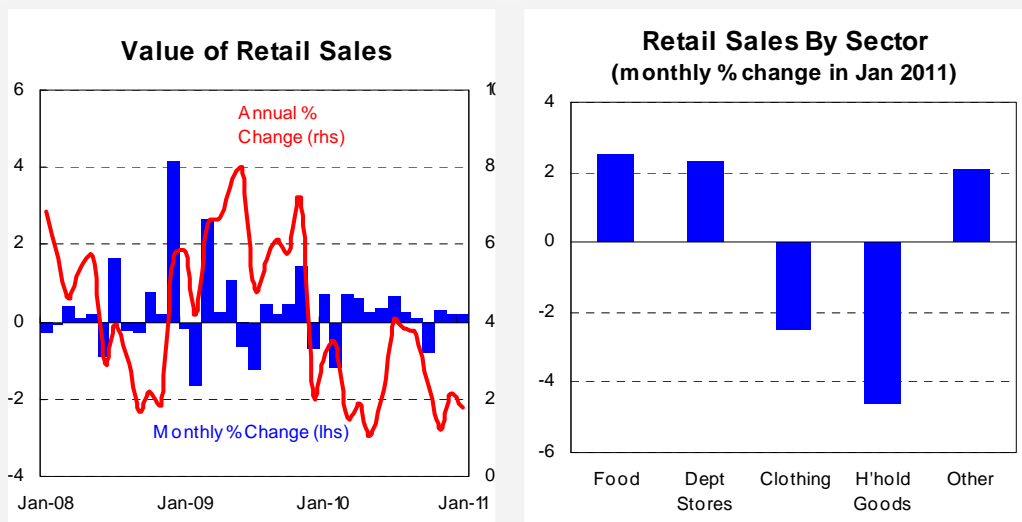


# DATA SNAPSHOT

## Aussie Economy: Keeps its Shine

Tuesday 1 March, 2011

- Our final forecast for GDP for the December quarter is for growth of 1.0% in the quarter and for growth of 3.0% on a year ago. A result in line with our forecasts highlights an economy running at a solid pace in the final three months of 2010. It also means the Aussie economy started 2011 in a good position to get through any flood-related bumps in the road in the near term.
- We believe the chances of an outcome for Q4 GDP that is anything but solid tomorrow is on the low side. So it adds to our long-held view that rate rises will be back on the Reserve Bank's agenda later this year and as soon as May or June.
- Retail sales grew by 0.4% in January, keeping the soft trend in retailing intact. Food retailing rose by its fastest pace in 12 years, possibly highlighting stockpiling activity related to the floods.
- The balance of payments data revealed a deterioration in the current account deficit from \$6.5bn in the September quarter to \$7.3bn in the December quarter. But it also revealed another increase in the terms of trade to take it to its highest level since the data started. The rises in the terms of trade are providing large net income injections to the Australian economy, helping to underpin economic activity and adding to inflationary pressures.
- Finally, data showed that public spending will make a solid contribution to Q4 GDP but net exports will make a nil contribution.



### Retail Spending:

Retail sales grew by 0.4% in January, which is a little above market expectations that focussed on growth of 0.3%. The overall trends in the data are still suggesting that consumers are cautious. This caution is prevalent, despite growth in household income, high levels of consumer confidence and a strong domestic economy. We believe it is due to the effect of rate rises over last year and lingering effects from the global financial crisis.

The Reserve Bank has, however, welcomed this caution by consumers because it represents a shift to greater saving and it also helps with keeping inflationary pressures at bay.

This retail sales release is one of the first 'major' economic releases for January when the devastating floods occurred in Queensland. The Bureau of Statistics note in their release that the floods have not affected the data quality or reliability.

The data, however, does show signs of the floods impacting expenditure. Food retailing, for example, jumped 2.5% in January, the biggest monthly percentage gain in 12 years. Retailing for department store sales and other retailing (includes books, recreational items, flowers, chemists, etc) also posted firm gains of 2.3% and 2.1%, respectively.

Falls in the month were recorded in clothing and department store sales, of 2.5% and 4.6%, respectively. The fall recorded in department store sales was the biggest monthly percentage drop since the middle of 2000.

Examining retail sales by State, the first spotlight shines on Queensland. Retailing in Queensland lifted by 0.3%, after strong growth of 1.3% over the previous two months. The floods are likely to have contributed to stockpiling in Queensland, helping retail sales grow in the month.

The two strongest States in January in retailing were Western Australia and South Australia. WA retail sales grew by 2.7%, the fastest monthly pace in 1½ years. SA retail sales grew by 2.4%, the fastest pace in one year, but following a decline of 2.5% over the October-to-December period. ACT also recorded solid growth of 2.2% in the month, the fastest monthly rate in more than one year.

NSW recorded only modest growth of 0.1% in January, but it follows strong growth of 1.2% over the November-December period.

Victoria was a weak spot in January; retail sales fell by 1%, the most in one year. The annual rate of growth in retail spending has also taken a noticeable step down from the 6.6% rate recorded in July last year to 2.7% in January.

#### **Balance of Payments:**

##### **- Current Account Balance**

The current account deficit deteriorated from \$6.5bn in the September quarter to \$7.3bn in the December quarter.

The trade deficit improved marginally from \$448 million to \$472 million. Exports rose by 3.03% in the December quarter but imports rose by 3.04% in the quarter.

The primary income deficit, which is the other big component of the current account balance, deteriorated by \$1.5bn. It can be argued that the primary income deficit reflects the price of Australia's commodity-success story. The mining sector is making huge profits, but some of the dividends and profits from these companies flow to offshore investors and/or parent companies.

##### **- Terms of Trade**

The balance of payments data also revealed a further increase in the terms of trade of 1.1%, taking the index to its highest level since the data goes back (in 1959 in this data series).

The rises in the terms of trade are providing large net income injections to the Australian economy, helping to underpin economic activity and lift inflationary pressures.

##### **- Net Exports Contribution to GDP**

Net exports are expected to make no contribution to GDP for the December quarter due tomorrow.

##### **- Net Foreign Debt**

Australia's net foreign debt liability decreased \$26.7bn to \$650.3bn in the December quarter.

**Government Spending:**

Government spending on consumption rose by 1.1% in the December quarter and on investment rose by 0.2%. It suggests that the government spending component of GDP will make a firm contribution to GDP growth in the December quarter.

**Q4 GDP Implications:**

The bucket of partial economic indicators that have been released over this week and last week have suggested upside risk to the GDP outcome for tomorrow.

Our final forecast for GDP for the December quarter is for growth of 1.0% in the quarter and for growth of 3.0% on a year ago. If the GDP result is in line with our forecasts it indicates that the economy was running at a solid pace in the final three months of 2010.

Note that the floods are likely to dampen the GDP result for the March quarter, which is not due for release by the Bureau of Statistics (ABS) until June.

As the economy was running at a good speed in the December quarter, it places the Aussie economy in a good position to get through any flood-related bumps in the road in the near term.

**Cash Rate Implications:**

We believe the chances of an outcome for GDP that is anything but solid tomorrow is on the low side. It adds to our long-held view that rate rises will be back on the Reserve Bank's agenda later this year and as soon as May or June.

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