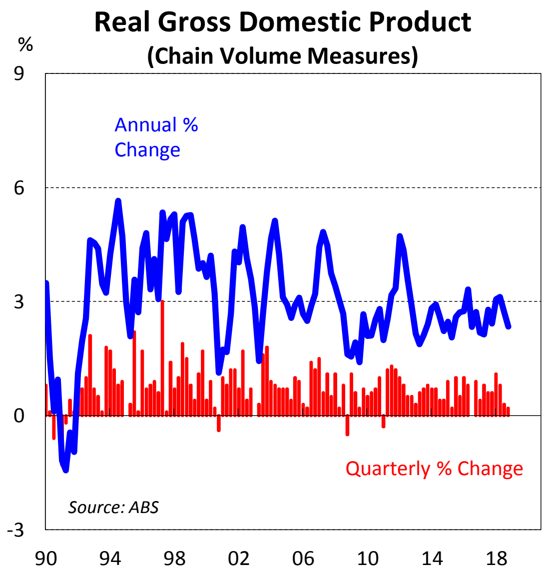
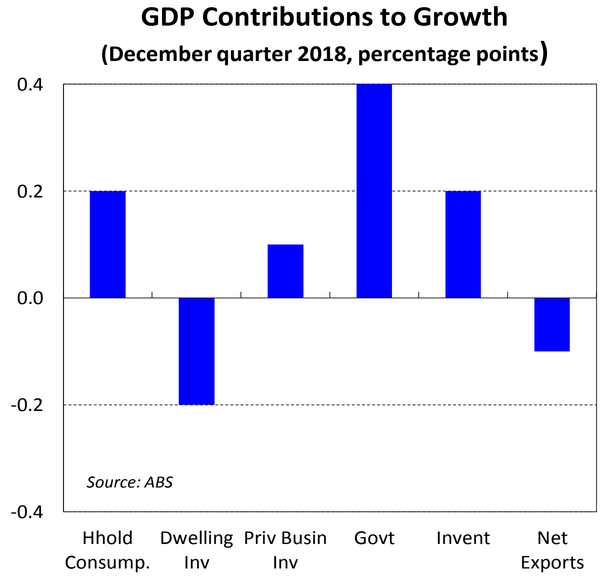
National Accounts - GDP

Economy Loses Momentum

- **The Australian economy lost steam over the second half of last year. The loss of momentum was driven by the downturn in housing and subdued consumer spending against a backdrop of slow wages growth. The economy also faced headwinds from the drought.**
- **Gross domestic product (GDP) rose by 0.2% in the December quarter, meeting our expectations, but slightly weaker than consensus expectations for a rise of 0.3%. This outcome followed another weak increase of 0.3% in the September quarter and was the smallest quarterly rise in GDP in just over 2 years.**
- **Annual growth slowed to 2.3% in the December quarter, from 2.7% in the September quarter. This rate remains below the 10-year average of 2.6% and below estimates of the trend pace of growth.**
- **GDP growth in the quarter was led by public spending. Household consumption and business investment made small contributions to growth. Meanwhile net exports detracted from growth.**
- **The household savings ratio edged up to 2.5% in the December quarter, from a decade low of 2.3% in the September quarter. Although household spending growth remained modest in the December quarter, it outpaced growth in gross disposable income.**





GDP Expenditure Measure:

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Household consumption added 0.2 percentage points to GDP growth in the quarter. This is a very weak contribution and follows a similar-sized contribution in the previous quarter. In terms of growth in the quarter, household consumption lifted by 0.4%, after 0.3% growth in the September quarter. The pace of household consumption clearly slowed in the second half of last year. By sector, the largest spending increases were for clothing & footwear (up 2.2% in the quarter) and health (up 1.9% in the quarter) while the weakest result was for cigarettes & tobacco (down 2.9% in the quarter) and electricity, gas & other fuel (down 2.4%). On a year ago, household spending slowed to a 2.0% pace, the weakest in 5½ years.

The soft growth in household consumption comes amid high levels of household debt, slow wages growth and a deepening in the housing downturn. There was a modest rise in the household savings ratio, from 2.3% in the September quarter to 2.5% in the December quarter. The ratio is long way off the post GFC peak of 10.9% (recorded in the December quarter of 2008). The low ratio suggests there is little room for households to dip into their savings to fund spending.

Selected Expenditure Items on GDP
Chain Volume Measures

	Contribution to GDP, ppt
Household Consumption	0.2
Dwelling Investment	-0.2
Business Investment	0.1
Public	0.4
Inventories	0.2
Net Exports	-0.1

The downturn in **housing,** as reflected in activity and prices, is expected to weigh on dwelling investment over the next 12-18 months. In the December quarter, it was reflected in the falls in new dwelling investments (-3.6%) and alterations & additions (-3.1%). Total dwelling investment dropped 3.4% in the December quarter, which is the biggest quarterly contraction in nearly two years. In terms of contributions, dwelling investment detracted 0.2 percentage points from growth in the quarter. Dwelling investment still increased 2.5% over the past year with strength in alterations and additions mostly underpinning annual growth. The slump in building approvals indicates the downtrend in dwelling investment has further to go and the annual rate will soon turn from growth to a contraction.

