

AN ECONOMIC UPDATE (WITH A PARTICULAR FOCUS ON COMMERCIAL CONSTRUCTION)

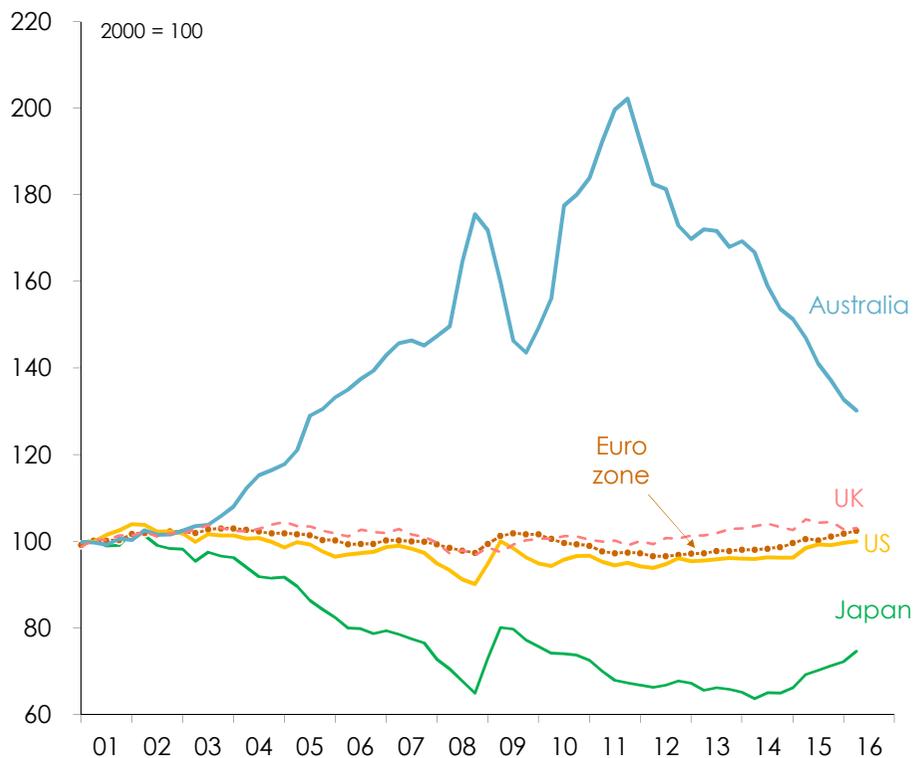
PRESENTATION TO NORMAN DISNEY & YOUNG'S
SHAREHOLDER DINNER

INTERCONTINENTAL HOTEL, ADELAIDE – 29TH AUGUST 2016

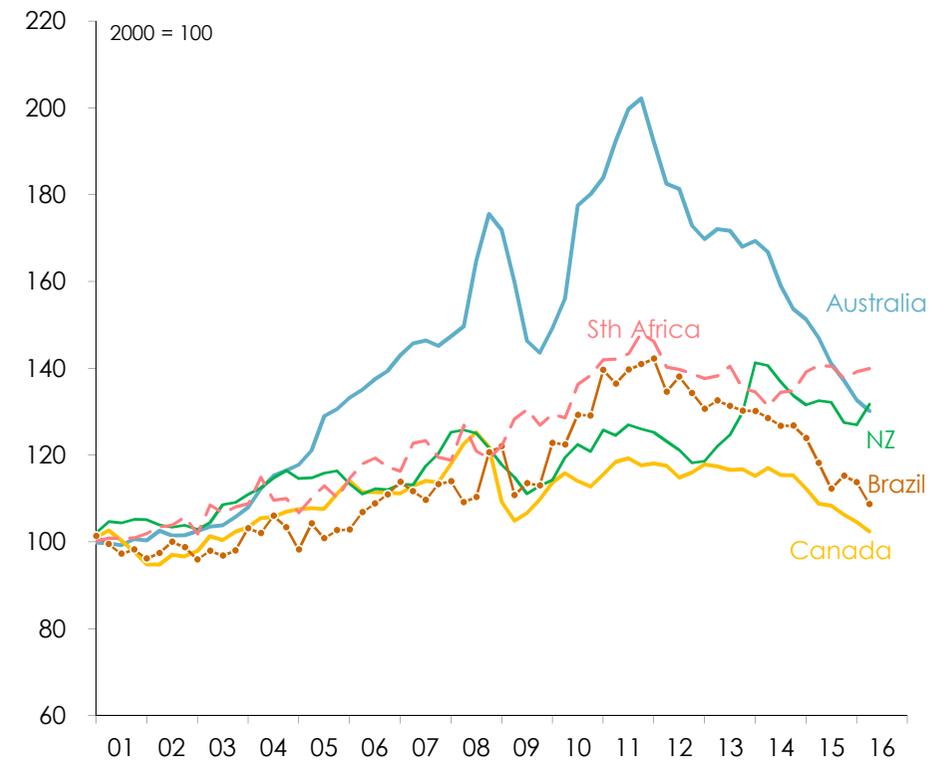
Australia

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

'Terms of trade' – Australia vs other 'advanced' economies



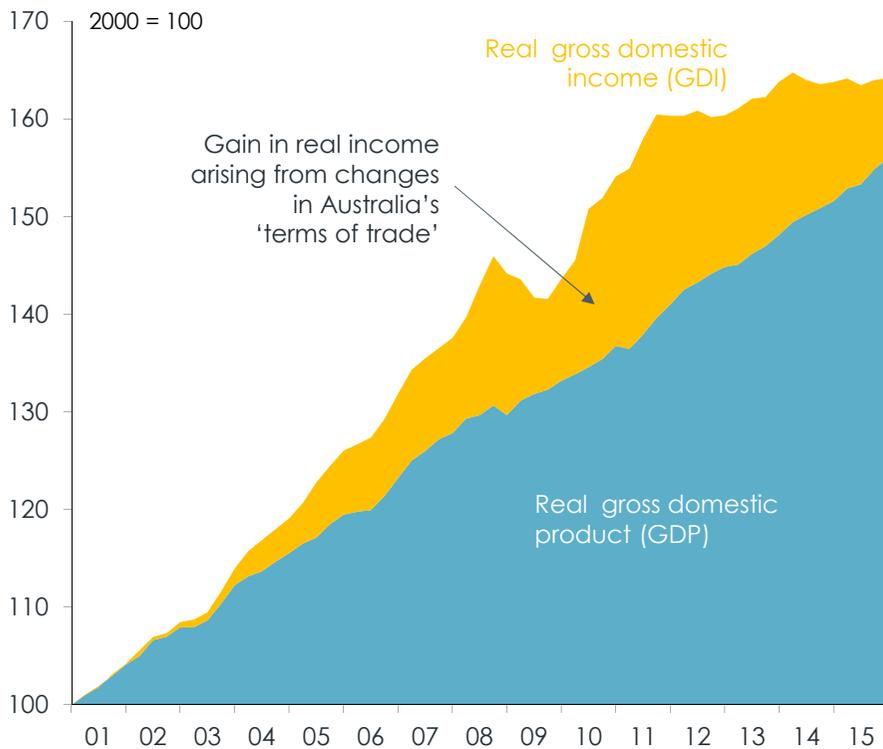
'Terms of trade' – Australia vs other commodity-exporting economies



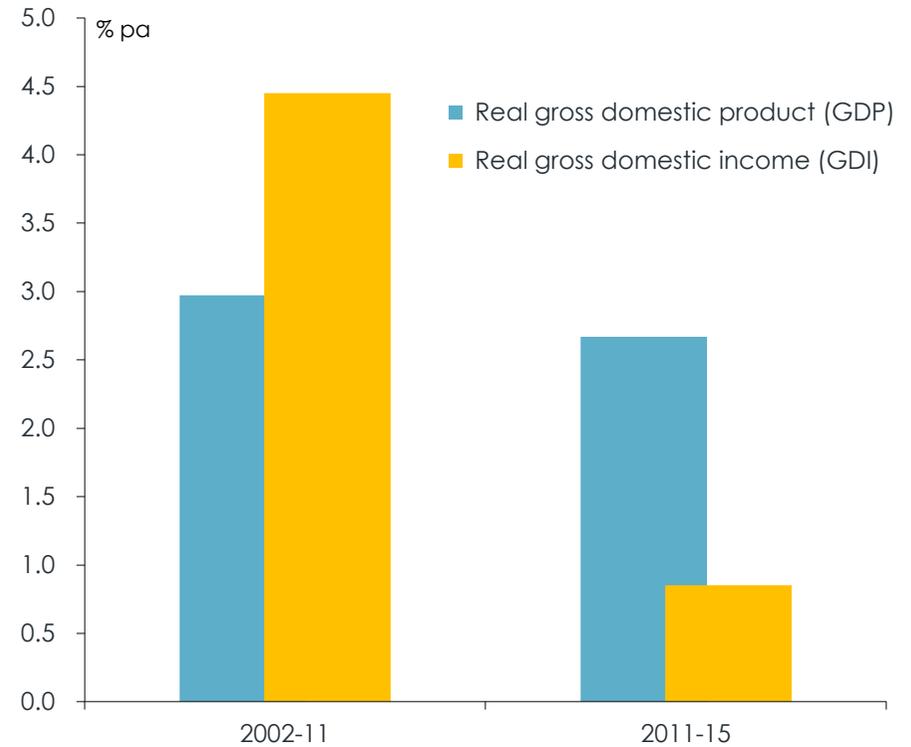
Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services.
Sources: ABS; US Bureau of Economic Analysis; Eurostat; UK Office for National Statistics; Japan Economic & Social Research Institute;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

The huge rise in Australia's 'terms of trade' represented a substantial addition to Australia's real income – which is now receding

Gains in real gross domestic income arising from changes in 'terms of trade'



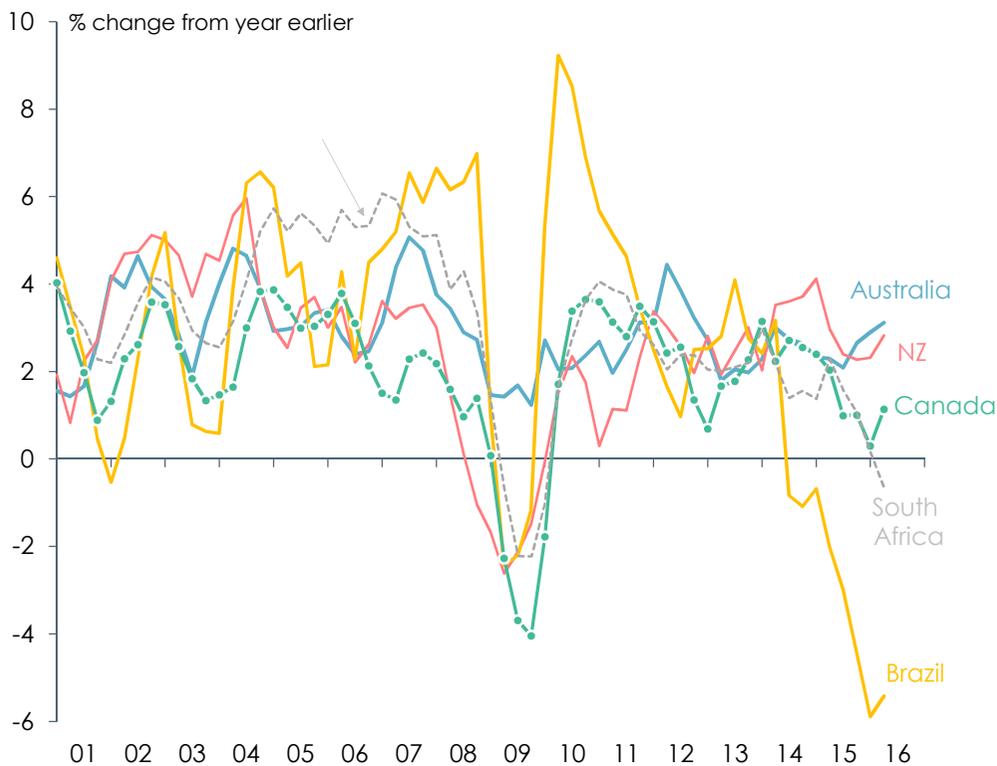
Growth in real gross domestic income (GDI) vs real gross domestic product (GDP)



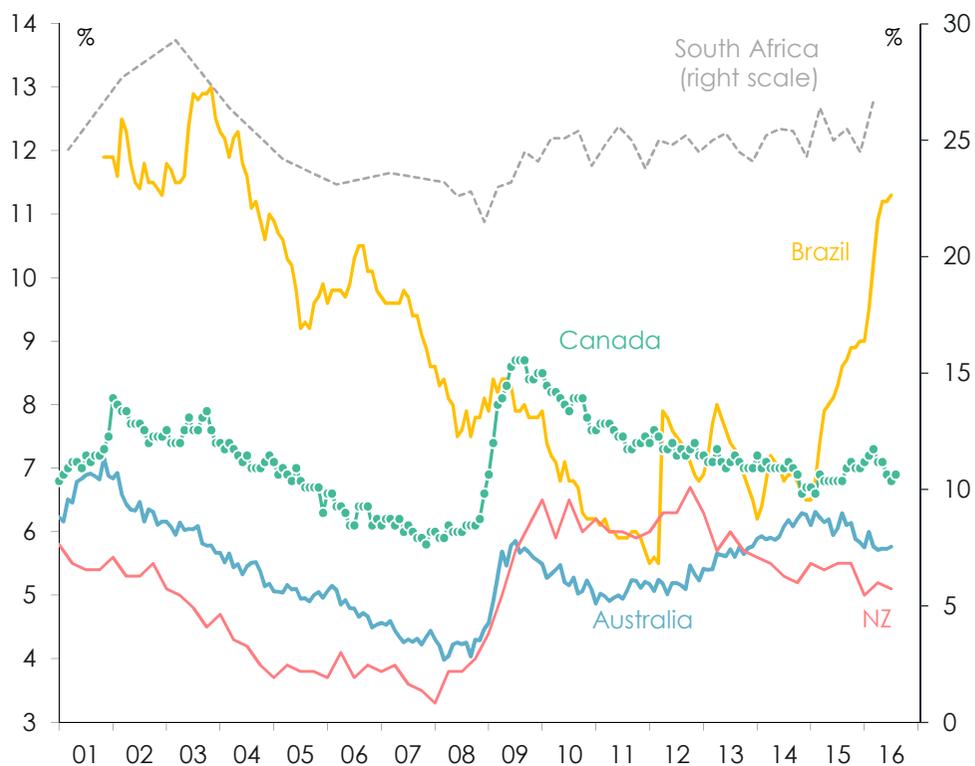
Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services. Real gross domestic income (GDI) is real gross domestic product (GDP) adjusted for income gains or losses arising from changes in the terms of trade.
Source: ABS.

Australia is faring better than most other commodity-exporting economies despite experiencing a sharper fall in its terms of trade

Australia and other commodity exporters – real GDP growth



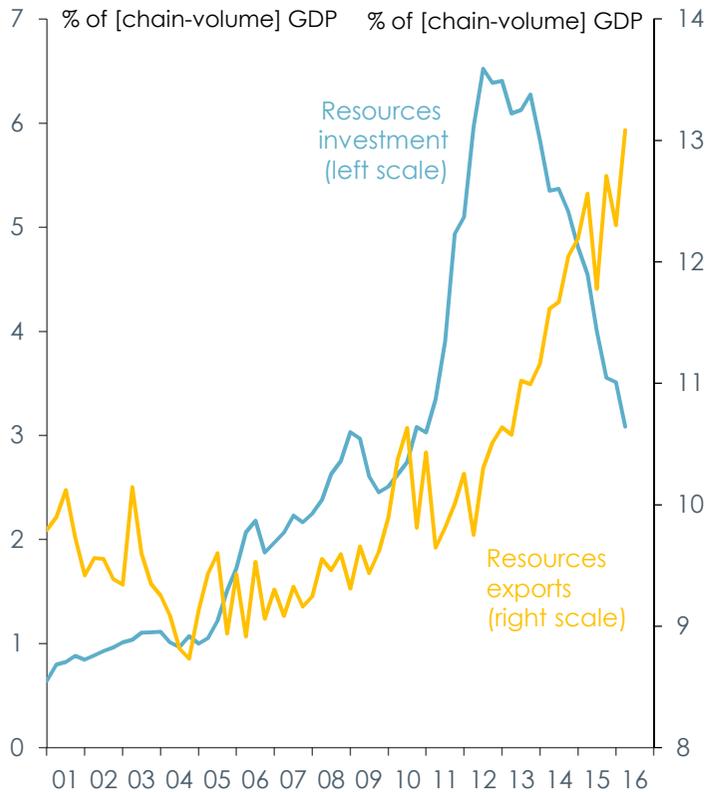
Australia and other commodity exporters - unemployment



Sources: ABS; Statistics NZ; Statistics Canada; Instituto Brasileiro de Geografia e Estatística; Statistics South Africa.

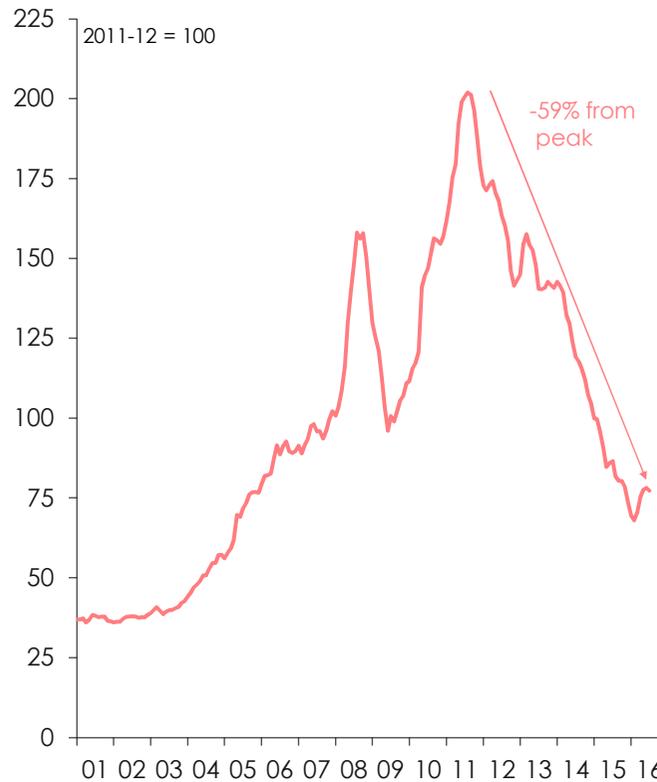
The resources investment boom is over – and while resources exports are rising, they are at falling prices and don't employ as many workers

Australia's resources investment & export volumes

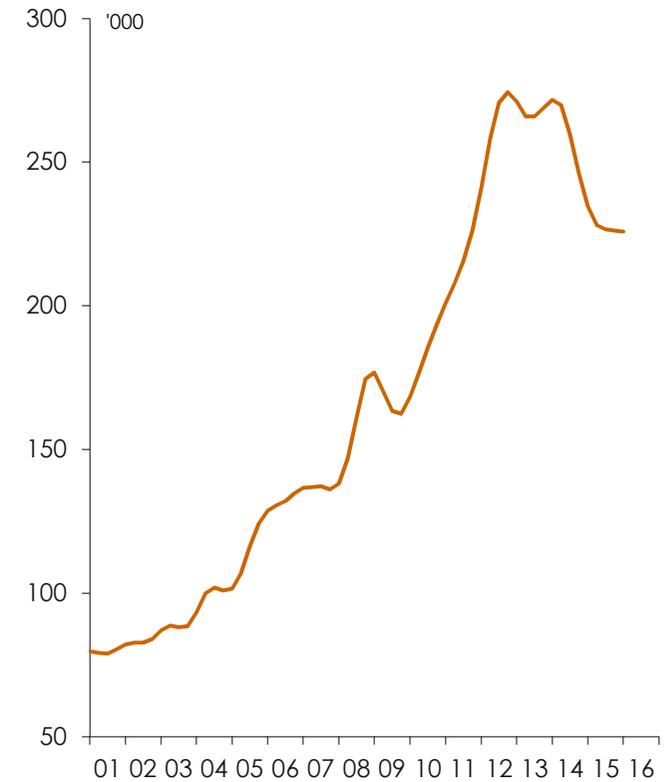


Note: Resources investment includes exploration expenditure.
Source: ABS.

