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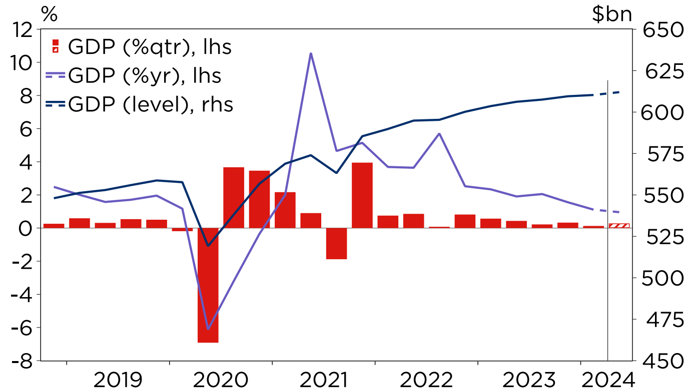
AUSTRALIAN GDP Q2: A PREVIEW BULLETIN

Growth expected to remain sluggish in Q2
Q2 GDP f/c: 0.3%qtr, 1.0%yr.

Key points

- The National Accounts are likely to show that the recent run of sub-par growth continued in the June quarter, when they are released next Wednesday.
- Growth in domestic spending is expected to remain weak. Foreign demand for our goods and services is expected to contribute significantly to GDP growth in Q2.
- Labour productivity is expected to grow by at least 1.0% in year-ended terms, suggesting that the supply side of the economy is expanding at its pre-pandemic average rate.
- We expect domestic demand to gradually improve. Cost-of-living support, tax cuts, moderating inflation and, eventually, lower interest rates will support consumer income and spending. That said, the pace of recovery is expected to be slow.

Australian economy f/c: 0.3% in Q2



Source: ABS, Macrobond, Westpac Economics

Domestic demand: +0.2%qtr
Productivity: +1.0%yr

The domestic demand impulse expected to be weak in Q2

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The National Accounts, to be released on Wednesday September 4, is likely to show that the recent run of sub-par growth in economic activity continued in the June quarter, driven by sluggish domestic spending. We expect GDP to have expanded by 0.3% in Q2. This would see annual growth ease to 1.0% in Q2 – the softest growth momentum since the early 1990s recession. This outcome is well below annual population growth, which is still running around a brisk 2½%.

Importantly, the domestic demand impulse (spending by consumers, businesses, and governments) is expected to remain weak, edging 0.2% higher for the second consecutive quarter. This would see the domestic demand impulse run at around 0.8% in six-month annualised terms – well below the pre-pandemic decade average of 2.5%.

Underlying our GDP forecast is a +0.2ppt contribution from domestic demand, a +0.6ppt contribution from net exports, while total inventories is expected to detract -0.5ppts from growth (which largely reverses the +0.7ppt contribution from inventories last quarter).

Domestic demand detail is expected to include: consumer spending +0.2%, housing investment 0.0%, business investment -0.1%, and new public demand +0.5%.

Risks

Risks to our GDP estimate are titled to the upside. Labour market data shows a large pick up in hours worked in the June quarter (+1.5%qtr). It was initially difficult to reconcile this will the soft underlying demand impulse, but partial economic data released over recent days go some way to addressing these apparent inconsistencies.

Firstly, foreign demand for our goods and services is stronger than previously estimated. Services exports (tourism and education) look to still be normalising, while services imports are largely back at pre pandemic levels. The volume of goods exported also look to have been stronger than expected, supporting activity in the quarter.

Furthermore, the ABS has significantly revised previous activity higher. The Capex data showed that growth in private investment was almost 1ppt stronger in Q1 than previously estimated. Construction work done showed that year-ended growth in Q1 was 1.3ppts stronger than initially estimated. This suggests that past activity was higher and therefore businesses could be responding to this by increasing hours worked.

Labour productivity and hours

Hours worked looks to have increased 1.5%qtr in Q2 to be flat over the year to Q2. Looking through the quarter-on-quarter volatility, and factoring the likely revisions mentioned above, labour productivity looks to have increased by at least 1.0% in year ended terms, suggesting that the supply side of the economy is expanding at its pre-pandemic average rate. Higher growth in labour productivity will help soften the rise in unit labour costs, reducing inflationary pressures in the services part of the economy.

Households

An update on household income and saving flows will be a key focus of the National Accounts. The household savings rate ticked lower in the March quarter to remain at low levels, implying households are continuing to use reserves accumulated during the pandemic to buffer against income pressures. Westpac's initial analysis suggests that most of the tax cuts that have flowed have been saved. This will not have a bearing on June quarter outcomes but could see the savings rate move higher in coming quarters.

The detail

Household consumption (0.2%qtr, 1.0%yr): Consumer spending has broadly flat-lined since the December quarter 2022 due to the squeeze on household budgets from bracket creep, higher interest rates and elevated (albeit moderating) inflation. We assess that consumer spending was again little changed in the June quarter, up a forecast 0.2%qtr. This includes a fall in retail spending, -0.3%qtr, offset by firmer services spending, although the latter likely remained mixed across discretionary and non-discretionary segments.

Dwelling investment (0.0%qtr, -4.0%yr): Home building activity stabilised in the June quarter but remains subdued, falling 4.0% in year-ended terms. We expect a small pick-up in renovations was offset by a fall in new home building. The effects of higher interest rates, elevated building costs and a rise in construction insolvencies are being felt.

New business investment (-0.1%qtr, 1.4%yr): Business investment is expected to have stalled in Q2 but remain at elevated levels. Capex suggests industries at the coal face of the consumer-led slowdown have pulled back on investment, while those catering to the bigger population continue to add to their capital stock. This divide is expected to continue until we see a sustained recovery in household spending.

Public demand(0.5%qtr, 3.2%yr): Public investment is expected to rebound after falling in Q1, as governments work through their large pipeline of infrastructure projects. Public consumption is expected to remain elevated, with ongoing cost-of-living assistance for households (around rental assistance, cheaper child care and cheaper medicines) showing through as higher public consumption. Public consumption is expected to receive a further boost from 1 July when recently announced cost-of-living assistance measures apply.

Net exports (+0.6ppts qtr, –0.6ppts yr): Exports are expected to have increased 3.0%qtr in Q2, on the back of higher services and goods exports. Imports look to have increased by around 0.8%qtr.

Total inventories (-0.5ppts cont'n qtr): Non-farm business inventories are expected to decline. Imports of consumer and intermediate goods slowed significantly over the quarter after increasing strongly in Q1. This suggests that firms are using some of that inventory to meet demand. We expect this occurred across the consumers sector, the business services sector and to a lesser extent, the mining sector. Public inventories are set to partly retrace last quarter's fall, as the public sector rebuilds its stockpile of medicines, vaccines and other health products.

Labour productivity and unit labour costs: Labour productivity was flat in the March quarter, both in quarterly and year ended terms. Labour productivity looks to have increased by at least 1.0% in year ended terms in Q2. Further, unit labour costs (ULC) rose +0.4% in the March quarter to be +5.8% higher in annual terms. Growth in ULCs is likely to have moderated to around 4.8%yr in the June quarter, reflecting the step-up in productivity growth and a slight moderation in wages growth. This remains elevated but represents a significant step down from recent rates (peak of 15.5%yr in Q3 2021) and will help reduce inflationary pressures in the economy.

Note:

Our net export estimate will be updated with next week's balance of payments release. The business indicators survey and government finance statistics due the same day will also provide some more clues around wage incomes, domestic demand, inventories, and public sector activity.

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