Q2 National Accounts

Headline Resilience But Underlying Weakness

BankSA Economics

6 September 2023

Contents

Overview and Outlook

- The economy continues to show a level of resilience, which is arguably unexpected at this point in the economic cycle. To put the GDP numbers into perspective, the pace of growth in the quarter and over the year was higher than the RBA's forecasts. Moreover, annual growth was only a tad below the long-run average and that follows 12 rate hikes in a 13-month period. Whilst the economic slowdown is not as deep as expected yet, we do expect activity to continue to step down until after the first rate cut surfaces. Rate cuts before the middle of next year seem unlikely.
- An explosion in population growth over the past year has been a big part of the 'resilience' story. Population growth will not continue at this remarkably fast pace of 2.4%, but it will stay solid. Extra people add to spending in the economy. If we strip away the impact of population, GDP per capita went south for the second straight quarter, which officially puts Australia in recession "in per capita terms".
- Whilst the population is growing, productivity is not. It continues to weaken and has led to a surge in unit labour costs, which threatens to pose a challenge to policymakers in bringing down inflation. Productivity growth is not easily generated and is hard won following innovation and reform. There is no silver bullet and all economic agents have their part to play.
- Inflation peaked late last year and is moderating, but at 6% in headline annual terms, it is still far from the desired target of 2-3%. Our central view is that the current cash rate of 4.10% is at a peak, but there remains some risk of another tap on the brakes in this cycle if inflation proves sticky. The surge in unit labour costs serves to remind us that we cannot yet declare victory on inflation.
- A feature of the growth outlook is the changing of the batons in growth drivers. Households are tightening their belts. This is not going away soon with the ongoing squeeze on budgets from higher mortgage rates, higher rents and elevated prices. Household consumption eked out growth this quarter, but it was the slowest rate in nearly two years. Households will continue to be more cautious and careful in spending their dollars and this will see a deeper shift away from discretionary spending, but businesses could continue to stay tenacious for a time yet. Business investment plans published last week point to a record 2023-24 financial year for non-mining businesses.
- Among the big swing factors for the outlook are inventories and trade. The former was a big drag in the quarter. Inventories had been run up to record levels during covid as supply chains were severely disrupted. With a normalisation underway, inventories ran down a massive $3.4 billion in the June quarter – the biggest drain since late 2008 when the economy was gripped by the GFC (outside of the pandemic). The risk lies to a further rundown in inventories, as consumer spending growth slows further and the wholesale sector is forced to move stock off floors.
- The trade sector helped offset the drag from inventories this quarter, but it may not be able to wave this wand next time, as global economic activity slows. Of most importance to Australia is China, our largest trading partner. China's growth story remains vulnerable.

GDP Expenditure Measure – GDP (E) – 1 of 2

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	0.1
Public Consumption	0.4
Dwelling Investment	-0.2
New Business Investment	2.1
New Public Investment	5.2
	Contribution to GDP, ppt
Inventories	-1.1
Net Exports	0.8

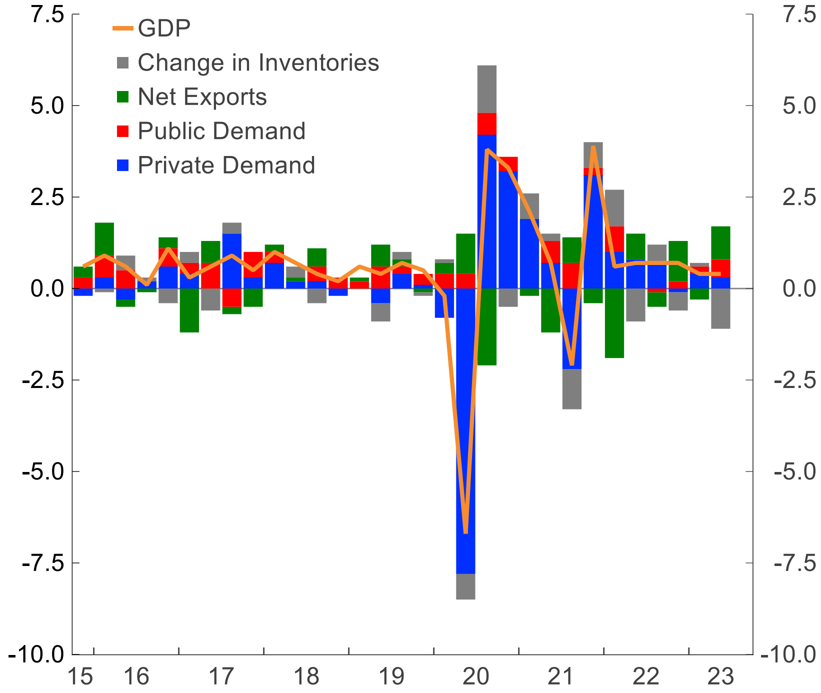
- Annual GDP growth slowed to 2.1% in the June quarter - a tad below the long-run average - and higher than the RBA forecast of 1.6%.
- Strong annual population growth of 2.4% has injected some resilience. GDP per capita fell 0.3% in June quarter – marking two straight quarterly falls and a recession in per capita terms. GDP per capita in annual terms also fell by 0.3%.

- Export volumes, business investment and government spurred growth in the June quarter. Consumers tightening their belts and a run down in inventories restrained growth. GDP in expenditure terms rose 0.4% in the quarter, which matches the downwardly revised pace in the March quarter. This is higher than the RBA forecast of 0.2% for the quarter.
- Higher interest rates and inflation continued to bite on household budgets, contributing to a further slowing in household consumption growth. There's been a weakening trend since late 2021. **Household consumption** edged 0.1% higher in the quarter – the weakest quarterly pace in nearly 2 years. A deeper shift away from discretionary spending occurred.
- The **government sector** – consumption and new investment collectively – added significantly to growth in the quarter of 0.3 percentage points.
- Businesses are still displaying some tenacity. **New business investment** grew 2.1% in the June quarter, following a solid gain of 3.6% in the March quarter. Investment on machinery and equipment led the way, propelled by a last-minute rush to take advantage of generous government tax incentives expiring on 30 June. Greater availability of equipment after the covid-related supply-chain disruptions also lifted investment. The contribution to growth in the quarter from capex was 0.2 percentage points.

