BULLETIN

7 June 2023

Australian national accounts, Q1. Growth slows to a crawl, as high inflation and rising interest rates weigh on consumer spending.

Q1 domestic demand: 0.6%qtr, 2.2%yr

Q1 real GDP: 0.2%qtr, 2.3% yr

Economic activity in the Australian economy has slowed to a tepid pace as the intense headwinds of high inflation and rising interest rates bite – leading to a decline in real household disposable income and a resulting deceleration in consumer spending to a weak pace.

Output nationally grew by 0.2% in the March quarter 2023, broadly as anticipated.

That represents a material slowing from a 0.6% result for the December quarter 2022 (upgraded from 0.5%) and an average quarterly pace of 0.65% throughout 2022.

Annual output growth is 2.3% and the level of activity is 7.4% above that at the end of 2019, prior to the pandemic.

The detail and tone of the March quarter National Accounts was, in broad terms, largely as anticipated.

The arithmetic of the March quarter result was: domestic demand growth of 0.6%; net exports –0.2ppts; total inventories flat; and the statistical discrepancy –0.1ppt (i.e. the income and production estimates of GDP at 0.2% were a fraction softer than the expenditure measure, which printed at 0.3%, meeting expectations).

In per capita terms, output contracted by –0.3% in the March quarter, the ABS advise. Outside of the covid lockdown quarters, that is the first decline in per capita output since December 2018, which was a –0.1%.

Population growth was 0.5% in the March quarter and 2.0% over the past year, boosted by a spike in arrivals on the reopening of the national border.

Domestic demand growth improved to a 0.6% in the March quarter, after a broadly flat final quarter for 2022 (revised up to +0.1% from flat). That result was centred on a strong quarter for business investment, 2.9%, and a modest rise in public demand, +0.8%, in the context of a cresting at a high level as the spike in covid related spending unwinds.

Looking ahead, the risk is that domestic demand growth slows, returning to the weakness evident at the end of 2022.

The most notable and concerning aspect of the national accounts was the weakness in consumer spending – which was much anticipated.

The Australian consumer continues to come under intense pressure. Consumer spending eked out a slight 0.2%qtr rise in the quarter, but the detail around both spending and incomes was again poor. The ‘triple-whammy’ of inflation, higher interest rates and fiscal drags is seeing the biggest annual contraction in real disposable incomes in forty years, with no let-up in sight.

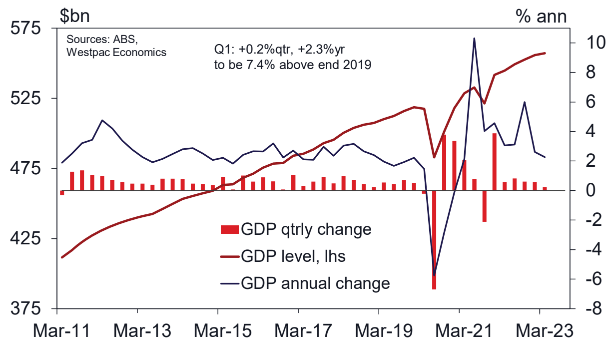
‘Big ticket’ discretionary spending is being wound back sharply. The offsetting gains in the quarter centred on utilities and transport (including tourism-related travel). Notably, spending has now recorded two material quarterly declines in per capita terms.

GDP: Mar qtr 2023

	% qtr		% yr	
	Dec	**Mar**	**Dec**	**Mar**
Private consumption	0.3	0.2	5.2	3.5
Dwelling investment	–0.8	–1.2	–3.6	–4.4
Business investment*	0.2	2.9	4.0	6.6
Private final demand*	0.1	0.5	3.7	2.8
Public spending*	0.1	0.8	2.3	0.7
Domestic demand	0.1	0.6	3.3	2.2
Stocks – private non-farm #	–0.7	0.3	–0.3	–0.6
– other #	0.3	–0.3	0.4	–0.2
GNE	–0.4	0.6	3.4	1.4
Exports	1.4	1.8	8.1	10.8
Imports	–4.0	3.2	12.4	5.1
Net exports #	1.1	–0.2	–0.4	1.3
Statistical discrepancy #	–0.2	–0.1	–0.2	–0.3
Non-farm GDP	0.6	0.2	3.1	2.5
GDP, real	**0.6**	**0.2**	**2.6**	**2.3**
GDP, nominal	2.2	2.1	12.0	9.2
GDP deflator	1.6	1.9	9.1	6.8
Household deflator	1.6	1.1	6.9	6.6
Earnings per worker (non-farm)	0.8	2.4	3.8	6.9
Real household disp income	–2.2	–0.3	–3.6	–4.0

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

Australian economy: growth slows to 0.2% in Q1



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Spending gains are also being funded entirely by lower new saving and a run-down of the large reserves accumulated during the pandemic – a dynamic that looks to have less scope to provide support going forward, the savings rate now having dropped to 3.7%.

