National Accounts

Toddling Along

Bank of Melbourne Economics

6 March 2024

Contents

Overview and Outlook	Page 3
GDP Expenditure, GDP (E)	Page 4-5
Population	Page 6
Households	Page 7-8
Productivity	Page 9-10
Investment – Business and Housing	Page 11-12
Government	Page 13
Trade	Page 14
Inflation Measures	Page 15
GDP Production, GDP (P)	Page 16
States	Page 17
Contacts List	Page 18
Disclaimer	Page 19

Overview and Outlook

- The Australian economy toddled along in the second half of 2023, growing by a subdued 0.2% over the December quarter. Growth in economic activity halved over the second half of the year compared with the first half of 2023 (0.5% and 1.0%).
- This annual growth rate is below the record 2.6% annual increase in the population, driving a 1.0% annual fall in GDP per capita. Population growth initially supported demand and provided a source of resilience. That now looks to be fading with the drag on incomes from elevated inflation, higher income tax and higher interest payments weighing on spending.
- The household sector continues to be under pressure. Eighteen months of declining purchasing power has left consumers battered and bruised. In the December quarter, purchasing power grew (just) for the first time in 1½ years. The data tells the story - consumption eked out a 0.1% gain in the quarter and households lifted their savings as spending essentially came to a standstill. Residential construction activity continues to fall fast, exacerbating the housing challenges.
- The government sector and business sector continue to provide a partial offset, with business investment, mining exports and government consumption (which includes cost of living support) adding to growth this quarter.
- Business investment (ex mining) was notable for rising to its highest share of the economy since the mining investment boom, despite the growth rate slowing in the second half of the year.
- Labour productivity continued to improve, particularly in domestic services sectors that are at the coalface of the slowdown in consumer spending. Going forward this will reduce labour costs and inflationary pressures, which is consistent with our view that services inflation will continue to ease. It is also consistent with our view that the next move by the Reserve Bank (RBA) will be down. We continued to expect the first rate cut to come in September.

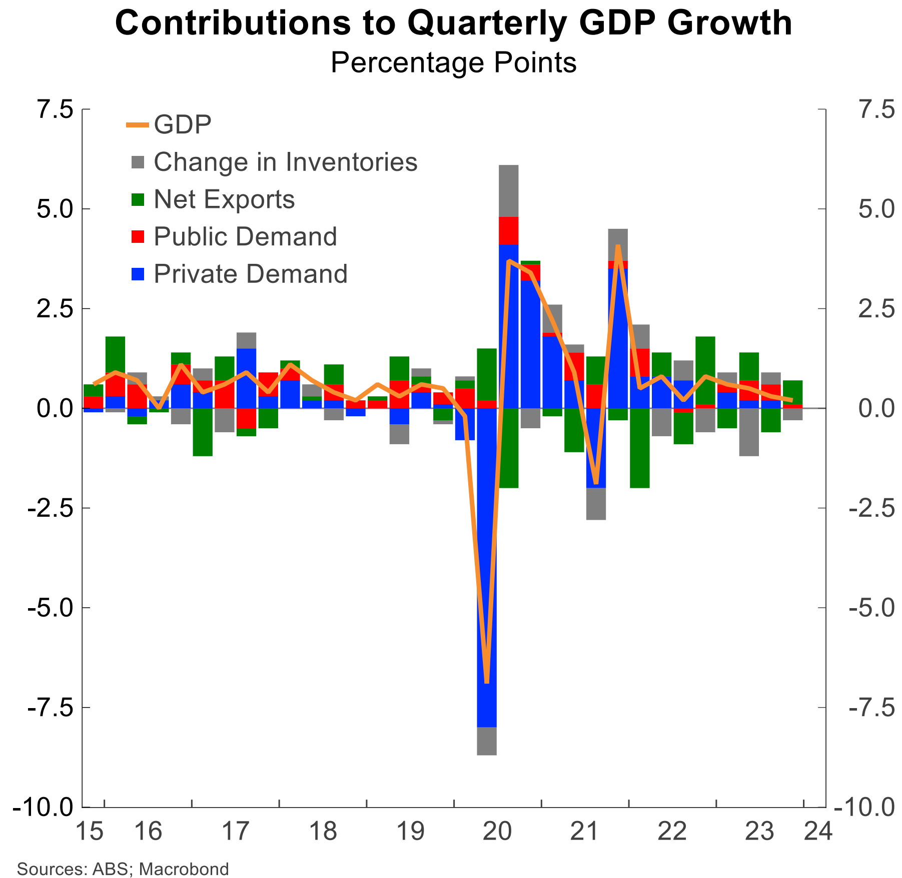
GDP Expenditure Measure, GDP (E) – 1 of 2

Selected Expenditure Items on GDP, Chain Volume Measures

	Quarterly % Change
Household Consumption	0.1
Public Consumption	0.6
Dwelling Investment	-3.5
New Business Investment	0.7
New Public Investment	4.6
	Contribution to GDP, ppt
Inventories	-0.3
Net Exports	0.6

