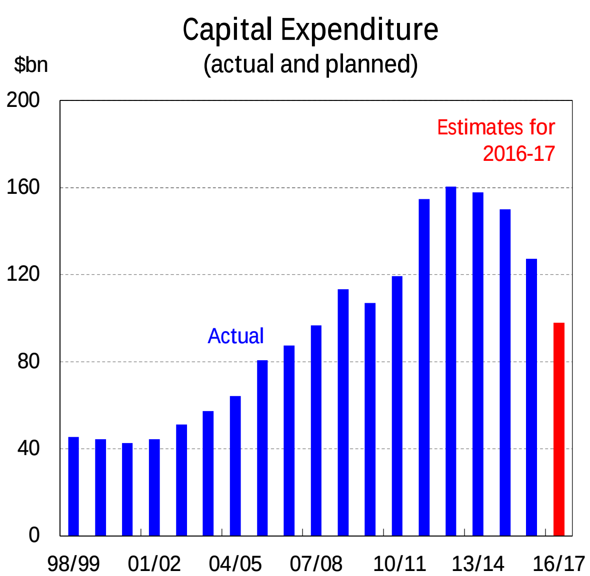
Data Snapshot

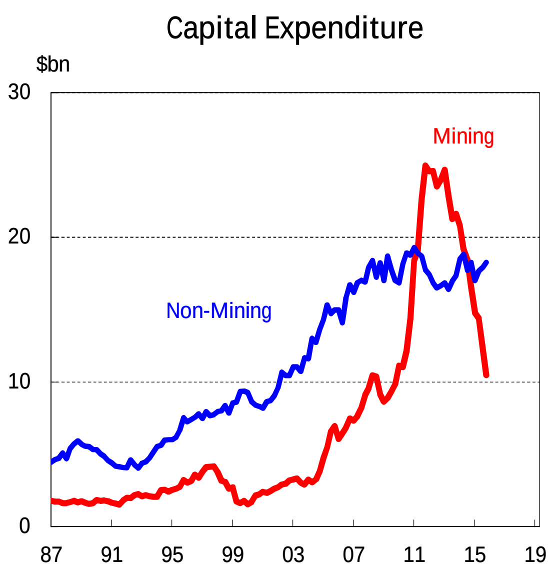
Thursday, 1 September 2016

Bank of Melbourne

Private Capital Expenditure
Silver Linings

- Private capital expenditure dropped 5.4% in the June quarter, falling in six out of the last seven quarters. The annual pace continued to be deeply in contraction, down 17.4% in the year to the June quarter.
- The sharp decline comes as no surprise given the ongoing downturn in mining investment. Indeed, the drop was entirely driven by mining capex which dropped 16.1% in the quarter. We are yet to see the unwinding of the mining investment boom run its course, but the drag on the economy should ease over time.
- There was however, some positive news within the non-mining sectors. Actual spending on non-mining capex increased in the June quarter. Moreover, spending plans for non-mining sectors were upgraded over 2016-17.
- Spending plans for 2016-17 were upgraded from $91.3bn to $105.4bn. The revision now suggests a 17.3% decline in spending from 2015-16 based on realisation ratios - an improvement on the 20% plus decline implied by earlier estimates, but still suggesting a sizeable decline.
- While the signs of improvement within non-mining investment are encouraging, planned spending is not yet implying a sustained recovery in non-mining investment. The pace of economic growth remains moderate, but we may need to see a pickup in growth beyond trend for inflation to return to target. Further improvement in investment spending would assist with this pickup.





Actual Spending

Private capital expenditure (capex) dropped 5.4% in the June quarter, falling in six out of the last seven quarters. The annual pace continued to be deeply in contraction, down 17.4% in the year to the June quarter.

The sharp decline comes as no surprise given the ongoing downturn in mining investment. Indeed, the drop was entirely driven by mining capex which dropped 16.1% in the quarter. However, there was better news within the non-mining sectors. Non-mining investment rose 2.1% in the June quarter, and has risen for three consecutive quarters. Manufacturing capex rose 12.9% in the June quarter after two consecutive quarters of decline. Capex in other sectors (which includes services) rose 0.8% in the quarter.

On an annual basis, mining investment was down 36.6% in the June quarter, the largest annual contraction in 16 years. Manufacturing capex was up 3.9% over the same period, while capex in other industries fell 0.6% in the year.

The breakdown by assets revealed a 10.6% decline in buildings in the June quarter, while equipment spending rose 2.8% in the June quarter.

Actual Spending by State

The weakness in capital spending was largely driven by an 18.4% drop in Western Australia. Investment spending has declined for five consecutive quarters in the State, as major resource projects approach completion. There were also modest declines in Queensland (-1.6%), Victoria (-1.1%) and South Australia (-0.8%). The Northern Territory posted a 18.8% jump in the June quarter, but this followed an 18.2% drop in the March quarter. There were also gains in capital spending in NSW (3.6%), Tasmania (7.6%) and the ACT (30.8%).