The productivity story remains very weak. The March quarter accounts reported a 0.6% rise in hours worked and only a 0.2% lift in output. Over the year to March, the increase in hours worked (+7.1%) has far outstripped that of output (+2.3%).

Impacted by this weakness in productivity, nominal unit labour costs jumped 2.0% in March, building on the 1.5% gain in December, 2.1% lift in September and June. This has seen the annual pace of unit labour cost surge to 7.9%yr in March, up from 4.0%yr in June – a troubling lift that the RBA has singled out as potentially making its task of reining in high inflation more difficult. The recent peak in unit labour costs annual inflation was 15.7%yr in June 2021 on the back of the COVID disruptions that drove a collapse in output.

Domestic demand (Andrew Hanlan)

Domestic demand (0.6%qtr, 2.2%yr): There was a bounce in domestic demand in the opening quarter of 2023, centred on business investment and public demand. That followed a broadly flat end to 2022 (a rise of only 0.1% in Q4, upgraded from flat).

Public demand (0.8%qtr, 0.7%yr): Government spending, in the form of public demand, is cresting at a high level as the spike in COVID-related spending unwinds.

Annual growth has slowed abruptly, to be at 0.7% currently, down from a high of 8.3% a year earlier. By way of comparison, annual growth averaged 5.3% for the five years prior to the pandemic.

For the March quarter 2023, public demand grew by 0.8%, led by a 4% gain in investment (centred on construction projects, which have further upside).

Private demand (0.5%qtr, 2.8%yr): Demand across the private sector advanced by 0.5% in the quarter, up from a meek 0.1% rise the quarter prior, led by business investment.

Consumer spending (0.2%qtr, 0.3%yr): Consumer spending growth slowed to a weak pace over the past half year, with outcomes of +0.3% for the December quarter and +0.2% for March. High inflation and higher interest rates have acted to crimp spending.

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

Home building (–1.2%qtr, –4.4%yr): Home building activity declined for a second consecutive quarter, down by –1.2% after a fall of –0.8%.

Renovation work, after a strong upswing, is easing back from elevated levels, contracting by –0.9%qtr, –8.2%yr in the March quarter. New home building work is being constrained by supply headwinds, with activity down –1.3%qtr, –1.6%yr in March.

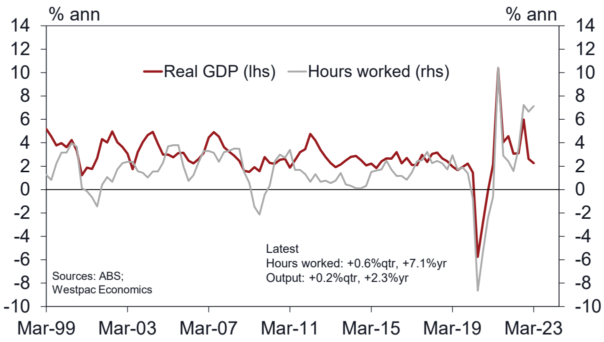
Real estate (–5.0%qtr, –22%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), has been in a sharp downturn as rapid interest rates rises bite, reducing turnover in the established property market. Conditions contracted for a fifth consecutive quarter in March.

More recently, and ahead of the RBA's June rate hike, conditions in the established housing market stabilised, with prices up but still in the context of relatively low volumes.

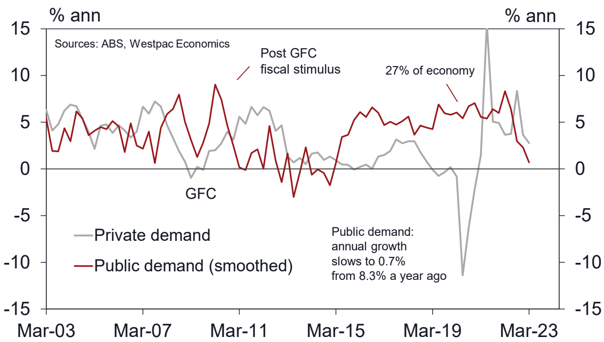
New business investment (2.9%qtr, 6.6%yr): Business investment has trended higher from the low point of September 2020. This was to meet rising demand and in response to emerging capacity constraints, as well as being encouraged by generous tax incentives.

