Australia GDP Preview – Q1 2016

by NAB Economics

27 May 2016

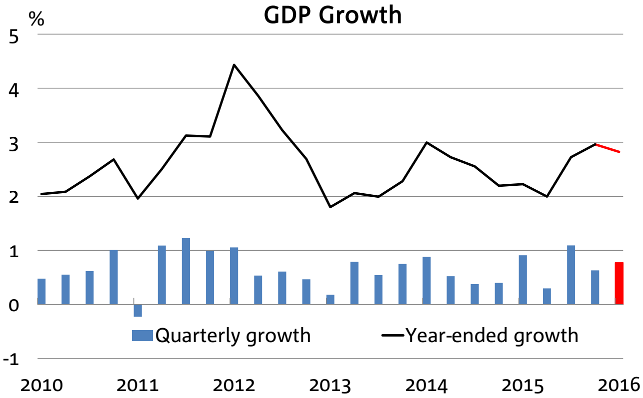
National Australia Bank

Q1 GDP data will be released on Wednesday 1 June at 11:30 AEDT.

- **Economic partials for Q1 GDP stronger real GDP growth of 0.8% in the quarter (up from 0.6% in Q4 2015).** Year-ended growth is expected to ease marginally but remain solid at 2.8% y/y – this is above our estimates of Australia's potential rate of growth of 2.5%[1] thanks to a strong contribution from commodity production/exports, but below the pre-GFC average of around 3¼% y/y.
- **The pattern of growth will be consistent with the ongoing sharp decline in mining investment, with offsetting strength in export volumes.** Dwelling investment will make a positive contribution, while household consumption will be solid, partly thanks to a further decline in the household savings ratio and apparent strength in services consumption.
- **Industry gross value added figures are likely to demonstrate that the recovery in the non-mining economy, particularly in services sectors, continues to gain traction.** As signalled by business conditions data from the NAB Business Survey, we expect further strength in household services (including health), business services, and sectors benefiting from tourism flows. Strong residential housing activity will also be supporting the construction industry, while retail activity looks to have lost some momentum. By state, domestic final demand is expected to have outperformed in NSW and Victoria, while the divergence between these states and a struggling WA will have intensified.
- **The terms of trade are expected to fall a further 1.8%, to be 10.9% lower over the year, which will continue to weigh on measures of national income.**
- **We will also be watching productivity estimates closely.** While productivity is likely to pick up amidst strong production/exports and subdued employment growth in the quarter, this effect will not be sustained into the medium term as the export surge runs its course, revealing a weaker medium-term outlook for productivity and potential growth.
- **Our forecasts are broadly consistent with those in the RBA's latest Statement on Monetary Policy. However the RBA will also be sensitive to indicators of the inflation outlook such as the average labour earnings and unit labour costs** which were particularly weak in Q4 – the former is expected to grow modestly in Q1, while unit labour costs may decline again owing to strong productivity.

[1] For NAB's latest estimates of Australia's potential growth rate, please see: [Australia's Changing Growth Potential – 26 May 2016]

Year-ended GDP growth still solid in Q1



Mining headwinds remain large

Australian National Accounts (a)

	Q/Q		Y/Y	Contribution to Q/Q
	Dec-15	Mar-16	Mar-16	Mar-16
Household Consumption	0.8	0.8	3.0	0.4
Dwelling Investment	2.2	1.3	6.1	0.4
Underlying Business Investment	-3.2	-3.5	-12.9	-0.4
Underlying Public Final Demand	1.3	0.0	2.6	0.0
Domestic Final Demand	**0.4**	**0.2**	**0.9**	**0.2**
Stocks (a)	0.2	0.0	-0.1	0.0
GNE	**0.5**	**0.1**	**0.9**	**n.a.**
Net exports (a)	**0.0**	**0.8**	**1.5**	**0.8**
Exports	0.6	3.5	5.4	0.8
Imports	0.6	0.1	-1.3	0.0
GDP	**0.6**	**0.8**	**2.9**	**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 above:

Household consumption: Employment has continued to increase despite losing some momentum, which should see consumption growth reasonably well supported in Q1 – even with persistent weakness in wages growth. Real retail sales growth held up at levels similar to last quarter, while indications are that services consumption may have been much stronger in the quarter. This is consistent with the NAB Business Survey, which showed business conditions in personal services remaining elevated. Overall, private consumption is expected to increase by 0.8% in Q1 (similar to Q4 2015), contributing 0.4 ppts to GDP and raising annual growth to 3%

Dwelling investment: Private dwelling investment may not be quite as strong as previously expected, with the recent construction work done figures from the ABS pointing to growth of around 1.3%, lower than the last two quarters. Nevertheless, continued growth in new dwelling investment is consistent with the extremely elevated pipeline of residential projects (with a high concentration in apartment construction), which should support growth for a number of quarters to come. Alterations and additions look to have increased as well in Q1, following declines in H2 2015.

