

Australian Economic Outlook

AICD Queensland

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May 2016



■ **Slower global growth in 2016**

- China's growth at 6% in 2016. US above average, EU weak. Asia slowing.
- lower oil/petrol prices are positive for consumers but risky for financial sector.
- central banks active - weaker Euro, JPY & CNY are underway, but stronger USD.
- Lots of risks: oil, Brexit, Spratlys, Middle East.

■ **Australian growth firm, but Queensland under pressure as commodity prices stay low.**

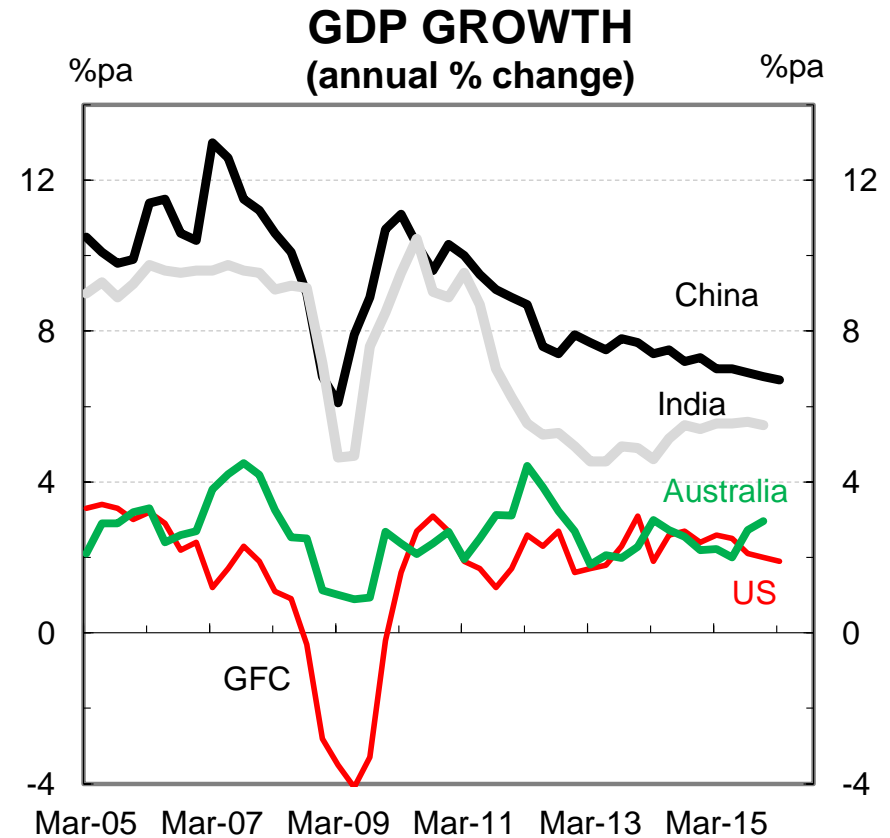
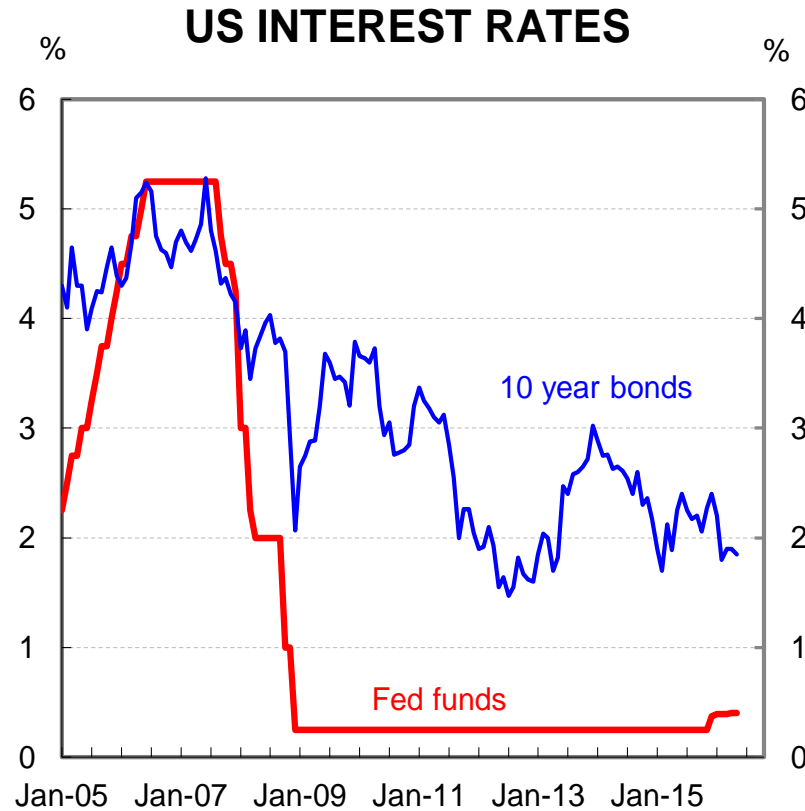
- *Federal Budget should lift business & consumer confidence over 2016 and 2017.*
- the growth transition is slowly underway, but jobs and income growth are modest.
- low inflation (~2%pa) via low petrol prices and softening wages trends.
- Queensland's has competing pressures from weaker mining and rising tourism.
- China's tourism and investment flows into Australia rising strongly.

