Thursday, 31 August 2017

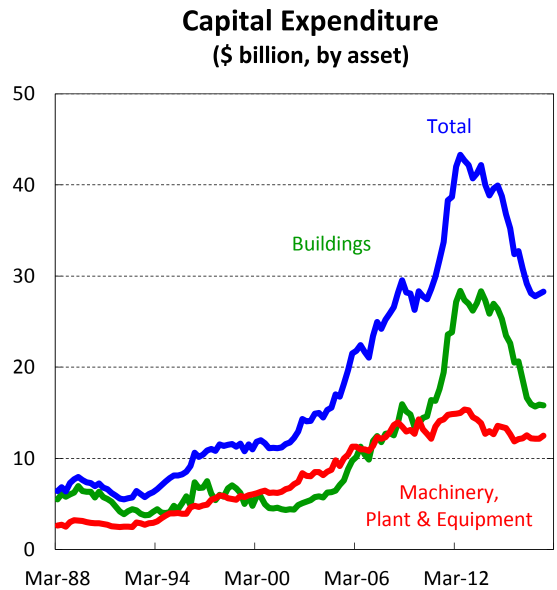
Bank of Melbourne

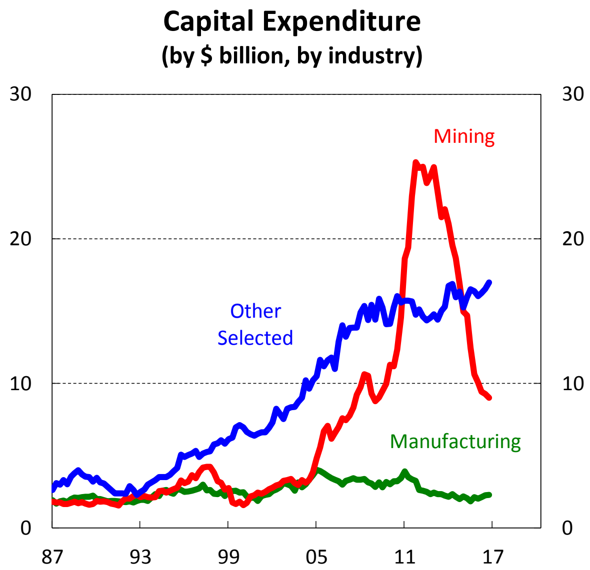
Private Capital Expenditure

Non-Mining Spending Plans Sprout Shoots

- **Private capital expenditure (also known as capex) rose by 0.8% in the June quarter. It is the second consecutive quarterly rise in capex, providing some encouraging signs that a capex recovery is now underway.**
- **The improvement in capex for the June quarter was due to rises in capex by manufacturing and other selected industries (mainly services). Non-mining capex rose by 2.6% in the June quarter, the biggest increase in 1½ years. Mining capex fell by 2.8%, but the annual rate of contraction is the weakest in over 2 years.**
- **The break-up of capex by industry illustrates that the drag from the mining investment downturn is waning and investment by the non-mining sectors is gaining traction.**
- **The actual capex outcome for 2016/17 was $114.3 billion. This result is $13.4 billion or 10.5% lower than that of 2015/16. But is an improvement on the 15.2% drop that occurred between 2014/15 and 2015/16. Furthermore, the spending estimates for 2017/18 suggest this improvement should continue for 2017/18.**
- **The third estimate for 2017/18 was $101.8 billion. This third estimate suggests a reduction in capex of $11.3 billion from 2016/17 when using realisation ratios, which provide a more valid form of comparison across estimates and actuals.**
- **Mining capex is the overwhelming driver of the reduction in capex plans for 2017/18. The lift in capex plans for other selected industries in 2017/18 is helping to partly offset the expected mining-driven decline in overall capex plans.**
- **The third estimate for capex for 2017/18 was an upgrade from the second estimate. The upgrade was due to revisions higher across both asset classes (buildings & structures and plant, machinery & equipment). There were also upgrades to the plans across all industries, but the upgrade to other selected industries overwhelmingly drove the improvement in spending plans.**
- **Outside of mining, a lasting recovery in business spending might finally be starting to emerge. It is reflected in the ongoing lift in capex for both manufacturing and other selected industries and is also reflected in the improvement to spending plans for 2017/18 in these industries too.**
- **Moreover, credit extended to business showed an ongoing improvement in data published by the Reserve Bank separately today.**
- **A broader and deeper recovery in business investment would strengthen the domestic economic outlook at a time when the residential construction cycle is turning. It would also help build momentum in jobs growth, spilling over to consumer spending.**

Actual Spending





Private capital expenditure (also known as capex) rose by 0.8% in the June quarter, helped by a rosier global growth outlook and higher commodity prices. Heightened business confidence and the improvement in business conditions are also factors likely spurring capex.

