# AUSTRALIAN ECONOMIC UPDATE

## GDP Q2 2019 – Private sector stalls

4 September 2019

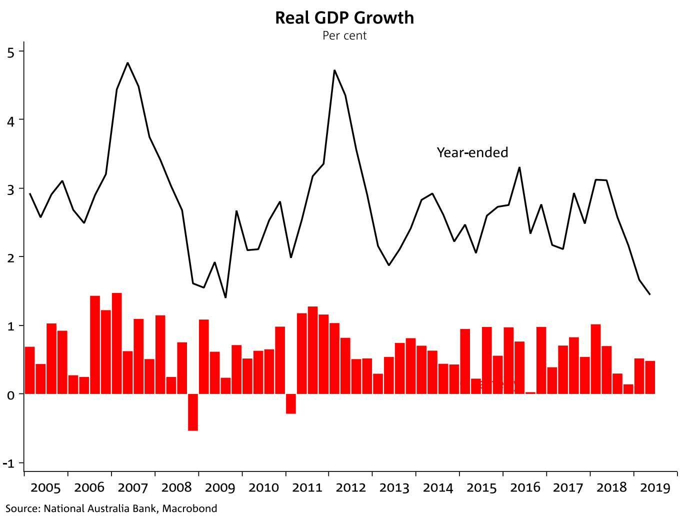
**<u>Bottom line:</u> Headline GDP growth posted a modest result in Q2 and has slowed considerably since mid 2018.** Output rose 0.5% q/q% to be 1.4% higher over the year. The dynamic of a weak private sector, offset by strength in public spending and trade continues to play out. Overall below-trend growth however makes it likely employment growth will slow and the unemployment rate will edge higher rather than fall as the RBA projects. The unemployment rate is already well above the RBA's 4.5% estimate of the NAIRU, keeping inflation below the RBA's 2-3% target range. Weak growth, higher unemployment and low inflation point to further rate cuts. The risk of further deterioration in the labour market adds to the possibility that the RBA cuts sooner than NAB's forecast of a November move, particularly given a more uncertain global backdrop. However, it seems that the RBA may again downplay weak growth given the data pre-date both the June/July rate cuts and income tax cuts, even though retail sales failed to show an initial boost from the tax refunds in July. That said, this weak outcome will again see the RBA mark down the starting point for its forecasts for growth at the November Statement on Monetary Policy, such that it will take longer to reduce unemployment with a slower return to target inflation. This ongoing challenge underscores the need for further monetary easing, with a move to some form of unconventional policy on the cards next year, particularly with the government seemingly reluctant to abandon its surplus objective to provide fiscal support.

**In Q2**, household sector weakness was again driven by a sharp fall in dwelling construction, while consumption growth remained weak. In addition, private business investment declined further. Public consumption and trade made solid contributions which were able to offset this weakness. Again, both the income and production measures of GDP were stronger than the expenditure measure. GDP (P) was supported largely by mining and the services sector. On the income side, growth in compensation of employees (both from an increase in employment and average compensation) and company profits – again largely supported by mining and sky-high iron ore prices - led the gains.

**Looking forward,** we expect year-average growth of around 1½% in 2019, before rising to 2¼% in each of the next two years. This represents an extended period of slightly below-trend growth led by private-sector weakness, cementing below-target inflation given the labour market is likely to weaken. We expect the dynamic of a weak household sector to remain in place, with dwelling investment continuing to decline at a rapid rate and consumption growth remaining weak on the back of slow income growth. Exports are expected to plateau in the near term, with LNG and iron ore at capacity. The key offset to the weakness in the household sector will be ongoing strength in spending by the public sector, with both the infrastructure pipeline elevated and the ongoing roll-out of the NDIS. Infrastructure spending is expected to spill over to business investment, while the long unwind in mining investment has come to an end, with investment in the sector likely to pick up modestly. There are risks to the non-mining investment outlook given the deterioration in business conditions, falling capacity utilisation, a pull-back in capex plans in the NAB Business Survey and the uncertain international environment.

