# AUSTRALIAN ECONOMIC UPDATE

## *GDP Q1 2020 – GDP declines on early COVID-19 impacts*

3 June 2020

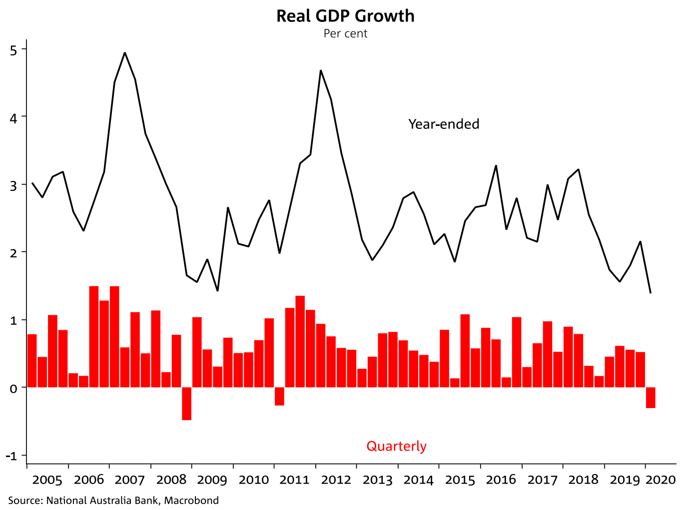
**<u>Bottom line:</u> GDP fell 0.3% in Q1 – the first quarterly fall since Q1 2011 – and was slightly weaker than our expected decline of 0.1%. This result reflects the early economic impacts of the coronavirus pandemic, where consumer spending and investment both fell around 1%. These factors subtracted a large 0.8pp from Q1 GDP growth, but were offset by strong government spending and net exports. The outcome in the quarter also reflected the general pattern of activity over the past year where net exports and government spending have supported growth while the private sector has been soft. As a result, growth in annual terms is now at its slowest pace since the GFC at 1.4% - and before the more significant impact of the pandemic flows through the accounts. Indeed, we continue to expect a large decline in GDP in Q2 before the beginnings of a recovery in Q3. This sees a large rise in the unemployment rate and a recovery in jobs growth and the unemployment rate that will take time. On the policy front, we see rates remaining low for an extended period and the likely need for more fiscal support as existing measures are legislated to end. A detailed update to our forecasts will be released next week.**

**In Q1**, domestic demand subtracted 0.5ppt from growth, driven by declines in consumer spending (with a significant fall in discretionary and services spending), residential construction and business investment, which was partially offset by a rise in government spending. Net exports were a significant support to growth in the quarter. By industry, production in accommodation & food services and transport, postal & warehousing (which captures travel and related support services) as well as the household service sectors drove the decline. The income side of the accounts was the weakest across the three measures in the quarter, with average real COE per employee declining by 0.4%.

**Looking forward,** we expect a much larger fall of around 8% in Q2 where strict containment measures were in place in the first half of the quarter. Beyond that we expect a small rise in GDP in Q3 before a more substantial pickup in growth in Q4. That sees a year average fall in GDP of 4.3% this year, followed by growth of around 4.0% in 2021. Despite the rebound in growth, we do not see the level of GDP fully recovering to its pre-virus levels until mid-2022. Therefore, while we see unemployment improving over 2021 from its peak in coming months, it should remain elevated for some time. Risks around his outlook will be the speed of the recovery in consumer and business confidence as well as developments around the globe.

**Key figures**

| Key aggregates | q/q % ch | | y/y % ch |
|---|---|---|---|
| | Dec-19 | Mar-20 | Mar-20 |
| GDP (A) | 0.5 | -0.3 | 1.4 |
| GDP (E) | 0.3 | -0.2 | 1.4 |
| GDP (I) | 0.7 | -0.4 | 1.4 |
| GDP (P) | 0.5 | -0.3 | 1.3 |
| – Non-Farm GDP | 0.5 | -0.3 | 1.6 |
| – Farm GDP | -0.7 | -2.4 | -10.3 |
| Nominal GDP | -0.2 | 0.8 | 3.1 |
| Real gross domestic income | -0.7 | 0.3 | 1.1 |
| Real net national disposable income per capita | -1.0 | 0.1 | 1.0 |
| Terms of trade | -5.2 | 2.9 | -0.9 |



