ECONOMICS WEEKLY

1 December 2017

AUSTRALIAN ECONOMIC DEVELOPMENTS

This week's data on Australian business activity and expectations indicate a cautiously positive outlook for the remainder of 2017 and into 2018. Globally, the OECD agreed this week with the IMF on a more positive outlook for 2018, but it expects growth to moderate again in 2019.[1]

In Australia, Ai Group's Australian Performance of Manufacturing Index (Australian PMI®) jumped 6.2 points to 57.3 points in November (results above 50 points indicate expansion with higher results indicating a stronger expansion). This marked a fourteenth month of expanding or stable conditions for the Australian PMI® and the longest run of expansion since 2005. New orders and exports were especially strong, which bodes well for growth in 2018. Input prices rose sharply in November however, with manufacturers across several sub-sectors noting that soaring energy costs are damaging their profitability.

Across most non-mining industries (with the glaring exception of local retailers), conditions have been steadily improving through 2017 and now non-mining business investment is improving also. The latest private sector investment numbers (CAPEX) indicate total CAPEX rose 1% q/q and 2.3% p.a. in Q3 2017, with CAPEX by all non-mining industries up by 1.5% q/q and 8.7% p.a.

Revised expectations for CAPEX in 2017-18 suggest annual spending could rise by up to 10% among businesses outside mining and manufacturing. If it eventuates, this will be a significant step up from just 1.8% p.a. growth in non-mining CAPEX in 2016-17 and a small fall in 2015-16.

Building approvals increased for a third consecutive month in October and housing credit lifted a notch indicating that there remains underlying support for housing construction amid record low interest rates and strong population growth.

OECD expects mildly better growth in 2018, but another slower year in 2019

Last week saw cautiously optimistic forecasts for 2018 from the RBA and the IMF. This week the OECD concurred, with better forecasts for 2018 for the global economy and for most but not all individual countries. For various reasons, the OECD expects 2019 to be another slower year. While the IMF (and Australia's own RBA) remain very concerned about persistently weak inflation and nominal wages growth globally, the OECD also highlighted slow investment and productivity:

> *Annual growth of the world economy is projected to improve slightly in 2018, but remains*

[1] www.aigroup.com.au/policy-and-research/economics/economicindicators/

> *below the pre-crisis [GFC] period and that of past recoveries. … Persistent effects of prolonged sub-par growth on private sector performance include investment, trade and productivity. … In the absence of a clear sign of change in [these] underlying trends, growth across the OECD is projected to weaken in 2019. … Countries should implement reform packages that catalyse the private sector to promote productivity, higher wages and more inclusive growth"*

The OECD revised up its global growth expectations very slightly, to reflect better than expected growth in 2017 to date. The OECD now expects global GDP growth of 3.6% p.a. in 2017, 3.7% in 2018 and 3.6% in 2019. Average growth for OECD countries will be slower than this (table 1), since stronger growth rates are expected for the developing and emerging economies outside the OECD group, such as China. Chinese GDP is projected to grow by 6.8% in 2017, 6.6% in 2018, and 6.4% in 2019, partly reflecting "the ongoing rebalancing in China's growth model."

For Australia, the OECD expects "robust" annual GDP growth of 2.8% in 2018 and 2.7% in 2019 (up from 2.5% in 2016 and 2017), with the unemployment rate dropping to 5.3% (currently 5.5%) (see table 1). A strengthening labour market should push up wages and inflation by enough to enable the RBA to begin to raise the cash rate from its current record low of 1.50%, in late 2018.

For the Australian Government, the OECD recommends policies and tax settings that are more supportive of business growth, trade and social inclusion. It says Australia has "*scope for further tax reforms that make greater use of efficient tax bases, such as the GST and land tax, in lieu of corporate tax and inefficient taxes. Improved competition policy would boost productivity and encourage market entry by innovative businesses*."

Table 1: OECD forecasts for 2018 and 2019, OECD average and Australia

	OECD average		Australia	
	2018	**2019**	**2018**	**2019**
GDP, % change p.a.	2.4	2.1	2.8	2.7
Unemployment rate, %	5.5	5.3	5.4	5.3
Business investment, % change p.a.	3.3	3.3	1.6	3.4
Consumption, % change p.a.	2.3	2.1	2.0	2.6
Export volumes, % change p.a.	4.3	4.2	6.3	3.7
Headline inflation, % change p.a.	2.1	2.3	2.0	2.2

Source: OECD, *Economic Outlook,* Nov 2017.

