AUSTRALIAN ECONOMIC UPDATE

GDP Q3 2018 – Consumer worries still loom large

NAB Group Economics 5 December 2018

Bottom line: GDP growth eased to 0.3% q/q and the annual rate of growth declined to 2.8%. The slowing in growth comes after a very strong H1 2018, which saw growth print near 4% in annualised terms but does little to change our view on the underlying pace of growth in the economy. While the softer outcome confirms our outlook for the economy - we had expected growth to slow in year-ended terms through the second half of 2018 and into 2019 – the data challenges the RBA view that growth will 'average around 3½ per cent over this year and next'. In the quarter, growth was supported by a solid rise in net exports and continued strong growth in government spending. The household sector was notably softer, with consumption making a small contribution and investment in dwellings lifting slightly. Business investment detracted from growth – with a further decline in the mining sector offsetting a rise in the non-mining sector. Wage and price variables – though dated – confirm that price pressures in the economy remain weak.

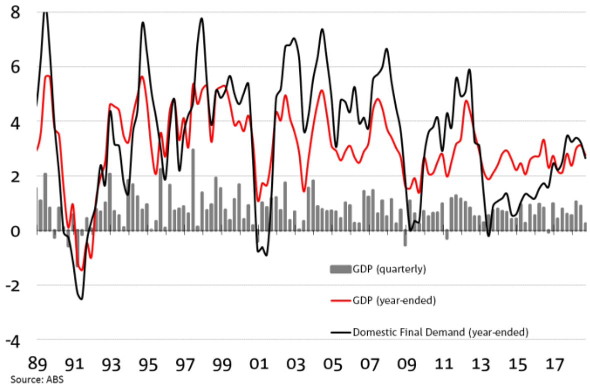
Looking forward, we still expect growth to be driven by public sector spending, non-mining business investment and a further uplift in commodity exports - before the last of the LNG projects reaches full production capacity. Consumption will likely only see modest growth, given the headwinds faced by households. Dwelling investment is expected to decline somewhat alongside the cooling in the housing market, but as today's positive surprise shows, this may be volatile as the pipeline of work yet to be done plateaus.

The key dynamic for monetary policy remains how quickly wages growth and inflation picks-up. We think there is still some degree of spare capacity in the economy even after the rapid growth seen earlier this year and the tightening that has occurred in the labour market. With growth looking to remain at or above trend, the **next move in rates is still most likely up**, but with inflation remaining low, any move appears some time away. Following the latest releases of growth, labour market and prices data, we are reassessing our view on monetary policy. While growth has turned out broadly as we expected over 2018, inflation has been weaker and the RBA appears more patient. We will release an updated set of growth and rates forecasts next week.

Key figures

Key aggregates	q/q % ch		y/y % ch
	Jun-18	Sep-18	Sep-18
GDP (A)	0.9	0.3	2.8
GDP (E)	0.9	0.4	3.3
GDP (I)	0.8	0.1	2.5
GDP (P)	1.0	0.3	2.5
– Non-Farm GDP	0.9	0.3	3.0
– Farm GDP	1.0	-0.9	-8.1
Nominal GDP	1.1	1.0	5.2
Real gross domestic income	0.6	0.4	3.4
Real net national disposable income per capita	0.0	-0.3	1.3
Terms of trade	-1.1	0.8	2.7

Real GDP and domestic demand



HIGHLIGHTS

- **Household consumption** rose by a modest 0.3% in Q3, which saw growth over the year tracking at 2.5%. While the quarterly outcome was slightly weaker than we expected (after previous quarters surprised on the upside) it is in line with our outlook of only modest growth for consumption over the next 2 years. By component, rises in insurance & financial services, transport services and food (non-discretionary spending) were offset by some weakness in non-discretionary items such as household goods and motor vehicles. Alongside the weakness in consumption, the savings rate declined further in Q3 (from an upwardly revised level), with consumption continuing to outpace the growth in household income.
- **Underlying business investment declined for the second consecutive quarter** (-1.9% q/q). This reflected a large fall in non-dwelling construction (-5.6% q/q) as both new building and, in particular, new engineering construction, declined. In contrast, underlying machinery & equipment investment increased (1.5% q/q), and is up a solid 4.7% over the year. The weakness in non-dwelling construction appears to be at least partly related to the mining sector – overall non-mining investment was up (1.0% q/q), while mining sector investment declined 7.5% q/q. There was a large fall in Northern Territory non-dwelling construction, possibly relating to the Ichthys project as it transitions

from construction to production. As the tail-end of the construction phase of the LNG mega-projects wraps up, we expect mining investment to stabilise, with some potential upside given the improvement in business conditions in the sector.

