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Plum Grove Conference

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Stephen Koukoulas
Market Economics

 @thekouk



The world economy now – solid, not strong

- Global economic growth after the GFC is moderate – unable to sustain a 4%+ expansion
- Europe is weak, US stronger, China slowing, India booming
- Australia's major trading partners are doing a little better than the world average, but there are signs of a cooling in activity



* Weighted using Australian export shares

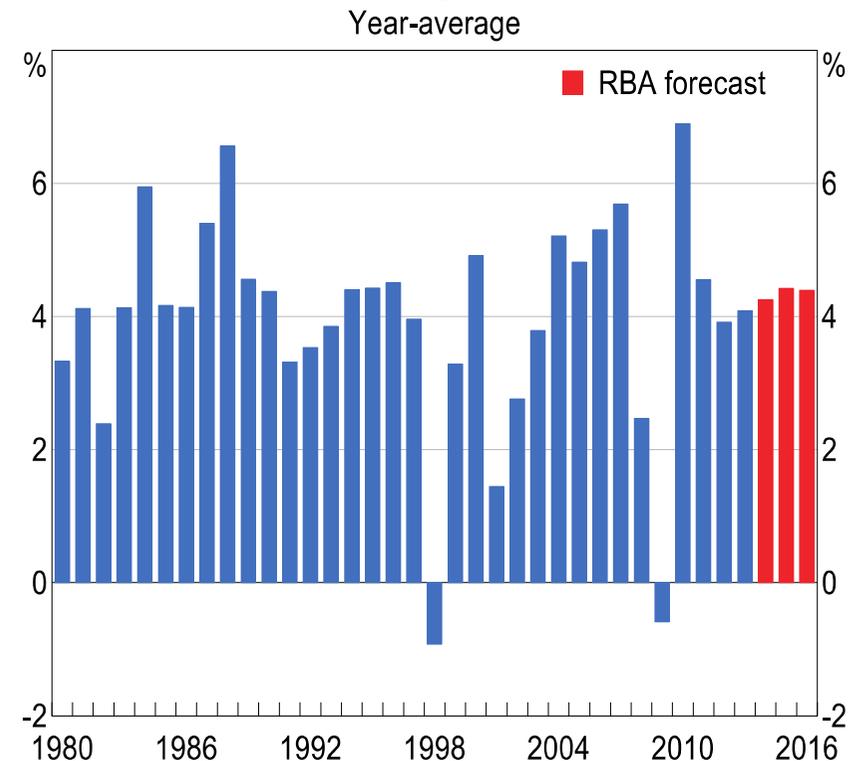
** PPP-weighted; accounts for 87 per cent of world GDP

Sources: ABS; CEIC Data; IMF; RBA; Thomson Reuters

The global outlook: A little bit better

- Both 2015 & 2016 are forecast to see Australia's major trading partners record good rates of growth
- With interest rates still incredibly low, there is a rising risk that later 2015 or 2016 will see some 'upside'
- Usually a strong world economy is good news for the Australian economy

Australia's Trading Partner Growth*



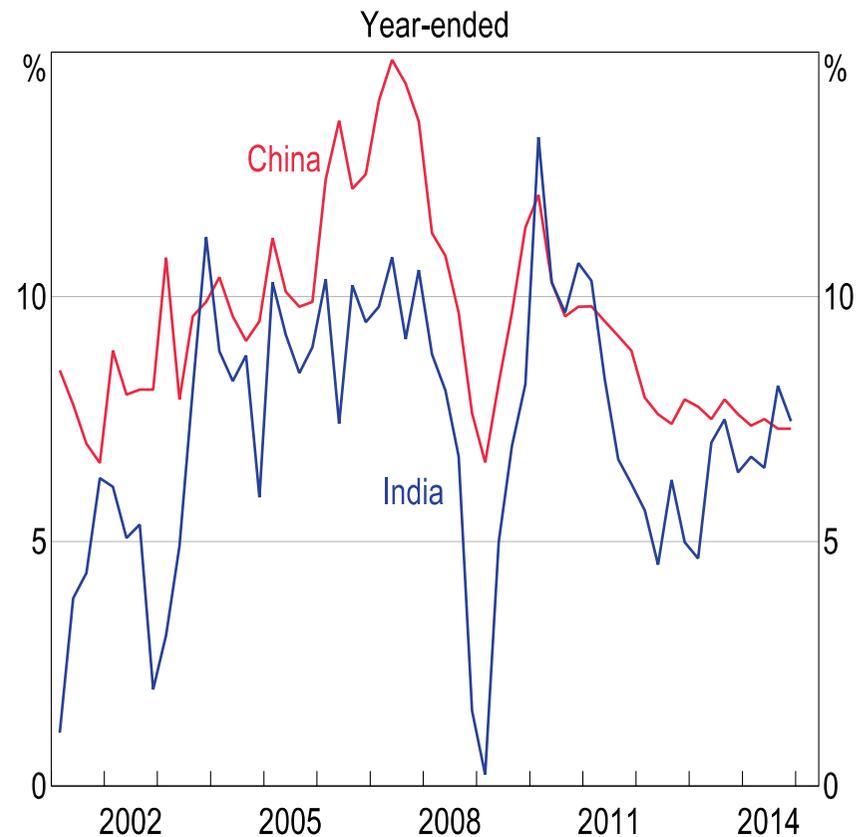
* Aggregated using total export shares

Sources: ABS; CEIC Data; RBA; Thomson Reuters

As China slows, India grows

- India seems certain to record faster growth than China not only in 2015, but perhaps for many years
- India is a 3rd largest economy in the world; is perhaps two decades behind China in terms of income growth
- Huge opportunities for Australian exporters to engage with India, even though China will remain a dominant export market

