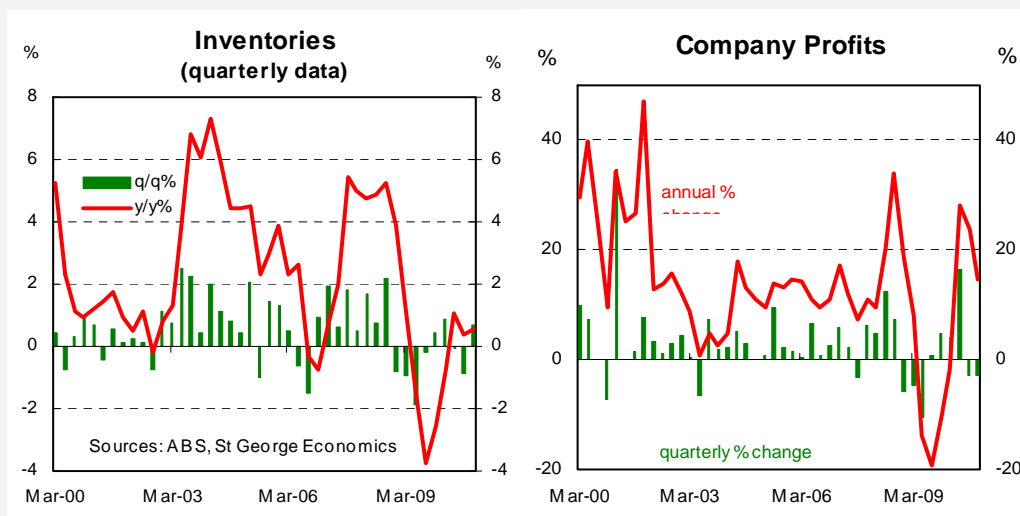


# DATA SNAPSHOT

## The (GDP) Waiting Game

Monday, 28 February 2011

- The run of recent partial indicators continues to suggest that the risk to the forecasts for GDP for the December quarter due on Wednesday is to the high side. We are expecting a solid GDP result for Q4, adding to the case for RBA rate rises to resume before the end of June this year.
- Company profits were softer than expected, falling by 2.8% in the December quarter, after falling 2.8% in the previous quarter. Mining profits fell in the quarter, but it reflects a pause for breath after strong growth earlier in 2010.
- Business inventories were stronger than expected, rising by 0.7% versus expectations for a contraction of 0.5%. Business inventories are likely to make a hefty contribution to Q4 GDP of 0.7 percentage points.
- Private sector credit rose by 0.3% in January with housing credit underpinning the overall gain. Business credit softened by 0.1% in the month, suggesting that companies are continuing to rely on internal cash flows or equity or a combination of both to fund spending.
- House prices fell in January according to data from RP Data-Rismark.



### Gross Company Operating Profits

Gross company operating profits fell 2.8% in the December quarter. Taken together with the 2.8% decline in the previous quarter, it was the largest two-quarter decline in company profits since the March-June quarters of 2009, in the aftermath of the GFC. Excluding mining, profits grew by 0.5%, but are down 0.1% year-on-year. For the year to December, total company profits are up 14.7%, reflecting strong growth in the first half of 2010.

The weakness in company profits in the December quarter were led by professional, scientific & technical services (-16.1%), followed by construction (-10.6%) and mining (-8.5%). These sectors all experienced their second consecutive quarter of declining profits.

The fall in mining profits made the largest contribution to the decline in overall company profits. Mining profits fell by 8.5% in the quarter but remain 59% higher on a year ago. The mining industry saw phenomenal growth in profits in the first half of 2010, so the decline in mining profits represents a contraction from record profit levels earlier last year. Looking forward, the March quarter should see a fall off in mining volumes, but higher prices should see a trend of rising profits again.

The company profits data gives us more information about the income side of the GDP equation. If we make an adjustment for inventory valuations, the national accounts measure of company profits is likely to show a rise of 0.7% in Q4.

### Inventories

Business inventories were stronger than expected, rising by 0.7% (consensus -0.5%), following two consecutive quarters of falling inventories (-0.9% in Q3 2010 and -0.1% in Q2 2010).

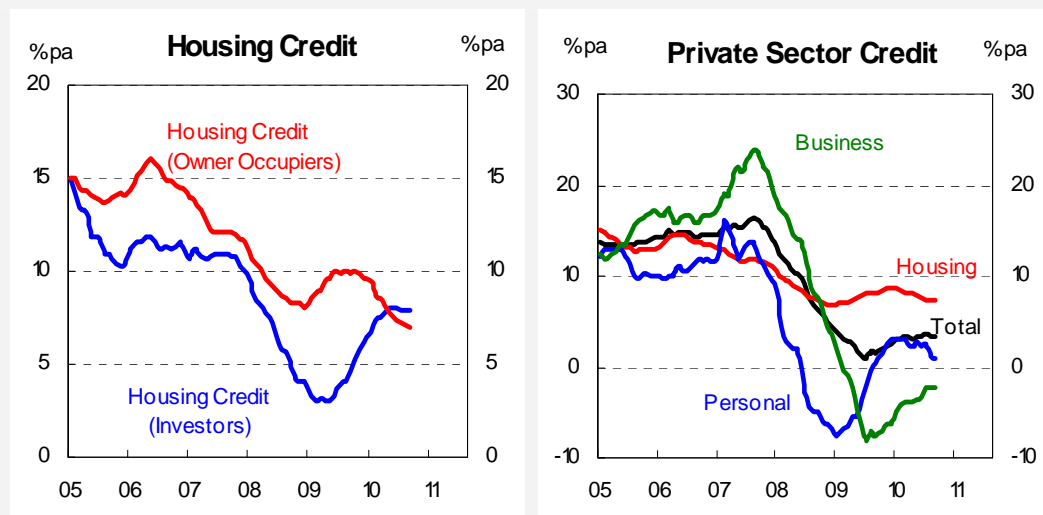
Inventories increased in the manufacturing, wholesale trade and retail trade industries. It suggests to us that some of the rise in inventories may have been unintended.

