

# **An Australian recession: possible, but not probable**

Presentation to the Portfolio Construction Forum  
2015 Conference

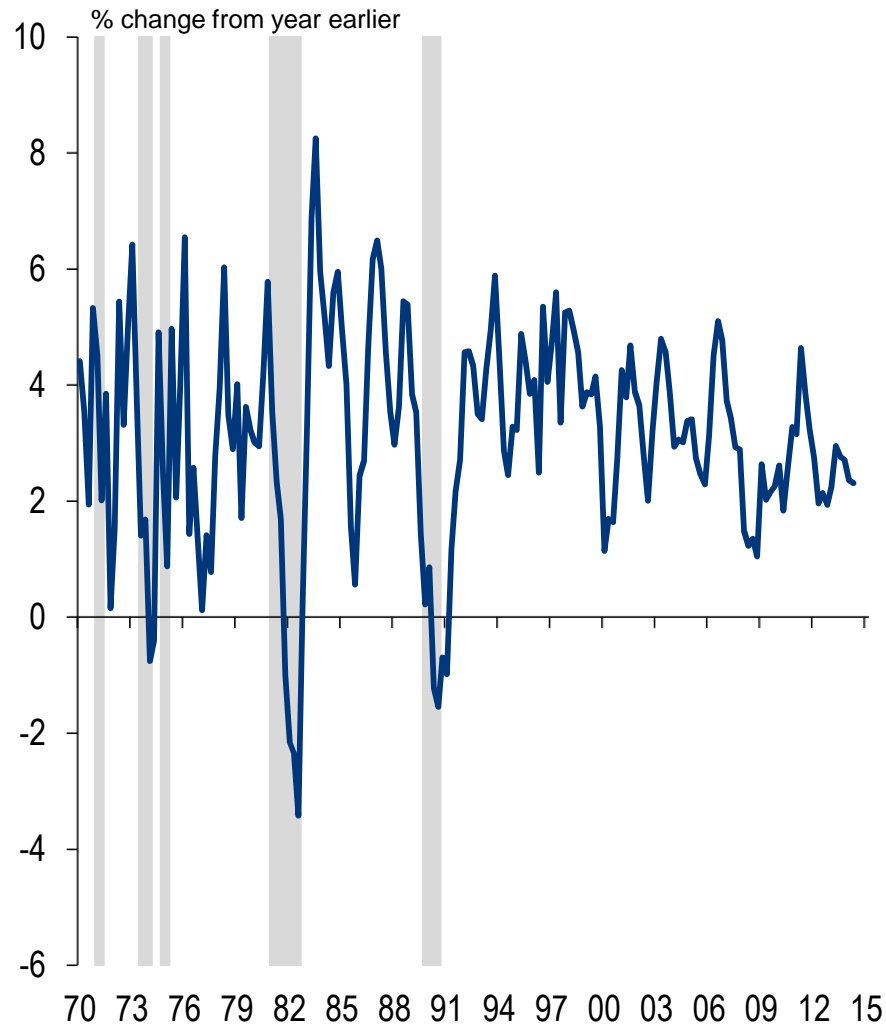
Saul Eslake

Australian Technology Park, Sydney  
19<sup>th</sup> August 2015

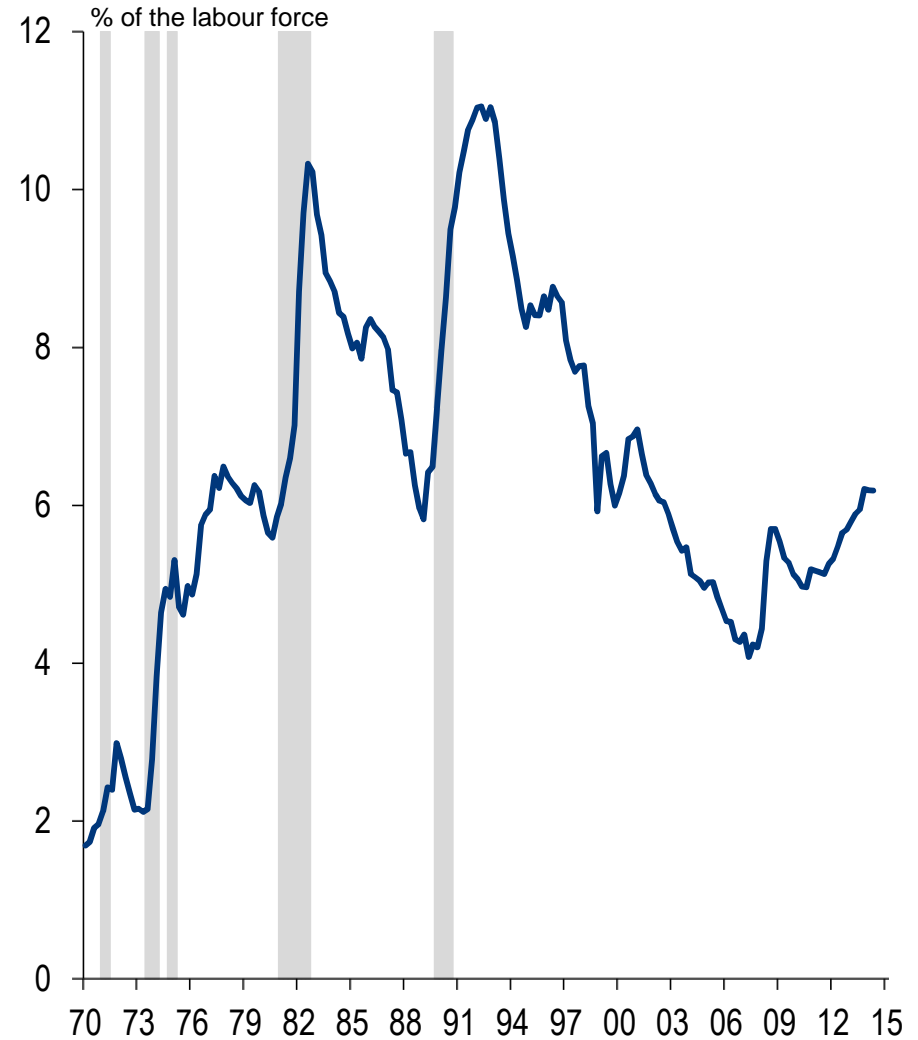
*[www.bettercallsaul.com.au](http://www.bettercallsaul.com.au)*

# Australia hasn't had a recession since 1991

## Australia's real GDP growth

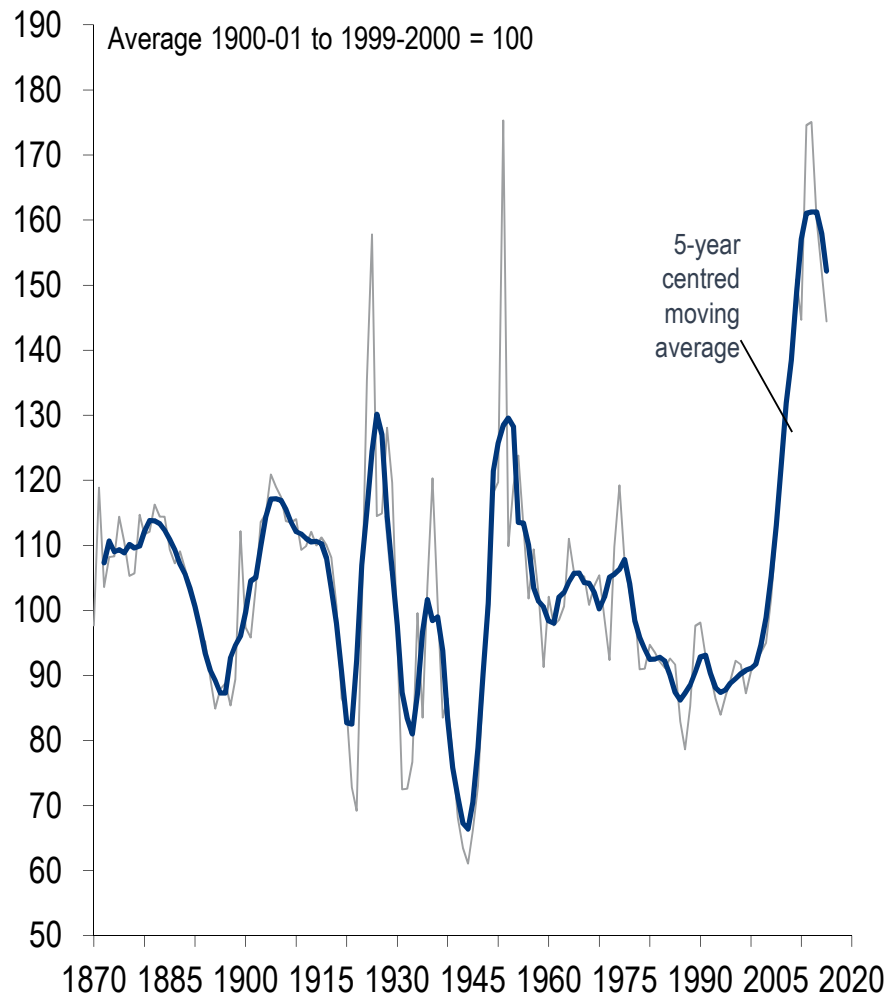


## Australia's unemployment rate



# We've been through the biggest 'commodities boom' in our history

## Australia's 'terms of trade' (ratio of export to import prices)

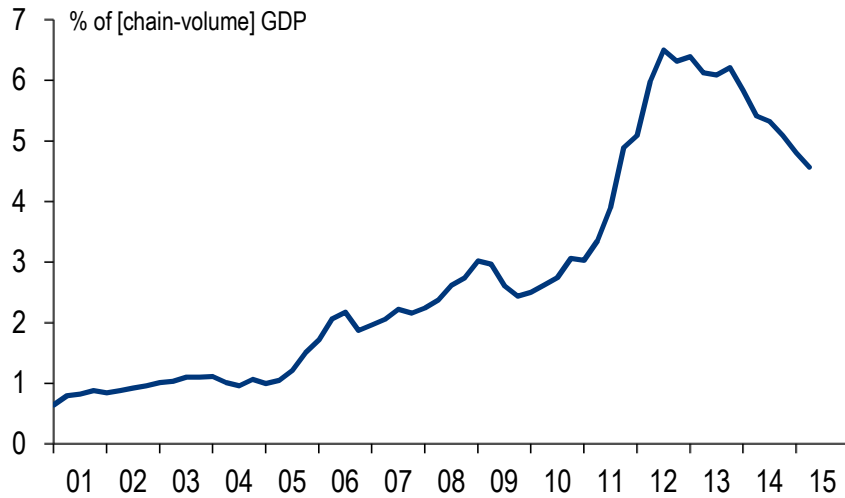


## Resources investment as a share of Australia's GDP

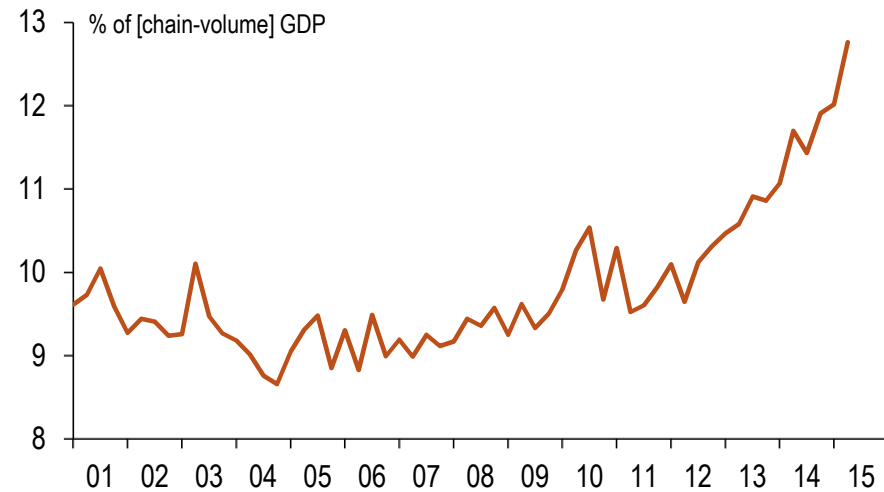


# The 'resources investment boom' is over – and although resources exports are rising, they are at falling prices and create fewer jobs

