BULLETIN

6 September 2023

Australian national accounts, June quarter. Subdued growth, consumer spending broadly flat. Households under pressure from inflation and interest rates.
Q2 domestic demand: 0.7%qtr, 2.2%yr
Q2 real GDP: 0.4%qtr, 2.1% yr

The Australian economy expanded by 0.4% in the June quarter following a 0.4% increase in the March quarter (revised up from 0.2%).

Key themes from the accounts are: ongoing weakness in consumer spending; slowing growth in employee compensation; rapid deterioration in productivity; and boosts from business investment and services exports.

Growth in household spending slowed to 0.1% in the quarter, down from 0.3% in the previous two quarters and the slowest growth in spending (excluding the pandemic quarters) since September 2019.

Discretionary consumer spending (–0.5%) contracted for the third consecutive quarter highlighted by recreation (–2.5%) and furnishings and household equipment (–2.5%). Other discretionary spending (transport; hotels; restaurants) continued to increase but at a much more subdued pace than in previous quarters. Essential spending lifted by 0.5%.

Compensation of employees continued to rise (1.6%), down from 2.4% in March and the lowest growth rate since September 2021 (a period impacted by delta). The sharp increase in compensation is starting to fade with the June quarter pace only slightly above the average pace (1.3%) in 2019, prior to the pandemic.

Slower growth in employee compensation at a time of the savings rate reaching historical lows signals further pressure on household spending. The household savings rate fell from 3.6% to 3.2% – the lowest savings rate since June 2008 and down from 12.9% in December 2021.

Strong growth in employee compensation and a falling savings rate have been key to supporting household spending when an excessive tax burden; higher interest costs and a rising cost of living have challenged household spending.

Prospects for a recovery in household spending under these circumstances are not encouraging.

GDP per hour worked fell 2.0% in the June quarter to be down by 3.6% over the year. Real unit labour costs lifted by 3.2% to be up by 5.8% over the year. While these measures are volatile the accounts continue to highlight the nation's productivity challenge.

Business investment and services exports were bright spots. New private business investment lifted by 2.1%, highlighted by new machinery and investment which rose by 4.3%, boosted by attractive tax concessions, in particular investment in motor vehicles. New public investment surged by 5.2%, reflecting ongoing work on large scale transport, health, and education projects.

Exports of goods and services rose by 4.3%, highlighted by services exports rising by 12.1%, from education and travel – with international students and Chinese tourists being strong contributors.

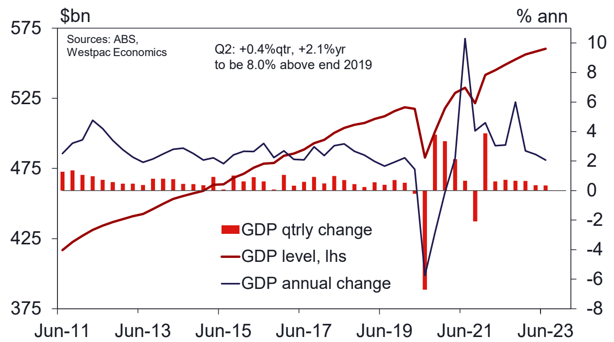
The terms of trade pulled back, down by 7.9% in the quarter, representing a hit to national income. The terms of trade are now 12.7% below the record high of a year earlier but still 53% above the long-run average.

GDP: June qtr 2023

	% qtr		% yr	
	Mar	**Jun**	**Mar**	**Jun**
Private consumption	0.3	0.1	3.6	1.5
Dwelling investment	–0.7	–0.2	–4.4	–1.1
Business investment*	3.6	2.1	7.1	8.0
Private final demand*	0.7	0.5	2.9	2.0
Public spending*	0.9	1.2	0.9	2.7
Domestic demand	0.7	0.7	2.3	2.2
Stocks – private non-farm #	0.3	–1.0	–0.6	–0.9
– other #	–0.2	–0.1	–0.2	–0.1
GNE	0.8	–0.4	1.6	1.2
Exports	1.8	4.3	10.9	9.8
Imports	3.6	0.7	5.7	4.4
Net exports #	–0.3	0.8	1.2	1.3
Statistical discrepancy #	–0.2	–0.1	–0.3	–0.4
Non-farm GDP	0.4	0.4	2.6	2.2
GDP, real	**0.4**	**0.4**	**2.4**	**2.1**
GDP, nominal	2.2	–1.2	9.5	3.6
GDP deflator	1.9	–1.5	7.0	1.5
Household deflator	1.2	1.2	6.5	6.1
Earnings per worker (non-farm)	2.0	0.9	6.4	6.0
Real household disp income	–0.4	–0.1	–4.1	–3.0

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

Australian economy: grew a subdued 0.4% in Q2



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Prospects for growth in the Australian economy hinge on the household sector. A rock bottom savings rate; slowing growth in employee compensation; low confidence and no prospect of any interest rate; tax; or cost of living relief point to the economy continuing to grow well below trend.

