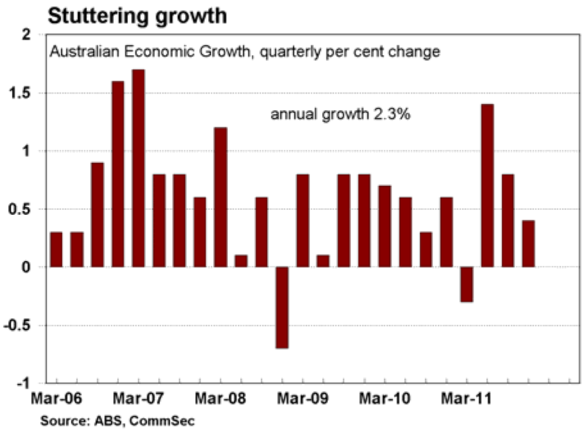
Economy limping, not leaping, into 2012

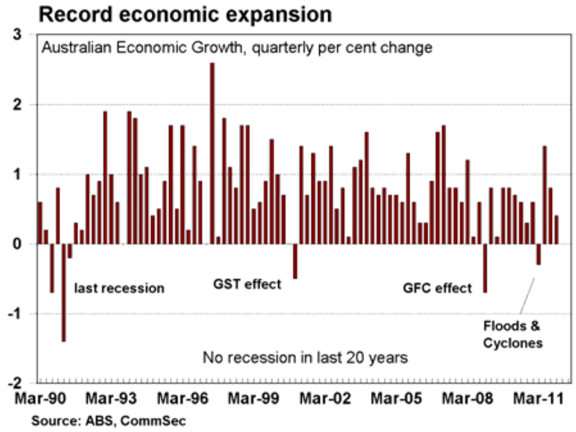
National accounts

- **<u>Sluggish economic growth:</u> The Australian economy grew by 0.4 per cent in the December quarter, after growing by a downwardly-revised 0.8 per cent in the September quarter (originally reported as a 1.0 per cent rise). Economists had expected growth of around 0.7-0.8 per cent in the quarter. Annual economic growth stands at 2.3 per cent, down from the long-term average of 3.00-3.25 per cent.**
- **<u>Contribution:</u> The biggest contributions to growth came from household spending, inventories and net exports (all contributing 0.3 percentage points), government consumption (+0.2pp). The biggest drag on growth was dwellings (0.2pp contraction) and machinery and equipment (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. Queensland had the fastest annual growth in the December quarter (up 8.9 per cent), followed by Western Australia (up 7.6 per cent), ACT (2.6 per cent), Victoria (up 1.4 per cent), NSW (up 1.1 per cent). Leading the declines was Tasmania (down 3.8 per cent), South Australia (down 0.5 per cent) and Northern Territory (down 0.1 per cent).**
- **<u>Industry sectors:</u> Seven of the 19 industry sectors contracted in the December quarter. Modest contributions to growth came from mining, manufacturing and financial and insurance services while the construction sector detracted 0.2 percentage points from economic growth.**
- **<u>Key indicators:</u> *<u>Productivity:</u>* GDP per hours worked grew by 0.4 per cent in the quarter and 1.1 per cent over the year. Gross value added per hour worked in the market sector rose 0.6 per cent in the December quarter to be up 1.9 per cent over the year.**
  <u>Household saving:</u> **the household saving ratio eased from 9.6 per cent to 9.0 per cent.**
  <u>Labour costs</u>: **real non-farm unit labour costs fell by 0.1 per cent in the quarter – the third straight fall – and was up just 0.6 per cent over the year.**
- **The economic growth data is backward-looking. But more recent figures have generally remained soft. We believe the Reserve Bank should cut rates again by mid year and are pencilling in a move in May.**

What does it all mean?

- We should never forget that the economic growth data is ancient history. The Reserve Bank sets monetary policy by looking forward, not back. And in terms of published economic data, we already have a number of figures for





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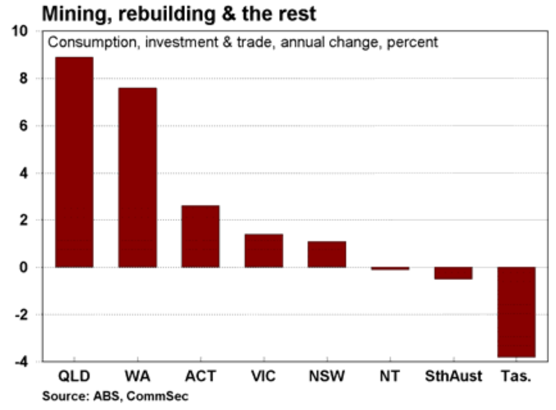
February available, so the December quarter is now a long way in the past.

