

Where is the economic growth coming from?

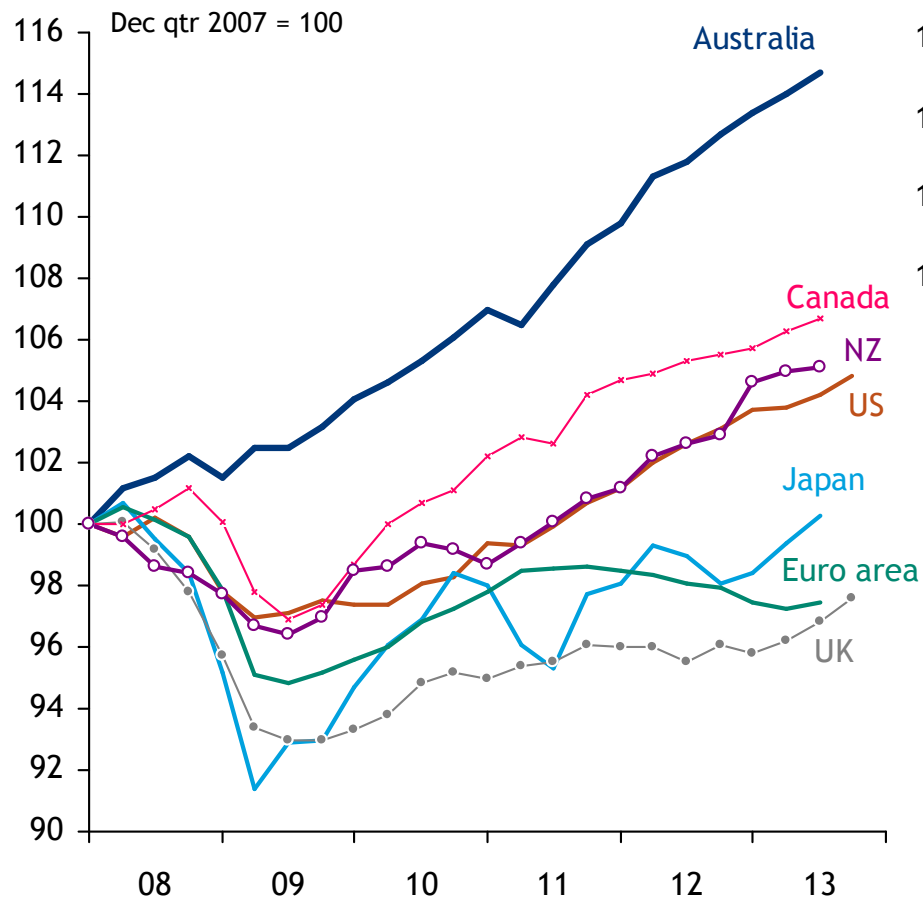
Presentation to the Private Health Care Australia conference

Saul Eslake

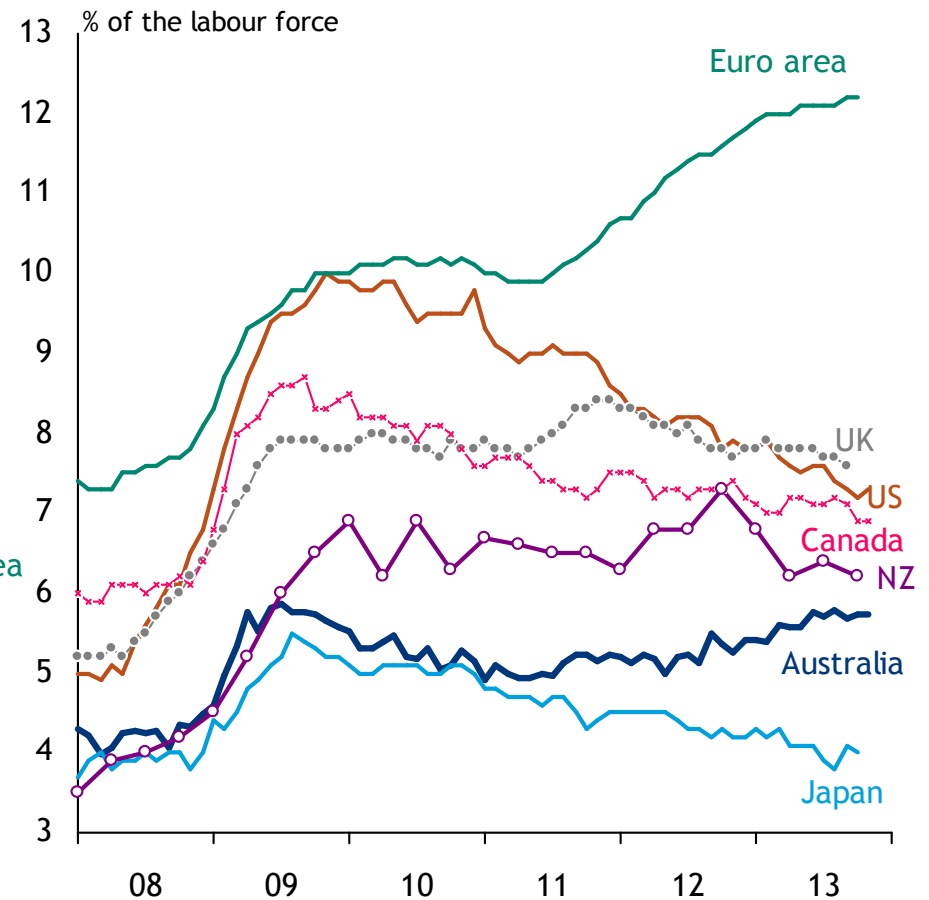
Hobart, 28th November 2013

Australia's economy has been doing better than its peers

Real gross domestic product



Unemployment rate

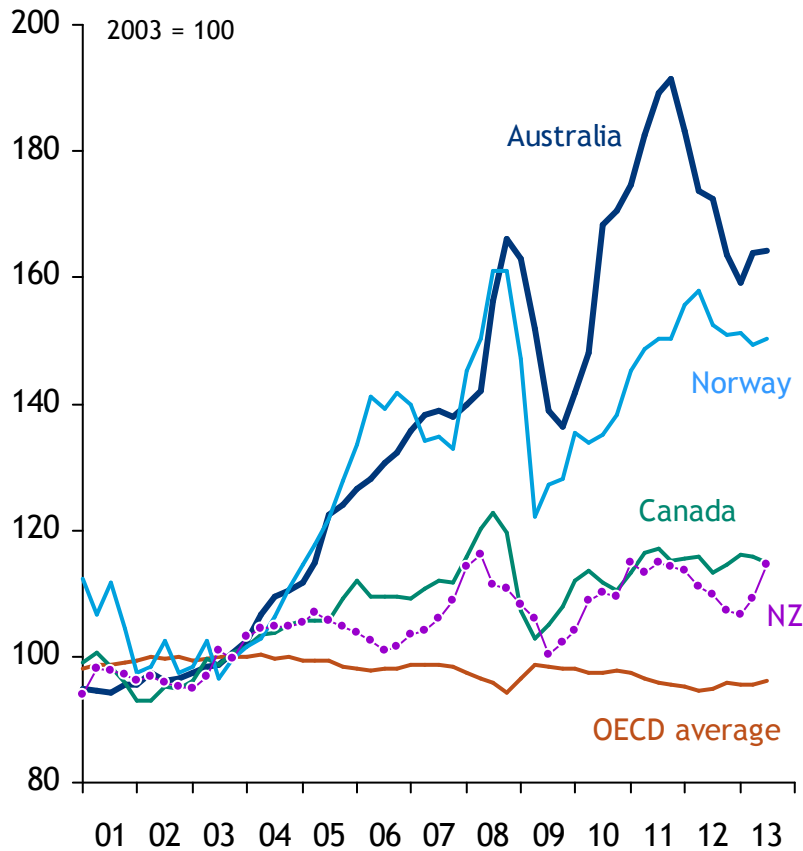


Sources: Australian Bureau of Statistics; US Bureau of Economic Analysis; Japan Economic & Social Research Institute; Eurostat; UK Office of National Statistics; Statistics Canada; US Bureau of Labor Statistics; Japan Home Ministry; Statistics New Zealand.

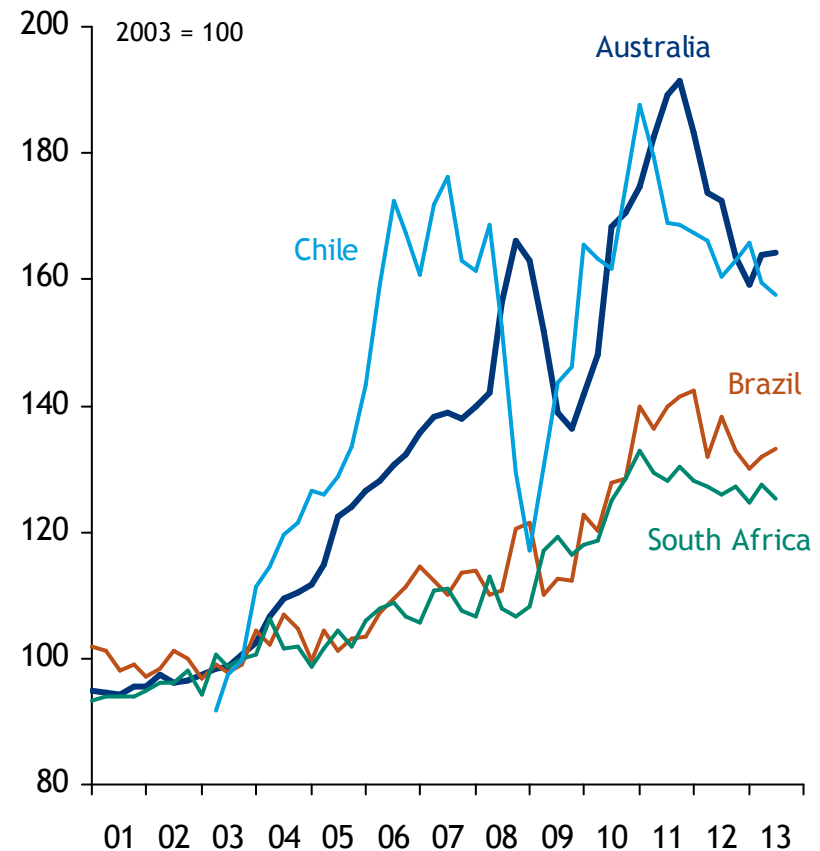
Having risen more than most other countries, Australia's "terms of trade" are now falling by more

Australia's terms of trade

Compared with other 'advanced' economies



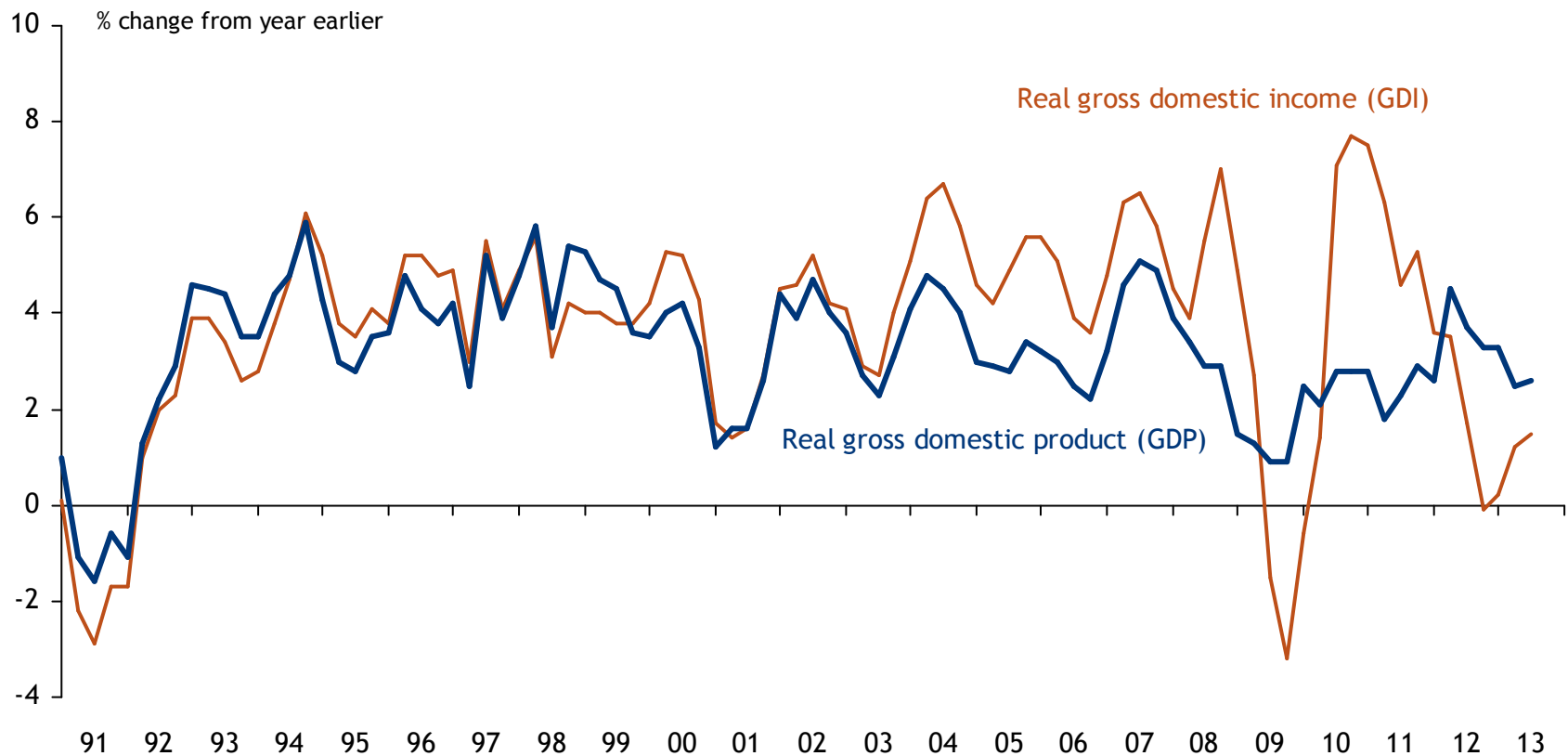
Compared with selected commodity-producing 'emerging' economies



Note: 'Terms of trade' is the ratio of export to import prices derived from the national accounts. Sources: National statistical agencies, Eurostat, OECD.

Falling terms of trade are now detracting from income growth - the opposite of what happened over the past decade

Real gross domestic product (GDP) and gross domestic income (GDI) growth

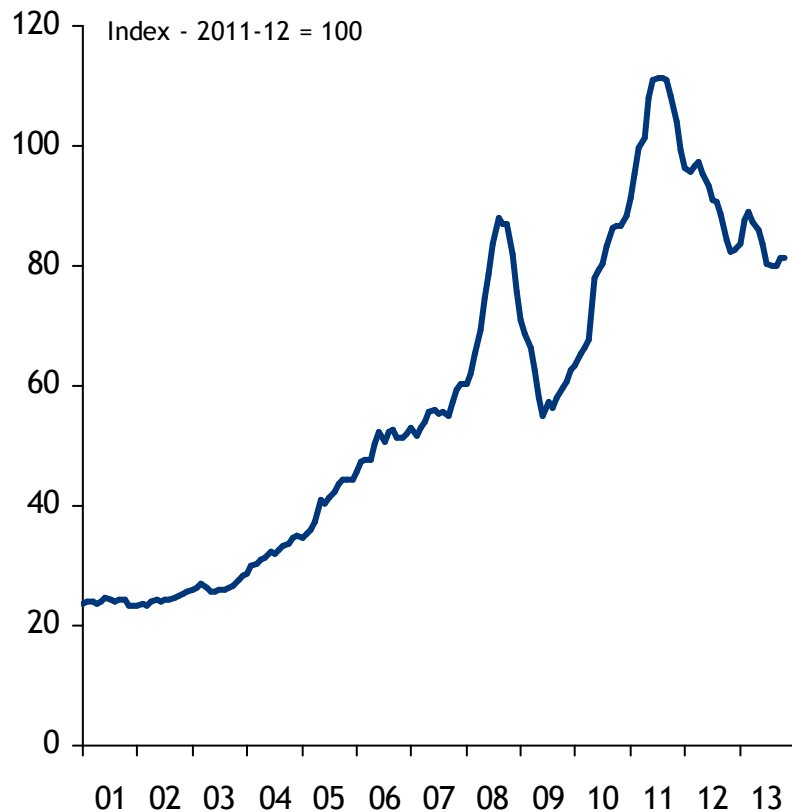


- Over the decade ended 2012, gains in Australia's "terms of trade" boosted the growth rate of real incomes (GDI) by 1.1% pa above the growth rate of real output (GDI)

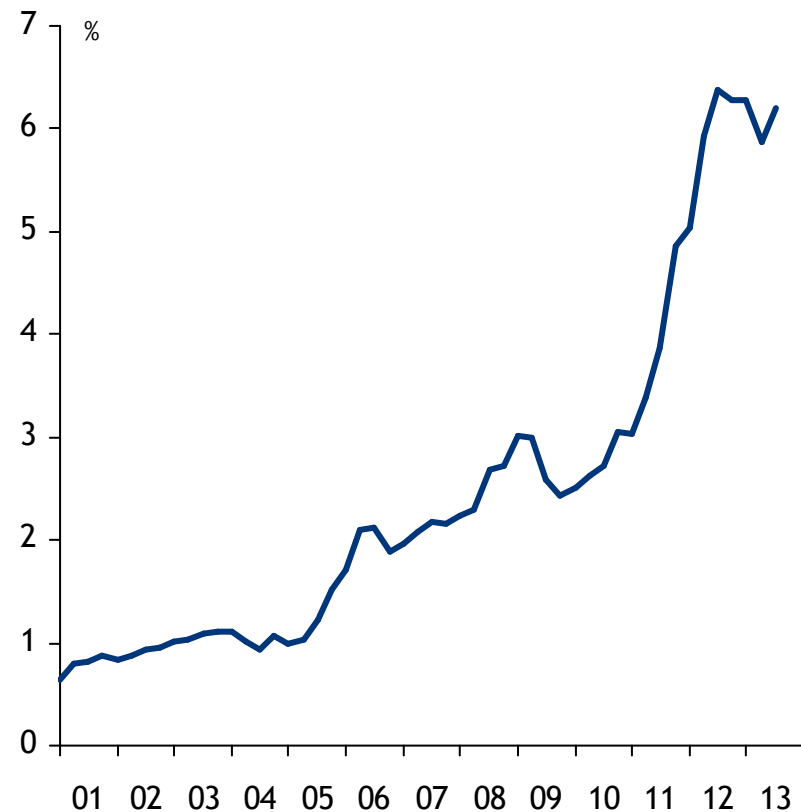
Sources: ABS.

