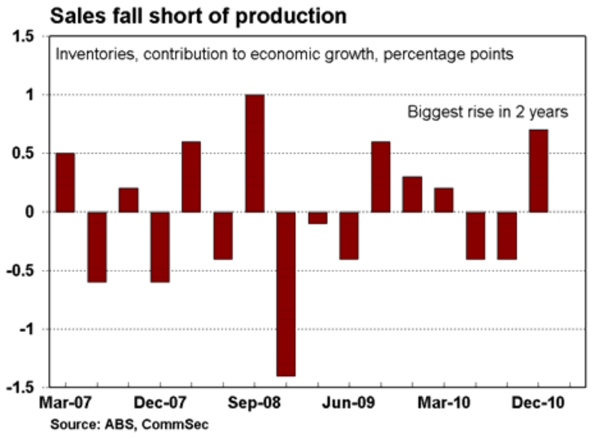
# Economic expansion still stuck in second gear

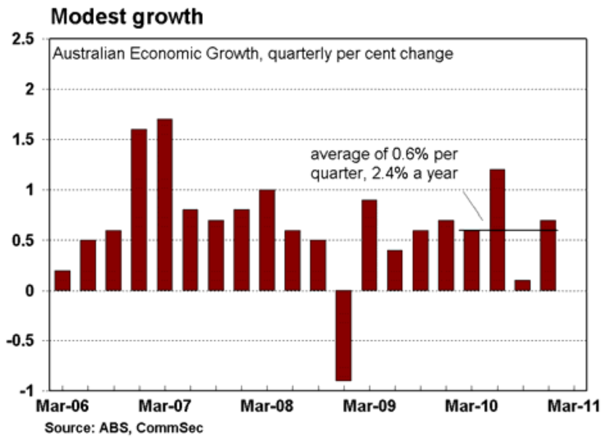
## National accounts

- **Australia's record economic expansion is now well into the 20th year. The Australian economy grew by 0.7 per cent in the December quarter, after lifting by a downwardly revised 0.1 per cent in the September quarer (originally reported as growth of 0.2 per cent). Annual economic growth held steady at 2.7 per cent.**
- **For the calendar year 2010 the economy grew 2.6 per cent in 2010, below 15-year average of 3.25 per cent.**
- **The biggest contribution to growth came from the change in inventories (+0.8pp), followed by household consumption and government investment (both +0.2pp).**
- **Eight of the 19 industry sectors contracted in the December quarter. The strongest contributions to growth came from Professional, scientific and technical services, Administrative and support services, and Arts and recreation services.**
- **The data is entirely consistent with surveyed evidence and what we are hearing from businesses across the country. The Reserve Bank has previously indicated that it is comfortable with current interest rate settings and there is nothing in today's result that is likely to see a shift from that view.**
- **A more accurate description of the performance of States and Territory economies is state final demand plus net exports. The Northern Territory (up 5.4 per cent), had the fastest growth in the December quarter, followed by South Australia (up 3.0 per cent),and  Western Australia (up 1.6 per cent). Growth was weakest in Queensland (down 1.5 per cent).**

### What does it all mean?

- The Australian economy recorded good, but not great growth in the December quarter. And while the headline growth result looks healthy, a closer look at the contributors to growth, suggests a different story. The key driver of growth was the surge in inventories – which recorded its biggest contribution to growth in two year. In effect the growth result has been artificially inflated by the unintended build in inventories over the past quarter. Businesses have produced goods that they haven't been able to sell and this has resulted in a false gloss being applied on the overall growth result.
- No doubt the vagaries in the weather played a part in the build up of inventories. The colder conditions and wet weather would have been a major deterrent in retailers trying to mover summer stock. And unfortunately given

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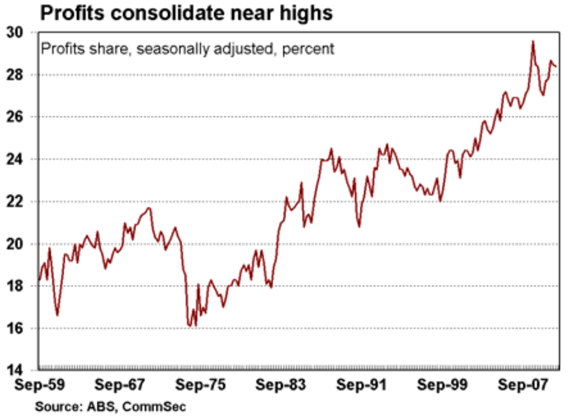
that the La Niña gauge still remains elevated the weather will continue to be a significant factor in how consumption patterns change.

