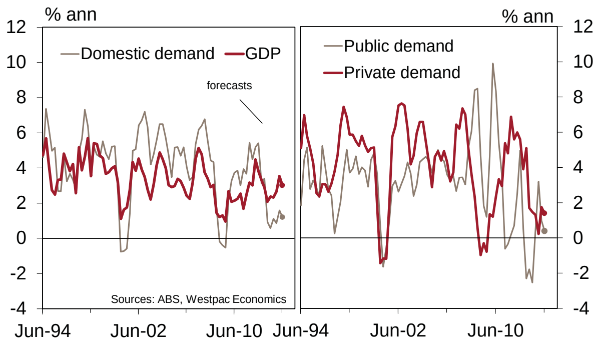
29 August 2014

Australian Q2 GDP, a preview:
Real growth hit by net exports pay-back
Nominal GDP to contract as ToT falls 5%
2014 Q2(f): 0.4%qtr, 3.0%yr

- **The Australian National Accounts, to be released on Wednesday September 3, will provide an estimate of economic activity in the June quarter.**
- **We expect the second quarter of 2014 to be a soft one for GDP, following a strong start to the year. Central to this profile is a lopsided performance by resource exports, with Q2 to see some payback for a burst in Q1.**
- **GDP growth is forecast to be 0.4%qtr, 3.0%yr in Q2. This follows an outcome in Q1 of 1.1%qtr, 3.5%yr.**
- **Net exports swing from a positive contribution of 1.4ppts to a 0.7ppts subtraction in the June quarter. Exports consolidated at a high level in Q2, following a 4.8% jump in Q1, when unseasonably benign weather conditions resulted in fewer disruptions to coal and iron ore production than normal for this time of year.**
- **A catch-up in imports reinforces this net exports profile. Imports rose by a strong 3.7% in Q2, following a fall in excess of 5% over the previous five quarters. Of note, services, including overseas travel, rebounded strongly, with Easter falling in April rather than March.**
- **Inventories (including farm) are expected to add +0.8ppts in Q2, after a –0.6ppts in Q1, with imports contributing to stock rebuilding. This 1.4ppts turnaround partially offsets a 2.1ppts deterioration in net exports.**
- **Domestic demand growth printed at 0.3%qtr in Q1 and we expect a repeat of this in Q2. Flat public demand, as governments focus on budget repair, is a headwind. Also, business investment is trending lower as the mining investment boom transitions to the production phase.**
- **However, household demand (i.e. consumption + dwelling activity) strengthened over the past year, with record low interest rates triggering a strong housing upswing. In Q1, household demand increased by 0.9%. Annual growth lifted to 3.2%, up from a low of 1.4% at the start of 2013. In Q2, we expect 0.6%qtr, 2.9%yr.**
- **Importantly, we expect the recent mismatch between the retail sales survey and total consumer spending in the national accounts to continue in the June quarter, as discussed in more detail below.**
- **We expect nominal GDP to contract in the June quarter, falling by 0.2%. This would be the first negative print since 2009, associated with the global recession. The terms of trade fell sharply, down an estimated 5%, on lower iron ore and coal prices. Total company profits are expected to fall by 4% or more in the quarter.**
- **For the RBA, key considerations are the momentum of the economy heading into the September quarter and further progress in the transition of the economy towards strength in the non-mining sectors. On these fronts, recent evidence is encouraging, notably positive business surveys for July and the most recent ABS capex survey.**

Australian economic conditions



Household consumption (0.5%): We expect the national accounts profile of total consumer spending to differ markedly from that in the retail survey. In Q1, retail jumped 1.2%, revised to 1.3%, but this failed to map to the accounts, with total consumption growth a modest 0.5%. In Q2, retail fell 0.2%, but we expect consumption to rise by 0.5%, with some catch-up in the retail component and strength in services and vehicle sales.

Dwelling investment (1.2%): New dwelling activity is in the midst of a strong upswing. Work rose a reported further 3.2% in Q2, to be up 11% on a year ago. The renovation cycle remains a stop-start affair, with Q2 a down quarter, –2.2%qtr, +0.4%yr.

New business investment (–0.5%): Business investment is expected to decline, the 5th fall in the past 6 quarters, although the rate of decline moderated. Non-residential building is a bright spot, +2.8%qtr, +5%yr. However, this is offset by a fall in infrastructure work, -2.2%qtr, with the maturing of the mining investment boom. Equipment spending edged lower, –0.9%, as a rise in such spending by the services sectors was outweighed by weakness from mining and manufacturing. We expect a 1% rise in intellectual property products spending.

Public spending (flat): Public demand has stalled, with a dip in investment ahead of a ramp-up on transport projects, and sluggish growth in consumption.

Net exports (–0.7ppts): Export volumes flat, after +4.8% in Q1, and imports up, +3.7%, following a period of weakness.

Private non-farm inventories (+0.5%, 0.9ppt contribution): The running down of inventories by business has been overdone. Inventory levels plunged in Q1, –2.0%qtr, –2.9%yr. We expect some rebuilding to emerge in the June quarter.

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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