# AUSTRALIAN ECONOMIC UPDATE

## *GDP Q2 2020 – A large hit to economic activity confirmed*

National Australia Bank

2 September 2020

**<u>Bottom line:</u> Q2 GDP fell by a massive 7% (-6.3% y/y), confirming the large hit to economic activity as a result of the shutdown to limit the COVID-19 pandemic. The fall in activity was driven by a collapse in household consumption, where spending on services fell 18% amid the peak of the restrictions. Likewise, by industry, hospitality and recreational services saw the largest falls in activity, although nearly all industries were heavily impacted. We expect that we are past the peak impact on activity, but the recovery will be still be a long process. We forecast a broadly flat outcome in Q3 (which will be impacted by the Victorian restrictions) and a ramping up in the level of activity as the economy reopens in the first half of 2021. The labour market will continue to deteriorate given the lags from activity to labour market and the worst in unemployment will probably be in early 2021. These accounts also clearly demonstrate the unprecedented support provided by policy makers, which has more than offset the hit to household income - but not the fall in the level of activity itself.**

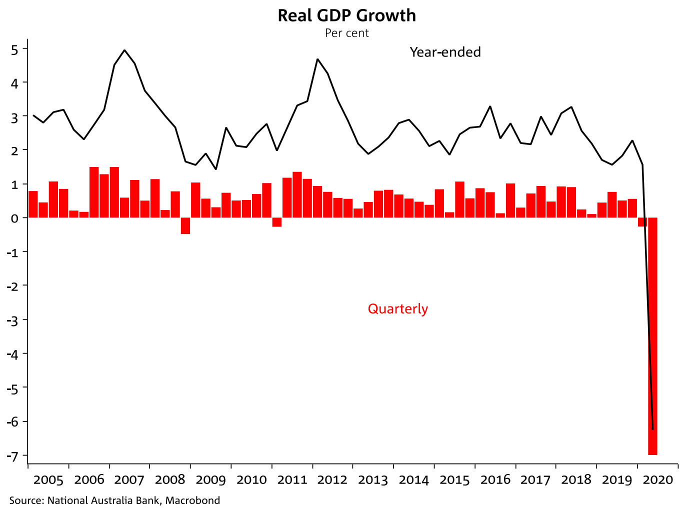
**Overall**, private sector demand drove the weakness in Q2, where it subtracted 7.9ppt from GDP. In particular, household consumption fell by a record 12% – with a very large 18% fall in services consumption, reflecting widespread restrictions in place early in Q2. Dwelling investment also saw a sharp 7% decline in the quarter, while new business investment fell 3.5%. This was partially offset by public sector spending and net exports.

These accounts also show the substantial support from government. Despite the large hit to activity and the 10% collapse in hours worked, household income rose 2.5%. This reflects the significant 42% increase in social assistance benefits (welfare payments) and 22% increase in gross mixed income (boosted by JobKeeper), while compensation of employees (wages) only saw a fall of 2.2% (also supported by JobKeeper).

**Looking forward,** we expect a flatter outcome in the September quarter and a gradual recovery from there – but do not expect the economy to recover its pre-virus level until early/mid 2023. The unemployment rate will continue to rise from here, reaching a peak of over 9% later this year and nearer 10% in early 2021. It will then begin to recover over the course of 2021 and 2022, but will remain well above its starting point and the NAIRU. From a policy perspective this outlook warrants ongoing support to ensure the recovery can happen as quickly as possible. We expect the RBA will remain on hold for an extended period with the risk of some further easing in policy should their forecasts be disappointed. On the fiscal side we think ongoing support is required and that more will be likely done – likely in the form of ongoing wage subsidies, higher unemployment benefits and possibly the bring forward of tax cuts. They may also bring forward infrastructure investment and structural reform which would also help.

