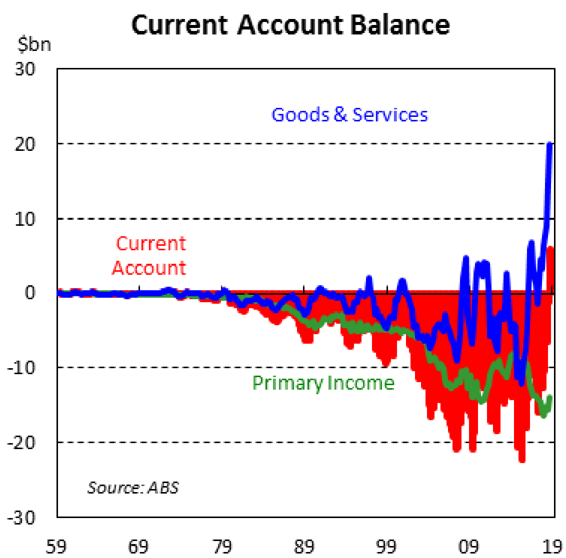
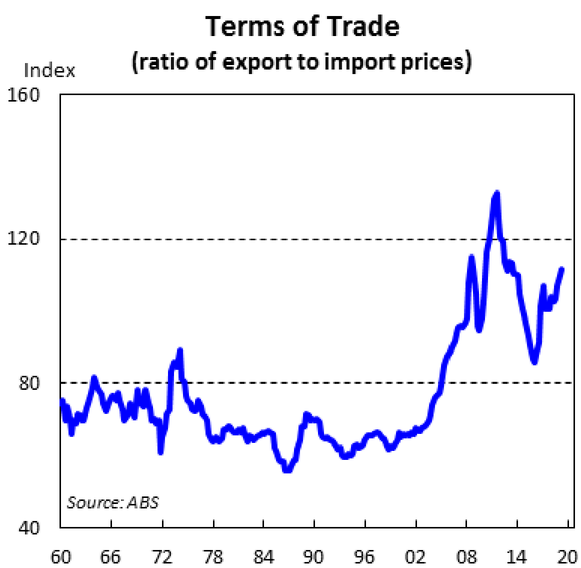
Current Account and GDP Preview

First Surplus since 1975!

- **The current account swung into surplus in the June quarter 2019, a result not seen since 1975. The first surplus in our lifetime was also the largest recorded (in dollar terms) at $5.9 billion.**
- **Surging exports receipts was mostly behind the turnaround, boosted by both higher export prices and volumes. Exports rose 4.0% in the June quarter, rising for the seventh consecutive month. Commodity prices have been steadily rising over the past few years. Iron ore prices have been especially strong, which neared US$120 a tonne, and their highest in five years.**
- **Strong growth in export volumes and the decline in import volumes indicate net exports will contribute 0.6 percentage points to GDP growth in the June quarter.**
- **The terms of trade lifted 1.5% in the June quarter, improving for the fourth consecutive quarter. The terms of trade is now 8.9% higher than a year ago, and the highest since the June quarter of 2013. A higher terms of trade is providing a boost to national incomes.**
- **The surplus on the current account is not likely to be sustained. Iron ore prices have already fallen sharply from their peaks and weaker global growth will weigh on export demand.**
- **We expect GDP rose 0.5% in the June quarter and by 1.4% in the year to the June quarter, which would be the weakest annual pace in nearly 10 years (in the midst of the GFC).**





Current Account

The current account swung into surplus in the June quarter 2019, a result not seen since 1975. The first surplus in our lifetime was also the largest recorded (in dollar terms) at $5.9 billion.

Surging exports receipts was mostly behind the turnaround, boosted by both higher export prices and volumes. Exports rose 4.0% in the June quarter, rising for the seventh consecutive month. Commodity prices have been steadily rising over the past few years. Iron ore prices have been especially strong, which neared US$120 a tonne, and their highest in five years.

