Economic Research Department

Asia

BBVA

GDP Observatory

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AUSTRALIA: Real GDP growth contracted 0.5% qoq (up 0.3% yoy) in Q4 2008, below forecasts

- **Real GDP growth was -0.5%qoq/+0.3% yoy in October-December 2008, below our and consensus forecast of 0.1% qoq/1.1% yoy. This is the first quarter of negative growth in eight years.**

- **Non-farm GDP posted -0.8% qoq/+0% yoy, the second consecutive quarterly decline, and thus, the non-farm economy has already fallen into recession.**

- **On the expenditure side, the largest negative contribution to growth in the December quarter was from inventories, offset by positive contributions from private investment and net exports.**

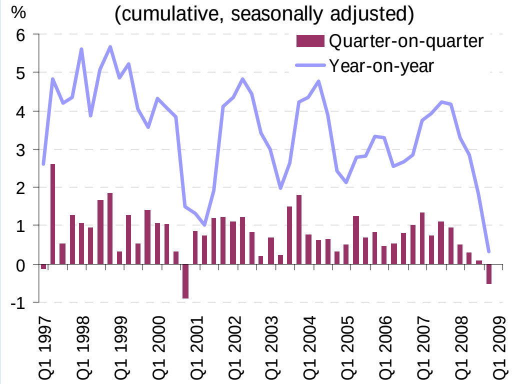
- **The ratio of export to import prices registered the largest quarterly fall since 1998, implying waning support to income from terms of trade gains. Moreover, the deleveraging process in households reflected in a surge in household savings instead of consumption spending.**

- **We currently estimate real GDP growth to slow down to 0.3% yoy in calendar year 2009 from 2.1% yoy in CY08, in line with the consensus forecast; the risk, however, is clearly to the downside.**

Australia's real GDP contracted by a sharper-than-consensus 0.5% quarter-on-quarter, or -1% seasonally-adjusted annualized (saar), in October-December 2008. This is the first negative quarterly reading since end 2000, and a reversal from a 0.1% gain in the previous quarter. Non-farm real GDP contracted for the second consecutive quarter by 0.8% qoq, following a fall of 0.2% qoq in the September quarter; and thus, the non-farm economy conforms to the definition of being in recession. On year-on-year terms, real GDP slowed down to 0.3% from 1.8% yoy in the previous quarters, and to 2.1% yoy in full 2008 from 4% yoy in 2007, both calendar years (CY); this is well below our and market forecast of 1.1% yoy in the December quarter/2.3% yoy in CY08.

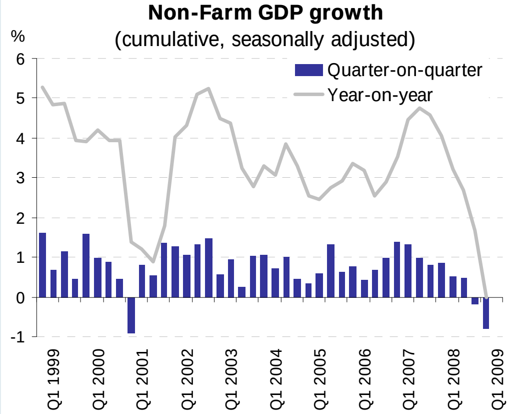
Nominal GDP contracted 0.3% qoq in the quarter (up 7.9% yoy), as the terms of trade posted the largest quarterly fall since 1998 at -2.8% yoy, after rising over 20% yoy in the previous three quarters; the GDP deflator slowed down to 0.2% over the previous quarter, and to 7.6% yoy from 8.6% yoy in the September quarter. Going forward, the economy faces a major drop in

Real GDP growth
(cumulative, seasonally adjusted)



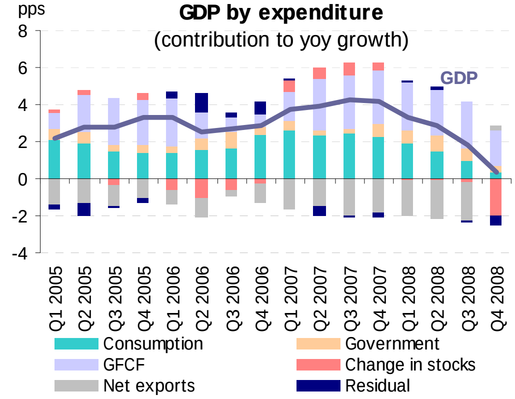
Source: Thomson Financial ERD BBVA

Non-Farm GDP growth
(cumulative, seasonally adjusted)



Source: Thomson Financial ERD BBVA

GDP by expenditure
(contribution to yoy growth)



Source: Thomson Financial ERD BBVA

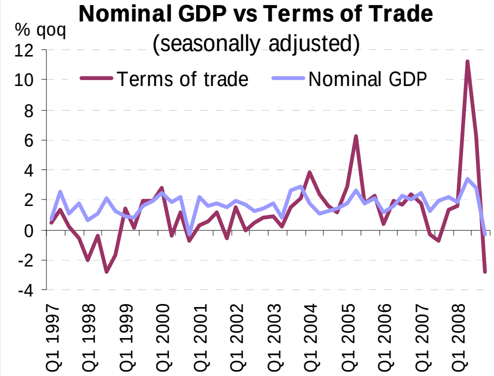
nominal income as the terms of trade gains unwind due to a lower ratio of prices of Australian exports to imports, namely commodity prices, while export volume growth declines on the back of waning global demand. This will sharply reduce corporate, household and government income growth.

