25 May 2015

Australian CAPEX plans: a preview
Est 2 for 2015/16: 3 scenarios
($121bn - neutral; $116bn - softer; $126bn - "good")
A high hurdle to achieve a "good" result

The ABS survey of private business investment plans, the CAPEX survey, will provide some further guidance to growth prospects. The March quarter edition will be released on May 28, with responses received over April and May.

This update will include the 6th estimate of capex plans for 2014/15, as well as the 2nd estimate of plans for 2015/16. The focus will be on prospects for 2015/16, with the 2014/15 year drawing to a close. The ultimate outcome for 2014/15 will be published on August 26, in the June quarter update.

Here we provide scenarios for the 2nd estimate for 2015/16.

A recap of the December capex survey

The surprisingly weak 1st estimate for 2015/16 was the key takeout from the December quarter survey. The implication was that business investment may be weaker in the year ahead than previously anticipated, adding to the risks that overall output growth in Australia will remain below trend. The survey pointed to a decline in non-mining capex, as well as a sharp drop in mining investment.

Estimate 1 for 2015/16 was $109.8bn. This is –12.4% below the corresponding estimate for the year prior. By industry, Est 1 on Est 1 was: mining, –19%; manufacturing, –12%; and services, -2%.

As for 2014/15, Est 5 was $153bn. This is –8.6% lower than the corresponding estimate for the prior year.

Interpreting Est 5 & Est 1: implications for investment

We stress that capex, which was $37bn in Q4, provides only partial coverage of total business investment, which was $62bn in Q4, and the capex survey overstates the importance of mining.

Nominal business investment will contract by 3% in 2014/15, based on applying Est 5 by industry to the national accounts. That is in line with our forecast for a 5% decline in real terms. However, for 2015/16, Est 1 points to a sharp fall in nominal business investment; down 8.5% (based on Est 1 on Est 1), which is weaker than our forecast for a 6% decline in real terms.

Scenarios for Est 2 for 2015/16

Recall, that
Est 1 for 2014/15 was $125bn;
Est 2 for 2014/15 was $138bn; and
Est 1 for 2015/16 was $109.8bn, –12.4% Est 1 on Est 1

Scenario 1: "neutral"
Est 2 of $121bn, –12.4% on Est 2 for 2014/15

Scenario 2: "softer"
Est 2 of $116bn, –16% on Est 2 for 2014/15

Scenario 3: "good"
Est 2 of $126bn, –9% on Est 2 for 2014/15

A high hurdle to achieve a "good" result

Upon release of the capex survey, the market will immediately turn to the Est 2 on Est 2 figure for the 2015/16 year for total capex. Accordingly, we have presented the three scenarios for 2015/16 on this basis.

In our view, there is a high hurdle for achieving a "good" result for the 2nd estimate. The reason surrounds the mark-up between Est 1 and Est 2 each year. Typically, all industries (mining, services and manufacturing) progressively upgrade their capex plans for the year ahead through the 2nd, 3rd and 4th estimates.

In recent years, the mark-up from Est 1 to Est 2 averaged 4%. In 2014/15, the mark-up was an historically large 10%. That broadly matched the 2007/08 mark-up of 11%, the strongest since the four year period of 1994/95 to 1997/98. The over-sized mark-up in 2014/15 was arguably because the initial estimate (surveyed during January to February 2014) was biased down by an initial post Federal Election let-down effect.

For the 2nd estimate for 2015/16 to be –12.4% Est 2 on Est 2 (thereby "franking" the Est 1 on Est 1 result) would thus require a repeat of the 10% mark-up between the 1st and 2nd estimates. While that is possible, we don't see it as likely.

For Est 2 to be a "good" result would require an unlikely mark-up of 15%. A "softer" result would need a 6% mark-up.

The implication here is that the 1st estimate for 2015/16 was even weaker than the -12.4% Est 1 on Est 1 figure suggests. Indeed, that is what our calculations show. Applying average realisation ratios, we estimate that Est 1 for 2015/16 implies the final outcome for 2015/16 will be –16.5% lower than the likely outcome for 2014/15.

Also, we would not necessarily characterise a –9% Est 2 on Est 2 result as a "good" one in an absolute sense. The industry mix underpinning such a figure is a relevant consideration.

That brings us to a final point, we would stress that the industry mix of capex plans for 2015/16 is of significance.

For instance, policy makers would take some comfort from any marked improvement in the plans of the service sectors. Recall that Est 1 on Est 1 for services surprised, printing as a negative, at –2%. It is the likely timing and strength of a sustained upturn in investment by the service sectors that is most uncertain and a development that is critical to Australia achieving the transition from mining investment led growth to strength across the broader economy.

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