The 'resources boom' is passing its second major turning point

Minerals and energy export commodity prices



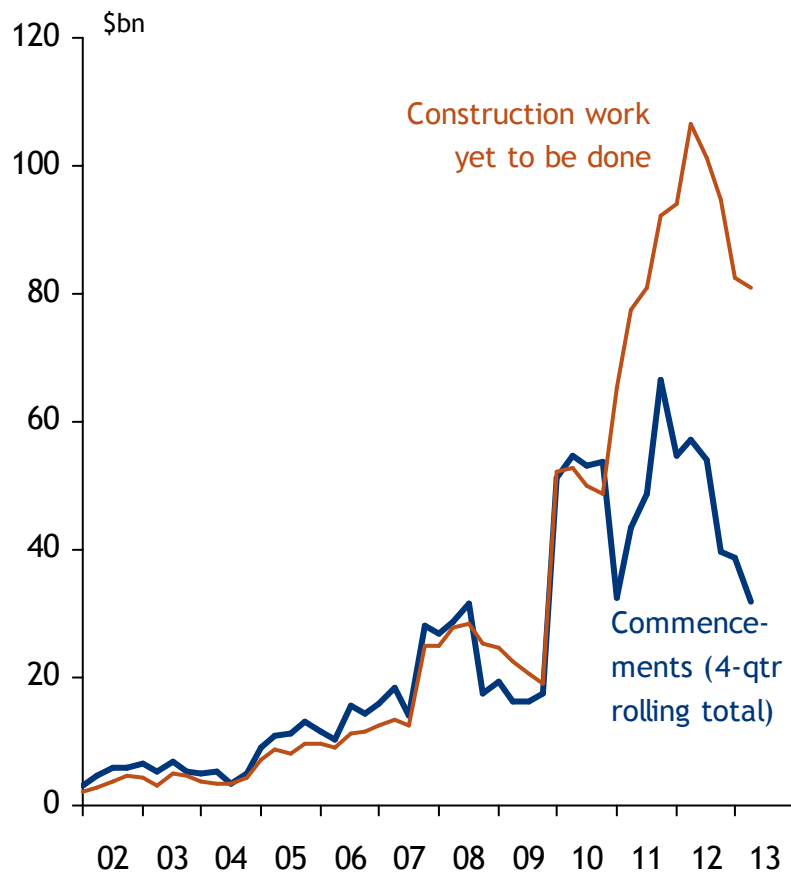
Mining investment as a pc of GDP



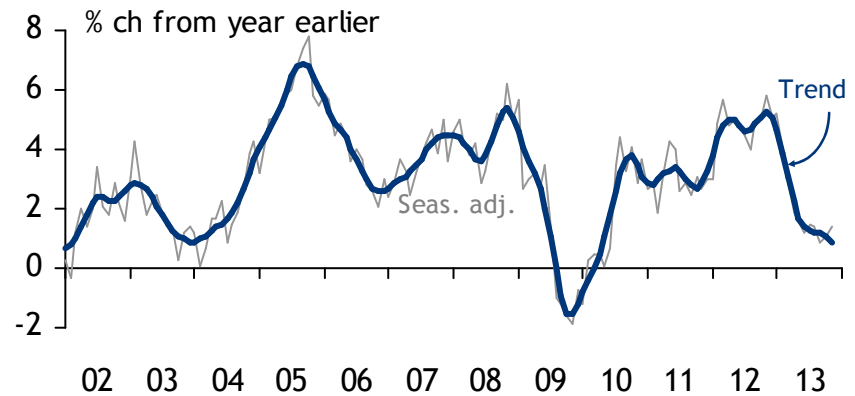
Note: 'Mining investment' excludes intangibles such as exploration and R&D expenditure. Sources: RBA; ABS.

Some pieces of evidence that the resources investment boom is peaking

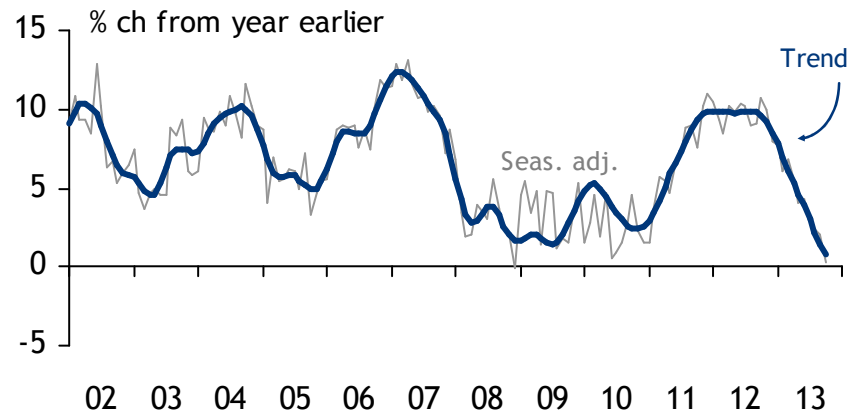
Engineering construction work - oil & gas fields and mines



Employment - WA



Retail sales - WA

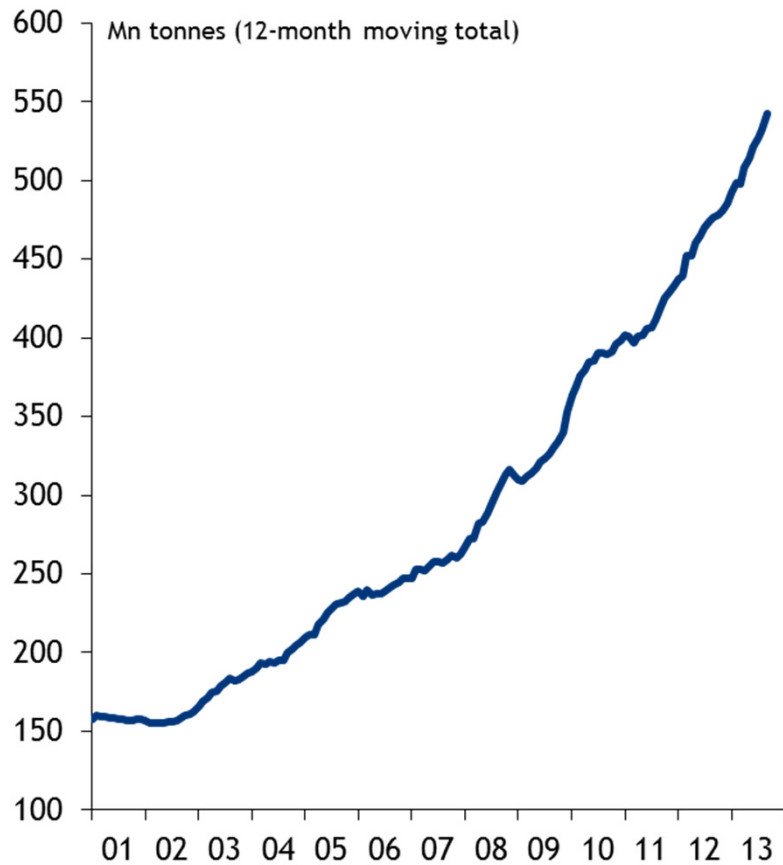


Source: ABS.

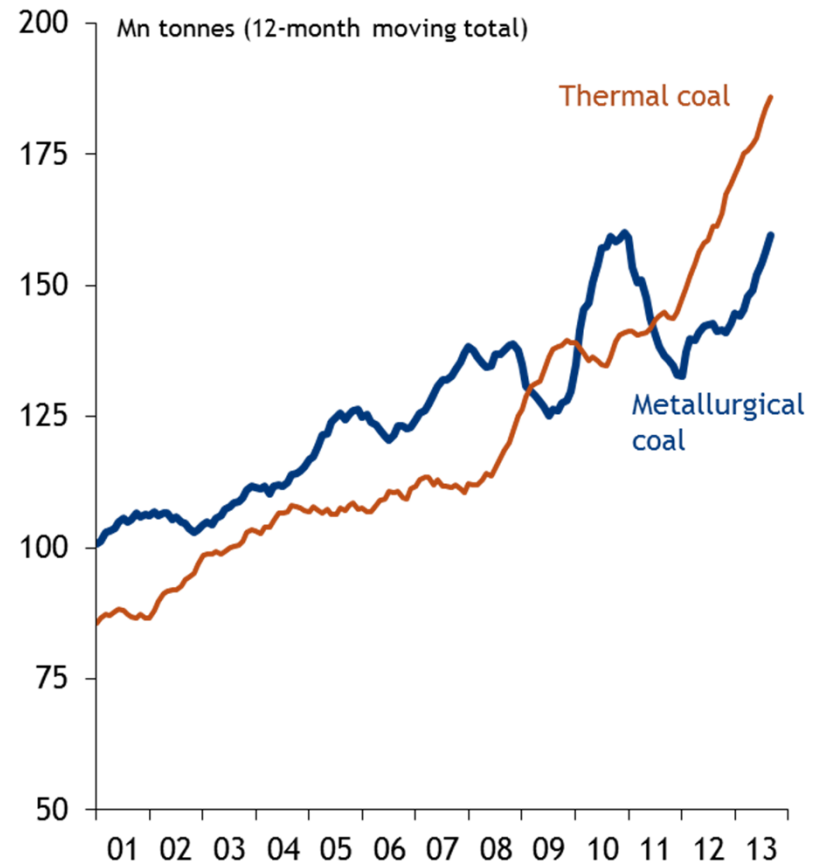
Iron ore and coal export volumes are now ramping up

Bulk commodity export volumes

Iron ore



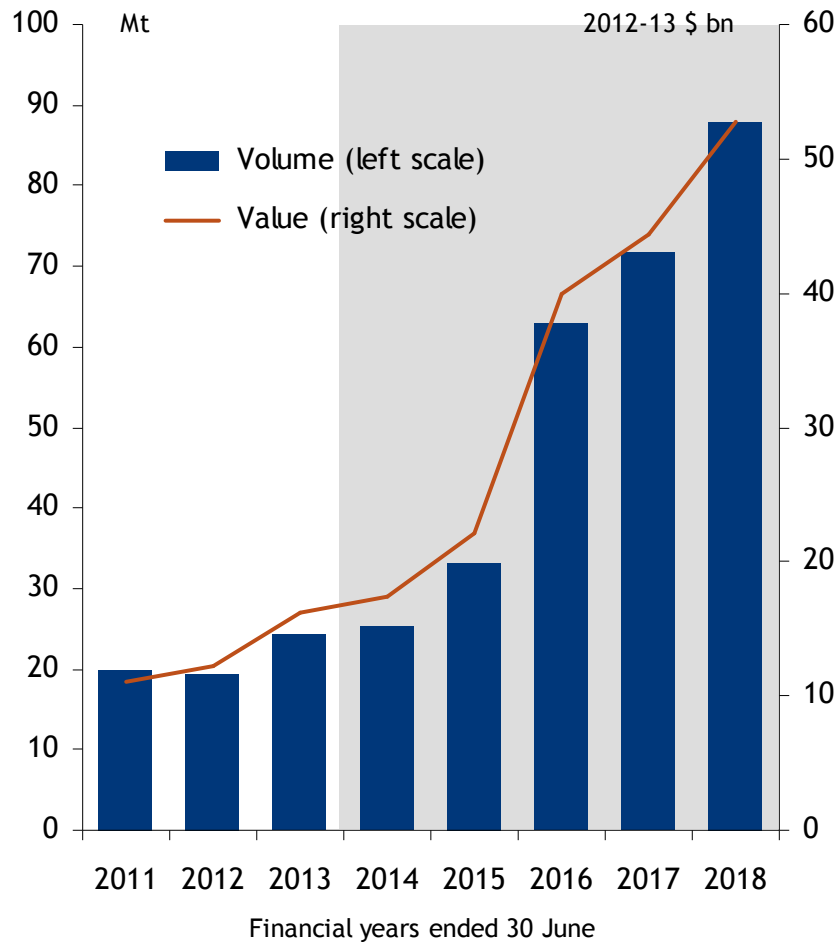
Coal



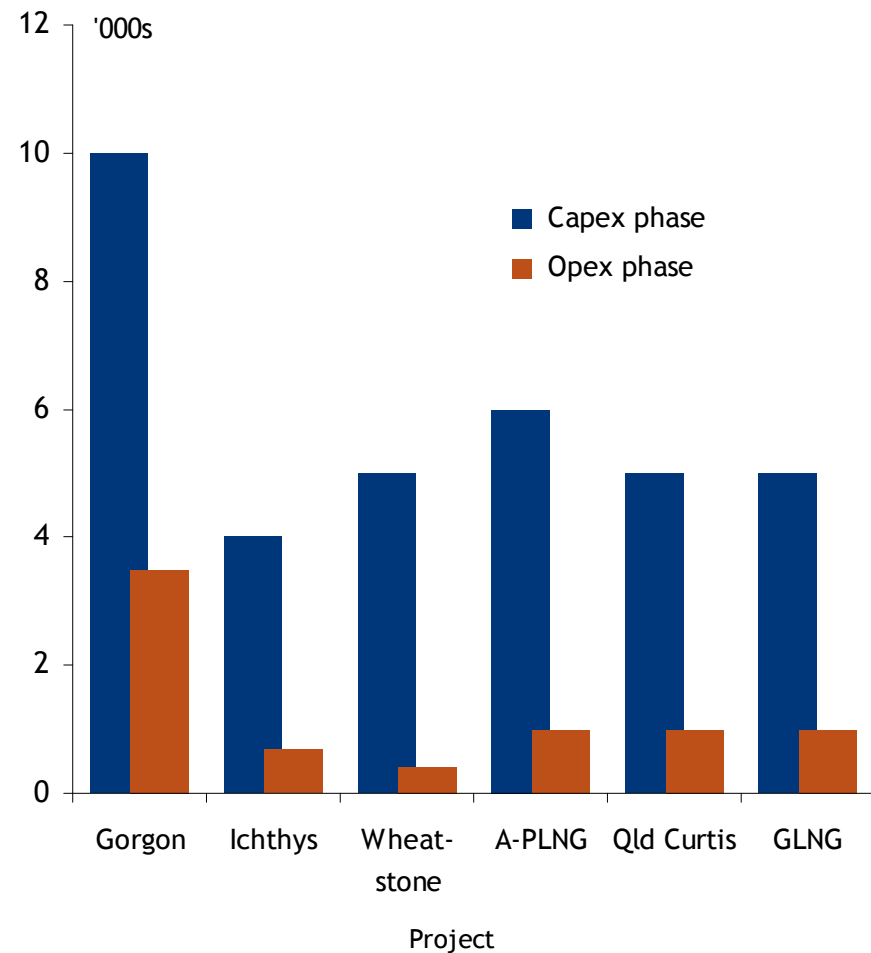
Sources: Bloomberg; ABS.

