

**Economic Research
Sydney**

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Australia economic update

Third quarter GDP

Annual growth still well above potential

Australia's economy posted a chunky 1.0%q/q gain in the third quarter, in-line with market expectations (JPMorgan 1.1%, consensus 1.0%). The year-on-year growth rate, however, was lower than anticipated at 4.3% (JPMorgan 4.9%, consensus 4.8%). Significant revisions to the historical data saw seven of the past ten quarters revised down by 0.1% or more (table). That said, even with the downward revisions, Australia's growth remains well above potential. Today's data shows growth has strengthened and accelerated over the third quarter.

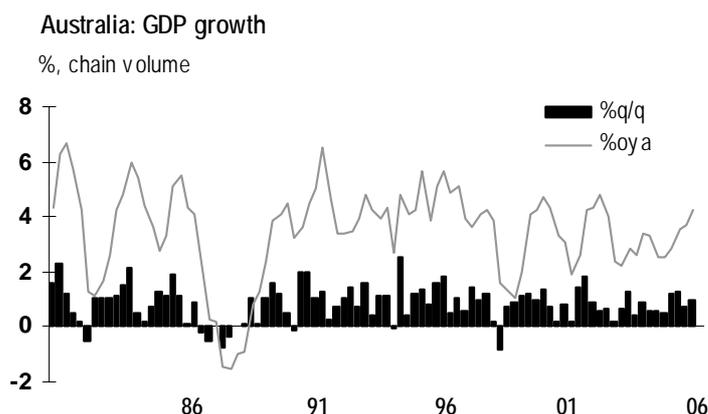
The household sector remains in great shape, thanks mainly to healthy income growth owing to a 33-year low in the jobless rate, and yet another round of personal income tax relief delivered in July. Export volumes spiked 2.3%q/q over the quarter, a welcome gain given the sub-optimal performance of the export sector - owing partly to lingering capacity constraints - over the past few years. Substantial mining investment appears to be addressing this problem, albeit slowly. Over the quarter, domestic demand posted a solid 0.8%q/q gain, thanks to a strong 1.2% increase in household consumption, and a 1.0% push in government expenditure. Import volumes also rose 2.3%q/q in 3Q.

An important point from today's release was the 0.8%q/q decline in the terms of trade - the first quarterly decline since December 2001. Should the dip in the terms of trade turn into a downward spiral, the substantial boost to national income experienced from the terms of trade since 2003 will be partially unwound and domestic demand will be dampened as a result.

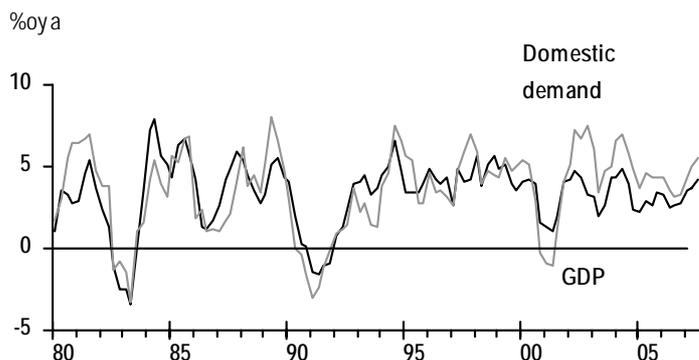
JPMorgan forecasts the economy will grow by 3.4%oya in 2008. The key to the 2008 outlook is the extent to which Australia's economy is affected by the expected slowdown in economic growth offshore. The sluggish growth in export volumes in recent years has triggered a substantial expansion of investment, particularly in mining, aimed at alleviating capacity constraints and infrastructure bottlenecks. Provided that growth in the global economy holds up as we expect, this investment should help to deliver a healthy rise in exports volumes in the latter stages of 2008. If the slowdown in global growth is unexpectedly severe, however, particularly in Asia, export volumes will languish. Domestically, next year is likely to see slower growth in consumer spending. Income growth will remain healthy owing to the firm labour market and rising wage rates, though there are headwinds that are strengthening - petrol prices are rising owing to elevated crude oil prices, and the RBA only recently raised interest rates in November.

Australia's GDP growth - revision to percentage changes

	Gross Fixed Capital Formation	Domestic Demand	GNE	Exports	Imports	GDP
Mar-2005	-0.1	0.1	0.1	0.0	-0.1	-0.1
Jun-2005	0.4	0.0	-0.1	0.1	0.3	-0.1
Sep-2005	0.4	0.0	-0.1	-0.1	0.0	-0.1
Dec-2005	-0.5	0.0	0.1	0.0	-0.3	0.4
Mar-2006	-0.8	-0.4	-0.4	0.1	0.0	-0.2
Jun-2006	0.1	0.0	0.1	0.1	0.4	0.2
Sep-2006	-1.3	-0.4	-0.4	-0.2	-0.5	-0.1
Dec-2006	0.0	0.1	0.3	0.1	-0.3	0.1
Mar-2007	0.2	0.0	-0.1	-0.1	-0.2	-0.3
Jun-2007	-1.0	-0.4	-0.5	-0.2	0.3	-0.2



Australia: growth in GDP and domestic demand



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