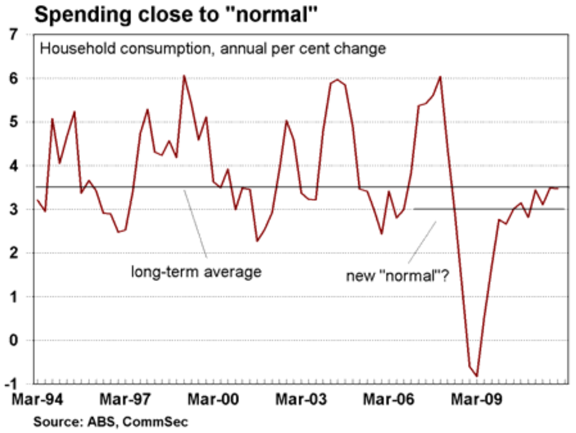
- Having said all that, the latest figures are disappointing. The Reserve Bank believes that economic growth is close to "trend" or "average", but you would be hard pressed to see that in the data. Economic growth averaged 3.0 per cent a year over the past decade and averaged 3.25 per cent over the past 15 years. But we haven't hit 3.25 per cent for almost four years. In fact average growth was just 2.6 per cent over the past 5 years of the mining "boom".
- While economic growth is sub-standard, other indicators are still encouraging. Consumer spending growth is close to normal; there are no wage or price pressures; and even productivity is looking perkier.

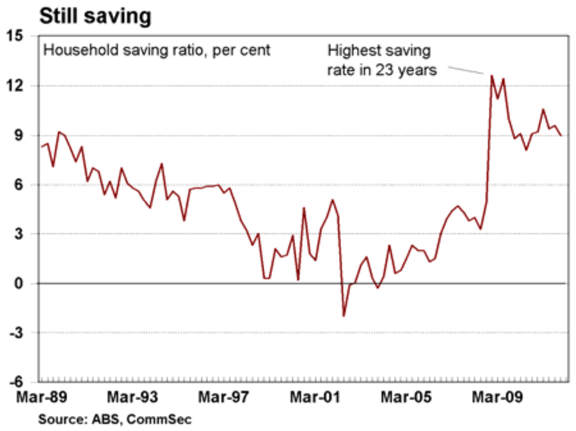


- And it is hard to be too despondent with a huge pipeline of resource projects to boost growth in coming years. The problem is that the structural adjustment in other sectors is offsetting the mining boom, leaving an economy that is limping not leaping.
- Queensland has its mojo back, with growth now faster than that recorded by Western Australia. However, it should be acknowledged that the pickup in economic growth is from a low base. Using data on state final demand and net exports to approximate gross state product, the Queensland economy grew by 1.8 per cent in the December quarter to be up 8.9 per cent over the year.
- The sluggish pace of the Australian economy keeps the door open to another rate cut. Not only has data confirmed that the economy is just chugging along, timelier indicators suggest there has been little improvement in 2012. In addition, productivity does appear to be recovering and inflation pressures are contained. We continue to pencil in a rate cut in May – but any fresh problems in Europe could see the rate cut brought forward.

What do the figures show?

- ***Economic Growth:*** The economy grew by 0.4 per cent in the December quarter, after growing by a downwardly-revised 0.8 per cent in the September quarter (originally reported as a 1.0 per cent rise). Annual economic growth slowed from 2.3 per cent, down from the long-term average of 3.00-3.25 per cent.
- The non-farm economy grew by 0.4 per cent in the December quarter after a 1.0 per cent rise in the September quarter. Annual growth stands at 2.5 per cent.
- Farm GDP fell by 0.1 per cent in the quarter and was down 7.5 per cent over the year.
- At current prices, GDP grew by 0.5 per cent in the quarter and 5.6 per cent over the year.
- GDP per person rose by 0.1 cent in the quarter to be up just 0.9 per cent over the year.
- ***Growth drivers:*** The biggest contributions to growth came from household spending, inventories and net exports (all contributing 0.3 percentage points), government consumption (+0.2pp). The biggest drag on growth was dwellings (0.2pp contraction) and machinery and equipment (0.1pp contraction).
- ***Inflation:*** The best measure of domestic price pressures, the household consumption implicit price deflator, rose by 0.5 per cent in the December quarter with annual growth at 2.7 per cent. Real non-farm unit labour costs fell by 0.1 per cent in the quarter – the third straight fall – and were up just 0.6 per cent over the year.
- ***Productivity:*** GDP per hours worked grew by 0.4 per cent in the quarter and 1.1 per cent over the year. Gross value added per hour worked in the market sector rose 0.6 per cent in the December quarter to be up 1.9 per cent over the year





