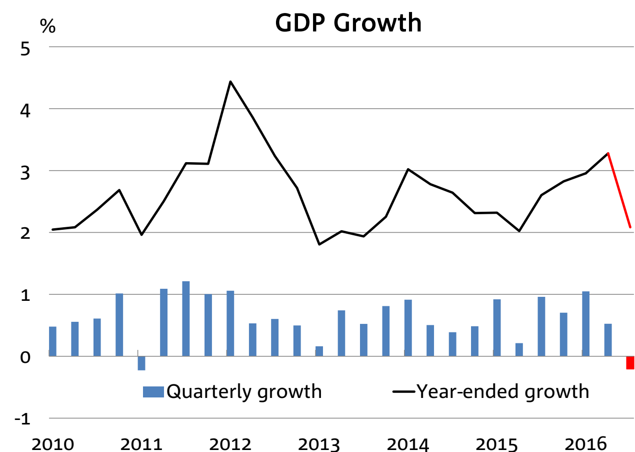
AUSTRALIA GDP PREVIEW – Q3 2016

By Group Economics

2 December 2016

Q3 GDP data will be released on Wednesday 7 December at 11:30 AEDT. Additional partials will be available next week prior to the GDP release.

- **Economic partials point to a small contraction in real GDP in Q3 of -0.2% q/q**. This follows moderate growth in Q2 (0.5% q/q) and strong growth in Q1 (1.0% q/q). The year-ended rate of growth will slow sharply to 2.1% from 3.3% in Q2.
- **The expenditure measure of GDP is looking particularly weak** with partial data pointing to a broad-based decline in business investment, a surprise contraction in dwelling investment and a subtraction from net exports (-0.3ppt). Household consumption growth is expected to be subdued (0.4%q/q), with particular weakness in retail trade. There is also downside risk to our forecast for public demand.
- **The income measure of GDP is likely to be mixed** but stronger than the expenditure measure. Higher commodity prices will see the terms of trade rise 4.3% following a 2.2% increase in Q2, as key commodity prices such as coal and iron ore increased (although larger increases will fall into Q4). This will flow through to positive growth in company profits, although labour income is forecast to increase moderately due to soft employment and low wages growth in the quarter.
- Meanwhile, **production or industry gross value added figures are likely to show that the recovery through the non-mining economy lost some momentum**.The NAB business survey showed weaker business conditions for retail trade, as well as wholesale trade, transportation and manufacturing activity, while construction activity was mixed. Household and business services however remained elevated despite easing moderately, which should be emulated again in the national accounts. Mining production is likely to have been moderately positive in line with higher exports in the quarter. By state, it will be interesting to see if the slowdown in business conditions and ABS employment data in NSW is reflected in softening domestic demand.
- **Our forecasts are well below those published in the RBA's latest Statement on Monetary Policy** which suggested real GDP growth of approximately 2 ¾ to 3%. This may elevate the RBA's concerns about the non-mining economy, particularly given uncertainty about the labour market at present. **At this stage, we remain comfortable with our call for two further rate cuts in mid-2017,** and flag the possibility of an earlier cut if current data on non-mining activity and employment fails to pick up. Inflation and wages figures in next week's national accounts data will also be watched closely , and are likely to remain subdued.



Domestic demand flat

Australian National Accounts (a)

	Q/Q		Y/Y	Contribution to Q/Q
	Jun-16	Sep-16	Sep-16	Sep-16
Household Consumption	0.4	0.4	2.3	0.2
Dwelling Investment	1.6	-2.7	3.9	0.2
Underlying Business Investment	-2.2	-2.1	-8.6	-0.2
Underlying Public Final Demand	2.4	0.1	4.8	0.0
Domestic Final Demand	**0.6**	**-0.1**	**1.5**	**-0.1**
Stocks (a)	0.3	0.1	0.2	0.1
GNE	**0.9**	**-0.1**	**1.9**	**n.a.**
Net exports (a)	**-0.2**	**-0.3**	**0.5**	**-0.3**
Exports	1.3	0.4	5.0	0.1
Imports	2.7	1.7	2.8	-0.4
GDP	**0.5**	**-0.2**	**2.1**	**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: Private consumption growth is expected to have softened moderately in Q3 on the back of weak real retail spending, while leading indicators suggest that services consumption growth could have slowed as well, but is likely to have remained more resilient. Our latest NAB Business Survey shows that trading conditions (in trend terms) in the retail sector have worsened notably since the middle of this year, while that of personal services have eased a little but remained elevated. Meanwhile, the Australian Performance of Services Index was in contractionary territory in two of out of the three months in the quarter. Wages growth has remained stubbornly soft, with year-on-year growth in the ABS Wage Price Index declining to a record low of 1.9% in Q3. It is worth pointing out, however, that the index is stratified in its construct and hence not able to fully capture the effects of compositional changes in the labour market on wages. Nevertheless, slowing employment growth and the continuous dominance of part-time jobs in newly created jobs are likely to have kept a lid on growth in aggregate wages. Overall, private consumption is expected to increase by 0.4% in Q3

Date **2 December 2016** | Authors: **Riki Polygenis +(61 3) 8697 9534; James Glenn +(61 2) 9237 8017**

© National Australia Bank Limited ABN 12 004 044 937 AFSL and Australian Credit Licence 230686

(similar to Q2 2016), which is equivalent year-on-year growth of 2.3%, contributing 0.2ppt to GDP in Q3.