GDP Growth – China and India

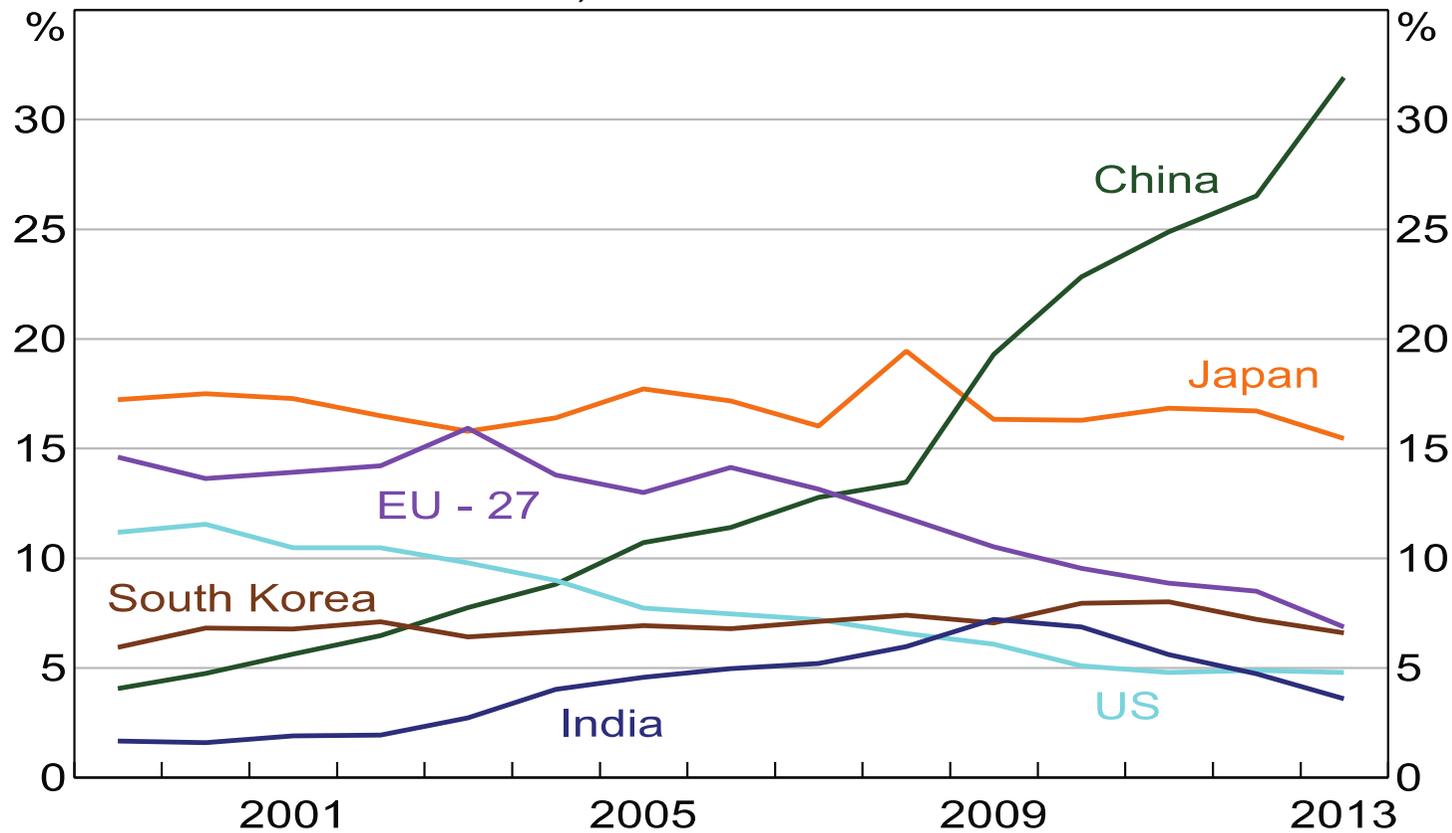


Sources: CEIC Data; RBA

Australia's future – It's all Asia

Exports by Destination

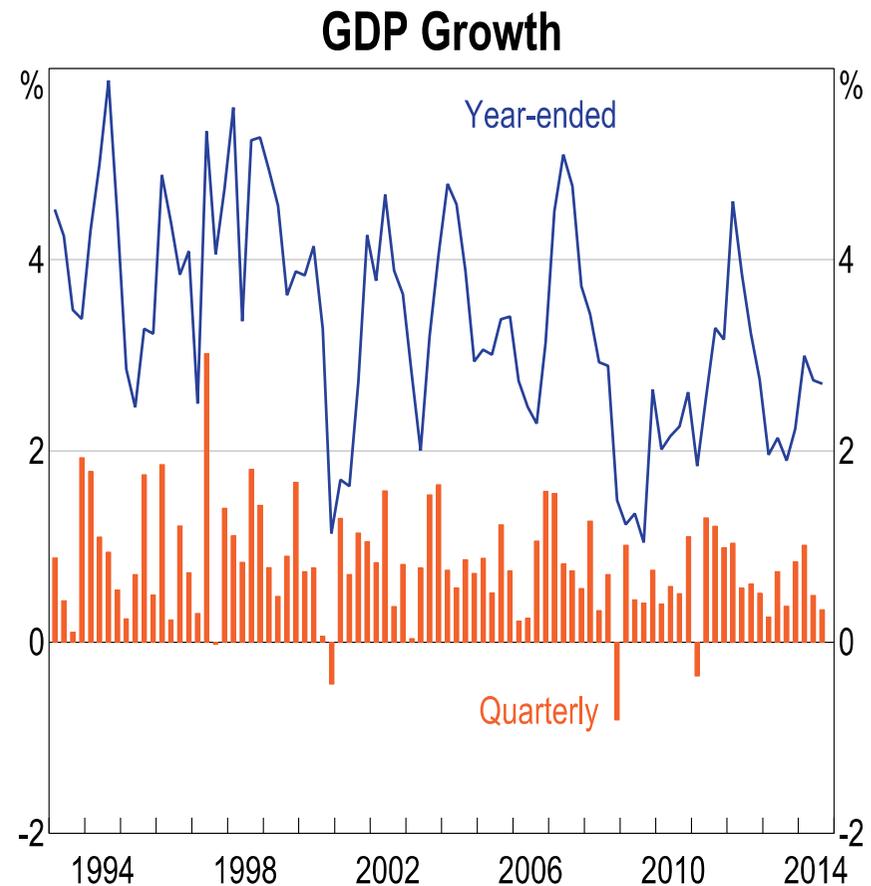
Annual, share of total values



Source: ABS

Australian economy – Stuck in the slow lane

- No recession, but soft, subdued, sluggish growth.
- It's been over 2 years since annual GDP growth was above 3%. We are used to an average of 3.25%
