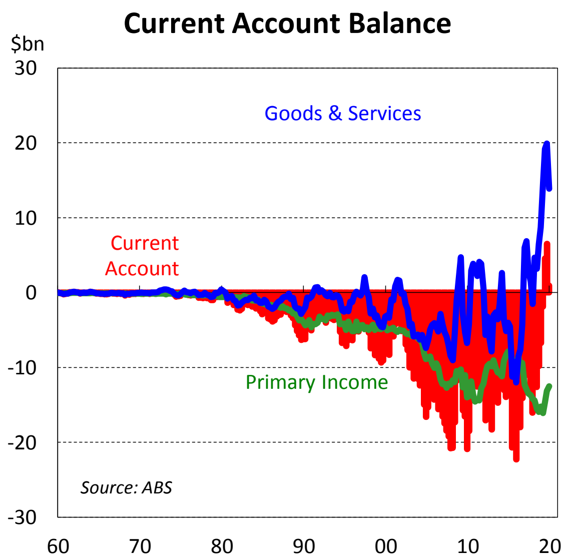
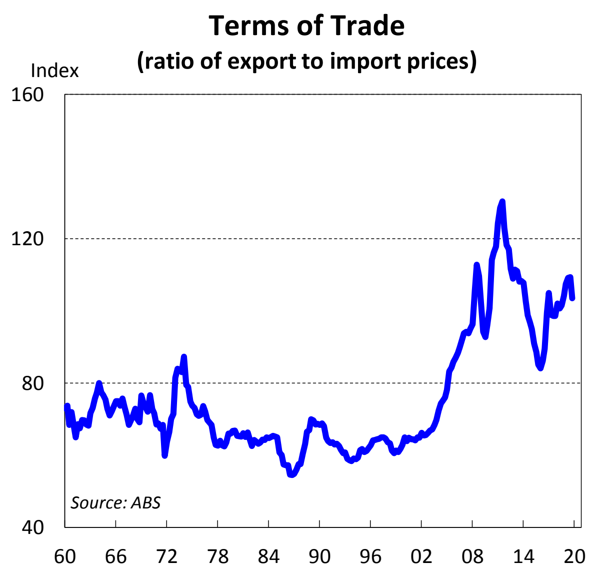
Tuesday, 3 March 2020

Current Account and GDP Preview

Surplus Hat-Trick

- **The current account registered its third consecutive surplus in the December quarter.**
- **However, falling commodity prices and a deterioration in the terms of trade have put downward pressure on the surplus. The December quarter surplus narrowed by $5.5 billion to $0.96 billion. We do not expect persistent current account surpluses to continue.**
- **Exports in value terms declined 4.5% over the quarter as commodity prices continued to drift back to earth. Import values rose by 0.3% in the December quarter. The goods and services surplus narrowed to $13.89 billion.**
- **Exports measured in volume terms were broadly flat in the December quarter and import volumes fell by 0.1%. Net exports are expected to contribute 0.1 percentage points to GDP growth in the December quarter.**
- **Government spending surprised to the downside. Government investment fell 0.4% during the December quarter while consumption rose 0.7%. Government spending is expected to contribute 0.1 percentage points to growth in the December quarter.**
- **Government spending and net exports had been some of the few areas lending support to growth over 2019. Their weaker-than-expected outturns in the December quarter highlight the fragility in the domestic economy. We have revised lower our December quarter GDP forecast to 0.3% over the quarter and 1.9% annually.**





Current Account

The current account registered its third consecutive surplus in the December quarter. Surging commodity prices and fewer capital outflows helped end an almost 46-year run of deficits last year. As commodity prices have receded, so too has the size of the surplus. In December it fell to $0.96 billion, down from a record high $6.50 billion in the previous quarter.

Exports in value terms declined 4.5% over the quarter as commodity prices continued to drift back to earth. Goods exports have been particularly impacted by surging iron ore prices, which rose to almost US$120 per tonne around halfway through 2019 and have subsequently drifted lower to about US$85 per tonne in the December quarter.

Soft domestic demand has been a key theme over 2019 and continued to limit the appetite for imports in the December quarter. Import values rose by a meagre 0.3% over the quarter after rising 1.3% in the September quarter.

The goods and services surplus narrowed to $13.89 billion in the December quarter from a record high $19.91 billion in the previous quarter. The goods and services surplus was just enough to offset a $12.50 billion deficit in the primary income balance. The primary income balance deficit has narrowed for three consecutive quarters and is now at the lowest since September 2016.

The latest decline in the goods and services surplus is further evidence that current account surpluses are not set to become persistent. The surge in iron ore prices last year was caused by natural disasters coupled with stimulus measures from China. Iron ore prices have since fallen more than 30% from their peak. In the near term there is a risk that the hit to global growth from the coronavirus will put further downward pressure on commodity prices and Australia's current account surplus.

Terms of Trade

The terms of trade, or the ratio of export prices to import prices, plunged in the December quarter, led by falling commodity prices. The terms of trade index fell 5.3%, led by a 6.5% fall in the goods index over the quarter.

Rising commodity prices have been supporting the terms of trade over recent years. Before Q4's fall it has risen for five consecutive quarters. On an annual basis, the terms of trade ended 2019 slightly lower by 0.6%. A worsening terms of trade will unwind some of the support to national incomes over the past year evident in company profits and taxation revenue.

Export and Import Volumes

The volume of goods exports was broadly flat in the December quarter. Another tepid outturn (export volumes fell 0.1% in the September quarter) suggests that the upward trend in exports is faltering. Commodity export volumes generally rose, with the exception of "other mineral fuels" (which includes LNG). Exports of metal ores and minerals, which includes iron ore, rose 0.7%. Coal coke & briquettes was the best performing hard commodity, rising 2.8% over the quarter. Metals exports rose 1.1%, but remain at a low level following a 14.1% plunge in the previous quarter.

Rural goods exports registered a 3.2% increase in export volumes over the quarter, rebounding from a low base. Rural goods exports have seen a large fall over the past year due to the drought.

The softness in the domestic economy was evident in another soggy outturn for imports in the December quarter. Goods imports fell 0.1% over the quarter. Consumption goods imports fell 0.2% over the quarter. Capital goods imports rose 0.9% over the quarter, ending 2 consecutive quarterly declines. The limited recovery in capital goods imports suggests that business investment remained soft in the December quarter, but is forming a trough.

The outperformance of exports relative to imports suggests that net exports will contribute 0.1 percentage points to GDP growth in the December quarter.

Government Finance Statistics

Government spending surprised to the downside in the December quarter. Government investment fell 0.4% over the quarter, led by an 8.6% decrease in investment by public corporations. Government investment is not expected to make any contribution to GDP growth in the December quarter. There continues to be a strong pipeline of public infrastructure spending, which should continue underpin economic growth over the medium term

Government consumption rose 0.7% and will contribute 0.1 percentage point to GDP growth in the December quarter. Government consumption has been boosted by spending on health, particularly the NDIS, over the past year.

GDP Preview

The weaker-than-expected outcomes for both net exports and government spending lead us to revise lower our forecast for tomorrow's December quarter GDP data. We expect quarterly GDP growth of 0.3% in the December quarter compared with 0.5% in the previous quarter. This outcome would leave annual growth at 1.9%, well below potential.

Net exports and government spending have been one of the few areas lending support to growth over 2019. The signs of softening in these growth propellers highlights the fragility of the domestic economy. Weak household consumption and tepid business investment will continue to constrain growth, with only a modest pickup in activity forecast over the year ahead.

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