Australia's resources export prices

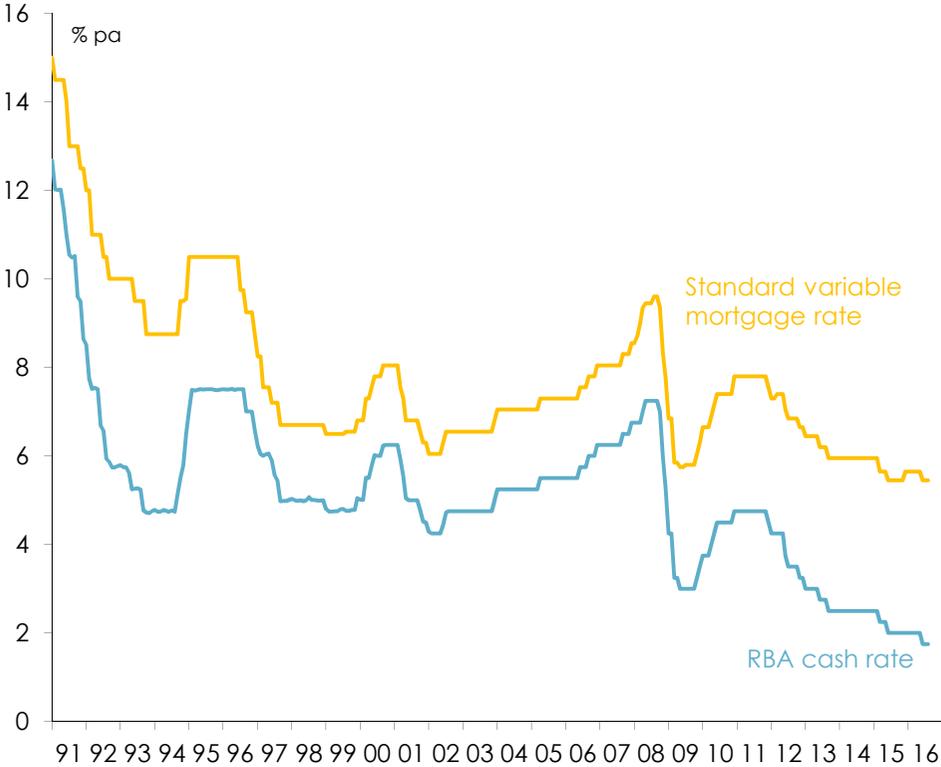


Australia's mining sector employment

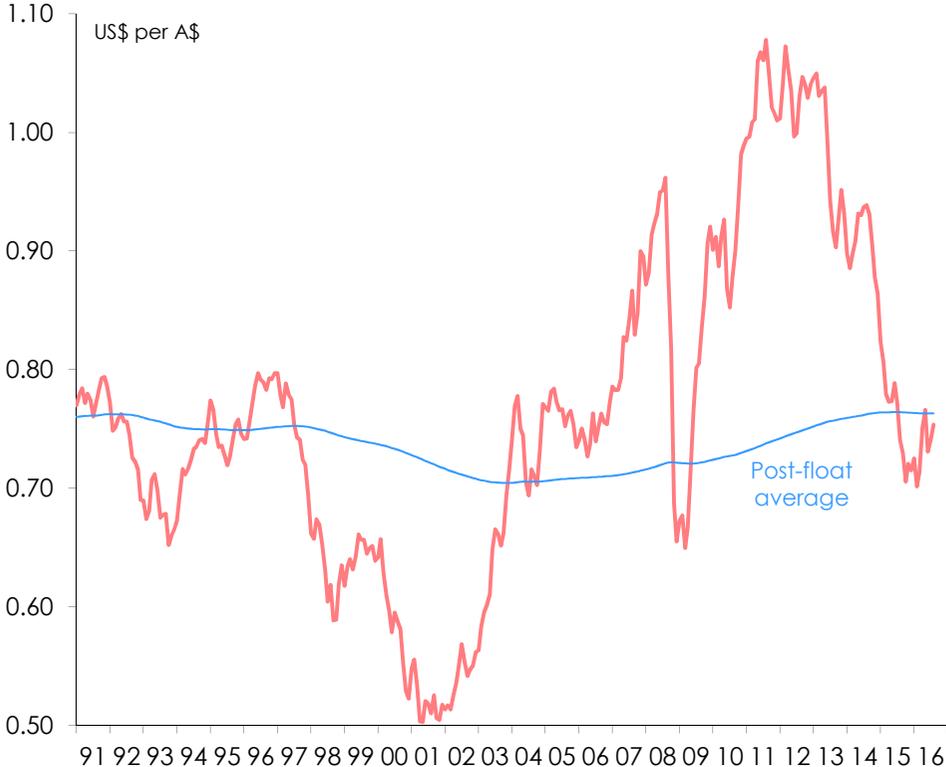


Australia is relying on record-low interest rates and a (now) below-its-long-term-average Australian dollar to support economic growth

Australian interest rates



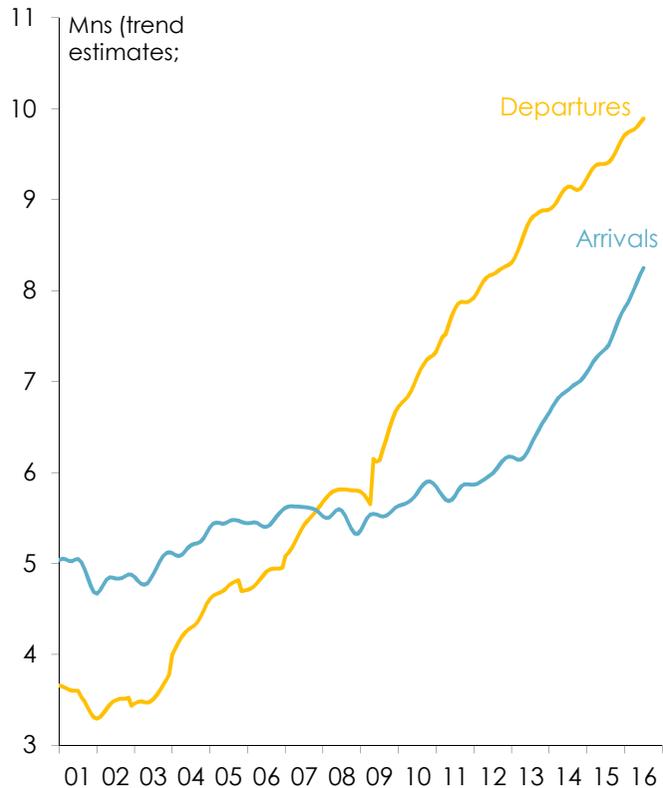
Australian dollar



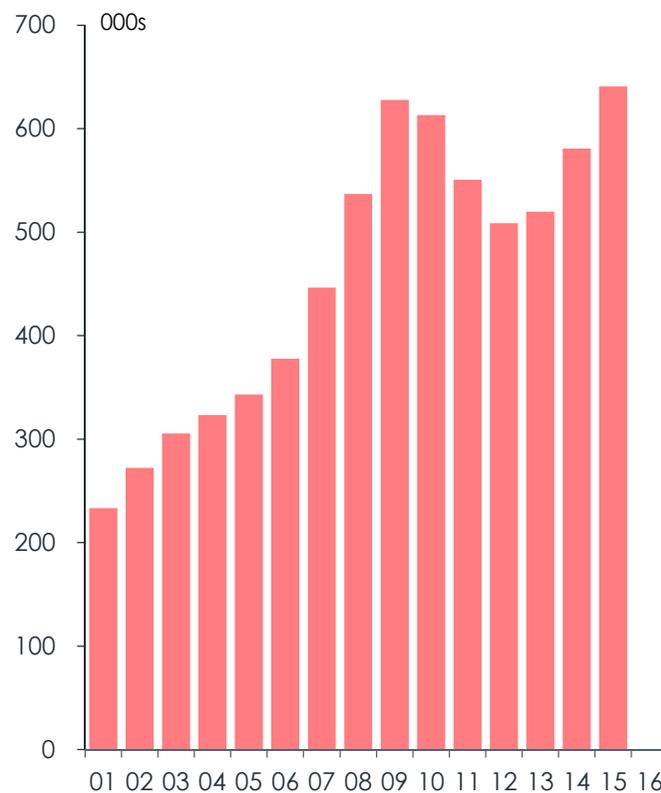
Source: Reserve Bank of Australia.

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

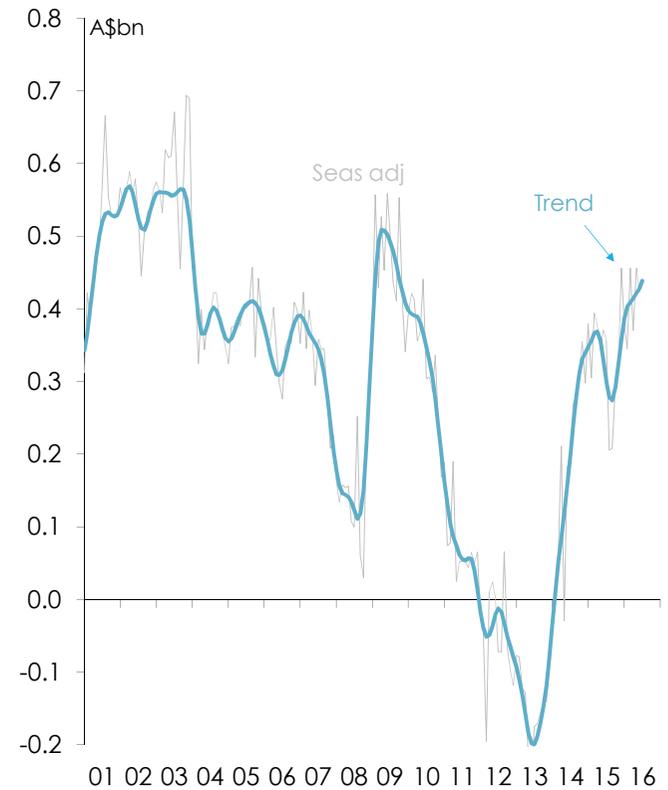
Short-term overseas arrivals and departures



Overseas student enrolments



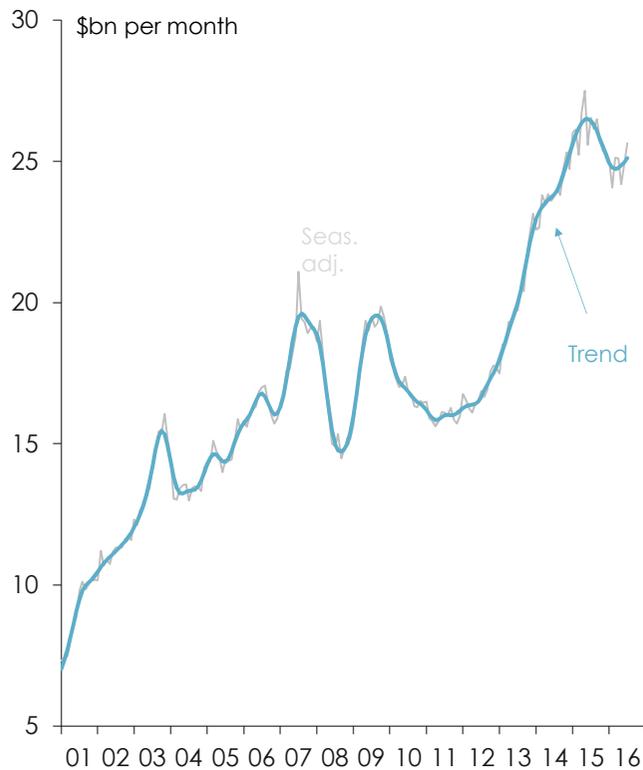
Travel-related services trade balance



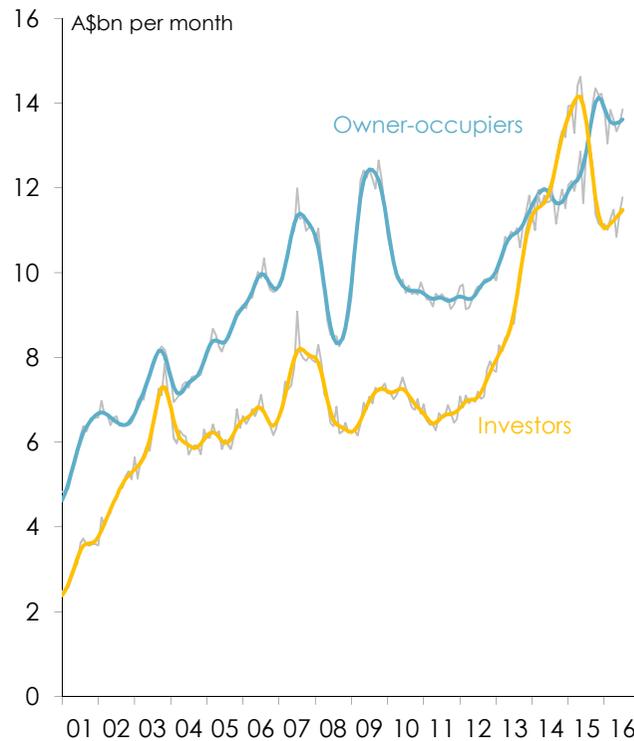
Note: The number of overseas student enrolments shown in the second chart exceeds the number of overseas students in Australia, since some students are enrolled in more than one category (eg higher education and English language). 'Travel-related services' includes accommodation, transport and food services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

Record-low interest rates have stimulated a substantial rise in housing demand – leading in turn to further escalation of housing prices

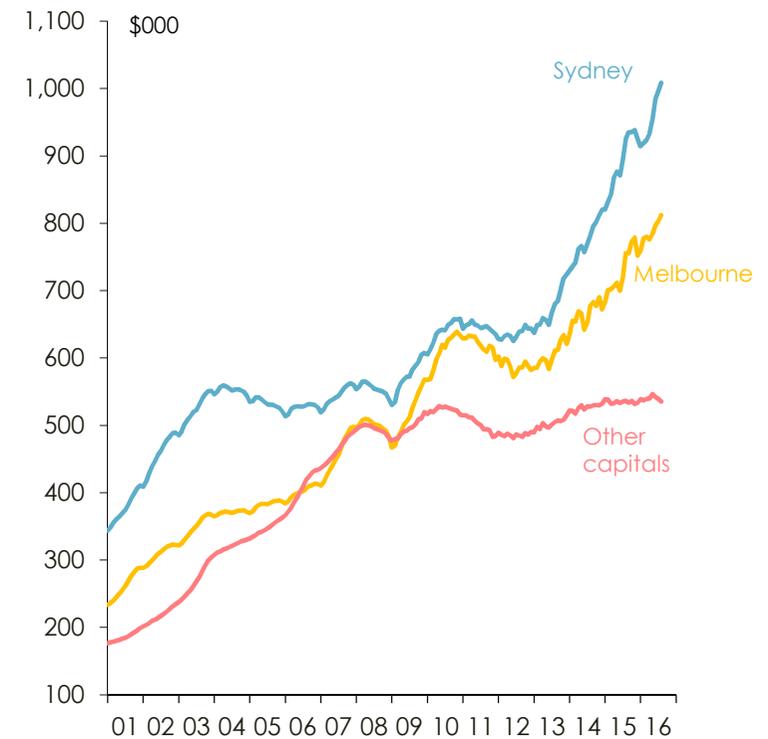
Lending for housing



Lending for housing, by type of borrower



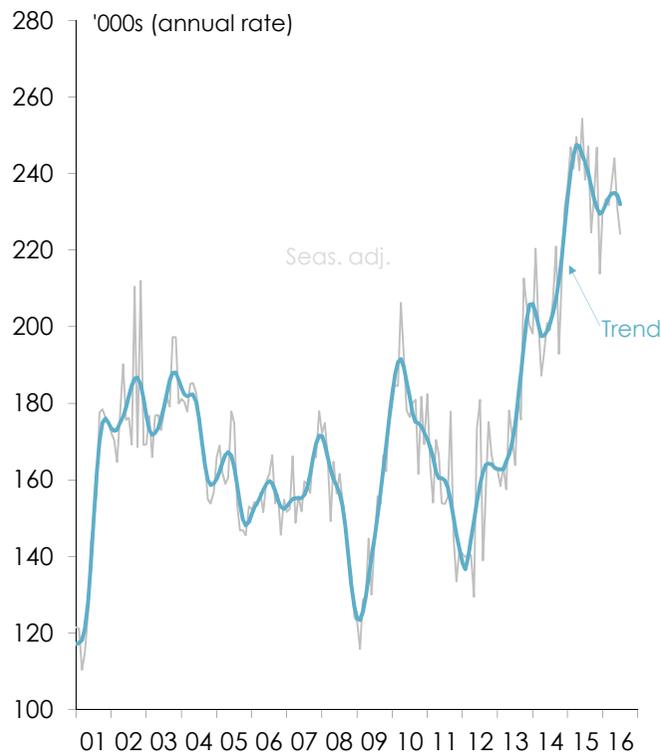
Capital city residential property prices



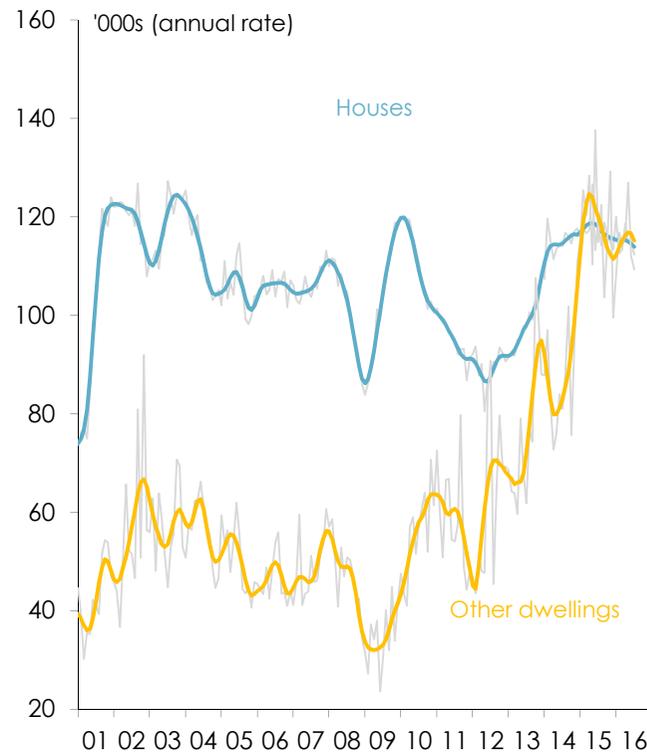
Note: grey lines in first and second charts above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'.
Sources: ABS; CoreLogic – RP Data.

Housing supply is also now rising more strongly – with more than half of the increase occurring in the form of high-rise apartments

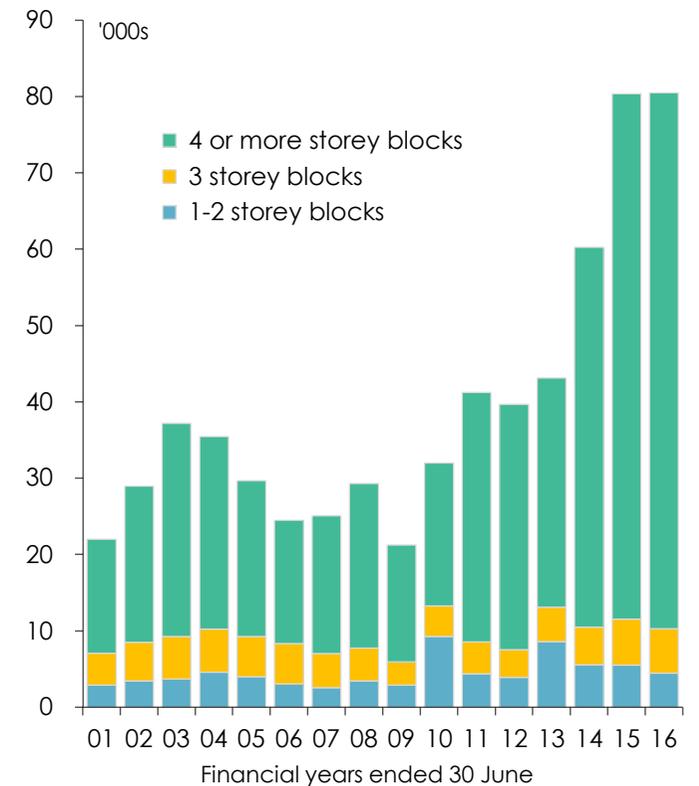
Residential building approvals



Private residential building approvals, by type of dwelling



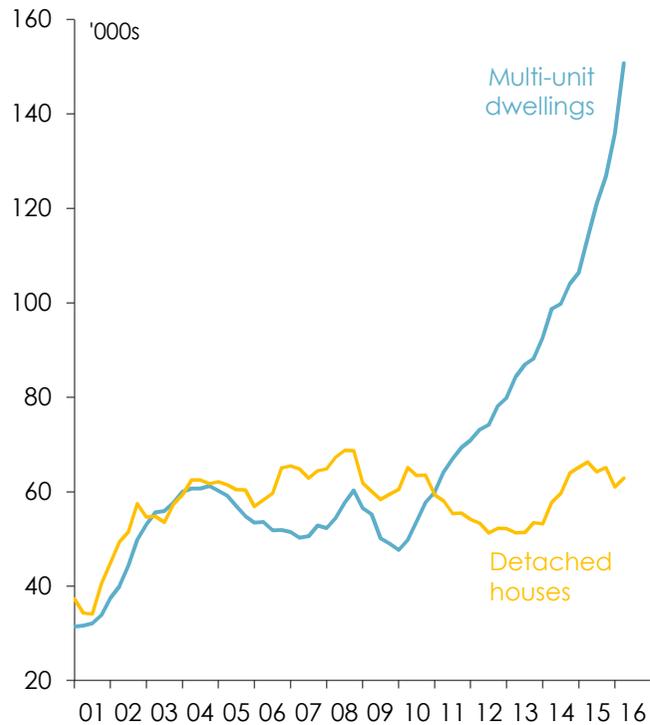
Approvals of 'other dwellings', by size



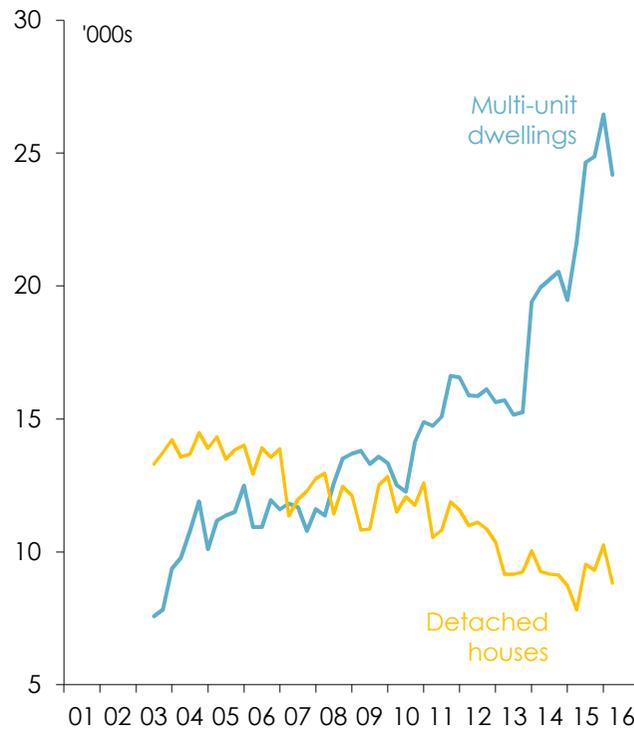
Note: grey lines in first and second charts above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'.
Source: ABS.

