AUSTRALIAN ECONOMIC UPDATE

GDP Q2 2021 – GDP surprises, rising 0.7% q/q

National Australia Bank

1 September 2021

Bottom line: Q2 GDP rose by a larger than expected 0.7% (9.6% y/y) – with the miss in our forecasts largely driven by a strong rise in public inventories and slightly better than expected consumption spending. This outcome sees GDP 1.6% above its pre-COVID level, following three quarters of strong growth as the economy rebounded from last year's contraction. Abstracting from a notable subtraction from net exports, these data show domestic demand continued to grow relatively strongly, supported by both the private and public sectors. They also reflect ongoing policy support, with a further strong outturn in business investment and another gain in dwelling investment. Household consumption and trade – especially services - continue to be impacted by pandemic-related border closures but showed further recovery in the quarter. However, these data are old news as they largely precede extended lockdowns which began in late June and are expected to last into Q4. Consequently, we expect a large fall in activity in Q3 but, more importantly, a solid rebound when restrictions ease. These data do not change our view on policy, with all focus now turning to how quickly we rebound from the current lockdowns acknowledging the fact the build-up of wage/inflationary pressure may take longer, centering the risk around our 2024 rate call.

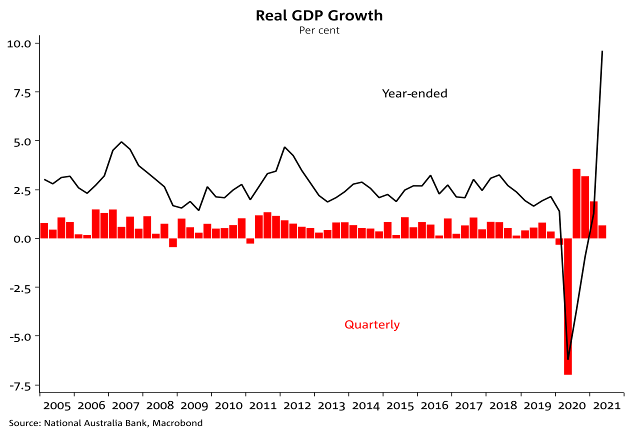
All three measures of GDP showed solid gains in the quarter led by GDP(P) but with both the income and expenditure measures showing healthy gains. On the expenditure side, household consumption rose 1.1% driven by a rebound in goods, while services continued to recover. Business investment saw further gains, mainly supported by equipment spending, but also a turnaround in non-res construction. The housing market also continued to support overall output, with both construction and ownership transfer costs (related to turnover) contributing. Public sector spending was a key support, driven by solid contributions from both consumption and investment (state and local government infrastructure spending). Net exports was the key detractor, with supply disruptions driving weakness in exports.

On the income side, compensation of employees and profits both made solid contributions with hours worked continuing to recover and a boost to profits in the mining sector. The production measure showed gains in most industries, with the admin & support services making the largest contribution (mining and construction related labour hire). Accommodation & food services and transport continued to recover but remain well below pre-COVID levels.

Looking forward, we expect GDP to fall by around 3.5% in Q3 and begin to rebound in Q4 as restrictions ease. Precisely when restrictions will start to ease will depend on when vaccination targets are reached, which is uncertain. While the pace of recovery will be dependent on how gradually restrictions are eased and whether households remain cautious – even assuming some reopening in Q4 it is likely GDP will remain lower over the second half. The duration of border closures also remains uncertain and will continue to impact the services side of both consumption and exports. That said, prior experience shows that activity tends to rebound fairly sharply once restrictions are eased and both fiscal and monetary policy are working to support the economy. We see growth of around 1.0% in 2021, 4.3% in 2022 and 2.0% in 2023 which should see the unemployment rate regain ground and continue to drive lower over the next couple of years, reaching around 4% by the end of 2023. We still expect that the first cash rate rise will be in early 2024; previously we had considered that the risk was that it might occur earlier, but now see the risks around this timing (earlier or later) as more evenly balanced because, with activity below its potential for longer, the wage price/pressure build-up may be delayed.

Key figures

Key aggregates	q/q % ch		y/y % ch
	Mar-21	Jun-21	Jun-21
GDP (A)	1.9	0.7	9.6
GDP (E)	2.0	0.4	9.6
GDP (I)	1.9	0.6	9.6
GDP (P)	1.8	0.9	9.6
– Non-Farm GDP	1.8	0.6	8.9
– Farm GDP	5.1	1.5	48.3
Nominal GDP	3.7	3.2	16.4
Real gross domestic income	3.7	2.2	15.0
Real net national disposable income per capita	3.5	1.8	17.2
Terms of trade	8.2	6.9	24.0