Business investment recovers in Q3, expected to grow further in 2018

The latest private sector investment spending numbers (CAPEX) indicate total CAPEX rose 1% q/q and 2.3% p.a. in Q3 2017 (inflation-adjusted and seasonally-adjusted), with CAPEX by all non-mining industries up by 1.5% q/q and 8.7% p.a. (table 2). Q3 was the third consecutive quarter of rising total CAPEX, despite the significant declines in CAPEX by the mining sector in almost every quarter since peaking in 2012. Mining CAPEX now accounts for one third of total CAPEX (around its long-run average), down from its peak of 59% in 2013.

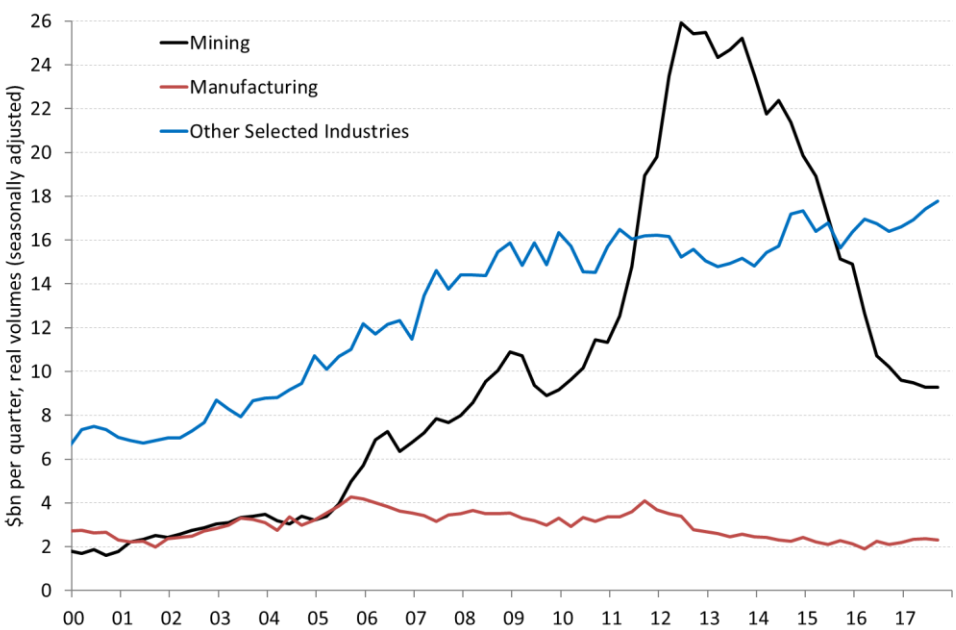
Most promisingly, Q3 was the fourth consecutive quarter of rising CAPEX by businesses outside of mining and manufacturing (table 2 and chart 1).

Table 2: actual CAPEX per quarter, by asset type and industry, Q3 2017

Real volumes, seasonally adjusted	$mn per Qtr	%q/q	%y/y	% of total
By type of asset:				
Buildings & structures	16,462	1.2	2.4	63.5
Equipment, plant & machinery	12,906	0.7	2.2	36.5
All CAPEX	**29,368**	**1.0**	**2.3**	**100.0**
By Industry:				
Mining	9,285	0.0	-9.1	32.1
Manufacturing	2,296	-2.7	9.8	7.7
Other Selected Industries	17,788	2.1	8.5	60.2
All industries other than mining	**20,084**	***1.5***	***8.7***	***67.9***

Source: ABS, *CAPEX,* Sep 2017.