The 2.9% increase in the March quarter included a 4.9% lift in equipment spending and a 3.1% rise in infrastructure activity (which

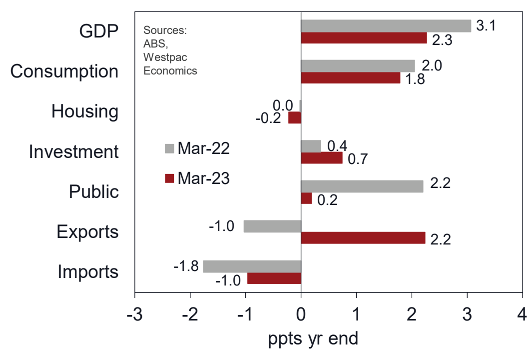
Hours worked: rise 0.6% in Q1



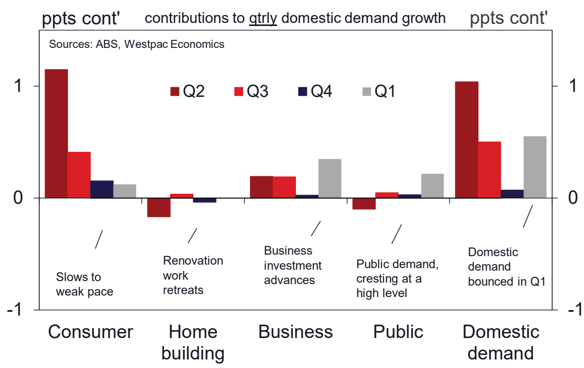
Public demand cresting at a high level



GDP growth: year-end contributions



Australia: domestic demand



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has further upside). Looking ahead, the risk is that firms trim equipment spending in response to weak household demand.

GDP: the expenditure estimate
The Expenditure estimate of GDP printed 0.3%qtr, 2.6%yr for the March quarter.

As noted above, domestic demand grew by 0.6% (0.55% to two decimal places) and there was a net subtraction of –0.2ppts from net exports (–0.2ppts) and total inventories (0.0ppts).

Net exports were a small negative for growth, subtracting 0.2ppts on import strength (+3.2%), while exports posted a 1.8% rise, centred on services (+7.7%) as tourism and international student numbers continue to recover.

Total inventories were neutral in the period, with a 0.3ppt contribution from private non-farm offset by farm and public authorities.

Household Sector (Matthew Hassan)
The Australian consumer continues to come under intense pressure from a combination of rising interest rates, reduced fiscal support and increases in the cost of living.

Consumer spending eked out a small gain in Q1, a 0.2%qtr rise coming in slightly better than our forecast flat result. That was despite a further contraction in real disposable incomes and, as in Q4, was 'funded' by reduced saving and an implied run-down in excess reserves accumulated during the pandemic. Notably, spending has now recorded two consecutive quarterly declines in per capita terms.

The upside surprise on spending centred on services with most other components recording declines. At a top level, our 'retail proxy' declined 0.4%qtr, slightly milder than the 0.6%qtr decline in retail sales volumes; new vehicle purchases declined 2.2%qtr vs a flat result for vehicle sales; vehicle operations rose 0.9%qtr vs a 2% gain in fuel consumption volumes; while a broad measure of services posted a 0.8%qtr gain, a slight improvement on the previous two quarters.

The more granular detail shows the Q1 gain was led by utilities (+5.2%qtr) and transport, which includes tourism-related travel (+4%qtr). The biggest drags came from 'big ticket' discretionary categories, household goods down 2.4%qtr and the aforementioned 2.2%qtr decline in vehicles.

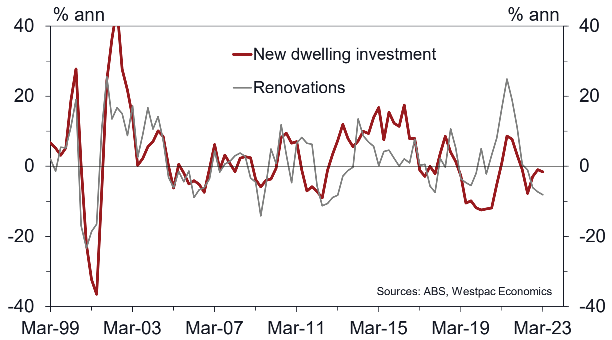
Around incomes, the picture was mixed with wages supporting a decent rise in nominal incomes but the gain outstripped by a stronger than expected increase in consumer prices, reduced saving again required to fund the slight lift in spending.

Total wage income posted a robust 2.3%qtr rise to be up a remarkable 10.1%yr, the strongest annual growth since 2007. Total hours worked rose 0.6%qtr with hourly compensation up 1.6%qtr, 2.7%yr.

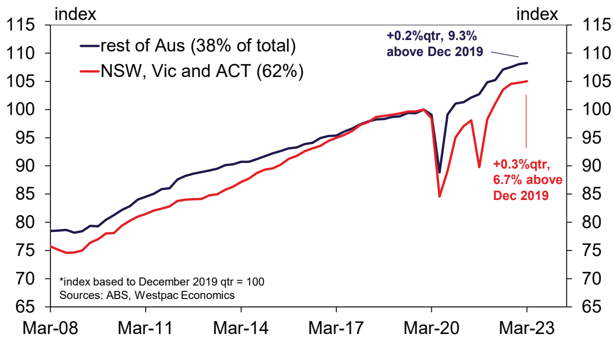
Non-labour income was much more uneven. Gross mixed income (mainly the profits of farm sector and unincorporated businesses) recorded a heavy 3.8%qtr fall to be down 4%yr. However, this was more than offset by a 2.5% rise in 'property' income (reflecting higher interest returns on deposits and dividends rather than returns on real estate) and a 2.7%qtr rise in 'gross operating surplus on dwellings' that is partly higher rent payments. While the net result was positive, the mix is not particularly promising from the point of view of future spending prospects.

