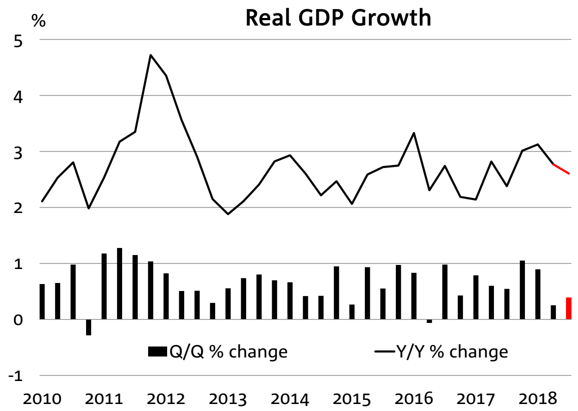
AUSTRALIAN GDP PREVIEW

Q4 2018 – household sector weakness to persist

NAB Group Economics 1 March 2019

<u>Bottom line</u>: **We expect Q4 GDP to confirm a softening trend, recording another soft print of 0.4% in the quarter to be 2.6% higher over the year. This release will also provide an important update on household sector dynamics around dwelling investment and consumption – two factors we see constraining growth over the next year or so and look to have done so in Q4. With growth projected to slow, amidst remaining spare capacity in the economy, we see rates on hold for an extended period. While this release is unlikely to trigger an immediate shift on rates, it will provide another marker on the growth front which may lead to an eventual reassessment of the future growth path by the RBA, particularly if weaker growth flows through to labour market conditions. Looking forward, we see the economy supported by public sector spending, a rise in LNG exports and healthy growth in business investment. Offsetting these supports, consumption is likely to only grow modestly and dwelling investment is expected to fall.**

- **Next Wednesday's GDP figures are forecast to show the economy growing at a similar pace to Q3, printing at 0.4% q/q and seeing a year-average result of 2.9% for 2018.** In doing so, the data would confirm the economy slowed significantly in the H2 2018. Retail sales data and NAB's modelling of household spending on services suggests that consumption growth will lift slightly to 0.5% - an improvement from Q3, but still a weak outcome. Official data on residential construction suggest dwelling investment is to fall by around 3%, in line with NAB's expectation of a decline of around 18% over the next two years, a view supported by the ongoing decline in building approvals. For our Q4 forecasts we see some downside risk to consumption and upside risk to public demand roughly offsetting.
- **Looking forward**, we expect growth over the next two years to be driven by public infrastructure investment, business investment and further growth in net exports, with consumption to only see modest growth and dwelling investment to fall relatively sharply. For now, we do not forecast a 'wealth effect' weighing on spending, despite our forecast for further declines in house prices, but rather see a larger effect from housing through a significant fall in the construction cycle.
- **The key uncertainty around our forecasts relates to consumption and business investment.** While consumption is playing out broadly as we expected based on weaker income growth, there remains some risk from further declines in house prices leading to a 'wealth effect'. On the business side, the NAB business survey suggests some loss in momentum over the past 6 months and a recent dip in capacity utilisation. This presents a downside risk to our strong outlook for investment.
- **With wage and price data suggesting inflationary pressure remained weak in Q4**, we expect national accounts measures of prices and income growth will also remain modest. Nonetheless, this release will provide an update on household income growth, the savings rate and the pattern of household expenditure. Unit labour costs look to have remained weak - consistent with ongoing weakness in market sector inflation.
- **Monetary policy implications**: While the RBA remains focused on labour market for now, weaker GDP data will provide little comfort that activity will support ongoing strong employment growth. Also, these data will provide a signal as to the likely speed and magnitude of the dwelling investment downturn as well as the pattern of household consumption – both downside risks to the RBA's forecasts for growth. The national accounts will likely confirm that income growth has remained low and also pose further questions around whether the labour market as a lagging indicator is yet to respond to the slowing in growth from mid last year. We think that the RBA will wait for further evidence of a slowing labour market before shifting to an easing bias as leading indicators of the labour market are still favourable. Though with growth slowing we think the risk is building to the downside as the last effects of strong growth early in 2018 fade.



Real GDP Forecasts

	Q/Q		Y/Y	Contribution to Q/Q
	Sep-18	Dec-18	Dec-18	Dec-18
Household Consumption	0.3	0.5	2.0	0.2
Dwelling Investment	1.0	-3.0	3.6	-0.2
Underlying Business Investment	-2.5	1.2	-1.4	0.1
Underlying Public Final Demand	1.5	0.8	4.3	0.2
Domestic Final Demand	**0.3**	**0.4**	**2.2**	**0.4**
Stocks (a)	-0.3	0.1	0.1	0.1
GNE	**0.0**	**0.5**	**2.2**	**n.a.**
Net exports (a)	**0.3**	**-0.3**	**0.7**	**-0.3**
Exports	0.1	-1.0	4.7	-0.2
Imports	-1.5	0.6	1.5	-0.1
Real GDP	**0.3**	**0.4**	**2.6**	**n.a.**

(a) Contribution to GDP growth

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