BULLETIN

7 December 2022

Australian national accounts, Q3
An economy in transition, impacts of high inflation and higher interest rates becoming apparent.
Q3 domestic demand: 0.6%qtr, 6.9% yr
Q3 real GDP: 0.6%qtr, 5.9% yr

The Australian economy expanded by 0.6% in the September quarter for annual growth of 5.9%.

That is slightly lower than we had anticipated (0.8%) with one outstanding drag (-0.2 ppt's) coming from the real estate sector in the form of Ownership Transfer Costs (turnover) that plunged by 11.2%.

Household spending growth slowed in the quarter from 2.1% in the June quarter, to 1.1%, although it did contribute all the 0.6ppt's overall growth. Motor vehicles sales and operations (0.4 ppt's); hotels, cafés and restaurants (0.4 ppt's); and transport services (0.3 ppt's) contributed most of the 1.1 ppt growth in household consumption. While not as strong as in the June quarter, the reopening up effect was once again apparent as a key driver of consumer spending.

Part of this lift in spending was funded by a further fall in the household savings rate from 8.3% in June to 6.9% in September, although the major fall from 19.4% in September 2021 has largely worked its way through.

Prospects for growth in consumer spending are easing as the reopening effect fades and the savings rate settles back at a more normal level. However, given the accumulated $260 billion in excess household savings it is likely that the savings rate will fall below equilibrium as households draw on these excess balances.

Consumer spending was also boosted by household incomes.

Compensation of employees rose 3.2% (including 2.7% in wages and salaries) in the quarter up from growth in the June quarter of 2.5% (2.2% in wages and salaries).

However, households were challenged by a sharp increase in prices, the consumption deflator rising by 2.0%, up from 1.6% in the June quarter, and the fastest increase since the introduction of the GST.

The weakness in housing activity was not only apparent in property turnover but a 2.2% decline in renovation work which was offset by a 3.4% increase in home building activity. The pipeline from the Home Builder subsidies is holding up for the time being.

Business investment was generally lack lustre (up 0.7%) with a 3.0% fall in machinery and equipment being offset by a 4.3% increase in non residential construction.

There are some clear themes in these accounts.

Household spending, boosted by a falling savings rate, continues to be the driver of growth largely through the reopening lift from travel; accommodation and hospitality; and motor vehicle purchases.

Some specific drag is apparent in the weak real estate market.

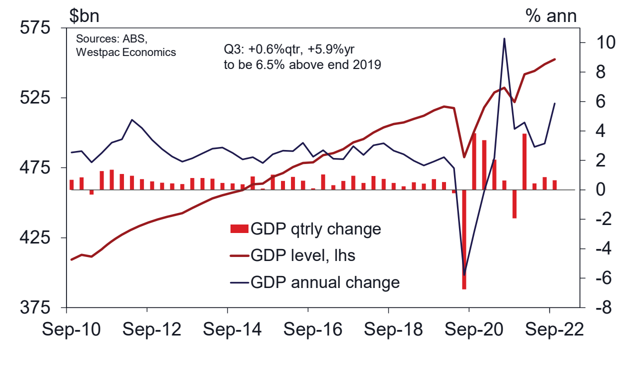
As we move forward, the reopening effect will fade; property weakness will linger; the savings rate will find a floor; and consumer spending growth will continue to slow.

GDP: Sep qtr 2022

	% qtr		% yr	
	Jun	Sep	Jun	Sep
Private consumption	2.1	1.1	5.1	11.8
Dwelling investment	-3.1	1.0	-4.8	-3.9
Business investment*	1.5	0.7	2.4	3.7
Private final demand*	1.5	0.7	3.7	8.4
Public spending*	-0.1	0.2	6.6	3.2
Domestic demand	1.0	0.6	4.5	6.9
Stocks - private non-farm #	-0.9	0.4	0.1	1.2
- other #	-0.1	-0.2	-0.3	-0.2
GNE	0.0	0.8	4.2	8.0
Exports	5.3	2.7	4.7	6.8
Imports	1.4	3.9	9.9	19.1
Net exports #	0.8	-0.2	-0.8	-1.9
Statistical discrepancy #	0.1	0.1	-0.1	0.1
Non-farm GDP	0.9	0.6	2.9	6.0
GDP, real	**0.9**	**0.6**	**3.2**	**5.9**
GDP, nominal	4.3	0.9	12.1	13.5
GDP deflator	3.2	0.2	8.4	6.9
Household deflator	1.5	2.0	4.3	6.0
Earnings per worker (non-farm)	1.5	2.5	3.3	4.7
Real household disp income	-1.0	-0.4	1.9	-2.6

*adjusted for asset sales. # ppt contribution to growth
Sources: ABS, Westpac Economics

Australian economy: advances 0.6% in Q3



But price and wage pressures are building, and it is these contrasting forces that will challenge policy.

