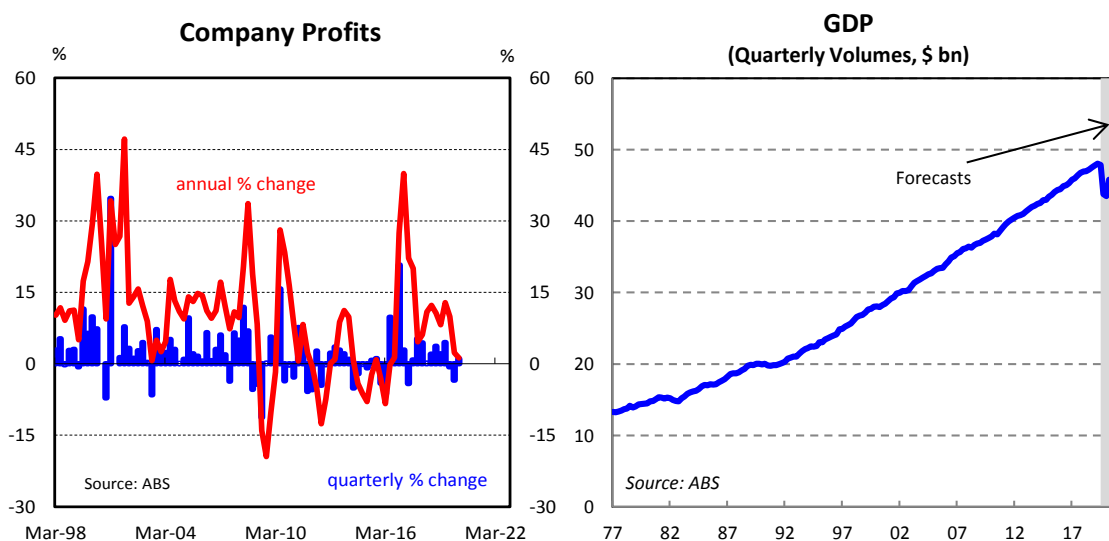


Tuesday, 2 June 2020

Co. Profits, Inventories & GDP Preview

Warning Lights Flashing

- Gross company operating profits rose 1.1% in the March quarter, the first increase in three quarters. The lift in company profits was despite the impact of COVID-19 and summer bushfires.
- Profits in sectors including mining, manufacturing, retail and other services rose during the quarter. Profits in these sectors comprise a larger proportion of total profits in comparison to accommodation & food services and arts & recreation services, where profits declined. These latter sectors were more directly impacted by COVID-19 restrictions.
- Wages & salaries were flat in the March quarter, reflecting the deterioration in the labour market over late March. It was the first time wages and salaries did not grow since the December quarter of 2016.
- Inventories declined sharply in the March quarter, falling 1.2%. It was the biggest decline in over five years. The combination of COVID-19-related restrictions and bushfires has likely had a detrimental impact on production, resulting in a drawdown in inventories across most sectors. Inventories are set to detract 0.5 percentage points from GDP growth in the March quarter.
- Government spending increased in the quarter and is expected to provide a modest contribution to GDP growth in the March quarter. Government spending will be an important pillar of support while much of the economy struggles as it adjusts to a new world with COVID-19.
- We continue to expect a contraction in GDP over the March quarter, but have revised our forecast up from -0.7% to -0.4%. The large shock from COVID-19 suggests a greater degree of variability than usual to our forecast for tomorrow's GDP number.



Gross Company Operating Profits

Gross company operating profits rose 1.1% in the March quarter, the first increase in three quarters. The lift in company profits was despite the impact of COVID-19. While most restrictions were in place late March, travel restrictions dented short-term arrivals, particularly from China. Moreover, bushfires earlier in the year also had an impact.

There was evidence of certain sectors being impacted negatively. Profits in accommodation & food services fell 11.5% in the March quarter, the largest fall in just over three years. Profits also declined in arts & recreation services, which were down 11.6%, and also in construction (-2.7%).

