HD **Improving net export picture central to Australia's Q4 performance and near-term growth outlook**

BY Bree Neff

WC 1,805 words

PD 6 March 2014

SN IHS Global Insight Daily Analysis

SC WDAN

LA English

LP

The Australian economy expanded at the fastest pace in a year during the December quarter as the economy appeared to be taking its first tentative steps towards rebalancing away from the investment stage of the **mining** boom.

IHS Global Insight perspective

TD

Significance

Real GDP growth reached 2.8% year on year in the fourth quarter of 2013, the strongest result since the third quarter of 2012, supported by a strong net export position and improved household consumption activity.

Implications

Although the investment portion of the **mining** boom is unwinding quickly, the boom is far from dead as net exports made the largest contribution to growth during the December quarter thanks to strong mineral exports. Although household spending picked up during the quarter, the remaining sectors of the economy are lagging behind on the transition away from the **mining** boom.

Outlook

The fourth-quarter GDP figure was stronger than expected, but it is still expected that the Australian economy will return a sub-trend performance for 2014. IHS' February forecast had called for growth of 2.4% for 2014, but because of positive momentum from the fourth quarter and a healthy net export position outlook, a mild upgrade to growth is possible. That said the room for upward revisions will be limited by the weakening labour market, fiscal consolidation measures by the government, and weak non-**mining** sector investment.

Australian economy beats expectations with Q4 growth figures

According to the Australian Bureau of Statistics (ABS) the economy expanded 0.8% in real, seasonally adjusted terms during the fourth quarter (Q4), an improvement from the previous quarter's 0.6% quarter on quarter (q/q) figure. In year-on-year (y/y) terms, the economy expanded 2.8%, up from the third-quarter reading of 2.4% y/y and the strongest reading since the third quarter of 2012. The result put annual GDP growth at 2.4% for 2013, down from 2012's growth of 3.6%.

```
Source:
Australian Bureau of Statistics( ABS)
```

Slumping imports and strong exports result in positive contribution to growth from net exports

Although the fourth-quarter contribution to growth from net exports was smaller than the 0.7-percentage-point contribution in the third quarter, the net export position provided the largest boost to growth in the fourth quarter. Exports of goods and services in real (inflation-adjusted or volume) terms recorded significantly stronger growth in the fourth quarter, led by 2.7% q/q growth in goods export volumes. Although a lot of talk in the past several months has focused on rising iron ore production from the mining investment boom, the growth in goods exports was led by coal products in the fourth quarter as they rose 12.5% q/q, supported by lower prices for the commodity. Iron ore exports were still supportive of growth but they rose a more modest 1.6% q/q. Export growth was also driven by the persistently volatile exports of non-monetary gold as they rose 14.3% q/q, largely unwinding the previous quarter's fall. Services exports meanwhile recorded more modest growth of 0.5% q/q in real terms, with the growth being led by a 1% q/q increase in travel services exports thanks in part to a weaker Australian dollar.

Imports of goods and services meanwhile recorded their second consecutive quarterly decline in response to the unwinding mining investment. Imports of goods fell 0.4% q/q despite growth in imports of consumption and intermediate goods of 0.4% and 0.6% q/q, respectively. The 1.9% q/q fall in capital goods imports was the main story, with falls across a number of major capital goods categories linked to the mining industry, including machinery and industrial equipment (-4.7%), industrial equipment not elsewhere specified (n.e.s; -9.3%), and capital goods n.e.s (-9.1%). In fact, the result might have been worse if not for the 27% q/q growth in imports in the civil aircraft and confidentialised items import category. Services imports were similarly weak as they fell 1.3% q/q, led by a 4.9% q/q fall in transport services imports in response to weaker merchandise import activity.

Household spending perked up as hoped

Improved household or private consumption spending was another favourable factor in the fourth-quarter data, and is something the government and Reserve Bank of Australia (RBA) would like to see continue, albeit at a measured pace. Household final consumption expenditure growth in real terms during the fourth quarter continued to be dominated by increased spending on services, although retailers also saw healthy sales during the quarter.

Growth was led by spending on finance and insurance services, which rose 1.8% q/q, and healthy growth was also recorded for recreation and culture services, and rent and dwelling services. As for non-services spending, clothing and footwear purchases performed surprisingly well for a second consecutive quarter, rising 3.0% q/q. In response to consumption growth and slowing growth in household disposable incomes, the ABS estimates that the household savings rate fell below 10% for the first time since 2010, easing to 9.7% in the fourth quarter from 10.6% in the previous quarter. The result hints at two contradictory trends, falling employment levels as well as improved consumption activity, and should be watched closely going forward to see if it is being driven by rising wealth or debt accumulation.

