

WHAT'S HAPPENING IN THE AUSTRALIAN ECONOMY?

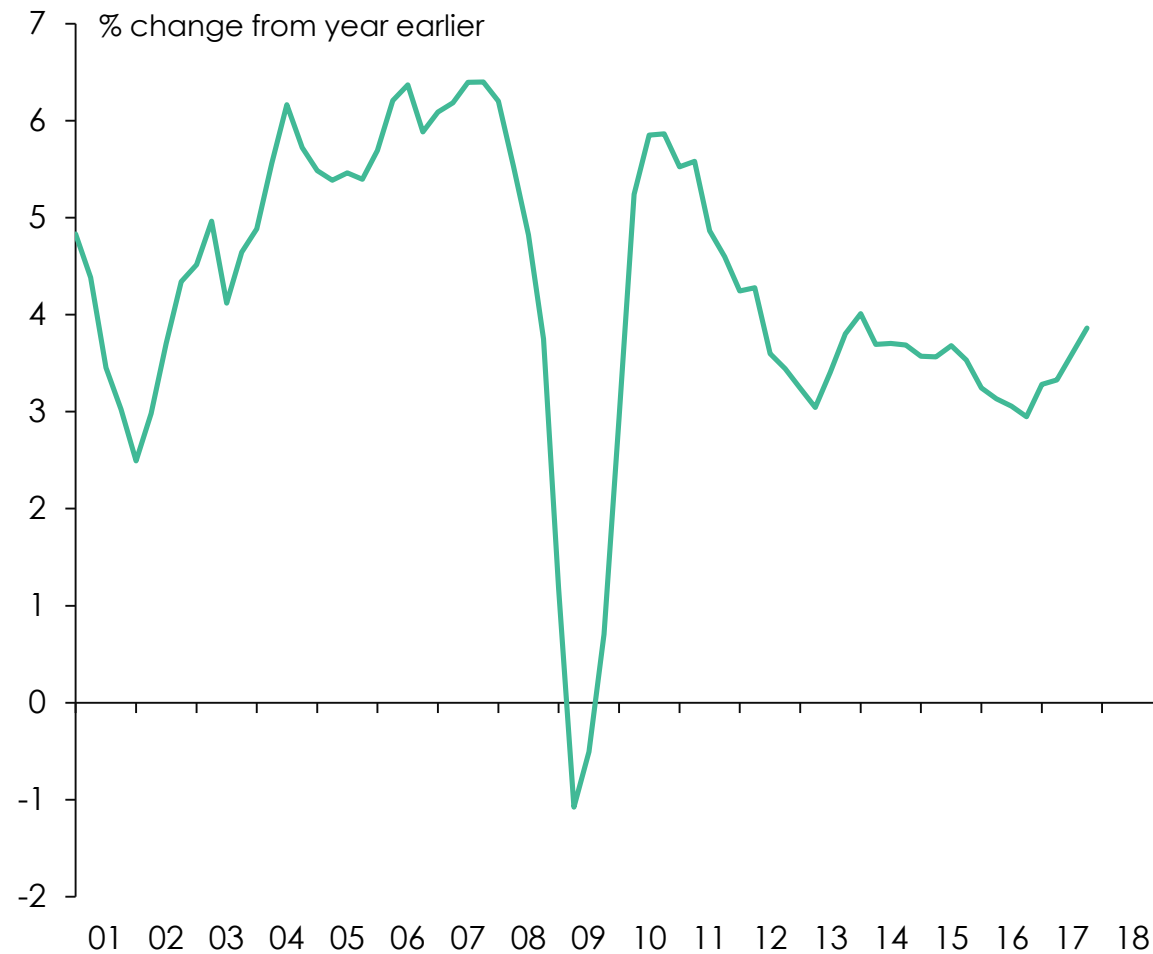
PRESENTATION TO SMITHS SNACKFOODS
DISTRIBUTOR PARTNERS

HENRY JONES ART HOTEL, HOBART, TASMANIA
– 16TH FEBRUARY 2018

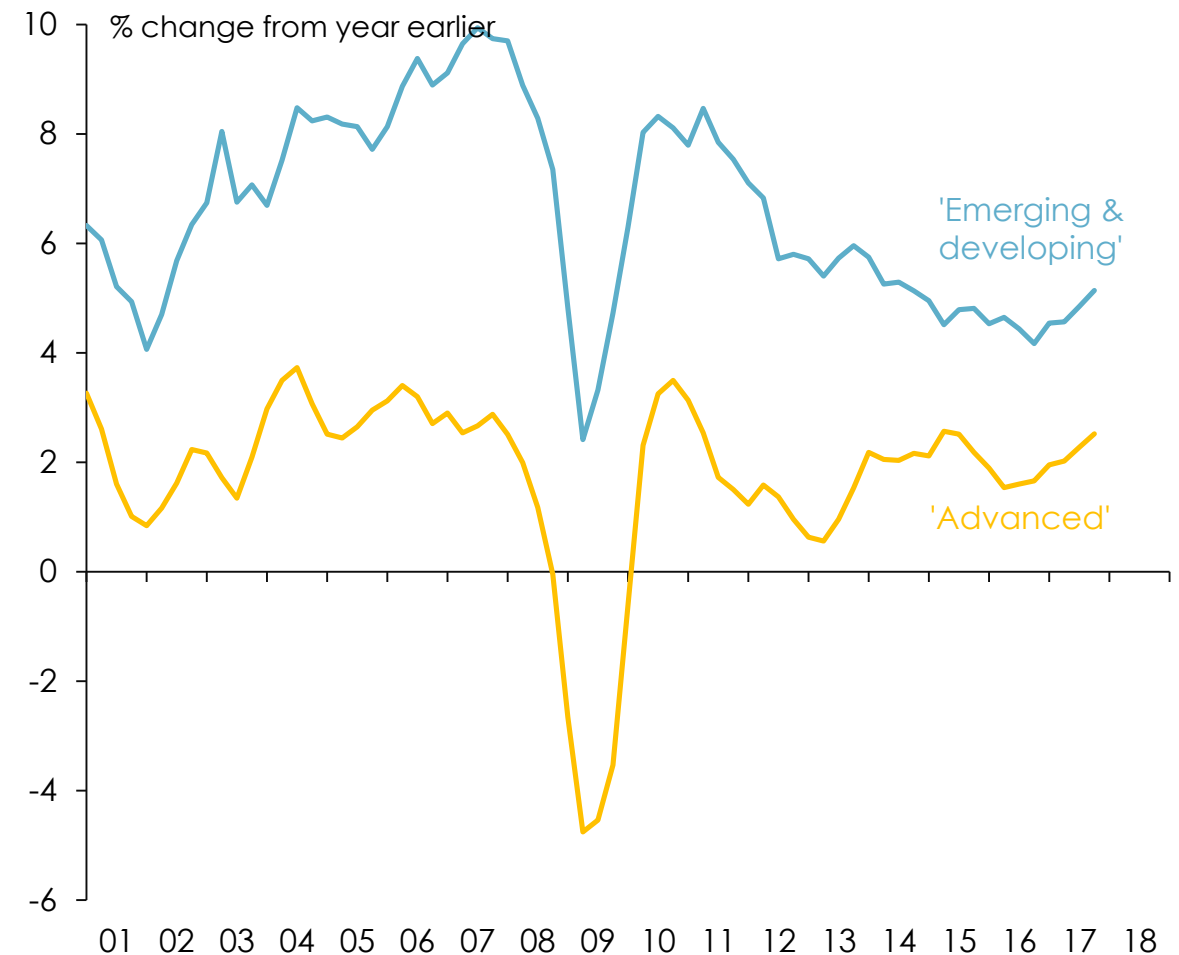
The world economy

World economic growth is picking up

World real GDP growth



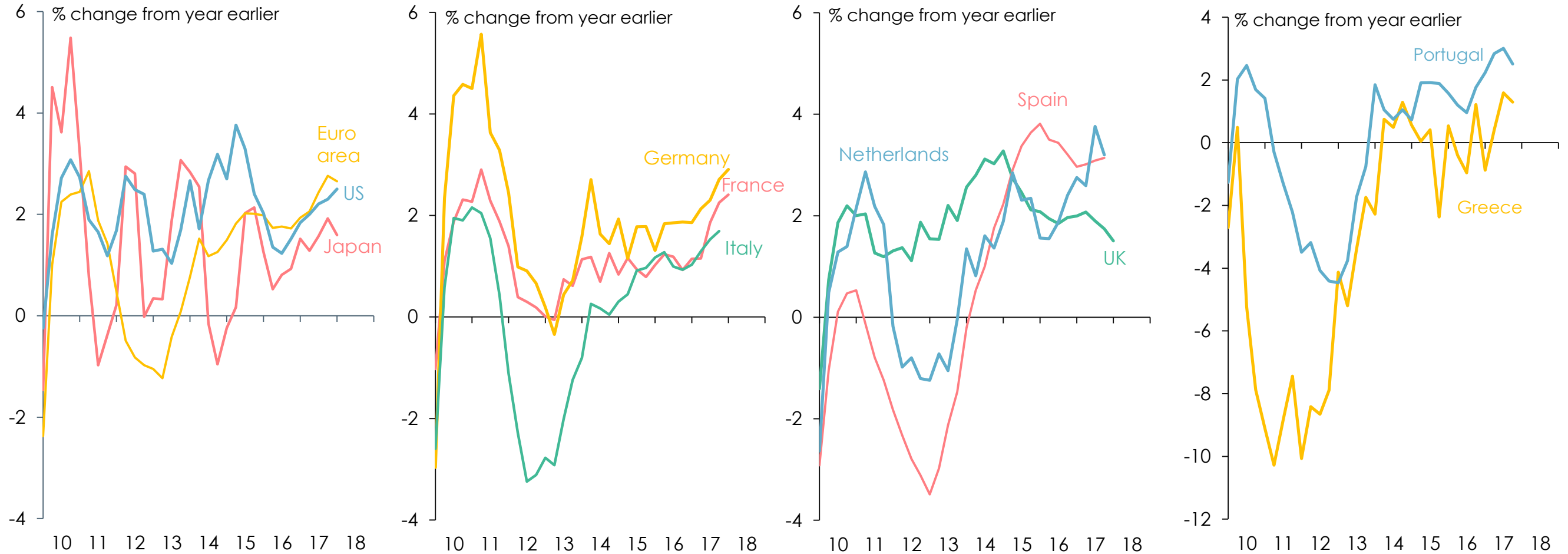
'Advanced' and 'emerging & developing' economies real GDP growth



Note: World GDP growth is the average of growth rates for 68 economies (42 'advanced' and 26 'emerging & developing') accounting for 90% of total world GDP (according to IMF estimates), weighted by their shares of 2016 world GDP at purchasing power parities. Sources: national statistical agencies and central banks; Corinna Economic Advisory.

The upswing in 'advanced' economies is more synchronized than at any time since the crisis – including within the euro area (but not the UK)

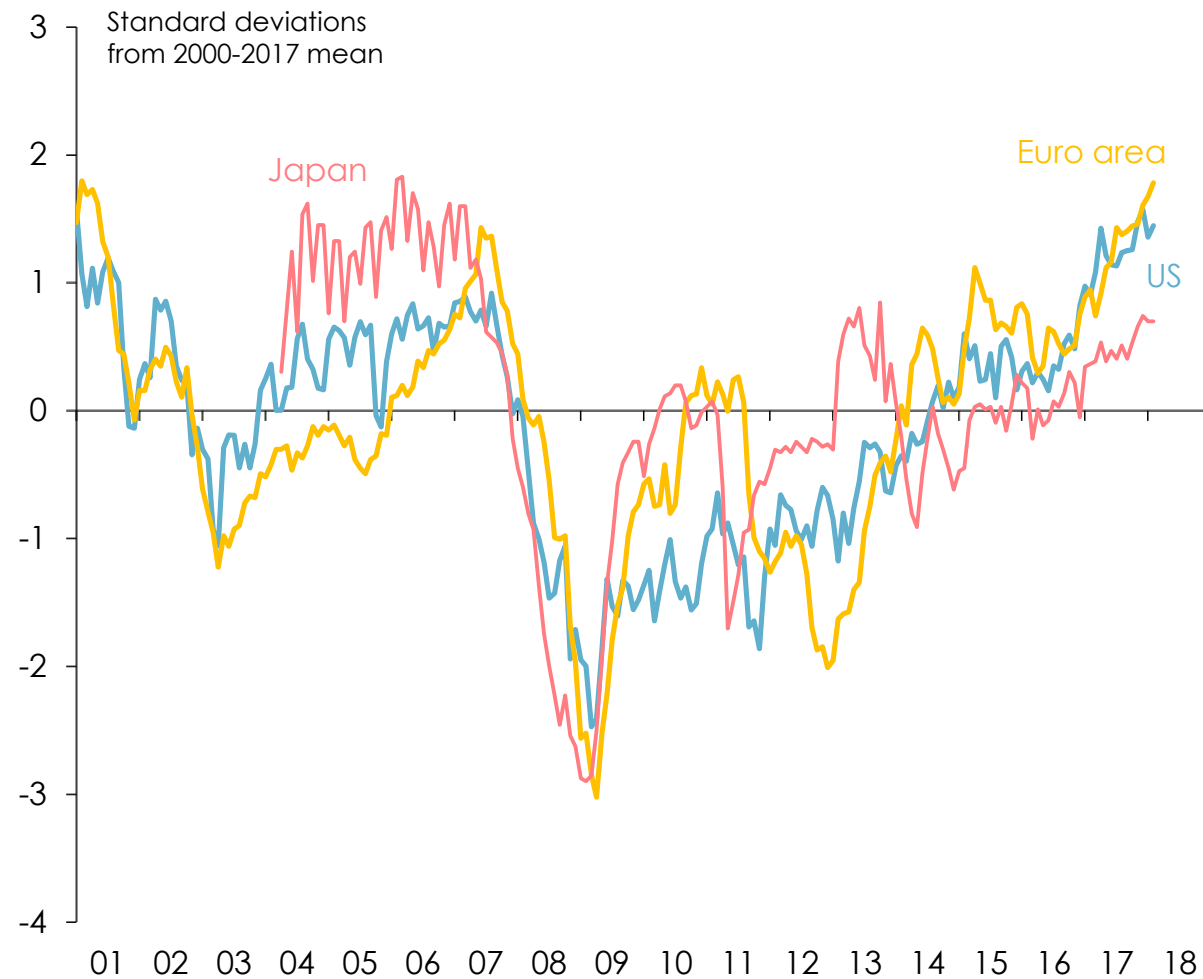
Real GDP growth in 'advanced' economies



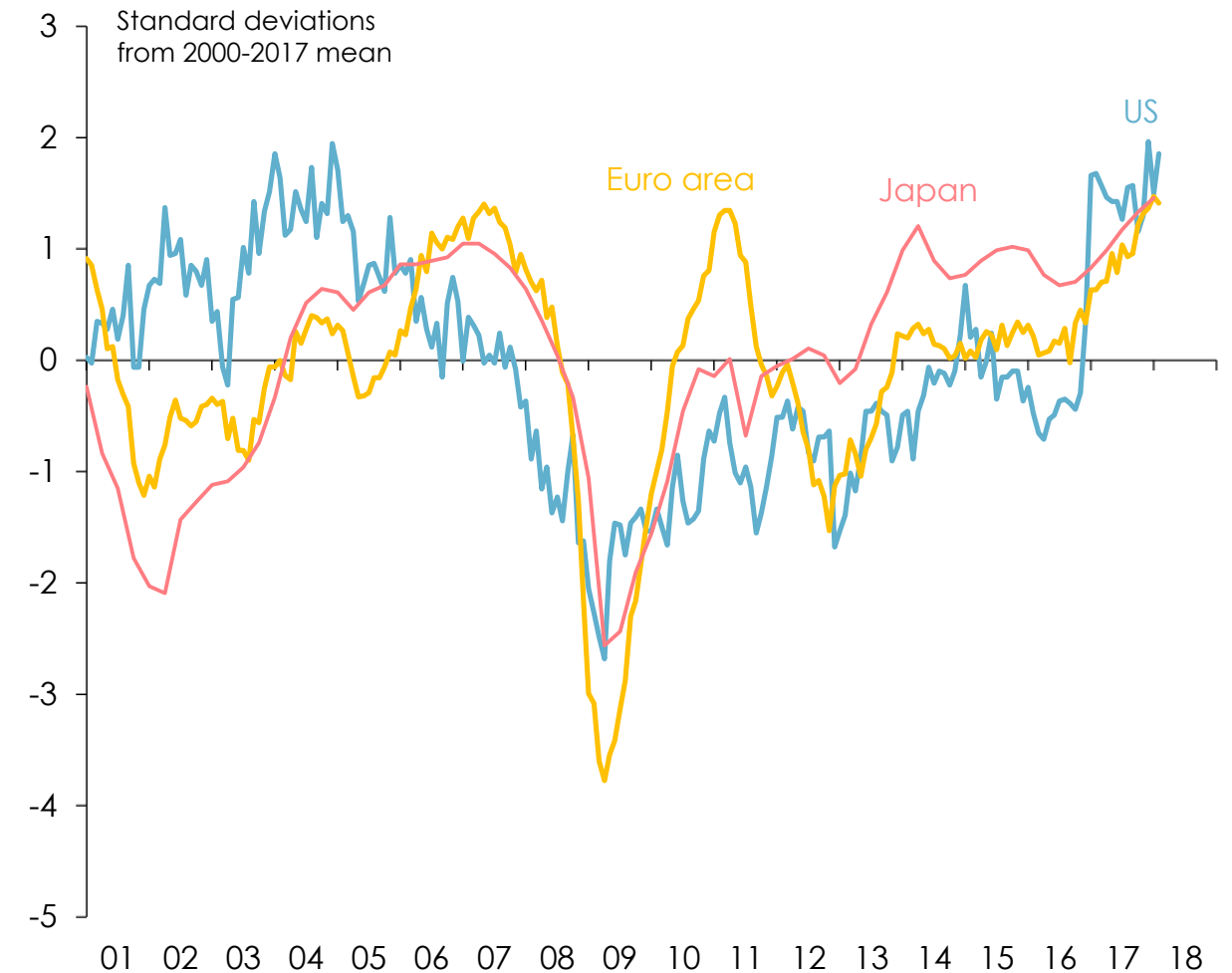
Sources: US Bureau of Economic Analysis; Eurostat; Japan Cabinet Office; UK Office of National Statistics.

Consumer and business confidence have also improved in the major 'advanced' economies, reflecting political as well as economic events

Consumer confidence



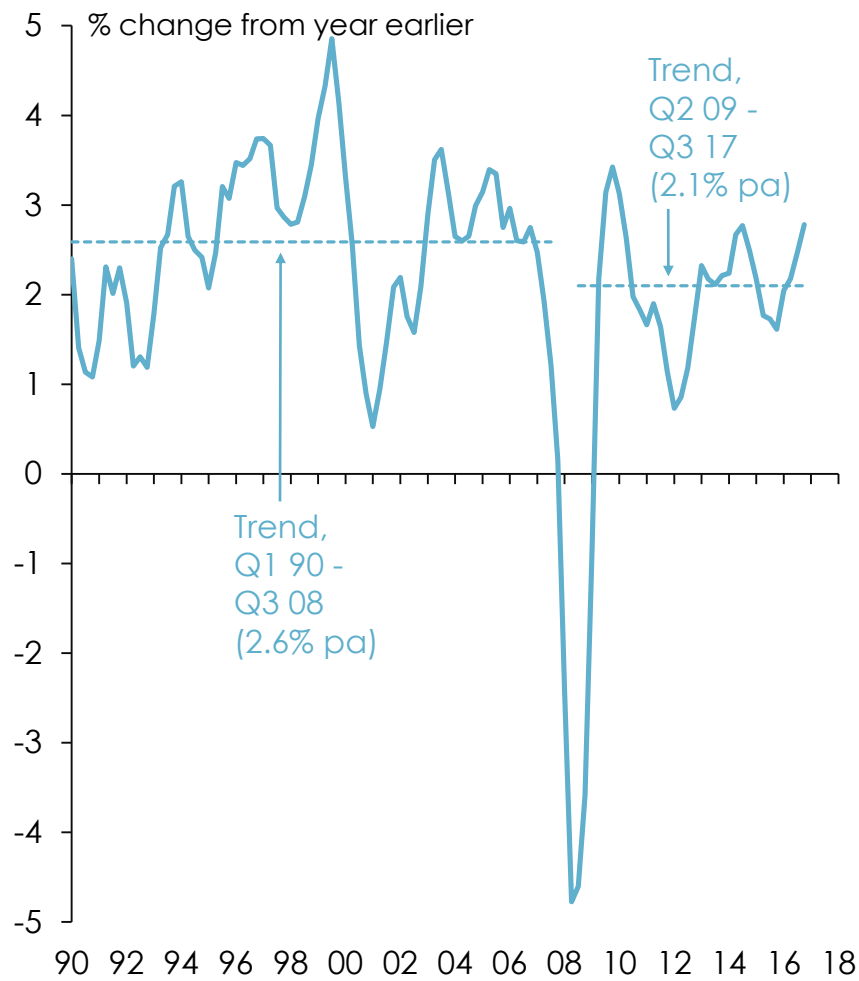
Business confidence



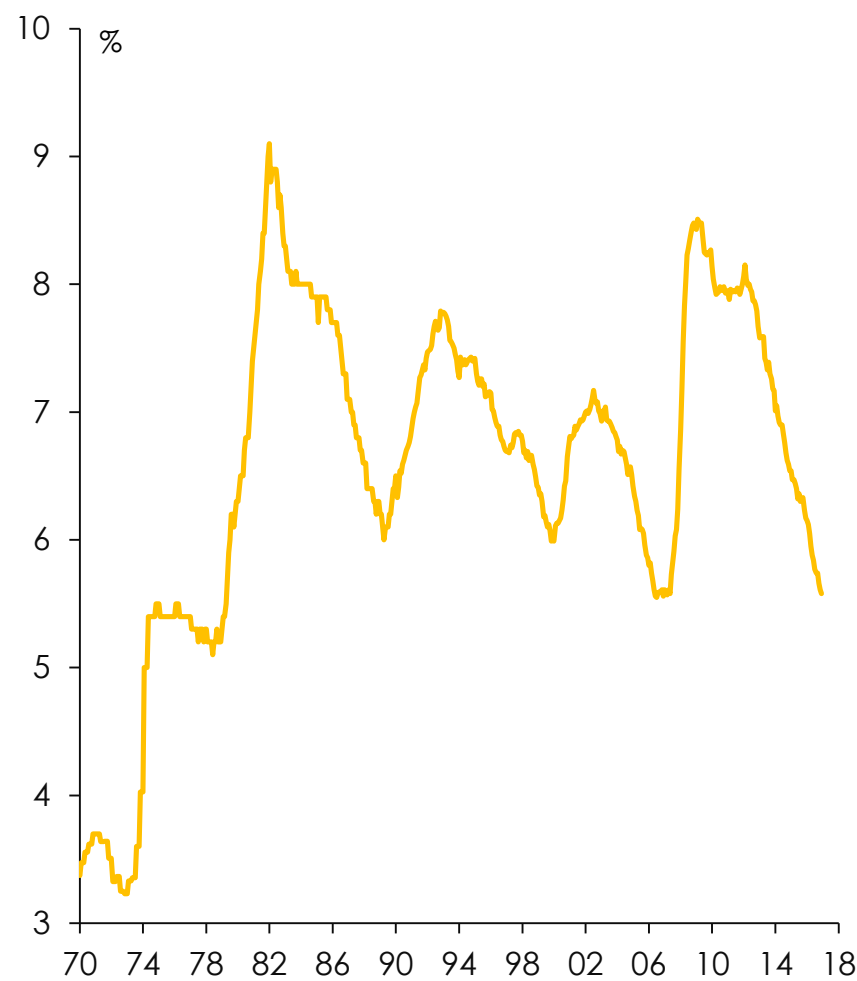
Note: Consumer confidence measures are those compiled by the Conference Board (US), European Commission (euro zone) and Cabinet Office (Japan). Business confidence measures are those compiled by the National Federation of Independent Businesses (US), European Commission (euro zone) and the Bank of Japan (the 'Tankan' survey, averaged over large and small businesses). Sources: above-mentioned agencies and Corinna Economic Advisory.

Economic growth across 'advanced' economies has until recently been mostly 'below trend' – yet unemployment has fallen sharply

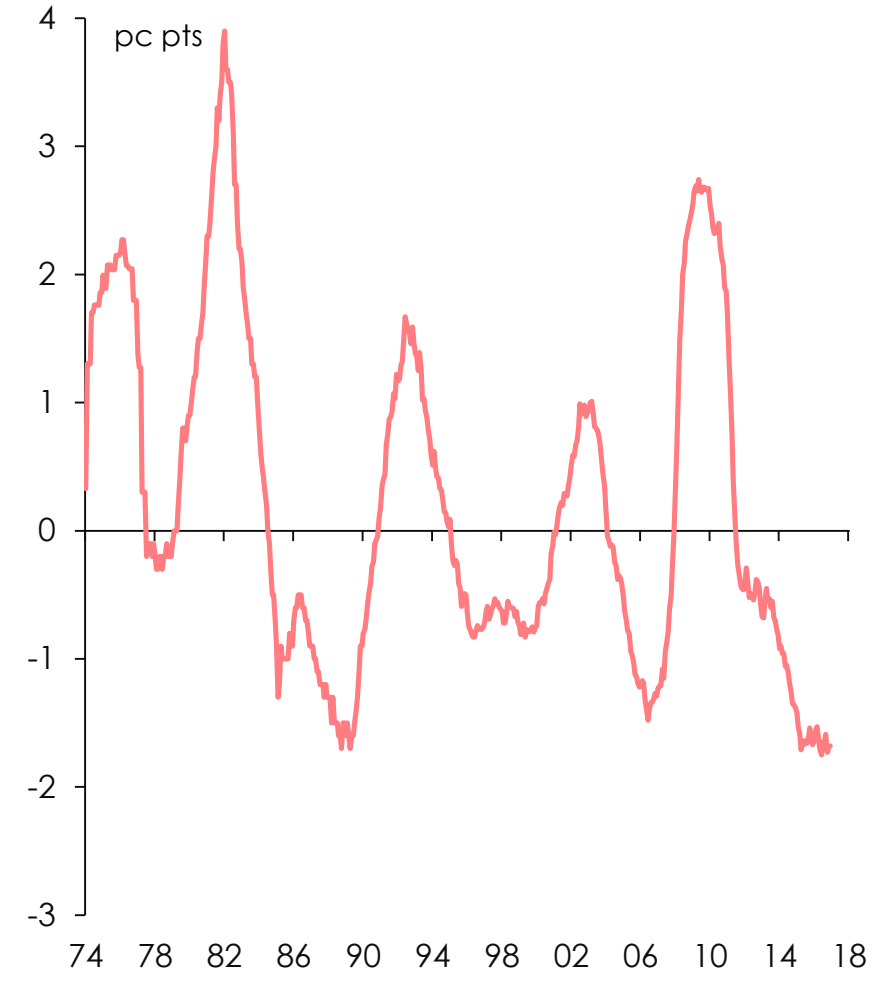
OECD area real GDP growth



OECD area unemployment rate



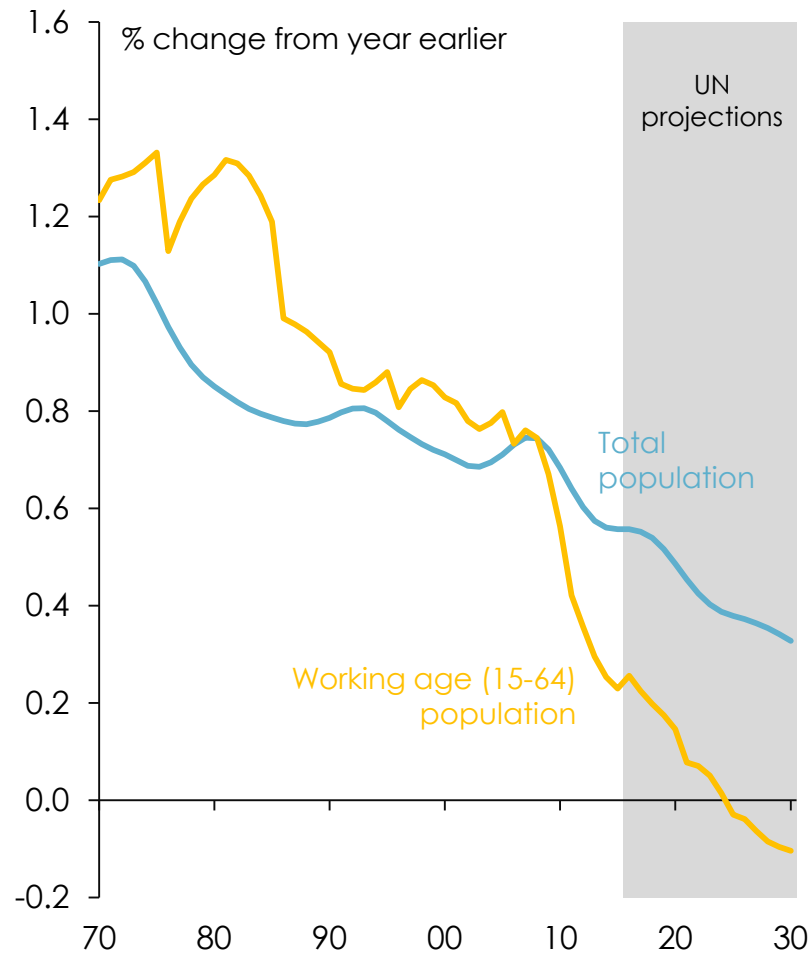
3-year change in OECD unemployment rate



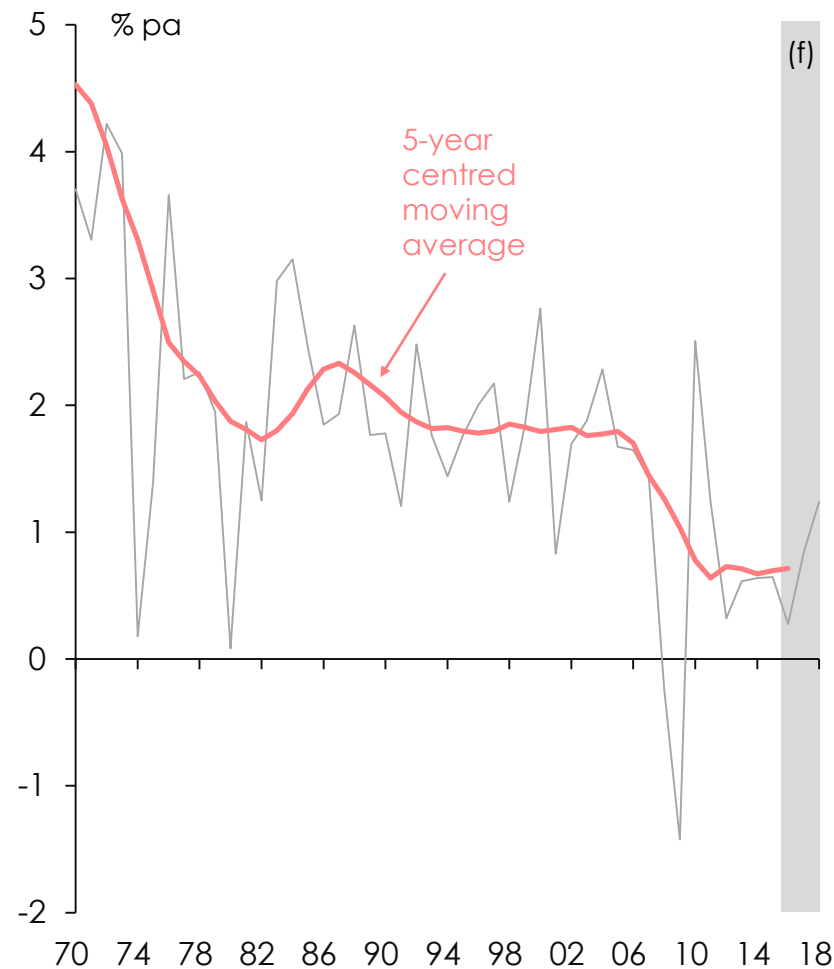
Source: Organization for Economic Co-operation & Development (OECD). The OECD comprises 34 (mostly) 'advanced' economies in North America and Europe, plus Japan, Korea, Australia, New Zealand, Mexico, Chile, Turkey & Israel.