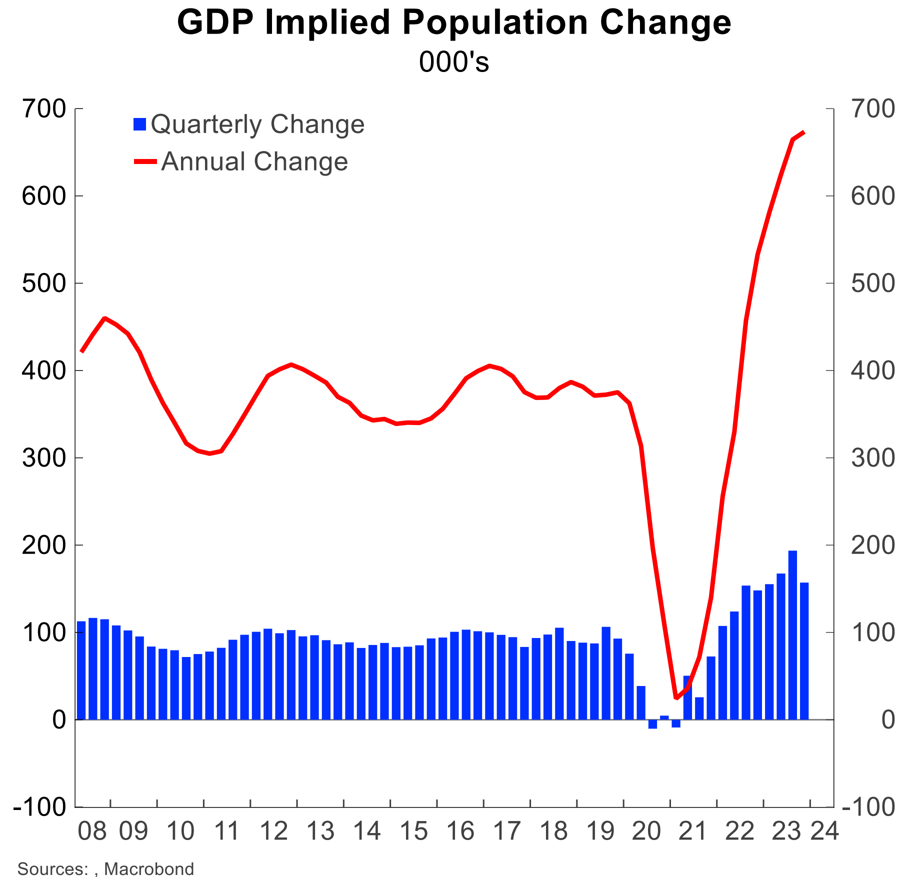
- **GDP** rose 0.2% in the final quarter of 2023, extending the run of uninterrupted growth to nine quarters since COVID. In annual terms, growth slowed to a 3-year low of 1.5% and is sitting below the long-run average and the potential growth rate of the economy.
- **Households** lifted spending by just 0.1%, supported by strong population growth. The second half of last year proved weaker than originally thought because the September quarter's flat outcome was revised to a contraction – the first fall in 3 years. Higher interest rates, higher tax payable, and elevated cost of living expenses all contributed to the soft spending in the second half of last year.
- **New business investment** lifted by 0.7% in the quarter and remained robust in year-on-year terms at 8.3%. Spending on new machinery and equipment shifted south, falling by 1.3% in the quarter. However, new commercial and engineering construction provided an offset. It left business investment adding 0.1 percentage points to growth in the quarter.
- The **government sector** – consumption and new investment collectively – added 0.1 percentage points to growth in the quarter. Government spending was supported by defence and large outlays on subsidies, including for energy and childcare.

GDP Expenditure Measure, GDP (E) – 2 of 2



- **Inventories** continued to be run down in the December quarter, but there were differences across the public and private sectors and farm and non-farm inventories.
- Non-farm inventories in the private sector were run down and dragged on growth over the quarter, whereas farm inventories and inventories in the public sector were rebuild, helping to minimise the overall drag to growth from inventories. Inventories pulled growth down in the quarter by 0.3 percentage points – a lot less than feared when the partial numbers were published earlier this week.
- The **external sector,** or net exports, contributed 0.6 percentage points to growth in the quarter. Exports declined by 0.3% in the December quarter, with rural exports falling, partly offset by an increase in resources exports. Imports declines 3.4% in the quarter, driven by a large fall in overseas travel.

Population Growth – The Resilience Injection



- Population expanded by a solid 2.6% in 2023, injecting extra spending activity in the economy.
- The sharp lift in net overseas migration spilled over into spending on goods and services. It has also added to challenges in housing amid an ongoing shortage of available dwellings to buy and rent in many markets.
- The data suggests population growth may have peaked in the September quarter in quarterly terms. That's consistent with what we're already seeing in the data for student arrivals and visas.
- GDP rose 0.2% in aggregate terms, but in per capita terms, which abstracts from the impact of the population, GDP fell by 0.3% in the December quarter. GDP per capita has contracted for three consecutive quarters, indicating that we were in a per capita recession for most of 2023.
- The annual fall in GDP per capita was a full 1.0% - the largest annual per capita decline since the 1990s recession (outside of COVID).

