24 February 2015

Australian CAPEX plans: a preview Est 5 for 2014/15: ($153bn - neutral; $148bn - soft; $158bn - good)

Risk that service sector capex disappoints

The ABS survey of private business investment plans, the CAPEX survey, will provide some further guidance to growth prospects. The December quarter edition will be released on February 26, with responses received over January and February. This update will include the 5th estimate of capex plans for 2014/15, as well as the initial estimate of plans for 2015/16.

Business capex is set to decline in 2014/15, as suggested by Estimate 4 of plans for this financial year. Capex spending will be led lower by a sharp investment downturn in the mining sector, with only a partial offset from the service sectors.

These broad themes are likely to be restated. That said, we see the risk that the modest improvement to date in service sector capex looses momentum and that plans for 2015/16 are softer than suggested by our central case forecasts. This is in the wake of disappointing economic conditions in recent months, following a significant negative income shock to Australia from the sharp drop in global commodity prices. This downside risk to service sector investment will be a key focus for policy makers.

The RBA does take note of the capex survey, but is mindful of its shortcomings, stating that: "the expectations component of the ABS capital expenditure survey ... tends to be a relatively imprecise guide to firms' realised spending".

A recap of the September capex survey

2014/15: Estimate 4

Est 4 for 2014/15 is $153bn, 8% below Est 4 for 2013/14.
By industry, Est 4 vs Est 4 a year ago are:
mining, –17% (up from –21%, as reported 3 months earlier);
manufacturing, –11%; and services, +11%.

Alternatively, applying average realisation ratios (RRs), we estimate that Est 4 implies a final outcome for 2014/15 of $147bn. That is 7% below the result for 2013/14. By industry, average RR's suggest: mining, –16%; manufacturing, –14%; and services, +9%.

Quarterly figures report that the service sectors have increased capex so far in calendar 2014, as follows: +3.3% in Q1, +4.6% in Q2 and +5.5% in Q3. The upshot, service sector capex spend in 2014 Q3, the initial quarter of 2014/15, was 10% above the quarterly average for 2013/14.

Interpreting Est 4: implications for business investment

What to make of the capex survey, what does it imply for overall business investment? Firstly, we would note that the capex survey provides only partial coverage of business investment and hence has its limitations. In Q3, capex was $38bn, while business investment in the national accounts was $63bn.

We calculate that Est 4 implies a decline in business investment in 2014/15 of 3% in nominal terms and a near 5% decline in real terms (based on applying industry weights from the national accounts). That is broadly consistent with our forecast for business investment to decline by 4% in real terms in 2014/15.

Scenarios for 2014/15: *risk of a softer result*

2014/15: Estimate 5

Here we set our three scenarios for Est 4 of 2014/15 capex.
The approach is based on applying average RR's.
Recall that Est 4 was $153bn, implying an outcome of $147bn, some 7% below the 2013/14 result.

Scenario 1, 2014/15: - a restatement of Est 4 (implied –7%)
Est 5 of $153bn.
Implies a final outcome of $147bn, –7% on 2013/14
Mining, –16%; manufacturing, –14%; services, +9%

Scenario 2, 2014/15: - a softer result
Est 5 of $148bn.
Implies a final outcome of $142bn, –10% on 2013/14
Mining, –19%; manufacturing, –17%; services, +6%

Scenario 3, 2014/15: - a more positive result
Est 5 of $158bn.
Implies a final outcome of $152bn, –4% on 2013/14
Mining, –13%; manufacturing, –11%; services, +12%

2015/16, initial estimate

We will receive Estimate 1 for 2015/16 capex spending. We note that Est 1 and Est 2 of capex plans have the advantage of being timely but are not always reliable.

An Est 1 of $123bn would be a robust result
(but risk is that we see a softer print)
Est 1 printing at $123bn would arguably be a robust result. We estimate that such a number generates a figure for business investment broadly in line with our central case forecast. **This analysis is on the assumption that Est 5 for 2014/15 is $153bn and our analysis is sensitive to the industry mix.**

Est 1 of $123bn would be -2% on Est 1 for 2014/15, a figure that is flattered by weak base effects. Note that Est 1 for 2014/15 was particularly soft at -17% on Est 1 for 2013/14. Prospects for 2014/15 have improved somewhat from this initial take.

We estimate that Est 1 of $123bn would imply an outcome of $137bn, based on applying average RRs. That would be 7% below the likely 2014/15 outcome **(assuming that Est 5 is $153bn)**.

Importantly, for this exercise, we've assumed that by industry, Est 1 on Est 1 would be as follows: mining, -8%; manufacturing -1%; and services +8%. The rationale is that applying realisation ratios yields the following, arguably plausible, combination:
mining -16%; manufacturing -8% and services +4%. Then, using national accounts weights, points to business investment in 2015/16 declining by 4% in nominal terms, a figure not greatly different from our forecast for a 3% fall in real terms.

We emphasise, these scenarios are calculated for the overall growth in investment. The industry mix could be quite different.

Andrew Hanlan Senior Economist, ph (61-2) 8254 9337

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as "relevant persons"). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Services Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA').

Disclaimer

This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.

For XYLO Foreign Exchange clients: This information is provided to you solely for your own use and is not to be distributed to any third parties. XYLO Foreign Exchange is a division of Westpac Banking Corporation ABN 33 007 457 141 and Australian credit licence 233714. Information is current as at date shown on the publication. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs. XYLO Foreign Exchange's combined Financial Services Guide and Product Disclosure Statement can be obtained by calling XYLO Foreign Exchange on 1300 995 639, or by emailing customercare@XYLO.com.au.

The information may contain material provided directly by third parties, and while such material is published with permission, Westpac accepts no responsibility for the accuracy or completeness of any such material. Except where contrary to law, Westpac intends by this notice to exclude liability for the information. The information is subject to change without notice and Westpac is under no obligation to update the information or correct any inaccuracy which may become apparent at a later date. Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.