Medium-to-longer term economic growth in 'advanced' economies is limited by demographic change and slower productivity growth

OECD area population growth



OECD area labour productivity growth



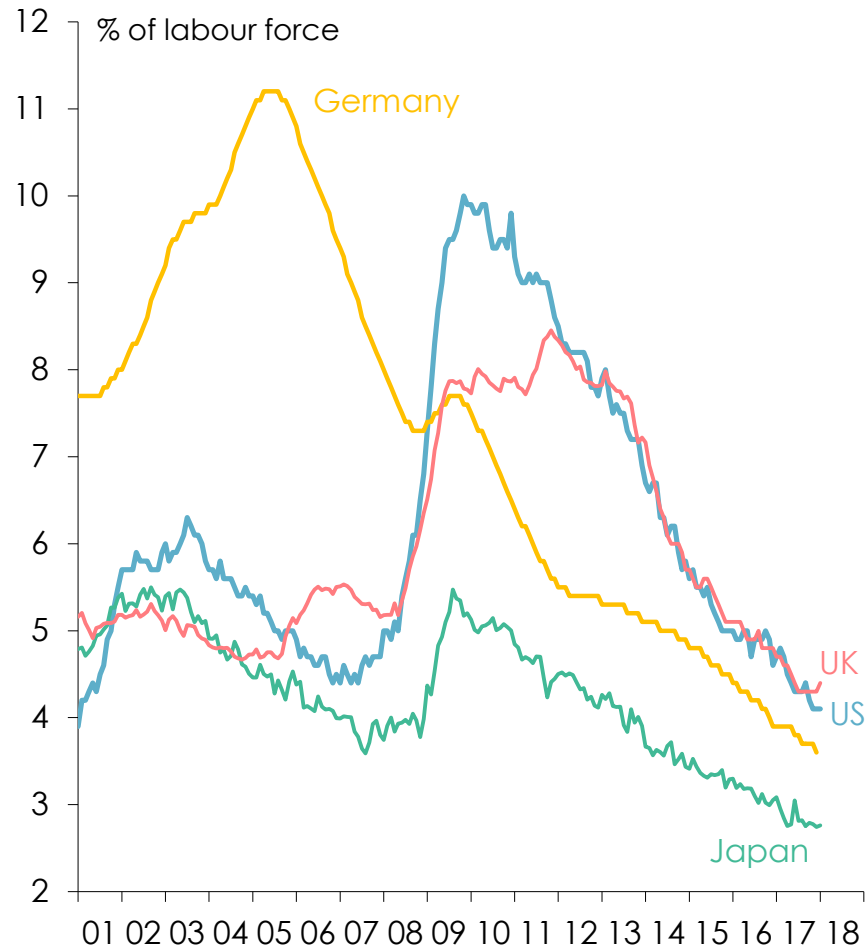
OECD area potential GDP growth



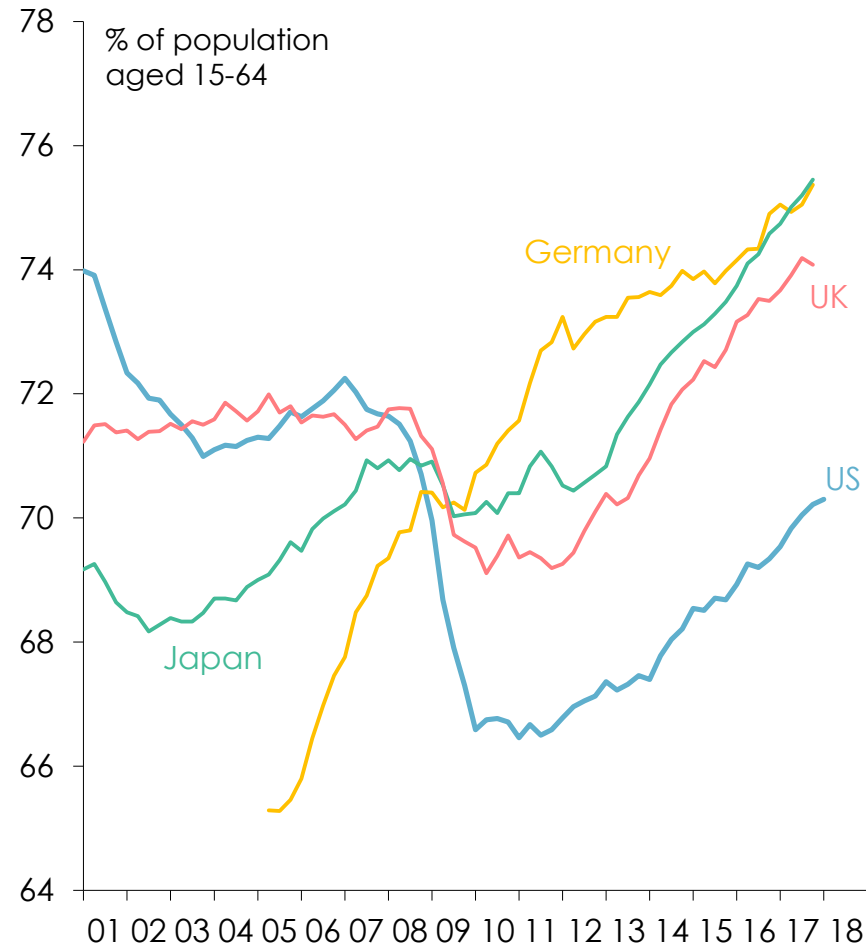
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2017 Revision*; Organization for Economic Co-operation & Development (OECD), *Economic Outlook* database June 2017. 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force. Note that the OECD area includes some 'emerging' economies (Mexico, Turkey, Chile) and excludes some 'advanced' ones (Taiwan, Hong Kong and Singapore)

The largest four 'advanced' economies don't have much 'spare capacity' left in their labour markets

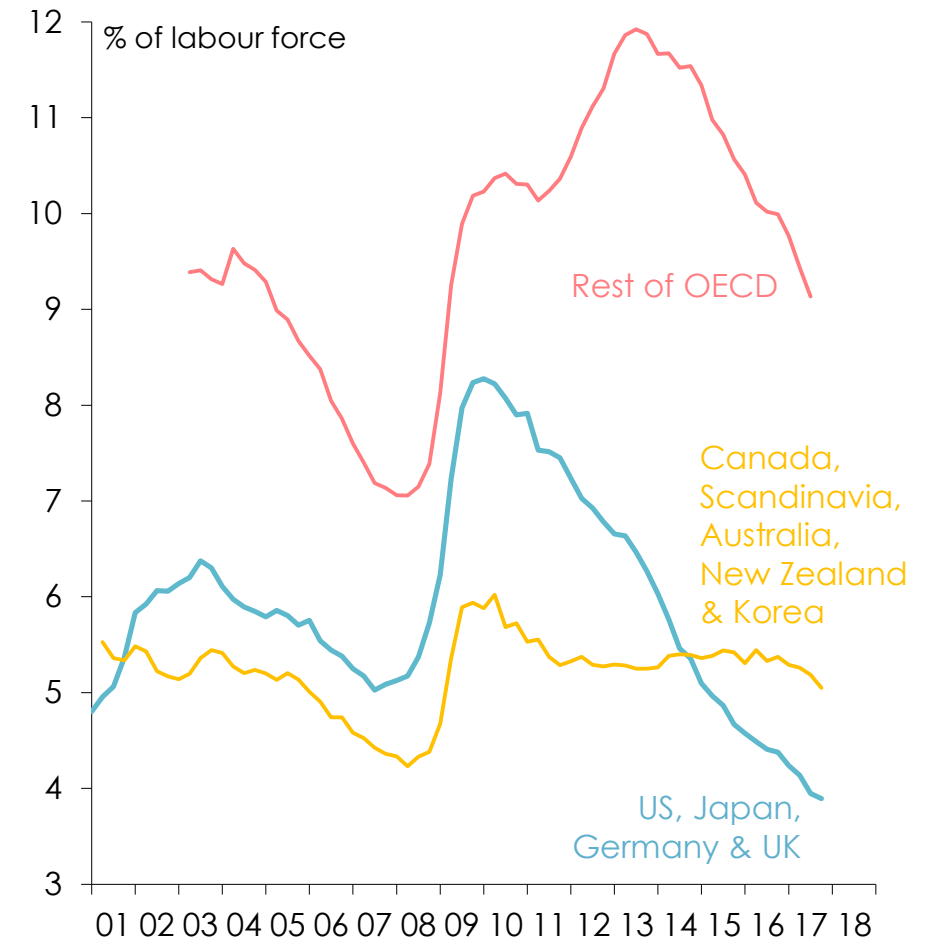
Unemployment – 4 largest 'advanced' economies



'Employment rates' – 4 largest 'advanced' economies



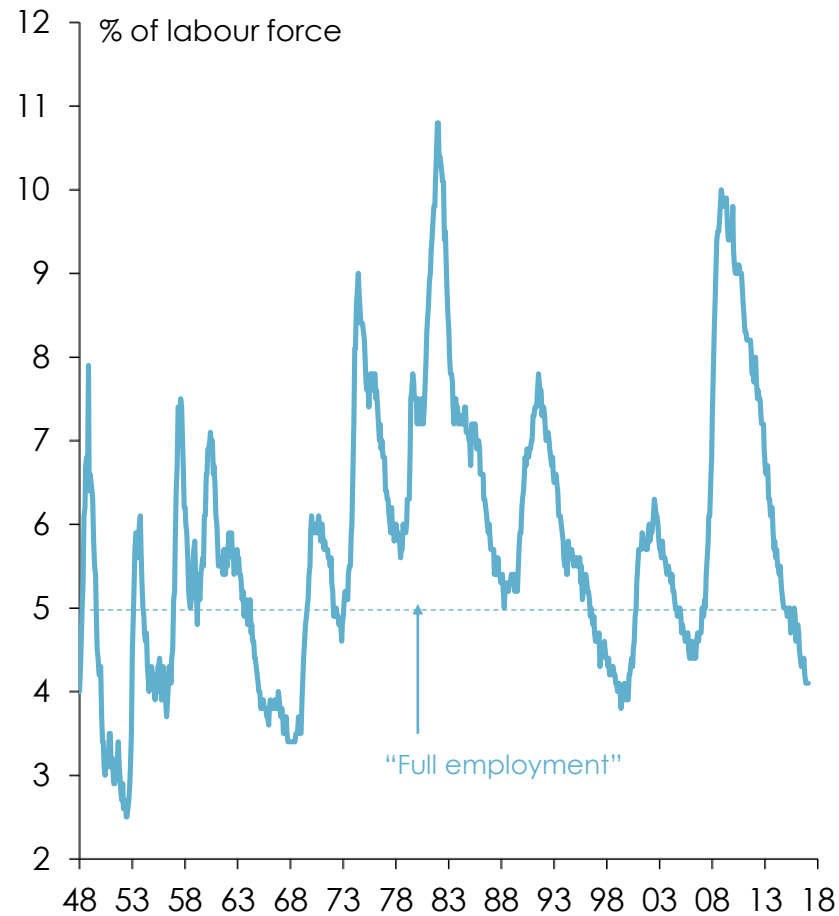
Unemployment rates – other OECD economies



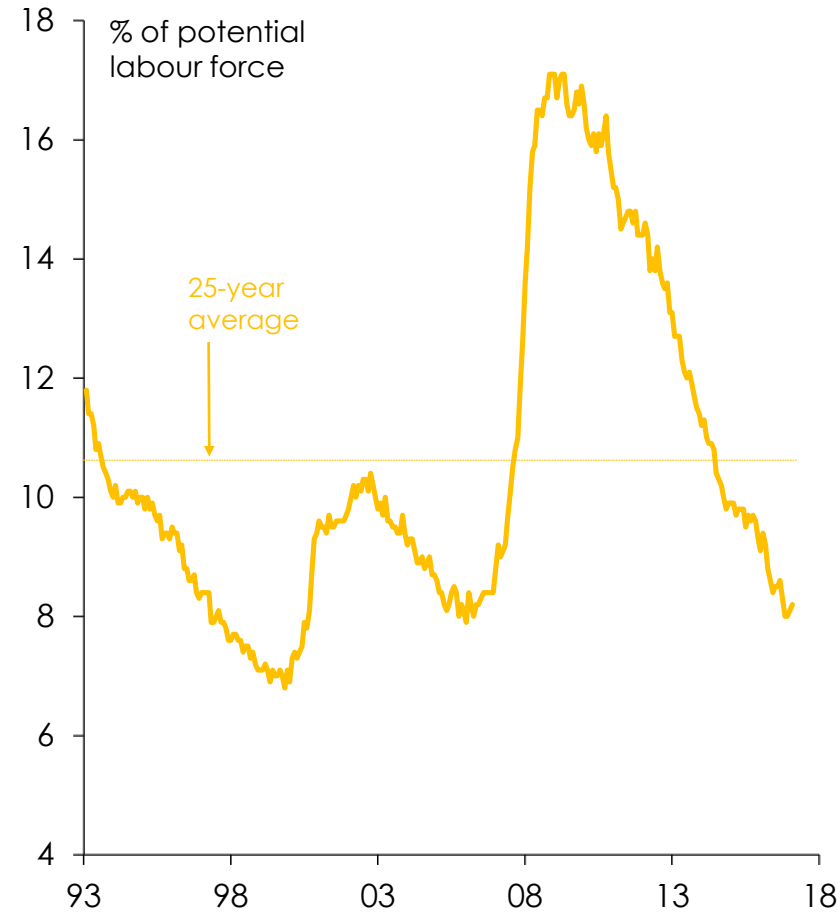
Sources: US Bureau of Labor Statistics; Eurostat; Japan Labour Ministry; Bundesagentur für Arbeit; UK Office of National Statistics; OECD Main Economic Indicators; Corinna Economic Advisory.

US labour market is getting very tight – and wages are now increasing at their fastest rate in nine years

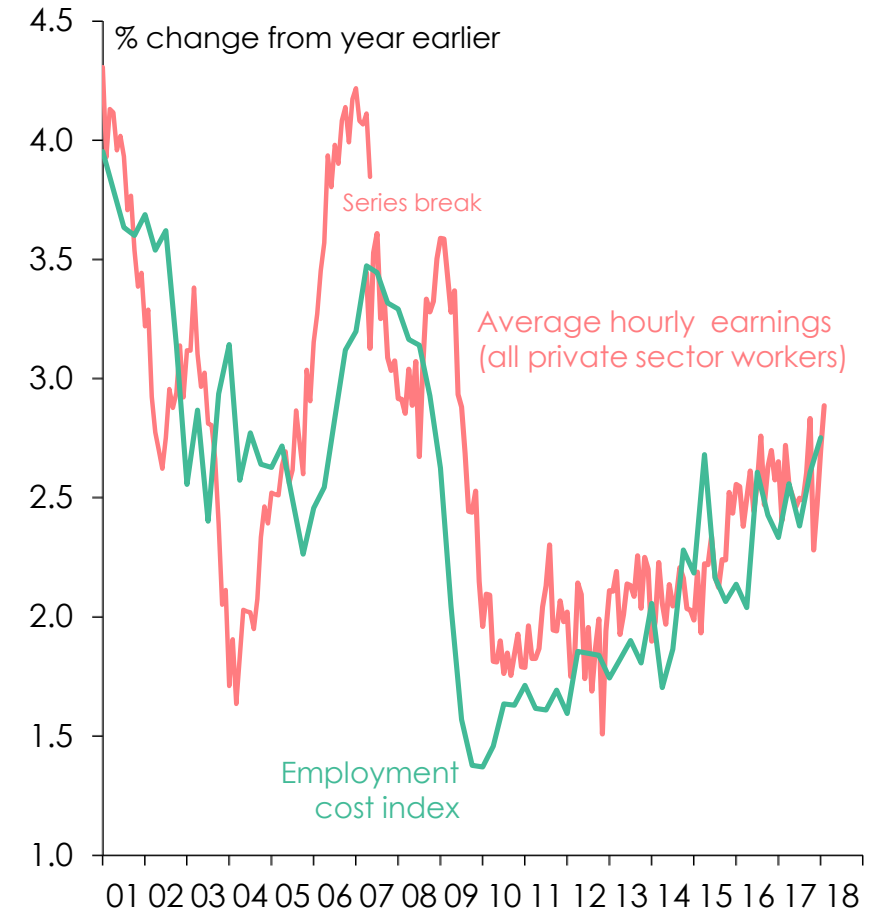
US unemployment rate in the post-war period



US labour force 'under-utilization'



US wages growth

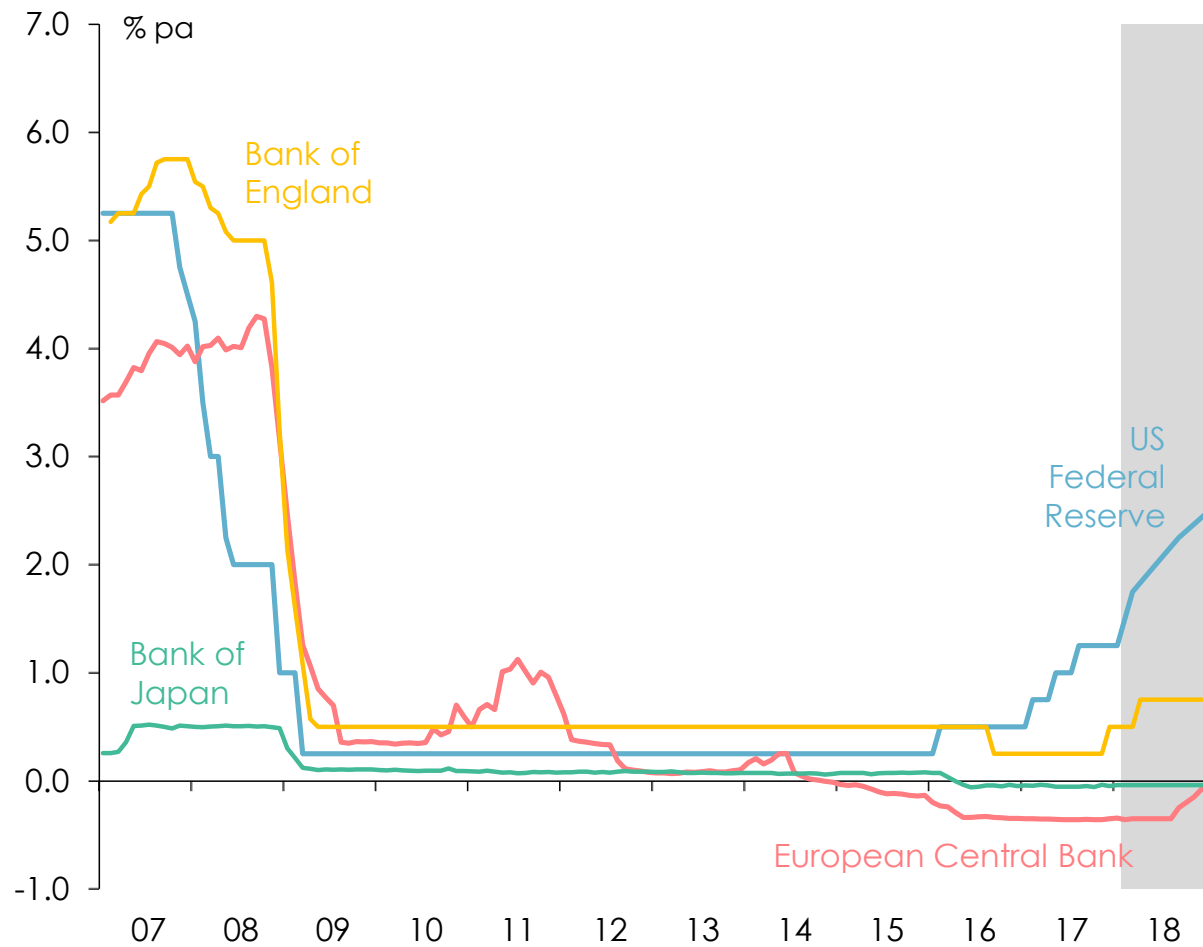


Note: 'under-utilization' is the 'U6' measure which includes people who are unemployed (as conventionally defined), 'discouraged workers', other 'marginally attached' workers, and people working part-time for 'economic reasons'. The employment cost index is the equivalent of the ABS 'wage price index'.

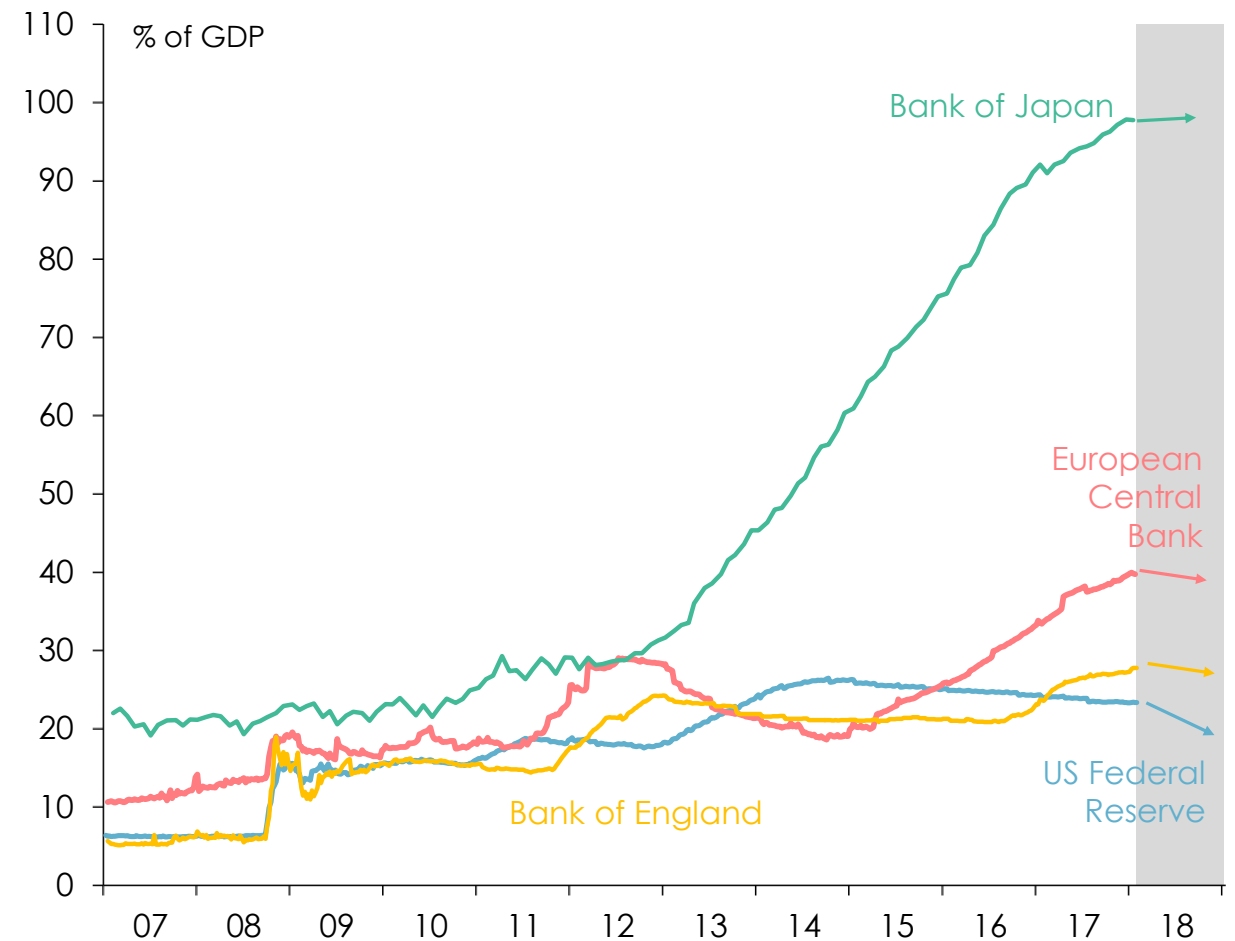
Source: US Bureau of Labor Statistics.