Monetary tightening had another material drag on disposable incomes, interest payments up 10.6%qtr to $27.8bn in Q1, another all-time high in absolute dollar terms and accounting for 7.5% of nominal disposable income (a nine year high). The rise effectively took 0.7ppts off disposable incomes in the quarter and a whopping 3.8ppts off disposable income growth over the last four quarters.

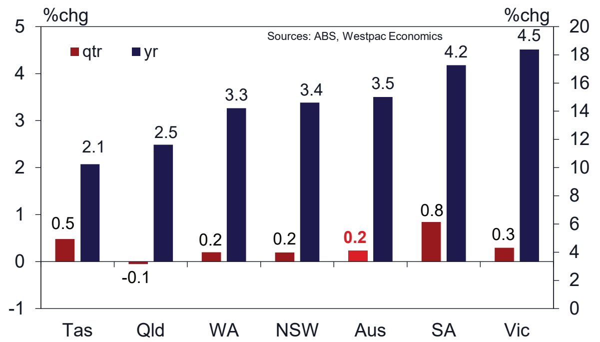
Home renovations pull-back from 2021 highs



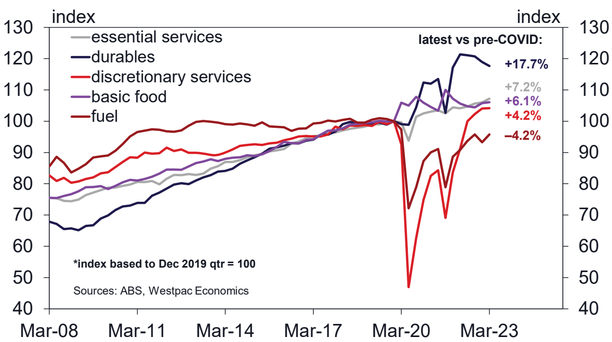
Consumer spending: 'delta states' vs rest



Consumer spending: Q1 2023



Consumer spending: broad categories



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Fiscal drags were also a factor with income tax payments pushing up another 3.3%qtr after jumping 7.2%qtr in Q4, payments up 14%yr and now accounting for 21.7% of disposable income (a 21-year high). This reflects both rising employment – which sees more people covered by income tax requirements – and rising wages putting more earnings into higher marginal tax brackets.

These drags pared back the gain in nominal disposable income (after interest and tax) to just 0.8%qtr. While this was better than the 0.7%qtr contraction in Q4, it was not enough to outpace a 1.2%qtr rise in prices – household disposable incomes in real, 'purchasing power' terms still contracting 0.3%qtr, and now down a whopping 4%yr, the largest annual decline since June 1983.

As this implies, consumers again used savings to buffer against the real income hit. The savings ratio (the portion of income unspent) declined from 4.4% in Q4 to 3.7% in Q1, a 15yr low. The fall effectively 'freed up' an additional $2bn in funding for expenditure. The scope for further falls in savings to continue buffering shocks to income is now very limited. The savings rate is now well below the 'par' of 6-6.5% and notionally implies a draw-down on the 'excess savings' accumulated during the pandemic – estimated at around $250bn – running at about $9bn/qtr.

The States (Elliot Clarke)
Conditions were mixed across the states in Q1 2023, with the quarterly outcomes spread between WA's 0.8% and Tas's –0.2%.

New South Wales' state demand grew 0.4% in Q1 2023 following a 0.1% decline in Q4 2022. Having averaged just 0.2% growth since June 2022, annual growth has abruptly slowed from Q3 2022's outsized peak of 10.5% to a sub-par 2.2%. Consumption has been a key contributor to this turn, annual growth having slowed from almost 18% at Q3 2022 to 3.4%, with activity essentially unchanged the past six months. Housing investment meanwhile has continued to edge lower, contracting by a cumulative 4.9% since its Q2 2021 peak. New construction is broadly unchanged the past 12 months; renovations 3.7% lower.