**Key figures**

| Key aggregates | q/q % ch | | y/y % ch |
|---|---|---|---|
| | Mar-20 | Jun-20 | Jun-20 |
| GDP (A) | -0.3 | -7.0 | -6.3 |
| GDP (E) | -0.2 | -6.8 | -6.0 |
| GDP (I) | -0.4 | -7.2 | -6.4 |
| GDP (P) | -0.2 | -7.1 | -6.4 |
| – Non-Farm GDP | -0.2 | -7.1 | -6.3 |
| – Farm GDP | -2.1 | -2.3 | -6.0 |
| Nominal GDP | 0.9 | -7.6 | -5.9 |
| Real gross domestic income | 0.4 | -7.0 | -6.7 |
| Real net national disposable income per capita | 0.4 | -8.0 | -8.0 |
| Terms of trade | 3.1 | 0.2 | -1.8 |



# HIGHLIGHTS

- **Household consumption** declined by 12.1% in the quarter (-12.7% y/y), driven by an 18% fall in services consumption. This is the first annual fall in consumption spending on record. Spending on goods also saw a relatively large decline of 2.8%. The largest falls occurred in transport services (-86%) and hotels, cafes & restaurants (-56.1%). Rec & culture, health (pausing of elective surgery in some jurisdictions and general deferral of health services by households) and other goods & services (a result of the decline in childcare spending) also saw sizeable decline.
- **Underlying business investment** fell 3.5% q/q. The weakness in business investment pre-dates COVID as (on an underlying basis) it has declined in each of the last four quarters, but this was the largest fall since mid-2015 even with a pick-up in mining sector investment. There was a large fall in machinery and equipment investment (-6.8% q/q, underlying basis) and new building construction also declined (-2.3%). Despite the increase in investment in the quarter, mining sector activity is unlikely to escape the impact of COVID-19 on the global economy and commodity prices – mineral exploration expenditure again fell to be 15% below its end-2019 level.
- **Dwelling investment** fell 6.8% in the quarter driven by a fall in investment in construction (-7.3%) and a fall in alterations & additions (-6.0%). Over the year dwelling investment has fallen 11.2% - with investment in new dwellings having fallen 15.7%. Dwelling investment declined across all states, led by declines in Vic and NSW, though Qld and WA also saw notable declines.
- **Government demand** again grew strongly (2.5% q/q). Growth in the quarter was driven by consumption (2.9% q/q) as underlying public investment declined by 1.6% q/q. The increase in government consumption was primarily at the state and local level (up 4.2% q/q) and there was also strong growth in national defence spending. Government consumption would have been boosted by COVID-19 related spending including childcare provision (replacing private consumption) although, interestingly, Federal government consumption only inched higher.
- **Net exports** contributed 1.0ppts to quarterly GDP growth. As in Q1, there were large falls in both exports and imports, particularly for services due to international travel restrictions. Exports fell by 6.7% q/q, including large falls in rural and manufacturing exports (and a smaller fall in resource exports) but the largest falls were in service exports with travel credits down 25% q/q and transportation 47% q/q. The fall in imports was even greater (-12.9% q/q) led by services debits which declined 51% mainly due to the near total collapse of travel debits (-99% q/q) which, unlike the credits side, does not have a large international student contribution.
- The household **net saving ratio** jumped to 19.8% in Q2, from 6%, its highest level since Q2 1974. This was driven by the collapse in household consumption, which contributed 11.6 pp to the rise in the savings ratio. However, income also rose, boosted by substantial government support. Welfare payments to households rose 42% in Q2, while wages only fell 2.5%, despite a 10% fall in hours worked, reflecting the support provided by the JobKeeper wage subsidy.
- **State final demand** was negative across the board in Q2. All states and territories imposed severe restrictions on activity late in Q1, which flowed well into Q2. Victoria did not record the biggest GSP fall in Q2, with its 8.5% decline just exceeded by New South Wales' 8.6% fall. While Victoria's second wave had begun to accelerate in June, restrictions on household gatherings and postcode lockdowns were only introduced towards the end of the month. Stage 3 restrictions for Melbourne were imposed in July and stage 4 in August – outside the scope of this release.
- The ACT recorded the smallest fall (-2.2%) followed by the Northern Territory (-4.9%), South Australia (-5.8%), Queensland (-5.9%), Western Australia (-6.0%), Tasmania (-7.4%), Victoria (-8.5%) and New South Wales (-8.6%). Sharp falls in household final consumption expenditure were widespread across the states (although largest in Victoria). This was also the case for private capital spending (except for the ACT). In Victoria, spending at pubs, cafes and restaurants dropped 64.1% and transport spending plummeted 88.4%. Q3 is likely to see substantially more divergent state trends, as Victoria faces a second wave, New South Wales and Queensland see much smaller outbreaks but eradication achieved (at least so far) in other states.
- Some **industries** recorded double digit quarterly declines. Accommodation & food saw the biggest drop, with a record 39.0% fall as essentially all international and a good deal of domestic tourism was cancelled, and dining out was heavily restricted. Arts and recreation services dropped 22.6%, while transport, postal and warehousing slid 21.5% led by huge 96.4% fall in air travel. Administrative & support services fell 20.1% while real estate declined 15.9%. Perhaps counter-intuitively, healthcare and social assistance fell 7.9%, but this reflects elective surgeries being delayed, reduced hospital presentations and a hit to allied health services. Construction dropped 8.2% while manufacturing was down 9.6%. Retail trade fell 4.5%, but NAB data shows substantial change in the composition of retail sales, with consumers focussing on household items. In contrast, public administration and safety grew 0.9% and mining also increased (due to an increase in iron ore mining, as well as in copper and gold mining production). Agriculture, forestry & fishing was down 1.9% but this largely reflected lower slaughter due to better seasonal conditions seeing restocking. Australia is on track for a much better season overall than last year.

