AUSTRALIAN ECONOMIC UPDATE

GDP Q1 2019 – household weakness persists

5 June 2019

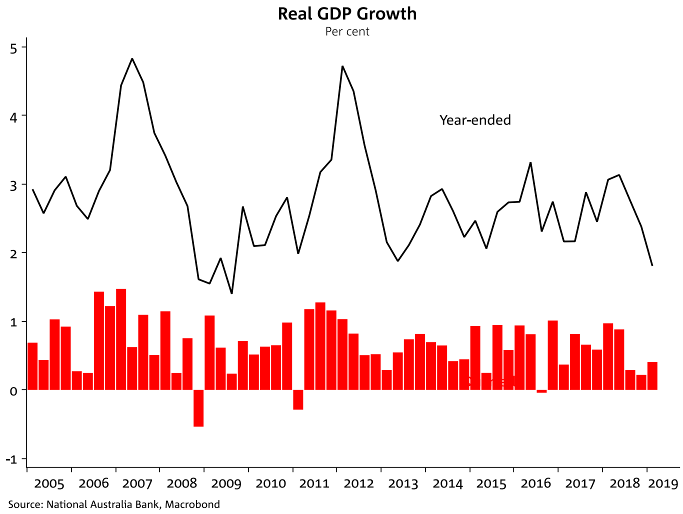
<u>Bottom line:</u> The national accounts recorded a 3rd successive print of below trend GDP growth. Output rose 0.4% q/q% to be 1.8% higher over the year. While growth was slightly stronger in quarterly terms, this outcome confirms the softening in growth over H2 2018 has persisted into 2019. Continued subdued economic activity will be a headwind to growth in labour demand, which is needed to prevent a rise in the unemployment rate. With ongoing spare capacity in the labour market and economy more broadly it is likely that domestic inflation pressures will remain weak. Today's release will have little impact on the near-term path for monetary policy, with the RBA remaining focused on developments in the labour market (and will not cause a large revision to its current set of forecasts). That said, the data suggests some risk of a further easing in the cash rate to below 1.0% should growth remain weak and the private sector continue to lag. We still expect a further easing in the cash rate to 1.0% in August with the risk of further easing later in the year should downside risks eventuate.

In the quarter, the softness was driven by a 2.5% fall in dwelling investment and a further slowing in consumption growth. Offsetting the weakness in the household sector was another solid contribution from public demand and a rebound in net exports. Both the income and production measures of GDP were stronger than the expenditure measure, reversing some of the weakness over the past year. GDP (P) was supported largely by the services sectors, with construction showing some weakness alongside the downturn in housing and further completions of mining projects. On the income side, growth in compensation of employees provided support in the quarter (due to strong employment growth), as did corporate income (driven by strong profits in the mining sector).

Looking forward, we expect year-average growth of 1.7% in 2019, before rising to 2¼% in each of the next two years – around ¼ to ½% below potential. We expect the downturn in the housing construction cycle to continue, with dwelling investment falling by around 20% from peak-to-trough, and household consumption to grow only modestly. Offsetting the household weakness, we see further support from exports in the near-term, and ongoing strength in public sector spending over the next two years. We also expect a sizeable contribution from private business investment. Overall, with below trend growth we see a slight deterioration in the labour market and ongoing spare capacity in the economy. This will result in a very gradual return to the inflation target – even with another rate cut factored in. Therefore, should weak GDP growth persist or a more significant global downturn eventuate, we see the risk of further rate cuts and the potential for additional stimulus measures (fiscal or otherwise).

Key figures

Key aggregates	q/q % ch		y/y % ch
	Dec-18	Mar-19	Mar-19
GDP (A)	0.2	0.4	1.8
GDP (E)	0.4	0.2	2.1
GDP (I)	0.1	0.5	1.5
GDP (P)	0.2	0.5	1.8
– Non-Farm GDP	0.3	0.4	2.0
– Farm GDP	-5.2	-0.2	-6.8
Nominal GDP	1.2	1.4	4.9
Real gross domestic income	0.9	1.1	3.2
Real net national disposable income per capita	1.0	0.5	1.3
Terms of trade	3.0	3.1	6.1



