Data Snapshot

Wednesday, 7 March 2018

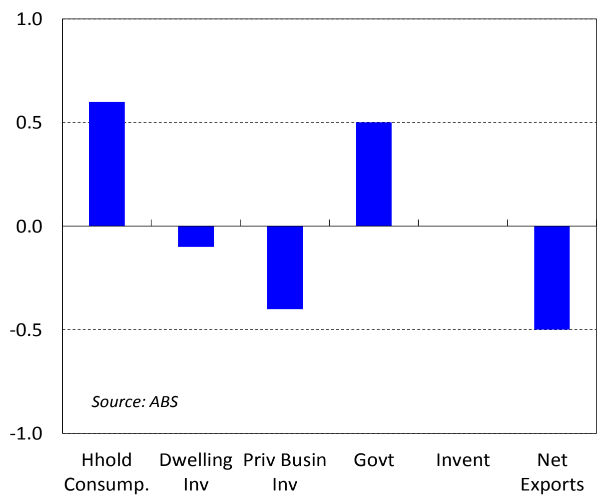
Bank of Melbourne

National Accounts - GDP

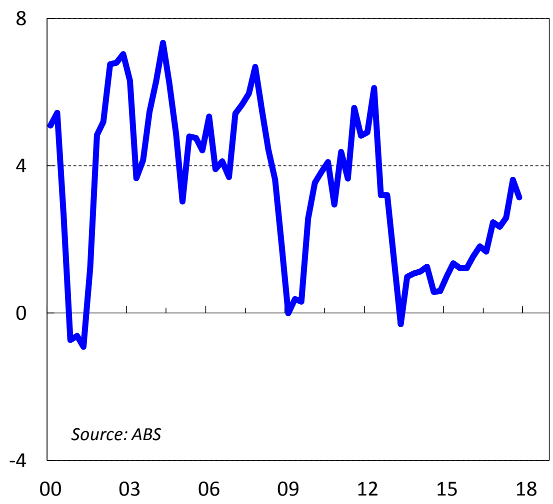
Better Than It Looks

- **Gross domestic product (GDP) rose by a smaller than expected 0.4% in the December quarter, following upwardly revised growth of 0.7% in the September quarter.**
- **Annual GDP growth slowed to 2.4% in the December quarter, from 2.9% in the September quarter. This pace is below the 20-year average of 3.1%.**
- **In the December quarter, household consumption gained solidly and the government sector contributed to growth, while private business investment and dwelling investment weakened.**
- **Household consumption rose by 1.0% in the December quarter, which was the strongest quarterly pace of growth since the March quarter of 2016. Encouragingly, the lift in household spending came entirely from growth in household incomes. Compensation of employees (total wages) grew at its strongest annual pace in over 5 years. We may be finally seeing benefits from the strength in the labour market flow through to consumer spending.**
- **The major sources of weakness in the December quarter were from business investment and exports, and this softness should be temporary. Today's data does not change our view of an economy that will grow at a pace closer to trend. We expect that GDP growth this year will exceed the pace over 2017.**

GDP Contributions to Growth
(December quarter 2017, percentage points)



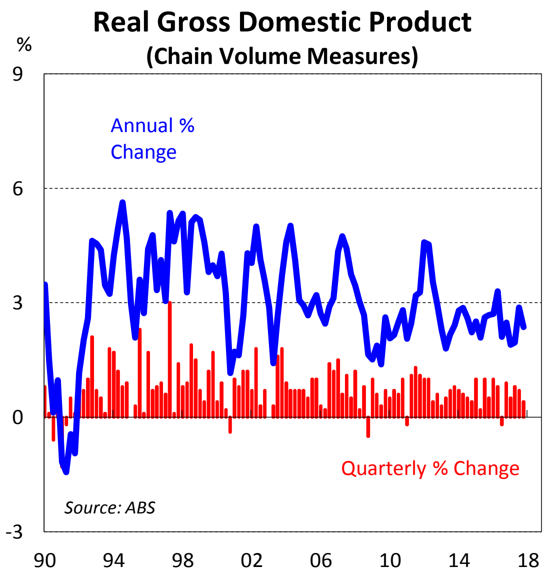
Domestic Final Demand
(Annual % Change)

