# Economic Analysis

# GDP June Quarter 2019

Real GDP rose a seasonally adjusted 0.5% in Q2 following a 0.5% increase in Q1 (revised from +0.4%). The result was as per market expectations and better than our forecast for a 0.3% rise. Annual growth fell to 1.4% YoY, from 1.7% in Q1.

| Seasonally Adjusted Chain Volume | QoQ | YoY |
|---|---|---|
| Real GDP | 0.5% | 1.4% |
| GDP (Expenditure) | 0.4% | 1.5% |
| GDP (Production) | 0.5% | 1.5% |
| GDP (Income) | 0.6% | 1.4% |
| Real Gross Domestic Income | 0.8% | 3.5% |
| Nominal GDP | 1.2% | 5.4% |
| Terms of Trade | 1.5% | 8.9% |
| GDP Deflator | 0.7% | 3.9% |

*All figures below are seasonally adjusted

### *Expenditure*

The expenditure measure of real GDP rose 0.4% in the quarter. Net exports contributed 0.6 percentage points (ppts) as export volumes rose 1.4% and imports were down 1.3%. A 2.7% increase in government consumption spending added 0.5ppts and a soft 0.4% increase in household consumption added 0.2ppts to growth. On the other side of the ledger, inventory changes cut 0.5ppts from growth. A 4.4% fall in dwelling construction (-0.2ppt) and a 0.9% drop in business investment (-0.1ppt) also made negative contributions.

### *Production*

The production measure of GDP rose 0.5%. A 3.4% rise in mining output added 0.3ppts while healthcare & social assistance (+1.5%), public administration & safety (+1.8%) and professional, scientific & technical services (+1.5%), each contributed 0.1ppts to growth. Construction, wholesale trade and manufacturing each saw a 1.4% drop in output and cut 0.1ppt from the headline.

### *Income*

The real income measure of GDP rose a 0.6%, however, as we receive income in current dollars, the income side is best looked at in nominal terms. Nominal income increased 1.2%, with employee compensation rising 1.3% in the quarter, with average compensation rising 0.9%. Employee compensation was up 5.0% YoY. The gross profits of private non-financial corporations rose 2.9% in the quarter. The wages share of total factor income fell 0.1ppt to 51.7%. The profit share rose to 29.4% from 29.2%, the highest level since March 2009. The household savings ratio slipped 0.7ppts to 2.3% in Q1, its lowest level since 2007.

### *Terms of Trade*

The terms of trade, the relative Australian dollar price of exports over imports, rose 1.5%, following a 3.1% rise in Q1, to be up 8.9% YoY. Real gross domestic income, which is terms of trade adjusted real GDP and to our minds is a better indicator than the headline real GDP of how the Australian economy is going when there are big swings in the terms of trade, rose 0.8% in the quarter with annual growth picking up 0.5ppt to 3.5% YoY.

### *Nominal GDP*

Nominal GDP rose 1.2% in the quarter following a rise of 1.6% in Q1, to be up 5.4% YoY. The GDP deflator, which is the broadest measure of inflation in the economy, was up 0.7% in the quarter and up 3.9% YoY. The GDP deflator is heavily influenced by international trade prices. The domestic final demand deflator, which is a better reflection of domestic price pressure, rose 0.4% in the quarter, to be up 1.7% YoY.

### *Productivity*

Productivity growth remains poor. Growth in gross value added per hour worked in the market sector was flat in the quarter, following a 0.3% fall in Q1, to be down 0.6% YoY. Non-farm real unit labour costs rose 0.3%, suggesting labour cost pressures picked up in the quarter, though they were down 0.4% on a year earlier.

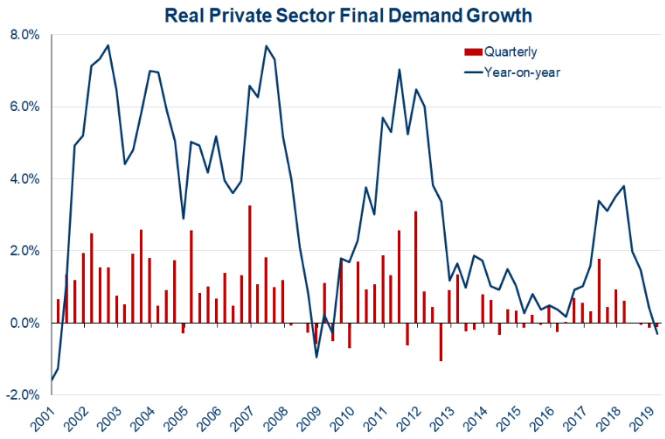
### *State Final Demand*

Real growth in domestic final demand was 0.3% for the nation as a whole, to be up 1.0% YoY. Quarterly growth in real state final demand was strongest in Western Australia with a 0.8%. Tasmania has seen the best growth over the past year with 3.1%.