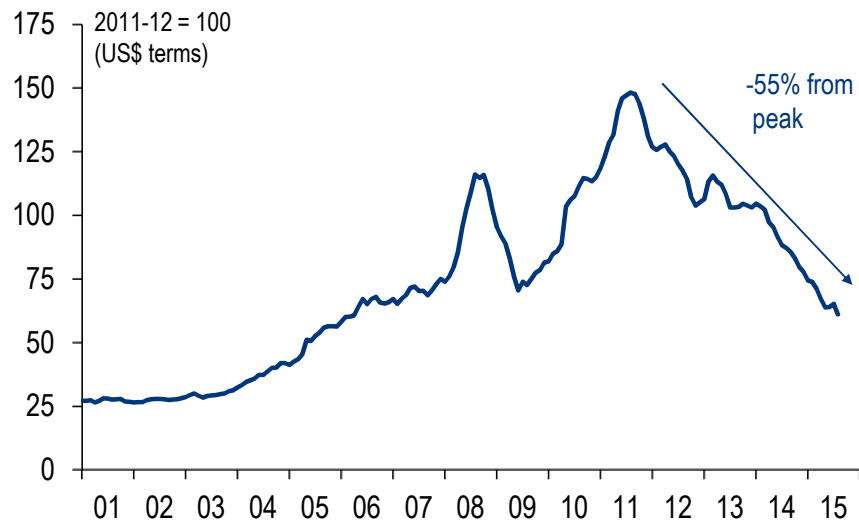
## Resources investment



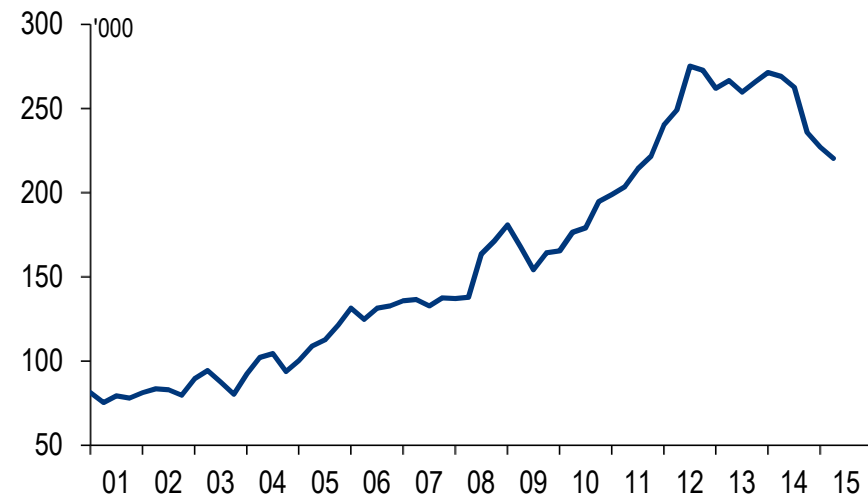
## Resources exports



## Resources commodity prices

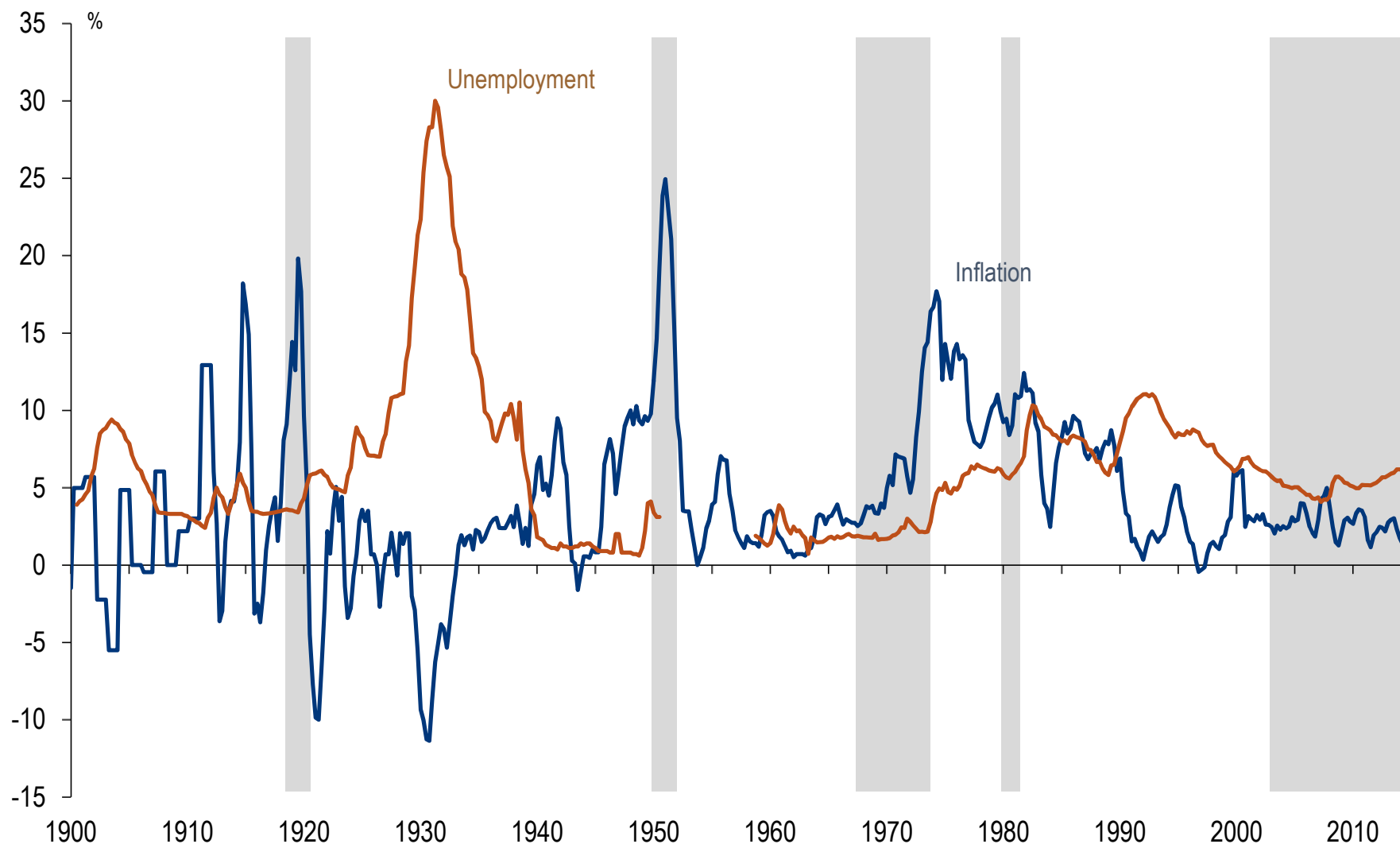


## Mining employment



# Previous commodities booms ended in double-digit inflation – making recessions almost inevitable: the latest one didn't

## Inflation, unemployment and commodities booms

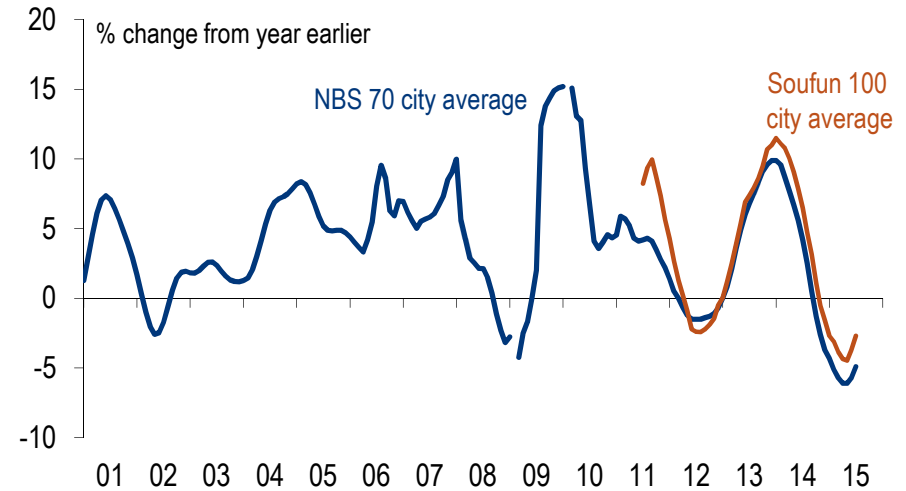


# A sharp slowdown in the Chinese economy could possibly push Australia into recession – but that's not the most likely scenario