HIGHLIGHTS

- **Household consumption** growth slowed further in Q4 rising by 0.3% in Q4 to be 1.8% higher over the year. The recent trends in consumer behaviour persisted in the quarter with spending on discretionary items a drag on growth. Spending on finance & insurance services, health, utilities as well as food drove the increase in Q1, while recreation & culture, hotels, cafes & restaurants and clothing & footwear were all lower. This outcome was slightly weaker than we expected but in line with official retail sales data as well as our own internal modelling of transactions data which suggests at present spending on goods remains weak, while services consumption has held up slightly better.
- **Underlying business investment** increased modestly (0.6% q/q). This is the second consecutive quarterly increase although it remains lower than a year ago (-1.3% y/y). The increase was driven by strong growth in new building construction (4.5% q/q) and continuing growth in intellectual property products (1.0% q/q) which more than offset falls in underlying machinery & equipment and engineering construction. The fall in engineering construction likely reflects the ongoing drag from the mining sector; the ABS estimates that mining investment declined 1.8% in the quarter, although this was the smallest fall since late 2017 consistent with our view that the mining headwind will fade this year. The increase in non-mining investment (2.0% q/q) is also consistent with our expectation that business investment will support growth, although the deterioration in business conditions is a concern.
- **Dwelling investment** fell 2.5% in the quarter driven by a fall in investment in new dwellings (-1.8%) and a fall in alterations & additions (-3.8%). Over the year dwelling investment has fallen 3.4% and is down 5.3% over the past 6 months alone. The decline was driven by further falls in NSW and VIC, though WA, SA and Tas also saw declines; QLD was up over 4%.
- **Government demand** remained strong. Underlying public demand grew by 1.1% q/q, contributing 0.3ppts to GDP growth. This mainly reflected further strong growth in Federal non-defence consumption (2.4% q/q) due to spending on disability (NDIS) and health services, as well as a turnaround in underlying public investment (2.1% q/q) after last quarter's small decline. Over the last year underlying public investment has increased by 8.7% consistent with the large public infrastructure pipeline.
- **Net exports** added 0.2ppts q/q to GDP growth, a reversal of the Q4 2018 outcome. Import volumes fell (-0.1 q/q) despite strong growth in consumption and capital goods imports, as intermediate goods imports and overseas travel declined. Export volumes rose 1.0% q/q, as the large fall in non-monetary gold exports in Q4 2018 was largely reversed and rural and services exports increased. Resource exports fell, including another large fall in metal ores & minerals (possibly due to supply disruptions) while other mineral fuels (LNG) eased but are still up 10% y/y.
- **Compensation of employees rose by 1.2% in the quarter.** This was a slight pickup in growth from the previous quarter, and reflects a strong rise in employment with average COE per employee growth edging down to 0.4%. COE per hour declined sharply in year-ended terms in the quarter. Overall, household income growth remains modest.
- **Nominal unit labour costs growth moderated in the quarter,** but after two previous strong outcomes is tracking at just over 2.0% in year-ended terms. The increase in the pace of unit labour costs growth over the past year suggests that some inflation pressure is building, but still remains weak.
- **By industry,** on a quarterly basis, the services industries contributed most significantly to growth with finance & insurance services, professional, scientific and technical services, administrative & support services as well as healthcare & social assistance all contributing 0.1ppt to growth. The construction sector detracted 0.1ppt on the back of weakness in the housing sector as well as ongoing declines in heavy and civil constructions on the back of completions of both mining and renewable energy projects.
- **By state**, the Tasmania saw the strongest growth in state final demand (+0.7% q/q), followed by Queensland (+0.5%), NSW (+0.4%). Growth was only very modest in Victoria (0.2% q/q) while state final demand declined in SA, the ACT (both -0.2% q/q), WA (-0.3%) and, in particular, the NT (-2.3% q/q). The primary driver of demand in the states that recorded growth was public demand although private investment was also a support in Tasmania and Queensland. WA and the NT have been dragged down by lower mining investment, although for the first time since mid-2017 non-dwelling construction increased in WA (but only slightly and was more than offset by a fall in equipment investment).
- **Farm GDP** again declined, but by a much smaller -0.2% q/q after a very weak Q4 2018 result (-5.2% q/q). Over the year to Q1, farm GDP has declined 6.8% y/y due to severe drought in eastern Australia – particularly New South Wales and Queensland. The traditional start to the winter planting has now passed, and while the break has come in some areas, others remain very dry. if conditions continue on this trajectory, an "average" season in eastern Australia could be difficult, although conditions in WA are closer to neutral.

