BULLETIN

2 September 2022

Australian Q2 GDP preview. Conditions improve, led by consumer spending on services. GDP forecast: +2.0%qtr, +4.5%yr

The Australian National Accounts, to be released on Wednesday September 7, will provide an estimate of economic activity for the June quarter.

It has been a challenging time for Australia, navigating the pandemic.

Activity contracted in 2020, down by -0.7%. Then, over the past year to March 2022, while activity expanded by a robust 3.3%, it was a bumpy ride. That result included a 1.8% contraction in the September quarter 2021, associated with the delta lockdowns. In the opening quarter of this year, activity grew by 0.8% with conditions impacted by the omicron wave and the La Nina which resulted in wet weather and flooding on the east coast.

Move forward to the June quarter and labour market trends suggest that conditions improved, with hours worked posting a strong 4.6% increase, more than reversing a 1% decline in the March quarter. This positive turnaround benefited from fewer covid restrictions, with spending supported by earlier stimulus. Consumer spending on services is the likely bright spot.

However, there is some conflicting evidence around the performance of the economy in the June quarter. Construction work contracted sharply in the period, down by -3.8% - with falls across dwelling activity and non-residential work. The construction sector was evidently impacted by ongoing weather disruptions and supply headwinds (labour and material shortages).

Our central case forecast is for GDP to expand by 2% in the June quarter - led by the consumer - but with considerable uncertainty given mixed signals.

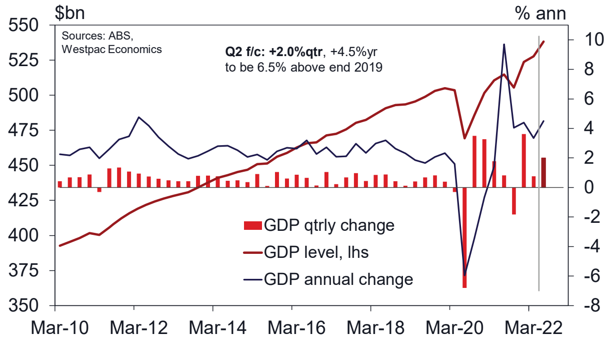
The arithmetic of our Q2 GDP forecast is: domestic demand +1.6%; net exports +1.0ppt; total inventories -0.7ppts and the statistical discrepancy +0.1ppt. The domestic demand detail is: consumer spending +2.8%; home building -4%; business investment +0.6%; and public demand +1%.

Information and colour around the household sector will be of interest - particularly the household saving ratio, which was still elevated in the March quarter, at 11.4%, after spiking to 19.7% in the September quarter 2021 associated with the delta lockdown. Households have the scope to lower the saving rate further and to draw on "excess" savings amassed during the pandemic, in the order of $265bn, to help fund future spending.

National income growth was brisk in the June quarter, with the rest of the world paying us more for our exports - in the form of higher global commodity prices. Nominal GDP growth is a forecast 4.3%qtr and a stellar 11.4%yr. This includes a 2.3% rise in the GDP deflator, incorporating an estimated 4% plus increase in the terms of trade.

Currently, policy stimulus is being unwound. The RBA, following the September meeting, is expected to have lifted the cash rate by 225bps in the space of four months (five meetings), to 2.35%. Higher interest rates and high inflation will weigh on housing and the consumer, with impacts to become more apparent heading into 2023 - which will have spillover effects on business spending and hiring. Output growth will likely be well below trend in 2023.

Australian economy: Q2, conditions improve



<u>Household consumption (+2.8%qtr)</u>: Consumer spending, currently accounting for 53% of the economy, was most impacted by covid related restrictions - and hence will rebound as those restrictions are eased. In the June quarter, households spent more freely on services, notably hospitality and travel. Domestic travel surged in April, with Easter and school holidays, and we have lift off on overseas travel with the reopening of the national border. The key uncertainty is scaling the increase in services spending.

Retail sales posted a robust 1.4% increase in the June quarter, despite a -0.8% fall in food retailing as folk switch away from dining in. Auto sales were down, impacted by limited supply.

<u>Dwelling investment (-4%qtr)</u>: The Construction Work survey was weak reporting a fall in home building activity in excess of 5%, on weather disruptions and supply headwinds. We anticipate that the National Account estimate will temper that fall to -4%.

<u>New business investment (+0.6%qtr)</u>: Weakness in construction activity in the period largely offset a lift in equipment spending, up by a reported 2.1% in the capex survey.

<u>Public spending (+1%qtr)</u>: Government spending in the form of public demand (27% of the economy) is expanding briskly (latest 8%yr) centred on rising investment and the health response to covid. The Q1 outcome of +2.6% was inflated by a spike in imported covid supplies. That, and a fall in public works, points to a more modest outcome for Q2, an anticipated 1%.

<u>Net exports (+1.0ppt qtr)</u>: Net exports are estimated to have added 1ppt to activity in the period, a partial reversal of -1.7ppts impact in Q1. Export volumes had a strong showing, up by an estimated 5.6% (resources, rural and services), after a run of disappointing outcomes. Imports advanced by an estimated 0.8%, building upon an 8% surge in Q1.

<u>Private non-farm inventories (+1.6% qtr, -0.5ppts contribution)</u>: After a record inventory rebuild in Q1, the pace of inventory accumulation likely cooled in Q2 and hence will subtract from activity in the period. Potentially this drag will be reinforced by a subtraction from "other" inventories - for a combined -0.7ppts.

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Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.