AUSTRALIAN ECONOMIC UPDATE

GDP Q1 2018 – growth rebounds

NAB Group Economics

6 June 2018

Bottom line: **GDP Growth rebounded in Q1, supported by the household and government sectors and export growth. While household consumption was weaker than we anticipated, this outcome followed a strong Q4, and is more in line with our assessment of the underlying pace of the growth in household spending. Public infrastructure investment and non-mining business investment in machinery and equipment also appear to be supporting growth. This release doesn't change our view that growth will lift in 2018, in part due to a ramp up of LNG exports. The Q1 outcome will provide some comfort to the RBA that the underlying pace of growth is improving in line with its forecasts for this year, but wage and price data will remain the key variables for monetary policy in 2018. Wage and income data from this release, while showing some improvement, do not change our assessment that the RBA will remain on hold until mid-2019.**

- **Australian GDP growth was in line with our expectations following the recent partial data.** Growth rose to 1.0% q/q in real terms (Mkt: 0.9% q/q). The year-ended rate of growth rose to 3.1% y/y.
- **Household consumption growth weakened in the quarter (+0.3% q/q) after recording a strong outcome in Q1.** While the quarterly outcome was weaker than we expected, it is more in line with our assessment of the underlying rate of growth in household spending. The significant headwinds faced by the household sector - weak wage growth, cooling house prices and high debt levels – continue, and are likely to weigh on consumption in 2018.
- **Investment continues to paint a picture of a handover to the non-mining sector – albeit with some volatility.** In underlying terms (excluding transfers) business investment recorded meek growth of 0.1% q/q. However, investment in machinery & equipment (largely the non-mining sector) rose 1.0% to be around 9% higher over the year. Engineering construction (often affected by lumpy LNG investment) also rose slightly in the quarter, suggesting a waning impact from the pull-back in mining investment as the bulk of large LNG projects enter the production phase. Buildings & structures investment weighed on investment growth in the quarter but remains higher over the year.
- **Government investment** (in underlying terms) rose in the quarter after declining in Q1. Investment in public infrastructure projects is likely to be a key source of growth going forward, where we expect the government sector to support domestic demand much the same way as it did this quarter.
- We believe this release will give comfort to the **RBA**, bringing the year-ended rate of growth in line with its latest forecasts for 2017/18. While growth appears relatively healthy, the weakness in household consumption is likely to remain a concern. Nonetheless, while this release **does not change our view on the path of monetary policy (first increase mid-2019)**, there was some tentative evidence of a pick-up in wages growth, with average earnings growth rising to 0.5% in the quarter (and a small upward revision to the previous quarter). Combined with continued strength in employment, compensation of employees as a whole continues to grow at a relatively strong rate – a positive for wage earners as a whole.

HIGHLIGHTS

- **On the expenditure side,** household consumption growth was soft, but growth was supported by still solid public demand (allowing for asset transfers), a contribution from inventory growth and a large turnaround in the net export contribution. The latter reflected a rebound in exports driven by resources exports. Growth in underlying business investment was relatively weak, but even this represented an improvement on Q4. Dwelling construction also showed modest growth, partially reversing the recent declining trend.
- **By industry**, gross value added was generally stronger, although not across the board. Mining and health care and social assistance provided the largest contributions to GDP growth (0.2ppt each s.a.), although both were outpaced by the statistical discrepancy. The strength in mining came in large part from oil and gas extraction (up 8.4%), reflecting the ongoing ramp-up of Australia's LNG exports. Australia is currently building enough LNG capacity to be the world's largest exporter but we see the GDP impact fading next year as projects reach completion. Health care and social assistance rose on both public and private health care. Agriculture was the weakest performer reflecting weakness in grains following a somewhat below average harvest. With conditions very dry, production could come under further pressure this season.
- **By state,** Tasmania saw the strongest growth in State Final Demand at 2.0% q/q, reflecting increased investment in machinery and equipment as well as strong public sector spending. Victoria was second, rising 1.9% q/q driven largely by an 8.1% q/q jump in private gross fixed capital formation. New South Wales grew 0.7% q/q and

Queensland 0.5% q/q, but Western Australia, South Australia, the Northern Territory and the Australian Capital Territory all contracted. The Northern Territory saw the weakest result of -2.0% q/q, reflecting weaker non-dwelling construction.