# HIGHLIGHTS

- **Household consumption** drove a significant portion of the weakness in the quarter falling by 1.1% (-0.2% y/y). The decrease was driven by a large 2.4% fall in spending on services (led by declines in transport, rec & cultural services hotels, cafes & restaurants and health services), which was partially offset by a 1% rise in spending on goods. Relatedly, spending on discretionary items drove the decline, while spending on essentials rose.
- **Underlying business investment** fell 0.8% q/q, similar to Q4 (-1.0% q/q). As with Q4, this was driven by a decline in non-mining investment (-2.5% q/q), while mining investment increased by 6.5% q/q its strongest rate of growth since 2012. However, mineral exploration activity declined, its first fall for a year, consistent with the notion that the fall in commodity prices due to COVID-19 will ultimately weigh on mining investment. There were declines in all the major investment categories except for engineering construction (consistent with the strength in mining); even intellectual property product investment declined, the first fall in almost four years.
- **Dwelling investment** fell 1.7% in the quarter driven by a fall in investment in construction (-2.9%) which was partially offset by a small rise in alterations & additions (0.4%). Over the year dwelling investment has fallen 9.7% - with investment in new dwellings having fallen 15.4%. Dwelling investment declined across most states, with large falls in NSW and WA. Vic and SA also recorded declines, while QLD and Tas saw an increase in investment.
- **Government demand** returned to solid growth in the quarter (1.5% q/q after 0.4% in Q4). Growth in the quarter was primarily driven by consumption (1.8% q/q) with underlying public investment growing only modestly (0.2% q/q). While in the recent past a driver of government consumption has been the NDIS roll-out, this time around the statistician attributed the growth to bushfire and COVID-19 related spending. Annual underlying public investment grew by 1.9% y/y, its slowest pace in over four years, suggesting that this growth driver is starting to wane (even if the level of investment were to remain high).
- **Net exports** contributed 0.5ppts contribution to quarterly GDP growth. Both exports and imports recorded large falls, primarily due to restrictions on international travel, but goods exports and imports also declined. Exports fell by 3.5% q/q mainly reflecting a 20% decline in travel service credits (tourism, business travel) and a 27% fall in passenger transport services. Goods exports also declined (-0.7% q/q) as a small rise in resource exports was offset by falls in the other major categories (rural, manufacturing, non-monetary gold). There were similarly large falls in service imports (travel down 23% q/q and 17% respectively for travel and passenger transport services), and the fall in goods imports was a substantial 3.9% q/q, perhaps in part due to supply chain disruptions.
- Growth in nominal **compensation of employees** slowed to 0.5% in the quarter, with average compensation per employee falling as hours declined (driven by a late March fall). More broadly, household disposable income growth – which will be a key factor in speed of the recovery in consumption – rose by 1.4% with social assistance benefits making its largest contribution since 2012 (0.6ppts). As noted by the ABS, benefits are likely to rise further in the June quarter providing further support to household income. The savings rate increase by 2ppt in the quarter on the back of weaker consumption.
- The combination of the COVID-19 pandemic and bushfires saw some massive swings by **industry**. There were big falls in accommodation and food services (down 7.5% q/q), transport postal and warehousing (down 4.9%), other services (down 4.2% q/q) and administrative services (down 3.7%). Household spending on transport services fell 12.0% and on hotels, cafes and restaurants it was down 9.2% as people cancelled holidays due to the fires and subsequently stopped dining out and travelling for work in response to the coronavirus. Air transport fell 14.6% (the China travel ban was one of the first restrictions, from 1 February) and rail was down 3.5%. Retail trade was up 1.7% and wholesale up 1.5%, reflecting stockpiling by consumers and demand for pharmacy and home office products. Manufacturing rose 2.1%, led by increased demand for cleaning products, steel and to a lesser degree, toilet paper. Health care and social assistance was slightly lower (-0.1%), largely reflecting declines in private healthcare as elective surgeries were delayed and allied health demand fell. While these swings look substantial, they are likely to be dwarfed by Q2.
- **Farm GDP** fell again in Q1, down 2.4% in the fourth straight quarterly decline. Farm GDP was just over 10% lower on an annual basis. Last season was one to forget for drought-ravaged farmers in New South Wales and Queensland. However, rainfall this year has been much more encouraging. Winter crop is now in the ground and a larger crop should contribute to farm GDP later this year. That said, better seasonal conditions are seeing big restocker interest, so we expect livestock slaughter to be lower and probably detract from growth.