■ **Economic policy and markets**

- Share markets do not like mix of slower growth in China, higher US interest rates & low oil.
- RBA cut cash rate to 1.75% yesterday, cuts to 1.25% on the way. Wages growth very weak.
- AUD to rise against USD, Euro & GBP. UK to vote on Brexit from EU on 23 June.

The Economy & Markets in 2016

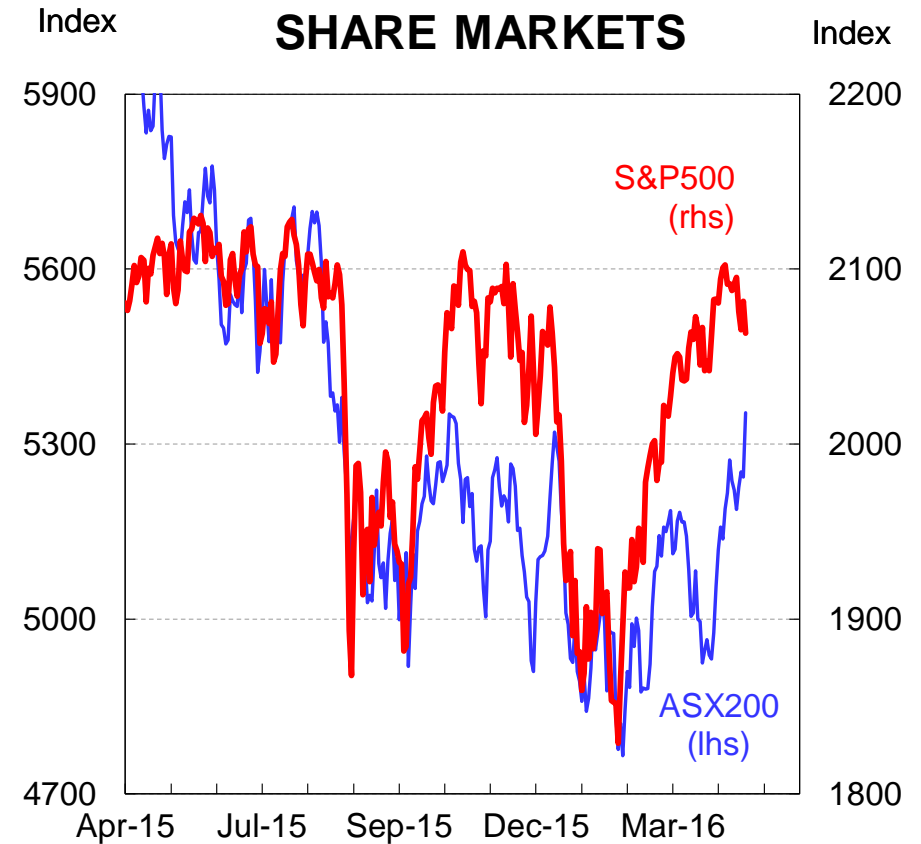
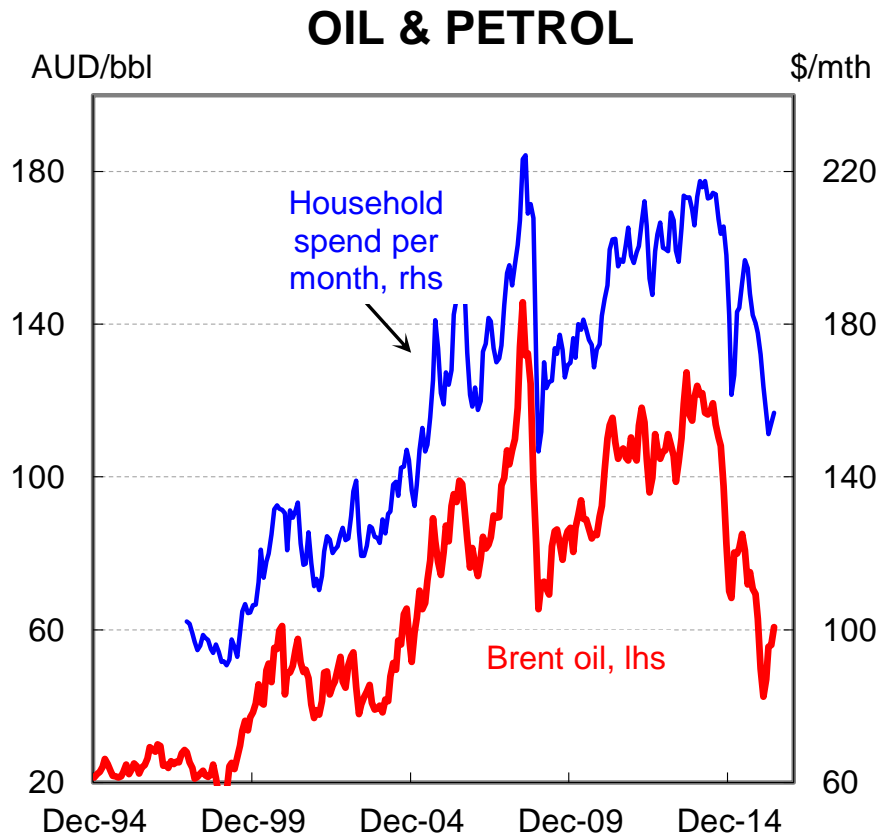
US Fed & China's Central Bank



