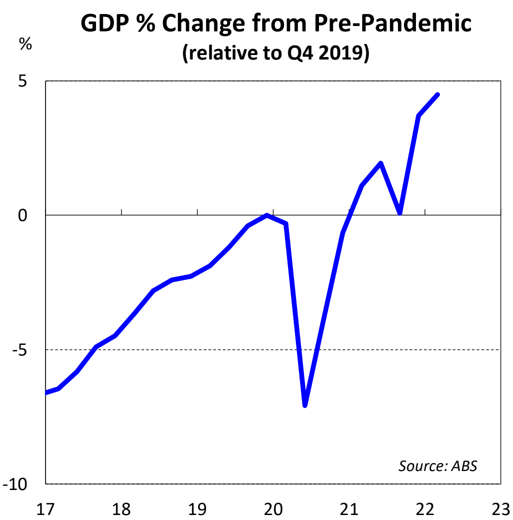
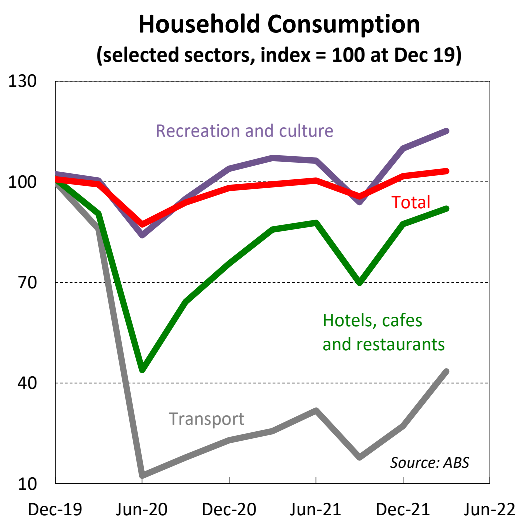
Wednesday, 1 June 2022

National Accounts

Consumer Spending Splash Drives Growth

- **The economy grew by 0.8% in the March quarter – a solid outcome amid the Omicron wave and weather disruptions in NSW and Queensland. Annual growth was 3.3% – above the long-run pace – and the economy was 4.5% bigger than before the pandemic.**
- **A consumer spending slash underpinned growth in the quarter. Consumer spending jumped 1.5% in the March quarter, after a spike of 6.4% in the December quarter. The gain over the two quarters to the March quarter was 8.0% – the second fastest on record.**
- **Spending growth was led by the industries that have been at the coalface of closed borders and mobility restrictions, notably transport services, hotels, cafes & restaurants and recreation & culture. Higher household incomes and households saving a lower share of their income facilitated the lift in spending.**
- **Economic conditions are converging across industries and across states and territories. Consumer spending ramped up the most in NSW and Victoria, where restrictions were strictest. And state final demand was fastest in Victoria in the March quarter.**
- **Government spending added considerably to growth in the quarter, reflecting support for flood-affected regions and spending on the pandemic response (e.g. rapid antigen tests).**
- **An uplift in business investment was also a feature. Business confidence remains buoyant and businesses are expanding and taking advantage of generous government incentives.**
- **An economic expansion is firmly underway but there are growing headwinds – especially inflationary pressures, exacerbated by staff shortages and supply-chain disruptions. The GDP chain price index, a measure of inflation in the national accounts, jumped by a record-sized 4.9% in the March quarter, taking annual growth to an elevated rate of 8.2%.**





Key Themes and Outlook

The Australian economy grew by 0.8% in the March quarter – a solid outcome amid an Omicron wave that swept through early in the quarter and weather disruptions in NSW and Queensland. It led annual growth to slow modestly to 3.3%, from 4.4% in the December quarter. This annual pace is still well above average annual growth over the past 10 years which sits at 2.3%. Moreover, the level of economic activity is 4.5% above that at the end of 2019, prior to the pandemic.