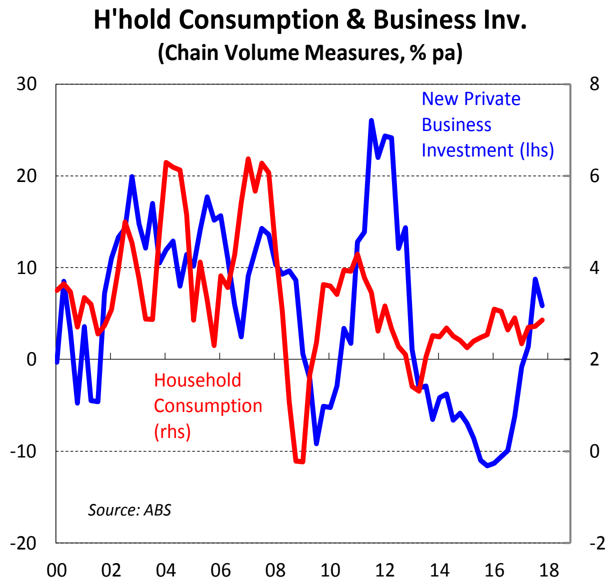


GDP Expenditure Measure:

Gross domestic product (GDP) rose by a smaller than expected 0.4% in the December quarter, following upwardly revised growth of 0.7% in the September quarter.

Annual growth slowed to 2.4% in the December quarter, from 2.9% in the September quarter.





Although today's headline number for GDP growth, at 0.4%, was disappointing, there were some reassuring aspects to the data, which suggest a more positive growth outlook in the year ahead.

One encouraging feature of today's data was healthy growth in household spending in the December quarter. Household consumption rose by 1.0% in the December quarter, which was the strongest quarterly pace of growth since the March quarter of 2016. By sector, spending in the quarter was strongest in health (3.4%), followed by hotels, cafes & restaurants (2.9%).

The household savings ratio lifted slightly in the December quarter, revealing households choose to save a little more. It was promising that households were able to spend more without dipping into their savings buffer.

Consumer spending growth has come under pressure in recent years as high levels of household debt and slow wages growth have crimped spending; the March quarter is already off to a lacklustre start, suggesting it may be difficult for consumption spending to match its pace from the December quarter in the current quarter.

Private business investment contracted by 2.7% in the December quarter. This contraction followed an increase of 10.0% in the September quarter. Private business investment detracted 0.4 percentage points from GDP growth in the December quarter. In annual terms, private business investment rose by 7.4% in the December quarter, down from 9.2% annual growth in the September quarter.

Although business investment weakened in the quarter, businesses capex plans, elevated business conditions, healthy confidence levels, and solid global economic growth suggest a positive outlook for business investment. The high level of government spending on infrastructure spending is spilling over to the private sector too.

A sub component of business investment is non-dwelling construction; it slumped 8.0% in the December quarter, after jumping 19.9% in the previous quarter. Non-dwelling construction detracted 0.5 percentage points from GDP growth in the December quarter. Despite weakness in the December quarter, the outlook for non-dwelling construction is upbeat, as evidenced by the pickup in non-residential building approvals over the past year.

Another sub component of business investment is machinery & equipment. It grew 3.3% in the quarter.

Meanwhile, dwelling investment fell 1.3% in the December quarter and was a drag on growth of 0.1 percentage points. Dwelling investment has declined in three out of the past four quarters. Dwelling approvals nationally peaked in August 2016, suggesting a more modest outlook for dwelling investment.

The government sector overall contributed 0.5 percentage points to GDP growth in the December quarter. Government consumption rose by 1.7% in the December quarter. Government investment increased by 2.9% in the quarter.

The sectors above give us the domestic final demand measure, which rose 0.6% in the December quarter. On an annual basis domestic final demand was a firm 3.1%, suggesting a stronger domestic economy without taking into account the traded sector.

The final components of the GDP expenditure measure are the trade sector and inventories.

Export volumes fell by 1.8% in the quarter, while imports rose by 0.5%. This resulted in a detraction of 0.5 percentage points from GDP growth. The contraction in exports should reverse in coming quarters as coal exports were temporarily impacted in the December quarter.

Inventories made a nil contribution to GDP growth in the December quarter.

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	1.0
Public Consumption	1.7
Dwelling Investment	-1.3
Business Investment	-2.7
Public Investment	2.9
	Contribution to GDP, ppt
Inventories	0
Net Exports	-0.5

GDP Income Measure:

GDP growth based on incomes rose 0.6% in the December quarter, following 0.7% growth in the September quarter. The lift in national incomes in the December quarter was as a result of both stronger profits and wages (i.e. compensation of employees).