There is a considerable pipeline of work yet to be started, or completed, on multi-unit residential building

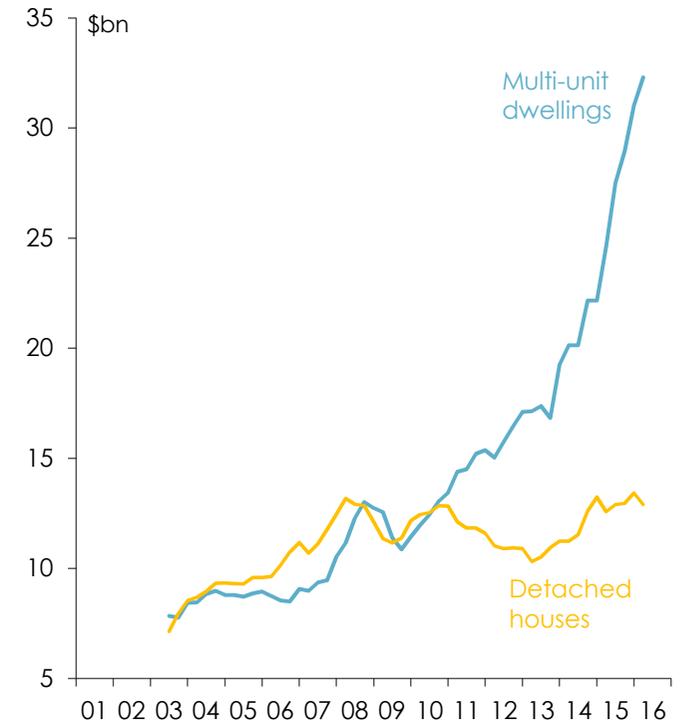
Residential buildings under construction



Residential building approved but not yet commenced



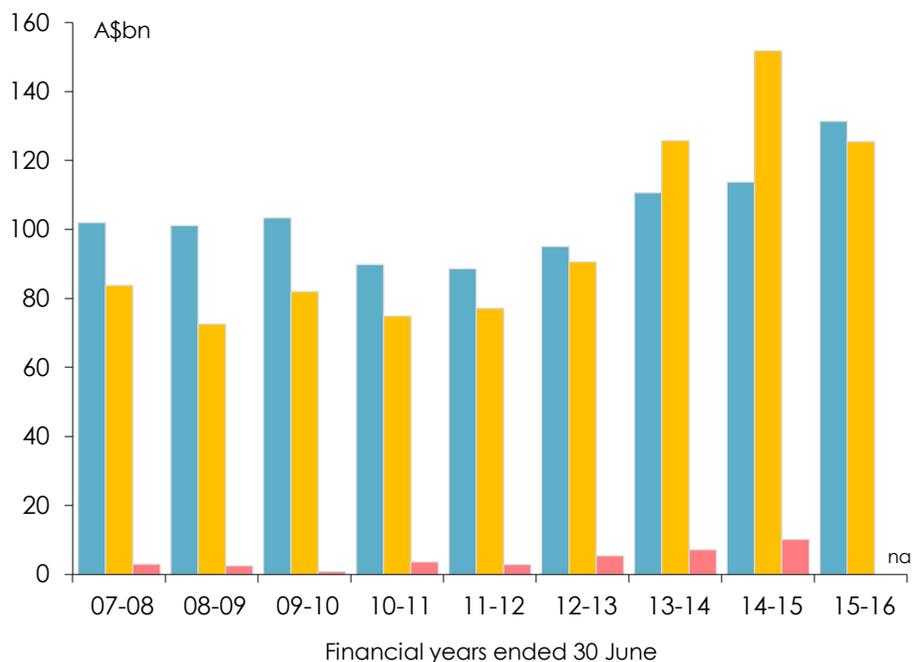
Value of residential building work yet to be done



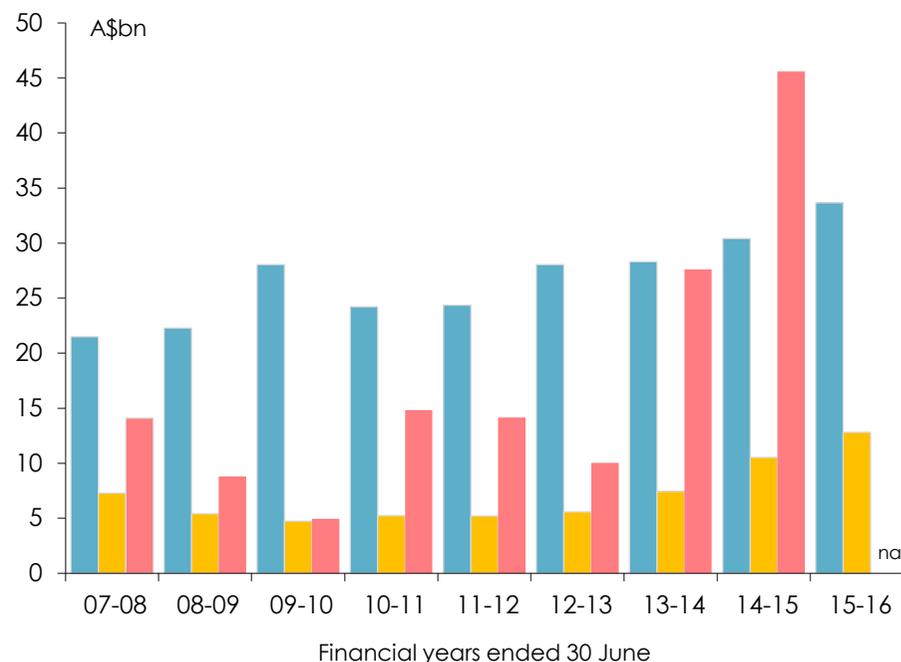
Note: Data are for private sector projects only.
Source: ABS.

Foreign investors appear to have been financed more new dwelling construction than domestic investors in recent years

Financing of the purchase of established dwellings



Financing of the purchase of new dwellings

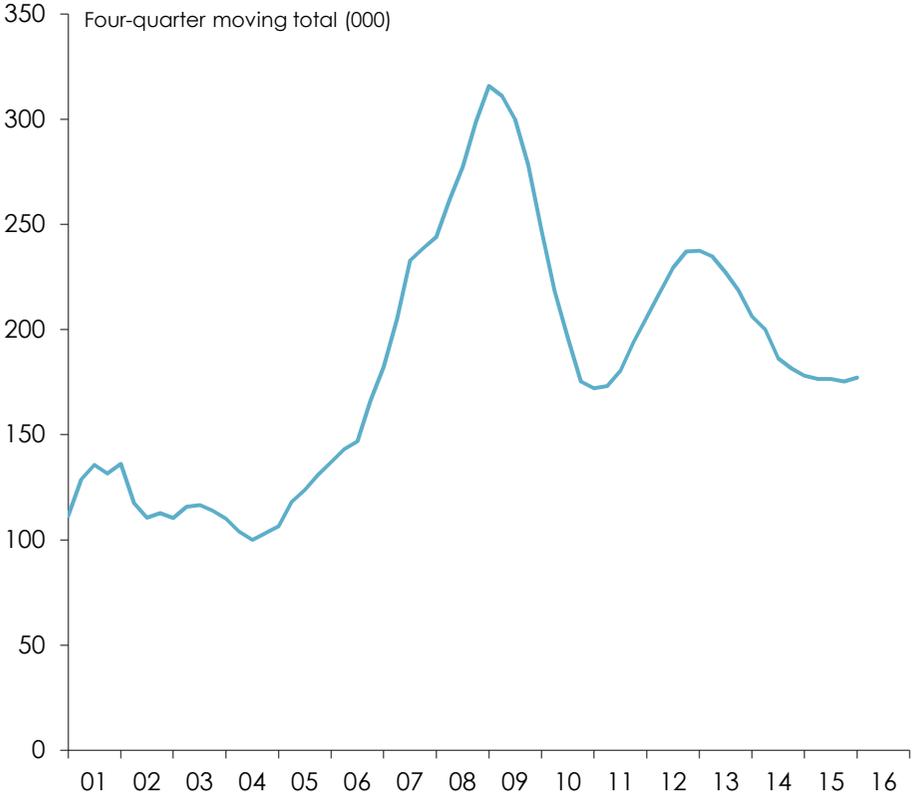


■ Australian owner-occupiers (borrowing)
 ■ Australian investors (borrowing)
 ■ Foreigners (FIRB approvals)

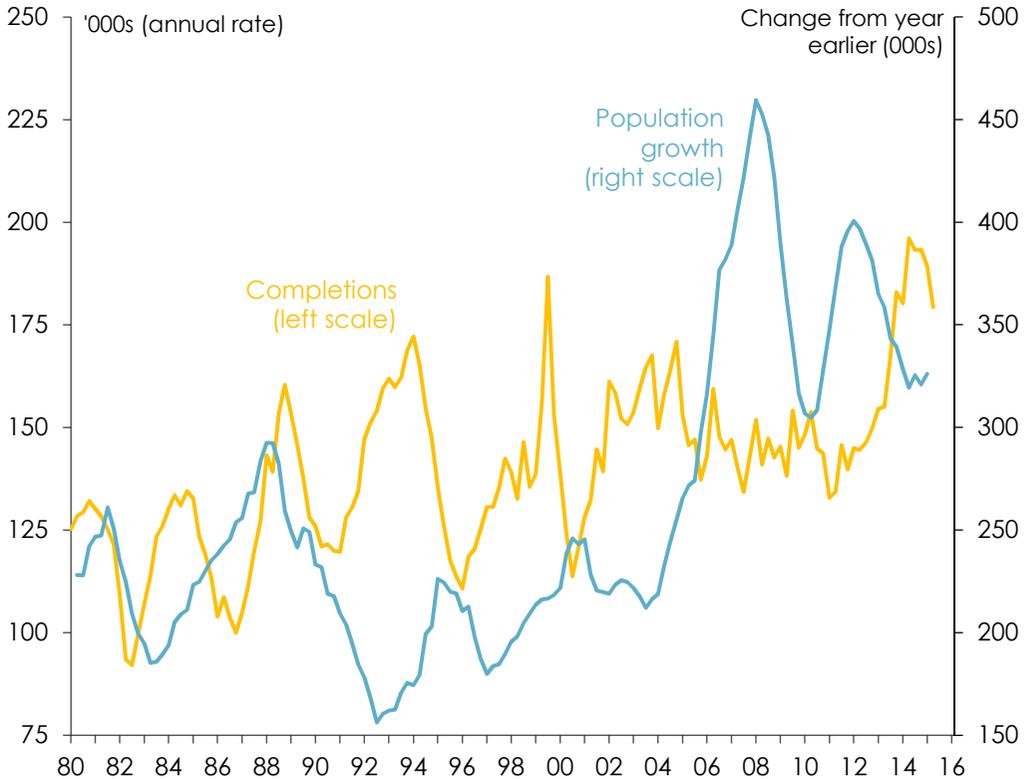
Note: Data for Australian purchases are for borrowing only (ie exclude deposit or other equity). Data on foreign purchases are FIRB approvals granted in the year indicated, which may not be the same year as that in which purchase occurs (if it does at all). Sources: ABS; Foreign Investment Review Board (FIRB) Annual Reports.

The supply-demand balance in Australia's housing market could change quite significantly over the next three years

Net immigration to Australia



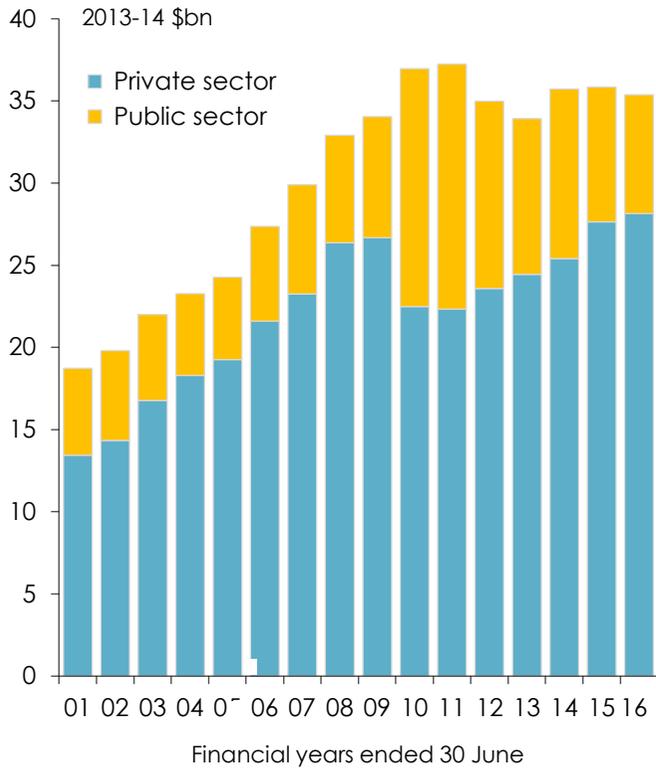
Housing completions vs population growth



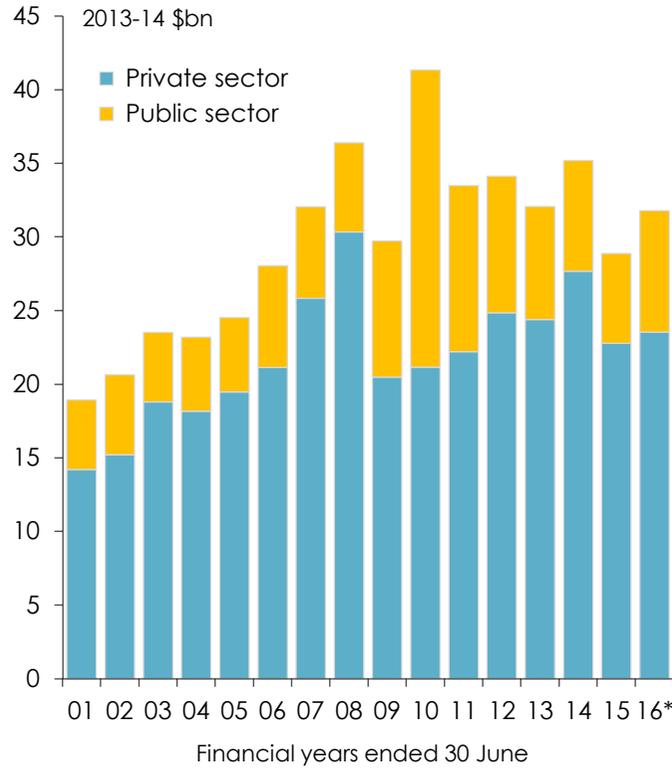
Source: ABS.

The outlook for non-residential building is quite subdued

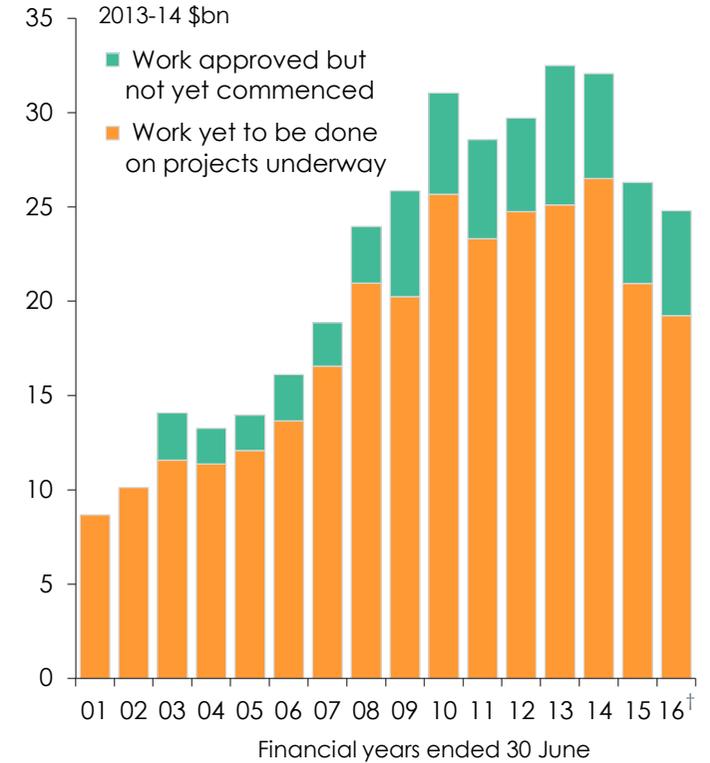
Value of non-residential building work done



Value of non-residential building commenced



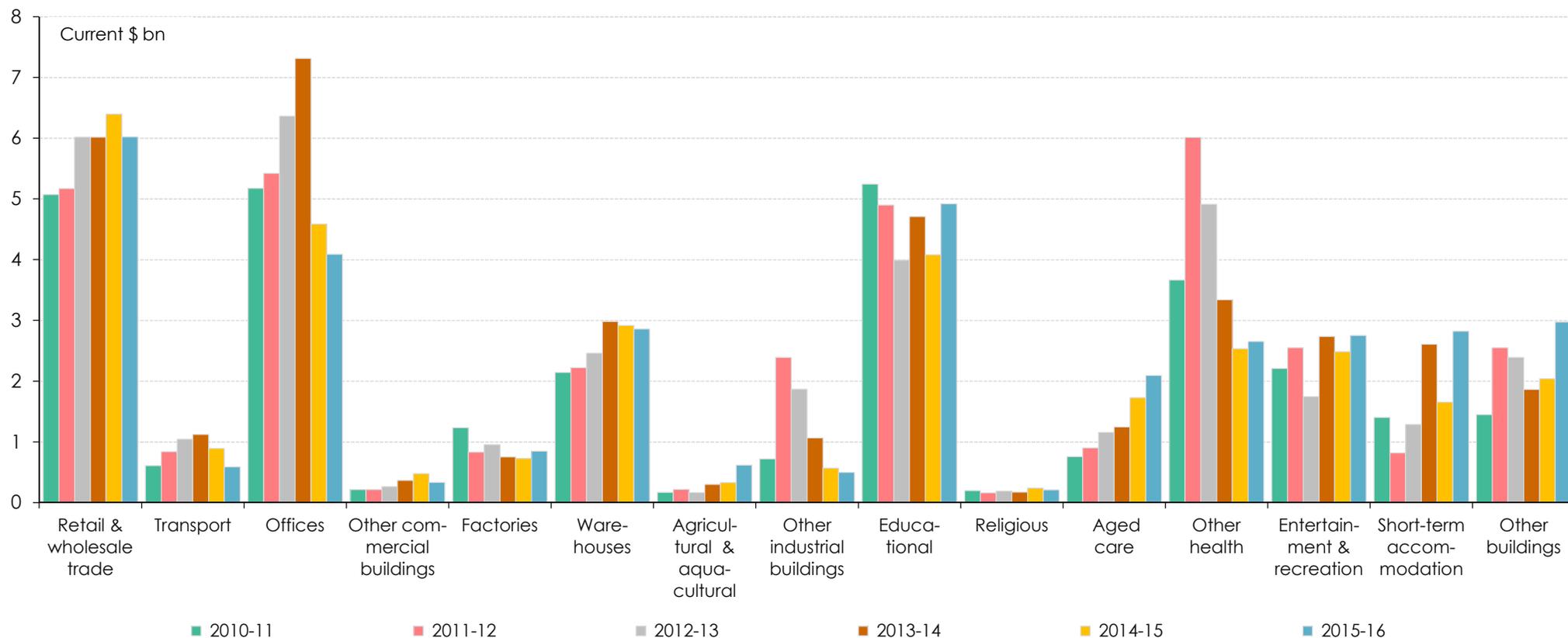
Value of non-residential building work yet to be done



* First three quarters at annualized rate. † As at end-March 2016.
Source: ABS.