LNG exports will rise sharply but employment will fall from 2015 on

Australian LNG exports



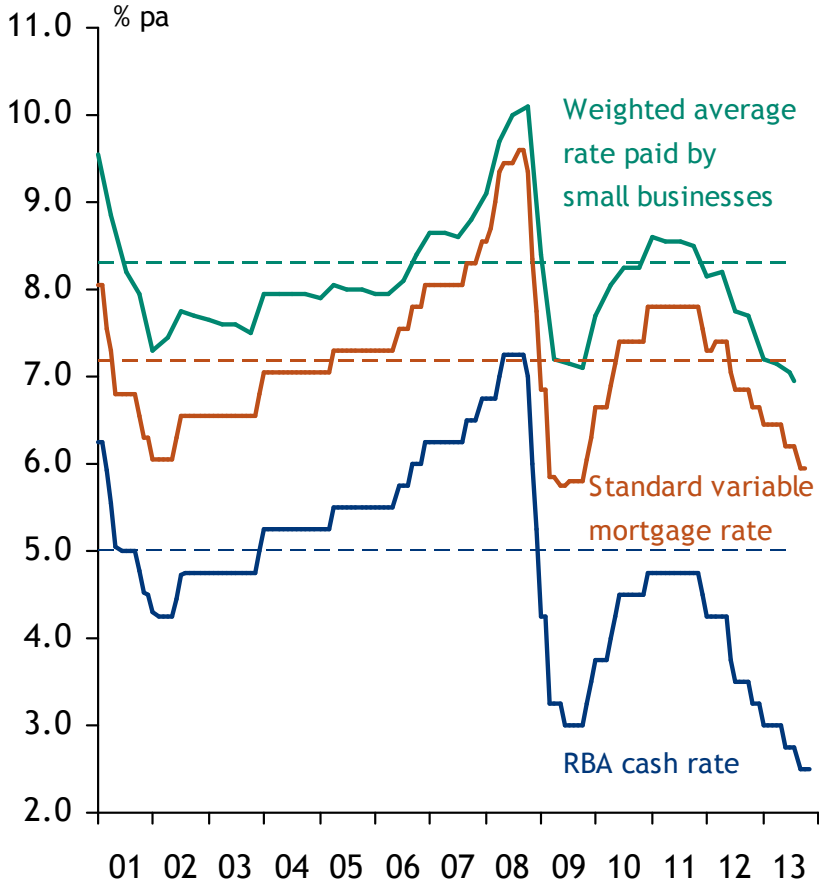
Employment directly associated with major LNG projects



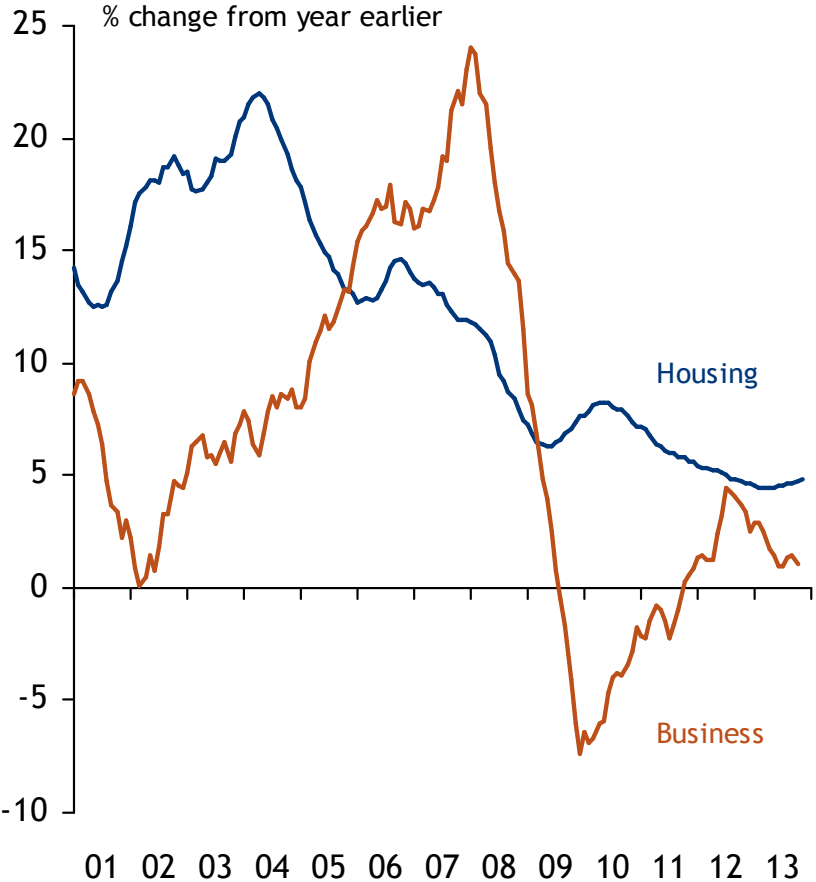
Source: Bureau of Resources & Energy Economics.

Lower interest rates are yet to stimulate faster growth in borrowing

Interest rates



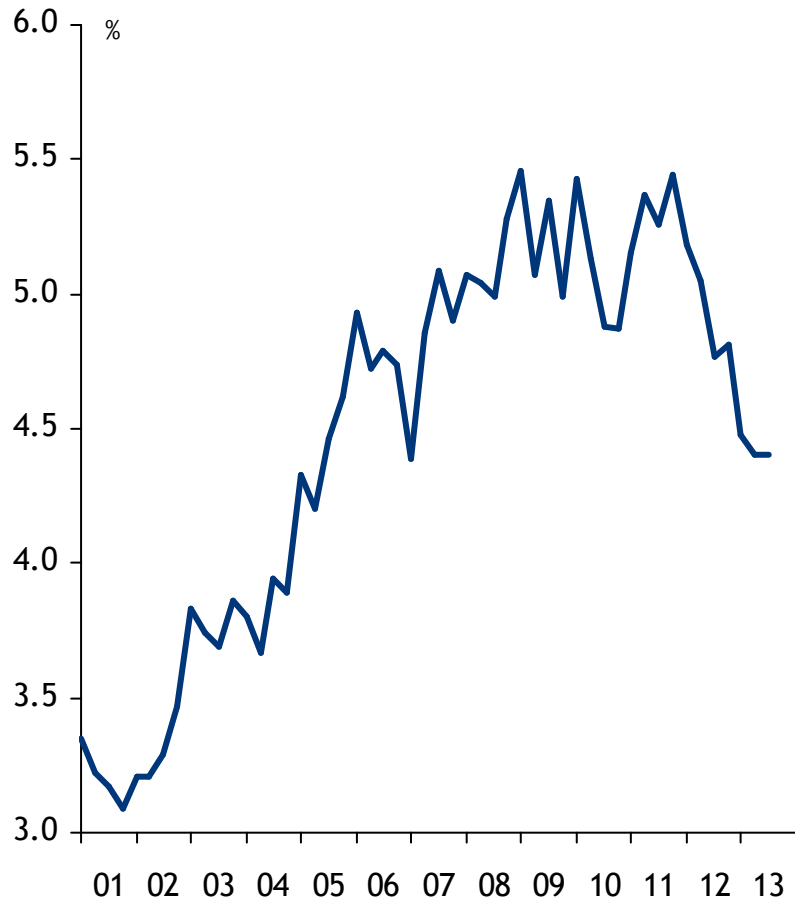
Credit growth



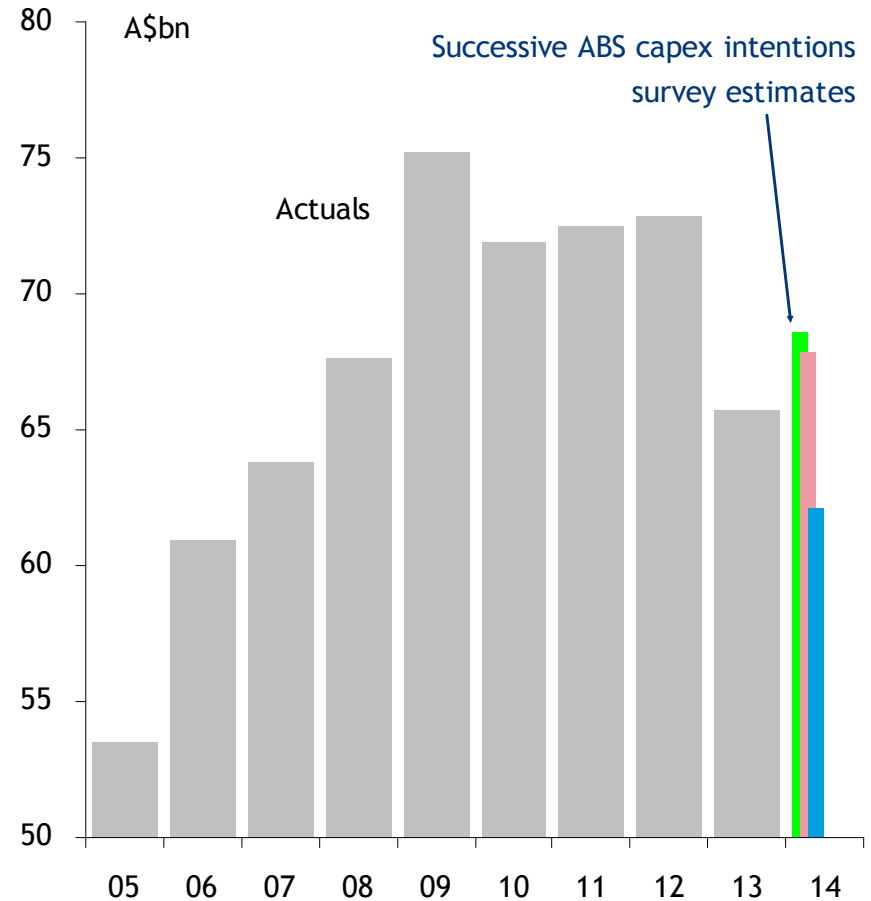
Note: Dotted lines indicate 15-year average of each interest rate shown.
Source: RBA.

Non-mining business investment still looks very weak

Non-mining business investment as a pc of GDP



Actual and intended non-mining business investment



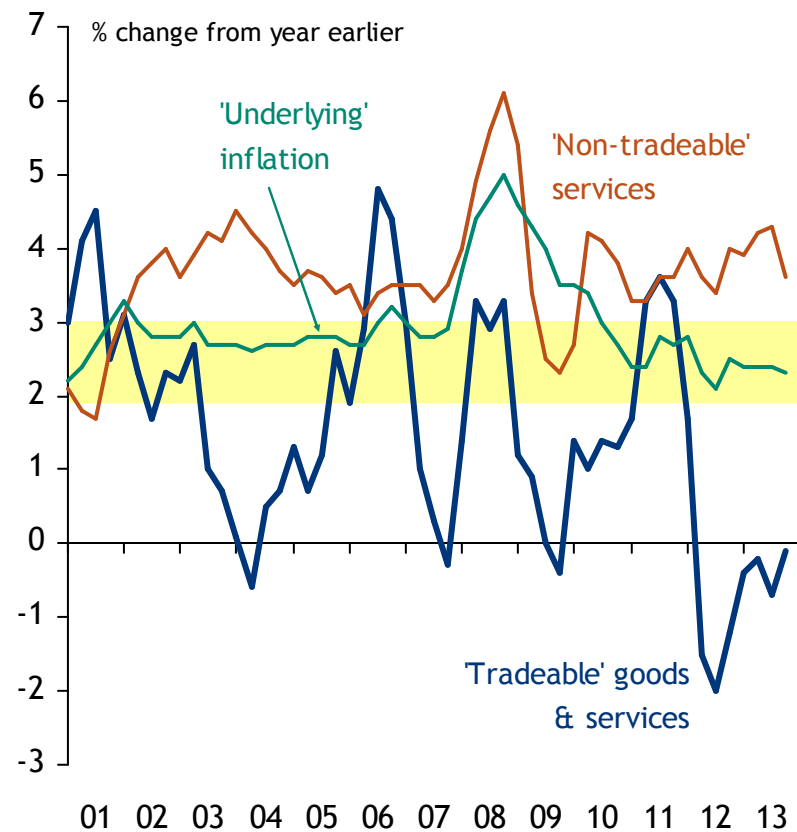
Source: ABS.

The strong A\$ helped keep inflation under control during the 'boom'

A\$ vs US\$



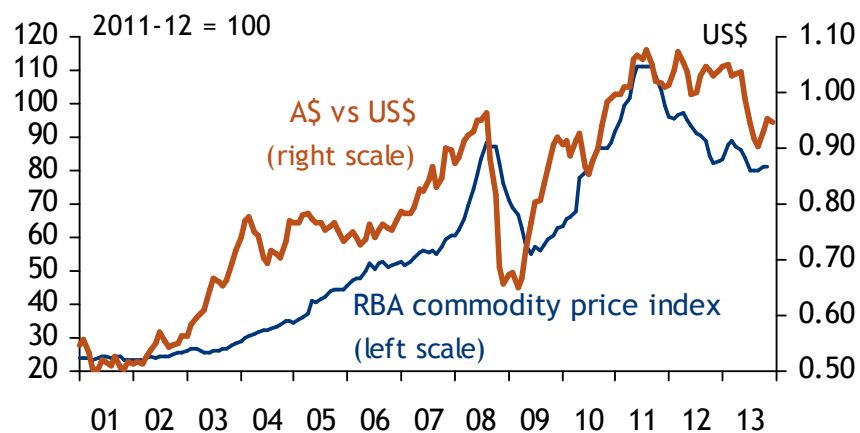
Consumer prices



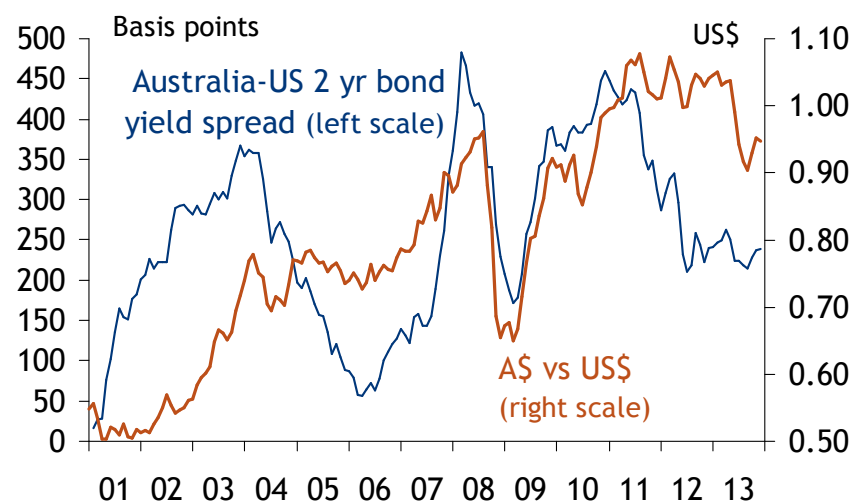
Sources: RBA; ABS.

But now, foreign capital inflows into mining are keeping the A\$ at levels above 'fundamentals'

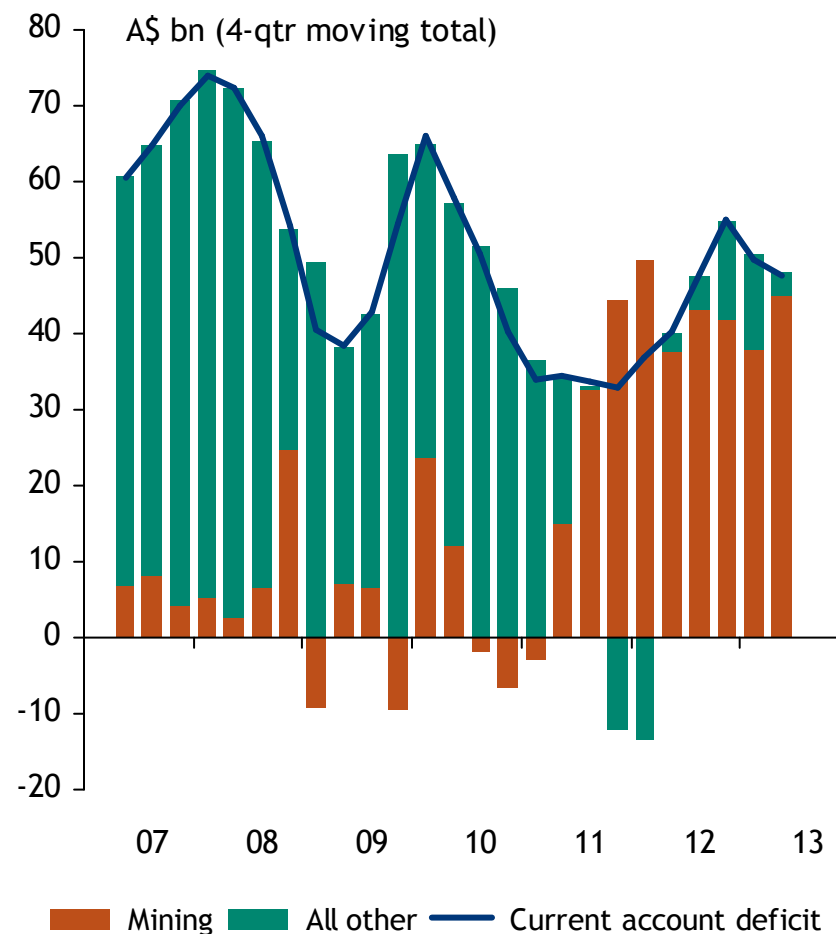
Commodity prices and the A\$



Interest rate spreads and the A\$



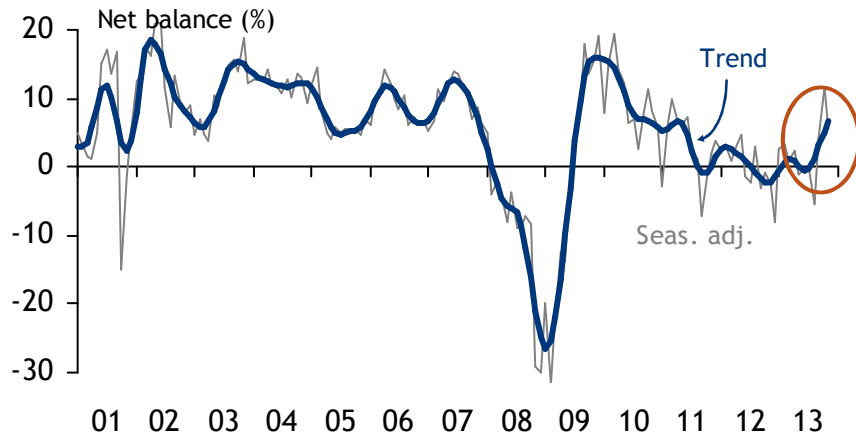
Net capital inflows by sector



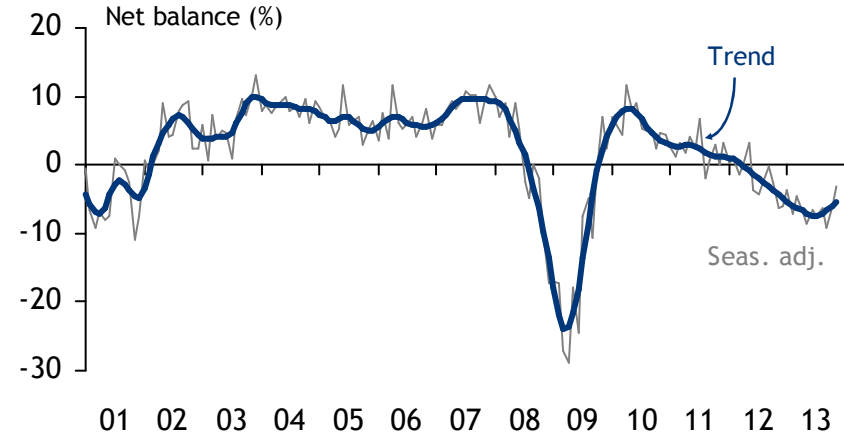
Sources: ABS (balance of payments data).