GDP Expenditure Measure – GDP (E) – 2 of 2

Contributions to Quarterly GDP Growth

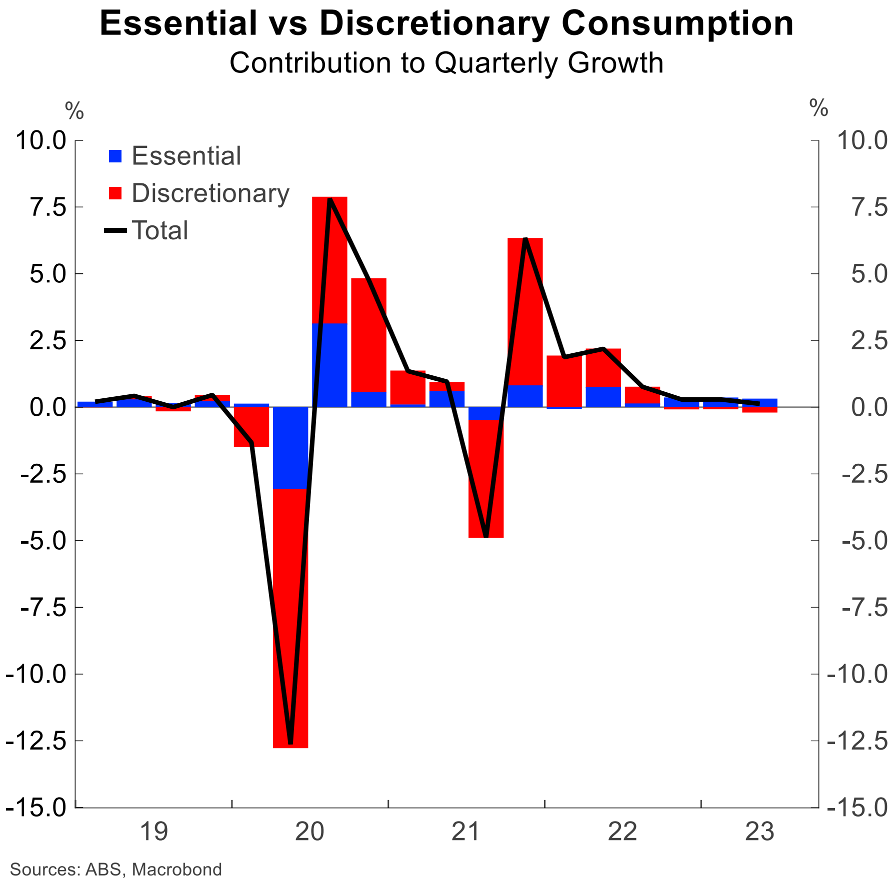
Percentage Points



Sources: ABS; Macrobond

- The biggest impacts on the GDP expenditure measure arguably came from inventories and the trade sector.
- **Inventories** were run down substantially. Indeed, the run down was $3.4 billion in size and the biggest since late 2008 when the world was in the grips of the GFC. The run down partly facilitated the rise in exports, but it also led to inventories swiping 1.1 percentage points off growth.
- **Net exports** added 0.8 percentage points to growth, almost unwinding fully the drag to growth coming from the run down in inventories. Export prices fell sharply, but a big lift in export volumes (+4.3% in the quarter) was able to drive forth an expansion in net trade volumes. Import volumes rose just 0.7% in the same period.
- Inventories have further to run down given the slowdown in consumer spending has further to run, but net exports may not provide the magical wand in coming quarters against a backdrop of weaking global growth. In particular, the growth outlook in China, our largest trading partner, continues to show cracks and the recovery in services exports is likely to lose pace after nearing pre-pandemic levels.

Discretionary Spending Freefall



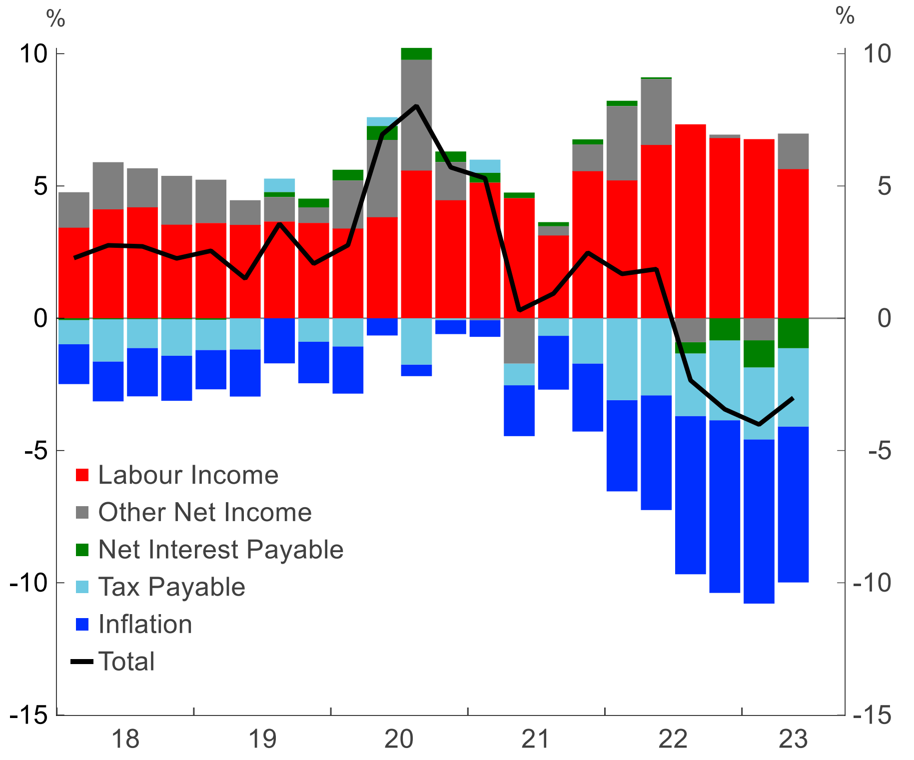
- Household spending continued to slow under the weight of elevated inflation and higher interest rates. Household consumption rose just 0.1% in the quarter and fell 0.5% in per-capita terms, the third consecutive per-capita contraction.
- A sharp 0.5% fall in discretionary spending underpinned the weakness, while essential spending gained 0.5%. Outside of the pandemic, this was the largest quarterly fall in discretionary spending in over a decade.
- In annual terms, discretionary consumption growth slowed to just 0.6%. After adjusting for population growth, discretionary consumption slid 1.7% in annual terms - the largest annual fall since the GFC.
- The shift in spending appetite drove large falls in recreation and culture (-2.5%) and household furnishings and equipment (-2.5%). However, households continued to cough up on transport services (3.2%) – including airfares – and dining out (0.2%).
- The biggest increase in spending came in the purchase of new vehicles (5.8%). This reflected a spike in deliveries on purchases made earlier in the year as supply chains continue to improve.

Passed Peak Pain for Real Disposable Incomes

- Household disposable income rose 1.1% in the June quarter, as a jump in labour income more than offset the burden of higher tax payable and interest repayments.
- Labour income rose 1.0% in the quarter, slowing from 1.5% in the March quarter. Growth in mortgage interest payable also slowed (from 11.5% to 10.9%) alongside a moderation in the pace of rate hikes.
- Inflation remains the biggest drag on household disposable incomes despite a slight moderation in the pace of consumption inflation. When accounting for inflation household disposable income fell 3.0% over the year to the June quarter, improving from a 4.0% fall in the March quarter.
- A further slowing in inflationary pressures over the period ahead is likely to mean the peak pain for real disposable incomes has likely passed.
- However, there remains areas of inflation that are troubling. The price of rents and other dwelling services surged 2.4% in the March quarter, the largest quarterly increase since the March quarter of 1989.
- Despite the improvement in real income growth, households continued to draw down on accumulated savings to finance their spending. Reflecting this, the household savings ratio eased to 3.2% from 3.4% in the March quarter.