**Key figures**

| Key aggregates | q/q % ch | | y/y % ch |
|---|---|---|---|
| | Mar-19 | Jun-19 | Jun-19 |
| GDP (A) | 0.5 | 0.5 | 1.4 |
| GDP (E) | 0.5 | 0.4 | 1.5 |
| GDP (I) | 0.5 | 0.6 | 1.4 |
| GDP (P) | 0.6 | 0.5 | 1.5 |
| – Non-Farm GDP | 0.5 | 0.5 | 1.7 |
| – Farm GDP | 0.5 | -2.4 | -8.3 |
| Nominal GDP | 1.6 | 1.2 | 5.4 |
| Real gross domestic income | 1.2 | 0.8 | 3.5 |
| Real net national disposable income per capita | 0.9 | 1.0 | 2.7 |
| Terms of trade | 3.1 | 1.5 | 8.9 |



# HIGHLIGHTS

- **Household consumption** growth printed 0.4% q/q in Q2 – a very slight improvement on Q1. However, growth over the year declined to 1.4%. The drivers of consumption growth in the quarter were a increases in spending on hotels, cafes & restaurants, recreation and culture and financial & insurance services. Vehicles and utilities were weaker. Over the year, spending on 'essentials' has continued to outpace that of 'discretionary' items. Relatedly, spending on services has continued to outpace goods consumption.
- **Underlying business investment** declined by 0.4% q/q and has essentially tracked sideways over the last three quarters. The fall was due to a large fall in underlying non-dwelling construction (-4.8% q/q) with similar declines in new building and engineering construction. There was strong growth in underlying machinery and equipment investment (3.2% q/q) – after two negative quarters – while growth in intellectual property products remains solid. For the first time in a year mining sector business investment grew consistent with our view that the mining investment will stabilise. However, non-mining investment declined, challenging our expectation that business investment will support growth.
- **Dwelling investment** fell 4.4% in the quarter driven by a sharp fall in investment in new dwellings (-5.9%) and a decline in alterations & additions (-1.4%). Over the year dwelling investment has fallen 9.1%, in line with the weakness in dwelling approvals which suggest the trend is likely to continue. The decline was driven by ongoing falls in NSW and VIC, though WA and QLD (which increased sharply last quarter) also declined.
- **Government demand** remained strong. Underlying public demand grew by 1.4% q/q, contributing 0.3ppts to GDP growth. Government consumption growth was a strong 2.7% q/q. While broad based across all levels of government, federal non-defence consumption (3.0% q/q) again recorded the fastest growth due to spending on disability (NDIS) and aged care services, as well as a turnaround in underlying public investment (2.1% q/q) after last quarter's small decline. Holding back public spending was a decline in underlying investment (-3.9% q/q) – while it remains at a high level – consistent with a large public infrastructure pipeline – compared to the same quarter a year ago it has only increased by 2.2% y/y.
- **Net exports** added 0.6ppts q/q to GDP growth, and 1.2ppts to growth over the year to the June quarter. Consistent with the weakness in domestic demand and de-stocking there was a broad-based fall in import volumes (-1.3 q/q), with consumption, intermediate and capital goods, as well as services, imports all down. In contrast, export volumes increased by 1.4% q/q, driven by a large (3.9% q/q) increase in resource exports (particularly LNG exports). Manufacturing and service exports (mainly for travel) also increased, but there was a renewed decline in rural exports, and last quarter's spike in non-monetary gold exports was partially reversed.
- **Compensation of employees rose by 1.3% in the quarter.** While employment growth was strong, average COE per employee rose a solid 0.9% in the quarter. COE per hour declined sharply in year-ended terms in the quarter. In annual terms, household income growth remains modest.
- **Nominal unit labour costs growth rose in the quarter,** after a flat outcome last quarter. Over the year labour costs have risen 3.5%. Though volatile, this suggests that there has been some pickup in inflationary pressure but our assessment is that overall it remains weak.
- **By industry**, mining contributed the most to quarterly GDP growth (0.3ppts), mainly reflecting the ongoing ramp up in the LNG industry (now close to completion). Public administration and safety, healthcare and social assistance each contributed 0.1% to growth, reflecting the ongoing strength in government consumption. Professional scientific and technical services also grew rapidly in the quarter. Manufacturing, construction and wholesale trade each detracted 0.1ppts from growth, agriculture again fell while retail was flat.
- **By state,** the ACT and WA saw the strongest growth in state final demand (+0.8% q/q). For WA this largely reflected mining investment. Victoria saw 0.5% growth, largely driven by public infrastructure investment and consumption spending, while private sector demand was much weaker. New South Wales and Queensland both saw flat state final demand in the quarter. In New South Wales, state and local public investment was down 8.6%, reflecting a pause in infrastructure construction as major projects were either completed (Sydney Metro) or neared completion (WestConnex stage 1). Queensland saw weaker investment, particularly in dwellings, but had strong public consumption and the strongest household consumption growth nationally. South Australia fell 0.2%, partly on lower energy infrastructure construction, as did the NT (-0.6% q/q) while Tasmania grew 0.3% q/q.
- **Farm GDP** declined further, falling 2.4% q/q. Over the year to Q2 it has declined 8.3% y/y due to an ongoing drought in NSW and Queensland. Grain yields should be reasonable in Western Australia, South Australia and Victoria if spring delivers some rain, although NSW will again struggle badly. Livestock prices have been fairly strong overall (very strong for lamb), but slaughter volumes will fall if seasonal conditions improve. Cotton is set for another disappointing season, while dairy production remains lower despite strong opening prices.