Chart 1: actual CAPEX per quarter, major industries



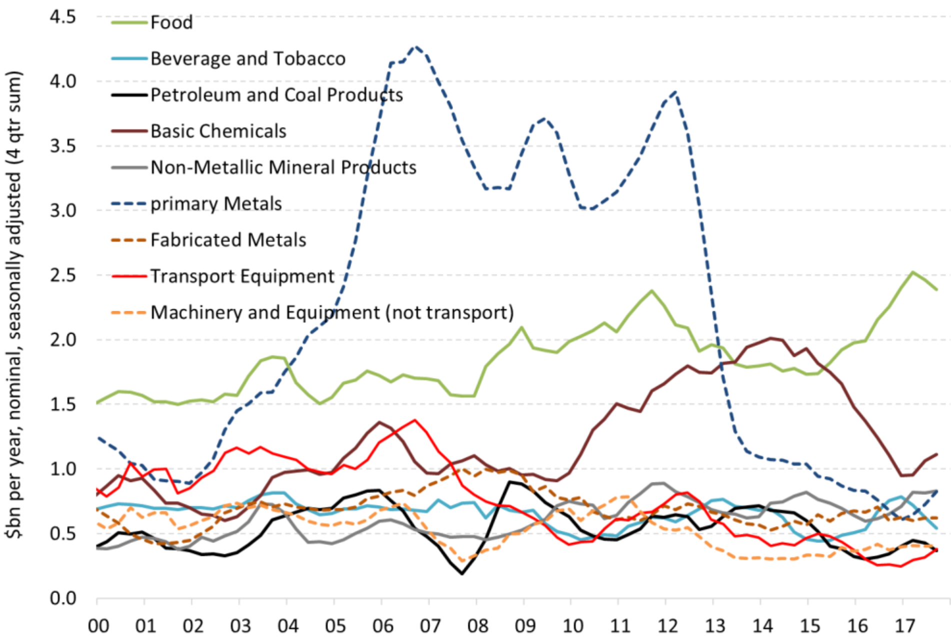
Across the states, CAPEX growth has been strongest over the year to Q3 in Victoria (+7.1% p.a.). South Australia (+41% p.a.), Tasmania (+35% p.a.) and the Northern Territory (+20% p.a.) all saw large spurts of CAPEX growth in the year to Q3, although the small numbers and choppy nature of the data suggest these were probably due to large but unique projects. CAPEX in Western Australia stopped falling in Q3 (+0.8% q/q and the first quarterly rise since Q3 2014) but remained 7.7% lower than one year earlier.

CAPEX by manufacturers fell 2.7% q/q in Q3 but remained a remarkable 9.8% higher than one year earlier (seasonally adjusted inflation-adjusted dollars). Manufacturing accounted for 7.7% of all CAPEX in Q3, which is higher than its current share of output (5.7%) or employment (7.3%).

This surge in manufacturing CAPEX is apparent across a number of manufacturing sectors including food and beverages, chemicals, non-metallic minerals (building materials) and metals (chart 2). These are the sectors which have indicated the strongest recoveries in production, sales, employment and orders through 2017 in the Australian PMI® and in various ABS data.

Perhaps more remarkably, the CAPEX data also indicate an uptick in investment spending through 2017 in the transport equipment manufacturing sector. The sector spent $380mn on CAPEX in the year to Q3 2017, compared to just $262mn one year earlier (up 45%, in nominal dollars). This is the sector that previously included passenger car automotive assembly, which has now exited from Australia and which previously invested heavily in local facilities and capabilities. This sector's current CAPEX is instead supporting auto parts and non-auto transport manufacturing such as trucks, boats, trains, buses, caravans, planes and more.

Chart 2: CAPEX per year, manufacturing



Source: ABS, *CAPEX,* Sep 2017.

This latest CAPEX release included the fourth estimate of annual CAPEX intentions for 2017-18. This indicated that Australian businesses plan to invest a total of $108,922m. This is 1.6% higher than Estimate 4 for 2016-17 (the equivalent estimate for one year earlier) and 5.6% higher than Estimate 3 for 2017-18 (the previous estimate for this current year).

Once adjusted for probable realisations (based on an average realisation ratio of the past five years), this implies total CAPEX in 2017-18 will be around $105,436mn, which is 7.8% lower than the actual amount of CAPEX in 2016-17 (in nominal terms). All of this fall however, is due to lower CAPEX in the mining industry, which is still coming down from record-high peaks.

Outside of mining, CAPEX looks likely to rise by 8.8% to $82,316mn in 2017-18. This will include a stable level of CAPEX in manufacturing (+0.1% p.a.) and an increase of around 10% among businesses outside mining and manufacturing, compared to 2016-17 (table 3). This is a significant step up from just 1.8% p.a. growth in non-mining CAPEX in 2016-17.

Table 3: Expected CAPEX per year, Q3 2017

	2016-17 (actual)		**2017-18 (estimate 4)***	
Nominal dollars per year	$mn	% p.a.	$mn	% p.a.
Mining				
Buildings and structures	33,277	- 30.0	23,832	-28.4
Plant and equipment	5,474	- 6.8	5,632	2.9
All mining	38,751	- 27.4	29,488	- 23.9
Manufacturing				
Buildings and structures	2,476	27.0	2,367	- 4.4
Plant and equipment	6,397	- 3.3	6,535	2.2
All manufacturing	8,873	3.6	8,881	0.1
Other selected industries				
Buildings and structures	29,353	6.2	35,368	20.5
Plant and equipment	37,430	- 1.7	36,628	- 2.1
All 'other selected industries'	66,783	1.6	73,435	10.0
All buildings and structures	65,105	- 15.6	59,738	- 8.2
All plant and equipment	49,301	- 2.5	47,658	- 3.3
ALL CAPEX	**114,406**	**-10.4**	**105,436**	**- 7.8**
all non-mining CAPEX	75,656	1.8	82,316	8.8

* five year average realisation ratio applied. Source: ABS, *CAPEX,* Sep 2017.