Office construction appears to be declining; retail is flat-lining; aged care and hotels, etc showing strongest growth

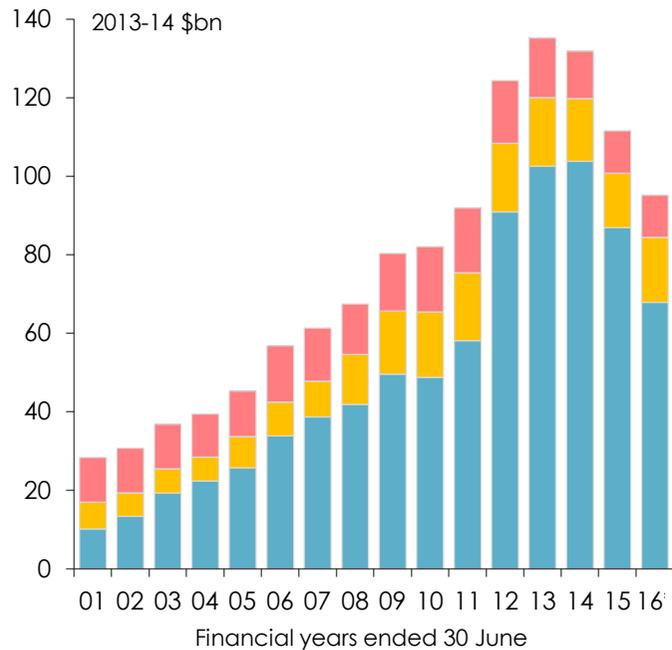
Non-residential building approvals by major category, 2010-11 to 2015-16



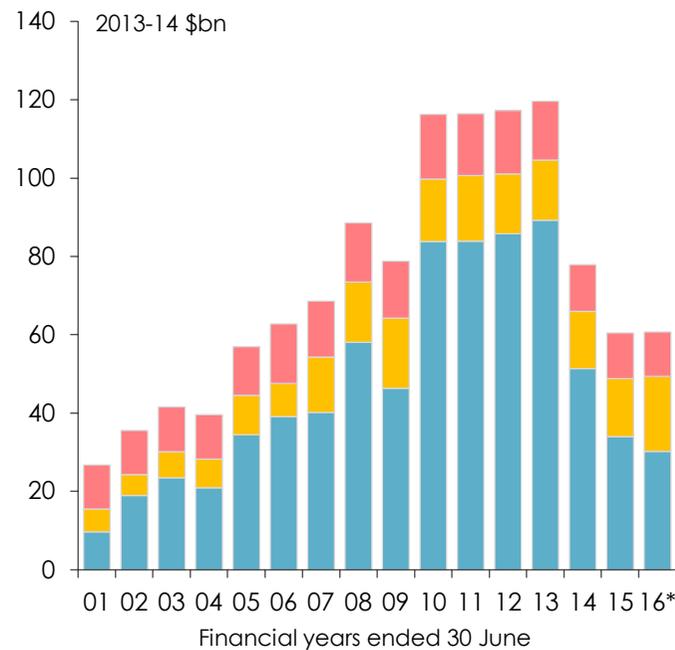
Source: ABS.

Engineering construction is coming off an extraordinary high as the mining investment boom winds down

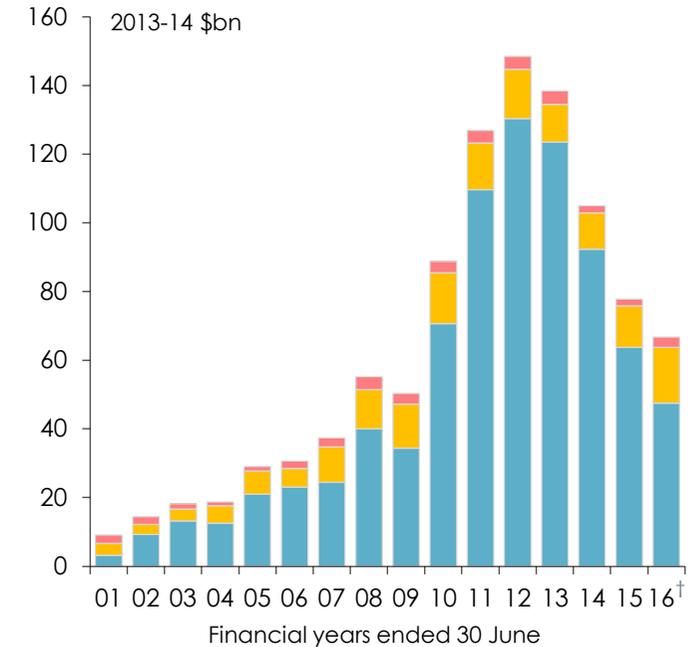
Value of engineering construction work done



Value of engineering construction commenced



Value of engineering construction work to be done

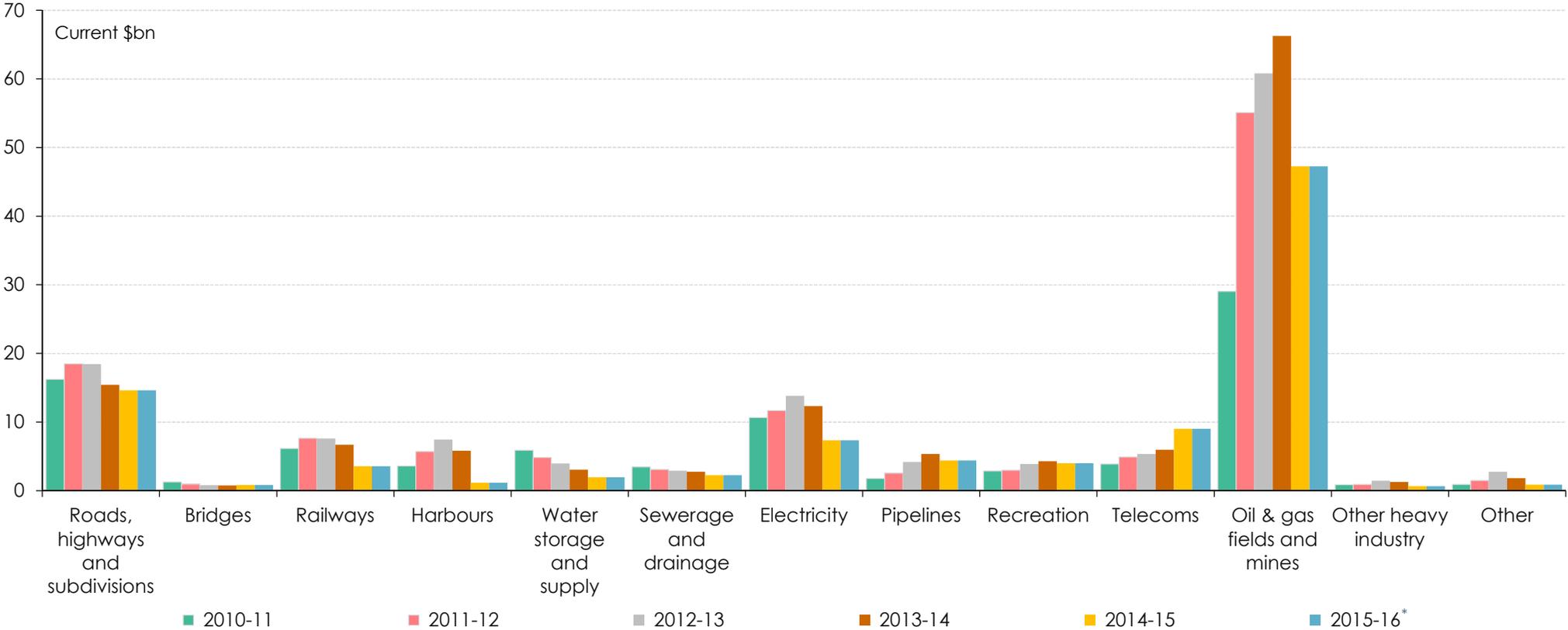


■ By the private sector for the private sector ■ By the private sector for the public sector ■ By the public sector for the public sector

* First three quarters of 2015-16 at annualized rate. † As at end-March 2016.
Source: ABS.

From a peak of more than 50% of engineering construction work done the resources sector is now heading down probably to less than 20%

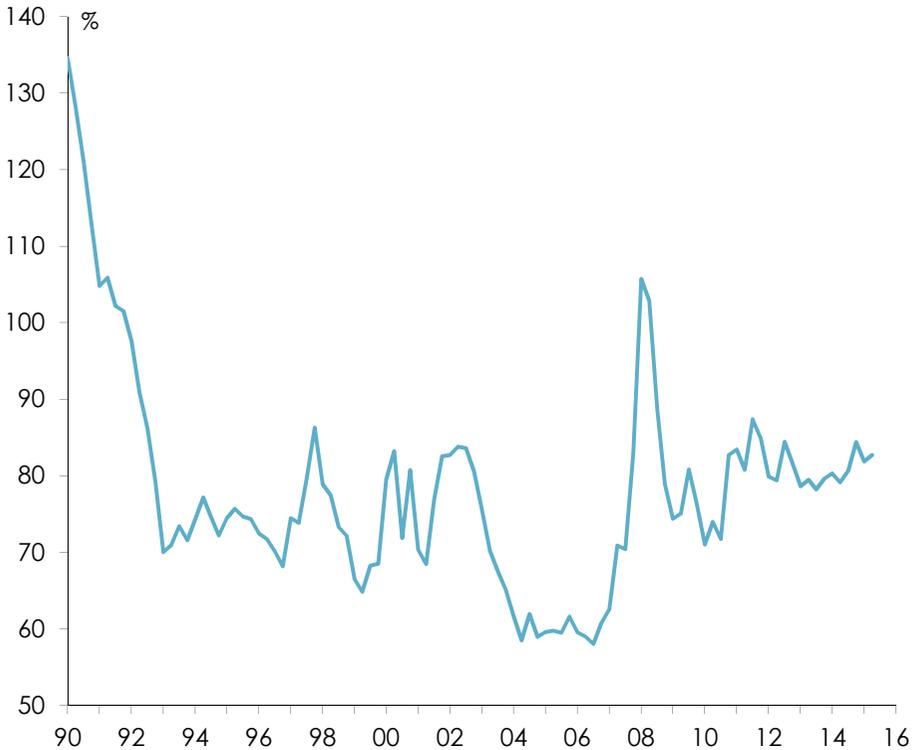
Engineering construction work done by major category, 2010-11 to 2015-16



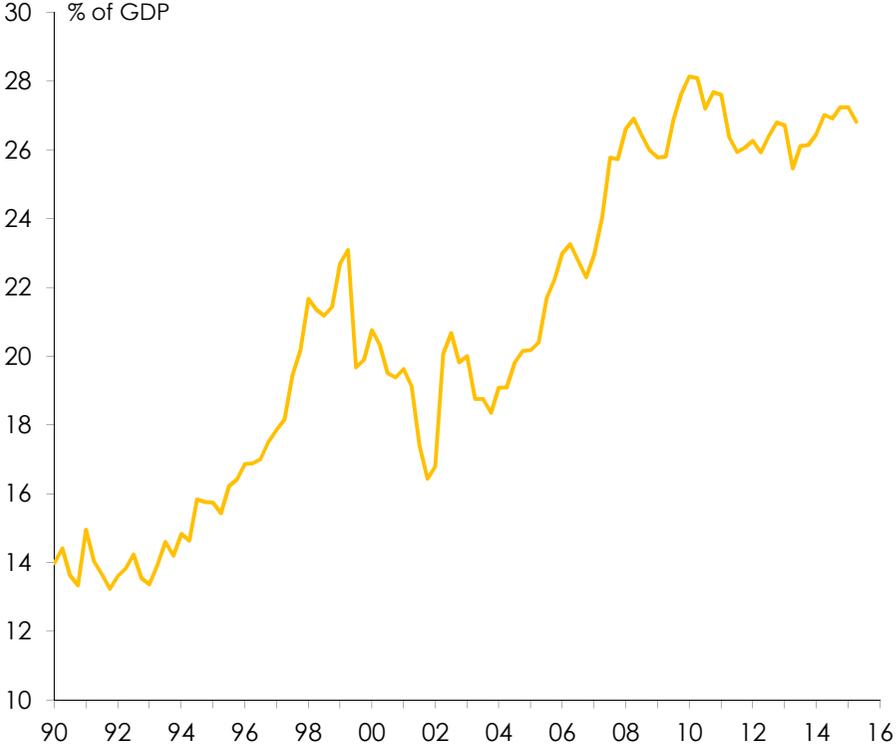
* First three quarters of 2015-16 at annualized rate. Source: ABS.

Corporate sector balance sheets are not an obstacle to higher levels of business investment

Non-financial corporate debt-equity ratio



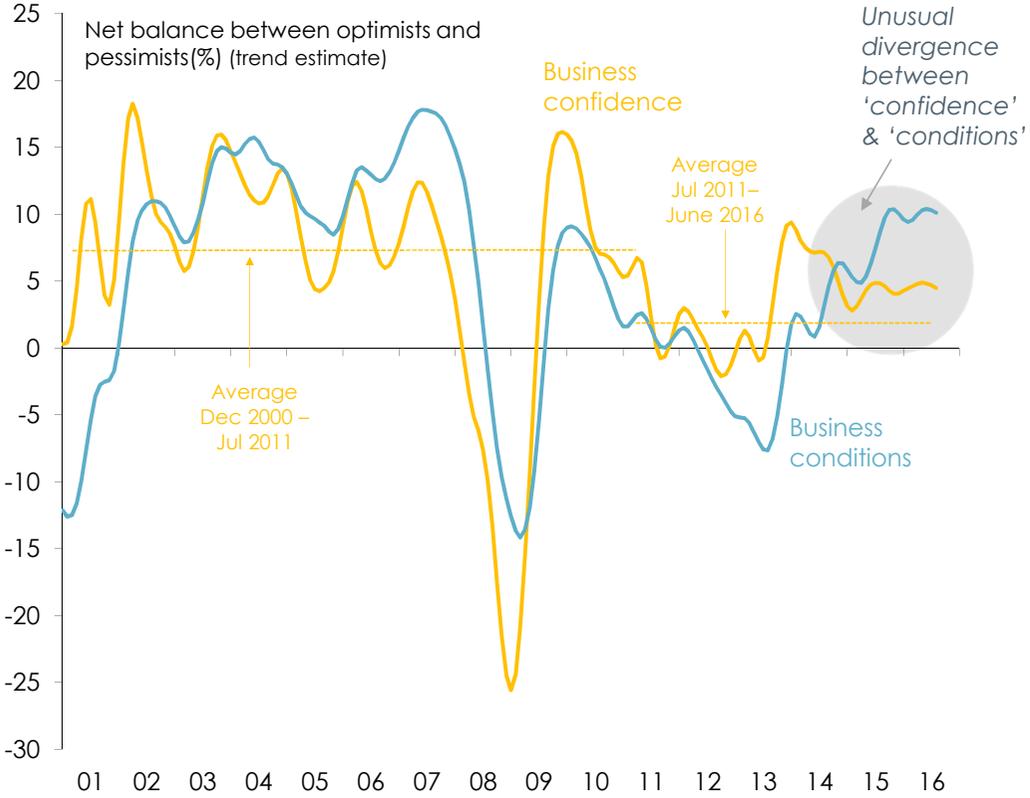
Non-financial corporate sector cash holdings



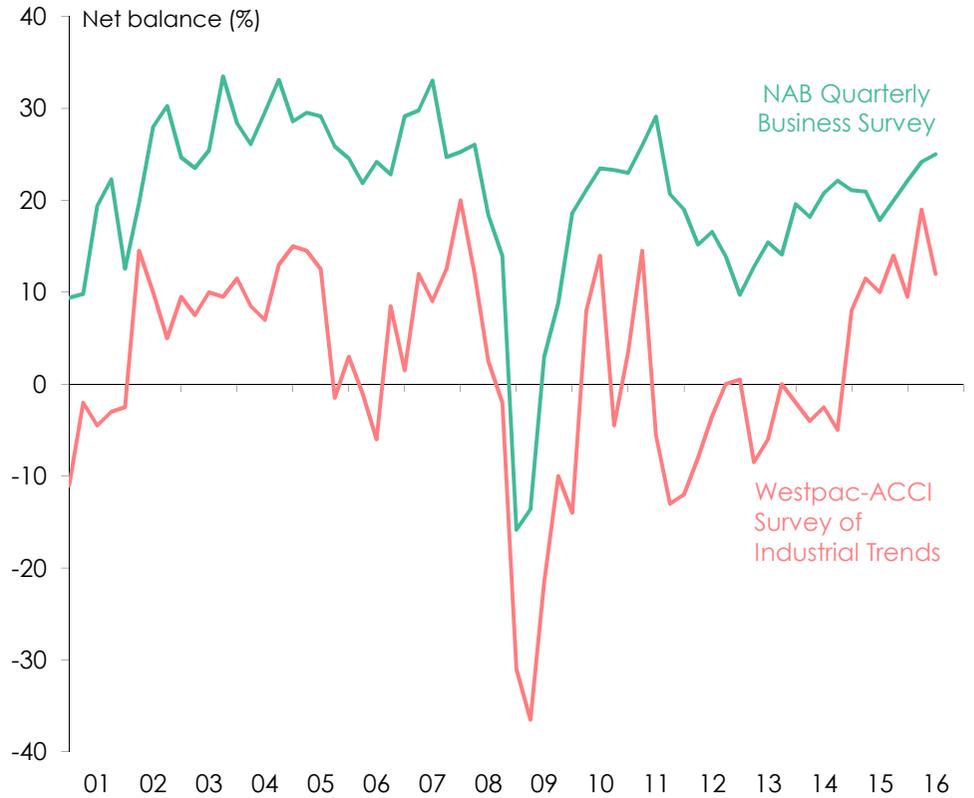
Source: ABS

Persistently weak business confidence is probably undermining business investment intentions

Business confidence and conditions



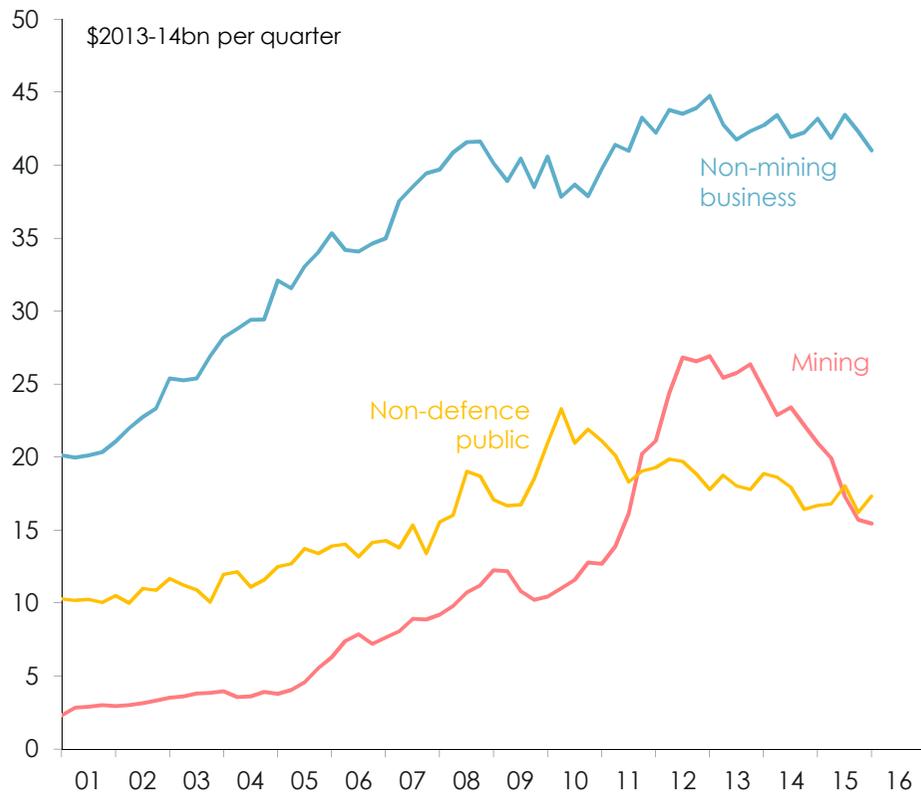
Business survey capex intentions



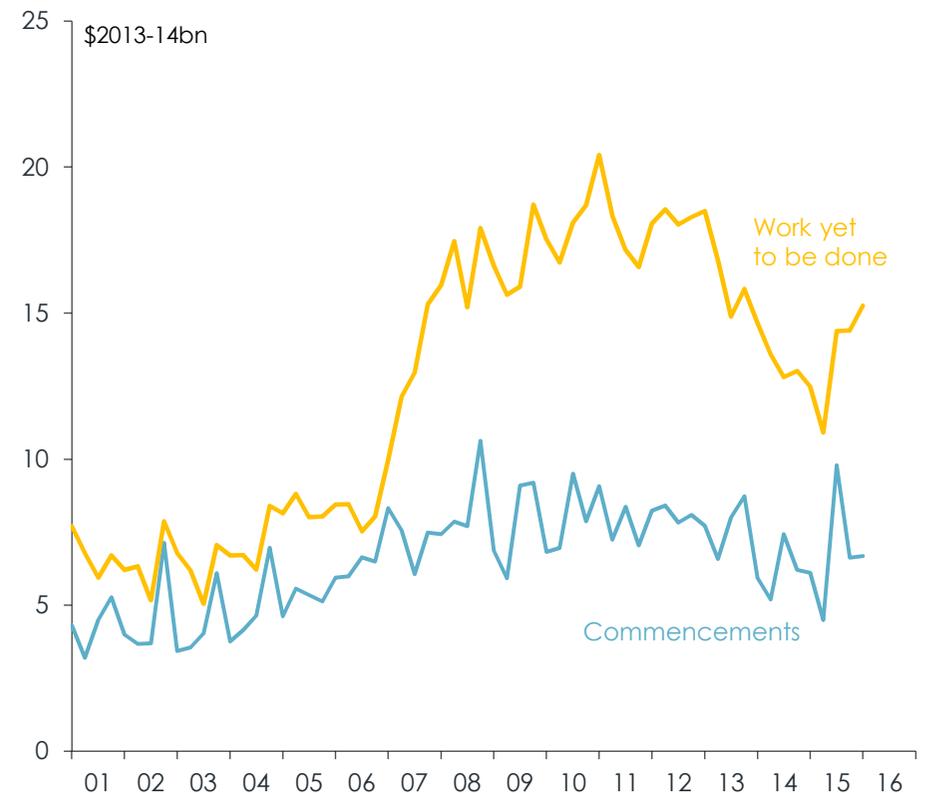
Source: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry

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.