SUMMARY CHARTS AND TABLES:

GDP (E) by component

GDP Expenditure Components	q/q % ch		y/y % ch	Contribution to q/q % ch
	Dec-18	Mar-19	Mar-19	Mar-19
Household Consumption	0.4	0.3	1.8	0.1
Dwelling Investment	-2.9	-2.5	-3.1	-0.1
Underlying Business Investment^	0.3	0.6	-1.3	0.1
Machinery & equipment	-0.6	-0.3	0.4	0.0
Non-dwelling construction	0.5	1.3	-4.8	0.1
New building	-0.5	4.5	0.6	0.1
New engineering	1.4	-1.5	-9.3	0.0
Underlying Public Final Demand	1.6	1.1	5.7	0.3
Domestic Demand	**0.4**	**0.1**	**1.6**	**0.1**
Stocks (a)	0.2	-0.1	0.0	-0.1
GNE	**0.6**	**0.0**	**1.6**	**0.0**
Net exports (a)	**-0.2**	**0.2**	**0.5**	**0.2**
Exports	-0.5	1.0	1.7	0.2
Imports	0.4	-0.1	-0.5	0.0
GDP	**0.2**	**0.4**	**1.8**	**0.4**

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

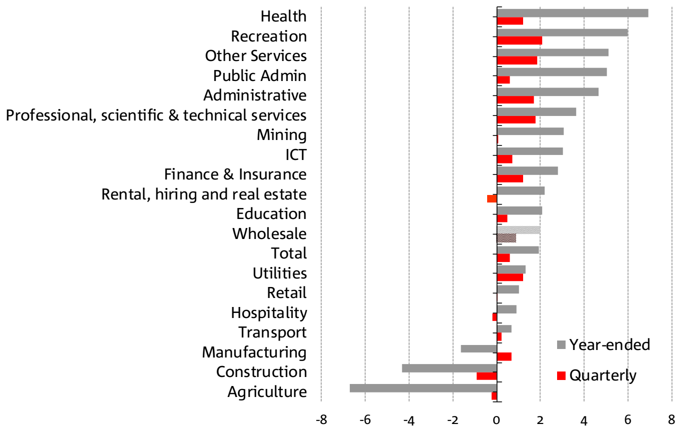
INCOME MEASURES

Income measures	q/q % ch		y/y % ch
	Dec-18	Mar-19	Mar-19
Real GDI	0.9	1.1	3.2
Real net disposable income per capita	1.0	0.5	1.3
Compensation of employees	0.9	1.2	4.3
Average compensation of employees (average earnings)	0.5	0.4	1.4
Corporate GOS	2.9	3.2	9.5
Non-financial corporations	3.3	3.6	10.2
Financial corpoarations	1.6	1.9	7.2
General government GOS	0.8	0.8	3.2
Productivity & unit labour cost			
GDP per hour worked	-0.3	-0.5	-1.0
GVA per hour worked mkt sector	-0.3	-0.4	-0.9
Non-farm nominal unit labour cost	0.9	0.0	1.6
Non-farm real unit labour cost	-0.2	-1.1	-1.7

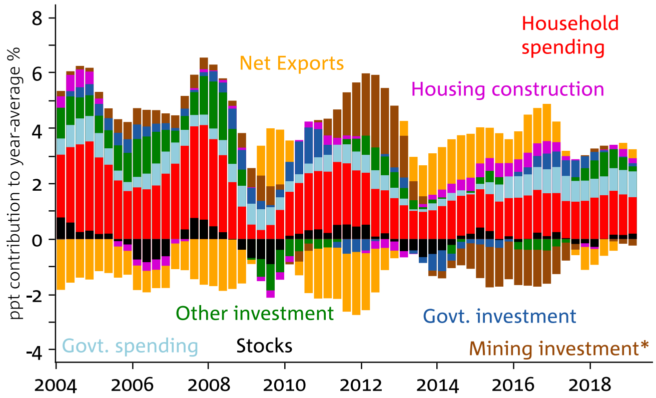
State final demand

State/ Territory	Q/Q Dec-18	Q/Q Mar-19	Y/Y Mar-19
TAS	1.9	0.7	5.0
ACT	1.0	-0.2	4.2
VIC	0.9	0.2	3.0
NSW	-0.1	0.4	2.1
SA	0.9	-0.2	1.8
QLD	0.8	0.5	1.4
WA	-0.6	-0.3	-1.4
NT	-2.2	-2.3	-14.8

