Australia: GDP grows 0.5% in 2Q

The prospect of further Reserve Bank of Australia (RBA) easing before the year-end is looking more remote after the economy grew 0.5% in the second quarter

0.5%

2Q19 GDP (QoQ)

1.4% YoY

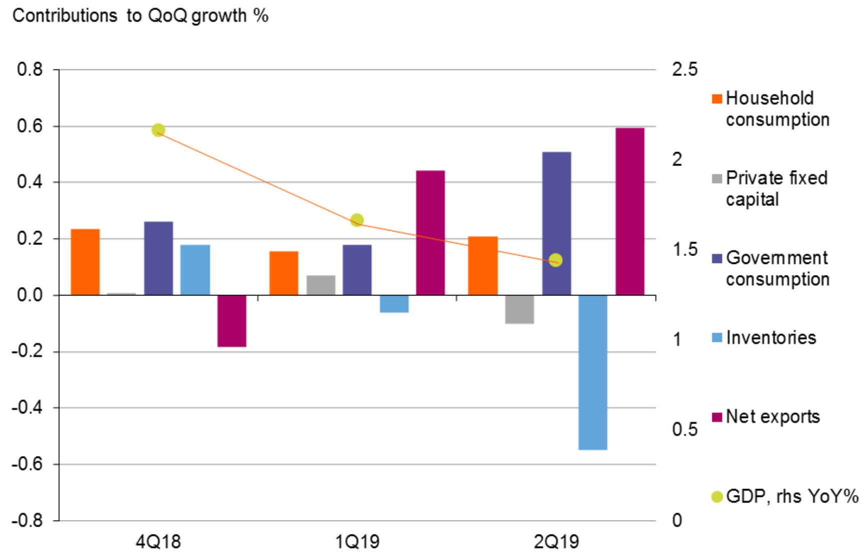
As expected

Focus on the quarterly increase, not the year-on-year amount

At only 1.4% YoY, a decrease from the 1.7% rate recorded in 1Q19, you might be tempted to paint a dim picture of Australian economic growth as measured by the latest 2Q GDP release. But that would be missing the point. Year-on-year figures tell you as much about what happened a year ago (which you already know) as they do about what has just happened. And a year ago, Australian GDP was being buoyed by a pick up in government spending and some reasonably supportive net export figures.

The more pertinent number is the QoQ increase, which at 0.5%, is the same as in 1Q19, and on an annualised basis equates to a growth rate of 1.9%. Even by just maintaining this pace of quarterly growth for the rest of the year, Australian GDP will rise to 2.0% YoY by the end of 4Q19. That might not sound too impressive, but given the weak trade and commodity backdrop, this is actually not a bad result.

Contributions to QoQ GDP growth and YoY%



Source: CEIC, ING

Domestic demand and net exports weighed down by capital spending

There is a lot of noise in these figures, but looking at the components on the basis of their contribution to the total growth rate, domestic demand added a respectable 0.3 percentage points, its strongest since 3Q last year.

More specifically, as last week's private capital formation figure suggested, much of the bad news in the second quarter came from capital investment. Gross private fixed capital formation knocked 0.3pp off the total GDP figure, but government consumption (employment wages usually) posted an offsetting 0.5pp lift.

Household consumption also added 0.2pp to the total and got an additional lift from net exports. The GDP total would have been even higher than reported but the net export strength (weak imports) is also almost certainly also to blame for the fall in inventories. Neither the net export nor the inventory swings are likely to be repeated in 3Q19.

On the whole, then, these figures tee the economy up for a similar rate of growth in 3Q19, barring accidents, and the government's latest budget may start to provide more support in the quarters ahead.

GDP is not what is driving the RBA

GDP itself is not the main driver for RBA policy. Rather, it is the role it plays in nudging the inflation rate in an appropriate direction that counts. This channel mainly works through the labour market and wages, and it was probably the unexpected rise in the unemployment rate in May from 5.1% to 5.2% that led to the following two 25bp rate cuts in June and July.

These cuts seem to have stopped the unemployment rate increase in its tracks, which remains at

5.2%, whilst the August employment figure was a solid increase of mainly full-time jobs. Meanwhile, the wage price index is also steady albeit moderate at 2.3%YoY and 2Q19 inflation has begun to recover, hitting 1.6%YoY up from 1.3% in 1Q19.

RBA Governor, Philip Lowe, would not want to be viewed as an "inflation nut", and though you might argue that inflation is sufficiently below its target range midpoint of 2.5% to warrant more easing, there are alternative responses that may be more appropriate. Inflation expectations look to have begun to edge higher. And with rates already low, it is arguable how much additional support a further cut in rates would lend to business investment, which is indisputably weak. An end to the trade war would probably do more to buoy this sector than any rate cuts.

So with the direction of economic travel positive, even if from a low level, our thinking is that the RBA will be reluctant to add to its recent easing with further stimulus unless conditions clearly deteriorate again. Simply being below "target" will not be enough. We have removed any easing from our forecasts for the remainder of the year in the recent forecast round, but we still have one further cut pencilled in for 2020. We'll leave that in for the time being as we assess incoming data and look for further signs that the economy is stabilising after the weakness of 2019. But it is on watch for removal.

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