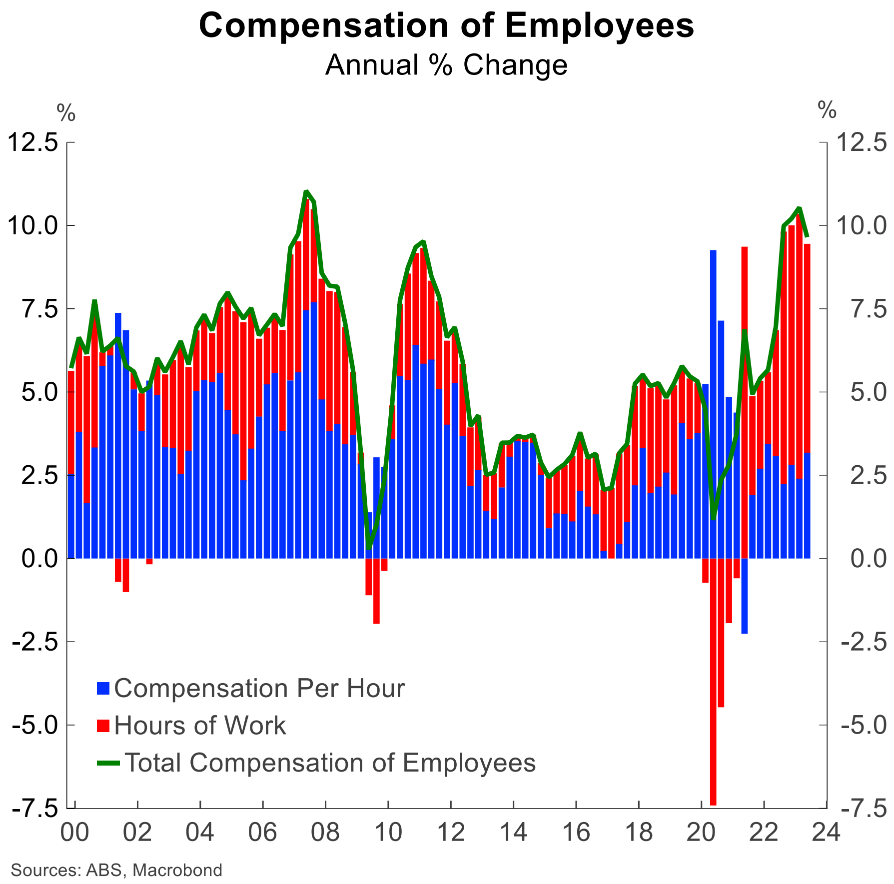
Household Real Disposable Income Growth

Contributions to Annual Growth



Sources: ABS, Macrobond

Hours Worked Continue To Drive Total Wage Bill



- Total compensation of employees (CoE i.e. total wages) grew 1.6% in the quarter – the slowest quarterly pace since the September quarter of 2021.
- In annual terms, CoE rose 9.6% – a step down from the recent annual pace of over 10% over the past three quarters.
- Growth was driven by an increase in the number of people employed – reflected in a 5.8% annual rise in hours worked.
- Non-farm CoE per hour worked rose a more modest 3.1% in annual terms – below the Wage Price Index (WPI) gain of 3.6% over the same period.
- The WPI is a pure measure of wage prices and is adjusted for compositional changes in the workforce, while non-farm CoE per hour worked is not adjusted.
- In quarterly terms, non-farm CoE per hour worked fell 0.4%.

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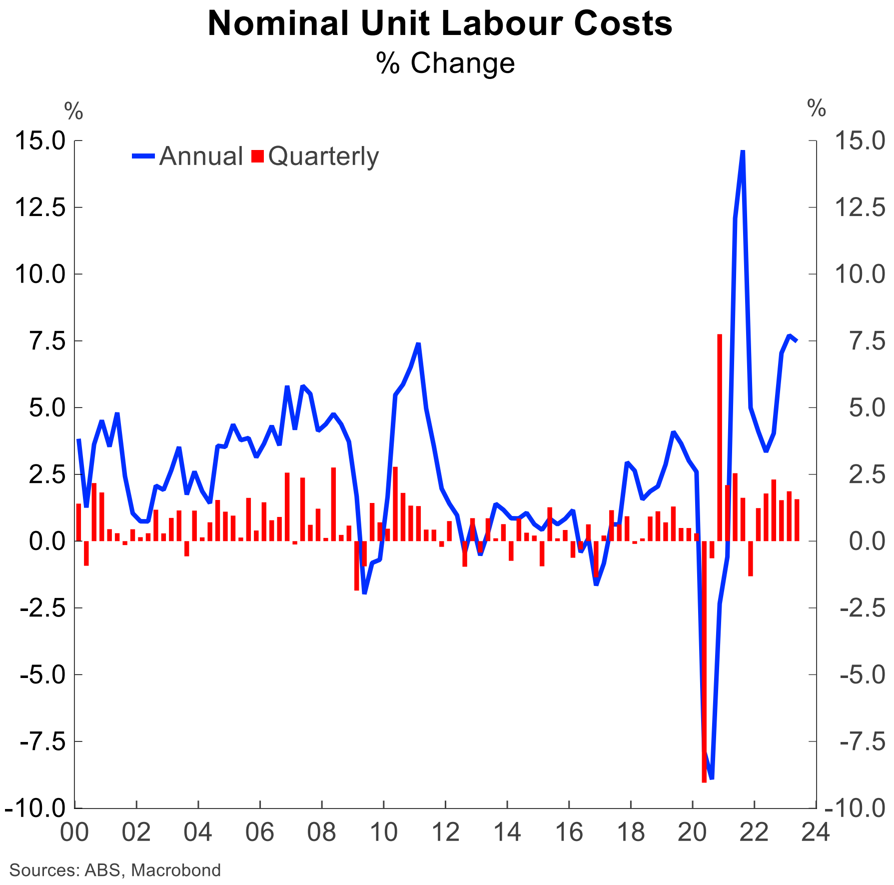
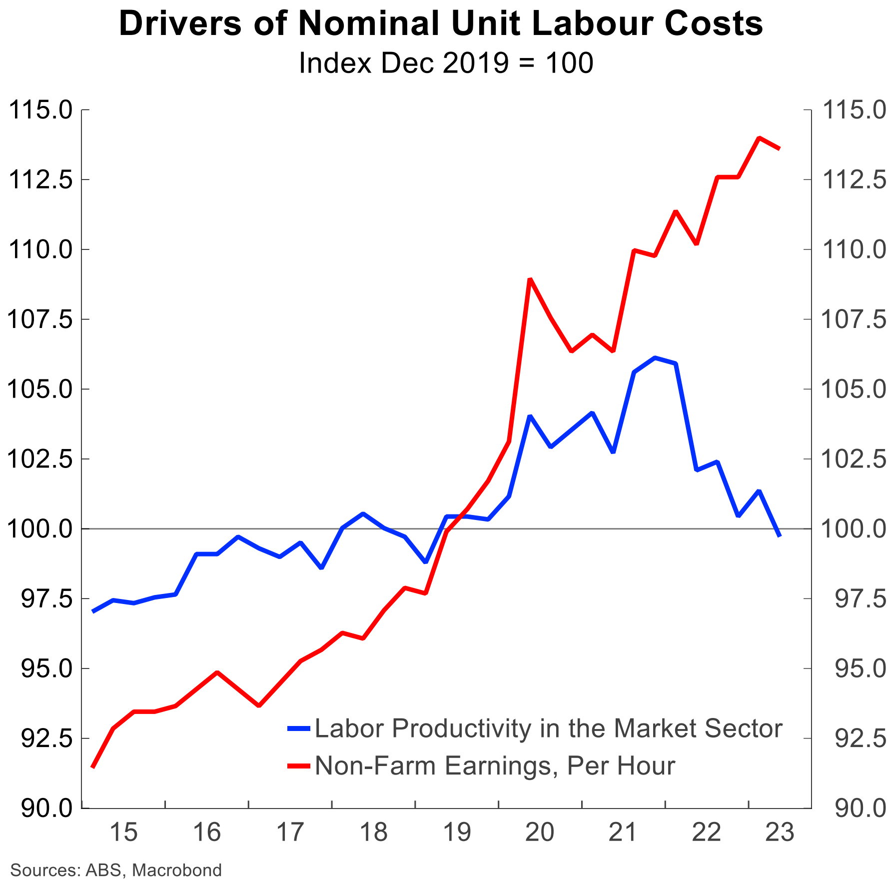
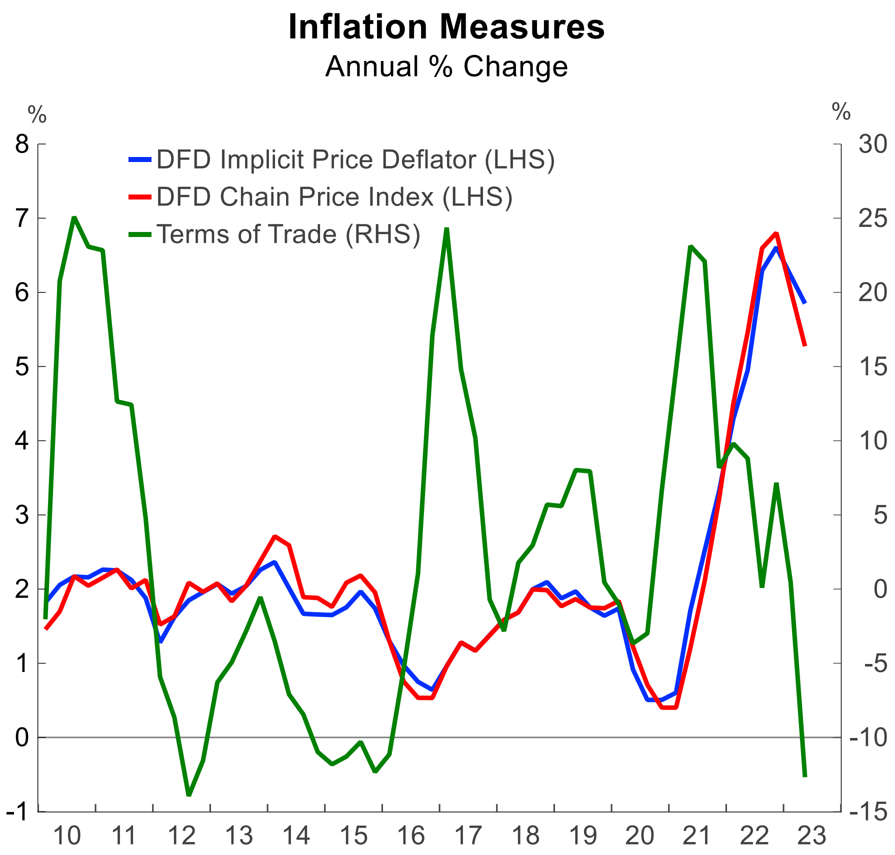
Unit Labour Cost Growth Eased But Still Elevated





