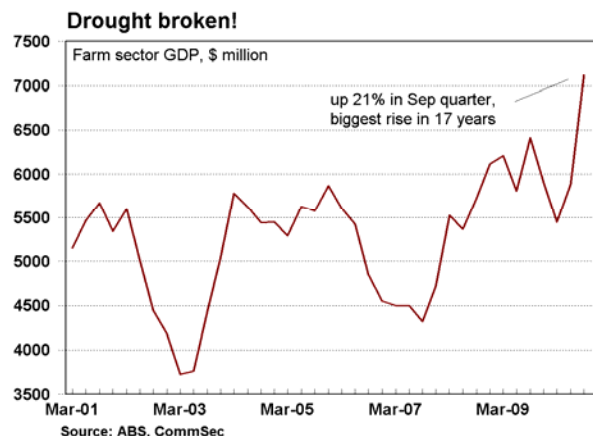


Record economic expansion moves into 20th year National accounts

- The current economic expansion began in the September quarter of 1991. The 19th year of the expansion was completed in the June quarter 2010 and the 20th year of growth has begun with the Australian economy expanding by 0.2 per cent in the September quarter. While growth was only modest in the latest quarter, arguably Australia is still in the strongest position of any global advanced economy.
- While growth was modest in the quarter, it follows a 1.1 per cent increase in the June quarter. The modest growth in the quarter should be regarded as the pause that refreshes. Annual economic growth now stands at 2.7 per cent – below the Reserve Bank's estimate of "normal growth" of 3.25 per cent.
- Eleven of the 19 industry sectors contracted in the September quarter. The strongest contribution came from agriculture, forestry and fishing (up 18.5 per cent in the quarter and contributing 0.4 percentage points to growth). Farm GDP rose by 21 per cent in the September quarter – marking the fastest quarterly gain in 17 years.
- The household saving ratio stands at 10.2 per cent. Productivity was disappointing – down 0.1 per cent in the quarter and up 0.5 per cent over the year. Inflation was under control – the household price deflator rose 0.3 per cent in the quarter and 2.0 per cent over the year.
- Real (inflation adjusted) spending on petrol fell by 5.2 per cent over the past year – the biggest drop in records going back 25 years.
- The Reserve Bank Governor has previously indicated that interest rate settings are on hold until 2011. There is nothing in today's data that is likely to see him shift from that view. In short, Merry Christmas!

What does it all mean?

- How many countries can claim to have notched up 19 consecutive years of economic growth? You'd be scratching to find any country apart from Australia in this elite club. No doubt there are challenges ahead to maintain the extraordinary run of prosperity, but clearly you would want to be in Australia's shoes as opposed to any other advanced nation. The challenge will be to expand productive capacity and take on more foreign



Craig James – Chief Economist (Author)

(02) 9312 0265 (work), 0419 695 082 (mobile), (02) 9525 2739 (home) | craig.james@cba.com.au

Savanth Sebastian – Economist CommSec (Author)

(02) 8223 7130 (work), 0414 188 161 (Mobile) savanth.sebastian@cba.com.au

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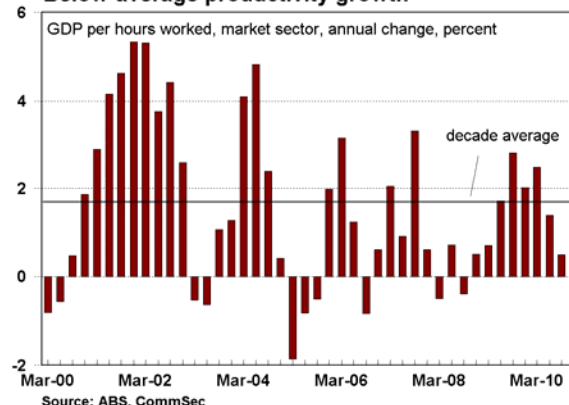
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workers to ensure that the economy doesn't hit the wall.