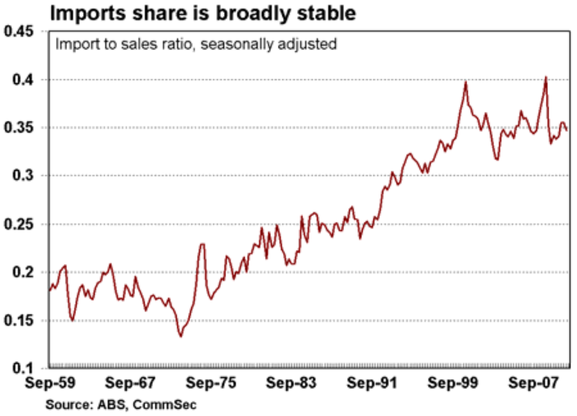
- The domestic economy has lost momentum and while the outlook is still optimistic, the momentum effect is clearly worrying. In fact if you take an average of the past two quarters, growth is just 0.4 per cent - hardly shooting the lights out. The rapid fire rate hikes and resulting conservatism being shown by consumers has ensured that household consumption remains weak. Even credit growth is suffering with household not inclined to take on any additional debt and businesses are showing a similar psychology.

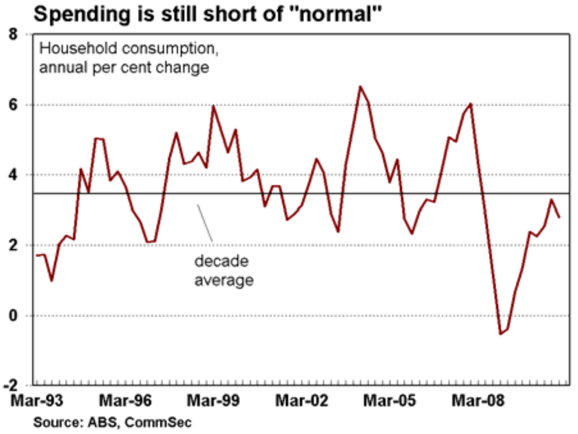



- The data across a range of indicators would categorise the economy recovery as very patchy. There is no question growth has slowed, and the near term outlook is likely to remain sluggish. Especially given the fact that the recent spate of natural disasters will shave growth from an already lacklustre economy.
- At present the economy may not be going anywhere, however the longer term story is sound. The domestic economy primed for growth in the second half of the year. The rebuilding phase and upgrade in business investment plans will drive activity levels in the second half of the year. But the Reserve Bank will need to do its part by keeping interest rates on hold over the next couple of months – which should in turn support consumer sentiment and household consumption.
- 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 – which is not altogether a bad outcome given it means future spending will be stronger.
- As the recovery gains traction in the second half of the year we expect the Reserve Bank to continue tightening monetary policy. So the cash rate may be closer to 5.50 per cent at year end rather than the current rate of 4.75 per cent.

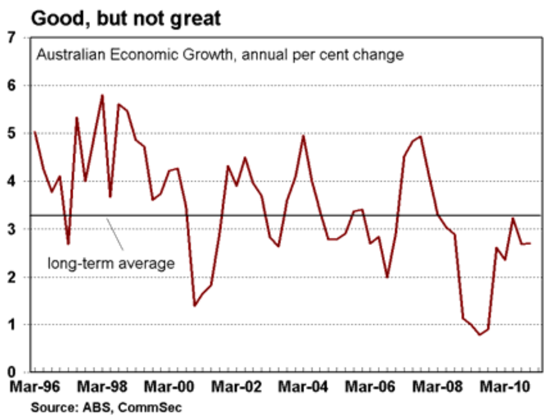
## What do the figures show?

- ***Economic Growth:*** The economy expanded by 0.7 per cent in the December quarter after growing by a downwardly revised 0.1 per cent in the September quarter. Annual economic growth remained steady at 2.7 per cent in the December quarter. For the calendar year 2010 the economy grew 2.6 per cent in 2010, below 15-year average of 3.25 per cent.
- The non-farm economy grew by 0.8 per cent in the December quarter after contracting by 0.4 per cent in the September. Annual growth stands at 2.1 per cent.
- Farm GDP fell by 1.0 per cent in the quarter and was up 32.6 per cent over the year.
- At current prices, GDP grew 1.2 per cent in the quarter and 8.8 per cent over the year. Real gross domestic income rose by 7.7 per cent over the year. Income levels are rising, but consumers and businesses are choosing not to spend.
- ***Growth drivers:*** Inventories added 0.8pp to (pp) to overall GDP growth in the December growth Household



