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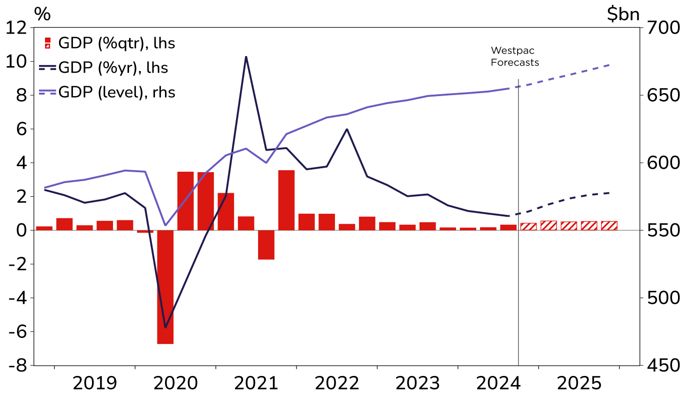
AUSTRALIAN GDP: A PREVIEW BULLETIN

Growth expected to tick higher in Q4. Q4 GDP f/c: 0.4%qtr, 1.1%yr.

Key points

- Domestic demand is expected to have grown 0.6%qtr in Q4, with private demand recording a modest recovery, up 0.6%qtr, but remains sluggish in annual terms (1.1%yr). Public spending will continue to make an outsized contribution (+0.8%qtr).
- 'Measured' labour productivity is expected to decline 1½% in annual terms. However, we expect the non-mining market sector, which is more important for domestic costs pressures, to record around average productivity growth. The deceleration in earnings growth will also help reduce underlying costs pressures.
- Going forward we expect private demand to gradually improve. Cost-of-living support, tax cuts, moderating inflation and lower interest rates will support consumer income and spending. That said, the pace of recovery is expected to be slow.

GDP Growth



Source: ABS, Macrobond, Westpac Economics

Domestic demand: 0.6%qtr, 2.1%yr.

Private demand expected to record a modest lift in Q4

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The National Accounts, to be released on Wednesday 5 March, are likely to show a gradual pickup in economic growth over the three months to the end of December (+0.4%qtr and +1.1%yr). We expect growth in private demand to have lifted on the back of tax cuts and moderating inflation. Growth in per capita GDP is likely to have stabilised, after falling for seven consecutive quarters – the longest run of consecutive declines on record.

Despite this the economy remains patchy at best. The recovery in private demand is expected to be driven by household consumption (0.7%qtr), and the construction of new dwellings and renovations (0.9%qtr). Capacity constraints that have plagued the sector look to be easing, with housing activity expanding in annual terms for the first time since the September quarter 2023.

Easing capacity constraints have also supported growth in infrastructure works with new engineering construction expected to have retraced last quarter's fall. But even this will be unable to account for the expected fall in new buildings and machinery and equipment. As a result, new business investment is expected to have dipped by around 0.2%qtr in the quarter to be broadly flat over 2024.

Overall, new private demand is expected to have grown 0.6%qtr in Q4 (and 1.1%yr), which is a touch faster than the pre-pandemic average of 0.5%qtr but still a sluggish result for annual growth. The key uncertainty remains the pace of the recovery in consumption. The Stage 3 tax cuts generated some positive traction in the September quarter (albeit with electricity rebate effects resulting in a flat quarter for consumer spending overall). The Q4 update is expected to show continued gains but tracking a moderate pace, with our indicators suggesting consumers have been saving most of the boost to incomes. As population growth continues to ease and one-off government support measures come to an end, private sector demand will need to show a more convincing pick up, or the economy may struggle to gather momentum over 2025 and 2026– a risk we have previously flagged.

Cost-of-living measures and ongoing robust rises in recurrent government spending will see public demand make another positive contribution to growth. New public demand is expected to grow 0.9%qtr in Q4 to be 4.8% higher in annual terms – this remains higher than the pre-pandemic decade average of 3.2%yr. As a result, we expect new public demand to increase to around 27.7% of real GDP, a fresh record high.

Domestic demand detail is expected to include: consumer spending +0.7%qtr, housing investment +0.9%qtr, business investment -0.2%qtr, and new public demand +0.8%qtr.

Some of the pickup in domestic demand is expected to have been met by a run down in inventories (particularly for consumer goods) and imports. Taken together, we expect a net detraction of -0.2ppts in the December quarter from inventories and net exports.

Why are the National Accounts important?

Given the long lag in the release of the Accounts, it can sometimes be dismissed as backward-looking with limited current information. The December quarter data for example, may be viewed as telling us something about last year's inflation fight and tax cut boost but little about this year's external concerns about tariffs and domestic support coming from lower interest rates.