Business investment: Overall, partial indicators are suggesting another weak outcome for underlying business investment in the quarter. The ongoing contraction in mining investment is the primary driver of the expected 3.5% decline in underlying investment in Q2, although the partials suggest non-mining investment was modest as well. According to Wednesday's construction work done release, engineering construction contracted 6.8% in the quarter, while private non-residential building was off 7.6%. Machinery and equipment investment experienced a much more modest decline of 0.5%, according to Thursday's capex release, although this survey does not cover all service sectors, suggesting upside risk.

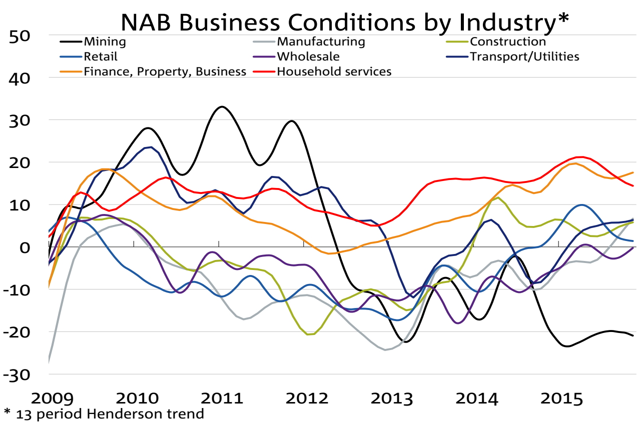
Government spending: There is likely to have been some payback in government investment in Q1, following the strong result in Q4 2015 that was associated with the commissioning of HMAS Adelaide (defence acquisitions also boosted the Q2 GDP figures and a subsequent fall in Q3). Growth in government consumption (largely the public sector wage bill) is likely to have been moderately positive given evidence of strong demand for labour in the public sector and the pace of public sector wages growth in Q1.

Net exports: Trade data for Q1 showed a better than expected trade surplus, which is mostly the result of an acceleration in exports. Commodity exports have again been a major driver, especially iron ore which has recovered from weather related disruptions early in the year, and non-monetary gold. Services exports (including tourism and education exports) also looked quite strong. In contrast, import volumes are expected to be relatively flat in Q1 as subdued domestic demand growth offset support from AUD appreciation towards the end of the quarter. Overall, net exports are expected to have contributed 0.8 ppts to GDP growth in the March quarter.

Non-mining economy picking up, but more slowly

While we don't explicitly forecast economic output on an industry basis, partial indicators from both employment data and the NAB Business Survey provide a read on potential changes in activity across industries. Outcomes for Q1 2016 are somewhat mixed as non-mining employment was essentially flat in the quarter, having increased steadily in the 2 years prior. The Business Survey shows non-mining sectors (especially services) remaining quite strong, although improvements have also slowed.

Service industries still the best performers



Source: NAB Economics

Implications for the RBA's cash rate

For the quarter, the RBA's May Statement on Monetary Policy (SoMP) forecasts year-ended GDP growth of around 2¾%, and would imply quarterly growth of around 0.7/0.8% which is only a fraction below our estimate.

With the strong net export contribution already known, the result is unlikely to significantly influence the RBA's read on the economy. In particular, the pattern of growth is likely to be consistent with the RBA's increasing confidence in the pace of non-mining activity.

However, given the subdued Q1 CPI figure, the RBA is likely to be also focused on the national accounts measures related to prices, including wages, unit labour costs, and the consumer price deflator – a cross-check on the weak CPI reading in Q1.

At this stage, NAB expects the RBA to remain on hold for the remainder of 2016, though we do acknowledge a further rate cut remains a possibility if inflation continues to surprise to the low side. With activity indicators positive NAB does not expect any consideration of further easing before the next CPI release (released 27 July).

Market implications

Rates

Front end rates have consolidated over the last two weeks, but implied RBA pricing still points to a 64% chance of a 25bp cut by August and a 1.50% cash rate is fully priced by November. Arguably Q1 GDP figures should take a back seat for the markets near term RBA expectations, with inflation data now regarded as more important. At the time of writing, there's little indication of where consensus sits and there's still more partial figures to come. NAB's view for a 0.8% q/q, 2.8% y/y headline number could give the market some pause for thought on cuts. The buy the dip mentality doesn't look like going away any time soon. A weaker than consensus number could see the very front end of the curve take back much of the post-RBA minutes retracement.

Currency

Given that the Australian economy has been performing "reasonably", as noted by RBA Governor Steven's early this week, cash rate expectations are currently more sensitive to the inflation outlook rather than domestic data releases. With that in mind, if as we expect, we get a solid Q1 GDP number driven by an uptick in net exports while domestic growth drivers remain subdued, then any positive reaction from the currency is likely to be short lived. A softer number, on the other hand is likely to play with the grain of the current AUD downtrend.

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