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Australian CAPEX plans: a preview Est 5 for 2015/16 & Est 1 for 2016/17

Capex survey likely to remain downbeat

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 25. This will include Estimate 5 for 2015/16 and Estimate 1 for 2016/17. Recall that Est 4 for 2015/16 was –21% vs Est 4 a year ago.

We expect the survey to remain downbeat, with **Est 5 for 2015/16 to be similar to Est 4, at $119bn, –21%, and Est 1 to be around $87bn, –15% on Est 1 a year ago.**

Mining investment returning to pre-boom levels is the key dynamic. Also, a sustained upturn in service sector investment has yet to emerge, despite an improvement in conditions and an associated strong increase in employment.

The December survey was conducted over January and early February. Business confidence has softened somewhat, to below average levels, on increased market volatility, an equity market sell-off and uncertainty ahead of a Federal Election in 2016. Business conditions remain at above average levels in the NAB business survey, but have moderated at the turn of the year, following a cooling of the housing market in the wake of higher mortgage rates.

For 2015/16, (1) our view on Australian growth incorporates a significant contraction in business investment, –11.5%; (2) but a fall that is not as sharp as suggested by the capex survey at present, –21%. For 2016/17, we expect –6.5% for total business investment.

We are mindful that: (a) the capex survey overstates the weight of the mining sector by a considerable margin; (b) capex excludes sectors (education and health) and assets (computer software) which are likely to expand investment; and (c) business conditions across the service sectors have improved, pointing to at least some resilience in equipment spending by these sectors - at odds with the capex survey at present, pointing to a contraction.

A recap of the September capex survey

Estimate 4 for 2015/16 is $120bn, –21% vs Est 4 for 2014/15. By industry: mining –34%; services –4%; and manufacturing –4%.

The survey was conducted during November and early December. Business conditions were above average, although the housing sector was cooling, impacted by higher rates.

Scenarios for Est 5 for 2015/16

Scenario 1: "neutral"
Est 5 of $119bn, –21% on Est 5 for 2014/15,
a 1% downgrade on Est 4

Scenario 2: "softer"
Est 5 of $112bn, –26% on Est 5 for 2014/15
a 7% downgrade on Est 4

Scenario 3: "less weak"
Est 5 of $127bn, –16% on Est 4 for 2014/15
a 5.5% upgrade on Est 4

The pattern between Est 4 and Est 5 has been variable of late, with a 1% downgrade in 2014/15. Prior to this, when mining capex was a smaller share, Est 5 was typically an upgrade on Est 4. The service sectors upgrade their investment plans as the financial year in question gets underway, given their focus on equipment spending, for which there are shorter lead times.

Estimate 1 for 2016/17

The capex survey, which overweights the mining sector, is likely to be weak for the 2016/17 year. We expect Estimate 1 to be at least 10% below Est 1 for 2015/16, with a fall potentially of 15%, driven by mining capex returning to pre-boom levels and factoring in only a slight increase, +1%, for service sector capex plans - see chart below. The downturn in mining capex is expected to be most intense during calendar 2016, as gas projects are completed, but will still be significant into 2017.

Focus on the service sectors
Investment intentions of the service sectors will be of particular interest to policymakers, including the RBA. The emergence of a sustained upswing in investment by the service sectors is a key element in the economy's successful transition from growth led by mining investment to strength across the broader economy. The RBA, forecasting real GDP growth of 3.0%yr for December 2017 and 3.5%yr for June 2018, will be looking to plans for 2016/17 for any evidence of a lift in service sector investment. Although, be mindful that Est 1 and Est 2 of service sector capex plans are often unreliable.

As noted above, there is the risk that service sector capex undershoots the improvement in business conditions. In addition to uncertainties encouraging businesses to delay committing to additional investment, there are negative spill-over effects from the mining investment downturn. The transport sector, which is in services, has negative capex plans for 2015/16, with some projects in this sector (ports and rail) mining related. Utilities, another service sector with a relatively high capex weight, is also downbeat on the investment spending outlook for 2015/16.

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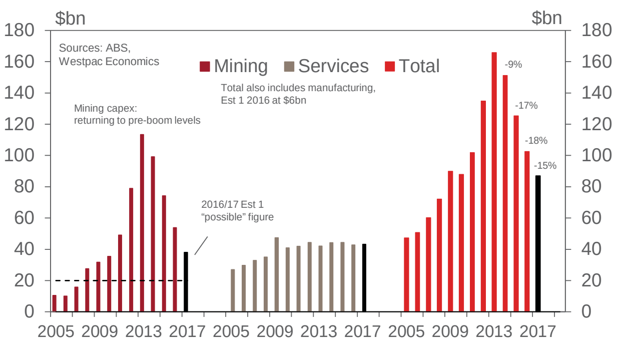
Capex plans, by industry: Estimate 1



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