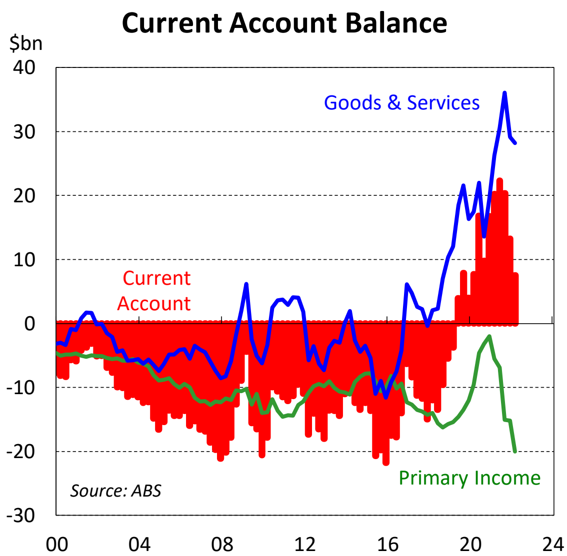
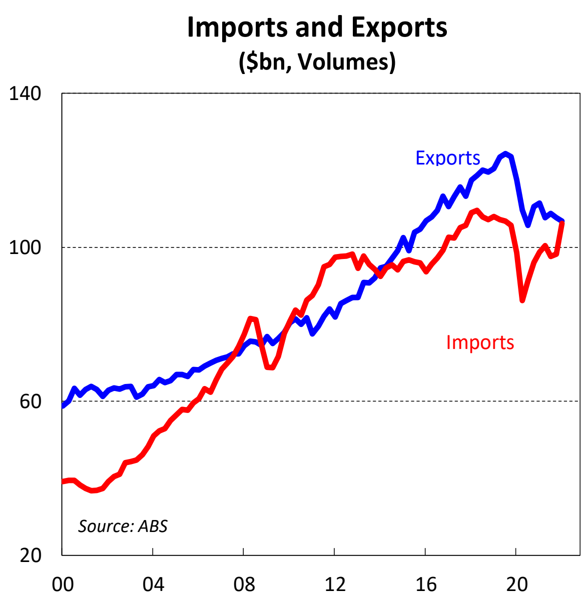
Tuesday, 31 May 2022

Current Account and GDP Preview

Q1 GDP Growth To Slow, Surplus Narrows

- **Australia reported its 12th consecutive quarterly current account surplus in the March quarter of 2022. However, the surplus narrowed by $5.7 billion to $7.5 billion.**
- **The narrowing reflected a $4.9 billion widening of the primary income deficit, to $20.0 billion, as mining companies distributed dividends to non-resident shareholders. Mining company profits were boosted by a 13.1% surge in commodity prices following the invasion of Ukraine. The terms of trade rose by 5.9% to hit a new record high.**
- **The trade surplus narrowed by $0.9 billion to $28.2 billion, reflecting a dramatic jump in imports ($12.7 billion, or 11.9%). This marks the strongest quarterly import growth since 1985! It was partly offset by higher exports ($11.8 billion, or 8.7%).**
- **Imports of consumption goods rose 17.5% in the quarter, the second largest increase on record, reflecting strong consumer spending as well as the acceleration in inflation.**
- **Net exports are expected to detract 1.7 percentage points from growth in the March quarter, reflecting a significant rise in import volumes (i.e. stripping out price effects) of 8.1%, compounded by a decline in export volumes (-0.9%).**
- **Public sector demand rose 2.5% in the March quarter. New public final demand is expected to add 0.7 percentage points to growth in the March quarter.**
- **March quarter GDP is out tomorrow. We predict GDP expanded by 0.6% in the quarter, to be 2.9% higher over the year, alongside continued growth in household spending. Public demand and inventories are also expected to add to growth, while the external sector dragged.**





Current Account

Australia reported its 12th consecutive quarterly current account surplus in the March quarter of 2022. However, the surplus narrowed by $5.7 billion to $7.5 billion. This is down from a revised outcome of $13.2 billion in the December quarter. The surplus has now narrowed for three consecutive quarters, from a record high of $22.3 billion in the June quarter of 2021. In dollar terms, the surplus was at its lowest level since the December quarter of 2019. Despite the narrowing of the surplus, this is the longest run of consecutive quarterly current account surpluses since the series began in 1959.

