

AUSTRALIA'S ECONOMIC HORIZON

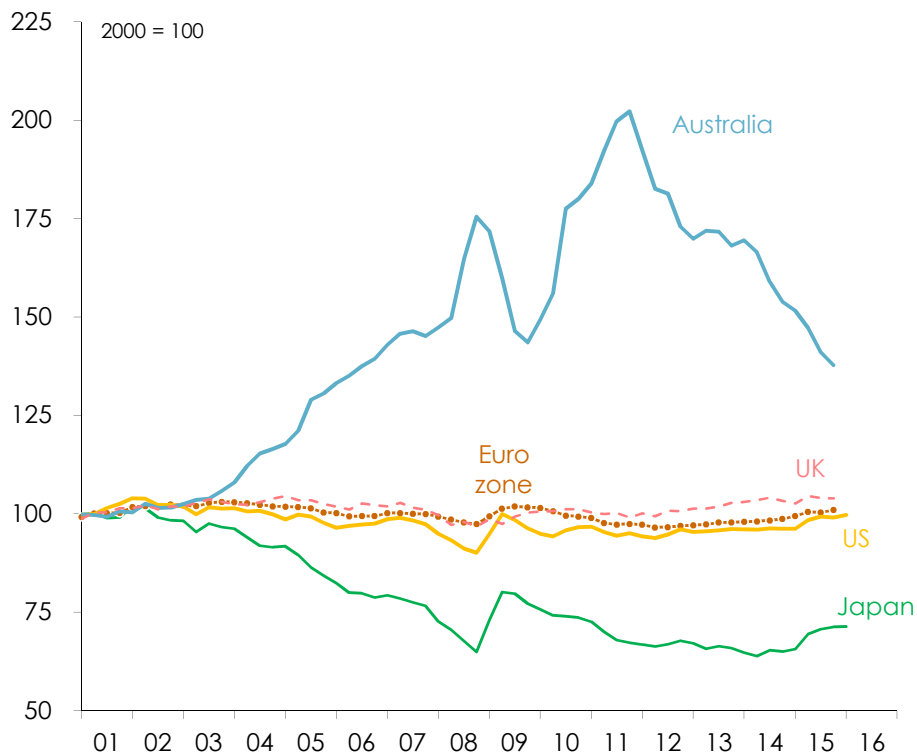
PRESENTATION TO ABARES OUTLOOK 2016 CONFERENCE

– NATIONAL CONVENTION CENTRE, CANBERRA

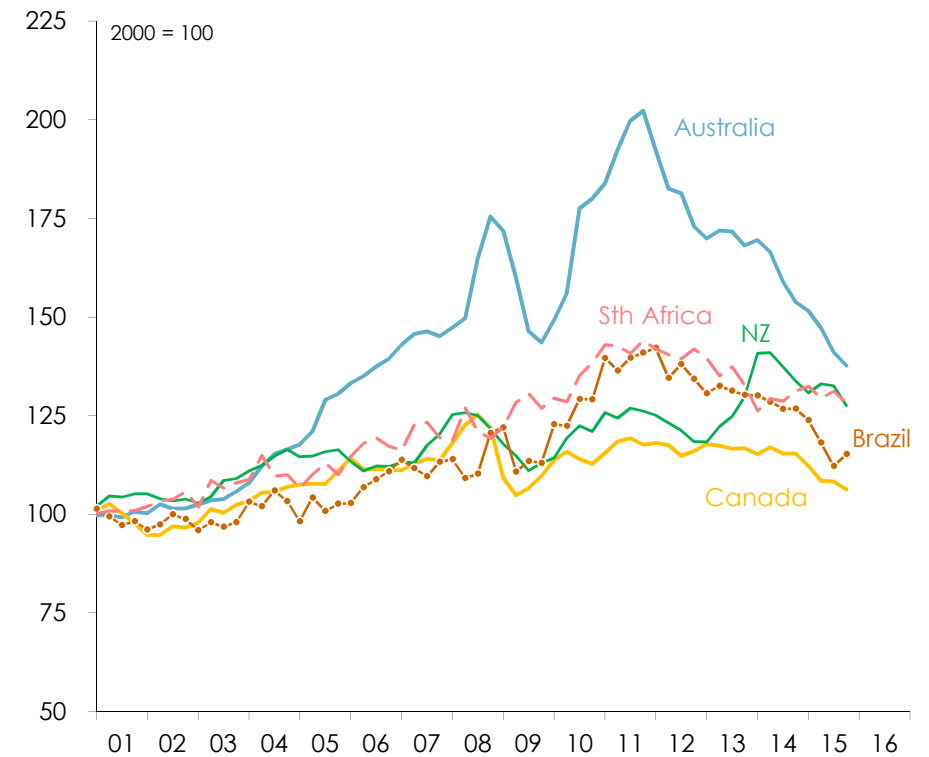
1ST MARCH 2016

Australia probably derived more benefit from Chinese growth and industrialization than any other nation on earth

Terms of trade – Australia vs other 'advanced' economies



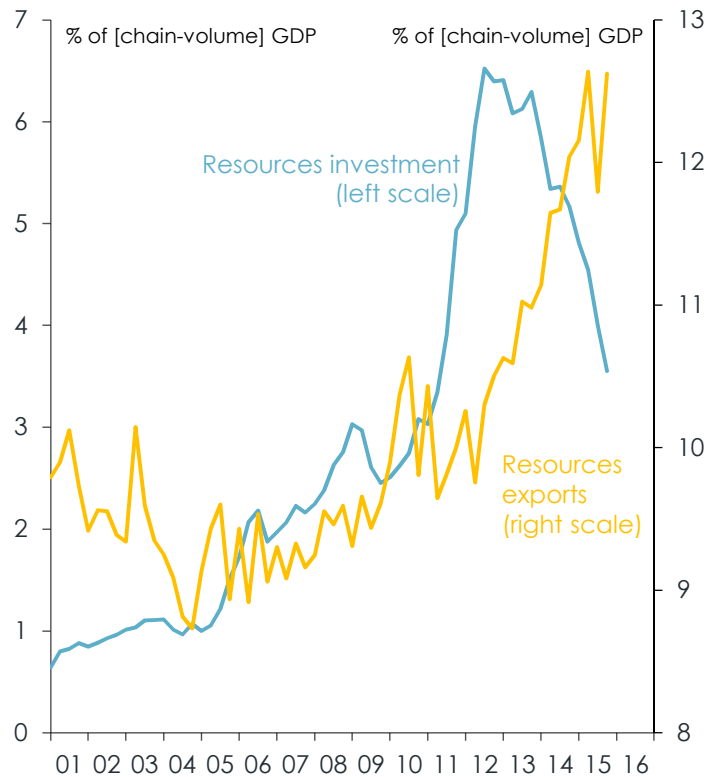
Terms of trade – Australia vs other commodity-exporting economies



Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services.
Sources: ABS; US Bureau of Economic Analysis; Eurostat; UK Office for National Statistics; Japan Economic & Social Research Institute; Statistics NZ; Statistics Canada; Statistics South Africa; Instituto Brasileiro de Geografia e Estatística; author's calculations.

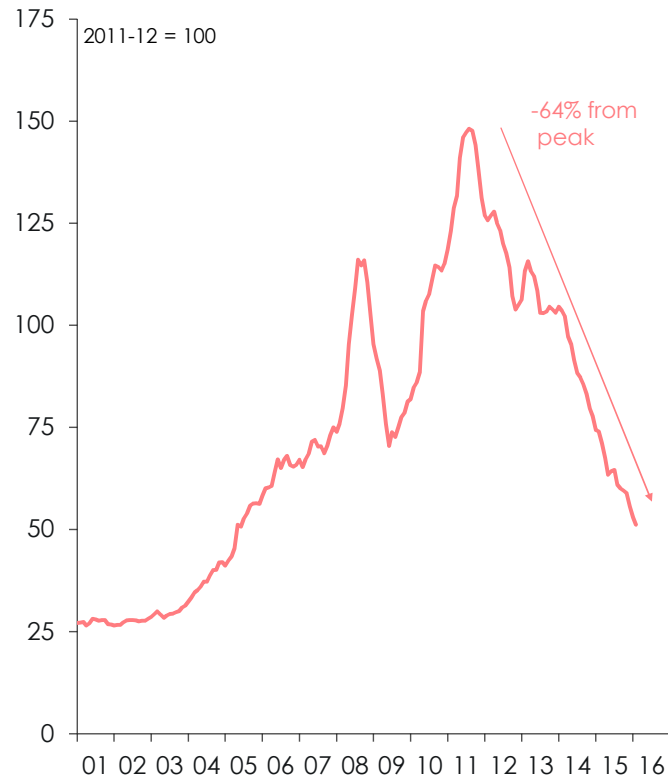
The resources investment boom is over – and while resources exports are rising, they are at falling prices and don't employ as many workers

Australia's resources investment & export volumes

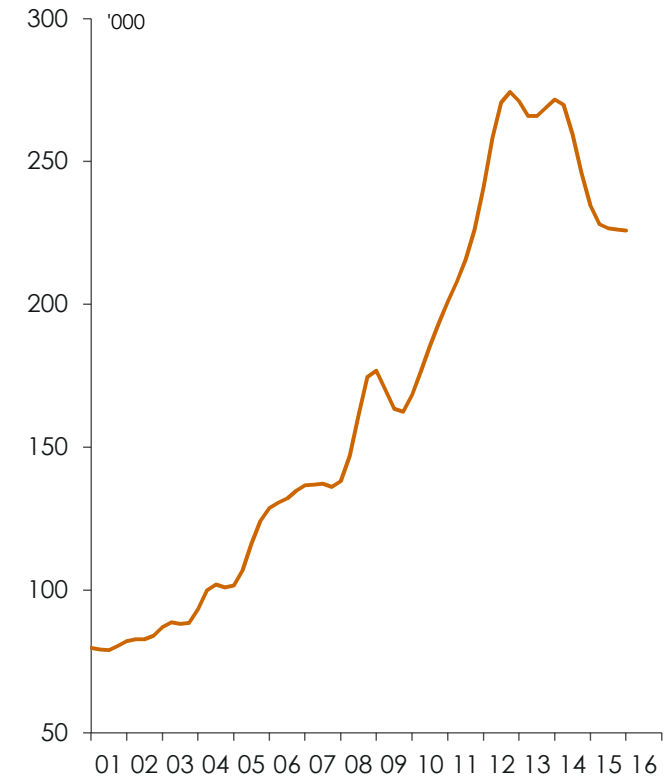


Note: Resources investment includes exploration expenditure.
Source: ABS.

Australia's resources export prices

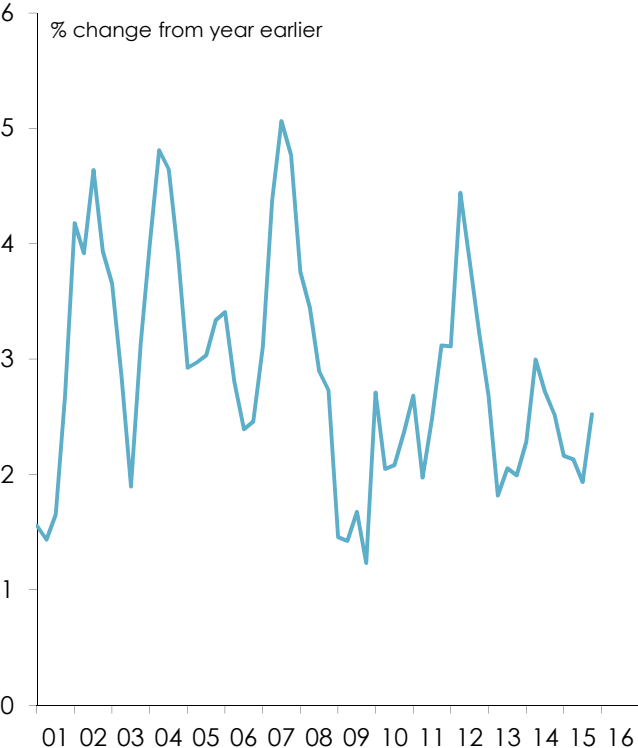


Australia's mining sector employment

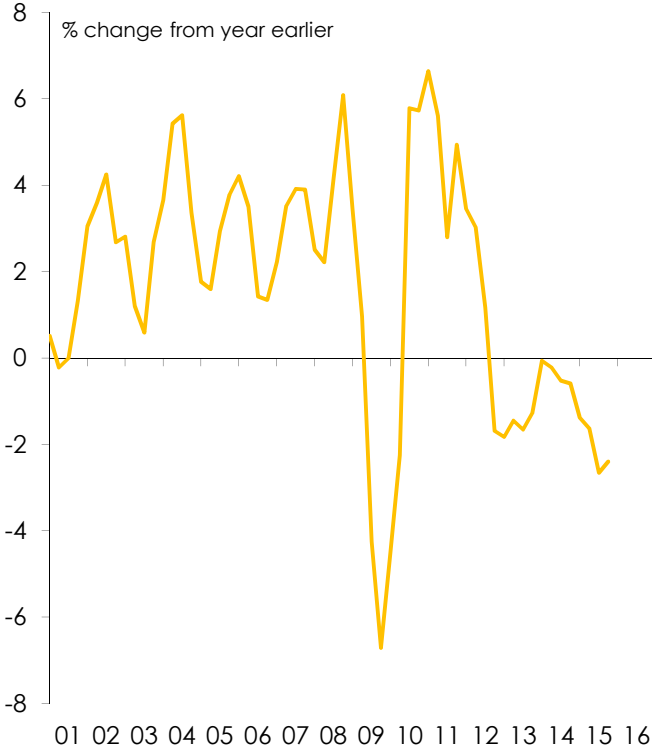


Australia has experienced sub-trend growth, declining real per capita incomes and rising unemployment since commodity prices peaked