On the expenditure side, the main factor that caused the sharp slowdown in real GDP was the fall in inventories, which subtracted near 2 percentage points to year-on-year growth in the December quarter. Other key areas of the economy like household consumption and government spending were weak, while investment stayed resilient and net exports posted a positive contribution to growth (0.2 percentage points) for the first quarter since Q4 2001, as result of the slowdown in import volume growth.

As major highlights during the December quarter: (i) the sharp adjustment in inventories, probably reflecting the plunge in overall demand; (ii) the surge in households net disposable income (gross disposable income net of depreciation of the capital assets) by 14.1% yoy from 8% yoy in the previous quarter; this mainly reflecting households de-leveraging and the government transfer payments in December 2008 as part of the economic stimulus measures; (iii) however, the resulting higher incomes have been used to repay debt or increase savings, as indicated by the jump in household savings ratio to 8.5%, the highest since 1990, from 3.4% of net disposable income in Q3; (iv) the aggregate gross operating profit growth, seasonally adjusted, fell 3.3% over the previous quarter, the first quarterly contraction since Q3 2004; the decline was broad-based across corporations. On year-on-year terms, aggregate profit growth nearly halved to 9.7% from 17.3% yoy in Q3 of which, private non-financial corporations rose 14.2% yoy, while financial and public corporations posted -13.9% and -12.5% yoy, respectively. Meanwhile, compensation of employees slowed down to 1.2% qoq from 2.6% in the previous quarter, albeit accelerated marginally to 7.9% yoy from 7.6% yoy in Q3; the latter trend would support the decision of the Reserve Bank of Australia (its central bank), before the release of the GDP report, to keep the cash rate target (policy rate) unchanged at 3.25%. The decision was clearly a surprise, after slashing rates by 325 bps since last September, and as against market expectation of a 25 basis point rate cut. The monetary policy statement notes that 'demand had not weakened as much as in other countries' and the Australian economy 'has not experienced the sort of large contraction seen elsewhere'. Notwithstanding, disinflationary pressures are expected to build up going forward, as result of both a negative shock on nominal incomes from the fall in terms of trade and increased precautionary savings and fall in consumption, in anticipation to deteriorating economic outlook.

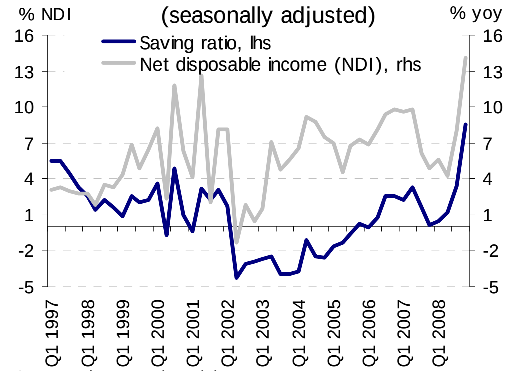
It won't be possible for Australia's economy to avoid short-term weakness as the global recession deepens. However, if we take into account: 1) Australian government estimates of its fiscal stimulus package to lift GDP by 0.5 percentage point in 2009 and 0.75-1 percentage point in 2010; 2) still considerable room for counter-cyclical fiscal and monetary policy measures to support growth and 3) Chinese demand expected to be relatively resilient, Australia's economy could maintain a marginally positive growth of 0.3% yoy in CY09, in line with the consensus forecast, from 2.1% yoy in CY08; the risk to this forecast is clearly to the downside.

Nominal GDP vs Terms of Trade
(seasonally adjusted)



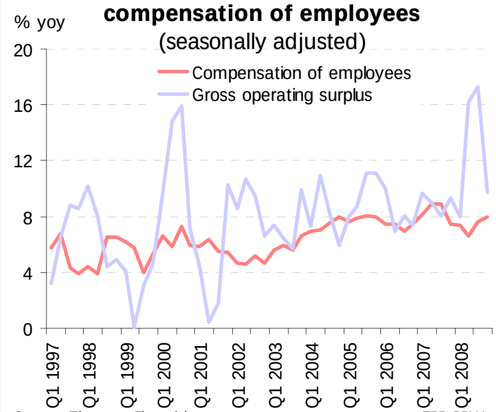
Source: National Statistics, Thomson Financial ERD BBVA

Households: income vs saving
(seasonally adjusted)



Source: Thomson Financial ERD BBVA

Gross operating profit vs compensation of employees
(seasonally adjusted)



Source: Thomson Financial ERD BBVA