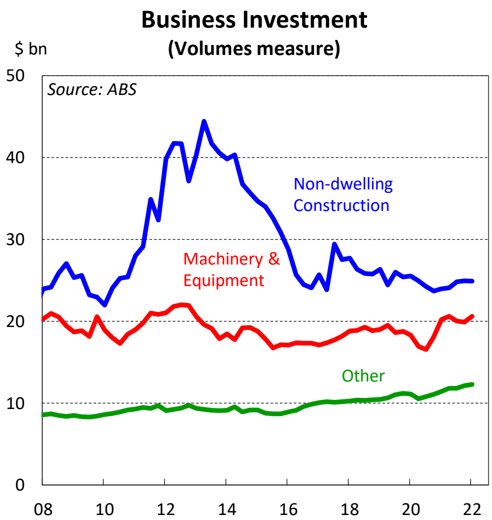
A consumer spending slash underscored the growth outcome in the quarter. Consumer spending jumped 1.5% in the March quarter, after a spike of 6.4% in the December quarter on reopening post-Delta lockdowns. Indeed, the gain over the two quarters to the March quarter was 8.0% – the second fastest on record.

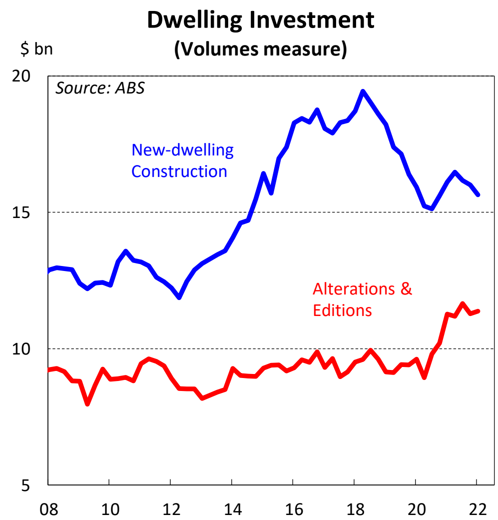
The reopening of domestic and international borders, pent-up demand after restrictions over large parts of 2020 and 2021, and a robust jobs market spurred consumers to spend. Spending growth in the quarter was led by the industries that have been at the coalface of closed borders and mobility restrictions, notably, transport services, which includes airline travel (+60.0%), hotels, cafes & restaurants (+25.2%) and recreation & culture (+17.1%). Households saving a smaller share of their income facilitated the lift in spending.

Green shoots are emerging in these industries. Indeed, economic conditions across industries are converging, a theme that is likely to continue over the rest of this year as spending rotates back to services (and away from goods).

The convergence theme is also evident across states and territories. In fact, household spending growth was strongest in the eastern states, which have been the most impacted by restrictions and lockdowns over the past two years. Consumer spending in Victoria jumped 2.7% in the quarter, followed by a 1.9% gain in NSW. Consumer spending in the ACT also jumped by 3.0%. State final demand was strongest in Victoria (up 2.4%), followed by WA (2.2%) and the NT (2.2%).

Public spending supported growth in the quarter, as government consumption rose by 2.7%, on the back of spending to support flood-affected regions of NSW and Queensland, and additional spending to manage the COVID-19 health response. Public investment was also 1.7% higher.





Growth in spending by businesses was also a feature. New business investment grew by 1.4% in the quarter, led by spending on machinery & equipment and on engineering. The generous government incentives still available, namely the instant asset-write off and loss carry-back scheme, are likely to have underpinned the spend. Buoyant business conditions and upbeat confidence are also underpinning the expansion of businesses.

Whilst the economy remained resilient, there are challenges ahead. An economic expansion is firmly under way, but inflation is also running hot. Staff shortages and supply-chain disruptions are exacerbating the inflationary pressures and contributing to a slide in sentiment among consumers. The GDP chain price index, a measure of inflation in the national accounts, jumped by a record 4.9% in the March quarter – taking annual growth to an elevated rate of 8.2%.

