AUSTRALIAN ECONOMIC UPDATE

GDP Q4 2018 – household income and construction drag

6 March 2019

<u>**Bottom line:**</u> **GDP recorded another quarter of weak growth,** lifting a modest 0.2% q/q and resulting in through the year growth of 2.3% in 2018. It is clear that growth in H2 2018 slowed significantly from the pace seen in H1 2018 – growth annualised at only 0.9% in H2 2018. Even with faster momentum through 2019, growth is unlikely to reach the 3.0% rate expected by the RBA over 2019. NAB's forecast is for the RBA to keep rates on hold for the foreseeable future, though we have signalled increased risk of a rate cut. Any significant deterioration in the labour market would likely see a series of cuts by the RBA. We will review today's data and next week's NAB Business Survey before releasing updated forecasts next week.

The soft results of recent quarters reflect a combination of the downturn in housing, continuing relatively slow income growth (though this has improved a little) and the tail end of the wind down in mining investment.

On the expenditure side, the weakness in the quarter was largely a result of soft consumption growth, a sizable fall in dwelling investment and weaker-than-expected growth in business investment. Growth was supported by a solid contribution from underlying public demand, driven by ongoing growth in government consumption – likely NDIS related; government investment fell in the quarter. Both the income and production measures of GDP saw weaker prints in the quarter and have tracked substantially below the expenditure measure over the year. Of note, the farm sector continued to show weakness, again falling in the quarter from the ongoing effects of the drought. Price and wage measures remain muted and despite a small lift in unit labour costs growth, overall inflationary pressures remain muted.

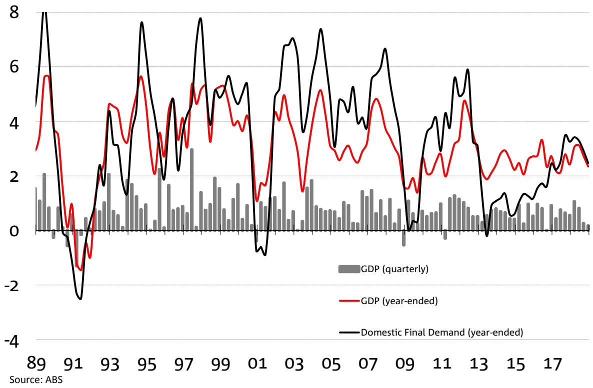
Looking forward, we expect growth to slow in year-average terms in 2019 and 2020. We expect household consumption – around 60% of GDP - to grow only modestly at 2-2½ per annum. Dwelling investment is expected to decline relatively sharply, falling by around 18% over the next two years (the RBA expects only a 10% decline over the same period). Countering some of the weakness in the household sector over the outlook will be a strong lift in government spending as well as a significant pickup in private business investment. Further, LNG exports will continue to ramp up over this year as the last of the remaining LNG projects reaches full production – before exports plateau at a high level.

Today's data place further downside risk on our forecast for an unchanged cash rate over the next 18-24 months. Any significant deterioration in the labour market would likely see a series of cuts by the RBA. As such, the next move in interest rates hinges on developments in the labour market. The recent tightening in the labour market has seen a gradual lift in wage growth but overall it remains weak. With ongoing headwinds in the household sector we see growth slowing and therefore only modest gains in the unemployment rate from here. We will review today's data and next week's business survey before releasing updated forecasts next week.

Key figures

Key aggregates	q/q % ch		y/y % ch
	Sep-18	Dec-18	Dec-18
GDP (A)	0.3	0.2	2.3
GDP (E)	0.5	0.3	3.1
GDP (I)	0.1	0.1	1.7
GDP (P)	0.2	0.2	2.2
– Non-Farm GDP	0.3	0.3	2.5
– Farm GDP	-2.4	-4.0	-5.8
Nominal GDP	1.0	1.2	5.5
Real gross domestic income	0.4	0.9	3.7
Real net national disposable income per capita	-0.2	0.8	2.1
Terms of trade	0.8	3.2	6.1