The era of 'ultra-cheap money' is drawing to a close

Major 'advanced' economy central bank policy interest rates



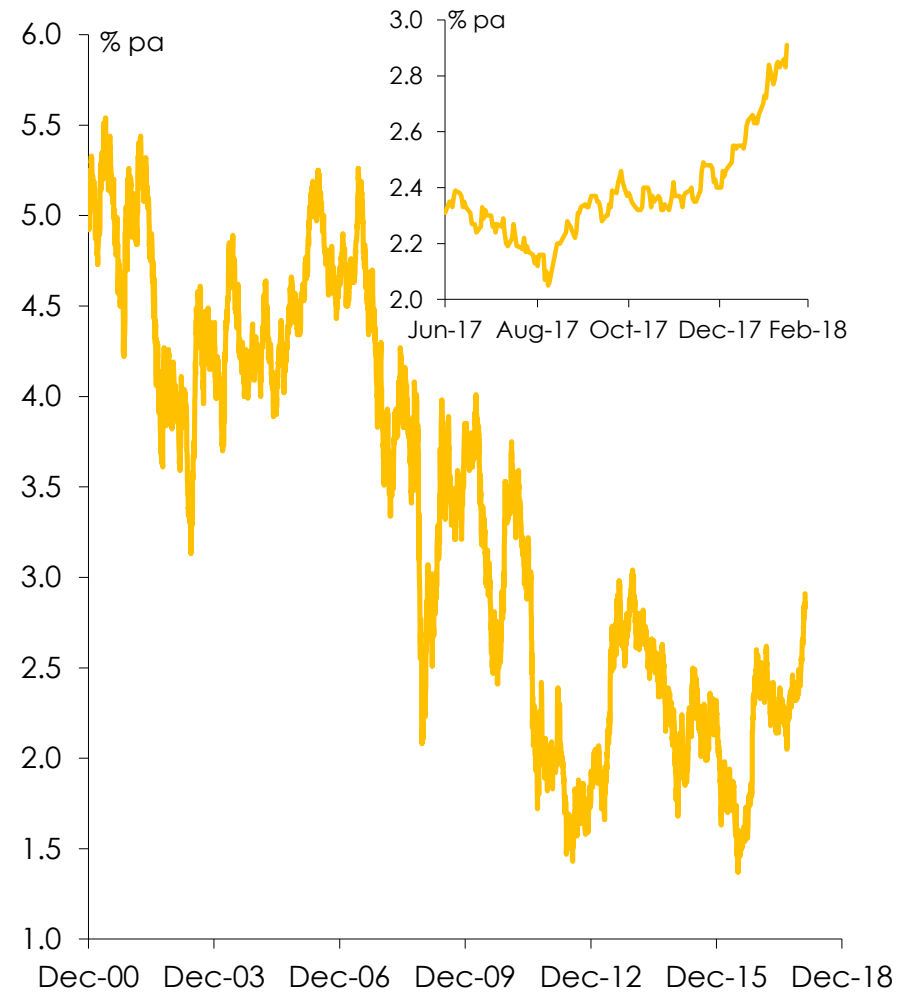
Major 'advanced' economy central bank balance sheets



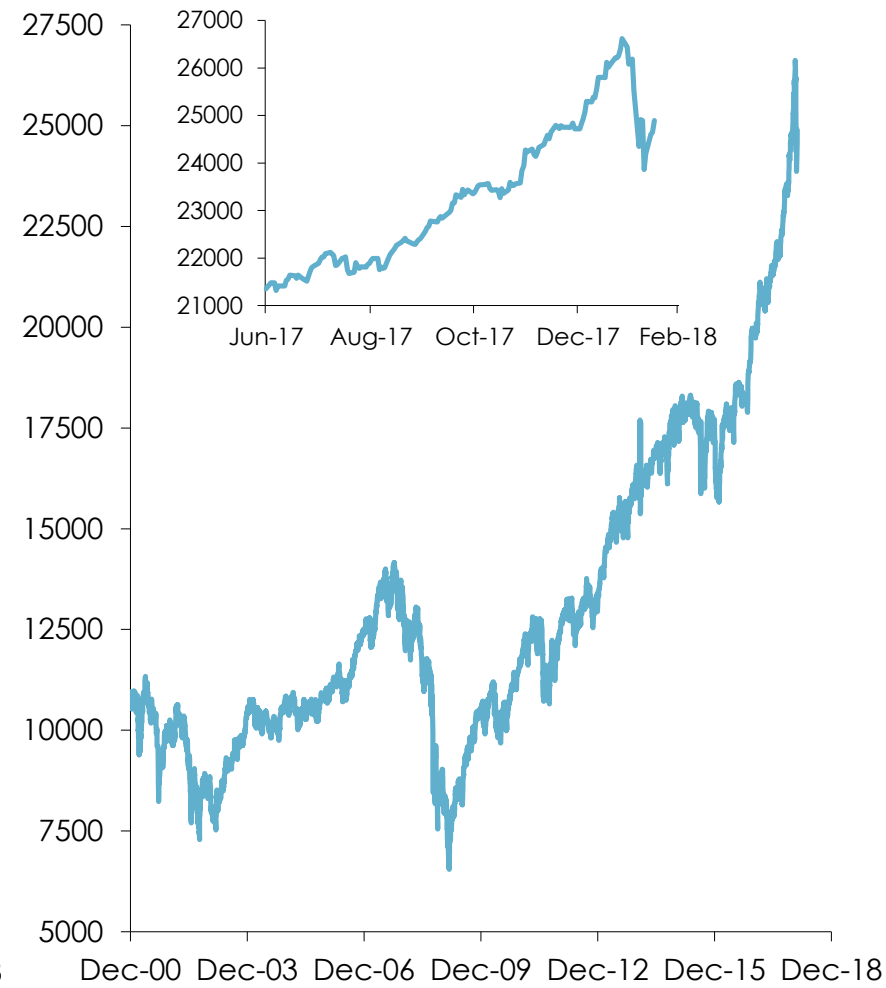
Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England.

The most recent data on US wages has been a wake-up call to complacent financial markets

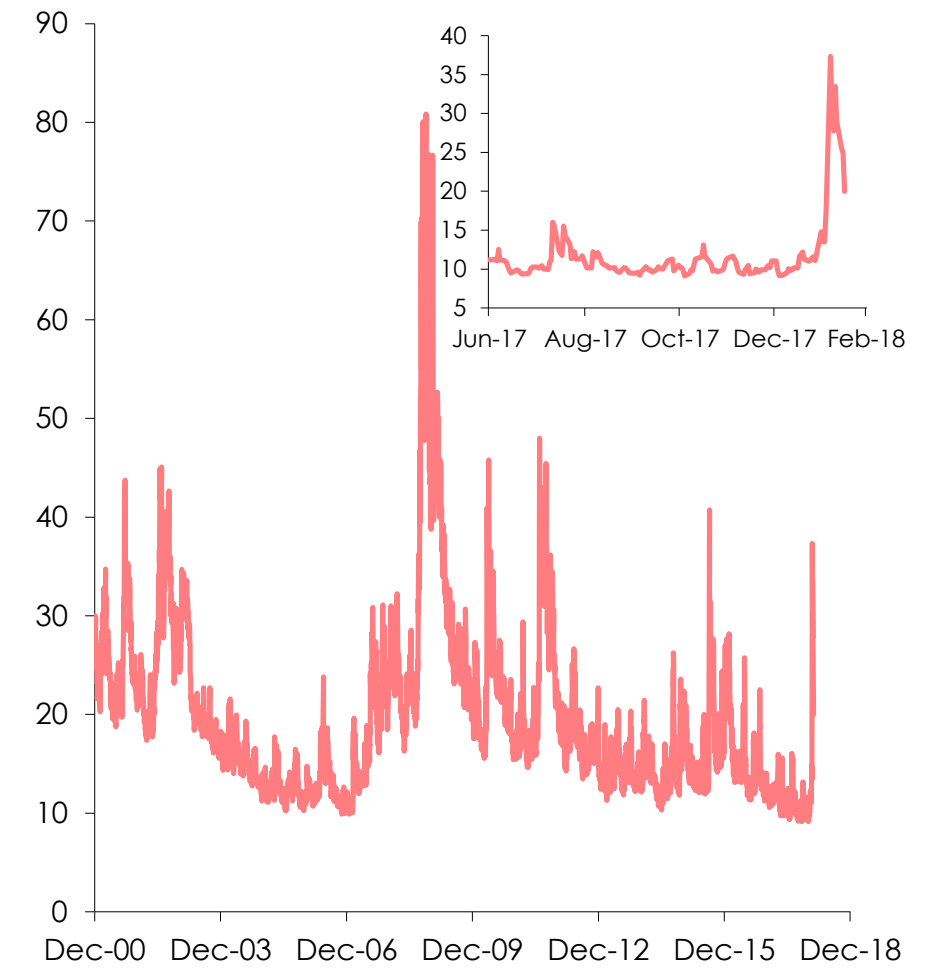
10-year bond yields



Dow Jones index



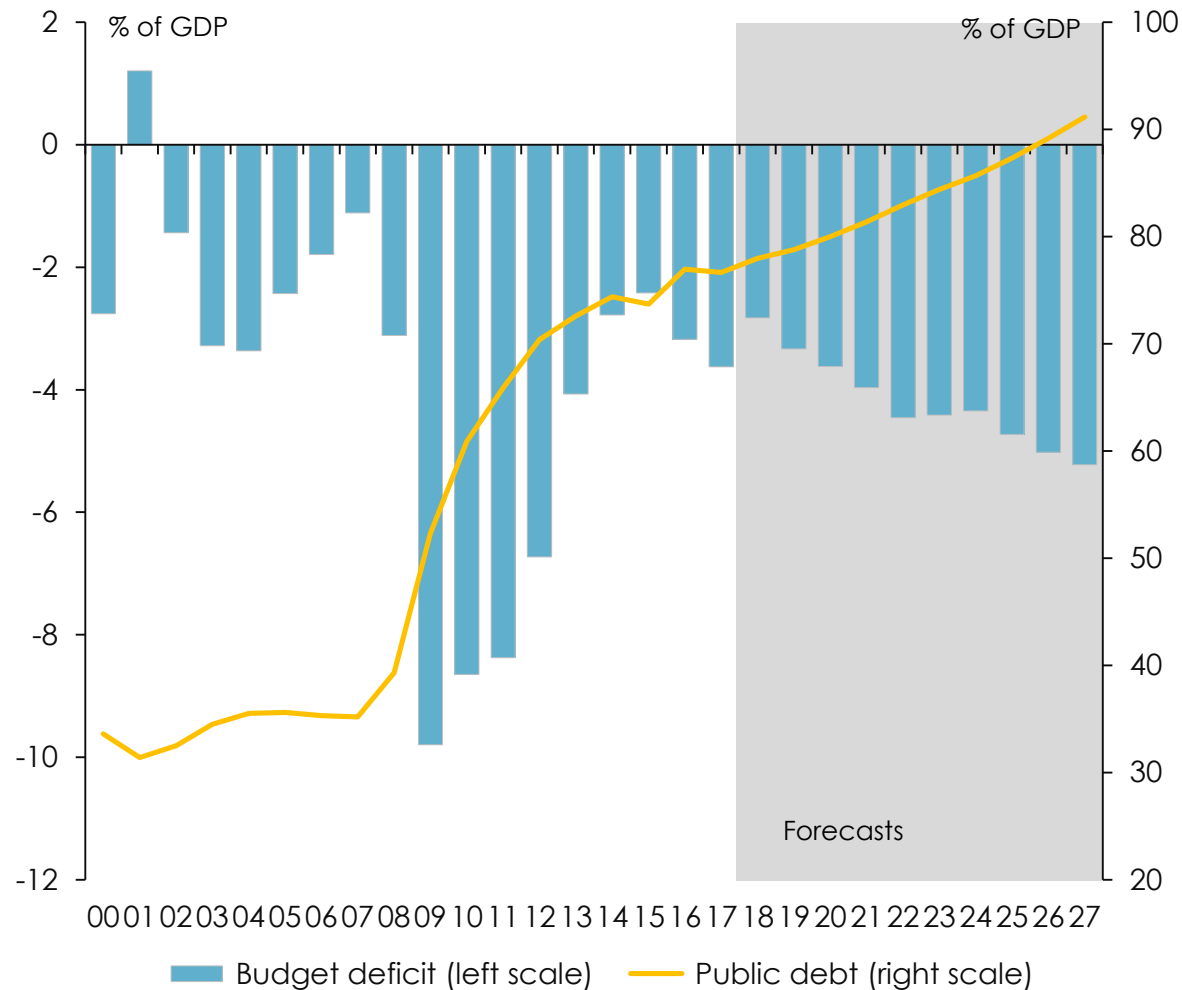
Volatility index ('VIX')



Source: Thomson Reuters Datastream.

US tax and spending measures will make this all worse, not better

US Federal Government budget deficit and debt



- ❑ The non-partisan US Congressional Budget Office most recently forecast a renewed widening in the US budget deficit to over US\$1 trn (4½% of GDP) by 2022, and public debt exceeding 90% of GDP by 2027
- ❑ That was last July, before the enactment of ...
- ❑ ... personal and corporate income tax cuts which will add US\$1½ trillion to the deficit over the next decade
- ❑ ... and last week's 'budget deal' which will add another US\$420 billion to the deficit over the next ten years
- ❑ And ahead of the Administration's proposed incentives for infrastructure investment which will cost a further US\$200bn over ten years
- ❑ All of this at a time when the US is more-or-less at 'full capacity' ...
- ❑ ... implying that these measures will boost demand by more than they boost supply, leading to higher inflation and/or a larger trade deficit

Source: US Congressional Budget Office.

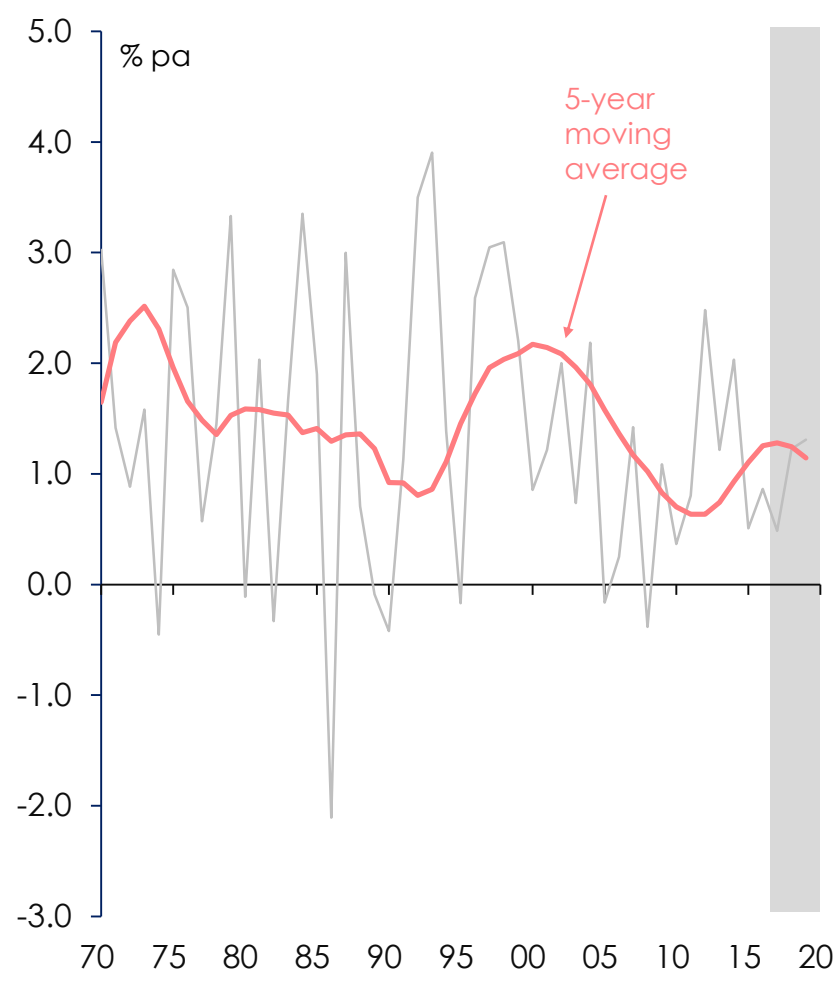
The Australian economy

Australia's demographic profile isn't as challenging as that of most other 'advanced' economies but potential growth will still be slower

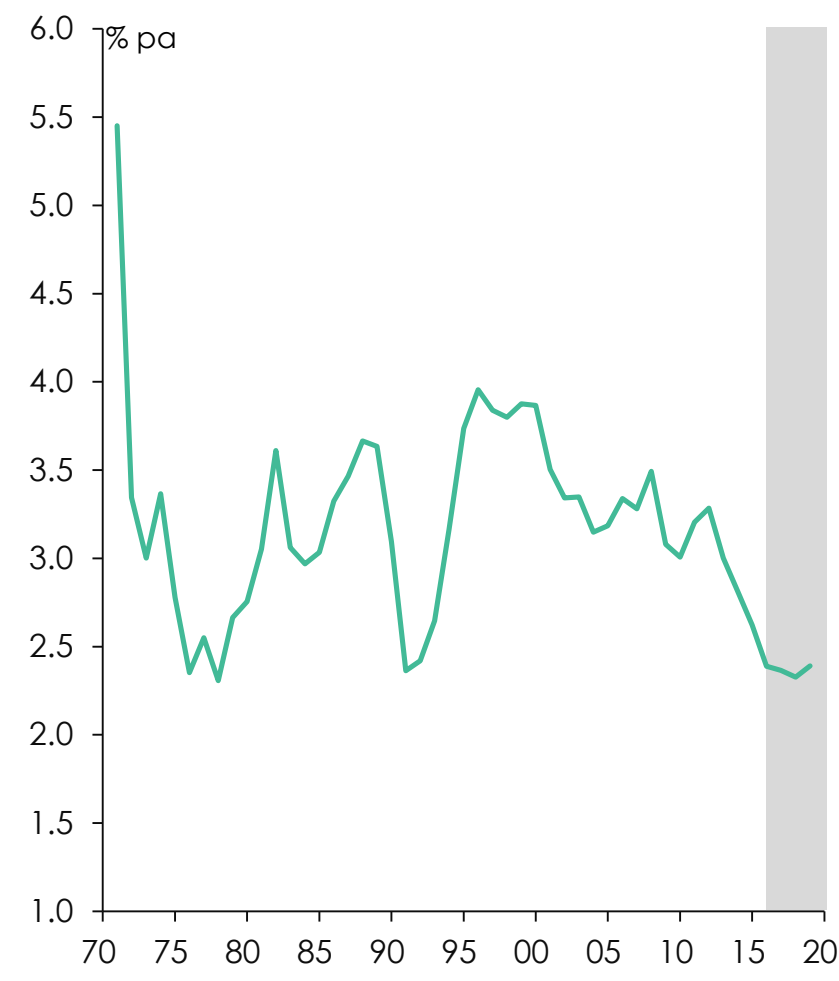
Australian population growth



Australian labour productivity growth



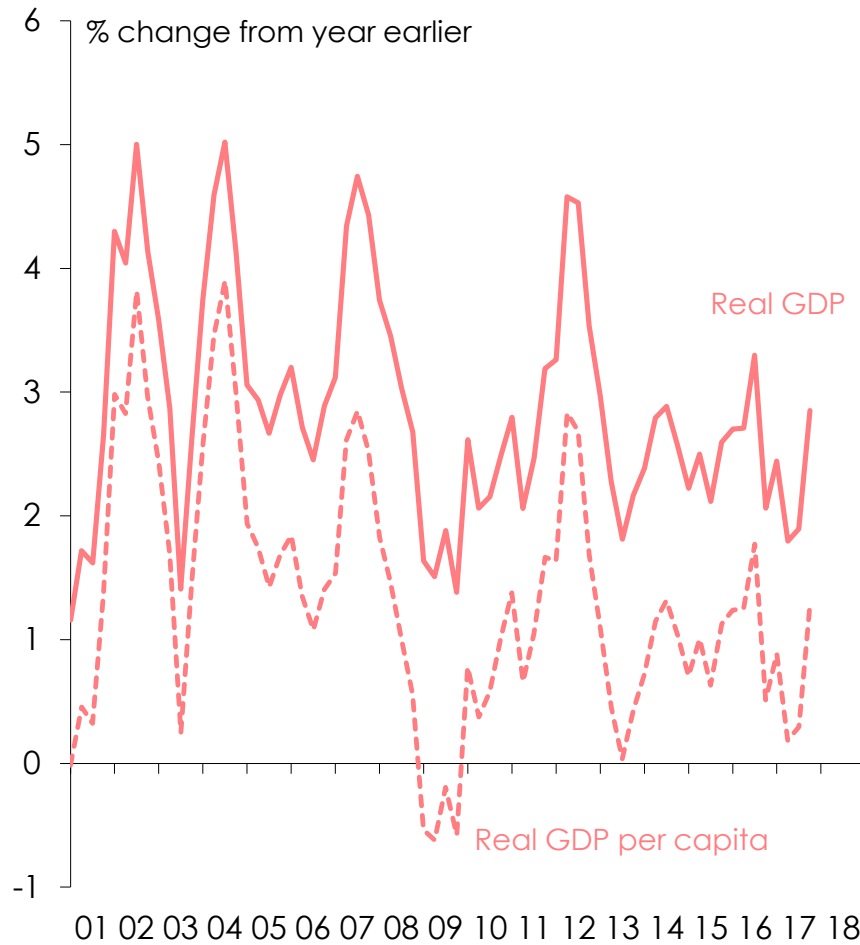
Australian potential GDP growth



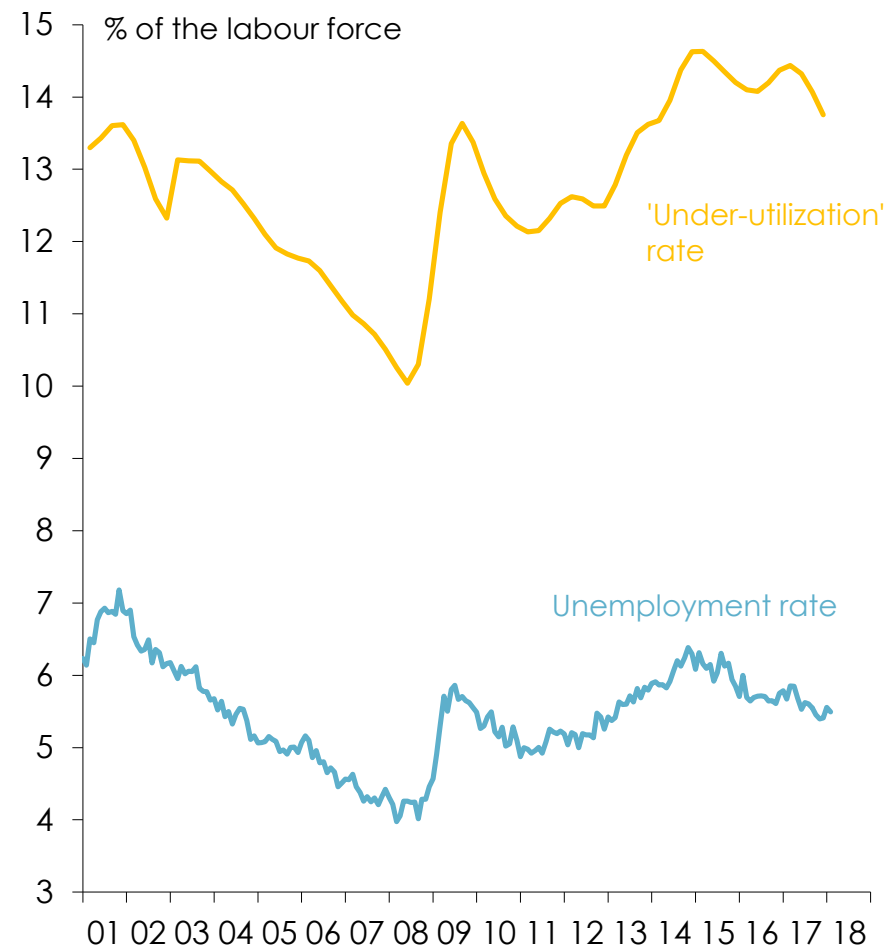
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2017 Revision*; Organization for Economic Co-operation & Development (OECD), *Economic Outlook* database December 2017. 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force.

Australian economic growth is lower than it should be, unemployment is higher than it should be, and inflation is lower than the RBA wants

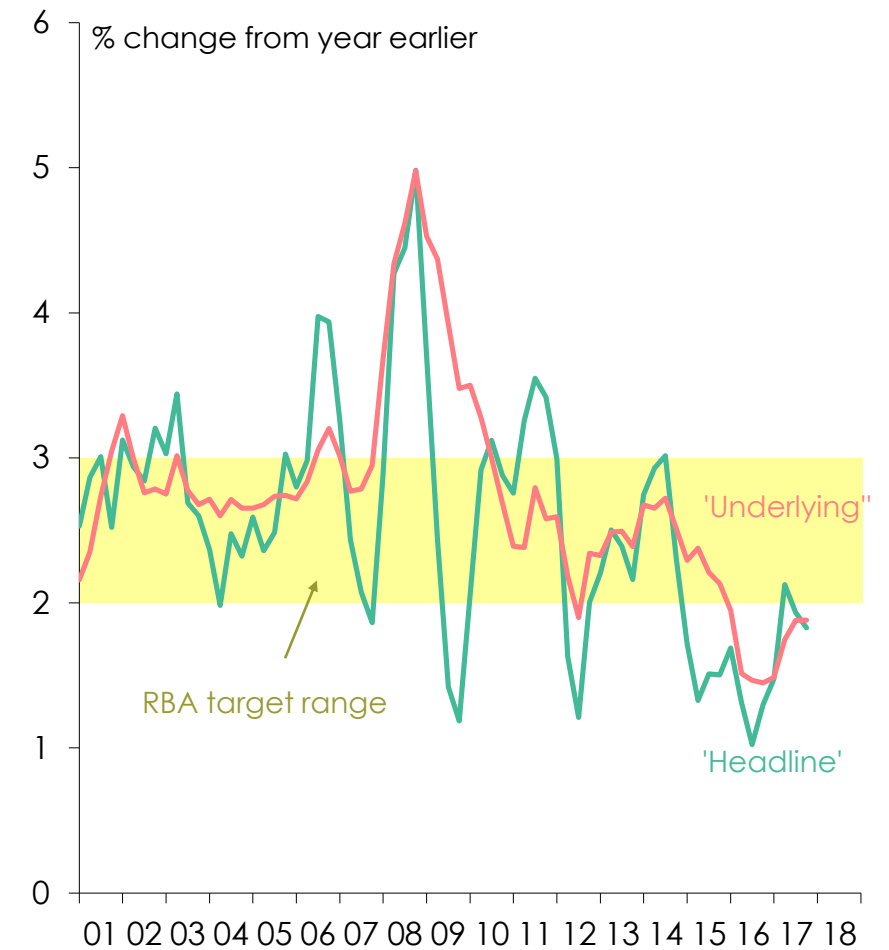
Economic growth



Unemployment and under-employment



Consumer prices

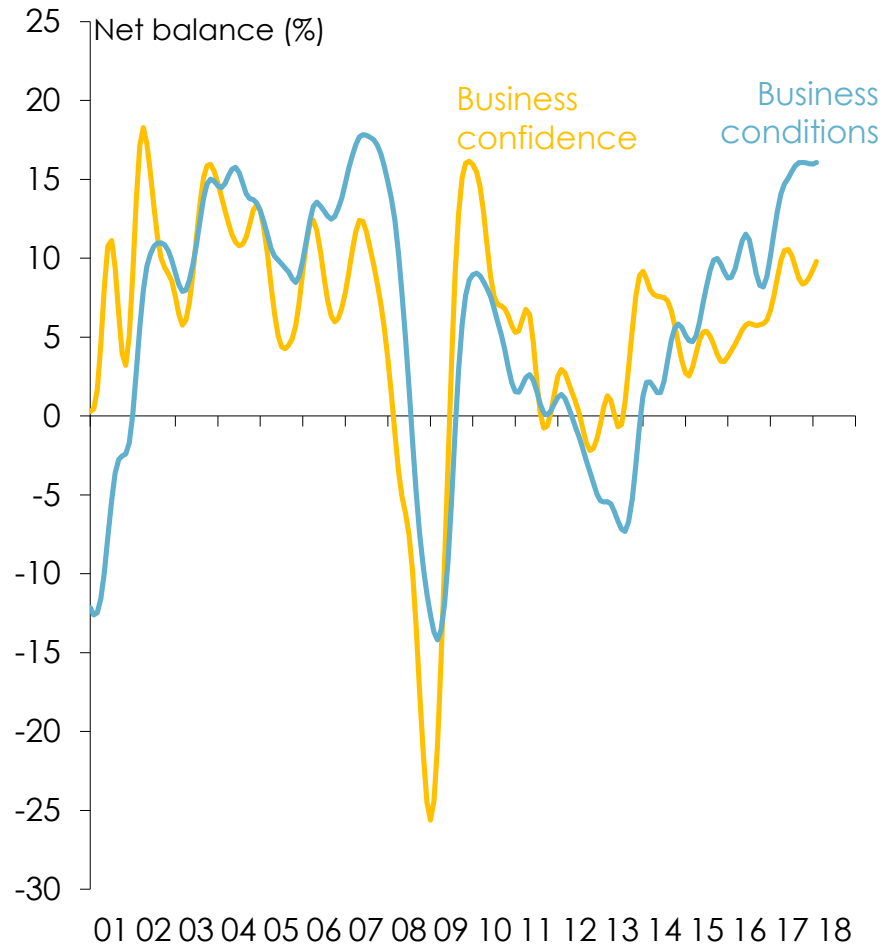


Note: The labour force 'under-utilization' rate includes people employed part-time who are willing and able to work longer hours (and weights them equally with people who are 'unemployed' in the conventional sense). 'Underlying' inflation abstracts from the impact of volatile items (typically items such as petrol, or fruit and vegetables) on the CPI.