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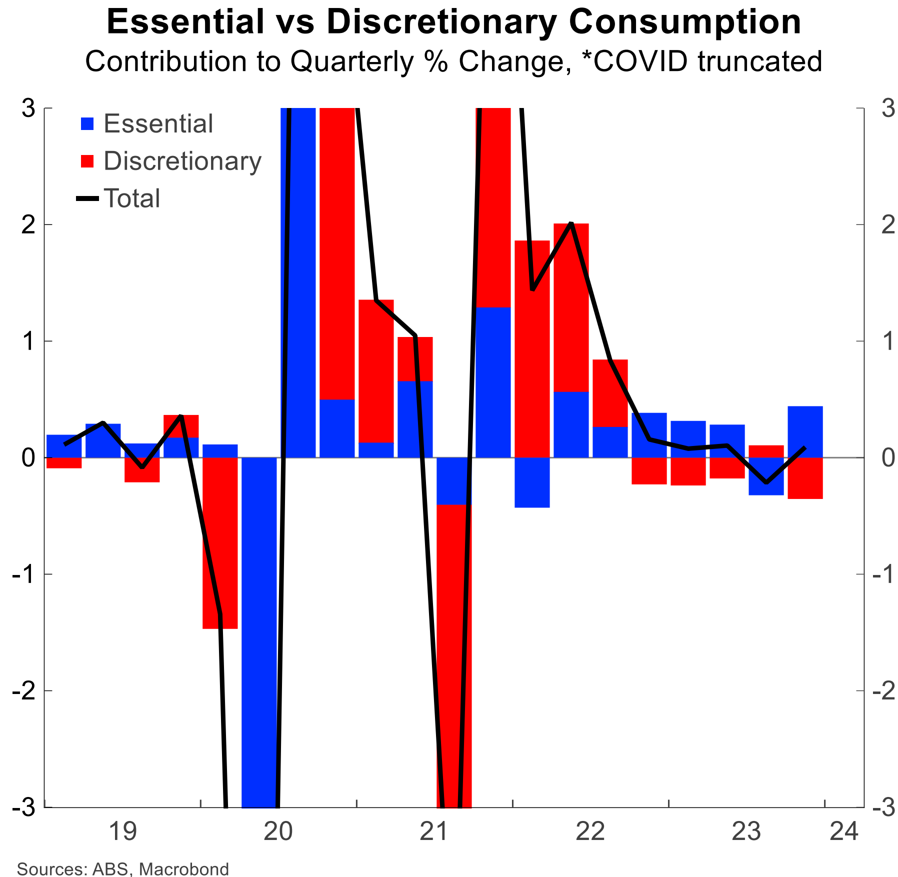
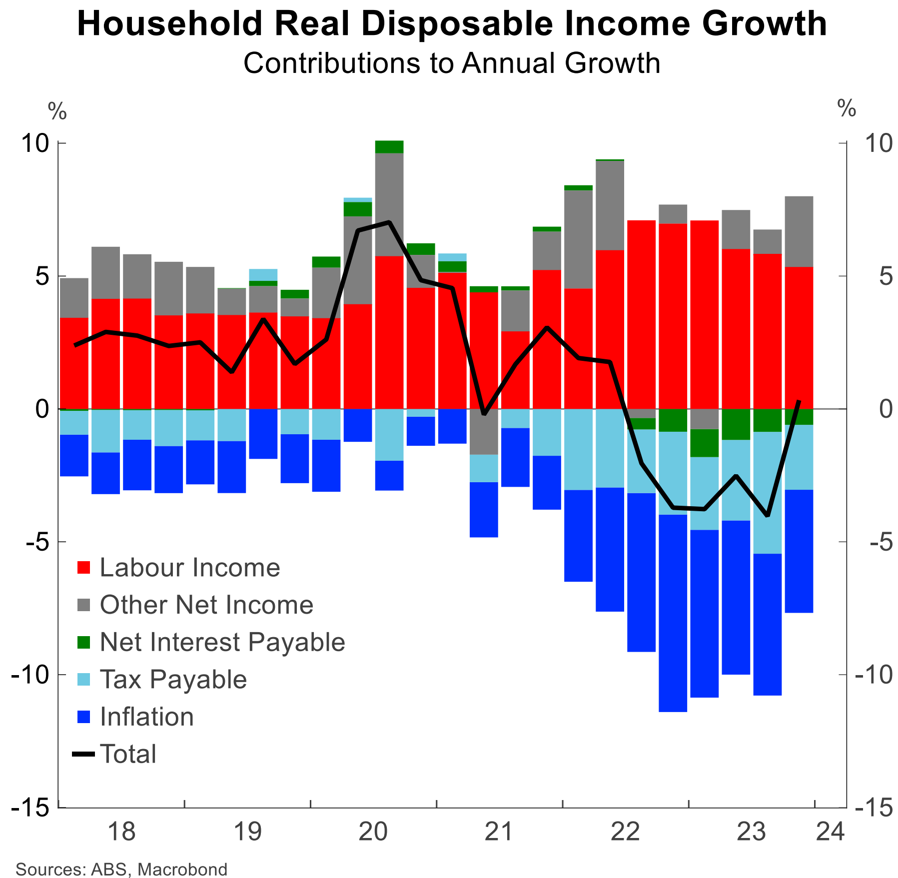
Household Consumption Stalled in the 2nd Half of 2023