- Growth in unit labour costs – wages adjusted for productivity – slowed in the quarter but remained elevated. ULCs grew 1.6% in the quarter, to be 7.5% higher through the year. Productivity continues to be lacklustre as GDP per hour worked in the market sector slipped 1.7% in the quarter and 2.3% in annual terms.

Domestic Inflation Measures & Terms of Trade



Sources: ABS, Macrobond

- Domestic price pressures continued to gradually ease from elevated levels. However, price pressures remain well above the Reserve Bank's (RBA) inflation target of 2-3%.
- The RBA remains mindful of inflationary pressures, particularly in the services sector, where inflation tends to be stickier.
  - The **Domestic Final Demand (DFD) Implicit Price Deflator**, which measures domestic price changes but also the effects of compositional changes in DFD, rose 1.2% in the quarter and 5.8% in the year.
  - The **DFD Chain Price Index**, which removes the impacts of compositional changes and is a pure measure of domestic prices changes only, rose 0.9% in the quarter. Annual growth eased from 6.0% to 5.3%.
- The terms of trade (i.e. ratio of export to import prices) dropped sharply, led by significant declines in commodity prices. The ToT plunged 7.9% in the quarter – the largest quarterly fall since the June quarter of 2009. In annual terms, the ToT dropped 12.7%.
  - Exports prices (-8.2%) and import prices (-0.3%) declined. However, the fall for export prices was larger than for import prices, resulting in a deterioration in the terms of trade.