It was the second consecutive quarterly rise in capex, providing some encouraging signs that a capex recovery is underway. The annual rate of change remained in contraction for the eighteenth consecutive quarter, but the annual rate of contraction has shrunk for the second consecutive quarter. The annual rate of contraction in Q2 was 3.0%, which is the smallest in 3½ years.

A break-up of capex by industry makes it clear that the drag from the mining investment downturn is waning and investment by the non-mining sectors is gaining traction.

The improvement in capex for the June quarter was due to rises in capex by manufacturing and other selected (mainly services) industries. Manufacturing capex rose by 1.4% in Q2, adding to the strong growth of 6.1% recorded in Q1. And capex in other selected industries rose by 2.8% in Q2, also building on the 1.7% growth recorded in Q1. Both industries have recorded three consecutive quarters of growth.

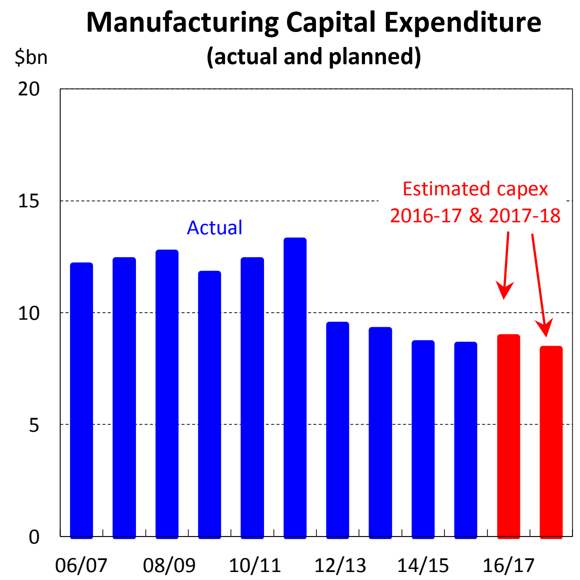
Mining capex declined by 2.8% in Q2 and the annual rate of change remains in negative territory. However, the annual rate of contraction in Q2 is 15.2%, which is smaller than the previous quarter's annual contraction of 25.7% and the smallest annual rate of decline in over two years.

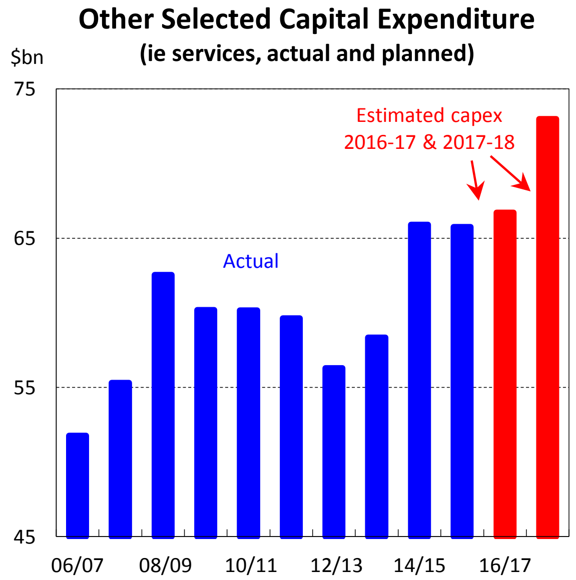
The data also provides a break-down by asset class. Capex on buildings & structures fell by 0.6% in the June quarter. The annual pace of decline in this asset class is also getting smaller; in Q2 it was 5.1%, from 14.6% in Q1. The sharp rise in infrastructure spending for Western Australia reported in the construction work done survey (released yesterday) was not mirrored in today's capex survey.

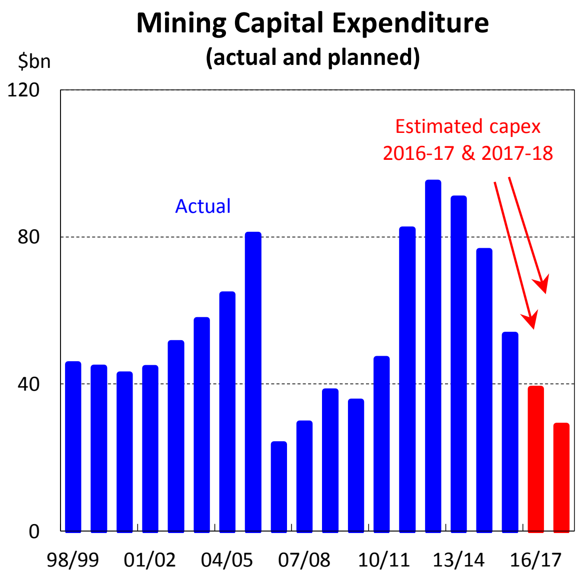
Capex on equipment, plant & machinery rose by 2.7% in the June quarter, which is the biggest quarterly growth rate in nearly three years. This component is a strong proxy for machinery & equipment gross fixed capital formation in the gross domestic product (GDP) figures, due for release on September 6. It adds to our view that we are in store for a solid GDP growth outcome in the June quarter.

