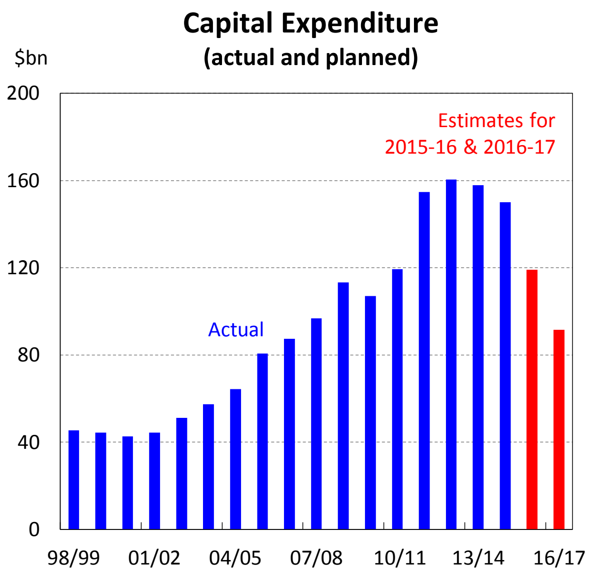
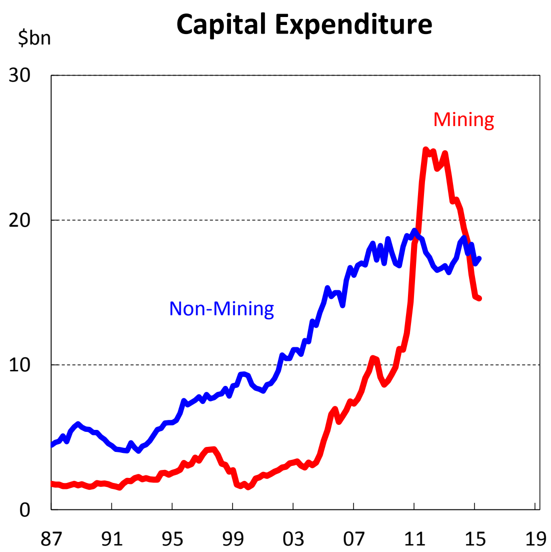
Private Capital Expenditure
Bottom Still Not Within Sight

- **Private capital expenditure lifted 0.8% in the December quarter, against expectations for a decline. Driving the increase was a rebound in capex spending for other industries. Mining and manufacturing capex declined.**
- **The actual spending outcome however, was where most of the good news ended. The first estimate for spending for 2016-17 was rather disappointing, at $82.6bn. This was 19.5% lower than the first estimate for spending for 2015-16 and suggests that the drag on the economy from capital spending will still be significant over 2016-17.**
- **The data is signalling a continuation of the same story in recent years– a big drag from mining investment will continue to weigh on growth, and there remains a lack of traction in non-mining business investment.**
- **There were positive rebounds in capital spending within the stronger-performing States of NSW and Victoria. Capex also increased in South Australia, but declined in Queensland, Western Australia, the Northern Territory, ACT and Tasmania.**
- **Today's data highlights a risk of below-trend growth for the remainder of the year, and raises the possibility the RBA will ease monetary policy further. However, the RBA will also continue to look to other surveys which suggest that conditions in non-mining sectors remain positive and may continue to support the labour market, even while signs of a recovery in non-mining investment remain lacking. Nonetheless, we maintain our view that the RBA to keep rates on hold for the remainder of the year, unless developments take a turn for the worse.**





Actual Spending

Private capital expenditure lifted 0.8% in the December quarter, against expectations for a decline. Driving the increase was a rebound in capex spending for other industries of 3.1%. Mining capex continued its steady decline, falling 0.9% in the quarter. It was the sixth consecutive quarter of decline, although it was the best quarterly result since the June quarter 2014. Manufacturing capex also declined, falling 3.6% in the quarter.

The annual pace in capex revealed weakness across all sectors. In the year to the December quarter, total capital expenditure contracted 16.4%, the third consecutive quarter of annual contraction. Mining capex declined 24.8% in the year to the December quarter. Business spending in manufacturing (-10.4%) and other (-7.2%) also fell in the year.

Despite the better-than-expected result for the quarter, the transition from mining investment to non-mining investment has been disappointing. We have known for some time that mining investment is weakening and dragging significantly on growth. Non-mining sectors are needed to fill some of this gap. Unfortunately, there has been little sign of a sustained pickup in non-mining investment as yet.

The breakdown by asset revealed that spending on buildings increased 1.2%, while capital spending on machinery and equipment edged up 0.1% in the December quarter.

Actual Spending by State

There were positive rebounds in capital spending within the stronger-performing States of NSW (10.7%) and Victoria (0.4%). Capex also increased in South Australia (1.2%).

Capital spending however, declined in all other States including resource States Queensland (-1.8%) and Western Australia (-0.3%) and Northern Territory (-5.6%). Capital spending also declined in the ACT (-13.6%) and Tasmania (-3.4%).

On an annual basis, capital spending remained in deep contraction for Queensland (-31.7%), as major LNG projects continue to wrap up. The Northern Territory (-23.0%) and Western Australia (-15.7%) also had sizeable declines over the year, in addition to South Australia (-26.8%). There were modest declines in the year for NSW (-4.1%) and Victoria (-0.9%). Tasmania (7.2%) and the ACT (3.4%) were the only States or territories with capital expenditure growing in the year to the December quarter.