Real GDP and domestic demand



HIGHLIGHTS

- **Household consumption** rose by 0.4% in Q4 (following a similar sized outcome in Q3), which saw growth over the year tracking at a modest 2.0%. Growth was supported by spending on health and clothing & footwear. Declines in household goods (related to housing turnover) and car sales weighed on consumption in the quarter. Overall, the outcome for consumption was broadly in line with our business survey that suggests significant weakness in the retail sector as well as our consumption modelling based on internal data. Over the year, services consumption appears to have held up better than household spending on goods – though both remain weak.
- **Underlying business investment increased modestly** (0.7% q/q) after falling in the two previous quarters. This reflected increases in underlying machinery and equipment investment (0.2% q/q), non-dwelling construction (0.6% q/q) and intellectual property products (1.8% q/q). The gain in business investment was despite a continuing drag from mining investment which declined 5.5% q/q; in contrast, non-mining investment has risen in each of the last two quarters (up 2.2% q/q in Q4). This is consistent with our expectation for healthy growth in business investment, particularly as the mining headwind is likely to fade this year with the end to the construction phase of the LNG mega projects and with mining exploration investment rising.
- **Dwelling investment** fell 3.4% in the quarter driven by investment in new dwellings (-3.6%) and a fall in alterations & additions (-3.1%). This follows the surprise increase in alterations & additions in the previous quarter which saw a small increase in dwelling investment overall. Today's outcome is in line with our expectation for a relatively sharp decline in dwelling investment over the next 2 years. Arguably the decline has started earlier than the RBA expected. The housing market has continued to cool with prices continuing to decline and activity data, such as building approvals, showing significant weakness.
- **Government demand** continues to underpin growth. Underlying public demand grew by 1.4% q/q, contributing 0.3ppts to GDP growth. Growth in the quarter was entirely driven by government consumption – up 1.8% q/q – reflecting spending on disability, health and aged care services (NDIS). In contrast, underlying public investment declined slightly (-0.4% q/q) although this follows robust growth in the previous quarter. Over the last year it has increased 8.6%; given the large pipeline of planned infrastructure this trend should continue.
- **Net exports detracted 0.2ppts q/q** from GDP growth. Import volumes grew only slightly (0.1% q/q) as increases in consumption and intermediate imports were largely offset by lower non-monetary gold, capital goods and services imports. Export volumes declined 0.7%q/q reflecting a large fall in non-monetary gold exports and another decline in rural exports likely due to east-coast drought effects. Manufacturing and resource export volumes increased, including another large rise in other mineral fuels (LNG) exports (now up more than 30% over the last year).
- **Compensation of employees rose by 0.9% in the quarter.** This was slightly slower than previous quarters likely due to slower employment growth and only modest wage growth in the quarter. Average COE per employee rose 0.5% - a slight increase on the previous quarters pace of growth but still modest. Overall, the pace of growth in COE per employee and COE per hour has risen in year-ended terms, suggesting some positive outcomes for income growth, even if still modest.
- **Nominal unit labour costs growth has increased over the second half of 2018.** While the quarterly outcome edged slightly lower, year-ended rates rose in the second half of 2018 have risen. However at 1.6% growth in domestic labour costs remains weak, implying little pick-up in inflationary pressure more broadly.
- **By industry,** on a quarterly basis, agriculture forestry and fishing, manufacturing, construction, professional services each detracted 0.1pp from GDP growth, while the biggest contributor to growth was healthcare and social assistance (+0.2pp contribution to growth). These industry breakdowns tell a familiar story: agriculture, forestry and fishing continues to be dented by the drought (now down 5.9% on a year-ended basis), while the slowdown in property, and a number of large mining projects approaching completion, is affecting construction. Weakness in these sectors is flowing through to manufacturing (food manufacturing and demand for building materials). Growth sectors show the impact of government spending, with healthcare and social assistance up 8.1% on a year ended basis as the NDIS rollout continues. Mining continues to perform well, driven by the LNG industry.
- **By state**, the ACT saw the strongest growth in state final demand (+1.4% on a quarterly basis), followed by Queensland (+0.9%), South Australia (+0.8%), Victoria and Tasmania (each +0.6%), while New South Wales, Western Australia and The Northern Territory recorded falls (down 0.1%, 0.3% and 2.5% respectively). A common feature of the strongest performing states was increased government spending – either government consumption, government capital spending or a combination of both. Western Australia and the Northern Territory were dragged down by lower private non-dwelling construction as the LNG terminal construction boom comes to an end. New South Wales saw a fall in investment, including in dwelling construction, as well as very weak household consumption growth.
- **Farm GDP** continues to be weak, down 4.0%q/q due to severe drought in eastern Australia – particularly New South Wales and Queensland. Western Australia produced a very strong winter crop which likely cushioned the impact. Conditions across most of the country are still extremely dry and, without rain, further downside in 2019 is possible.