# SUMMARY CHARTS AND TABLES:

## GDP (E) by component

| GDP Expenditure Components | q/q % ch Mar-19 | q/q % ch Jun-19 | y/y % ch Jun-19 | Contribution to q/q % ch Jun-19 |
|---|---|---|---|---|
| Household Consumption | 0.3 | 0.4 | 1.4 | 0.2 |
| Dwelling Investment | -2.2 | -4.4 | -9.1 | -0.2 |
| Underlying Business Investment^ | 0.0 | -0.4 | -1.6 | 0.0 |
| Machinery & equipment | -0.4 | 3.2 | 5.2 | 0.1 |
| Non-dwelling construction | 0.0 | -4.8 | -9.8 | -0.3 |
| New building | 4.6 | -5.0 | -3.8 | -0.1 |
| New engineering | -4.0 | -4.7 | -14.8 | -0.1 |
| Underlying Public Final Demand | 1.1 | 1.4 | 5.5 | 0.3 |
| **Domestic Demand** | **0.1** | **0.3** | **1.0** | **0.3** |
| Stocks (a) | -0.1 | -0.5 | -0.7 | -0.5 |
| **GNE** | **0.0** | **-0.2** | **0.2** | **-0.2** |
| **Net exports (a)** | **0.4** | **0.6** | **1.2** | **0.6** |
| Exports | 1.9 | 1.4 | 2.9 | 0.3 |
| Imports | -0.2 | -1.3 | -2.8 | -0.3 |
| **GDP** | **0.5** | **0.5** | **1.4** | **0.5** |