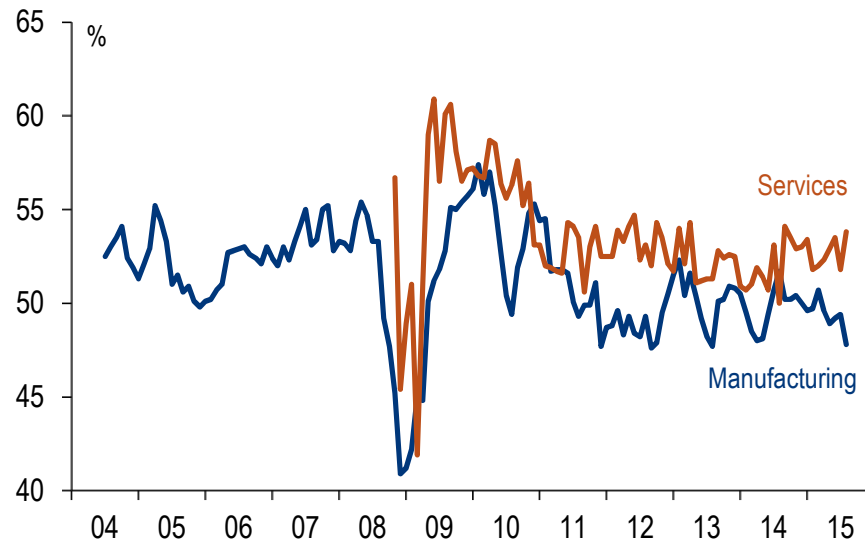
## Chinese real GDP



## Chinese urban property prices



## Chinese purchasing managers' indices

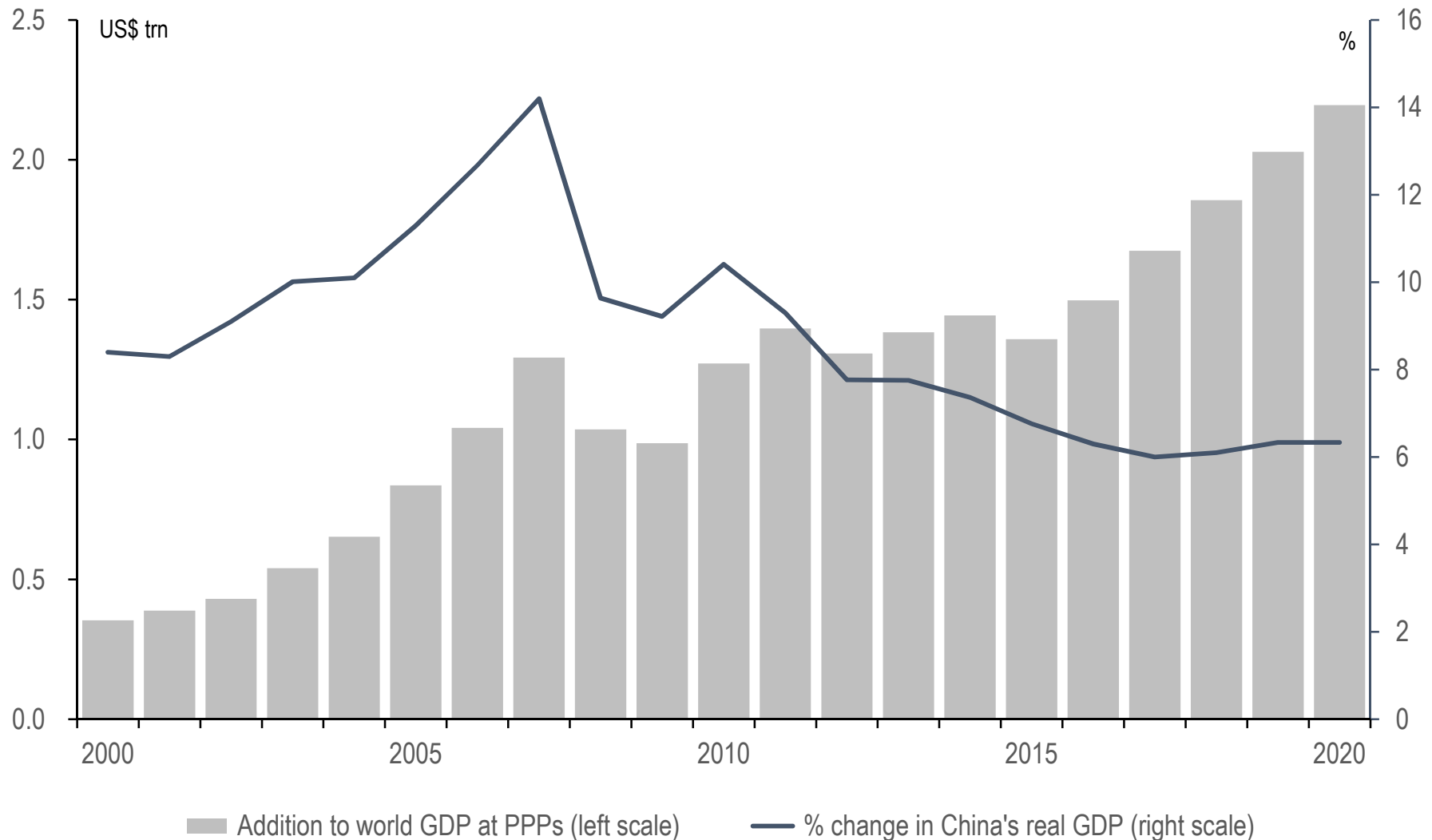


## Shanghai stock market



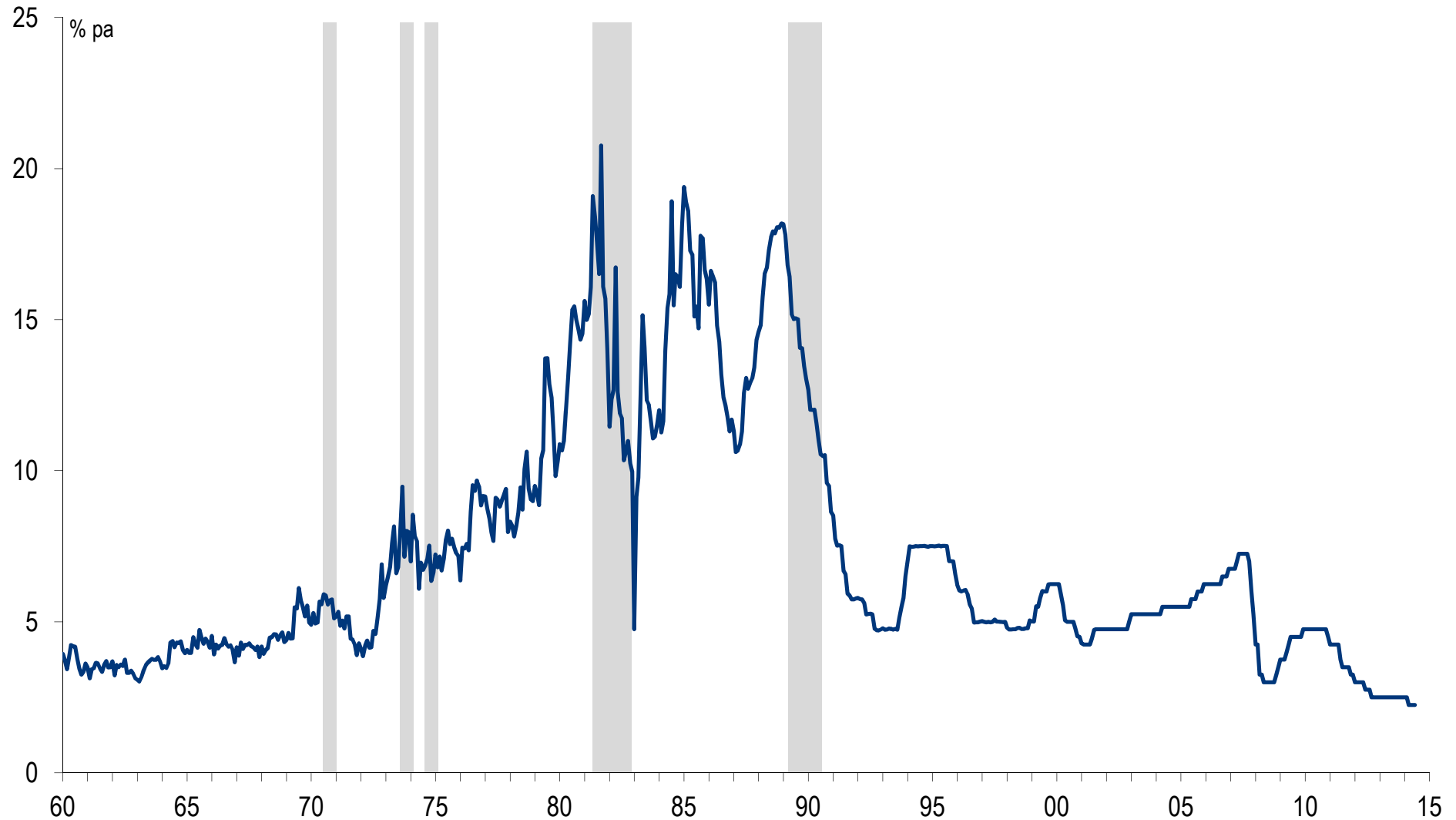
# China's contribution to growth in the world economy is increasing despite slower growth in its real GDP

## Chinese economic growth rate and contribution to change in world GDP



# Past recessions have been preceded by periods of high interest rates (by standards of the day) – yet rates are now at record lows