# SUMMARY CHARTS AND TABLES:

## GDP (E) by component

| GDP Expenditure Components | q/q % ch Mar-20 | q/q % ch Jun-20 | y/y % ch Jun-20 | Contribution to q/q % ch Jun-20 |
|---|---|---|---|---|
| Household Consumption | -1.2 | -12.1 | -12.7 | -6.7 |
| Dwelling Investment | -1.0 | -6.8 | -11.2 | -0.4 |
| Underlying Business Investment^ | -0.7 | -3.5 | -5.5 | -0.4 |
| Machinery & equipment | -2.1 | -6.8 | -13.4 | -0.3 |
| Non-dwelling construction | -0.2 | -0.2 | -0.3 | 0.0 |
| New building | -1.8 | -2.3 | 0.3 | -0.1 |
| New engineering | 1.5 | 1.9 | -1.0 | 0.0 |
| Underlying Public Final Demand | 1.7 | 2.1 | 6.3 | 0.5 |
| **Domestic Demand** | **-0.4** | **-7.4** | **-7.0** | **-7.2** |
| Stocks (a) | -0.2 | -0.6 | -0.6 | -0.6 |
| **GNE** | **-0.6** | **-8.0** | **-7.7** | **-7.8** |
| **Net exports (a)** | **0.4** | **1.0** | **1.6** | **1.0** |
| Exports | -4.4 | -6.7 | -10.6 | -1.4 |
| Imports | -6.7 | -12.9 | -19.1 | -2.5 |
| **GDP** | **-0.3** | **-7.0** | **-6.3** | **-7.0** |

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

## INCOME MEASURES

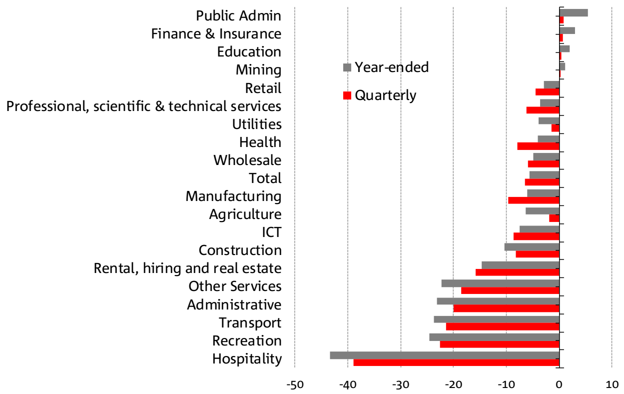
| GDP Expenditure Components | q/q % ch Mar-20 | q/q % ch Jun-20 | y/y % ch Jun-20 | Contribution to q/q % ch Jun-20 |
|---|---|---|---|---|
| Household Consumption | -1.2 | -12.1 | -12.7 | -6.7 |
| Dwelling Investment | -1.0 | -6.8 | -11.2 | -0.4 |
| Underlying Business Investment^ | -0.7 | -3.5 | -5.5 | -0.4 |
| Machinery & equipment | -2.1 | -6.8 | -13.4 | -0.3 |
| Non-dwelling construction | -0.2 | -0.2 | -0.3 | 0.0 |
| New building | -1.8 | -2.3 | 0.3 | -0.1 |
| New engineering | 1.5 | 1.9 | -1.0 | 0.0 |
| Underlying Public Final Demand | 1.7 | 2.1 | 6.3 | 0.5 |
| **Domestic Demand** | **-0.4** | **-7.4** | **-7.0** | **-7.2** |
| Stocks (a) | -0.2 | -0.6 | -0.6 | -0.6 |
| **GNE** | **-0.6** | **-8.0** | **-7.7** | **-7.8** |
| **Net exports (a)** | **0.4** | **1.0** | **1.6** | **1.0** |
| Exports | -4.4 | -6.7 | -10.6 | -1.4 |
| Imports | -6.7 | -12.9 | -19.1 | -2.5 |
| **GDP** | **-0.3** | **-7.0** | **-6.3** | **-7.0** |