- **Dwelling investment** increased 1.0% in the quarter, and has risen in each of the last four quarters. The increase was entirely driven by alternations & additions (up 4.5% q/q), as investment in new dwellings fell 0.8% q/q. Alongside the cooling in the housing market, we expect dwelling investment to decline over the next couple of years – with a pull-back in new building approvals already evident – though the large pipeline of work-yet-to be done will provide some support, suggesting the real weakness will likely occur in 2020.
- **Government demand** continues to be a major support for growth. Underlying public demand alone contributed 0.4ppts to GDP growth in the quarter. Growth in government consumption moderated to 0.5% q/q, but this reflected a fall in state/local government consumption, with national government consumption – driven by the spending on health, aged care and disability services (the NDIS roll-out) – continuing to power along (1.9% q/q). After declining in the previous quarter, underlying public investment bounced back strongly (6.2% q/q) and we expect the upwards trend will continue given the large pipeline of planned infrastructure.
- **Net exports contributed a solid 0.3ppt q/q.** Imports were weaker this quarter with a fall in consumption, capital goods and non-monetary gold imports. Overall exports edged higher in the quarter as a rise in service and LNG exports were offset by declines in exports of metal ores and coal. While rural exports rose slightly in the quarter, with continued sharp falls in cereal exports offset by other components, we expect the ongoing effects of the drought to further drag on rural exports over the coming financial year.
- **Compensation of employees rose by 1.0% in the quarter.** Again this was almost entirely driven by increases in employment and hours worked with average COE per employee only recording a 0.2% q/q rise. The weakness in average earning reflects the ongoing weakness in wage growth which, while showing signs of a pickup in the Q3 WPI release, remains low.
- **Nominal unit labour costs increased** in the quarter with small increase in wage growth offset by a decline in productivity. While volatile on a quarterly basis, unit labour costs represent a key mechanism through which higher wage growth will flow through to inflation. For now, national accounts measures of price growth suggest inflationary pressure remains weak.
- **By industry**, administrative & support services (+ 2.8%), health care & social assistance (+ 2.6%) saw the largest increases. The solid 0.2ppt contribution from healthcare & social assistance reflects ongoing strong public and private spending, as well the ramp-up in the NDIS rollout. Construction contracted the most (- 2.2%), detracting 0.2ppt from growth, largely reflecting the completion of several large mining and renewable energy projects. Mining detracted 0.1ppt from growth in Q3, although was still the second fastest growing sector in annual terms. The ABS reports that the weak result was largely a result of planned maintenance for coal and iron ore mining, and that natural gas continues to rise.
- **By state,** New South Wales recorded strong growth in state final demand in the quarter (+1.1%), driven by a sharp rise in state and local government infrastructure investment (public investment 8.9%), which offset relatively soft household consumption (0.2%). Strong government expenditure in the ACT and Tasmania also drove solid Q3 growth outcomes of 0.9% and 0.6%, while in Victoria (0.2%), solid growth in household spending and private investment were surprisingly partly offset by declines in government spending. Nevertheless, Victoria has a very large infrastructure pipeline and we expect government investment spending to be elevated for some years to come. In the mining states, the completion of large LNG projects continues to be a drag on NT, but as mining activity elsewhere lifts, increased machinery and equipment investment has boosted WA final demand.
- **Farm GDP** fell 0.9% in Q3, while agriculture, forestry and fishing GVA dropped 1.6%. This negative print does not come as a surprise, with the drought in eastern Australia – especially New South Wales and Queensland –a key driver of the results.