At its meeting in December the Reserve Bank Board lifted the cash rate by 25 basis points and indicated that it expects to increase the rate further.

The effect of higher rates is apparent in the accounts, in housing and property turnover as well as in some components of consumption – food; household furnishings and equipment; and recreation all contracted in the quarter. These trends can be expected to accentuate through 2023, although data from our Westpac Card Tracker Index suggests that after a difficult October spending bounced back in November associated with the Black Friday sales.

The reason behind the RBA Board's commitment to even higher rates can be clearly seen in the wages and prices series in the national accounts. Policy will need to be vigilant to avoid a wage/price spiral and while spending will slow further in 2023, the Board's first obligation must be to return inflation to its target range over time.

It is for that reason that we expect the cash rate will need to lift to 3.85% from the current 3.1% during the first half of 2023 before going on hold in the second half as the pace of the spending slowdown intensifies.

Bill Evans, **Chief Economist**

Domestic demand (Andrew Hanlan)

Domestic demand (0.6%qtr, 6.9%yr): Domestic demand growth slowed from a brisk 1.7% for March 2022 to 1.0% for June and then a more moderate 0.6% for the September quarter.

Public demand (0.2%qtr, 3.2%yr): Government spending, in the form of public demand, crested at a high level in the June and September quarters, with outcomes of -0.1% and 0.2%. Annual growth has slowed abruptly from a rapid 8.2% in March to 3.2% currently.

Public demand had been running at a brisk pace for a number of years (from 2015 onwards) as governments boosted spending on investment and the broader health sector. More recently that strength in spending was led by the response to the pandemic - lifting the sector to an elevated (and likely unsustainable) 27.8% of the economy in the March quarter.

Private demand (0.7%qtr, 8.4%yr): Demand across the private sector grew by 0.7% in the quarter - held back by a sharp fall in the real estate sector as higher interest rates impact.

Consumer spending (1.1%qtr, 11.8%yr): Consumers spending increased by a robust 1.1% in the September quarter, led by services (as the reopening effect continues) and motor vehicles (on additional supply). That represents a moderation from strong results of 1.8% and 2.1% for the March and June quarters, when the reopening effect from the delta lockdowns was most apparent.

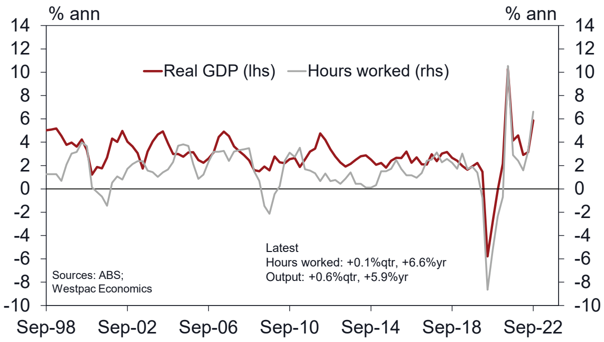
For more detail, see below for a discussion of the household sector.

Home building (1.0%qtr, -3.9%yr): Home building activity posted an increase in the September quarter, +1.0%, following three quarters of decline and a flat outcome for the corresponding quarter a year ago.

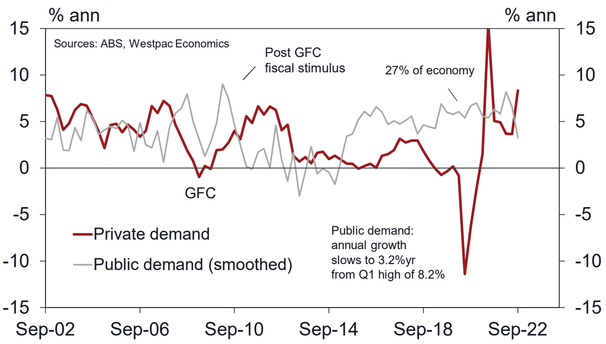
Material and labour shortages, as well as inclement weather, and now rising interest rates, have impacted the sector.

New home building work rose by 3.4% in the quarter but is still 3.8% below the level at the end of 2019, prior to the pandemic. A sizeable work pipeline remains. Renovation work surged by 22% from end 2019 to September 2021, responding to policy stimulus. However, over the past year, renovation work has eased back, declining by 5.3%, including a 2.2% fall in the latest quarter.