- **Fed policy uncertainty and China growth concerns are key drivers:**
 - the Fed has emphasised that US interest rate rises will be slow and cautious.
 - moves in the China's GDP growth need to be put in the longer context.

Oil & Share Markets

The new view



- Low oil prices seen as “problem” because of energy debt exposures. Producers?
- Central bank activity distorts interest rate markets – depresses rates.
- Business & investment cycle not responding to near zero rates.

Australia: 2016 GDP Near 2.8%.

STRONGEST GROWTH OUTLOOK

NSW: Residential construction, alts & adds, related retail.

Housing Alts & Adds

Inbound tourism - hotels.

Infrastructure – roads, rail, water, power, utilities.

-related construction, engineering & services.

Retail hardware. Cafes, restaurants, communications

Mining – coal *production & exports*.

New car sales

MODERATE TO LOW GROWTH OUTLOOK

Staples – groceries, food sales, clothing, alcohol/drugs.

Health & allied services, defence & primary education.

Media. Discretionary retail – shoes, cosmetics, a/visual.

Manufacturing – metals & wood related.

Domestic tourism. Tertiary education.

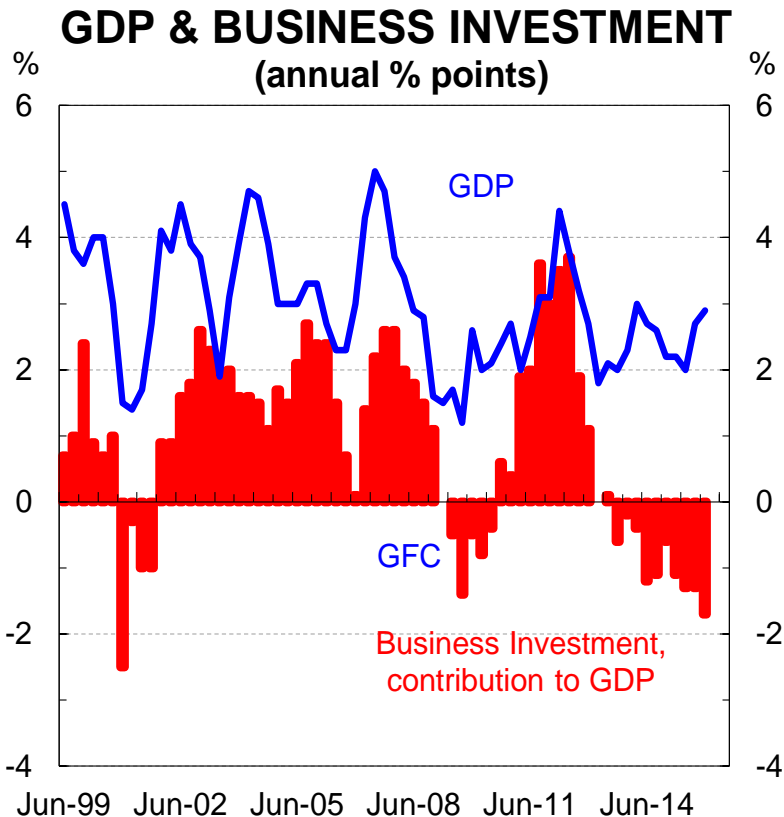
SECTORS WITH DOWNSIDE RISK

Mining construction: Iron ore & coal (thermal & coking)

Commercial construction – fit-outs & conversions

Retail exposed to internet-based alternatives.

Manufacturing – engineering, food, textiles & car parts.



GDP:

10 year average is 3.1%pa

Budget: Winners & Losers

Winners

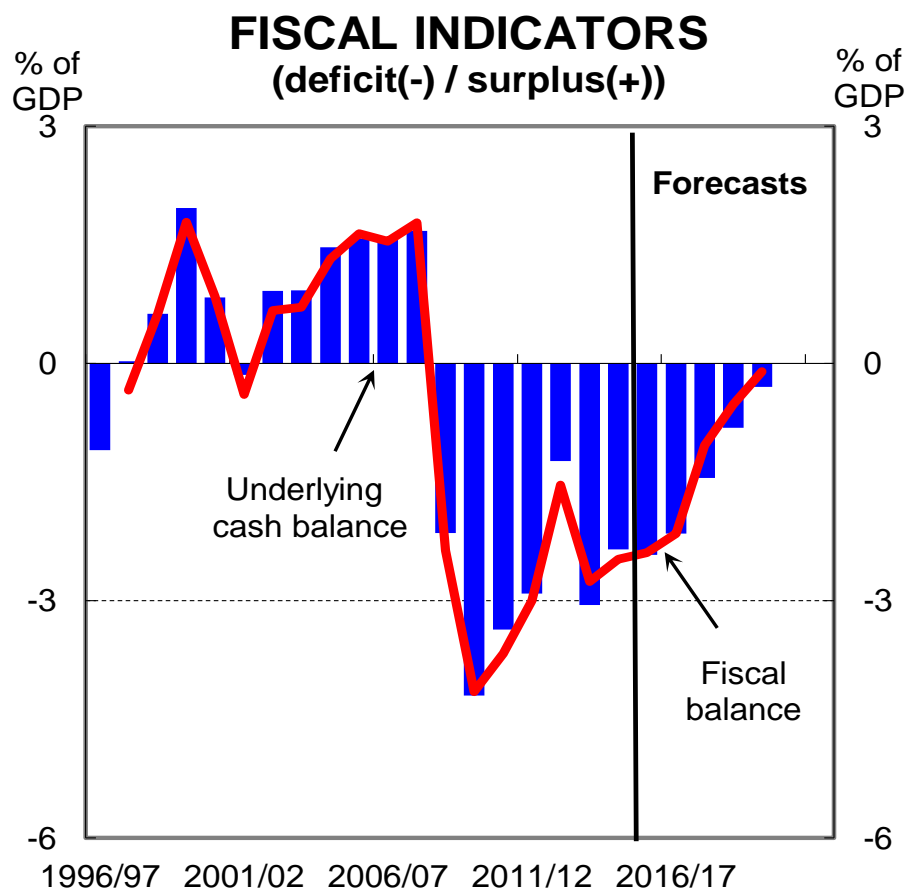
- Small business up to \$10m turnover will have company tax cut to 27.5%. Cuts to 25% for all companies over ten years.
- Start-up businesses and entrepreneurships – tax concessions extended including depreciation pooling provisions.
- Employers can receive wages subsidies of \$6 to \$10k to employ people under 25.
- Middle income earners – the 32.5% marginal tax rate extended to \$87k, from \$80k. Benefits half a million taxpayers.
- No changes to negative gearing arrangements – at this stage.
- Re-announcement of \$50bn infrastructure fund, including contributions to Melbourne & Sydney rail metros.
- Education: Schools to receive \$1.2bn depending on better education outcomes.
- Health: \$2.9bn for public hospital services, expanded dental program for children and low income earners.