## Reserve Bank of Australia's official cash rate



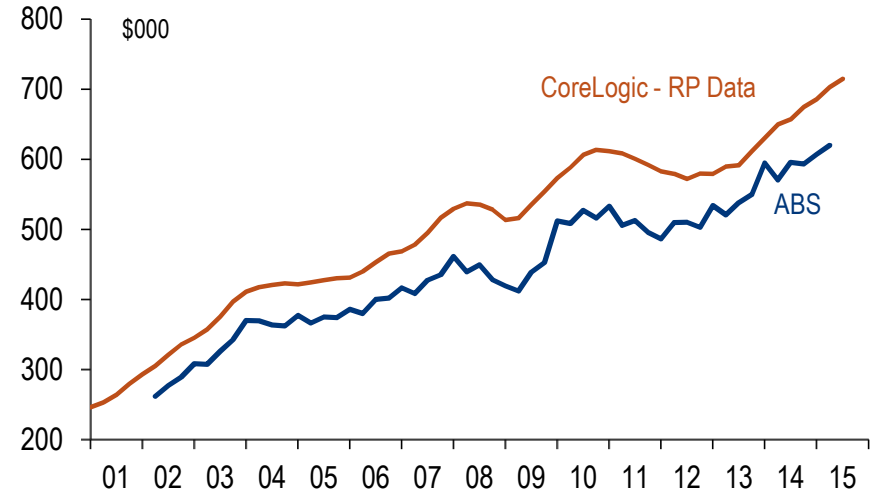


# Record low interest rates have certainly boosted the demand for housing – and housing prices

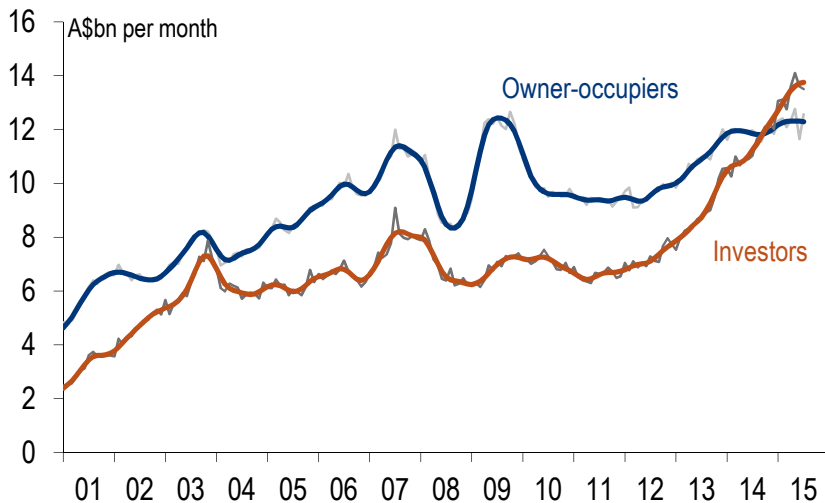
## Housing finance commitments



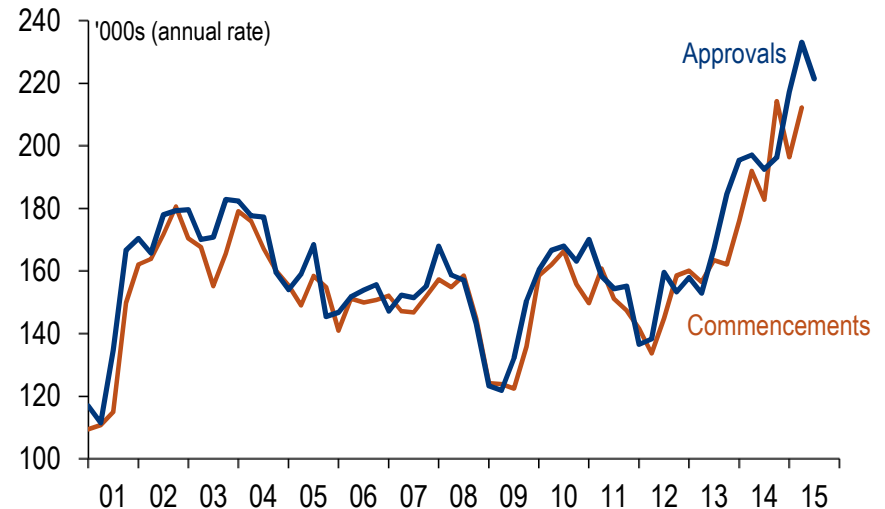
## Capital city house prices



## Owner-occupier vs investor housing borrowing

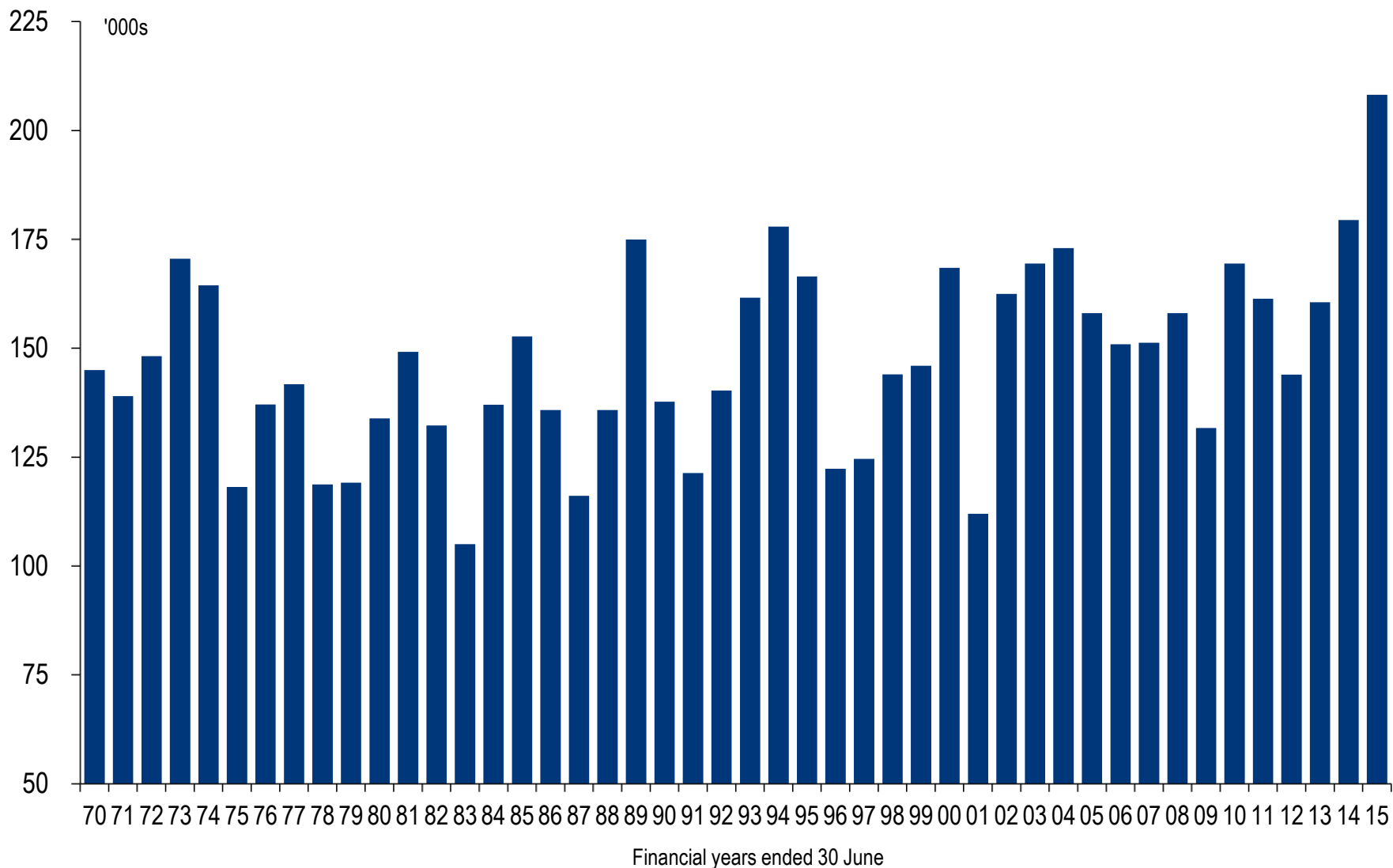


## Housing approvals and commencements



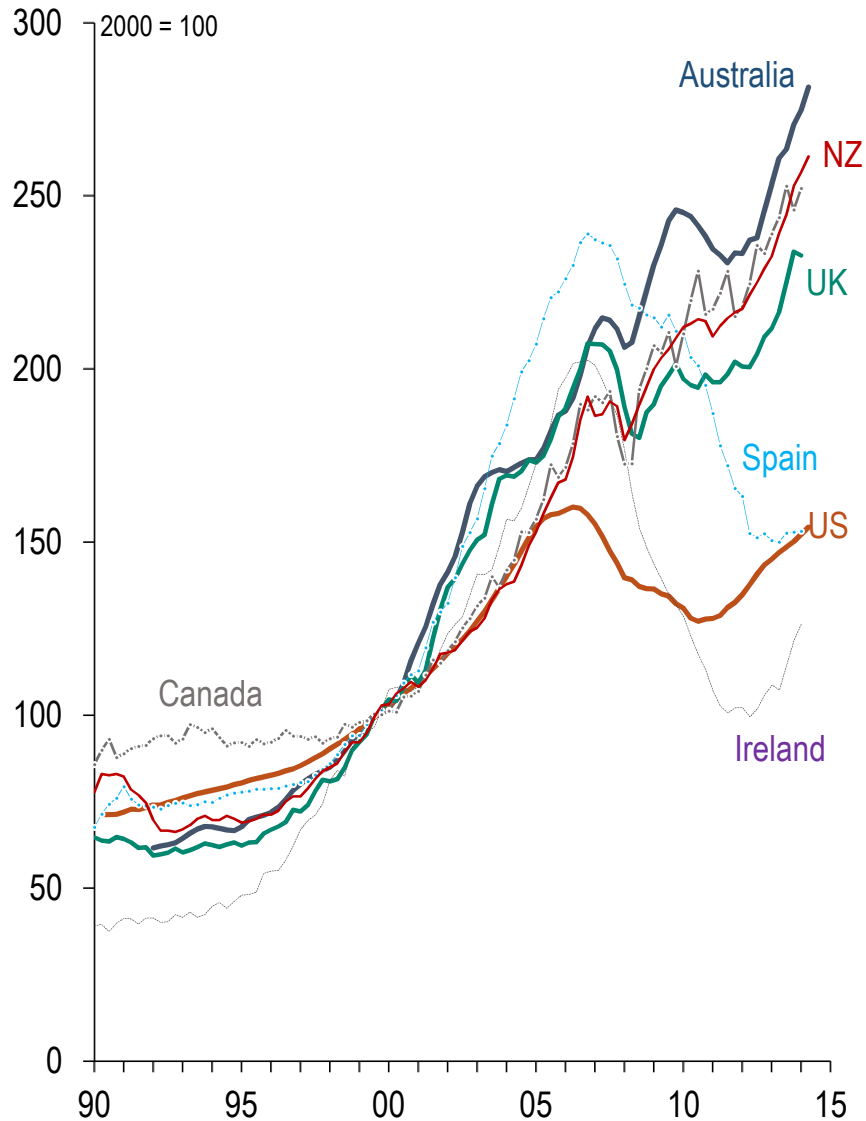
# Housing activity is at an all time high – and there's no reason to expect an imminent sharp downturn