ADDITIONAL CHARTS AND TABLES:

GDP (E) by component

GDP Expenditure Components	q/q % ch Sep-18	q/q % ch Dec-18	y/y % ch Dec-18	Contribution to q/q % ch Dec-18
Household Consumption	0.3	0.4	2.0	0.2
Dwelling Investment	0.5	-3.4	2.5	-0.2
Underlying Business Investment^	-1.3	0.7	-0.2	0.1
Machinery & equipment	2.7	0.2	3.9	0.0
Non-dwelling construction	-5.3	0.6	-5.8	0.0
New building	-2.7	0.1	-4.6	0.0
New engineering	-7.4	1.0	-6.8	0.0
Underlying Public Final Demand	2.5	1.4	6.2	0.3
Domestic Demand	**0.5**	**0.3**	**2.5**	**0.3**
Stocks (a)	-0.3	0.2	0.0	0.2
GNE	**0.3**	**0.5**	**2.5**	**0.5**
Net exports (a)	**0.2**	**-0.2**	**0.7**	**-0.2**
Exports	-0.1	-0.7	4.7	-0.1
Imports	-1.0	0.1	1.5	0.0
GDP	**0.3**	**0.2**	**2.3**	**0.2**

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

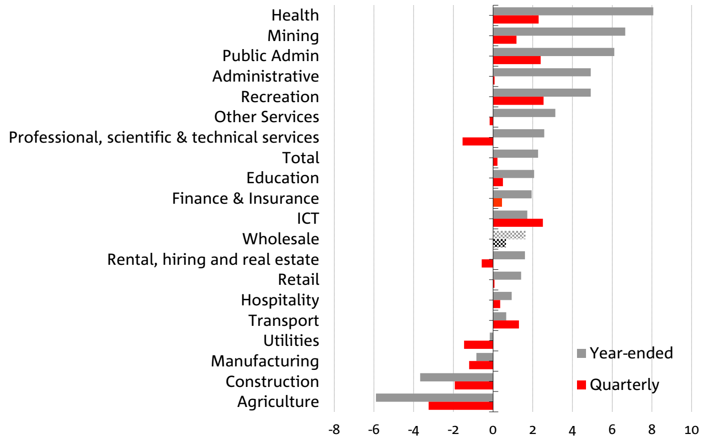
INCOME MEASURES

Income measures	q/q % ch Sep-18	q/q % ch Dec-18	y/y % ch Dec-18
Real GDI	0.4	0.9	3.7
Real net disposable income per capita	-0.2	0.8	2.1
Compensation of employees	1.3	0.9	4.3
Average compensation of employees (average earnings)	0.5	0.5	1.7
Corporate GOS	1.5	3.0	9.6
Non-financial corporations	1.3	3.5	10.5
Financial corpoarations	1.9	1.4	6.8
General government GOS	0.7	0.8	3.3
Productivity & unit labour cost			
GDP per hour worked	-0.1	-0.2	-0.2
GVA per hour worked mkt sector	-0.1	-0.2	-0.2
Non-farm nominal unit labour cost	1.3	0.8	1.3
Non-farm real unit labour cost	0.1	-0.1	-2.1