Government consumption spending meanwhile was supported by increased spending at the national level for defence purposes (up 0.9% q/q) and by increased state and local government consumption activity (up 0.7% q/q). However, fiscal consolidation measures to rein in non-defence spending at the central government level helped contain overall growth for the quarter.

Weakness in business investment more apparent in Q4's data

December-quarter fixed-investment data was relatively easy to interpret as the distortions caused by the sale of public-sector assets to the private sector in previous quarters appear to have largely worked their way through the data. Overall private business gross fixed-capital formation fell 3.6% in real terms during the fourth quarter. The weakness was led by an 8.8% q/q plunge in machinery and equipment expenditures, and was supported by a 1.9% q/q fall in non-dwelling construction activity. Highlighting the unwinding mining investment activity was the 10.7% q/q fall in mineral and petroleum exploration activity as it built on the third quarter's fall of 8.0% q/q. Dwelling construction activity was positive, rising 1.0% q/q, more than unwinding the previous quarter's 0.4% fall. Public-sector investment activity was also surprisingly strong, rising 4.3% q/q thanks in part to a 3.8% q/q increase in public corporations spending and a 4.6% q/q increase in general government investment activity.

Because inventories fell by just AUD461 million (USD412 million) over the fourth quarter they made a surprise positive contribution to growth during the quarter. Inventories fell for some of the economy's major sectors including mining, wholesale trade, and retail trade, but rose sharply in the manufacturing and farm sectors after both of those sectors recorded sizeable inventory rundowns in the third quarter. The depletion of mining sector inventories is unsurprising after seeing the strength of the fourth-quarter export figures and the retail/wholesale inventory weakness could stem from better-than-expected consumption activity from the household sector.

Growth dynamics shifted significantly in 2013 as mining investment peaked

Source: ABS

Growth slowed significantly in 2013, as mentioned above, it came in at just 2.4% for the year. One thing to note is that 2012 benefited significantly from favourable base effects as the economy rebounded from the devastating floods of 2011. By comparison, 2013 looks very weak, but during 2013, quarter-on-quarter growth was significantly stronger than what was seen during the second–fourth quarters of 2013.

The most dramatic story of 2013 has to be the turnaround in the country's net export position as net exports made a 2.4-percentage-point contribution to growth, the largest contribution to annual growth since 1990. The strong position stems from the progression of the **mining** boom from the investment/construction phases of projects to the output phases. This transition saw imports to support construction and project build-up activity fall sharply while mineral export receipts beat expectations. The shift in the **mining** investment story is also clear in the headline gross fixed-capital investment result as it indicates a contraction for the first time since 2009. When looking at the consumption picture, the annual figures point to only modest growth, but the picture is not as weak as it seems with household consumption activity improving solidly each quarter.

Outlook and implications

The strengths seen in net exports and household consumption in the fourth quarter are welcomed as tentative steps towards the economy adjusting to the unwinding of the **mining** investment boom, which was in full evidence in the fourth quarter's data. In the year ahead, the rebalancing or adjustment of the economy will be under intense scrutiny from government policymakers and investors. One area for scrutiny in the economy's near-term outlook remains non-**mining** business investment, where business sentiment surveys point to mildly positive investment intentions but actual investment activity remains sluggish. It is expected that improvements here will be led by the housing sector thanks to rising home prices.

Meanwhile other non-**mining** investment will receive some support from still-low interest rates and minor improvements to the external outlook from a weaker Australian dollar and gradually improving global growth. Overall the improvements in non-**mining** investment are expected to just barely offset falling **mining** investment. For this reason, fixed investment remains one area where IHS could potentially downgrade our forecasts for the near and medium term. Thankfully the weakness in fixed investment is largely offset by weaker imports of investment goods which will support a positive net export position. This should help keep the economy growing albeit at a below-trend pace.

One key downside risk to our outlook could arise from a sudden retrenchment in consumer spending from rising unemployment and the potential for higher interest rates, both of which would undermine disposable income growth. Another significant risk is a sudden relapse in demand for Australia's major commodities exports of **iron ore** or **coal**, either from top export market **China** or other Asian economies. Overall, IHS expects growth in the mid-2% range for 2014 as the economy is not expected to quickly adjust to its new circumstances and as downside risks abound.

NS c312 : External Markets | e1101 : Economic Growth | gtrade : Tariffs/Trade Barriers | e512 : Physical Trade | c31 : Marketing | ccat : Corporate/Industrial News | e11 : Economic Performance/Indicators | e51 : Trade/External Payments | ecat : Economic News | gcat : Political/General News | gdip : International Relations | gpir : Politics/International Relations | ncat : Content Types | nfact : Factiva Filters | nfcpin : FC&E Industry News Filter

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

IPD Main Story

PUB Global Insight Limited

AN Document WDAN000020140306ea360001x