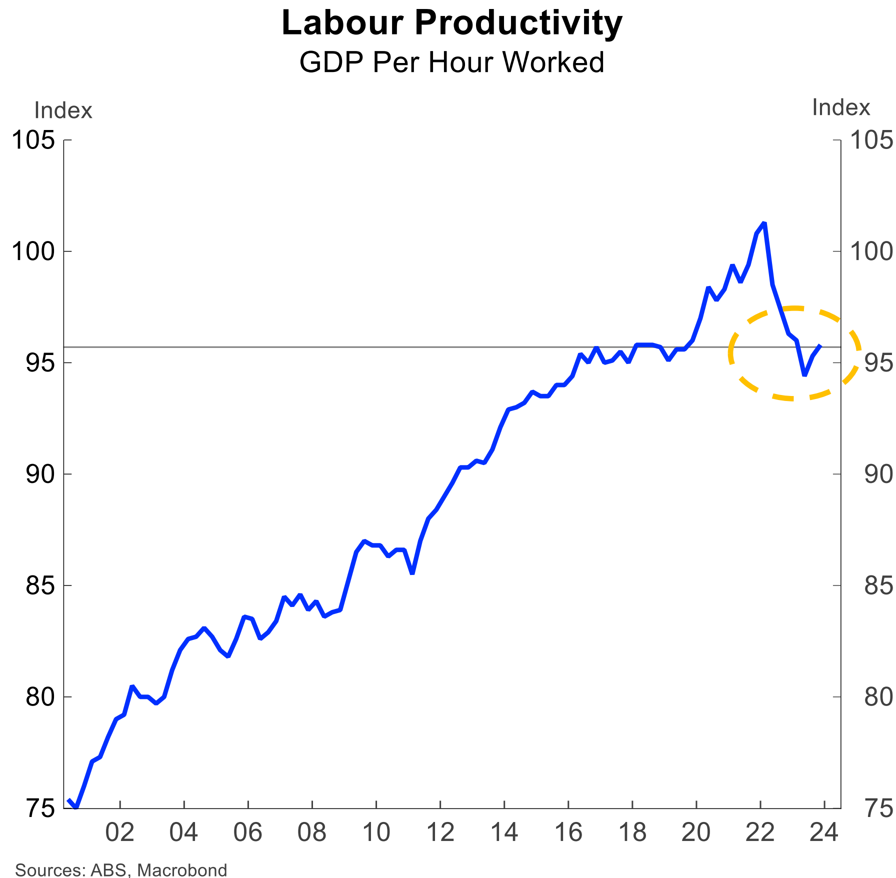
- Household spending rose just 0.1% in the December quarter, despite household disposable income recovering and eking out modest growth in annual terms (0.1%).
- Household spending on a quarterly basis has been experiencing soft growth for five quarters, coinciding with the rate-hiking cycle from the Reserve Bank. We expect the November 2023 rate hike was the last.
- The large divergence between spending on essentials and discretionary items continued. Essential spending rose 0.7% in the quarter. Discretionary spending fell 0.9%. Outside of COVID, it was the largest quarterly fall in discretionary spending since the GFC.
- Households shunned dining out in preference for home-cooked meals. Spending on food rose 0.9% in the quarter compared to a sharp 2.8% fall in spending at hotels, cafés and restaurants.
- There were also signs of a rotation in spending away from international travel and towards domestic recreation. International spending on tourism as a share of recreation spending pulled back in the December quarter.

Rapid Budget Relief Likely Temporary



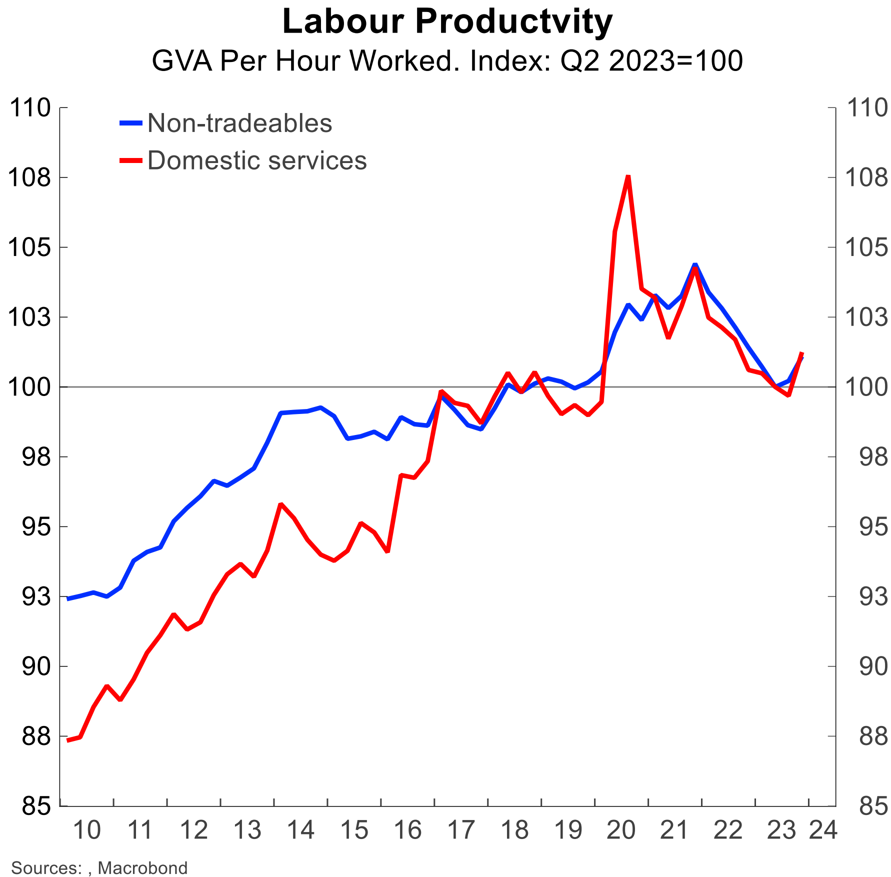
- Real household disposable income returned to growth in the December quarter. But this appears to be more of a blip rather than a sign that the pressures on household income are subsiding rapidly.
- Driving most of the improvement in real household disposable income was a fall in tax payments reflecting residual seasonality from one-off changes to tax policy.
- Overall, the drag on household income from elevated inflation, a rising tax take and higher interest will continue to gradually ease, but this is against the backdrop of slowing labour income as the labour market and hours worked also cool.
- Household real disposable income growth will incrementally improve, but it will be a slow grind higher rather than a stellar recovery. Stage 3 tax cuts later this year will be an important contributor to this improvement.
- The drag on household disposable income from higher interest rates surprisingly fell in the December quarter, despite another 25-basis point rate hike from the RBA. This suggests that households are paying down debt and improving their balance sheet positions to mitigate the impact of higher rates.
- This is supported by an increase in the household savings ratio during the December quarter. The savings rate rose to 3.2%, from 1.9% as households diverted the improvement in real disposable income towards saving rather than consumption.

