

25 November 2016

AUSTRALIAN ECONOMIC DEVELOPMENTS

This week the ABS released construction activity data for the September quarter (Q3), providing the first of a set of key 'partial' Q3 data, ahead of the main Q3 *National Accounts* (GDP) release on 7 December. These latest construction figures point to significant declines in construction activity in Q3, driven mostly by declines in private engineering construction (mainly mining and LNG facilities) but also declines in residential construction activity (mainly apartments), which had been somewhat cushioning the effect of plummeting mining construction up until now. An exception to this decline in Q3 is public sector engineering construction, driven by some large Government infrastructure projects (mainly in NSW). The RBA suggests that the worst may now be over in terms of declining engineering construction following the mining investment boom, with smaller, slower declines likely to weigh less heavily on economic activity from here.

In a speech by RBA assistant governor Christopher Kent this week, the RBA offered interesting insights into how Australia's economic transition after the mining investment boom is playing out, at a state level. In forming an assessment of the economy as a whole, the RBA stressed that an understanding of state level economies is important. There are some important differences in growth patterns across the states at present, including in: non-mining business investment; labour markets (weaker in the mining states); housing markets (significantly stronger in Melbourne and Sydney than in the rest of Australia); and significantly stronger population growth for Victoria compared to elsewhere. Large declines in mining investment and commodity prices have helped shift the focus of growth back to the eastern states (the reverse of what occurred during the mining boom), with weaker conditions now evident in the mining states. However, the forces driving these divergent outcomes appear to be easing, with prospects of recovering growth in the mining states ahead. If this includes stronger prices for key resources (e.g. iron ore, coal and oil), this will help push inflation back up to target levels in the 2% to 3% range, according to the RBA.

Also out this week, the Department of Foreign Affairs and Trade (DFAT) released its annual report on *International Investment in Australia 2015*, which outlines trends in foreign investment in Australia and Australian foreign investment for the 2015 year. This report confirms that foreign investment in Australia has been growing strongly, with major international investment flowing in from the US, UK, Japan, Singapore and Europe. Foreign direct investment in Australia in 2015 was dominated by mining investment and investment in services industries, with manufacturing only attracting a small proportion of total foreign direct investment.

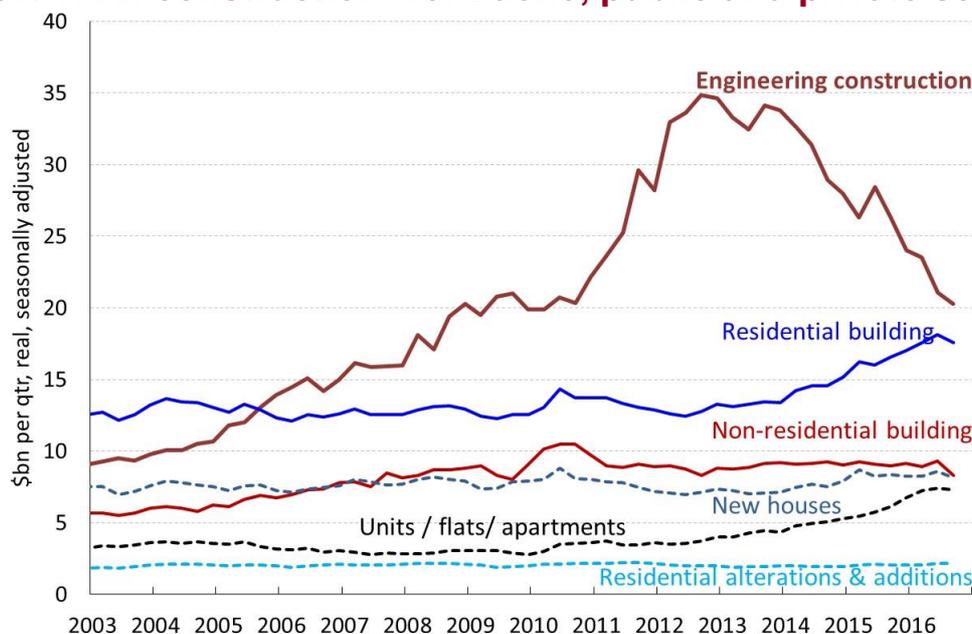
Construction activity plummets, residential construction joins decline

The volume of all construction work done in Q3 2016 (inflation adjusted), dropped by 4.9% q/q and 11.1% p.a.. This was the sharpest annual decline since Q2 in 2001 and was mainly because residential construction - which had been growing steadily and somewhat cushioning the long decline in mining-related engineering construction work - faltered. Construction volumes have now fallen for over two years, with declines evident across most sectors. Recent approvals, CAPEX expectations and other data suggest this decline in engineering construction activity may have bottomed out, with the worst declines having already occurred. Future further declines in engineering construction (and total construction activity) are unlikely to be as large.