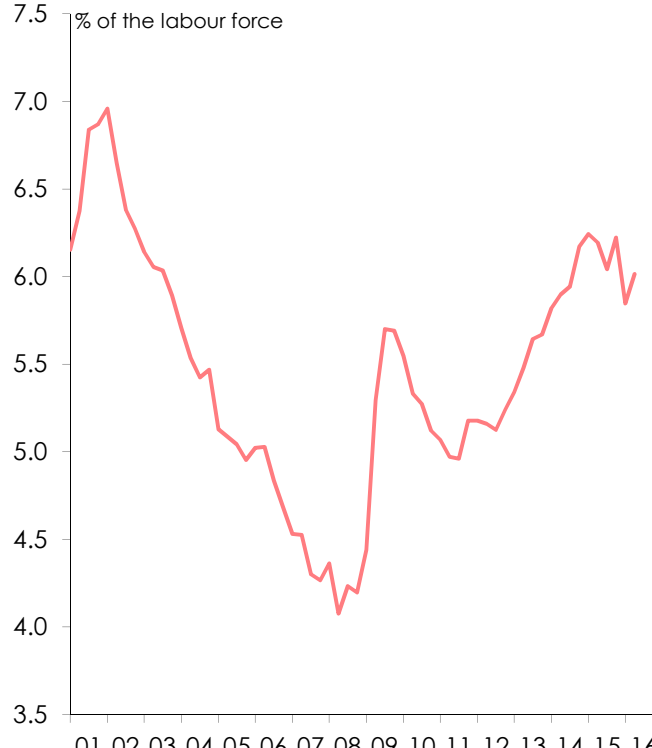
Australia – real GDP growth



Growth in real net national disposable income per head



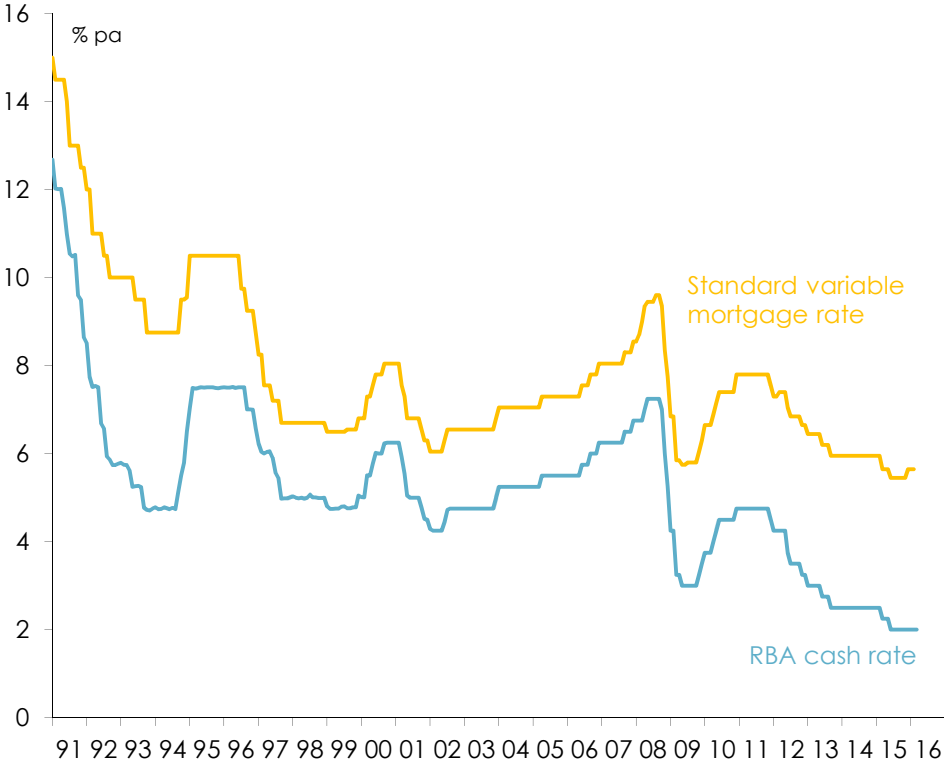
Unemployment rate



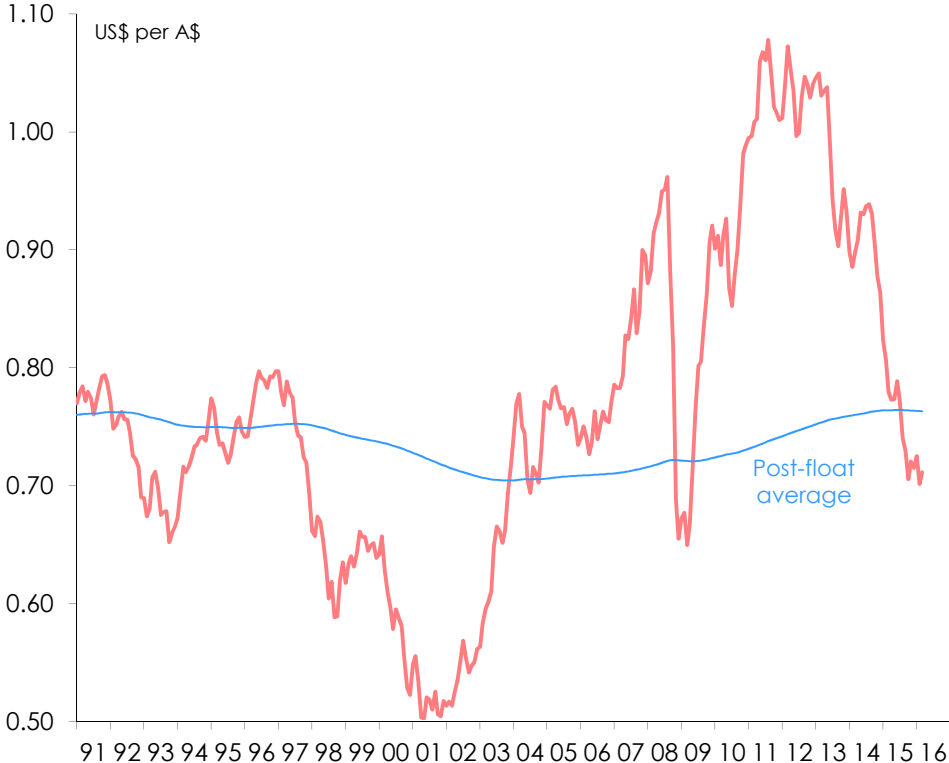
Note: Real net national disposable income (NNDI) is real GDP adjusted for changes in the terms of trade, minus net factor income and transfers overseas, minus depreciation. Source: ABS.

Australia is relying on record-low interest rates and a (now) below-its-long-term-average Australian dollar to support economic growth

Australian interest rates



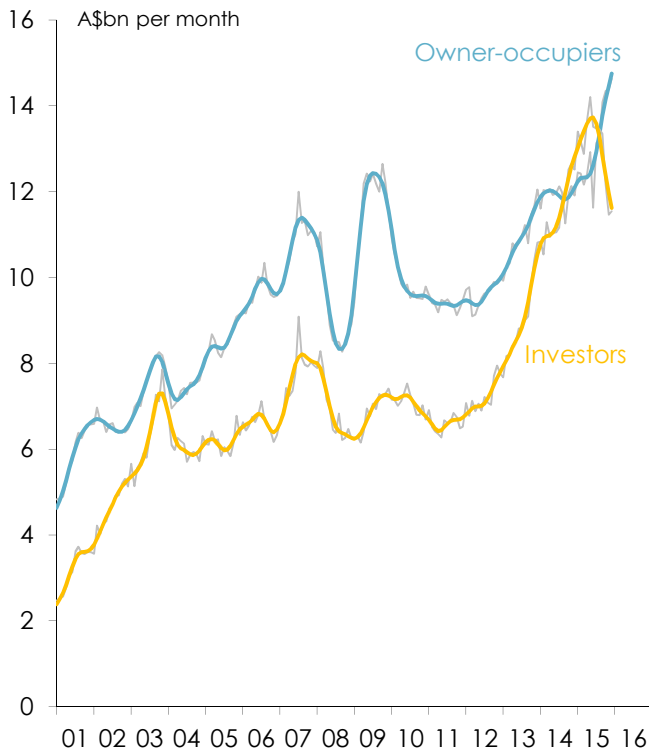
Australian dollar



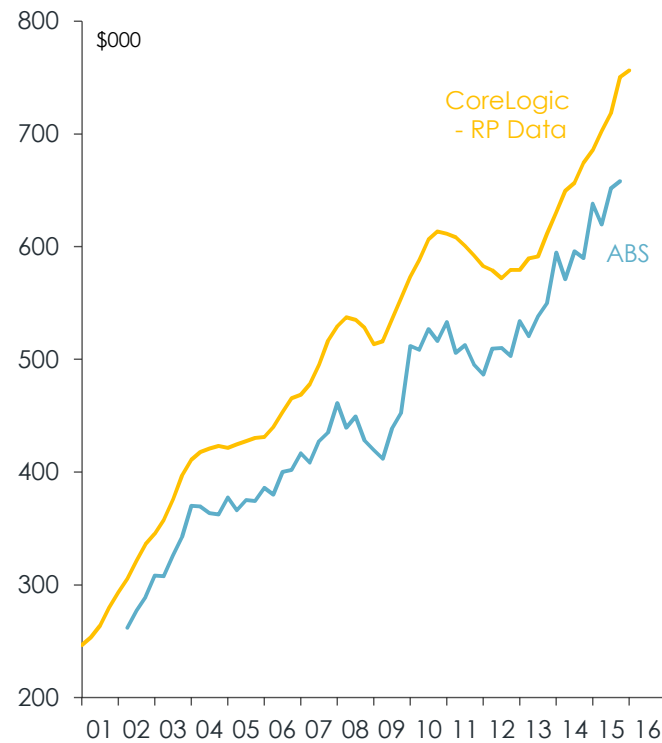
Source: Reserve Bank of Australia.

Record-low interest rates stimulated a substantial rise in housing demand, housing prices and (eventually) housing supply

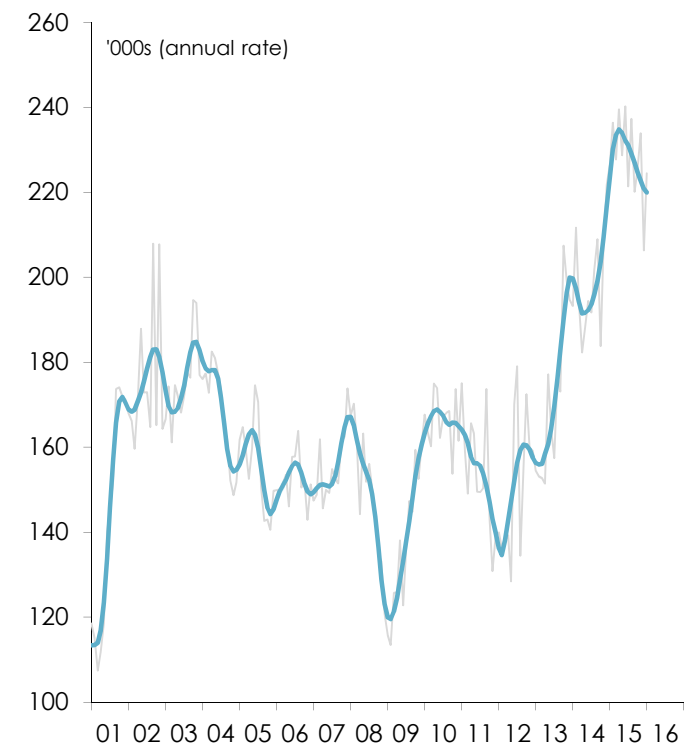
Lending for housing



Capital city residential property prices



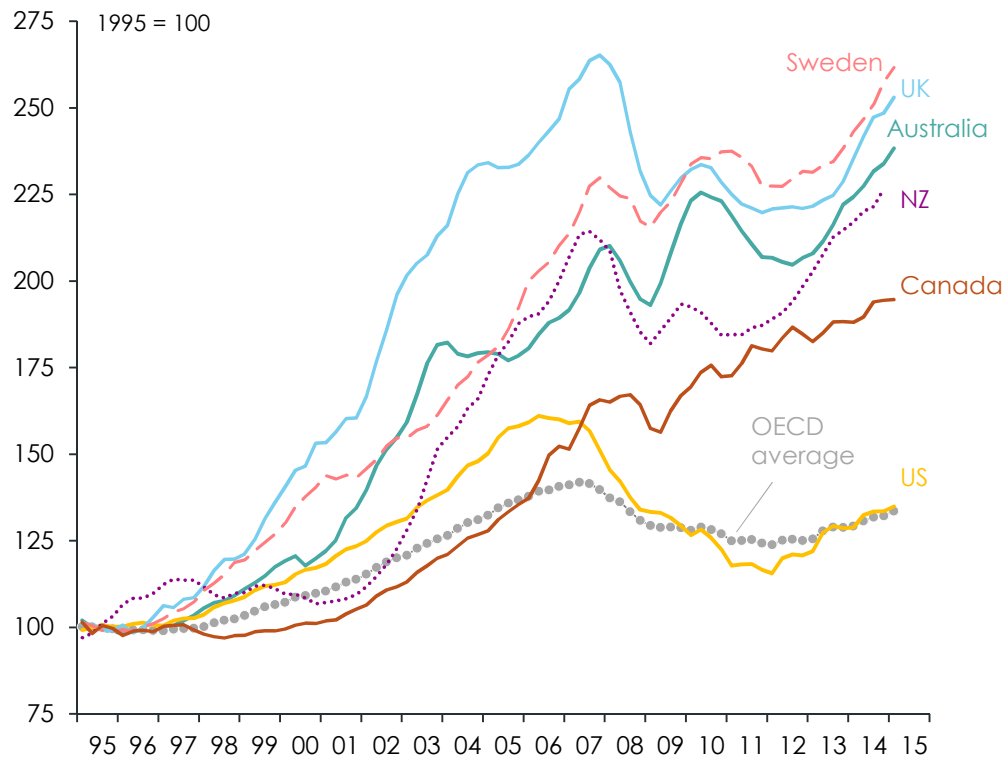
Residential building approvals



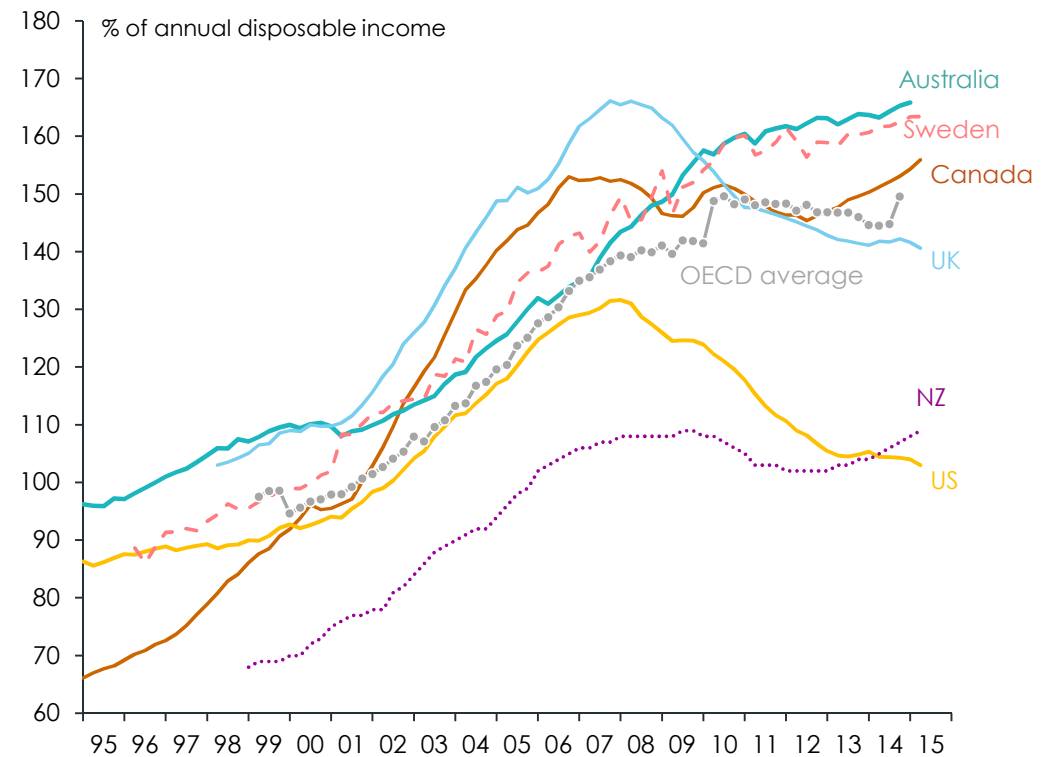
Note: grey lines in first and third charts above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'. Sources: ABS; CoreLogic - RP Data.

