Q1 National Accounts

1st Step Towards a Per-Capita Recession

7 June 2023

Bank of Melbourne Economics

Contents

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Summary – Top Things You Need To Know

1. The economy is slowing quickly. Activity expanded by 0.2% over the March quarter – the smallest increase in 1½ years. On an annualised basis, the rate of growth was 1.6% over the past two quarters.
2. Strong population growth has supported the aggregate outcome, growing by 0.5% over the March quarter. Consumption on a per capita basis has fallen over two consecutive quarters, as elevated cost of living pressures and higher interest rates bite.
3. Inflation measures in the national accounts have peaked but remain elevated. Goods prices are moderating but services prices accelerated. Wage pressures have continued to rise. Total compensation of employees grew at an annual pace of 10.8% - the fastest since the September quarter 2007.
4. The Reserve Bank Board is particularly concerned by the growth rate in wages against a backdrop of weak productivity, which means unit labour costs are rising rapidly. GDP per hour worked, a measure of productivity, fell 0.3% in the quarter while growth in unit labour costs accelerated to 2.0% in the quarter.
5. Global supply chain disruptions have dissipated. We are seeing the implications through an easing in the price of capital goods and imports. Combined with an elevated pipeline of engineering construction projects, this is helping to support business investment, which was strong over the quarter. Business investment grew at the fastest quarterly pace in over two years.
6. The housing imbalance is getting worse. Dwelling investment has fallen in six of the last eight quarters at a time when population is growing at a record pace.

GDP Expenditure Measure – GDP (E)

Selected Expenditure Items on GDP, Chain Volume Measures	
	Quarterly % Change
Household Consumption	0.2
Public Consumption	0.1
Dwelling Investment	-1.2
New Business Investment	2.9
New Public Investment	0.3
	Contribution to GDP, ppt
Inventories	0.0
Net Exports	-0.2

- The expenditure measure of GDP rose by only 0.2% in the December quarter - the softest outcome since the September quarter of 2021.
- Annual growth of GDP slowed to 2.3% in the March quarter, from 2.6% in the December quarter. The annual pace is now a tad below the trend pace of growth in the economy.

- The widely anticipated further slowing in **household consumption** growth materialised. Household consumption grew by just 0.2% in the quarter and added only 0.1 percentage points to growth in the quarter. It is the softest quarterly growth rate since the covid-related lockdowns and restrictions in 2021. Household consumption growth has slowed for three straight quarters. More slowing is inevitable, especially after yesterday's rate hike.
- The **government sector** – consumption and investment collectively – added modestly to growth in the quarter of 0.2 percentage points.
- One of the biggest **stand outs** was **new business investment**. It grew by 2.9% in the quarter – the fastest in two years. Annual growth accelerated from 4.0% in the December quarter to 6.0% in the March quarter. New business investment added 0.3 percentage points to growth – the most of any of the key measures. The lift in business investment was broad based with gains in engineering, construction and machinery & equipment.
- Drags on GDP growth in the quarter came from the **trade sector** (detracted 0.2 percentage points) and **new dwelling investment** (-0.1 ppts). Meanwhile, the change in **inventories** made a nil contribution.

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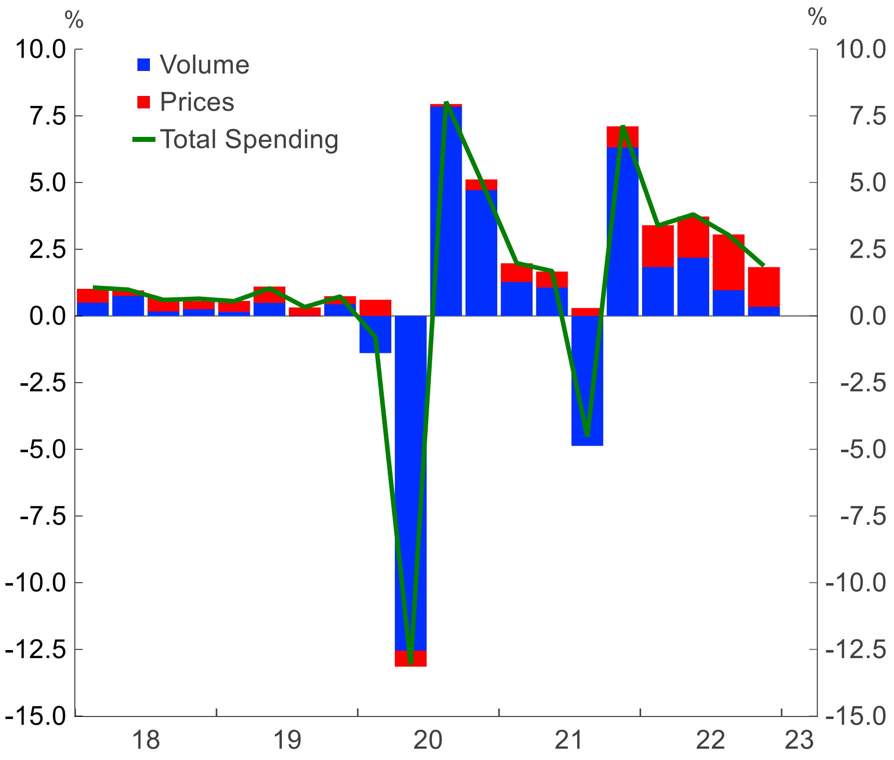
Consumption Grinding to a Halt



Sources: ABS; Macrobond

- Household consumption rose an anaemic 0.2% in the quarter, the smallest quarterly increase since the reopening from the Delta lockdowns at the end of 2021.
- Adjusting for a larger population, per capita consumption declined for a second consecutive quarter falling 0.3%.
- That is, if it wasn't for the record surge in new arrivals, spending would have been negative. In fact, migration has propped up consumption in around one in four quarters over the past 20 years.
- Reflecting the importance of new arrivals and the headwinds on household budgets, essential and non-essential spending diverged wildly in the quarter.
- Growth in essential spending accelerated to 1.1%, driven by utilities (+5.2%), transport services (+4.0%) and rents (+0.5%).
- In contrast, spending on discretionary items (-1.0%) fell for the first time since lockdowns. Spending on household furnishings (-2.4%) and vehicle purchases (-2.2%) were particularly weak.

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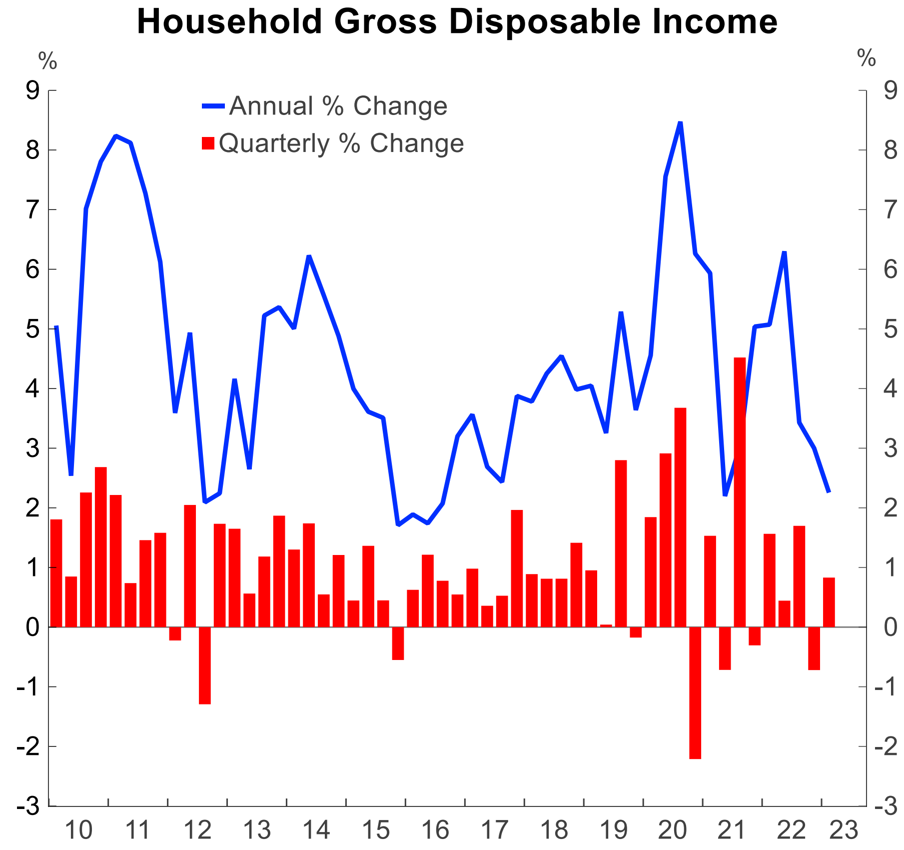
Despite a Rise in Disposable Income