The narrowing reflected a widening of the primary income deficit. The primary income deficit widened by $4.9 billion, from $15.2 billion in the December quarter of 2021 to $20.0 billion in the March quarter of 2022. This was due to a jump in primary income debits to their highest level on record, as mining companies distributed higher profits from elevated commodity prices in the form of dividends to non-resident shareholders.

A smaller trade surplus also contributed to the narrowing of the current account surplus. The trade surplus narrowed by $0.9 billion, to $28.2 billion. This reflected a spike in imports of goods and services ($12.7 billion, or 11.9%) – the strongest growth since the June quarter of 1985! Surging imports were partly offset by an increase in exports of goods and services ($11.8 billion, or 8.7%).

The rise in import values reflected higher imports of consumption goods (17.5%) alongside strong consumer spending. This was the second largest quarterly rise in consumption goods imports on record, going back to 1981. Higher prices also contributed to the gain as annual inflation accelerated to its highest level in nearly 21 years in the March quarter.

Imports of intermediate and other merchandise goods also rose (11.6%) as households stocked up on rapid antigen tests during the spike in case numbers associated with the Omicron outbreak. Imports of fuels & lubricants rose (7.5%) for a fifth consecutive quarter, reflecting higher petrol prices. Imports of capital goods were also higher (6.3%), in particular, imports of machinery & industrial equipment (15.9%) and other capital goods (18.0%). This is consistent with higher machinery and equipment spending by businesses reported in the capex survey last week.

The rise in exports of goods and services reflected higher commodity exports, particularly metal ores & minerals (18.2%) – largely iron ore exports, and coal, coke & briquettes (11.3%) as commodity prices and demand were elevated over the quarter.

Export and Import Volumes

Net exports are expected to detract from growth in the March quarter by 1.7 percentage points. This is a larger detraction than the 1.4 percentage points expected by consensus.

The expected detraction from growth reflects a significant rise in import volumes (i.e. stripping out price effects) of 8.1% – the strongest percentage increase since the December quarter of 2009. This was compounded by a decline in export volumes (-0.9%). During the pandemic, import volumes have typically followed household spending patterns, decreasing during lockdowns and increasing as restrictions ease and household spending rebounds. The lift in import volumes in the March quarter reflected stronger activity following the Delta lockdowns in 2021.

The increase in import volumes reflected stronger imports of goods (8.3%) and services (6.8%). Consumption goods (14.9%), particularly non-industrial transport equipment i.e. cars (32.1%), and other consumption goods (12.5%), drove most of the gain in import goods volumes. All sub-categories of consumption goods were higher, including household electrical items, food & beverages, and textiles, clothing & footwear. Imports of intermediate & other merchandise goods

(5.1%), and capital goods (5.0%) also added to volume growth.

The decrease in export volumes reflected a decline in the export of rural goods (-2.0%), particularly cereal grains & cereal preparations (-14.1%). Meat & meat preparations were also lower (-2.9%), while other rural goods rose (8.8%). Non-rural goods (-0.4%) also contributed to the decline in export volumes. Within this category, declines were driven by weaker non-rural commodity exports. In particular, metal ores & minerals (-2.7%), other mineral fuels, namely LNG (-2.3%), and coal, coke & briquettes (-1.8%) all declined in the quarter. Supply disruptions across the resources sector contributed to the volume of non-rural commodity exports being lower in the quarter, despite higher commodity prices lifting values across some key commodities.