Australia now has relatively high residential property prices (by international standards) and very high levels of household debt

Real house prices – Australia vs other 'advanced' economies



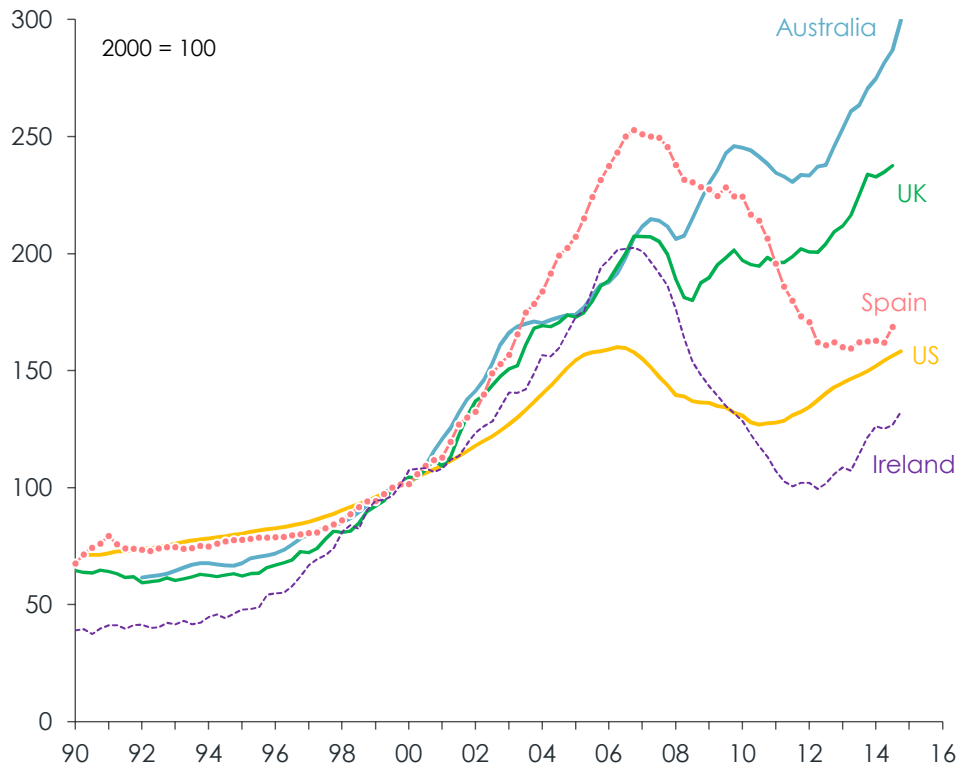
Household debt – Australia vs other 'advanced' economies



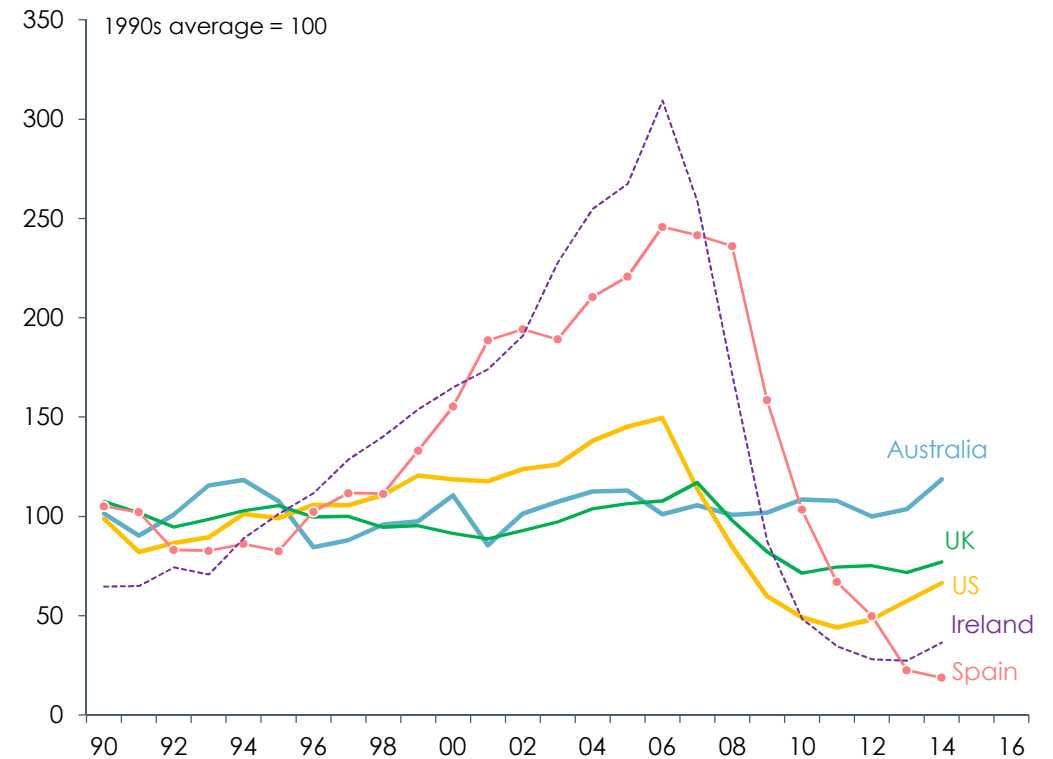
Note: OECD average for household debt to income ratio based on a limited number of countries.
Source: International Monetary Fund, *Australia: Selected Issues*, Country Report No. 15/275 (September 2015), p. 4.

Overseas experience suggests that housing 'busts' occur when demand declines abruptly after an extended period of rapid growth in supply

House prices – Australia and other selected 'advanced' economies



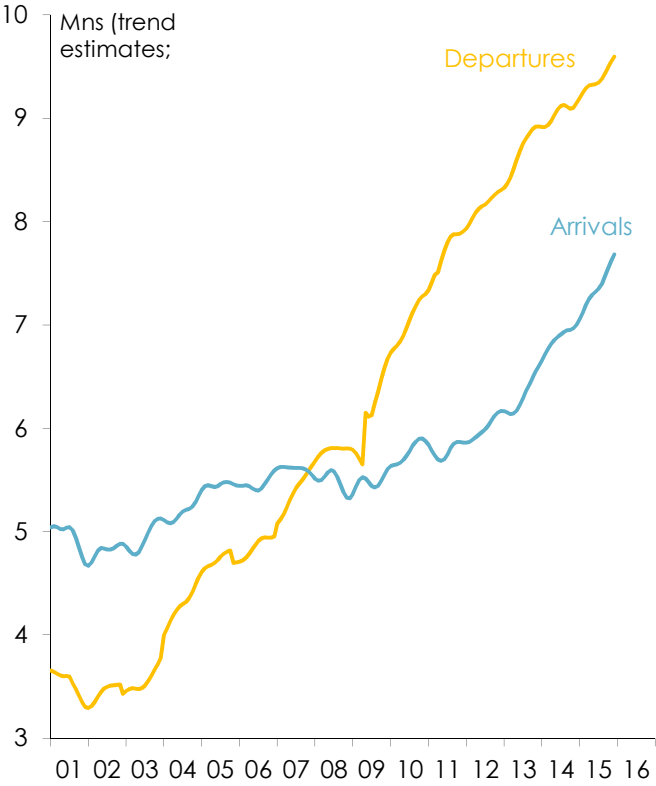
Housing completions – Australia and other selected 'advanced' economies



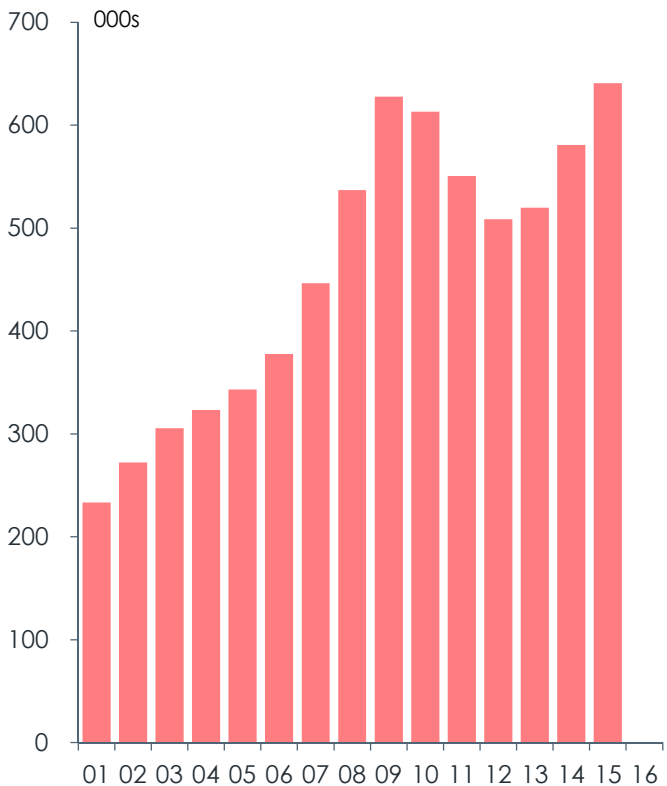
Sources: ABS; US Commerce Department; UK Office for National Statistics; Eurostat; CoreLogic; S&P; Bank for International Settlements;

The fall in the A\$ has had a substantial influence on the tourism and education sectors

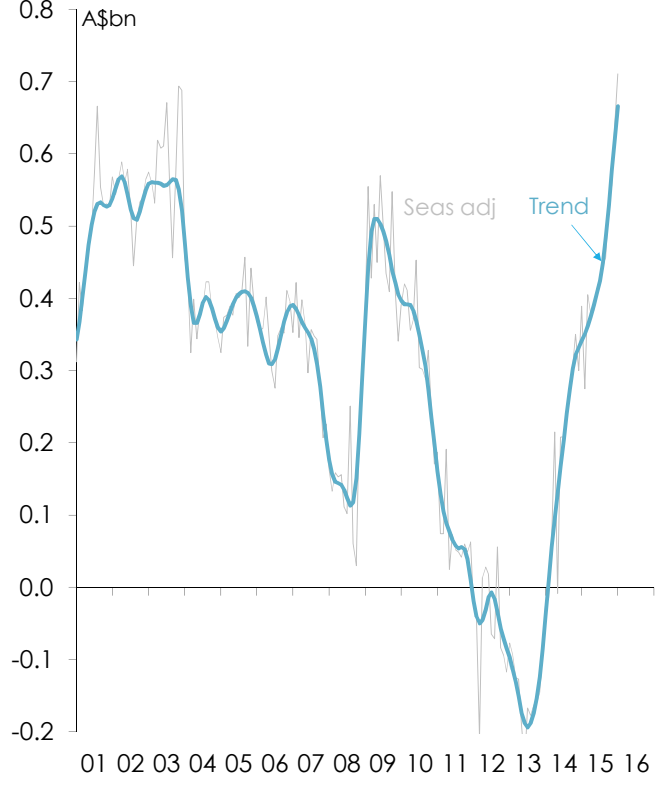
Short-term overseas arrivals and departures