- RBA & Treasury expect GDP to stay around 2.5% in 2015 - & it might hit 3% next year.
- For some parts of the economy it will feel very weak

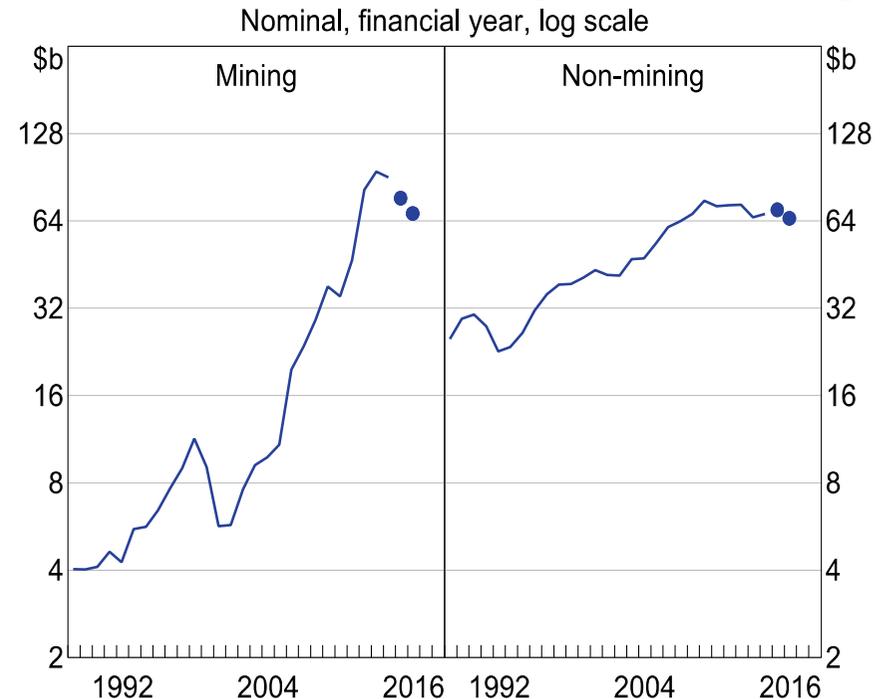


Source: ABS

Mining investment on the edge of a cliff

- Mining investment – is starting to fall. By 2018, it will be 75% off its peak
- Non-mining is not yet picking up the slack
- There are hopeful signs in infrastructure spending, tourism and education but business confidence is also weak