HIGHLIGHTS

- **Household consumption** rose a further 1.1% q/q (15.4% y/y) driven by services consumption which rose 1.3% in the quarter, though goods spending also rebounded after falling in Q1. Of note was a strong rise in transport services (up 25.4%) while spending on utilities, health, motor vehicles and hotels, cafes & restaurants also saw gains. The ongoing disruption to consumption patterns remains evident, however, with transport services and hotels, cafes & restaurants still 68% and 18% below pre-pandemic levels respectively. That said, these data show some evidence of a rotation in spending away from goods, to services with food and alcohol down for a second consecutive quarter and household goods edging lower. Relatedly, the savings rate declined further in the quarter, falling to 9.7% but remains elevated compared with history as consumption continues to be disrupted while incomes have seen solid support.
- **Underlying business investment** growth moderated from its rapid Q1 pace but at 2.3% q/q was still solid, despite a small fall in investment by the mining sector. Business investment was not only above its pre-COVID-19 level but also at its highest since Q1 2019. The increase in investment was reasonably broad-based, with major categories - machinery & equipment, new building, engineering and intellectual property products – seeing gains of between 1.5% to 3.0% q/q (on an underlying basis).
- **Dwelling investment** rose 1.7% to be 15.7% higher over the year after rising for four consecutive quarters. The rise was driven by an increase in both renovations (+1.9%) and new construction (+1.6%) and reflects ongoing work-through of the HomeBuilder pipeline. By state, WA and SA led the gains with QLD and NSW also lifting. Vic saw a decline in the quarter, as did the territories.
- G**overnment spending** grew at a robust pace in the quarter (1.9% q/q on an underlying basis), a notable pick-up from the last two quarters. There was solid growth in government consumption (1.3% q/q) at both the Federal and state/local levels which, according to the ABS, was driven by health-related spending. Public underlying investment also grew strongly (4.7%) due to state and local government infrastructure projects. There was also a large increase in government inventories, basically mirroring the fall in non-monetary gold exports.
- **Net exports** detracted 1.0ppts from quarterly GDP growth. Export volumes declined 3.7% q/q, largely driven by a fall in resource exports. Exports of metal ores (iron ore), coal, and other mineral fuels (LNG) each fell by 3.7% q/q or more, with the ABS citing disruptions to both production and transportation to ports as a factor. Non-monetary gold exports also recorded a large fall. Import volumes increased 0.8% q/q due to increased imports of capital and intermediate goods; consumption goods imports fell slightly (but are still well above pre-COVID levels reflecting the switch to goods consumption). Travel service imports also picked up notably with the NZ travel bubble starting during the quarter (now paused); its impact on the export data is less clear.
- **State final demand (SFD)** grew at a solid pace across all jurisdictions. Growth was highest in the NT due to mining and public investment. NSW (2.2% q/q) and Qld (2.0%) grew at a similar pace, followed by SA (1.8% q/q), and then Vic and Tas (both 1.4% q/q), WA (1.2% q/q), and the ACT (0.9% q/q). All states saw an increase in household consumption, particularly NSW (in part to the state government's Dine & Discover scheme), though Vic (0.1% q/q) saw a softer outcome reflecting the lockdown during the quarter (NSW's lockdown was too late in the quarter to have a material impact). All states saw an increase in both private and public investment, except for WA where private investment was dragged down by falls in mining sector investment and a decline in ownership transfer costs. Compared to its pre-virus level, SFD is strongest in the NT (up 8.2%), followed by WA (5.7%) and the ACT (5.6%), with NSW (3.2%) and, in particular, Victoria (0.7%) the weakest.
- The **production side** of the accounts showed **gains across most industries**. Admin & support services made the largest contribution to growth (0.2ppts) as labour hire services in mining and construction picked up. Accommodation & food and transport, postal & warehousing continued to recover, contributing 0.1ppts in the quarter. The other major contributors were construction, rental, hiring & real estate, business services and healthcare. All other industries rose in the quarter but made little contribution, with the exception of mining which fell 1.3% and subtracted 0.1ppt.
- **Agriculture** continues to perform very strongly, reflecting an extremely strong season last year and all indications point towards a repeat this year. While the base effects of last year could blunt some of the GDP impact, agriculture, forestry and fishing was still up 41.9% over the year. On a q/q basis the sector rose 1.3%, with livestock a key boost. As we look to another excellent winter crop ahead, we expect some further upside in the back half of 2021.

SUMMARY CHARTS AND TABLES:

GDP (E) by component

GDP Expenditure Components	q/q % ch		y/y % ch	Contribution to q/q % ch
	Mar-21	Jun-21	Jun-21	Jun-21
Household Consumption	1.3	1.1	15.4	0.6
Dwelling Investment	7.5	1.7	15.7	0.1
Underlying Business Investment^	4.3	2.3	6.2	0.3
Machinery & equipment	10.1	2.4	19.5	0.1
Non-dwelling construction	0.5	2.3	-4.4	0.1
New building	-1.5	1.5	-8.9	0.0
New engineering	2.3	3.0	-0.2	0.1
Underlying Public Final Demand	0.6	1.9	5.8	0.5
Domestic Demand	**1.9**	**1.7**	**12.2**	**1.6**
Stocks (a)	0.7	-0.2	1.5	-0.2
GNE	**2.7**	**1.4**	**13.9**	**1.4**
Net exports (a)	**-0.6**	**-1.0**	**-3.7**	**-1.0**
Exports	0.0	-3.2	-2.6	-0.7
Imports	3.4	1.5	16.8	-0.3
GDP	**1.9**	**0.7**	**9.6**	**0.7**