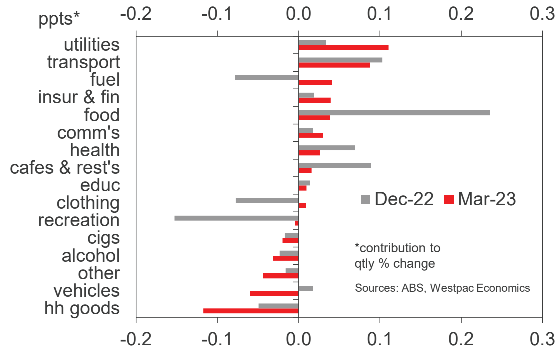
Business investment is still up 8.2% compared to Q1 2022, but only circa 2.5% annualised the past 6 months. Over the last 6 months, non-residential construction has contracted while equipment spending slowed to a sub-par pace. However, engineering construction jolted up to reach a new high back to Q1 2019 and before that 2012/13. The outlook for infrastructure remains promising; but for other investment, decidedly uncertain. Public demand seems to be holding its level amid choppy growth in public investment, but is not adding significantly to growth.

Victoria's economy was among the strongest performers in Q1 2023, its 0.7% gain second only to WA's 0.8%. At the margin, Vic household consumption is carrying greater momentum than NSW (4.5%yr against 3.4%yr). However, housing investment is materially weaker in Vic (-2.4%; -7.1%yr). Over the year, renovation work has been hit hard, down 12%; while new home construction is 'only' 4.6% lower. Looking ahead, consumers across the south east face considerable headwinds as the high cost of living depletes savings and labour market uncertainty grows.

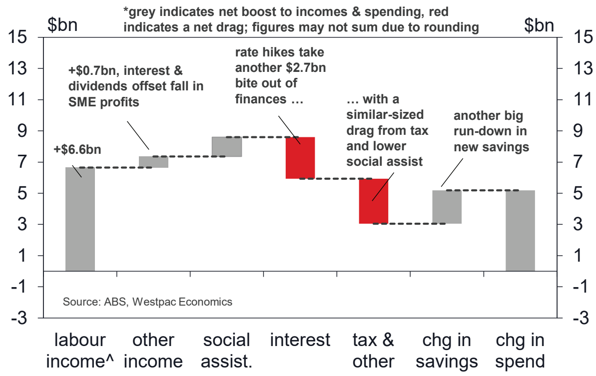
As for NSW, while total business investment is up a robust 8.8% compared to Q1 2022, the quarterly outcomes are highly volatile. In contrast to NSW however, momentum is broad-based across the sub-sectors, equipment spending, engineering and non-residential construction having gained 12%, 10% and 10% respectively over the year. Investment by the public sector has been similarly volatile, but currently is up 4.8%yr. Weakness in public consumption has offset, leaving public demand 1.7% lower than in Q1 2022.

Queensland state demand also recorded a gain of 0.4% in Q1 2023 (2.3%yr), in line with NSW. At 2.5%yr, annual consumption growth in Qld is the weakest of all the mainland states. Moreover, activity in the sector has essentially been unchanged for 9 months. While the cost of living is as significant a concern in Qld as elsewhere,

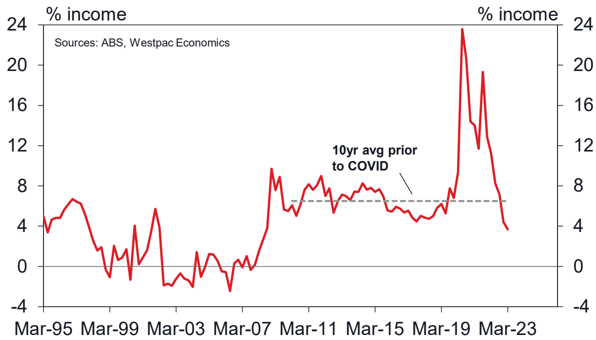
Consumer spending by category



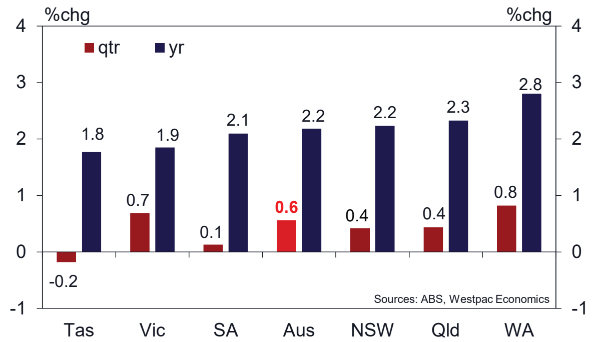
Household income flows: change, Q4 to Q1 2023



Household savings ratio



State demand: Q1 2023



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arguably this poor performance is also a consequence of the state fairing well through the COVID-19 lockdowns and therefore not having the same degree of catch-up as NSW and Vic. Households are clearly holding back on big ticket items, renovation work 15% lower than Q1 2023. New home construction has been a partial offset, gaining 4.7%yr.