Capital Expenditure – Mining and Non-mining*

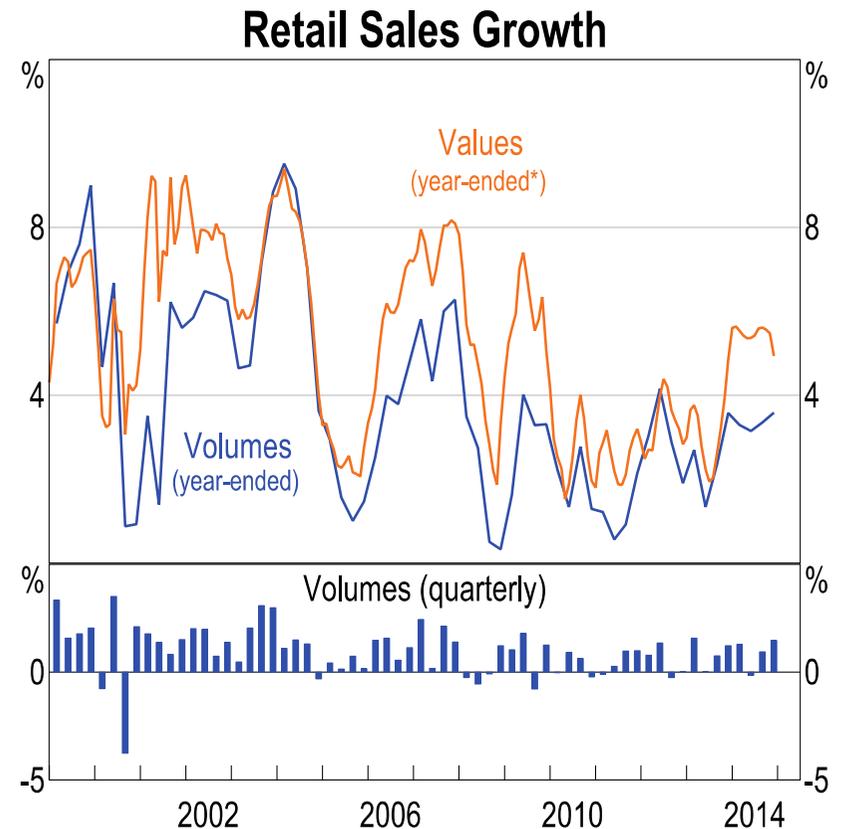


* Sample of firms' spending plans; dots represent the survey's most recent estimates for 2014/15 and 2015/16 adjusted for historical realised spending

Sources: ABS; RBA

Retail sales – doing okay

- Consumer spending – like the rest of the economy – is reasonable. Not strong, but not weak either
- Some of the recent increases in spending have been driven by more debt, lower savings
- Consumer sentiment remains low – needs a boost if optimism and spending are to rise

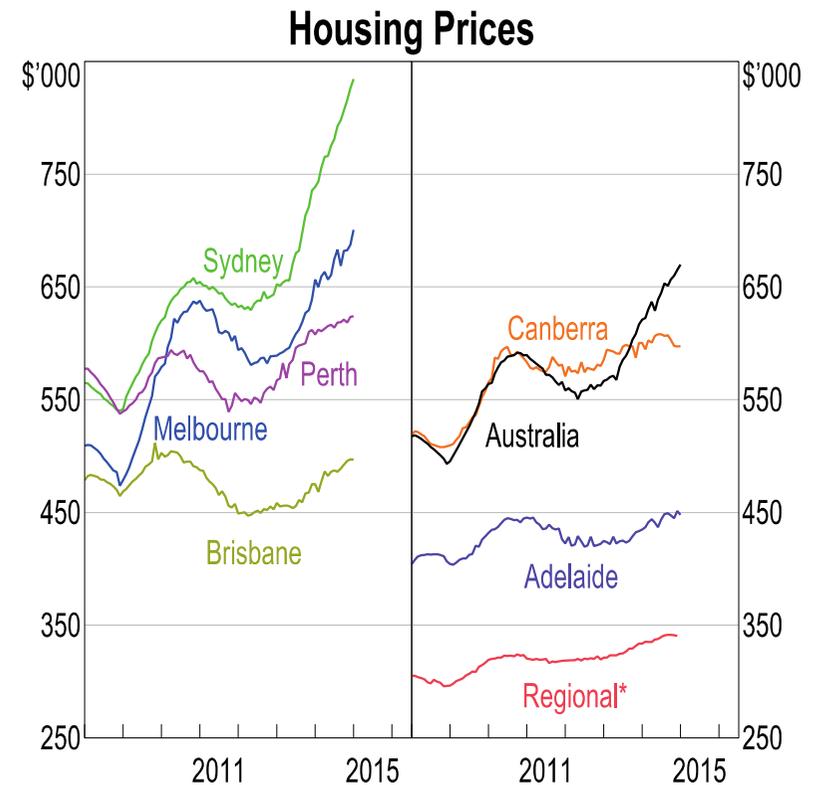


* Percentage change over year to latest three months

Source: ABS

House prices – silly in Sydney – others more sober

- House prices are booming in Sydney and to a slightly lesser extent, Melbourne. Investors are driving the gains
- Other cities house prices are little changed from levels around 2009 and 2010
- A cooling in house prices will allow RBA to deliver yet lower interest rates

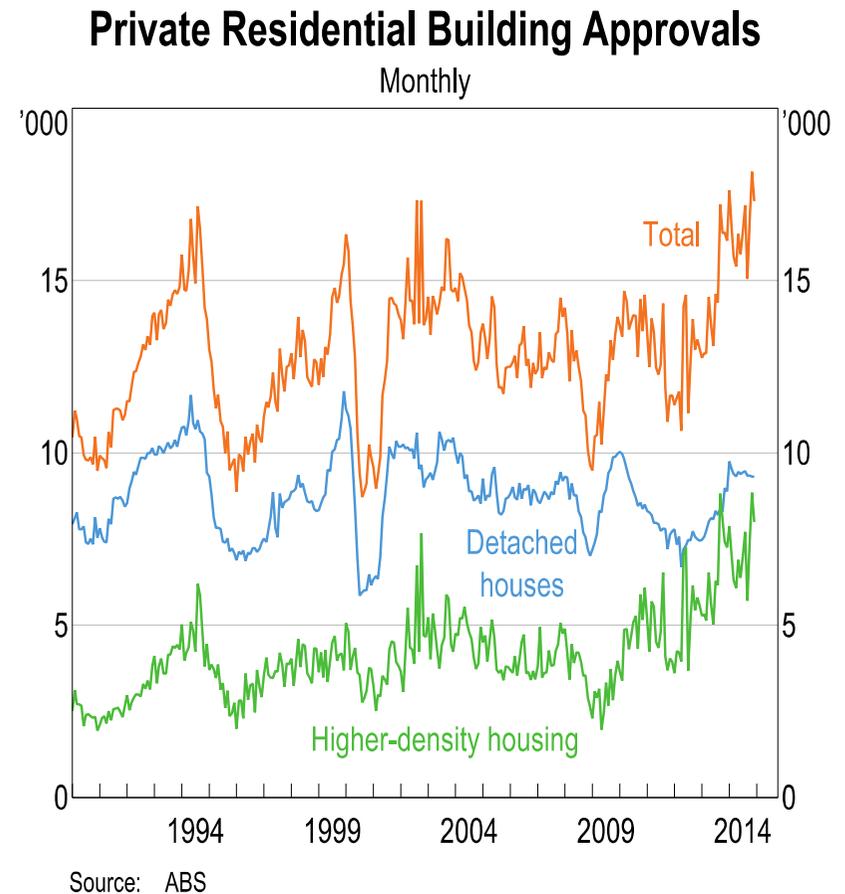


* Excludes apartments; measured as areas outside of capital cities in mainland states