- Growth in **income measures** such as real gross domestic income were a little higher than real GDP growth in Q1 with a pick-up in the terms of trade. Per capita growth in incomes rose in the quarter after a weak outcome in Q4. Labour income (compensation of employees) was up 1.2% q/q, driven by both an increase in hours worked but also a small rise in average earnings of 0.5% q/q and 1.6% y/y. Growth in corporate profits (GOS) picked up strongly in the quarter to 5.2% q/q. **Labour productivity** was flat in the quarter, with growth in hours worked matching the rise in economic output.

Key figures

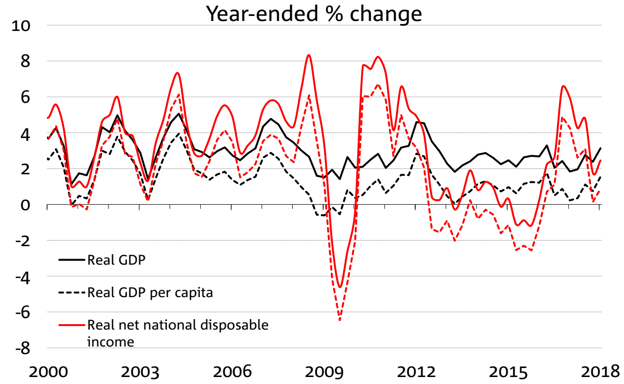
Key aggregates	q/q % ch		y/y % ch
	Dec-17	Mar-18	Mar-18
GDP (A)	0.5	1.0	3.1
GDP (E)	0.3	1.2	3.0
GDP (I)	0.7	1.2	3.6
GDP (P)	0.6	0.8	2.8
– Non-Farm GDP	0.6	1.1	3.6
– Farm GDP	-1.8	-1.9	-14.9
Nominal GDP	0.9	2.2	3.9
Real gross domestic income	0.6	1.8	2.6
Real net national disposable income per capita	0.1	1.5	0.9
Terms of trade	0.4	3.3	-2.6

GDP (E) by component

GDP Expenditure Components	q/q % ch		y/y % ch	Contribution to q/q % ch
	Dec-17	Mar-18	Mar-18	Mar-18
Household Consumption	1.0	0.3	2.9	0.2
Dwelling Investment	-0.1	0.9	-1.0	0.1
Underlying Business Investment^	-0.4	0.1	3.1	0.0
Machinery & equipment	2.5	1.4	9.3	0.1
Non-dwelling construction	-2.8	-1.4	-1.6	-0.1
New building	3.3	-3.8	1.9	-0.1
New engineering	-7.5	0.7	-4.2	0.0
Underlying Public Final Demand	1.2	1.5	5.5	0.3
Domestic Demand	**0.8**	**0.6**	**3.2**	**0.6**
Stocks (a)	0.2	0.2	-0.1	0.2
GNE	**0.9**	**0.8**	**3.1**	**0.8**
Net exports (a)	**-0.7**	**0.3**	**-0.2**	**0.3**
Exports	-1.5	2.4	4.6	0.5
Imports	1.6	0.5	4.7	0.1
GDP	**0.5**	**1.0**	**3.1**	**1.0**

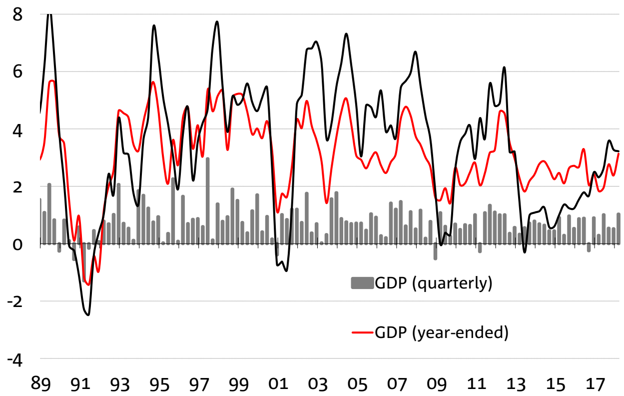
(a) Contribution to GDP growth ^ Excluding transfers between the private and public sector