Hours worked fell in the March quarter, driven by wet weather and Omicron wave, although compensation of employees still rose at a solid rate, reflecting building wages pressures. Hours worked are recovering in the current quarter and the unemployment rate is brushing up against full employment and likely to fall further over 2022.

The tightening jobs market amid elevated inflation means the Reserve Bank (RBA) will keep raising rates to tame inflation. The RBA hiked last month for the first time in 11½ years, taking the cash rate from a record low of 0.10% to 0.35%. Another rate hike next week is a done deal. Only the size of the rate hike is up for debate. As the RBA tightens rates, dwelling prices and the share market will come under more pressure.

The risk for policymakers is that inflation stays above the RBA's target band of 2-3% and growth falters. Achieving the right policy will be tricky against a background of heightened uncertainty and factors driving inflation that are supply-side related and outside of the central bank's control (i.e. the war in Ukraine and China's covid-zero policy, both of which are pushing up global inflation).

GDP Expenditure Measure:

The headline GDP measure is an average of 3 measures – expenditure, income and production.

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	1.5
Public Consumption	2.7
Dwelling Investment	-1.0
New Business Investment	1.4
Public Investment	1.7
	Contribution to GDP, ppt
Inventories	1.0
Net Exports	-1.7

The expenditure measure of GDP rose by 0.8% in the quarter.

The main driver was consumer spending, which contributed 0.8 percentage points to growth in the quarter. **Household consumption** rose by 1.5% in the quarter, to be 4.0% higher over the year. The gain in the March quarter means that household consumption rose to be 2.5% above pre-pandemic levels (as at December quarter of 2019).

The growth in household spending reflected higher expenditure on discretionary goods and services (4.3%), which was partly offset by falls across essential goods and services (-0.2%).

The growth in spending was led by gains across transport services, which surged by a massive 60.0% in the quarter as state border restrictions lifted prompting a resurgence in domestic travel. Additionally, Australia's international border reopened in February 2022 and international travel resumed.

Services and recreational spending also contributed strongly to consumption growth, as spending patterns continue to transition back towards pre-pandemic patters as most restrictions have lifted. Growth was strong in recreation and culture (4.8%), and hotels, cafes & restaurants (5.3%). People also went out and updated their wardrobes, as clothing & footwear rose by 3.1% in the quarter.

Vehicle purchases jumped by 13.0% in the quarter, following two consecutive quarters of negative growth. This reflects the easing of some supply chain disruptions that have been impacting the car industry and is consistent with the strong growth in vehicle imports from yesterday's balance of payments release.

On the other side of the ledger, food spending detracted from growth (-2.0%), as households reduced the time they spent at home and reacquainted themselves with their favourite restaurants. Health spending (-2.3%) was down as elective medical services (e.g. elective surgeries) were cancelled during the Omicron outbreak. Alcoholic beverages (-2.9%), electricity, gas & other fuel (-2.4%), and cigarettes & tobacco (-2.6%) also detracted from household consumption growth in the quarter.

Net exports were a significant drag in the March quarter, detracting 1.7 percentage points from growth. This reflected an 8.1% surge in imports, compounded by a 0.9% fall in exports. Import volumes increased significantly in line with higher household spending in the quarter. Import volumes have typically mirrored household spending during the pandemic – falling during periods of lockdowns and bouncing back once restrictions lift.

Additionally, export volumes were weaker, led by softer commodity exports as adverse weather and labour shortages impacted production.

New business investment advanced in the quarter, rising by 1.4%. The growth reflected gains in spending on new machinery and equipment (3.2%), partly offset by a 0.2% fall in non-dwelling construction. Spending on intellectual property products (1.5%) and cultivated biological resources (0.6%) also added to business investment. Business spending plans reported in the capex survey last week suggest that spending is expected to lift over the rest of 2021-22 and into 2022-23.