Sources: CoreLogic RP Data; RBA

Housing construction booms!

- The house price problem will be fixed via an increase in housing supply – that is, more houses being built
- Note also population growth is slowing which is taking some heat out of demand
- In the big cities, it is apartment construction rather than free-standing houses



Unemployment rate grinding higher

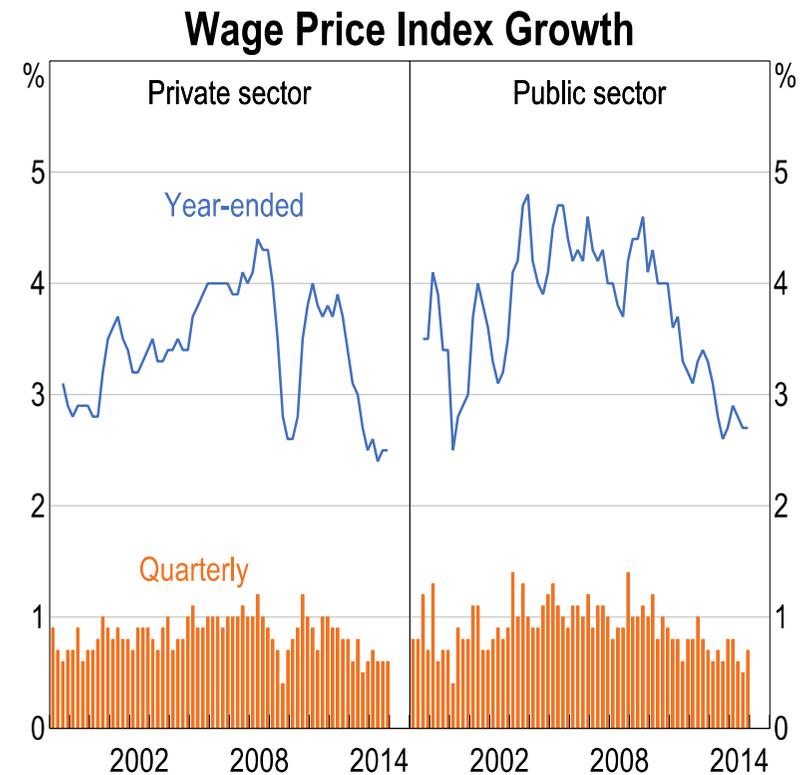
- The unemployment rate has been trending up for the past few years – no sign of a turnaround
- The economy is simply too soft to generate sufficient jobs
- The solution – grow the economy faster. Easier said than done. Low interest rates, lower Aussie dollar help
- A pro-growth budget in May?



Source: ABS

Weak wages growth – a big economic risk

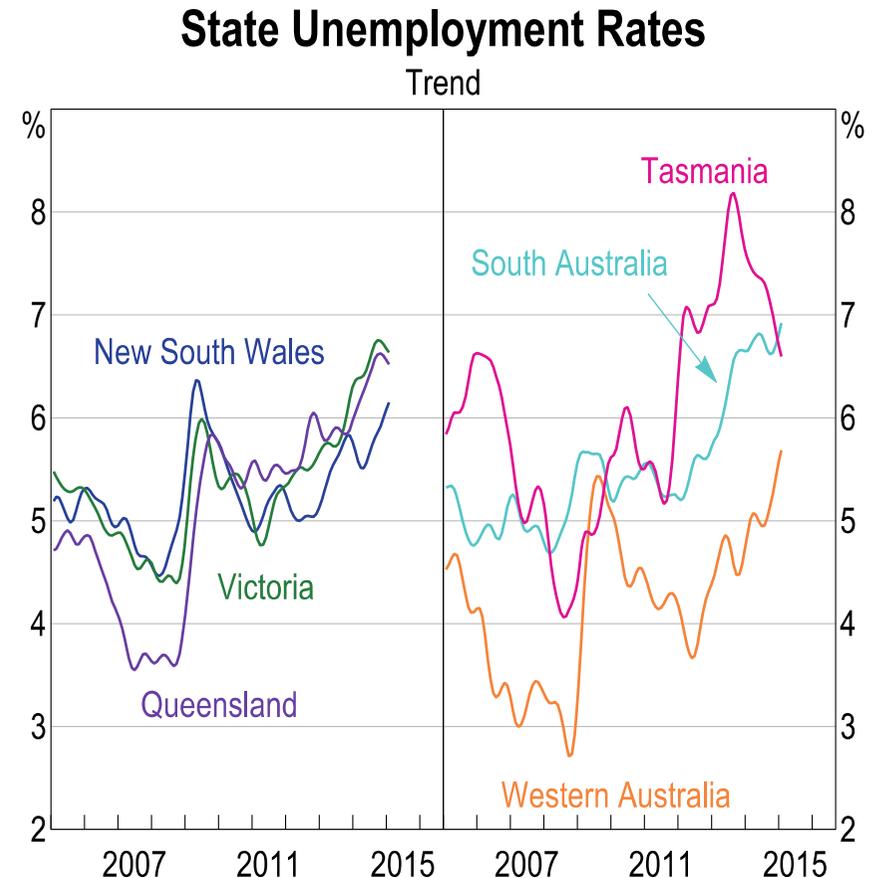
- Wages growth is running at a record low
- Bad: It dampens household incomes, spending power & borrowing
- It is a negative risk to the economic outlook
- But it has an upside – employer demand for labour remains firm so it helps job creation