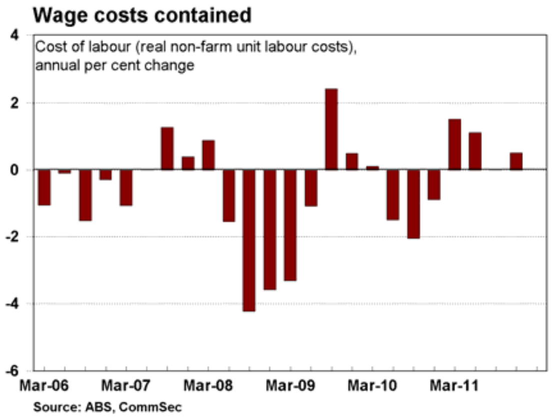
- ***The best description of the performance of States and Territory economies is state final demand plus net exports***. Queensland had the fastest annual growth in the December quarter (up 8.9 per cent), followed by Western Australia (up 7.6 per cent), ACT (2.6 per cent), Victoria (up 1.4 per cent), NSW (up 1.1 per cent). Leading the declines was Tasmania (down 3.8 per cent), South Australia (down 0.5 per cent) and Northern Territory (down 0.1 per cent).
- In the December quarter the changes in state final demand plus net exports were: NSW (+1.1 per cent), Victoria (-0.4 per cent), Queensland (+1.8 per cent), South Australia (+1.3 per cent), Western Australia (+2.4 per cent), Tasmania (-3.2 per cent), Northern Territory (+1.8 per cent) and ACT (+1.5 per cent).
- ***Modest consumer spending.*** Household consumption rose by 0.5 per cent in the December quarter – the slowest outcome in a year – after gains of 1.1 per cent in the September quarter and 1.0 per cent in the June quarter. Annual growth stands at 3.5 per cent. Strongest growth of spending in the quarter was recorded by *Purchase of vehicles* (up 2.0 per cent), followed by *Clothing & footwear* (up 1.6 per cent) and *Insurance and other financial services* (up 1.4 per cent)*.* Five of the 17 spending categories fell in the quarter. Leading the declines was *Cigarettes & tobacco* and *Furnishings & household equipment* and *recreation & culture* (all down 0.3 per cent).
- ***Sectors:*** Seven of the 19 industry sectors contracted in the December quarter. Modest contributions to growth came from *mining, manufacturing, wholesale trade, financial and insurance services, heath care and social assistance and public admiistration & safety* (all adding 0.1 percentage points to growth). The *construction* sector detracted 0.2 percentage points from economic growth.
- ***Other points:***
  - ***Profit share eases.*** In seasonally adjusted terms, the ratio of profits to total factor income fell from 29.2 per cent to 28.5 per cent in the December quarter. **The wages share** rose from 52.8 per cent to 53.1 per cent in the December quarter.
  - ***Household savings eased.*** The household saving ratio fell from 9.6 per cent to 9.1 per cent, in seasonally adjusted terms in the December quarter. In trend terms household saving fell for the third consecutive quarter, easing from 9.5 per cent to 9.3 per cent.
  - ***Imports rose as a share of spending.*** The imports to sales ratio rose from 0.369 in the September quarter to a three-year high of 0.386 in the December quarter.
  - ***The inventory to sales ratio rose*** from a record low of 0.599 in the September quarter to 0.610 in the December quarter.

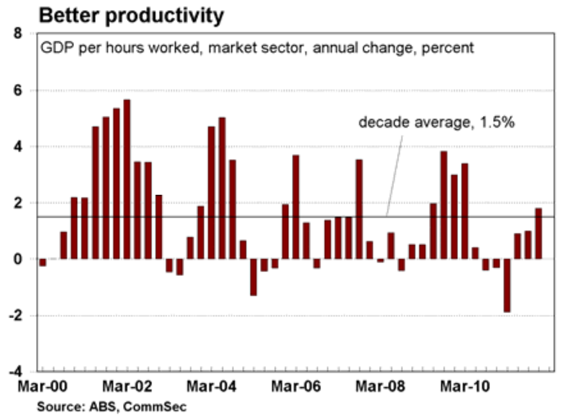
What is the importance of the economic data?

- 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?

- While the Reserve Bank looks forward, not backwards, it will be a little disappointed by today's data. The importance of the figures is that the base of growth is lower than assumed by the central bank, ensuring that rate cuts remain on the drawing board.
- The mixed nature of current economic conditions is clear from the latest GDP data. Western Australia is still





powering ahead and Queensland is benefitting from rebuilding and the mining boom. But other states are struggling. Northern Territory will lift over the coming year from the $35 billion Inpex LNG deal and US army base. South Australia also has potential to lift if BHP Billiton goes ahead with expansion of Olympic Dam. But other economies could drift in the months ahead.

- The real disappointment 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.
- Inventories boosted economic growth in the December quarter but it looks to be “unintended” investment – goods added to shelves that weren’t sold. The March quarter GDP result won’t get the same boost from inventories, making it hard to work out where the growth will come from. It has to be investment.
- CommSec continues to pencil in a rate cut for May.

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