Business confidence is picking up - but hiring and capex plans aren't

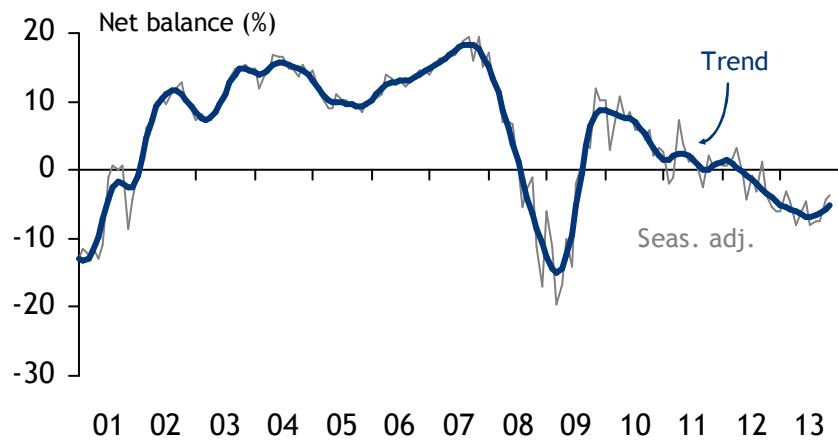
Business confidence



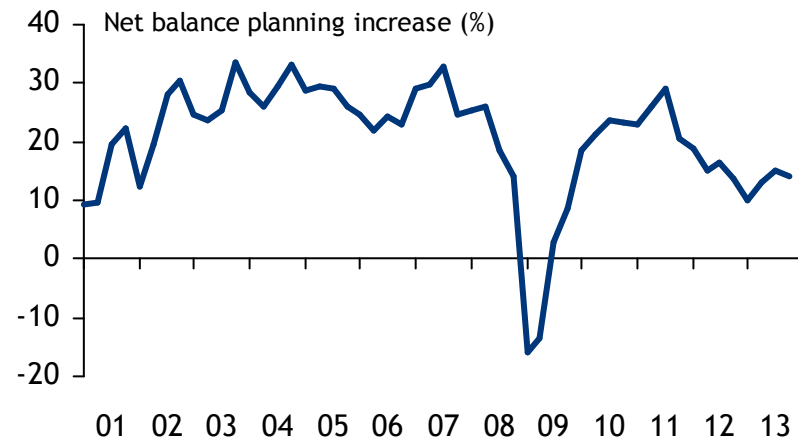
Employment intentions



Business conditions



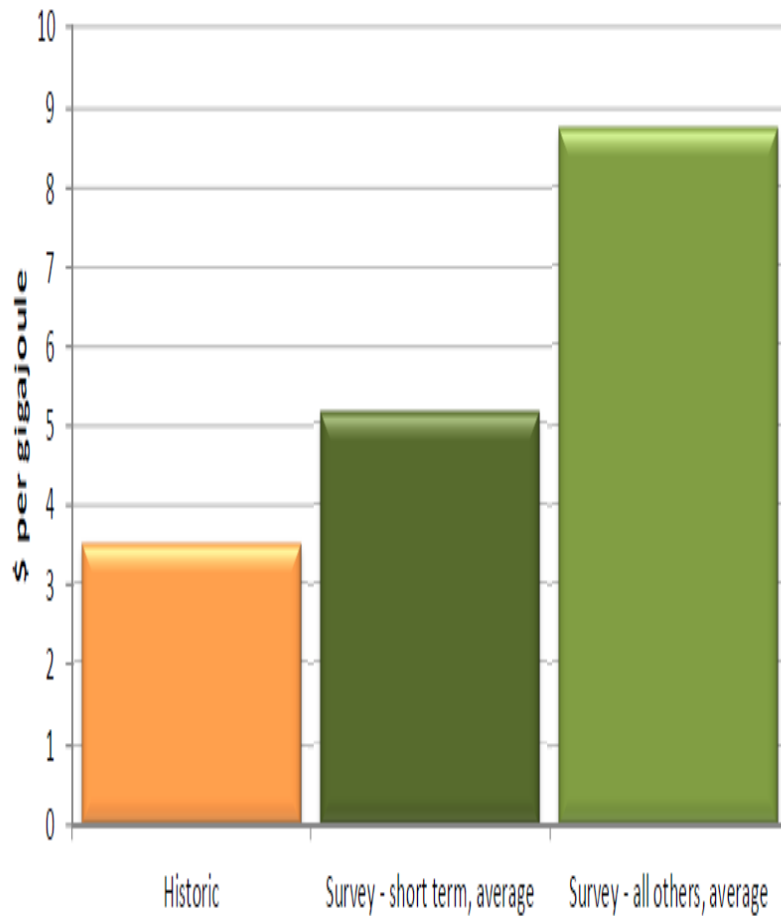
Capital expenditure intentions



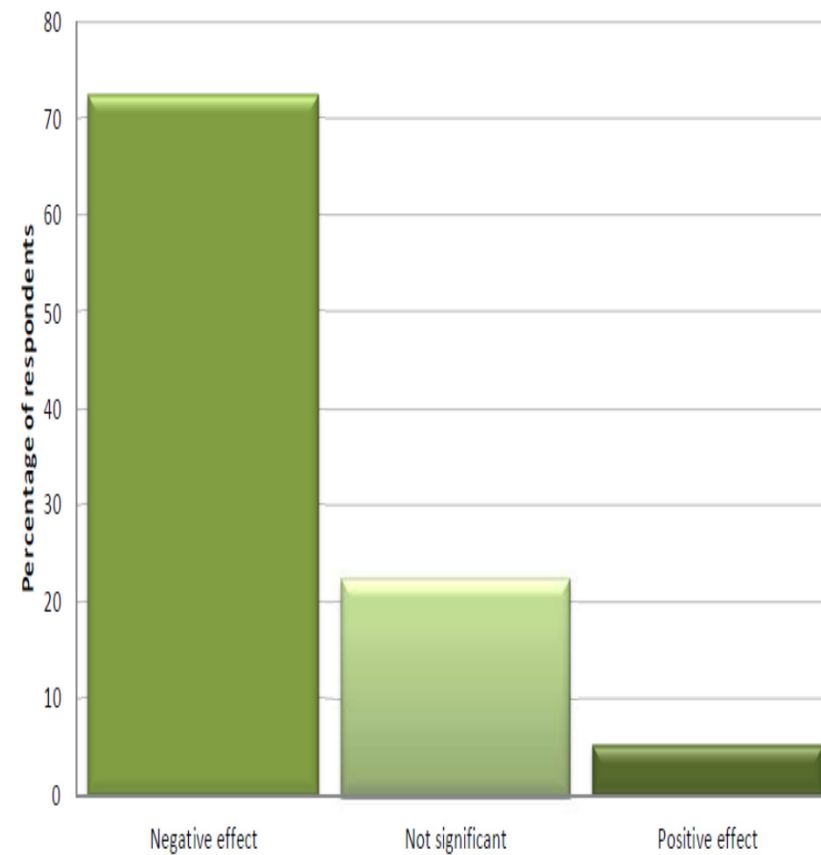
Sources: NAB monthly and quarterly business surveys.

A spike in gas prices may also be a deterrent to higher investment

Historic and offered gas prices



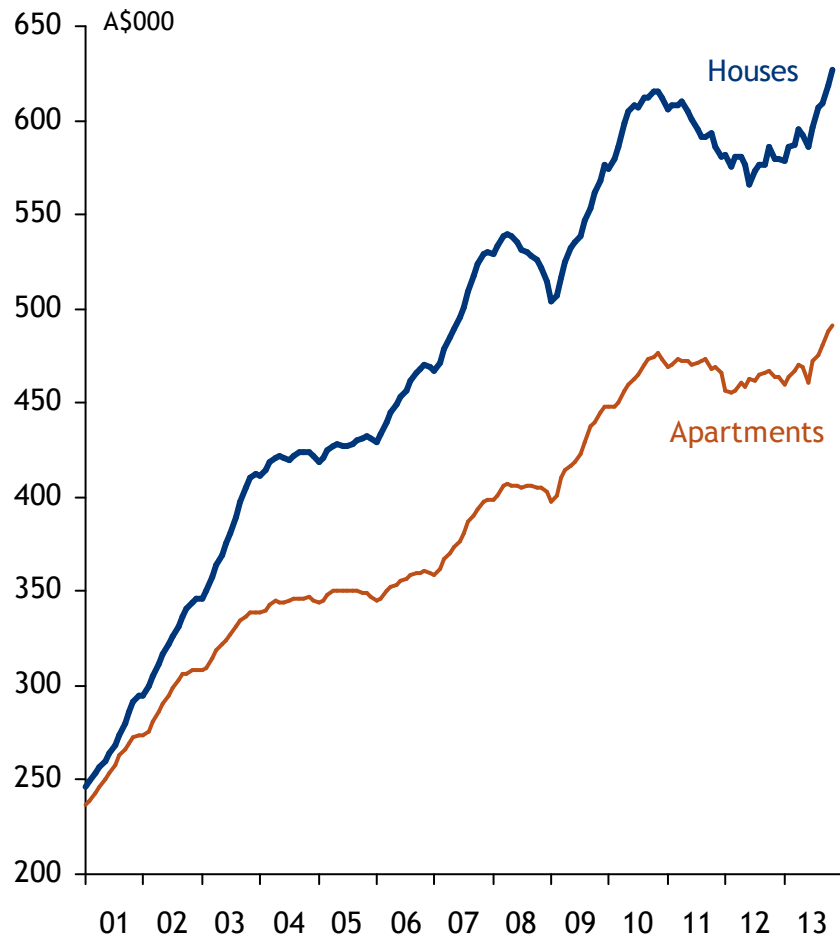
Impact of gas prices on investment



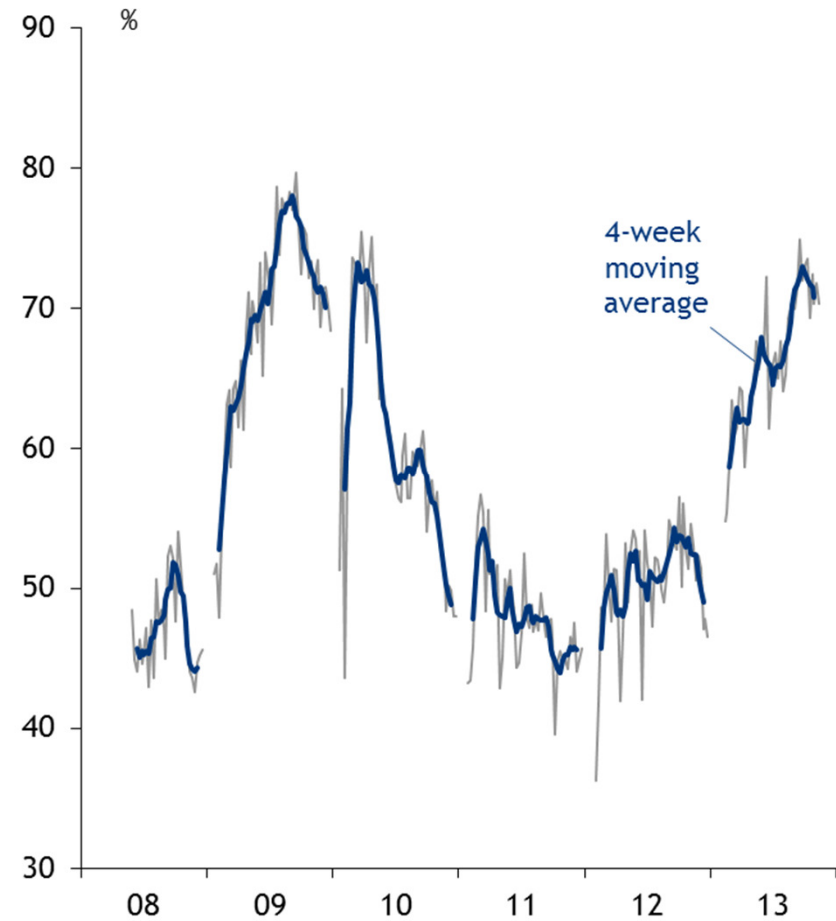
Source: Australian Industry Group, *Energy Shock: The 'Gas Crunch' is Here*, July 2013.

The housing market does seem to be springing to life again ...

Capital city dwelling prices



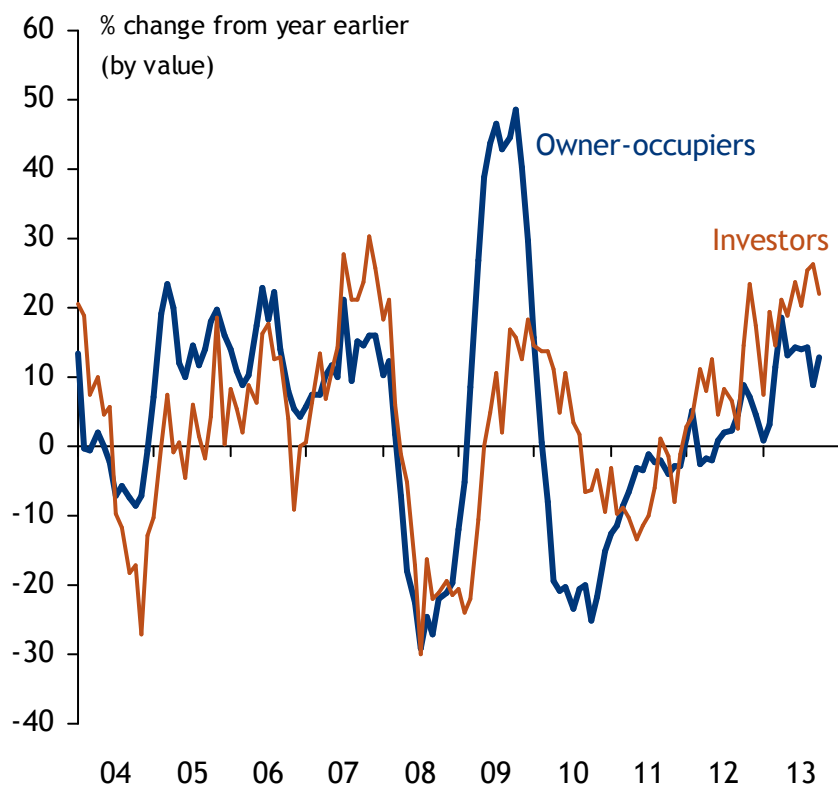
Capital city auction clearance rates



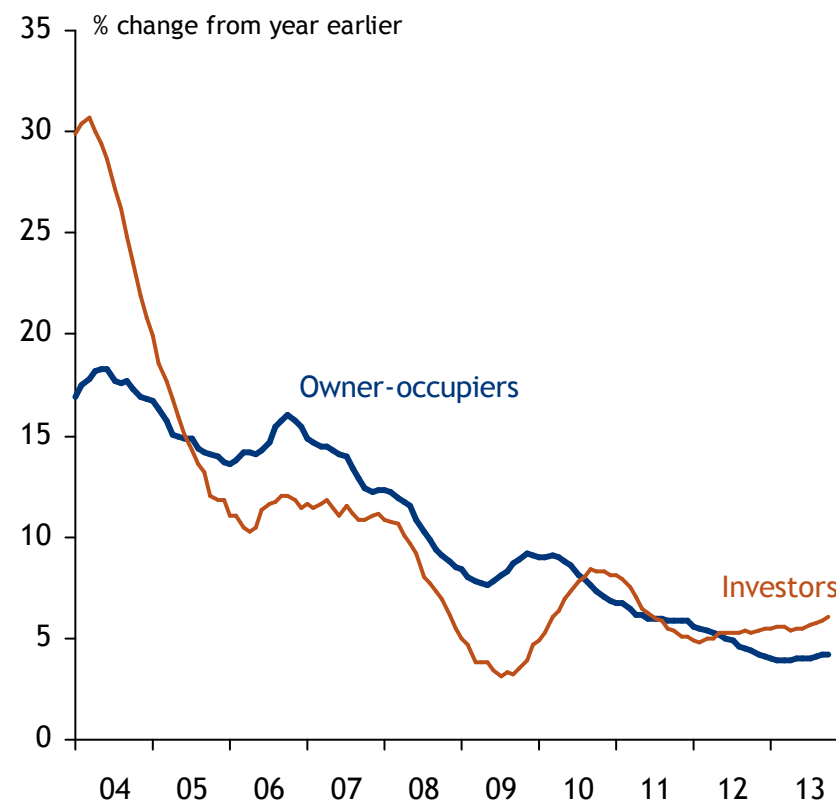
Source: RP Data - Rismark.

