Economic Insights

Economics | June 6 2012

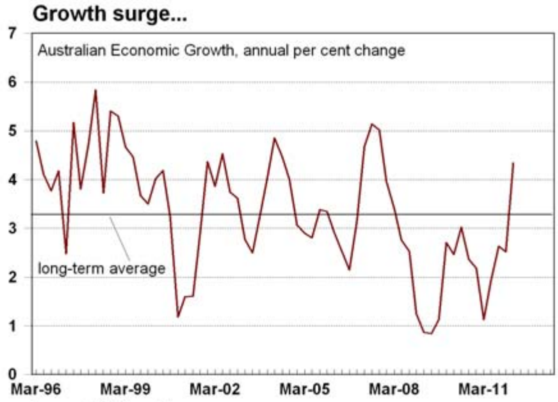
Mining states propel growth to a five year high

National accounts

- **<u>Healthy economic growth:</u> The Australian economy grew by 1.3 per cent in the March quarter, after growing by a upwardly-revised 0.6 per cent in the December quarter (originally reported as a 0.4 per cent rise). Economists had expected growth of around 0.7-0.8 per cent in the quarter. Annual economic growth stands at 4.3 per cent, well above the long-term average of 3.00-3.25 per cent.**
- **<u>Contribution:</u> The biggest contributions to growth came from non-dwelling construction (+1.0pp), followed by household spending (+0.9pp), and government consumption (+0.1pp). The biggest drag on growth was and net exports (-0.5pp) followed by inventories, dwellings and machinery and equipment (all showing a 0.1pp contraction).**
- **<u>States & territories:</u> The best description of the performance of States and Territory economies is state final demand plus net exports. The Northern Territory was had the fastest annual growth in the March quarter (up 13.8 per cent), followed by Queensland (up 9.0 per cent), Western Australia (up 7.7 per cent), ACT (3.0 per cent), Victoria (up 2.6 per cent), South Australia (up 1.8 per cent, Tasmania (up 0.8 per cent) and NSW (up 0.7 per cent).**
- **<u>Industry sectors:</u> Just three of the 19 industry sectors contracted in the March quarter. Modest contributions to growth came from mining, financial &insurance services and professional & scientific services, while the manufacturing sector detracted 0.1 percentage points from economic growth.**
- **The economic growth data is backward-looking. But more recent figures have generally remained soft. We believe the Reserve Bank should cut rates again, especially given the downside risks to global growth and are pencilling in a move in August.**

What does it all mean?

- The latest boost to growth was certainly surprising far surpassing economists' expectations. The domestic economy recorded 1.3 per cent growth for the March quarter. In fact if you exclude the June quarter last year – when the rebuilding following the natural disasters artificially boosted growth – the latest 1.3 per cent expansion marked the best result in five years.
- Consumers and businesses have been decidedly pessimistic in recent times and the heady headline result coupled with the recent rate cuts is just the right prescription to boost. The last thing the Reserve Bank would have wanted to see was a poor GDP reading to sap the impact of yesterday's rate cut. Especially given it is clear that the fundamentals for the domestic economy remain sound but it is a crisis of confidence that has held back activity.
- The disparity in growth across the states truly highlights the multi-speed nature of the economy. The Northern Territory economy grew at a staggering 13.7 per cent over the past year, followed by Queensland (9 per cent) and Western Australia (7.7 per cent), while at the other end of the scale Victoria and NSW languished with below trend growth levels. And looking forward mining and related sectors will continue to be the backbone of growth ensuring further divergence in growth across the states.
- It is important to highlight that while the latest result confirms the underlying strength in the domestic economy, it is