Overseas student enrolments



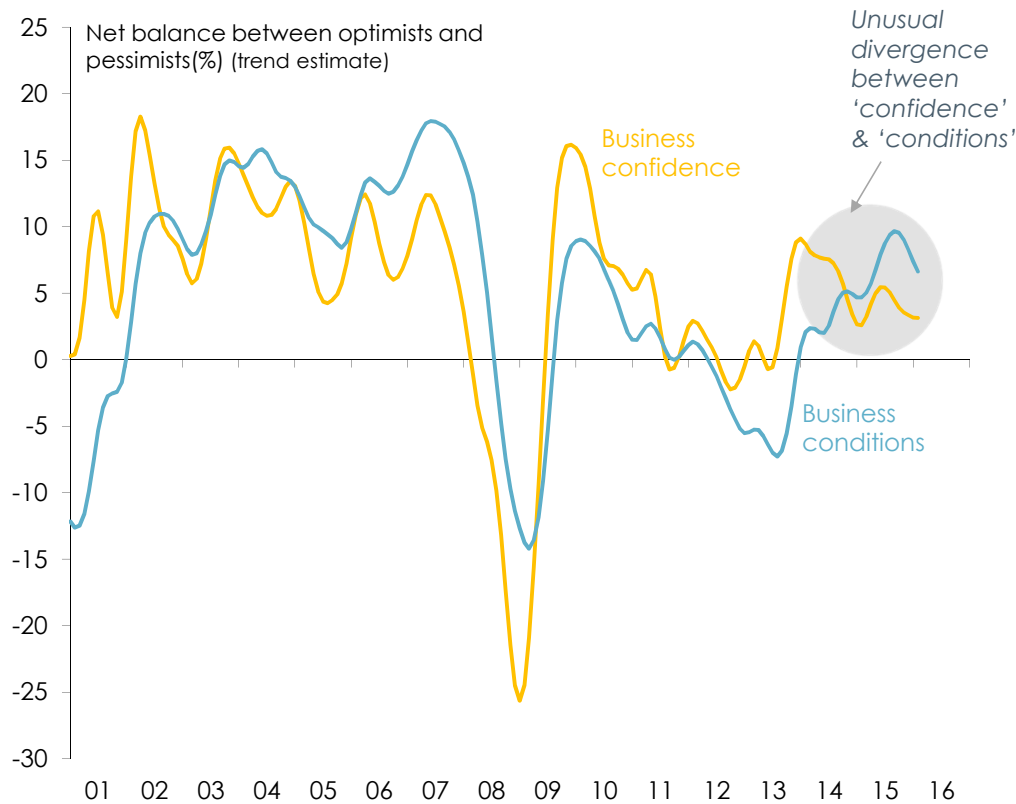
Travel-related services trade balance



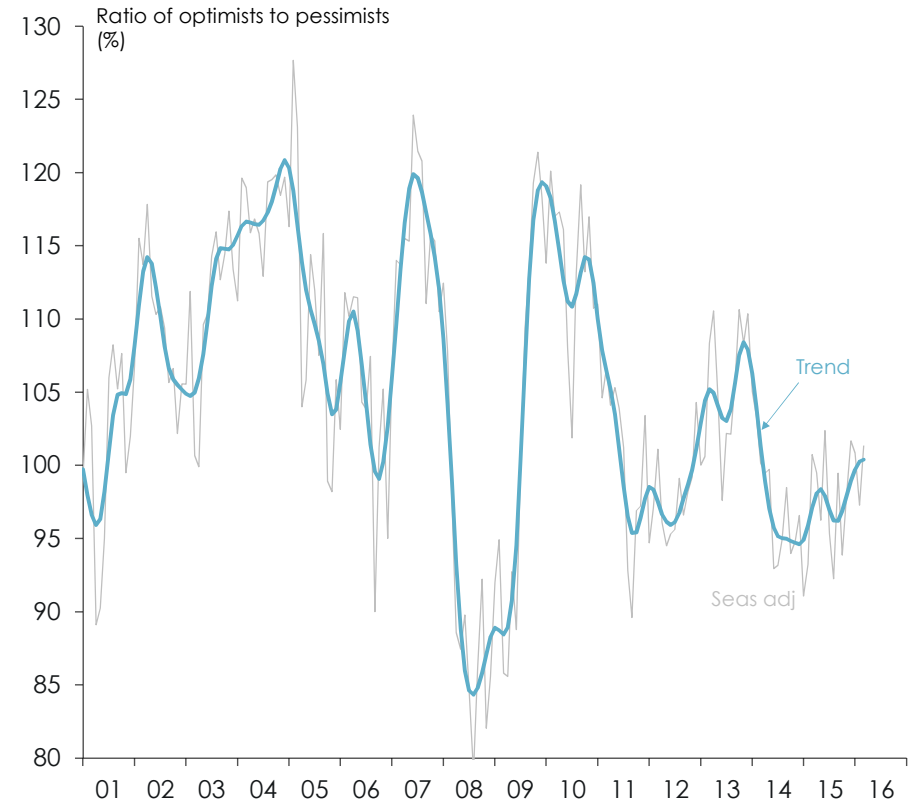
Note: The number of overseas student enrolments shown in the second chart exceeds the number of overseas students in Australia, since some students are enrolled in more than one category (eg higher education and English language). 'Travel-related services' includes accommodation, transport and food services provided to foreign students as well as tourists. Sources: ABS; Australian Department of Education and Training.

It's possible that last year's change in political leadership could have a meaningful (positive) effect on business and consumer confidence

Business confidence and conditions



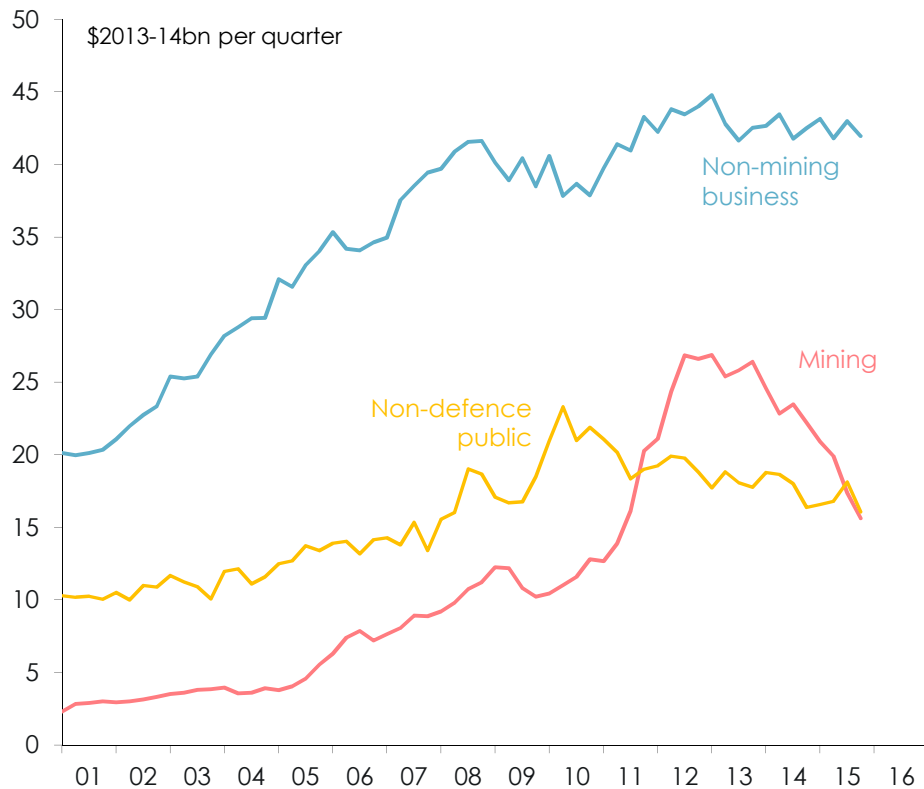
Consumer confidence



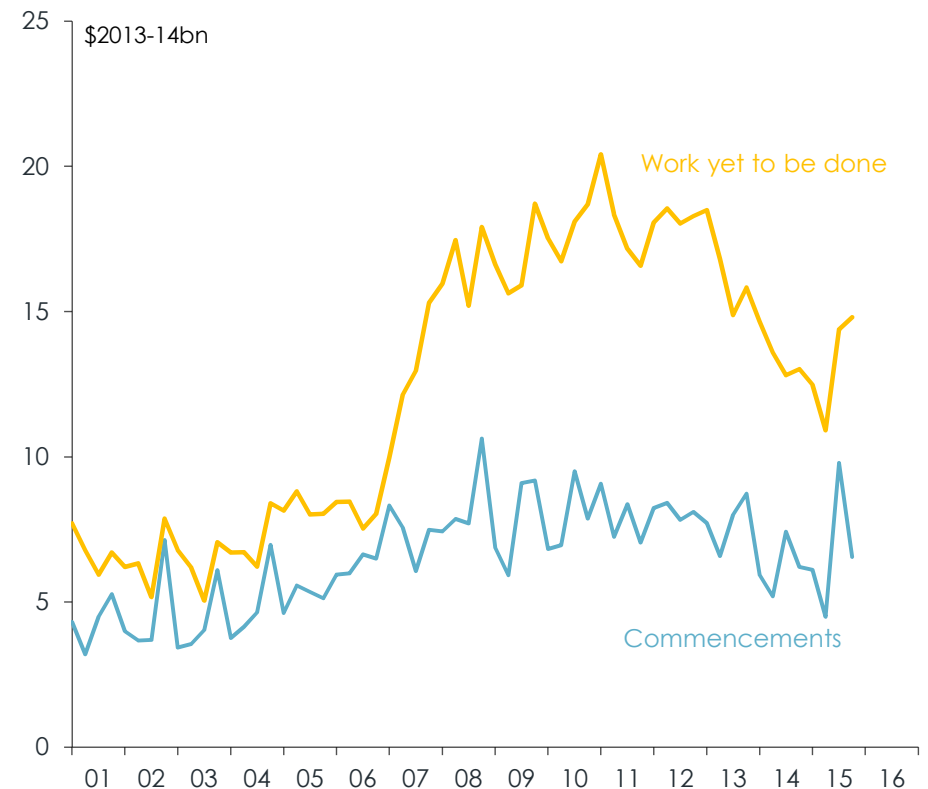
Source: National Australia Bank Monthly Business Survey; Westpac-Melbourne Institute.

Improved business confidence would help lift non-mining business investment - infrastructure investment would help too

Capital investment, by sector



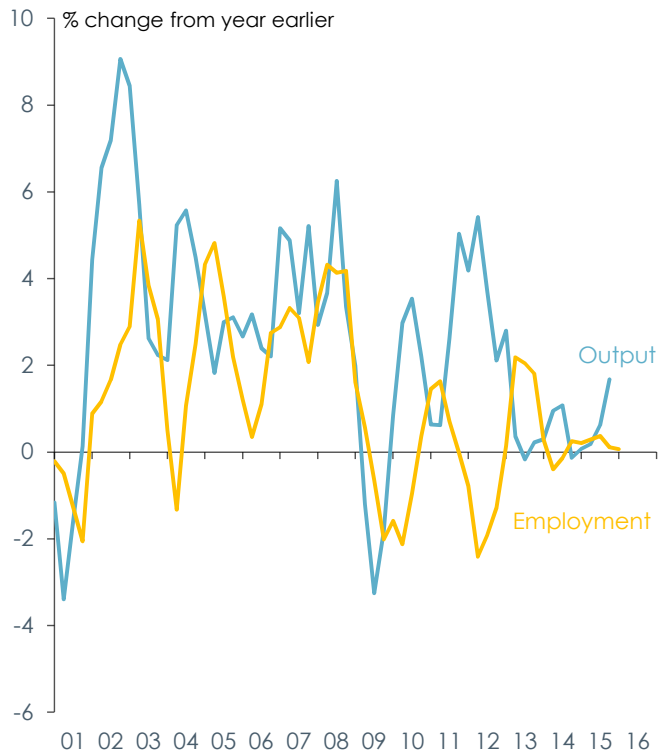
Public sector infrastructure spending



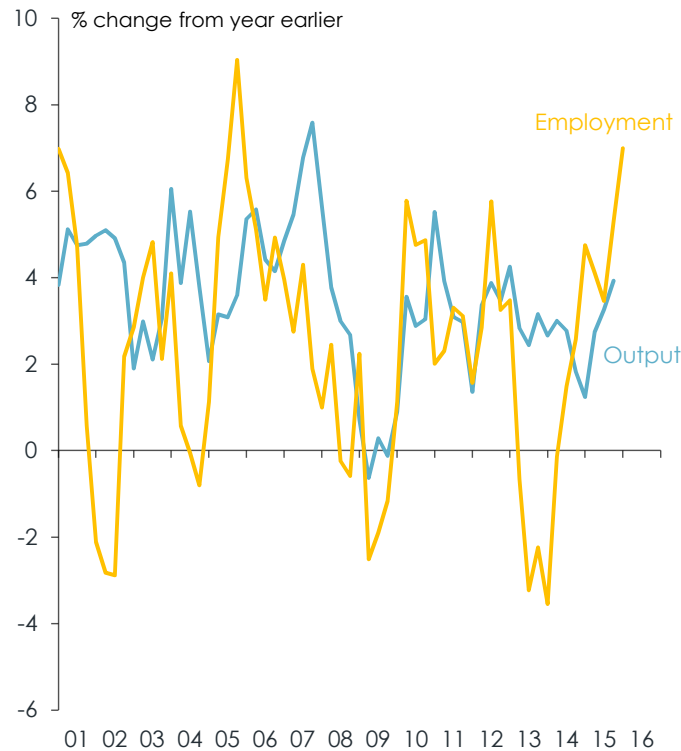
Note: Public sector infrastructure spending includes work done by the private sector for the public sector. Source: ABS.

Household and business services sectors are doing well; goods-producing and distribution sectors (mining and non-mining) are struggling

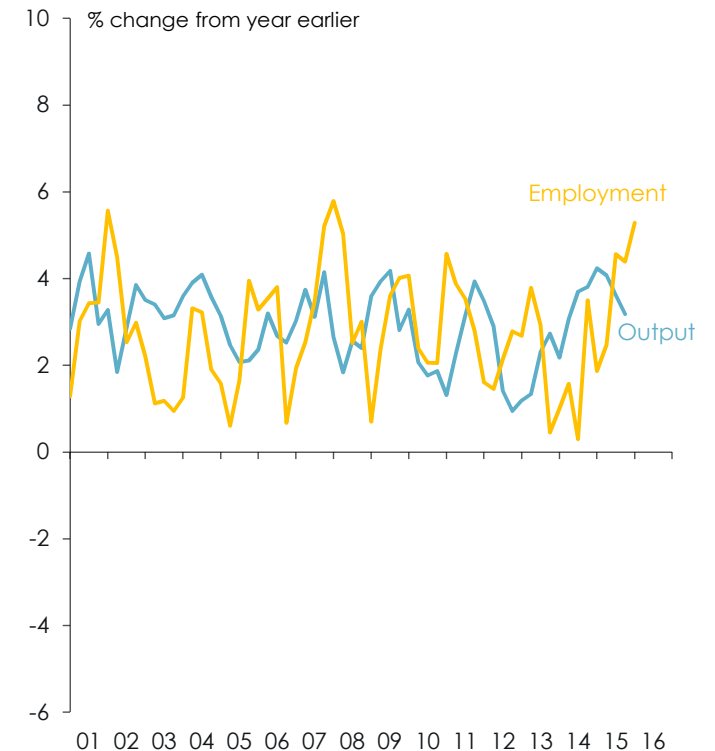
Goods (excluding mining)



Business services



Household services

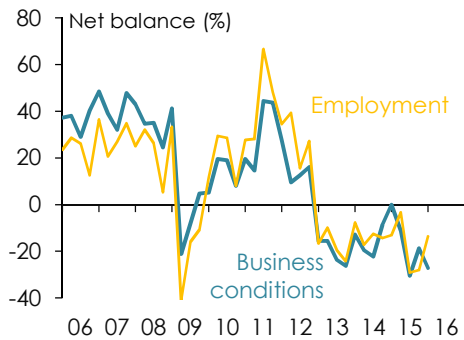


Note: 'Goods' sector includes manufacturing; electricity, gas, water & waste services; construction; transport, postal & warehousing; wholesale trade; and retail trade. 'Business services' includes professional, scientific & technical services; finance & insurance; administration & support services; rental hiring and real estate services; and information, media & telecommunications. 'Household services' includes accommodation & food services; education & training; health care & social services; arts & recreation; & other services. Not included are agriculture, forestry & fishing; mining; and public administration & safety. Source: ABS.