Losers

- Smokers to pay higher taxes, rising by 12.5% each year till 2021.
- Tightening of welfare safety net to make employment more attractive.
- Multi-national companies to face tougher penalties for tax avoidance.
- Superannuation contributions tax to be set at 30% (from 15% up to \$300k) for those earning over \$250k.
- New \$1.6m cap on tax-free super contributions into retirement phase.
- Annual concessional super contributions cap now \$25k for all. Lifetime cap of \$500k for non-concessional contributions
- Earnings of transition to retirement incomes to be taxed to weaken tax minimisation incentives.

Budget Overview

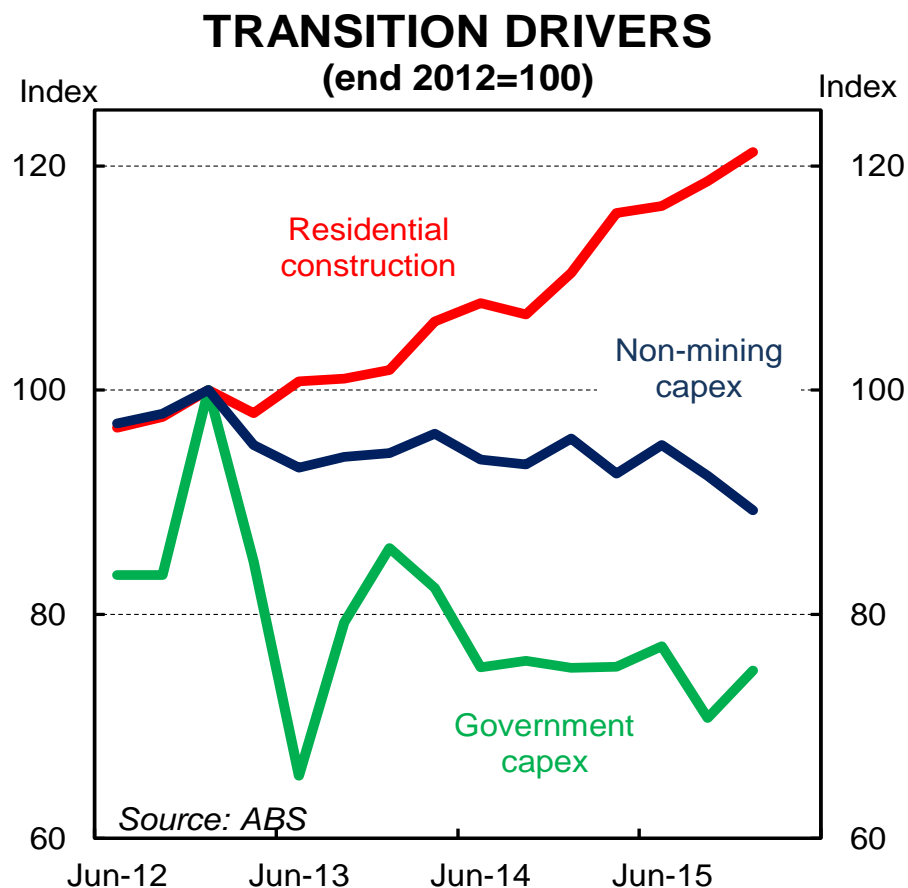
Key numbers



- **Underlying cash deficit for 2016/17 put at \$37.1bn (2.2% of GDP) a small improvement on the previous deficit of \$39.9bn.**
- **Underlying cash deficit narrows to \$6.0bn (0.3% of GDP) at horizon.**
- **Revenues of \$416bn, spending of 450bn!!!**
- **Net debt peaks (as a share of GDP) in 2017/18 at 19.2%.**
- **Limited new policy initiatives, plus a steady improvement in revenue growth and significant degree of outlay restraint.**

The Transition & The Federal Budget

Will it help the Great Transition?