Implications for monetary policy

Today's outcome was weaker than we expected for the quarter, but broadly in line with our ongoing view for the economy. However, this outcome will likely challenge the RBA's view that growth will remain above-trend and consumption will grow at around 3%, despite the ongoing headwinds faced by the household sector. It is likely they will consider centralising the risk around their consumption forecasts, which would see a slower pace of overall growth, and would imply spare capacity being more slowly eroded than currently anticipated by the Bank. This may well delay their expectations of the timing of the first rate increase as taken at face value, and imply an even more gradual lift in inflationary pressure than previously thought. NAB continues to forecast that the next move in the cash rate will be an increase, currently pencilled in for mid-2019. We have had this forecast for some time now but it's fair to say the RBA still doesn't look very close to making their first hike. Progress on inflation and wages is occurring only slowly and more importantly the RBA is showing a greater deal of patience (in waiting for clear signs of higher wages/inflation) than we expected. As a result, our monetary policy forecasts are currently under review, with the results to be published with our updated economic forecasts on Wednesday 12th of December.

ADDITIONAL CHARTS AND TABLES:

GDP (E) by component

GDP Expenditure Components	q/q % ch		y/y % ch	Contribution to q/q % ch
	Jun-18	Sep-18	Sep-18	Sep-18
Household Consumption	0.9	0.3	2.5	0.2
Dwelling Investment	1.9	1.0	7.1	0.1
Underlying Business Investment^	-0.1	-1.9	-0.8	-0.2
Machinery & equipment	-1.4	1.5	4.7	0.1
Non-dwelling construction	-0.3	-5.6	-7.2	-0.3
New building	-0.6	-2.4	-1.2	-0.1
New engineering	-0.1	-8.2	-11.8	-0.3
Underlying Public Final Demand	0.5	1.5	4.5	0.4
Domestic Demand	**0.7**	**0.3**	**2.7**	**0.3**
Stocks (a)	0.1	-0.3	0.1	-0.3
GNE	**0.8**	**0.0**	**2.7**	**0.0**
Net exports (a)	**0.2**	**0.3**	**0.6**	**0.3**
Exports	1.2	0.1	4.1	0.0
Imports	0.5	-1.5	1.5	-0.3
GDP	**0.9**	**0.3**	**2.8**	**0.3**

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

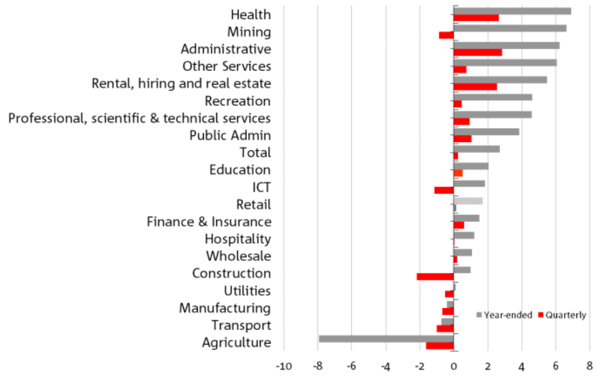
INCOME MEASURES

Income measures	q/q % ch		y/y % ch
	Jun-18	Sep-18	Sep-18
Real GDI	0.6	0.4	3.4
capita	0.0	-0.3	1.3
Compensation of employees	0.8	1.0	4.3
Average compensation of employees (average earnings)	0.1	0.2	1.2
Corporate GOS	0.6	1.7	7.1
Non-financial corporations	0.4	1.7	7.5
Financial corpoarations	1.4	1.7	5.8
General government GOS	0.8	0.7	3.5
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	-0.3	0.9	0.8
Non-farm real unit labour cost	-0.4	0.0	-1.5