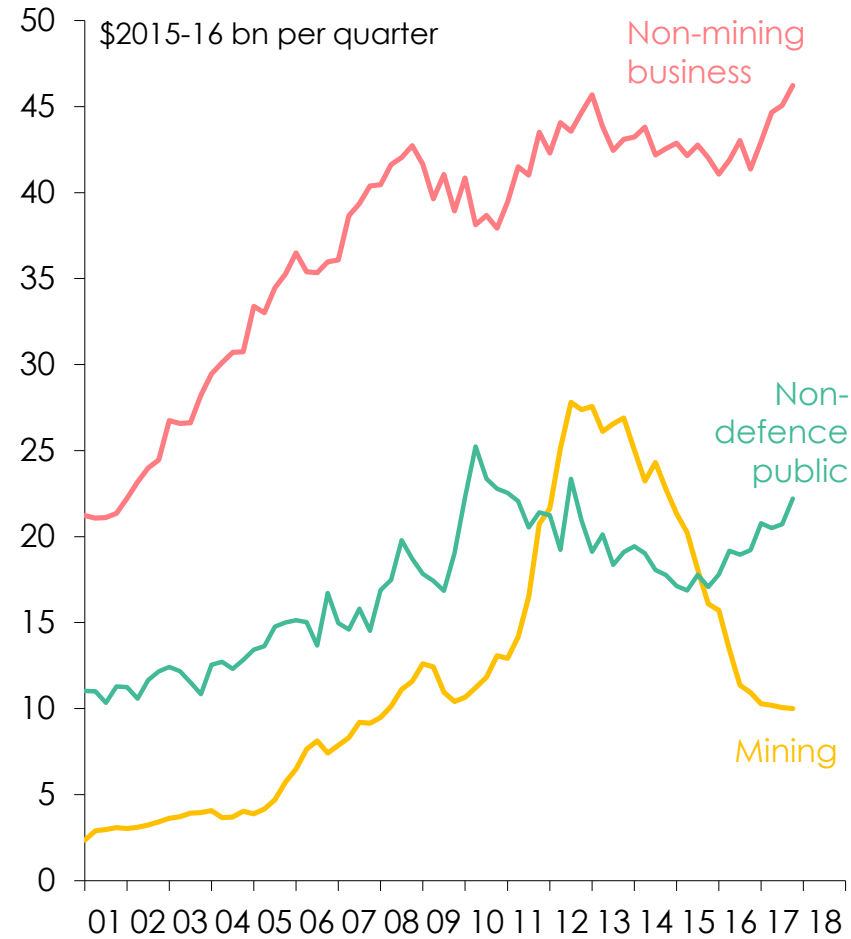
Source: Australian Bureau of Statistics.

Australian business conditions are clearly improving, and that is fostering a long-awaited pick-up in (non-mining) business investment

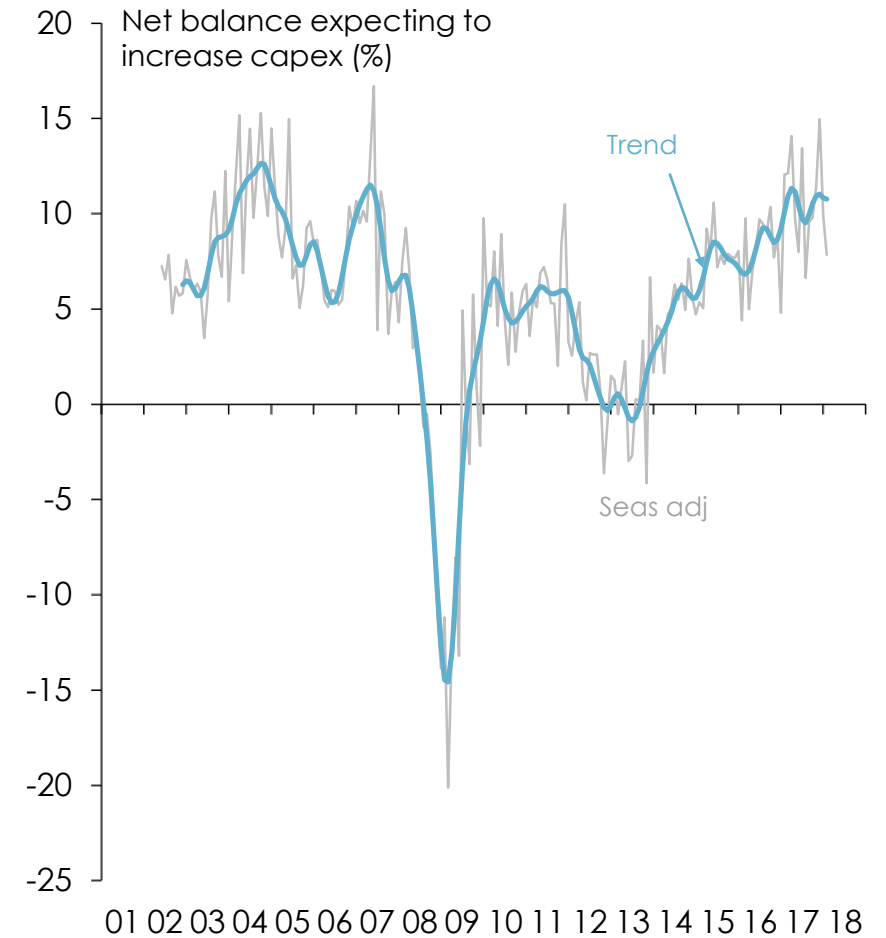
Business conditions and confidence



Non-residential investment – mining vs other sectors



Business survey capital expenditure expectations

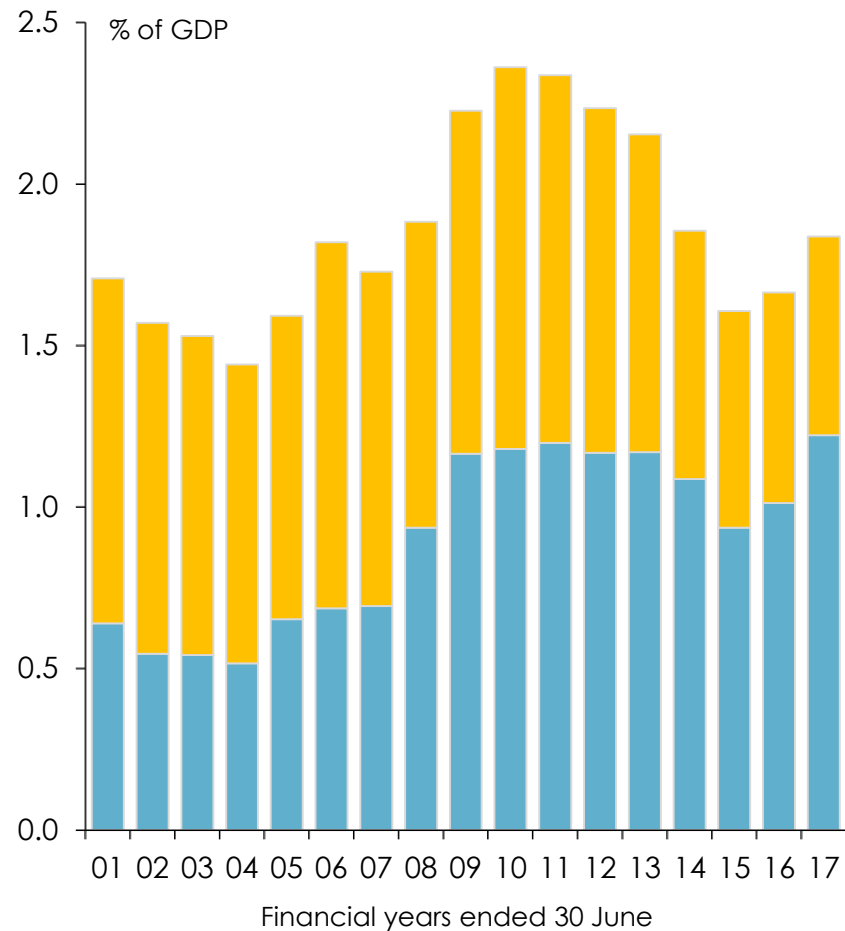


Sources: National Australia Bank; ABS.

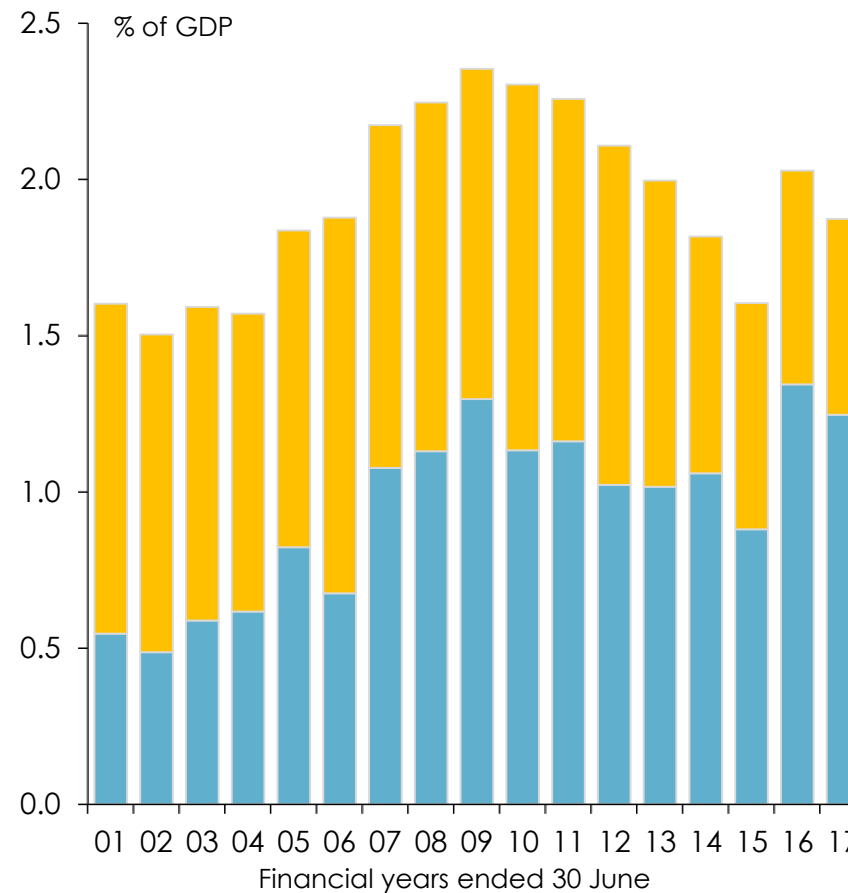
Higher levels of infrastructure investment spending are now beginning to provide some real impetus to economic growth

Indicators of engineering construction activity for the public sector

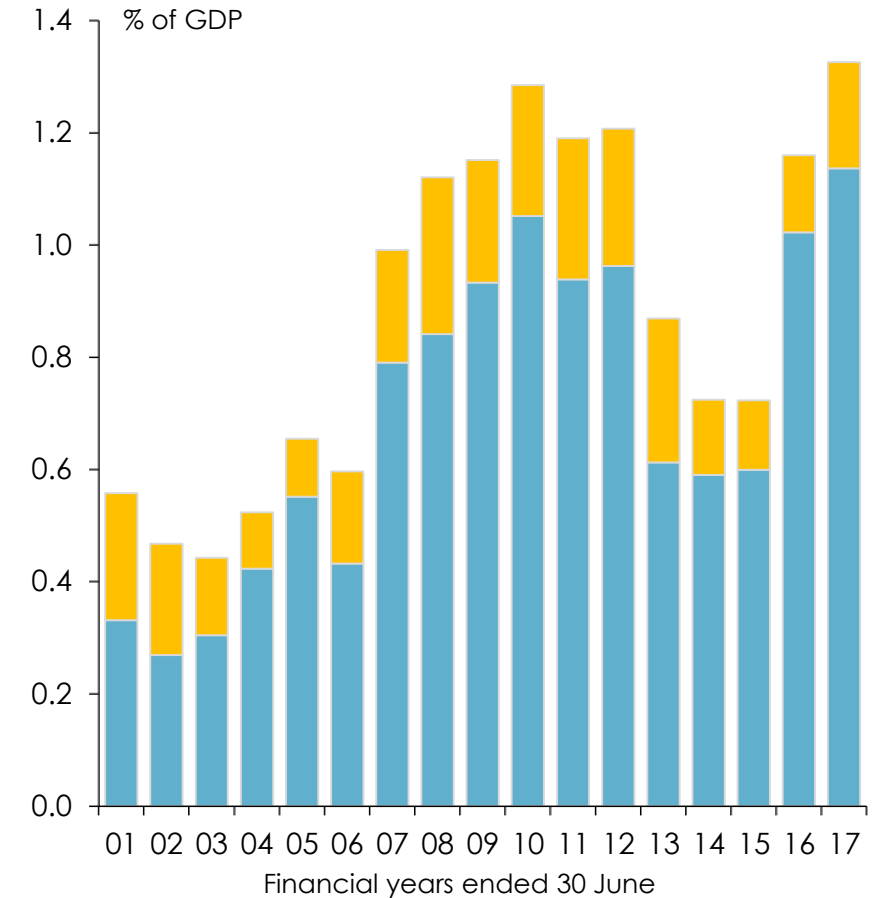
Value of work done



Commencements



Work yet to be done

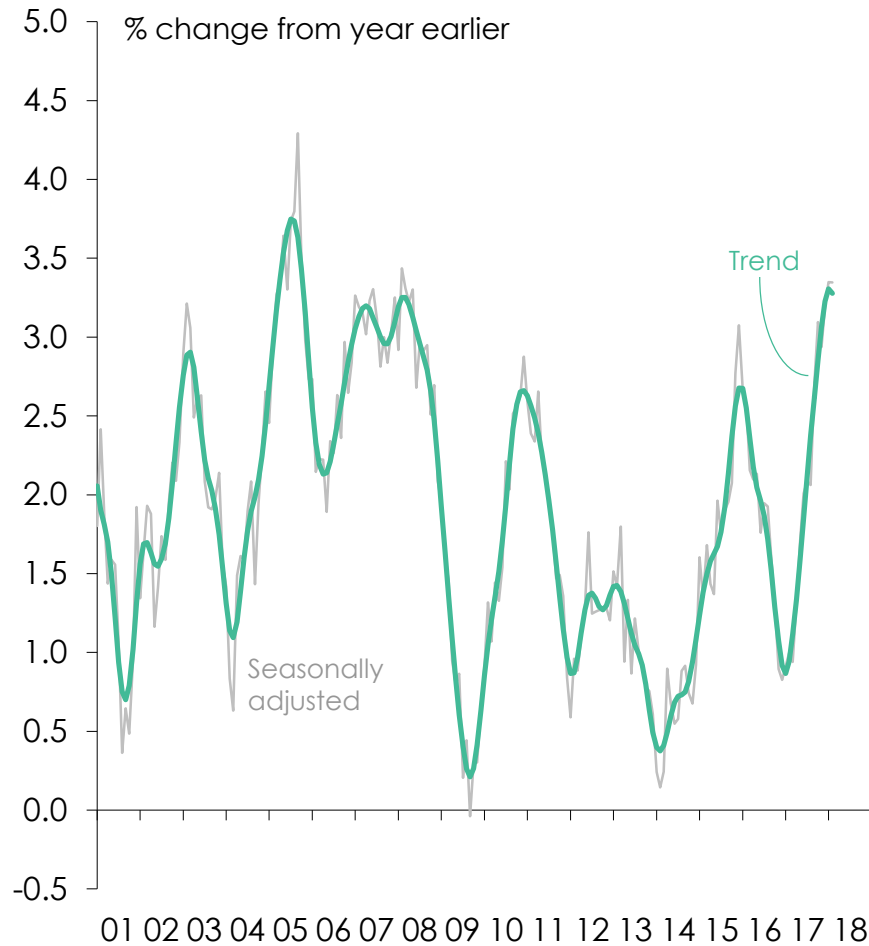


■ Work by the private sector for the public sector
 ■ Work by the public sector for the public sector

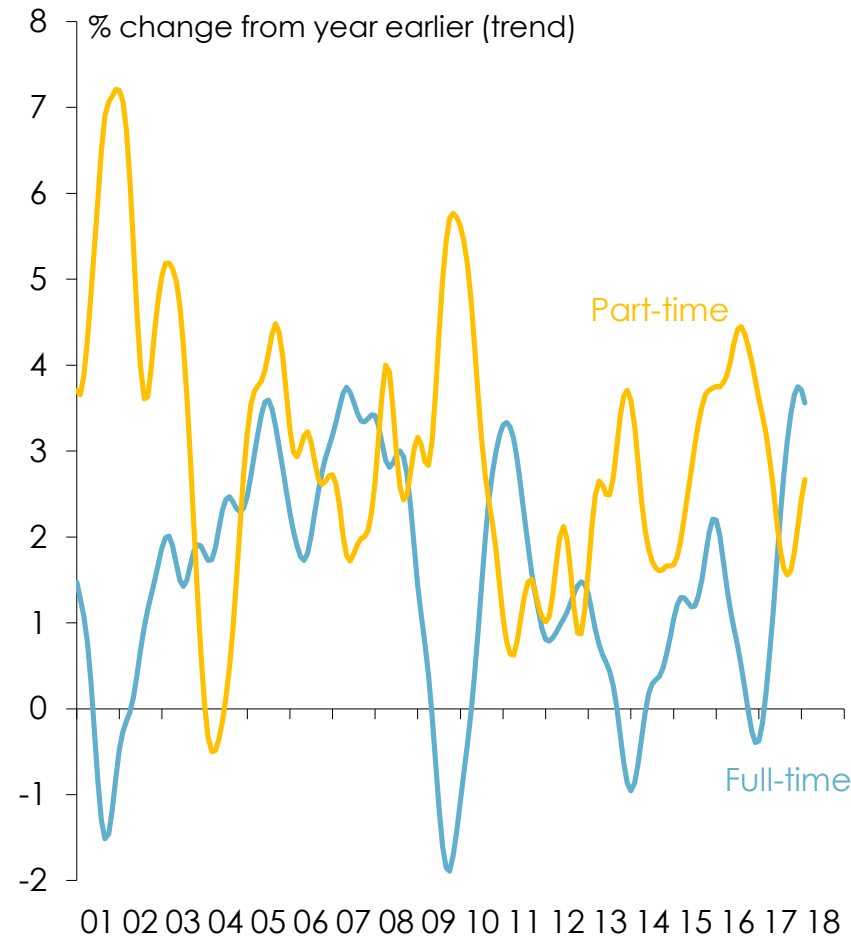
Source: ABS.

Employment growth has picked up – this time led by full-time employment – and seems likely to be sustained

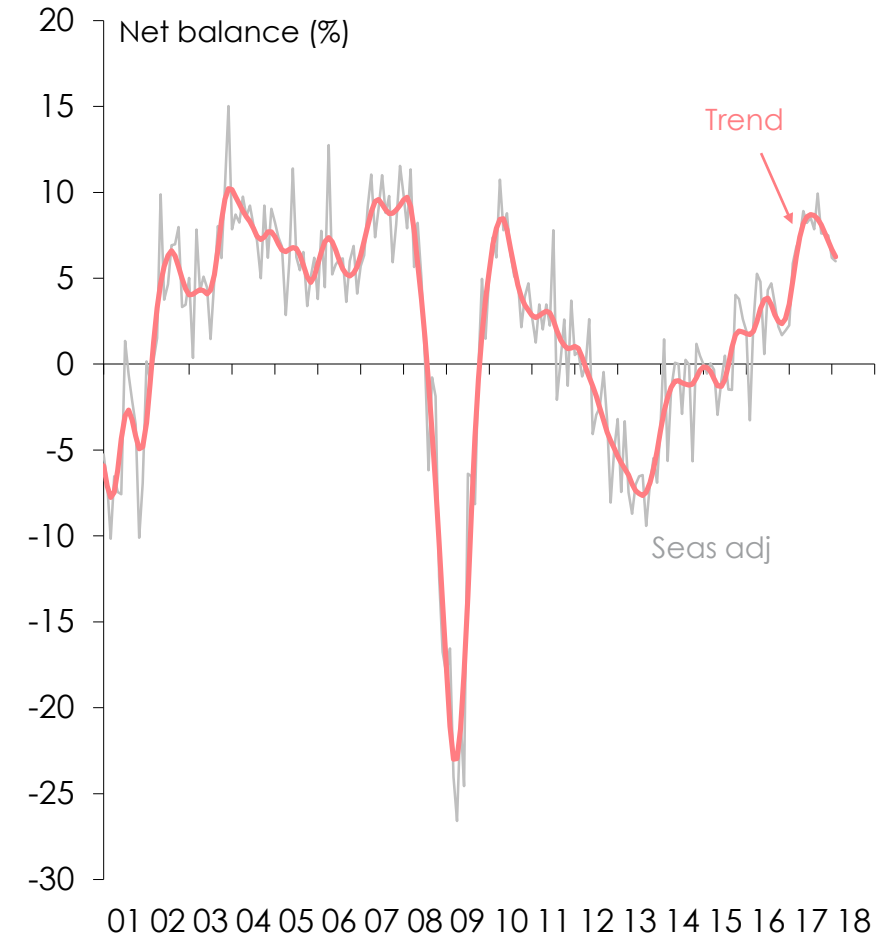
Employment growth



Full-time vs part-time employment



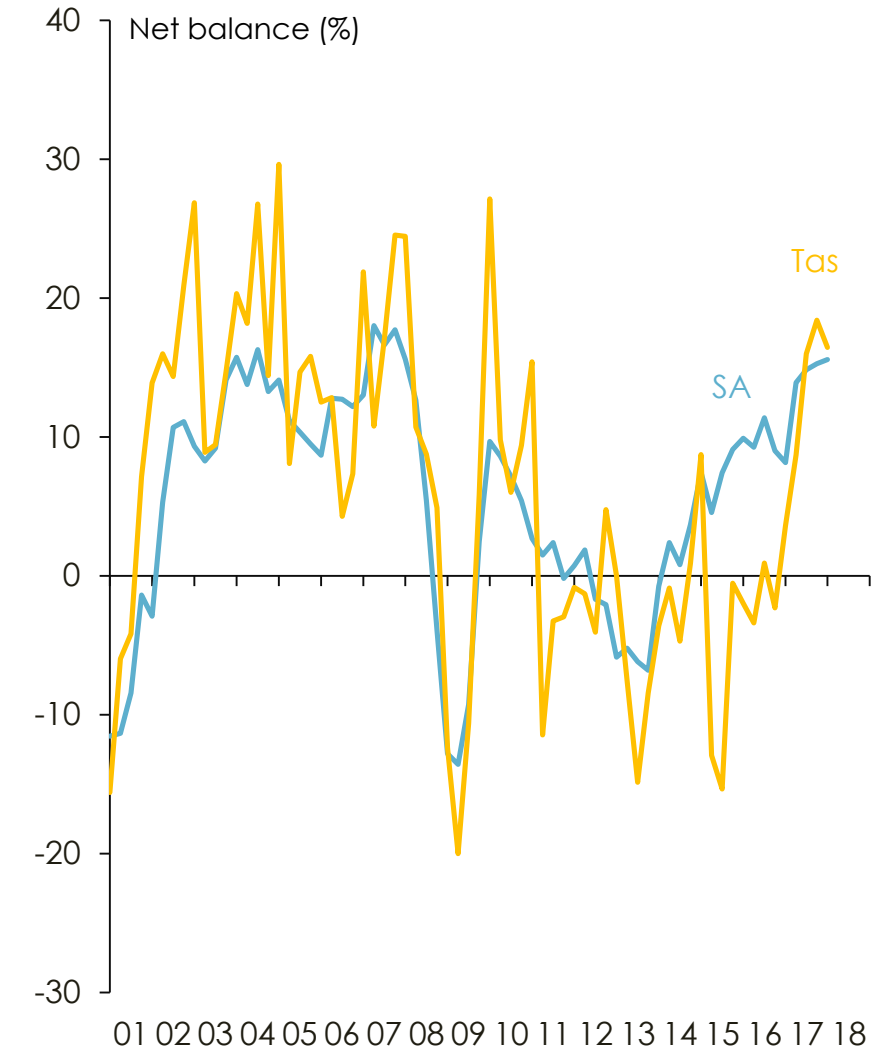
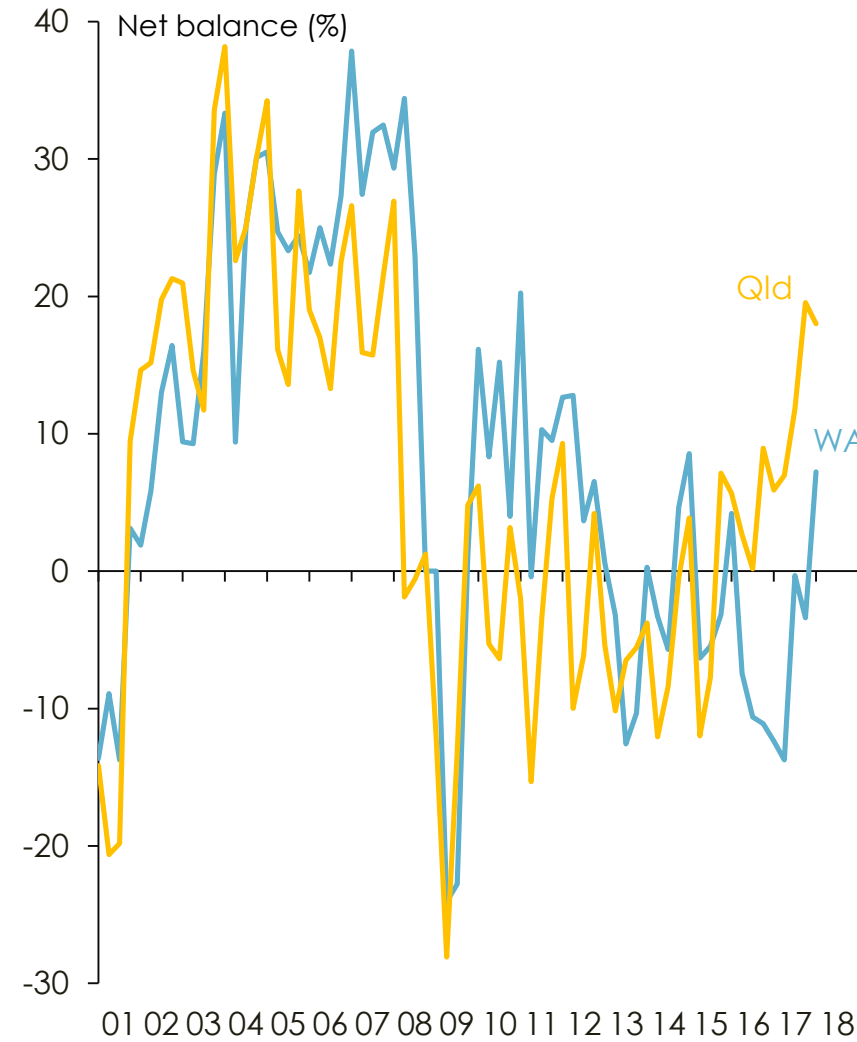
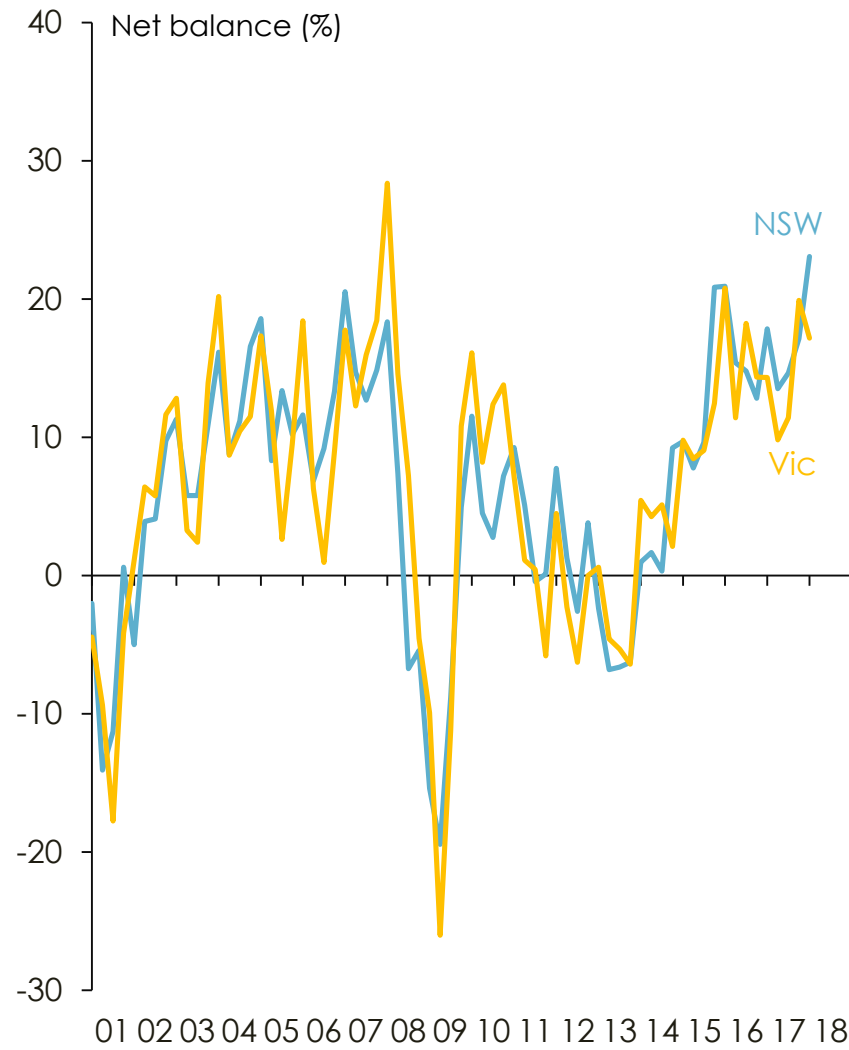
NAB business survey – employer hiring intentions



Sources: ABS; National Australia Bank.