... but the upswing in demand is being driven mainly by investors

Housing finance commitments



Housing debt outstanding

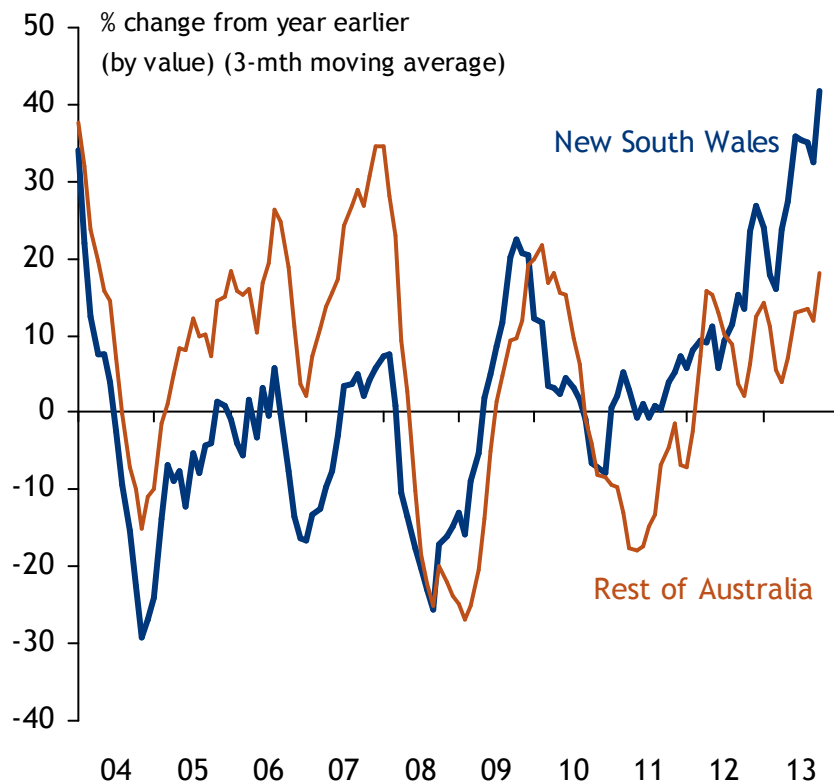


- 60% of the *increase* in total housing finance commitments since 2011 have been to investors (cf. their 40-45% share of total housing finance commitments over the past decade)

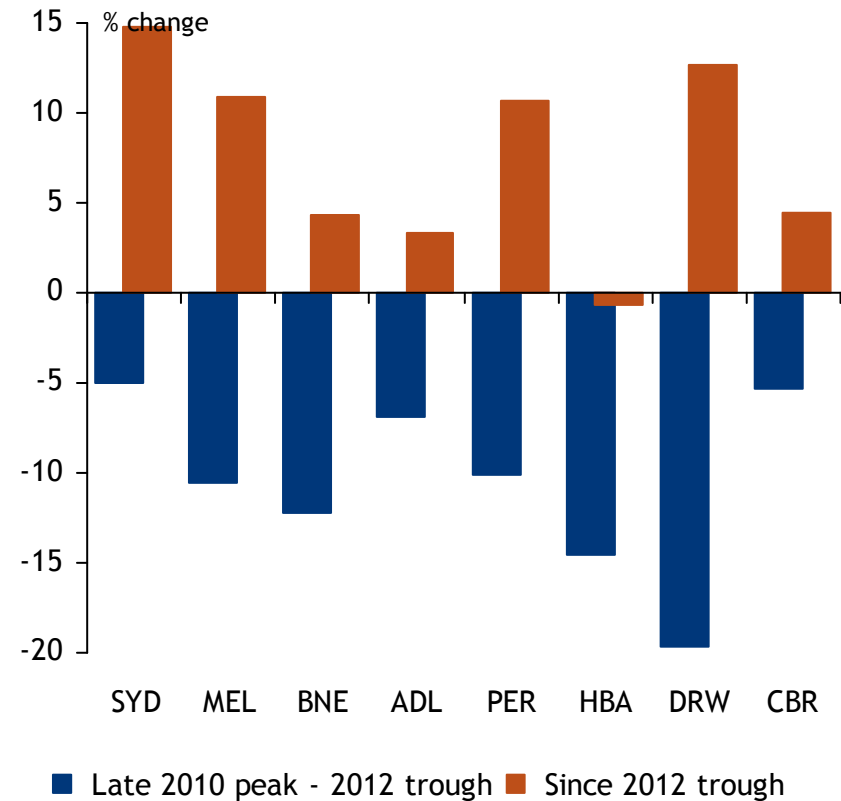
Sources: ABS; RBA

... and overwhelmingly in Sydney

Housing finance commitments to investors



Capital city dwelling prices

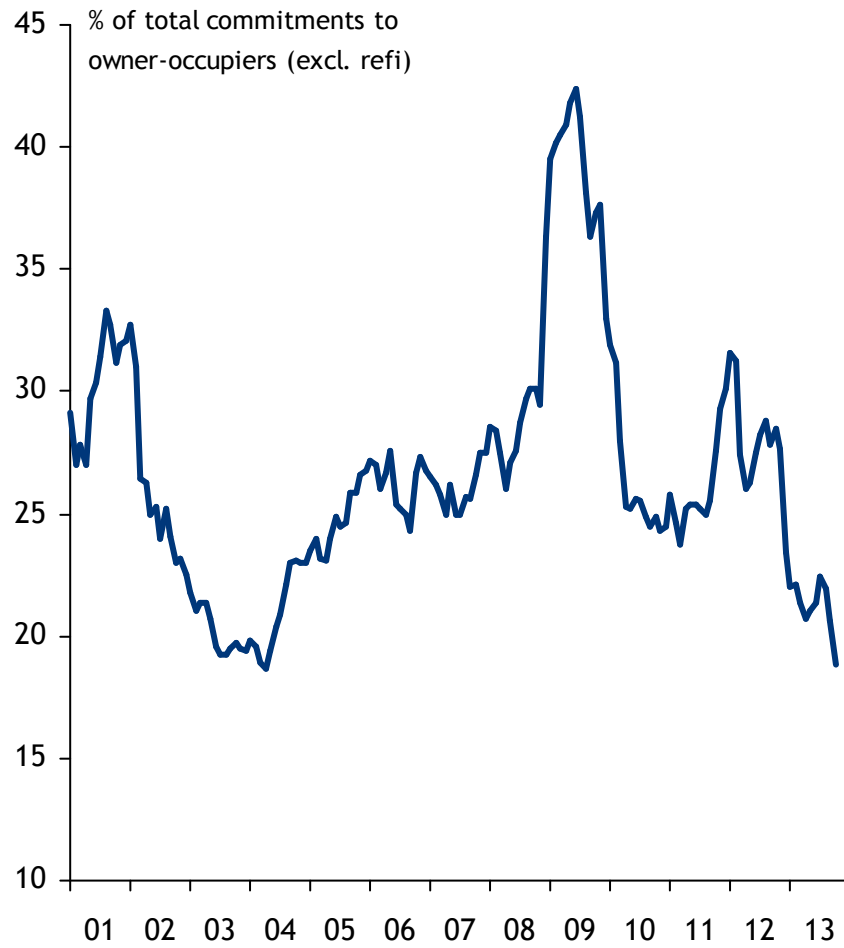


- More than two-thirds of the *increase* in total housing finance commitments to investors so far this year have been in New South Wales

Sources: ABS; RP Data Rismark.

First home buyers have been conspicuous by their absence from the housing market

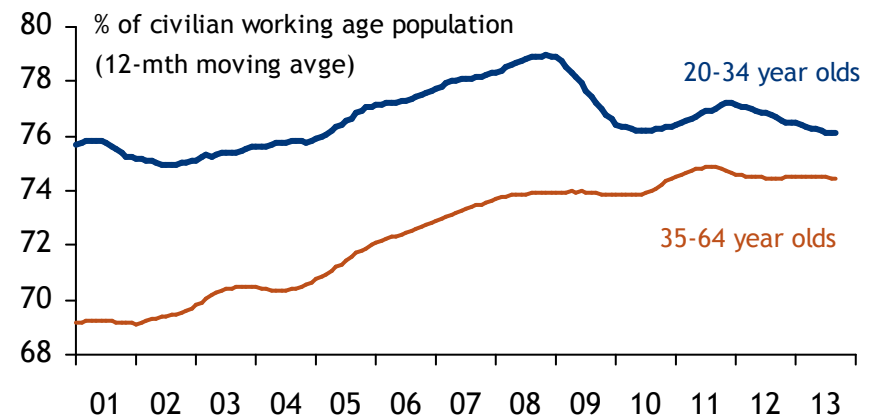
Housing finance commitments to first-time buyers



Consumer sentiment about home-buying conditions



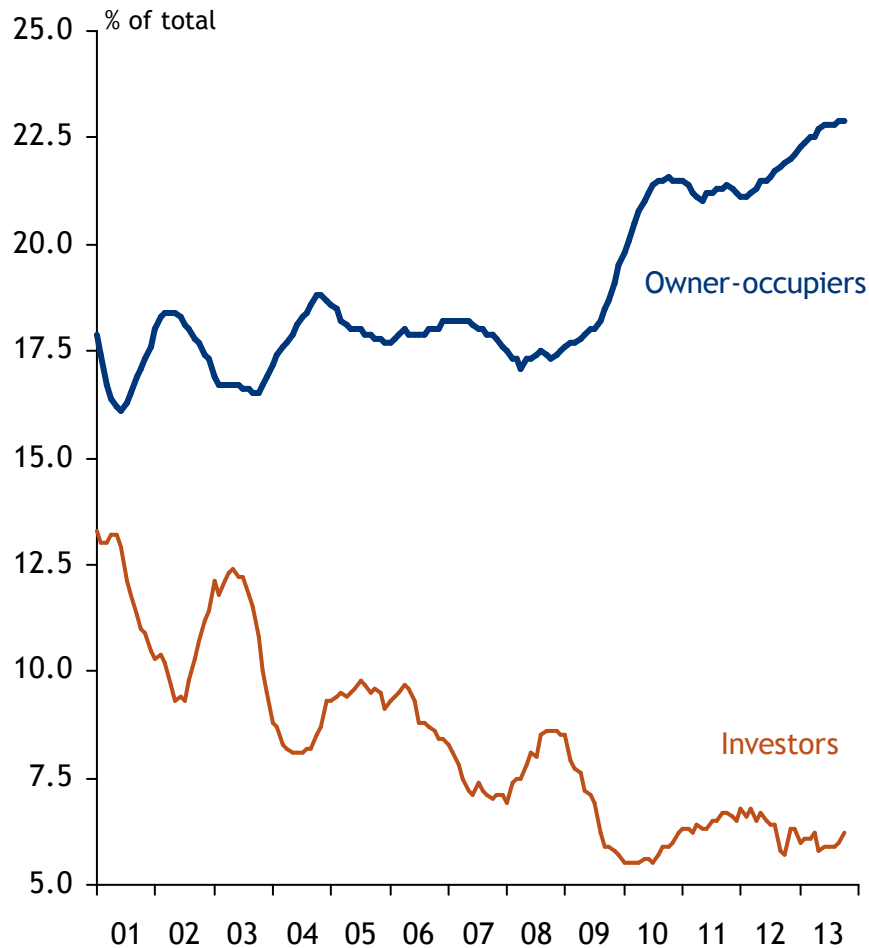
Employment-population ratios



Sources: ABS; Westpac-Melbourne Institute.

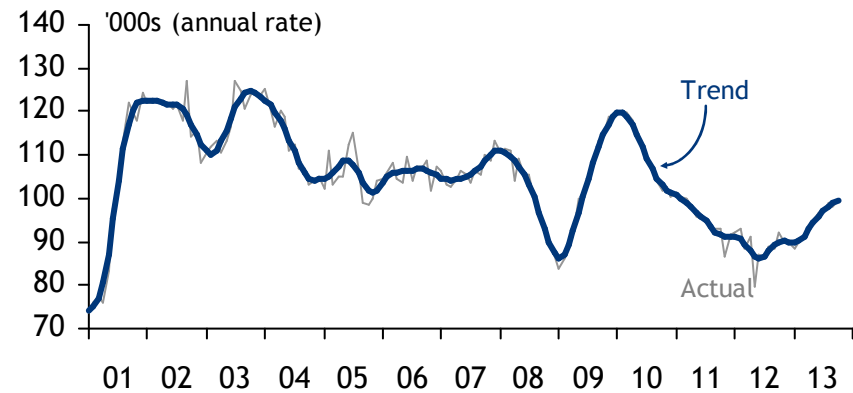
Investors are much less likely to buy a new dwelling - and especially a house

Lending for new housing as a pc of total, by type of borrower

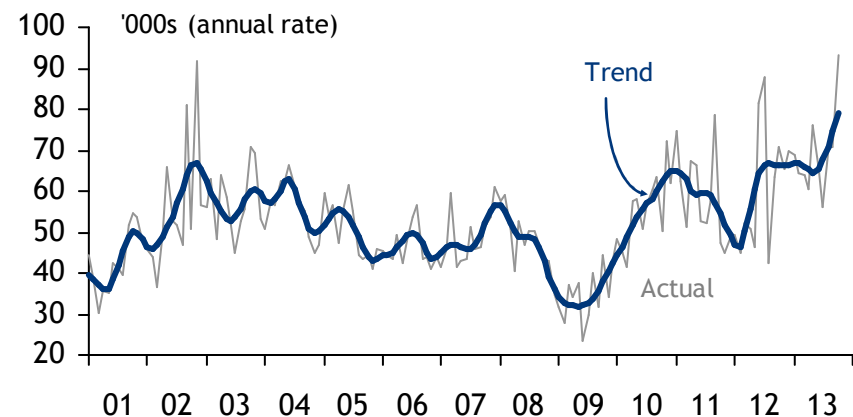


Private residential building approvals

Houses



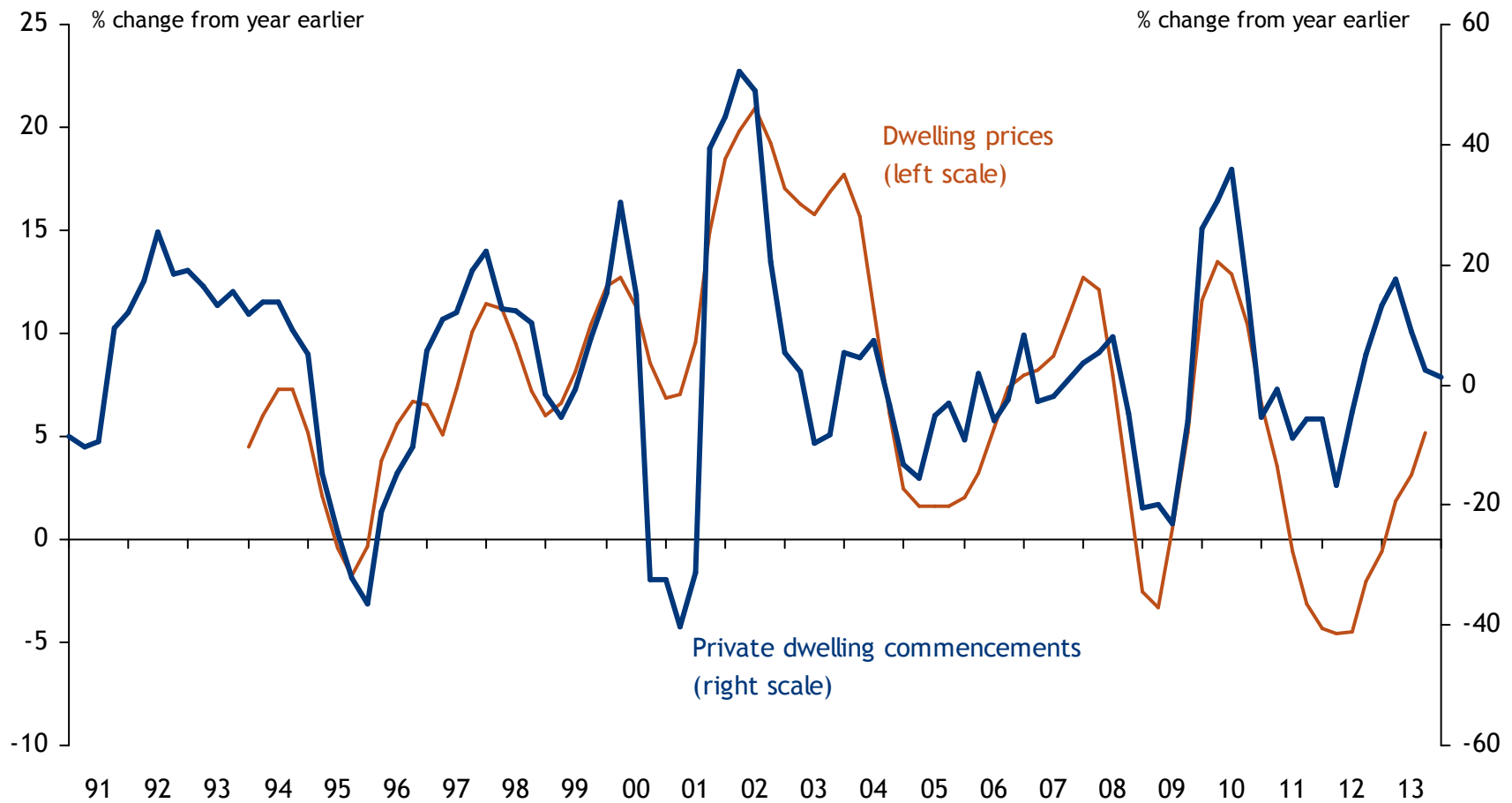
Other (apartments, etc.)



Source: ABS.