Source: ABS, CommSec

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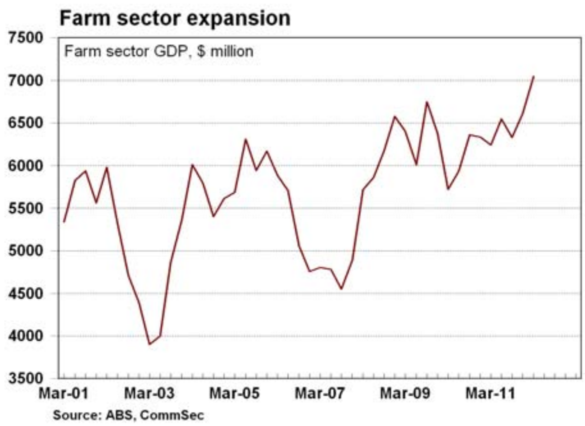
backward looking. More forward looking indicators would categorise the economy as very patchy. And while the near term outlook remains dim, it is hard to be to despondent with a huge pipeline of resource projects. In addition the household consumption looks healthy, there are no wage or price pressures; and even productivity is looking perkier.

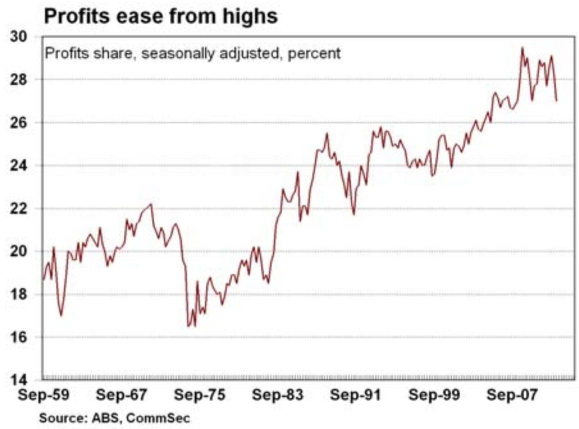
- Despite the upbeat result it is unlikely that the Reserve Bank will be altering its view on the economy and interest rates. In fact it is still more likely that the Reserve Bank will be cutting rates over the second half of the year. The downside risk to global growth, uncertainty surrounding Europe and the slowdown in China is likely to see the Reserve Bank take out an added degree of insurance. CommSec expects the Reserve Bank to once again cut interest rates by 25 basis points in August.

What do the figures show?

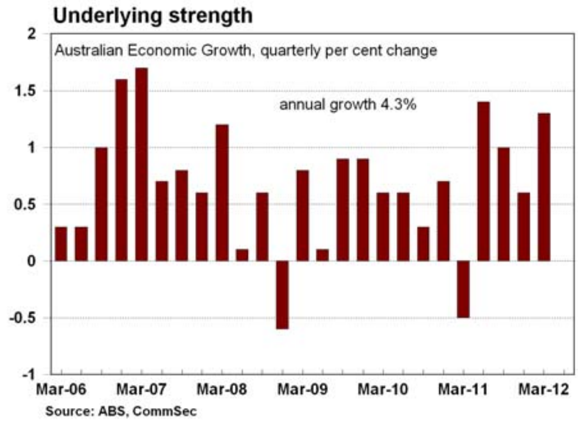
National Accounts:

- ***Economic Growth:*** The economy grew by 1.3 per cent in the March quarter, after growing by an upwardly-revised 0.6 per cent in the December quarter (originally reported as a 0.4 per cent rise). Annual economic growth rose to 4.3 per cent, well above the long-term average of 3.00-3.25 per cent.
- The non-farm economy grew by 1.2 per cent in the March quarter after a 0.5 per cent rise in the December quarter. Annual growth stands at 4.2 per cent.
- Farm GDP rose by 6.7 per cent in the quarter and was up 12.9 per cent over the year.
- At current prices, GDP grew by 0.3 per cent in the quarter and 4.6 per cent over the year.
- GDP per person rose by 1.0 per cent in the quarter to be up just 2.9 per cent over the year.
- ***Growth drivers:*** The biggest contributions to growth came from non-dwelling construction (+1.0pp), followed by household spending (+0.9pp), and government consumption (+0.1pp). The biggest drag on growth was and net exports (-0.5pp), followed by inventories, dwellings and machinery & equipment (all showing a 0.1pp contraction).
- ***Inflation:*** The best measure of domestic price pressures, the household consumption implicit price deflator, was flat in the March quarter with annual growth at just 1.4 per cent. Real non-farm unit labour costs rose by 1.7 per cent in the quarter and were up 1.9 per cent over the year.
- ***Productivity:*** GDP per hours worked grew by 2.0 per cent in the quarter and 4.0 per cent over the year. Gross value added per hour worked in the market sector rose 2.3 per cent in the March quarter to be up 5.3 per cent over the year.
- ***The best description of the performance of States and Territory economies is state final demand plus net exports***. The Northern Territory was had the fastest annual growth in the March quarter (up 13.8 per cent), followed by Queensland (up 9.0 per cent), Western Australia (up 7.7 per cent), ACT (3.0 per cent), Victoria (up 2.6 per cent), South Australia (up 1.8 per cent, Tasmania (up 0.8 per cent) and NSW (up 0.7 per cent).
- ***Healthy consumer spending.*** Household consumption rose by 1.6 per cent in the March quarter, after gains of 0.6 per cent in the December quarter and 1.0 per cent in the September quarter. Annual growth stands at 4.2 per cent. Strongest growth of spending in the quarter was recorded by *Transport services* (up 5.5 per cent), followed by *Health* (up 2.6 per cent) and *Education services* & *Hotels, cafes and restaurants* (both up 2.0 per cent). Just one of the 17 spending categories fell in the quarter - *Purchase of Vehicles* (down 0.4 per cent).
- ***Sectors:*** Just three of the 19 industry sectors contracted in the March quarter. Modest contributions to growth came from mining, *financial &insurance services* and *professional & scientific services*, while the *manufacturing sector* detracted 0.1 percentage points from economic growth.





- ***Other points:***
  - ***Profit share eases.*** In seasonally adjusted terms, the ratio of profits to total factor income fell from 28.2 per cent to 27.0 per cent in the March quarter. **The wages share** rose from 53.3 per cent to 54.6 per cent in the March quarter.
  - ***Household savings eased.*** The household saving ratio eased from 9.4 per cent to 9.3 per cent, in seasonally adjusted terms in the March quarter. In trend terms household saving fell for the fourth consecutive quarter, easing from 9.5 per cent to 9.4 per cent.
  - ***Imports fell as a share of spending.*** The imports to sales ratio fell from 0.386 in the December quarter to a 0.373 in the March quarter.
  - ***The inventory to sales ratio rose*** from 0.614 in the December quarter to 0.624 in the March quarter.



What is the importance of the economic data?

- The quarterly **National Income, Expenditure and Product release (national accounts)** from the Bureau of Statistics is the most complete assessment of Australia's economic performance. Detailed estimates are provided on incomes (wages, profits), spending (such as household, dwelling investment and trade (exports and imports) and production (comparing industry performance). Other data includes household saving and the economic performance of States and Territories.
- The main use of the national accounts figures is as a historical record of economic performance. The information has little forward-looking value for currency, interest rate or share markets.

What are the implications for interest rates and investors?

- The real disappointment in the latest result is housing investment – in essence, home building. Governments of all description are sweeping the problem under the carpet, failing to address the factors holding back new investment in residential buildings.
- The mixed nature of current economic conditions is clear from the latest GDP data. Northern Territory powered ahead from the $35 billion Inpex LNG deal and US army base, while Western Australia accelerated and Queensland is benefitting from rebuilding and the mining boom. But other states are struggling.
- While the Reserve Bank looks forward, not backwards, it will be more comforted by today's data. The importance of the figures is that the base of growth is higher than assumed by the central bank.
- At present there are downside risks to domestic growth, however the longer term story is sound. The continued rebuilding phase and upgrade in business investment plans will drive activity levels once the recovery becomes more entrenched. But the Reserve Bank will need to do its part by keeping interest rates in a stimulatory setting over the near term. In addition, productivity does appear to be recovering and inflation pressures are contained. We continue to pencil in a further rate cut in August.

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