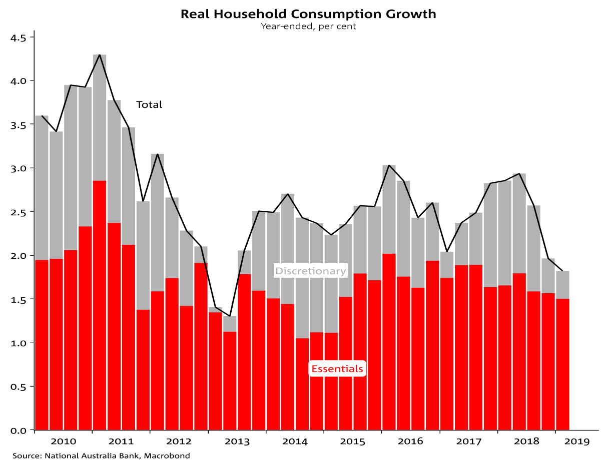
Industry GVA Growth



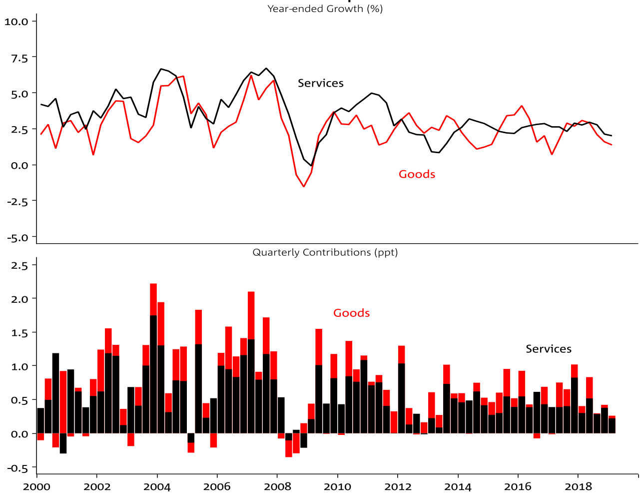
Contributions to GDP Growth



* New Engineering Construction
Source: National Australia Bank, ABS

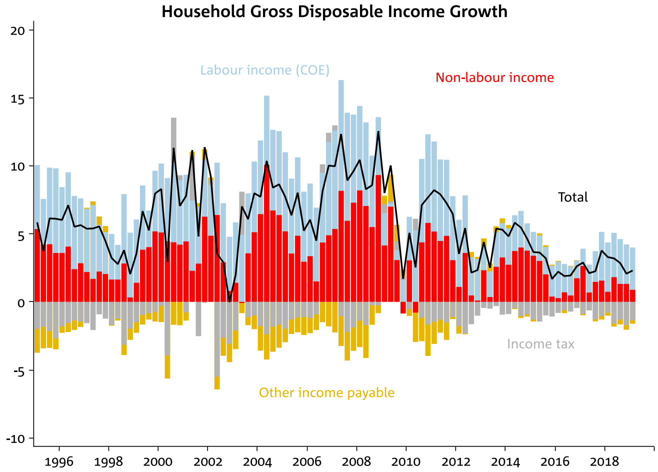


Household Consumption Growth



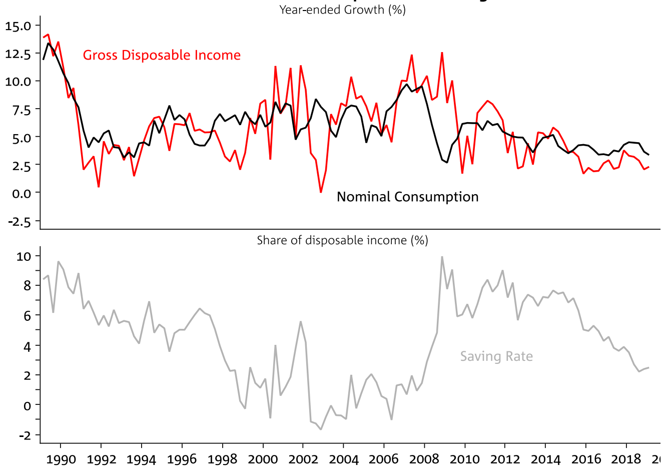
Source: National Australia Bank, Macrobond

