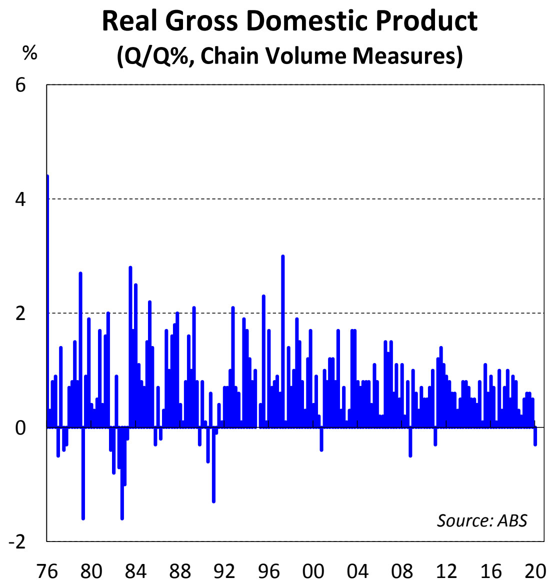
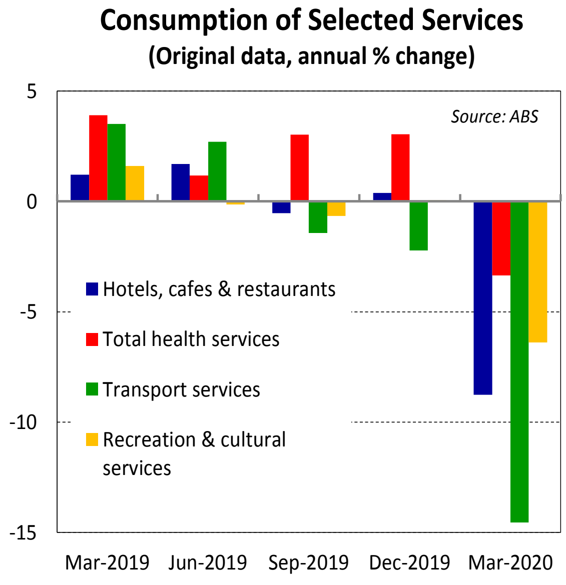
Wednesday, 3 June 2020

National Accounts - GDP

It Was a Good Run

- **The Australian economy contracted over the first quarter of the year. GDP fell by 0.3% in the quarter, the first contraction in nine years.**
- **Annual growth slowed further in the March quarter to 1.4%, which is the slowest pace in 10½ years and well below potential growth or trend growth of around 2.6%.**
- **The twin impacts of bushfires and COVID-19 caused economic activity to shrink in the quarter.**
- **Private demand was very weak across consumption, business investment and housing. Incomes were also very soft. Net exports and public demand helped limit the size of the contraction, but net exports only added to growth because the fall in imports outpaced the drop off in exports.**
- **The impact of COVID-19 was evident in the sharp decline in spending on services, especially services tied to the transport (including air travel), hotels, cafes & restaurants and recreation & culture sectors. Restrictions also bit these sectors hardest.**
- **With the bulk of restrictions fully in place towards the end of March, a much sharper contraction in activity is expected to have occurred in the second quarter of the year. It means a recession is virtually a certainty and has been underway since early this year. It would be the first recession in Australia since 1991, ending Australia's enviable long record of 29 years without a recession.**
- **The good news is the duration of this recession might be quite short and limited to just two quarters, although economic activity is likely to remain in a slow gear for some time.**





Key Themes & Summary:

Economic activity shrunk 0.3% in the March quarter, which is very close to our final forecast for GDP of -0.4%. The range of forecasts was very wide from economists: -1.1% to +0.2%, reflecting the unprecedented nature of the twin shocks of COVID-19 and summer bushfires during the quarter.

Annual growth slowed further in the March quarter to 1.4%, which is the slowest pace in 10½ years and well below potential growth or trend growth of around 2.6%.

The underlying weakness in the economy was largely as expected with private demand very weak across consumption, business investment and housing. Incomes were also very soft. Net exports and public demand helped limit the size of the contraction in the quarter, but net exports only adding to growth because the decline in imports outpaced the drop off in exports.

The economy was affected by bushfires across Eastern Australia in the early part of the quarter, followed by an escalation of COVID-19 around the world and domestically. The impact of COVID-19 was prevalent in the sharp decline in spending on services, especially services tied to the transport (including air travel), hotels, cafes & restaurants and recreational & culture sectors. Restrictions also bit these sectors hardest.