House prices are usually *co-incident* with starts - they don't *lead* starts

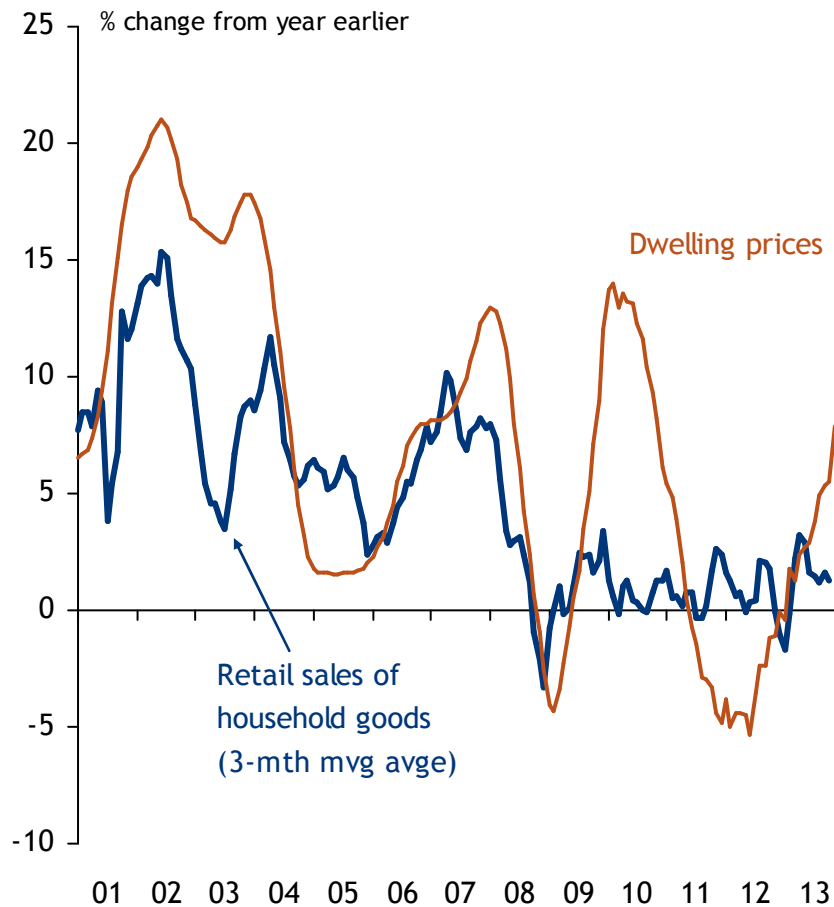
Residential property prices and residential building commencements



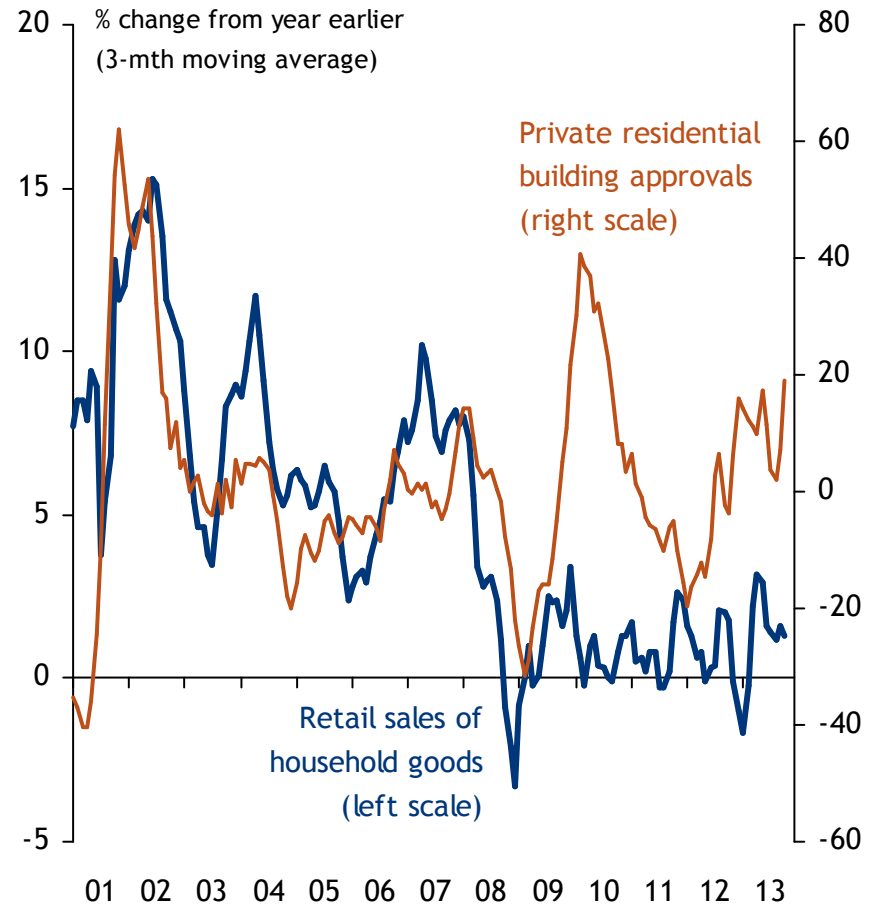
Sources: ABS; RP Data-Rismark.

Higher house prices don't directly spur faster growth in retail sales

Property prices and retail sales of household goods



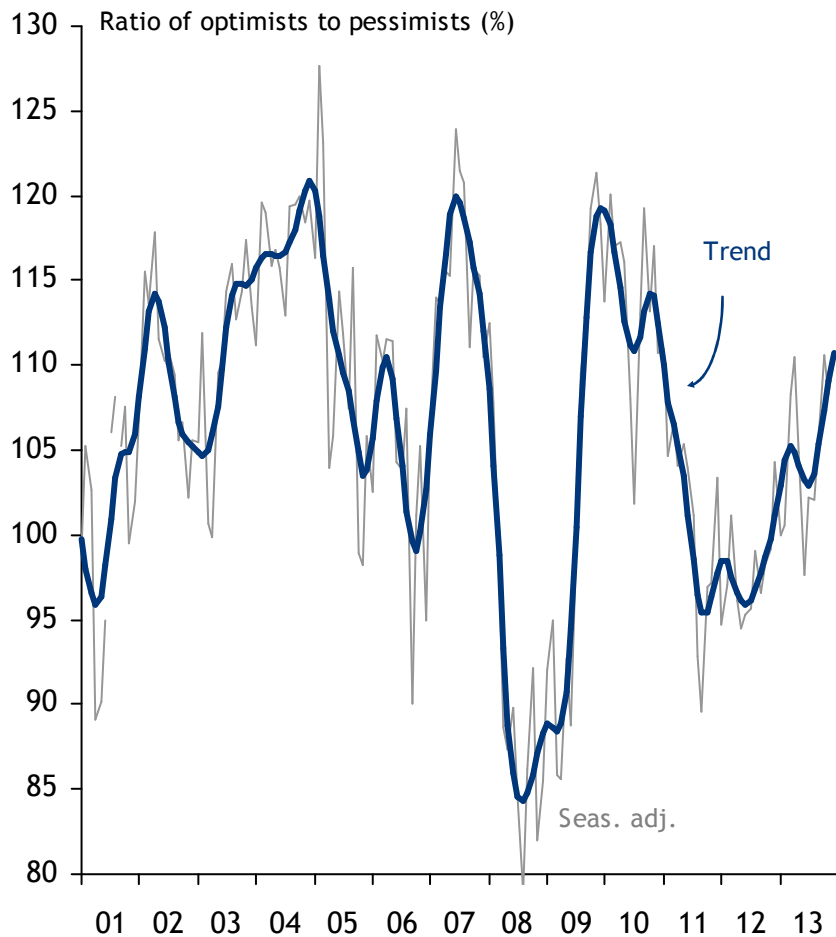
Residential building approvals and retail sales of household goods



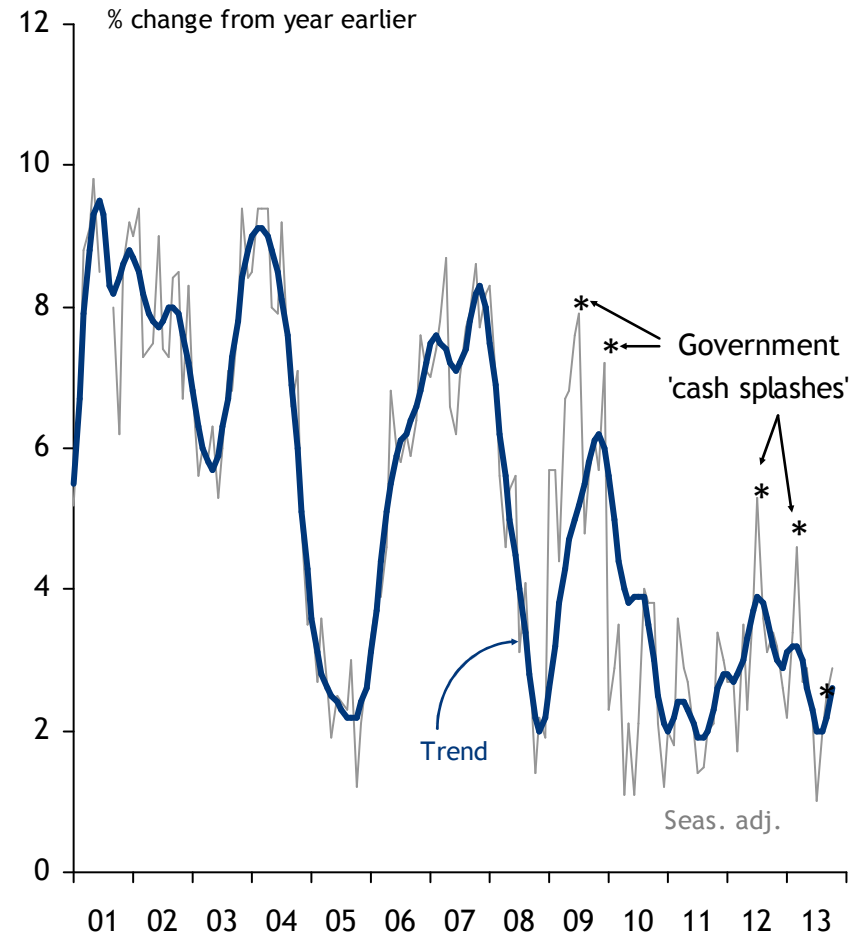
Sources: ABS; RP Data-Rismark.

Consumer confidence has improved but retail sales still remain weak

Consumer confidence



Retail sales

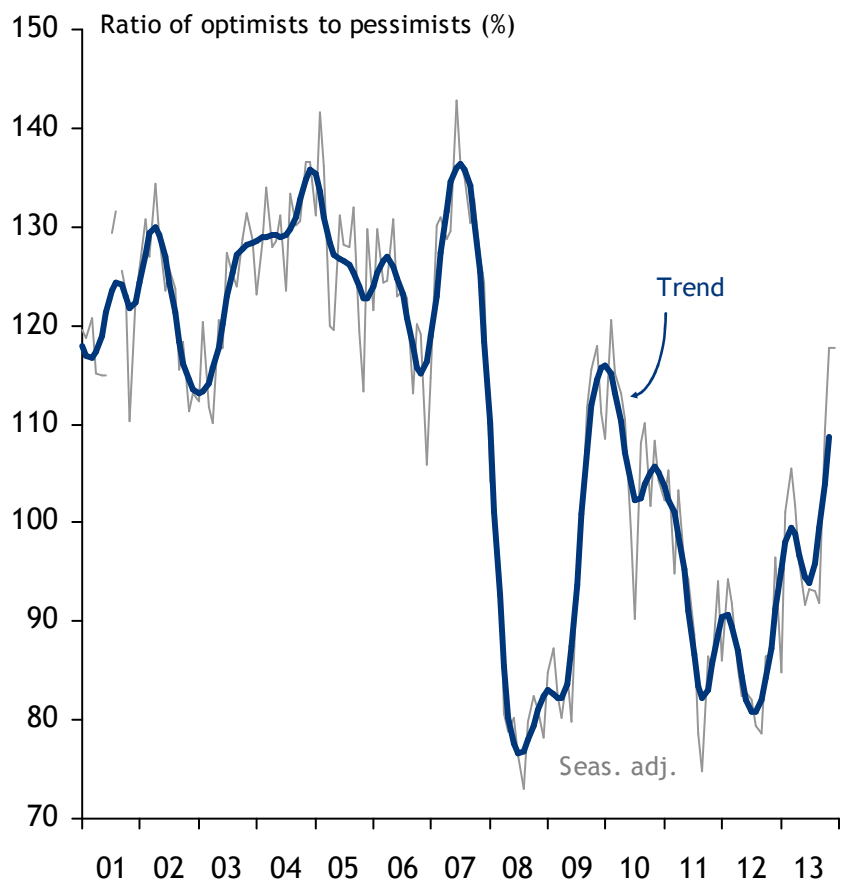


Sources: Westpac-Melbourne Institute; ABS.

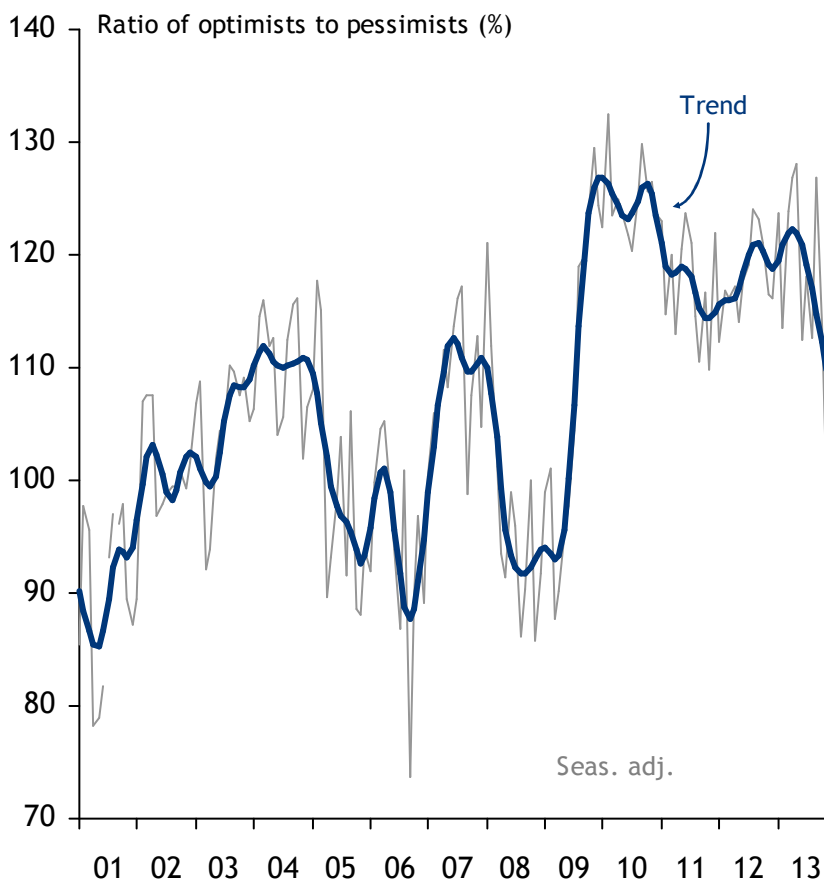
The jump in consumer confidence is wholly due to Coalition voters

Consumer confidence by voting intention

Coalition voters



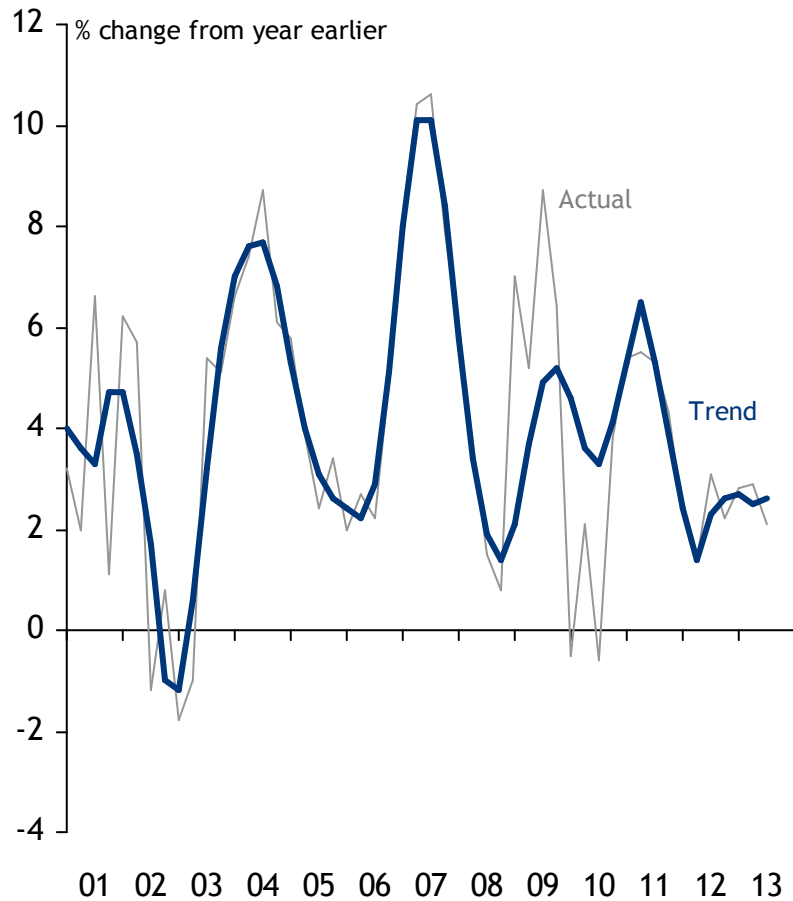
Labor voters



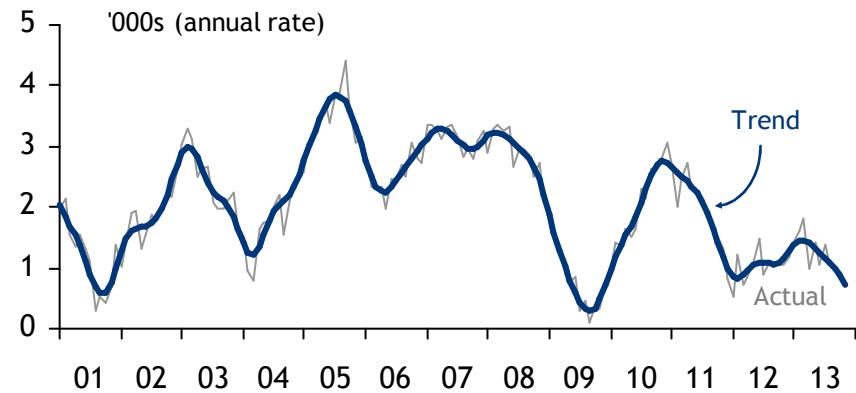
Sources: Westpac-Melbourne Institute.