GDP and national income growth
Year-ended % change



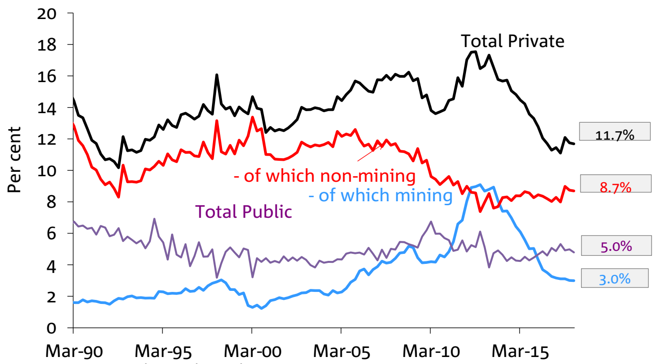
Income measures	q/q % ch		y/y % ch
	Dec-17	Mar-18	Mar-18
Real GDI	0.6	1.8	2.6
capita	0.1	1.5	0.9
Compensation of employees	1.2	1.2	5.1
Average compensation of employees (average earnings)	0.2	0.5	1.6
Corporate GOS	0.8	5.2	5.2
Non-financial corporations	0.7	6.1	4.6
Financial corpoarations	0.9	2.2	7.2
General government GOS	0.7	0.7	2.9
Productivity & unit labour cost			
GDP per hour worked	-0.4	0.0	0.1
sector	-0.2	0.0	1.0
Non-farm nominal unit labour cost	0.8	-0.4	1.6
Non-farm real unit labour cost	0.5	-1.6	1.1

Real GDP and domestic demand

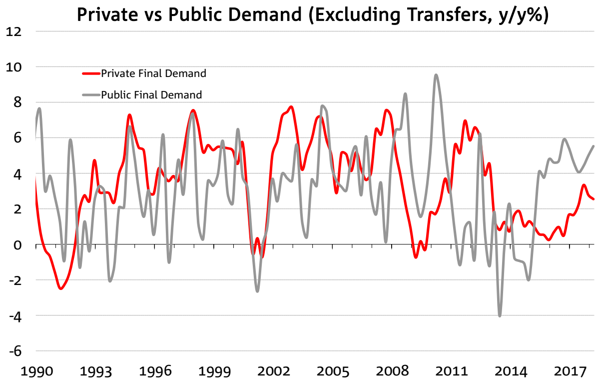


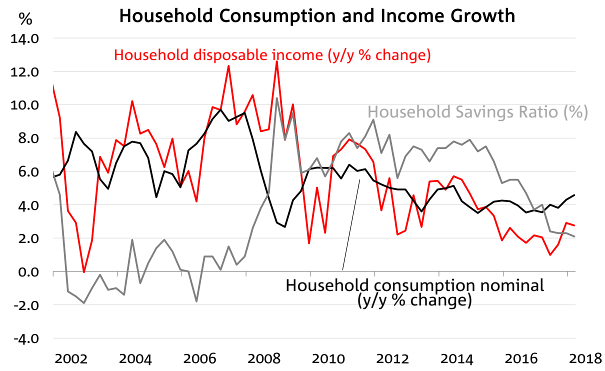
Source: ABS

Investment Share of GDP

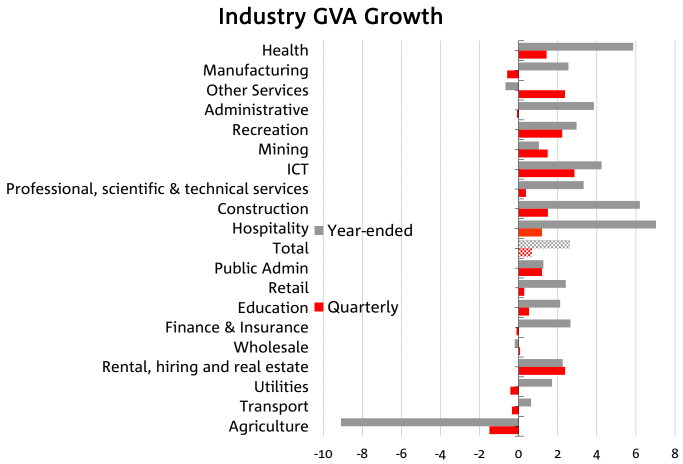


Source: ABS, National Australia Bank





Source: ABS, NAB Group Economics



State final demand

State/ Territory	Q/Q Dec-17	Q/Q Mar-18	Y/Y Mar-18
VIC	0.4	1.9	4.9
TAS	0.9	2.0	3.9
NSW	1.1	0.7	3.7
QLD	1.1	0.5	3.1
SA	1.3	-0.2	2.1
ACT	0.8	-0.8	1.6
WA	0.5	-1.1	0.8
NT	-6.0	-2.0	-7.9

EXPENDITURE COMPONENT DETAILS

Household consumption growth was a surprisingly weak 0.3 % q/q. However, it followed strong growth in previous quarters, and the annual growth rate was unchanged at 2.9 %, a modest pace by past (pre-GFC) standards.

