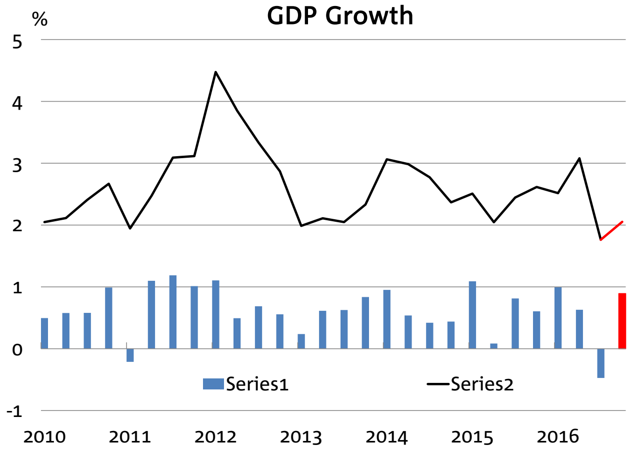
AUSTRALIA GDP PREVIEW – Q4 2016

By Group Economics

24 February 2017

Q4 GDP data will be released on Wednesday 1 March at 11:30 AEDT. Additional partials will be available next week prior to the GDP release.

- **Economic partials point to a rebound in real GDP in Q4 of +0.9% q/q.** This follows a surprise contraction in growth in Q3 (-0.5% q/q) which partly stemmed from temporary disruptions (including weather-related disruptions to construction). The year-ended rate of growth will lift a little to 2.1% from 1.8% in Q2.
- **GDP by expenditure components is showing a relatively broad-based bounceback.** Most expenditure components look to have been flat-to-higher in Q4, although **partials suggest** the rebound in dwelling investment (1.3%) and public investment (0%) was a little underwhelming. That said, we see some upside risk to the forecast **based on partial data this week, although we will review this forecast following business indicators, balance of payment and government finance statistics released on Monday and Tuesday.**
- **Another big jump in the terms of trade will again contribute to income measures of GDP.** Higher commodity prices will contribute to a 9.2% rise in the terms of trade in Q4, following up the 4.5% jump in Q3. That will have some positive flow-on effect for company profits, while labour income growth looks to have improved modestly due to better employment growth relative to Q3 and fairly steady (albeit subdued) wages growth.
- On a **production (or industry gross value added) basis, the non-mining recovery may have lost more momentum, although the evidence is mixed.** The NAB business survey showed weaker business conditions in Q4, which included disappointing outcomes for retail trade, as well as some pull-back in the outperforming services industries. However, the slump appeared to turn around late in the quarter and continued to strengthen going into early 2017. Nevertheless, other timely indicators for the services sector were encouraging in Q4, while the mining industry is becoming less of a drag on the economy.
- Our forecasts are similar to those published in the RBA's latest Statement of Monetary Policy which suggested real GDP growth of around 2%. Consequently, this outcome is unlikely to have big implications for monetary policy, with the RBA likely to remain firmly on hold in the near-term. We recently revised our expectations for monetary policy to include a 25bp cut to the cash rate in November. We remain comfortable with that view which is underpinned by our expectation for the economy to weaken more than the RBA expect in 2018, keeping pressure on the labour market.



Domestic demand flat

Australian National Accounts (a)

	Q/Q Sep-16	Q/Q Dec-16	Y/Y Dec-16	Contribution to Q/Q Dec-16
Household Consumption	0.4	0.8	2.5	0.4
Dwelling Investment	-1.4	1.3	6.7	0.4
Underlying Business Investment	-4.5	0.3	-9.2	0.0
Underlying Public Final Demand	-0.6	0.0	2.9	0.0
Domestic Final Demand	**-0.5**	**0.6**	**1.5**	**0.6**
Stocks (a)	0.1	0.0	0.1	0.0
GNE	**-0.3**	**0.6**	**1.7**	**n.a.**
Net exports (a)	**-0.2**	**0.2**	**0.9**	**0.2**
Exports	0.3	2.9	8.1	0.6
Imports	1.3	1.8	3.6	-0.4
GDP	**-0.5**	**0.9**	**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 see a reasonable bounce in Q4, supported by solid retail spending growth. However other partial indicators were somewhat mixed in late 2016, including available indicators of services consumption. The NAB Business Survey showed that the trend for trading conditions in retail has deteriorated considerably (although this could reflect weakness in prices rather than volumes), while recreation & personal services also softened in late 2016 – albeit still holding at elevated levels. In contrast, the AIG Performance of Services Index suggested solid expansion during the quarter. Consumption continues to be challenged by lacklustre growth in wages, a shift towards part-time versus full-time employment weighing on household income growth combined with relatively high household debt levels. Overall, private consumption is expected to increase by 0.8% in Q4 (up from 0.4% in Q3 2016), which gives year-on-year growth of 2.5%, contributing 0.4ppt to GDP growth in Q3.