- While growth was only modest in the quarter, it follows a 1.1 per cent lift in the June quarter. So on average the growth performance remains positive. Rather the softer result in the September quarter reflects some hesitancy from the private sector to take the baton from the public sector. Provided that the Reserve Bank stays on the interest rate sidelines until well into 2011, businesses and consumers should pick up their spending.
- Across Australia, people have been telling us that the economy is very patchy and this is borne out in the latest economic growth figures. The data is certainly a wake-up call to those focussing unduly on the mining boom and neglecting the other 90 per cent of the economy. We argued that cash rates shouldn't have been lifted in November and this validates our view.
- While the Australian economy managed to scrape out another quarter of growth, much is owed to the performance of the farm sector. The farm sector grew by a staggering 21 per cent over the quarter – marking the fastest rate of quarterly growth in 17 years. No doubt favourable weather conditions and buoyant agricultural commodity prices were the key drivers. Looking forward the strength of the Australian dollar will play an integral part in how well the farm sector performs.
- At present the economy may not be going anywhere, however the longer term story is sound. On many occasions the Reserve Bank has highlighted the significant boost to the terms of trade and the challenges that it is likely to create in terms of capacity, employment and inflation. However this is more a longer term thematic.
- At present the income boost from higher iron ore and coal prices is not as visible across the economy. The extra dollars coming into the Australian economy is not being spent. Rather consumers and business are holding onto the cash until the economic recovery gains traction. The double digit household savings ratio and weak private sector investment outside the mining sector adds weight to this argument.
- Unfortunately the forward looking data suggests that activity is likely to remain stuck in third gear in the near term. Recent economic data has been patchy at best, and the inherent conservative attitude by consumers and businesses is likely to take time to change. No doubt the uncertainty in terms of the global economic story will also figure in the mix.
- CommSec expects the Australian economy to grow by around 3.25 per cent over the coming year – in other words, “normal” growth is expected.

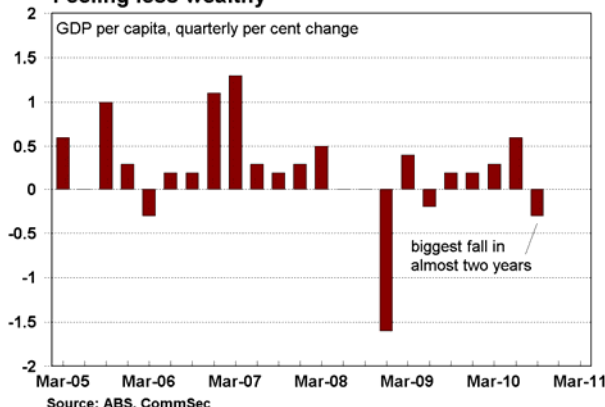
Below-average productivity growth



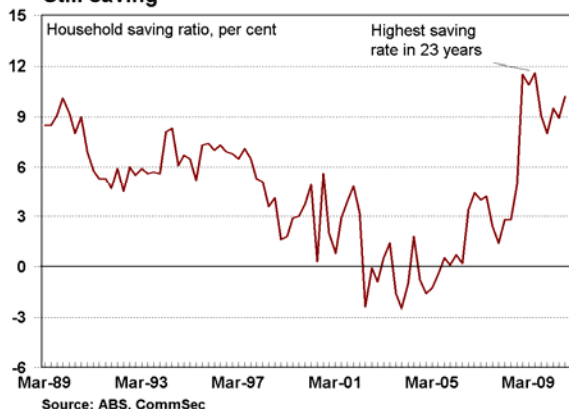
What do the figures show?

- **Economic Growth:** The economy expanded by 0.2 per cent in the September quarter after growing by a downwardly revised 1.1 per cent in the June quarter. Annual economic growth fell from 3.3 per cent to 2.7 per cent in the September quarter.
- The non-farm economy fell by 0.2 per cent in the September quarter after expanding by 1.0 per cent in the June quarter. Annual growth stands at 2.5 per cent.
- Farm GDP rose by 21.0 per cent in the quarter and was up 11.1 per cent over the year. The 21.0 per cent quarterly rise was the largest quarterly growth increase in 17 years.

