

Australian economic update

Inventories and company profits – Q2

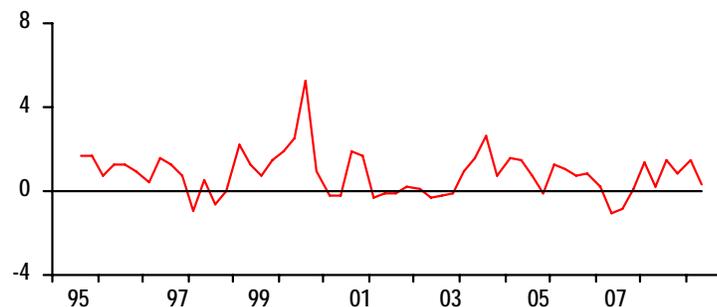
Today's business indicators publication provided two important components of the 2Q GDP data, released Wednesday. The data showed an unexpected bounce in company operating profits, which will feed into the income side of the GDP data, but a smaller than expected contribution from inventories. Inventories look likely to make a slightly larger subtraction from GDP growth in 2Q, partly because there was a huge upward revision to the inventory accumulation for 1Q. Together with the unexpected subtraction from GDP growth from net exports in 2Q (a 0.1% subtraction in today's current account data, against market expectations of a 0.2% positive contribution), it now looks likely that the GDP print will be slightly weaker than our initial forecast of 0.4%q/q.

Company operating profits soared 14.3%q/q in 2Q on the back of a 40% rise in mining company profits - this mainly reflects the new contract prices for coal and iron ore, which rose substantially in the quarter. Ex-mining, operating profits rose just 5.3%q/q. There also were big rises in profits for firms in manufacturing and construction, but profits fell for companies in property and business services, and in 'other selected industries'. Operating profits across all industries have risen 21.5%oya.

Inventories rose an unexpectedly low 0.3%q/q in 2Q, but there was a substantial upgrade to the 1Q increase in inventories, which now shows inventories rising 1.5%q/q (previously published as 0.9%). This means inventories are likely to subtract 0.5% points from GDP growth on Wednesday, slightly more than our original estimate of a 0.4% subtraction. The bad news for GDP growth, of course, is that many firms seem to be loaded up with unwanted stock, perhaps because of unanticipated weakness in final sales, which means they probably will trim output in coming quarters.

Australia: inventories

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Today's data has no material implication for tomorrow's RBA decision. The data was for a period that ended more than two months ago, and RBA officials probably will put more weight on more recent partial data showing abrupt weakness in domestic demand in 3Q. That said, the surge in company profits, largely owing to a bounce in the terms of trade, highlights that the economy is hardly on its knees, even with domestic demand having softened. We expect a 25bp official rate cut tomorrow, but a statement from the RBA that indicates that a series of interest rate cuts extending well into 2009 is far from a 'done deal'.

Australia: company operating profits