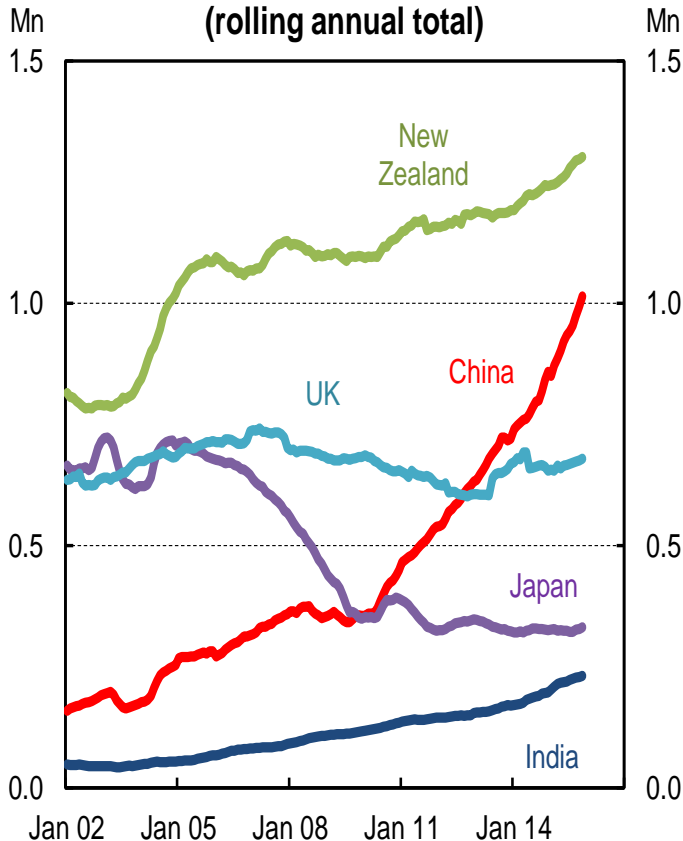


- The transition to non-mining led growth is based on **residential construction**, **non-mining capex** and **government infrastructure**.
- The transition is uneven.
- The May RBA interest rate cut is positive.
- A number of Budget initiatives should help:
 - \$50bn infrastructure fund;
 - \$2bn water investment in dams & pipelines;
 - Defence programs over next decade.