- The soft rise in spending was despite a solid rise in household disposable income and a steep fall in the savings ratio.
- Household disposable income rose 0.8% in the quarter, following a 0.7% decline in the December quarter.
- Growth in disposable income was driven by a 2.3% rise in labour income, which was partly offset by a sharp increase in interest payable on dwellings (+11.5%) and a lift in income taxes (+3.3%).
- Interest payments have more than doubled over the past 12 months alongside the RBA's tightening cycle, marking the largest annual increase (+107%) in interest payments on record.
- The savings ratio fell to 3.7% in the March quarter, from 4.4% previously as households diverted a higher share of their income towards spending.
- This was the lowest savings rate since the September quarter of 2008 - reflecting that households, in aggregate, are now drawing down on the pool of savings that were accumulated during the pandemic to fund consumption.
- We expect consumption growth will continue to soften as household savings dry up further.



Sources: ABS, Macrobond

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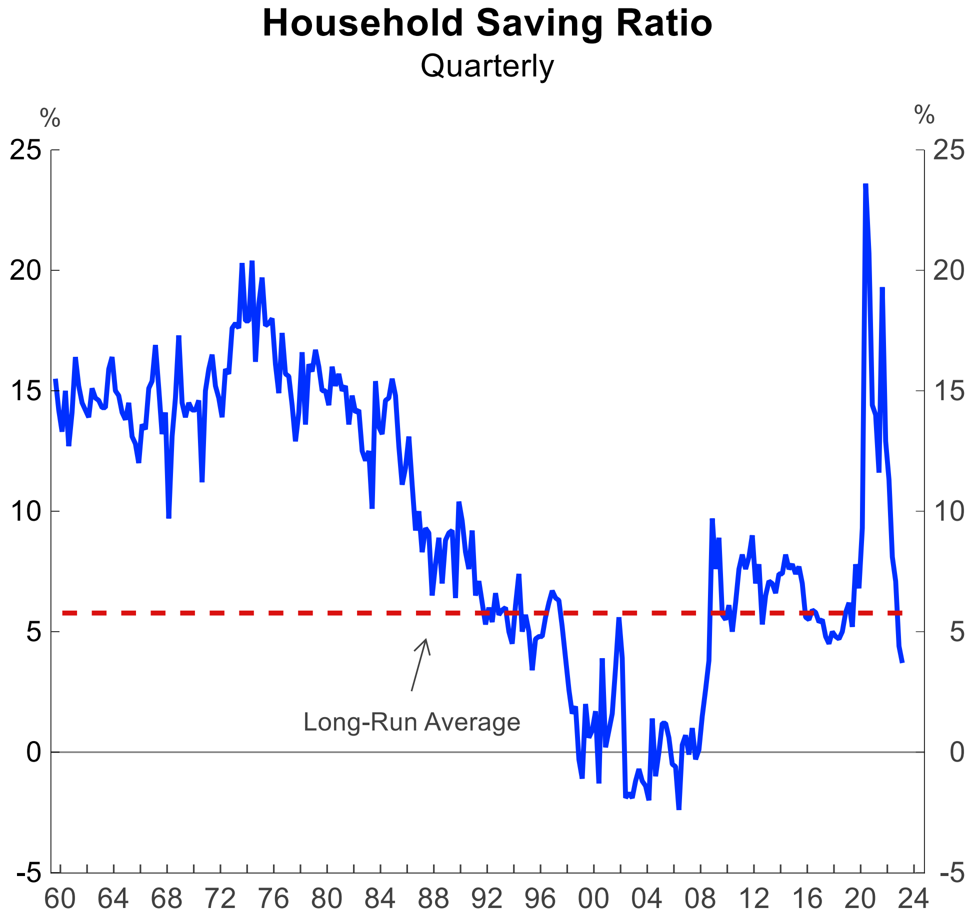
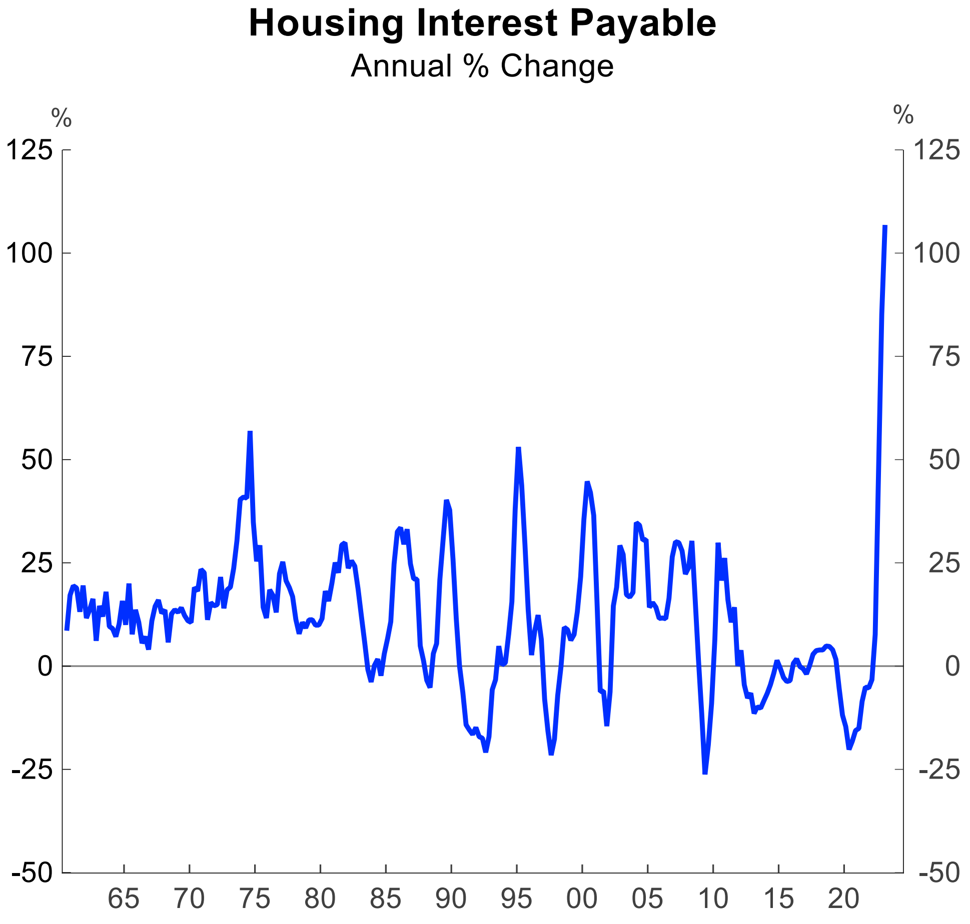
Households Are Drawing on Savings to Fund Spending