More well-targeted and properly-governed infrastructure spending would be helpful to sustaining economic growth

'Infrastructure spending has a role to play in sustaining growth and also in generating confidence ...

It would be confidence-enhancing if there was an agreed story about a long-term pipeline of infrastructure projects, surrounded by appropriate governance on project selection, risk-sharing between public and private sectors at varying stages of production and ownership, and appropriate pricing for use of the finished product.

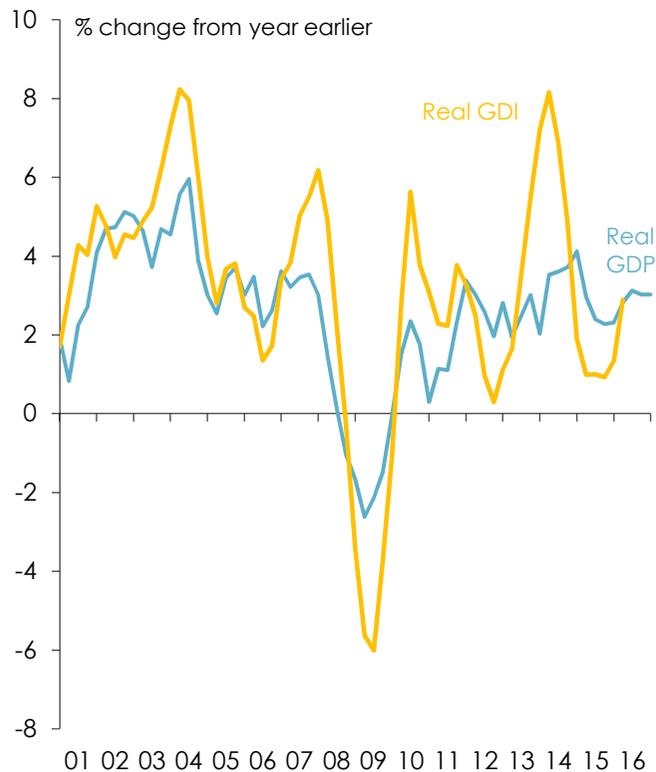
The impediments to this outcome are not financial. The funding would be available, with long term interest rates the lowest we have ever seen or are likely to ... The impediments are in our decision-making processes and, it seems, in our inability to find political agreement on how to proceed'

— Glenn Stevens, '[Economic Conditions and Prospects: Creating the Upside](#)',
Address to an Economic Society of Australia luncheon, Brisbane, 10th June 2015

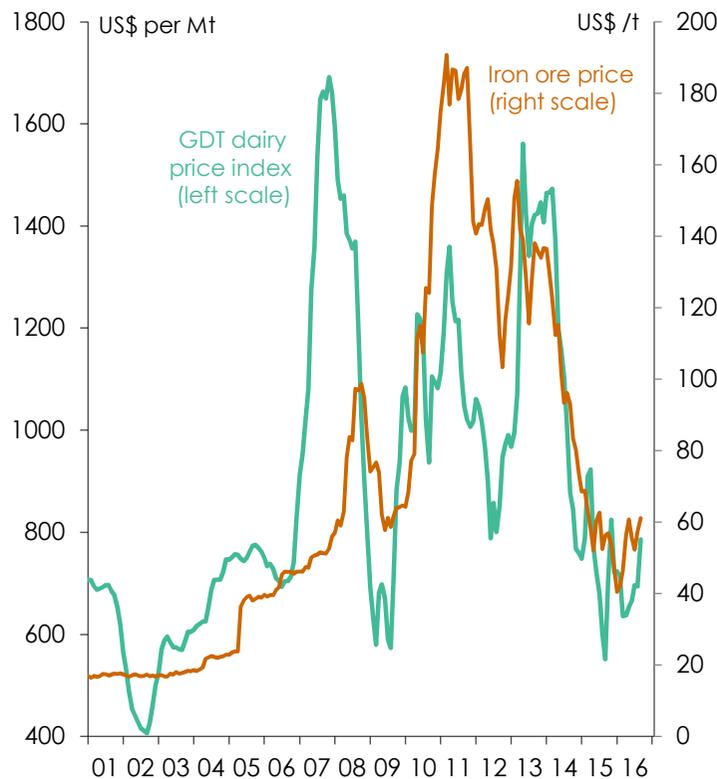
New Zealand

New Zealand is fairly successfully weathering the aftermath of its commodity boom

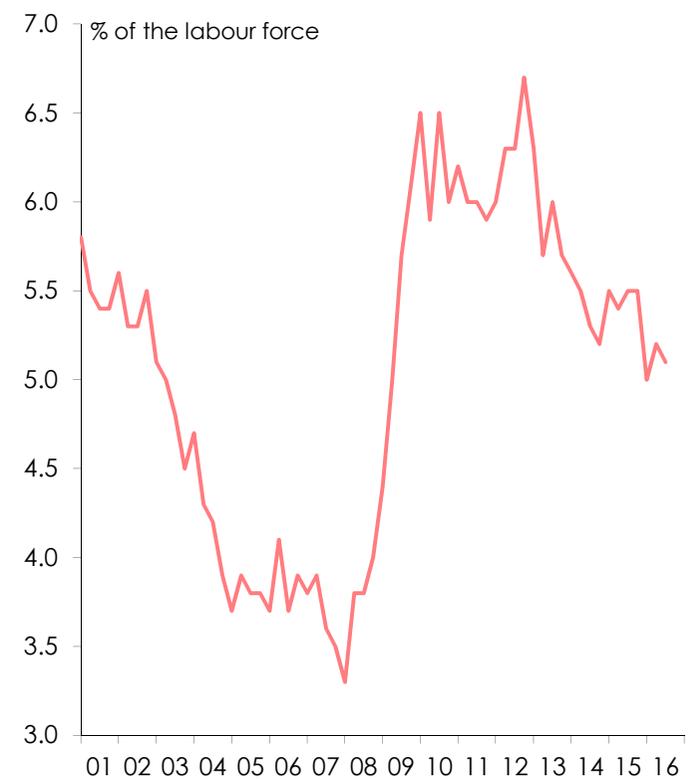
New Zealand real gross domestic product and income



Dairy product vs iron ore prices



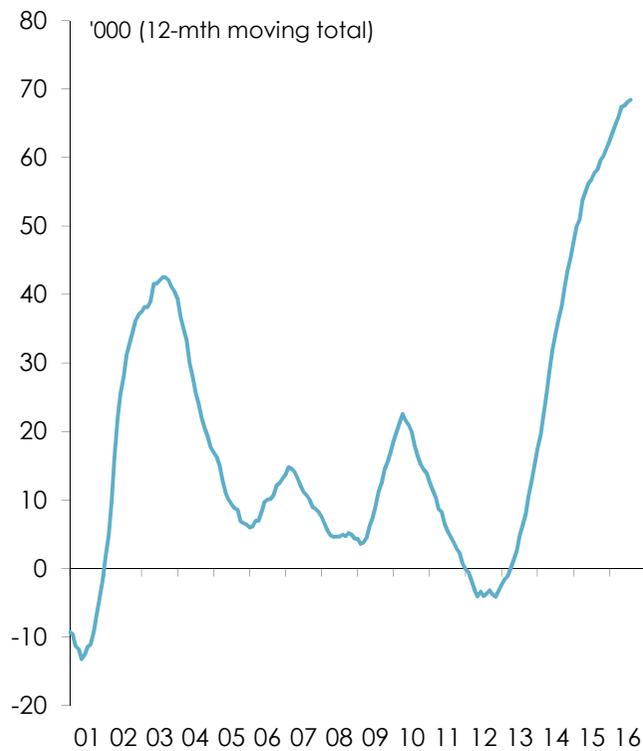
New Zealand unemployment rate



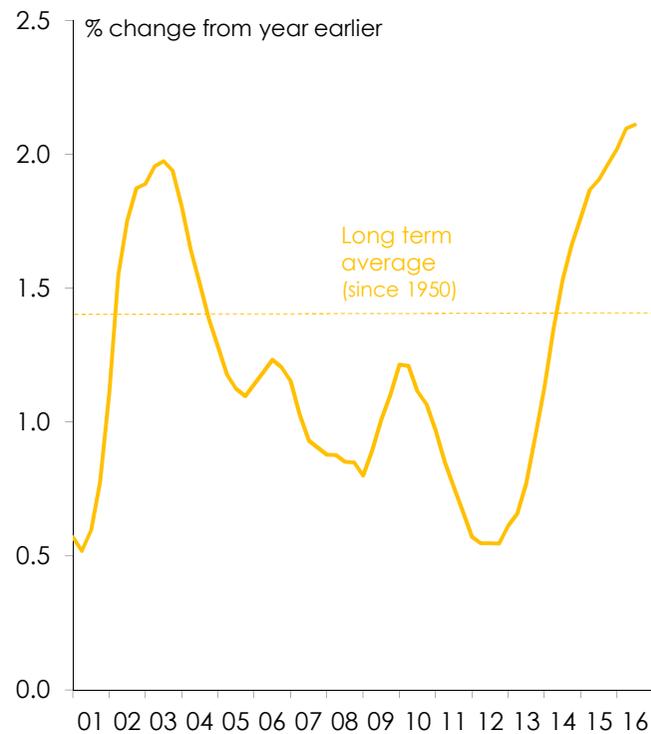
Note: Real gross domestic income (GDI) is real GDP plus net income gains (or losses) arising from changes in the terms of trade (the ratio of export to import prices).
Sources: Statistics NZ; Global Dairy Trade; Thomson Reuters Datastream.

New Zealand is also experiencing an almost unprecedented surge in immigration - and a tourism boom

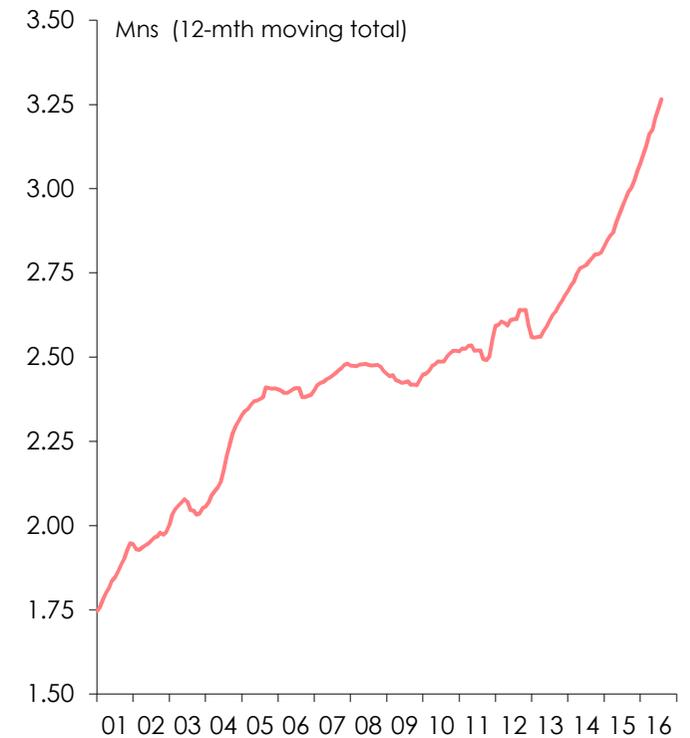
Net long-term and permanent immigration to New Zealand



New Zealand population growth



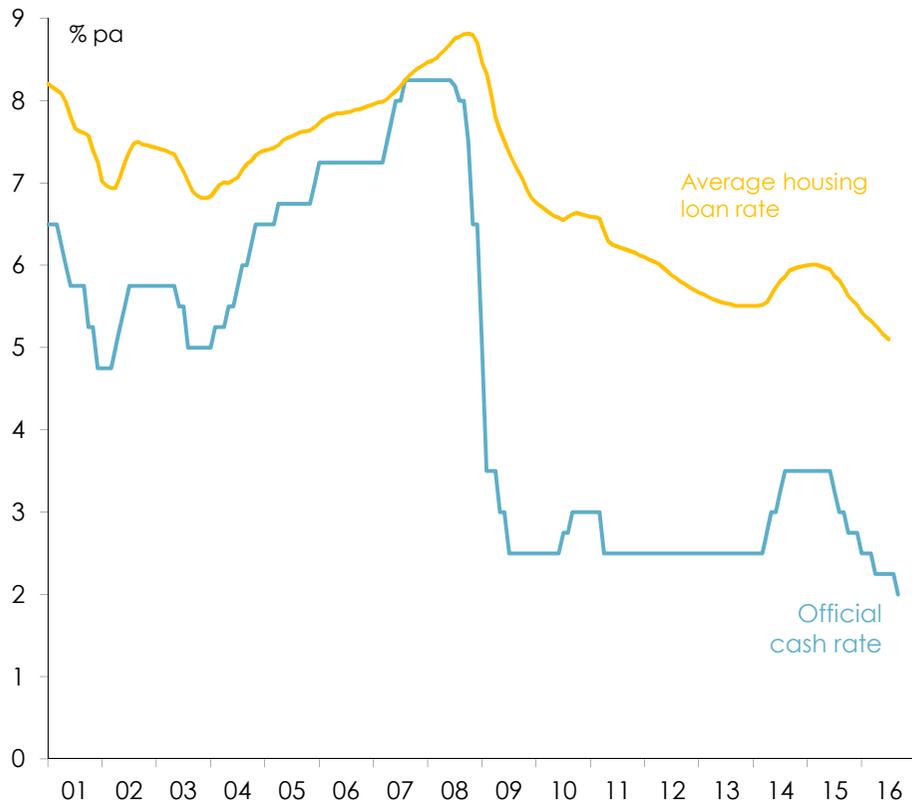
New Zealand short-term overseas visitor arrivals



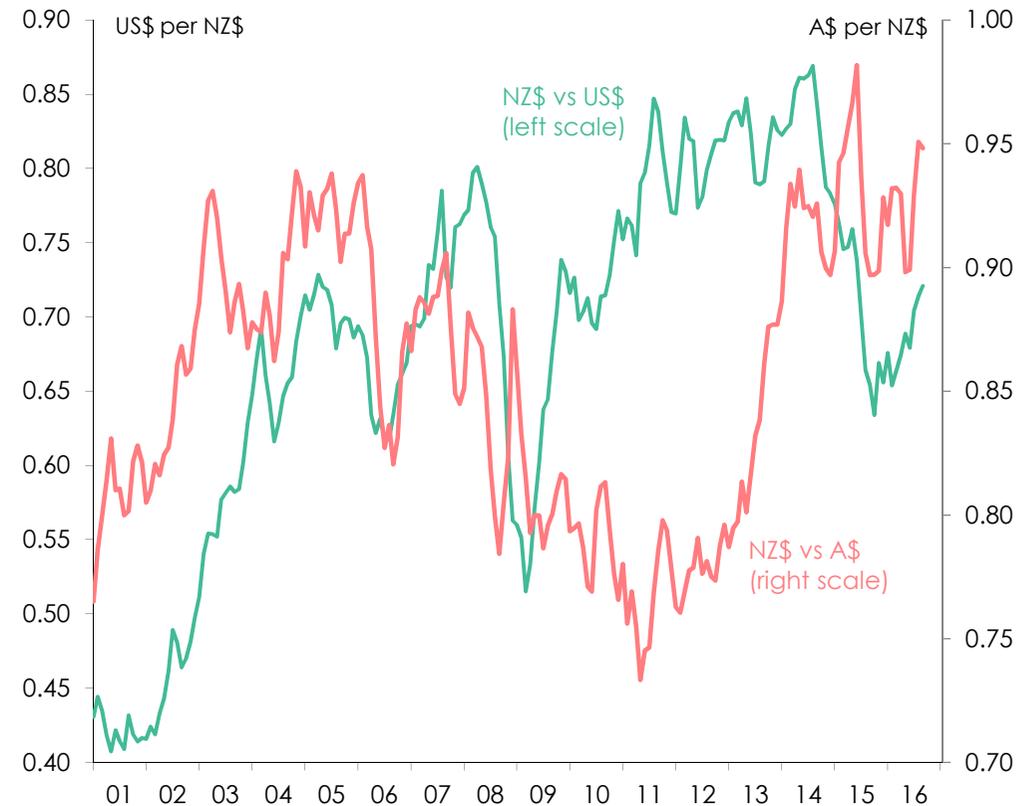
Source: Statistics NZ.

New Zealand interest rates are also now at record lows – although the NZ has remained stubbornly strong

New Zealand interest rates



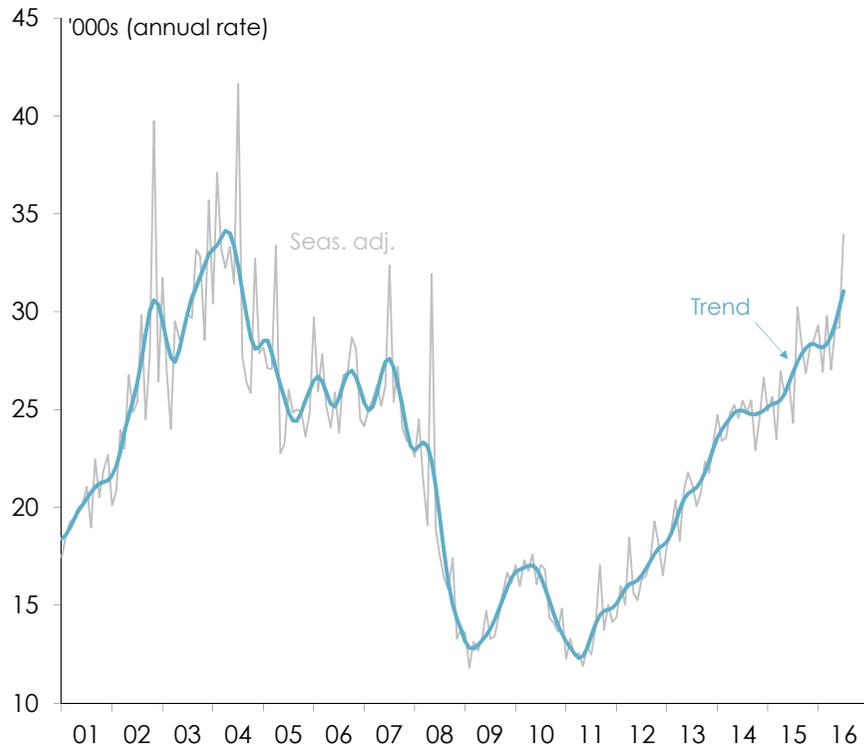
New Zealand dollar



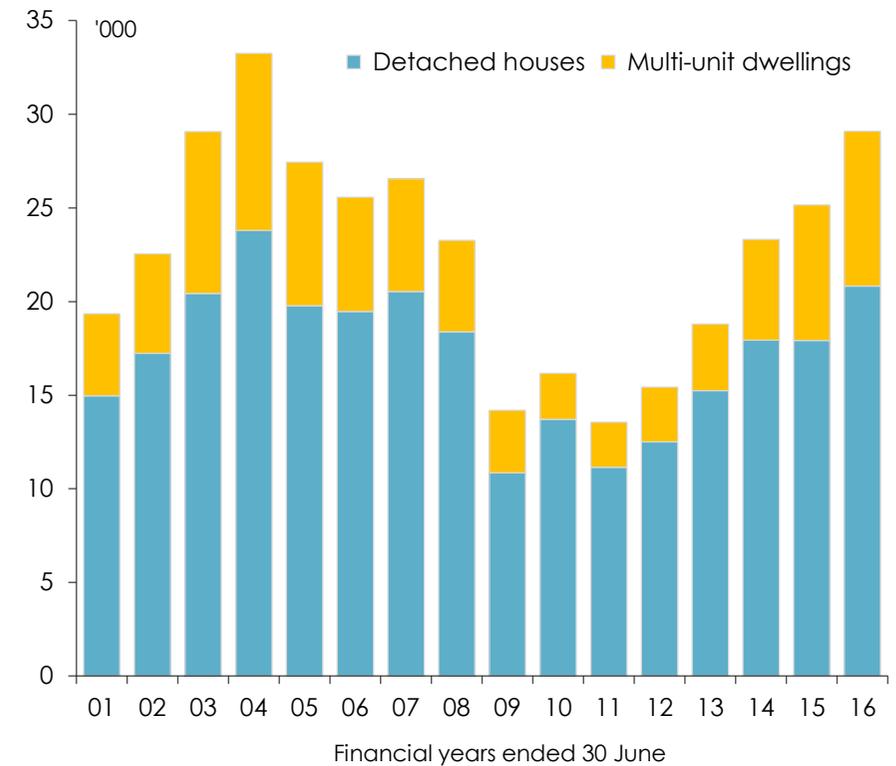
Source: Reserve Bank of New Zealand; Thomson Reuters Datastream.