Business investment's outlook is also uncertain, 7.1% annual growth masking a stagnant 6 months to March. Growth by sub-sector is also varied, engineering work and equipment spending respectively 19%yr and 7.8%yr higher, but non-residential construction down 4.4%yr. Helpfully, public investment continues to show considerable strength, up 12%yr.

Western Australia's economy outperformed in Q1 2023, gaining 0.8% in the quarter and 2.8% versus a year ago. Household consumption has been volatile quarter to quarter but, over both 6 and 12 months, growth remains healthy, 3.3%yr. New home construction has stabilised over the past year, –1.1%yr; renovation work looks to be under greater pressure, –4.1%yr.

While annual growth in business investment is weaker than the other states bar Tas, 3.0%yr compared to 6.6%yr for the nation, the 6 months to March have been more constructive. Over both periods, growth has been concentrated in construction. During the past 6 months, public investment growth has also firmed.

South Australia's economy gained just 0.1% in Q1 2023, only partly retracing Q4 2022's 0.3% decline. Annual growth now stands at 2.1%yr, having slowed from 5.0%yr at Q2 2022. Consumption has lost momentum of late; though at 4.2%yr, SA consumers are one of the better performers nationally, perhaps as a result of the lower level of house prices and hence household debt service. Business investment is also continuing at pace, up 8.0%yr, thanks to a 23%yr gain for non-residential construction and a 10%yr rise in equipment spending. Housing investment has been hit however, new construction down 6.3%yr and renovation work broadly flat versus Q1 2022.

Tasmania was the weakest of the states in Q1 2023, state demand declining 0.2%, bringing annual growth down to 1.8%yr. Household consumption has clearly lost momentum the past 6 months, 2.1%yr. Business investment has also reversed course over the period, leaving annual growth at –2.2%yr. And, although housing investment gained 6.1% in Q1 2023, this followed an 18% decline over the 5 quarters to Q4 2023. Public demand has only provided a partial offset to this weakness, 3.4%yr, with investment declining over the 6 months to March.

Production: an industry perspective (Ryan Wells)
The Production estimate of GDP printed 0.2%qtr, 2.3%yr for the March quarter.

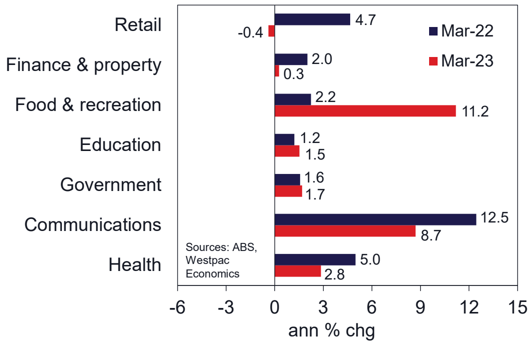
Across the broad segments of the economy, activity conditions continued to soften. The performance from services was weak, with business services contracting moderately and household services unable to produce momentum. Goods provided a limited offset, with distribution and production both growing modestly.

Household services was unable to make up for its lacklustre showing over the previous two quarters, the 0.8% rise in Q1 representing only a marginal improvement on the 0.7% gain in Q4 and 0.3% lift in Q3. Performances varied by industry, but together they highlight the downtrend in consumer spending as cost-of-living pressures impact.

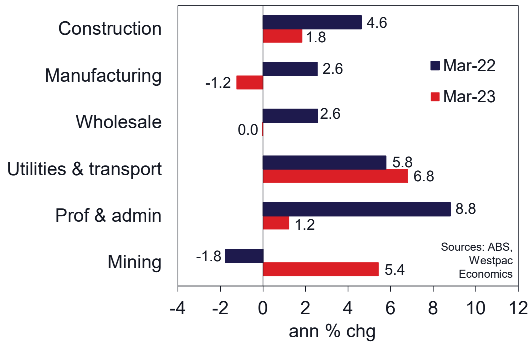
The main positive was an expansion in health care & social assistance across both private and public providers, giving way to a 1.1% bounce-back from two quarters of mild declines.

Meanwhile, food and accommodation posted its weakest result since the onset of the 'delta' outbreak, rising by a tepid 0.7%. This was fully offset by a fall in arts and recreation, which albeit more volatile on quarterly basis, has been in a clear downtrend since Q3 2022, annual growth having fallen from 17.4% to 4.3% currently.

