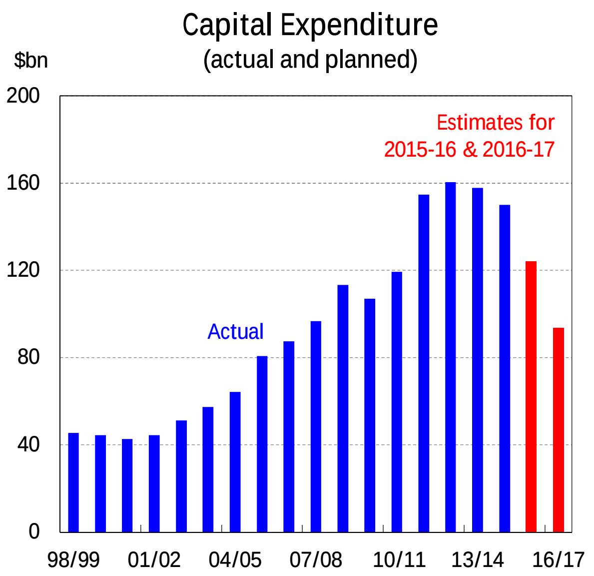
Data Snapshot

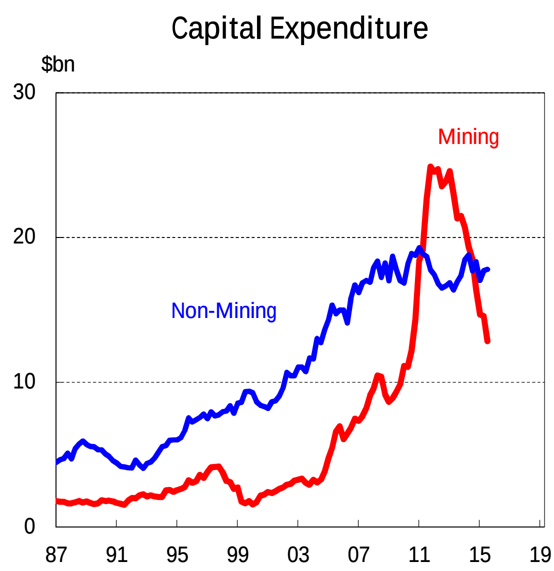
Thursday, 26 May 2016

Bank of Melbourne

Private Capital Expenditure
Still Waiting for Godot!

- Private capital expenditure fell 5.2% in the March quarter. This was in line with our expectation of a 5.0% decline but somewhat worse than the broader market had been expecting. Business investment spending was weakest in the mining sector with a decline of 12.0% in the March quarter.
- Some of the positive rebounds seen across the States in the December quarter were reversed in the March quarter. NSW and Tasmania saw a lift in capex but all the other States and territories experienced declines.
- It was not all bad news. Non-mining private capital expenditure (manufacturing plus services) rose 0.7% over the year.
- Spending plans painted a slightly more positive picture for the business investment outlook than previously. Estimates for spending in both 2015-16 and 2016-17 were upgraded, although they still imply a large fall in capital expenditure of 17.1% and 24.5%, in 2015-16 and 2016-17, respectively.
- The outlook for spending points to an improvement, but it still provides a continuation of the story over the past few years - that the big drag from mining investment will continue to weigh on growth and there remains a lack of traction in non-mining business investment.





Actual Spending

Private capital expenditure (capex) fell 5.2% in the March quarter. This was in line with our expectation of a 5.0% decline but somewhat worse than the broader market had been expecting. Business investment spending was weakest in the mining sector with a decline of 12.0% in the March quarter. This was the seventh straight quarter of decline but had been largely anticipated.

The 10.3% decline in capex by the manufacturing sector during the March quarter was disappointing given the weaker Australian dollar over the past year. It has now fallen in six of the last eight quarters. On a brighter note, spending by the services or 'other' sectors rose 1.8% and has risen in six of the last eight quarters.

The annual pace in capex revealed weakness across mining and manufacturing with total capex down 15.4%. This has been an ongoing story for just over three years. The mining boom was great while it lasted but we are now seeing the after-effects. The manufacturing sector also faces significant competitive challenges. Over the year, mining capex fell 30.7%, manufacturing was down 13.8% and 'other' was up 2.6%. Non-mining capex (manufacturing plus services / other) rose 0.7% over the year.

Actual Spending by State

Some of the positive rebounds seen across the States in the December quarter were reversed in the March quarter. Victoria saw a 0.2% decline following a rise in the December quarter of 2.2% while South Australia moved from a rise of 2.8% to a decline of 2.3%. Queensland (-13.0%) experienced its tenth successive quarterly decline and capex in Western Australia was down for its third quarter out of four. There was better news in NSW where a solid 13.4% rise in the December quarter was followed by a 3.4% rise in the March quarter.