There has been an encouraging lift in wage incomes in recent quarters. The strength of the labour market is a key factor behind this lift. Wage growth at the individual level remains low, but the strength in job growth over the past year has translated to more Australians being in paidemployment. In aggregate, growth in overall employee compensation has therefore picked up. Total wages (compensation of employees) grew 1.1% in the December quarter, for annual growth of 4.8%. It was the strongest annual pace in over 5 years.

Corporate profits were also higher, rising 0.7% in the quarter. On an annual basis, profits grew 4.0% in the December quarter, down from 11.6% in the year to the September quarter, but still suggesting a steady rate of growth.

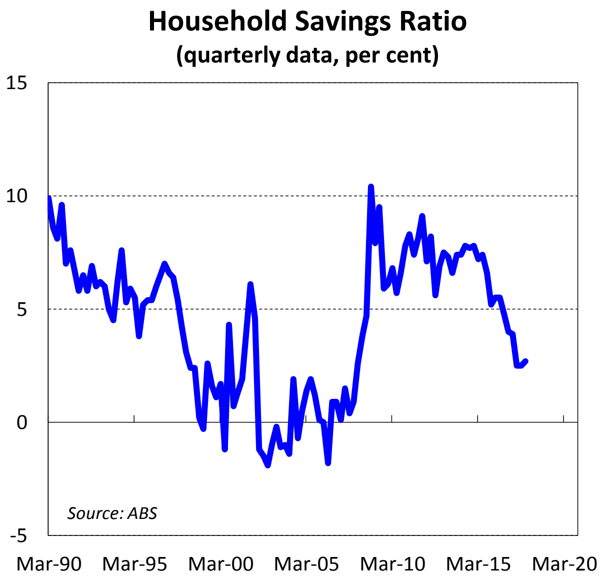
- **Terms of Trade**

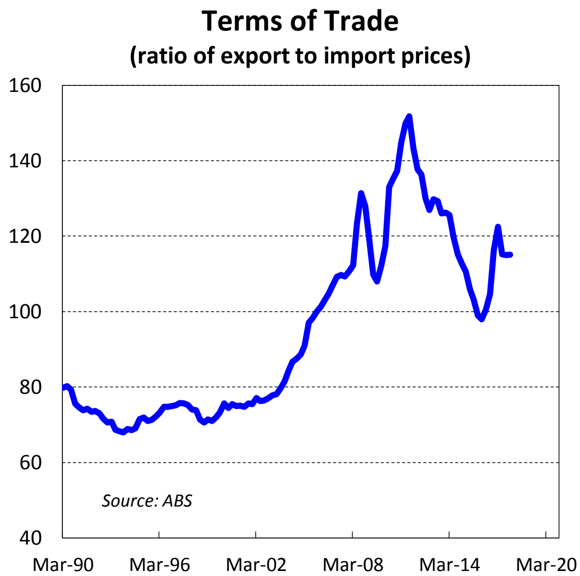
The terms of trade (ratio of export to import prices) was little changed in the December quarter, edging 0.1% higher. Prices of most commodities have risen since, which suggests a higher terms of trade over the March quarter. On a year ago, the terms of trade fell 1.0%.

Household Savings Ratio

The household savings ratio managed to lift from 2.5% to 2.7% in the December quarter. While household consumption was solid in the quarter, households managed to spend through an increase in incomes without a need to tap further into their savings.

That said, the household savings ratio is still close to its lowest in almost ten years. There is not a lot of scope for consumers to run down savings for future spending. Given high household debt levels, growth in consumption will need to come from growth in incomes. The pickup in household incomes in recent quarters, however, has been encouraging. Further strength in the labour market will be a positive development in supporting household spending.





Industry Break Down:

Out of the 19 industries, 13 recorded growth in the December quarter. The strongest performing industry in the quarter was information, media & telecommunications, which grew 2.9% in the quarter. Annual growth, however, was strongest accommodation & food services, which grew 6.7% in the year to the December quarter.