Feeling less wealthy

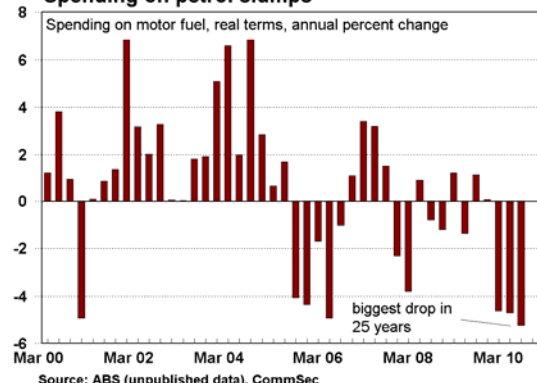


Still saving

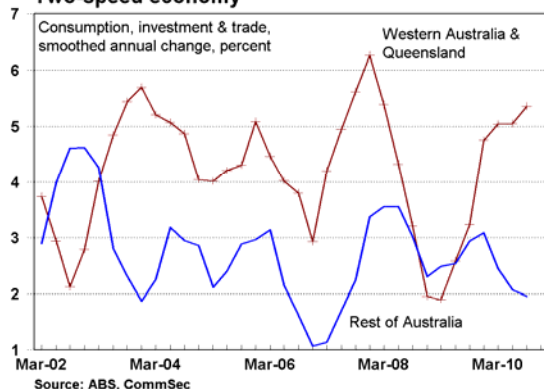


- At current prices, GDP grew 1.2 per cent in the quarter and 9.6 per cent over the year, boosted by mining profits. Real gross domestic income rose by 7.8 per cent over the year. Income levels are rising, but consumers and businesses are choosing not to spend.
- Growth drivers:** Household consumption added 0.3 percentage points (pp) to overall GDP growth in the September quarter. Private business investment and Government investment both added 0.1pp. Net exports were actually the main detractor from the result, slicing 0.5pp. Inventories detracted 0.2pp to growth while dwelling investment detracted 0.1pp and Government consumption added 0.1pp.
- Inflation:** The best measure of domestic price pressures, the household consumption implicit price deflator, rose by 0.3 per cent in the September quarter with annual growth steady at 2.0 per cent. Real non-farm unit labour costs rose by 1.4 per cent in the September quarter after remaining unchanged in the June quarter. Labour costs are down 2.2 per cent over the year.
- Productivity:** GDP per hour worked in the market sector fell by 0.1 per cent in the September quarter in seasonally adjusted terms. Productivity grew by 0.5 per cent over the year.
- A more accurate description of the performance of States and Territory economies is state final demand plus net exports:** The ACT (up 2.2 per cent) had the fastest growth in the September quarter, followed by Western Australia (up 1.2 per cent), South Australia (up 0.9 per cent), NSW (up 0.8 per cent), and Tasmania (up 0.7 per cent). Growth fell the most in the Northern Territory (down 3.6 per cent), followed by Victoria (down 0.7 per cent) and Queensland (down 0.4 per cent).
- Stronger consumer spending.** Household consumption rose by 0.6 per cent in the September quarter. Annual growth stands at 3.2 per cent. Strongest growth of spending in the quarter was recorded by both *Hotels, cafes & Restaurants*, and *Insurance & other financial services* (both up 1.6 per cent), while *Recreation & culture* recorded 1.5 per cent growth. The biggest declines were in *Purchase of vehicles* (down 3.1 per cent) and *Cigarettes and tobacco* (down 2.8 per cent).
- Sectors:** Eleven of the 19 industry sectors contracted in the September quarter. Weakest growth was in *Information media and telecommunications* (down 1.4 per cent), followed *Rental, hiring and real estate services* (down 1.3 per cent). Strongest growth occurred in *Agriculture, forestry and fishing* (up 18.5 per cent), followed by *Administrative and support services* (up 1.8 per cent).
- Other points:**
 - **Profit share falls.** In seasonally adjusted terms, the ratio of profits to total factor income fell from 28.8 per cent to 28.5 per cent in the September quarter. **The wages share** held steady at 52.6 per cent in the September quarter.
 - **Household savings rose.** The household saving ratio rose from 8.9 per cent to 10.2 per cent, in seasonally adjusted terms in the September quarter.
 - **Imports took a larger share of spending.** The imports to sales ratio rose from 0.356 in the June quarter to 0.357 in the September quarter.
 - **The inventory to sales ratio** remained steady at 0.676 in the September.