Sources: ABS; Macrobond



Sources: ABS, Macrobond

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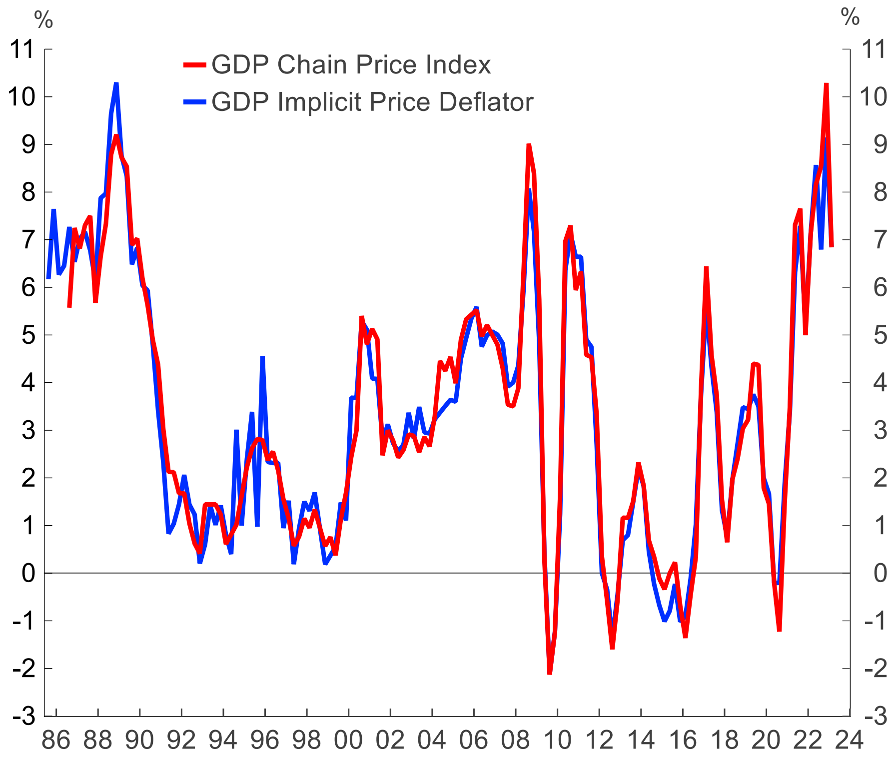
Inflation Measures



Sources: ABS; Macrobond

- The various price measures in the national accounts reveal that inflation has peaked but remains elevated.
- The moderation in prices from the peak is led by a goods deflation. Services inflation has accelerated.
- The RBA Board are concerned about services inflation and the stickiness shown in other major economies. It is one of the factors the Governor called out as contributing to yesterday's rate decision.
- The **GDP implicit price deflator**, which measures price changes but also the effects of compositional changes in GDP, rose by 1.9% in the December quarter and by 6.9% in the year to the December quarter. Annual growth eased from above 9.0% in the December quarter, which was the fastest pace since the late 1980s.
- The **GDP chain price index**, which removes the impacts of compositional changes and is a pure measure of prices changes only, rose 1.8% in the March quarter. This is an acceleration from the 0.5% quarterly growth rate recorded in the previous quarter. Annual growth eased from 10.3% to 6.8%.

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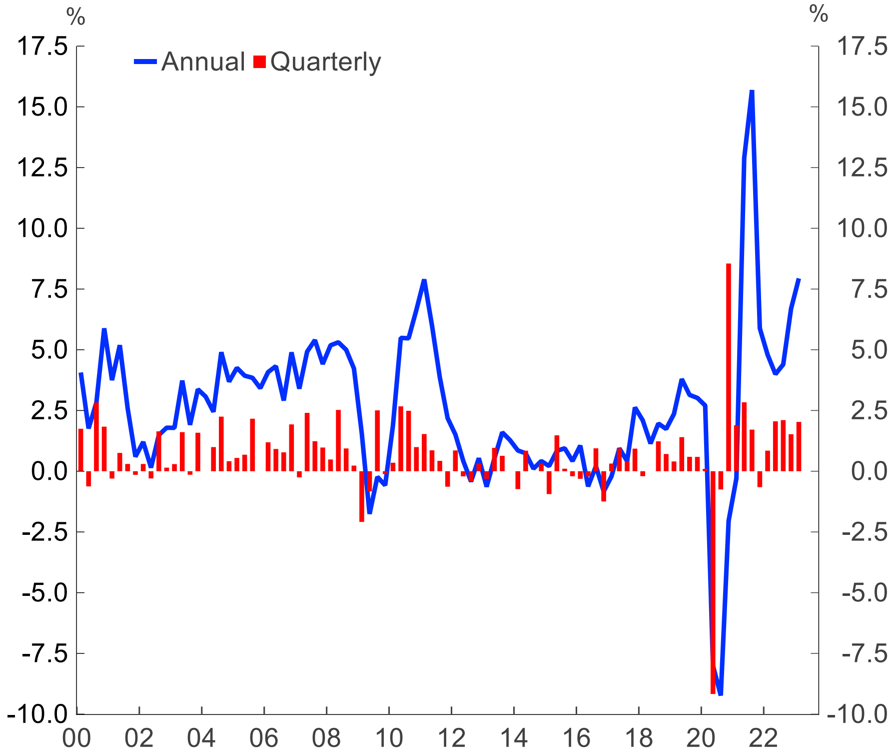
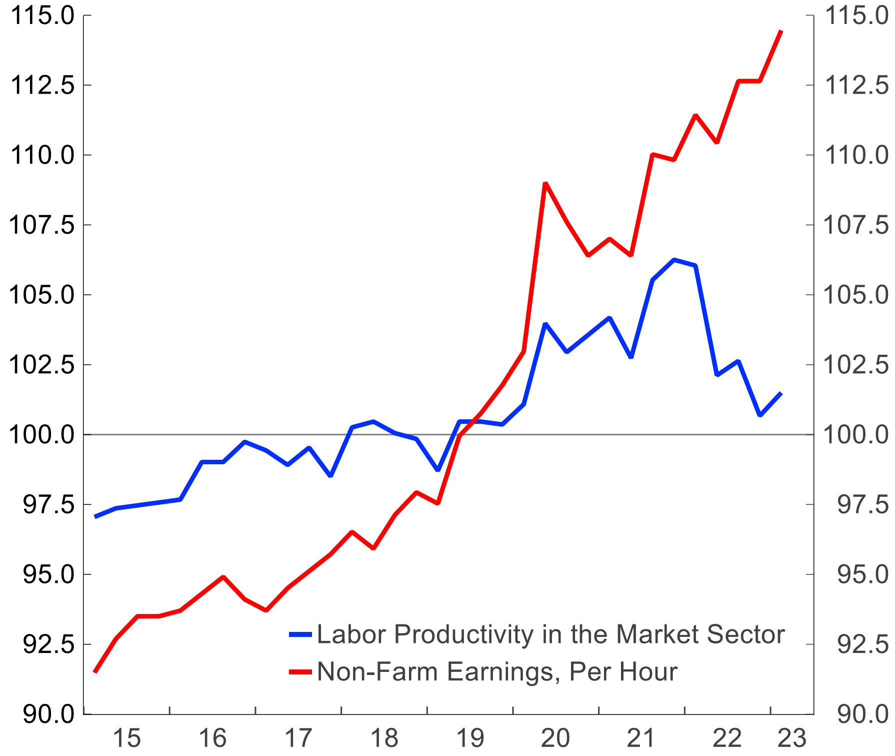
Unit Labour Costs Accelerated in the March Quarter

Nominal Unit Labour Costs
% Change, Non-Farm



Sources: ABS, Macrobond

Drivers of Nominal Unit Labour Costs
Index Dec 2019 = 100



Sources: ABS, Macrobond

- Labour productivity remains broadly in line with its pre pandemic level. Non-farm earnings per hour have increased by close to 15% over this period, with the economy's total wage bill growing at its strongest pace since the June quarter 2007.