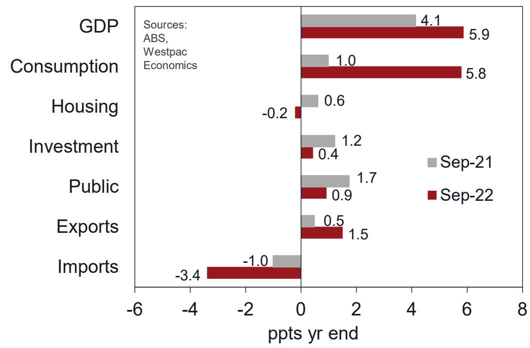
Hours worked weakness in Q3, at +0.1%qtr



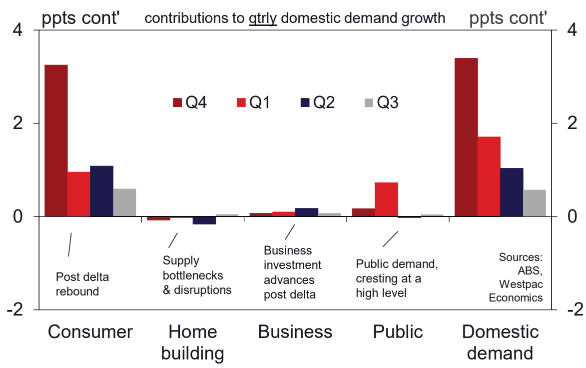
Public demand surge fading



GDP growth: year-end contributions



Australia: domestic demand



Real estate (-11.2%qtr, -16.2%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), plunged by -11.2% in the quarter, subtracting 0.2ppts from activity, as higher interest rates impact. That follows more modest falls over recent quarters (-1.1%, -2.5% and -2.1%).

New business investment (0.7%qtr, 3.7%yr): Business investment is 3.7% above the level of a year ago, including a 0.7% rise in the September quarter.

Construction work rebounded, up by 4.3%, aided by fewer weather disruptions and a sizeable work pipeline. Equipment spending eased back, down by -3.0%, following a strong bounce over the first half of the year (+3.2% and +4.7%). Firms have been responding to rising demand, tight capacity and generous tax incentives.

GDP: the expenditure estimate

The Expenditure estimate of GDP printed 0.6%qtr, 5.8%yr for the September quarter.

Net exports subtracted -0.2ppts from activity in September.

Import volumes have surged 19.1% over the year, including a 3.9% rise in the quarter, responding to rising demand and with increased overseas travel on the reopening of the national border.

Export volumes grew by a more moderate 2.7%qtr, 6.8%yr in the September quarter. Supply disruptions, including inclement weather, have constrained export shipments from the resource sector.

Total inventories added 0.2ppts to activity in the quarter.

Non-farm business inventories increased by a sizeable 2.0% in the quarter, adding 0.4ppts to activity. The mining sector accumulated inventories as transport networks to the ports were disrupted by flooding.

Public authorities inventories subtracted 0.2ppts from activity in the period - likely due to some unwinding of the earlier run-up of covid vaccine supplies.

Household sector (Matthew Hassan)

Consumers had a mixed quarter with a better than expected gain in labour incomes but both rising interest rates and prices a material drag. Total consumer spending rose 1.1%qtr, largely in line with expectations, the detail around both spending and saving confirming that post-COVID 'normalisation' has now largely run its course.

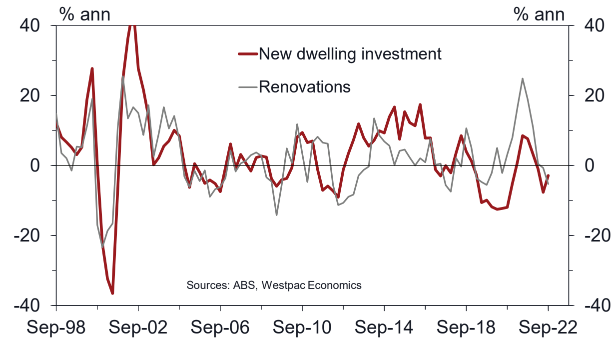
The Q3 expenditure detail again highlighted reopening drivers, more strong gains for transport (+13.9%qtr), and cafés & restaurants (+5.5%qtr) accounting for about two thirds of the overall rise in spending in the quarter. That said, a dip in spend on 'recreation and culture' (–1.1%qtr) which includes many services that were unavailable during lockdowns, suggests the catch-up has already completed in other areas. Notably, fuel spend rose 3.5%qtr but is still 4% below pre-COVID levels, likely reflecting a longer-lasting reduction related to working from home arrangements and reduced commuting.