The contraction of 0.3% in the quarter marks the first contraction in economic activity since the March quarter of 2011 when the economy also shrunk by 0.3%. Back then, natural disasters in Australia caused the trade sector to contract significantly. Before the March quarter of 2011, the last contraction in GDP was in the December quarter of 2009 when the economy was experiencing the adverse effects of the global financial crisis (GFC).

It sets up the Australian economy to record its first technical recession since 1991, ending Australia's enviable global record of 29 years without a recession. A contraction in the June quarter (the data for which will be released in early September) is guaranteed. The impact of COVID-19 was felt the deepest in the June quarter, especially as lockdown-related restrictions characterised much of the quarter and led to a collapse in demand for goods and services for many businesses. This drop in demand led many businesses to cut hours worked; a drop in total hours worked was already evident in the March quarter data with hours worked down 0.8%. Our preliminary forecast is for a contraction in the June quarter of 8.5% with a recovery over the second half of this year. But the decline could end up being closer to 7% given the reopening of the economy has already commenced.

The good news is the duration of this recession might be quite short and limited to just two quarters, although economic activity is likely to remain in a slow gear for some time, especially as the effects of the pandemic are likely to cast a shadow over the economy for an extended time. In 1991, the recession was also just two quarters, although the period of economic malaise was longer in length. Australia's deepest post-war recession so far has been the 1982-83 recession; the duration of this recession extended beyond 2 quarters with GDP down 6 out of 7 quarters beginning in the December quarter of 1981. During the GFC, the Australian economy managed to escape recording a technical recession, although economic activity still slowed.

Moreover, whilst Australia recorded a contraction in the March quarter, the size of the fall is more modest than anticipated when restrictions were first introduced. This builds the case for the RBA's statement yesterday that the depth of the downturn might not be as big as earlier thought. In addition, Australia's contraction in the March quarter is much smaller than comparable falls recorded in the US (-1.3%), UK (-2.0%) and euro area (-3.8%) economies for example.

GDP Expenditure Measure:

COVID-19 had a clear impact, particularly on household consumption which fell sharply. While the most severe restrictions on movements and business operations were imposed over late March, travel restrictions were implemented earlier in the year, which resulted in a sharp fall in tourist arrivals. Bushfires earlier in the year also affected travel and household services-related spending.

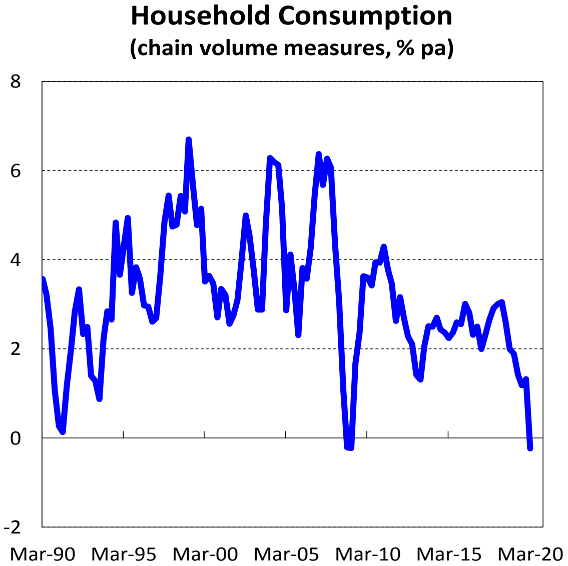
Household consumption fell 1.1% in the quarter, the first fall since the December quarter 2008.

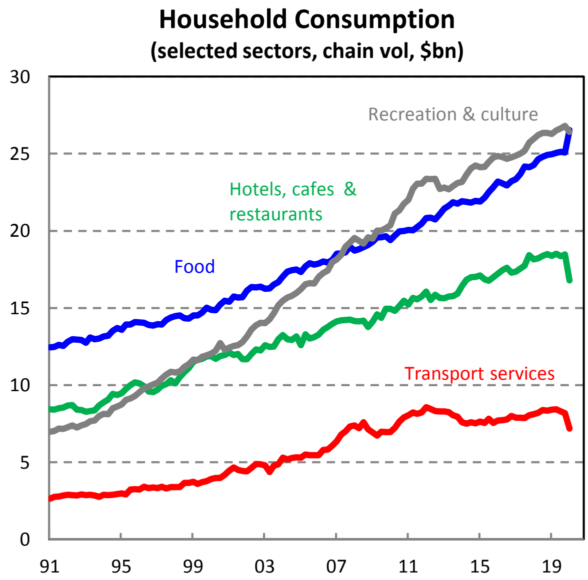
Services were hit the hardest, declining 2.4% in the quarter. Meanwhile, consumption of goods rose 1.0%, as households stockpiled on food, medical supplies and household goods.