Economic performance is becoming more even across Australia's states

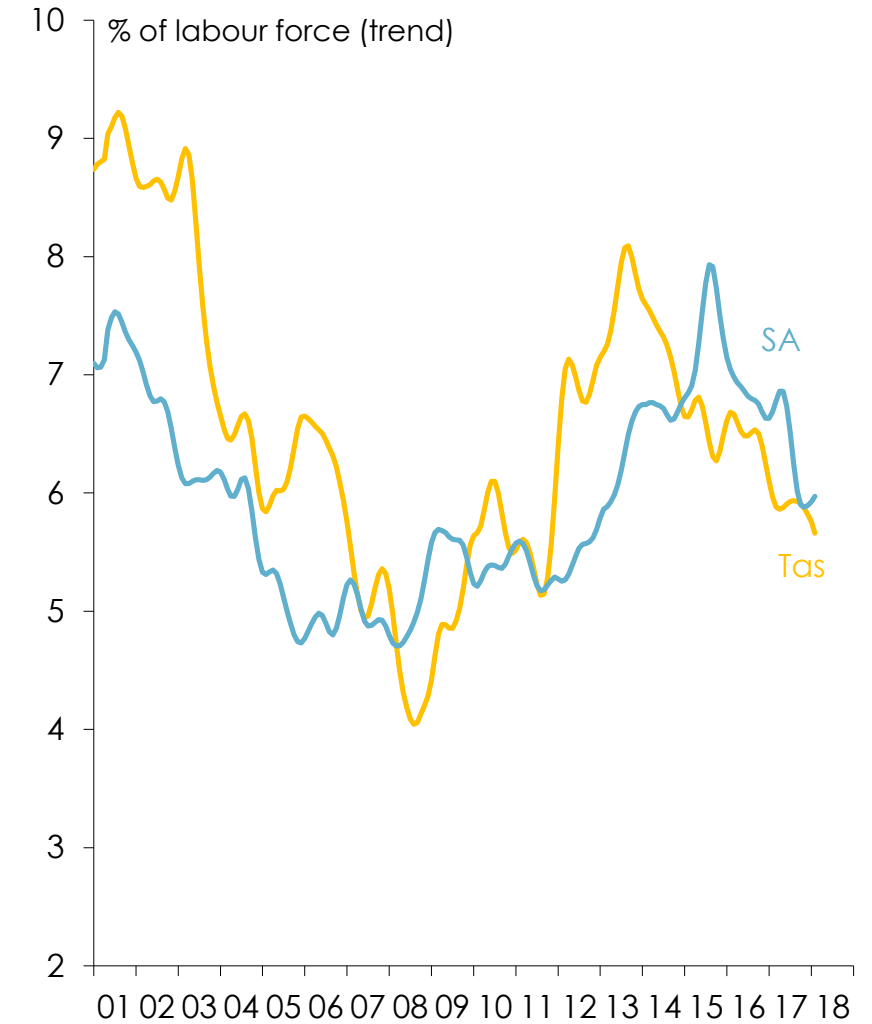
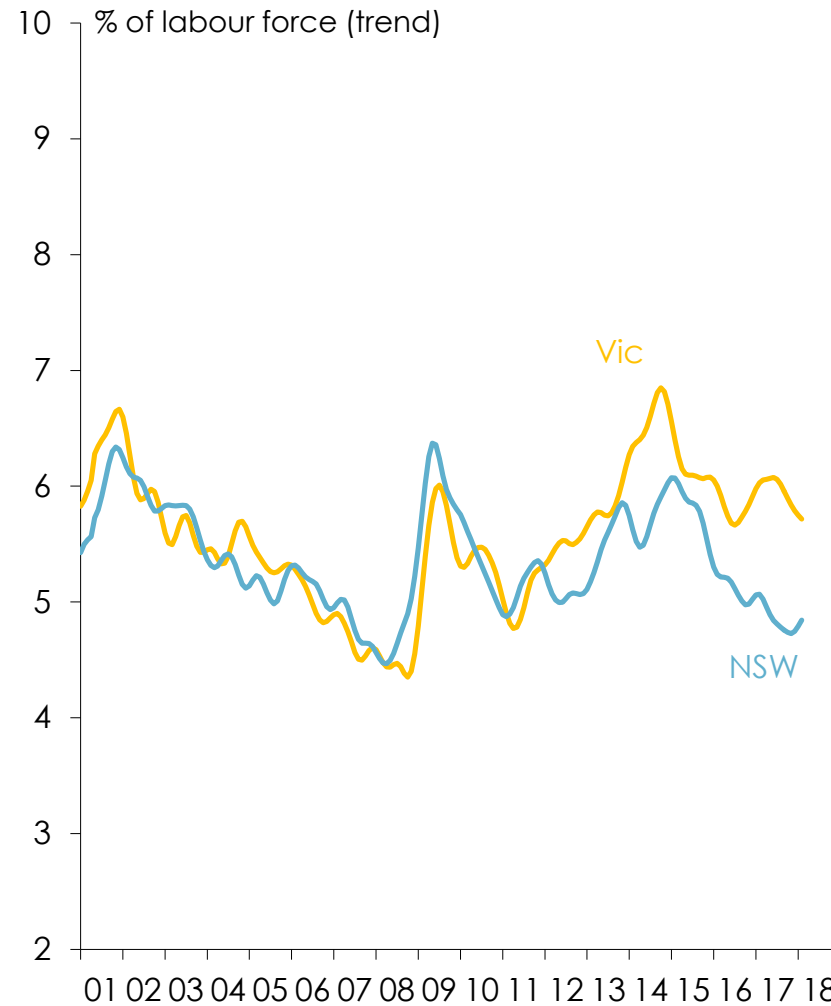
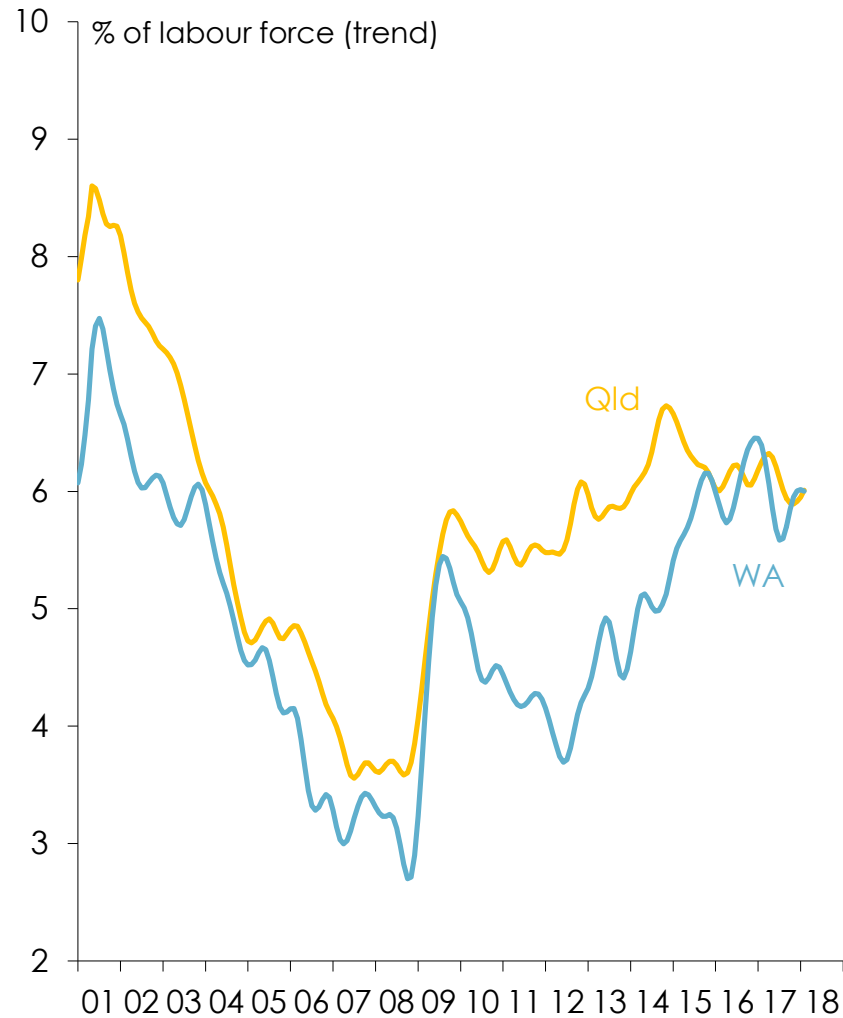
National Australia Bank quarterly business survey – business conditions, by State



Source: National Australia Bank.

Economic performance is becoming more even across Australia's states (continued)

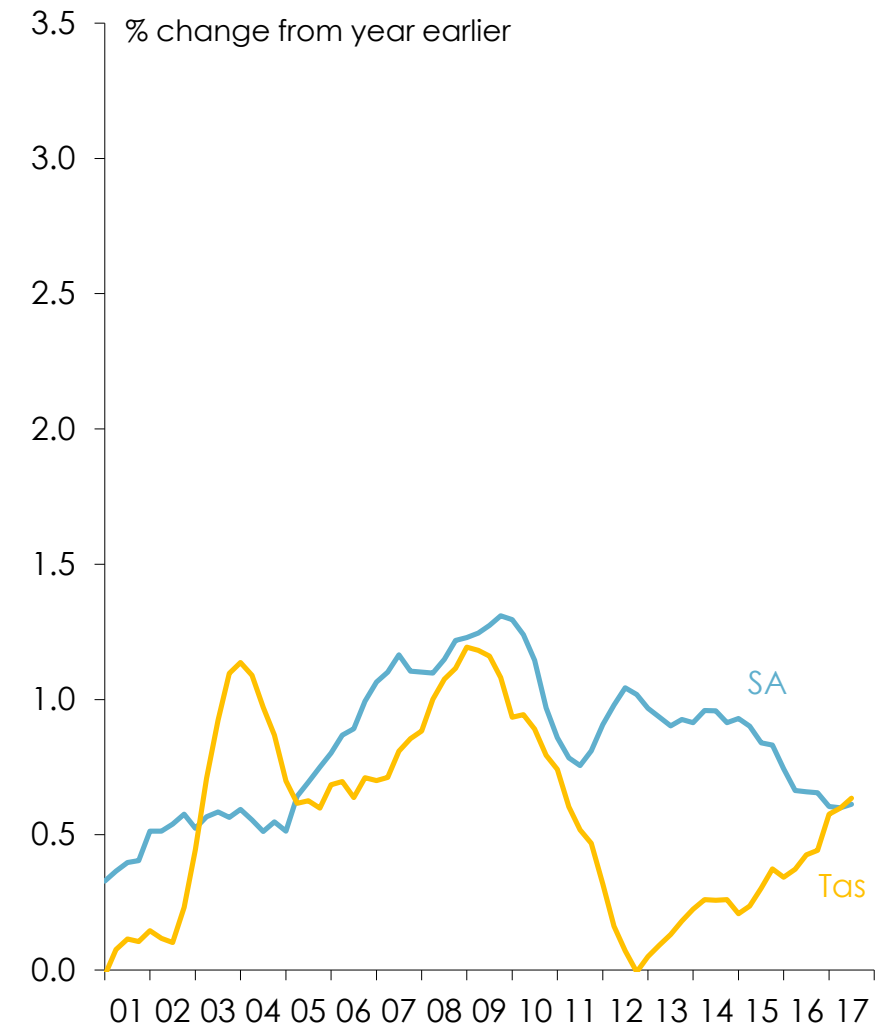
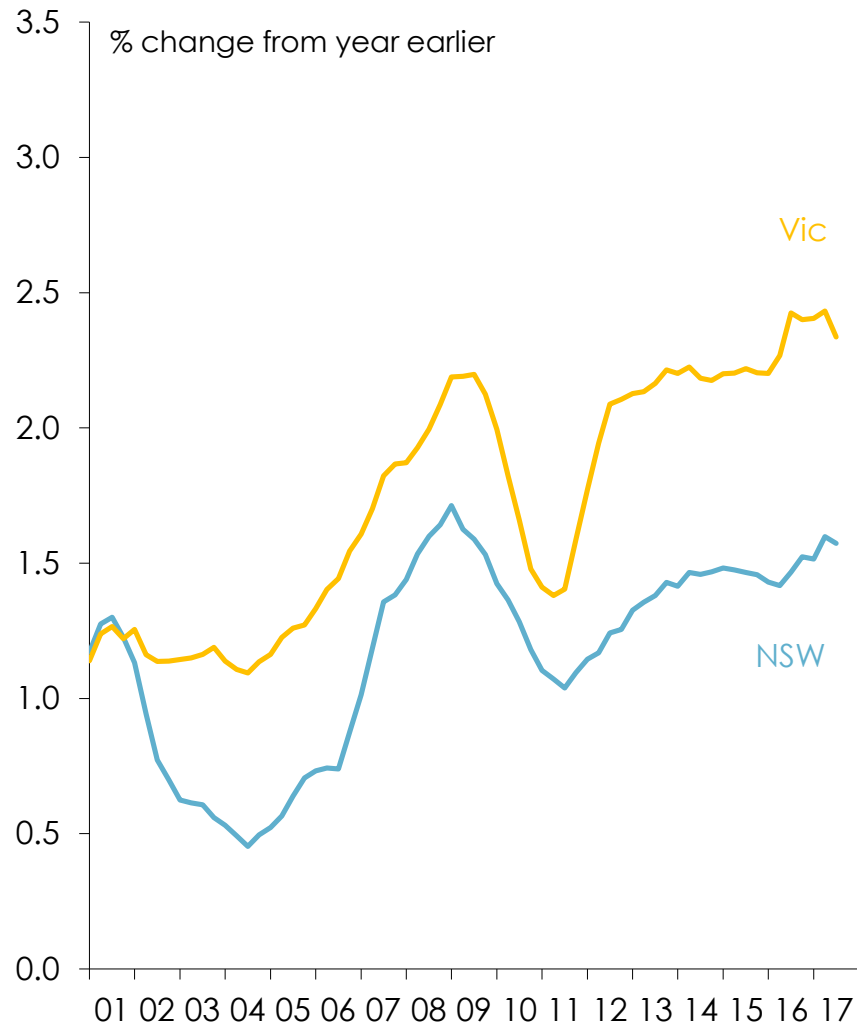
Unemployment rates, by State



Source: ABS.

Economic performance is becoming more even across Australia's states (continued)

Population growth rates, by State



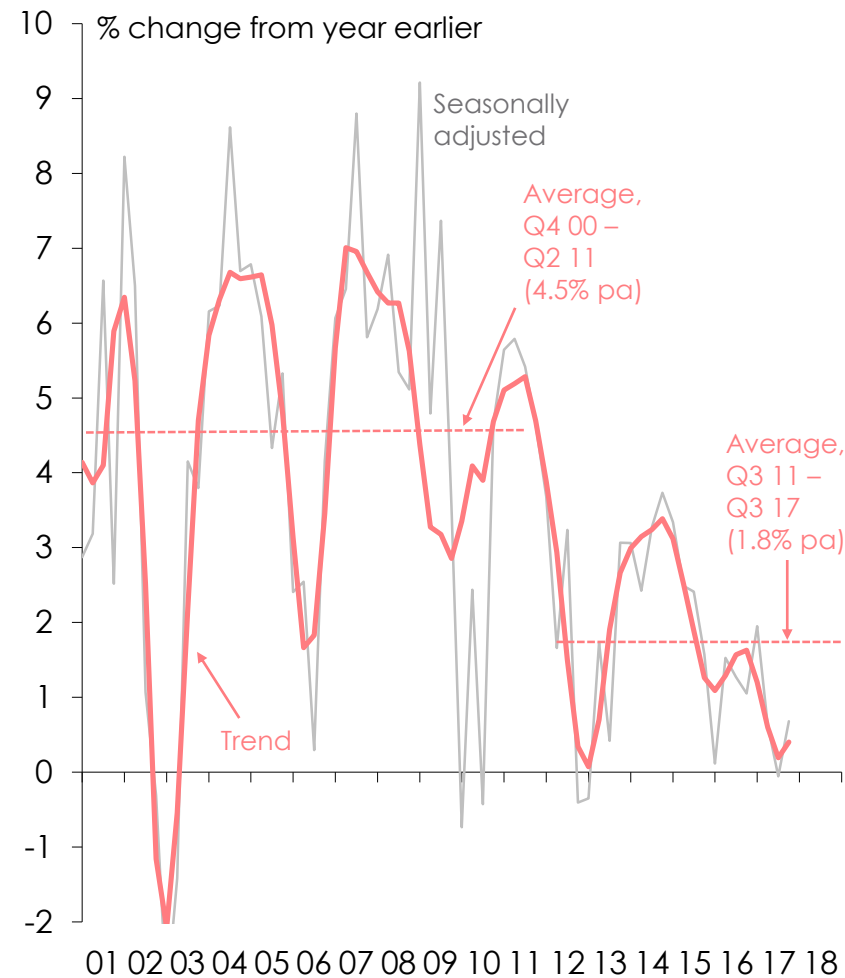
Source: ABS.

Sluggish wages growth has meant weak growth in household incomes and lower growth in household spending

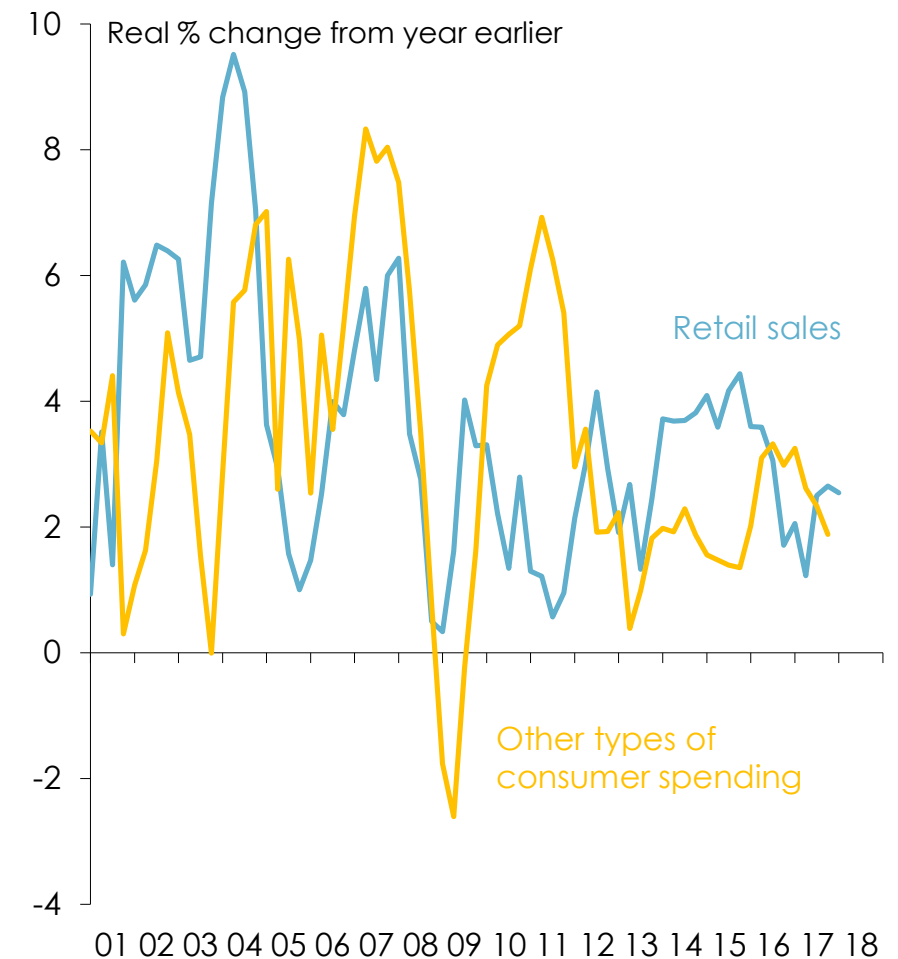
Nominal and real wages



Household disposable income



Household consumption spending



Source: ABS

There's no hard statistical evidence that employment has become more insecure over the last 20 years

Employed persons by duration of employment with current employer



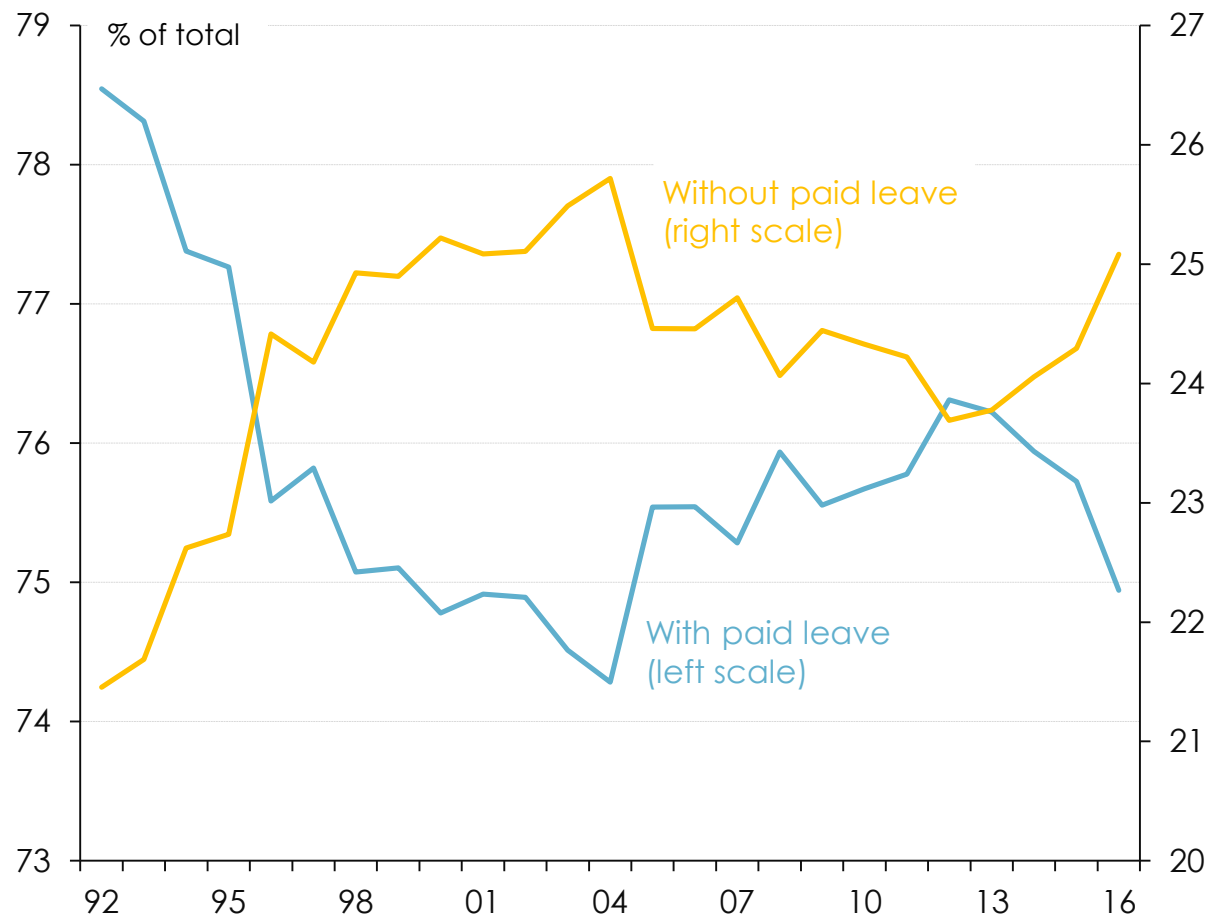
Employees not expecting to be with present employer in 12 months' time



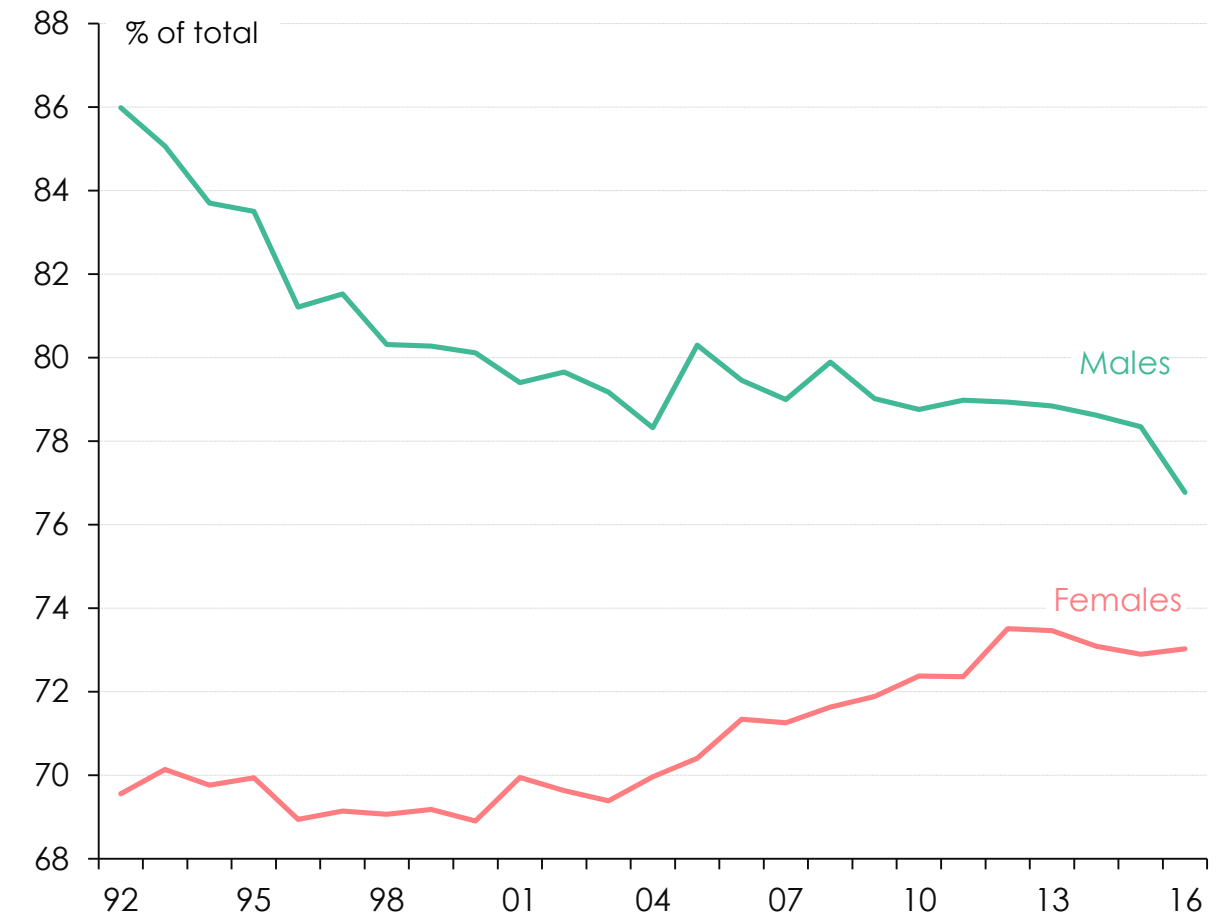
Sources: ABS, *Labour Force, Australia, Detailed, Quarterly*, August 2017 (6291.0.55.003); *Forms of Employment* (6359.0), and *Labour Mobility* (6209.0). Surveys are typically taken in the middle month of a quarter, but not necessarily every year: for example the question "do you expect to be with your current employer in 12 months' time" was not asked between 1999 and 2003 inclusive.

