

# Investment markets research – Economic note

3 June 2009

## Australia: a “recession”, but not as we know it

- **Australia’s Q1 09 GDP rose 0.4%/qtr, avoiding the “two quarters in a row of negative GDP growth” definition of recession.** Continuing the theme of Australia outperforming other major economies. **This is a very welcome achievement.**
- However, **the better-than-expected GDP number was driven by a strong contribution from net exports that looks unsustainable.** While the consumer/household sector was supported by significant monetary and fiscal policy stimulus, **the investment and income sides of the economy were extremely weak.**
- **The danger is, therefore, that over the remainder of 2009, the strength in net exports and consumer activity will wane and the local economy will suffer at the hands of a sharp fall in business investment and declining income growth, likely leading to higher unemployment rates and a return to negative GDP prints – before a more substantial recovery gets underway in 2010.**
- The good news is that while the RBA left interest rates unchanged at 3.0% this week, they **signalled a continuing easing bias as inflation pressure are likely to weaken** if the scenario outlined above comes to pass.
- In addition, **more timely data for the month of April showed a solid start to the June quarter for both building approvals and retail sales.**

### Q1 09 GDP:

Australia’s economy, (as measured by gross domestic product, GDP) grew by 0.4% in the March qtr 2009, higher than market expectations and a solid increase from the revised 0.6% decline of the December qtr 2008. The annual pace of growth slowed to 0.4%/yr, from an upwardly revised 0.8%/yr at the end of 2008, but well down from 3.4%/yr in the March qtr 2008. See chart below for details.

With the seasonally adjusted rise in GDP in the March qtr 2009, Australia has avoided one technical definition of recession, ie. two quarters in a row of negative GDP growth. However, while the media and, no doubt, some politicians will focus on this achievement, it is also important to focus on the composition of growth and on the view expressed by the RBA Governor that the ‘two quarters in a row of negative growth’ definition is “not very useful”.<sup>1</sup> (It is likely also worth noting that the trend series of GDP has been negative for two quarters in a row, with falls of -0.1%/qtr in both the December qtr 2008 and March qtr 2009).

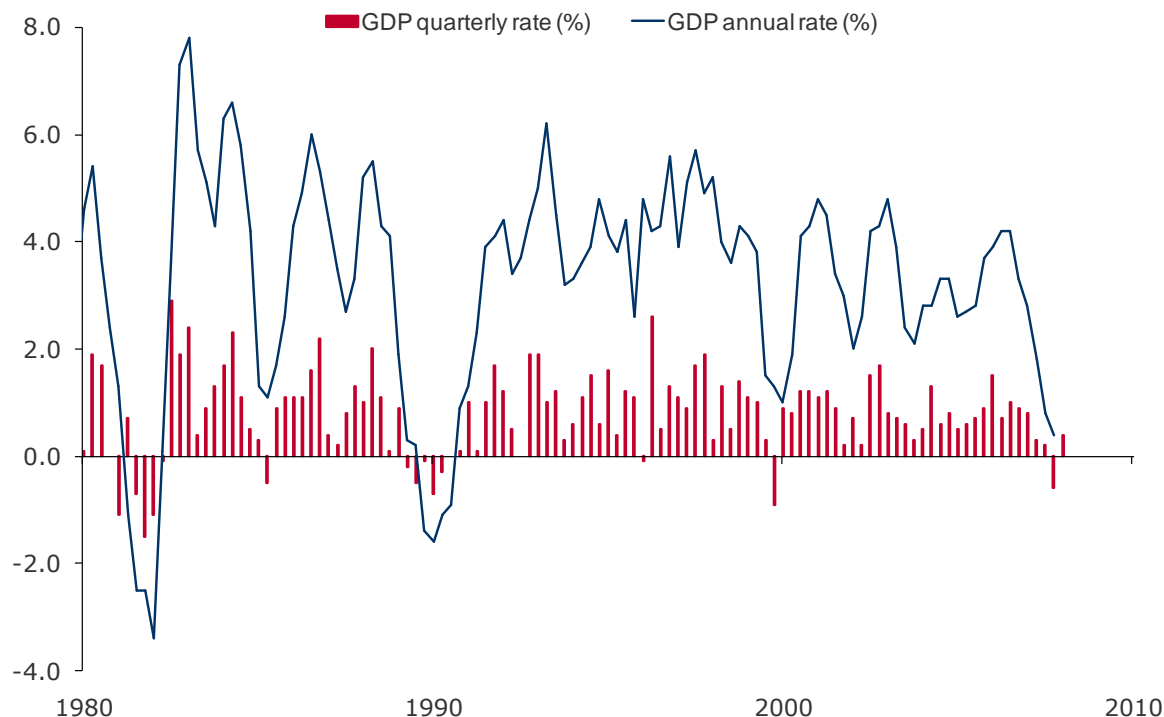
In the March qtr 2009 the strength in the economy was led by private consumption (clearly linked to the aggressive monetary and fiscal policy easing) and a huge increase in net exports. Household consumption expenditure rose 0.6%/qtr, providing 0.3%/pts to GDP growth. Away from this, however, the remainder of the domestic economy was weak.