Consumer spending isn't likely to pick up while income growth is weak

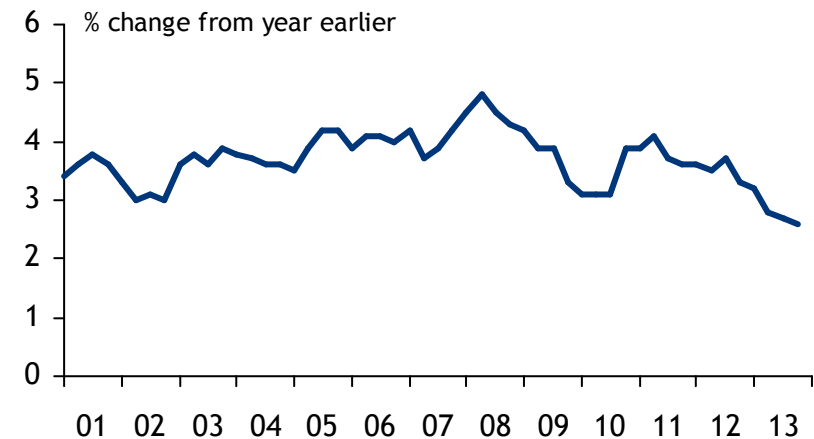
Real household disposable income



Employment growth



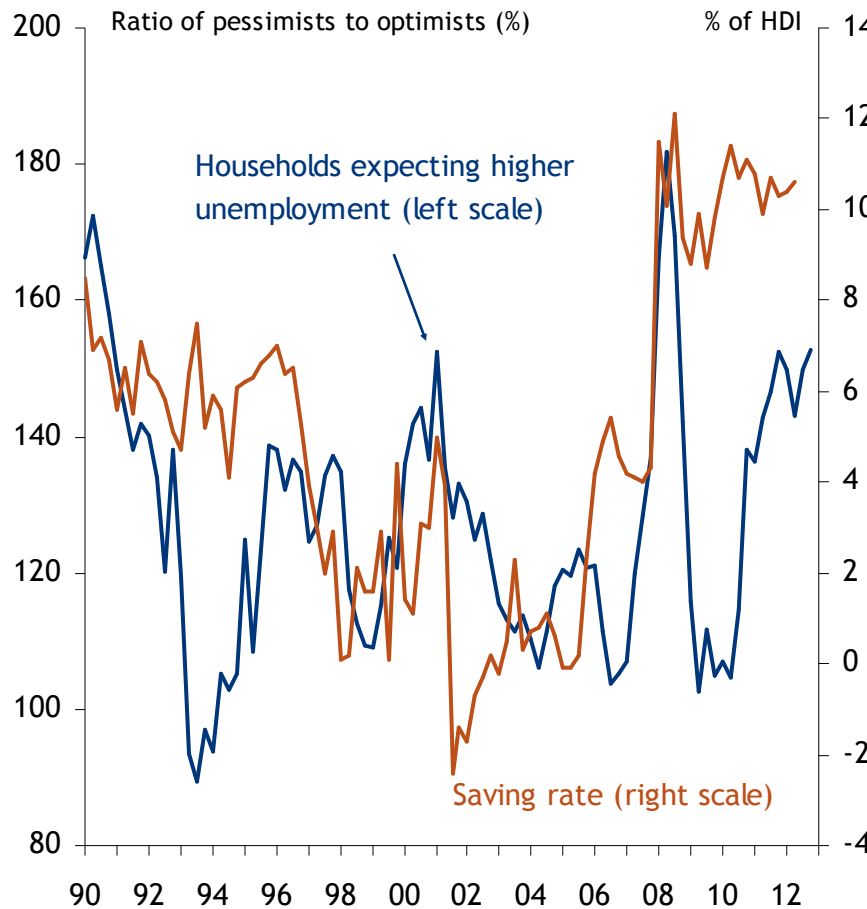
Wages growth



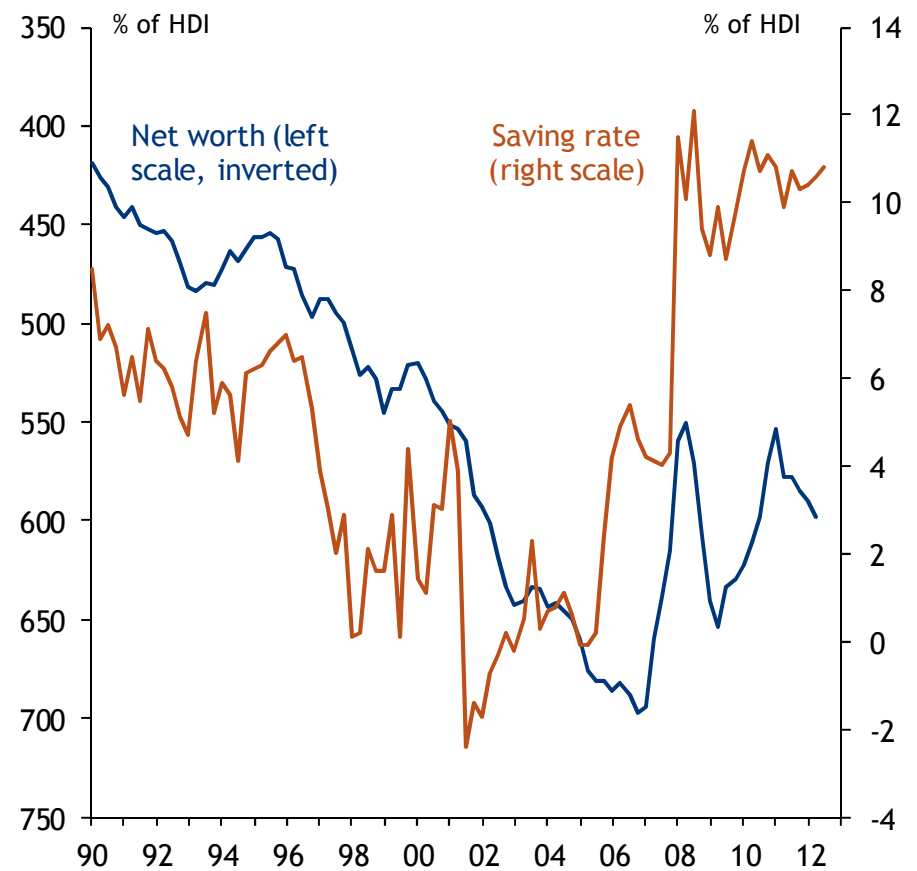
Source: ABS.

No compelling reason to think households are about to save less

Unemployment expectations and household saving



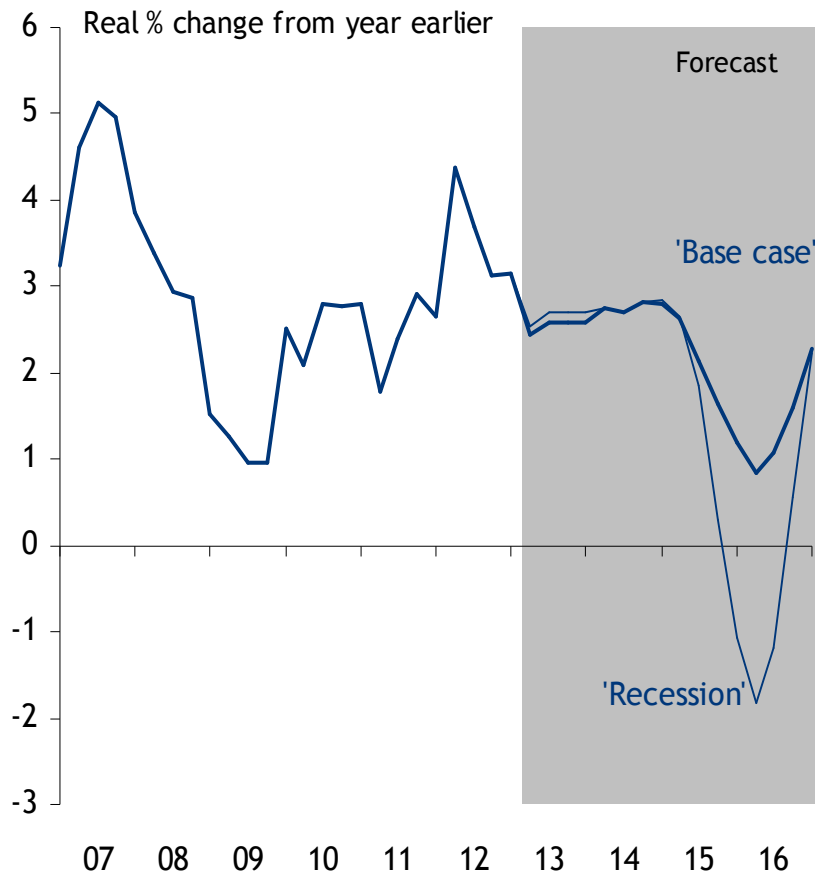
Household net worth and household saving



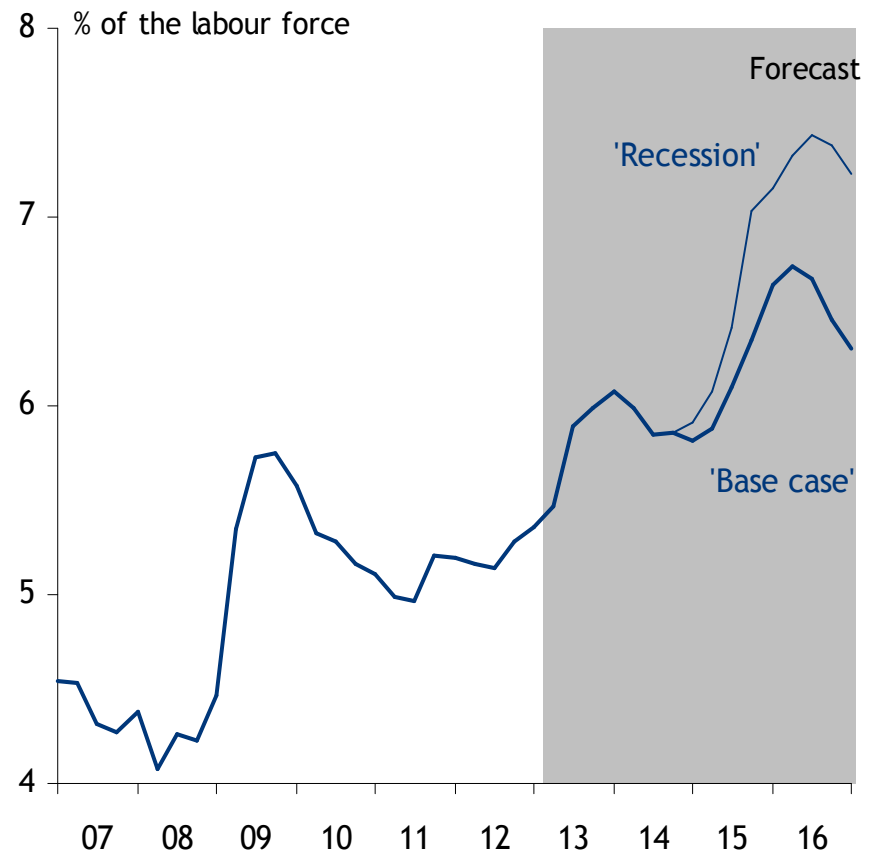
Sources: Westpac-Melbourne Institute; RBA; ABS.

There is a risk Australia could experience recession around 2015-16

Real GDP growth



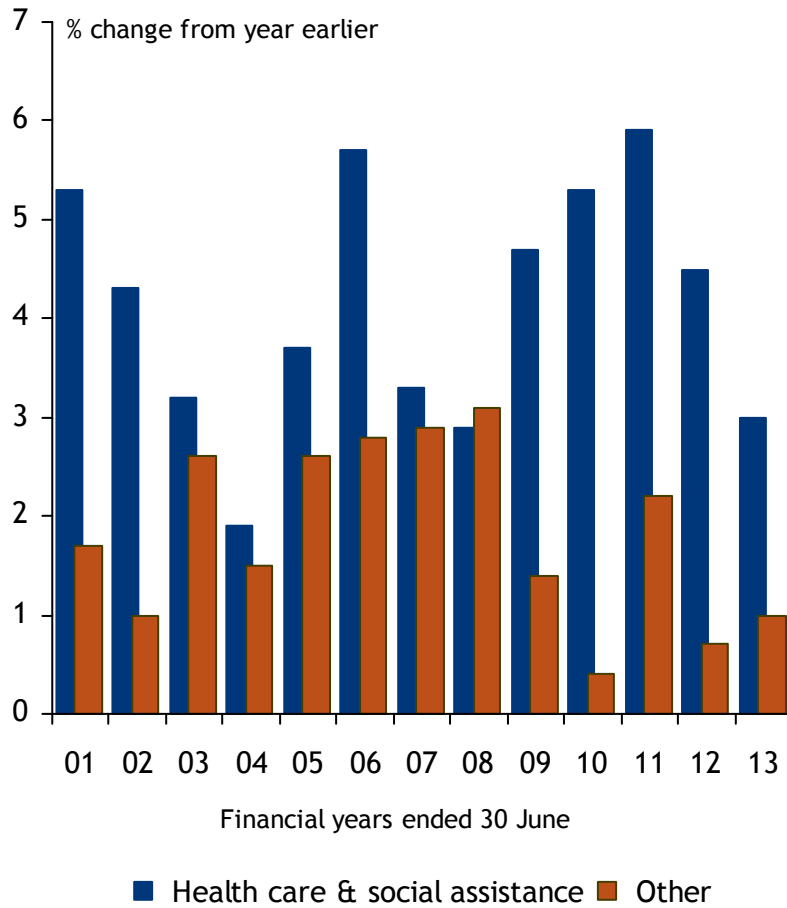
Unemployment rate



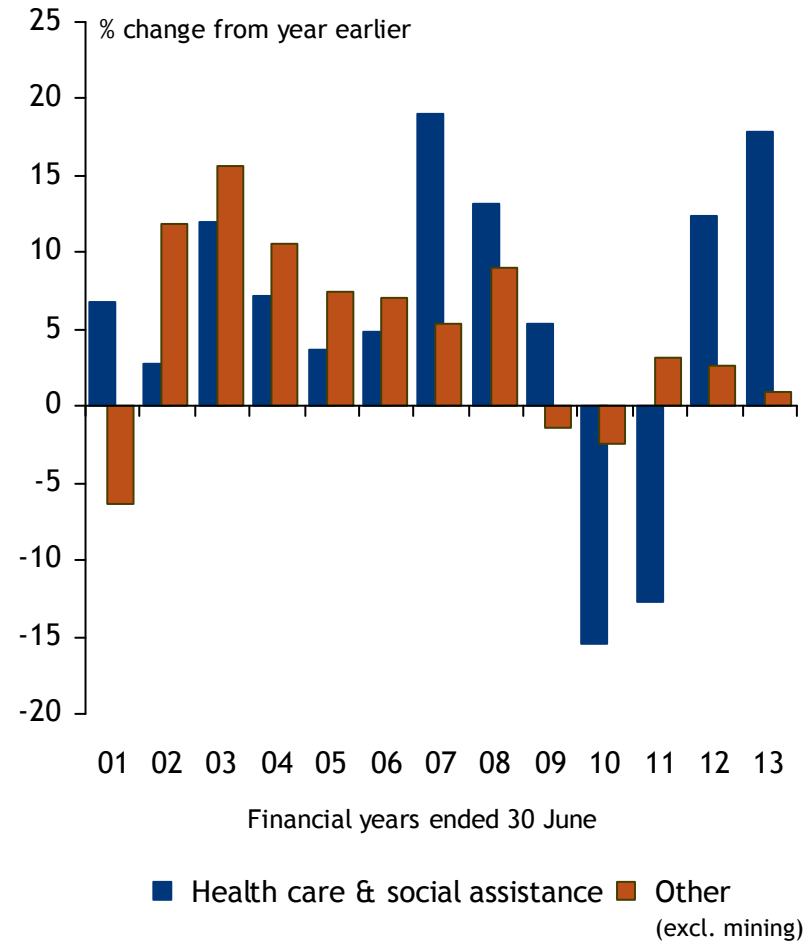
Sources: ABS; Bank of America Merrill Lynch Global Research.