Casual employment is becoming more commonplace, but not as dramatically as is widely believed

Employees with and without paid leave entitlements



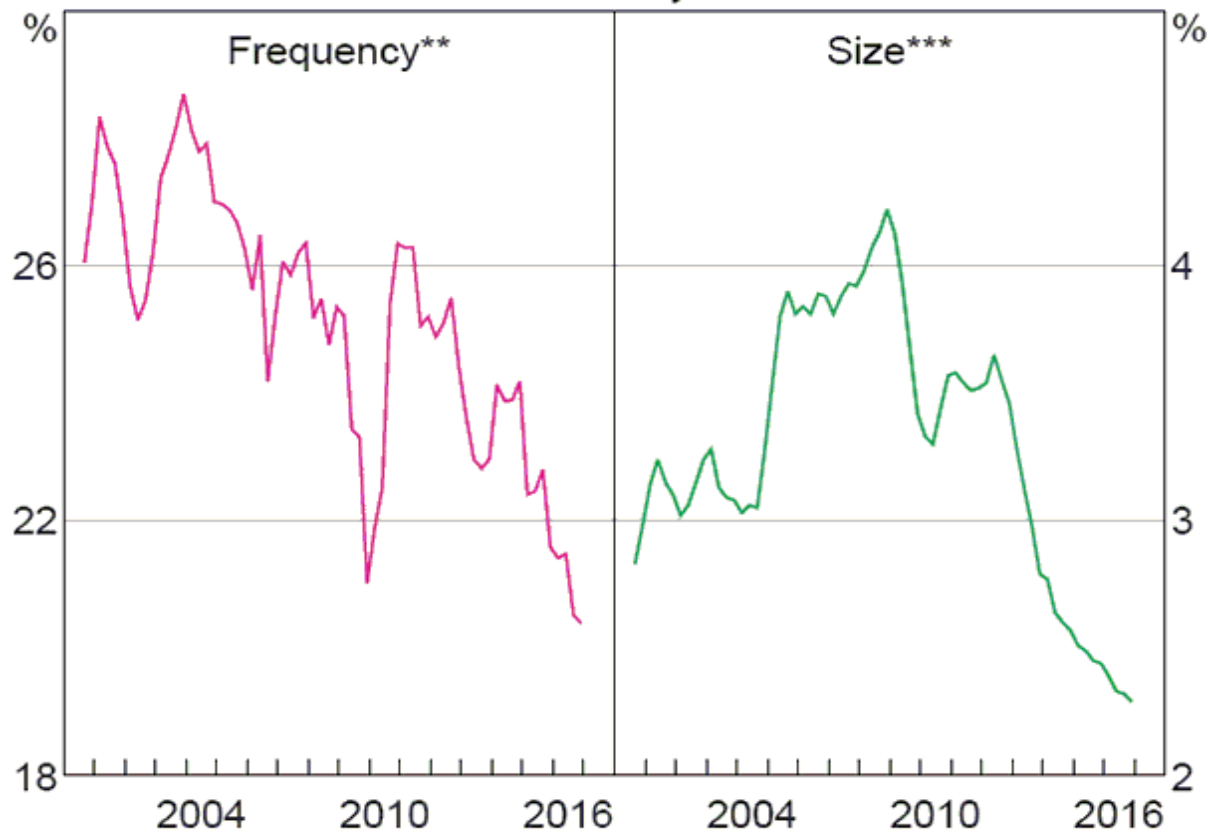
Employees with paid leave entitlements, by gender



Note: The ABS uses 'employees without paid leave entitlements' as the primary measure of casual employment. This is an objective measure that can be collected consistently. An employee with paid leave entitlements has access to either paid holiday leave or paid sick leave, or both. Sources: ABS, *Characteristics of Employment*, August 2016 (6333.0) and *Australian Labour Market Statistics*, July 2013 (6105.0). Surveys are in either August or November of each year.

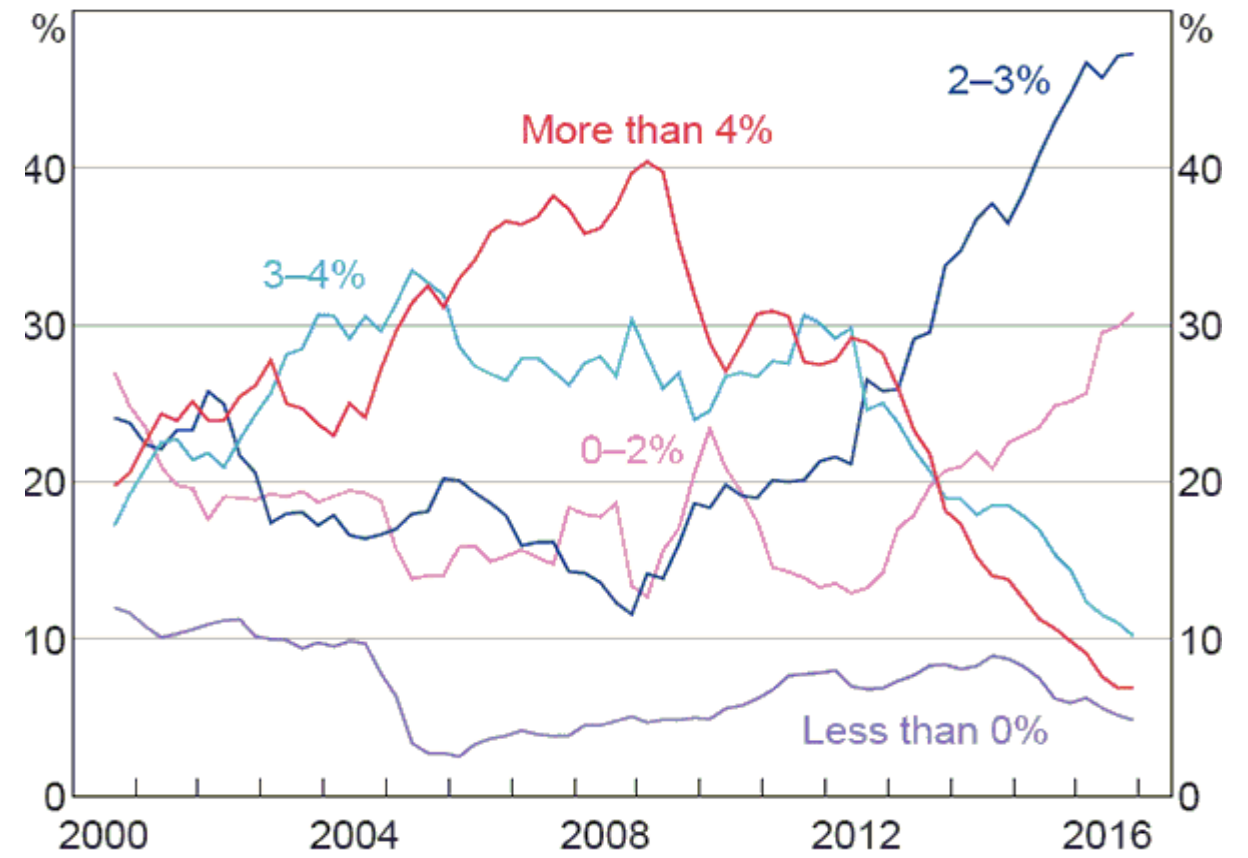
But wage increases have become smaller, and less frequent, since the financial crisis and especially since the end of the mining boom

Frequency and size of wage changes



- * Smoothed using a four-quarter trailing average
- ** Share of jobs with a wage change
- *** Average percentage wage change, conditional on a wage change

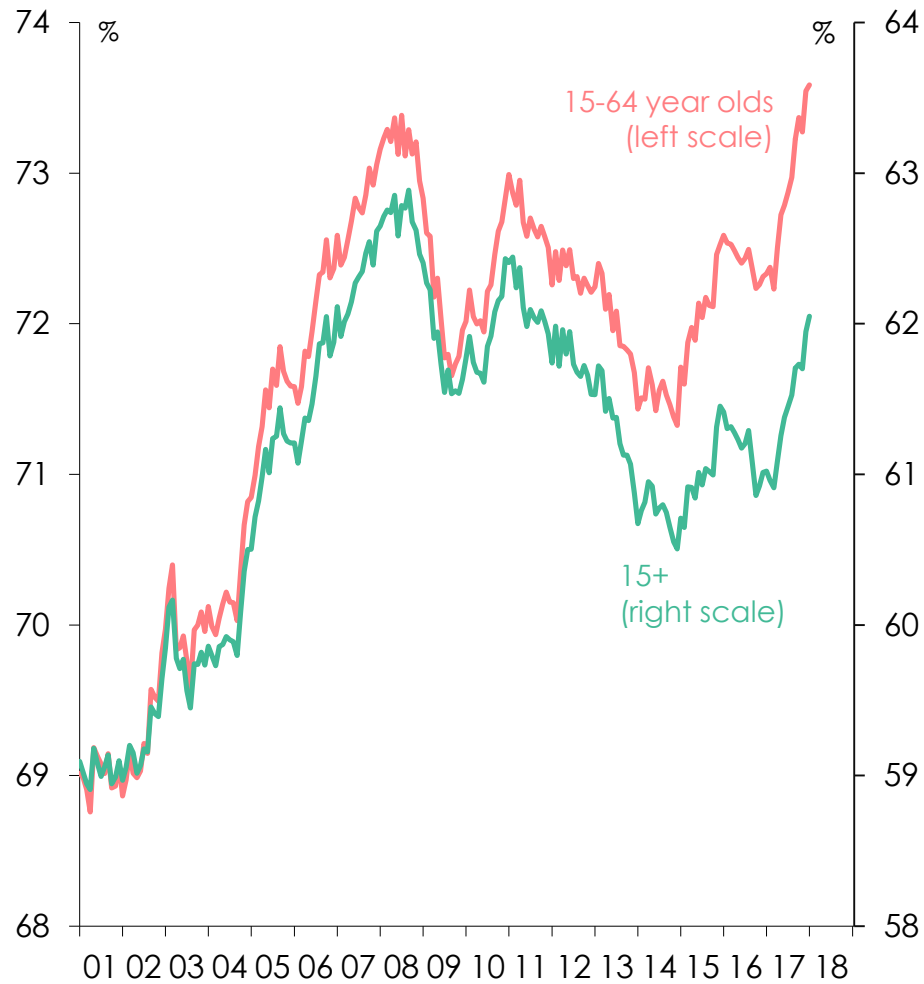
Share of jobs that experience a wage change of given size



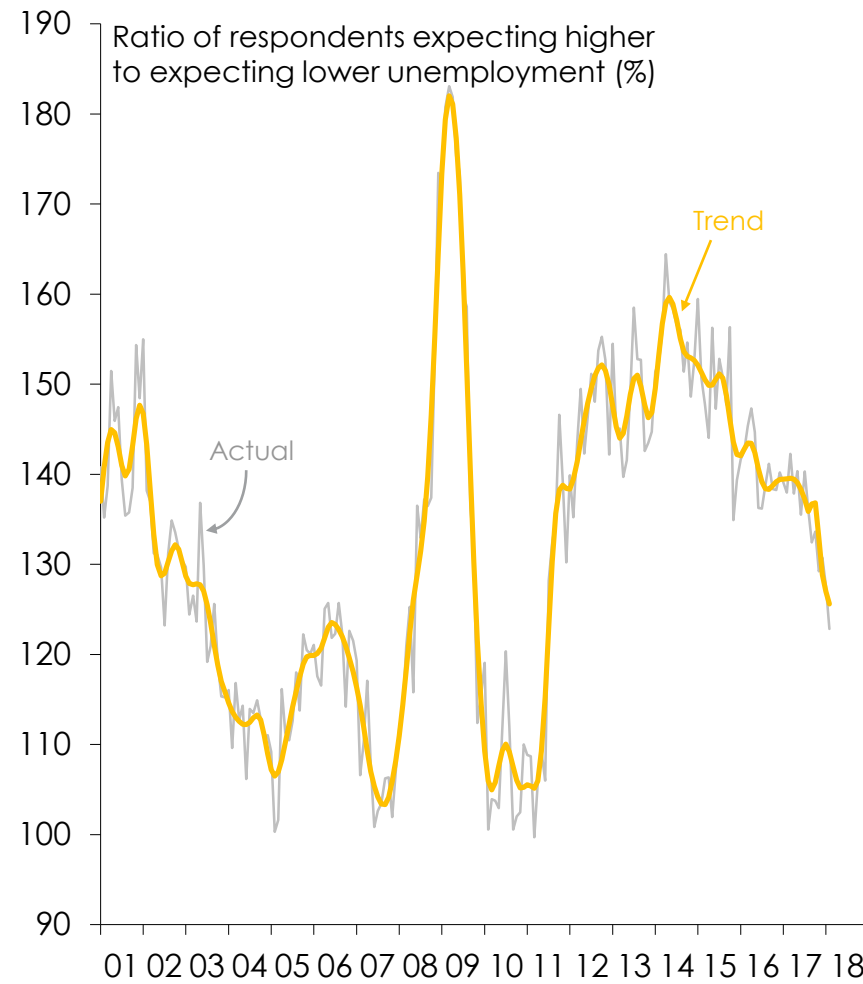
- * Smoothed using a four-quarter trailing average

However the upturn in employment growth appears to have led to a recovery in consumer confidence

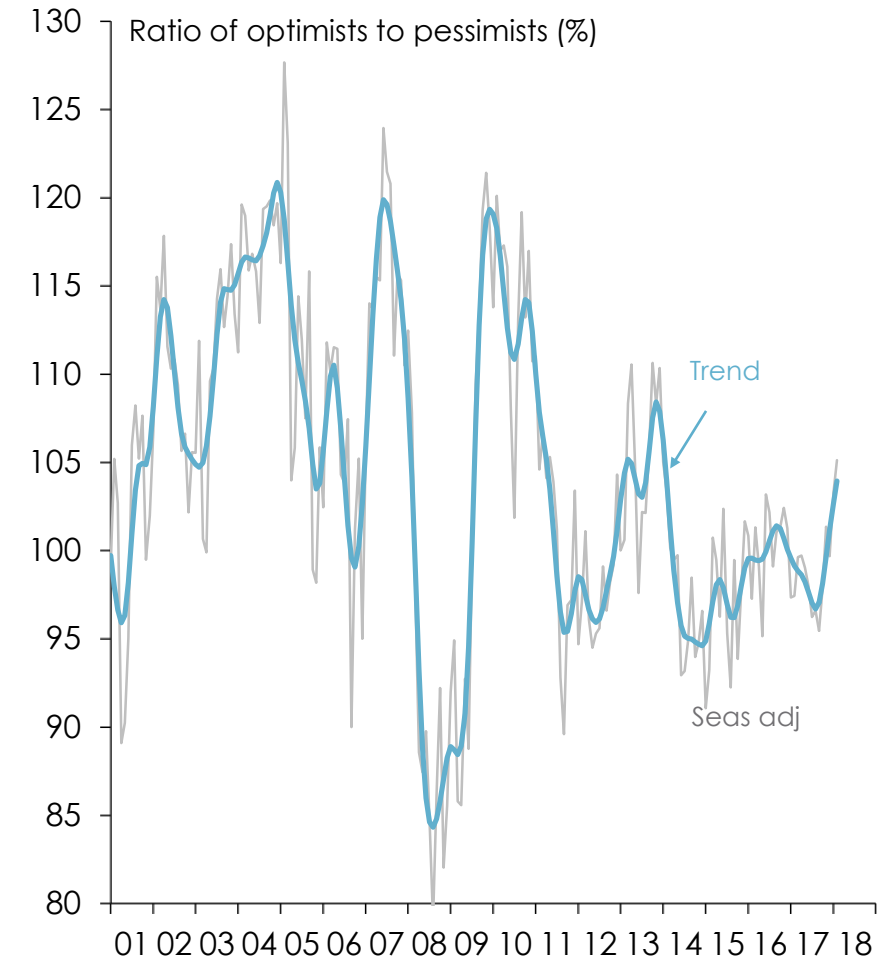
Employment as a pc of working-age population



Household unemployment expectations



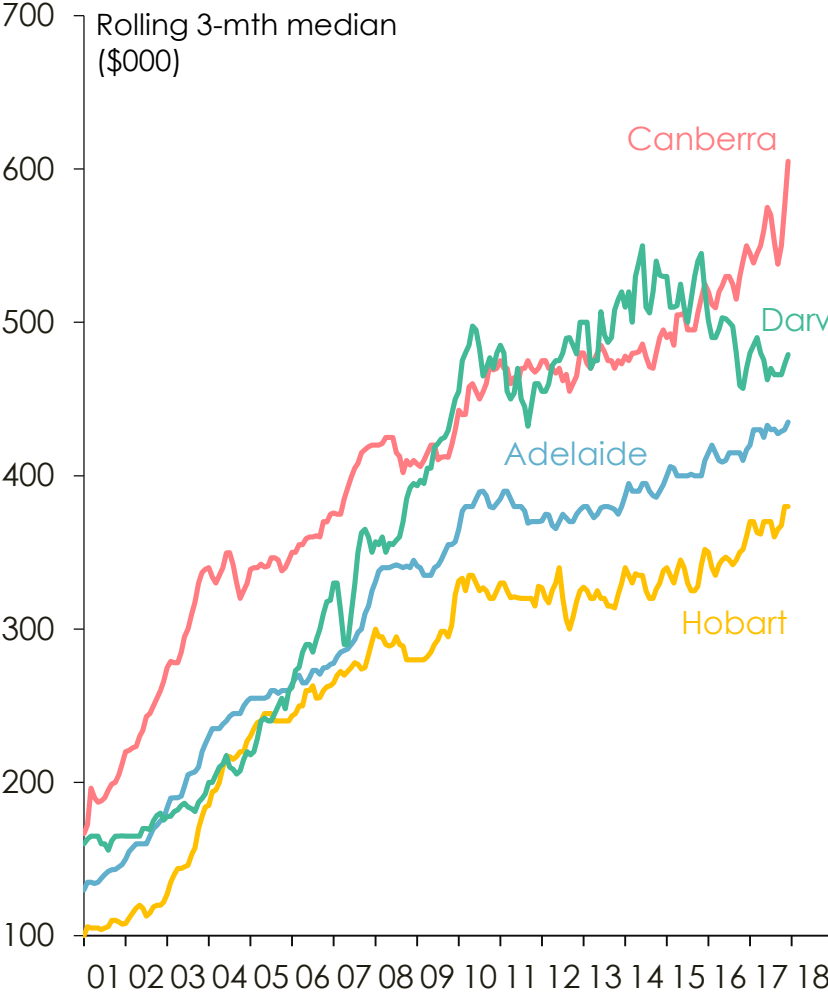
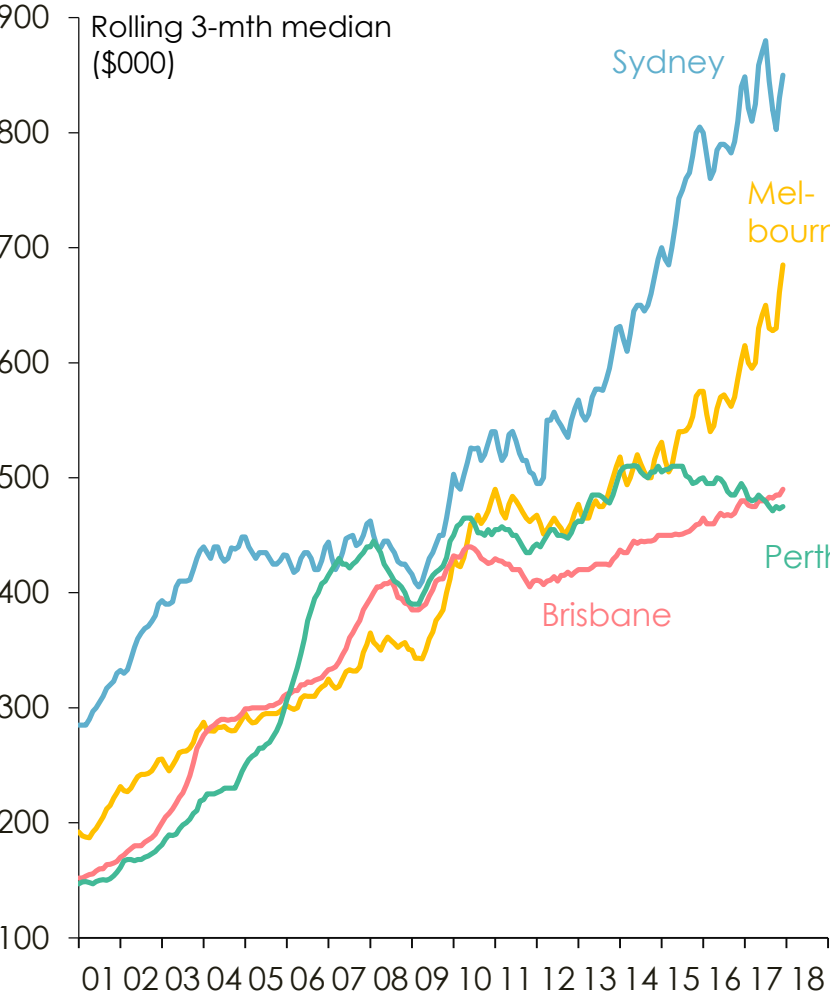
Consumer confidence



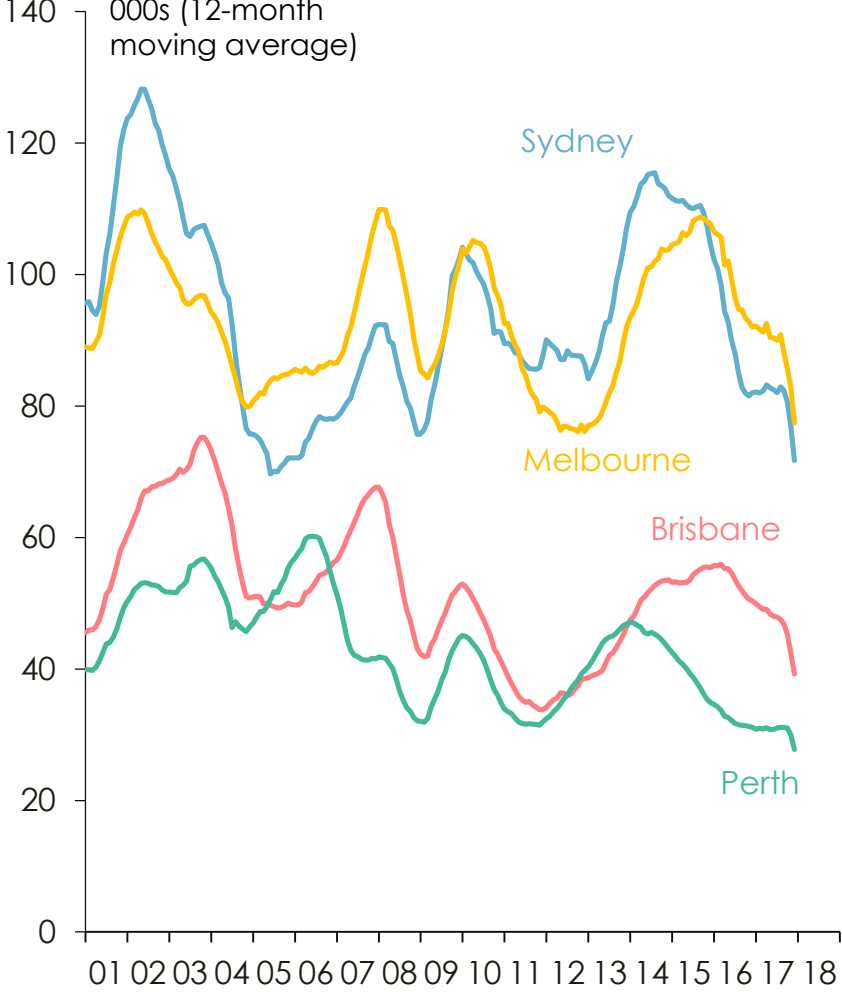
Sources: ABS; Westpac-Melbourne Institute.

Capital city residential property markets appear in most cases to have peaked

Capital city median dwelling sale prices



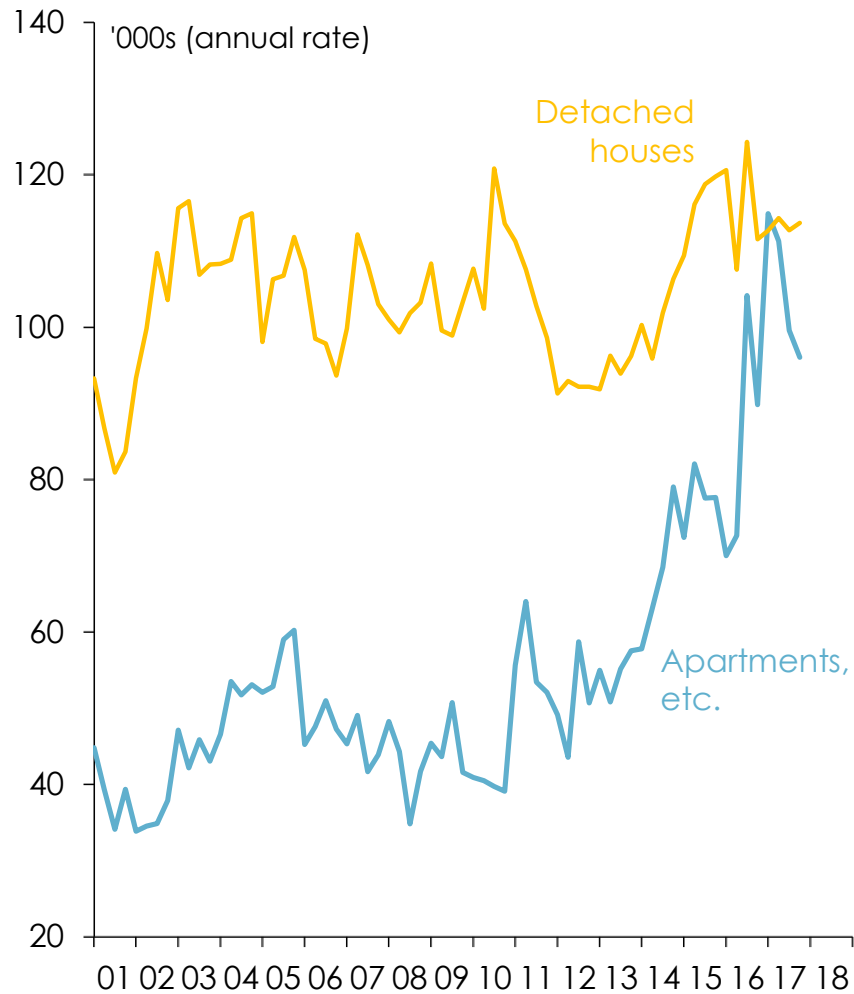
Sales volumes



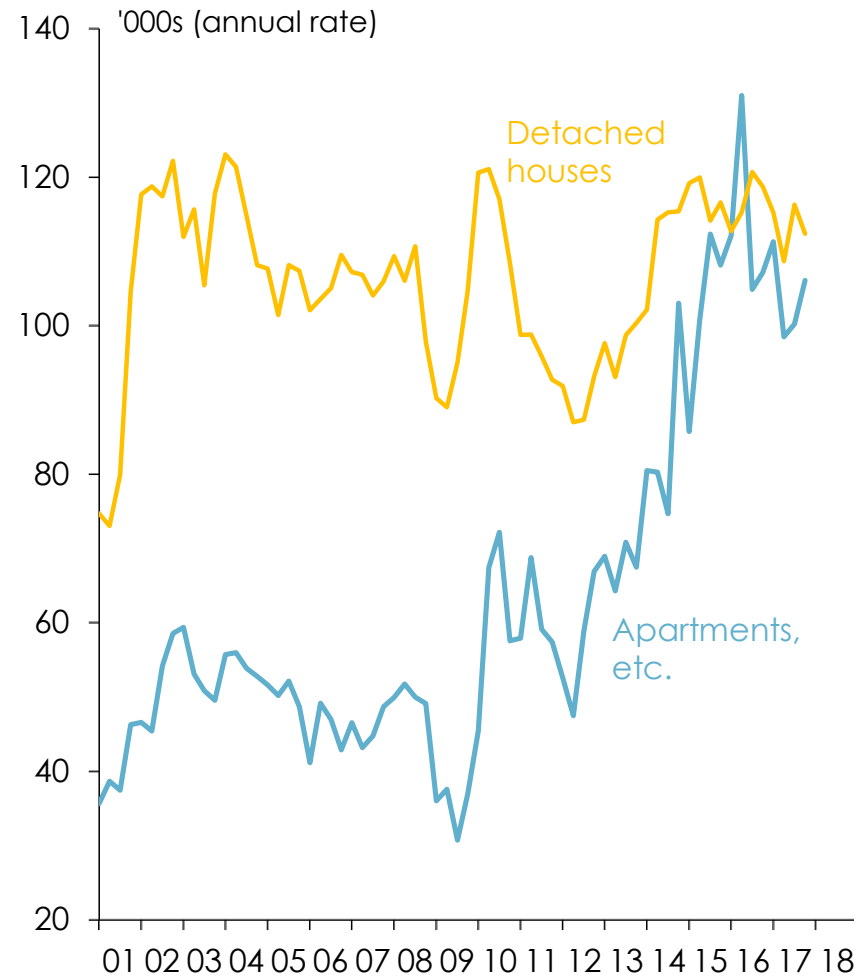
Source: CoreLogic.