On an annual basis, capital spending remained in deep contraction for Queensland (-32.0%), as the completion of major LNG projects continues to have an impact. The Northern Territory (-25.4%), Western Australia (-22.2%) and South Australia (-12.2%) also had sizeable declines over the year however the decline was only mild in the ACT (-0.6%). NSW (9.3%), Victoria (0.3%) and Tasmania (19.9%) were the States or territories with capital expenditure growing in the year to the March quarter.

Spending Plans

Spending plans painted a slightly more positive picture for the business investment outlook than previously. In today's release, we received the sixth estimate for spending in 2015-16 and the second estimate for spending for 2016-17.

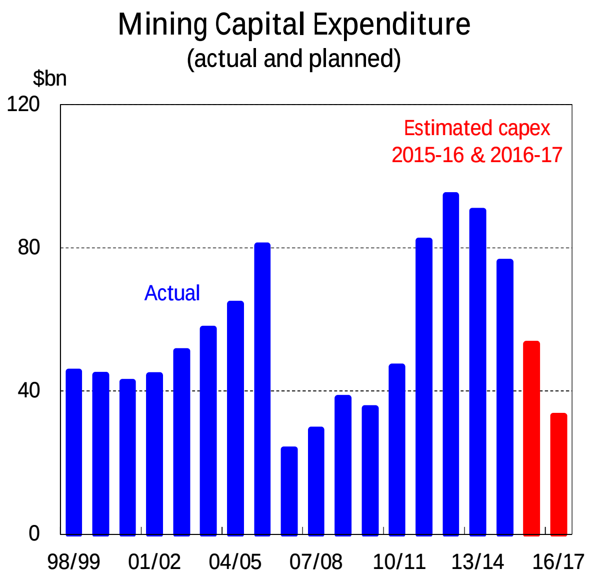
Estimates for spending in both years were upgraded. The sixth estimate for spending in 2015-16 was 2.9% higher than the fifth estimate at $126.8bn. Meanwhile, the second estimate for spending in 2016-17 was upgraded 6.3% to $89.2bn from previously.

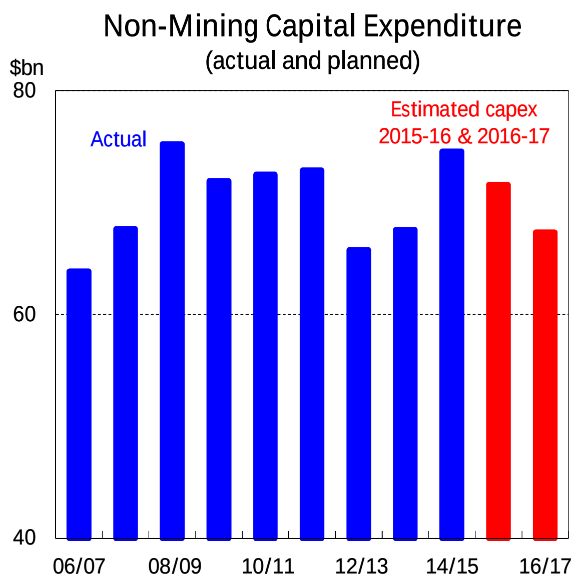
Despite the upward revisions to spending, the estimates still imply a large fall in capital expenditure of 17.1% and 24.5%, in 2015-16 and 2016-17, respectively (using realisation ratios).

The declines were driven by mining, which include the completion of major projects. The sharp declines have been expected for some time, and will come as no surprise to the RBA or market participants.

The most encouraging aspect of the survey was non-mining investment. Capital spending in manufacturing was upgraded for 2015-16 and 2016-17 by 3.4% and 11.3%, respectively. Similarly, estimates for spending in other selected industries lifted from earlier estimates for both years.

Note however, that the data is not yet suggesting a clear pickup in non-mining investment over the coming year. Indeed, estimated spending (using realisation ratios) still suggests a small decline in non-mining capital expenditure in 2016-17. Nonetheless, the second estimate of spending can be unreliable and there is the likelihood that plans, particularly for 2016-17, can be upgraded further. The successive upgrades to spending over the past year and above average conditions reported by non-mining businesses suggests that scope for further improvement remains.





Outlook and Implications

The actual spending outcome was broadly as we expected. As such, we have left our GDP forecast for the March quarter unchanged at 0.7% growth in the quarter and 2.7% growth in the year.

The outlook for spending points to an improvement, but it still provides a continuation of the story over the past few years - that the big drag from mining investment will continue to weigh on growth and there remains a lack of traction in non-mining business investment.

The RBA has placed less focus on this survey in recent times. Firstly, because today's capital expenditure survey does not fully capture all business investment and excludes other key areas of non-mining investment. Secondly, despite the mediocre recovery in non-mining investment, the labour market has improved and the unemployment rate has fallen.

There will be little change to the RBA's outlook for economic growth after today. Nonetheless, questions will remain about the strength of recovery in non-mining investment, which is one of the missing links that would help drive a pickup in economic growth. These questions, combined with the low inflation outlook, suggest that another cut to the cash rate remains on the cards and we expect that this could occur in August.

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