Spending Plans

There was little positive news in the spending plans. In today's release, we received the fifth estimate for spending in 2015-16 and the first estimate for spending for 2016-17.

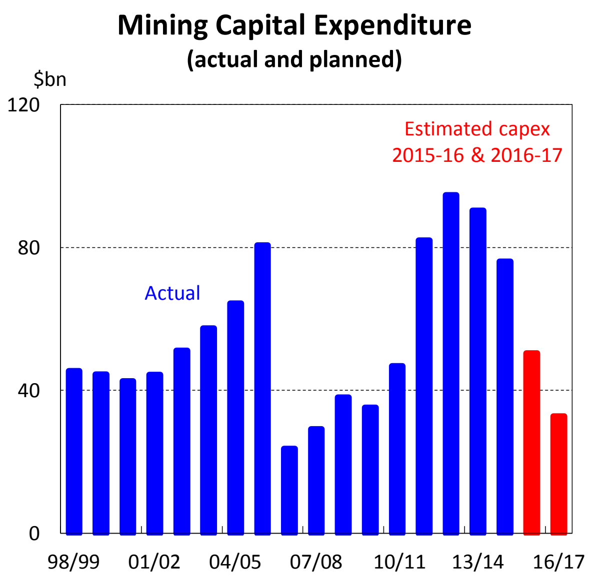
There was a slight downgrade in the fifth estimate for spending of 0.6% for 2015-16 in comparison to the fourth estimate. It continues to signal a sizeable decrease in spending from 2014-15 of just over 20% (based on realisation ratios). This is largely old news, and paints a similar picture presented in the previous survey.

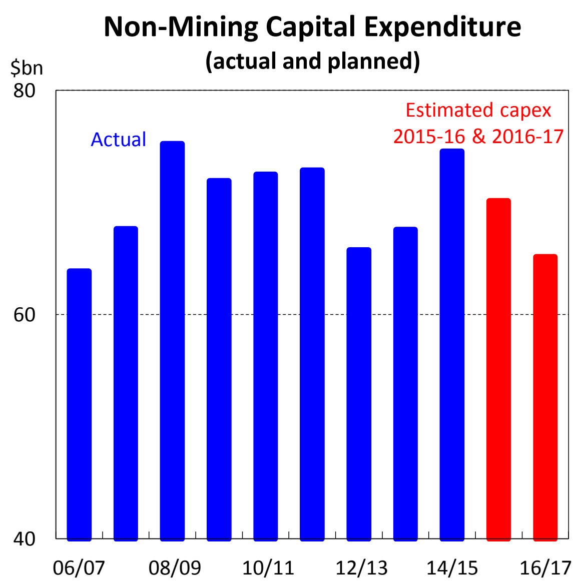
The real focus for determining the outlook is on the first estimate for spending for 2016-17. This was rather disappointing, coming in at $82.6bn. This was 19.5% lower than the first estimate for spending in 2015-16, and implying another chunky decline in spending over the year. This suggests that the drag on the economy from capital spending will still be significant over 2016-17, and larger than we had previously thought.

The industry breakdown had mining capital expenditure at $34.4bn for 2016-17, and 36.2% lower than the first estimate for 2015-16. The estimate for manufacturing in 2016-17 was encouragingly, 9.3% higher than the same estimate for 2015-16, but the estimate for capex for services (other) was 2.5% lower. This would continue to suggest ongoing subdued spending in non-mining investment with virtually no growth implied over 2016-17.

There are however, some silver linings in this otherwise gloomy picture. First estimates tend to be unreliable estimates of actual spending. Thus, there is scope for spending to be upgraded in upcoming quarters. In particular, non-mining investment (both manufacturing and other capex) have been progressively upgraded over 2015-16 over the course of the year. Today's capital expenditure survey also does not fully capture all business investment and excludes other key areas of non-mining investment.

Nonetheless, the data is signalling a continuation of the story in recent years, which will extend into 2016-17– a big drag from mining investment will continue to weigh on growth, and there remains a lack of traction in non-mining business investment.





Outlook and Implications

Today's result for actual spending was better-than-expected. Taken with other partial data, we estimate the economy grew 0.7% in the December quarter for 2.8% annual growth.

However, the less positive news comes from the outlook for investment spending. The ongoing weakness in both mining and non-mining investment as suggested by today's data indicates that the RBA's forecasts for a pickup in growth over late 2016 and 2017 are looking optimistic.

It appears increasingly likely that economic growth may remain below-trend growth for the remainder of the year. This raises the risk that the RBA will downgrade its economic growth forecasts again, and the possibility the RBA will ease monetary policy further.

However, the RBA will also continue to look to other surveys which suggest that conditions in non-mining sectors remain positive and may continue to support the labour market, even while a recovery in non-mining investment is lacking. The RBA will also recognise that today's survey does not fully represent total business investment in the economy, particularly within the non-mining sector.

The implications for monetary policy will depend significantly on upcoming developments in the labour market. How much strength can be sustained in the job market will be a critical question, particularly given that growth may stay below trend for a while longer. This uncertainty, along with global jitters and low inflation will keep the possibility of further monetary easing alive. Nonetheless, we maintain our view that the RBA to keep rates on hold for the remainder of the year, unless developments take a turn for the worse.

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