## Housing commencements

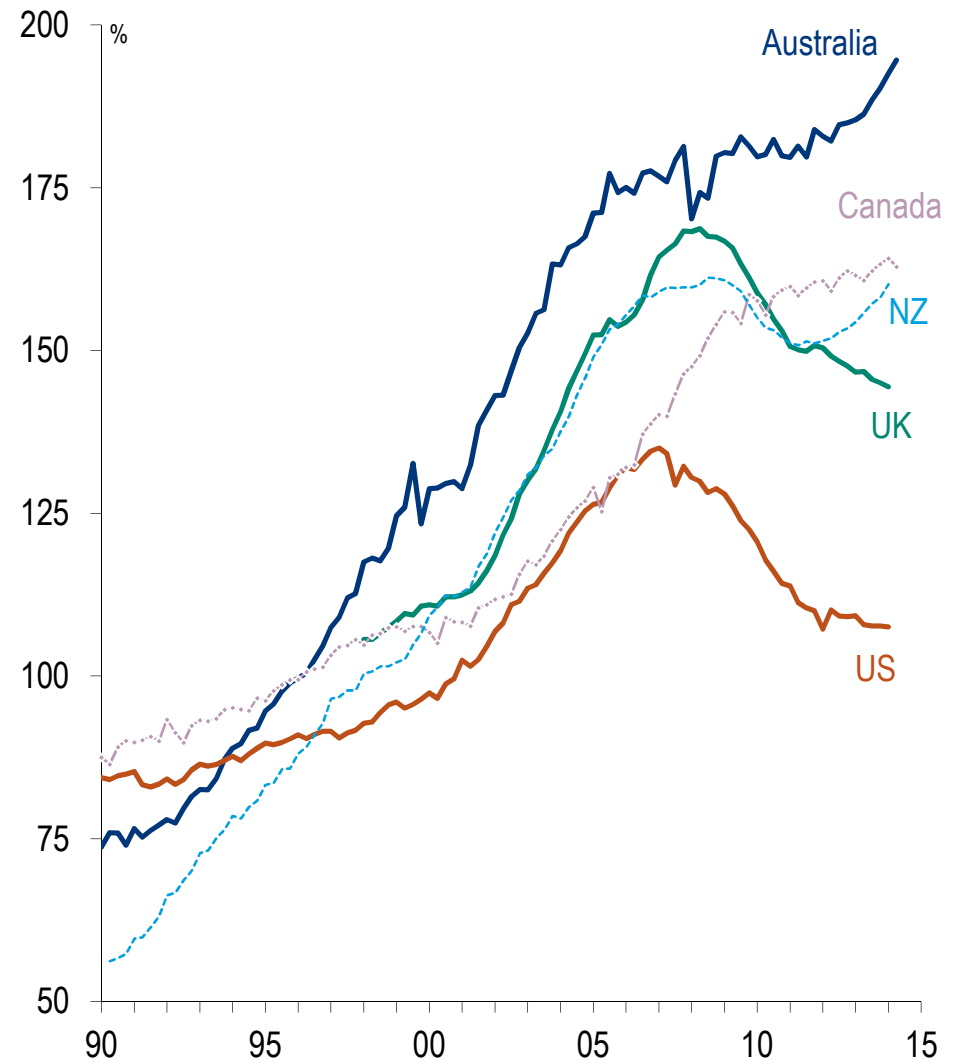


# It's true that Australia now has very high house prices, and high household debt, by historic

## House prices



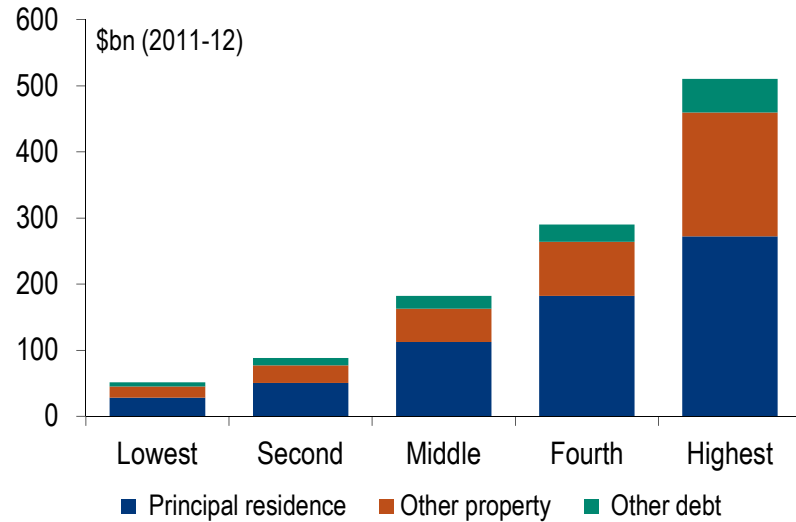
## Household debt



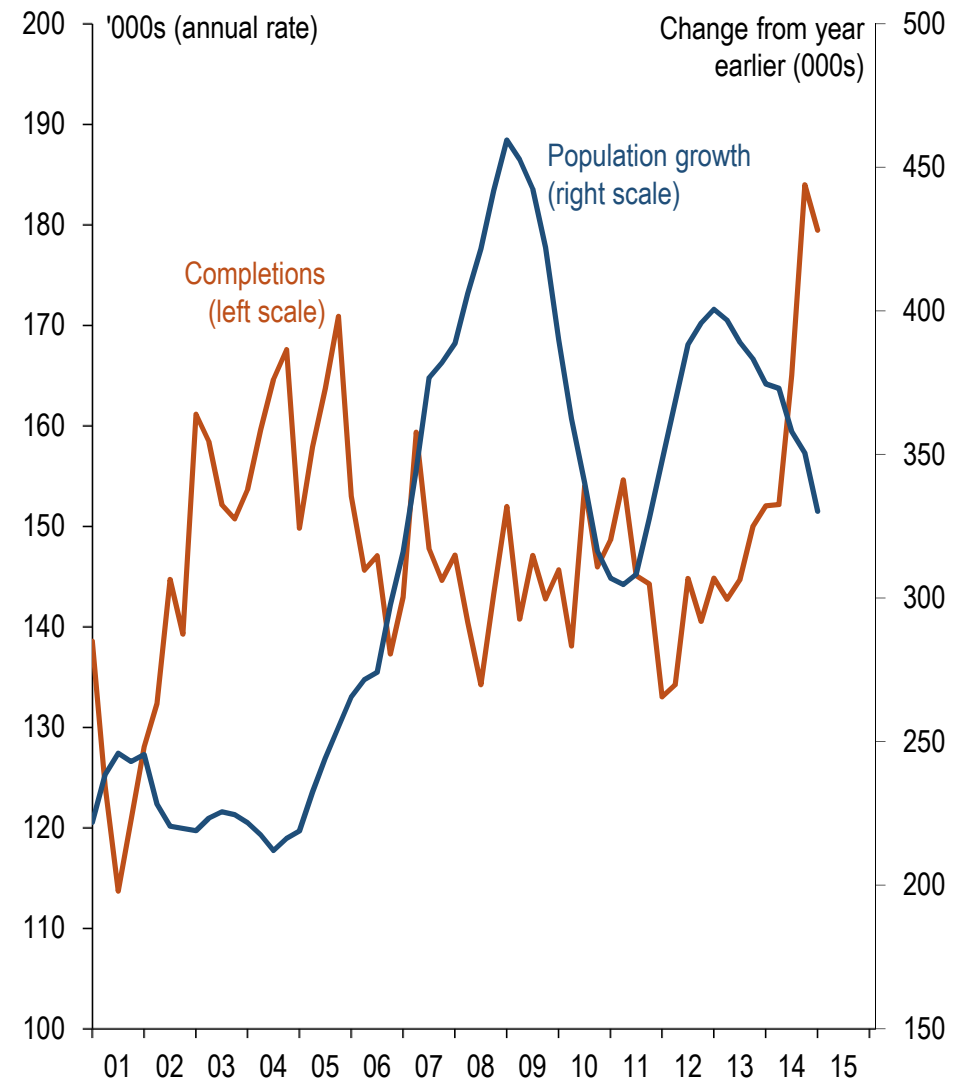
Sources: Australian Bureau of Statistics; US Bureau of Economic Analysis; UK Office for National Statistics; Statistics Canada; Statistics NZ; RP Data-CoreLogic; US Federal Home Financing Agency; Bank for International Settlements.

# However that of itself doesn't mean that a housing price crash, or a wave of debt defaults, is either imminent or likely