Vehicle purchases rebounded strongly, a 10.1%qtr gain reflecting a combination of easing supply chain disruptions and insurance-funded replacement purchases associated with recent flooding events. FCAI figures show sales have continued to hold at relatively high levels through Oct-Nov.

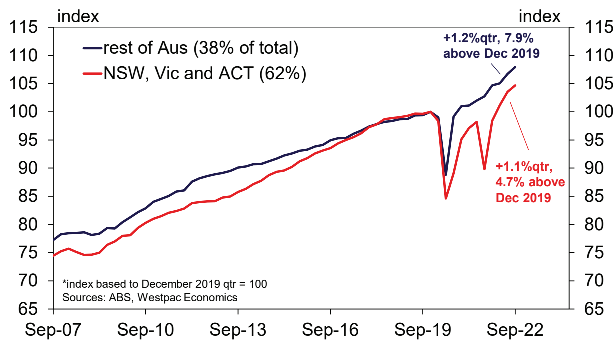
The remaining detail showed small declines in spending on utilities (–1.5%qtr), household goods (–0.9%qtr) and basic food (–0.7%qtr) more than offset by strong rises for clothing (+4.2%qtr), health (+3.2%qtr) and 'other' goods and services (+2.9%qtr).

The state detail shows similar gains across 'delta-lockdown' states and the rest; spending up 1.1%qtr in NSW, Vic and ACT on a combined basis, and 1.2%qtr for the rest of Australia.

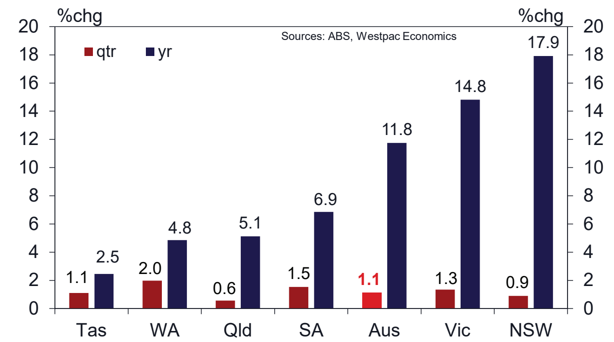
Housing hit by bottlenecks & disruptions



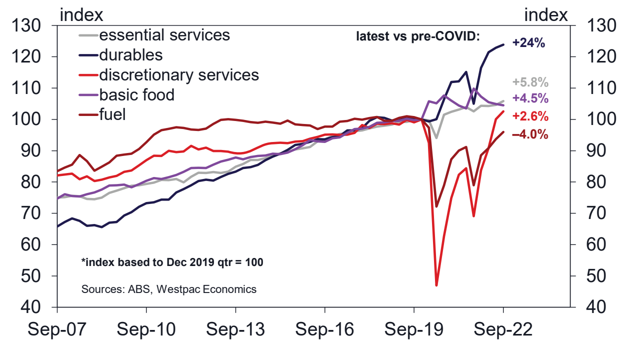
Consumer spending: 'delta states' vs rest



Consumer spending: Q3 2022



Consumer spending: broad categories



That implies delta-related reopening effects ended around mid-year with 'normalisation' since then relating more to wider drivers such as the reopening of external borders.

As noted, household incomes held up better than expected. Nominal disposable income (after tax and interest payments) rose 1.6%qtr, supported by a strong rise in wage income that more than offset a steep rise in interest payments.

Total wage income rose 3%qtr, the strongest quarterly gain since the height of the mining boom over 15yrs ago. The bulk of the gain came from increased compensation per employee. Total employment rose 0.3% in the quarter, much slower than the gains seen in the first half (0.9% in Q2, 2.1%qtr in Q1). Total hours worked also posted a modest 0.3%qtr gain. Average non-farm earnings per employee rose 2.5%qtr to be up 4.7%yr. The aggregate moves likely mask a complex mix of COVID-related disruptions to availability, leave-taking and staff loading.

Non-wage incomes showed a milder gain. Gross mixed income (mainly the profits of farm sector and unincorporated businesses) dipped 1.9%qtr but were coming of a tear, reopening driving a 12% surge over the previous four quarters. And the dip was more than compensated by a strong 9.5%qtr gain in property income (dividends and deposits) courtesy mainly of higher interest rates. Other components were buffeted by one-offs associated with temporary fiscal supports and weather-related insurance payouts.

As noted, the quarter saw a large hit to disposable incomes from higher interest rates. Interest payments spiked 33%qtr, a $5.1bn rise that effectively took 1.4ppts off disposable incomes in the quarter. That still left a decent nominal gain of 1.6%qtr. However that was not enough to keep pace with strong inflation – a 2%qtr rise in the consumption deflator, meaning disposable incomes went backwards in real terms, declining 0.4%qtr.