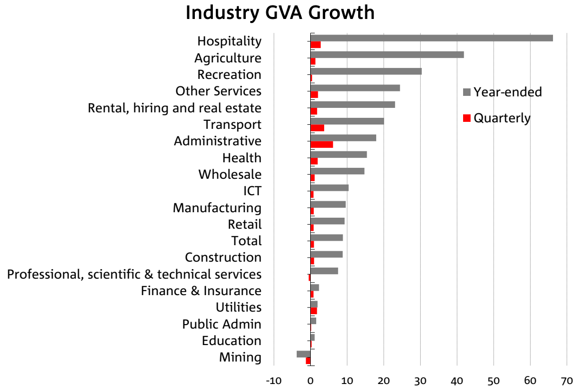
(a) Contribution to GDP growth ^ Excluding transfers between the private and public sector

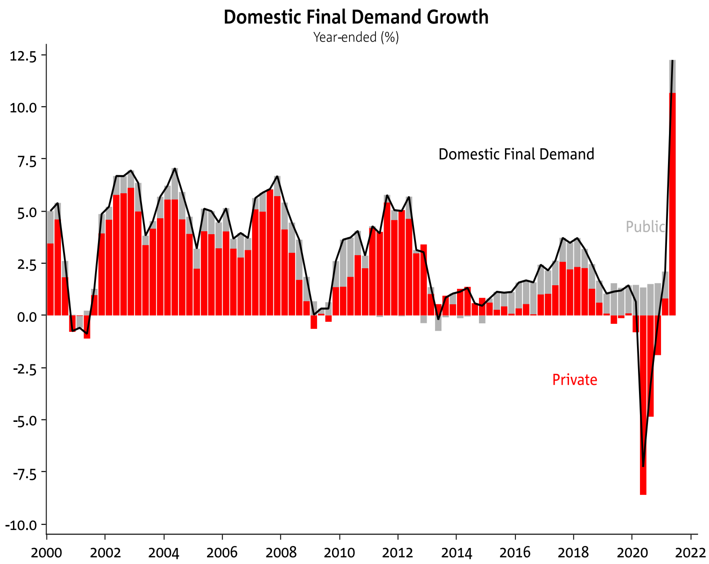
INCOME MEASURES

Income measures	q/q % ch		y/y % ch
	Mar-21	Jun-21	Jun-21
Real GDI	3.7	2.2	15.0
Real net disposable income per capita	3.5	1.8	17.2
Compensation of employees	1.5	1.3	6.8
Average compensation of employees (average earnings)	0.3	-0.1	0.3
Corporate GOS	-1.9	5.7	1.2
Non-financial corporations	-2.5	6.7	0.4
Financial corporations	0.9	1.7	4.7
General government GOS	1.4	1.4	5.7
Productivity & unit labour cost			
GDP per hour worked	1.1	-1.2	-0.7
GVA per hour worked mkt sector	0.5	-1.3	-1.9
Non-farm nominal unit labour cost	8.8	2.9	13.7
Non-farm real unit labour cost	7.1	0.4	6.7

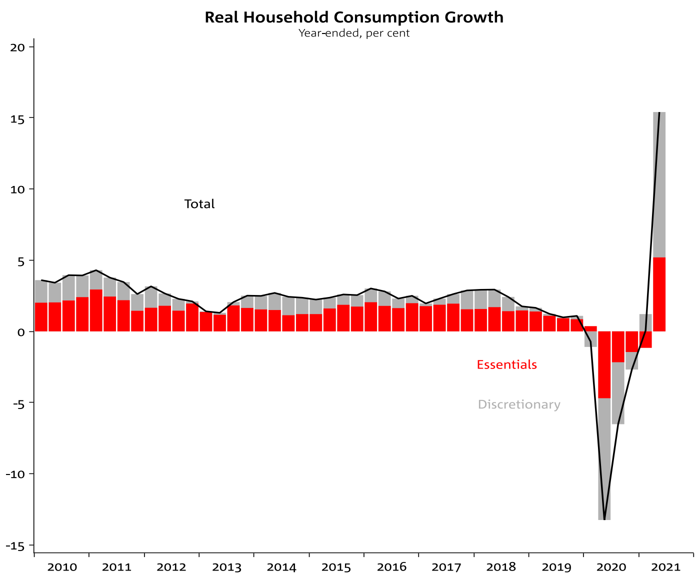
State final demand

State/ Territory	Q/Q		Y/Y
	Mar-21	Jun-21	Jun-21
NSW	1.9	2.2	14.6
NT	-2.2	5.3	14.3
TAS	1.7	1.4	13.1
WA	3.2	1.2	12.4
SA	2.3	1.8	12.4
QLD	0.3	2.0	11.5
VIC	2.6	1.4	10.5
ACT	0.8	0.9	6.1





Source: National Australia Bank, Macrobond



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