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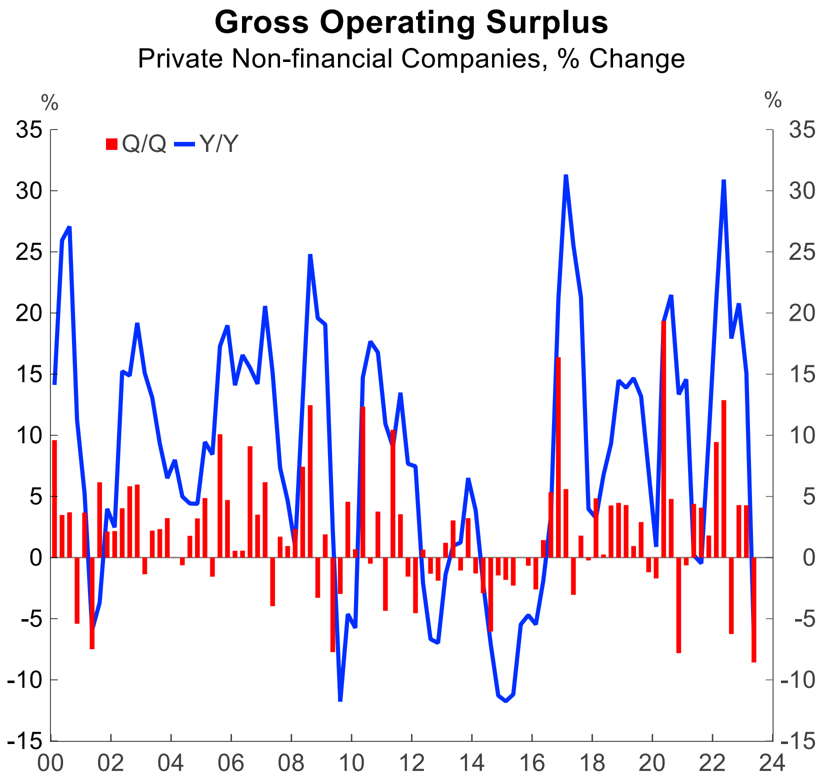
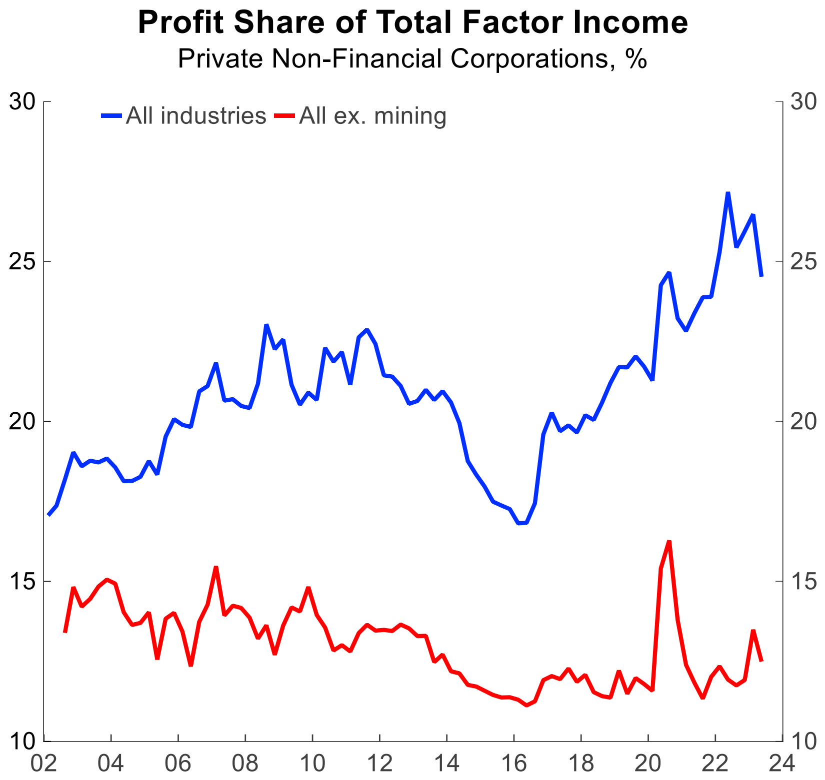
Profits Experience Largest Fall Since 1990's Recession



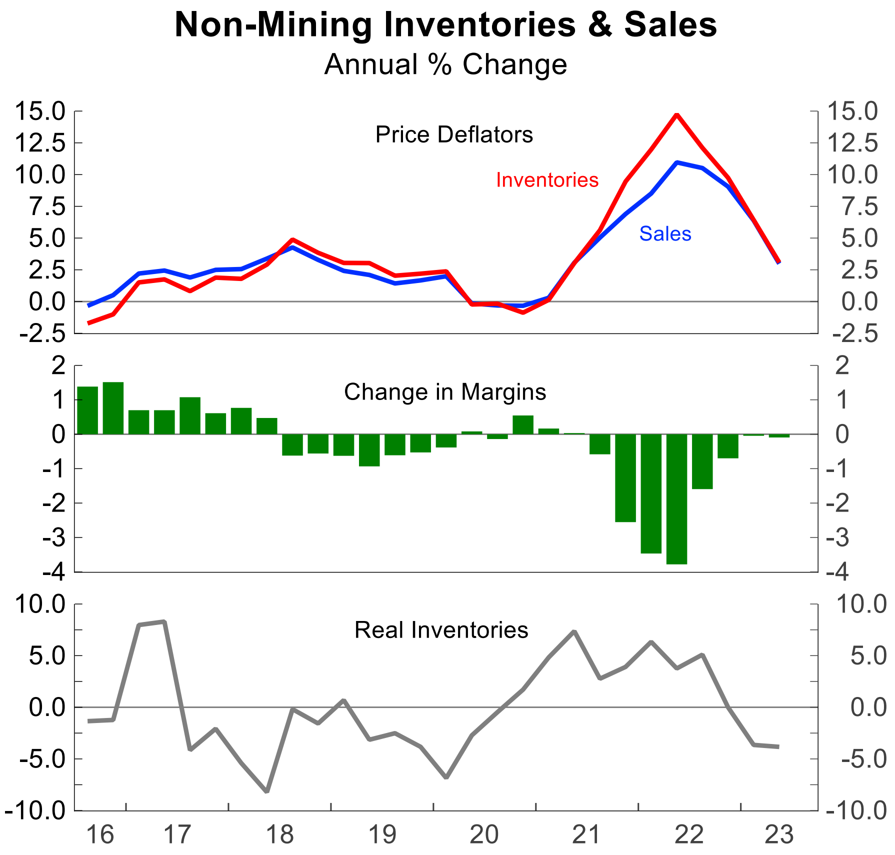
Sources: ABS; Macrobond



Sources: ABS, Macrobond

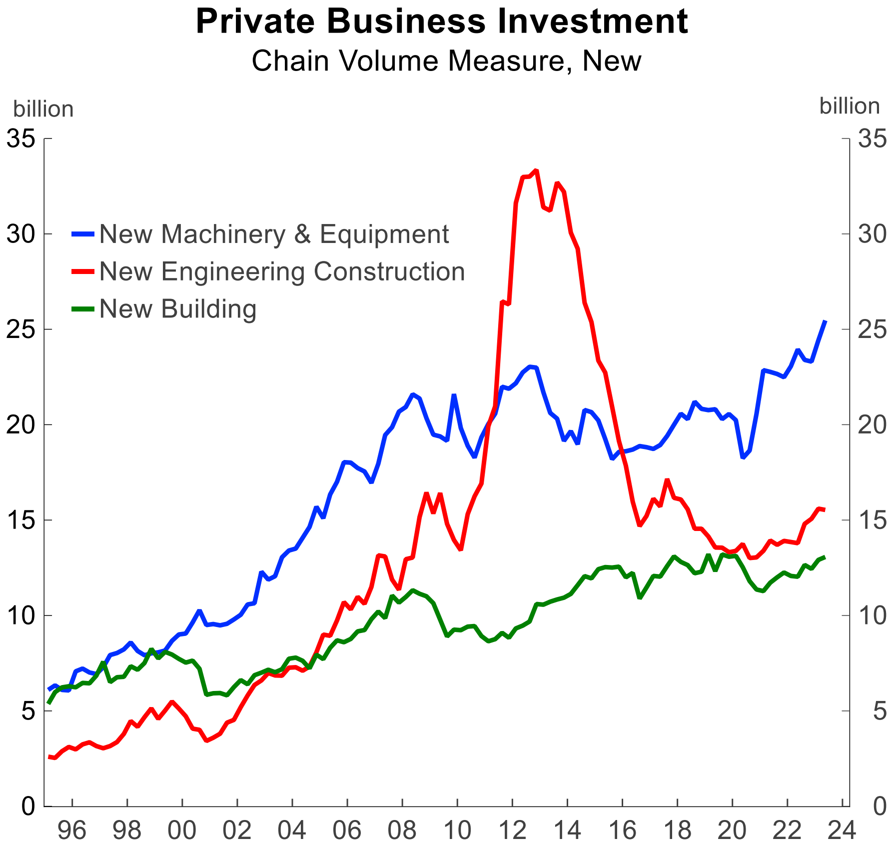
- **Gross operating surplus** (i.e. profits) tumbled 4.5% in the quarter to be 1.4% lower over the year. This was the largest quarterly contraction since the March quarter of 1991, during the 1990's recession.
- This was driven primarily by a fall in mining profits as commodity prices fell. However, there was also weakness among accommodation & food and transport, postal & warehousing.