Lower 'new' savings (the portion of income unspent) again bridged the gap between falling real disposable income and rising real expenditure. The savings ratio dropped to 6.9% in Q3 from 8.3% in Q2, 11.2% in Q1 and 12.9% in Q4. That essentially completes the return to normal with the saving rate averaging around 6.5% over the decade prior to COVID.

The rate is likely to push somewhat lower depending on the extent to which households draw on the excess reserves they have accumulated over the last two years – a reserve that now sits around $250-270bn in aggregate. With more substantial rises in interest payments due in coming quarters, at least some draw-down looks probable.

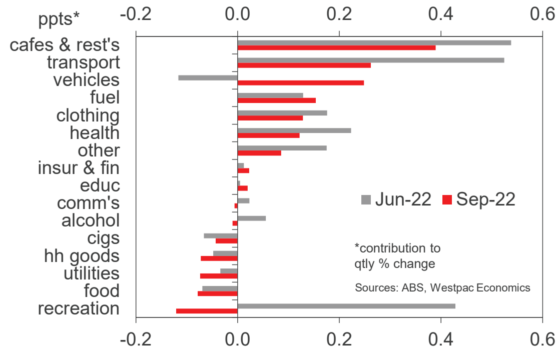
The States (Elliot Clarke)

Mixed conditions were seen across the nation in Q3, with Tas, NSW, Qld and WA experiencing robust growth as Vic and SA stood still.

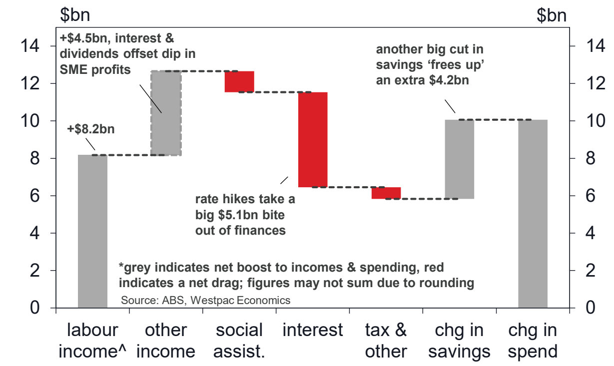
New South Wales state demand rose 0.7% in Q3, leaving annual growth at 11%yr as Q3's 6.3% delta contraction fell out of the calculation. Household consumption growth slowed abruptly following the re-opening surge of the 9 months to June, but was still healthy at 0.9% (18%yr). Housing investment meanwhile recovered most of the ground lost in Q2, increasing 0.9% in Q3. New construction and renovation work both continue to struggle with supply constraints, their gain over the 12 months to September limited to 2.2%yr and 2.5%yr respectively.

It seems business investment is less affected by labour and part shortages, with a strong gain of 7.1% seen over the past 6 months, leaving annual growth at 9.3%yr. Non-residential construction showed the greatest momentum in Q3 (7.9%; 8.8%yr), though the gains for equipment spending and engineering work have been more persistent over the year (15%yr and 7.2% respectively). Public demand also continues to aid NSW's economy, with total spending up 3.7%yr as public investment rose 6.3%yr.

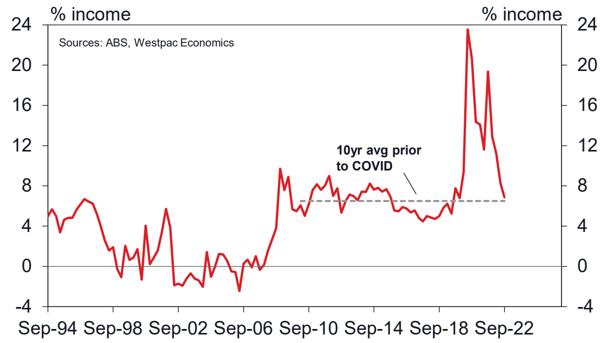
Consumer spending by category



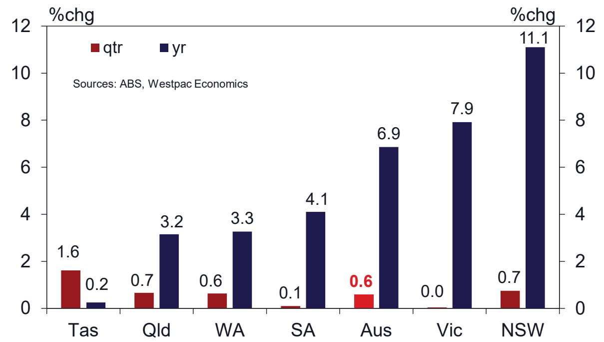
Household income flows: change, Q2 to Q3 2022