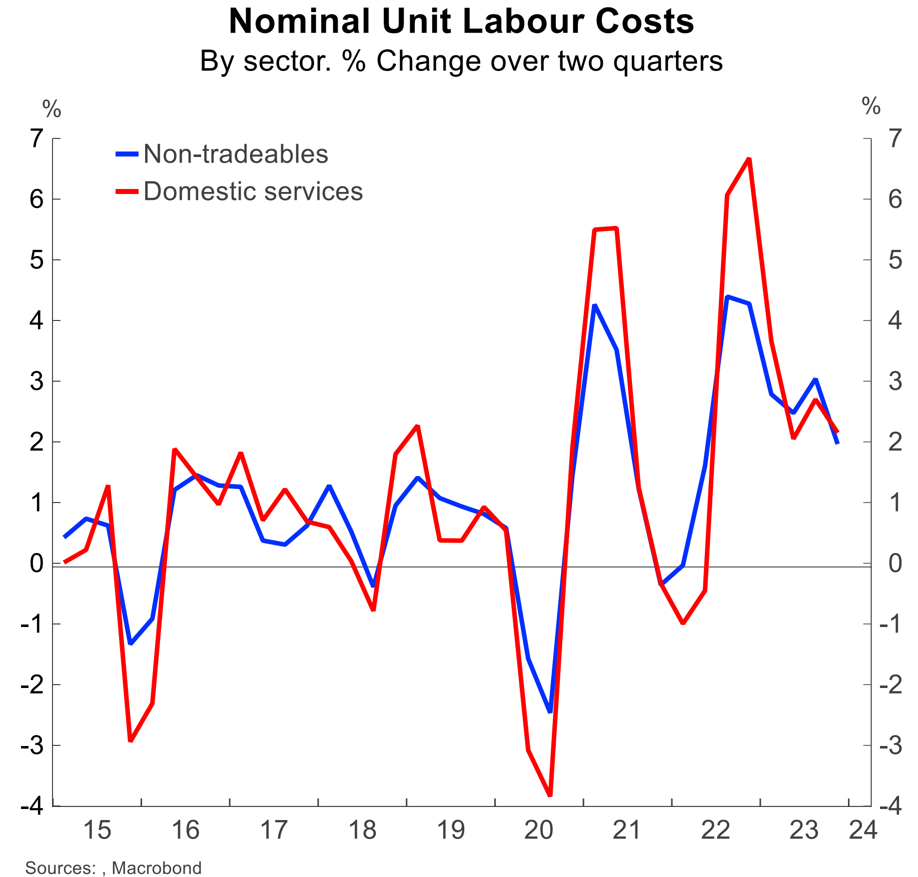
Productivity Bounce Points To Easing Costs Pressures



- As we anticipated, labour productivity – or the amount of output produced by each hour of work – has recovered by 1.5% over the last six months, to be around the levels recorded prior to the pandemic.
- Domestic services that continue to be impacted by the slowdown in consumer spending recorded sizable increases in productivity – the slowdown in demand is incentivising businesses to reduce costs and improve productivity.
- This will flow through into lower growth in unit labour costs, which will help reduce inflationary pressures over time.
- Importantly, labour costs in domestic sectors (such as accommodation, recreational services and professional services) are now running around where they were just before the pandemic.
- Preliminary analysis suggests that easing cost pressures are being passed through to the final consumer. This is consistent with RBA liaison that businesses are finding it more difficult to increase prices.

Particularly In Domestic Sectors





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Strong Investment in the Non-mining Sector

- Non-mining investment was the standout in the December quarter, rising 2.8%. Non-mining investment hit its highest level since the September quarter 2008 as a share of GDP.
- Mining investment tumbled 5.3% partially offsetting the strength in the non-mining sector.
- When accounting for second hand assets transfers, new private business investment rose 0.7% over the quarter.
- A solid 2.7% increase in non-dwelling construction was partly offset by a 1.3% fall in new spending on machinery and equipment.
- Growth in new business investment slowed in the second half of 2023.
- However, the level of new investment remains elevated relative to history. This is important because the flow of new investment will help build the capital stock and underpin a normalisation in productivity.
- The elevated level of new business investment has been an important driver behind strong business credit growth.