# SUMMARY CHARTS AND TABLES:

## GDP (E) by component

| GDP Expenditure Components | q/q % ch Dec-19 | q/q % ch Mar-20 | y/y % ch Mar-20 | Contribution to q/q % ch Mar-20 |
|---|---|---|---|---|
| Household Consumption | 0.5 | -1.1 | -0.2 | -0.6 |
| Dwelling Investment | -4.1 | -1.7 | -9.7 | -0.1 |
| Underlying Business Investment^ | -1.0 | -0.8 | -2.6 | -0.1 |
| Machinery & equipment | 0.8 | -1.9 | -3.3 | -0.1 |
| Non-dwelling construction | -3.4 | -0.3 | -5.4 | 0.0 |
| New building | -3.3 | -2.3 | -4.4 | -0.1 |
| New engineering | -3.5 | 1.7 | -6.3 | 0.0 |
| Underlying Public Final Demand | 0.4 | 1.5 | 5.4 | 0.4 |
| **Domestic Demand** | **0.2** | **-0.5** | **0.5** | **-0.5** |
| Stocks (a) | 0.2 | -0.2 | -0.2 | -0.2 |
| **GNE** | **0.4** | **-0.7** | **0.2** | **-0.7** |
| **Net exports (a)** | **-0.1** | **0.5** | **1.2** | **0.5** |
| Exports | -0.2 | -3.5 | -2.0 | -0.8 |
| Imports | 0.1 | -6.2 | -7.7 | -1.3 |
| GDP | **0.5** | **-0.3** | **1.4** | **-0.3** |

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

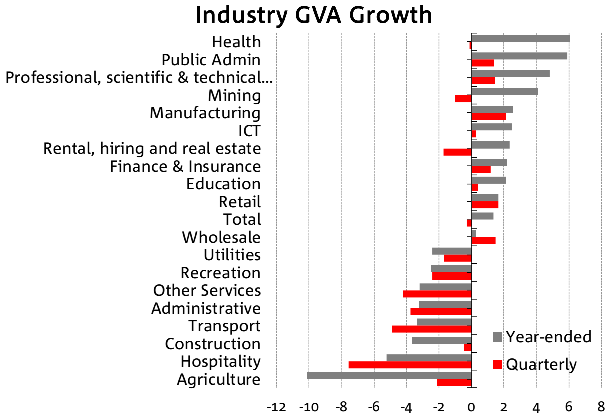
## INCOME MEASURES

| Income measures | q/q % ch Dec-19 | q/q % ch Mar-20 | y/y % ch Mar-20 |
|---|---|---|---|
| Real GDI | -0.7 | 0.3 | 1.1 |
| Real net disposable income per capita | -1.0 | 0.1 | 1.0 |
| Compensation of employees | 1.0 | 0.5 | 4.2 |
| Average compensation of employees (average earnings) | 0.6 | -0.4 | 1.9 |
| Corporate GOS | -1.4 | 0.9 | 3.5 |
| Non-financial corporations | -2.0 | 0.8 | 3.3 |
| Financial corporations | 0.7 | 1.5 | 3.9 |
| General government GOS | 1.4 | 1.4 | 5.6 |
| **Productivity & unit labour cost** | | | |
| GDP per hour worked | 0.3 | 0.5 | 1.4 |
| GVA per hour worked mkt sector | 0.3 | 0.8 | 1.4 |
| Non-farm nominal unit labour cost | 0.7 | 0.1 | 2.7 |
| Non-farm real unit labour cost | 1.5 | -0.9 | 0.9 |