| Seasonally Adjusted Chain Volume | QoQ | YoY |
|---|---|---|
| Western Australia | 0.8% | -0.1% |
| New South Wales | 0.0% | 1.3% |
| Victoria | 0.5% | 1.9% |
| Queensland | 0.0% | 0.4% |
| South Australia | -0.2% | 0.4% |
| Tasmania | 0.3% | 3.1% |
| Australia | 0.3% | 1.0% |

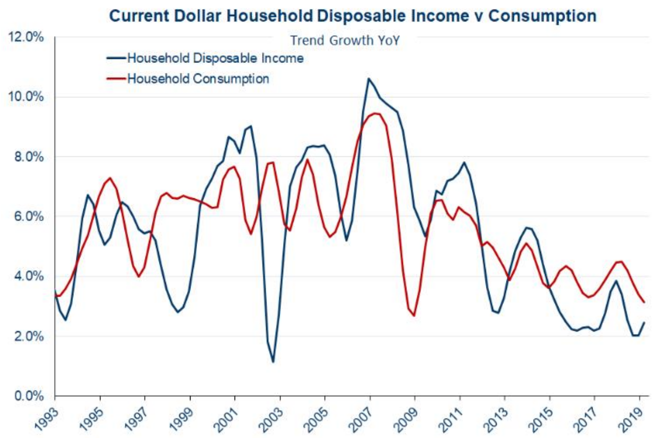
### *Comment*

While the headline exceeded our expectations the overall report was another weak one, with growth driven by government spending and overseas demand for our commodities. Real private sector domestic demand growth was slightly negative.



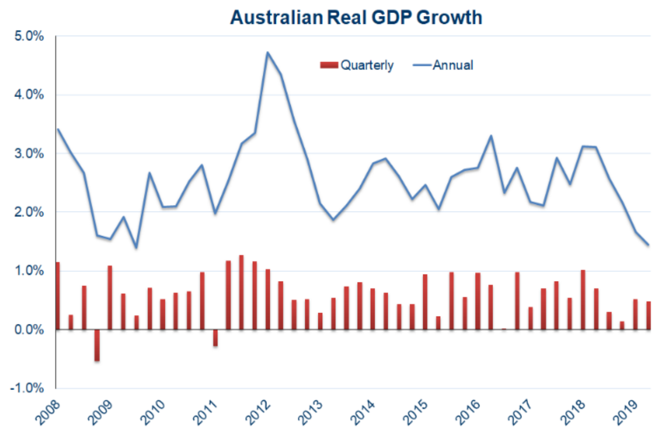

We also shouldn't discount the ongoing contribution of population growth with per capita real GDP growth flat during the month and down 0.2% YoY.

Household consumption remains a key weakness with real consumption spending rising a soft 0.4% in the quarter to be up just 1.4% YoY. With income growth so soft, even this sluggish rate of spending growth was enough to push the household savings rate to a fresh post-GFC low. The tax cuts may provide a small boost to spending in Q3, but we think any improvement will be short-lived in the absence of a sustained pick up in household income growth. The majority of the boost to disposable income from the RBA cash rate cuts is likely to be put toward the faster paying down of debt rather than be spent on consumption.




With a substantial rise in business investment unlikely and the decline in residential construction set to continue it is difficult to see where the expected pick-up in growth the RBA expects is likely to come from. While demand for our key commodity exports remains solid, the boost to national income from the sharp increase in the terms of trade now looks to be fading.

While the national accounts pre-date the impact of the back-to-back RBA rate cuts in June and July, such is the weakness of the report that is appears the central bank will have little choice but to cut rates further.




The annual growth rate of 1.4% YoY was not only a near decade low, but well short of the RBA forecast for 1.75%. This suggests some downside risk to the RBA forecast for growth to return to trend over the next couple of years.

Among the technical assumptions the RBA used in formulating its forecasts was two more 25 basis point cash rate cuts as per market pricing. We expect that the RBA will implement the first of those cuts in November though, given the underlying weakness of this report, we wouldn't count out October.

***4 September 2019***

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