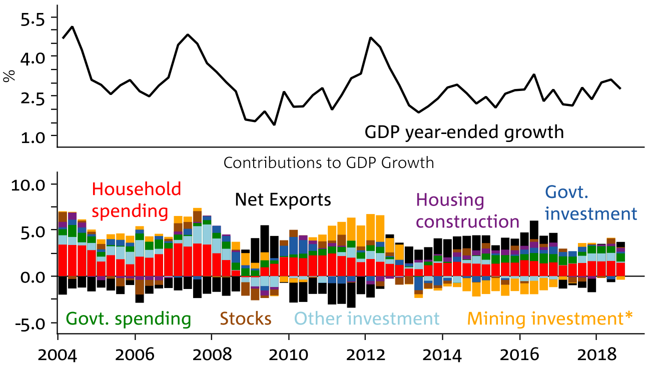
State final demand

State/ Territory	Q/Q		Y/Y
	Jun-18	Sep-18	Sep-18
VIC	1.4	0.2	4.3
TAS	0.9	0.7	4.1
ACT	2.4	0.9	3.9
NSW	0.5	1.1	3.7
SA	1.2	-0.2	2.7
QLD	0.5	-0.4	2.2
WA	-0.4	0.4	-0.6
NT	-2.0	-8.2	-17.5

Industry GVA Growth

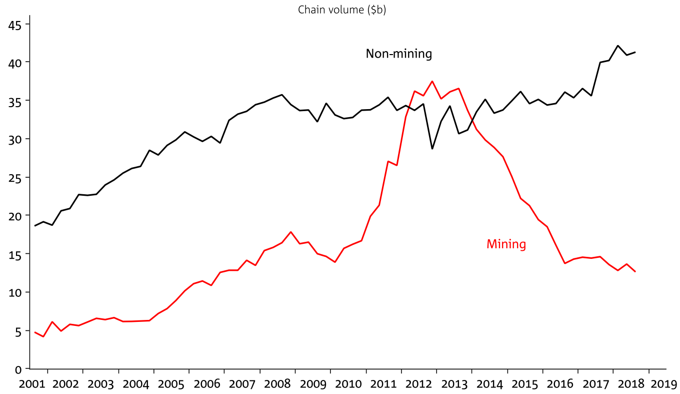


Contributions to GDP Growth



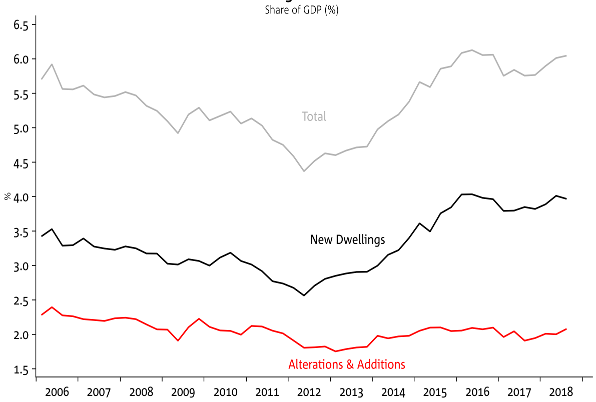
* New Engineering Construction
Source: National Australia Bank, ABS

Business Investment
Chain volume ($b)

