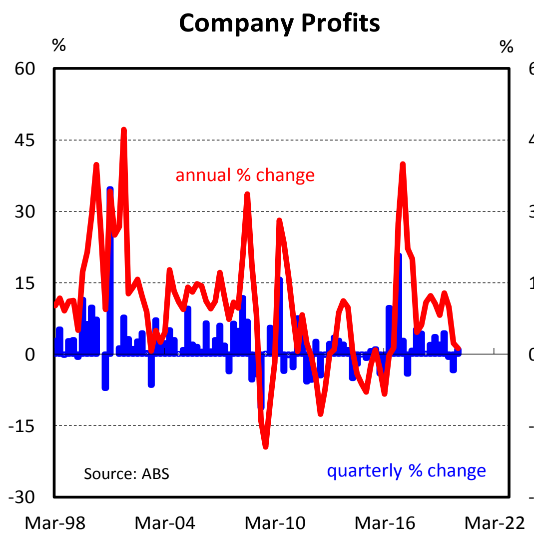
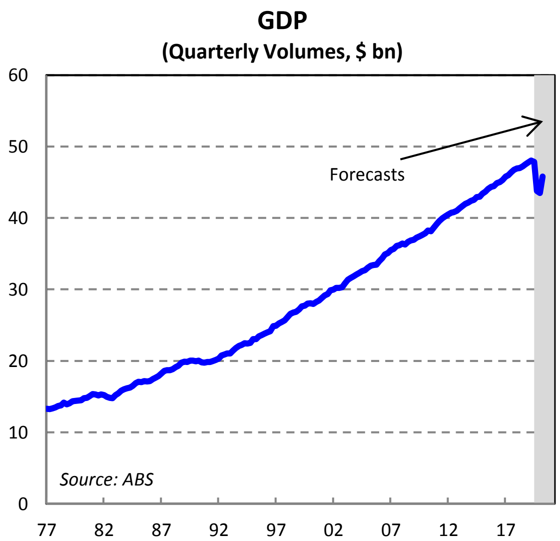
Co. Profits, Inventories & GDP Preview

Warning Lights Flashing

- **Gross company operating profits rose 1.1% in the March quarter, the first increase in three quarters. The lift in company profits was despite the impact of COVID-19 and summer bushfires.**
- **Profits in sectors including mining, manufacturing, retail and other services rose during the quarter. Profits in these sectors comprise a larger proportion of total profits in comparison to accommodation & food services and arts & recreation services, where profits declined. These latter sectors were more directly impacted by COVID-19 restrictions.**
- **Wages & salaries were flat in the March quarter, reflecting the deterioration in the labour market over late March. It was the first time wages and salaries did not grow since the December quarter of 2016.**
- **Inventories declined sharply in the March quarter, falling 1.2%. It was the biggest decline in over five years. The combination of COVID-19-related restrictions and bushfires has likely had a detrimental impact on production, resulting in a drawdown in inventories across most sectors. Inventories are set to detract 0.5 percentage points from GDP growth in the March quarter.**
- **Government spending increased in the quarter and is expected to provide a modest contribution to GDP growth in the March quarter. Government spending will be an important pillar of support while much of the economy struggles as it adjusts to a new world with COVID-19.**
- **We continue to expect a contraction in GDP over the March quarter, but have revised our forecast up from -0.7% to -0.4%. The large shock from COVID-19 suggests a greater degree of variability than usual to our forecast for tomorrow's GDP number.**





Gross Company Operating Profits

Gross company operating profits rose 1.1% in the March quarter, the first increase in three quarters. The lift in company profits was despite the impact of COVID-19. While most restrictions were in place late March, travel restrictions dented short-term arrivals, particularly from China. Moreover, bushfires earlier in the year also had an impact.

There was evidence of certain sectors being impacted negatively. Profits in accommodation & food services fell 11.5% in the March quarter, the largest fall in just over three years. Profits also declined in arts & recreation services, which were down 11.6%, and also in construction (-2.7%).

However, sectors including mining (2.9%), manufacturing (6.1%), retail (3.2%) and other services (0.9%) gained in the quarter. Profits in these sectors comprise a comparatively larger proportion of total profits, and were relatively less affected by COVID-19 in the first three months of the year.

On an annual basis, company profit growth slowed from 2.4% in the December quarter to 1.5% in the March quarter.

Wages

Wages & salaries were flat in the March quarter, reflecting the deterioration in the labour market over late March. It was the first time wages and salaries did not grow since the December quarter of 2016. Annual growth eased from 5.0% in the December quarter to 3.8% in the March quarter, the weakest outcome in 2½ years.

The flat outcome for wages and salaries is likely to bring down total incomes in the quarter. The wages component comprises just under half of GDP (based on the income measure).

A much sharper deterioration in profits and wages is expected over the June quarter, in line with the very rapid deterioration in business conditions and the labour market.

Inventories

Inventories declined sharply in the March quarter, falling 1.2%. It was the biggest decline in over five years. The combination of COVID-19-related restrictions and bushfires has likely had a detrimental impact on production, resulting in a drawdown in inventories across most sectors. The largest drawdown was in accommodation & food services (-5.4%), but there were also sizeable falls in inventory in manufacturing (-2.0%) and retailing (-1.2%); the latter reflecting consumer stockpiling of household goods while the former may have been affected by supply-chain issues due to COVID-19. Mining inventories also declined (-0.8%), which was affected by cyclone activity in Western Australia earlier in the year.

Inventories are expected to detract 0.5 percentage points from GDP growth in the March quarter.

Government Spending

Government spending increased in the quarter and is expected to provide a modest contribution to GDP growth in the March quarter. Consumption spending rose 1.8%, while government investment fell 0.7% in the quarter Government spending will be an important pillar of support while much of the economy struggles as it adjusts to a new world with COVID-19.

GDP Forecast

Partial economic indicators have been mixed in the lead up to the GDP release tomorrow.

Some areas of spending were not as weak as feared in the March quarter, including retail spending and business investment. The big contractions in these areas are likely to have occurred in the June quarter of the year. Government spending and net exports are also set to provide positive contributions to growth.

However, other aspects of consumer spending (such as services) are likely to be very weak and inventories are expected to detract a sizeable chunk from GDP growth.

Moreover, other components of GDP, especially on the incomes, are likely to be very weak, reflecting a flat wages bill and a contraction in profits.

We continue to expect a contraction in GDP over the March quarter, but have revised our forecast up from -0.7% to -0.4%. It would be the first decline in GDP in nine years, since the time of the GFC. Such an outcome would leave annual economic growth at 1.3%, which is well below potential or the trend rate of around 2.6%. The large shock from COVID-19 suggests a greater degree of variability than usual to our forecast.

There is some risk of a small positive result for GDP, but it is not our central view. Weak private demand and soft incomes are likely to ensure GDP contracted in the March quarter.

The biggest contraction to GDP is expected to occur in the current June quarter. This data will not be available until early September.

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