As we saw in these national accounts and the March quarter, GDP per capita is contracting – by 0.3% in both quarters. Prospects for that changing over the next year or so are not encouraging.

Under these circumstances the Reserve Bank is likely to keep rates on hold at the current contractionary level until well into 2024. Some relief is likely in the second half of 2024 when rates can be eased, and the important Stage 3 income tax cuts are scheduled to be delivered.

Bill Evans, Chief Economist, Westpac Group

Domestic demand (Andrew Hanlan)

Domestic demand (0.7%qtr, 2.2%yr): Spending across the domestic economy grew by 0.7% in both the March and June quarters, driven by a burst of business investment and a lift in public demand.

Public demand (1.2%qtr, 2.7%yr): Government spending, in the form of public demand, finished the 2022/23 financial year, posting a robust increase in the June quarter, up by 1.2%.

Public consumption continues to crest at a high level, up 0.35% in the June quarter, as the spike in COVID-related spending deflates. Annual growth at 1.4% currently is well down from the high of 8.9% at the start of 2022.

Public investment rose particularly strongly, up 5.2%, to be 9.4% higher over the year. The investment upward trend is set to continue, with a sizeable pipeline of work on transport infrastructure projects – a much needed investment to expand capacity to meet the needs of a growing population.

Private demand (0.5%qtr, 2.0%yr): Demand across the private sector grew by 0.5% in the period, led by business investment.

Consumer spending (0.1%qtr, 1.5%yr): Consumer spending was broadly flat in the June quarter, inching 0.1% higher, slowing from already weak outcomes of 0.3% for each of the past two quarters.

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

Home building (–0.2%qtr, –1.1%yr): Home building activity edged lower in the quarter, down by -0.2%.

The renovations boom continues to deflate, with further downside, with work contracting by –2.4% in the quarter. New dwelling activity expanded by 1.2%, with builders reducing what is a sizeable backlog of work which emerged during the pandemic.

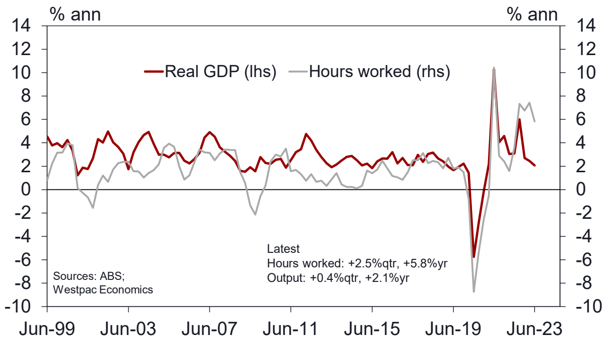
Real estate (3.9%qtr, –14.2%yr): The real estate sector, in the form of Ownership Transfer Costs (turnover in the property sector), rose by 3.9% in the quarter, the first increase since September 2021. Demand is being supported by strong population growth and a robust labour market, at a time of limited supply.

New business investment (2.1%qtr, 8.0%yr): There was a burst of business investment over the past two quarters, +3.6% and +2.1%, extending the upward trend from the low point of September 2020.

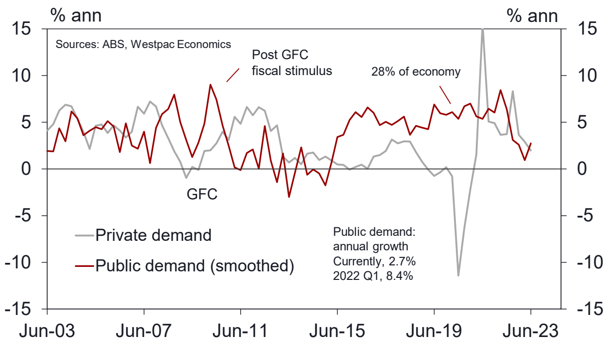
The lift in investment is in response to capacity constraints, as well as being encouraged by generous tax incentives – some of which expired on 30 June 2023.

The investment increase of 2.1% in the June quarter, included: equipment spending, +4.3%; infrastructure, –0.4%; new building, +1.2%; and Intellectual Property Products, +2.2%.