Not surprisingly New Zealand is experiencing a housing construction boom - but unlike in Australia most of it is in detached dwellings

Dwelling consents (residential building approvals)



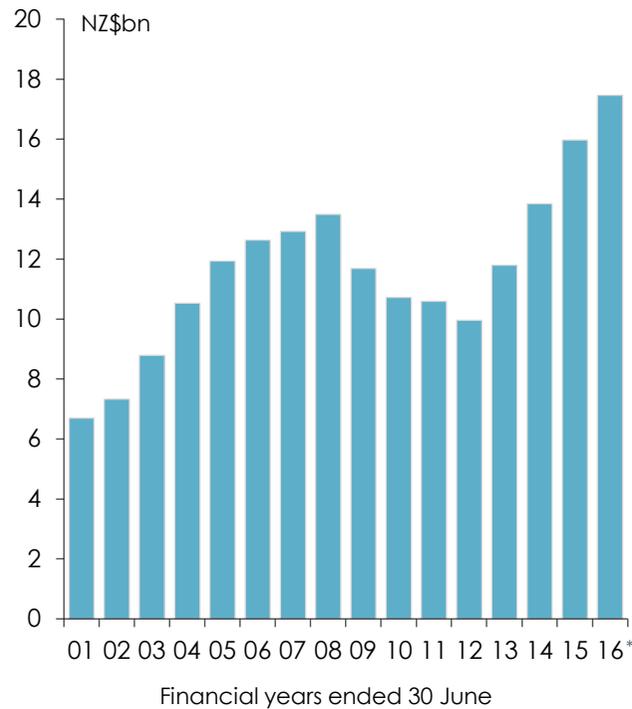
Dwelling consents by category of building



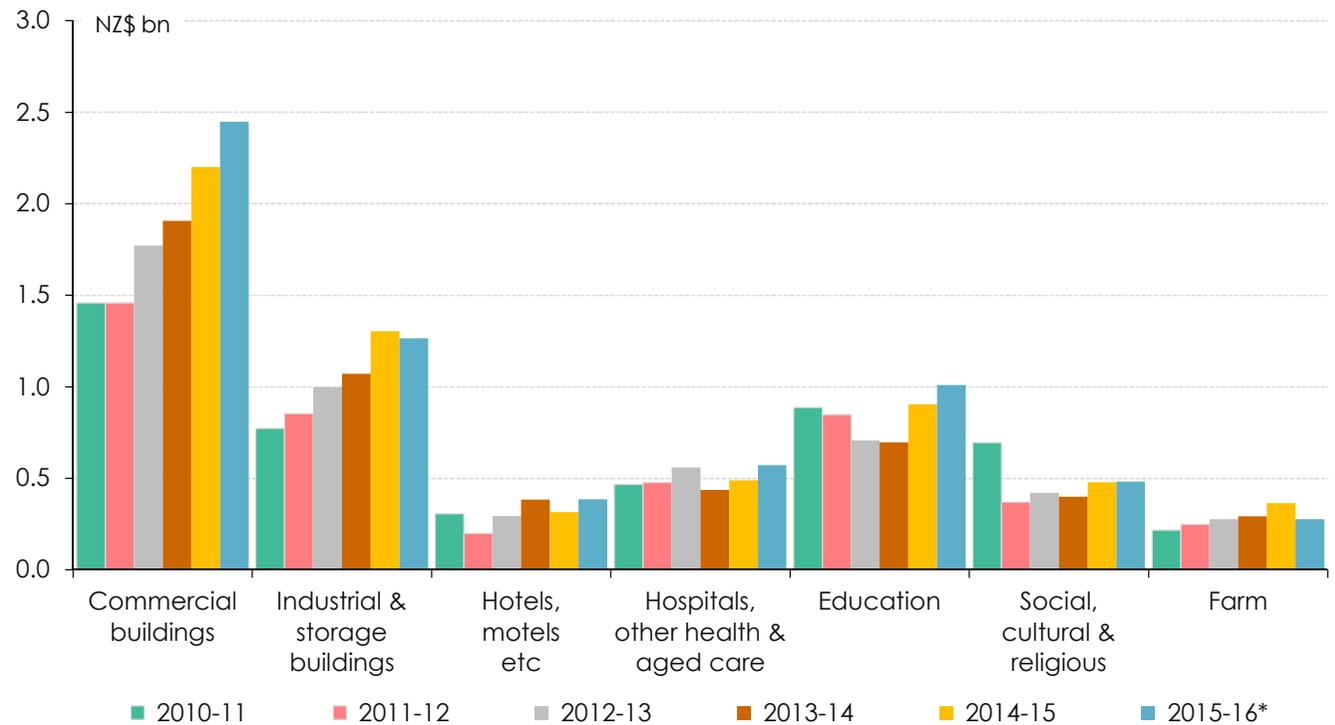
Source: Statistics New Zealand.

In marked contrast to Australia, non-residential building activity has been rising strongly in New Zealand

Value of non-residential building work done



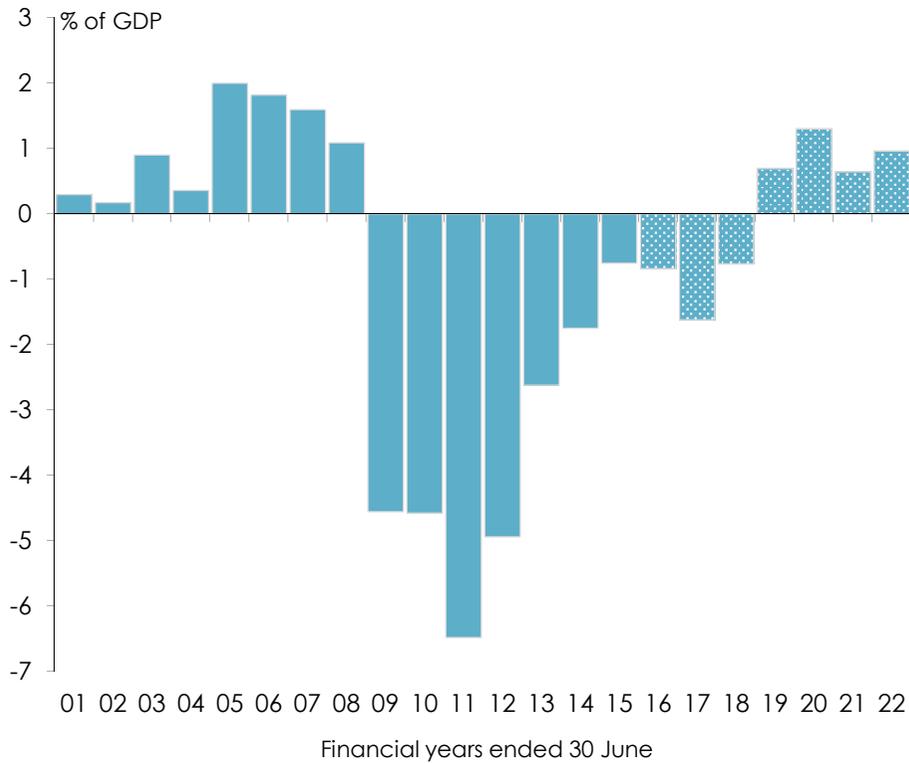
Value of non-residential building by type of building



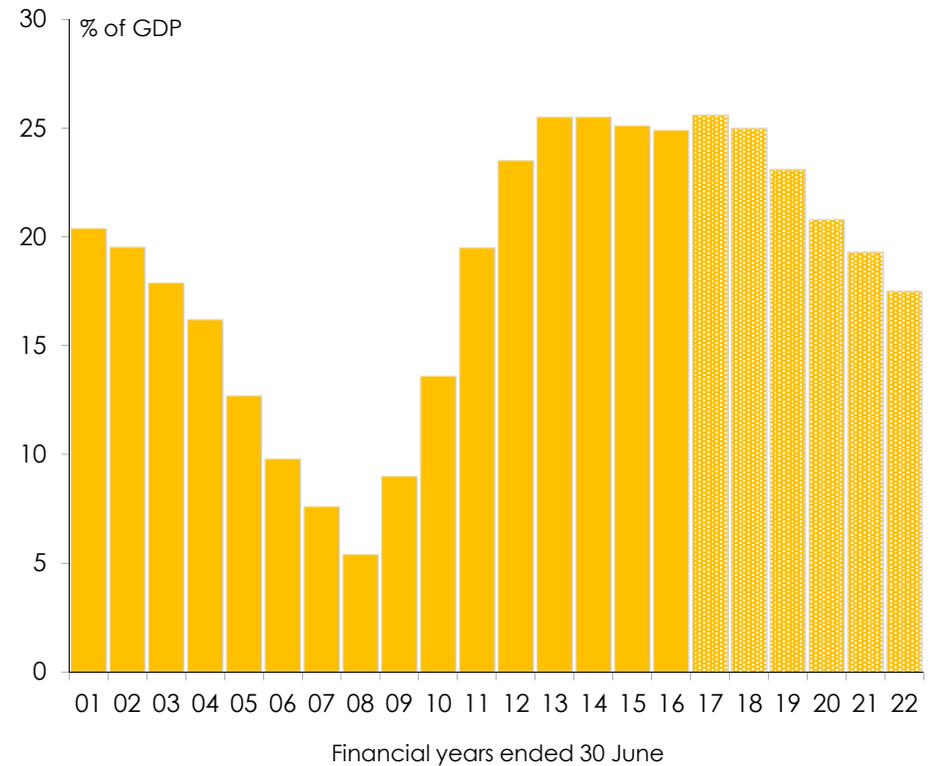
* First three quarters at annualized rate. Data are in current prices.
Source: ABS.

Something which New Zealand has and Australia doesn't is a competent, popular government

New Zealand Government 'residual cash balance'



New Zealand Government 'core Crown net debt'

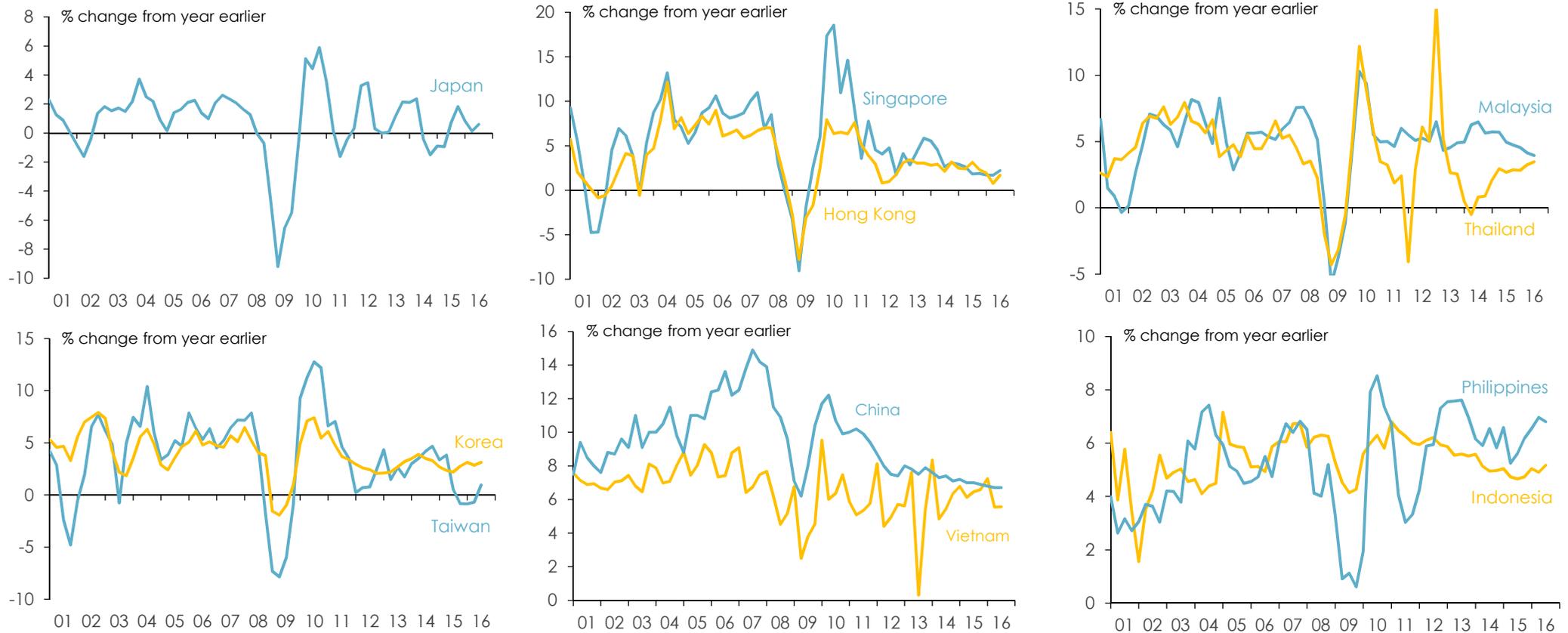


Source: New Zealand Treasury

Asia

Economic growth has slowed across most of East Asia (except for Indonesia, Philippines and Vietnam) since the financial crisis

Real GDP growth – East Asian economies

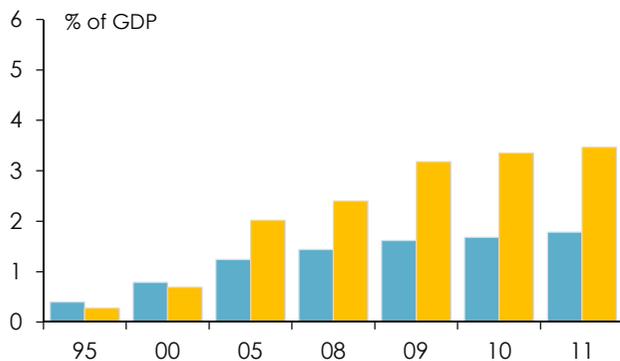


Sources: national statistical agencies and central banks; Thomson Reuters Datastream.

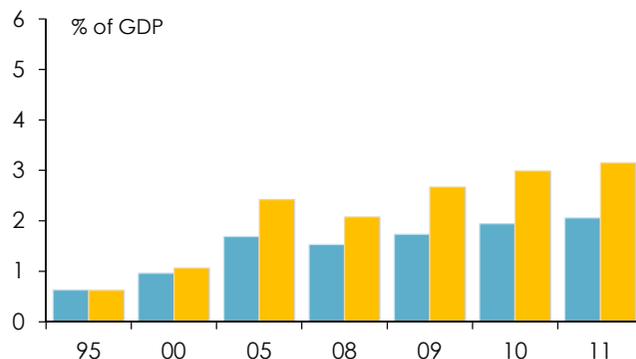
Relative exposure to China – and in particular to Chinese fixed investment – has been a major influence on Asian economies' growth performance

Share of domestic value added in Asian economies' exports to China

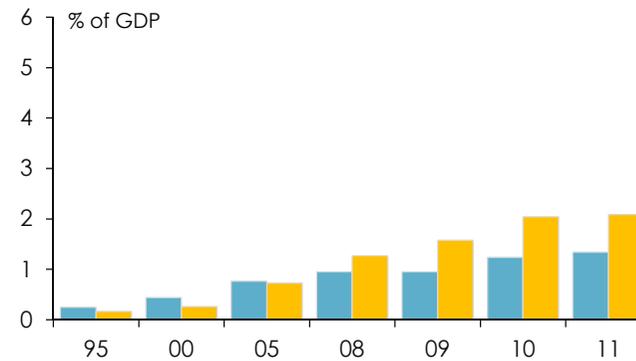
Korea



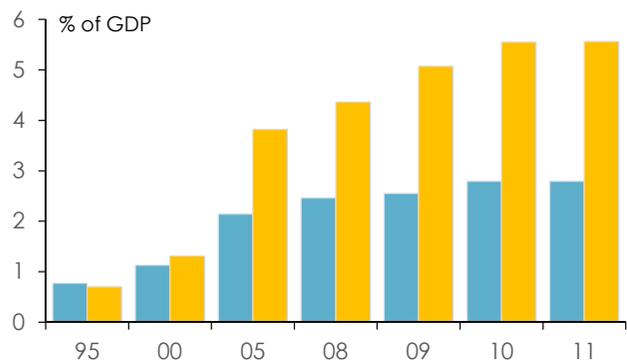
Malaysia



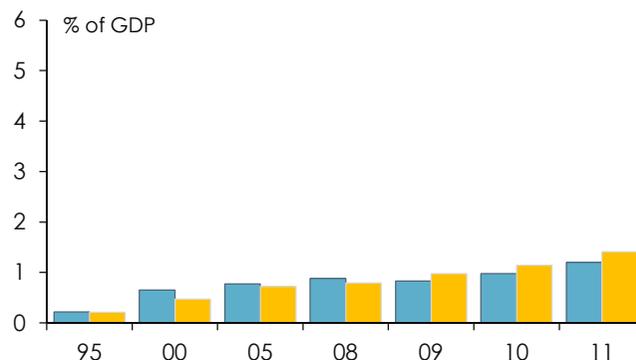
Australia



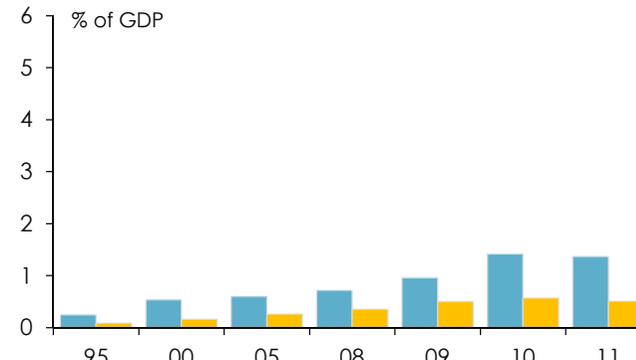
Taiwan



Indonesia



New Zealand



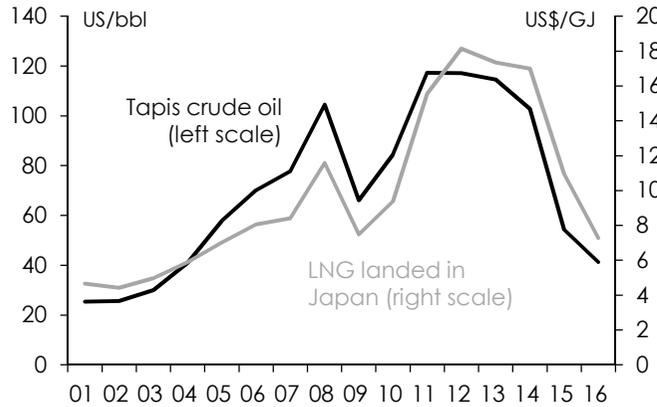
■ Domestic value added in Chinese consumption ■ Domestic value added in Chinese fixed investment

Source: Gee Hee Hong, Jaewoo Lee, Wei Lao and Dulani Seneviratne, *China and Asia in Global Trade Slowdown*, IMF Working Paper No 16/105, May 2016.

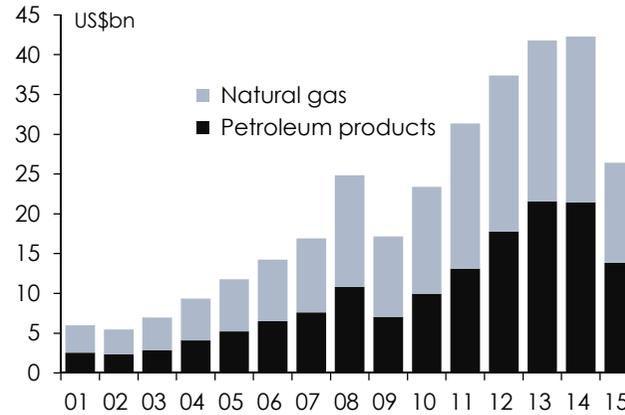
SAUL ESLAKE

Declining energy prices since 2011 have hurt Malaysia's and Indonesia's export incomes, but lowered Korea's and Taiwan's import bills