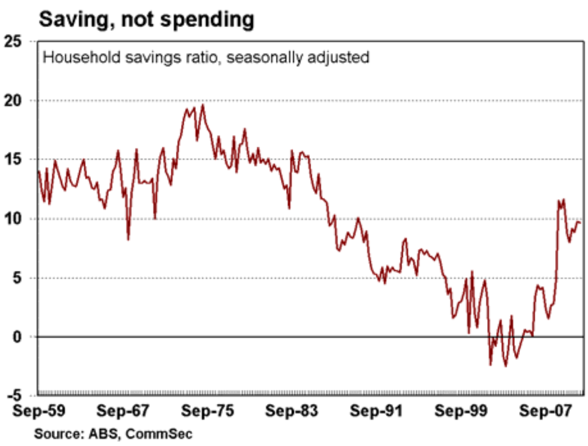
consumption and Government investment both added 0.2 while Net exports, Private business investment and dwelling investment were all flat in the quarter.

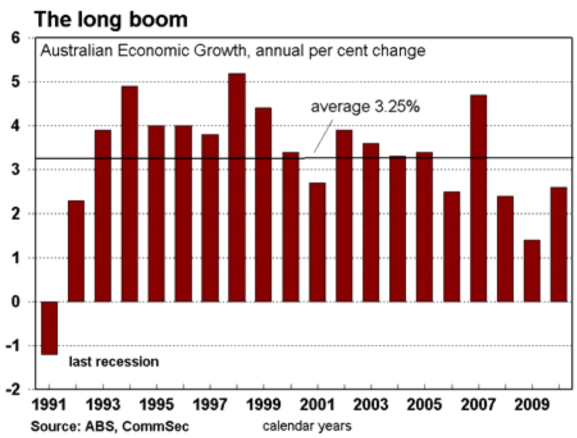



- ***Inflation:*** The best measure of domestic price pressures, the household consumption implicit price deflator, rose by 0.5 per cent in the December quarter with annual growth at 1.8 per cent. Real non-farm unit labour costs fell by 0.4 per cent in the December quarter after rising by 1.2 per cent in the September quarter. Labour costs are down 0.7 per cent over the year.
- ***Productivity:*** GDP per hour worked in the market sector fell by 0.1 per cent in the December quarter in seasonally adjusted terms. Productivity grew by 1.0 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 Northern Territory (up 5.4 per cent), had the fastest growth in the December quarter, followed by South Australia (up 3.0 per cent), Western Australia (up 1.6 per cent), Tasmania (up 1.5 per cent), ACT (up 0.8 per cent) and NSW (up 0.2 per cent), and). Growth fell in only Queensland (down 1.5 per cent). Growth remained unchanged in Victoria (unchanged).
- ***Stronger consumer spending.*** Household consumption rose by 0.4 per cent in the December quarter. Annual growth stands at 2.8 per cent. Strongest growth of spending in the quarter was recorded by *Electricity, gas and other fuel* (up 2.0 per cent), while *Transport services* recorded 1.9 per cent growth. The biggest declines were in *Purchase of vehicles (down 3.8 per cent)* and *Communications* (down 0.7 per cent).
- ***Sectors:*** Eight of the 19 industry sectors contracted in the December quarter. Weakest growth was in *Rental, hiring and real estate services (down 4.0 per cent*), followed *Mining* (down 3.1 per cent). Strongest growth occurred in *Professional, scientific and technical services* (up 5.0 per cent), followed by *Administrative and support services* (up 4.9 per cent).
- ***Other points:***
  - ***Profit share falls.*** In seasonally adjusted terms, the ratio of profits to total factor income fell from 28.5 per cent to 28.4 per cent in the December quarter. **The wages share** eased from 52.7 to 52.6 per cent in the December quarter.
  - ***Household savings rose.*** The household saving ratio eased from 9.8 per cent to 9.7 per cent, in seasonally adjusted terms in the December quarter.
  - ***Imports took a smaller share of spending.*** The imports to sales ratio fell from 0.356 in the September quarter to 0.347 in the December quarter.
  - ***The inventory to sales ratio*** fell from 0.673 to 0.668 in the December.

## 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?

- Consumers and businesses remain super-conservative. Consumers are reluctant to spend, businesses reluctant to borrow. If the economic expansion is to gather momentum 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.
- While there is some uncertainty about the pace of the economic recovery going forward, the fundamental health of corporate and the underlying strength in the labour market gives us confidence that the private sector will drive activity over the second half of the year.
- 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 steady over the next couple of months.

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