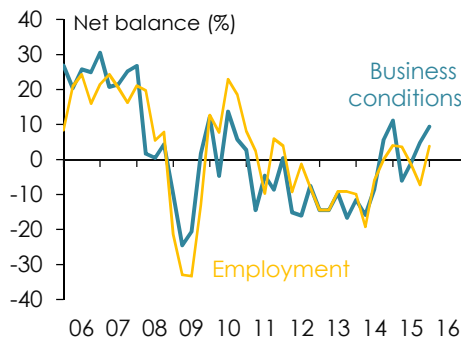
Private sector surveys present a broadly similar picture of goods-producing sectors struggling but construction and services doing well

Actual and expected economic conditions

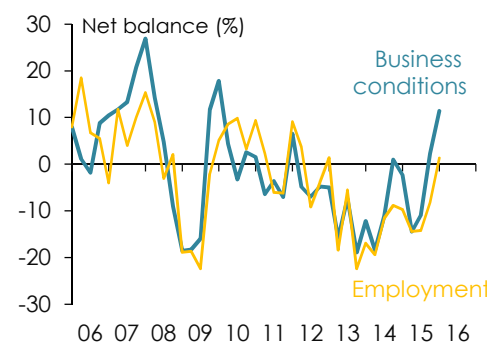
Mining



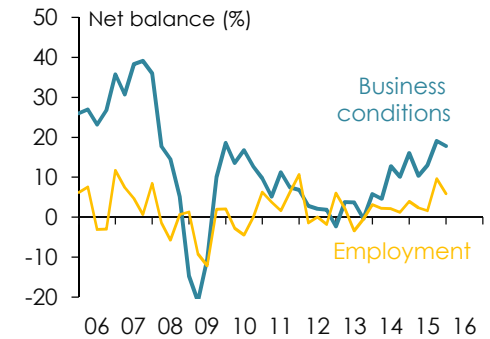
Construction



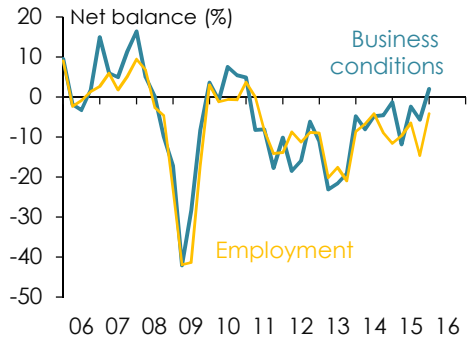
Wholesale trade



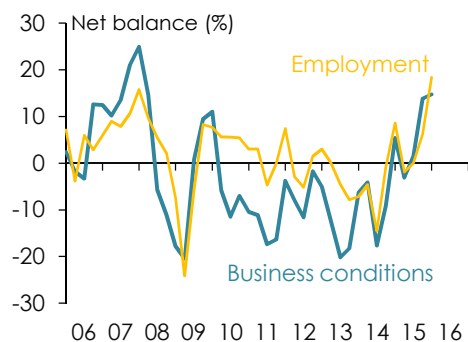
Finance



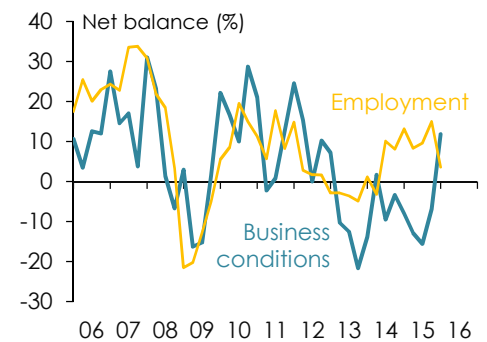
Manufacturing



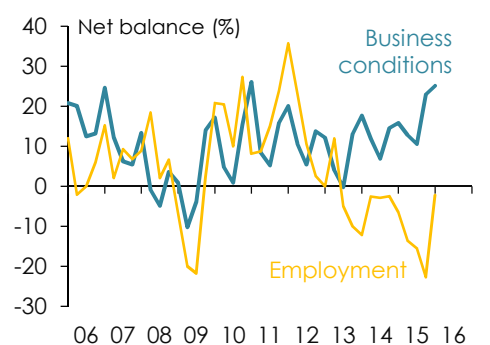
Transport



Retail trade



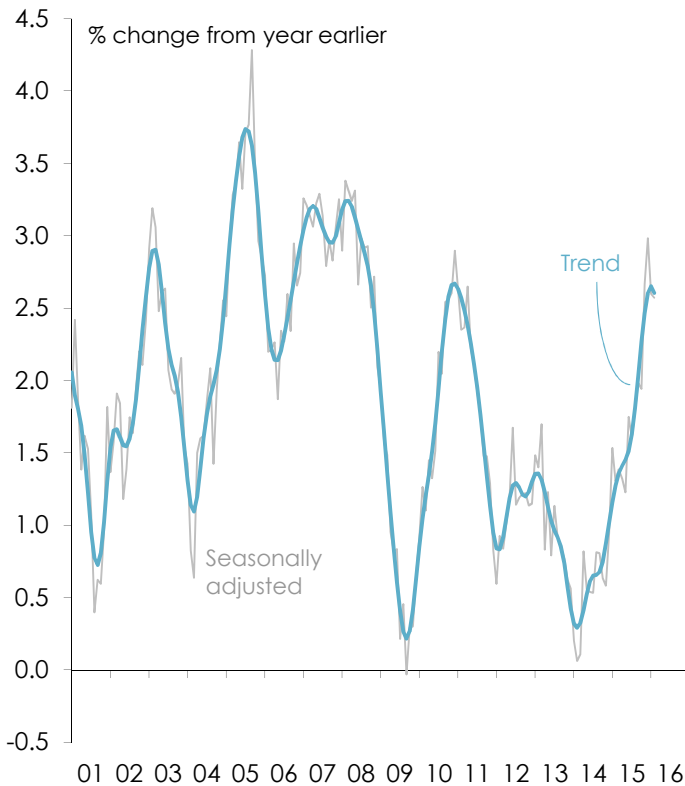
Recreation



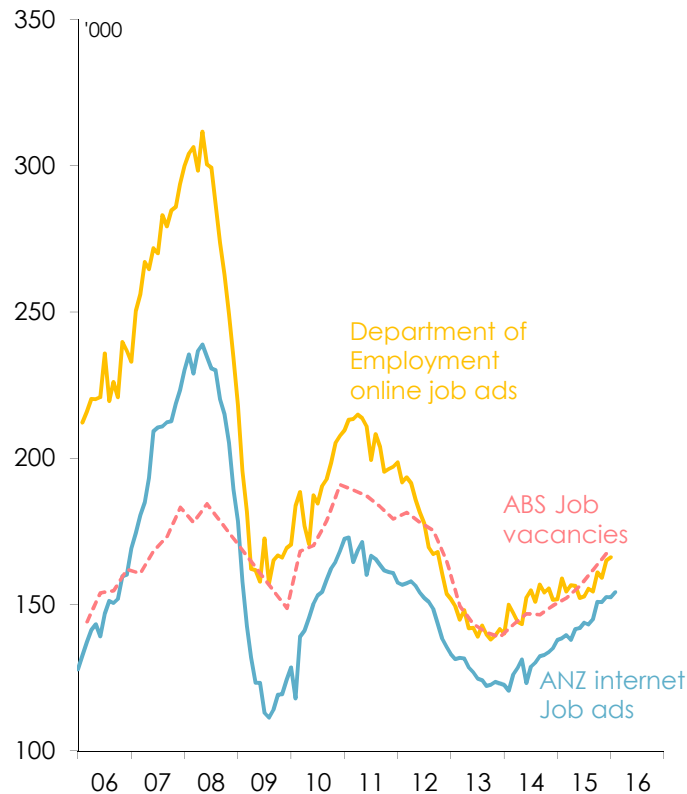
Source: National Australia Bank Quarterly Business Survey.

Because the (growing) services sectors are more labour-intensive than (struggling) goods-producing sectors, employment growth has picked up

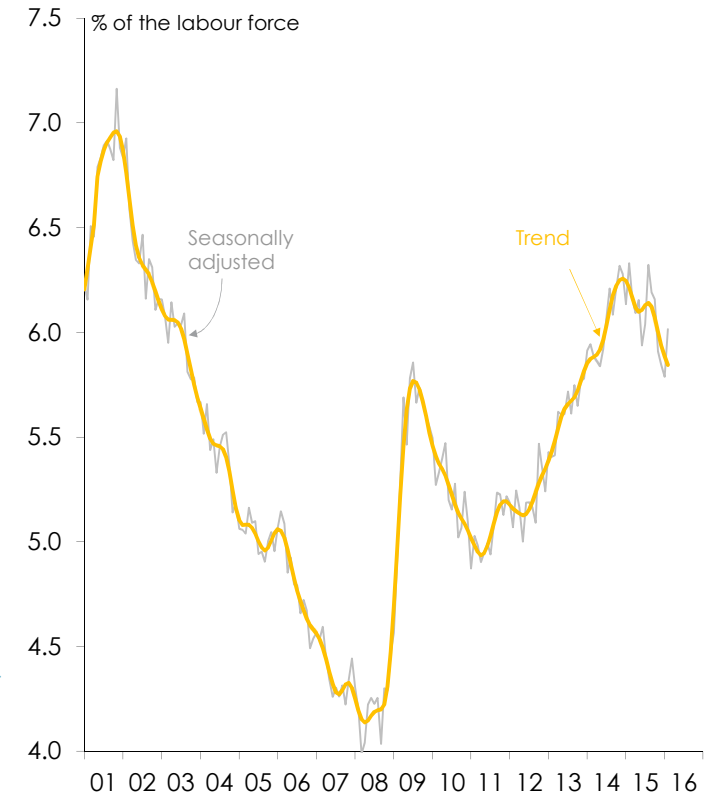
Employment growth



Job vacancies & advertisements



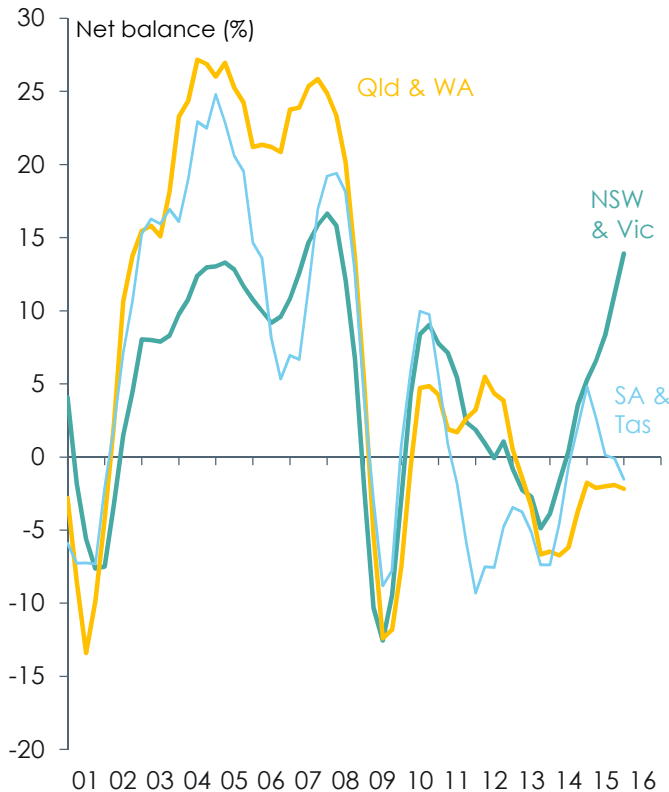
Unemployment rate



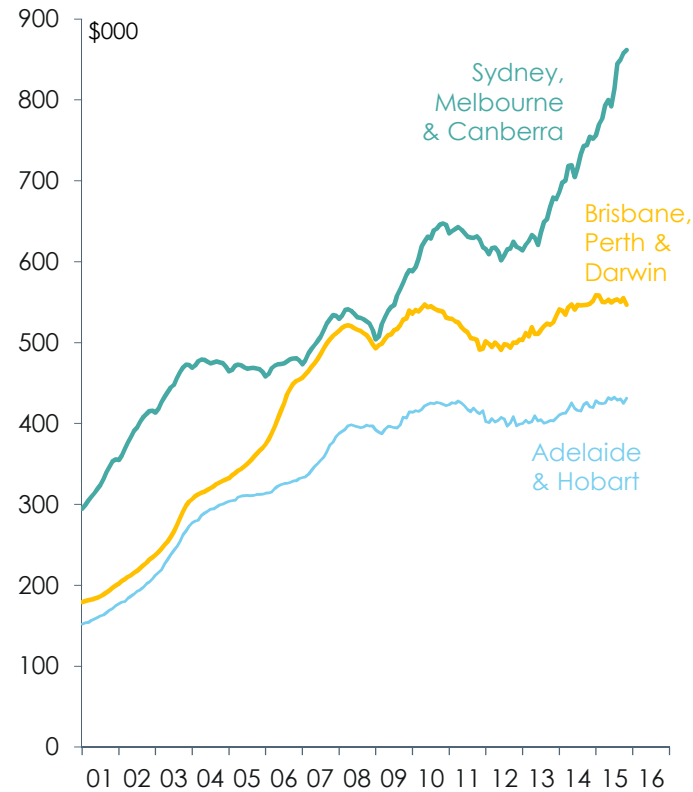
Sources: ABS; Australian Government Department of Employment; ANZ Bank.