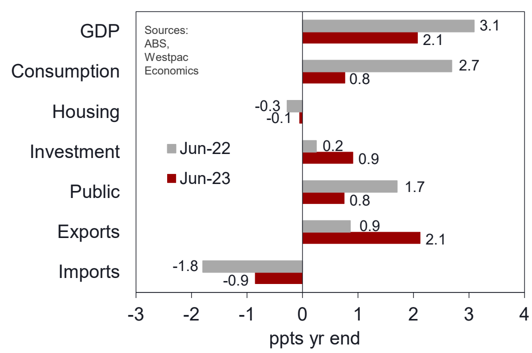
Hours worked: jump 2.5% in Q2



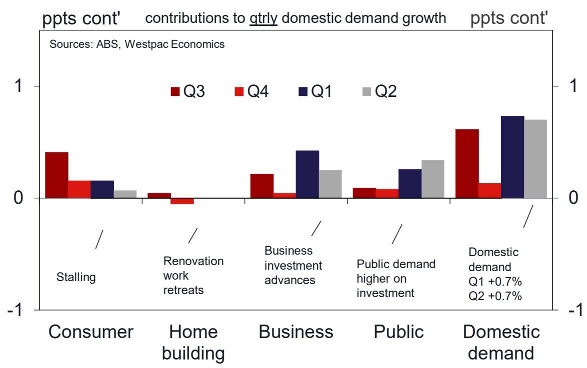
Public demand: trend slowing, covid spend unwind



GDP growth: year-end contributions



Australia: domestic demand



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GDP: the expenditure estimate

The Expenditure estimate of GDP printed 0.4%qtr, 2.5%yr for the June quarter.

Domestic demand grew by 0.7% and there was a net subtraction of –0.3ppts from total inventories (-1.1ppts) and net exports (+0.8ppts).

Net exports made a sizeable positive contribution to activity in the quarter, adding 0.8ppts.

Exports expanded strongly, up by 4.3%, including a stellar 12.1% increase in services as the recovery in student numbers and tourists continues. Goods exports rose by 2.5% in the quarter, with resource shipments up 2.8% and manufactured goods 2.2% higher.

Import volumes rose by a modest 0.7%, constrained by a 0.2% dip in goods associated with more mixed domestic demand. Service imports rose by 4.7% as more of us holiday abroad.

Total inventories subtracted a hefty –1.1ppts from activity in the quarter, centred on a –1.0ppt drag from non-farm inventories, which declined by a sizeable –$3.5bn in the quarter.

Household Sector (Matthew Hassan)

Australian consumers had another very difficult quarter, income rises again more than offset by the combined effect of higher interest rates, higher tax payments and higher prices. The net result was a fifth consecutive quarter of shrinking real disposable incomes. Total spending still managed to eke out a slight rise but only through a further reduction in new saving and it was not enough to prevent a third successive decline in spending in per capita terms.

Drawing this into perspective, the last five quarters marks the longest run of consecutive declines in real disposable income since estimates began in 1960. The last three quarters also mark the second longest run of per capita declines in spending (the longest being during the GFC). In terms of magnitude, both contractions have also eclipsed those seen during the early 1990s recession.

Consumer spending rose just 0.1% in Q2, broadly in line with expectations. That follows a 0.3%qtr gain in Q1, revised up slightly from 0.2%qtr, and a 0.3%qtr lift in Q4. Annual growth slowed to 1.5%yr, but with gains tracking a sub-1% pace over the last three quarters.

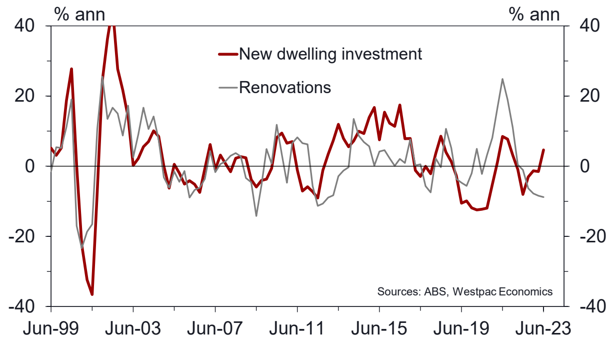
The quarterly detail was also largely as anticipated. At a top level: our 'retail proxy' declined 0.5%qtr, in line with volumes in the retail survey; new vehicle purchases surged 5.8%qtr, in line with the lift in vehicle sales; vehicle operations were up 0.3%qtr, somewhat softer than the 2%qtr gain in fuel consumption; and the broad measure of services we track was up just 0.1%qtr (we had been anticipating a flat result).

The more granular detail shows the main drags came from a big pull-back in recreation spending, covering both goods and services (–2.5%qtr), and continued falls in spending on household goods (–2.5%qtr), with declines in spending on alcohol and tobacco also a factor. Aside from vehicles, the quarter also saw a solid gain for transport spend (+3.2%qtr, likely centred on a continued rebound in tourism travel); with solid gain for utilities (2.2%qtr); health (+0.5%qtr) and insurance & finance (+0.6%qtr) as well.