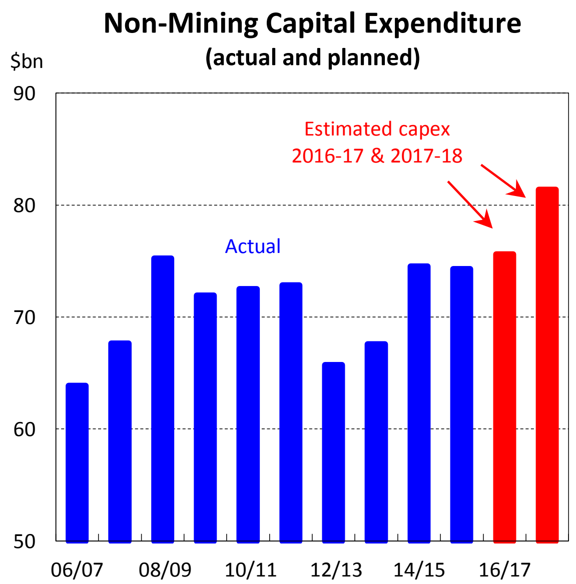
Spending Plans

Today's release provided the final outcome for capex spending for the 2016/17 financial year and the third estimate for the 2017/18 financial year.









The actual outcome for 2016/17 was $114.3 billion. This result is 10.5% lower than that of 2015/16. It is an improvement on the 15.2% drop that occurred from 2014/15 to 2015/16. Spending estimates for 2017/18 suggest the improvement should continue for 2017/18.

The third estimate for 2017/18 was $101.8 billion, which is a massive 17.6% upgrade on the second estimate for 2017/18. The upgrade was due to upgrades across both asset classes. There were also upgrades to the plans across all industries, but the upgrade to other selected industries overwhelmingly drove the improvement in spending plans.

We need to apply realisation ratios to the spending plans because anticipated spending differs from what actually occurs and using realisation rations helps address this gap.

Therefore, applying realisation ratios, the third estimate for 2017/18 sat at $103.0 billion, which is still a strong upgrade on the second estimate (of 8.2%). Compared with the final outcome for

2016/17, spending plans suggest a fall of $11.3 billion or a fall of 9.7% (using realisation ratios) in 2017/18. This fall will be primarily driven by another fall in mining capex in 2017/18. Manufacturing capex is also set to fall in 2017/18 but by less than was previously estimated. Other selected industries are the shining beacon; capex plans show an expected 9.4% lift in other selected industries using realisation ratios.

The deepening spending plans for other selected industries is encouraging, especially when combined with the improving trend recorded in credit extended to business (please refer to our separate data snapshot on private sector credit, also published today).

Some words of caution, however. It is the third estimate for capex plans that is available for 2017/18 and it is usually subject to revision and therefore at times is not always a reliable guide to actual spending. A wider issue for this capex survey is it excludes spending on some assets, such as software, and some key industries, such as health, education and agriculture. This capex survey places too much weight on mining.

States and territories

It was a mixed bag across the States and territories in the June quarter. Capex growth in Q2 was recorded in NSW, Victoria, Tasmania and the ACT. Other States and territories recorded declines in the quarter.

Of note, capex for buildings & structures in Victoria is running at above 20% per annum for the third straight quarter, helping Victoria record the strongest annual growth rate for overall capex (of 8.6%). And South Australia recorded the biggest decline in capex across the States in the June quarter of 5.5%, partly reversing a spike in the March quarter.

Outlook

We appear to be nearing the end of the downturn in mining investment and today's data underscores this view. It means the drag on the economy from the mining investment downturn is lessening.

Outside of mining, large infrastructure spending plans by the government, elevated business confidence, improving business conditions and low interest rates might finally be helping get a recovery in business capex underway. It is reflected in the ongoing lift in capex for both manufacturing and other selected industries and is also reflected in the upgrades to spending plans for 2017/18 in these industries too.

A broader and deeper recovery in business investment would strengthen the domestic economic outlook at a time when the residential construction cycle is turning. It would also help build momentum in jobs growth, spilling over to consumer spending.

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