Growth leadership has passed from the 'resources States' to the major south-eastern States

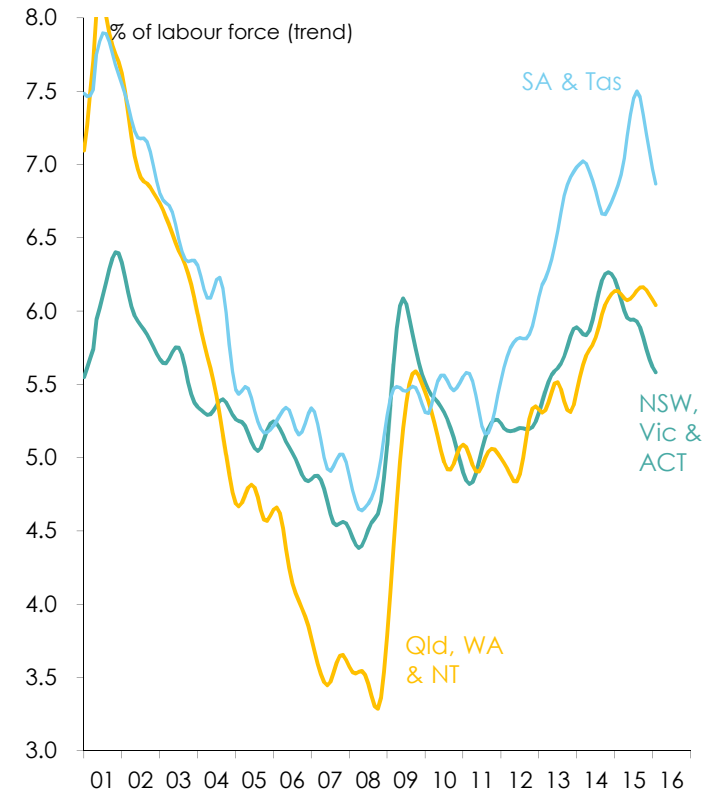
Business conditions



Residential property prices



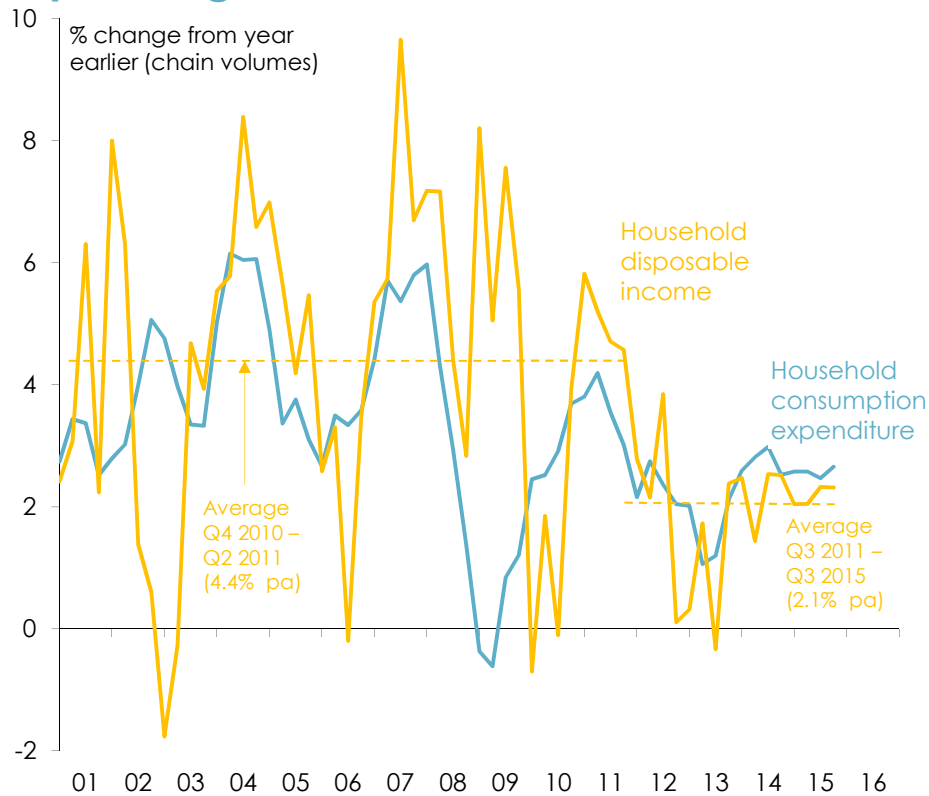
Unemployment rate



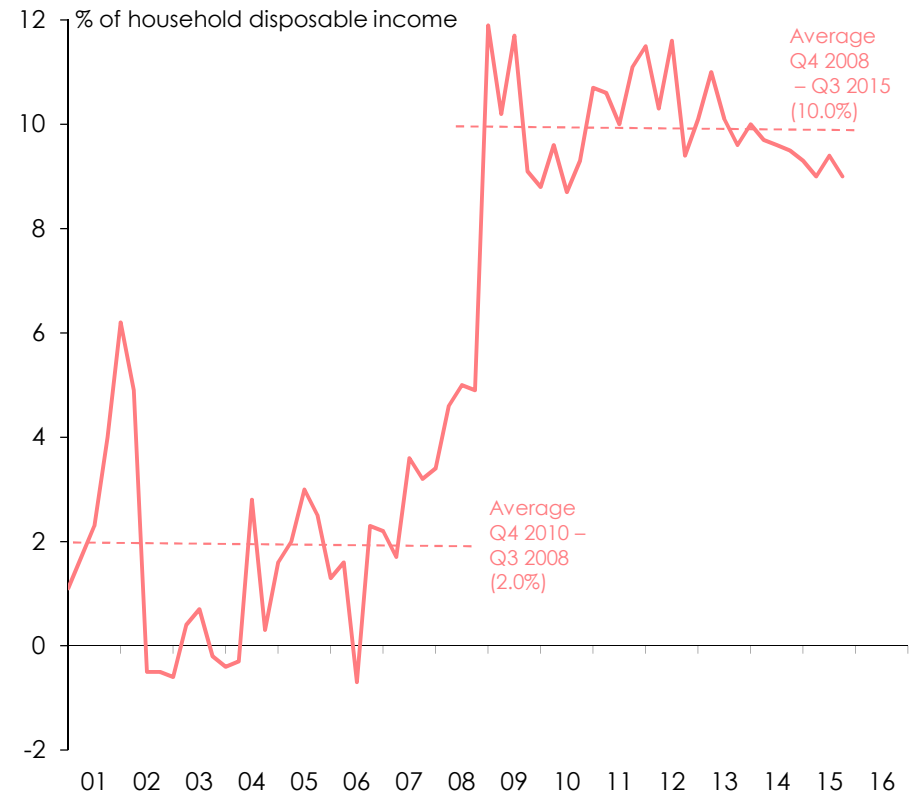
Note: Business conditions and capital city property prices are weighted by State or Territory shares of GDP. Sources: National Australia Bank; CoreLogic – RP Data; ABS; author's calculations.

Household income is growing much more slowly than before the financial crisis and peak in the terms of trade – and households are saving more

Real household disposable income and spending



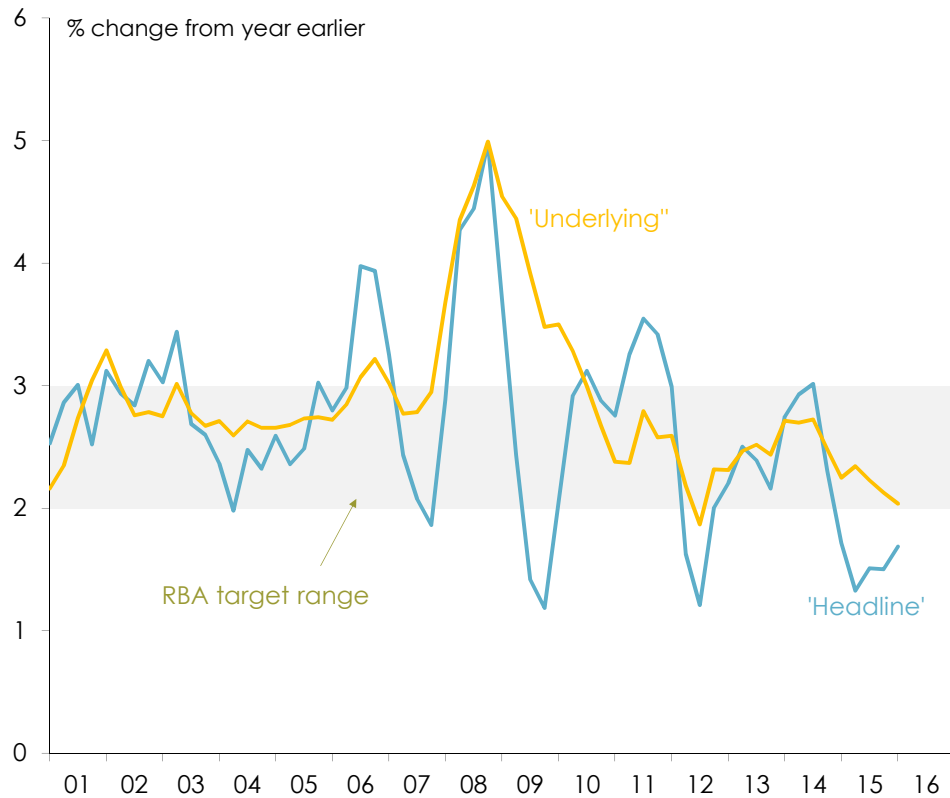
Household saving



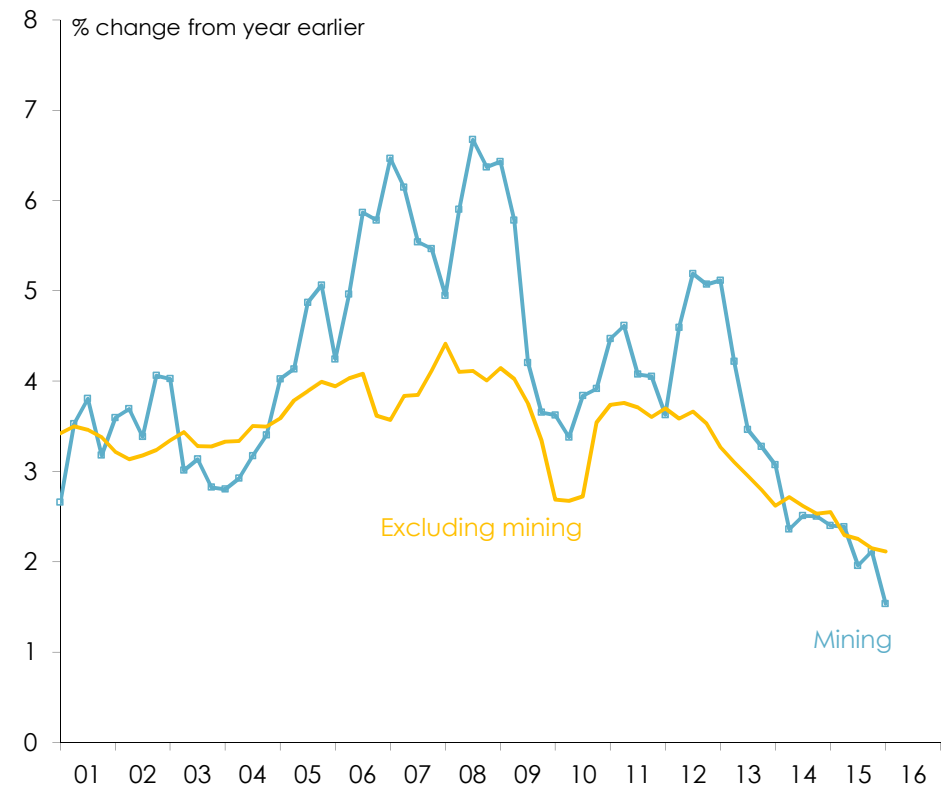
Sources: ABS.

Sustained low inflation gives the RBA 'room' to cut interest rates again 'if needed' – but it probably won't be

Consumer prices



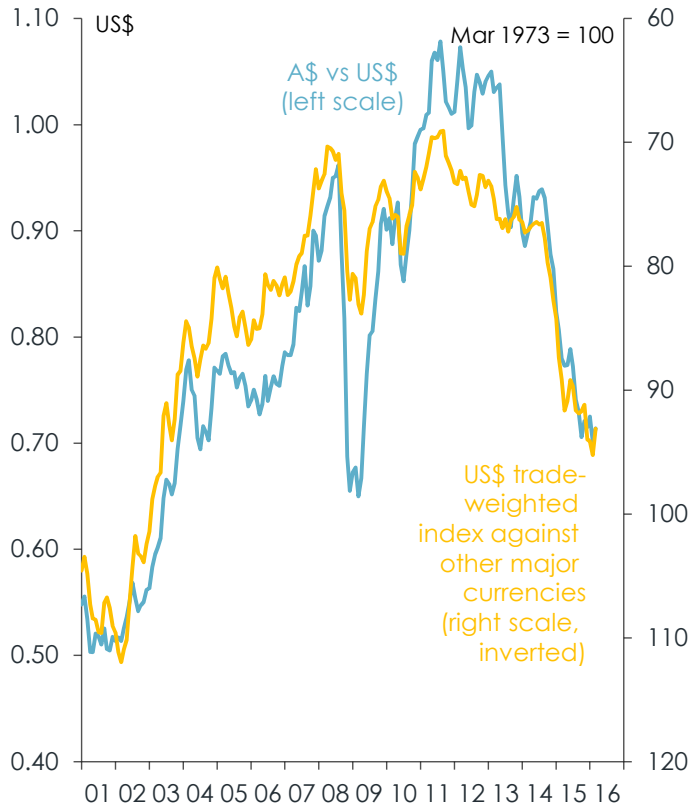
Wage costs



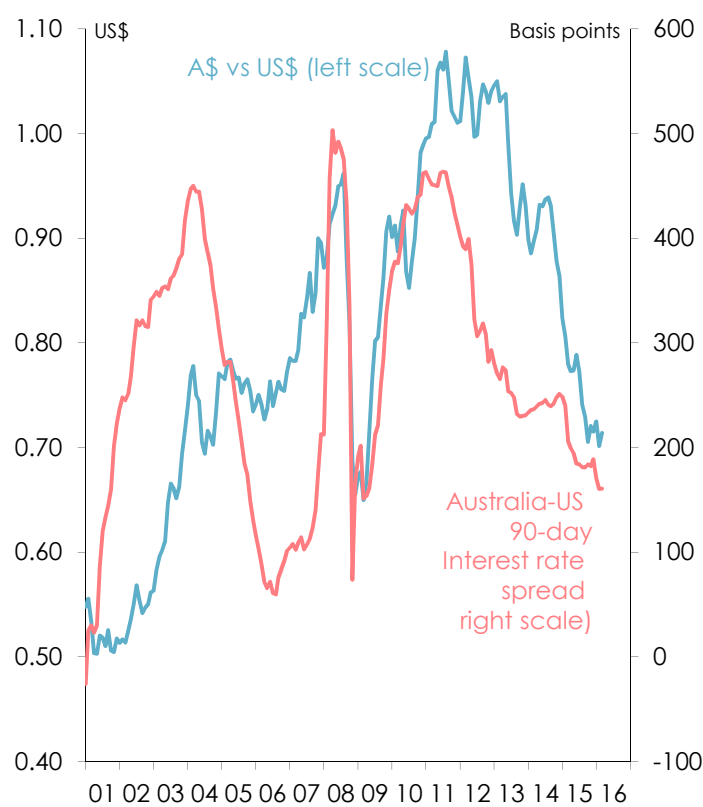
Sources: ABS; Reserve Bank of Australia.