Dwelling investment shrunk by 1.0% in the March quarter. The fall reflected a 2.2% drop in new dwelling construction, partly offset by a 0.7% gain in alterations and additions. This is the second consecutive quarter of negative growth in dwelling investment. The dwelling construction pipeline is very large following the steep increase in new housing demand during the pandemic, supported by low interest rates and government policy measures, such as HomeBuilder. However, home builders have faced challenges in working through the large pipeline. Cost pressures, labour shortages, and bad weather have impacted construction, meaning that the average time to completion of projects has increased.

Ownership transfer costs fell for the second consecutive quarter, down 1.4% in the March quarter. This follows strong growth during the pandemic as housing turnover increased and dwelling prices rose. The housing market has been steadily losing momentum since monthly dwelling price growth peaked at 2.8% in March 2021. The reduction in momentum and reduced sales volumes have impacted ownership transfer costs. This category represents the expenses associated with transactions related to new and existing properties, for example, real estate agent and legal fees.

The **government sector** contributed to growth in the quarter. Public consumption rose by 2.7% in the quarter, driven by increases across national non-defence, state & local, and national defence spending categories. The gains reflected spending by government to support flood-affected regions of NSW and Queensland, in addition to continued spending on the COVID-19 health response (e.g. on rapid antigen tests). Public investment was 1.7% higher, led by a large 13.6% increase in national defence investment. State & local general government investment also rose by 1.0% in the quarter. The government sector has been a strong driver of growth during the pandemic, reflecting large spending on healthcare in response to the pandemic, and increases in public investment to support the economic recovery.

Domestic final demand rose by 1.6% and contributed 1.6 percentage points to growth in the quarter. In annual terms, domestic final demand grew by 4.8%.

Finally, **inventories** added 1.0 percentage points to growth. The increase was concentrated in a build-up of inventories across retail trade, public authorities, wholesale trade, and manufacturing.

GDP Income Measure:

The income measure of GDP rose by 0.8% in the March quarter, when excluding the impact of prices. In nominal terms, GDP (I) rose 3.7% over the quarter to be 10.2% higher over the year.

Wage pressures are continuing to build.

Compensation of employees (i.e. wages, salaries and other benefits) increased by 1.8% over the quarter, following a 2.0% increase in the December quarter. The increase in compensation occurred despite a 0.9% fall in **hours worked** in the quarter because of Omicron-driven absenteeism. Over the year, compensation of employers was up 5.5%, up slightly from 5.3% annual growth over the year to the December quarter.

Wages and salaries and **employer's social contribution** (i.e. superannuation) were both 1.8% higher in the March quarter. The increase in the quarter was almost entirely driven by the private sector (2.3%), while public sector compensation of employers edged only marginally higher (0.1%).

The **gross operating surplus** (i.e. profits) of private non-financial companies jumped 7.3% over the quarter. The increase mostly reflected a sharp lift in mining profits (+14.7%) alongside the sharp increase in the prices of iron ore, coal and LNG off-the-back of disruptions associated with the Ukraine war. Wholesale trade profits also rose as margins on grains, petroleum products and motor vehicles increased. These gains were partly offset by falls in profits in manufacturing, as businesses absorbed higher input costs, including an increase in utilities prices. There were also falls in profits in construction, accommodation & food services and other services as government subsidies were unwound.

Taxes less subsidies jumped 15.7% in the quarter, reflecting both an increase in tax revenues as household consumption continued to pick up, and a sharp fall in subsidies as various government support payments rolled off.

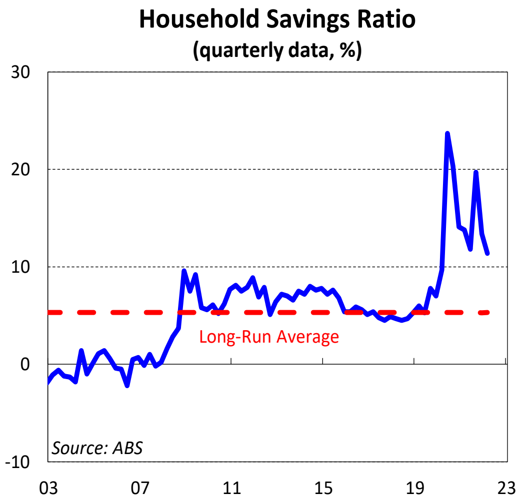
Gross **household disposable income** rose 0.6% over the quarter to a new record high. The increase reflected a pick up in labour income, alongside the tightening in the labour market.

