

Australian economic update

GDP growth slows to 0.6%q/q in 4Q

Australia's GDP growth slowed to 0.6% in 4Q (JPMorgan 0.5%, consensus 0.6%) from a revised 1.1% in the September quarter (previously 1.0%). Annual GDP growth slowed from 4.3% to a still-healthy, and above potential, 3.9%, primarily driven by domestic demand.

While the soaring terms of trade and rising real gross domestic income made significant contributions to growth on the income side of the accounts (each rising 0.7%), of the expenditure components, household final consumption was the main driver of 4Q GDP growth. Household consumption grew 1.6%, adding 0.9 percentage points to GDP growth. Business investment also was a key growth source, with private business investment growing 0.4%. Presumably, this investment was directed into alleviating capacity constraints and infrastructure bottlenecks, particularly in the mining sector, that are holding back exports.

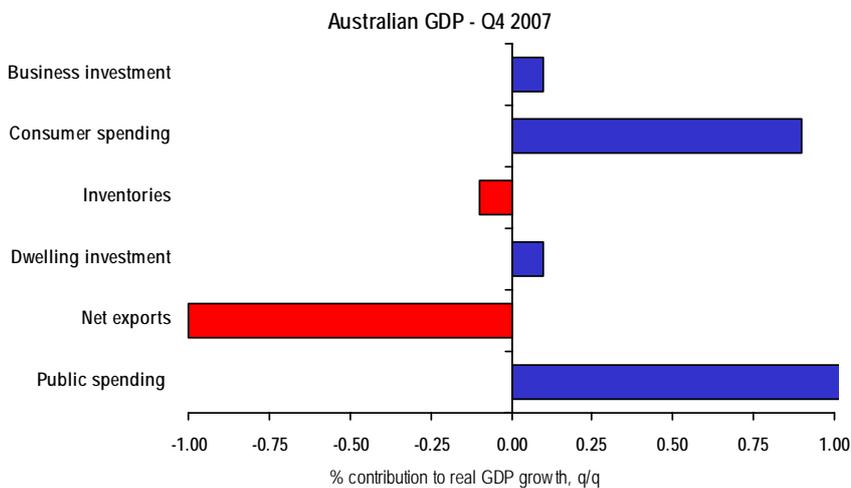
Australian GDP - Q4 2007

	Q/Q	Y/Y
Consumer spending	1.6	5.0
Public consumption	1.7	4.0
Dwelling investment	2.1	1.6
Business investment	0.4	11.9
Public investment	5.5	4.7
Exports	-0.6	2.6
Imports	3.6	10.3
GDP	0.6	3.9

Indeed, solid business investment in earlier quarters failed to boost exports, however, with net exports again a primary laggard on growth. Net exports subtracted 1.0 percentage point from economic growth as import volumes surged on the back of solid domestic demand and strong AUD. Imports of goods and services made the largest negative to GDP growth (-0.8 percentage points) driven by growth in imports of consumption goods. The negative contribution of net exports was widely anticipated following yesterday's current account numbers, which showed the current account gap ballooning to 7.0% of GDP in the December quarter, owing to a significant deterioration of the trade gap.

Price pressure in the economy rose in 4Q, with the implicit price deflator for GDP increasing to 1.1% from 0.8% in 3Q. The still significant gap between actual and potential GDP growth means, though, that inflation pressures will continue to build. The outlook for inflation has deteriorated significantly of late, with the RBA forecasting that inflation will remain above its 2-3% target range until mid-2010. The RBA has hiked interest rates twice this year, and further tightening (we expect another 25bp hike in May) will likely curb domestic demand throughout 2008, although not severely as the household sector remains supported by firm income growth.

On the external front, below trend growth in Australia's major trading partners this year will reduce demand for Australia's exports. Net exports are expected, however, to become positive this year for the first time since 2001 as solid investment in recent years aimed at boosting productivity capacity allows exports volumes to rise, and farm exports also increase thanks to improved weather conditions.



The details:

- 4Q GDP growth slowed to 0.6%q/q from 1.1% in 3Q. Annual GDP growth moderated to 3.9% from 4.3%.
- Domestic demand was a key driver of growth, adding 1.6 percentage points to GDP growth in 4Q.

- As expected, inventories and net exports subtracted from growth, taking 0.1 and 1.0 percentage points off GDP, respectively.
- Economy-wide price pressures rose, with the GDP deflator rising to 1.1% from 0.8%.

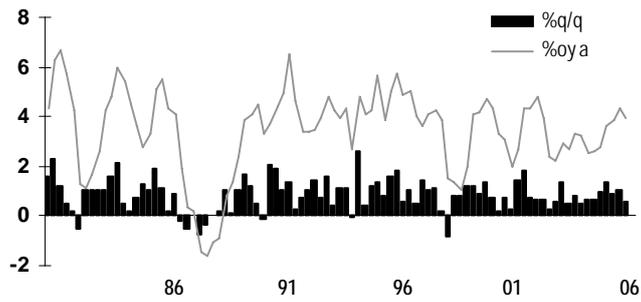
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Economic Research
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Australia: GDP growth

%, chain volume



Australia: growth in GDP and domestic demand

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