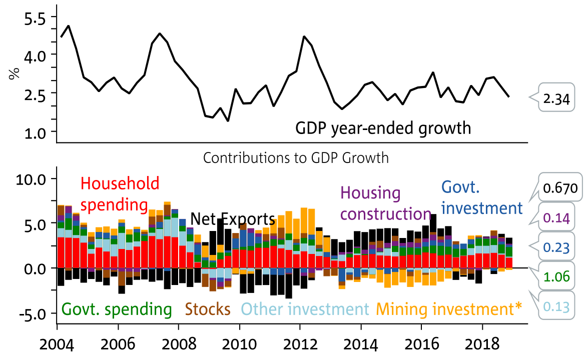
State final demand

State/ Territory	Q/Q Sep-18	Q/Q Dec-18	Y/Y Dec-18
VIC	0.6	0.6	5.2
TAS	0.5	0.6	5.1
ACT	2.2	1.4	5.0
NSW	1.4	-0.1	2.6
SA	0.2	0.8	2.4
QLD	-0.2	0.9	2.1
WA	0.1	-0.3	-1.6
NT	-8.4	-2.5	-15.0

Industry GVA Growth



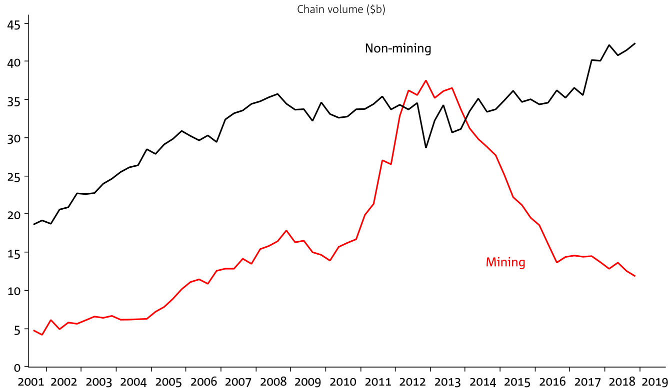
Contributions to GDP Growth



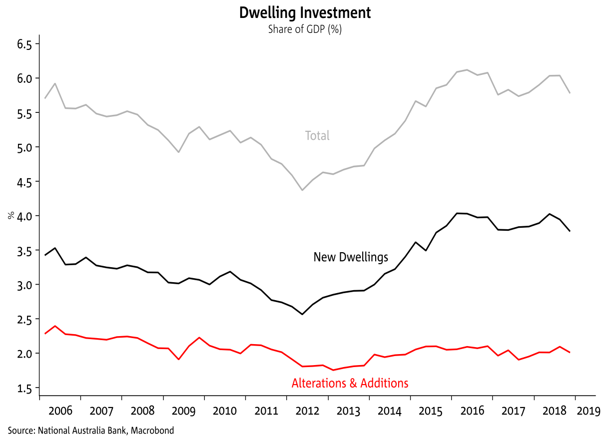
* New Engineeering Construction
Source: National Australia Bank, ABS