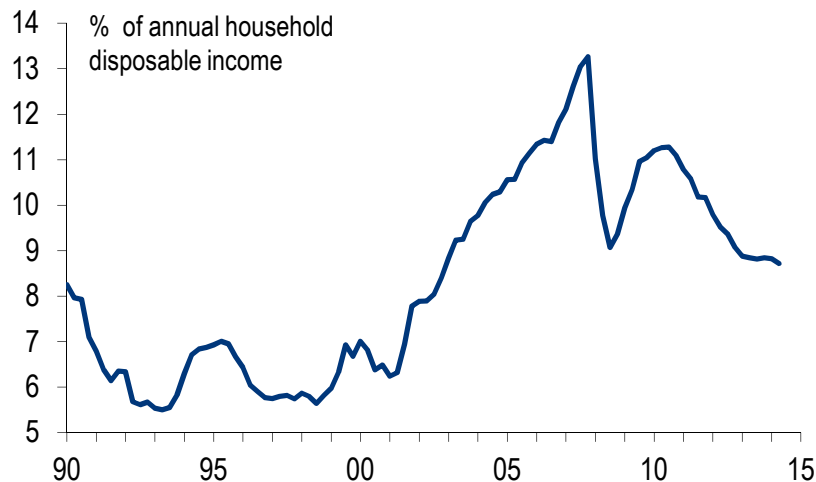
## Household debt by income quintile



## Housing supply and demand

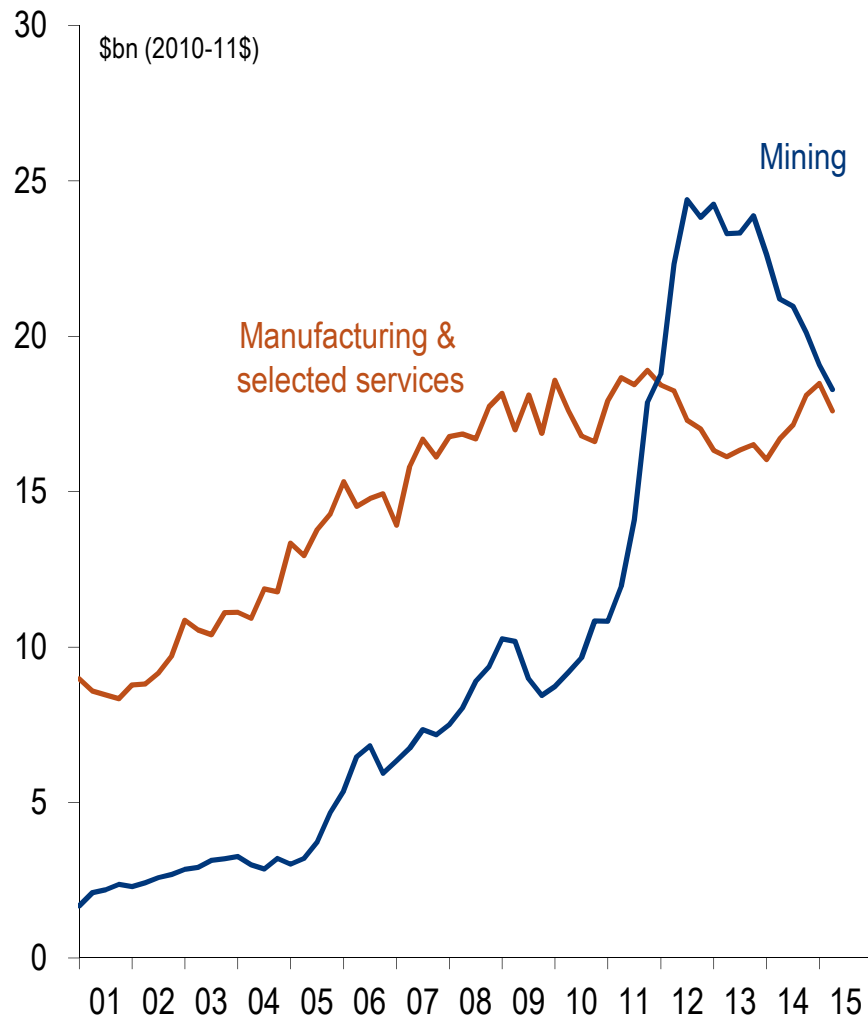


## Household interest payments

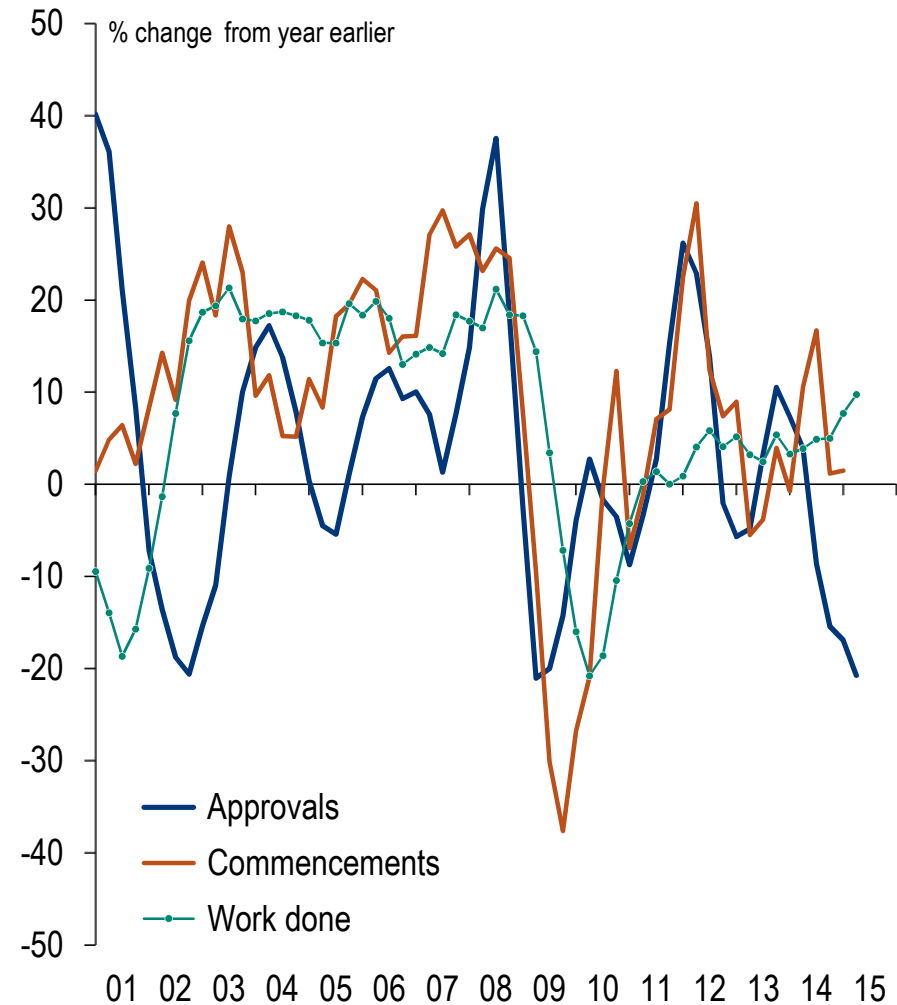


# Lower interest rates haven't done much to stimulate other types of investment

## Business investment – mining vs other sectors

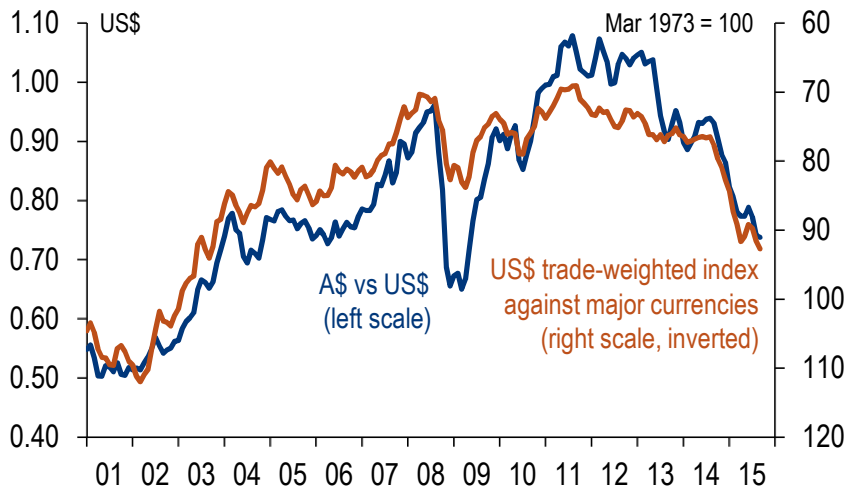


## Private non-residential building activity

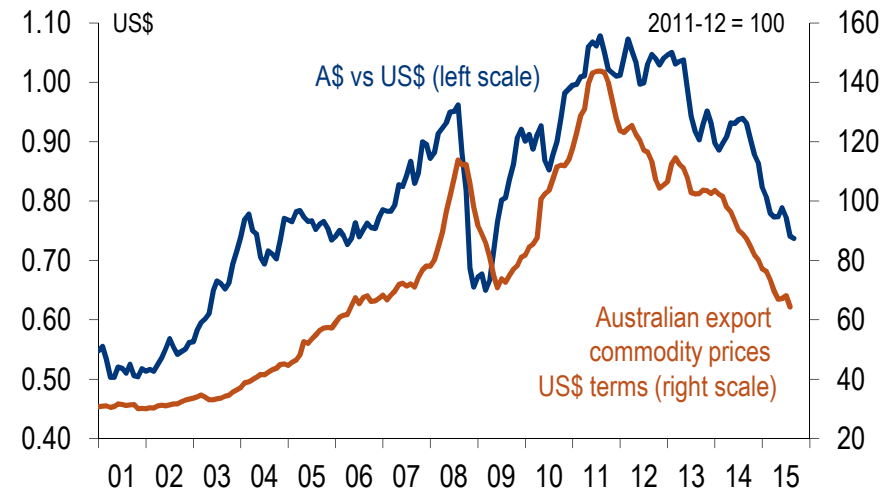


# The A\$ has now fallen quite a long way – but will fall further as US interest rates begin to rise and commodity prices fall further