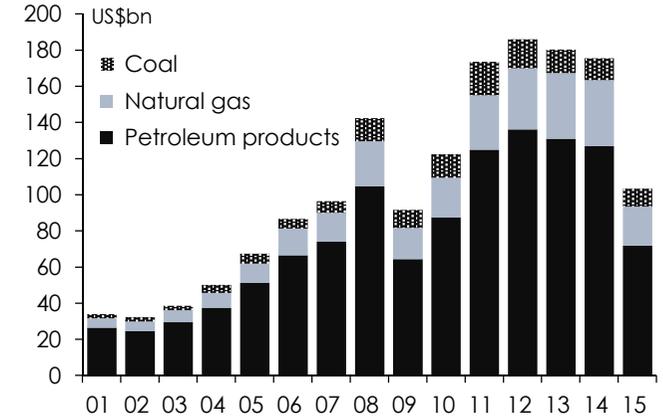
Asian oil and LNG prices



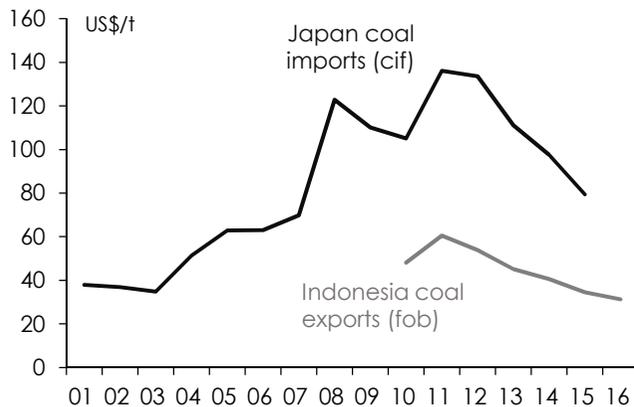
Malaysia energy exports



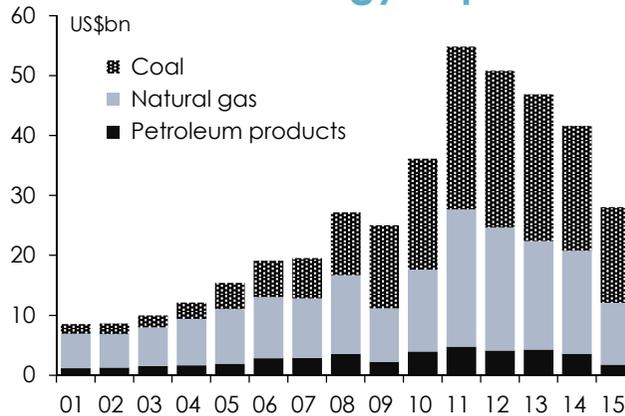
Korea energy imports



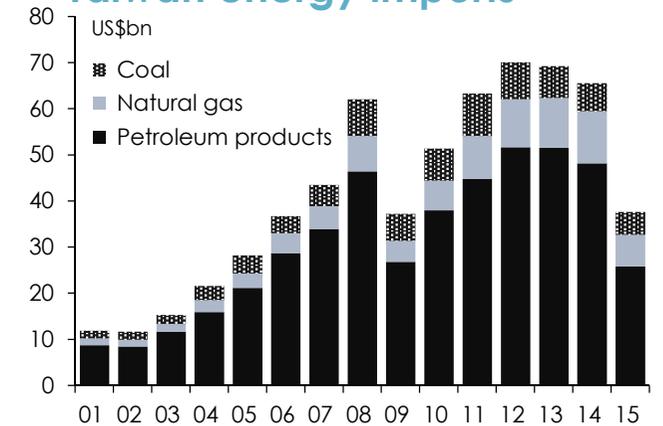
Asian thermal coal prices



Indonesia energy exports



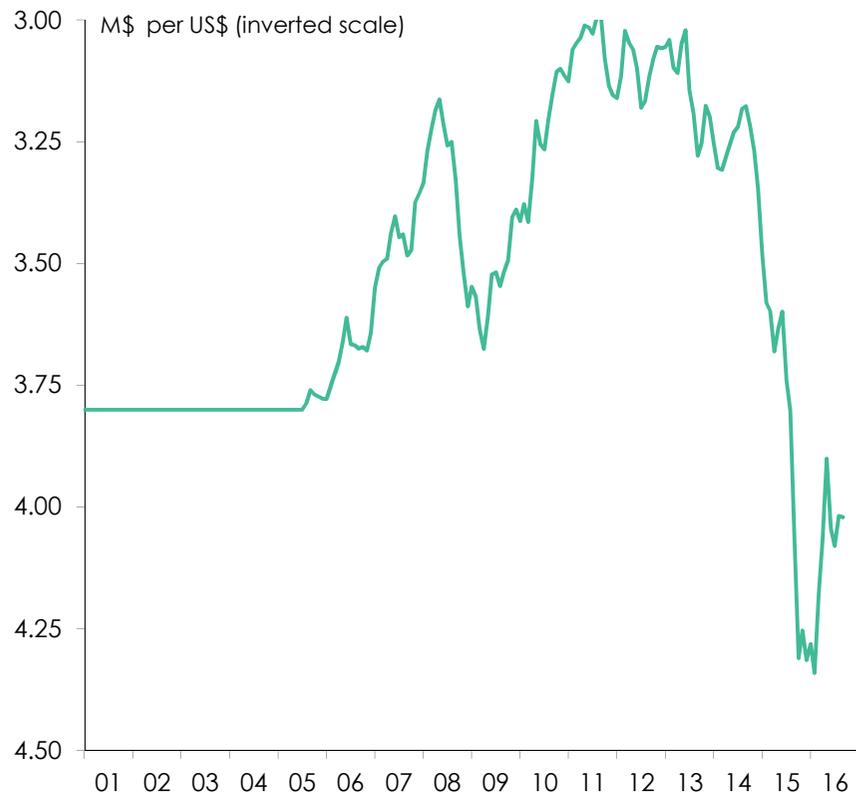
Taiwan energy imports



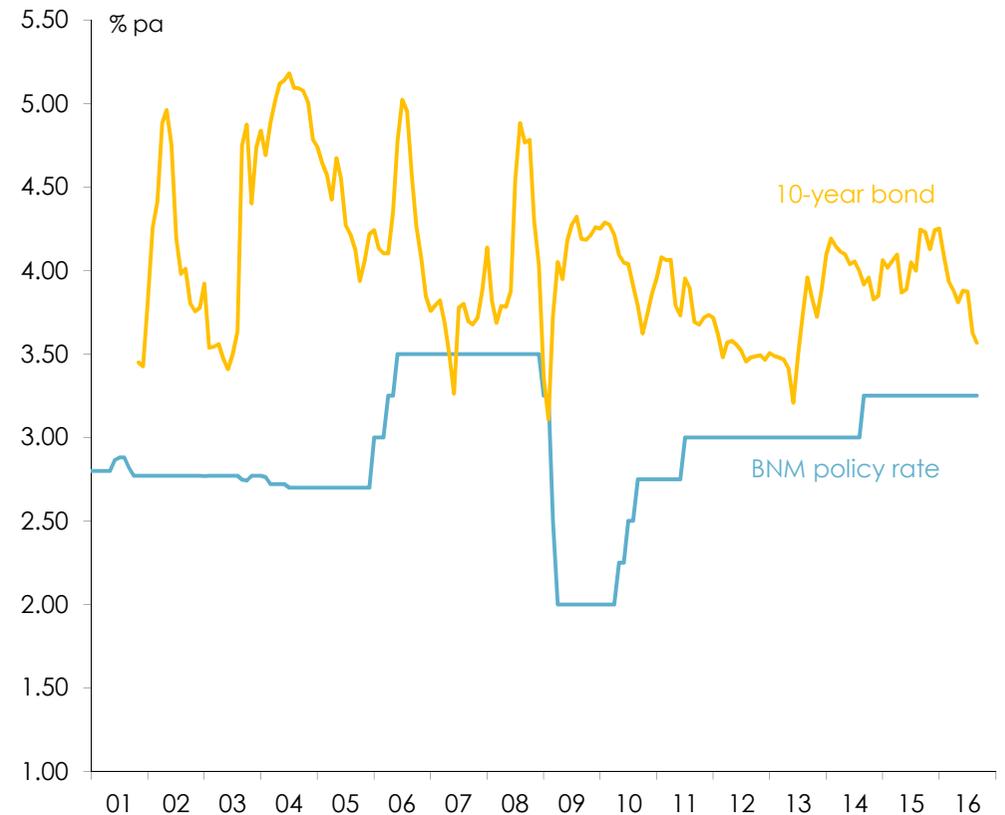
Sources: Thomson Reuters Datastream; IMF; Malaysia Department of Statistics; Statistics Indonesia; Korea Statistical Information Service; Taiwan Ministry of Finance.

The Malaysian ringgit has been much weaker than other Asian currencies – and Malaysian interest rates have gone up, not down

Malaysian ringgit vs US\$



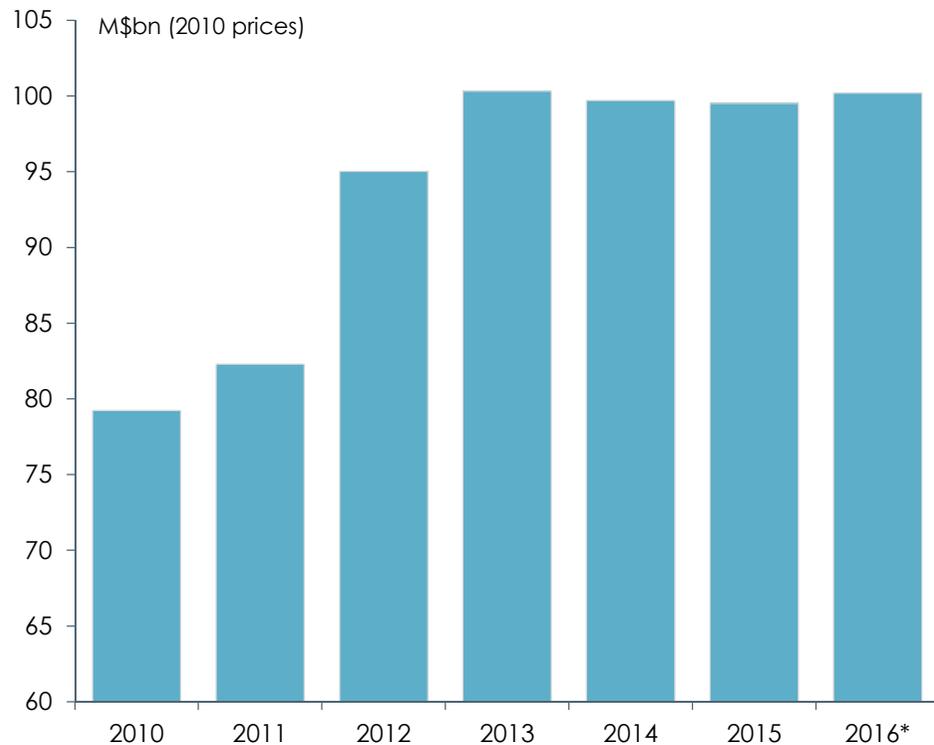
Malaysian interest rates



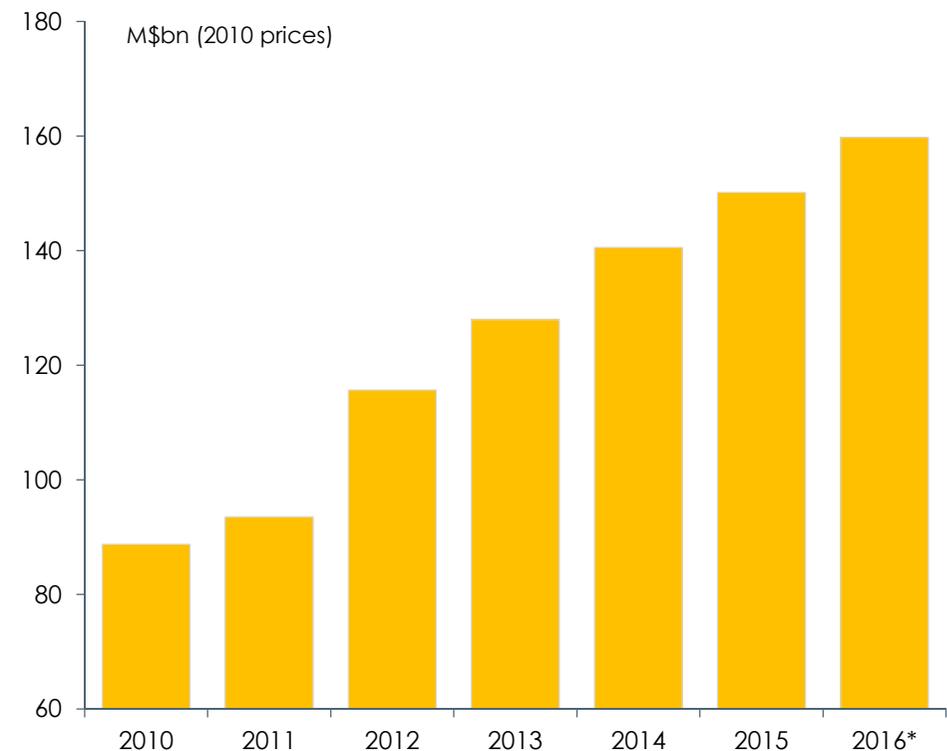
Source: Thomson Reuters Datastream; Bank Negara Malaysia

Growth in Malaysian construction has slowed significantly over the past four years

Real gross value added in construction - Malaysia



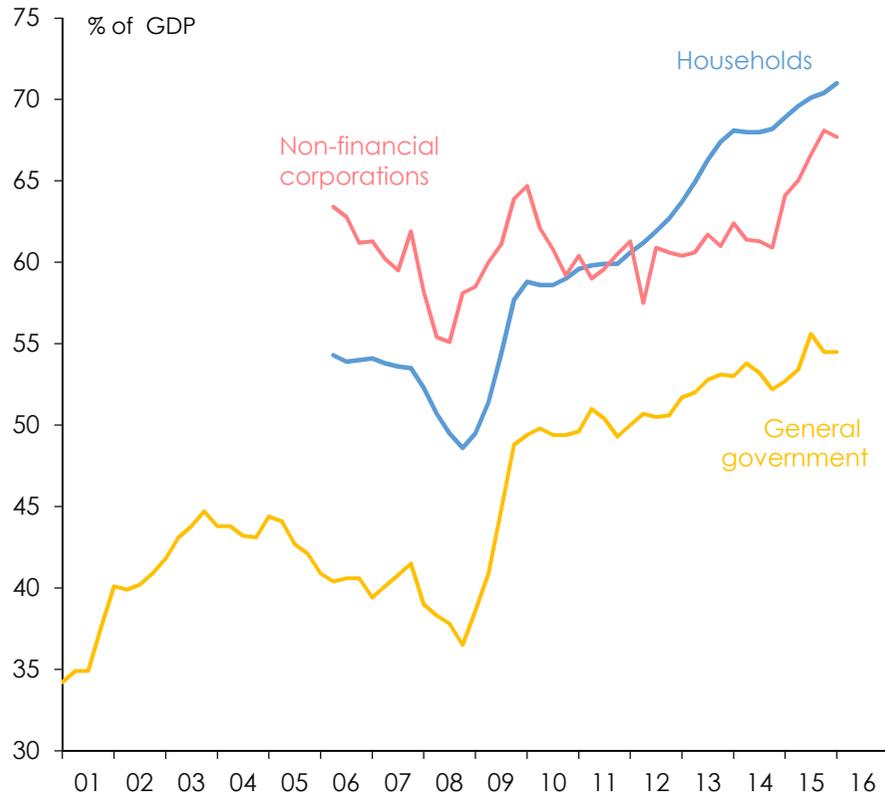
Real gross fixed capital expenditure on structures - Malaysia



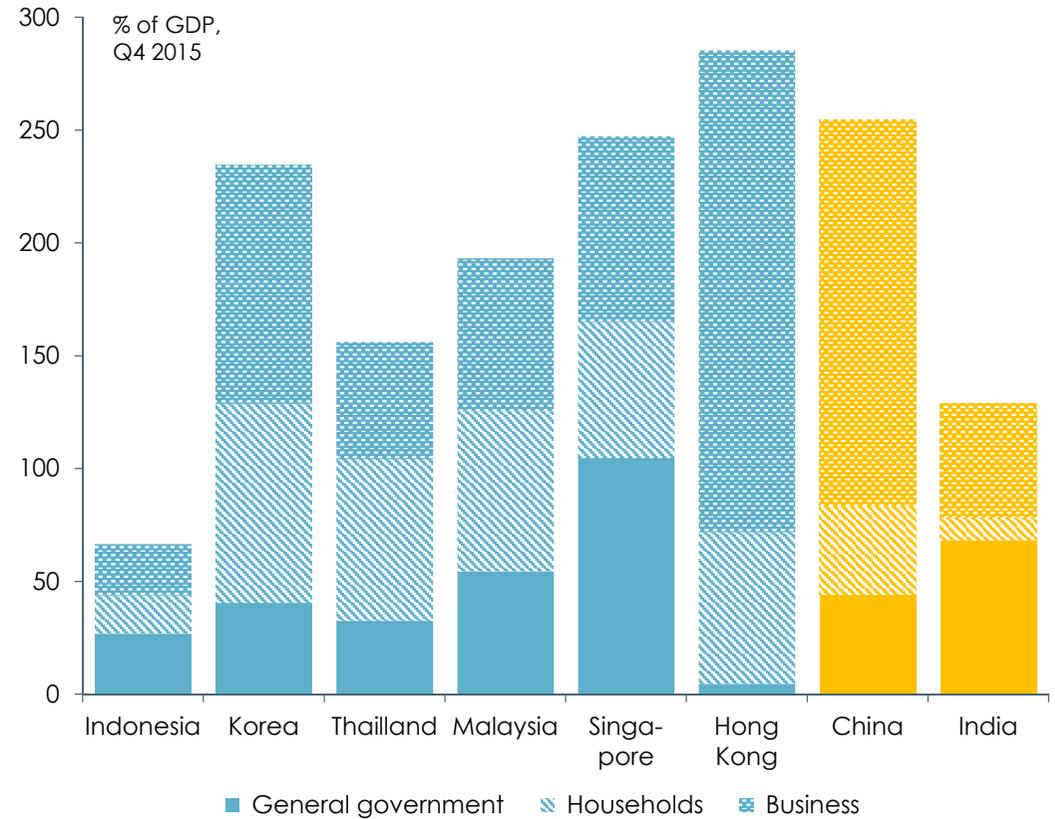
Source: Malaysia Department of Statistics.

The Malaysian private sector has a lot of debt by comparison with other Asian economies at similar stages of development

Malaysia – debt by major sector

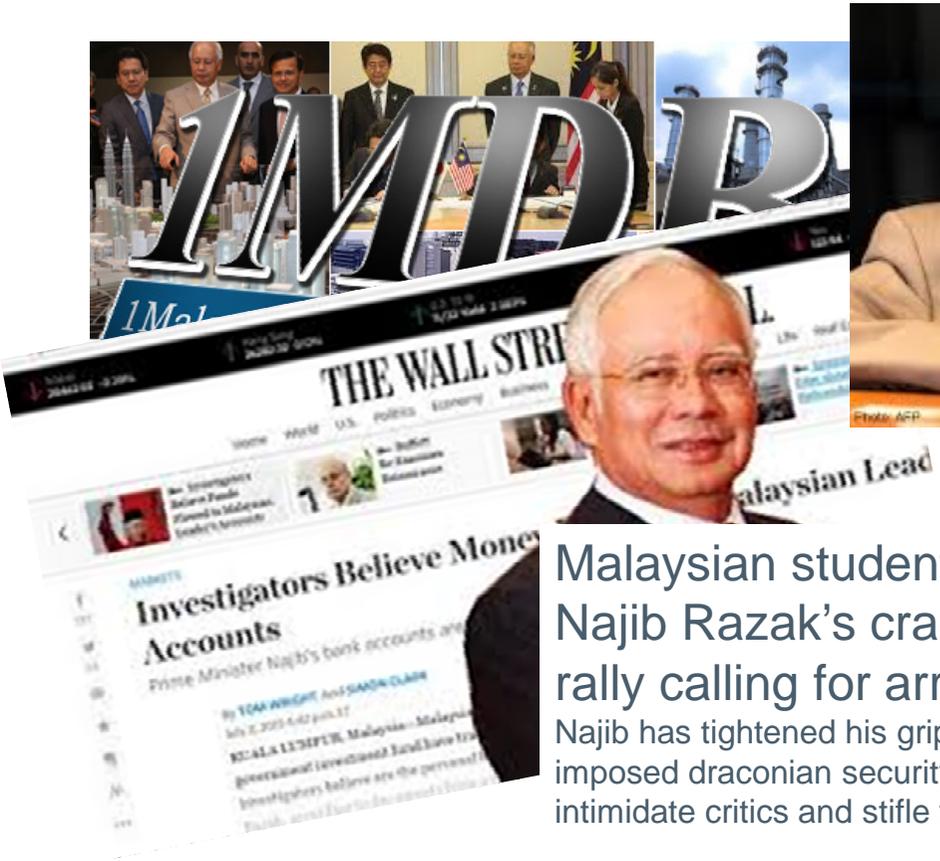


Debt – Asian economies, end-2015

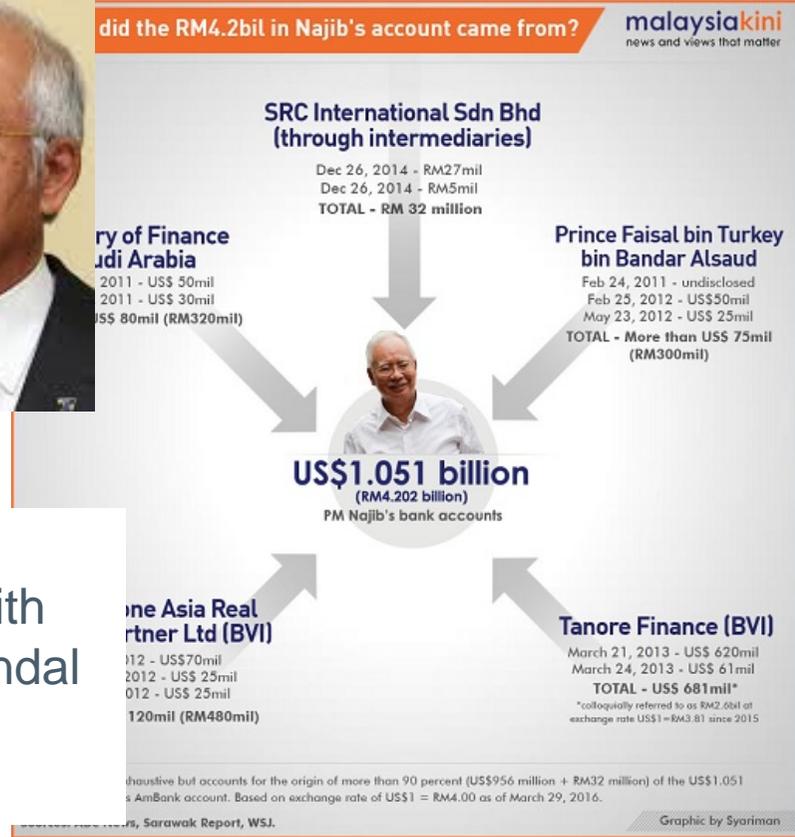


Source: Bank for International Settlements

The political environment in Malaysia has become more uncertain

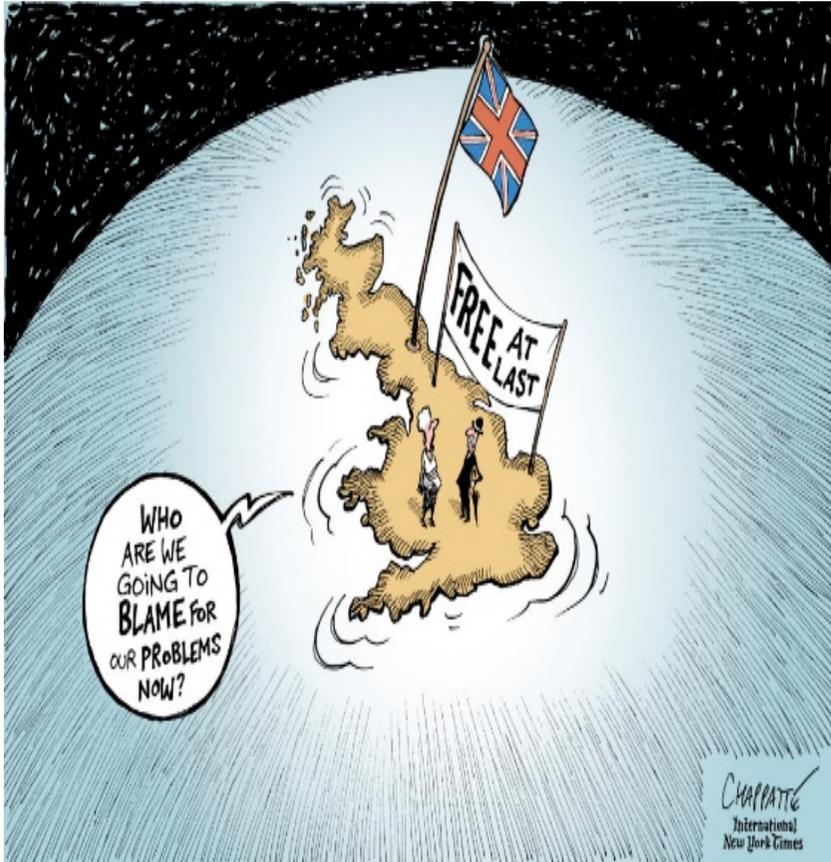


Malaysian students vow to defy Najib Razak's crackdown on dissent with rally calling for arrests over 1MDB scandal
 Najib has tightened his grip on the ruling party and imposed draconian security and sedition laws to intimidate critics and stifle free speech



... and speaking of politics ..