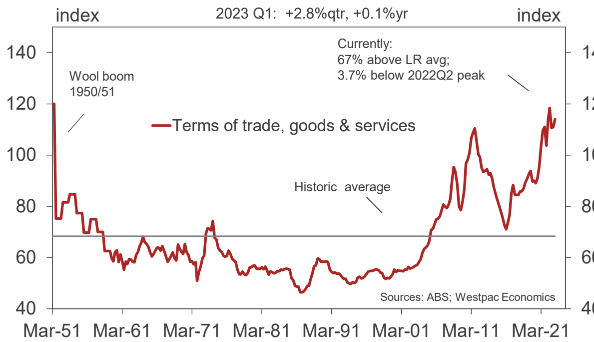
GDP by industry



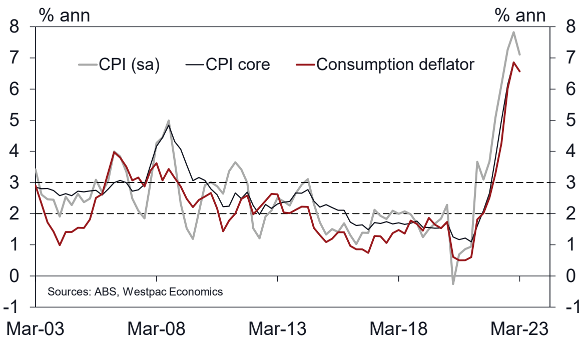
GDP by industry



Terms of trade, remains near record high



Consumer inflation surge



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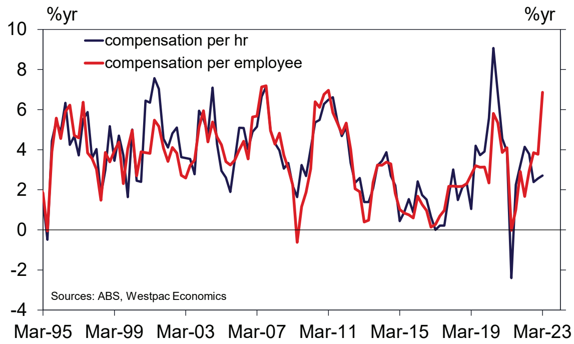
Business services were a key disappointment, contracting 0.6% in the March quarter, leaving annual growth at a lukewarm 1.5%yr. The weakness here was broadly-based, with declines across professional (–1.2%), administrative (– 1.4%) and real estate services (–1.6%) all reflecting a cooling in demand as higher interest rates impact.

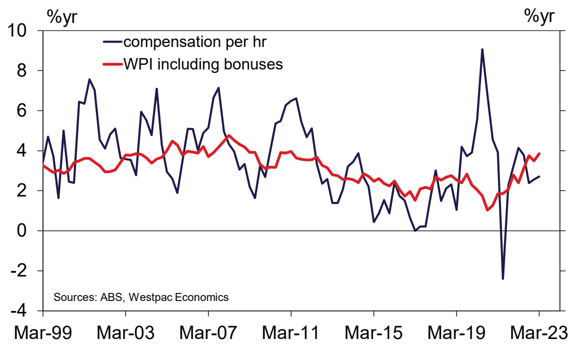
The goods distribution sector, outside of business services, had the softest performance in the quarter, rising 0.3%. Underlying this is a fairly mixed performance, as a robust gain in wholesale trade (+1.3%) met with a soft outcome in transport, postal and warehousing (+0.4%) and a fall in retail trade (–0.5%) given the growing pressure on consumer's discretionary spending capacity.

Goods production was also subdued, rising 0.5% in the quarter, leaving the sector up 5.4% relative to pre-pandemic levels. Increased production in manufacturing (+2.4%) was a key support, coupled with greater demand for utilities (+1.5%) due to warmer weather. Meanwhile, construction (+0.2%), agriculture (–0.2%) and mining (–0.3%) all had softer performances upon maintenance and weather-related disruptions.

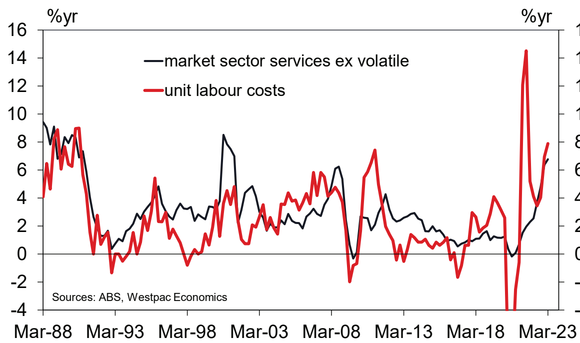
Non-farm workers compensation



Non-farm workers compensation vs. WPI



Unit labour costs & services inflation



Income (Andrew Hanlan)

The real income estimate of GDP printed 0.2%qtr, 2.1%yr.

Nominal GDP grew by 2.1%qrt, 9.2%yr, with the GDP deflator increasing by 1.9%qtr, 6.8%yr (as discussed below).

A rise in the terms of trade, +2.8%, provided a boost to national income in the period.

The following analysis is based on nominal data.

Total factor income (TFI), which is GDP (I) minus taxes less subsidies, increased by 2.1% in the quarter – in line with the increase in nominal GDP.

Total compensation of employees, the wage income bill, increased by 2.4%qtr, 10.8%yr associated with the 0.6% rise in hours worked in the March quarter (as discussed in more detail above and below).