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Dwelling investment: Preliminary indicators suggest that dwelling construction did not bounce back as much as expected in Q4. Preliminary construction work done, released by the ABS on Wednesday, showed that new private dwelling construction rose by 0.9% q/q after contracting by 1.9% in the previous quarter. The underlying loss of momentum in residential construction in recent quarters is a little surprising given the resurgence in property prices over 2016 and the already very elevated stockpile of construction work in the pipeline. Aside from the observed weather disruptions in Q3, this trend could point to additional constraints on growth, such as limited spare capacity and uncertainty over the housing market outlook. That would be consistent with anecdotal reports of developers shelving projects in some areas. However, medium density projects (which make up a significant share of residential projects) also tend to be 'lumpy' by nature. Meanwhile, renovation activity rebounded in the quarter (up 2.2%), following a decline in Q3. Overall, we expect that total private dwelling investment rose 1.3% in the quarter, up from -1.4% growth in Q3. Assuming a majority of the pipeline eventually progress to completion, dwelling construction could continue to see growth over coming quarters, although the profile will likely be lumpy and the magnitude of the contribution to growth appears to be slowing sooner than previously expected.

Business investment: Private business investment is slowing looking more encouraging, while the drag from mining investment continues to subside. Partial were quite positive for private business investment in Q4, although the strength may simply point to a bounce-back from weather related disruptions in the previous quarter. Indeed, business conditions from the NAB Business Survey actually softened notably in Q4 2016, suggesting a less favourable underlying environment for investment – although business conditions improved considerably late in the quarter and into early 2017. Underlying private business investment is expected to rise by 0.3% in Q4, once again held back by a drop in mining investment (down -9.4%) reported in the ABS Private Capital Expenditure (Capex) Survey. Wednesday's construction work done (CWD) release showed engineering construction contracting by 3.4% 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 partial recovery of 5.1% in the quarter, although that follows and almost 11% decline the previous quarter, while capex data suggests machinery and equipment investment rose modestly (0.4%) in the quarter.

Government spending: There is only limited preliminary data available on government spending, with more available early next week. Construction data point to a modest decline in public investment during Q4, which is once again a surprising outcome, especially given the amount of infrastructure spending that is in the pipeline. Last week's CWD release showed public construction falling 1.6% in the quarter. Growth in government consumption (largely the public sector wage bill) is likely to have been moderately positive given evidence of relatively subdued growth in both public sector wages and hours worked in the sector during Q4.

Net exports: Net exports are expected to contribute to GDP growth in Q4 2016. Export prices were sharply higher, but export volumes also look to have increased and were only partly offset by solid imports, resulting in a small positive contribution from net exports in the quarter. For major commodities, export volumes rose modestly during the quarter for iron ore, coking coal and LNG, while thermal coal exports declined slightly. Services exports are likely to have continued growing too, despite a higher AUD. Improved climatic conditions saw rural exports increase by 9.2% in value terms, and likely even higher in volume terms given lower prices. Import volumes are estimated to have increased by 1.8% over the quarter, helped by the appreciation in the AUD, especially for services. Higher bulk commodities and base metals prices have boosted the terms of trade and therefore the nominal trade balance considerably. Available trade data showed that the trade balance shifted from a deficit of $A3.8 bn in Q3 to a $A4.8 bn surplus in Q4. Overall, net exports are expected to have added 0.2ppts from real GDP growth in the December quarter.

Market implications

Rates

With RBA policy seemingly set fair for a good while yet, it will likely take a GDP print outside of a 0.5-1.0% range to elicit more than a knee jerk intra-day FX market reaction (and bearing in mind there was no lasting negative reaction to the unexpectedly weak Q3 outcome).

Currency

At the time of writing, there's no consensus for GDP available and further partial figures are yet to be released. Based on NAB economics view of +0.9% q/q with upside risks, the GDP print risks adding some further upward pressure on front end rates, especially in light of the RBA's recent optimistic comments on the outlook. That said, any reaction will be limited by the fact that the market is only priced for 3bp of easing this year and around 40bp of tightening is priced in for 2018.

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