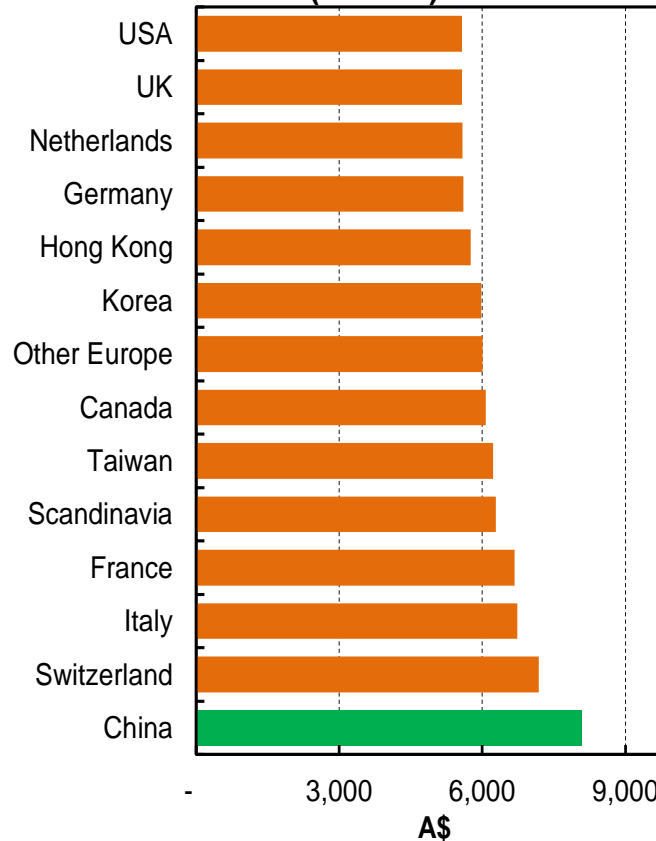
Tourism - Income Opportunities

The tourism example

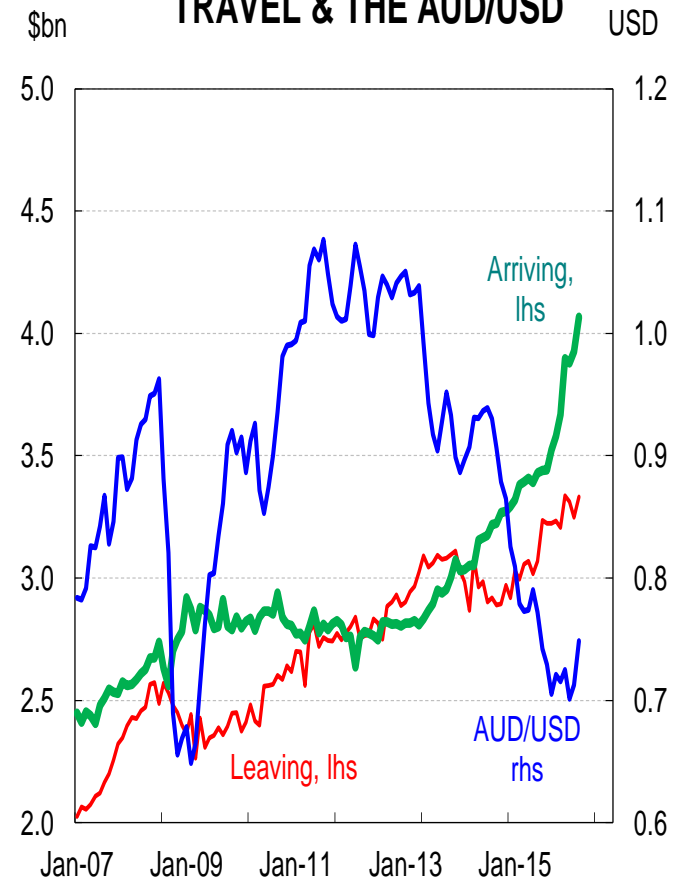
SHORT TERM OVERSEAS ARRIVALS