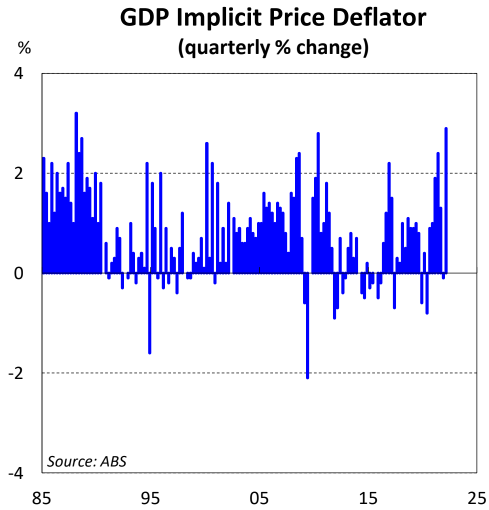
Non-labour income was also higher, underpinned by a sharp lift in insurance claims related to flooding in Queensland and New South Wales, partly offset by a decline in social assistance payments as restrictions eased and the unemployment rate continued to decline. Absent the insurance claims related to the floods, the household saving ratio would have been 0.8 percentage points lower.

The household **saving ratio** declined to 11.4% in the March quarter, from 13.4% in the December quarter as the increase in spending outpaced the lift in income. The saving ratio is well down on its peak of 23.7% in the June quarter of 2020, as the easing of restrictions opened up spending opportunities – notably for services, such as travel, which have been hindered by lockdowns.

However, the saving ratio remains well above its pre-COVID level of around 5%, likely reflecting the impact of the Omicron outbreak. Households may also be displaying some caution against a backdrop of rising inflation and the expectation of higher interest rates. We expect the saving ratio to continue to normalise over the coming quarters, which will provide ongoing support to consumer spending.

The evolution of household saving behaviour is a key uncertainty for the outlook. The higher share of their income that households spend rather than save, the faster growth will be in the near term. Some households have accumulated large saving buffers during the pandemic, which are expected to support spending and buffer those households against rising interest rates rise and elevated inflationary pressures. However, not all households are in the same boat. The squeeze on budgets is likely to be more acute for lower-income households. Typically, they have smaller saving buffers and spend more of their income on essential goods.





The **terms of trade** (the ratio of export prices to import prices) jumped 5.9% in the quarter, to a new record high. Both export prices (9.6%) and import prices (3.5%) rose strongly. Supply disruptions, exacerbated by the invasion of Ukraine, paired with an uplift in global demand underpinned a sharp rise in commodity prices. Over the year, the terms of trade were 8.3% higher. A higher terms of trade supports national income through higher profits for mining companies, increased dividends for investors, and greater tax receipts for the Federal and state governments.

It is no surprise but there was also evidence of the acceleration in inflation.

The GDP **chain price index**, a measure of inflation in the national accounts, jumped by a record-sized 4.9% in the March quarter, taking annual growth to an elevated rate of 8.2%. The chain price index is a measure of pure price changes in the national accounts.

Another measure of price pressure, which measures price changes but also reflects compositional changes in GDP, the GDP **implicit price deflator** leapt a whopping 2.9% in the March quarter, its fastest increase in 34 years! The deflator was up 6.6% in annual terms.

Price pressures are multi-pronged. Global supply disruptions have driven significant increases in input costs which are flowing onto consumers, but the pick up in domestic activity is also driving broader price pressures. The domestic final demand implicit price deflator, which measures price and compositional changes of expenditure on goods and services in Australia, rose 1.4% in the quarter and 4.1% in annual terms.