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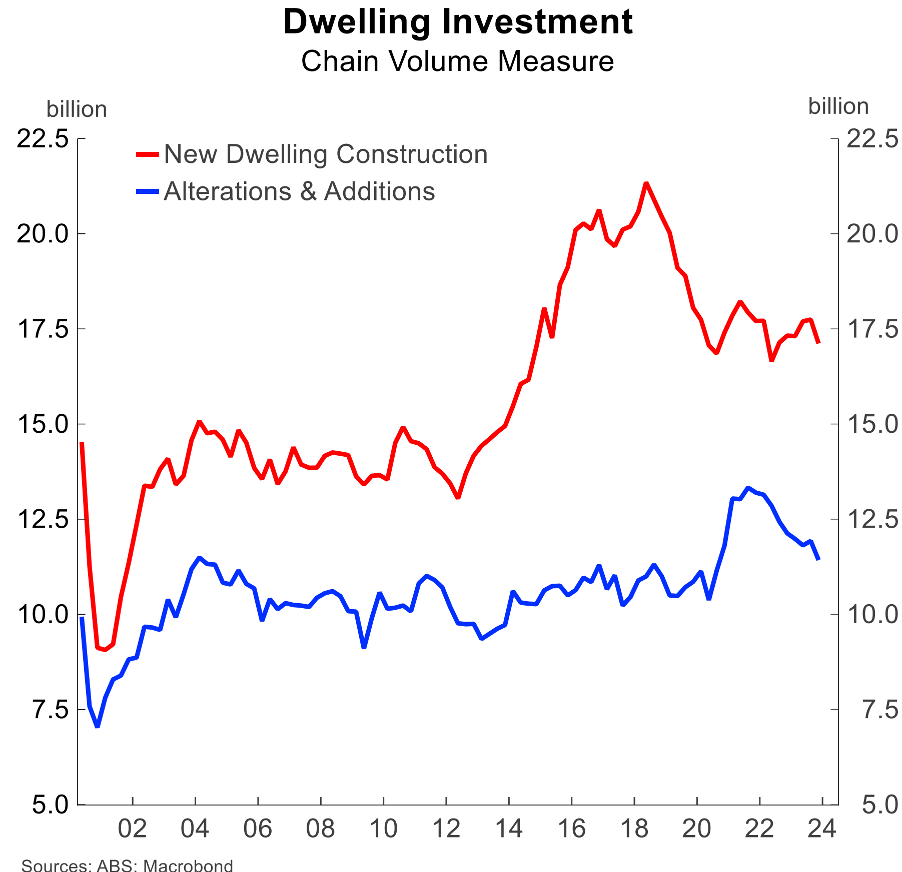
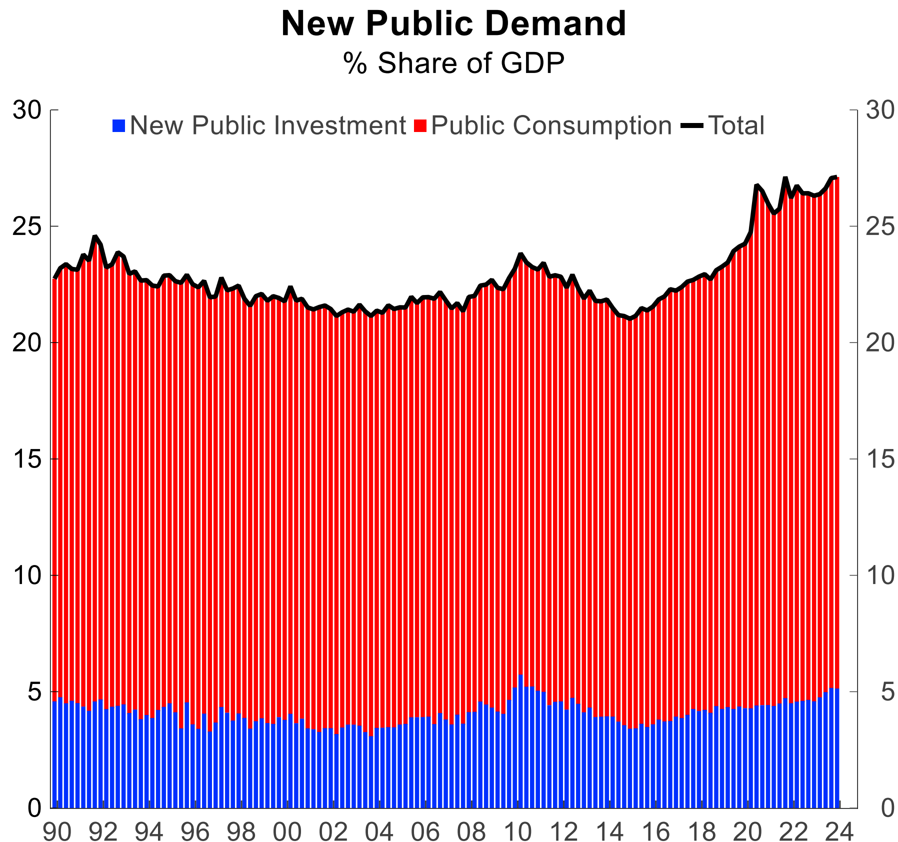
Investment Paints an Ugly Picture for Housing Supply



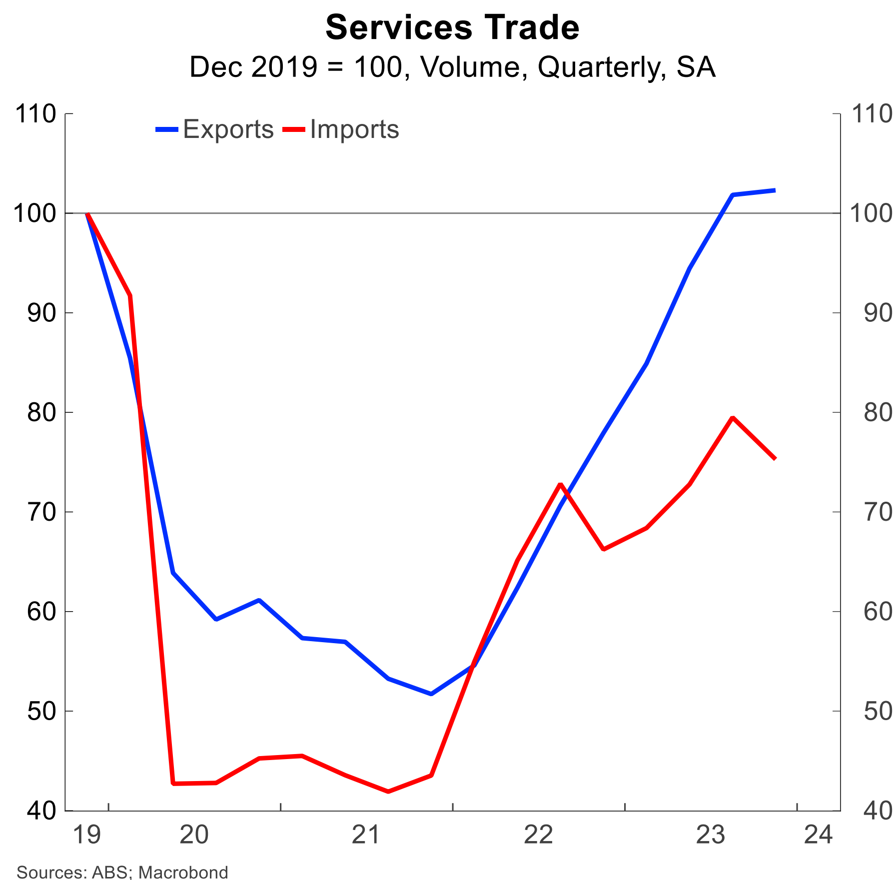
- Despite a strong existing pipeline of residential building projects, dwelling investment remains incredibly weak.
- Dwelling investment tumbled 3.1% in the December quarter, detracting 0.2 percentage points from growth.
- Both new dwelling construction and renovation activity contracted in the December quarter. Renovation activity declined 4.2% while new dwelling construction was down 3.5%.
- Both new dwelling construction and renovation activity were weaker than a year ago.
- The result points to a weak growth in new dwelling supply and suggests there will be little near-term relief from to the existing pressures in the housing market.