Food consumption increased, lifting 5.8% in the March quarter. Alcoholic beverages also increased strongly in the quarter, rising 3.9%, while furnishings & household equipment rose 1.5%.

The largest declines within household consumption were unsurprisingly in hotels, cafes & restaurants (-9.2%) and transport services (-12.0%), which were impacted the most heavily from containment measures to stem the spread of COVID-19. Spending on these two areas detracted a total of 0.6 percentage points from domestic final demand.

Clothing & footwear (-8.9%) also declined sharply, as retail foot-traffic was reduced.





Uncertainty with regards to the outlook negatively impacted **business spending**. Total private business investment fell 0.4% in the quarter and a further sharp decline is likely as business conditions deteriorated significantly over the second quarter of the year. According to the survey published by the Australian Bureau of Statistics (ABS) capex, spending plans over 2019-20 and 2020-21 have been downgraded, further underscoring a weak outlook for business investment.

Dwelling investment was also not immune to the broader downturn, and declined 1.7% in the quarter.

Stronger **government spending** provided some offset to the weakness in the private sector. While the bushfires contributed to the decline in household spending on services, spending on roads, damaged infrastructure and evacuations helped drive public spending higher.

Government spending was also boosted through the response to COVID-19. Government consumption spending rose 1.8% in the quarter, with the strongest gains in NSW, Victoria and the ACT.

The public sector contributed 0.3 percentage points to GDP, which mitigated the loss in demand in the private sector.

Overall, demand in the economy weakened significantly. **Domestic demand** fell 0.5%, the largest fall since the March quarter 2009, led by a large 1.1% fall in private demand.

Net exports provided a positive contribution to growth of 0.5 percentage points, but this mostly reflected the sizeable decline in imports (-6.2%) compared with exports (-3.5%). Trade in services was the most negatively impacted, including tourism which was curtailed by travel restrictions. Supply-chain disruptions and weather-related disruptions also impacted trade flows.

Inventories detracted 0.2 percentage points from growth. The combination of COVID-19-related restrictions and bushfires likely had a detrimental impact on production, resulting in a drawdown in inventories.

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	-1.1
Public Consumption	1.8
Dwelling Investment	-1.7
New Business Investment	-0.8
Public Investment	-0.7
	Contribution to GDP ppt
Inventories	-0.2
Net Exports	0.5

GDP Income Measure:

When excluding the impact of prices, GDP based on the incomes measure fell 0.4% in the March quarter.

Nominal GDP growth, as measured by incomes rose by 0.8% in the March quarter after falling by 0.2% in the December quarter of 2019. On an annual basis, the pace of growth slowed from 3.9% in the December 2019 quarter to 3.1% in the March quarter, the slowest pace of growth in four years.

The shock to the labour market in late March caused by restrictions aimed at slowing the spread of COVID-19 led to a weak outturn for household incomes. Wages incomes (total compensation of employees or COE), rose 0.5% over the quarter. It was the slowest quarterly growth since the December quarter of 2016. On an annual basis, the pace of growth stepped down from 5.1% in the December 2019 quarter to 4.2% in the March quarter.

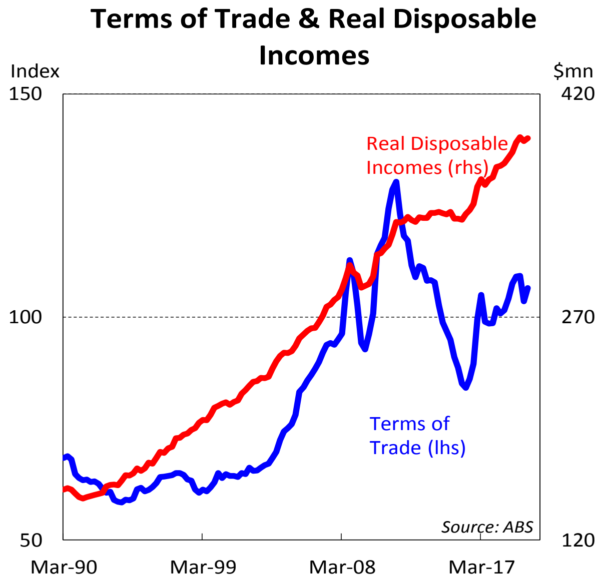
During the March quarter, hours worked declined by 0.8% following a 0.3% increase in the previous quarter. Note that the manual calculation of the change in the hours worked index results in a 0.9% decline over the quarter due to rounding. Labour incomes are expected to come under particular pressure in the June quarter. Movement restrictions intensified in April and despite being gradually eased in May, were in effect for most of the June quarter. Data from the ABS's labour force survey showed that hours worked plunged 9.2% in April, which will have a substantial effect on wage income.