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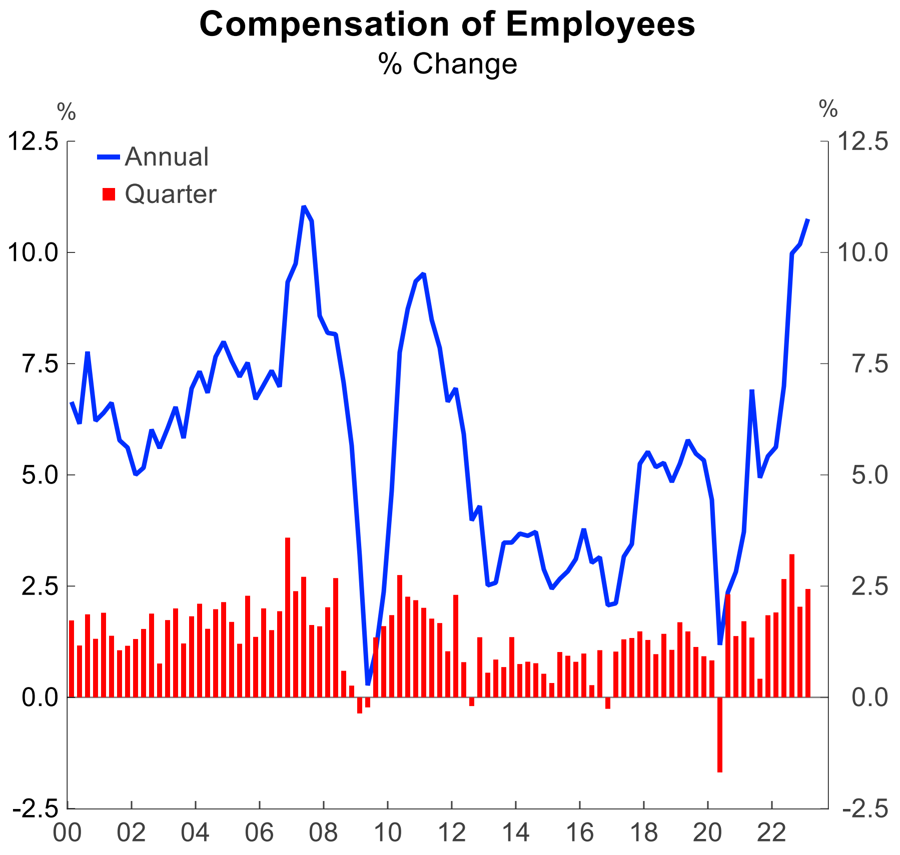
The Wage Bill Growing At Its Strongest Pace Since 2007



Sources: ABS; Macrobond

- Total compensation of employees (or the economy’s wage bill) grew by 10.8% over the year to the March quarter 2023.
- This is the strongest annual growth recorded since the June quarter 2007.
- The strong growth was driven by an increase in the number of people employed and an increase in average wages.

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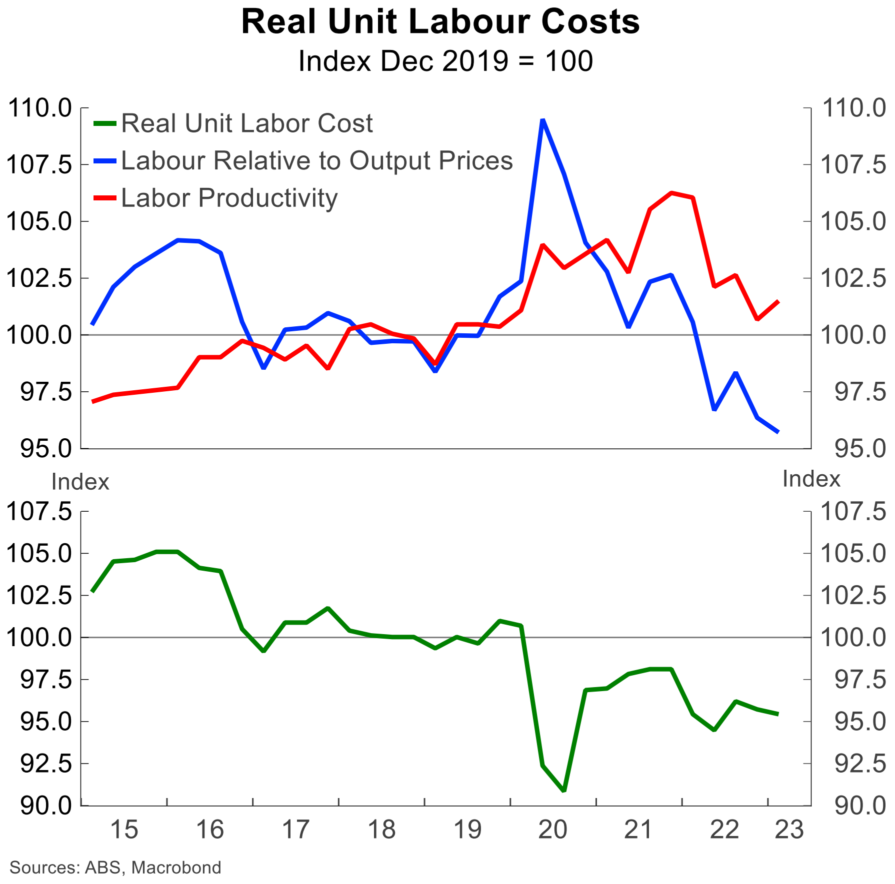
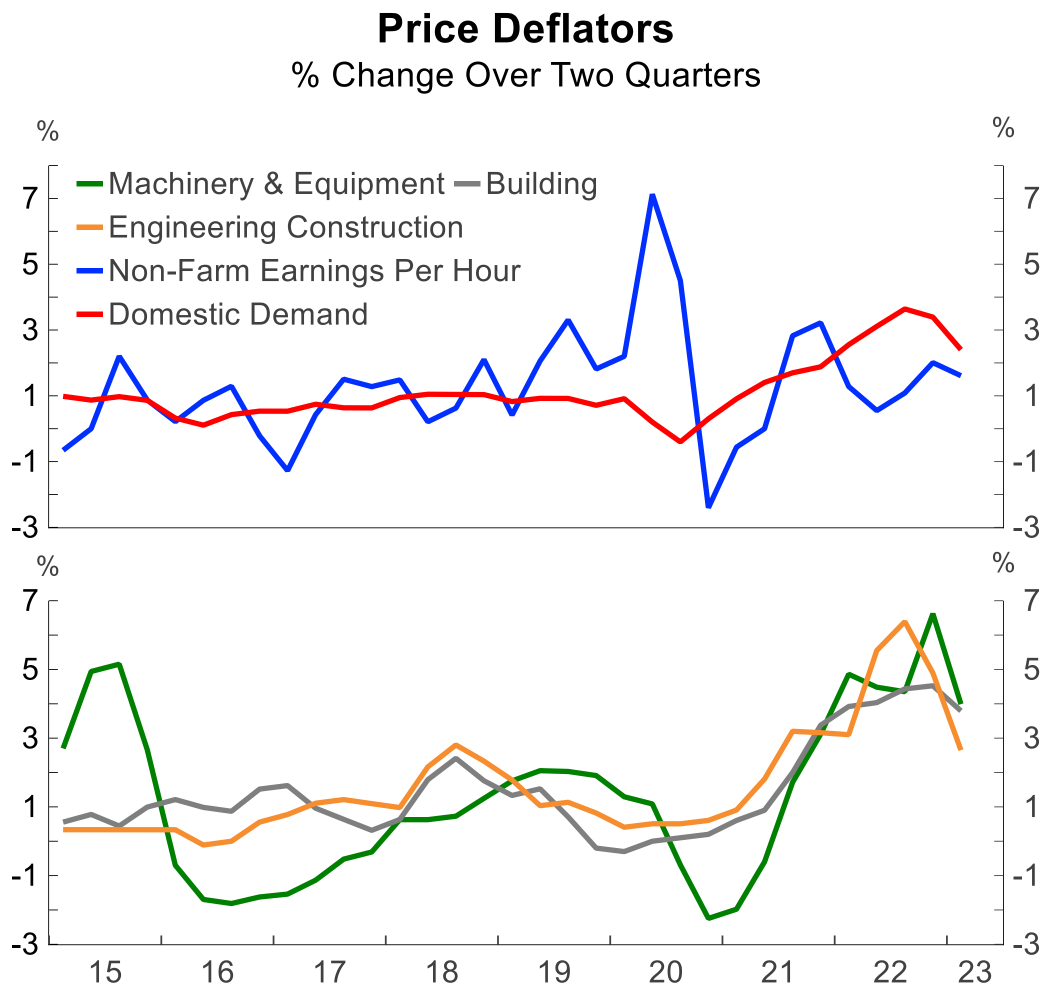
Businesses Still Incentivised To Hire