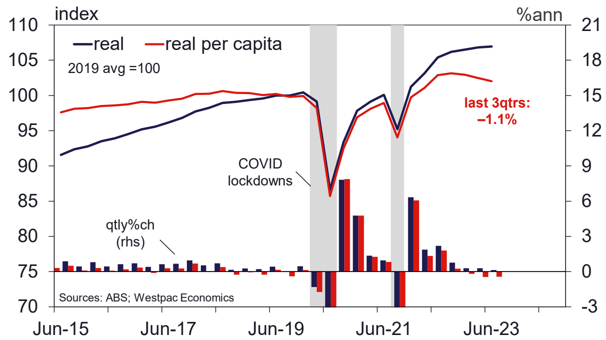
Around incomes, the overall picture was largely as expected but with some offsetting surprises in the detail.

Total wage income posted a robust 1.6%qtr gain but came in a little weaker than we had expected based on the somewhat stronger rise in hours worked (+2.5%qtr on a national accounts basis). Total wages paid are still up 9.2%yr. For non-farm workers, average compensation rose 0.9%qtr but declined 0.4%qtr on a per hour basis.

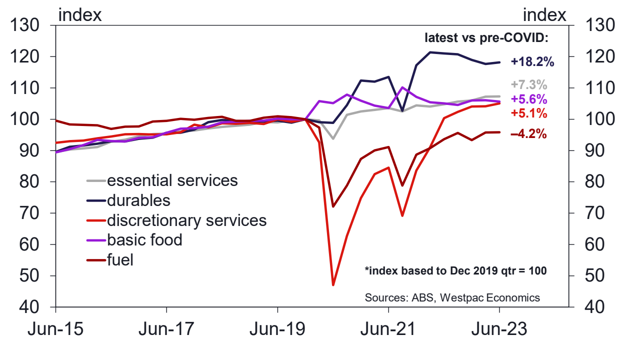
Home renovations boom deflates



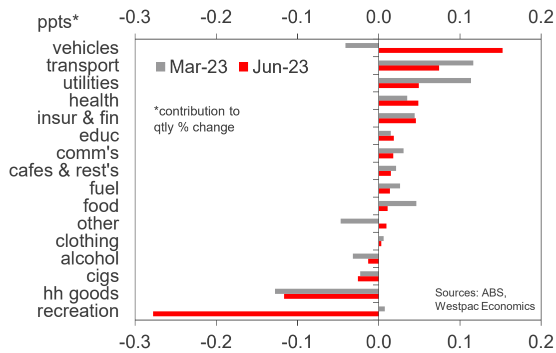
Consumer spending



Consumer spending: broad categories



Consumer spending by category



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.

Non-labour income was again uneven, with strong gains for ‘property’ (which includes dividends and interest returns on deposits) and rental income (which largely nets out on the spending side of the household account) partially offset by another large 2.7%qtr decline for gross mixed income (mainly the profits of farm sector and unincorporated businesses).

The net result produced a solid 1.8%qtr rise in gross incomes. However, about 0.7ppts of that gain was offset by bigger drags from interest and income tax payments. Interest payments surged another 10.1%qtr to $30.6bn in Q2, a new record high in dollar terms and hitting 8.2% of nominal disposable income (a decade high). Income tax payments also pushed up another 2.2%qtr, annual growth hitting a remarkable 15%yr. Total income tax payments rose above 22% of disposable income for the first time since 2002. Note that a large part of this is due to rising employment which sees more people covered by income tax requirements – with rising wages also putting more earnings into higher marginal tax brackets.

These drags pared back the gain in nominal disposable income (after interest and tax) to just 1.1%qtr, a marginal improvement on the 0.8% gain in Q1. However, this was again not enough to keep up with prices which rose another 1.2%qtr to be up 6.1%yr. Real household disposable incomes dipped 0.1%qtr to be down –3%yr.

As this implies, consumers again used savings to buffer against the real income hit. The savings ratio (the portion of income unspent) declined from 3.6% in Q1 to 3.2% in Q2, a new 15-year low. The fall effectively ‘freed up’ an additional $1.2bn in funding for expenditure. 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 $260bn – running at about $12.6bn/qtr. In total, about $32bn of this reserve now looks to have been drawn down.

The States (Ryan Wells)

Domestic demand was the key driver of growth in the quarter, up 0.7%. Performances across the nation varied, however, with state final demand up notably in both Queensland and South Australia (+1.3%) but to a lesser degree in New South Wales (+0.8%) and Victoria (+0.7%), while more subdued outcomes were observed in both Western Australia (+0.4%) and Tasmania (–0.2%).