Dwelling investment fell by 5.6%/qtr, providing -0.3%/pts contribution to growth, while business investment fell 6.1%/qtr, subtracting 1.1%/pts from growth. A small positive contribution to growth from ownership transfer costs (+0.1%/pts) was offset by a small decline in public investment (-0.1%/pts). With the change in inventories providing no contribution to growth on the quarter, Gross National Expenditure (GNE) declined by 1.0%/qtr.

This weakness in the domestic side of the economy was, however, more than offset by a 2.2%/pts contribution to growth from net exports, with a 2.7%/qtr increase in exports on the quarter adding 0.6%/pts to growth, while a 7.0%/qtr decline in imports added a massive 1.6%/pts to growth.

<sup>1</sup> Glenn Stevens “The Road to Recovery” 21 April 2009. “Perhaps it is useful to be clear what we mean by the term ‘recession’. The original definition is ‘a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income and other indicators.’”

## GDP: Annual and Quarterly Growth (%)



Source: ABS. Seasonally adjusted figures. Data to 31 March 2009

As highlighted in the data release, it is also important to focus on what is happening on the income side of the economy. Real gross domestic income adjusts the GDP measure for changes in the Terms of Trade (export prices relative to import prices). As shown in the chart below, for many years real gross domestic income was rising much faster than GDP, thanks to the boom in Australia's terms of trade. This growth in real gross domestic income was the primary driver of strength of many indicators in the Australian economy, including employment, wages growth, company profits and private capital expenditure. It was also a large part of the boom in government tax revenue that led to the large budget surpluses and a primary driver behind the RBA's monetary policy tightening phase as inflation pressure built.