Inventory Run-down to Address Excess Stock



- Private inventories declined by $4.1 billion in the June quarter, following an increase of $2.4 billion in March.
- Businesses in the Wholesale ($1.6 billion), Mining ($1.1 billion) and Retail ($0.9 billion) industries contributed the most to the decline. The government sector increased inventory levels by around $700 million over the June quarter.
- Overall, inventories detracted a hefty 1.1 percentage points from economic growth over the quarter.
- Inventories are normalising from elevated levels after a build-up in the wake of the pandemic. Excess inventories appear to be adding to discounting as demand slows.
- Excluding the mining sector, inventory prices are growing faster than sales prices. This is a sign businesses are starting to see pressure on margins, especially among industries with excess stock.

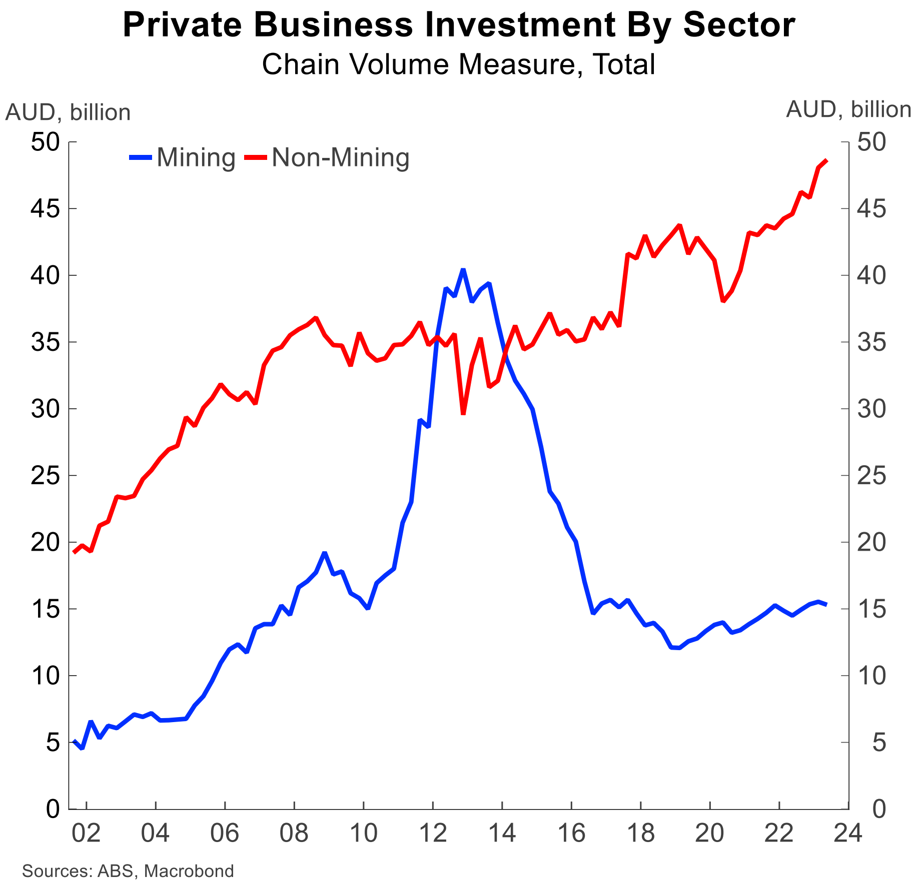
Business Investment Has Bounced Back



Sources: ABS, Macrobond

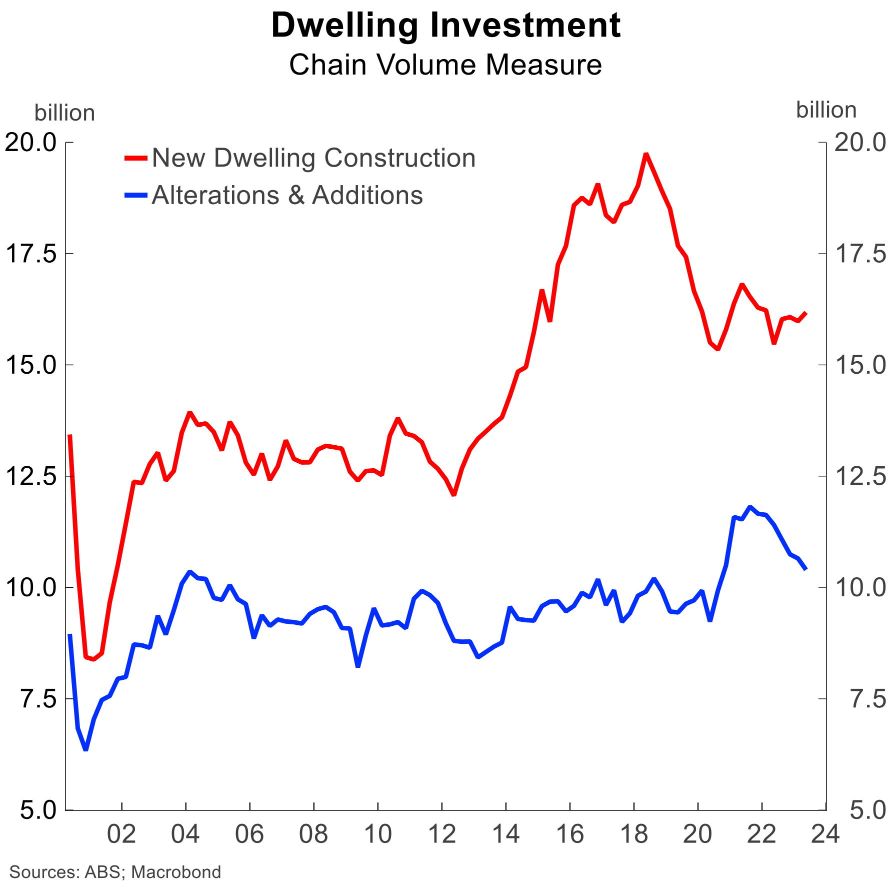
- Businesses are rebuilding capital stocks to accommodate the larger population now that global supply chain disruptions are easing.
- New private business investment grew 2.1% over the quarter to be 8.0% higher over the year.
- Investment in new machinery and equipment grew by 4.3% to be 6.3% higher than a year ago. This was boosted by the improved availability of motor vehicles and other equipment.
- New engineering construction fell 0.4% but remained 12.6% higher than a year ago. Large transfers to the public sector impacted the quarterly outcome.
- New building construction grew by 1.2% over the June quarter to be 8.6% higher than a year ago. The March outcome was revised up to 3.8%, from 1.3% initially reported.