Household consumption came in broadly as expected, up 0.1% across the nation. The variability in state final demand can, in part, be explained by differences in this category. Household spending was the softest in Victoria (–0.2%) and New South Wales (0.0%), outside of Tasmania (–0.5%). The detail highlights the current constraints households are facing in regard to their spending capacity, with an increased spending on essentials such as food and utilities being met with a reduction in spending in discretionary categories, such as household contents and recreation/culture. Positive results across Western Australia (0.8%), South Australia (0.6%) and Queensland (0.3%) provided an offset to that weakness, although this is largely associated with an increase in vehicle purchases as orders were continued to be fulfilled.

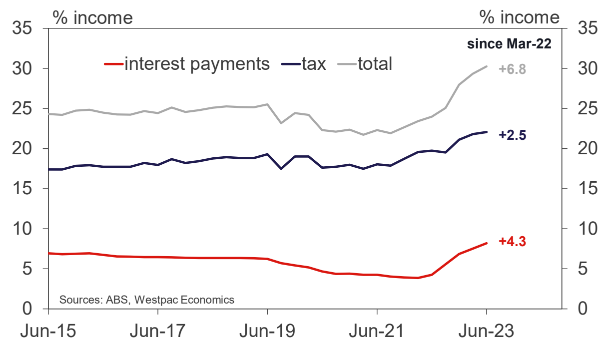
Public investment was a key contributor to domestic demand in June, up by 8.2% (or 5.2% after excluding second hand asset sales). Results varied in magnitude across the states but were consistent in direction: Victoria (+12.2%), Queensland (+8.9%), South Australia (+7.5%), New South Wales (+7.2%), Western Australia (+3.0%) and Tasmania (+2.1%). Elements of the private investment profile were also positive across the states, namely spending on machinery and equipment, with results on housing and non-dwelling construction more varied.

Production: an industry perspective

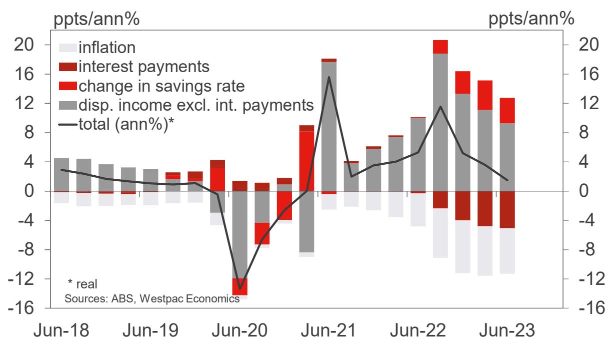
The Production estimate of GDP printed 0.4% (2.1%yr) for the June quarter.

Activity conditions across the broad segments of the economy were subdued in the quarter. Services sectors have slowed over the past year and are very soft relative to pre-pandemic observations.

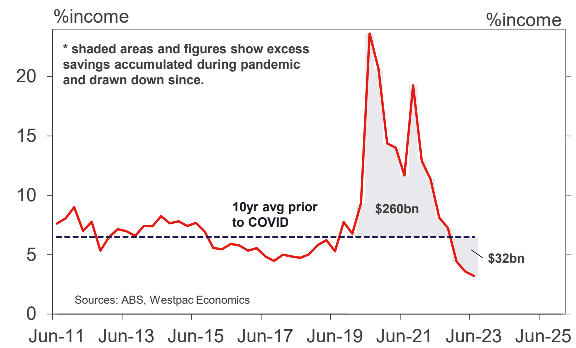
Household interest and income tax payments



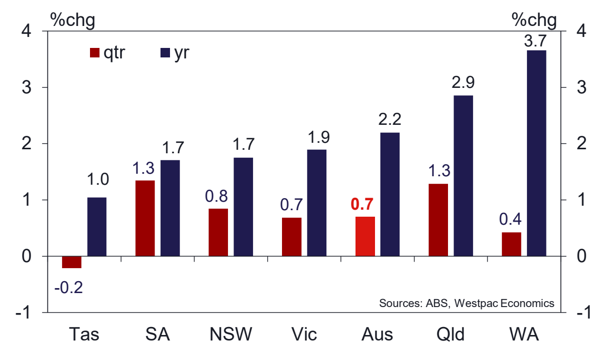
Consumer spending: drivers and headwinds



Household savings ratio



State demand: Q2 2023



Momentum in goods production has been moderating but remains positive overall. Goods distribution meanwhile had the softest performance.

Household services rose 0.7% (2.8%yr) in Q2, following a run of similar gains over the previous two quarters (0.7% in Q1, 0.8% in Q4). The sectoral breakdown was also very similar to what was seen in March, lifts in education and training (0.4%) and health care and social assistance (0.9%) – the two largest household services sectors – matching the outcomes seen in the previous quarter.

