

Slow growth for the Australian economy in Q3 09

Economic note

16 December 2009

- The Australian economy grew by just 0.2%/qtr in Q3 09, taking the annual growth rate to 0.5%/yr (from 0.6%/yr in Q2 09).
- Growth in the quarter was driven by public investment spending (ie. the government's fiscal package), as well as household consumption spending and dwelling investment. This was partly offset by falls in net exports and private business investment.
- Although this data is quite historical, the Q3 09 GDP reinforces the view that the Australian economy continues to outperform other major countries. This economic performance has delivered a significantly better outcome for the Australian labour market, but is also clearly why the RBA sees the need to be pre-emptive in returning monetary policy to a more normal setting.
- It is interesting to note, however, that the RBA Deputy Governor has today stated that rising bank lending margins vs the cash rate imply that monetary policy "is now back in the normal range."

Slow growth in Q3 09 – but we have all moved on since then

According to the latest National Accounts, the Australian economy grew by an anaemic 0.2%/qtr in Q3 09 (consensus f/c 0.4%), bringing the annual growth rate down to 0.5%/yr from 0.6%/yr in Q2 09 (see first chart for details). While the economic growth rate in Q3 09 was slower-than-expected, it must be remembered that this data is for the July-August-September period, with good signs that the pace of economic activity has improved since then (ie. stronger employment numbers, improved consumer and business confidence and growing expectations for private business investment).

The 0.5%/yr annual growth rate remains well above other developed economies, (ie. the US is at -2.5%, UK -5.1%, EU -4.1%, Japan -5.1%, Canada -3.5%, New Zealand -2.1%, but with Korea at +0.9%, India +7.9% and China at 8.9%) and is consistent with the RBA's desire to return monetary policy to a more normal setting.

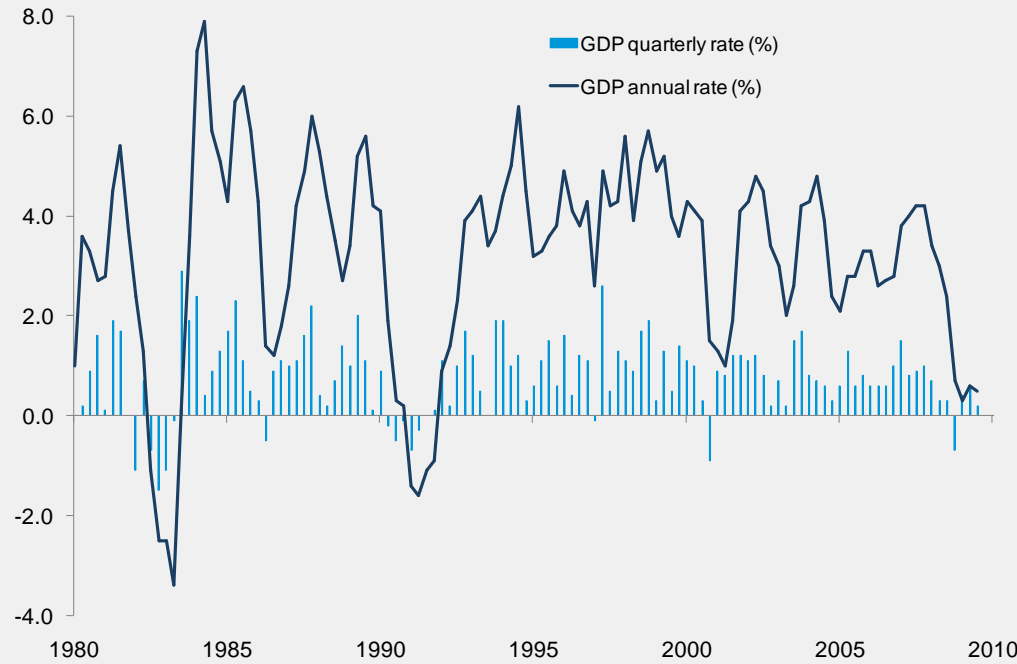
Financial markets expect this process of monetary policy normalisation to continue through 2010. However, it is interesting to note that in a speech today the RBA Deputy Governor has laid out the argument that widening bank lending rate spreads relative to the cash rate mean that monetary policy is "now back in the normal range." (see below for full quote).

Australian economic growth in Q3 09 was driven by a combination of government and private capital and consumer spending. Public gross fixed capital formation rose by 6.2%/qtr and made a 0.3 percentage points (0.3%pts) contribution to growth. Private spending on dwellings rose by a strong 5.9%/qtr and also contributed 0.3%pts to GDP growth. Household final consumption spending rose by 0.7%/qtr and contributed 0.4%pts to growth. This was offset by a significant -1.6%pts contribution from net exports (exports -2.3%/qtr and imports +5.8%/qtr). Also weighing on the

economy during the quarter was private non-dwelling construction (-4.3%/qtr and -0.3%pts contribution) and private machinery & equipment spending (-4.1%/qtr and -0.3%pts contribution).