- Growth in output prices continues to outpace the growth in labour costs.
- The wedge is large enough to cover the lacklustre productivity growth.
- The net impact - real unit labour costs faced by businesses has come down since the pandemic.

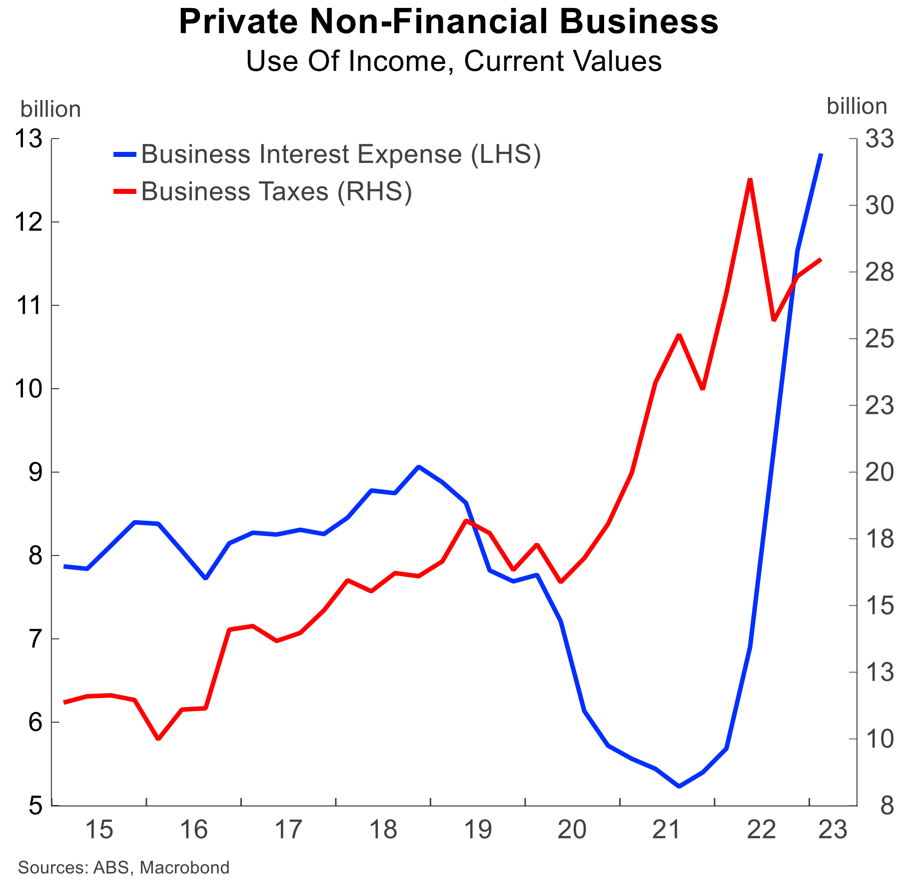
But This Is Turning…

- Growth in domestic prices have started to ease, while labour costs remain elevated.
- This is in part due to growth in capital good prices also easing, with these goods now easier to source.
- Given recent wage decisions and expectations of stronger wages growth, this dynamic is likely to continue.
- In this environment – businesses may demand higher productivity.
- This could be achieved by reducing labour and increasing capital – reversing the trend over the past three years where employment has grown but capital investment has been subdued.



Sources: ABS, Macrobond

Business Expenses Have Increased



- Non-financial businesses have seen costs increase.
- **Interest expense** has increased by 125% over the past year.
- **Taxes** have increased by more 40% over the past two years. A larger nominal economy increases the tax take for governments.

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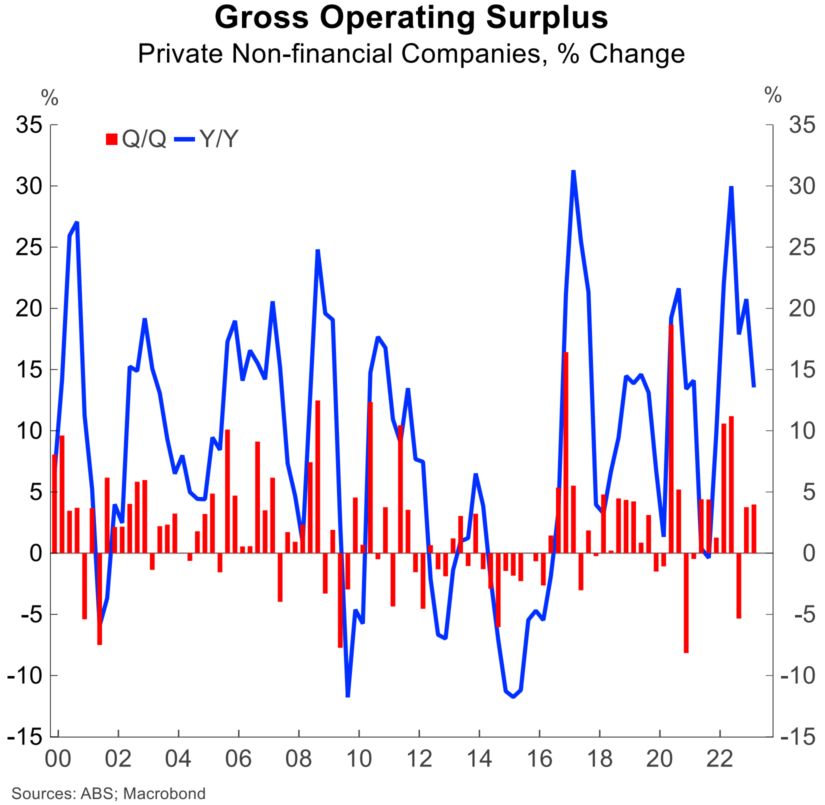
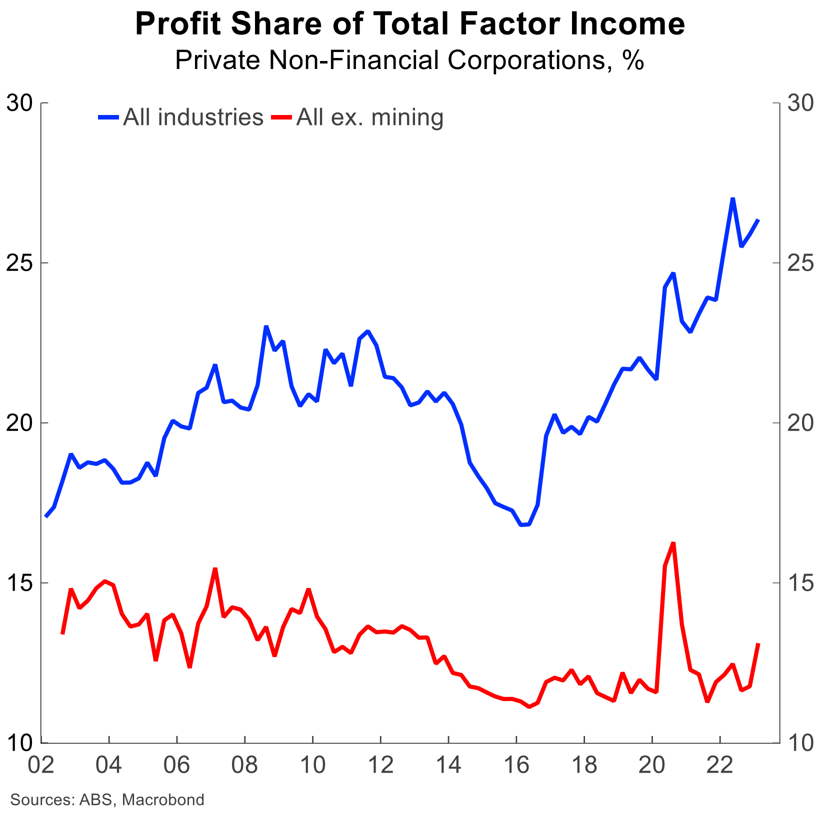
Profits