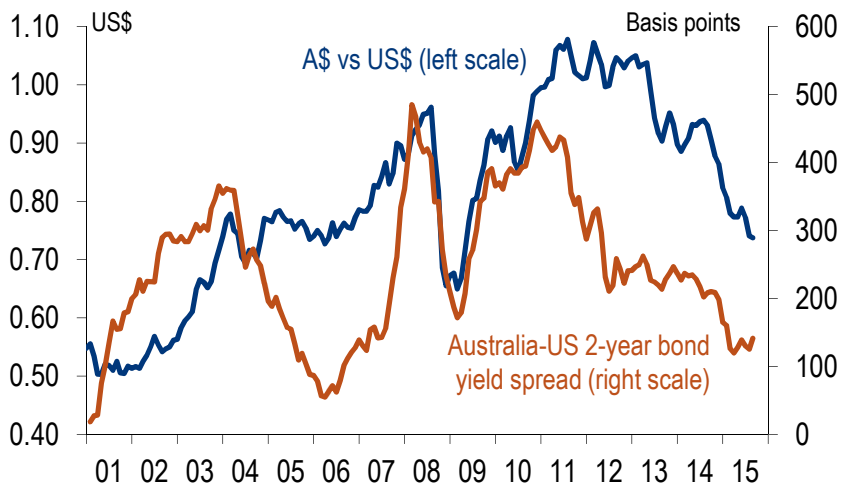
## A\$ and US\$ effective exchange rate



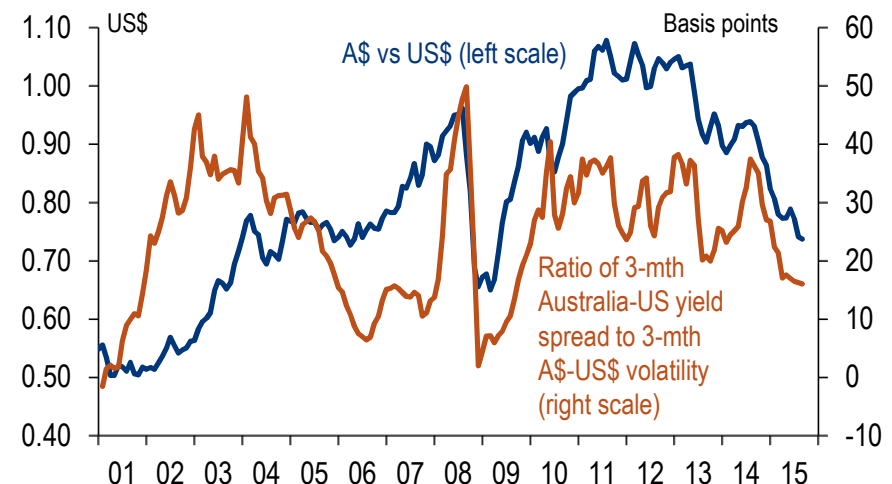
## A\$ and export commodity prices



## A\$ and the spread between Australian and US interest rates

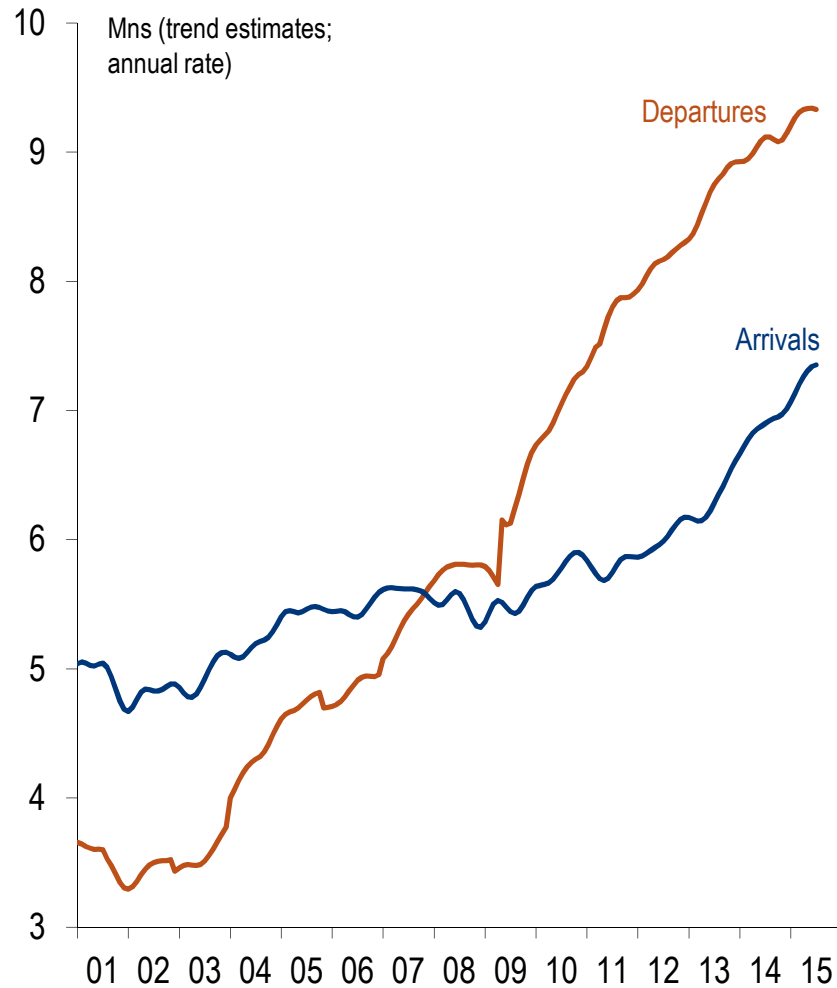


## A\$ and the arbitrageur's risk-reward ratio (interest rate spread / volatility)

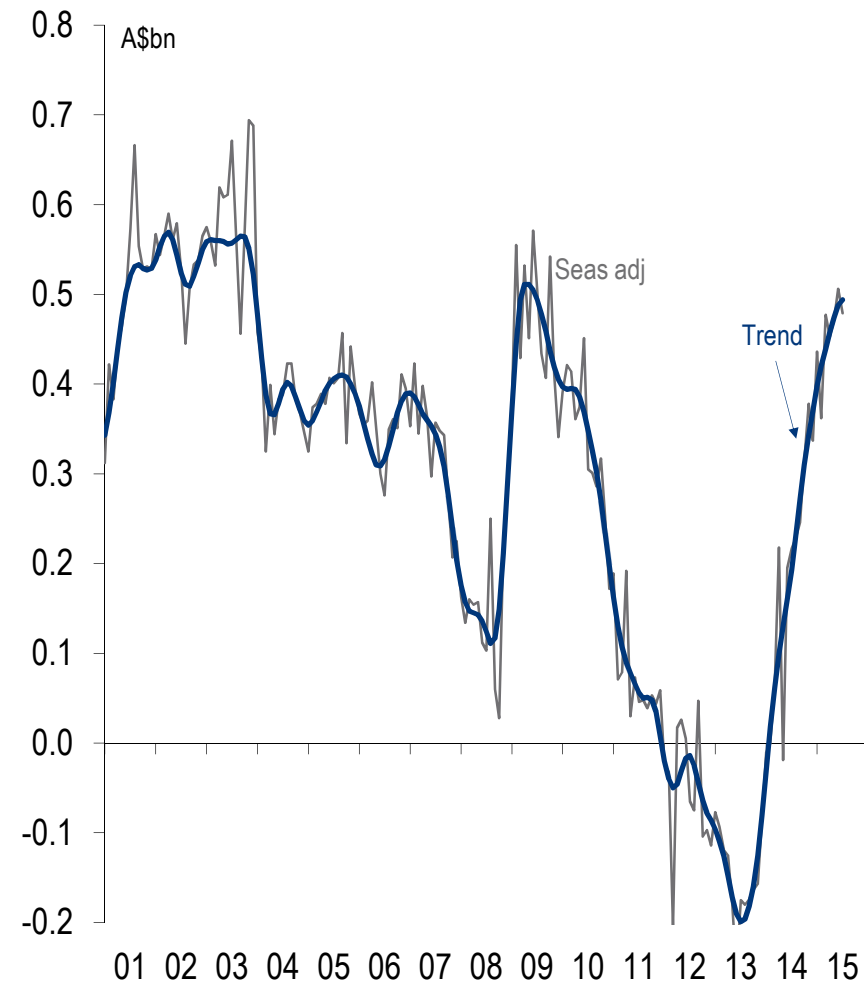


# The lower A\$ is already had a significant positive impact on the tourism sector

## International travel movements

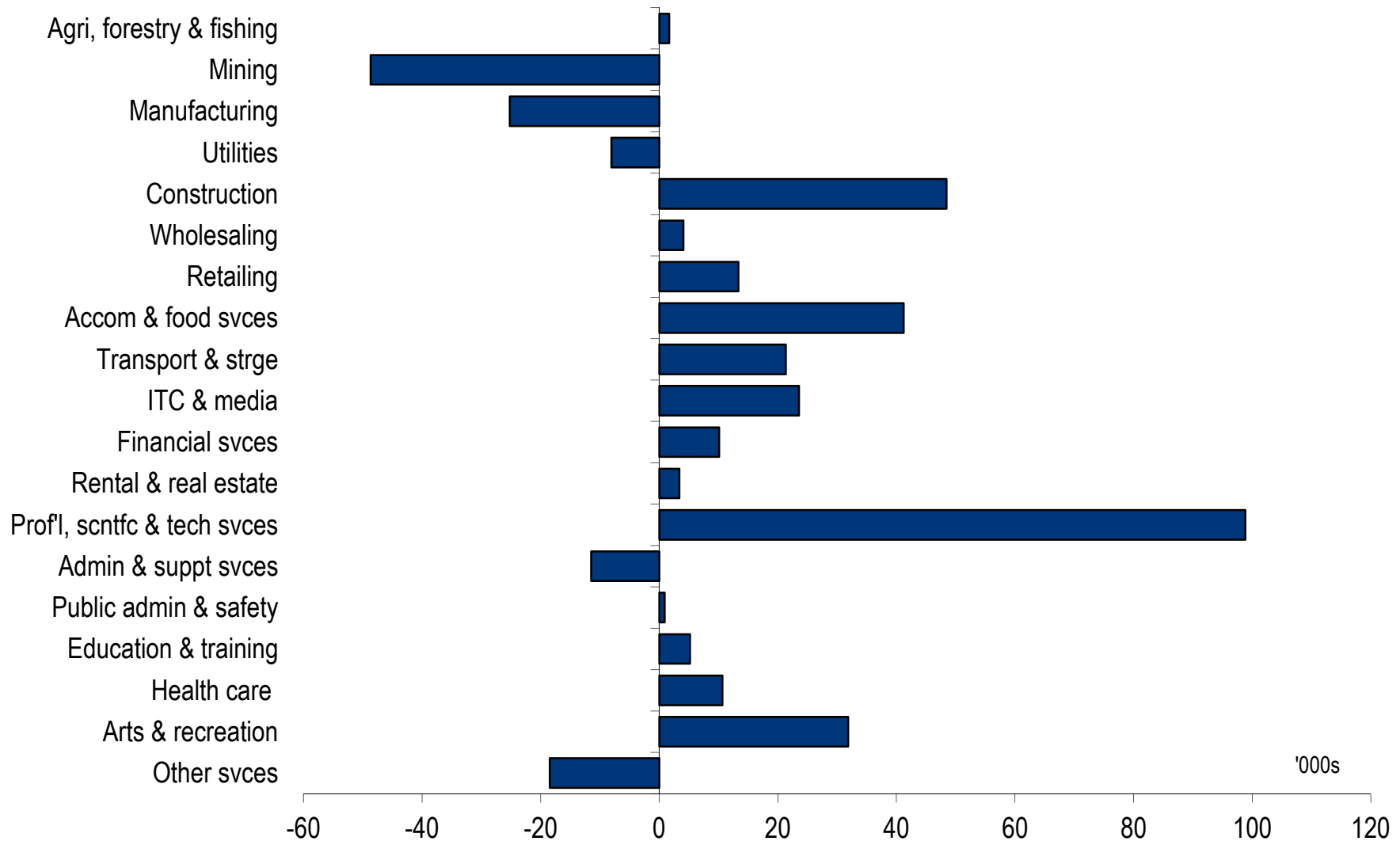


## Tourism services trade balance



# Employment growth is picking up in some of the more labour-intensive sectors of the economy

## Employment growth by sector – 12 months ended May 2015





# Employment growth is picking up, and the unemployment rate may have peaked already despite ongoing slow GDP growth

## Employment growth



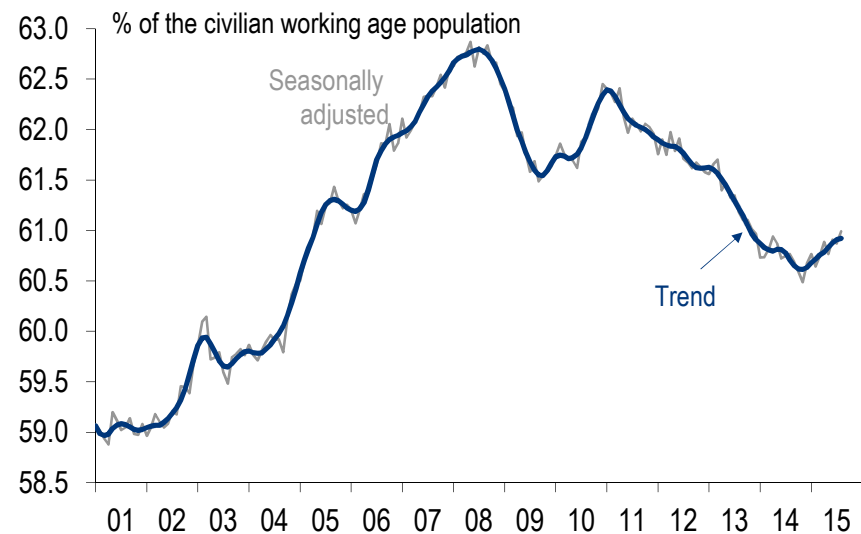
## Labour force participation rate



## Unemployment rate

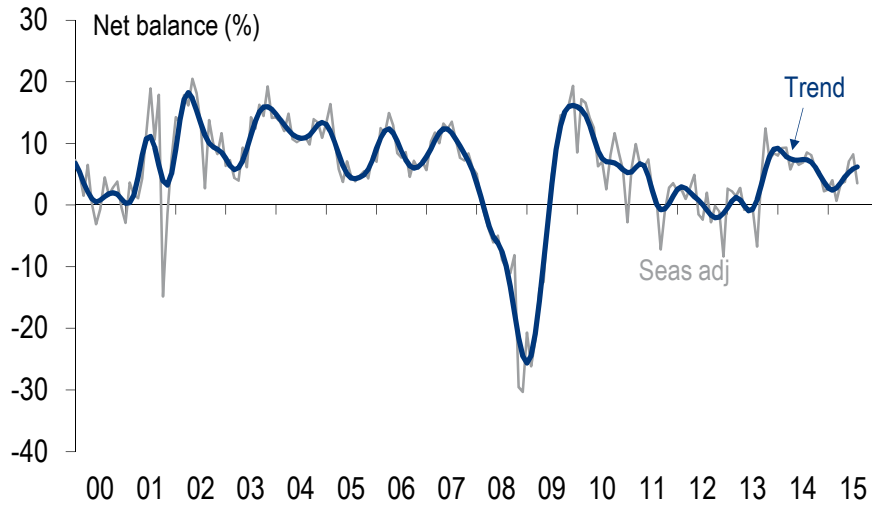


## Employment-population ratio

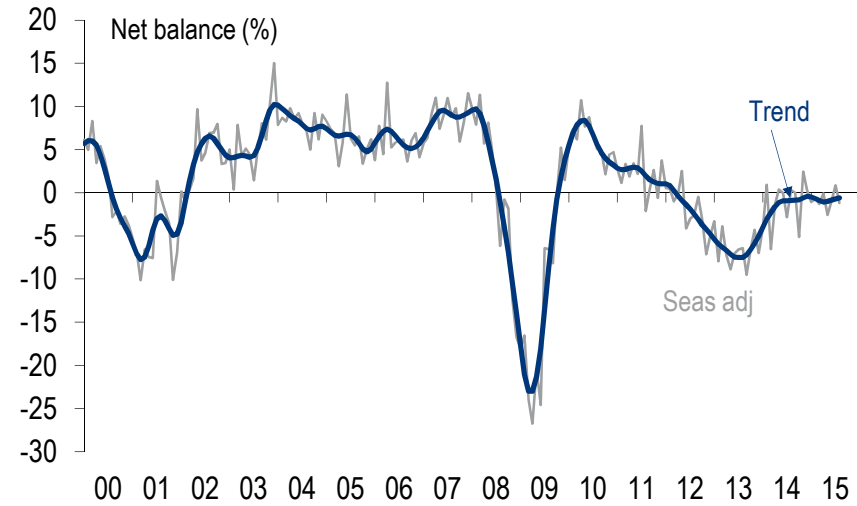


# Business confidence and forward-looking expectations are also showing some improvement

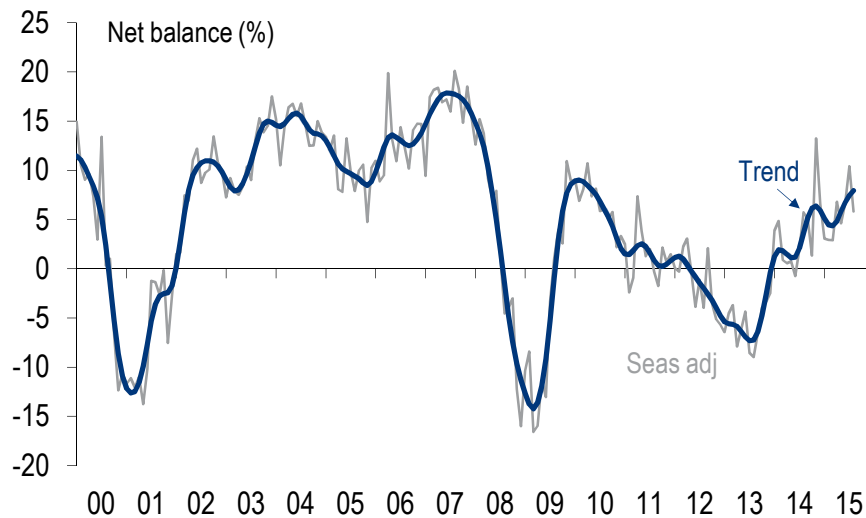
## Business confidence



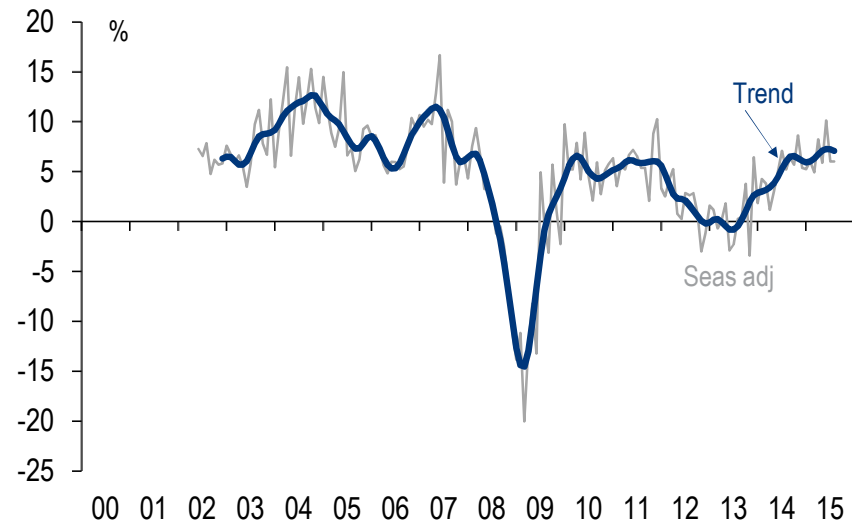
## Business hiring intentions



## Business conditions

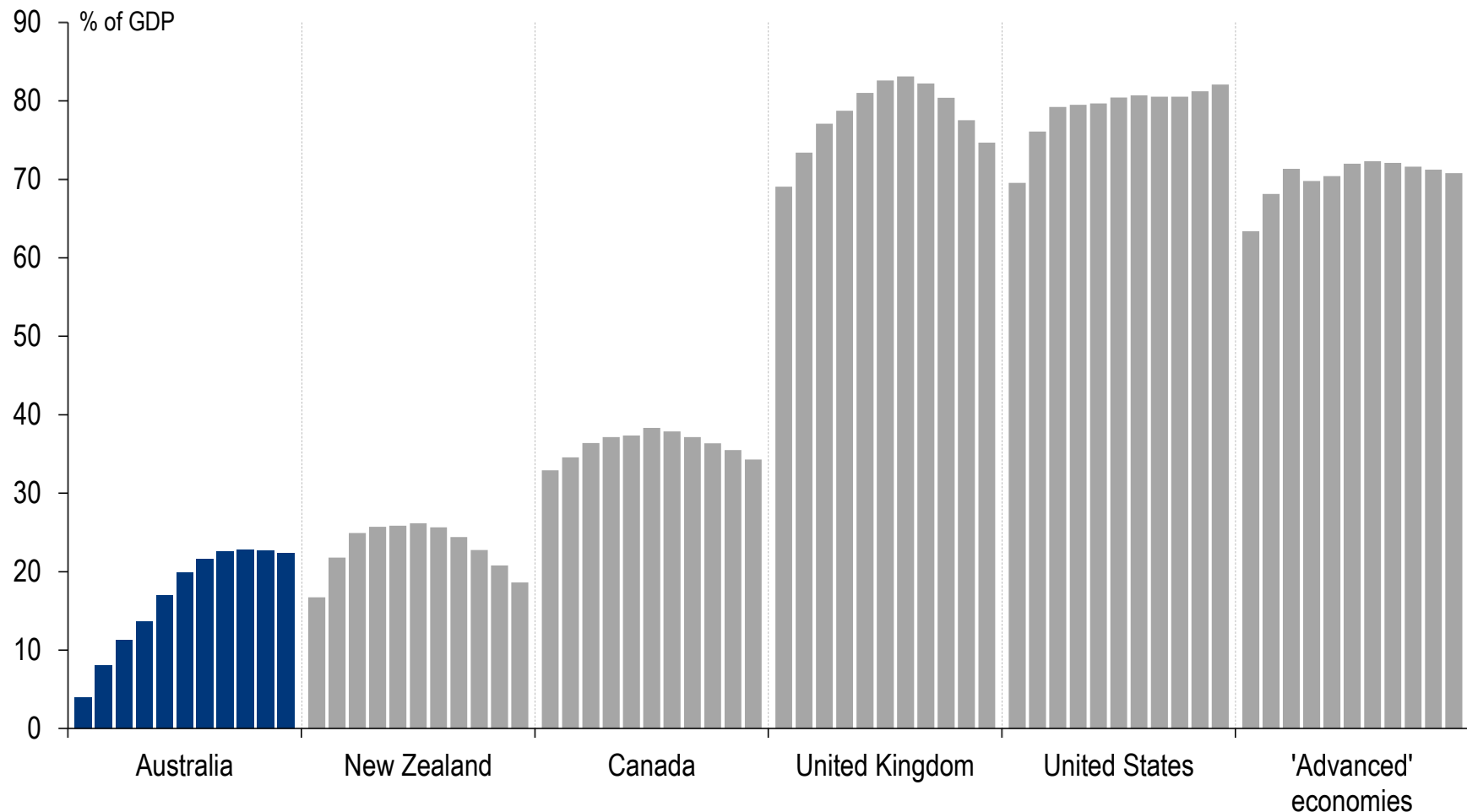


## Business capital expenditure intentions



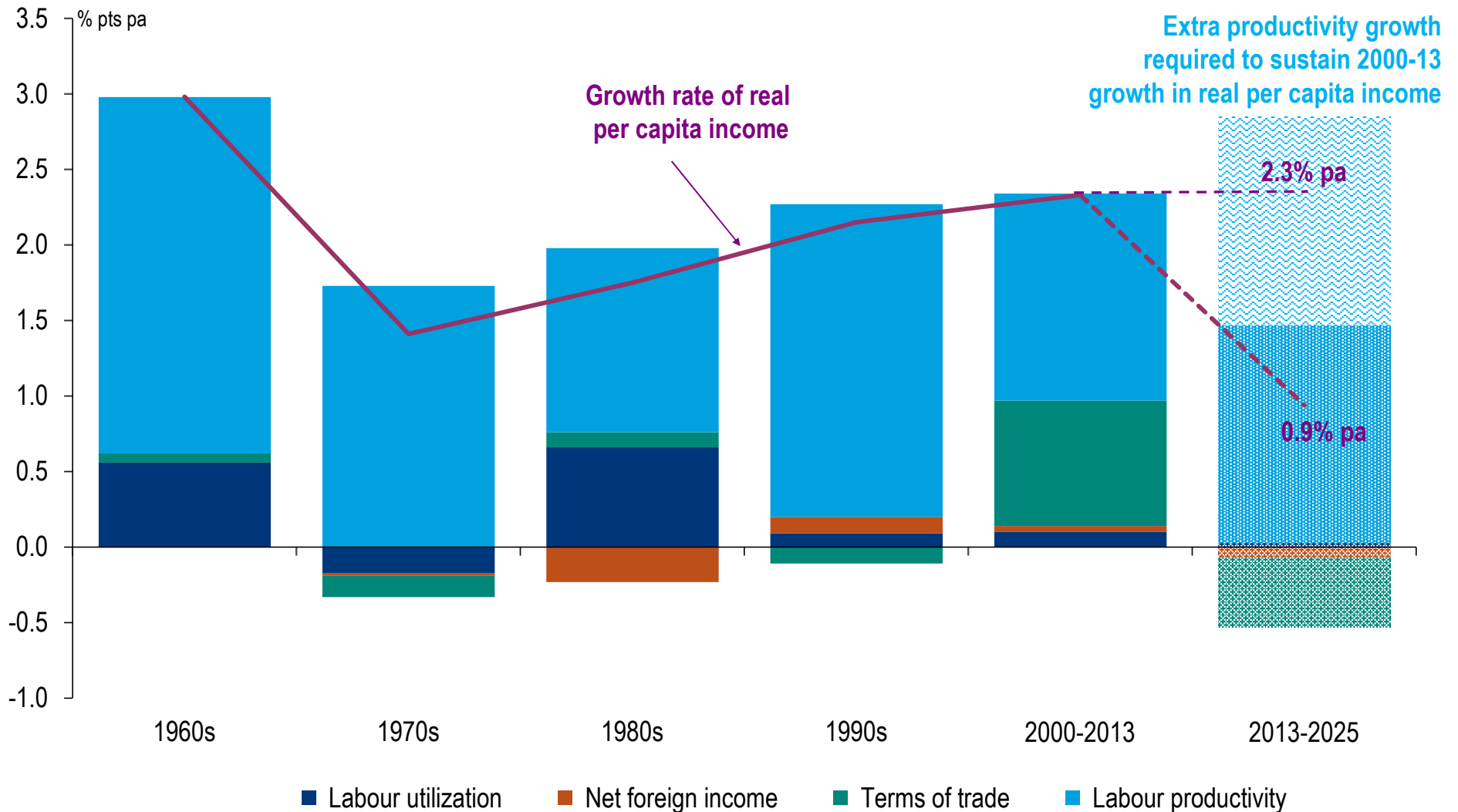
# Australia has considerable scope to use fiscal policy to ameliorate the effects of any significant negative economic shocks

**'General government' net debt – Australia vs other 'advanced' economies  
2010-2020**