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

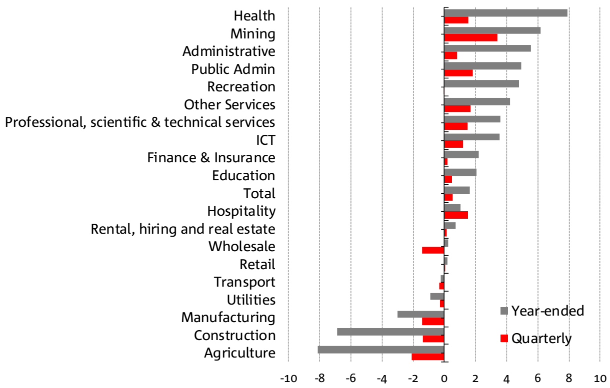
## INCOME MEASURES

| Income measures | q/q % ch Mar-19 | q/q % ch Jun-19 | y/y % ch Jun-19 |
|---|---|---|---|
| Real GDI | 1.2 | 0.8 | 3.5 |
| Real net disposable income per capita | 0.9 | 1.0 | 2.7 |
| Compensation of employees | 1.3 | 1.3 | 5.0 |
| Average compensation of employees (average earnings) | 0.5 | 0.9 | 2.5 |
| Corporate GOS | 3.4 | 2.3 | 11.9 |
| Non-financial corporations | 3.8 | 2.8 | 13.6 |
| Financial corpoarations | 2.0 | 0.7 | 6.6 |
| General government GOS | 0.8 | 0.9 | 3.3 |
| **Productivity & unit labour cost** | | | |
| GDP per hour worked | -0.3 | 0.4 | -0.2 |
| GVA per hour worked mkt sector | -0.3 | 0.0 | -0.6 |
| Non-farm nominal unit labour cost | 0.0 | 1.3 | 3.5 |
| Non-farm real unit labour cost | -1.1 | 0.6 | -0.6 |

## State final demand

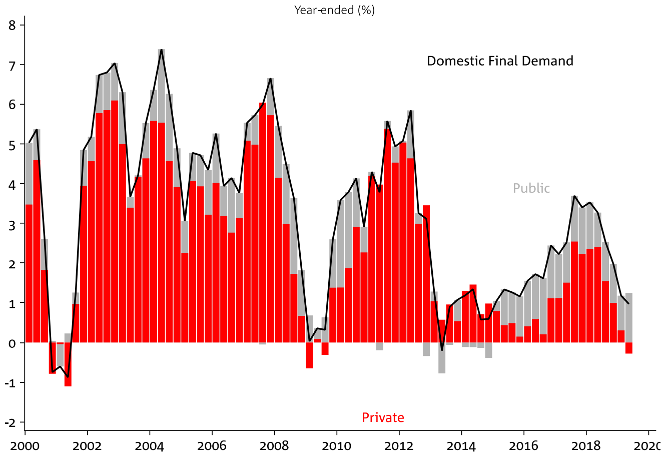
| State/ Territory | Q/Q Mar-19 | Q/Q Jun-19 | Y/Y Jun-19 |
|---|---|---|---|
| TAS | 1.1 | 0.3 | 3.1 |
| ACT | -0.2 | 0.8 | 2.7 |
| VIC | 0.1 | 0.5 | 1.9 |
| NSW | 0.4 | 0.0 | 1.3 |
| SA | -0.2 | -0.2 | 0.4 |
| QLD | 0.4 | 0.0 | 0.4 |
| WA | -0.6 | 0.8 | -0.1 |
| NT | -2.1 | -0.6 | -13.2 |

## Industry GVA Growth




### Domestic Final Demand Growth

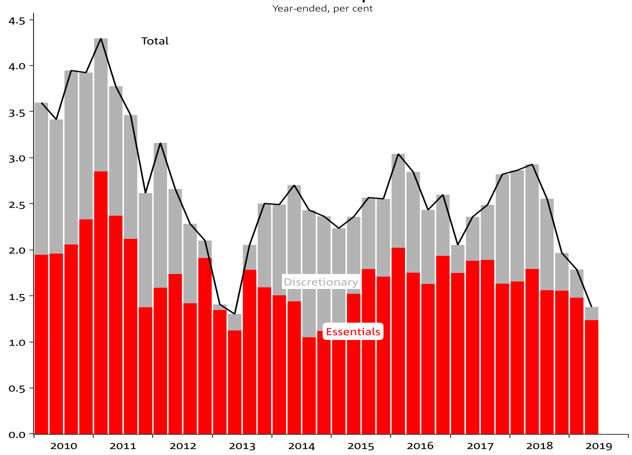
Year-ended (%)