Speaking more directly to key consumer sectors, food and accommodation posted its weakest result since the onset of the 'delta' outbreak, rising by a tepid 0.4% (19.1%yr in Q1 to 7.1%yr in Q2). The profile for arts and recreation remains choppy on a quarterly basis, but the downtrend that emerged from Q3 2022 remains firmly in place, annual growth down from a peak of 18.5%yr to 1.9%yr currently. In line with our view, these results highlight the emerging weakness in households' discretionary spending capacity under the weight of high inflation and elevated interest rates.

Business services more than made up for its soft patch in March, up 0.6% in June. It was constructive to see a broad base to this positive result, with lifts across administrative (1.8%), information media and telecommunication (0.3%), financial and insurance (0.2%) and real estate services (2.6%), the latter two of which mirror improvement in housing market conditions. That said, business services as a whole remain in a clear downtrend, growth unchanged on an annual basis (1.8%yr) and soft relative to pre-pandemic trends.

Goods distribution exhibited the weakest performance, nudging down just –0.1% (1.5%yr). Transport, postal and warehousing remains a stand-out positive, up 1.1% (5.0%yr), but this was effectively offset by broad-based weakness in wholesale trade, down –1.5% (0.1%yr). While the extent of weakness in retail trade has been moderating, the sector still posted its third consecutive quarterly decline, down –0.1% (–0.9%yr), reflective of the weakness in household spending as consumer's discretionary spending capacity remains under pressure.

Goods production was up 0.5% in June (1.9%yr). Momentum within the sector has been gradually moderating on a quarterly basis, but flattered by earlier weakness in 2022, annual growth continues to rise. Activity in the latest quarter looks to be broad-based across key sectors: agriculture (+0.9%), manufacturing (+0.7%), utilities (+2.9%) and construction (+2.2%), with mining the only negative as a consequence of adverse weather and maintenance (–1.3%).

Income (Andrew Hanlan)

The real income estimate of GDP printed 0.3%qtr, 2.1%yr.

Nominal GDP contracted by a hefty –1.2% in the quarter, with the GDP deflator declining by –1.5% (as discussed below).

A fall in the terms of trade, –7.9%, provided a hit to national income in the period. Global commodity prices have retreated from the highs of a year earlier, but remain elevated.

The following analysis is based on nominal data.

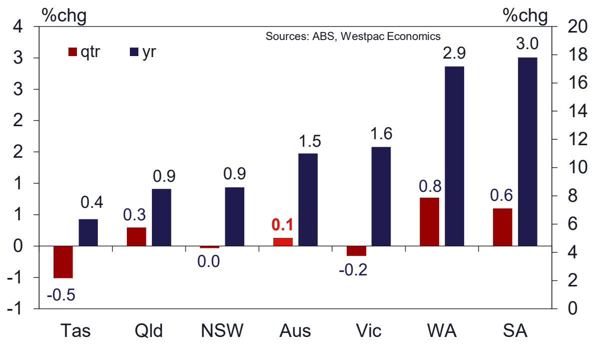
Total factor income (TFI), which is GDP (I) minus taxes less subsidies, declined by –1.3% in the quarter.

Total compensation of employees, the wage income bill, increased by 1.6% in the quarter, associated with the 2.5% rise in hours worked in the June quarter (as discussed in more detail above and below).

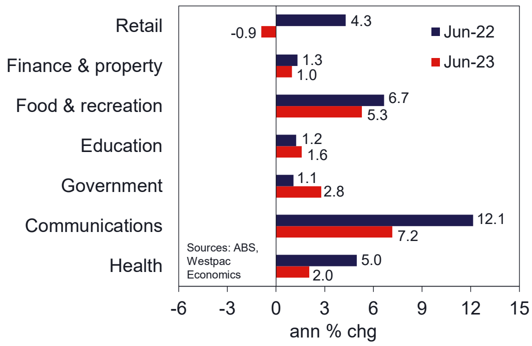
Company profits (private non-financial) contracted sharply, down by –8.6%. Mining profits retreated from their highs on lower commodity prices, while profits across the broader economy fell on challenging conditions – patchy sales and rising costs.

Gross mixed income, spanning small business and the farm sector, fell for a fourth consecutive quarter, down by –2.7%qtr, –8.8%yr.