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

## State final demand

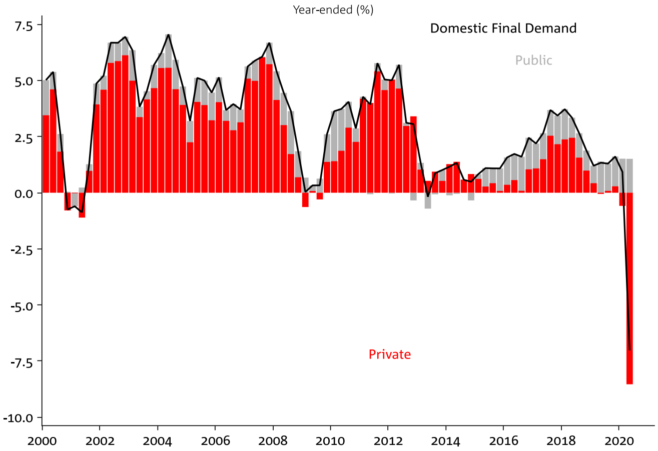
| State/ Territory | Q/Q Mar-20 | Q/Q Jun-20 | Y/Y Jun-20 |
|---|---|---|---|
| ACT | 2.6 | -2.2 | 2.0 |
| WA | 0.9 | -6.0 | -4.0 |
| QLD | -0.3 | -5.9 | -5.2 |
| NT | -1.5 | -4.9 | -6.3 |
| SA | -0.9 | -5.8 | -6.7 |
| TAS | 0.8 | -7.4 | -6.8 |
| VIC | -0.2 | -8.5 | -8.3 |
| NSW | -1.3 | -8.6 | -9.1 |

### Industry GVA Growth




### Domestic Final Demand Growth

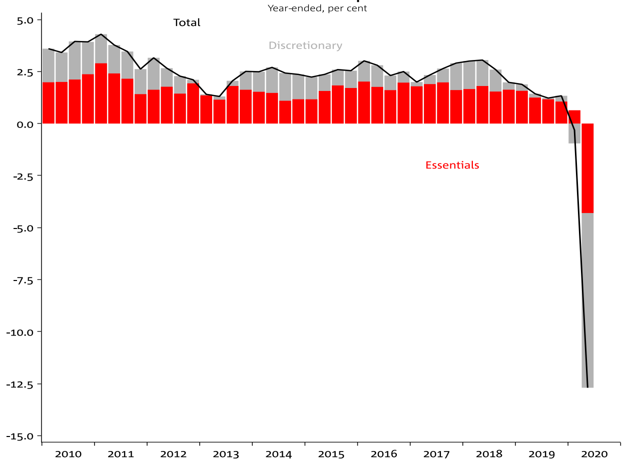
Year-ended (%)