Source: ABS

Unemployment by State. WA surging

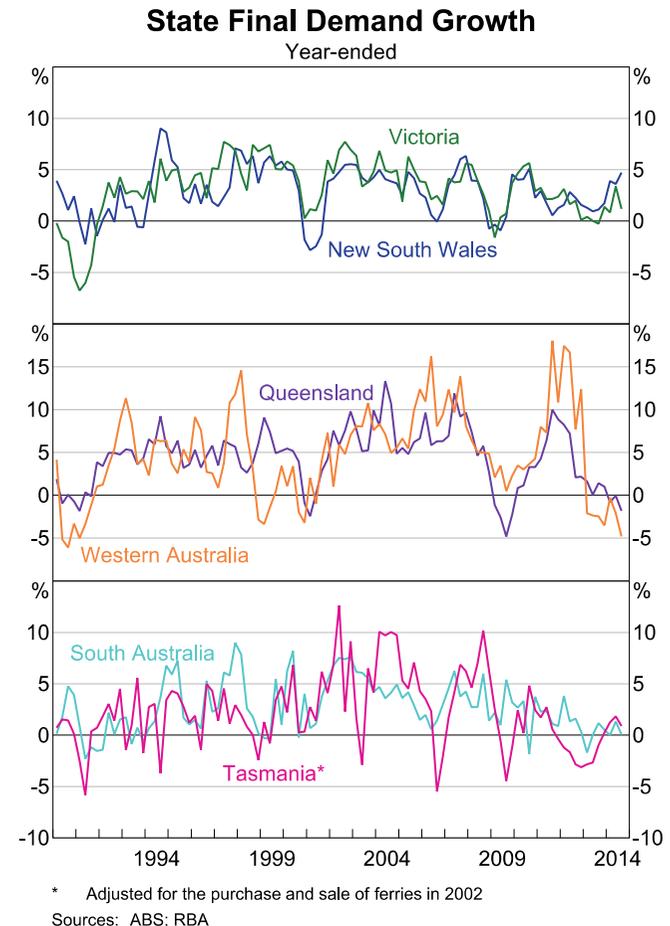
- The eastern States all have similar unemployment rates and all going the same direction – up
- WA has the sharpest deterioration in unemployment – the fall in mining investment is hurting
- SA – highest unemployment rate and worried about manufacturing – cars and submarines



Source: ABS

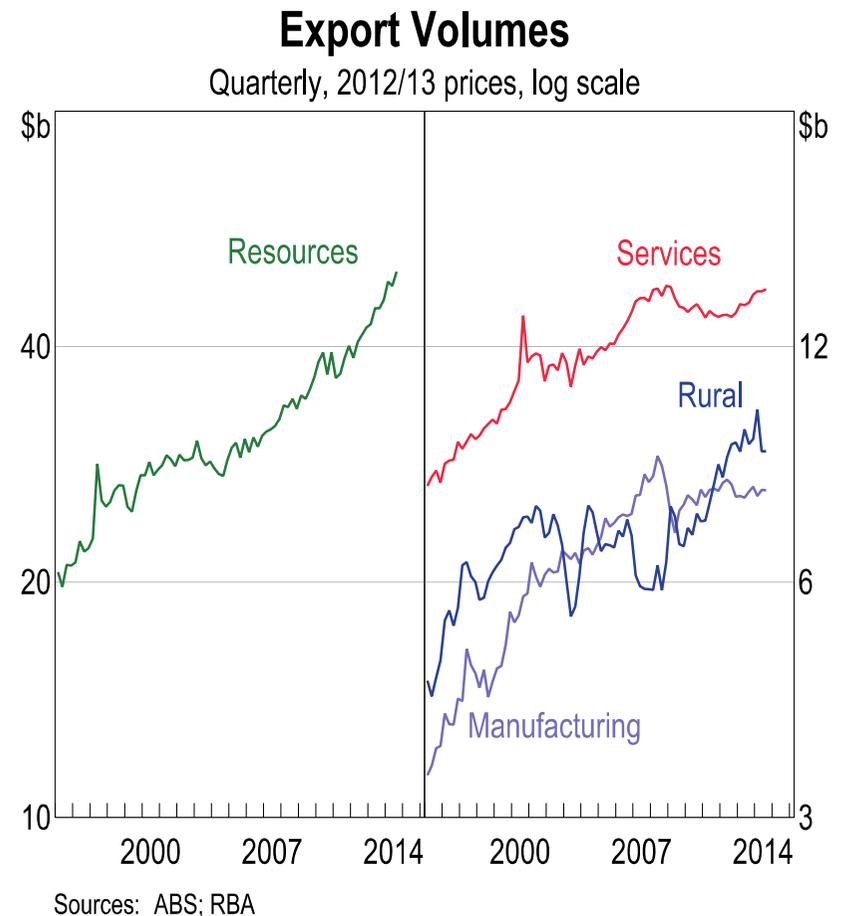
State demand – mining downturn evident

- WA and QLD are slowing at an alarming pace – the mining investment fall is impacting
- SA and TAS were the weakest but there are some tentative signs of a turn, especially in TAS
- NSW and VIC still expanding at a decent pace – less volatile than the other states – helped by housing boom