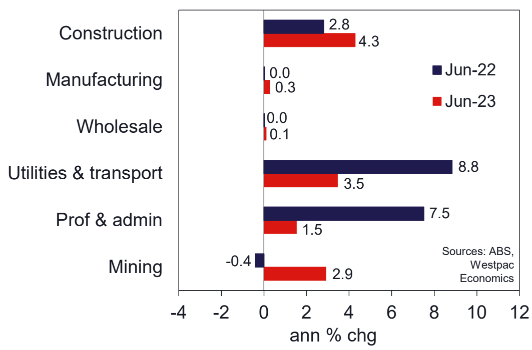
Consumer spending: Q2 2023



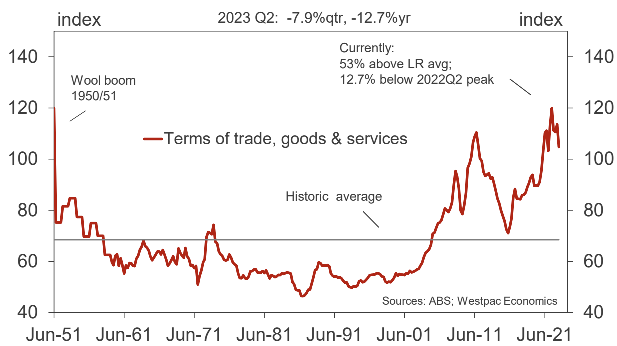
GDP by industry



GDP by industry



Terms of trade, recedes from record high



Total financial corporations posted a 1.6% increase after two weak quarters, on a lift in lending for the established housing market.

Inflation (Justin Smirk)

The GDP implicit price deflator fell 1.5% in the June quarter, the largest drop since June 2009 which, on its own, seems quite startling given just how robust other price measures are. The Domestic Final Demand deflator (DFD) gained 1.2% in the quarter. The important difference between the two is that the terms of trade can have a significant impact on the GDP deflator and the larger the contribution of international trade to GDP is, the larger the impact the terms of trade has on the GDP deflator. In the June quarter the terms of trade fell 7.9%.

The Gross National Expenditure deflator (GNE), which is not impacted by changes in the terms of trade, gained 0.5% in June to be up 5.4% in the year. This is a moderation from the 6.5%yr pace in March and the recent peak of 6.9%yr in December.

The household final consumption expenditure deflator (HFCE) continues a robust trend rising 1.2% in the June quarter, the same increase reported in the March quarter following a moderation from the 1.6% increase in December 2022 and 2.0% increase in September 2022. This has seen the annual pace lift from 6.1%yr in September to a peak of 6.8%yr in December before moderating to 6.5%yr in March then down to a still robust 6.1%yr in June. In a following article on the price deflators the ABS has noted that the June increase in the HFCE was driven by the largest quarterly rise in the rent and other dwelling services implicit price deflator in over 34 years. Prices rose for food products such as breads, fruits, and vegetables. International airfares also rose but were partly offset by a fall in fuel prices.

Compare that to the seasonally adjusted CPI which lifted 0.9% in June following on from a 1.3% gain in March and a 1.9% increase in December. The annual pace of inflation in the seasonally adjusted CPI peaked at 7.8%yr in the December quarter and was down to 6.1%yr in June; the same annual pace as reported by the HFCE.

There are some significant differences between the HFCE and the CPI, one of which is that the HFCE has a floating basket of goods and services with the weights set by consumption in that quarter whereas the CPI has the fixed basket with a fixed set of weights. As such the HFCE will be affected by changes in consumer spending patterns as relative prices change – i.e. moving away from more expensive goods and towards cheaper goods.

This quarter the ABS also noted that not only does the HCFE has a different basket of goods and services to the CPI, but also it has different price measures for certain goods/services. This quarter it made note that the main difference in growth rates between the HFCE (1.2%) and the CPI (0.9%) was the higher share of rent in the HFCE. Both the CPI and HFCE include actual rents, but HFCE also includes imputed rents for owner occupiers. In the CPI, inflation in owner occupied dwelling is measured via the price of new dwellings purchased (excluding land values). In the June quarter rents rose strongly in both the HFCE (+2.4%) and CPI (+2.5%). However, due to the larger expenditure share in HFCE, rents made a larger contribution to the overall HFCE than to the CPI.

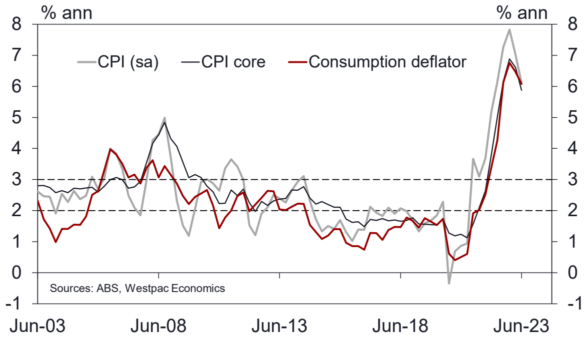
While there are differences between the various price measures, all are suggesting that annual rates of inflation peaked in the December quarter and have been moderating so far through 2023.