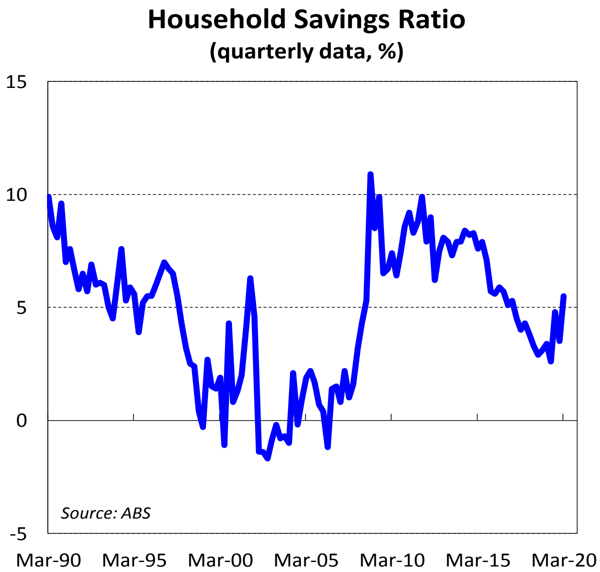
Gross disposable incomes rose 1.4% in the March quarter after a 0.4% fall in the December quarter of 2019.

Company profits rebounded, but growth remained sluggish. Profits by corporations rose 0.9% over the quarter, up from a 1.4% declined registered in the December quarter of 2019. Resilience in commodity prices supported mining profits following a sharp decline in the latter months of 2019. On an annual basis, company profits rose 3.5% in the March quarter.

The reduction in spending amid growing uncertainty surrounding the spread of COVID-19 led to a rise in the **household savings ratio**. A rise in social assistance benefits also gave a boost to the ratio. The household savings ratio rose to 5.5% from 3.6% in the December quarter of 2019. The household savings ratio is at its highest in 3½ years reflecting increased household caution.

The **terms of trade** (or the ratio of export prices to import prices) rose 2.9% in the March quarter, bouncing back from a 5.4% decline in the previous quarter. An increasing term of trade is a boon for national incomes because it means imports can be procured relatively more cheaply than exports are sold for. The terms of trade have now increased in six out of the past seven quarters, although on an annual basis it remains 0.9% lower. The dire outlook for global growth due to COVID-19 presents a negative outlook for commodity prices and, therefore, the terms of trade. However, there are upside risks if China introduces large-scale infrastructure stimulus or if the world economy can fully re-open more quickly than anticipated.





State Final Demand:

The fortunes of the States began to converge in the March quarter, although there were some outliers. Overall, State final demand was soft, mostly reflecting weakness in household consumption amid the dual shocks of bushfires early in the quarter and COVID-19 towards the end.

Of the eight States and territories, three recorded an increase in State final demand while five experienced a decline in the March quarter.

New South Wales recorded the largest fall, of 1.5%. Household consumption in the State fell by 1.6%, as consumers decreased expenditure on transport and on hotels, cafes & restaurants. The bushfires and COVID-19 restrictions impacted both these industries. Some of the decline in household consumption was offset by a 1.8% increase in government consumption as expenditures rose as part of the response to the bushfires and COVID-19. Dwelling investment fell 4.5% in the State while new engineering construction investment declined 12.0% following reduced work on major road projects.

There were also significant declines in the Northern Territory (-1.2%) and South Australia (-1.0%). South Australia's growth was also driven by a substantial fall in expenditure on hotels, cafes & restaurants. Private gross capital formation in the State fell 2.3%, driven by a 14.1% fall in machinery and equipment spending. Government final consumption rose 0.9%, led by a 2.2% increase in state government spending due to its bushfire response and subsequent local tourism campaign to aid the recovery. The fall in the Northern Territory reflected a contraction in mining investment as work on large projects completed and petroleum exploration reduced. Private gross capital investment in non-dwelling construction fell 9.0%.