Industry Gross Value Added, Chain Volume Measures

By Industry Sector	Quarterly % Change	Annual % Change
Info, media & telco	2.9	4.2
Rental, hiring & real estate services	2.5	2.5
Arts & recreation services	2.2	2.8
Healthcare	1.9	6.4
Other services	1.9	-0.7
Mining	1.3	1.0
Public admin & safety	1.2	1.3
Accomm & Food Services	1.0	6.7
Education & training	0.5	2.1
Professional, scientific & technical services	0.3	3.7
Retail Trade	0.3	2.5
Construction	0.3	4.9
Financial & insur services	0.1	4.1
Wholesale Trade	-0.2	-0.4
Administrative & support services & safety	-0.6	3.8
Elec, gas, water & waste services	-0.8	1.3
Transport, Postal & warehousing	-0.8	0.3
Mfg	-1.0	2.5
Agri, Forestry & Fishing	-2.7	-8.8

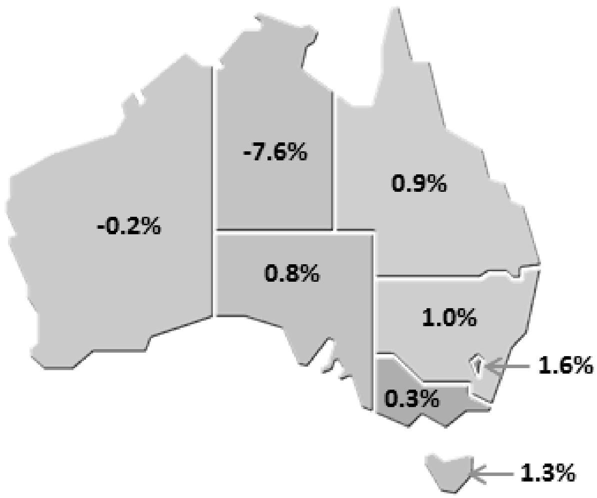
State Final Demand:

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 excludes the trade sector, but is published more frequently (i.e. quarterly).

The strongest growth in the September quarter in State final demand was in the ACT (1.6%), followed by Tasmania (1.3%), NSW (1.0%), Queensland (0.9%), South Australia (0.8%) and Victoria (0.3%). Growth contracted in WA (-0.2%), after two quarterly increases. The largest decline, however, was in the Northern Territory (-7.6%).

On an annual basis, there was strong growth in final demand in the ACT (5.0%), South Australia (4.9%), Tasmania (4.8%), Victoria (4.4%), NSW (3.0%), Queensland (2.6%) and Western Australia (1.2%). Demand weakened in the Northern Territory (-3.1%) in the year to the December quarter.

State Final Demand
(quarterly %, December quarter 2017)



Source: ABS

Outlook:

Economic growth in the December quarter was a touch disappointing. The annual pace of 2.4% is below the 20-year average of 3.1%. For the year 2017, average growth stood at just 2.3%, down from 2.6% in 2016.

Nonetheless, there were some positive details in today's GDP release.

Firstly, the major sources of weakness in the December quarter were from business investment and exports, and this softness should be temporary. The outlook for business investment is improving given recent surveys on intended spending. Non-mining investment is picking up while the drag from mining investment will continue to dissipate. Exports are also expected to rebound, as coal exports recover from a temporary disruption in the December quarter.

Secondly, the strong growth in household consumption in the quarter was underpinned by a growth in household incomes. We may be finally seeing benefits from the strength in the labour market over the past year flow through to consumer spending. Ongoing growth in household incomes through the continued strength in the labour market suggests that household spending will receive some support in coming quarters. It provides a welcome development when slow wage growth at the individual level and high household debt levels are providing downside risks to household spending.

Additionally, there is a solid pipeline of public infrastructure spending which is boosting demand and is spilling over to stronger demand in the private sector.

However, a slowing in housing conditions is expected to continue to weigh on dwelling construction. While activity looks to be stabilising at a high level over the near term, a further softening in housing conditions could result in a further drag on economy. Softer housing prices will also impact consumer sentiment and represent a downside risk for consumer spending that needs to be eyed carefully.

Today's data does not change our view of an economy growing at a reasonable pace. We expect that GDP growth this year will exceed the pace of 2017, and run closer to a pace of 2.8%.

Jo Horton, Senior Economist
Ph: 02-8253-6696
&
Janu Chan, Senior Economist
Ph: 02-8253-0898

Contact Listing

Chief Economist

Besa Deda
dedab@bankofmelbourne.com.au
(02) 8254 3251

Senior Economist

Josephine Horton
hortonj@bankofmelbourne.com.au
(02) 8253 6696

Senior Economist

Janu Chan
chanj@bankofmelbourne.com.au
(02) 8253 0898