Data Snapshot

Wednesday, 7 September 2016

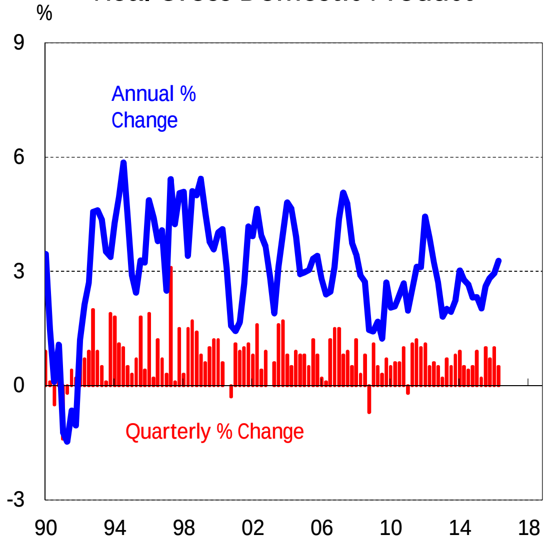
Bank of Melbourne

National Accounts - GDP

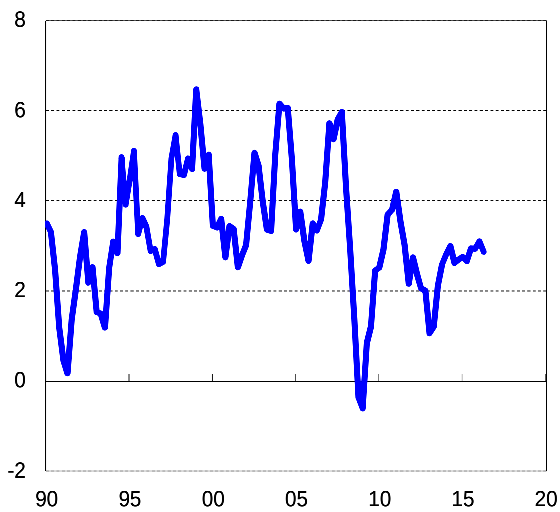
25 Years of Economic Growth

- GDP growth was in line with our expectations, rising by 0.5% in the June quarter. This followed a revised increase of 1.0% in the March quarter.
- For the year to the June quarter, GDP rose to 3.3% and marks 25 consecutive years of annual economic growth. The 3.3% annual pace was the strongest since June 2012.
- The detail behind the GDP data was mixed with positive contributions from government spending and housing and an ongoing, but fully anticipated, contraction in business investment.
- Incomes, which include wages and profits, strengthened in the June quarter. Although wages growth remained soft, profits strengthened, boosted by a rebound in commodity prices in the quarter.
- Weakness in business investment weighed on State final demand in most of the major States. State final demand was strongest in the ACT (3.8%) and rose in all other States, with the exception of Western Australia (-2.5%).
- We expect the RBA will need to cut its cash rate again in the current cycle in an attempt to lift underlying inflation towards its target of 2-3% p.a. over the course of the economic cycle.

Real Gross Domestic Product



Household Consumption
(chain volume measures, % pa)



GDP grew 0.5% in the June quarter, which was in line with our forecast (0.5%) and close to the consensus forecast of 0.6%. In addition, GDP growth from the March quarter was revised slightly lower, to a 1.0% increase.

The annual pace of growth picked up from a revised 3.0% in the year to the March quarter (previously reported as a 3.1% increase) to 3.3% for the year to the June quarter. This was again an above-trend pace of economic growth and was the strongest annual pace since June 2012. The Australian economy completed its 25th consecutive year of annual GDP growth.

There was a different composition to growth in the June quarter compared to the previous quarter. Last quarter net exports took the lead in growth. In the June quarter, net exports detracted from growth with a pick up in imports and a slower pace of export expansion.

GDP Expenditure Measure:

The detail behind the GDP data was mixed with solid contributions from government spending and housing and an ongoing, but fully anticipated, contraction in business investment.

Net exports have been a major driver behind the recent volatility in quarterly economic growth. That trend continued in the June quarter where net export detracted 0.2 percentage points to growth compared to a 1.1 percentage point positive contribution in the March quarter. Exports rose a further 1.3% in the June quarter while imports were up 2.7%. The increase in resource production capacity following the resource investment boom is enabling strong growth in resource exports but in the June quarter that pace of growth slackened.

Business investment continues to detract from growth as the mining investment boom winds down. Business investment fell 5.7% in the June quarter, the eighth consecutive quarterly decline. For the year to the June quarter, business investment fell 14.7%, the largest annual decline since the December quarter 2000. Business investment detracted 0.7 percentage points from GDP growth in the June quarter.