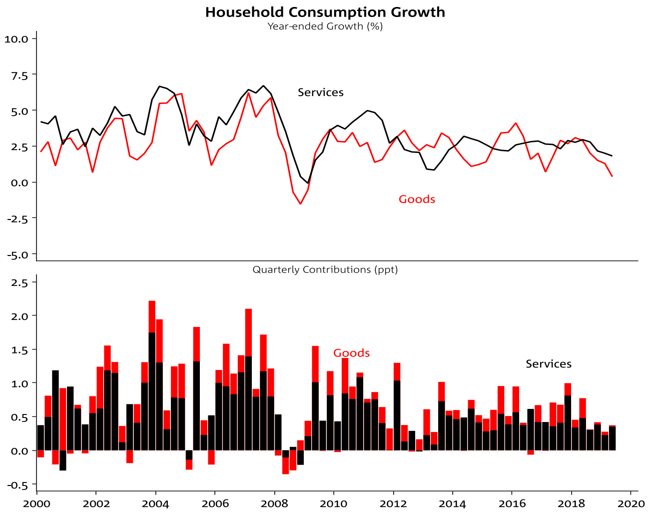

Source: National Australia Bank, Macrobond

### Real Household Consumption Growth

Year-ended, per cent




Source: National Australia Bank, Macrobond

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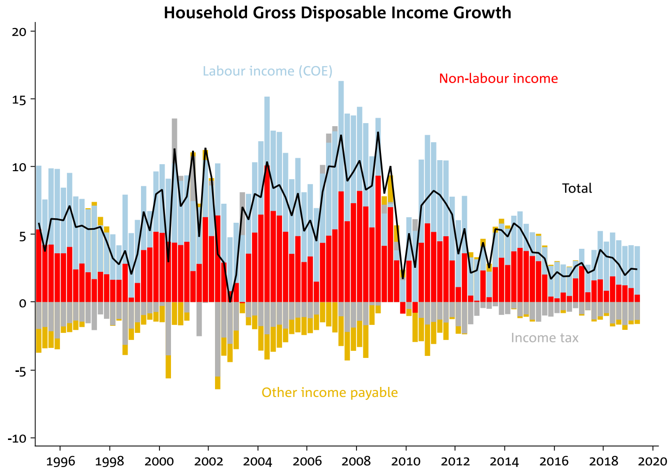


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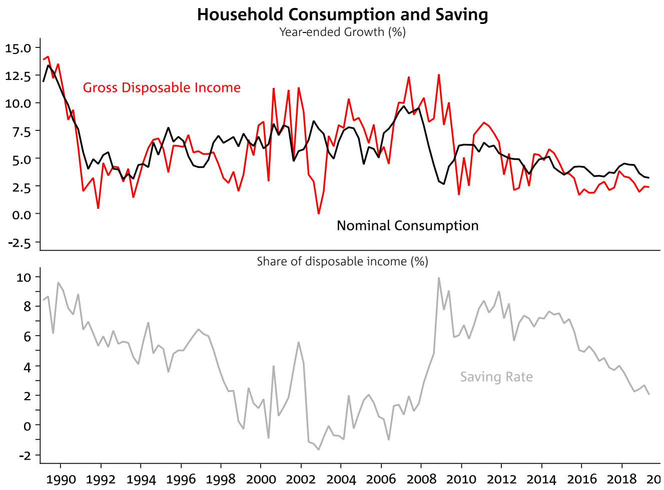


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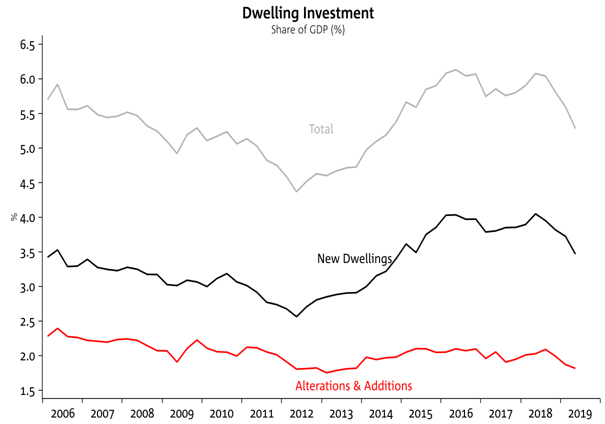