The A\$ is likely to fall further as the US\$ and US interest rates rise, and commodity prices continue to decline

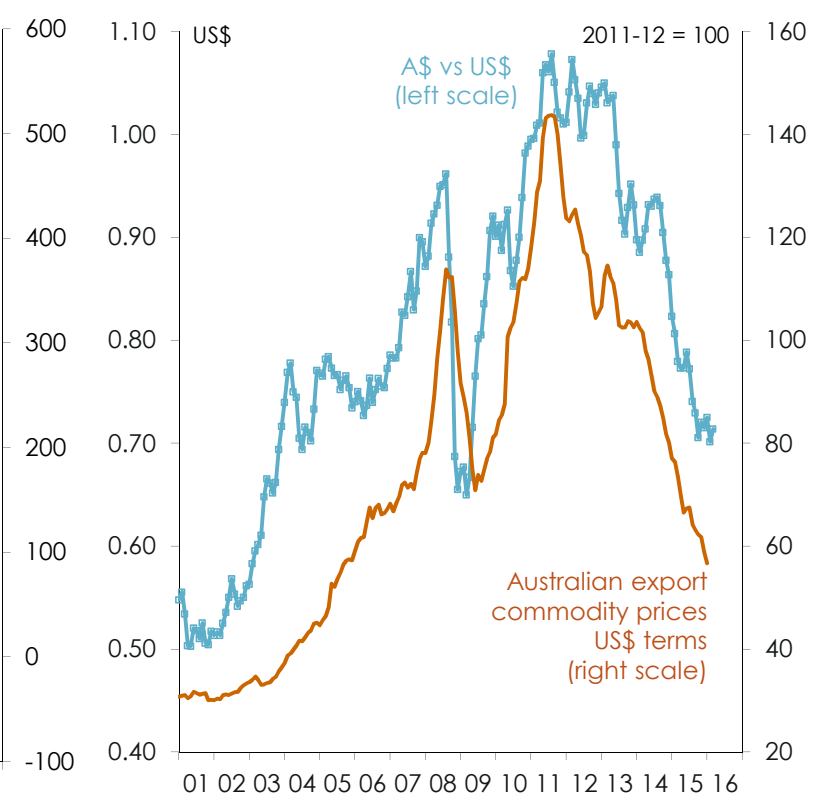
A\$-US\$ and US\$ vs other currencies



A\$-US\$ and Australia-US interest rate spreads



A\$-US\$ and commodity prices



Sources: Thomson Reuters; US Federal Reserve; Reserve Bank of Australia

SAUL ESLAKE

Risks to the Australian economic outlook

❑ Another global economic downturn

- the major 'advanced' economies have far less capacity to ward off another global recession than they did in 2008-09
- China arguably still has the capacity to respond as forcefully as it did in 2008-09 but is less likely to use it
- Australia has far less 'policy ammunition' than it did in 2008-09

❑ A 'hard landing' in China

- China now takes almost one-third of Australia's (merchandise) exports – a higher proportion than any single country has done since the mid-1950s – and this figure understates Australia's economic exposure to China
- as with a global downturn, Australia has far less 'policy ammunition' to respond to a Chinese 'hard landing' than before

❑ A\$ reversing course and rising sharply

- putting the RBA into an unpleasant dilemma as to whether or not to cut interest rates even further

❑ A 'housing bust'

- risk is widely exaggerated, but were it to occur it would have a bigger impact on economic activity (by prompting higher levels of saving as borrowers sought to reduce debt and avoid default) than financial system stability

❑ Renewed erosion of business confidence

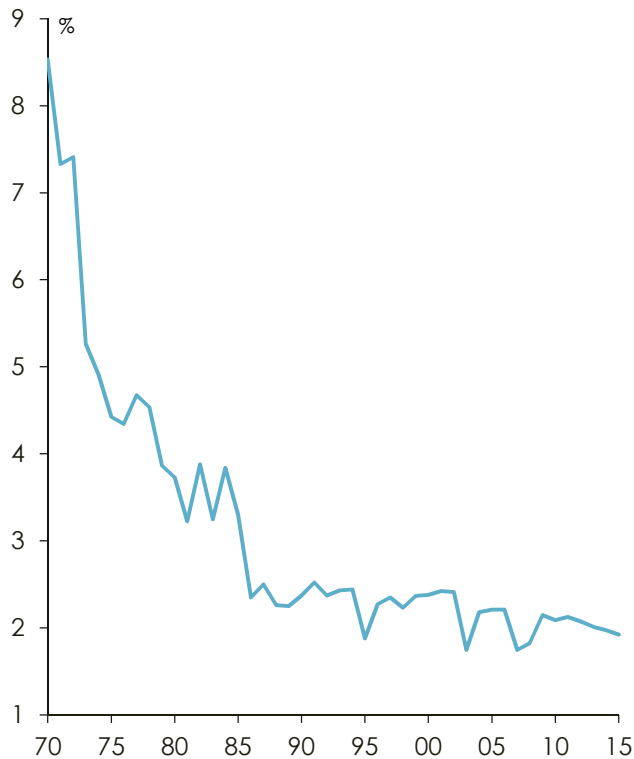
- most likely as a result of growing frustration with political outcomes and/or political system
- reflected in on-going weakness in business investment and (possibly) slower job creation

❑ Failure to put budget on a credible path back to surplus

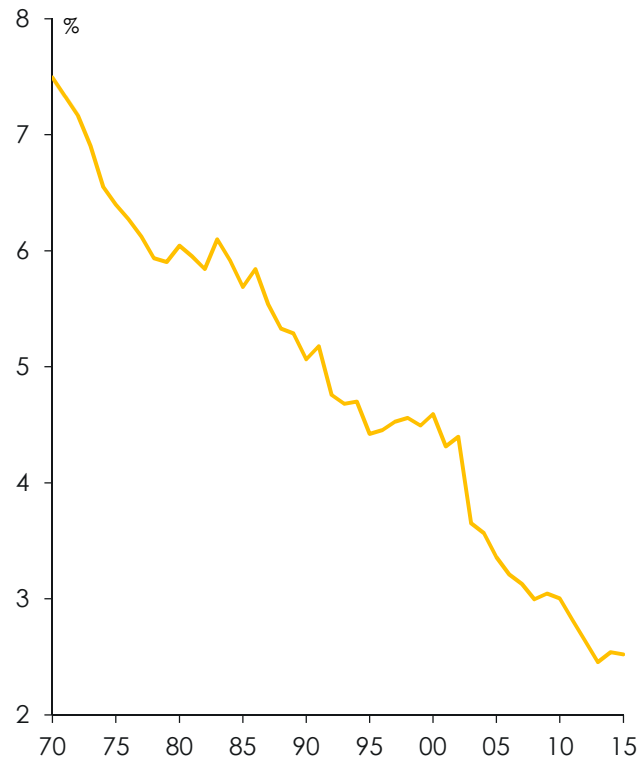
- not a problem requiring immediate drastic action, but rather steady progress over the next 4-8 years
- almost certainly can't be achieved in politically acceptable ways solely through measures on one side of the budget
- failure will further hamper Australia's ability to respond to any future economic downturn (however caused) and lead to loss of AAA rating

History suggests it is easy to be pessimistic about the future of agriculture

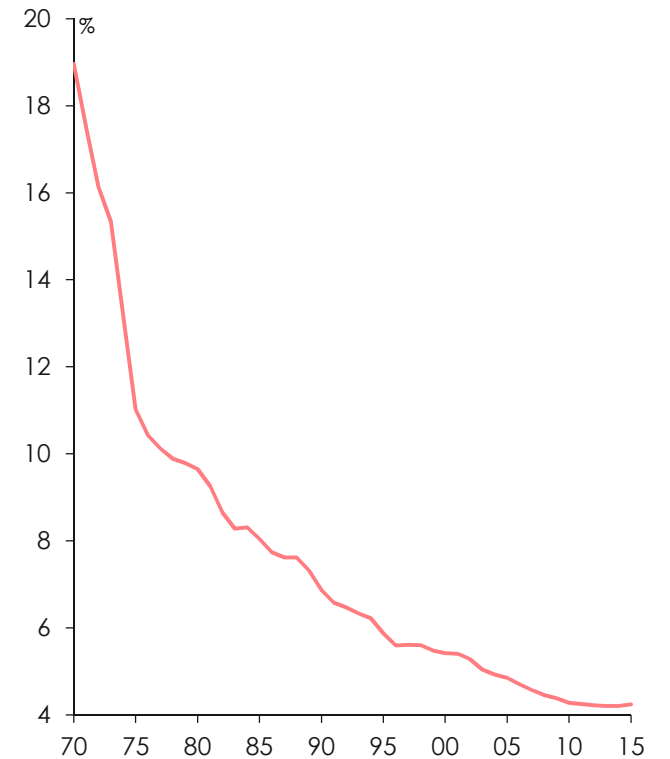
Gross farm product as a pc of GDP



Farm employment as a pc of total employment



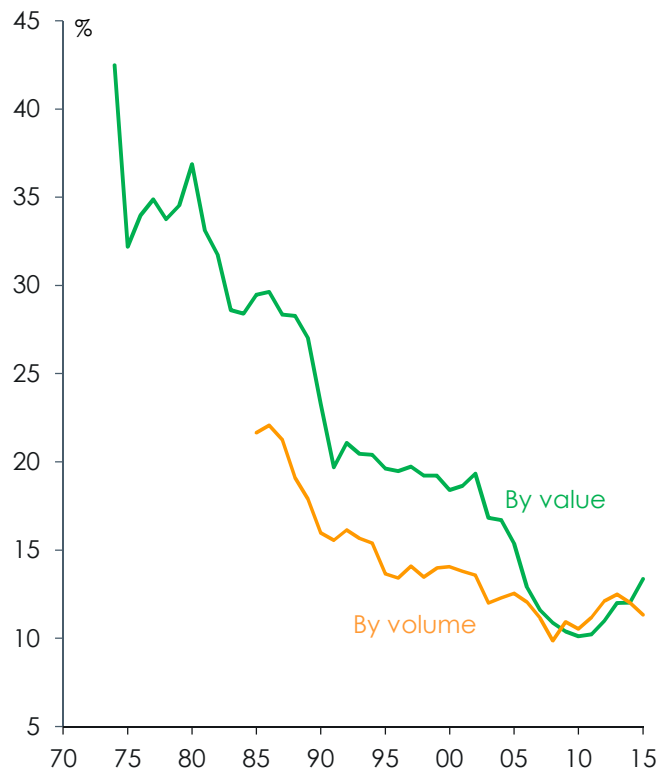
Capital stock in agriculture as a pc of total industry capital stock



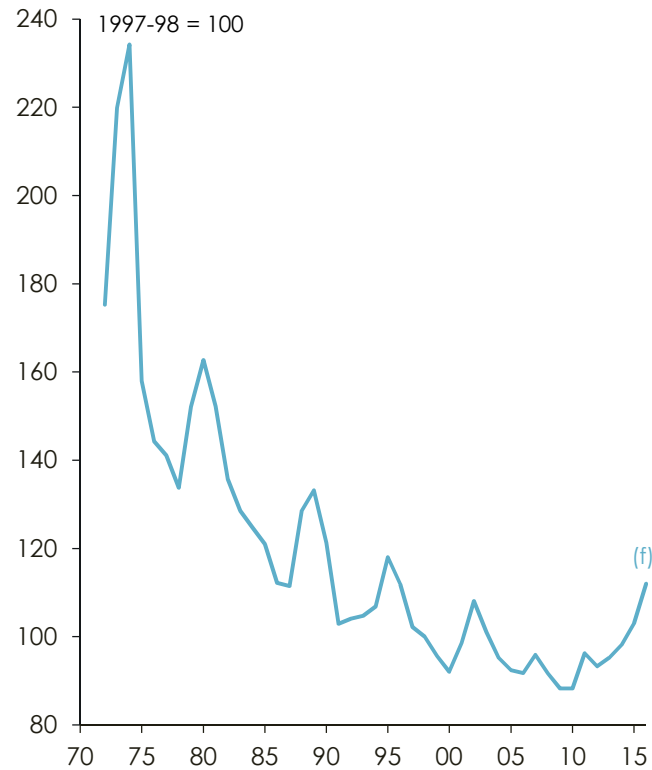
Note: 'Agriculture' capital stock includes forestry & fishing; total industry capital stock excludes dwellings.
Sources: ABS; ABARES.