Non-mining Sector Leading the Way



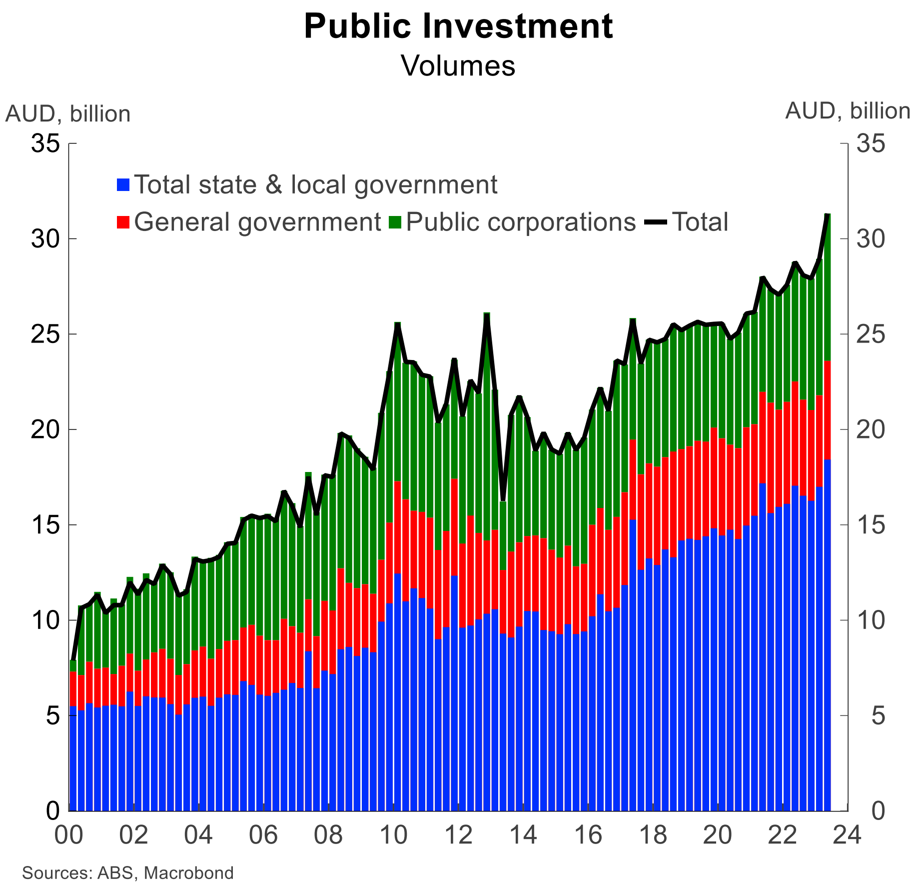
- This has been driven by the non-mining sector of the economy.
- Total non-mining investment grew by 1.2% over the quarter to be 9.1% higher in annual terms – the strongest annual growth rate since the June quarter 2018, outside of COVID.
- Mining investment declined by 1.5% over the quarter.
- This is consistent with the CAPEX surveys which showed solid investment intention outside the mining sector.

Housing Investment Continues to Underperform



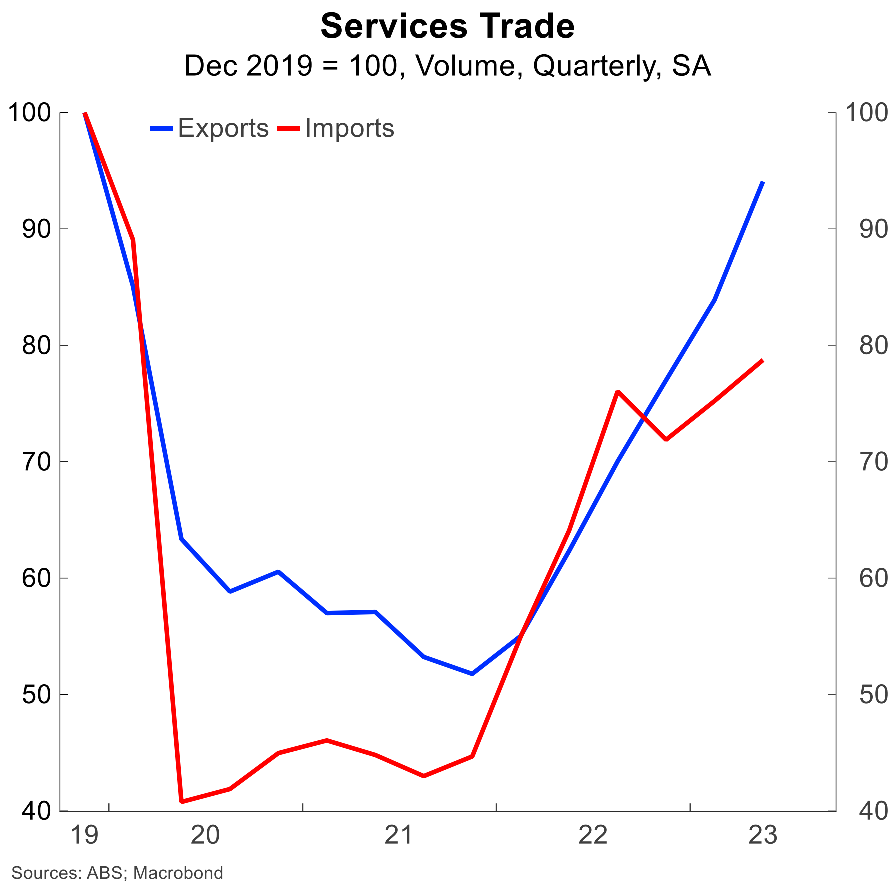
- Renovation activity declined by 2.4% over the quarter to be 8.8% lower than a year ago – the sharpest annual fall since the December quarter 2012.
- Investment in new dwellings increased 1.2% over the June quarter to be 4.6% higher than a year ago. Construction of new apartments rose strongly in Sydney and Brisbane.
- Disruptions in the sector are impacting how quickly the pipeline of projects approved during the pandemic can be completed.
- Even more concerning, forward indicators, such as approvals, suggests the pipeline of projects will continue to fall in the near term.