Even with only soft real consumption growth in the quarter, household spending grew at a faster pace than disposable incomes (0.7% q/q compared with nominal consumption growth of 0.9% q/q). As a result, the household savings ratio continued its downward trend and is at its lowest level since 2007 (see chart above).

The soft growth in Q1, which was driven by growth in non-discretionary categories, as well as the run-down of the savings rate to finance consumption, reinforces our caution about the outlook for the consumer. This reflects several headwinds including rising energy costs, low wages growth, stalling growth in housing wealth (with house prices falling in some markets) and high debt levels.

Dwelling investment rose by 0.9% q/q, although this only partially reversed the declines seen in the previous two quarters. However, the bounce back was entirely due to growth in alterations and additions, with new and used dwelling investment falling. As a result our view remains that the dwelling construction cycle has largely peaked, and we expect to see a relatively moderate decline over time.

Underlying private business investment (which excludes asset transfers) recorded a small rise in the quarter (0.1% q/q) following a slightly larger decline in Q4. However, it is still up 3.1% over the year.

Machinery and equipment investment (ex asset transfers) recorded further solid growth (1.1% q/q) and over the last year has increased over 9%. However, while non-dwelling construction grew by 1.6% q/q, excluding asset transfers it declined by 1.4%. Engineering construction recorded only modest growth after a large fall in Q4 (which likely reflected the timing of imports of LNG facilities) while new building construction fell 3.8%.

While the recent pause in underlying business investment is somewhat disappointing, conditions are still supportive of further growth in investment, highlighted by the growth corporate profits (with non-financial corporation gross operating surplus up 5.2% in Q1) and the strength in business conditions reported in NAB's Monthly Business Survey.

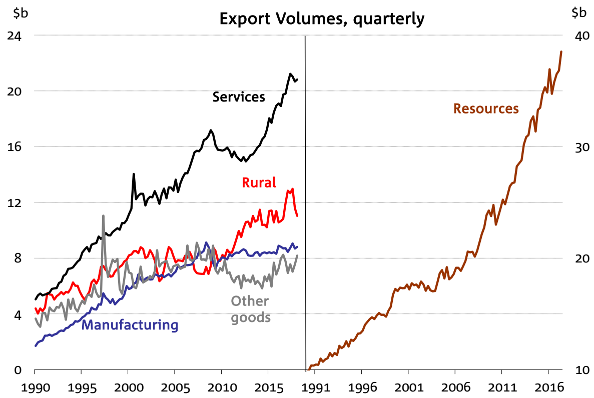
Moreover, separately released data from the ABS shows that mining investment increased in Q1. This is the second increase in the last three quarters, consistent with a fading drag from mining investment.

While headline **Government spending** moderated in Q1 following strong 2017 Q4 growth, allowing for the impact of net second hand asset transfers to the private sector, growth remained very solid (and has been at or above 1% q/q in the last five quarters). Public consumption growth in particular remained strong, while underlying public investment grew again after a fall in the previous quarter. Over the year to Q1, underlying public investment grew by 7.4%, consistent with an elevated public infrastructure pipeline.

Inventories made a 0.2ppt contribution to GDP growth in the quarter, which was entirely driven by wholesale trade inventories.

Net exports added 0.3ppts to GDP growth in Q1, following a large 0.7ppts detraction in 2017 Q4. Export growth strengthened noticeably, rising 2.4% q/q (after falling in the previous quarter) while import growth moderated.

The turnaround in exports was driven by resource exports and came despite another decline in rural export volumes. Coal exports rebounded after appearing to have been affected by supply disruptions in the previous quarter, while ‘other mineral fuels’ grew a rapid 12% q/q, consistent with our expectation that LNG exports would ramp up this year as new platforms came on line.



The moderation in import growth to 0.5% q/q (from 1.6% q/q in Q4) reflected small falls in consumption and intermediate goods imports (after strong growth the previous quarter). Services imports again fell. In contrast, capital goods imports rebounded (4.3% q/q), resuming the upwards trend evident since mid-2016, consistent with the growth in underlying business investment.

AUTHORS

Gareth Spence, Senior Economist
Antony Kelly, Senior Economist
Phin Ziebell, Economist

Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Economics
+(61 3) 8634 2331

Australian Economics and Commodities

Gareth Spence
Senior Economist
+61 (0) 436 606 175

Tony Kelly
Senior Economist
+(61 3) 9208 5049

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

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

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

John Sharma
Economist
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836