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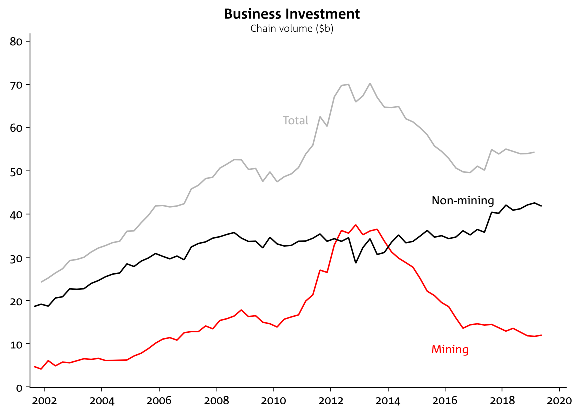


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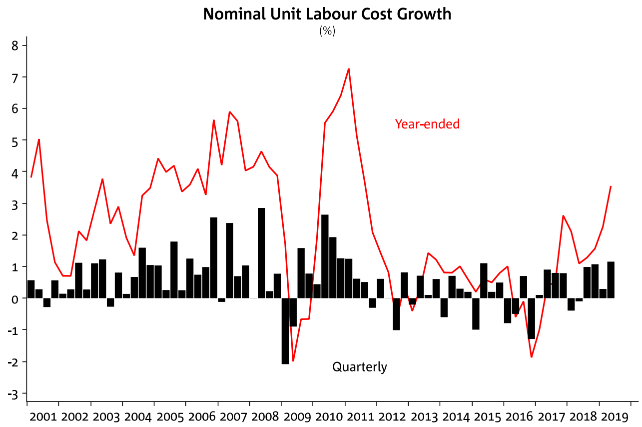


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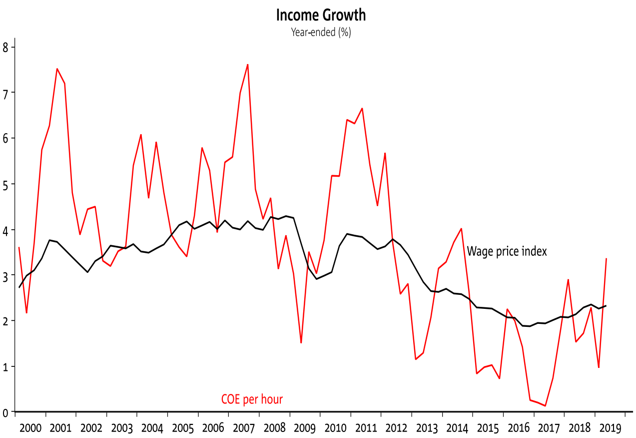


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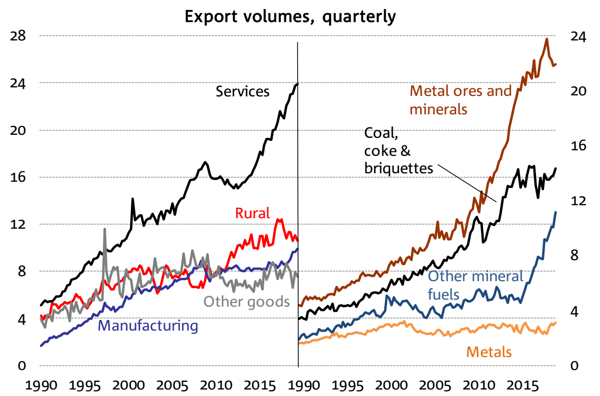

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