# The most likely scenario for Australia's economy after the resources boom is an extended period of slow growth

## Sources of growth in Australian real gross national income per capita



## Summary – an Australian recession is distinctly possible, but it's not the most probable scenario

- ❑ In a purely chronological sense, Australia is 'overdue' for a recession
  - but the business cycle doesn't behave according to the dictates of the calendar
- ❑ Every previous Australian 'commodities boom' has been followed by a recession, and the most recent 'resources boom' was the biggest of them all
  - but every previous 'commodities boom' led to double-digit inflation, whereas the most recent one didn't
- ❑ Australia is much more exposed to a sharp slowdown (or recession) in China than ever before
  - it would be foolish to discount that possibility entirely, but it's not the most likely scenario
- ❑ Previous Australian recessions have all been preceded by a period of high interest rates (by the standards of the time)
  - whereas Australian interest rates are currently at record lows, and are unlikely to rise to high levels (by recent standards) in the foreseeable future
- ❑ Record-low interest rates and (belatedly) a lower exchange rate are helping to offset the effects of the end of the resources boom – especially on employment
- ❑ Australia has room to use fiscal policy, and to allow the A\$ to fall further, in response to further adverse economic shocks
- ❑ The most likely medium-term scenario for Australia is an extended period of sub-par economic growth – not a recession

# Important information

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