In the June quarter and September quarters of last year, inventories were run down. So the rise in stocks in December quarter could also reflect a build up of stocks after stocks had been run down too far.

Stocks were run down in the 'accommodation and food services' (-0.2%), 'electricity, gas, water and waste services' (-6.0%) industries as well as in the mining sector (-3.5%).

For mining, it was the fourth consecutive quarter in which inventories have decreased, as export orders were met by depleting stocks. The ABS, however, cautioned that the mining estimates should be used with caution. This was because there were difficulties obtaining estimates in QLD, particularly for the mining industry, due to heavy rains and flooding in December 2010. Note that we expect stock levels in the mining sector may fall further due to flood-related disruptions early this year.

Business inventories should add 0.7 percentage points to the expenditure side calculations of Q4 GDP. There are three measures of GDP, the expenditure, income and production measures, which are averaged to arrive at an overall measure of GDP.



### Private Sector Credit

Total credit continued to pick up in January, rising by 0.3%. It follows 0.2% growth in December. The expansion has occurred, despite the floods and a subsequent weakening in business confidence.

Driving credit was housing credit. It expanded 0.6% after rising at the same pace of 0.6% in the previous month. This result is consistent with signs of a recovery in housing finance seen in the last few months. The rise in new mortgages is occurring even as house prices have been showing signs of weakness. So the slight correction being experienced in the major housing markets may then continue to be gradual rather than volatile with demand showing a healthy response to lower prices.

Business credit contracted 0.1% in January. This represents an improvement on the average monthly decline of 0.4% over the previous six months. Nonetheless, it is a contraction and indicates private lending to businesses continues to languish.

The business credit aggregates underlines the unevenness across key sectors of the economy and stand in stark contrast to last week's Q4 private capital expenditure survey. The survey, which includes Australia's major corporates, continued to highlight a vast lift in private business spending plans within the mining industry. To finance this boom many of these companies will source their finance from their own cash earnings or from overseas.

Business credit is more likely to reflect demand from small to medium sized businesses, and are typically outside of the mining sector. Even though there are signs of recovery in many of these industries it is not sufficient as yet to warrant an expansion in their capital base.

Other personal credit was flat in January. This outcome compares to a 0.4% decline in December. Personal credit has been choppy in recent months and is in line with retail figures suggesting households have become increasingly cautious since the November rate rise. There has also been an increase in other household costs such as electricity and school fees. It also correlates with a rise in household savings.

### **House Prices**

In a separate release from RP Data-Rismark today, dwelling prices in capital cities fell 1.6% in January, with the natural disasters in Queensland, Victoria and New South Wales impacting prices. For the year to January, capital city dwelling prices edged up 1.2%. This slower growth in house prices reflects interest rate rises from the RBA over the past year. Indeed, the RBA has called the easing in dwelling price growth a "welcome development".

Over the year to January, Darwin (4.7%) was the best performing city, followed by Melbourne (3.6%). Perth (-3.8%) and Brisbane (-3.7%) house prices slid over the same period.

Dwelling prices outside of the capital cities slid 1.2% in January, and are down 0.2% for the year.

### **GDP Forecasts**

The company profits and inventories data provide us with more detail for our GDP forecasts for the December quarter. We also obtained more detailed from last week's releases for construction work done and private new capital expenditure.

These partial indicators collectively so far suggest upside risk to the GDP numbers to be released this Wednesday. We will publish our final GDP forecasts tomorrow.

There are still two further partial indicators due tomorrow before GDP forecasts will be fully finalised – the balance of payments and government finance statistics.

We also continue to maintain our long-held view that the Reserve Bank will resume raising rates before the end of June (most likely in May or June) with a follow-up rate hike in the September quarter.

## St.George Contact Listing.

---

### Economics & Strategy:

Chief Economist	Besa Deda	<a href="mailto:dedab@stgeorge.com.au">dedab@stgeorge.com.au</a>	(02) 9320 5854
Senior Economist	Josephine Heffernan	<a href="mailto:heffernanj@stgeorge.com.au">heffernanj@stgeorge.com.au</a>	(02) 9320 5751
Senior Economist	Kate King	<a href="mailto:kingk@stgeorge.com.au">kingk@stgeorge.com.au</a>	(02) 9320 5892
Market Economist	Amanda Tan	<a href="mailto:tanam@stgeorge.com.au">tanam@stgeorge.com.au</a>	(02) 9320 5816

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 St. George has a contract to supply Information, the supply of the Information is made under that contract and St. George's agreed terms of supply apply. St. George does not represent or guarantee that the Information is accurate or free from errors or omissions and St. George 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 St. George products and details are available. St. George 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. St.George owns copyright in the Information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of St. George.