However, sectors including mining (2.9%), manufacturing (6.1%), retail (3.2%) and other services (0.9%) gained in the quarter. Profits in these sectors comprise a comparatively larger proportion of total profits, and were relatively less affected by COVID-19 in the first three months of the year.

On an annual basis, company profit growth slowed from 2.4% in the December quarter to 1.5% in the March quarter.

Wages

Wages & salaries were flat in the March quarter, reflecting the deterioration in the labour market over late March. It was the first time wages and salaries did not grow since the December quarter of 2016. Annual growth eased from 5.0% in the December quarter to 3.8% in the March quarter, the weakest outcome in 2½ years.

The flat outcome for wages and salaries is likely to bring down total incomes in the quarter. The wages component comprises just under half of GDP (based on the income measure).

A much sharper deterioration in profits and wages is expected over the June quarter, in line with the very rapid deterioration in business conditions and the labour market.

Inventories

Inventories declined sharply in the March quarter, falling 1.2%. It was the biggest decline in over five years. The combination of COVID-19-related restrictions and bushfires has likely had a detrimental impact on production, resulting in a drawdown in inventories across most sectors. The largest drawdown was in accommodation & food services (-5.4%), but there were also sizeable falls in inventory in manufacturing (-2.0%) and retailing (-1.2%); the latter reflecting consumer stockpiling of household goods while the former may have been affected by supply-chain issues due to COVID-19. Mining inventories also declined (-0.8%), which was affected by cyclone activity in Western Australia earlier in the year.

Inventories are expected to detract 0.5 percentage points from GDP growth in the March quarter.

Government Spending

Government spending increased in the quarter and is expected to provide a modest contribution to GDP growth in the March quarter. Consumption spending rose 1.8%, while government investment fell 0.7% in the quarter. Government spending will be an important pillar of support while much of the economy struggles as it adjusts to a new world with COVID-19.

GDP Forecast

Partial economic indicators have been mixed in the lead up to the GDP release tomorrow.

Some areas of spending were not as weak as feared in the March quarter, including retail spending and business investment. The big contractions in these areas are likely to have occurred in the June quarter of the year. Government spending and net exports are also set to provide positive contributions to growth.

However, other aspects of consumer spending (such as services) are likely to be very weak and inventories are expected to detract a sizeable chunk from GDP growth.

Moreover, other components of GDP, especially on the incomes, are likely to be very weak, reflecting a flat wages bill and a contraction in profits.

We continue to expect a contraction in GDP over the March quarter, but have revised our forecast up from -0.7% to -0.4%. It would be the first decline in GDP in nine years, since the time of the GFC. Such an outcome would leave annual economic growth at 1.3%, which is well below potential or the trend rate of around 2.6%. The large shock from COVID-19 suggests a greater degree of variability than usual to our forecast.

There is some risk of a small positive result for GDP, but it is not our central view. Weak private demand and soft incomes are likely to ensure GDP contracted in the March quarter.

The biggest contraction to GDP is expected to occur in the current June quarter. This data will not be available until early September.

Janu Chan, Senior Economist

Ph: 02-8253-0898

Contact Listing

Chief Economist

Besa Deda
dedab@banksa.com.au
(02) 8254 3251

Senior Economist

Janu Chan
chanj@banksa.com.au
(02) 8253 0898

Economist

Nelson Aston
nelson.aston@banksa.com.au
(02) 8254 1316

The information contained in this report (.the Information.) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom BankSA has a contract to supply Information, the supply of the Information is made under that contract and BankSA's agreed terms of supply apply. BankSA does not represent or guarantee that the Information is accurate or free from errors or omissions and BankSA disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to BankSA products and details are available. BankSA or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. BankSA owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of BankSA.

Any unauthorized use or dissemination is prohibited. Neither BankSA- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.