Company profits (private non-financial) posted a rise of 4.0%qt, 13.5%yr rise. While a sizeable rise in aggregate, detailed data (from the Business Indicators survey) describes a mixed picture by industry - as to be expected at a time of sharply rising input costs and mixed demand.

Gross mixed income, spanning small business and the farm sector, weakened further, declining by –3.8%qtr (the fourth decline in the past five quarters) to be 5.4% below the level at the end of 2021. Incomes have been impacted by a pull-back in global rural commodity prices (from historic highs) and for some, margin squeeze in the face of sharply higher input costs.

Total financial corporations posted a decline of -0.2% following a slowing to a rise of 0.6% the quarter prior, evidence of the challenging environment as interest rates rise rapidly and the economy slows.

Inflation (Justin Smirk)

The GDP deflator rose 1.9% in the March quarter to be up 6.8% in the year. The GDP deflator has been very volatile through the last year lifting 3.1% in June then was almost flat with a 0.1% increase in September before a 1.6% bump in December. This saw the annual pace peak at 9.1%yr in December before moderating to a still very solid 6.8%yr pace in March.

The GNE deflator, which is not impacted by changes in the terms of trade, rose 1.5% in March following on from a 1.3% lift in December, a 2.0% gain in September and a 1.6% rise in June. The annual pace lifted from 5.5%yr in June, peaked at 6.9%yr in December and moderated to a robust 6.5%yr in March. The terms of trade remains an inflationary pulse for the Australian economy.

The consumer price deflator (household consumption deflator) lifted 1.1% in the March quarter, a moderation from the 1.6% gain in December and a very much out-sized gain of 2.1% in September. The annual pace lifted from 6.0%yr in September, peaking at 6.9%yr in December then moderating to 6.6%yr in December.

Compare that to the seasonally adjusted CPI which gained 1.4% in the March quarter to be up 7.0% in the year, a moderation from the 1.9%qtr/7.8%yr peak in the December quarter.

The household consumption deflator has a floating basket of goods and services, compared to the fixed basket in the CPI, so it captures any change in consumer spending patterns as relative prices change – i.e. moving away from more expensive goods and towards cheaper goods. As such, when there is greater than usual inflationary pressure, the consumption deflators in the National Accounts can run at a more modest pace than the CPI measures.

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Wages, labour costs and productivity

Labour costs in the national accounts are measured by total compensation of employees, i.e. the wages bill. Total non-farm compensation of employees lifted 2.4% in March following on from the solid 2.4% gain in December and the significantly out-sized 3.2% gain in September. Total non-farm compensation is up 10.8% in the year to December, continuing the modest acceleration from 10.2%yr in December, 10.0%yr in September but quite a marked up-tick from the solid 7.0%yr print in June. However, this number is not just affected by changes in wages but also by any change in number of employees and the hours they work.

Non-farm compensation per hour was a bit softer but still a solid 1.6% gain in the March quarter, lifting from a flat print in December and a 2.0% print in September. Interestingly, this series contracted –0.9% in June 2022. The annual pace for non-farm compensation has been holding just under 3%yr for most of last year, starting out at 2.9%yr in June before moderating to 2.2%yr in September then holding at 2.8%yr in both December and March.

The national accounts measure of hourly rates of pay inflation are significantly more volatile than that from the Wage Price Index (WPI), but they have also been running at a pace that is somewhat softer pace than the WPI, which is a more pure expenditure weighted price index of hourly wage rates.

The WPI (including bonuses) may have lifted just 0.9% in the March quarter, but this followed a 0.8% gain in December, 1.1% in September and 0.9% in June. This saw the annual pace lift from 3.1%yr in June to 3.8%yr in March, a meaningfully faster pace than what we have seen in the average hourly wage inflation from the national accounts.

While this softer pace of wage inflation from the national accounts may disappoint those hoping that average compensation measures would show more wage inflation than the WPI, we caution that this may shift very soon. The almost 6% average increase in awards/minimum wages will hit in the September quarter and, when combined with the 15% increase in the awards for aged care workers, the possible flow-on to other wage claims (both enterprise bargaining and individual arrangements) plus the removal of wage increase caps by the states' public services, this could see a much larger increase in national accounts measures of wages in the second half of this year.

Nevertheless, when thinking about how wage inflation might impact on consumer price inflation we have to take offsetting productivity into account. This can be done via unit labour costs, that is the labour cost to produce one unit of GDP output. It is here that we see the impact of poor growth in productivity. Nominal unit labour costs jumped 2.0% in March, building on the 1.5% gain in December, 2.1% lift in September and June. This has seen the annual pace of unit labour cost surge to 7.9%yr in March, up from 4.0%yr in June. The recent peak in unit labour costs annual inflation was 15.7%yr in June 2021 on the back of the COVID disruptions collapse in output.

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