The health care sector is expanding rapidly

Employment



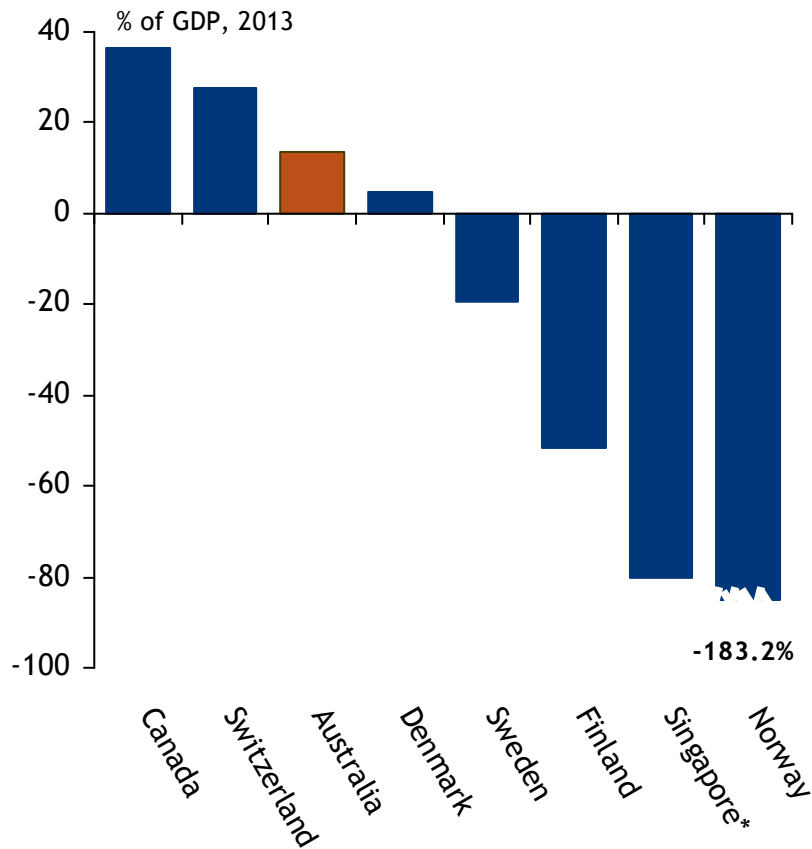
Capital investment



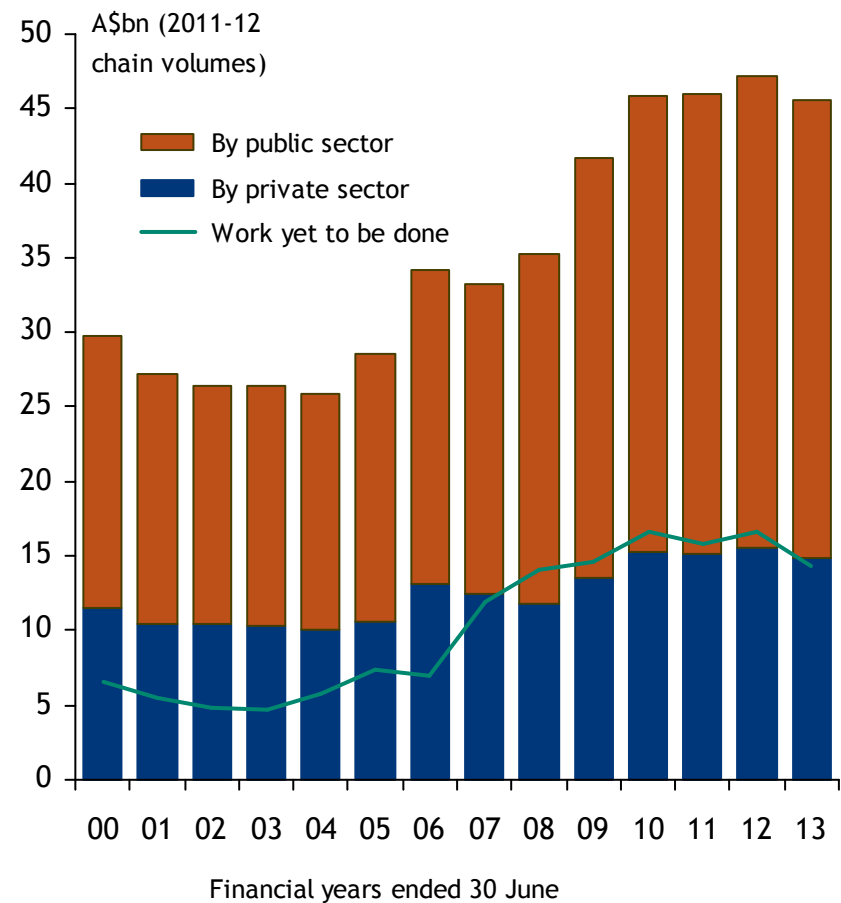
Source: ABS.

There's plenty of scope to borrow more to fund infrastructure spending

AAA-rated sovereigns - net public debt to GDP ratios, 2013



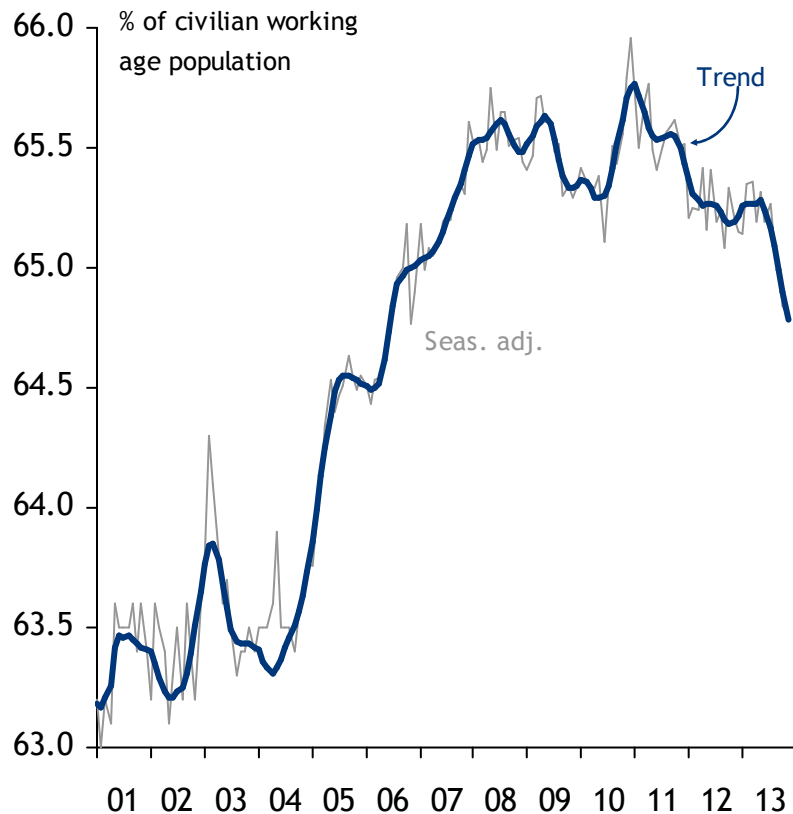
Engineering construction work done for the public sector



Sources: IMF World Economic Outlook October 2013 database; S&P; ABS; BofA Merrill Lynch Global Research.

Declining work force participation is obscuring the rise in unemployment

Labour force participation rate



Unemployment rate



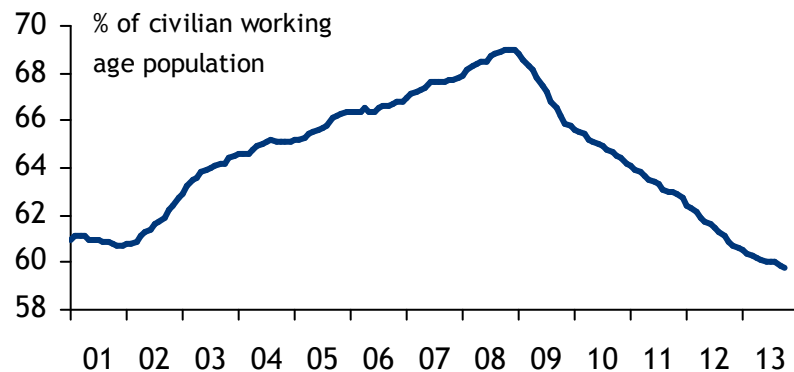
- If the labour force participation rate had remained at its 2011 average (not its peak), the unemployment rate would now be 6.8%, not 5.7%

Source: ABS.

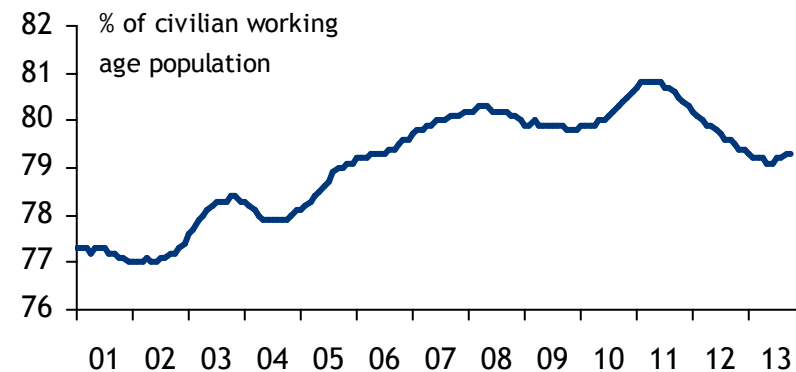
The falls in participation have been among young people, not retirees

Employment-population ratios

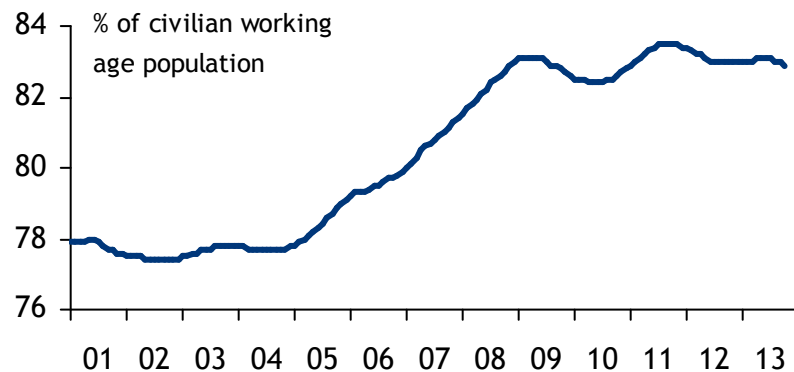
15-24 year olds



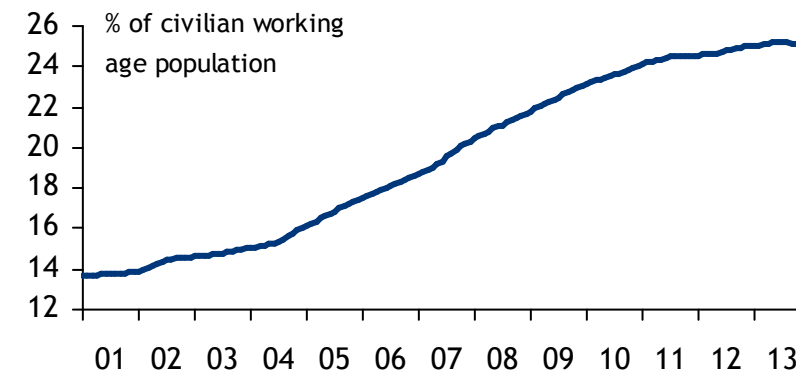
45-59 year olds



25-44 year olds



60 year olds and over

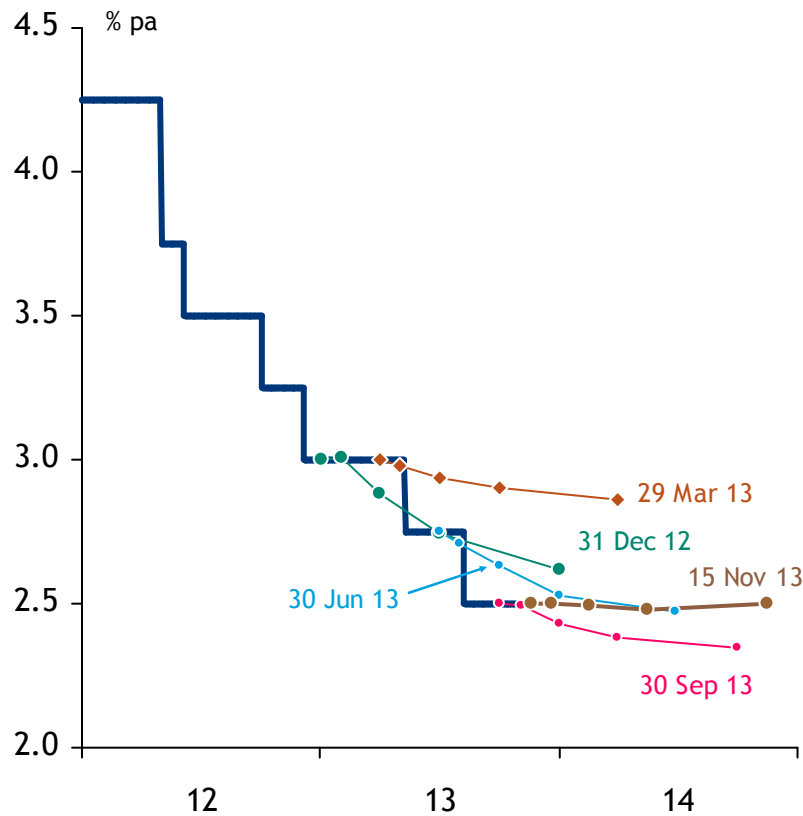


- Since September 2008, the proportion of 15-24 year olds in employment has dropped by 5¾ pc pts, but the proportion attending full-time education has only risen by 3¾ pc pts

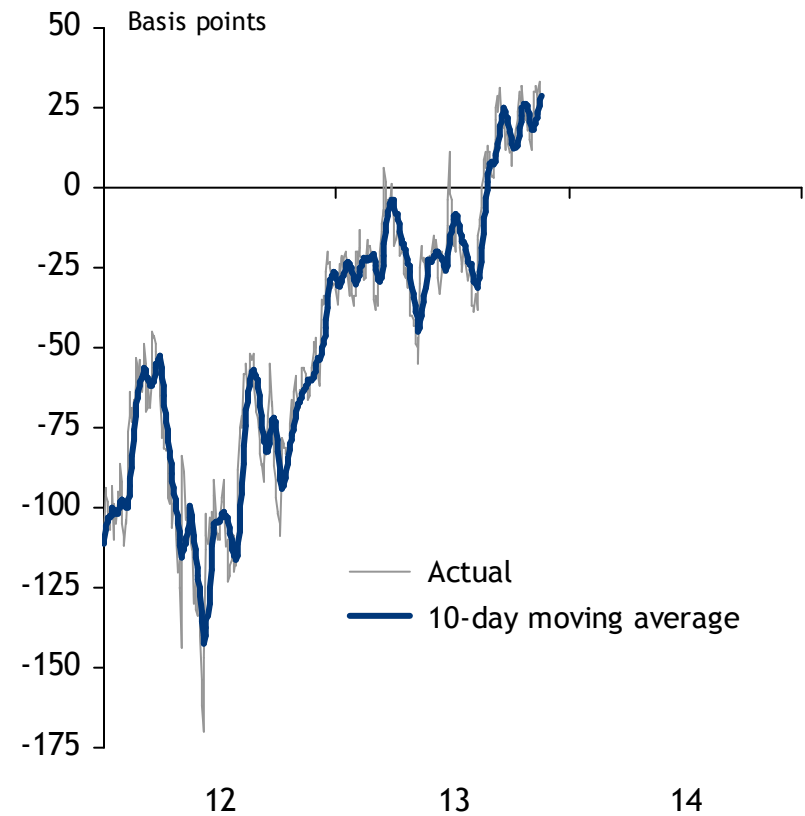
Source: ABS.

The market is no longer expecting any further rate cut from the RBA

RBA cash rate and OIS pricing



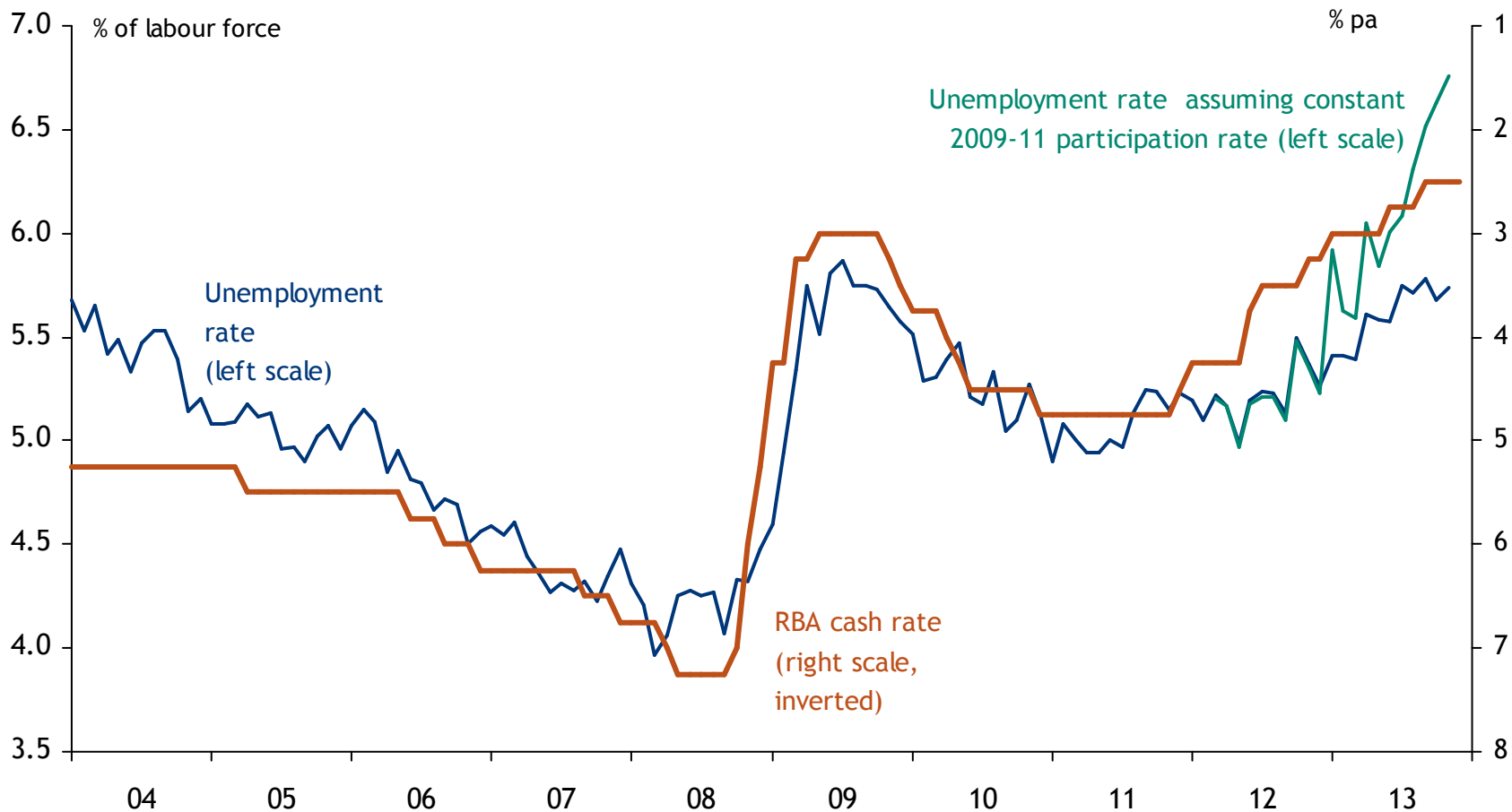
2-year bond yield - cash spread



Sources: Thomson Reuters Datastream ; BofA Merrill Lynch Global Research.

Rising unemployment will force further declines in the cash rate

Unemployment, participation and the cash rate



Sources: ABS, RBA; BofA Merrill Lynch Global Research.

Important Disclosures

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