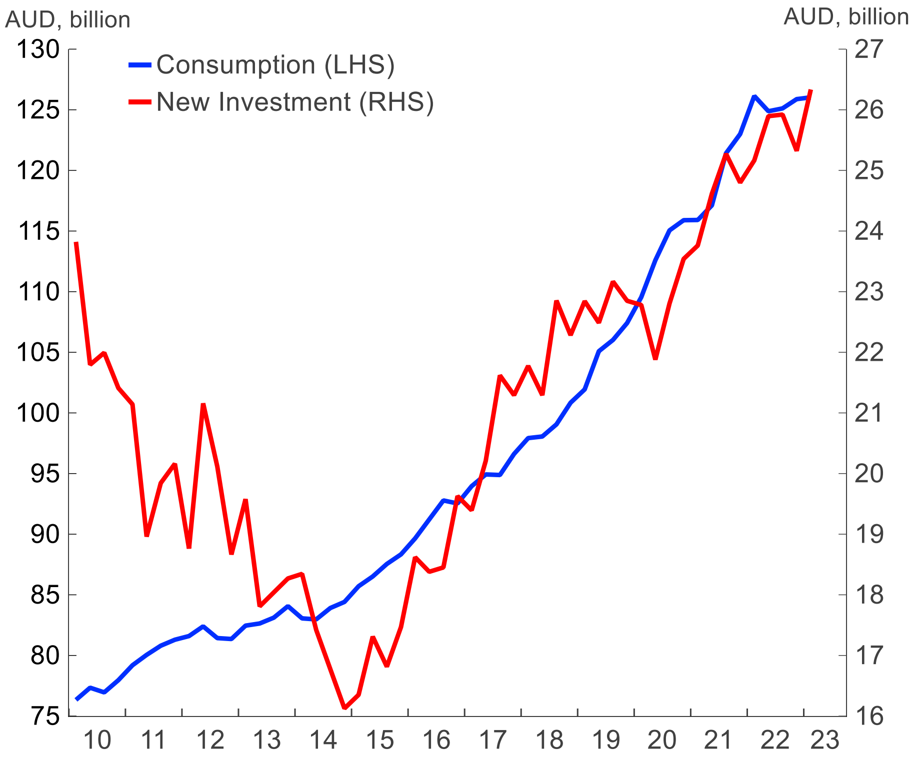




- **Gross operating surplus** (i.e. profits) rose 3.0% in the quarter and jumped 11.5% over the year. This followed 3.0% growth in the December quarter. The gain was driven by a 4.0% increase in profits of private non-financial corporations, including wholesale trade, manufacturing, and accommodation & food services.
- The profit share of non-financial corporations rose to 13.1% – the highest since 2013 (excluding COVID).

Government

Public Demand
Volumes



Sources: ABS, Macrobond

- New public sector demand grew 0.6% in the March quarter and 0.7% over the year. This followed 0.3% growth in the December quarter.
- New public demand added 0.2 percentage points to growth.
- Public consumption expanded 0.1% in the quarter, driven by an increase in national non-defence spending, which rose 1.1%. This was partly offset by declines across national defence (-0.9%) and state and local consumption (-0.4%).
- Over the year, public consumption declined 0.1%, as spending slows from elevated levels driven by the pandemic response.
- New public investment grew by a very solid 4.0% in the quarter and 4.6% over the year. Investment is being supported by a large pipeline of infrastructure projects.
- Work has been impacted by weather-related disruptions, in addition to materials shortages and challenges sourcing labour. These disruptions had less of an impact in the March quarter as supply-chain disruptions and labour shortages ease.

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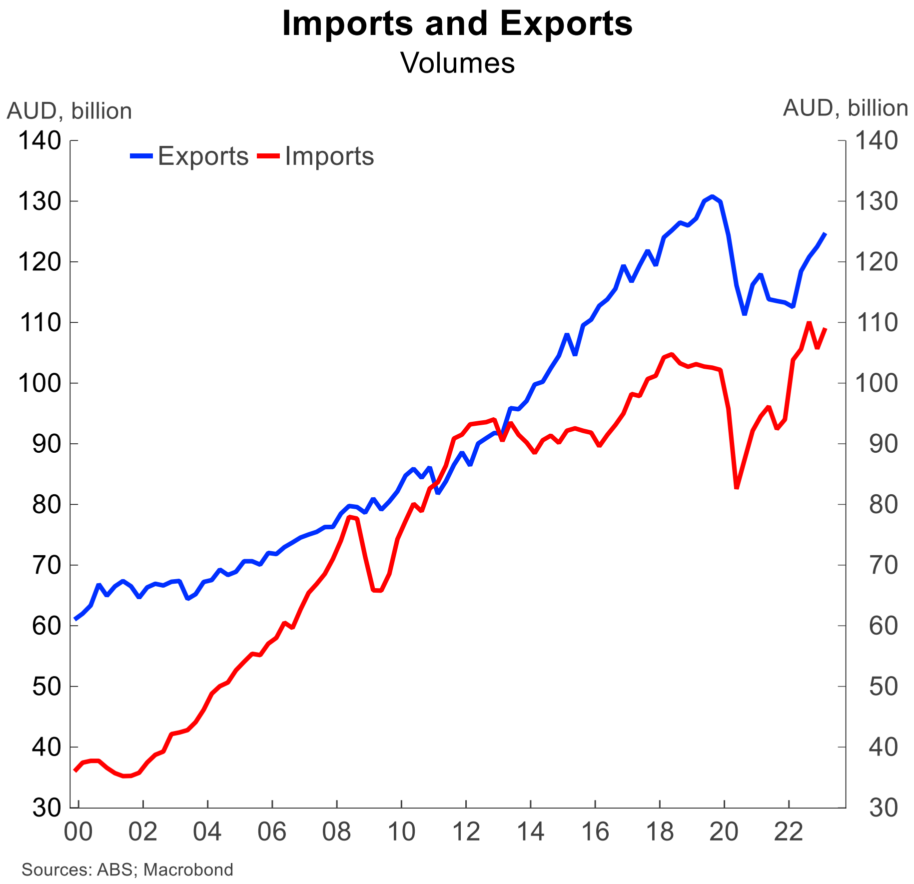
Terms of Trade – Second Highest Level in History