Public Investment the Strongest Since 2017



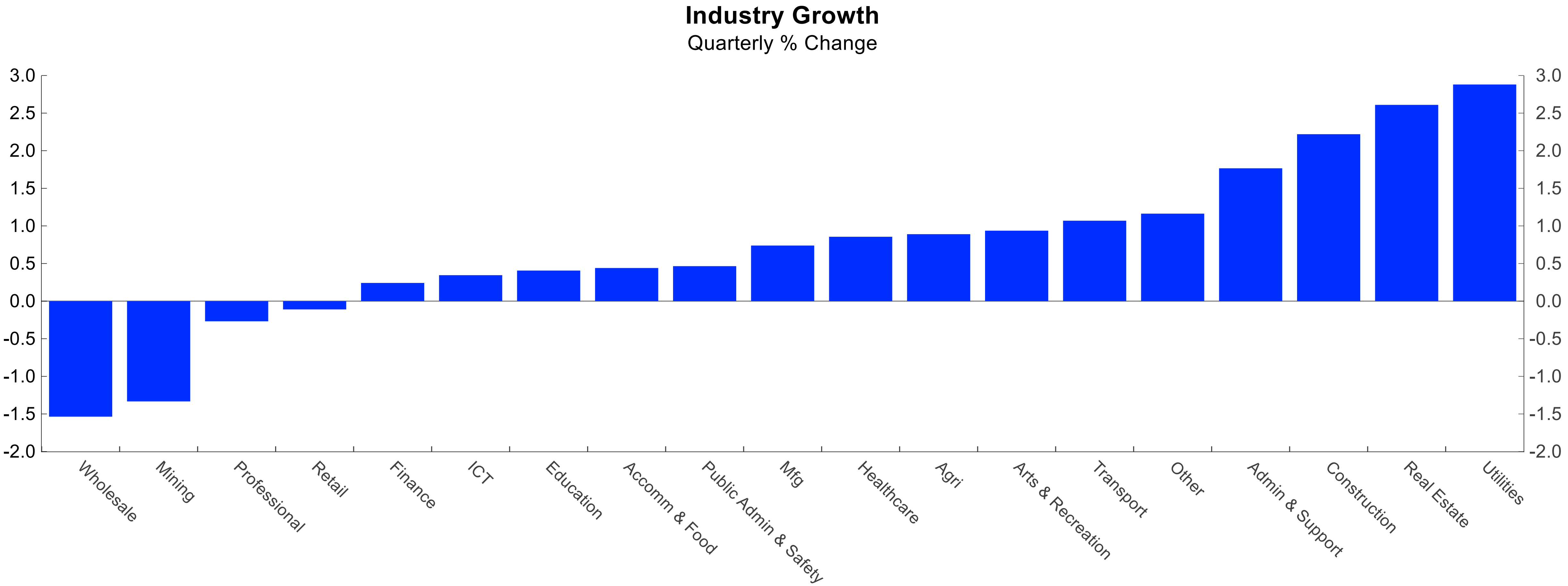
- New public investment increased 5.2% over the June quarter – the strongest growth since the September quarter 2017.
- Investment by state and local governments increased by 8.4%, the strongest growth since the June quarter 2017 (outside COIVD).
- The pipeline of infrastructure projects at the state and federal level will continue to support investment. The pipeline includes projects such as Snowy 2.0, the Western Sydney Airport, Inland Rail, Sydney's new metro and Brisbane's Cross River Rail.
- Public consumption also expanded 0.4% in the quarter, driven by an increase in national non-defence spending, which rose 1.2%. This was partly offset by a decline in state and local government consumption (-0.2%).
- New public demand added 0.3 percentage points to growth.

Services Exports Near Pre-COVID Amid Int. Student Boom



- The external sector was the strongest contributor to growth as exports grew strongly while import growth was weak.
- **Net exports** added 0.8 percentage points to growth.
- **Export of goods and services** jumped 4.3% in the quarter, to be 9.8% higher through the year.
    - Services exports surged 12.1%. This reflected a continued rebound in international students and travel. Services exports are at 94% of pre-pandemic levels as student numbers surpassed pre-pandemic levels.
    - Goods exports grew 2.5% – led by commodities.
- **Imports of goods and services** grew a modest 0.7% in the quarter, to be 4.4% higher through the year.
    - Services imports jumped 4.7% as Australians continued to venture to Europe and other overseas destinations.
    - Goods exports slipped 0.2% as demand slows.

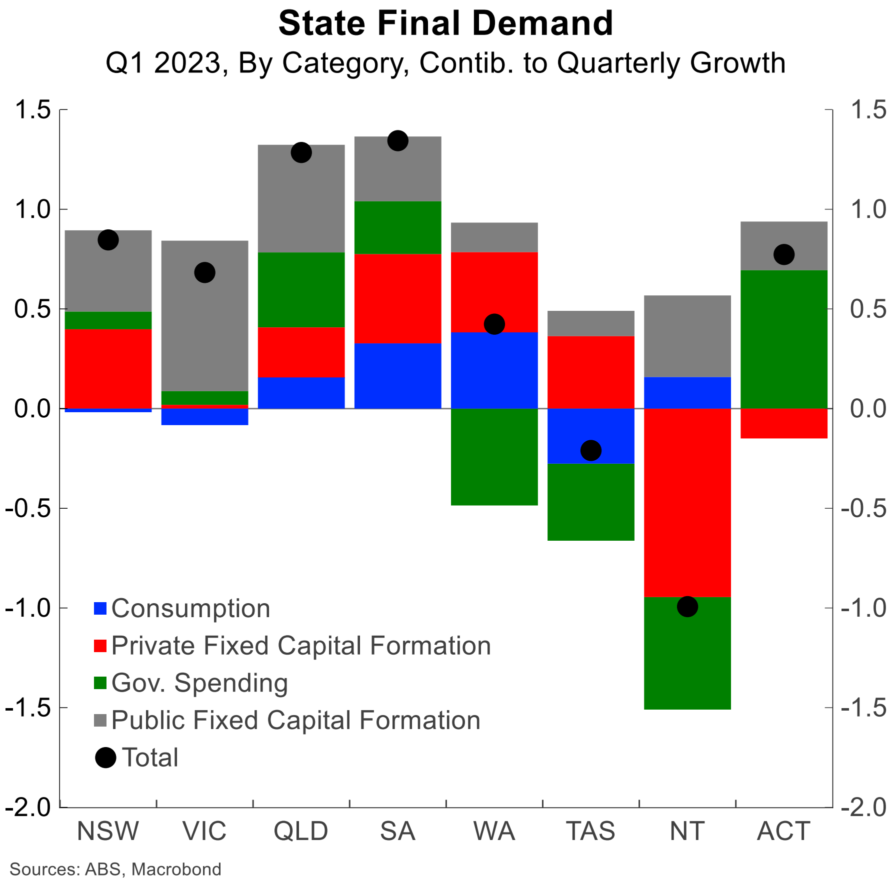
GDP Production Measure - GDP(P)



Sources: ABS; Macrobond

- 15 of 19 industries grew in the June quarter, up from 13 in the previous quarter.

States Picture



- Activity was mixed across the country, with public investment the only category which contributed to quarterly growth for all regions.
- SA and Queensland recorded the strongest quarterly growth – both at 1.3%. Most other states and territories also grew. Tasmania and the NT were the outliers, contracting in the quarter.
- Public investment was the standout, jumping considerably in Victoria (12.2%), Queensland (8.9%), SA (7.5%), and NSW (7.2%). The ABS noted several major projects, including Snowy 2.0, the Western Sydney Airport, Inland Rail, Sydney's new metro and Brisbane's Cross River Rail.
- Private investment was also a strong contributor to growth across all states but detracted from growth across the territories.
- Household consumption was strongest in the smaller states of WA and SA, while it also added modestly to growth in Queensland and the NT. It was negative or flat in Tasmania, Victoria, NSW and ACT.
- Government spending was mixed across regions but detracted from growth in the NT, WA and Tasmania.

Contact listing

Chief Economist
Besa Deda
dedab@banksa.com.au
+61 404 844 817

Senior Economist
Pat Bustamante
pat.bustamante@banksa.com.au
+61 468 571 786

Senior Economist
Jarek Kowcza
jarek.kowcza@banksa.com.au
+ 61 481 476 436

Economist
Jameson Coombs
jameson.coombs@banksa.com.au
+61 401 102 789

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