(rolling annual total)



AVERAGE TOURIST SPEND
(2014/15)



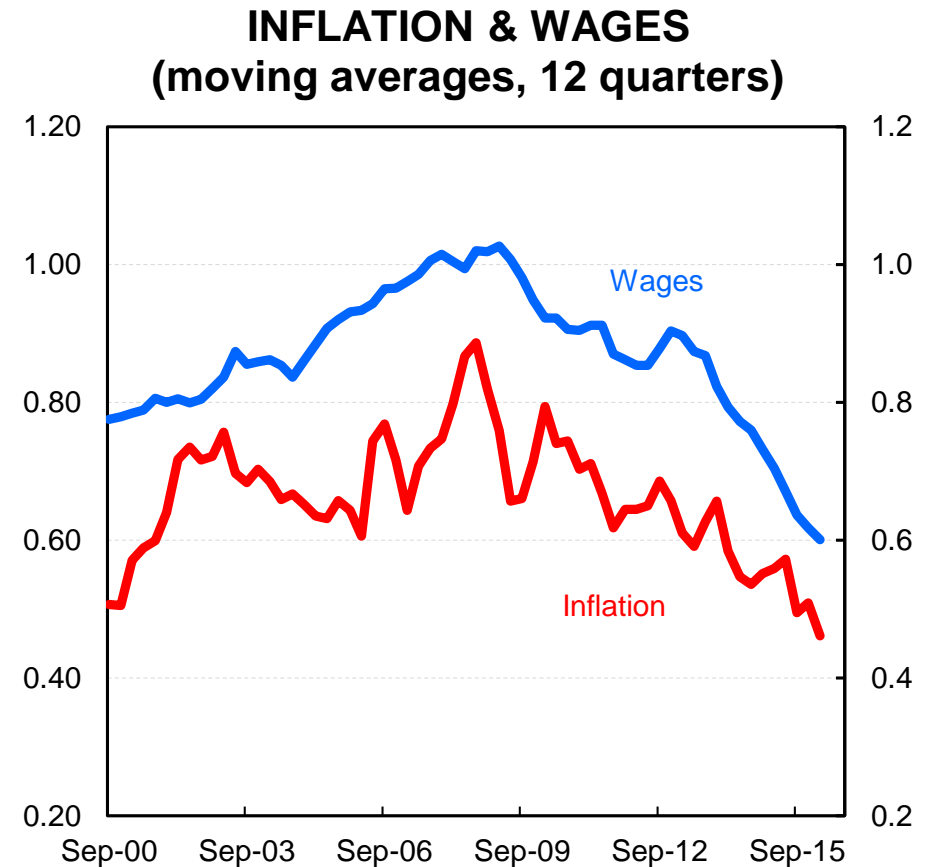
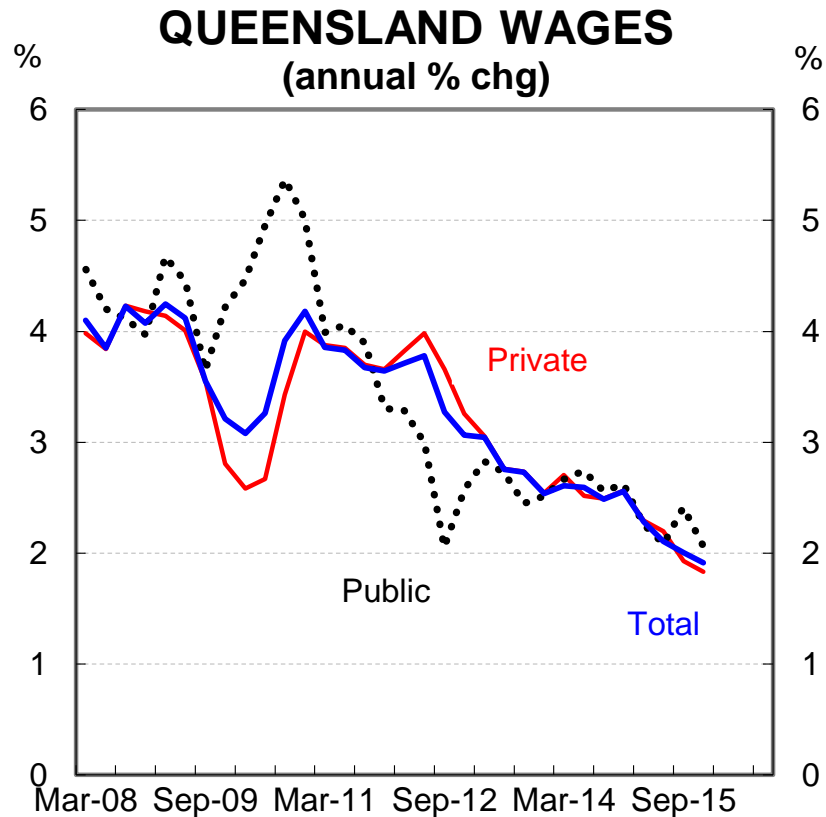
TRAVEL & THE AUD/USD