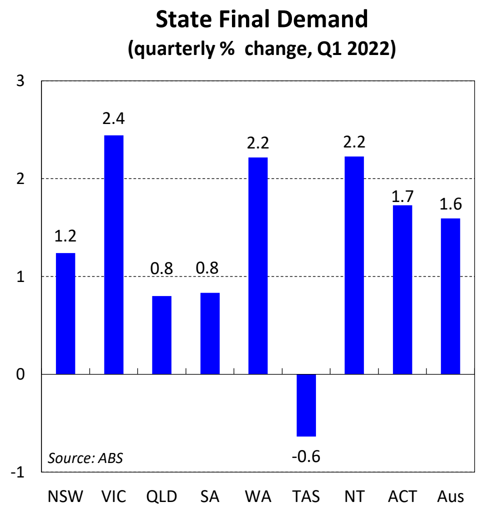
State Final Demand:

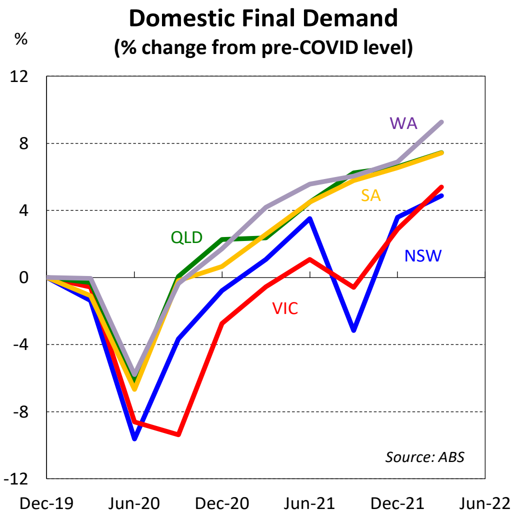
State final demand rose across all states and territories in the March quarter, apart from Tasmania which recorded a modest decline. Reopening tailwinds continued to support demand across NSW, Victoria, and the ACT, while disruptions from Omicron impacted activity across the country. Severe flooding in parts of NSW and Queensland also impacted activity in those states, for example, across household consumption and businesses investment. However, the government response to the spread of Omicron and flooding drove a sharp rise in government spending across the states, which contributed strongly to demand.

Growth was strongest in Victoria (2.4%), underpinned by a 2.7% gain in household consumption as the reopening boost continued, despite Omicron disruption. The gradual return of domestic and international travel also provided a boost, spending on transport services more than doubled (surging 104.4%) in the quarter. Household consumption in Victoria is now just 0.2% below pre-pandemic levels. Higher government spending on healthcare in response to spiking COVID-19 cases also supported demand in the first quarter. Business investment was a highlight in Victoria, lifting 3.5%.

Severe flooding across NSW and Queensland added to the disruptions from Omicron in the March quarter. Despite this, both states recorded a rise in state final demand. Demand lifted 1.2% in NSW, supported by a 1.9% jump in consumption expenditure, as households rode the reopening tailwind. Government consumption also rose 2.1% as governments ramped up spending in response to COVID-19 and the floods. Similarly, government spending spiked in Queensland (3.2%), underpinning a 0.8% rise in activity in the state. Household consumption was softer in Queensland (0.4%), likely reflecting relatively less 'catch-up' from disruptions over 2021. Weather disruptions delayed construction activity in the quarter, weighing on private gross fixed capital formation (i.e. business and dwelling investment) across both states.

Demand was also strong in WA (2.2%) and the NT (2.2%) in the March quarter, supported largely by the public sector. Both states reported a considerable jump in public spending alongside the spread of Omicron, while household consumption was soft. WA enjoyed a sizeable 3.2% lift in private gross fixed capital formation underpinned by a material jump in machinery and equipment investment (14.8%). In contrast, the public sector was responsible for the rise in investment in the NT alongside a lift in government investment.