Private sector engineering construction fell by 6.6% q/q and 35.6% p.a. in Q3, as large-scale LNG plants near completion and fewer new major resources projects commence. This was somewhat counterbalanced by public sector engineering construction (such as Government transport projects in NSW and Victoria), which grew by 1.4% q/q and 15.8% p.a. Engineering construction accounted for 43.9% of total construction work done in the quarter (27.9% private, 16.0% public).

Outside the engineering construction segment, non-residential construction activity (e.g. shops, offices, factories and hospitals) shrank by 5.7% q/q but was 1.4% higher over the year. Residential construction (houses and apartments), appears to be finally slowing from recent peaks, with quarterly activity down by 3.1% q/q (but still up 6.3% p.a.). The inflation-adjusted value of all residential construction (public and private sectors) was estimated at \$17.6bn, or about 38% of the total volume of construction in Q3. Much of the demand for residential construction work has recently been driven by apartment construction, but this now looks to be flattening out (chart 1).

Chart 1: All construction work done, public and private sector



Source: ABS, *Construction Work Done*, September 2016.

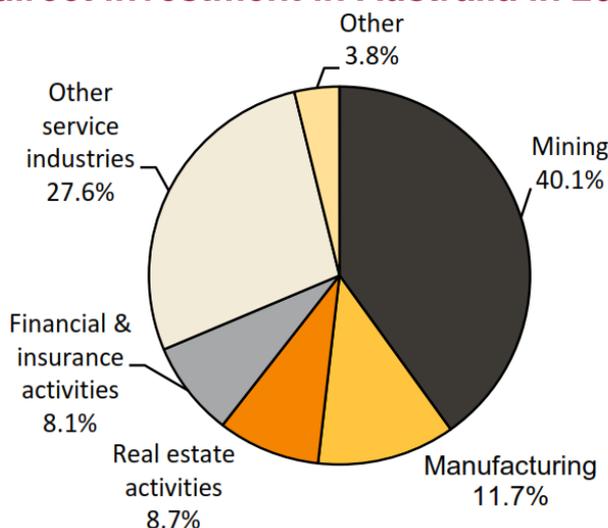
Foreign investment grew strongly in 2015

Net inflows of foreign investment into Australia increased by 7.9% p.a. (\$75.6bn) in 2015 to reach \$3.0 trillion, according to the latest report from the Department of Foreign Affairs and Trade (DFAT), *International Investment in Australia 2015*. Net foreign investment accounted for 17.8% of Australia’s total investment requirements during 2015. Australia has long been a net importer of capital, relying heavily on foreign investment to support new projects and businesses.

Looking at the sources of Australia’s foreign investment, the biggest source countries as at 2015 were the US (\$860bn), the UK (\$500bn), Belgium (\$239bn), Japan (\$200bn) and Singapore (\$99bn). Despite perceptions of large amounts of investment from China, investment from China ranked 7th, with a relatively small \$75bn invested as at 2015, compared to the nations above.

In terms of outflows, Australian investment abroad increased by 8.2% p.a. (\$5.1bn) in 2015 to reach \$2.1 trillion. Australian investment abroad is largest in the US (\$594bn), the UK (\$353bn) and New Zealand (\$99bn).

Chart 2: Foreign direct investment in Australia in 2015, industry shares



Source: DFAT, *International Investment In Australia 2015*

Looking at the types of foreign investment being made in Australia, the total stock of foreign direct investment in establishing business operations or acquiring business assets was valued at \$736bn in 2015, up by 7.2% p.a. (\$49bn). The largest holders of this total stock of foreign direct investment in 2015 were the US (\$174bn), Japan (\$86bn) and the UK (\$76bn). The largest sources for new foreign direct investment in 2015 were the US (\$27bn), Singapore (\$22bn) and the European Union (\$15bn).