The weakness in business investment continues to weigh on domestic demand. Domestic demand posted a gain of 0.6% following a revised 0.4% increase in the March quarter. This is below the 0.8% average quarterly gains seen since June 2000. For the year to the June quarter, domestic demand increased 1.2%, down from 1.3% annual growth in the March quarter.

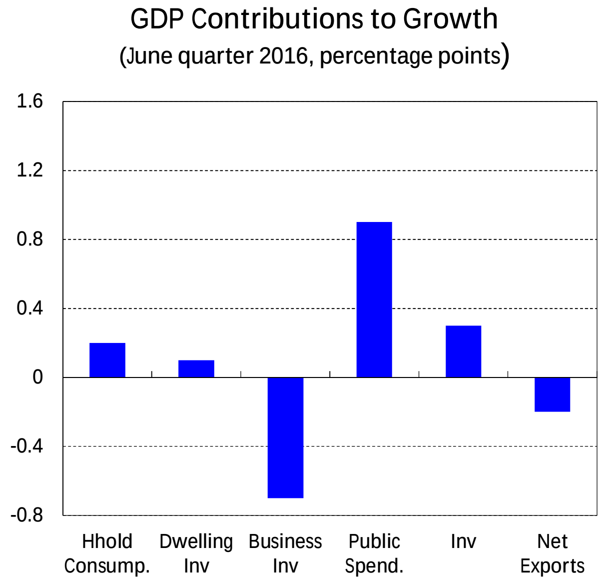
Household consumption rose by a subdued 0.4% in the June quarter, after rising 0.8% in the March quarter. Job growth and ongoing low interest rates are supporting demand. However, the impact of low interest rates on those who rely on income from savings may now be playing out in the softer consumption numbers. Also potentially holding back household demand is the slow pace of wages growth.

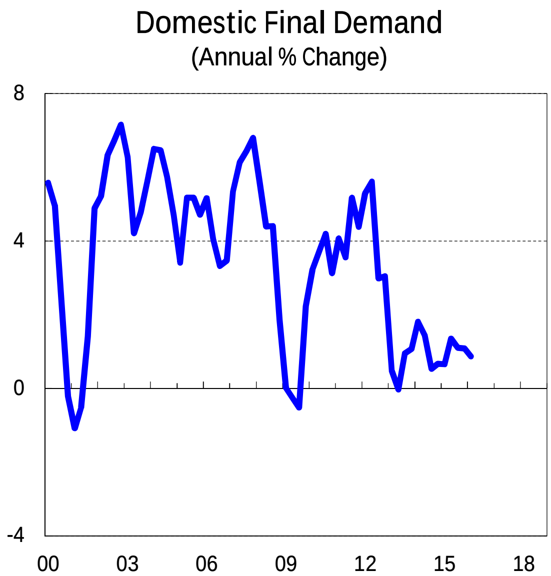
Dwelling investment has been a key driver of growth over the past three years. In the June quarter, dwelling investment rose 1.6%, down from the 2.8% seen in the December quarter and the 2.1% reported in the March quarter. With building approvals having kicked up recently we expect dwelling investment to continue to add to growth for the remainder of 2016. The RBA's August rate cut also appears set to consolidate demand for housing assets.

Government expenditure supported economic growth in the quarter. Government investment rose 19.8% in the June quarter, while government consumption spending lifted 1.9% for the quarter. The quarterly increase in government investment was the strongest since June 2008 and likely reflects the extensive infrastructure construction currently being undertaken.

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	0.4
Public Consumption	1.9
Dwelling Investment	1.6
Business Investment	-5.7
Public Investment	19.8
	Contribution to GDP, ppt
Inventories	0.3
Net Exports	-0.2





GDP Income Measure:

GDP growth based on incomes was stronger than the headline GDP figure in the June quarter. Incomes in nominal terms (or unadjusted for inflation) jumped 1.3% in the June quarter. Over the year, the income component of GDP strengthened, rising by 3.4%, up from 2.1% growth in the year to the March quarter.

This measure largely comprises wages and profits. While wages growth remained soft in the June quarter, profits strengthened on rising commodity prices.

- Gross Operating Surplus

Profits (gross operating surplus) for total corporations jumped 2.5% in the June quarter, more than fully retracing a 1.9% decline in the March quarter. It was the largest quarterly increase in corporate profits since the December quarter 2013. The improvement in corporate profits in the June quarter was driven by a rebound in commodity prices.