Business approvals and private sector credit suggest housing will remain elevated in 2018

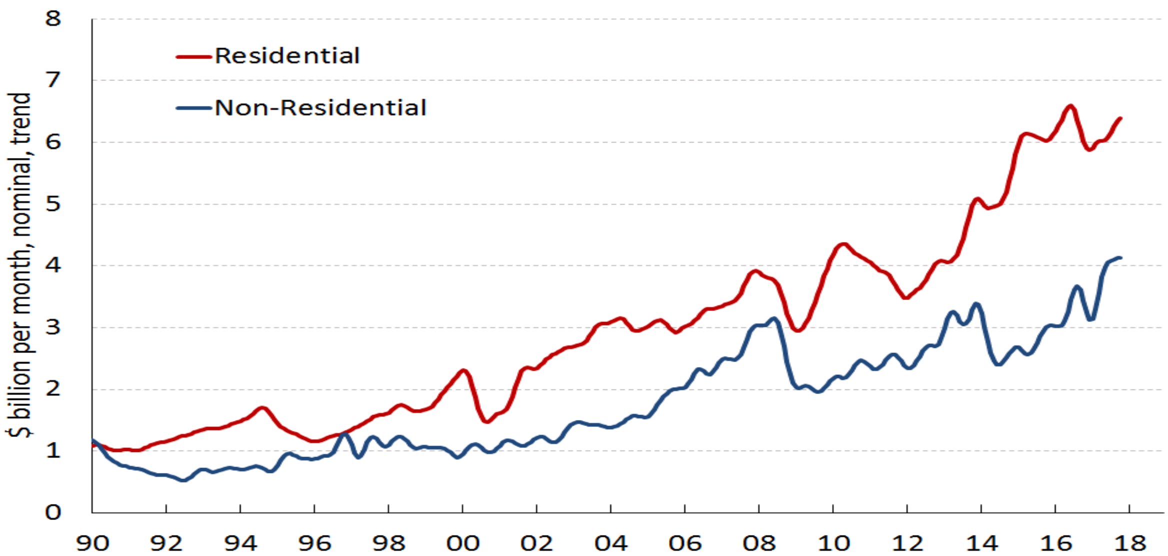
The latest ABS monthly residential building approvals data for October show that approvals have continued their gradual improvement of recent months. Residential building approvals lifted by 0.9% in October after an increase of 0.6% in September. Within this total, private sector house approvals were higher (+1.5% m/m and +6.2% p.a.) while approvals for private sector “other dwellings” (which includes apartments, flats and multi-units), drifted lower (-1.0% and +37.6%) in the month.

The total number of approvals is now 13.5% higher than in March 2017 (the recent low) but remains 14.4% lower than the national record high in August 2016 (seasonally adjusted). This continues to indicate that the residential construction cycle has turned but points to activity remaining at a high level in 2018. Reflecting this still solid pipeline of new residential construction, housing credit growth lifted a notch in October (+0.5% m/m) to be 6.5% higher over the year while recently released housing finance data for September indicates continued strength in lending for the construction of new dwellings.

In value terms, building approvals decreased by 1.1% (seasonally adjusted) in October to be 26.2% higher than a year earlier. The value of residential approvals increased by 5.4% m/m and +22.7% p.a., including a rise of 3.6% m/m and +23.9% p.a. in the value of new home construction. The value of home renovation activity (a smaller but valuable segment) increased by a solid 21.4% m/m in October to be 14.7% p.a. higher over the year

Despite the value of non-residential building approvals dropping by 10.1% m/m (seasonally adjusted) in October, approvals across this sector have generally trended higher this year with annual growth at a solid 32.3% p.a.. Whilst the pipeline is mixed, rising approvals in major building categories including accommodation, offices, education buildings and industrial premises will help to support stronger commercial construction activity over the coming year or so.

Chart 3: Value of building approvals per month (trend)



Source: ABS, *Building Approvals,* Oct 2017.