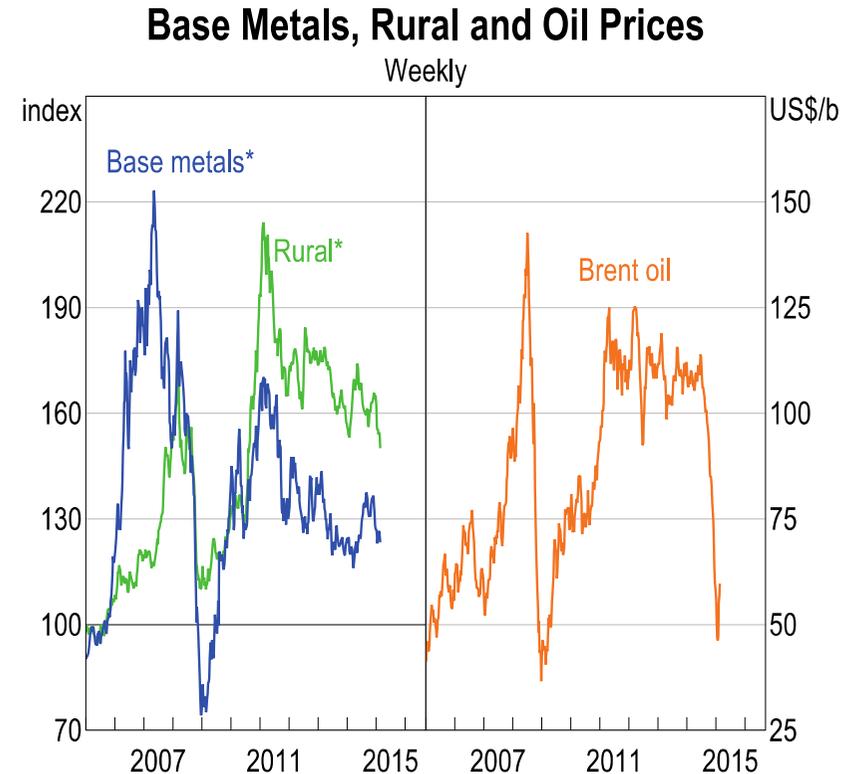
Exports – resources strong, but so too is rural

- It has been obvious for many years that mining exports have been booming. Despite weak prices, export volumes continue to grow
- Manufacturing and services exports were flat – the GFC and Aussie dollar hurt
- Rural export volumes continue to trend solidly higher



All commodity prices are lower – rural less so

- A lot of focus recently has been on the slump in iron ore, coal, oil and gold prices
- Rural prices have also fallen, but less so than metals and oil. The weaker Aussie dollar is cushioning the blow of lower prices
- In Aussie dollar terms, some rural prices have actually risen in the last year



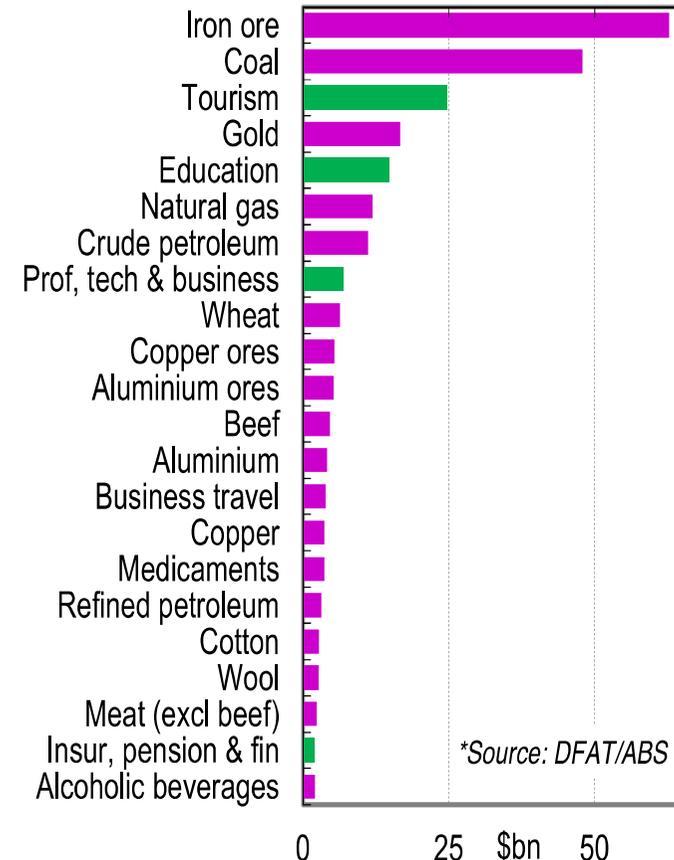
* RBA Index of Commodity Prices sub-indices; SDR terms; 2005 average = 100

Sources: Bloomberg; RBA

Australia's Top 20 Exports

- There has been massive growth in exports of iron ore and coal for more than a decade
- Services exports are trending higher with tourism and education now important sources of export dollars
- Rural exports have been rising solidly, in line with the rise in output – wheat, beef, cotton and wool the main items