Household Gross Disposable Income Growth



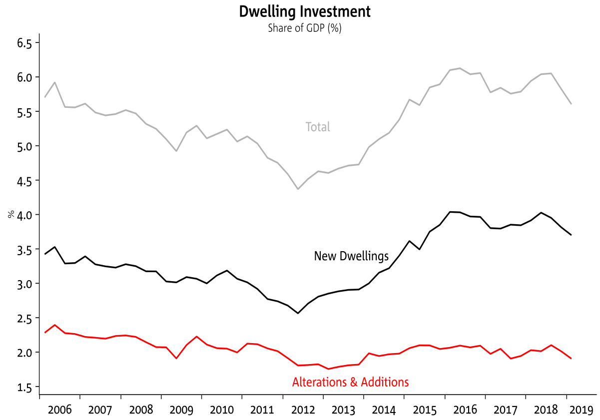
Source: National Australia Bank, Macrobond

Household Consumption and Saving



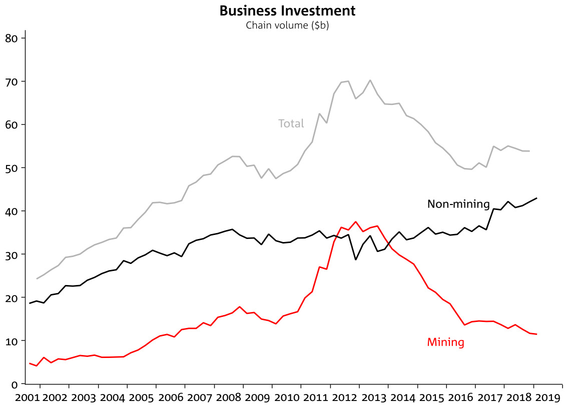
Source: National Australia Bank, Macrobond

Dwelling Investment



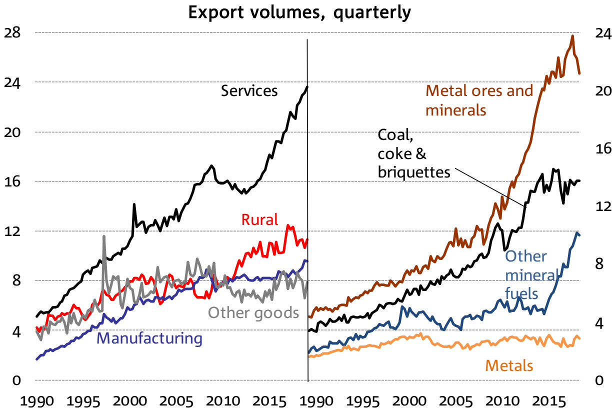
Source: National Australia Bank, Macrobond

Business Investment

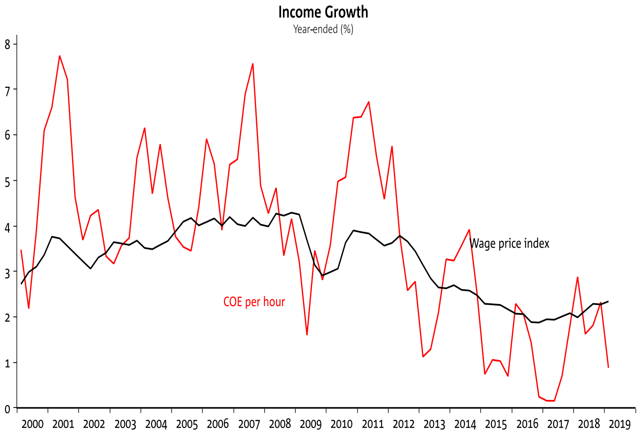


Source: National Australia Bank, Macrobond

Export volumes, quarterly

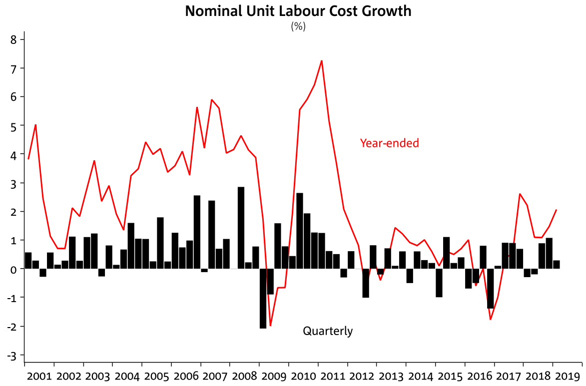


Income Growth



Source: National Australia Bank, Macrobond

Nominal Unit Labour Cost Growth



Source: National Australia Bank, Macrobond

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