Public Demand Strong but Slowing



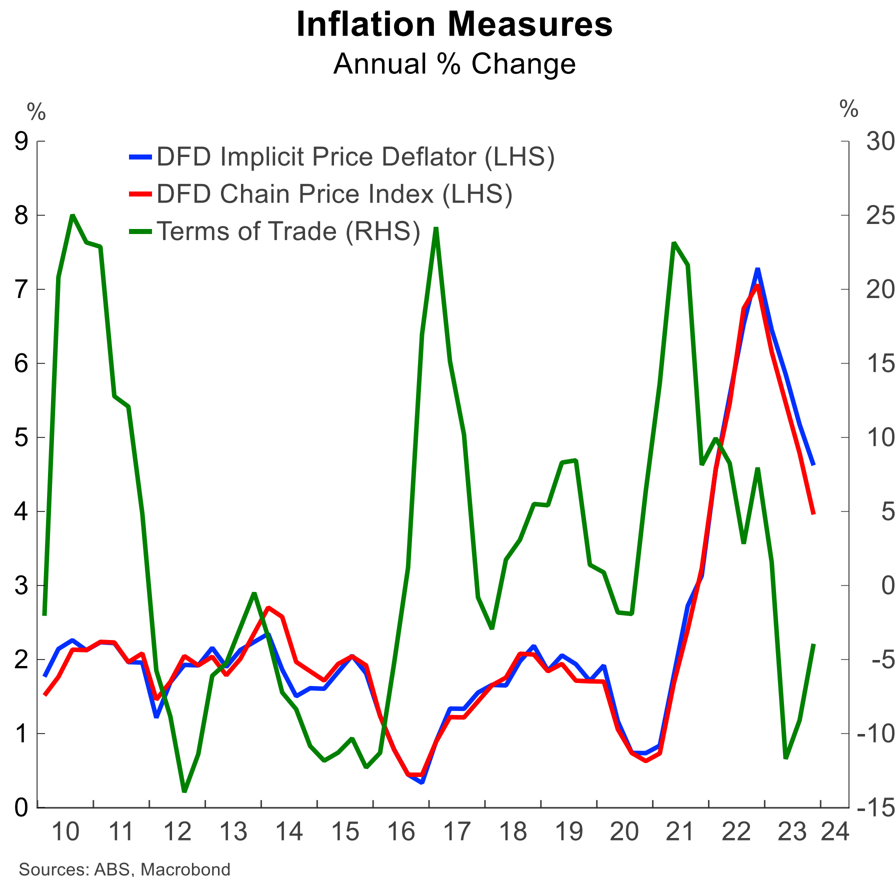
- New public demand increased 0.4% in the December quarter. Consumption rose solidly, while new public investment slipped.
- New public investment edged down 0.2% over the December quarter to be 13.7% higher in annual terms – the strongest since the September quarter 2017. Despite the fall, the level of investment remains very high.
- The pipeline of infrastructure projects at the state and federal level will continue to support investment. The pipeline includes projects such as Snowy 2.0, the Western Sydney Airport, Inland Rail, Sydney's new metro and Brisbane's Cross River Rail.
- Public consumption also expanded 0.6% in the quarter, driven by an increase in non-defence spending (2.0%) and national government consumption (1.0%) – this included social benefits to households and employee expenses.
- New public demand added 0.1 percentage points to growth.

Post-COVID Travel Boom has Rolled Over



- The external sector supported growth in the December quarter, as imports slipped faster than exports on softening domestic demand.
- **Net exports** added 0.6 percentage points to growth.
- **Exports of goods and services** fell 0.3% in the quarter, largely driven by weak rural and manufacturing exports.
  - Services exports have now fully recovered to pre-pandemic levels after a large upward revision to the September quarter figures.
  - Services exports expanded a modest 0.5% in the December quarter, while goods exports slid 0.4% in the quarter.
- **Imports of goods and services** fell sharply, slipping 3.4%.
  - The post-COVID travel boom looks to have run its course. Services imports slipped a massive 5.3%, underpinned by a sharp fall in travel imports.
  - Goods imports also went backwards as domestic demand continues to soften. Goods imports fell 2.8% in the quarter.

Domestic Inflation Measures and the Terms of Trade



- Progress on domestic price pressures continued in the December quarter. The annual growth rates of inflation softened.
- The **Domestic Final Demand (DFD) Implicit Price Deflator**, which measures domestic price changes but also the effects of compositional changes in DFD, rose 1.0% in the quarter and 4.6% in the year.
- The **DFD Chain Price Index**, which removes the impacts of compositional changes and is a pure measure of domestic price changes only, rose 0.7% in the quarter. Annual growth eased from 4.8% to 4.0%.
- Both annual rates are still above the Reserve Bank's 2-3% inflation target band, although the RBA targets the consumer price index (CPI) measure.
- The terms of trade (i.e. ratio of export to import prices) jumped on strong commodity prices and subsiding global inflation pressures. The ToT rose 2.3% following a 2.1% fall in the September quarter. In annual terms, the ToT dropped 3.9%.