On an annual basis, declines in Western Australia (-33.9%), Queensland (-28.4%), and the Northern Territory (-9.6%) continue to reflect weaker mining investment. The annual pace was also weak in South Australia (-5.0%), the ACT (-2.8%) and Victoria (-0.8%), suggest that non-mining investment is yet to gain much traction. NSW (7.0%) and Tasmania (2.1%) were the only States where capex grew on a year earlier.

Spending Plans

There was some positive news in spending plans. In today's release, we received the seventh and final estimate for spending in 2015-16 and the third estimate for spending for 2016-17.

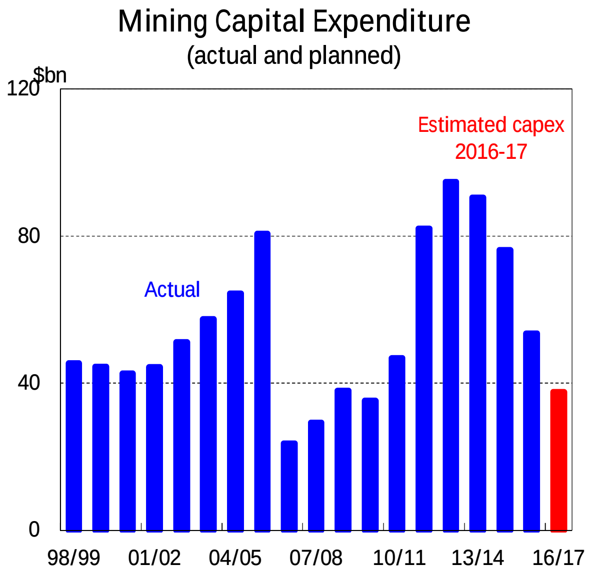
Actual spending over 2015-16 was broadly as estimated in the previous quarter at $127.4bn. Of greater interest is the estimate for spending for 2016-17, which revealed an upgrade in spending plans to $105.4bn up from $91.3bn estimated in the previous quarter. The revision now suggests a 17.3% decline in spending from 2015-16 based on realisation ratios - an improvement on the plus 20% decline implied by earlier estimates, but still suggesting a sizeable decline.

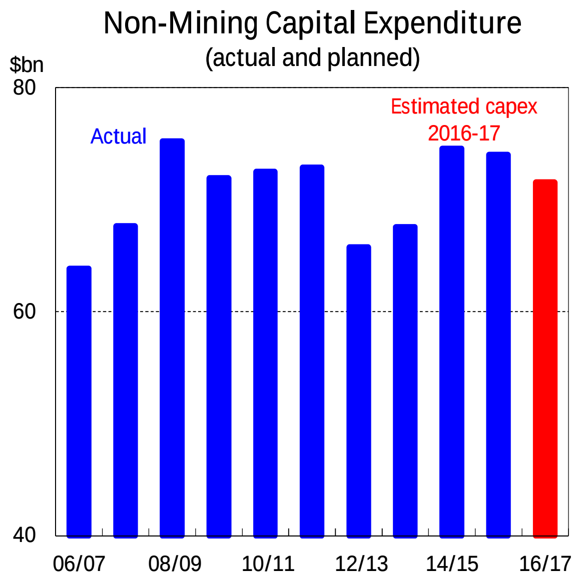
Plans across all major sectors were upgraded over 2016-17. A rebound in commodity prices may have helped to boost investment intentions in the mining sector. The estimate for spending was 14.5% higher than previously, but the global environment points to a weak outlook for mining sector. Planned spending is still implying a sizeable fall of 30% decline in mining investment over

2016-17.

Non-mining capital spending was similarly upgraded in 2016-17 for both manufacturing and other selected industries. These industries saw lifts in estimated spending from the previous quarter of 16.5% and 15.5%, respectively.

Spending plans now imply a flat result in manufacturing in 2016-17 from 2015-16 and a 3.8% decline in capex in other industries. This improvement is encouraging, but the data is not yet suggesting the recovery in non-mining investment that the RBA had hoped for.





Outlook and Implications

The unwinding of the mining investment boom, driving a decline capital spending, has been an ongoing theme that has played out over the last few years. We are yet to see this run its course, but the drag on the economy should ease over time.

The signs of improvement for the non-mining investment outlook were the most encouraging aspects of this release. Capital spending in manufacturing and other industries picked up in the quarter, and spending intentions improved.

Nonetheless, it is important not to get too carried away by this improvement – planned spending is not yet implying a sustained recovery in non-mining investment. Further improvement in investment spending would likely be necessary for a pickup in economic growth. While the current pace of economic growth remains moderate, growth will need to pick up beyond trend for inflation to return to target. Without a strong prospect of above trend economic growth, the likelihood of further rate cuts from the RBA remains.

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