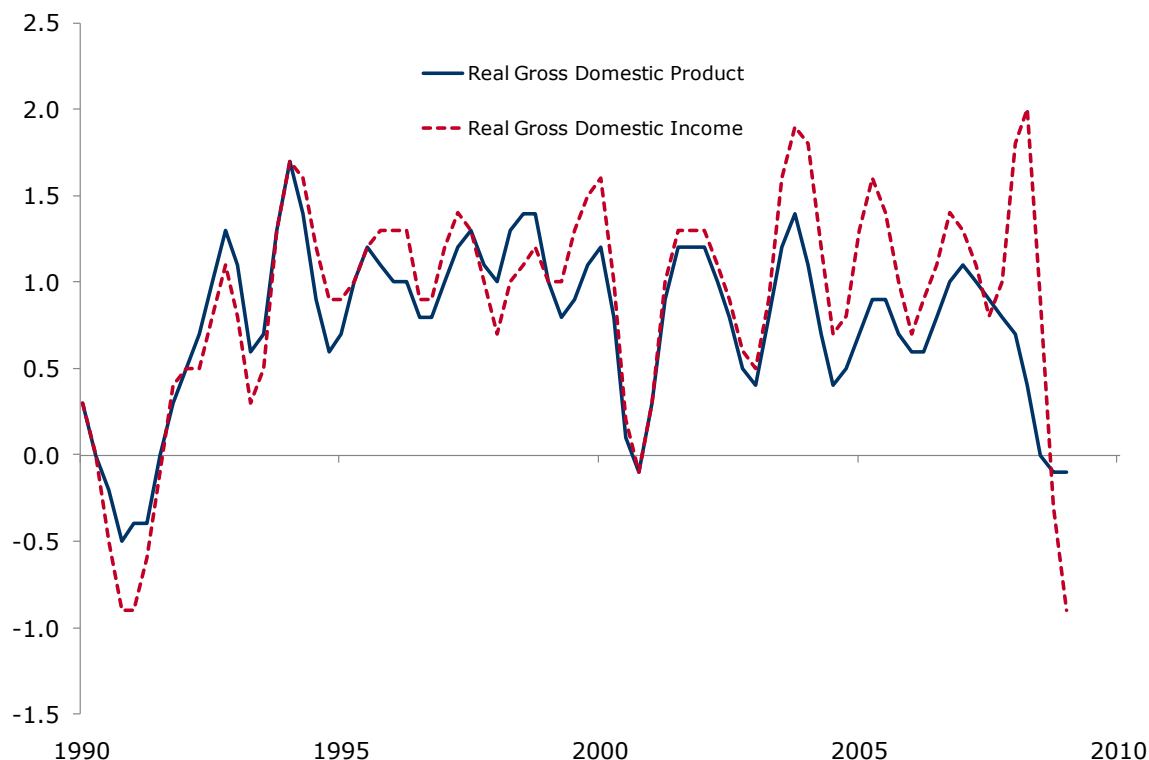
Now this development is reversing. Real gross disposable income declined by 1.4%/qtr in the March qtr 2009, with the terms of trade down 7.8%/qtr. The key here is that further sharp falls in real gross disposable income could be expected over the remainder of 2009, as the terms of trade continues to move lower (due largely to falling prices for our key commodity exports, coal and iron ore).

This sharp fall in real gross disposable income is likely to show itself in a continued rapid decline in private capital investment, reduced income growth for companies (ie. lower company profits) and individuals (ie. lower wages) and a rise in the level of unemployment. The concern is, therefore, that the remainder of 2009 could look worse for the Australian economy, as the monetary policy and fiscal stimulus benefit to the consumer and household sector wanes and before the increase in public sector capital investment (ie. the government's focus on infrastructure spending) really kicks in.

Another way to look at this development is nominal GDP growth. The terms of trade decline in the March qtr 2009 saw the GDP deflator decline by a large 1.0%/qtr, with nominal GDP growth contracting by 0.6%/qtr. As highlighted by the Treasurer today, this was the sharpest quarterly fall in nominal GDP growth since 1963 and will be reflected on the income side of the economy over time.

As noted below, this outcome is something the RBA will be focused on, given it implies reduced inflation pressures, and financial market would do well to also reflect on this possible outcome.

## GDP by different measures



Source: ABS. Trend data. Data to 31 March 2009

### RBA signals easing bias remains:

Following yesterday's Board meeting, the Reserve Bank of Australia (RBA) held the cash rate steady at 3.0%. This outcome was widely expected by the markets. In announcing the policy decision the RBA clearly indicated that they retained an easing bias, stating that "the prospect of inflation declining over the medium term suggests that scope remains for some further easing of monetary policy, if needed."

This statement was likely added in as a signal to markets that the aggressive unwinding of monetary policy easing expectations, and subsequent rally in the AUD and sell-off in the bond market, which has occurred over the past few weeks, was not compatible with the still difficult outlook for the economy and expectations of declining inflation. Market expectations now are centred on one final 25bp policy easing by October/November.