At the same time, imports have been weak, reflecting soft demand in the domestic economy. Imports declined 0.3% in the June quarter.

The combination of strong exports and weak imports bolstered the goods and services surplus to a whopping record of $19.9 billion. It was more than enough to offset the primary income deficit. Indeed, the income deficit unexpectedly narrowed, from $15.5 billion in the March quarter to $13.9 billion in the June quarter.

Unfortunately, the surplus on the current account is not likely to be sustained. Iron ore prices have already fallen sharply from their peaks and weaker global growth will weigh on export demand.

Terms of Trade

The terms of trade lifted 1.5% in the June quarter, improving for the fourth consecutive quarter. March quarter, the third consecutive quarterly increase.

The terms of trade is now 8.9% higher than a year ago, and the highest since the June quarter 2013. A higher terms of trade is providing a boost to national incomes, and flowing through to stronger company profits and taxation revenue.

These good times, however, are unlikely to last. Iron ore prices have since fallen over 25% since its recent peak, suggesting that the terms of trade is likely to be lower over the June quarter. Trade tensions and weakening global growth have also weighed on prices of other commodities.

Export and Import Volumes

Export volumes of most commodities were higher, including metal ores & minerals (0.6%), coal, coke & briquettes (3.7%), metals (excluding monetary gold) (5.7%) and other mineral fuels (10.9%). The rebound reflects a recovery from weather disruptions earlier in the year.

Rural-good exports weakened 4.3%, still being impacted by the effects of the drought.

A 1.3% fall in import volumes highlighted the areas of weakness in the domestic economy. In particular, consumption imports were weak, declining 2.9%. The decline was driven by weak imports in household electrical items (-6.1%) and cars (or non-industrial transport equipment) (-10.6%).

Volumes of capital goods (-0.5%) and intermediate and other merchandise goods (-1.4%) also fell in the quarter, further pointing to weakening conditions in the business sector.

Strong growth in export volumes and the decline in import volumes indicate net exports will contribute a solid 0.6 percentage points to GDP growth in the June quarter.

Government Finance Statistics

Government spending grew strongly in the June quarter, led by government consumption. Government consumption rose 2.7% in the quarter, while government investment fell 2.3% in the quarter.

The data indicates that the government sector has played an important role in supporting economic growth in the June quarter. There continues to be a strong pipeline of public infrastructure spending, which should continue underpin economic growth over the medium term.

GDP Preview

Tomorrow, we receive an update on the national-accounts data for the June quarter of 2019. This data will include the gross-domestic-product (GDP) outcome, which measures the pace of broader economic activity in the economy. We expect GDP rose 0.5% in the June quarter and by 1.4% in the year to the June quarter, which would be the weakest annual pace in nearly 10 years (in the midst of the GFC).

GDP data has revealed a loss of momentum in the domestic economy since the second half of last year, led by the consumer and housing downturn, and these factors are expected to continue over the June quarter. While house prices are bottoming, the residential-construction downturn has further to run, dragging on economic growth. Consumer spending will benefit from tax cuts and rate cuts, but this is mostly a story for the second half of this year. Even then, we expect the recovery in consumer spending won't be strong enough to return growth to trend next year. GDP should also show the business-investment story remains soft.

In the June quarter, net exports and government consumption underpinned growth. Indeed, net exports likely added 0.6 percentage points to growth. The strong performance of the exports sector reflected in the first current account surplus since 1975. We predict government consumption added a firm 0.5 percentage points to growth in the quarter.

Stronger commodity prices have boosted the terms of trade and national incomes in the June quarter. While this has supported company profits and taxation revenues the benefits to household incomes has been limited. Moreover, this boost to incomes is unlikely to be sustained.

Beyond Q2 represents a crucial turning point for the Australian economy. Tax cuts, RBA rate cuts and a recovery in dwelling prices should result in an improvement in domestic demand over the second half of this year. However, the net exports story might lose some of its shine, as iron ore and other commodity prices ease and trade tensions remain elevated.

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