AUSTRALIAN TRADE
(top export categories, 2011/12)

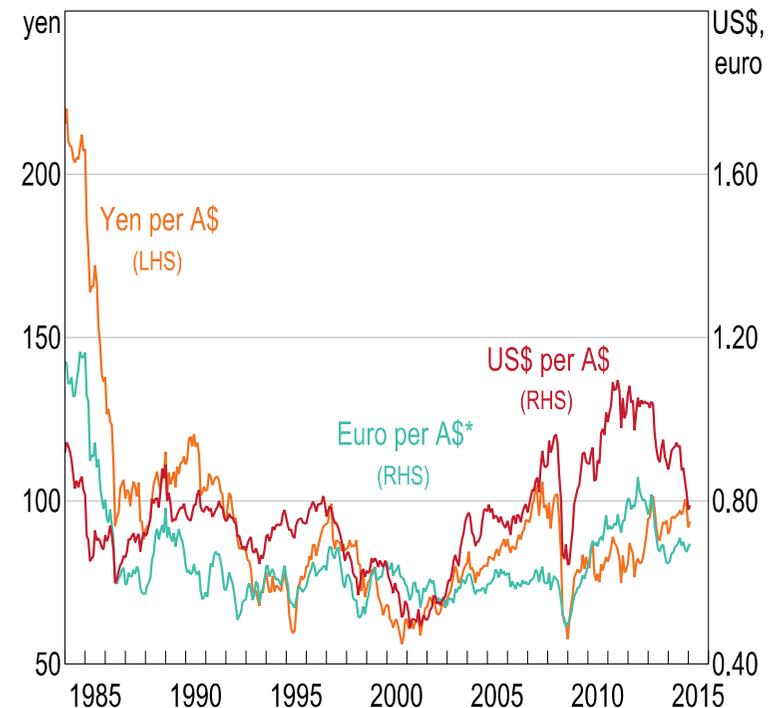


Source: CBA

The Aussie dollar – has fallen a lot

- The Aussie dollar peaked at 1.10 in 2011. It has dropped a stunning 33 cents since then.
- This is a huge fall, but it remains well above the long run average
- While further weakness remains likely, it would be no surprise to see the bottom for the Aussie in the next few months

Australian Dollar against US Dollar, Euro and Yen



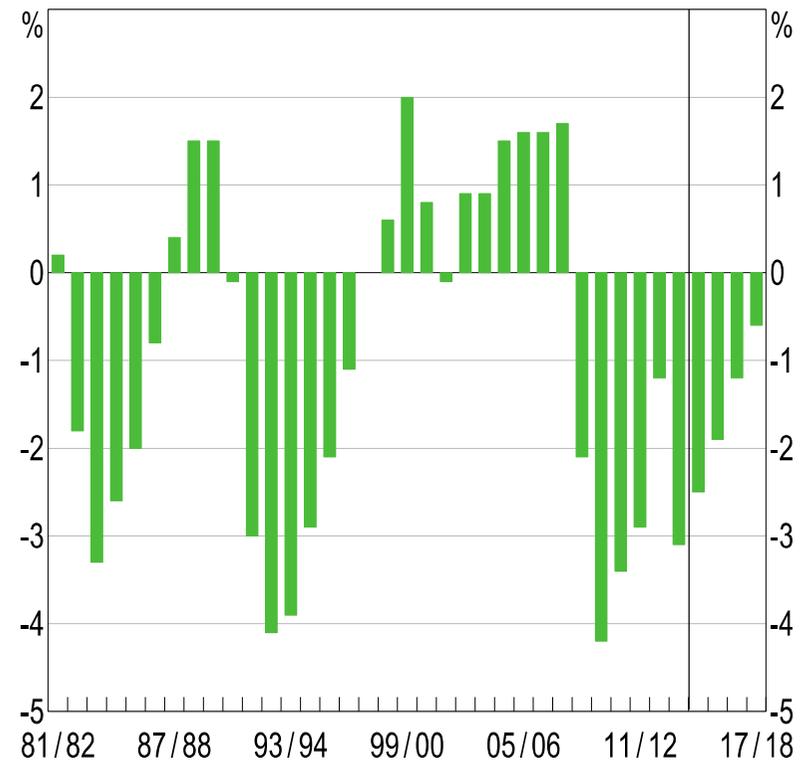
* ECU per A\$ until 31 December 1998

Sources: Thomson Reuters; WM/Reuters

The Budget – economic leadership needed

- Six weeks to the budget
- Not financial crisis or emergency, but policy reform, leadership and vision needed
- Some poor policy / politics in recent years in a problem that has impacted both sides
- Business sector lacks the confidence to invest, employ and expand

Australian Government Budget Balance*
Per cent of nominal GDP



* Underlying cash balance; MYEFO 2014/15

Source: Australian Treasury

What's ahead - The big issues and risks

- Australia is doing reasonably well. Some big negatives from commodity prices but positives from lower Aussie dollar and low interest rates
 - The positives likely to remain in place, or get more positive, through 2015
 - Confidence must be restored.
- Globally – beware of interest rate rises in the US
- Upside risk from Europe and India

The forecasts

- GDP growth around 2.5% in 2015 – should see 3% in 2016
- Unemployment rate to peak near 6.75% - stays above 6% for several years
- Inflation set to stay near 2% in 2015 – could edge up late in the year as lower Aussie dollar boosts some prices
- The RBA – one more interest cut likely
- Australian dollar – has already fallen over 30 cents – getting close to a bottom. Don't bank on 70 cents or less