For the year to the June quarter total corporations profits rose 1.5%, up from a decline of 2.7% in the year to the March quarter. This was the strongest annual gain in corporate profits since the June quarter 2014 and followed six consecutive quarters of declining annual growth.

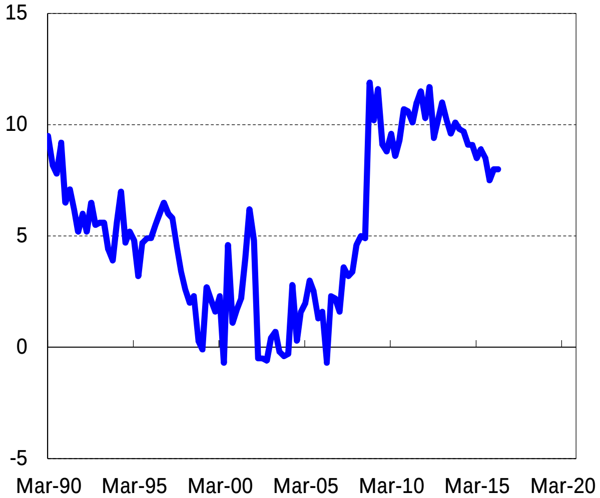
A further lift in commodity prices since the end of the June quarter is an encouraging sign for the outlook for mining profits in the near-term. A lower Australian dollar should continue to provide support to company profits across all sectors. Moreover, businesses continue to report above-average conditions in surveys.

- Wages

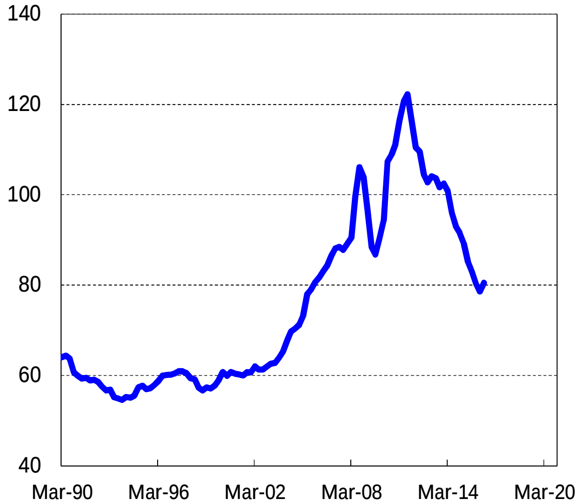
Wages (including employer's social contributions) rose by 0.5% in the June quarter, the slowest quarterly wages growth in over a year. The annual pace of growth eased to 3.1%, from 3.6% in the year to the March quarter. National Accounts wages data more accurately reflects the recent softness in other wages indicators following the release of this June quarter data.

Household disposable income, which includes non-wage income, was a little firmer than wages income, rising by 0.9% in the June quarter. For the year to the June quarter, household disposable income rose 3.1%, down from growth of 3.9% in the year to the March quarter.

Household Savings Ratio
(quarterly data, per cent)



Terms of Trade
(ratio of export to import prices)



- Household Saving Ratio

The household saving ratio held steady at 8.0% in the June quarter, unchanged from the March quarter, but down from a recent peak of 11.7% in the June quarter 2012. The slower growth in household spending reflects a lack of willingness among householders to further rundown their savings in the June quarter.

The household savings ratio remains above the 10-year average, and suggests that there is further scope among households to draw on their savings, particularly while interest rates remain low and household wealth levels are rising.

- Terms of Trade

The terms of trade (ratio of export to import prices) rose 2.4% in the June quarter, reflecting the increase in commodity prices in the quarter. It was the first quarterly increase in the terms of trade since the December quarter 2013. The terms of trade has declined 5.4% over the year to the June quarter.

The terms of trade is now 34.1% below the peak reached in the September quarter 2011, but is only 0.4% below the 20-year average.

Industry Break Down:

Industry Gross Value Added, Chain Volume Measures

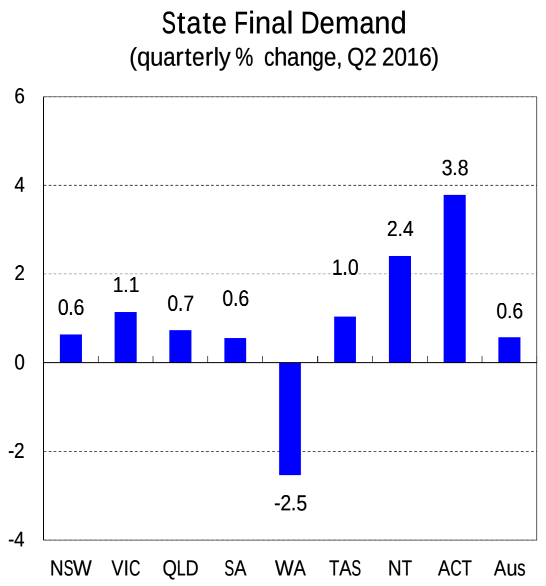
By Industry Sector	Quarterly % Change	Annual % Change
Other services	3.8	1.8
Professional, scientific & technical services	3.2	2.3
Rental, hiring & real estate services	3.1	8.6
Administrative & support services	2.3	-0.5
Healthcare	1.8	3.8
Wholesale Trade	1.7	5.3
Financial & insurance services	1.3	5.3
Manufacturing	1.0	-2.1
Education & training	0.7	2.7
Retail Trade	0.5	2.7
Information media & telecommunications	0.4	4.5
Public Admin & safety	0.3	5.1
Transport,postal & warehousing	0.3	-0.9
Electricity gas, water & waste services	0.2	1.7
Accommodation & food services	-0.3	-0.6
Arts & recreation services	-0.4	3.7
Construction	-0.8	1.4
Mining	-3.5	9.0
Agriculture, forestry & Fishing	-3.8	-3.3

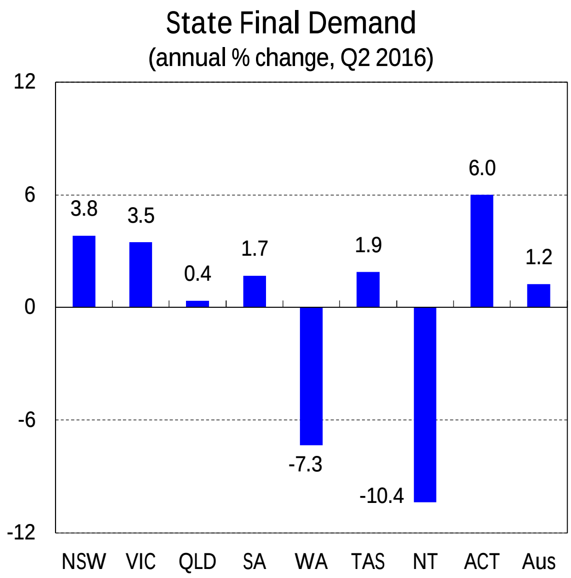
State Final Demand:

Weakness in business investment continued to weigh on State final demand in most of the major States. State final demand rose in all of the States and territories, with the exception of Western Australia, where it fell 2.5% in the June quarter. The strongest growth in State final demand was in the ACT (3.8%), followed by the Northern Territory (2.4%), Victoria and Tasmania (both 1.1%), Queensland (0.7%) and New South Wales and South Australia (both 0.6%).

Strong growth in the ACT in the June quarter was driven by private and government investment, as well as government consumption spending. Growth in Victoria's State final demand was led by government investment, while private investment fell in the June quarter. Similarly in New South Wales, private investment fell in the June quarter, although government investment and household spending gained ground. Household spending growth was strongest in South Australia in the June quarter, while private investment sank. The largest quarterly decline in private investment was unsurprisingly in Western Australia (-13.0%), causing State final demand to fall for the quarter, despite a strong increase in government investment.

On an annual basis, final demand was also strongest in the ACT (6.0%), followed by New South Wales (3.8%), Victoria (3.5%), Tasmania (1.9%), South Australia (1.7%) and was more subdued in Queensland (0.4%, and the first increase in annual growth since the June quarter 2014). In Western Australia, State final demand fell 7.3% in the year to the June quarter, the fastest rate of decline since this series began in 1985. In the Northern Territory, State final demand in annual terms contracted 10.4% in the June quarter.





Outlook

Net exports took a back seat in the June quarter GDP numbers but are expected to contribute to growth in the year ahead. While business investment continues to contract, the time will come when it is no longer such a drag on the numbers. Domestic demand remains modest. Ongoing growth in jobs will assist domestic demand but pressure to balance the Budget is likely to prevent fiscal policy making as positive contribution. We expect annual GDP growth to remain close to 3.0% over 2016, but the risk is that growth will be closer to trend rate of 2.75% in 2017.

We expect the RBA will need to cut its cash rate again in the current cycle in an attempt to lift underlying inflation towards its target of 2-3% over the course of the economic cycle. Unless there are changes to underlying economic conditions, we expect the cash rate to fall to 1.0% by mid-2017. We expect the first cut to occur in November - unless there is a turnaround in underlying economic conditions or housing regains stronger momentum than expected. A substantially lower AUD could be one of those changes in underlying conditions.

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