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Economics Group

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Rare Decline in Australian GDP

While a larger-than-expected decline in Australia's third quarter GDP probably overstates the challenges now facing that economy, it puts the possibility of further rate cuts in play for the Reserve Bank.

Into Every Life a Little Rain Must Fall

For the first time in more than five years, the Australian economy posted a negative print for GDP growth in the third quarter. Although a modest pullback was expected, the 1.9 percent annualized rate of contraction was larger than expected.

Australia is unique among most major economies in that it was able to sidestep a recession during the broad decline in global economic activity in 2009. To some extent, the country's seeming invulnerability to recession in that period was attributable to robust growth in China, which is Australia largest export market. As growth in China has moderated in recent years, Australia's growth drivers have shifted to domestic demand. In the third quarter, that narrative remained largely intact as some components of domestic demand held up enough to offset the drag from trade, but a retrenching in business investment ultimately offset the gains enough to drag the headline number into negative territory.

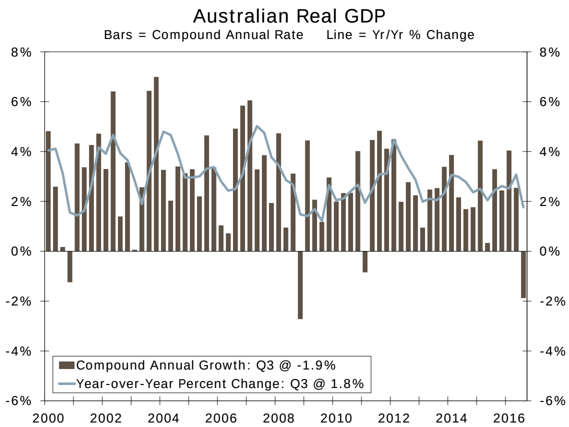
Consumer spending held up in the third quarter, although the 1.8 percent annualized growth rate for consumer spending was the softest pace in over a year. Government spending was also positive in the quarter. Exports nudged slightly higher in the quarter but that was offset by a larger gain in imports, which resulted in a negative contribution of 0.8 percentage points from net trade overall.

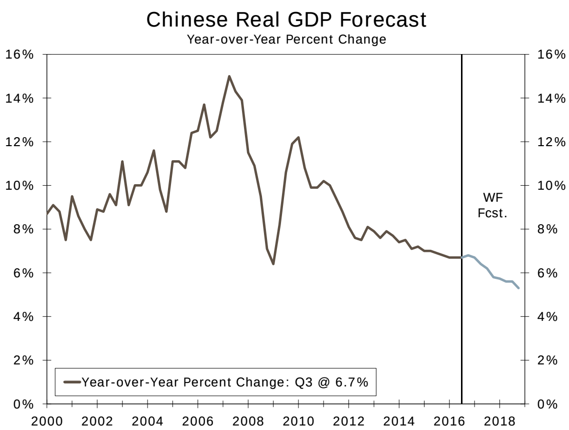
The biggest drag, however, was attributable to a decline in business investment, which fell for the fifth time in seven quarters. The official GDP report also broke down production activity by sector, and revealed declining activity from the usual culprits, specifically mining and construction.

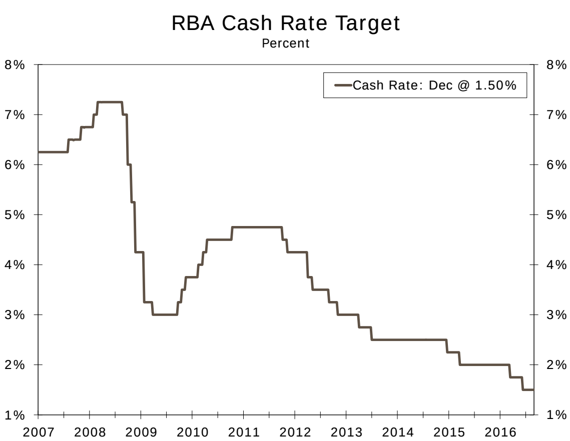
Although the decline was larger than expected, it was presaged somewhat by recent choppiness in the job market. Although full-time jobs increased 41,500 in October, that follows full-time job losses of 74,300 in September.

On balance, we think Australia's growth prospects are contained somewhat by the continuing moderation in China and a global economy that is still growing a bit below average. That said, the third quarter print perhaps overstated the weakness somewhat in our view. Consumer spending is still steady, the unemployment rate is still falling and, according to our latest forecast, 2016 will likely mark the softest year for global GDP growth since the recession, which suggests upside for Australia's export-oriented economy going forward.

Before this report, we might have argued that Australia's Reserve Bank (RBA) was almost done cutting rates in this cycle, but this GDP number was just weak enough to revive the possibility of further monetary policy accommodation by the RBA in 2017.







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