Household savings ratio



State demand: Q3 2022



Victoria's economy marked time in Q3, though annual growth accelerated to 7.9% as Q3 2021's loss dropped out. Business investment was a key source of weakness in Q3, with total activity down 1.6% as equipment spending declined 8.2% (–3.5%yr) and non-residential construction stalled (4.4%yr) – engineering work was a partial offset in Q3 (8.0%; –1.5%yr). Housing investment also faltered in the three months to September (–1.1%; –3.3%yr), gains for new construction (3.4%; –2.6%yr) more than offset by renovation work (–9.7%; –4.8%yr). Albeit at the margin, public demand was also a negative in Q3 (–0.8%; 3.0%yr) despite continued strength in public investment (1.8%; 9.5%yr).

In contrast to the other sectors, household consumption continued to show strength in the three months to September (1.3%; 14.8%yr). This momentum notwithstanding, the ongoing decline in real incomes and rapid increase in interest rates during 2022 are likely to weigh heavily on spending amongst consumers heading into 2023.

Queensland also experienced robust growth of 0.7% in Q3. But, having largely been spared the cost of delta lockdowns in 2021, annual growth remained materially below NSW and Vic (3.2%yr). For the same reason, household consumption growth was modest in Q3 at 0.6% (5.1%yr) while dwelling investment remained under pressure (0.1%; –14%yr); for the latter, the weakness over the 12 months to September has been equally shared across new building and renovation work (–12%yr and –16%yr).

Business investment is looking much more constructive for Qld, with equipment investment continuing to trend higher (0.9%; 13%yr) as non-residential construction and engineering work experienced strong gains (in turn 5.7% and 3.1%; –2.6%yr and –0.4%yr). Public spending also remains supportive of growth (0.9%; 3.7%yr).

Western Australia's economy expanded by 0.6% in Q3 (3.3%yr). As for Qld, the lack of lockdowns in 2021 has resulted in a more stable, but still strong, 2022 growth profile for consumption (2.0%; 4.8%yr). Like the rest of the country however, a further deceleration has to be expected hence under the weight of declining real incomes and interest rate increases. This is also the case for dwelling investment which, at September, is 13% lower than a year ago, the decline broad based across new construction and renovation work (respectively –14%yr and –12%yr).

Business investment remains fickle in the west, with Q3 growth in non-residential construction marginally higher than the annual rate (6.0%; 5.9%yr). Equipment investment is also currently 5% lower than a year ago after a 10% decline in Q3. And, although public demand has gained 5.7% over the 12 months to September, public investment is only marginally ahead of its year-ago level (0.5%yr).

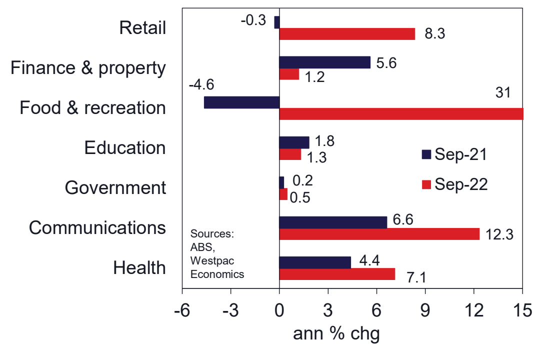
South Australia was another state that experienced a quiet Q3 and less of a whipsaw from 2021 lockdowns (0.1%; 4.1%yr). Household consumption continues to show strength (1.5%; 6.9%yr) with housing affordability and debt service arguably less of a concern in SA. Support from dwelling investment continues to wane however, total activity falling 4.3% in Q3 owing to a 9.1% decline in renovation work (respectively 1.2%yr and –6.4%yr).

Business spending is also varied across sub-categories, with non-residential construction and engineering investment up 30%yr and 9.1%yr, but equipment spending down –6.9%yr. Public demand meanwhile continued to subtract from aggregate momentum in Q3 (–2.8%; –0.6%yr), with public investment down 20%yr.

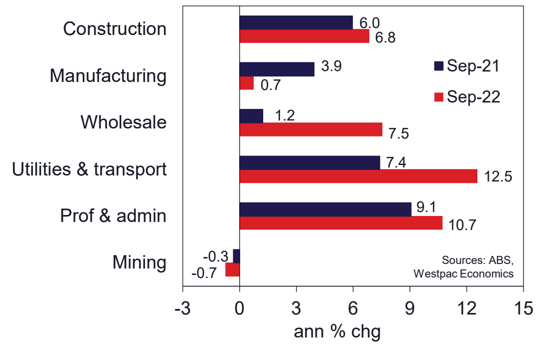
Tasmania saw the strongest growth in Q3, activity rising 1.6%. However, this result only partially offsets the decline over the 6 months to March 2022; so annual growth at September was just 0.2%yr. Consumption growth was strong in Q3 and robust over the year (1.1%; 2.5%yr).