### More recent data for April

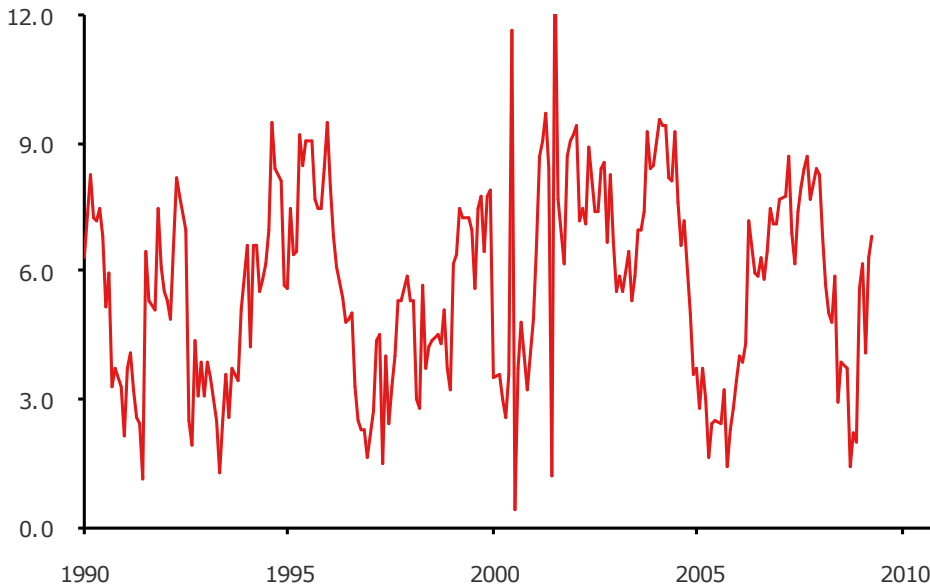
#### Retail sales:

The government's large fiscal stimulus for income earners and first home-owners, and a rapid easing in monetary policy have promoted a sustained surge in Australian retail sales since December 2008. Sales rose 0.3%/mth in April, having risen 2.2%/mth in March. Annually sales grew 6.8%/yr, the fastest annual rate since January 2008, having troughed at 1.4%/yr in September 2008 - due to the legacy of tight monetary policy and substantial global uncertainty.

Analysis of the individual segments shows annual growth is fastest in the food segment at 9.5%/yr. The next strongest segment was cafe and restaurants at 3.1%/yr and other (includes recreational and sporting goods) at 2.7%/yr. Annual growth remains slow to negative in household goods and department stores, though recent monthly changes show signs of improvement, reflecting the positive impact of the government stimulus.

The rate of annual growth is likely to remain strong over coming months, before likely waning later in 2009. This will be driven by the substantial increase in sales since the lows of mid to late 2008 and increased household formation, driven by the extension of the first home owners grant boost and low mortgage rates. The sustainability of this rebound through the whole of 2009 will be dependent upon the extent of further labour market deterioration and the maintenance of the current monetary policy stance.