Dwelling investment: Private dwelling investment was surprisingly weak in Q3 according to the preliminary construction work done release from the ABS. Despite resilient property price growth and an extremely elevated pipeline of residential projects, the preliminary data showed private new residential construction falling 3.2% in the quarter. However, this follows four consecutive quarters of solid growth and might be the result of temporary weather disruptions – although other partials are suggesting some loss of underlying momentum (particularly in the apartment segment). That is consistent with increased reports of shelved projects as developers respond to deteriorating market conditions (in some areas). However, medium density projects (which make up a significant share of residential projects) tend to be 'lumpy' by nature, while emerging bottlenecks may be another factor. Renovation activity also declined in the quarter (down 0.7%), following a strong increase in Q2. Overall, we expect that total private dwelling investment dropped 2.7% in the quarter, down from 1.6% growth Q2. Assuming a majority of the pipeline eventually progress to completion, dwelling construction should still support growth over coming quarters – although the profile will likely be lumpy.

Business investment: Private business investment has remained weak and likely contracted further in the September quarter. Partials point to relatively broad-based weakness in private investment, but while temporary weather related factors may have contributed, further falls in mining investment were expected and slowing credit growth and the recent pull-back in business conditions suggests other underlying factors may be weighing on investment more broadly. Underlying private business investment is expected to decline by 2.1% in Q3, largely reflecting a 7.2% drop in mining investment reported in the ABS Private Capital Expenditure (Capex) Survey – although the Survey also points to declines in other industries. We have not fully passed on the weakness recorded in the partials as some key performing industries tend to be underrepresented. Last Wednesday's construction work done (CWD) release showed engineering construction contracting by 6.6% in the quarter, which is a more modest decline than we saw last quarter, although engineering construction can be quite lumpy. Private non-residential building according to the CWD release recorded a surprisingly large decline of 12.9% in the quarter, its largest decline since 2000, while capex data suggests machinery and equipment investment fell by 1.9% in the quarter.

Government spending: Preliminary data suggests a decline in public investment during Q3, following solid gains in recent quarters, although there is downside risk given the sharp increase in defence spending in Q2 (possibly related to the procurement of the Chinook helicopter). Given the amount of infrastructure spending that is in the pipeline, it is possible that public construction was also affected by weather disruptions in the quarter. Last week's CWD release showed public construction falling 0.2% in the quarter. Growth in government consumption (largely the public sector wage bill) is likely to have been moderately positive given evidence of fairly subdued growth in public sector wages and a slight decline in hours worked in the sector in Q3 – the strength in the previous quarter related to hep C drugs being added to the PBS is unlikely to unwind however.

Net exports are expected to make another subtraction from GDP in Q3, with growth in import volumes outweighing growth in export volumes. However, trade data showed that the trade balance narrowed from a deficit of $A6.903 bn in Q2 to $A5.164 bn in Q3, largely driven by an improvement in the terms of trade. For major commodity exports, both LNG and iron ore export volumes rose modestly during the quarter. Thermal coal exports rose by approximately 8.0% while metallurgical coal exports declined due to weather and transport disruptions, but are expected to pick up in the upcoming quarters. Services exports are likely to have been marginally higher in volume terms despite a strong 3.4% increase in nominal terms, while rural exports look to have declined by approximately 3% with export values up approximately 3½% and prices up 6½% . Import volumes are expected to have increased by 1.8%, reflecting the higher AUD and despite no growth in domestic demand in the quarter. Overall, net exports are expected to have subtracted 0.3ppts from GDP growth in the September quarter.

Market implications

Rates

Against a volatile and bearish US Treasury backdrop, most Australian economic data struggles to have much relevance for the rates market. This theme isn't likely to change on a backward looking GDP release, barring a shocking outcome in either direction. A small negative GDP print might give some market participants pause for thought on the real risk of rate cuts, but won't likely drive a significant repricing.

Currency

The AUD has shown only a small-scale negative response to recent weaker than expected Australian data (e.g. building approvals, capex). So GDP will need to be sufficient weak to have the market more seriously entertaining thoughts of a resumption of RBA easing early next year to elicit a strong negative AUD response. Any upsides surprise will likely need to be very significant to overwhelm the global forces currently driving most of the current day-to-day volatility in the currency.

For more information, please contact

Alan Oster +61 3 8634 2927
Riki Polygenis +61 3 8697 9534
James Glenn +61 2 9237 8017
Ray Attrill +61 2 9237 1848
Skye Masters +61 2 9295 1196
Vyanne Lai +61 3 8634 0198
Amy Li +61 3 8634 1563

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Riki Polygenis
Head of Australia Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 2) 9237 8017

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Phin Ziebell
Economist – Australia
+61 (0) 475 940 662

Amy Li
Economist – Australia
+(61 3) 8634 1563

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Steven Wu
Senior Analyst – Industry Analysis
+(61 3) 9208 2929

International Economics
Tom Taylor
Head of Economics, International
+(61 3) 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Senior Currency Strategist
+61 2 9293 7109

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Senior Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Jason Wong
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

UK/Europe
Nick Parsons
Head of Research, UK/Europe, and Global Co-Head of FX Strategy
+44 207 710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532

Asia
Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

Important Notice
This document has been prepared by National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 ("NAB"). Any advice contained in this document has been prepared without taking into account your objectives, financial situation or needs. Before acting on any advice in this document, NAB recommends that you consider whether the advice is appropriate for your circumstances.
NAB recommends that you obtain and consider the relevant Product Disclosure Statement or other disclosure document, before making any decision about a product including whether to acquire or to continue to hold it.
Please click **here** to view our disclaimer and terms of use.