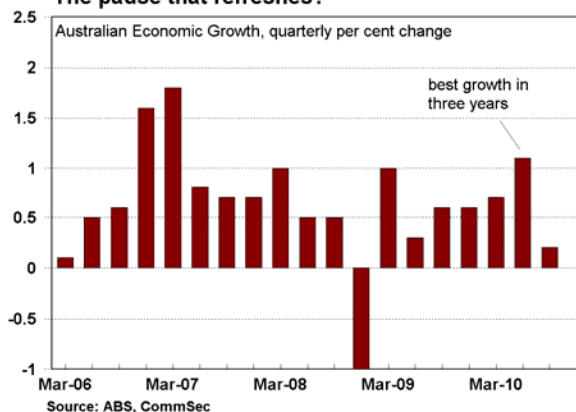
Spending on petrol slumps



Two-speed economy

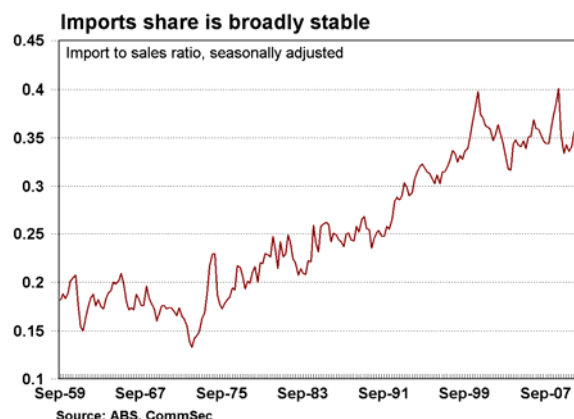


The pause that refreshes?



What is the importance of the economic data?

- The quarterly **National Income, Expenditure and Product release (national accounts)** from the Bureau of Statistics is the most complete assessment of Australia's economic performance. Detailed estimates are provided on incomes (wages, profits), spending (such as household, dwelling investment and trade (exports and imports) and production (comparing industry performance). Other data includes household saving and the economic performance of States and Territories.
- The main use of the national accounts figures is as a historical record of economic performance. The information has little forward-looking value for currency, interest rate or share markets.



What are the implications for interest rates and investors?

- While there is some uncertainty about the pace of the economic recovery going forward, the fundamental health of corporate and housing sectors gives us confidence that the private sector can take up the growth baton over 2011.
- In the near term growth is likely to be more subdued. Consumer spending will largely be dependent on how long the Reserve Bank remains on the interest rate sidelines. CommSec expects the cash rate to hold over the next few months.
- Consumers and businesses remain super-conservative. Consumers are reluctant to spend, businesses reluctant to borrow. If the economic expansion is to continue for a 20th year the conservatism will have to fade. Business and consumer balance sheets are in good shape – but many are concluding that if you don't have to spend, you won't. Retailers still face difficult times ahead.
- The Australian dollar dropped after the GDP result with investors concluding that interest rates are solidly on hold. While those travelling overseas won't be happy, tourists, exporters, farmers and manufacturers will be celebrating the softer Aussie.

Craig James, Chief Economist, CommSec

Work: (02) 9312 0265; Home: (02) 9525 2739; Mobile: 0419 695 082

Savanth Sebastian, Economist

Work: (02) 8223 7130; Mobile: 0414 188 161