- Net exports detracted 0.2 percentage points from growth in the March quarter.
- In volume terms (i.e. stripping out price effects), imports (3.2%) and exports (1.8%) rose.
- Strong import volumes reflected gains across both goods (3.3%) and services (3.1%).
- Export volumes were supported by a surge in services (7.7%) and a modest gain in goods (0.7%).
- Services exports and imports have rebounded to around 82% and 73% of pre-COVID levels, respectively.
- The terms of trade (ratio of export to import prices) rose 2.8% in the quarter to the second highest level in history.
- Both import prices (-4.0%) and export prices (-1.3%) declined. However, the fall for import prices was larger than for export prices, resulting in an improvement in the terms of trade.

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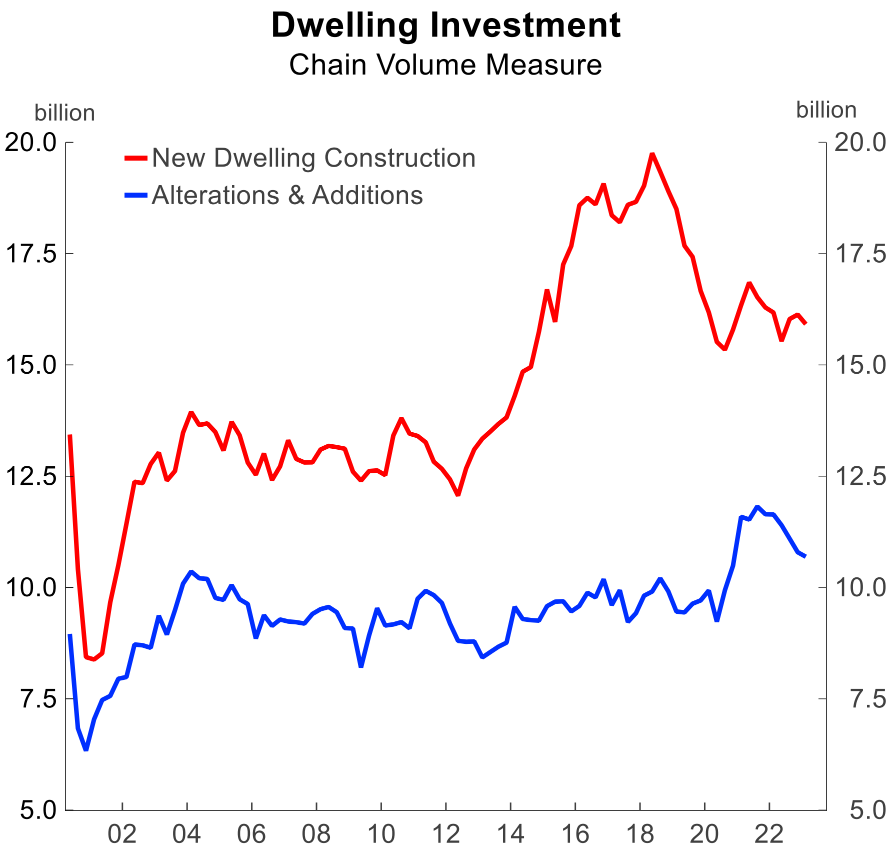
Housing Imbalance Will Get Worse



Sources: ABS; Macrobond

- Investment in new dwellings declined by 2.3% over the March quarter.
- Activity is at its lowest level since the December quarter 2020.
- Renovation activity grew by 0.7% over Q1 but is 8.1% lower than a year ago.
- Disruptions in the sector are impacting how quickly the pipeline of projects approved during the pandemic can be completed - completions declined over December quarter.
- Even more concerning, forward indicators, such as approvals, suggests the pipeline of projects will continue to fall in the near term.

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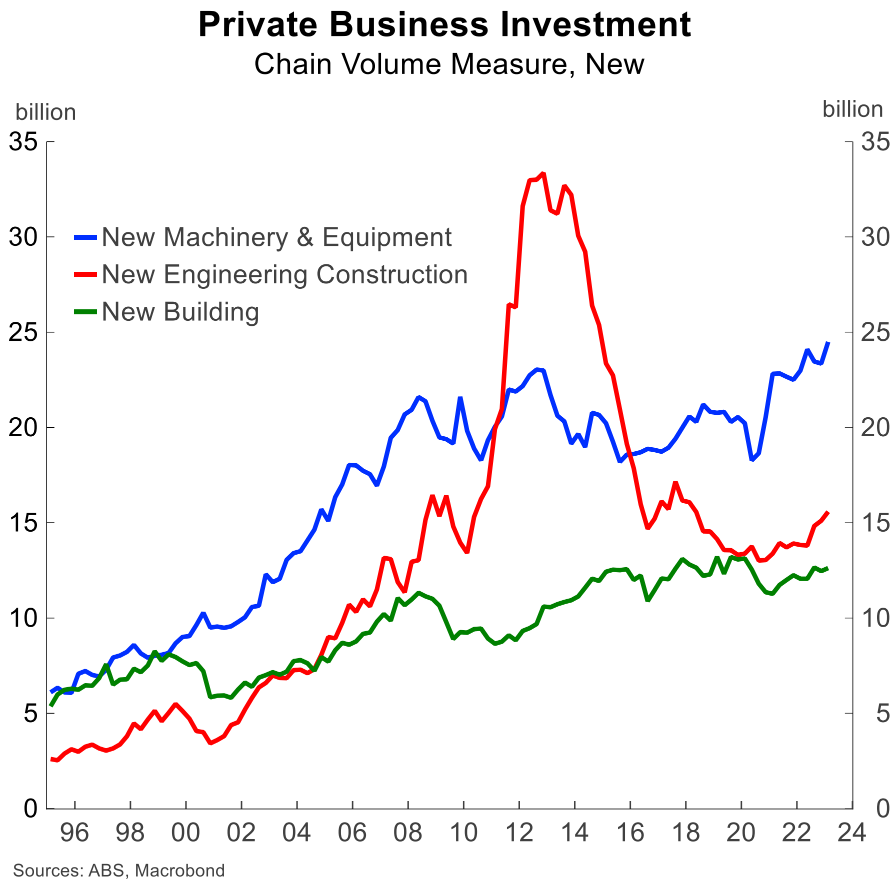
Private Business Investment Has Bounced Back



- New private business investment grew by 2.9% to be 6.6% higher than a year ago.
- Investment in new machinery and equipment grew by 4.9% over the March quarter to be 6.6% higher than a year ago.
- The outcome was driven by investment in vehicles, agricultural equipment and automation.
- New engineering construction grew by 3.1% over Q1 to be 12.6% higher than a year ago. The outcome was driven by investment in renewables and electricity infrastructure.
- New building construction grew by 1.3% over the March quarter to be 4.7% higher than a year ago.