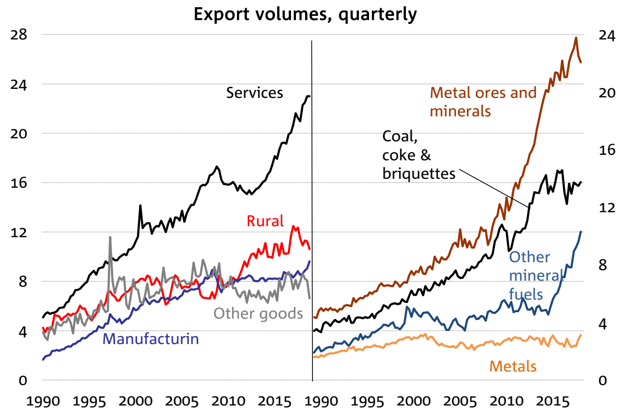
Business Investment

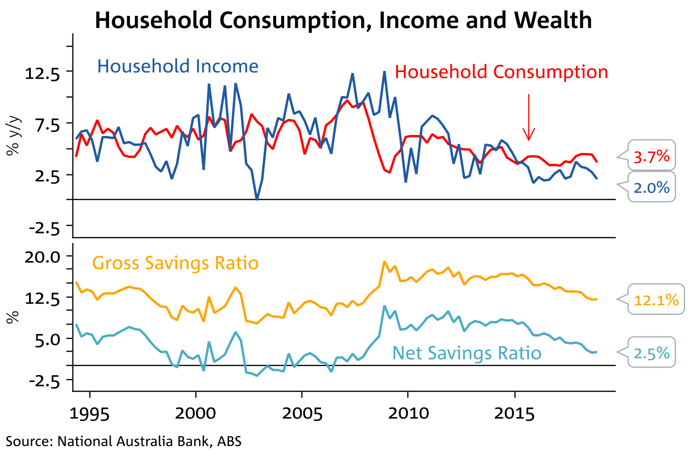
Chain volume ($b)

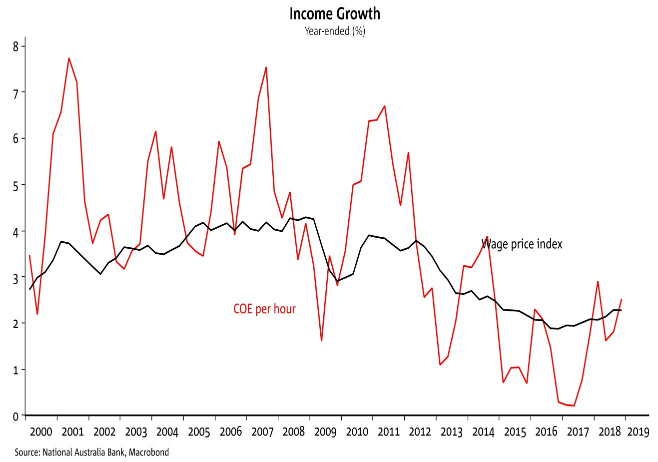


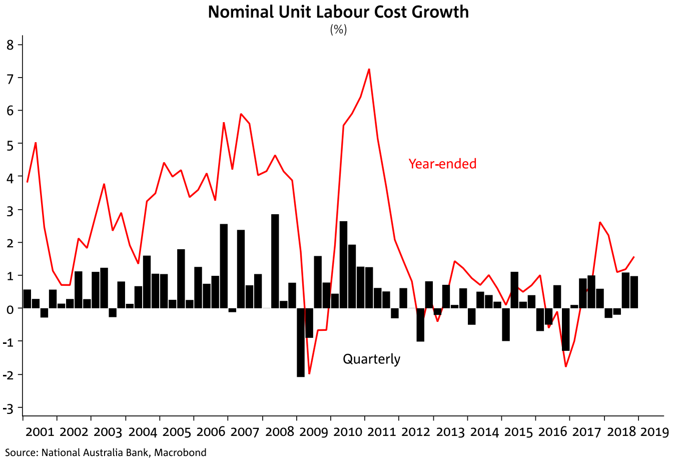
Source: National Australia Bank, Macrobond

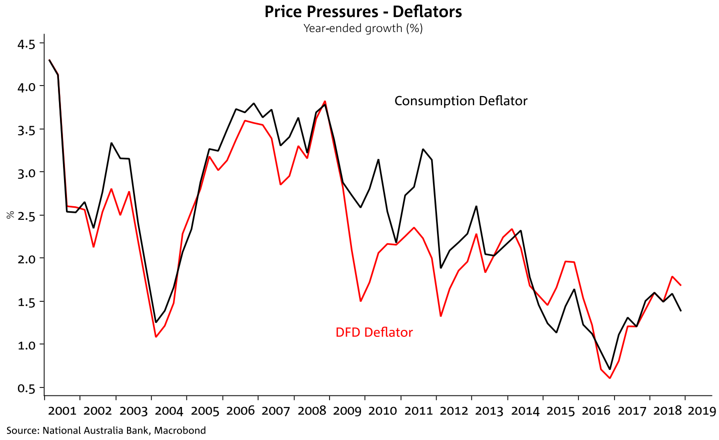












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