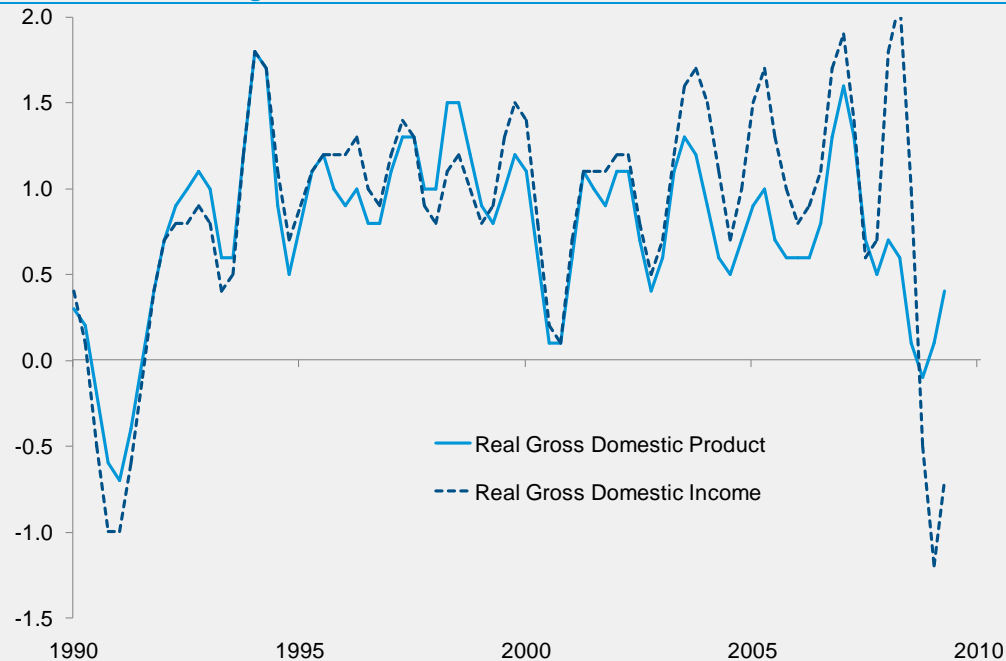
Significantly, Australia's terms of trade (export prices relative to import prices) rose by 1.0%/qtr in Q3 09. This helped real domestic income increase by 0.4%/qtr (see second chart for details). In addition, inventories made a positive 0.8%pts contribution to growth in Q3 09. All these gains were the first since Q3 08, ie, the start of the global financial crisis. It is also worth noting, however, that GDP per capita declined by 0.4%/qtr, continuing a run of flat numbers since Q2 08.

Australian economic growth – Quarterly and Annual change



Source: ABS

Australian economic growth – Production vs Income measures



Source: ABS

Other interesting points from the Q3 09 GDP data were:

- On an industry basis, the strongest gains over Q3 09 were in rental, hiring & real estate services (+0.3%pts contribution), construction (+0.2%pts), wholesales trade (+0.1%pts), transport, postal and warehousing (+0.1%pts), and financial & insurance services (+0.1%pts).
- These positive contributions were offset by declines for public administration & safety (-0.2%pts), electricity, gas, water & waste services (-0.1%pts) and information media & telecommunications (-0.1%pts).
- For Q3 09 the rise in inventories was centred around wholesale trade. This was offset by continued destocking in manufacturing.
- Compensation per employee rose 0.2%/qtr, with the share of total factor income accounted for by wages rising a little to 54.6%.
- Private gross operating surplus declined by 1.2%/qtr, although “other” gross operating surplus gained 2.7%/qtr. Gross operating surplus of corporations represented 26.2% of total factor income.
- The household savings ratio declined to 3.9% in Q3 09, from closer to 6.0% in Q2 09. But the Q3 09 reading remains well above the -2% seen just prior to the onset of the GFC.
- With regard to prices, the chain price index for household final consumption spending rose 0.6%/qtr. Private gross fixed capital formation prices gained by 0.7%/qtr. Export prices declined by 2.7%/qtr and are down 19.0%/yr. Import prices declined by 3.2%/qtr and are down 4.0%/yr.
- Looking at the states, NSW was the largest contributor to national growth, with state final demand growth of 1.3%/qtr. South Australia (+1.9%) and ACT (+1.3%) also recorded positive growth, while NT (-3.2%), WA (-1.3%), Victoria (-0.3%) and Tasmania (-0.2%) all faced falls in state final demand. Queensland recorded flat growth.
- NSW benefited from strong public and private (capital formation) investment and positive gains in public and private final consumption. Interestingly the fall in Western Australia was driven by sharp falls in public and private investment, although this would be expected to turn around in Q4 09 and beyond given the rebound in mining investment, with this shown in positive import figures, most likely capital equipment for mining and infrastructure work.
- As noted, the RBA Deputy Governor, Ric Battellino, has today signalled that monetary policy is now closer to a normal setting. His full quote is as follows: “as you know, the cash rate is currently 3.75%. This is still 50bp below the previous cyclical low of 4.25% in 2001. On the surface this might suggest that the cash rate is still unusually low. However, with other interest rates in the economy having risen by at least 100bp relative to the cash rate over the past couple of years, they are now above their previous cyclical lows.
- “Another way to think about this is that the current level of deposit rates, housing loan rates and business loan rates would have been consistent, before the crisis, with a cash rate of at least 4.75%. Taking these considerations into account, it would be reasonable to conclude that the overall stance of monetary policy is now back in the normal range, though in the expansionary segment of that range. The appropriateness of this will be monitored by the Reserve Bank over the months ahead in the light of the data becoming available on economic activity and inflation.”

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