In contrast, dwelling investment was 12% lower than a year ago at September despite a 4.4% gain in Q3. A 14% jump in equipment investment in the 3 months to September also only partially reversed prior losses for the sub-sector (-15%yr).

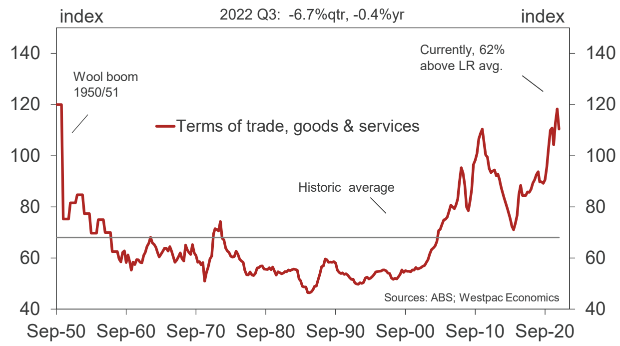
GDP by industry



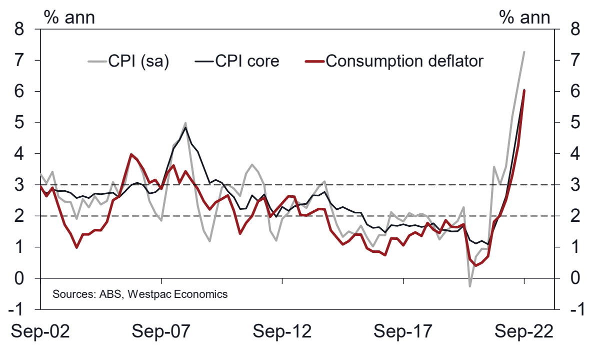
GDP by industry



Terms of trade, descends from June peak



Consumer inflation surge



Engineering construction and non-residential investment are meanwhile down 19% and up 2.4% compared to a year ago.

Production: an industry perspective (Andrew Hanlan)
The Production estimate of GDP printed 0.7%qtr, 5.9%yr for the September quarter.

Activity conditions across the broad segments of the economy were mixed in the quarter. Household services were subdued in aggregate, public administration contracted, while business services and goods distribution both posted gains in excess of 1%, lastly goods production grew broadly in line with national output.

Household services expanded by a tepid 0.3% in the quarter, representing a consolidation following a 2.9% jump in June. That has the level of activity 10.9% above that of a year ago - flattered by weak base effects (associated with the delta lockdowns of the corresponding quarter a year ago).

Hospitality performed well in the quarter, +3.4%qtr, +47.6%yr, as the reopening effect continued. Elsewhere, results were patchy.

The goods distribution sector grew by 1.9%qtr, 11.0%yr in the September quarter. Transport, postal and warehousing was a standout, +3.5%qtr, +16.6%yr, led by increased holiday travel, as well as transport services more generally on increased mobility with fewer covid restrictions.

Business services posted a fourth consecutive robust increase, at 1.1%qtr, 6.6%yr. Strength is evident across communications, professional services and administration services. By contrast, finance and the real estate sectors have cooled as higher interest rates impact.

Goods production expanded by 0.8%qtr, 1.9%yr in the September quarter. Conditions were mixed, with gains led by construction and mining while there were patchy results in the period for agriculture, manufacturing and utilities.

Construction posted a strong quarter, 2.3%qtr, 6.8%yr on fewer weather disruptions and a sizeable work pipeline. Mining output advanced by 1.2% but is still 0.7% lower over the year, held back by supply headwinds.

Income (Justin Smirk)
Commodity prices fell in the September quarter on the fears that the global economy could slip into a recession and this was reflected in the weaker incomes estimates. Real gross domestic income printed –1.0%qtr, 5.8%yr for the September quarter. With base effect the annual pace lifted from 4.9%yr in June and 4.8%yr in March even though the quarterly pace has moderated from +2.1% in June and +2.2% in March.

Nominal income (gross national income) fell 0.3% in September following on from a solid 3.7% gain in June. Again, due to base effects the annual pace lifted from 8.4%yr to 10.4%yr.