However, this ignores the comprehensive nature of the update which provides important information on the state of the economy heading into these shifts, especially around the balance of demand and supply domestically. Key issues we will be looking at include:

- The extent to which capacity constraints are dissipating, particularly in construction and some of the services sectors.
- How private demand is responding to fiscal supports. Partial data suggests that private demand has picked up, but only modestly.
- The detailed picture around productivity and cost pressures – while the aggregate performance has been poor it has been driven by the expansion of the non-market sector and mining. How the non-mining market sector is performing has more direct relevance for prices and costs pressures.
- Whether unit labour costs (ULCs) moderate and earnings growth continues to surprise on the downside. The RBA closely monitors ULCs which provide a medium-term anchor for domestically-driven inflation pressures. While 'measured' productivity has been soft, this has been offset by decelerating earnings growth, which has surprised on the downside.

Labour productivity and hours

Hours worked looks to have increased 0.6%qtr in Q4 to be 2.5% higher in annual terms. This was driven by both the market and non-market sectors. The Labour force survey shows that hours worked in the market sector has started to recover, increasing 0.6%qtr and 1.8%yr, consistent with early signs that growth in private activity may be picking up. Hours worked in the non-market sector continues to grow, up 0.6%qtr to be 4.4% higher over the year. Note that the

December quarter Labour Account, due 7 March, is the ABS's preferred benchmark for these measures and will provide a better gauge of sectoral trends.

Looking through the quarter-on-quarter volatility, labour productivity looks set to record a decline of around 1¼% in annual terms. However, as we have been saying, the fall in aggregate productivity has been skewed by the expansion of the non-market sector, which has a significantly lower level of 'measured' productivity, and the trend decline in mining productivity as the sector continues to run down its capital stock. Productivity in the market sector excluding mining is expected to have performed better.

The detail

Household consumption (+0.7%qtr, +1.0%yr): 'Measured' consumer spending is expected to have increased 0.7%qtr, following the flat outcome in Q3 and the shock decline of 0.3% in Q2. The increase in the December quarter will leave consumption around 0.4% higher than the level recorded in Q1. In the context of continued strength in population growth (around 1.5% over the same period), this points to still subdued growth in household spending. Retail trade volumes grew 1.0% in Q4 as consumers took advantage of discounting and continued to benefit from the Stage 3 tax cuts, while the experimental household spending indicator also points to some strengthening in the December quarter. Westpac data shows slightly firmer spending on discretionary services over the quarter. Note that spending in the national accounts is net of electricity and other rebates, which accounted for much of the flat result for 'measured' spending growth in Q3 – an effect that will start to reverse in Q4.

Dwelling investment (1.3%qtr, -2.3%yr): Home building activity continued to expand after going backwards over the second half of 2023. With capacity constraints easing, Q4 is expected to be the first quarter in over a year that home building activity has grown in annual terms, fully retracing the falls we saw in 2023. Based on partials, we expect a solid pickup in both new home building and renovation activity. Backlogged work and a pickup in approvals and starts, particularly in WA, is now clearly flowing into higher activity.

New business investment (-0.2%qtr, -0.1%yr): Business investment is expected to have fallen for a second consecutive quarter to remain broadly flat over 2024. Partials suggest that new engineering construction advanced over the quarter. However, this was more than offset by a fall in new machinery and equipment and the construction of new buildings (such as commercial and retail floorspace). The capex survey also showed that industries at the coalface of the consumer-led slowdown continued to pull back on investment, while those catering to the bigger population, and at the forefront of the structural changes impacting the economy (such as investment in energy generation), continue to add to their capital stock.

Public demand (0.8%qtr, 4.5%yr): Electricity rebates, highly concessional public transport fares, discounted government services fees (including registration costs), will see new public demand continue to increase over the quarter and reach a fresh record high of 27.7% of real GDP. Partials suggest that public consumption and new public investment continued to expand. As noted, given some of the boost to public consumption reflects rebates and subsidies for households, this will also reduce 'measured' household consumption. In addition, the still-large pipeline of public works will see public investment remaining elevated in the near term.

Net exports (–0.2ppts qtr, –1.2ppts yr): Net exports are expected to detract around –0.2ppts from growth in GDP over Q4. This detraction is expected to be evenly split between the goods trade and services trade balances. While the nominal goods trade balance improved over the quarter, this was mainly a prices and softer exchange rate story, with mining volumes remaining broadly unchanged. Short term arrivals and departures data, combined with aggregate spending data, suggests that the services trade balance will detract from growth in GDP.

Total inventories (flat ppts cont'n qtr): Non-farm business inventories are expected to decline. We expect businesses used some of the inventory built up earlier in the year to meet the pick-up in consumer demand. Public inventories are set to partly retrace last quarter's increase, as the public sector runs down its stockpile of medicines, vaccines and other health products.

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