Increased housing supply is confined to apartments – there has been no upsurge in supply of detached dwellings

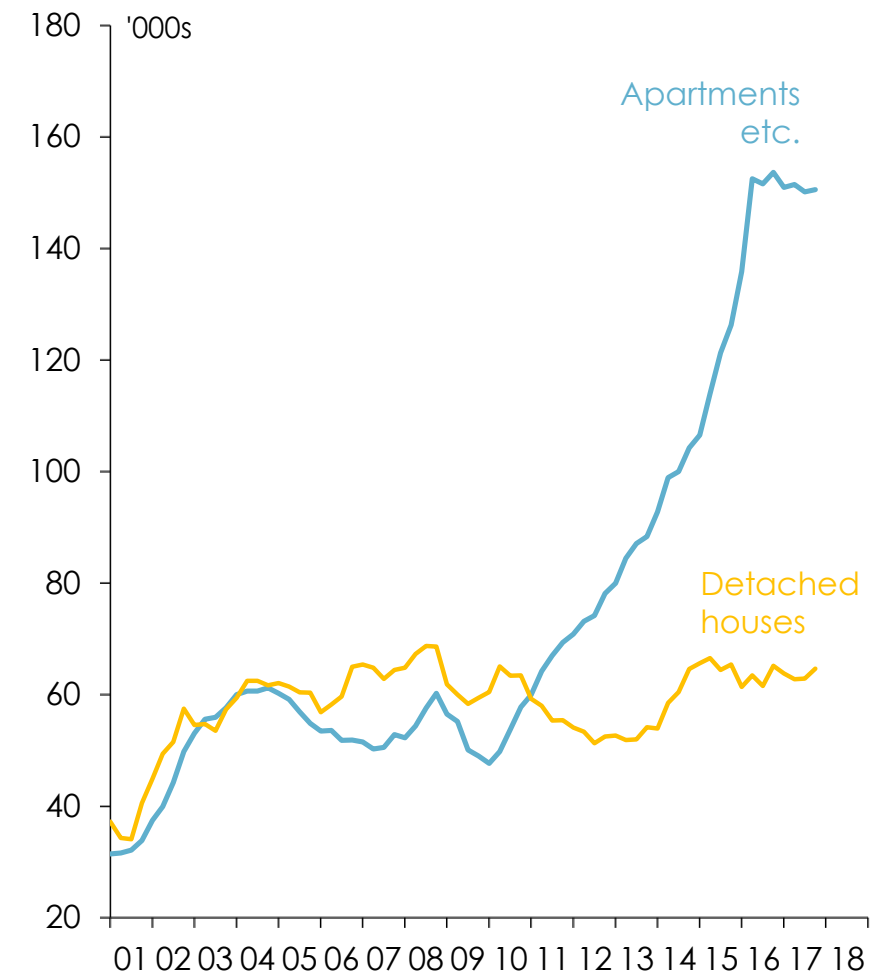
Housing completions



Housing commencements



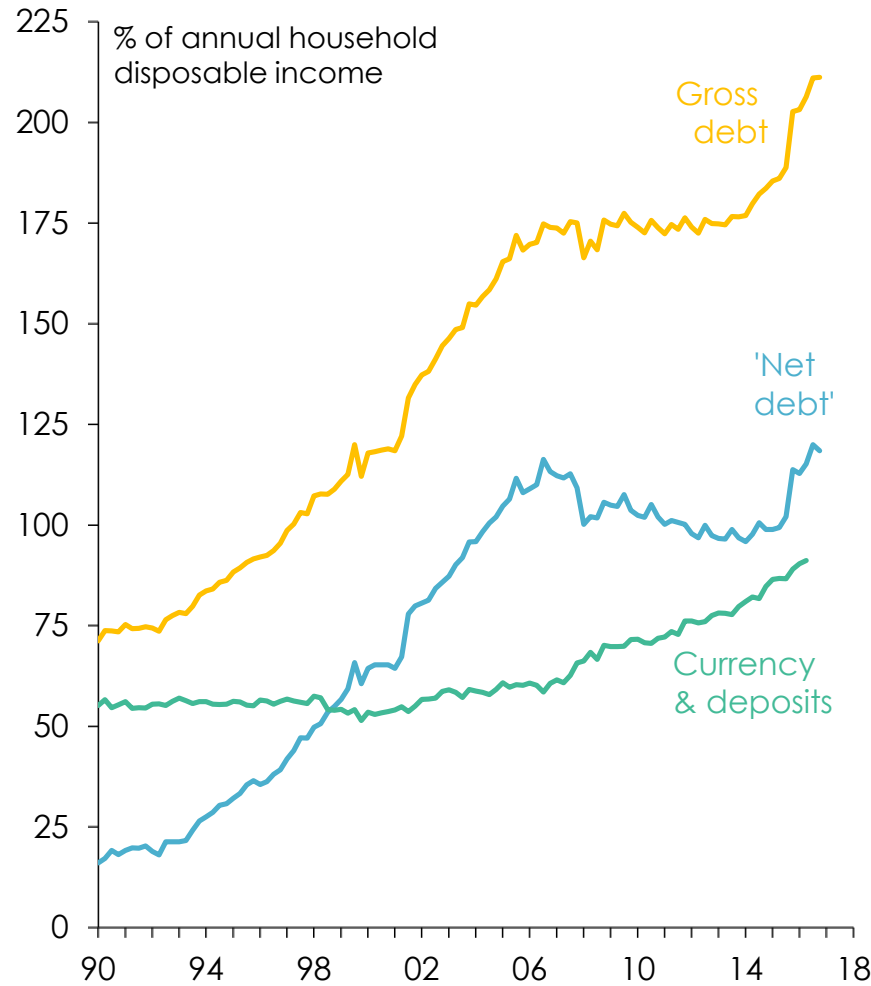
Housing under construction



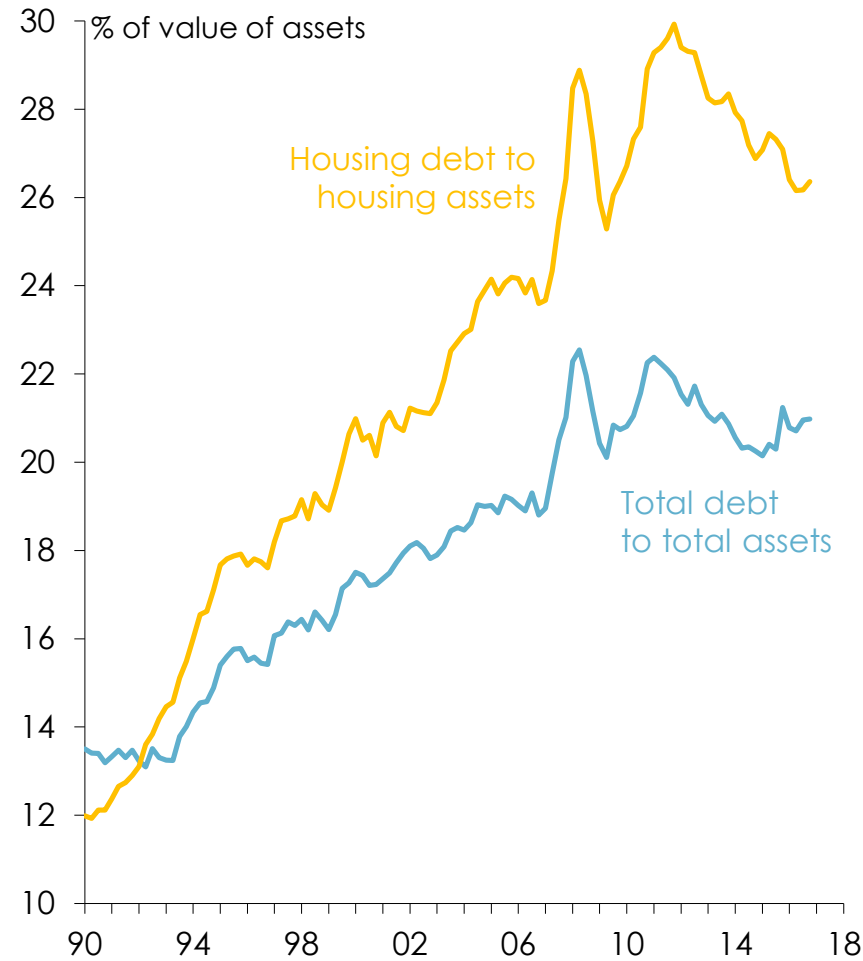
Source: ABS.

High level of household debt shouldn't be considered independently of the level of liquid assets, other assets or debt servicing capacity

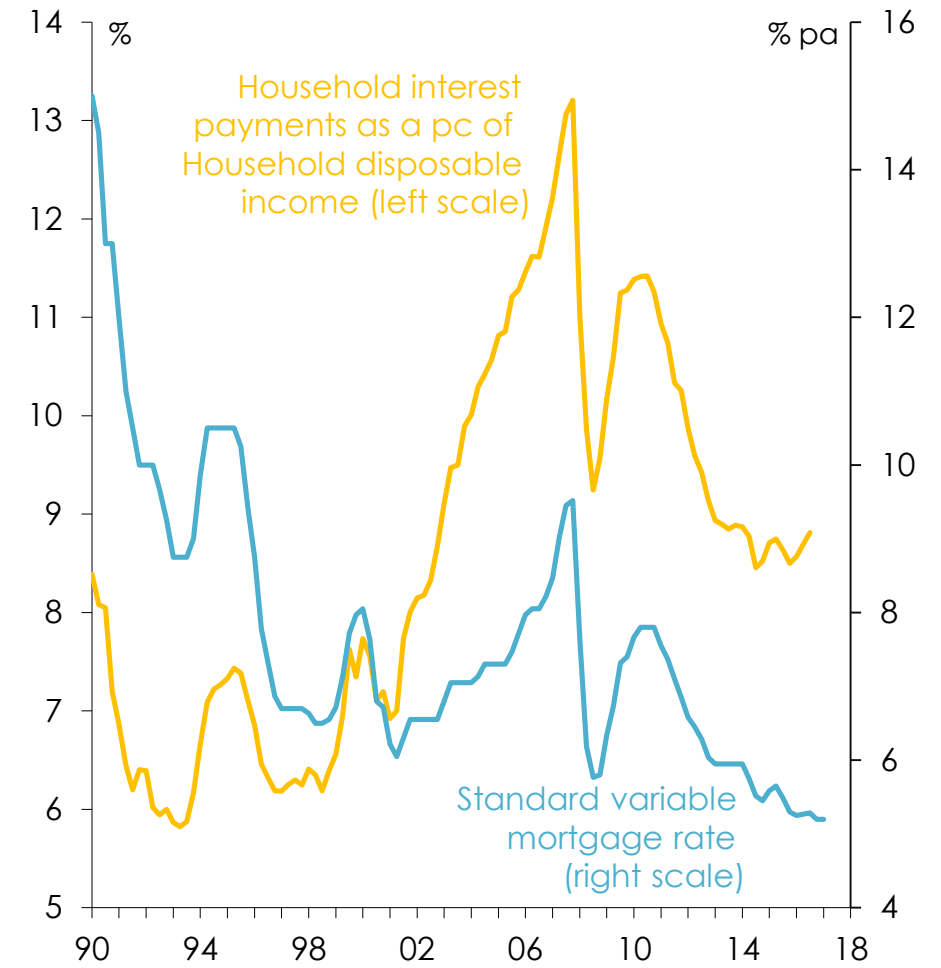
Household gross debt, liquid assets and net debt



Household debt-to-assets ratio



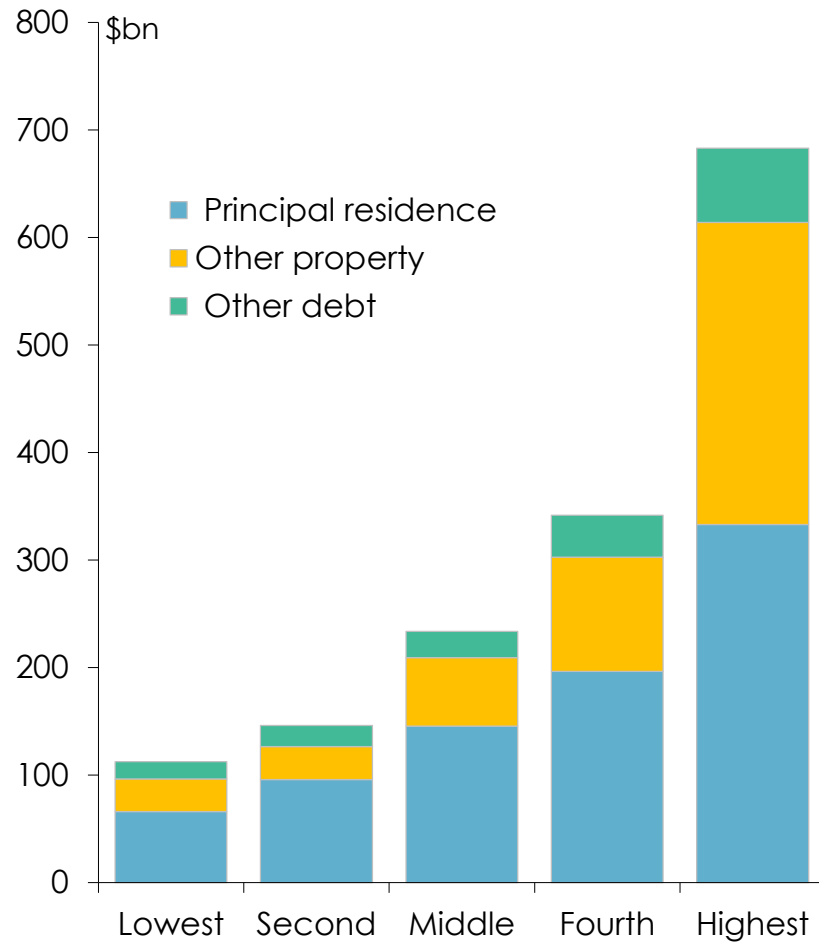
Household interest-to-income ratio



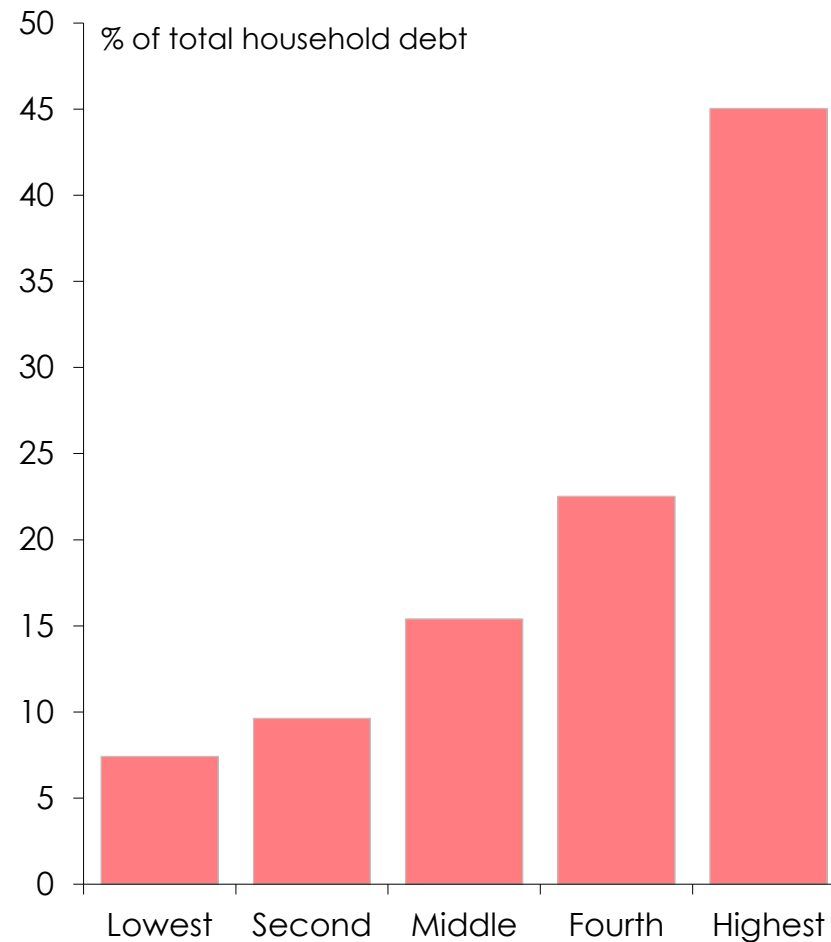
Sources: ABS; RBA.

Two-thirds of Australian household debt is owed by the richest 40% of households – and that has barely changed over the past dozen years

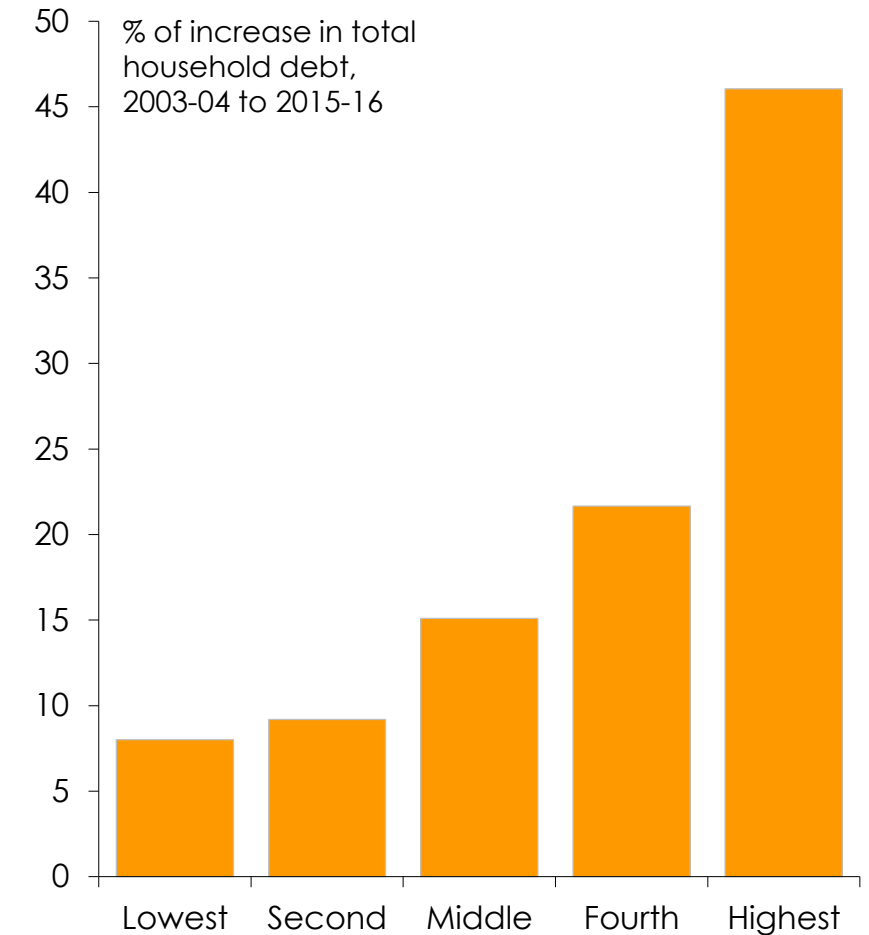
Household debt by income quintile, 2015-16



Share of total debt by income quintile, 2015-16



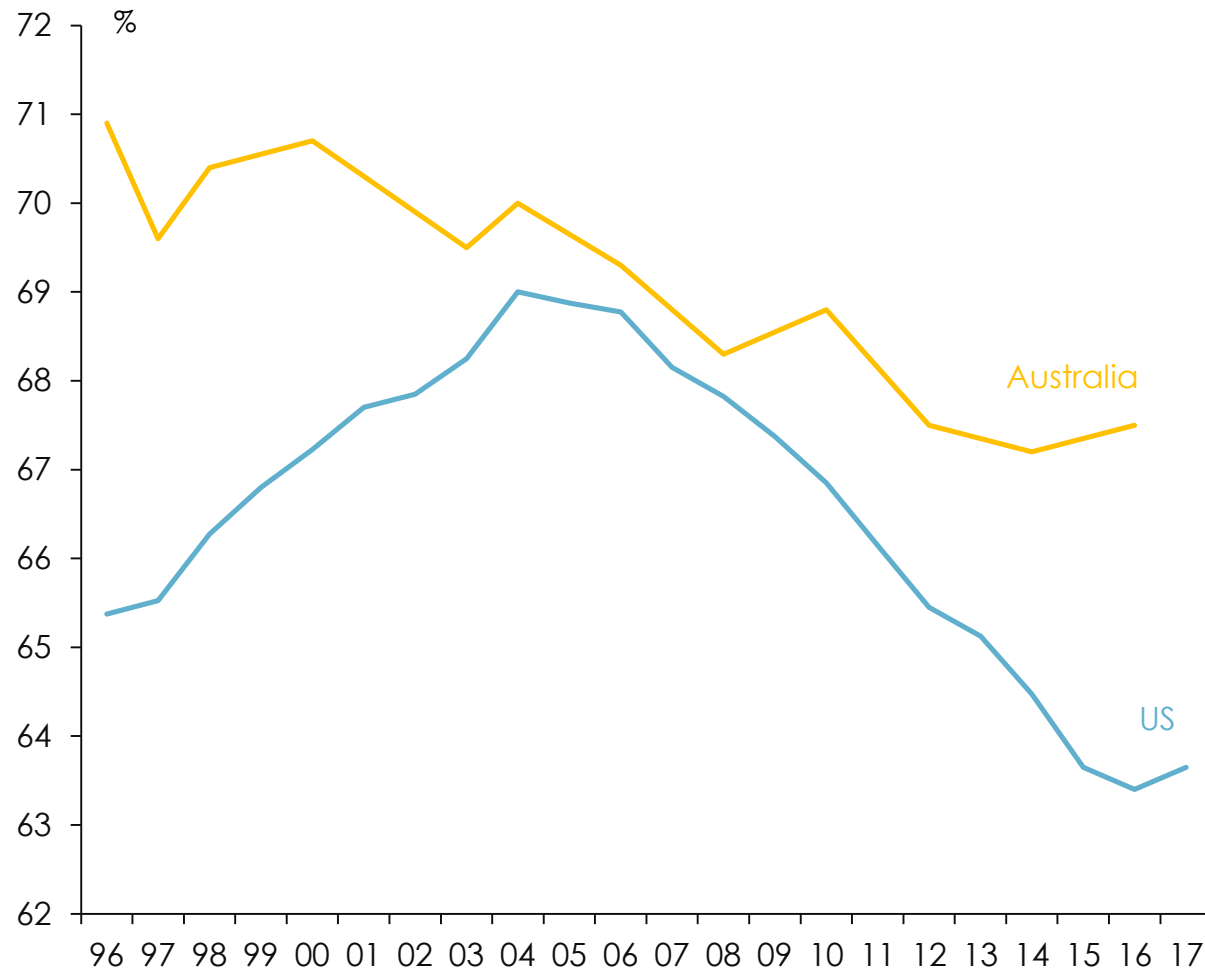
Share of increase in debt by quintile, 2003-04 to 2015-16



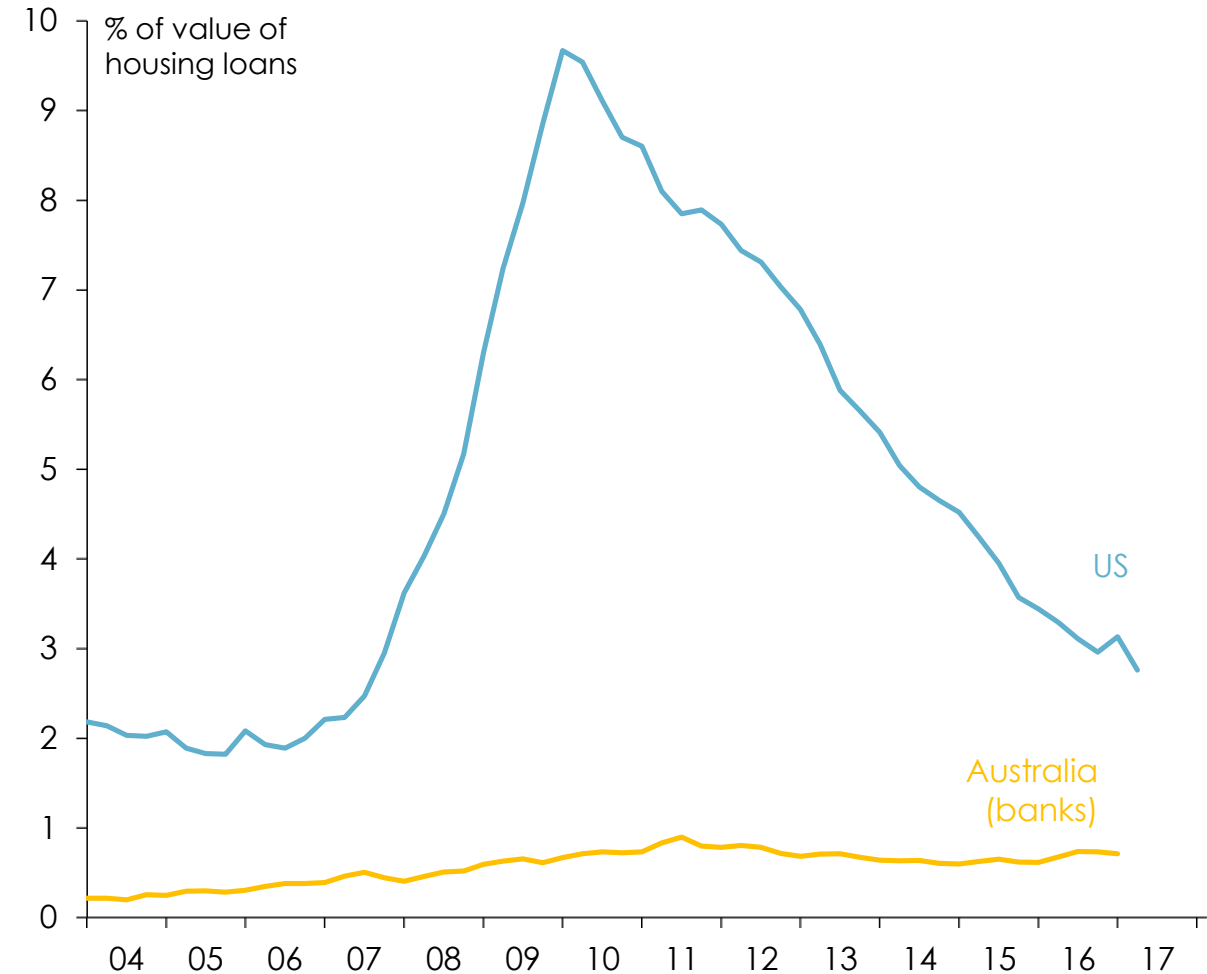
Source: ABS.