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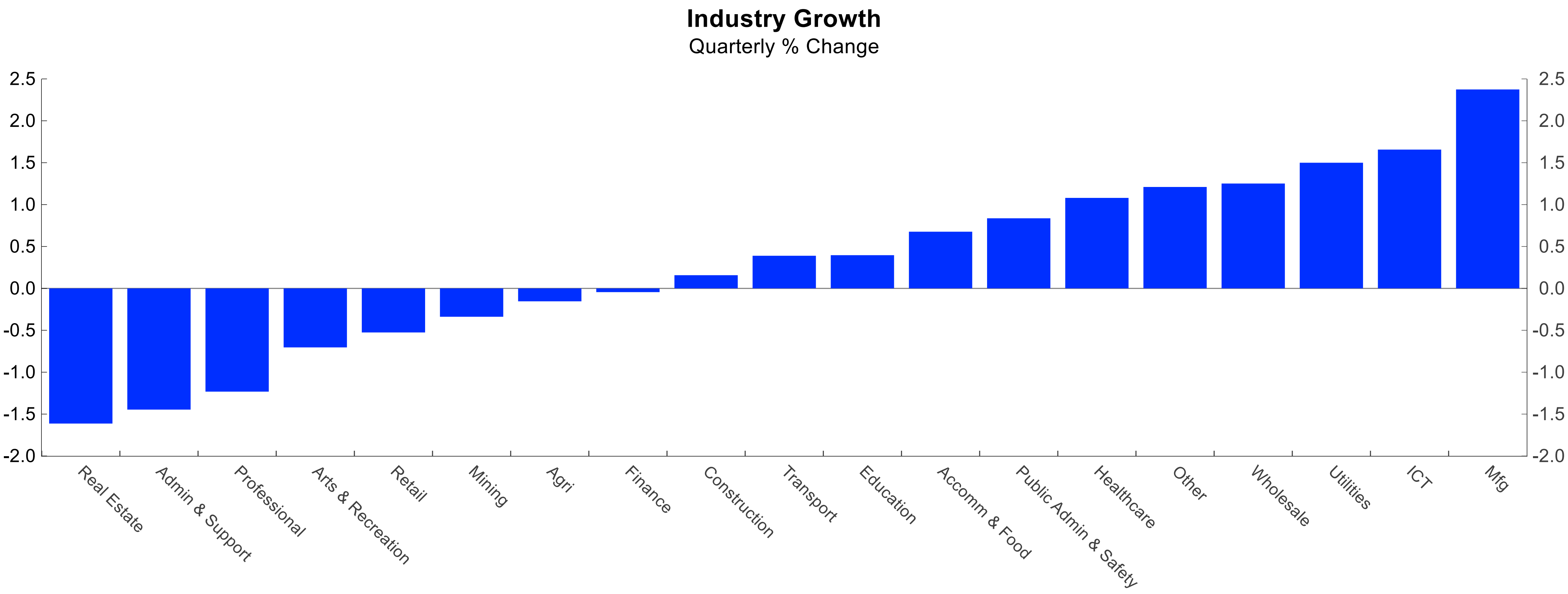
GDP Production Measure - GDP(P)



Sources: ABS; Macrobond

- 11 of 19 Industries were growing in the March quarter, down from 12 in the previous quarter.

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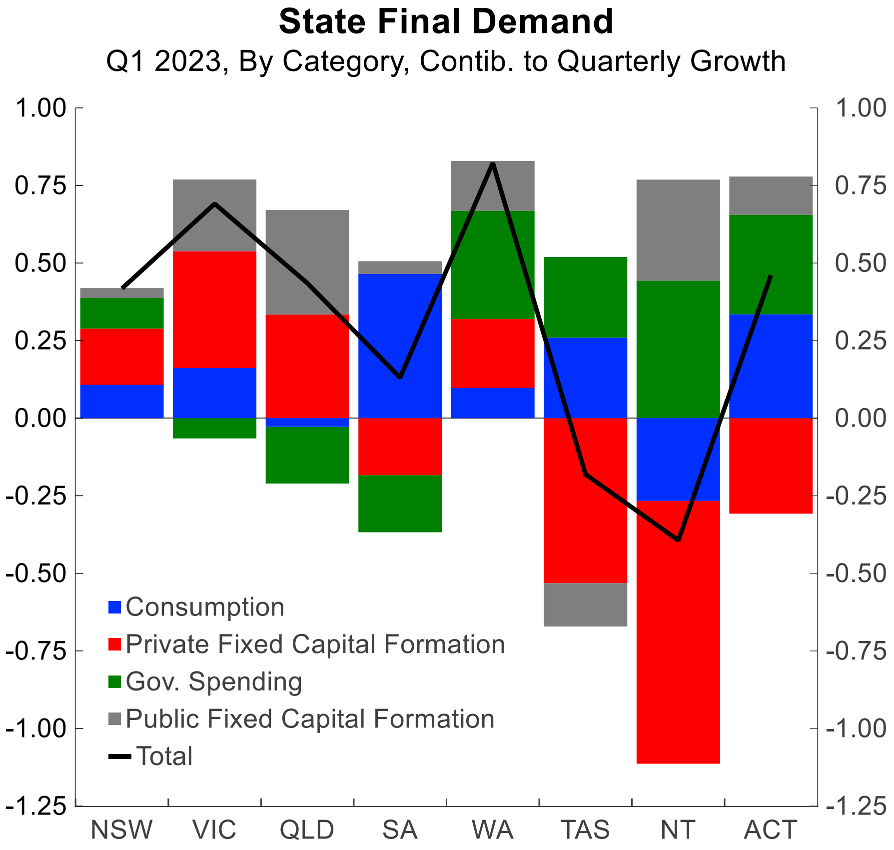
States Picture



Sources: ABS, Macrobond

- Activity was mixed across the states and territories in the March quarter but was tepid across the board.
- The major states of NSW, Victoria, Queensland, SA and WA reported growth alongside the ACT. Tasmania and the NT were outliers, contracting in the quarter.
- Quarterly growth improved in every state and territory except for the NT, providing some positive signs for the domestic economy.
- Household consumption was stronger in most regions barring Queensland and the NT where household spending detracted from growth. Spending was strongest in the ACT, SA and Tasmania.
- Private investment grew strongly in Victoria, Queensland, NSW and WA but was weaker in the remaining regions. Public investment was positive in every region save for Tasmania and was particularly strong in Queensland, the NT and Victoria.
- Government spending was softer in Queensland, Victoria and SA, while the spending from the remaining state governments added to growth.

Outlook

- The economic slowdown is likely to deepen as we move through the remainder of 2023. The recent rate rises with the prospect of further tightening should weaken household spending, especially discretionary spending, more noticeably.
- Household consumption is the engine room of the economy. The softer outlook for household consumption is likely to weigh heavily on GDP. A further contraction in dwelling investment is also likely to continue to detract from GDP.
- New business investment growth is also likely to step down after the covid measures for businesses – immediate expensing and the loss carryback scheme – expire on 30 June 2023.
- The RBA Governor often refers to the narrow path of bringing down inflation while keeping the economy on an even keel (and retaining jobs gains). We believe yesterday's rate hike likely led the economy off that narrow path, making a harder landing more likely.
- The Australian 2-10-year generic government yield curve inverted at the close of trade for the first time since 2008 – suggesting risks of a recession have grown, although a sustained and extended inversion is required to provide a clearer signal.
- A per capita recession will come sooner than an outright recession. After a fall in per capita GDP in the March quarter, a per capita recession could materialise as early as next quarter.

Contact listing

Chief Economist
Besa Deda
dedab@bankofmelbourne.com.au
+61 404 844 817

Senior Economist
Jarek Kowcza
jarek.kowcza@bankofmelbourne.com.au
+ 61 481 476 436

Senior Economist
Pat Bustamante
pat.bustamante@bankofmelbourne.com.au
+61 468 571 786

Economist
Jameson Coombs
jameson.coombs@bankofmelbourne.com.au
+61 401 102 789

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