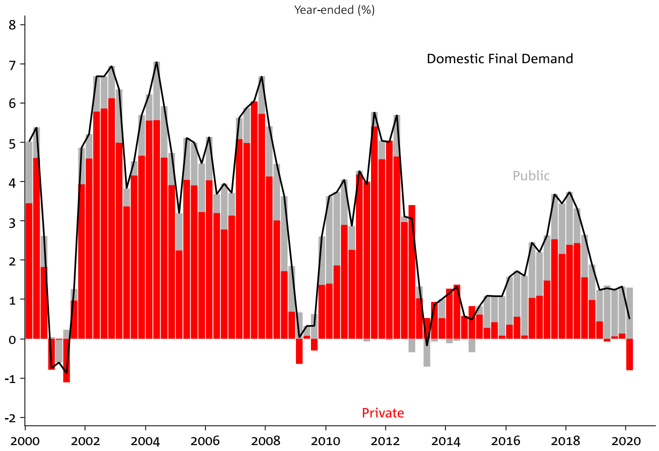
## State final demand

| State/ Territory | Q/Q Dec-19 | Q/Q Mar-20 | Y/Y Mar-20 |
|---|---|---|---|
| ACT | 0.8 | 2.1 | 4.2 |
| WA | -0.1 | 0.9 | 3.4 |
| TAS | -0.9 | 0.6 | 1.2 |
| VIC | -0.2 | -0.1 | 0.9 |
| QLD | 0.4 | -0.3 | 0.6 |
| NSW | 0.5 | -1.5 | -0.7 |
| SA | 0.1 | -1.0 | -1.0 |
| NT | -0.1 | -1.2 | -2.8 |