Private business investment was encouraging, rising by 0.7% in the December quarter, after two consecutive quarterly declines. The latest capex data renewed hopes that there is further to run in the upswing in non-mining investment, with businesses upgrading spending plans this year and the first reading for 2019-2020 positive. On a year ago, private business investment was 0.2% lower.

The **government** sector was one of the largest contributors to GDP growth in the December quarter, overall contributing 0.4 percentage points in the December quarter. Spending on health and on transport infrastructure projects are trending markedly higher and tax revenues have been boosted by higher profits.

Government consumption rose by 1.8% and government investment increased 0.3% for the quarter.

Inventories contributed 0.2 percentage points to GDP growth in the December quarter.

Exports fell 0.7% in the December quarter while imports edged up just 0.1%. Drought conditions and supply disruptions hurt exports in the quarter. Net exports, therefore, took away 0.1 percentage points to growth in the December quarter.

GDP Income Measure:

Nominal GDP rose 1.2% in the December quarter, which was the fastest pace of growth in three quarters. The annual pace of nominal GDP (incomes) rose by 5.5% in the quarter. It was the strongest annual pace in five quarters. Stronger commodity prices, which drove a lift in the terms of trade, were supportive of incomes.

Wage incomes (total compensation of employees) rose 0.9% in the quarter. The annual pace of growth eased further from 4.6% in the September quarter to 4.3% in the December quarter. Slow wage growth is continuing to weigh on income growth, although solid job creation should enhance aggregate incomes.

Company profits grew by a solid 2.4% in the December quarter, the sixth consecutive quarterly gain. The annual pace of company profits growth edged up from 5.5% to 7.7%, which was the strongest in five quarters. Higher commodity prices and increased production volumes were supportive of profits in the mining sector.

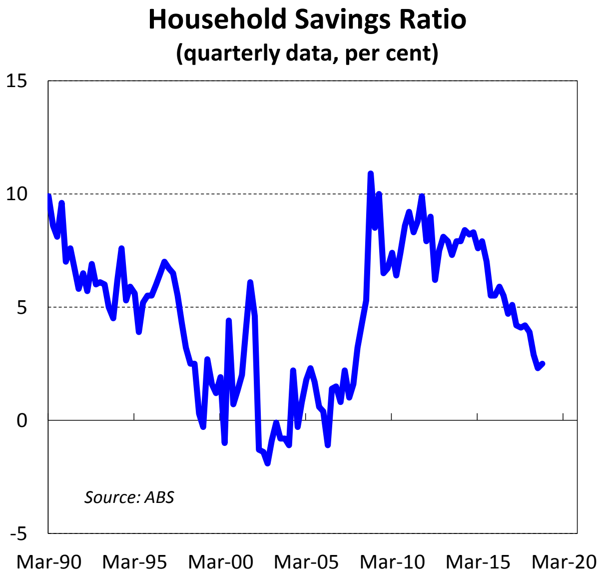
When excluding the impact of prices, GDP based on incomes rose just 0.1% in the December quarter, after rising 0.1% in the September quarter. It was the smallest quarter-on-quarter increase since 2011.

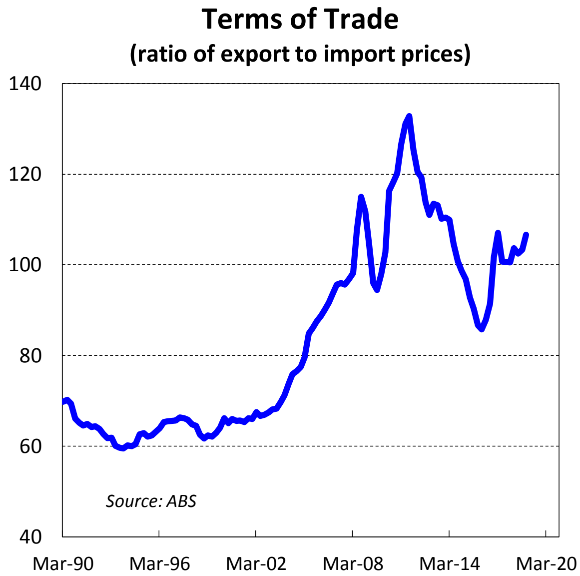
- **Household Savings Ratio**

The household savings ratio edged up to 2.5% in the December quarter, from a decade low of 2.3% in the September quarter. Although household spending growth remained modest in the December quarter, it outpaced growth in gross disposable income. Despite the uptick in the household savings ratio, it remains low. Taken together with the high level of household debt and slow wages growth, there is limited scope for households to continue to dig deeper into their savings to fund consumer spending.