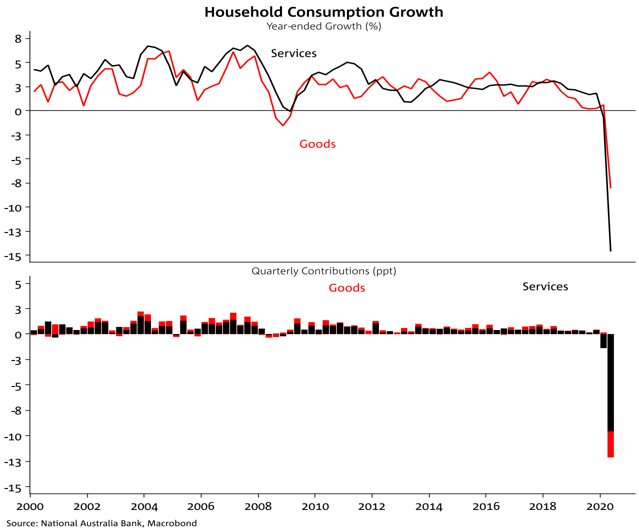

Source: National Australia Bank, Macrobond

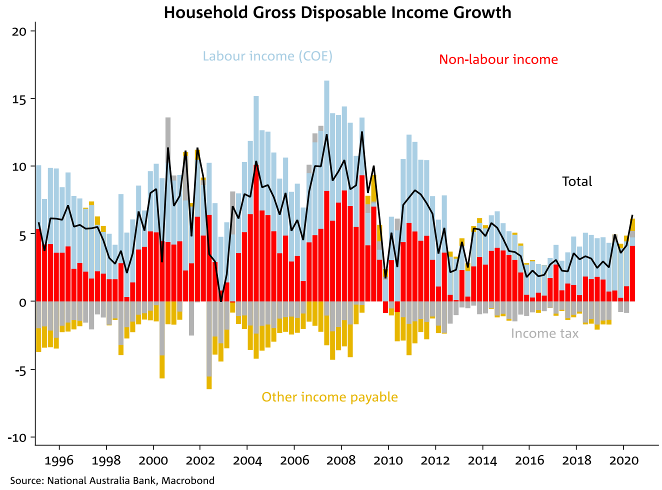
### Real Household Consumption Growth

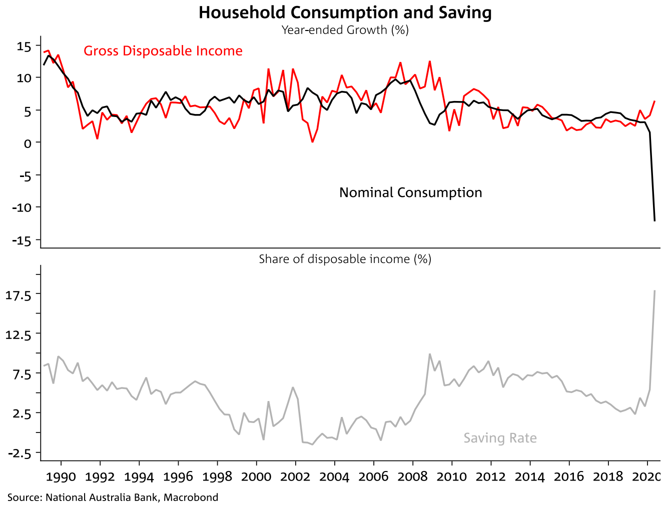
Year-ended, per cent

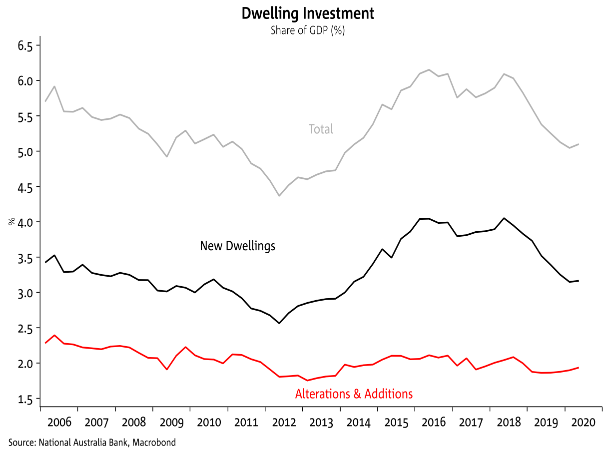


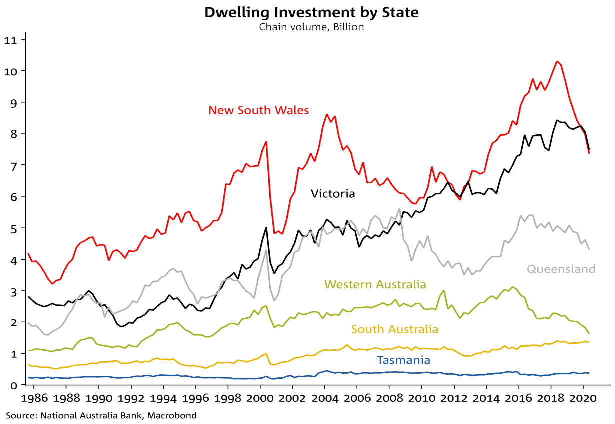

Source: National Australia Bank, Macrobond

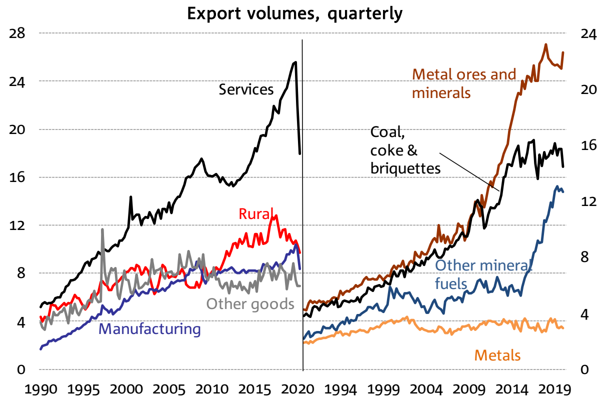

Household Consumption Growth
Year-ended Growth (%)
Services
Goods
Quarterly Contributions (ppt)
Goods
Services
Source: National Australia Bank, Macrobond

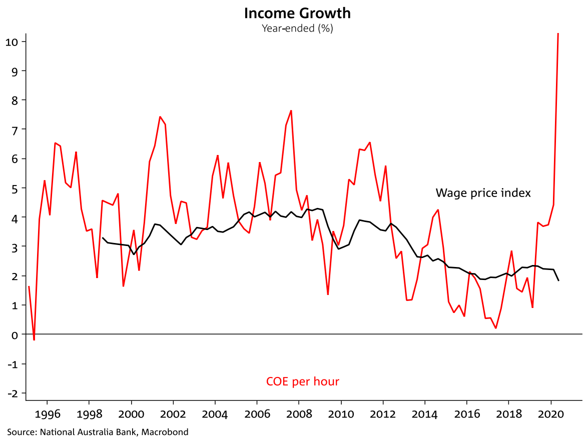

Household Gross Disposable Income Growth
Labour income (COE)
Non-labour income
Total
Income tax
Other income payable
Source: National Australia Bank, Macrobond