There's unlikely to be 'forced selling' of Australian residential real estate on anything like the scale there was in the US 10-12 years ago

Home ownership rates, US and Australia



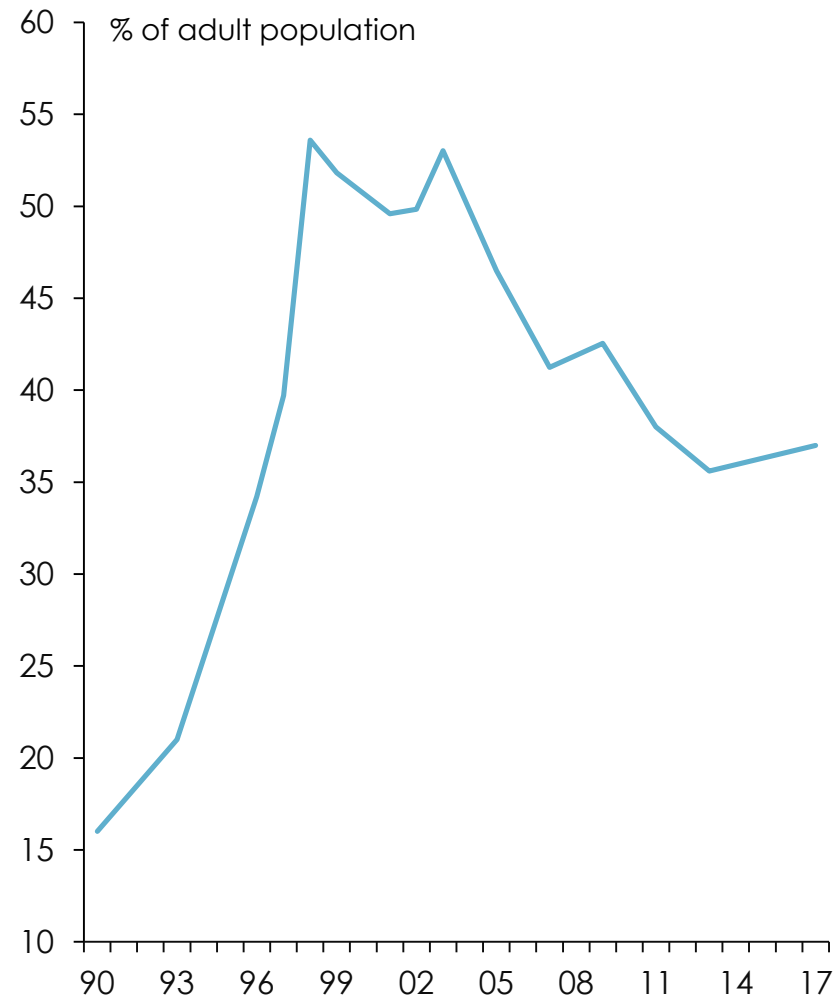
Mortgage delinquency rates, US and Australia



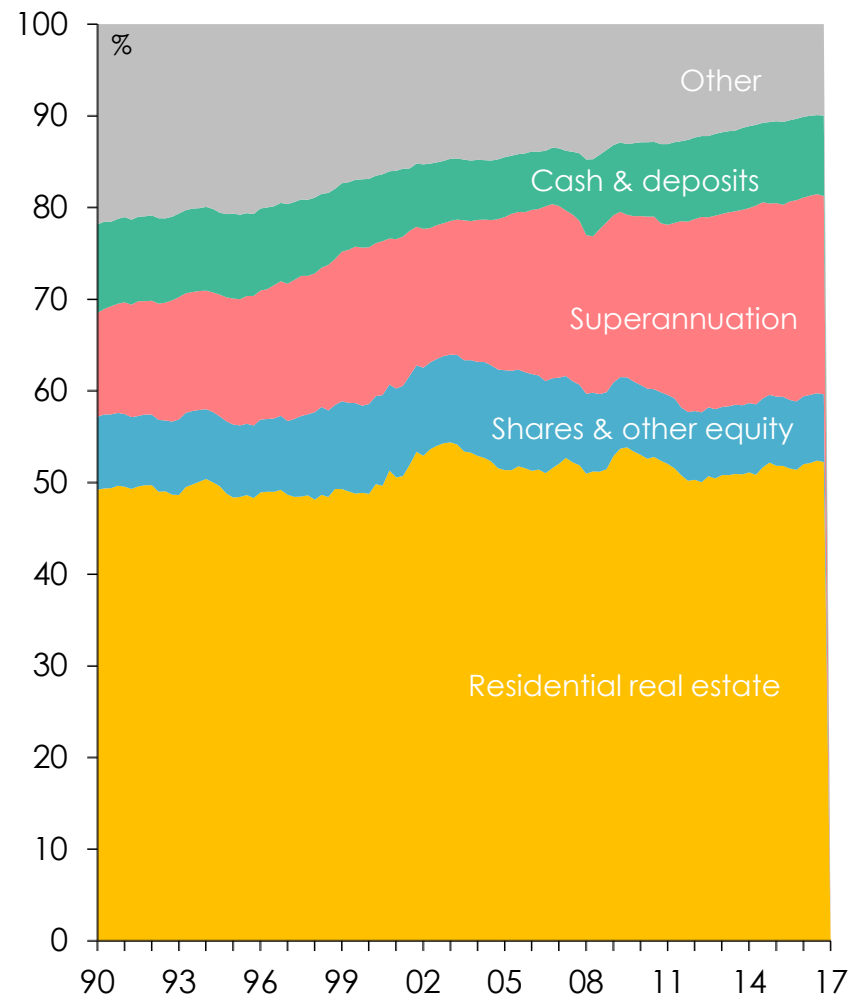
Sources: ABS, US Department of Commerce; ; Reserve Bank of Australia; Mortgage Bankers' Association of America.

Australian consumer confidence and spending/saving behavior may also be affected by large share market moves

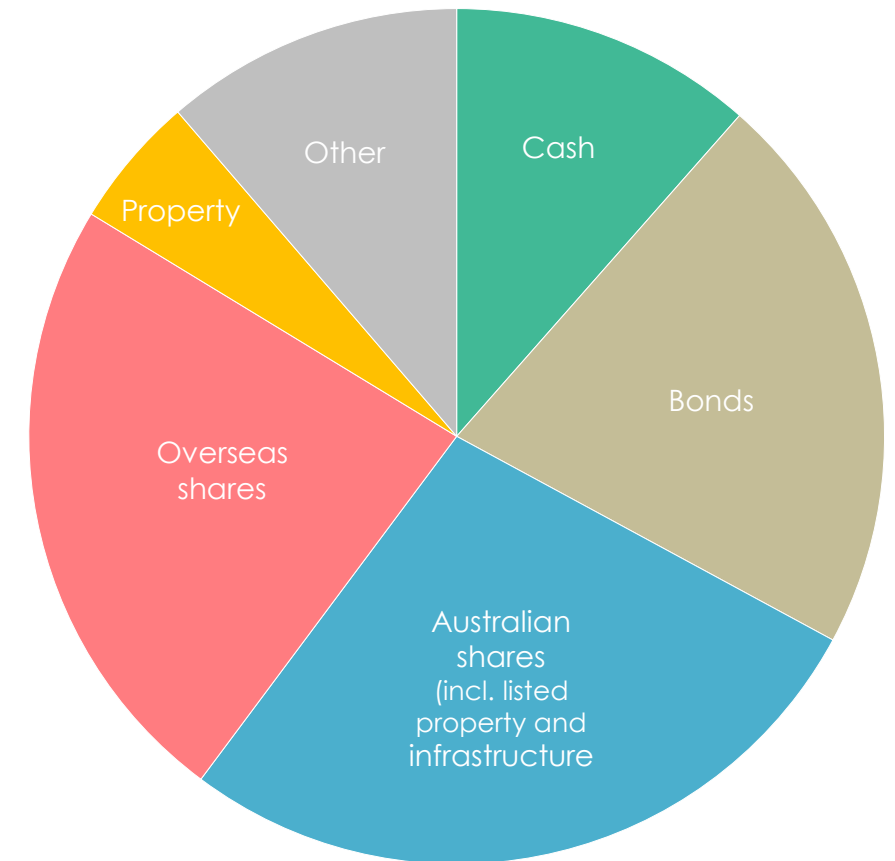
'On exchange' investors as a pc of adult population



Composition of household assets



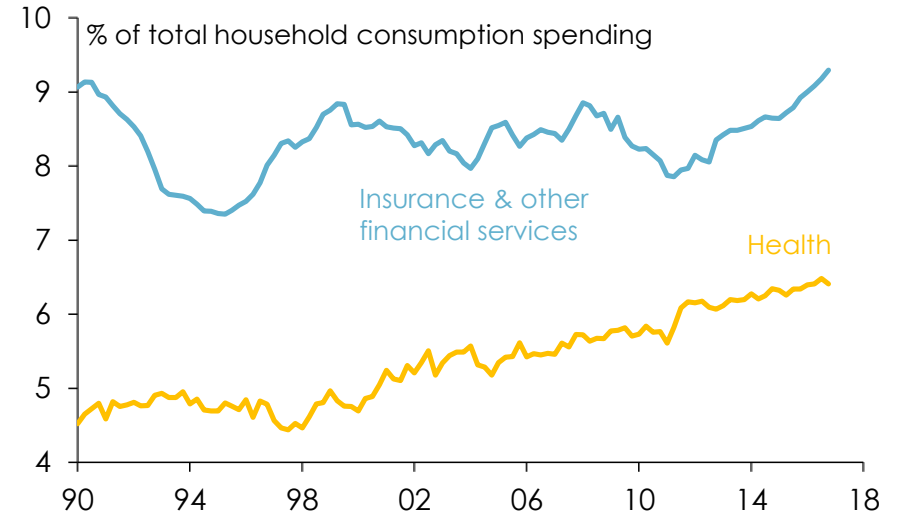
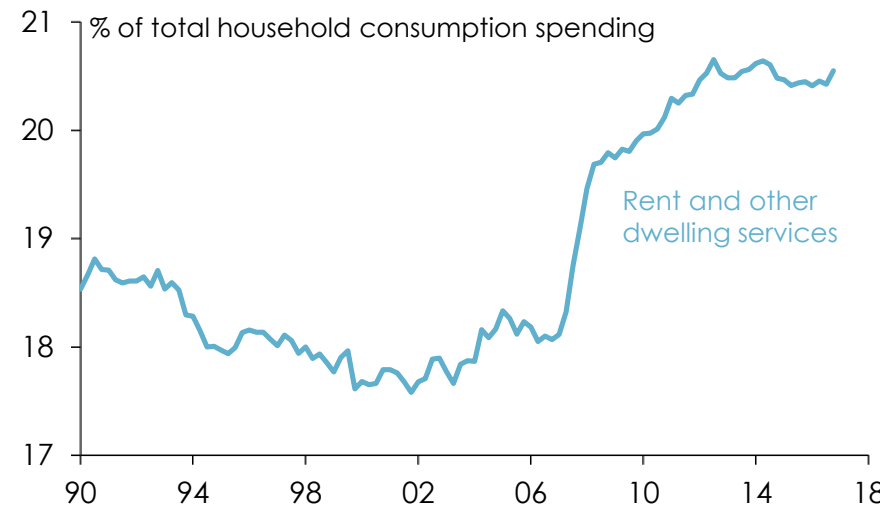
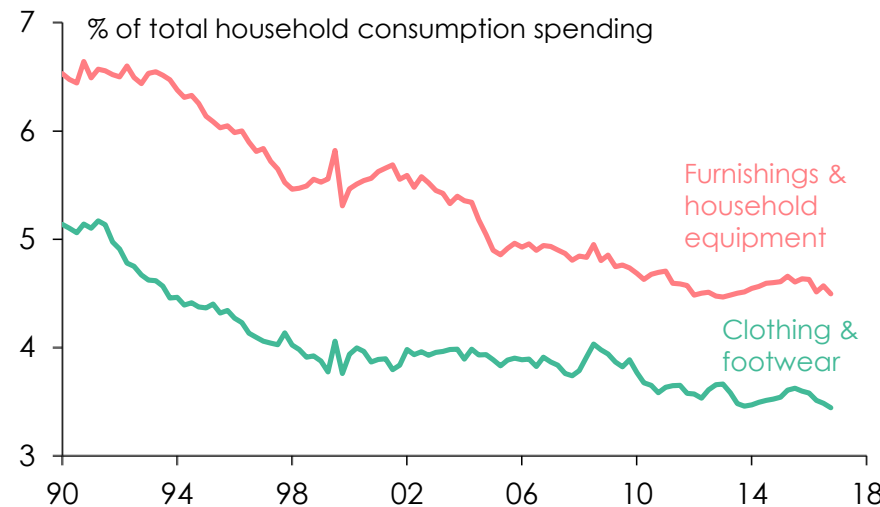
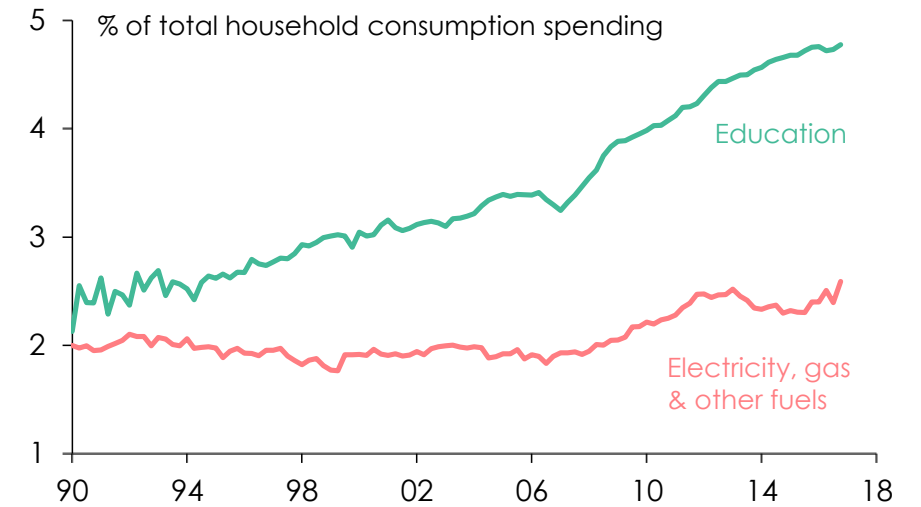
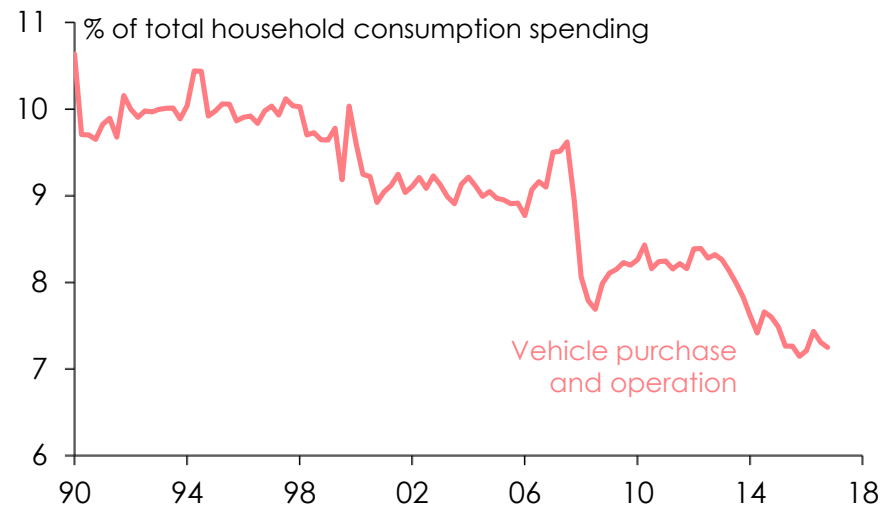
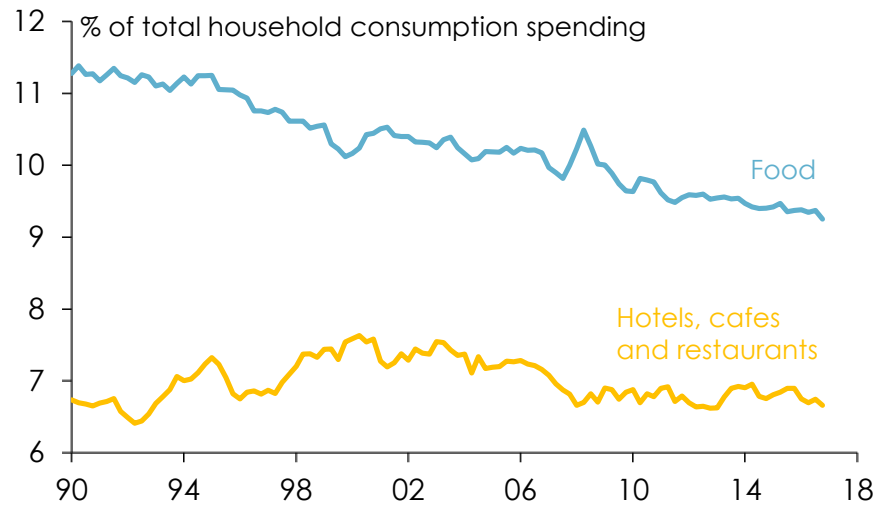
Superannuation fund asset allocation, Sep 2017



Sources: ASX & Deloitte Access Economics; ABS; Australian Prudential Regulation Authority.

Rising housing and education costs a major factor in longer-term trends in the composition of household spending

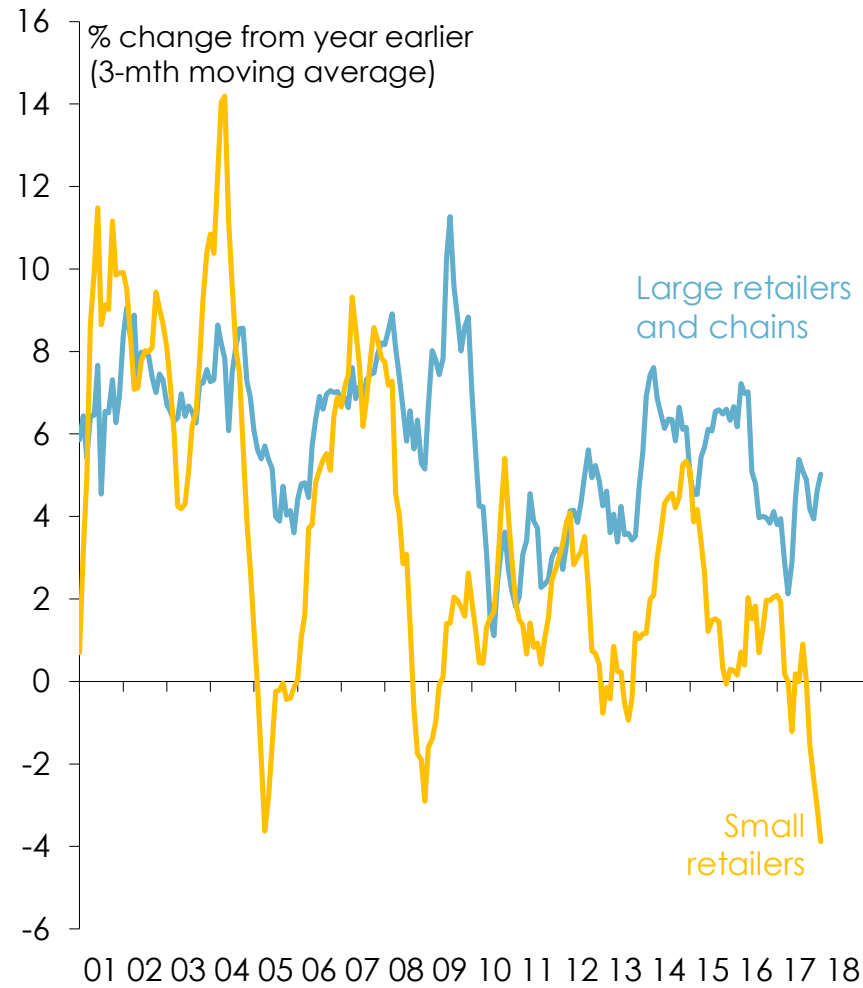
Composition of household consumption expenditure, 1990-2017



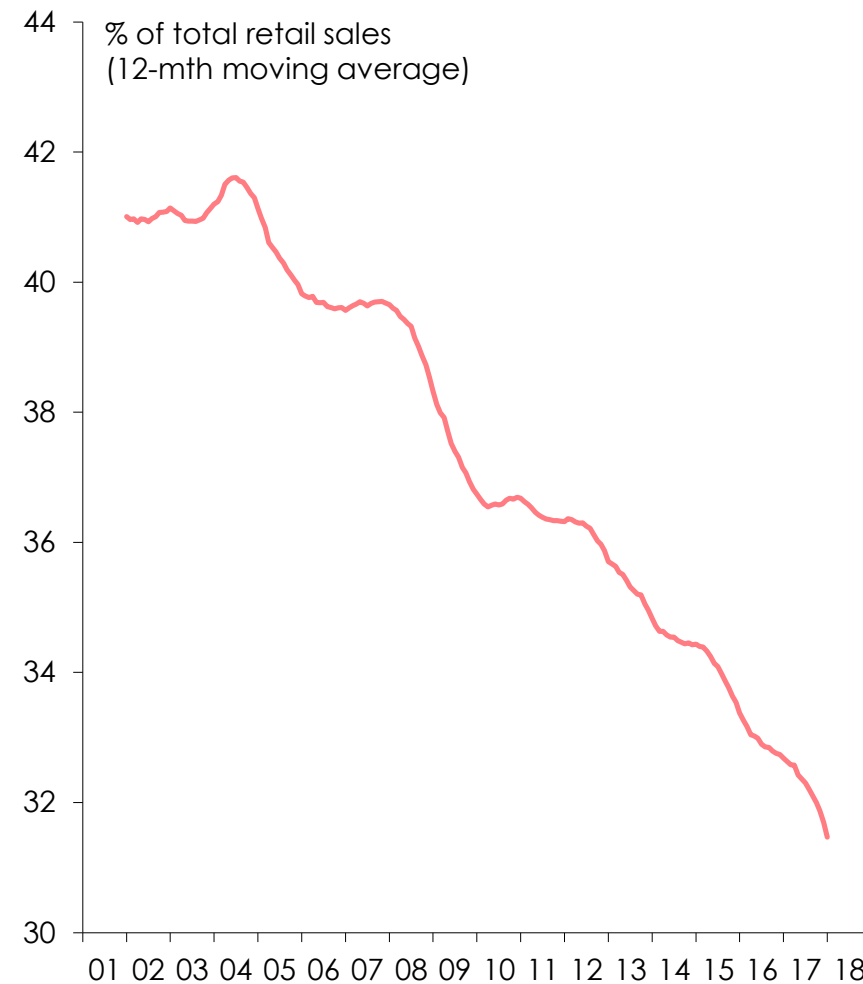
Note: data are in current price terms so reflect movements in both prices and volumes. Some categories (alcohol and tobacco, transport and communications services, recreation and culture, and other goods & services not shown. Source: ABS

Small retailers are losing 'market share' to large retailers and chains - and all 'bricks and mortar' retailers are losing out to on-line retailers

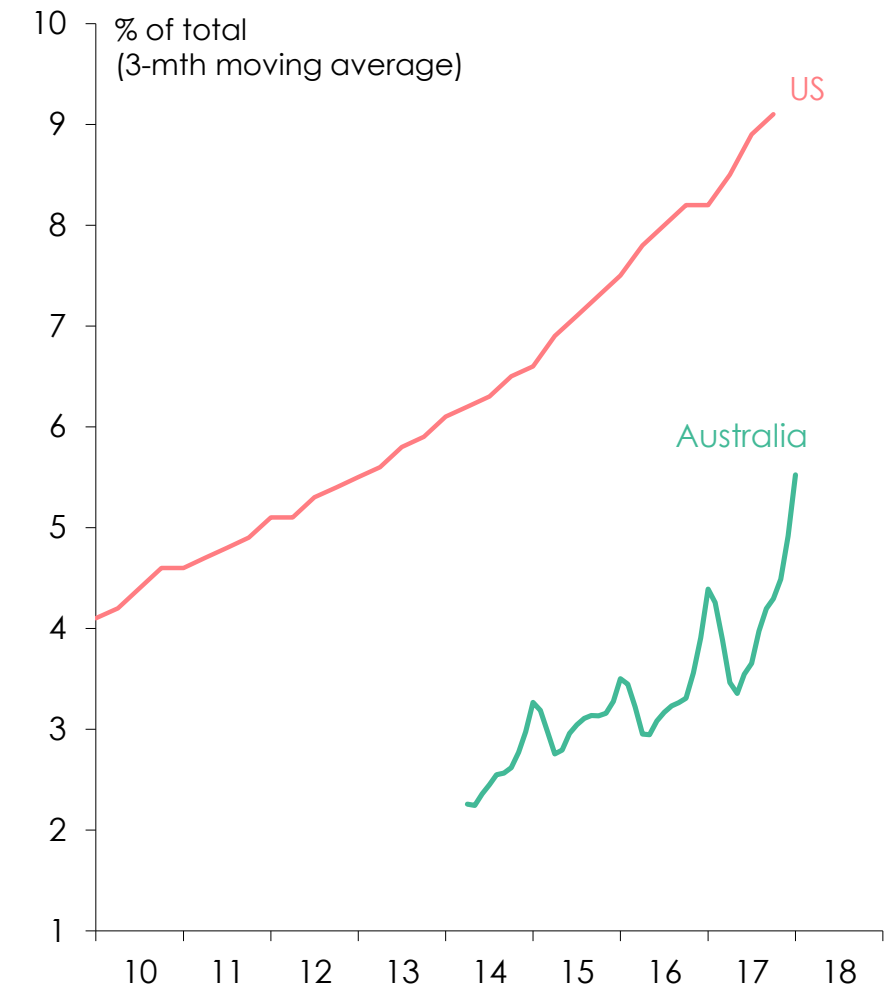
Retail sales growth by size of retailer



Small retailers' market share



On-line retail sales as a pc of total

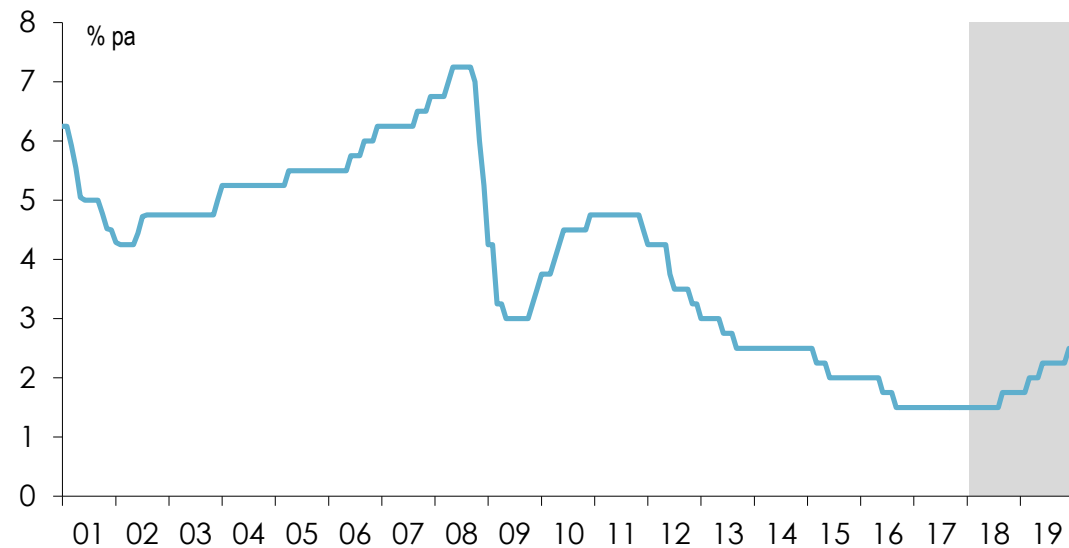


Note: 'on-line' retail sales excludes overseas on-line sales.

Sources: ABS; US Department of Commerce.

Australian interest rates will likely start rising later this year or early next

RBA cash rate



- ❑ The RBA expects economic growth to remain ‘below trend’ until the second half of 2018, ‘spare capacity’ in the labour market to persist until after 2019, and ‘underlying’ inflation to remain below its target band until mid-2019
- ❑ These are not the forecasts of a central bank that is on the cusp of tightening monetary policy
- ❑ Of course, the RBA need not keep interest rates at current record lows until all of the key economic variables are where they want them to be
- ❑ But the RBA’s current set of forecasts does not impel any urgency about moving away from current monetary policy settings
- ❑ The RBA would be delighted to see [further] increases in foreign interest rates while it ‘stands pat’ reflected in a decline in the A\$
- ❑ Increases in overseas interest rates could prompt banks to raise loan interest rates independently of changes in the RBA cash rate – which the RBA would take into account in deciding when and by how much to lift its cash rate

RBA forecasts

	Year-ended					
	Dec 2017	Jun 2018	Dec 2018	Jun 2019	Dec 2019	Jun 2020
GDP growth	2½	2¾	3¼	3½	3¼	3
Unemployment rate ^(b)	5.5	5¼	5¼	5¼	5¼	5¼
CPI inflation	1.9	2	2¼	2¼	2¼	2¼
Underlying inflation	1¾	1¾	1¾	2	2	2¼

Source: RBA.

Summary

- ❑ The world economy is doing better than at any time since before the financial crisis – but this is probably ‘as good as it gets’
- ❑ The global financial market upheavals of the past two weeks represent a belated recognition that the ‘era of cheap money’ is drawing to a close
- ❑ The Australian economy has been ‘under-performing’ since the end of the ‘mining boom’ five years ago – but it has picked up over the past year or so, and should do better again in 2018
- ❑ Differences in economic performance across Australia are narrowing
- ❑ Consumer spending is the weakest part of the Australian economy – because of the combination of very slow growth in wages, tighter fiscal policy (no tax cuts or cash hand-outs) and very high levels of household debt
- ❑ Wages growth probably won’t start to pick up until next year – and personal income tax cuts won’t arrive until after the next election (although they will probably be announced this year)
- ❑ A ‘housing bust’ is unlikely – but the boom is over, and the legacy of high debt will remain for a long time, making households vulnerable to increases in interest rates
- ❑ On-going changes in household spending patterns, and in the structure of the retail sector, mean that retailers will continue to face a challenging business environment
- ❑ Individual retailers will have to find ways of increasing market share if they are to meet demanding sales targets