Across the states, growth in residential building approvals was driven by Victoria (+24.3% m/m) and Queensland (+6.1% m/m). These rises out-stripped declines in Western Australia (-17.8% m/m), South Australia (-8.4%) and NSW (-6.8% m/m).

This week's data and events, 27 November – 1 December 2017

Day	Date	Data / event	Data period	Current release
Thurs	30 Nov	ABS assets and liabilities	Sep (Q)	total assets +0.5% q/q
		ABS private new capital expenditure (CAPEX)	Sep (Q)	+1.0% q/q, +2.3% p.a.
		ABS building approvals	Oct (M)	total number of dwelling units approved +0.9% m/m, +18.4% p.a.
		RBA private sector credit	Oct (M)	total credit outstanding +0.4% m/m, +5.3% p.a.
Fri	**1 Dec**	**Ai Group Australian PMI**	**Nov (M)**	**57.3 points**

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

Next week's data and events, 4 – 8 December 2017

Day	Date	Data/event	Data period due for release	Previous release
Mon	4 Dec	ABS business indicators	Sep (Q)	Jun: corp. profits -4.5% q/q
Tue	5 Dec	ABS balance of payments	Sep (Q)	Jun: current account -$9.6bn
		ABS retail trade	Oct (M)	Sep: nominal value of sales 0.0% m/m
		RBA interest rate decision	**Dec (M)**	**Cash rate: 1.50%**
		Ai Group Australian PSI®	**Nov (M)**	**51.4 points**
Wed	6 Dec	**ABS national accounts (GDP)**	**Sep (Q)**	**Jun: GDP +0.8% q/q; +1.8% p.a.**
Thu	7 Dec	ABS international trade	Oct (M)	Sep: Exports $33.0bn; Imports $31.2bn
		Ai Group Australian PCI®	**Nov (M)**	**53.2 points**
Fri	8 Dec	ABS housing finance	Oct (M)	Sep: -2.3% m/m

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

Australian economy: latest full-year growth rates and government forecasts

RBA SoMP (Nov 2017)	**2015-16 actual**	**2016-17 actual**	**Jun '18 f**	**Jun '19 f**	**Dec '19 p**	
GDP, % change p.a., year end	3.1	1.8	2.75	3.5	3.25	
Unemployment rate, %, year end	5.8	5.6	5.5	5.5	5.25	
Inflation (CPI), % change p.a., year end	1.0	1.9	2.0	2.25	2.25	
Treasury 2017-18 Budget (May 2017)	**2015-16 actual**	**2016-17 actual**	**2017-18 f**	**2018-19 f**	**2019-20 p**	**2020-21 p**
GDP, % change p.a., year average	2.6	2.0	2.75	3.0	3.0	3.0
Household consumption, % p.a., year average	2.9	2.6	2.75	3.0		
Dwelling investment, % p.a., year average	10.6	-2.5	1.5	-4.0		
Business investment, % p.a., year average	-10.3	-1.6	0.0	3.0		
Employment growth, % p.a., year end	1.9	2.1	1.5	1.5	1.5	1.5
Unemployment rate, %, year end	5.8	5.6	5.75	5.5	5.5	5.25
Terms of trade, % change p.a., year end	-10.2	14.9	-2.75	-4.25		
Inflation (CPI), % change p.a., year end	1.0	1.9	2.0	2.25	2.5	2.5
Wages (WPI), % change p.a., year end	2.1	1.9	2.5	3.0	3.5	3.75

f = forecast. p = projection.
Sources: ABS various data; RBA *Statement on Monetary Policy* (SoMP), latest quarter; Australian Treasury, *Budget 2017-18* (May 2017).

Australian economy: latest indicators

Economy				**FX and commodity prices (Friday morning)**		
RBA official cash rate, %	Nov (M)	1.50	-	AUD/USD exchange rate	US$0.7564	▼
Real GDP, % change p.a.	Jun (Q)	1.8%	▲	Oil price (WTI light crude, USD/BBL)	US$57.4	▼
Headline CPI, % change p.a.	Sep (Q)	1.8%	▼	Gold price (USD/OZ)	US$1,274.70	▼
Unemployment rate, % trend	Oct (M)	5.5%	-	Copper price (USD/tonne, LME spot)	US$6,739.50	▼

Australian Industry Group monthly performance of industry indexes

Australian PMI®	Nov (M)	57.3 ▲
Australian PSI®	Oct (M)	51.4 ▼
Australian PCI®	Oct (M)	53.2 ▼

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 Thu); London Metals Exchange market prices (as of Fri).

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