**Annual Retail Sales Growth (%)**



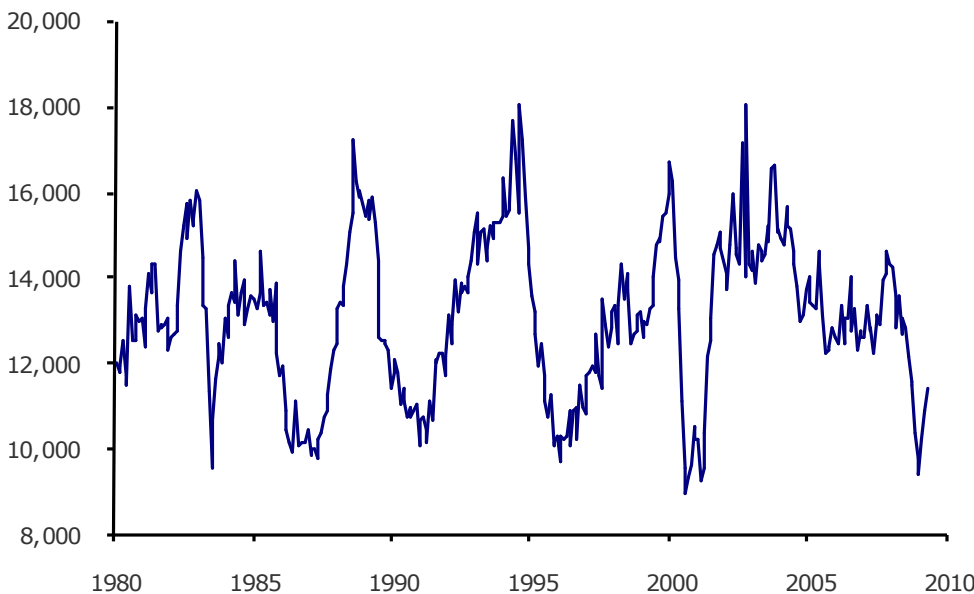
Source: ABS. Seasonally adjusted data. Data to 30 April 2009.

**Building approvals:**

Australian building approvals rose 5.1%/mth in April. Building Approvals have now recorded three consecutive monthly gains (with March upwardly revised from 3.5% to 6.3%). However, on a year-on-year basis, approvals are still down 16.1%. Looking at the breakdown, the gains in April were driven private sector houses (+7.2%/mth), while other dwellings fell (-1.4%/mth). Non-residential approvals fell 8.6%/mth. The small public sector also bounced another 16.2%/mth, while medium density approvals fell.

On a state by state basis, NSW experienced the biggest monthly gain, up 37.7%/mth. Both private sector houses and other approvals contributed to this large gain in NSW although most of the contribution was in the volatile apartment sector. Queensland (+13.1%/mth), SA (+5.1%/mth) and WA (+3.4%/mth) also all rose. Victoria experienced a pick-up in private sector houses (+7.3%/mth), but overall total dwelling units were down -13.3%/mth.

**Total Building approvals**



Source: ABS. Seasonally adjusted data. Data to 30 April 2009

## Colonial First State Global Asset Management Investment Markets Research

### Contact details

Stephen Halmarick	Head of Investment Markets Research	+612 9303 3030	shalmarick@colonialfirststate.com.au
Belinda Allen	Analyst, Investment Markets Research	+612 9303 3110	ballen@colonialfirststate.com.au
James White	Analyst, Investment Markets Research	+612 9303 2645	jwhite@colonialfirststate.com.au

#### DISCLAIMER

Product Disclosure Statements (PDS) and Information Memoranda (IM) for the funds issued by Colonial First State Investments Limited ABN 98 002 348 352, Commonwealth Managed Investments Limited ABN 33 084 098 180, and CFS Managed Property Limited ABN 13 006 464 428 (collectively CFS) are available from Colonial First State Global Asset Management. Investors should consider the relevant PDS or IM before making an investment decision. Past performance should not be taken as an indication of future performance.

No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of CFS. This material contains or is based upon information that we believe to be accurate and reliable. While every effort has been made to ensure its accuracy we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them.

This material has been prepared for the general information of clients and professional associates of CFS. You should not rely on the contents. To the fullest extent allowed by law, CFS excludes all liability (whether arising in contract, from negligence or otherwise) in respect of all and each part of the material, including without limitation, any errors or omissions.

This material is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render specific advice. It is not an offer document, and does not constitute a recommendation of any securities offered by CFS. No person should act on the basis of any matter contained in this material without obtaining specific professional advice.

Colonial First State Global Asset Management is the consolidated asset management division of Commonwealth Bank of Australia ABN 48 123 123 124.

Copyright © (2009) Colonial First State Group Limited.  
All rights reserved.