## Industry GVA Growth

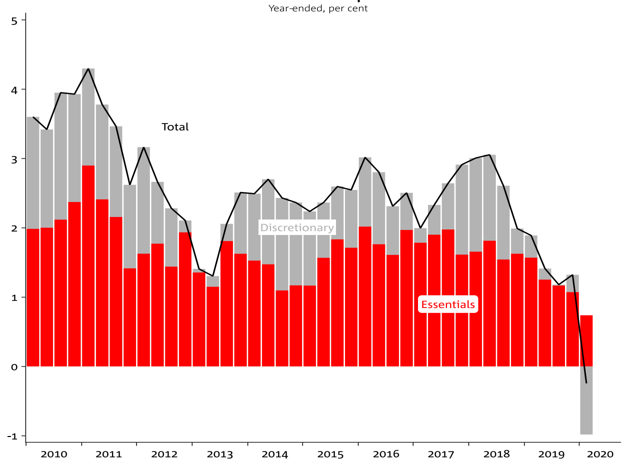



**Domestic Final Demand Growth**
Year-ended (%)

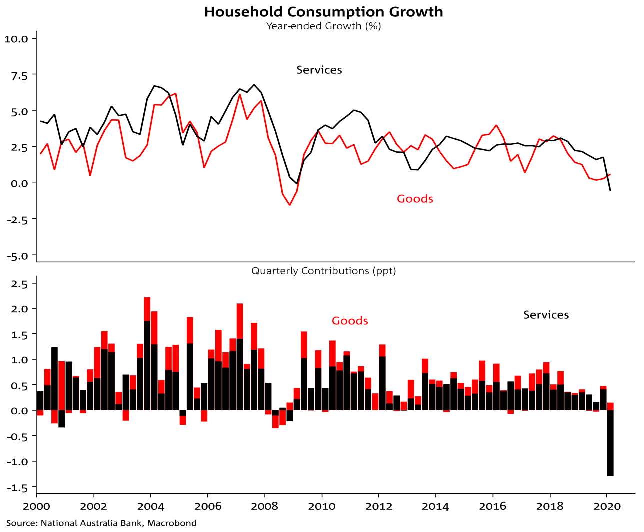


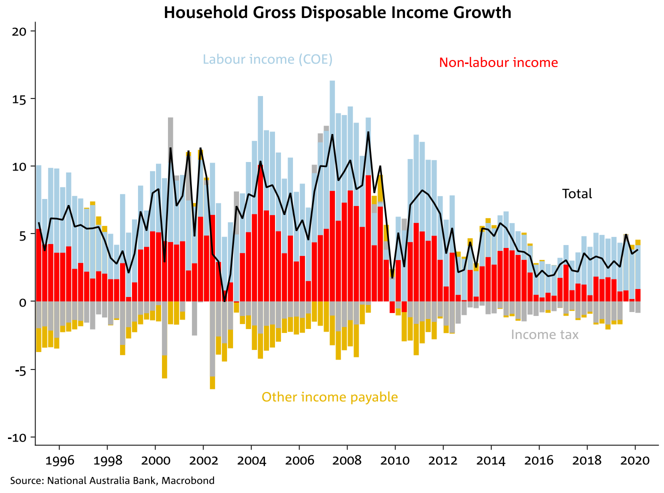

Source: National Australia Bank, Macrobond

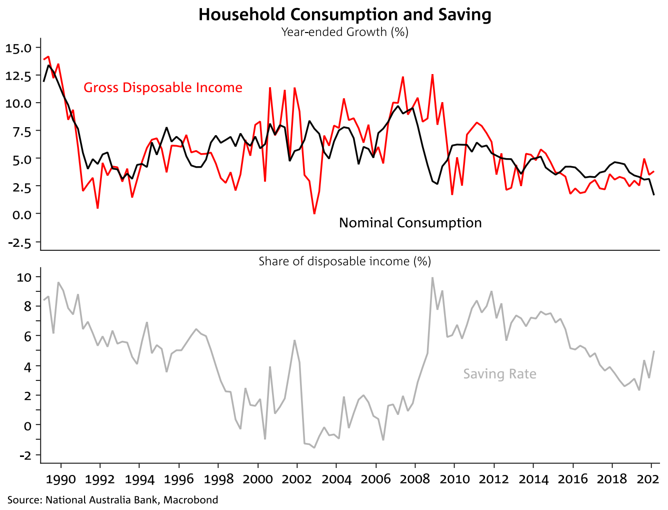
**Real Household Consumption Growth**
Year-ended, per cent