However there are actually some signs of what could potentially be a long-term turnaround in Australian agriculture

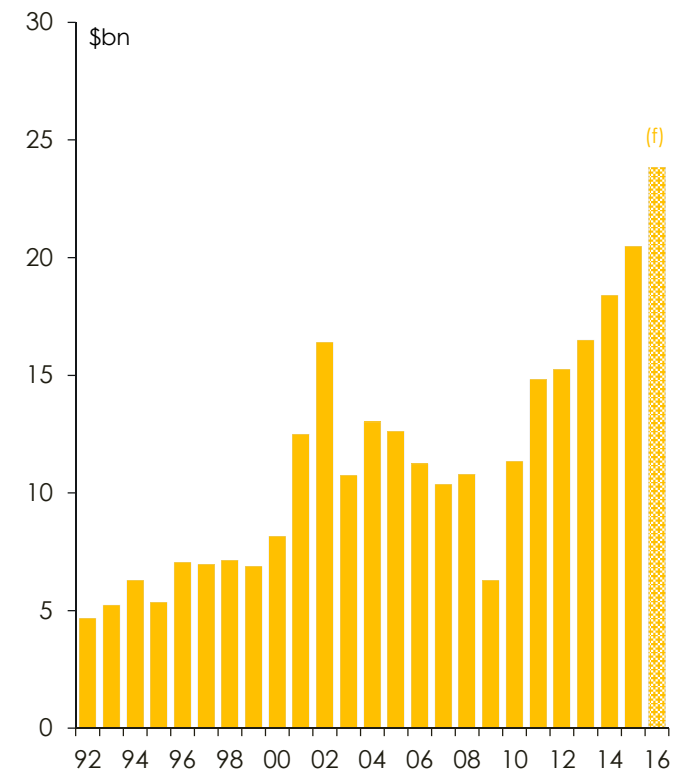
Rural exports as a pc of total exports of goods and services



Farmers' "terms of trade"



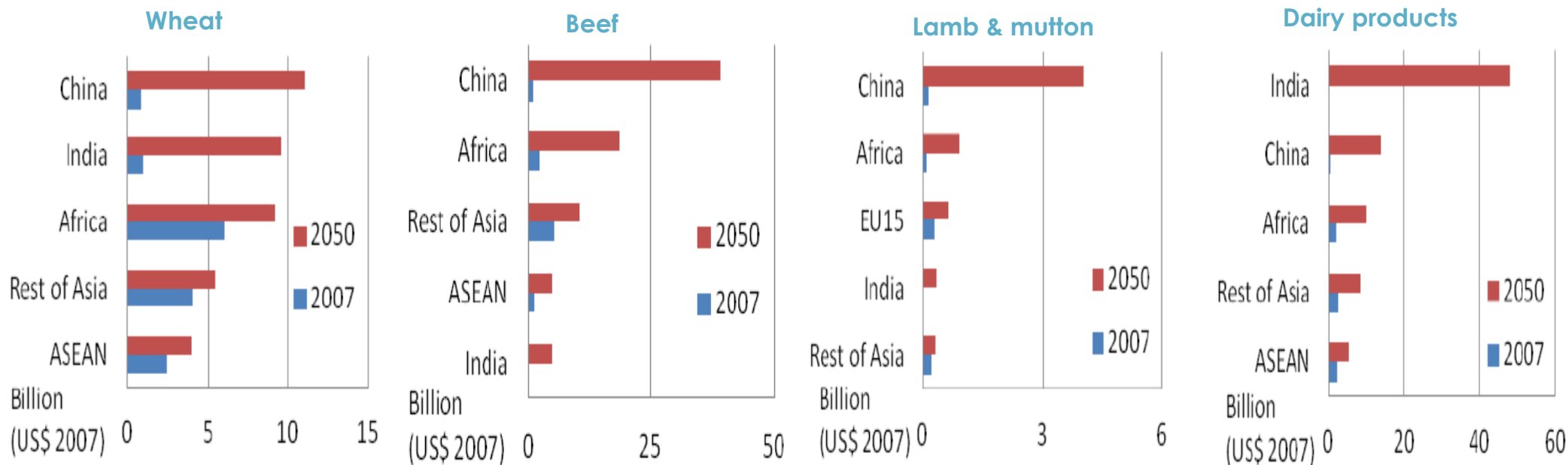
Net farm cash income



Note: Farmers' "terms of trade" is the ratio of prices received by farmers to prices paid. (f) Forecasts from ABARES *Agricultural Commodities* December 2015.

Asian countries will need to import a lot more food products over the next 40 years – and Australia could supply some of that

Sources of global food import demand



Source: Verity Linehan, Sally Thorpe, Neil Andrews, Yeon Kim & Farah Beaini, *Food Demand to 2050: Opportunities for Australian Agriculture*, Paper presented to 42nd ABARES Outlook Conference, 6-7 March 2012; Australian Government, *Australia in the Asian Century White Paper*, October 2012.

The three 'Free Trade Agreements' completed last year do create some real opportunities for Australian agricultural producers

❑ No 'Free Trade Agreement' ever produces genuinely 'free' trade

- and some of the ones Australia has signed in recent years (eg with the US or Thailand) didn't do much for Australian exporters

❑ However the agreements signed last year with Korea, Japan and China are genuinely 'good' agreements which open up genuine opportunities for Australian exporters, including agricultural exporters

❑ The agreement with Korea

- immediately abolishes Korean tariffs on Australian sugar, wheat and wine
- provides duty-free access for seasonal horticultural products (such as potatoes)
- phases out tariffs on beef, sheep meat, pork, and dairy products over periods of between three and 13 years (in most cases)

❑ The agreement with Japan

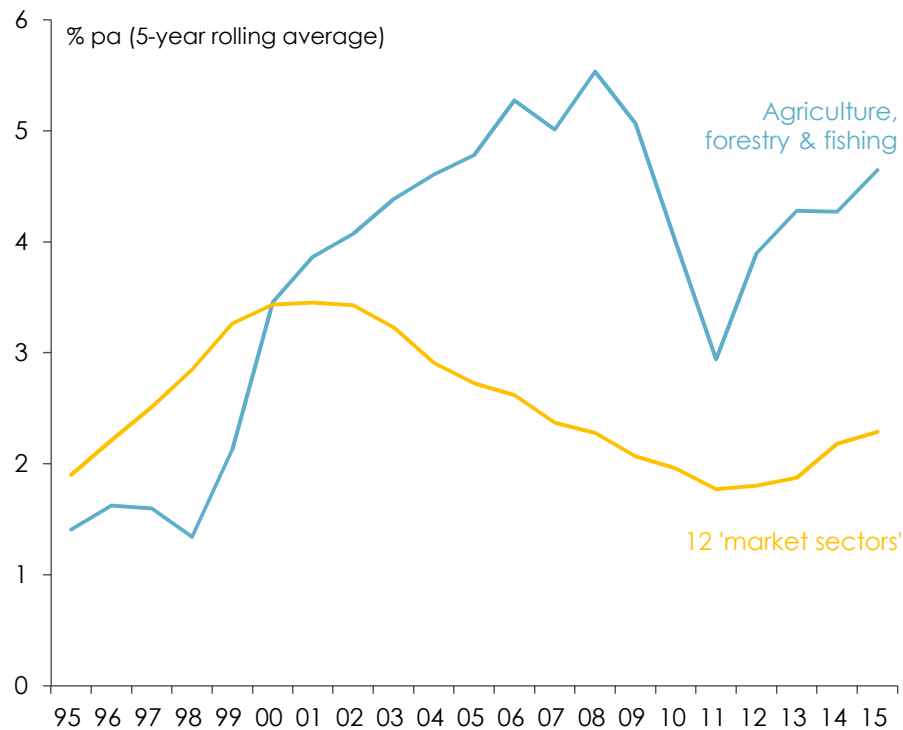
- provides for fairly swift reductions in tariffs on beef (though not complete elimination)
- institutes duty-free quotas for cheese & milk protein concentrates
- allows greater access for a range of horticultural products (especially seasonal ones)

❑ The agreement with China

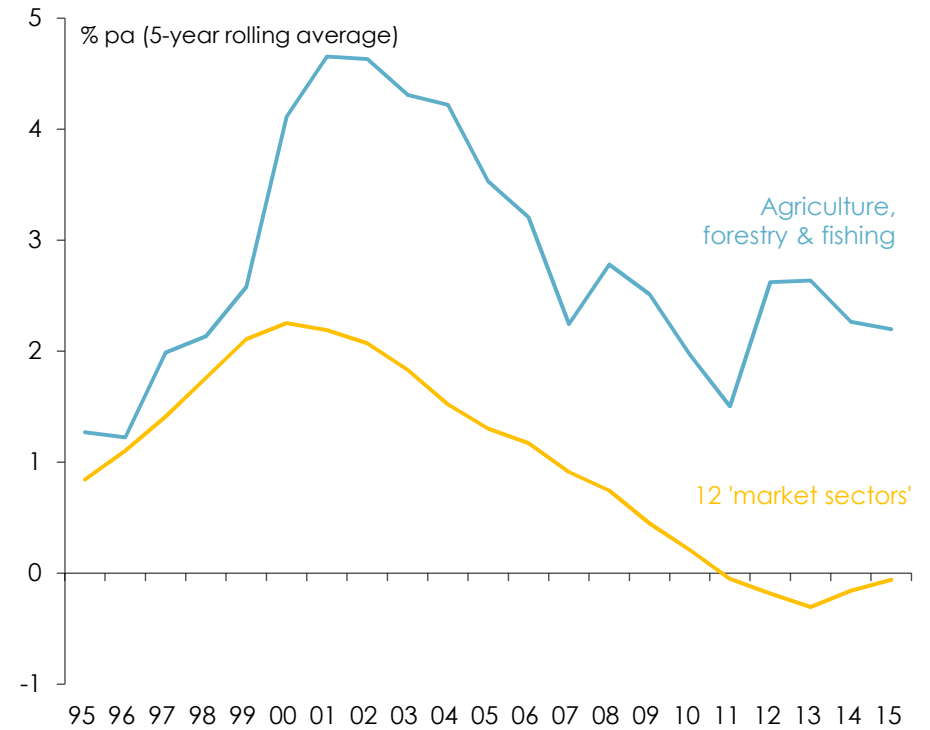
- provides for the phasing out of tariffs on beef, all dairy products, sheep meat, pork, fruit & vegetables over 2-9 years
- and for a duty-free quota of 30Kt of wool growing to 44Kt 2024, in addition to Australia's existing access under a global 287Kt quota cases)

Agriculture has been doing a better job of improving productivity than other sectors of the economy (in aggregate)

Labour productivity



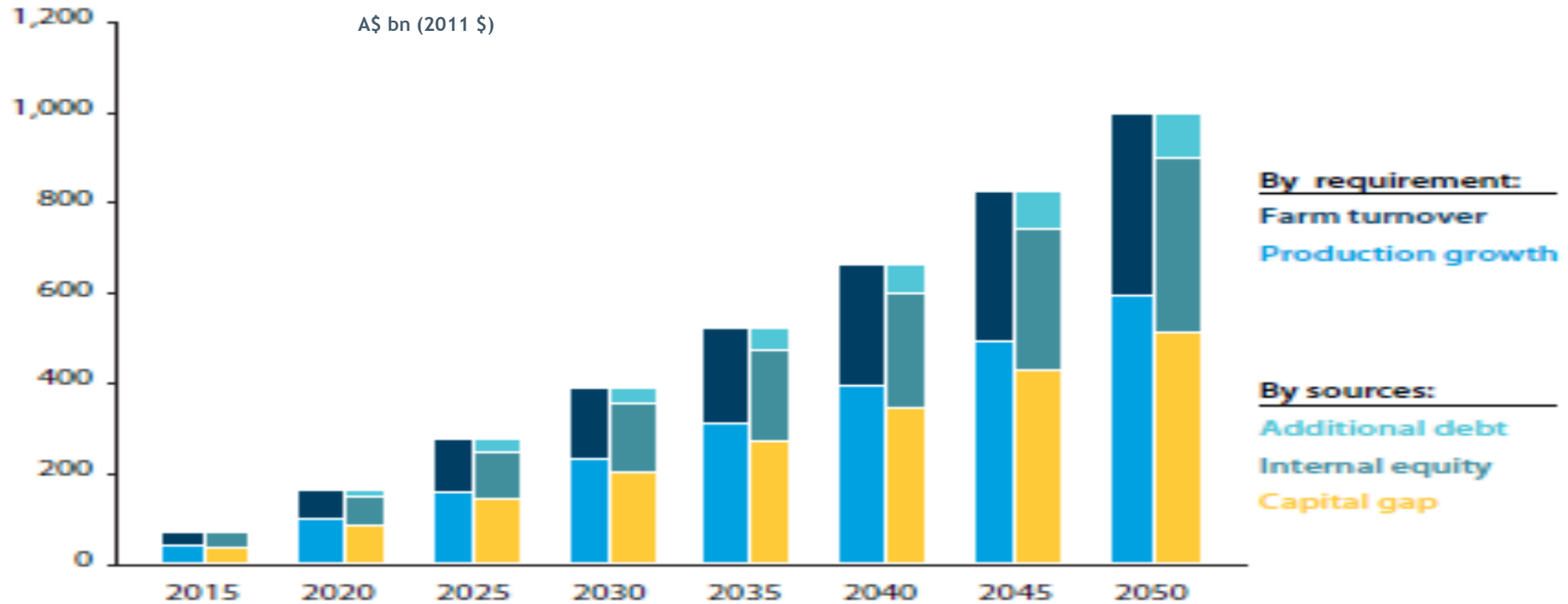
'Multi-factor' productivity



Note: Productivity growth is calculated as the average for a five-year period compared with the average for the preceding five years, expressed as an annual rate. '12 market sectors' are agriculture, forestry & fishing; mining; manufacturing; utilities; construction; wholesale trade; retail trade; accommodation & food services; transport, postal & warehousing services; information, media & telecommunications services; financial & insurance services; and art & recreation services; for which productivity estimates are available back to 1989-90. 'Multi-factor' productivity is output per unit of labour and capital services input, but does not include land and hence differs from the concept of 'total factor productivity' used by ABARES researchers. Source: ABS.

Agriculture needs to attract more capital in order to take full advantage of the opportunities that are 'out there'

Cumulative capital required by the Australian agricultural sector



Source: ANZ & Port Jackson Partners, *Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand*, October 2012.

For more details...

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