Given the fall in commodity prices in the quarter on the back of rising global recession fears, it is not surprising the terms of trade (ToT) contracted by 6.7% in the quarter, down from the June record high. However, the ToT is still some 62% above its long-run average. Through the December quarter commodity prices broadly strengthened setting the scene for both a stronger ToT and national income.

The following analysis is based on seasonally adjusted nominal data.

Total factor income (TFI), which is GDP (I) minus taxes less subsidies, lifted 0.4% in the September quarter to be up 10.4% in the year. These numbers have seen significant volatility through the last few years due to the introduction and the expiry of significant fiscal support packages introduced during the Covid lock-down periods. From a recent low of 3.0%yr in September 2021 the annual pace recently peaked at 12.3% in June 2022.

Company profits (private non-financial) fell 4.9% in the quarter but given earlier gains is still up 17.2% in the year, a moderation from the 28.6%yr pace in June. The fall in commodity prices, particularly iron ore and coal, saw mining operating surplus fall 7.1%. There was also a fall in manufacturing profits as margins came under pressure due to weaker sales and rising energy costs which was partially offset by a rise in wholesale trade profits due to an increase in sales and a moderation in cost pressures. Financial corporations operating surplus (+4.9%) partly offset the fall in mining, increasing at its fastest rate since September quarter 2008, as the increase in the cash rate improved the margins for lenders offsetting the slowdown in housing lending.

Inflation
The fall in the ToT did not just impact on incomes and profits but it also has a dampening effect on GDP price/inflation measures. The GDP deflator lifted just 0.2% in the September quarter, as the fall in the ToT offset domestic inflationary pressures, taking the annual pace back to 6.9% from 8.4%yr in June.

The GNE deflator, which is not impacted by changes in the ToT, lifted 2.0% in the quarter, the strongest quarterly gain since March 1988, taking the annual pace to 6.5%yr from 5.5%yr. The 6.5%yr pace in September was the strongest annual growth rate seen since June 1990.

The consumer price deflator (household consumption deflator) surged 2.0% in September, up from the 1.5% gain in June, and is the strongest quarterly gain in this inflation measure since December 1990. In the four quarters to June 2022 the quarterly gain in the consumption deflator underperformed that for the seasonally adjusted CPI and is reflected in a softer annual pace for the consumer deflator (6.0yr in September) compared to the 7.3%yr pace in the seasonally adjusted CPI. The household consumption deflator has a floating basket of goods and services so it captures the change in consumer preferences as relative prices change, that is it can capture the impact of consumers moving away from more expensive goods and towards cheaper goods. As such, in a period of stronger than usual inflationary pressure, National Accounts consumption deflators tend to run at a more modest pace than the CPI measure.

Labour costs, as measured by compensation of employees (COE) lifted 3.2% in the quarter, the strongest quarterly rise since December 2006. As observed earlier in other wage measures, such as the Wage Price Index, broader wage pressure have emerged this year due to a shortage of skilled labour. This has been reflected in the 2.5% increase in the average COE per employee. A larger than usual increase in the minimum wage, plus the 0.5% increase in the superannuation guarantee, contributed to growth in labour costs. The superannuation guarantee rate increased from 10.0% to 10.5% on 1 July 2022 added 0.5ppt to the growth in COE, the largest contribution since the series began.

Labour costs, measured by average non-farm compensation per employee, gained 2.5% in the quarter to be up 4.7% in the year. This was the largest quarter rise since the 4.1% surge in June 2020

Total hours worked disappointed our expectation rising just 0.1% to be up 6.6%yr. Hours worked were a bit strong in the market sector, +0.4%qtr/9.6%yr, highlighting that the non-market sector of the economy has not experienced the same post Covid boost to activity that can be found in the market sector.

GDP per hour worked reversed some of June's contraction (-2.8%) lifting 0.6% in the quarter to be down -0.6% in the year. Output from the market sector was very similar to the national average with GDP per hour worked up 0.7% in the quarter. However, due to base effects and the out sized -3.1% contraction in June, GDP pre hour worked in the market sector is down 2.6% in the year September.

With such a strong gain labour costs, and more modest gain in productivity, unit labour costs jumped 2.2% in September to be up 4.0% in the year. Due to significant base effects from a 2020/2021 surge, the annual pace is still down from 5.0%yr pace in December and the recent peak of 14.5%yr at September 2021.

In real terms, unit labour costs gained 2.0%yr in September to be down 2.6% in the year which is a strengthening from the –4.5%yr pace in June. Wages are already picking up and while they are lagging broader inflationary pressures, they are matching what we would expect to see given how tight the labour market is. As such, we don't expect to see the peak in annual wage inflation until late 2023.

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