In terms of industries, the mining industry is the largest destination for foreign investment holdings, at 40.1% of the total stock of foreign investment (\$295bn). Services industries also attracted a significant 27.6% (\$205bn) of total investment, while 11.7% is invested in manufacturing (\$86bn).

This week's data and events, 21 November – 25 November 2016

Day	Date	Data/event	Data period	Previous release
Tue	22 Nov	ABS producer price index - additional information	Sep (M)	-
		RBA Dep. Governor Guy Debelle speech	Nov (M)	-
Wed	23 Nov	ABS construction work done	Sep (Q)	-4.9% q/q; -11.1% p.a.
		Department of Employment skilled vacancies	Oct (M)	IVI +1.9% m/m; +2.2% p.a.
Thu	17 Nov	ABS detailed labour force statistics	Oct (M)	-

M = monthly. Q = quarterly. H = half-yearly. A = annual. All data are seasonally adjusted unless otherwise noted.

Next week's data and events, 28 November – 2 December 2016

Day	Date	Data/event	Data period due for release	Previous release
Tue	29 Nov	ABS balance of payments	Jun (Q)	Mar: Trade bal -\$8.0bn; +8%q/q
		RBA private sector credit	Oct (M)	Sep: +0.4% m/m; +5.4% p.a.
		Ai Group Australian PMI®	Nov (M)	Oct: 50.9
Wed	30 Nov	ABS building approvals	Oct (M)	Sep: -8.7% m/m; -6.4% p.a.
Thu	1 Dec	ABS capital expenditure	Sep (Q)	Jun: -5.4% q/q; -17.4% p.a.
Fri	2 Dec	ABS retail trade	Oct (M)	Sep: +0.6% m/m

M = monthly. Q = quarterly. H = half-yearly. A = annual. All data are seasonally adjusted unless otherwise noted.

Australian economy: latest full-year estimates and government forecasts

RBA (Nov 2016)	2014-15 actual	2015-16 actual	2015-16 f	2016-17 f	2017-18 f	2018-19 p	2019-20 p
GDP, % change p.a.	2.2	3.3	2.5-3.5	2.5-3.5	2.5-3.5	-	
Inflation (CPI), % change p.a.	1.5	1.0	1.5	1.5-2.5	1.5-2.5	-	
Treasury (May 2016)							
GDP, % change p.a.	2.2	3.3	2.5	2.5	3.0	3.0	3.0
Household consumption, % p.a.	2.7	2.9	3.0	3.0	3.0		
Dwelling investment, % p.a.	7.9	8.3	8.0	2.0	1.0		
Business investment, % p.a.	-6.2	-14.7	-11.0	-5.0	0.0		
Employment growth, % p.a.	1.6	1.9	2.0	1.75	1.75	1.25	1.5
Unemployment rate, %	6.1	5.8	5.75	5.5	5.5	5.5	5.5
Terms of trade, % change p.a.	-10.3	-5.4	-8.75	1.25	0.0		
Inflation (CPI), % change p.a.	1.5	1.0	1.25	2.0	2.25	2.5	2.5
Wages (WPI), % change p.a.	2.3	2.1	2.25	2.5	2.75	3.25	3.5

Sources: ABS various data; RBA *Statement on Monetary Policy*; and Australian Treasury, *Federal Budget 2016-17*. f = forecast. p = projection.

Australian economy: latest indicators

Economy				FX and commodity prices (as of Friday)		
RBA official cash rate, %	Nov (M)	1.50	-	AUD/USD exchange rate	US\$0.7415	▲
Real GDP, % change p.a.	Jun (Q)	3.3%	▲	Oil price (WTI light crude, USD/BBL)	US\$47.95	▲
Headline CPI, % change p.a.	Sep (Q)	1.3%	▲	Gold price (USD/OZ)	US\$1,175.06	▼
Unemployment rate, % trend	Oct (M)	5.6%	▼	Copper price (USD/tonne, LME spot)	US\$5,562.00	▲

Australian Industry Group monthly indexes

Australian PMI®	Oct (M)	50.9	▲
Australian PSI®	Oct (M)	50.5	▲
Australian PCI®	Oct (M)	45.9	▼

M = monthly. Q = quarterly. All data are seasonally adjusted unless otherwise noted.

Arrows represent direction of movement relative to last week for prices, and last observation for growth rates and indexes.

Sources: ABS various data; Ai Group; Australian Financial Review market prices (as of Fri); London Metals Exchange market prices (as of Fri).

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