Bulletin

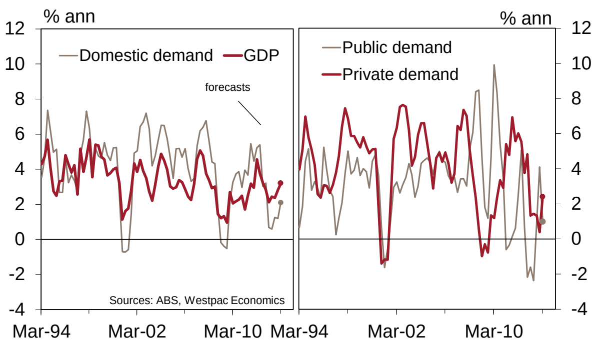
30 May 2014

Australian Q1 GDP, a preview: Annual growth to hit "trend" 3% on exports surge and burst of consumer spending

2014 Q1(f): 0.9%qtr, 3.2%yr

- **The Australian National Accounts, to be released on Wednesday June 4, will provide an estimate of economic activity in Q1.**
- **The economy gained momentum at the turn of the year. GDP growth printed at 0.8% in Q4 and we anticipate a 0.9% increase in Q1. That is an improvement from an average of 0.65% over the initial three quarters of 2013.**
- **Risks to our 0.9% forecast would appear to be skewed to the upside, gauging from available information on the expenditure components. However, this is tempered by other indicators, such as private business surveys.**
- **Our forecast for Q1 GDP growth of 0.9% lifts annual growth from 2.8% to a "trend" 3.2%, the first result at 3% or above since 2012 Q3, when mining investment peaked.**
- **Historically low and declining interest rates in 2013 ignited a burst of consumer spending. We expect consumer spending growth of 0.8% in Q1, a repeat of the Q4 outcome, lifting annual growth from 2.6% to 2.9%, the strongest result since 2011 Q3.**
- **Exports are boosting growth, as the mining boom moves into the output phase, and imports have weakened, in part due to a downturn in capital imports. We calculate that net exports in Q1 will add 0.9ppts qtr and 2.1ppts yr.**
- **Housing is at the start of a strong upswing. Record low rates have led to record high approvals. New dwelling construction jumped by a reported 7.8% in Q1.**
- **Conditions elsewhere were mixed. In Q1, domestic demand growth is forecast to be 0.6%qtr, 2.1%yr. We anticipate a pull-back in public demand. Business investment is likely to report only a modest rise following a sharp fall in Q4, limited by the downturn in mining investment. While inventories are expected to subtract from growth as the bumper winter crop in WA is exported.**
- **The national accounts commend themselves by providing a detailed overview of the Australian economy. However the information is somewhat dated. Recent developments suggest the economy may have lost momentum heading into the June quarter. It is telling that in their May Statement on Monetary Policy the RBA lowered its GDP growth forecast for June 2015 to 2.75% (a sub-trend pace) from 3.0% in February.**
- **Record low interest rates are a key tailwind for growth, but the economy remains constrained by a number of headwinds. In particular: a tightening of fiscal policy; a slowing of growth in China, triggering a dip in our terms of trade; a still high currency; and a downturn in mining investment. Consumer sentiment fell from 99.7 in April to 92.9 in May, in the wake of the Federal Budget, down from a high of 110.3 last November. This retreat in confidence points to the risk of a dip in consumer spending growth.**

Australian economic conditions



<u>Household consumption (0.8%)</u>: Consumer spending is forecast to increase by 0.8% in Q1. Real retail sales grew by a reported 1.2% in the quarter, following a 1.1% rise in Q4. However, motor vehicle sales softened in the quarter, down 2% , following a flat Q4. We expect solid growth in spending on services.

<u>Dwelling investment (5%)</u>: An upswing in housing construction is underway, with approvals exceeding the peak of ten years earlier. New dwelling construction, after a broadly flat 2013, increased in Q1 by a reported 7.8% and renovation work was up 1.9%.

<u>New business investment (0.7%)</u>: Following a 3.4% slump in Q4, as business "froze spending", we anticipate a modest 0.7% increase in Q1. Infrastructure work edged lower, as mining investment turns down, and we expect a drop in exploration activity to drive a fall in the intellectual property products segment. Offsetting this, non-residential building work rose and equipment spending staged a partial rebound.

<u>Public spending (–0.8%)</u>: A see-saw pattern in public investment is expected to continue, with a 5% drop in Q1 reversing a 4.6% bounce in Q4. Consumption is expected to remain soft as governments seek to constrain expenditures.

<u>Net exports (0.9ppts)</u>: Export volumes expanded by an estimated 3.0% in Q1 on increased shipments of iron ore, coal, gas and rural goods. Imports declined by an estimated 1.2%, with falls in capital goods and services offsetting modest rises in consumption and intermediate goods.

<u>Private non-farm inventories (–0.5%, 0.0ppt contribution)</u>: We anticipate a further run-down of inventories, given the focus on cost control and the softness of imports relative to spending.

The Business Indicators survey (Mon), the Balance of Payments (Tue) and Public Demand data (Tue) will provide further clues as to the risks surrounding our forecast for GDP (published Wed).

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