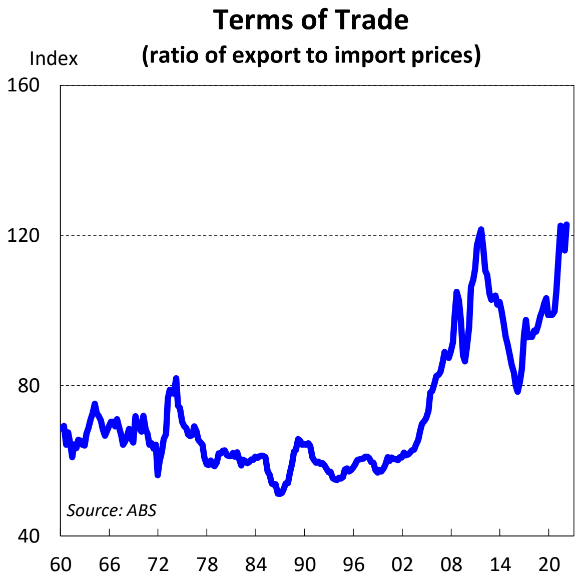
Outside the resources sector, export volumes for non-commodity-related non-rural goods rose, with other manufacturers (12.6%), and machinery (10.0%) contributing the most to growth.

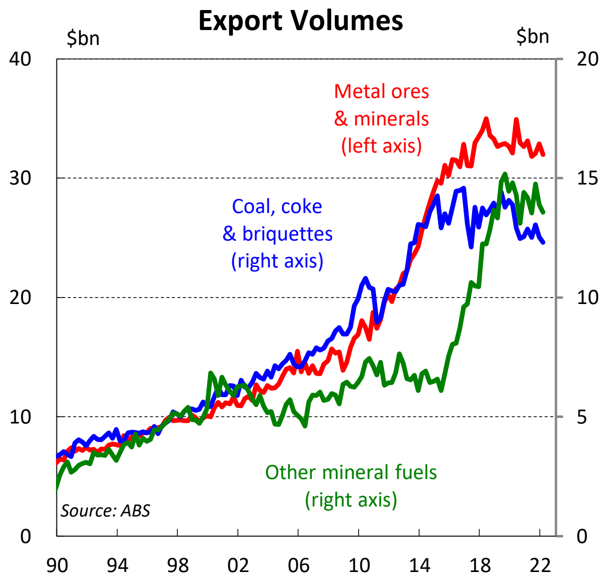
Services exports and imports both rose over the quarter, by 2.3% and 6.8%, respectively. Services trade has been heavily impacted by the pandemic. However, Australia's international borders reopened in February 2022. International tourism has recommenced, and international students are also beginning to return to Australia. However, despite the increases in the quarter, services trade remains well-below pre-pandemic levels. It will likely take some time before services trade recovers to pre-pandemic levels.

Terms of Trade

The terms of trade, which is a ratio of export prices to import prices, rose by 5.9% in the March quarter to hit a new record high. The boost reflects increases in the price of Australia's commodity exports. The Reserve Bank's index of commodity prices surged by 13.1% in the March quarter, alongside the invasion of Ukraine, reaching the highest level in the history of the series (going back to 1982).

In annual terms, the terms of trade was 8.3% higher over the year to the March quarter. A higher terms of trade supports national income through higher income for exporters and greater tax receipts for government.





Government Finance Statistics

Total new demand from the public sector rose by 2.5% in the March quarter. This follows of 0.1% decline in the December quarter of 2021. The rise reflected gains across public consumption

(2.7%) and new public investment (1.6%). The public sector has been a strong contributor to growth since the pandemic began, due to the unprecedented fiscal stimulus unleashed to support the economy.

New public final demand is expected to add 0.7 percentage points to GDP growth in the March quarter.

GDP Preview

Today's data has led us to upgrade our expectations for March quarter GDP. We now predict GDP to have expanded by 0.6% in the quarter, to be 2.9% higher over the year. This is an upgrade from our previous expectation of 0.2% growth in the quarter.

Economic activity likely continued to expand in the March quarter, as household spending, which accounts for around half of GDP, likely added to growth, supported by an expected reduction in the household savings ratio from elevated levels. The labour market also continued to strengthen during the quarter and the unemployment rate fell to 3.9%, a near 50-year low.

Today's partial indicators show that the public sector is expected to add to growth, and inventories also increased by more than expected.

However, there are a range of headwinds facing the economy. The March quarter was impacted by a spike in case numbers associated with the Omicron outbreak, flooding across large parts of NSW and Queensland, and elevated inflationary pressures for households. Additionally, today's data shows that the external sector is expected to drag on growth as imports bounced back strongly in the quarter.

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