- **Terms of Trade**

The terms of trade (ratio of export to import prices) rose 3.2% in the December quarter, to be 6.1% higher in the year. Higher commodity prices were supportive of export prices and lent support to incomes growth.



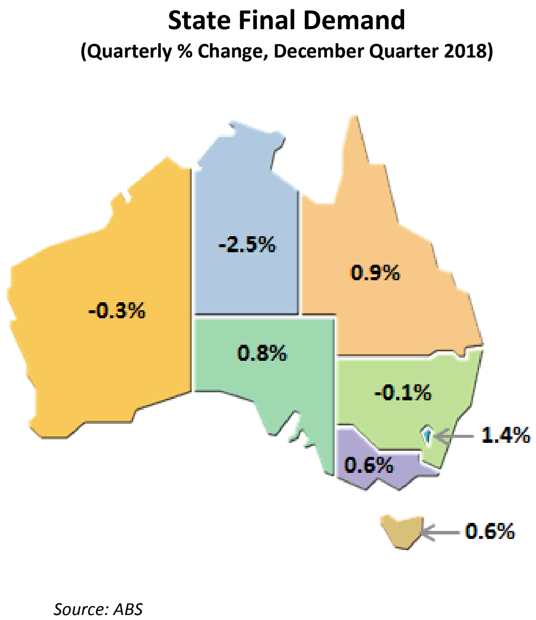


State Final Demand:

Economic activity by State and territory is provided by Gross State Product (GSP). GSP is the closest measure to GDP. However, GSP is only published annually. State final demand is published more frequently (i.e. quarterly), but it excludes the trade sector.

In the December quarter, State final demand was mixed across the States. There was strong growth in the ACT (1.4%), where private investment growth was strongest, followed by Queensland (0.9%), South Australia (0.8%) and Victoria and Tasmania (each 0.6%). State final demand weakened in the Northern Territory (-2.5%), WA (-0.3%) and NSW (-0.1%). The decline in NSW was led by weakness in investment, both private and government.

On an annual basis, growth was strongest in Victoria (5.2%), followed by Tasmania (5.1%), the ACT (5.0%), NSW (2.6%), South Australia (2.4%) and Queensland (2.1%). Annual growth fell in Western Australia (-1.6%) and in the Northern Territory (-15.0%).



Industry Break Down:

Out of the 19 industries, 12 industries recorded growth in the December quarter.

The strongest performing industry in the quarter was arts & recreation services (2.5%), followed by information, media & telecommunications (2.5%) and public administration & safety (2.4%).

The weakest sector was agriculture, forestry & fishing (-3.2%), with the drought in parts of Australia impacting growth in the sector. This was followed by construction (-1.9%).

Annual growth was strongest in healthcare & social assistance, at 8.1%.

Industry Gross Value Added, Chain Volume Measures

By Industry Sector	Quarterly % Change	Annual % Change
Arts & recreation services	2.5	4.9
Info, media & telco	2.5	1.7
Public admin & safety	2.4	6.1
Healthcare & social assistance	2.3	8.1
Transport, postal & warehousing	1.3	0.7
Mining	1.2	6.7
Wholesale trade	0.6	1.6
Education & training	0.5	2.1
Accommodation & food services	0.4	0.9
Financial & insurance services	0.3	2.7
Administrative & support services	0.1	4.9
Retail Trade	0.1	1.4
Other services	-0.2	3.1
Rental, hiring & real estate services	-0.6	1.6
Manufacturing	-1.2	-0.8
Professional, scientific & technical services	-1.5	2.6
Electricity, gas, water & waste services	-1.5	-0.2
Construction	-1.9	-3.7
Agriculture, forestry & fishing	-3.2	-5.9

Outlook

The Australian economy grew at a soft pace for the second consecutive quarter. Following a strong pace of growth in the first half of 2018, the pace of economic growth slowed in the second half of the year. Economic growth this year is expected to consolidate at a below-trend pace.

The detail in the GDP release highlights areas of concern and downside risk in the growth outlook. Without the boost provided by government consumption in the quarter, the GDP outcome would have looked significantly weaker. Consumer spending growth remained soft in the December quarter, constrained by high levels of household debt, slow wages growth and the housing market downturn. It is difficult to foresee a robust pace of consumer spending growth in the absence of a more significant increase in wages growth. Additionally, dwelling investment detracted from growth in the December quarter and that trend is expected to continue this year and next.

While the strong pipeline of public infrastructure spending, solid business investment and ongoing employment gains should provide some support for economic growth, it is unlikely to be enough to reboot momentum in economic growth. Today's data adds to our expectation the Reserve Bank will cut official interest rates later this year.

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