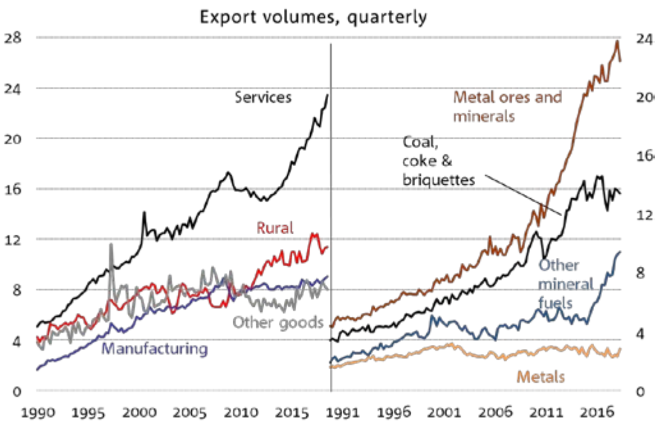


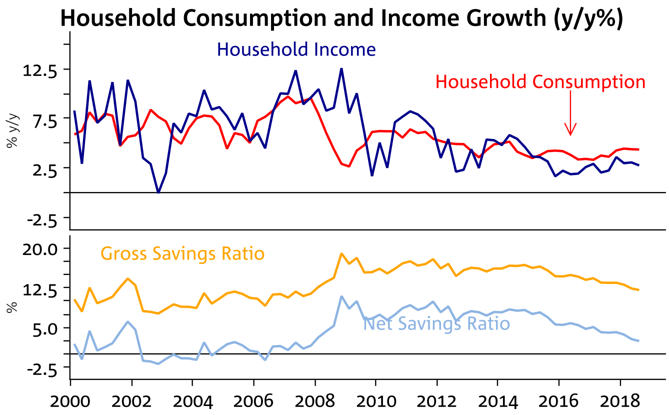
Source: National Australia Bank, Macrobond

Dwelling Investment
Share of GDP (%)

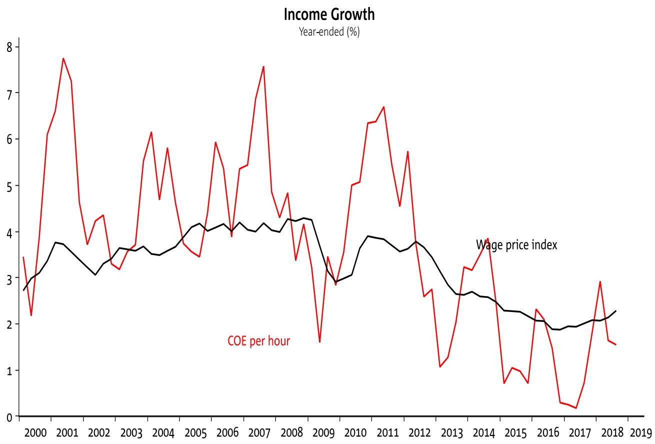


Source: National Australia Bank, Macrobond

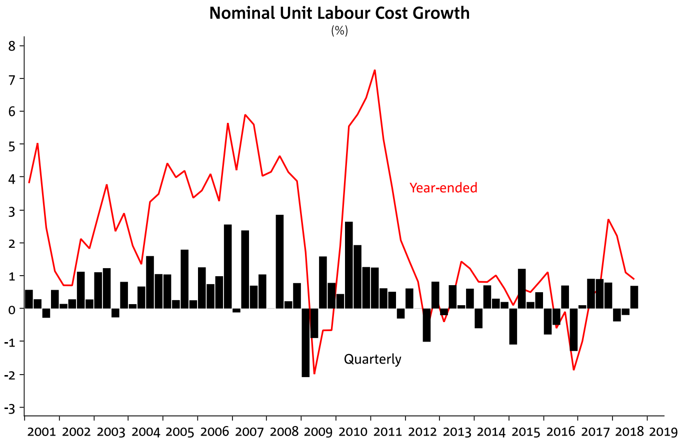




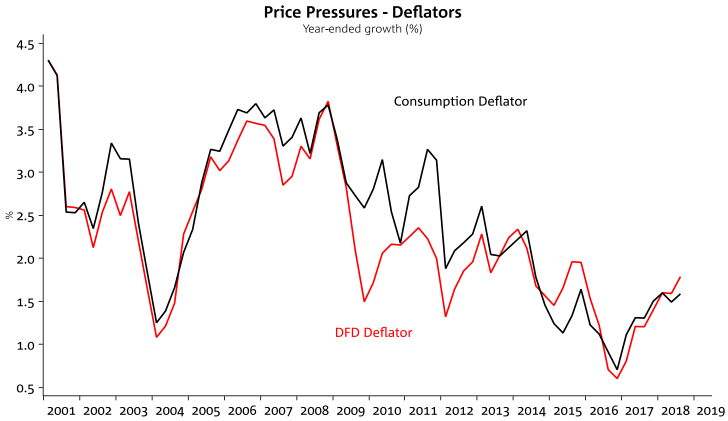
* CoreLogic Hedonic Price; December estimate
Source: National Australia Bank, CoreLogic, ABS



Source: National Australia Bank, Macrobond



Source: National Australia Bank, Macrobond



Source: National Australia Bank, Macrobond

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