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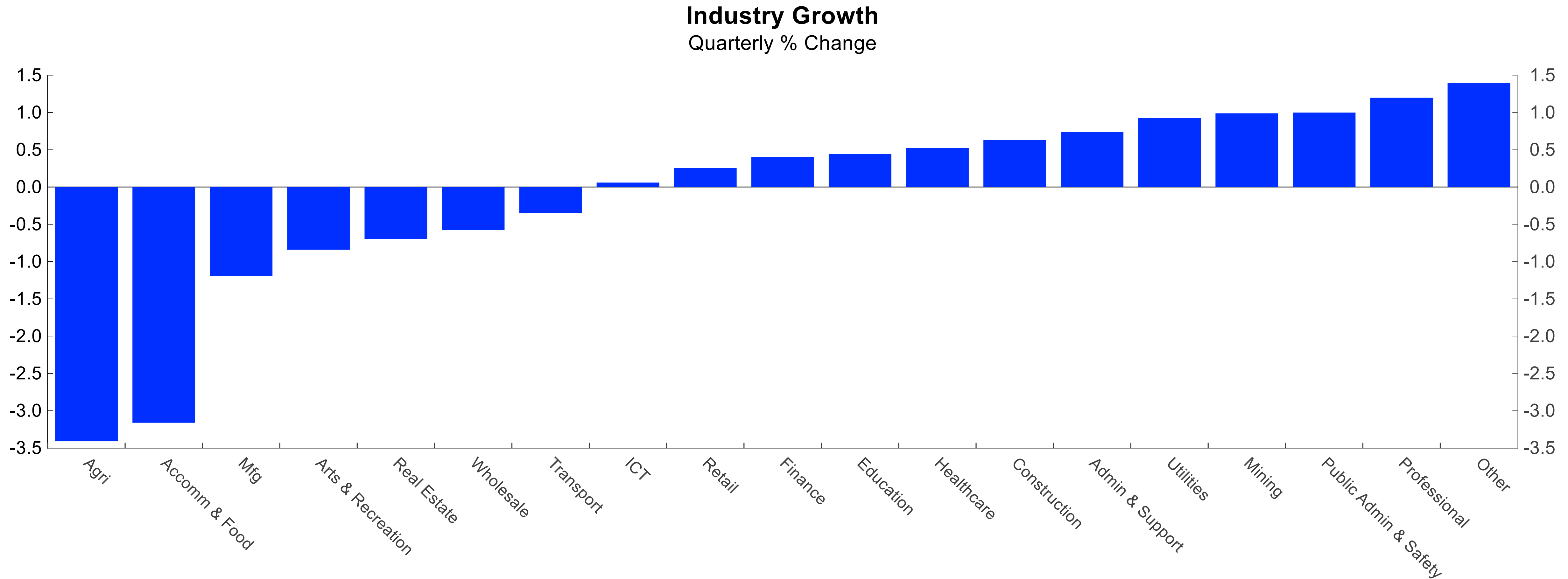
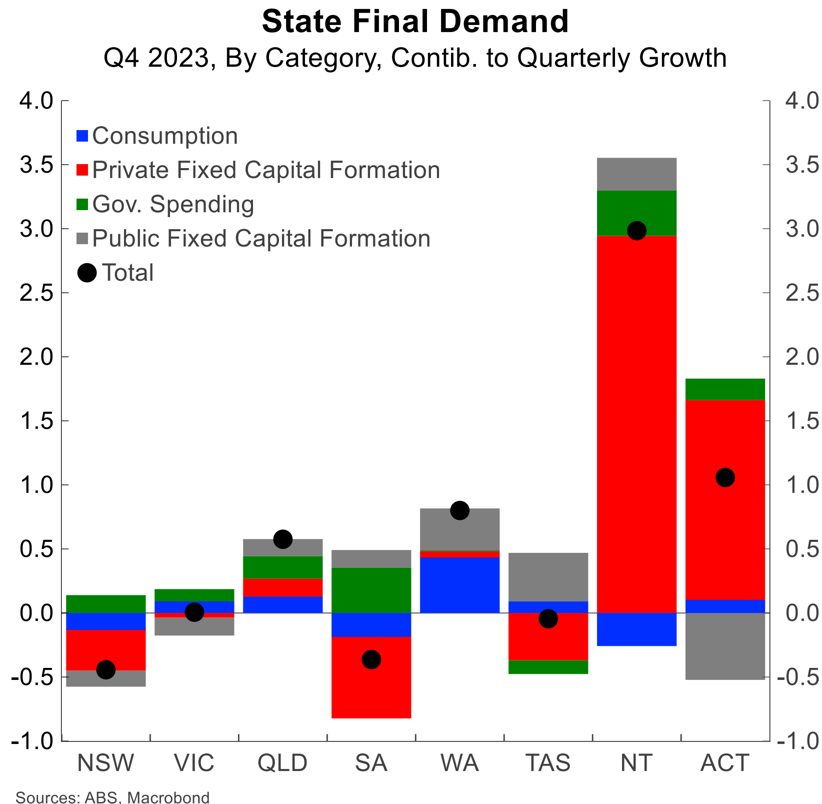
GDP Production Measure - GDP(P)



- 12 of 19 industries grew in the December quarter, unchanged from the previous quarter.

States Picture



- Activity varied considerably across the states and territories in the December quarter.
- The strongest growth occurred in the territories and smaller states.
- The economies in the territories were supported strongly by business investment and government spending.
- Growth was weakest in NSW, South Australia and Tasmania. Weak private investment was a consistent theme across these states, while consumption dragged on activity in both NSW and South Australia.
- The most balanced growth across the States was arguably QLD with growth occurring across all key components.
- Public spending contributed positively to growth across all states and territories apart from Tasmania.
- Growth in household consumption was mixed in the December quarter. Apart from WA, household consumption was broadly weak or negative.

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