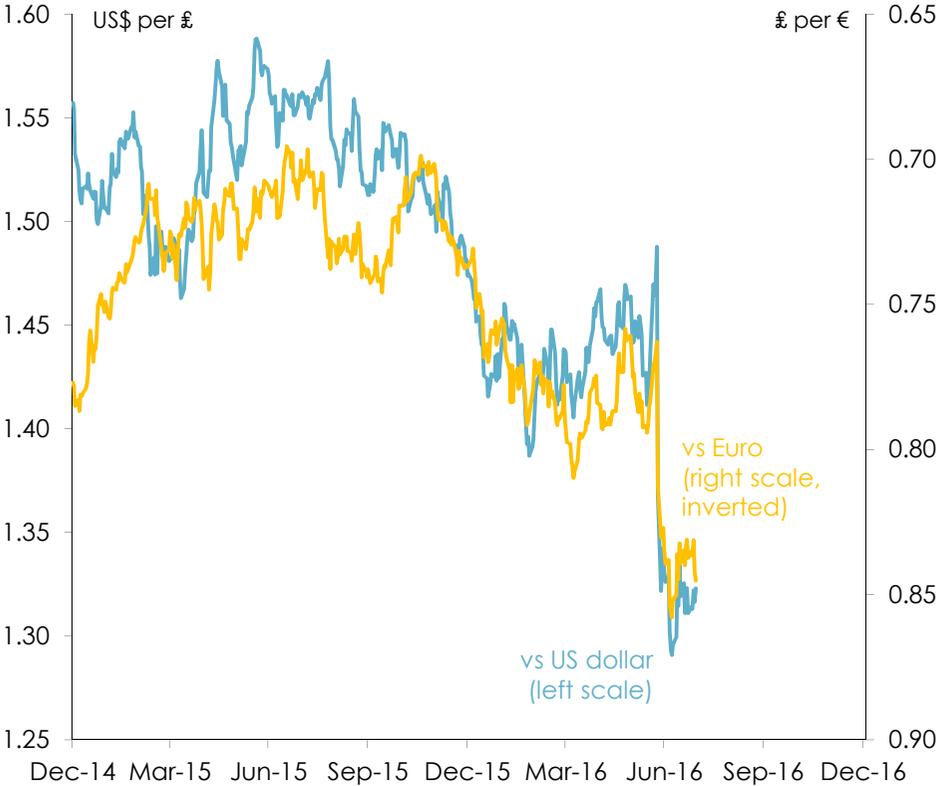
Understanding Britain's vote to leave the EU



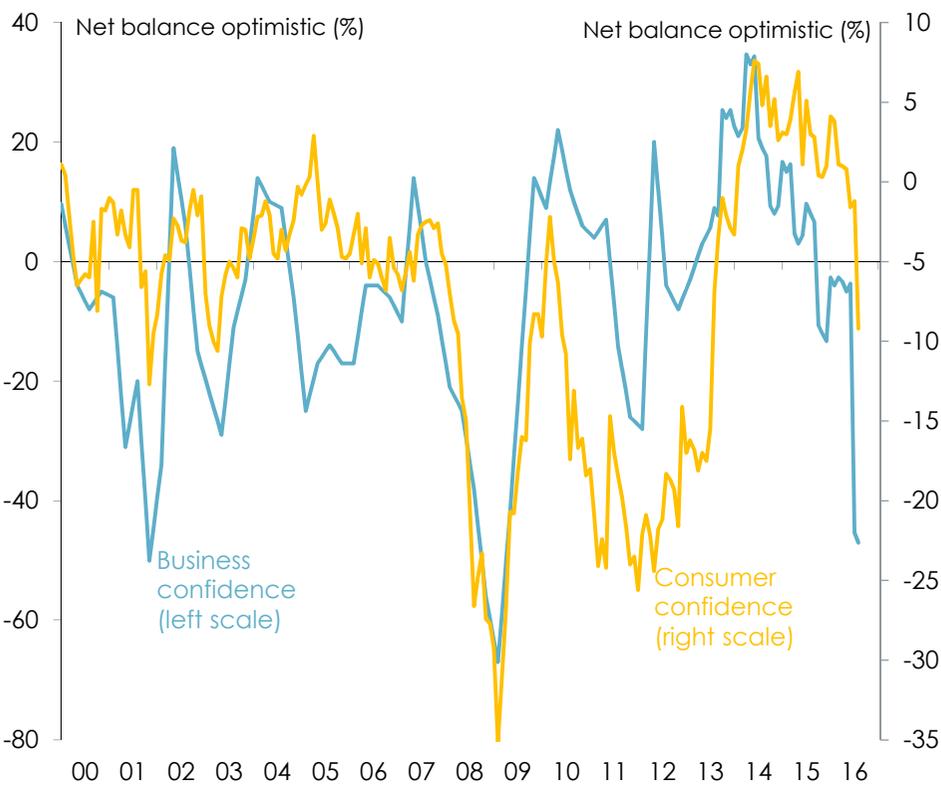
- ❑ The 'Brexit' vote was a victory of
 - the old over the young
 - the angry over the ambivalent
 - the fearful over the hopeful
 - the insular over the cosmopolitan .. and
 - people living in small towns and rural areas over people living in big cities
- ❑ It was to some extent a triumph of
 - those who see themselves as 'victims' of globalization, of rapid technological and social change, and of changes in the ethnic or racial composition of society ...
 - over those whom the same people see as the 'perpetrators' of those changes (the 'elites' and 'experts')
- ❑ And it was a vote for greater control by national governments over the movement of goods, services, capital and (especially) people across national borders
 - and against individuals' ability freely to choose where they live, and from where they buy goods and services

The Brexit vote is likely to have an immediate negative effect on the British economy – and adverse long-term effects as well

Pound sterling vs other currencies



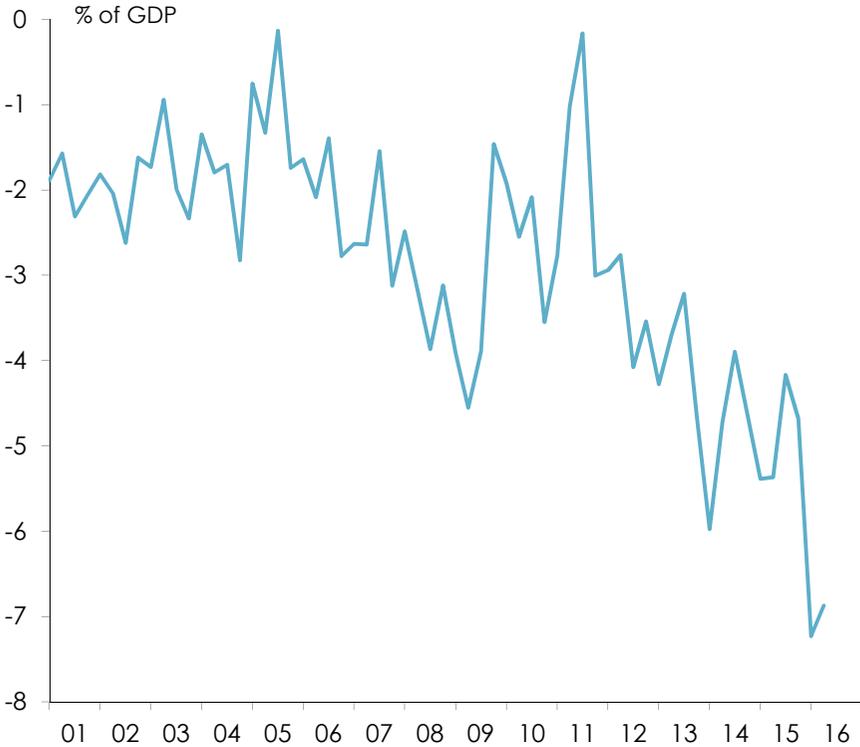
UK business and consumer confidence



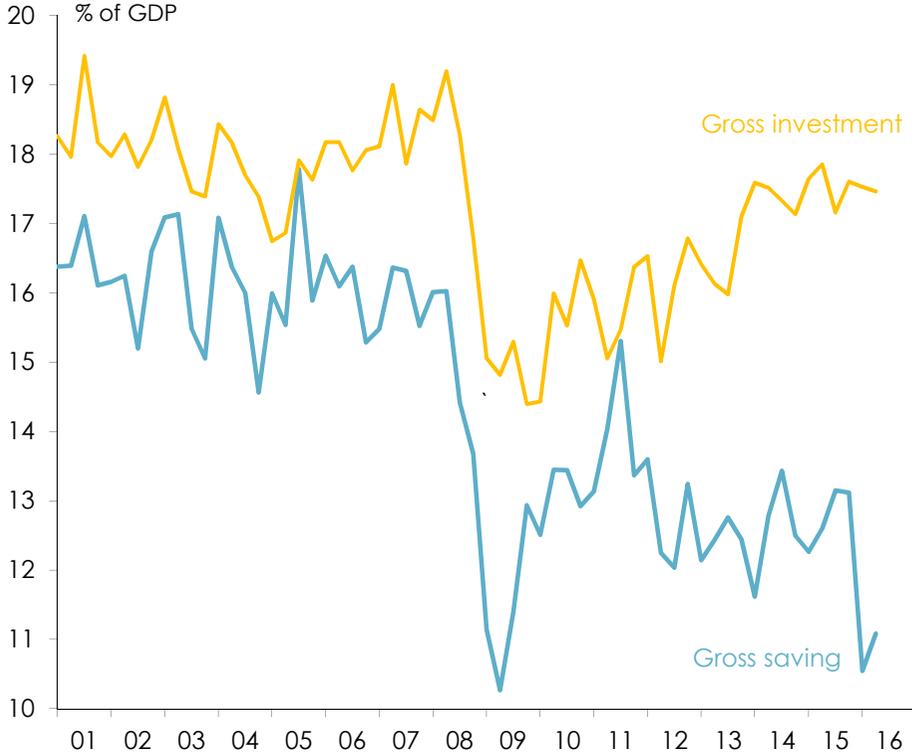
Sources: Thomson Reuters Datastream; UK Confederation of British Industry (CBI); European Commission.

If the UK can't attract the foreign investment required to finance its large current account deficit, saving must rise and/or investment must fall

UK current account balance



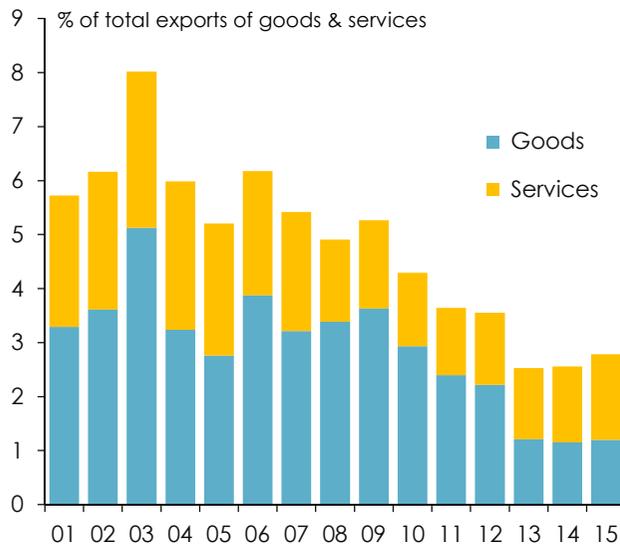
UK gross saving and investment



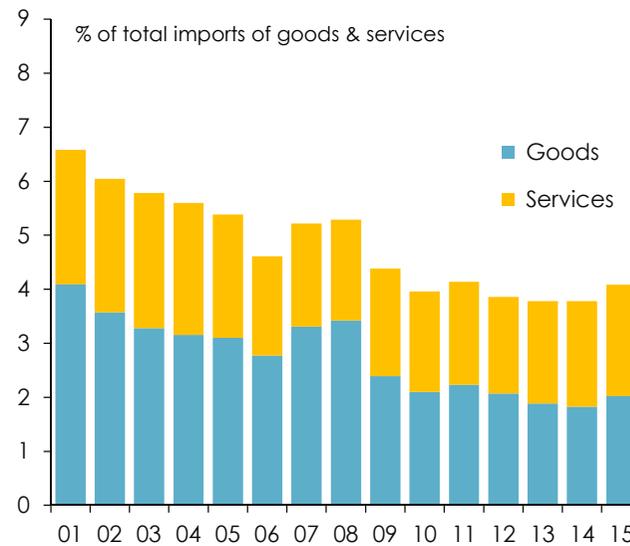
Source: UK Office for National Statistics.

The UK is no longer an important trading partner for Australia – but it is the second-most important source of and destination for investment

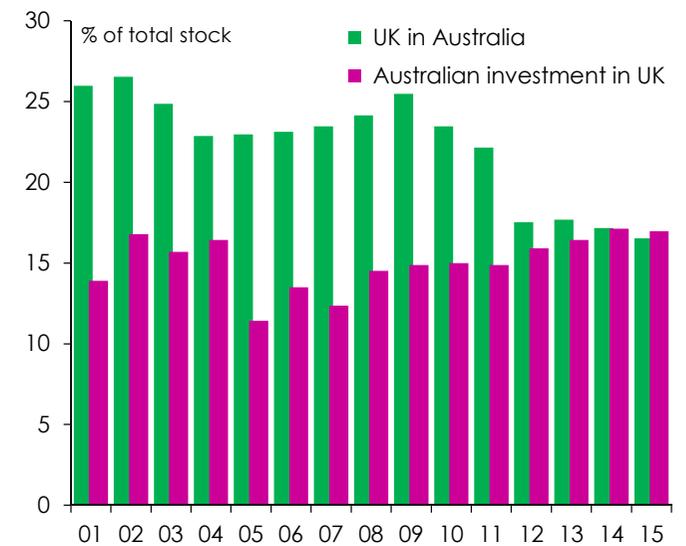
Australian exports to the UK



Australian imports from the UK



Australia-UK cross-border investment



- ❑ Post-Brexit Britain will be keen to show it can ‘do’ trade deals – perhaps Australia could regain the access its agricultural producers had to the UK market before 1973
- ❑ And perhaps having the Queen’s name in our passports and the British flag in the corner of ours might once again count for something at Heathrow

Sources: Department of Foreign Affairs & Trade; ABS.

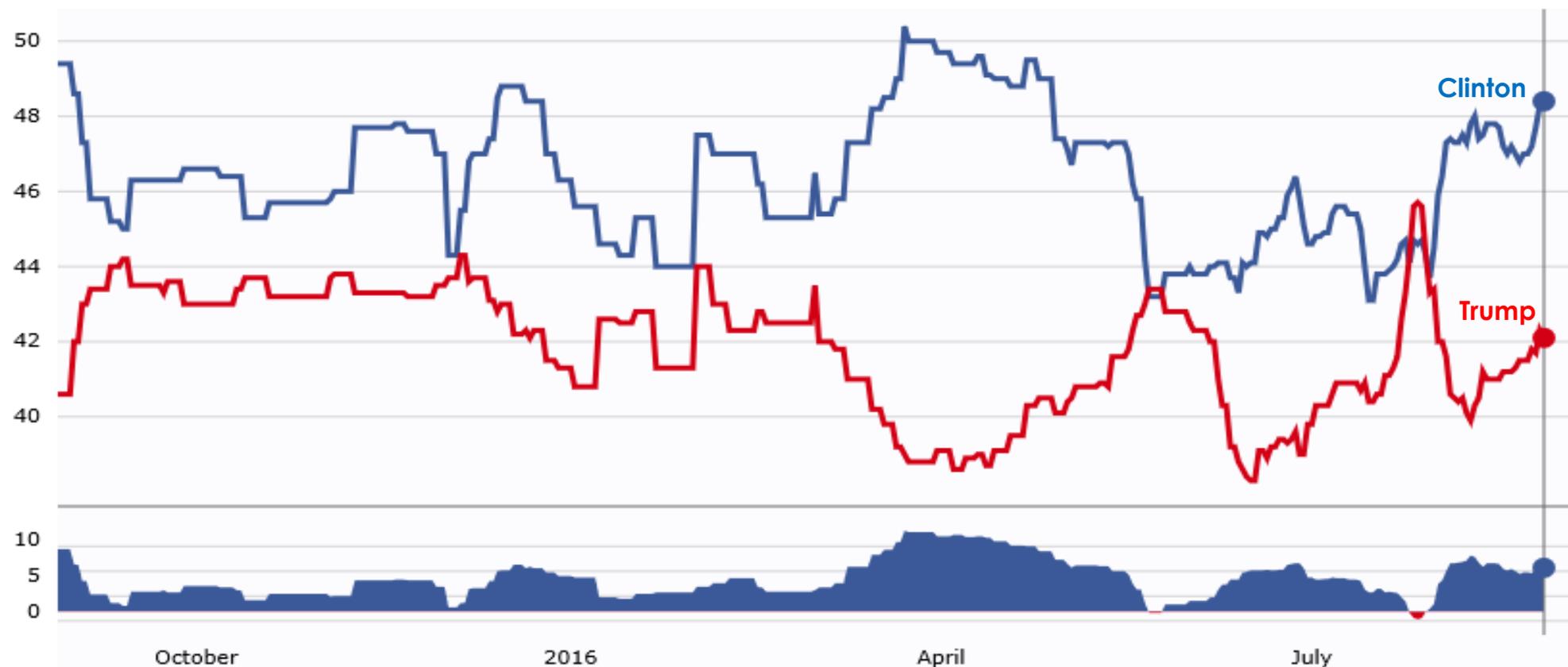
Will America switch
from 'Yes we can'... ... to 'I alone can' ?



Opinion polls currently give Hillary Clinton a clear lead over Donald Trump – as they did ‘Remain’ over ‘Leave’ in the UK referendum

US presidential voting intentions

27 August 2016



Source: RealClearPolitics.

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What might a Trump presidency mean for Australia?

❑ A shock to global financial markets – and to Australia's

- financial markets are assuming that Hillary Clinton will win – just as they assumed that Britain would vote to stay in the EU
- a different outcome could likewise produce sharp movements on financial markets (after all, there's more at stake)

❑ An abrupt decline in business confidence – in the US and elsewhere

- notwithstanding US business' traditional alignment with the Republican Party, most American business leaders don't want a Trump Presidency – any more than they would have wanted Bernie Sanders in the White House

❑ Possibly, a large fall in the US dollar

- foreigners have over US\$30 trillion (170% of US annual GDP) invested in the US
- if foreign investors seek to reduce their exposures to the US, the US\$ could fall significantly
- in such circumstances, the A\$ (along with other freely-floating currencies) could rise sharply against the US\$
- which, as the RBA has said after each recent Board meeting, would 'complicate' the adjustments currently under way in the Australian economy

❑ A 'trade war' with China – and possibly Japan

- a Trump Administration would declare China (and potentially Japan) a 'currency manipulator' – opening the way for the imposition of tariffs of up to 45% on imports from China (and possibly Japan)
- such measures would be intended to cause a sharp drop in Chinese (and Japanese) exports to the US – which would in turn likely result in those economies weakening – with adverse consequences for Australia's exports to them
- it's hard to believe that China and Japan wouldn't retaliate in some (equally damaging way)

❑ 'Trade wars' can lead to real wars

- Australia would be a big loser from any armed conflict between its biggest trading partner and its most important ally

For more details...

bettercallsaul.com.au

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This document has been prepared by Saul Eslake on behalf of Corinna Economic Advisory Pty Ltd, ABN 165 668 058 69, whose registered office is located at Level 11, 114 William Street, Melbourne, Victoria 3000 Australia.

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