Activity also picked up in the ACT (1.7%) and SA (0.8%). Both regions recorded a solid increase in consumption alongside the broader economic recovery, although, the ACT experienced a more pronounced rise in household spending as it bounced back from stricter mobility restrictions Tasmania was the only state to record a quarterly fall in demand (-0.6%), reflecting a steep decline in gross fixed capital formation and a fall in household consumption. Construction activity was impaired by labour and materials shortages.

Industry Breakdown:

Most industries reported growth in the March quarter, although Omicron disruption and adverse weather weighed on several sectors. A normalisation in spending patterns alongside the reopening saw services-driven sectors outperform. Promisingly, 14 of the 19 industry categories experienced growth in the March quarter, while activity in 14 industries is running above pre-pandemic levels.

Industry Gross Value Added, Chain Volume Measures

Ranked by Quarterly % Change, March Quarter 2022

By Industry	Quarterly % Change	Annual % Change
Arts & Recreation Services	4.4	7.3
Transport, Postal & Warehousing	4.3	8.3
Accommodation & Food Services	3.7	-0.5
Wholesale Trade	3.2	2.3
Professional, Scientific & Technical Services	3.1	8.7
Information, Media & Telecommunications	1.2	10.2
Manufacturing	1.1	3.2
Electricity, Gas, Water & Waste Services	0.9	2.4
Retail Trade	0.8	4.8
Financial & Insurance services	0.7	3.1
Administrative & Supportive Services	0.5	11.1
Education & Training	0.4	1.5
Construction	0.2	4.2
Public Administration & Safety	0.2	2.9
Other Services	-0.2	3.3
Healthcare	-0.9	5.1
Mining	-1.5	-2.0
Rental, Hiring & Real Estate Services	-1.8	1.1
Agriculture, Forestry & Fishing	-5.8	10.2

Source: ABS

Growth was strongest in arts & recreation (4.4%), transport, postal & warehousing (4.3%) and accommodation & food services (3.7%). These industries benefitted most from the reopening tailwind as COVID-19 restrictions continued to ease over the March quarter. Notably, the resumption of international and domestic travel resulted in a dramatic 101.3% rise in air and space transport activity, underpinning the firm growth in the transport, postal and warehousing sector.

Encouragingly, quarterly growth in the arts & and recreation industry pushed activity in this category above pre-pandemic levels for the first time since the outset of the pandemic. The arts industry was one of the hardest hit by lockdowns; activity slumped over 25% below pre-pandemic levels, as at the December quarter 2019, in the June quarter of 2020. In contrast, despite the upswing in the accommodation & food services and transport & postal services industries activity in these sectors is still 9.1% and 6.0% below pandemic levels, respectively.

The wholesale trade (3.2%) and manufacturing (1.1%) sectors benefitted from strong goods demand which has proved a hallmark of the pandemic. Easing of some supply constraints and a lift in demand for mining equipment also contributed to the gains. The professional, scientific & technical services (3.1%) and information, media & telecommunication (1.2%) industries also reported a solid lift in activity in the March quarter.

The construction sector expanded 0.2%, as businesses worked through project backlogs and large construction pipelines. However, weather related delays, material constraints and labour shortages exacerbated by COVID-19 absenteeism put the handbrake on activity.

Agriculture, forestry & fishing (-5.8%), rental, hiring & real estate services (-1.8%) and mining (-1.5%) dragged on growth in the March quarter. Activity in the agriculture sector fell 6.6% as adverse weather stalled crop and livestock production. However, this follows an 8.3% gain in the December quarter boosted by a strong grain harvest. Flooding also impacted activity in the mining industry, alongside elevated labour shortages. Production was hit hardest in the iron ore (-3.4%) and coal (-2.7%) mining sectors.

Meanwhile, activity fell 0.9% in the healthcare sector. The fall was predominantly driven by the private health industry, as elective surgeries were suspended during the quarter to free up hospital capacity in the wake of surging COVID-19 cases.

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