (ECB and US payrolls) a big (sustained) reaction to a significant GDP surprise looks unlikely.

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