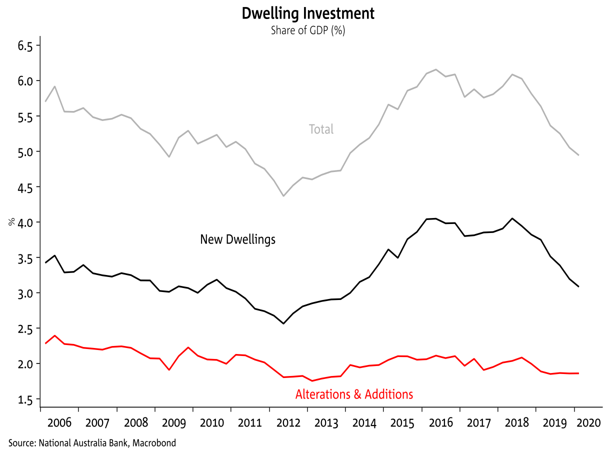


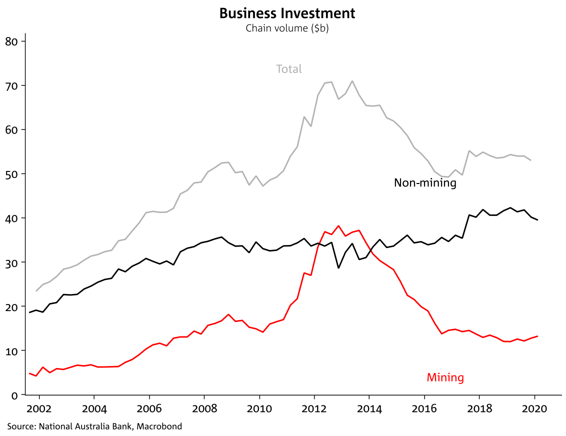

Source: National Australia Bank, Macrobond

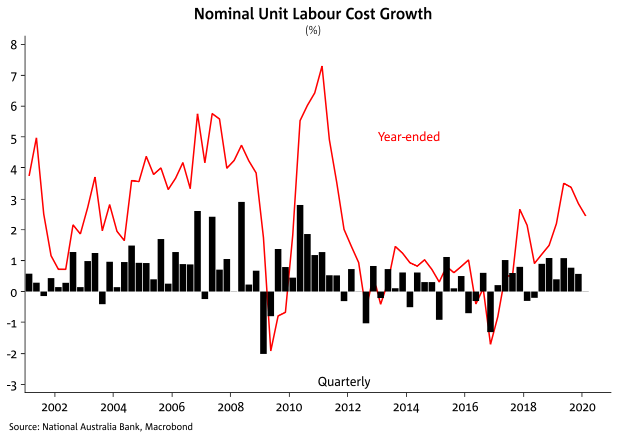

Household Consumption Growth
Year-ended Growth (%)
Services
Goods
Quarterly Contributions (ppt)
Goods
Services
Source: National Australia Bank, Macrobond

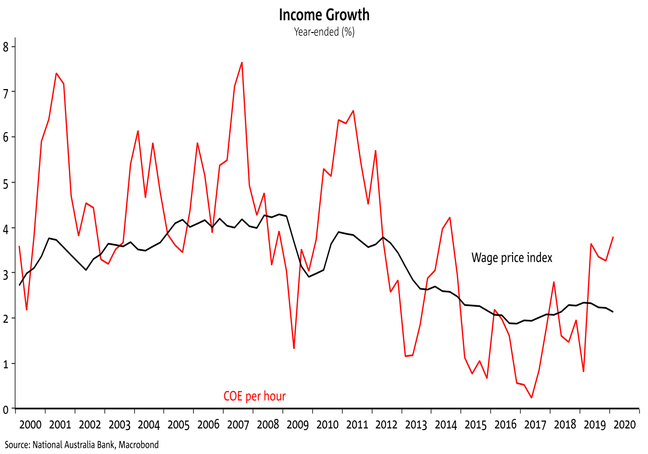

Household Gross Disposable Income Growth
Labour income (COE)
Non-labour income
Total
Income tax
Other income payable
Source: National Australia Bank, Macrobond

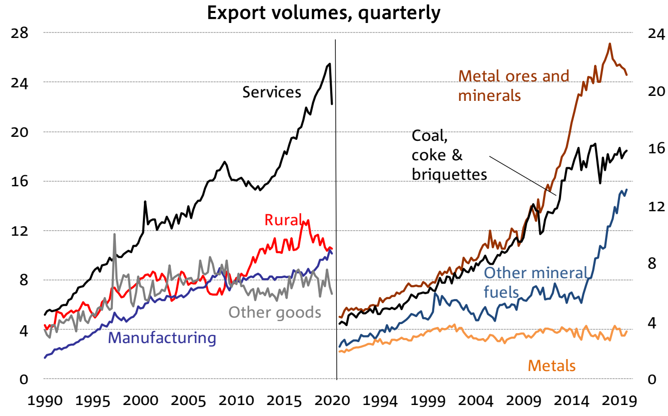

Household Consumption and Saving
Year-ended Growth (%)
Gross Disposable Income
Nominal Consumption
Share of disposable income (%)
Saving Rate
Source: National Australia Bank, Macrobond


Dwelling Investment
Share of GDP (%)
Total
New Dwellings
Alterations & Additions
Source: National Australia Bank, Macrobond


Business Investment
Chain volume ($b)
Total
Non-mining
Mining
Source: National Australia Bank, Macrobond


Nominal Unit Labour Cost Growth
(%)
Year-ended
Quarterly
Source: National Australia Bank, Macrobond


Income Growth
Year-ended (%)
Wage price index
COE per hour
Source: National Australia Bank, Macrobond


Export volumes, quarterly
Services
Rural
Other goods
Manufacturing
Metal ores and minerals
Coal, coke & briquettes
Other mineral fuels
Metals

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