Wages, labour costs and productivity

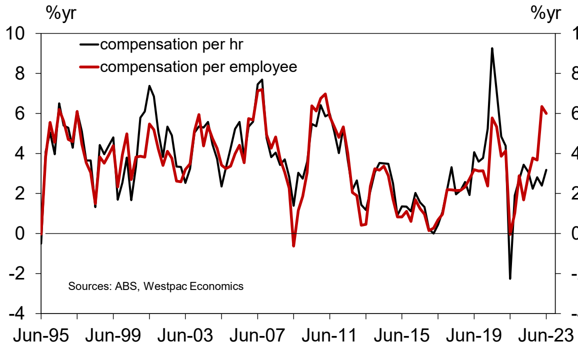
Labour costs in the national accounts are measured by total compensation of employees, i.e. the wages bill.

Total non-farm compensation of employees rose 1.6% in the June quarter to be up 9.7%yr, a moderation from the 10.6%pyr pace in March which was the fastest annual pace of growth since September 2007 (10.8%yr). This is not a pure wage measure as it is affected not just by changes in rates of pay but also by changes in the number of employees and in hours worked as well as the composition of the workforce.

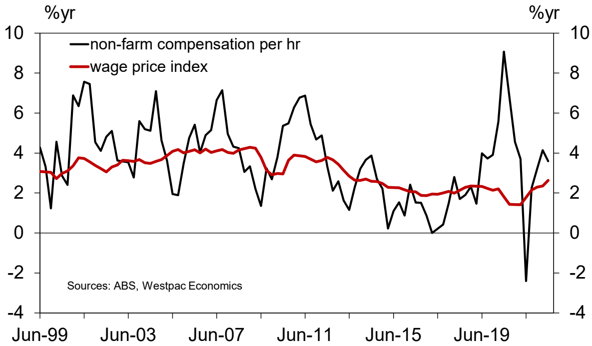
Consumer inflation surge



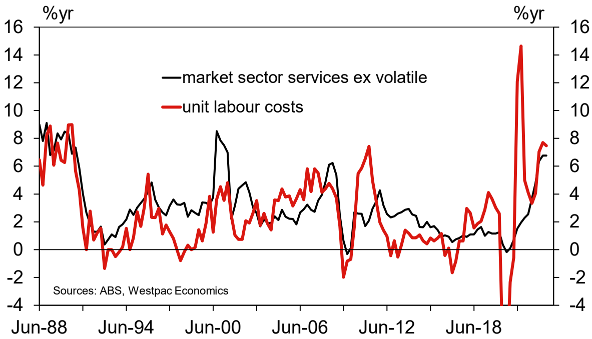
Workers' compensation



Workers' compensation – NA vs. WPI



Unit labour costs & services inflation



Non-farm compensation per hour worked fell 0.4% in the June quarter following on from a 1.3% gain in March, a flat print in December and a 2.2% surge in September. This saw the annual pace lift to 3.1% in June from 2.4%yr March and 2.6%yr pace in December. The recent peak was 4.1% pace in the year to March 2022.

The national accounts measure of hourly rates of pay are significantly more volatile than that from the Wage Price Index (WPI) but through recent history they have been painting a softer picture of wage inflation than the WPI. The WPI (including bonuses) rose 0.8% in the June quarter, the same print as the March quarter, taking the annual pace down from 3.8%yr to 3.7%yr.

As such, wage inflation from the national accounts is consistent with WPI in suggesting that wage inflation has not picked up as much as we had expected it to given just how tight the labour market is. However, we caution that it is still too early to call a peak in wage inflation. 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, could see a much larger increase in national accounts measures of wages (as well as in the WPI) in the second half of this year.

Productivity can be the offsetting factor for faster wages growth. However, labour productivity remains dismal with hour worked rising faster than output. GDP per hour worked fell 2.0% in June and while this saw the annual pace improve from –4.6% to –3.5% this was due to the base affect of a –3.1% decline in June 2022 falling out of the calculation.

Due to such a poor productivity profile, even a modest rate of wage inflation has meaningful broader inflationary implications. Unit labour costs, that is the labour cost to produce one unit of GDP output, rose 1.6% in June, a moderation from the 1.9% in June taking the annual pace down to 7.5%yr from 7.7%yr. We have found that unit labour costs are providing us with a good understanding on the evolution of market services inflation, and thus a framework for forecasting this measure of domestic core inflation. As such, the poor productivity performance suggests that inflationary pressures on market services is likely to remain meaningful even if wage inflation does come in lower than expected.

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