Queensland recorded a 0.3% decline in State final demand with household consumption 0.5% lower in the March quarter while private investment fell 0.1%. Dwelling construction investment jumped 2.2%, due to increase spending on repairs following hailstorms on the Sunshine Coast.

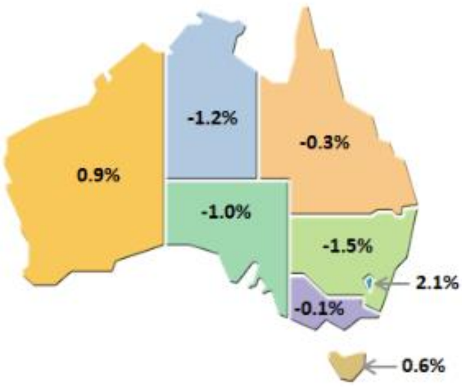
The ACT recorded another strong quarterly outturn in State final demand, rising by 2.1% in the March quarter, its eighth straight quarterly increase. Tasmania also recorded a pick-up in state final demand during the quarter, with a 0.6% rise.

Western Australia showed further signs of an emerging recovery in the March quarter, although the heightened impact of COVID-19 in the June quarter is likely to drag growth lower. State final demand rose 0.9%, bolstered by a 5.2% increase in private gross capital formation as mining investment picked up. Dwelling construction investment fell by 4.7% due to a decline in alterations & additions activity.

Victorian State final demand fell by a mild 0.1%, following a 0.2% decline registered in the December quarter of 2019. Household final consumption fell 1.2% amid an 11.2% decline in clothing and footwear spending and as hotels, cafes & restaurants spending fell 8.4%. Public investment rose 3.4% on the back of increased investment in roads and sewerage infrastructure. Government consumption also rose strongly, up by 3.3% as the State responded to the bushfire emergency.

On an annual basis, State final demand in most States and territories was below its long-run average. Annual state final demand was lower in New South Wales (-0.7%), South Australia (-1.0%) and the Northern Territory (-2.8%). Positive growth was recorded in Victoria (0.9%), Queensland (0.6%) and Tasmania (1.2%) but all States were below their long-run averages. Annual growth was more robust in Western Australia (3.4%) and the ACT (4.2%).

State Final Demand
(quarterly % change, March quarter 2020)



Source: ABS

Industry Break Down:

Eleven out of the 19 industries contracted over the quarter. The headwinds from COVID-19 and the bushfires weighed heavily on certain sectors.

The most deeply affected was accommodation and food services, which contracted 7.5%.

Transport postal and warehousing also had a sizeable contraction, declining 4.9%, as did other services (4.2%).

Agriculture, forestry & fishing declined 2.1% in the quarter, and was the weakest industry on an annual basis (-10.1%). The combination of drought and the bushfires has not been kind to the sector.

Industry Gross Value Added, Chain Volume Measures

Ranked by Quarterly % Change

By Industry Sector	Quarterly % Change	Annual % Change
Manufacturing	2.1	2.6
Retail Trade	1.7	1.7
Wholesale trade	1.5	0.3
Professional, scientific & technical services	1.5	4.8
Public admin & safety	1.4	5.9
Financial & insurance services	1.2	2.2
Education & training	0.4	2.1
Info, media & telco	0.3	2.5
Healthcare & social assistance	-0.1	6.1
Construction	-0.5	-3.7
Mining	-1.0	4.1
Electricity, gas, water & waste services	-1.7	-2.4
Rental, hiring & real estate services	-1.7	2.3
Agriculture, forestry & fishing	-2.1	-10.1
Arts & recreation services	-2.4	-2.5
Administrative & support services	-3.7	-3.2
Other services	-4.2	-3.2
Transport, postal & warehousing	-4.9	-3.4
Accommodation & food services	-7.6	-5.2

Source: ABS

The sectors which saw growth included manufacturing (2.1%), retail trade (1.7%), wholesale trade (1.5%), professional, scientific and technical services (1.5%), public administration & safety (1.4%), finance & insurance services (1.2%), education & training (0.4%) and information media & telecommunications (0.3%).

Some of these industries are showing greater resilience from the COVID-19 restrictions, including public administration & safety, however, many of these industries, including manufacturing and retail trade are likely to weaken in the period ahead.

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