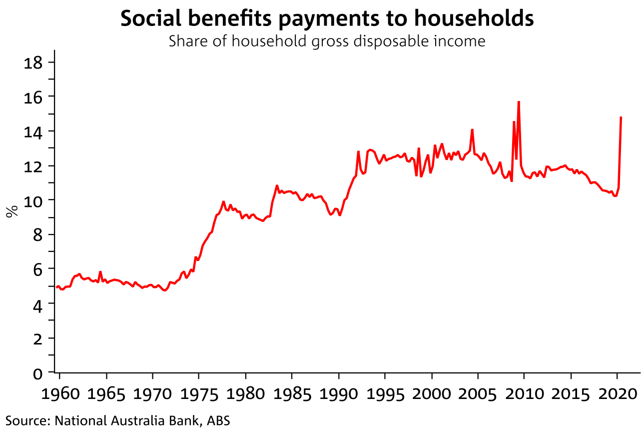

Household Consumption and Saving
Year-ended Growth (%)
Gross Disposable Income
Nominal Consumption
Share of disposable income (%)
Saving Rate
Source: National Australia Bank, Macrobond


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


Dwelling Investment by State
Chain volume, Billion
New South Wales
Victoria
Queensland
Western Australia
South Australia
Tasmania
Source: National Australia Bank, Macrobond


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


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


Social benefits payments to households
Share of household gross disposable income
%
Source: National Australia Bank, ABS

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