- Education and tourism inflows have been rising for past 2 years.
- Weaker AUD and changes to China's travel regulations mean more tourists.

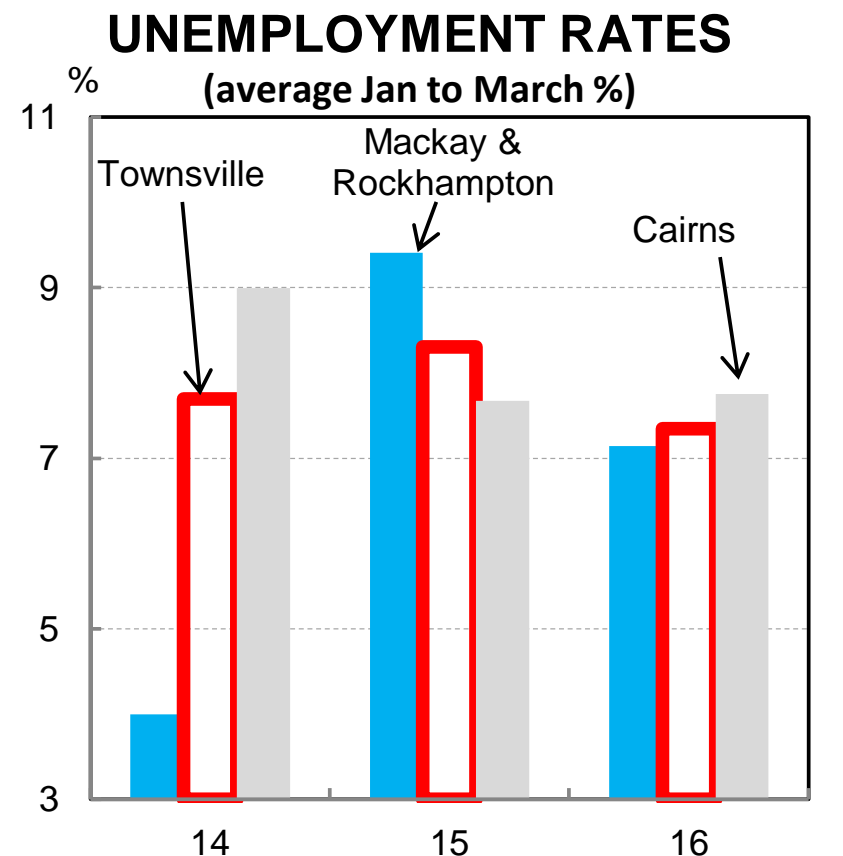
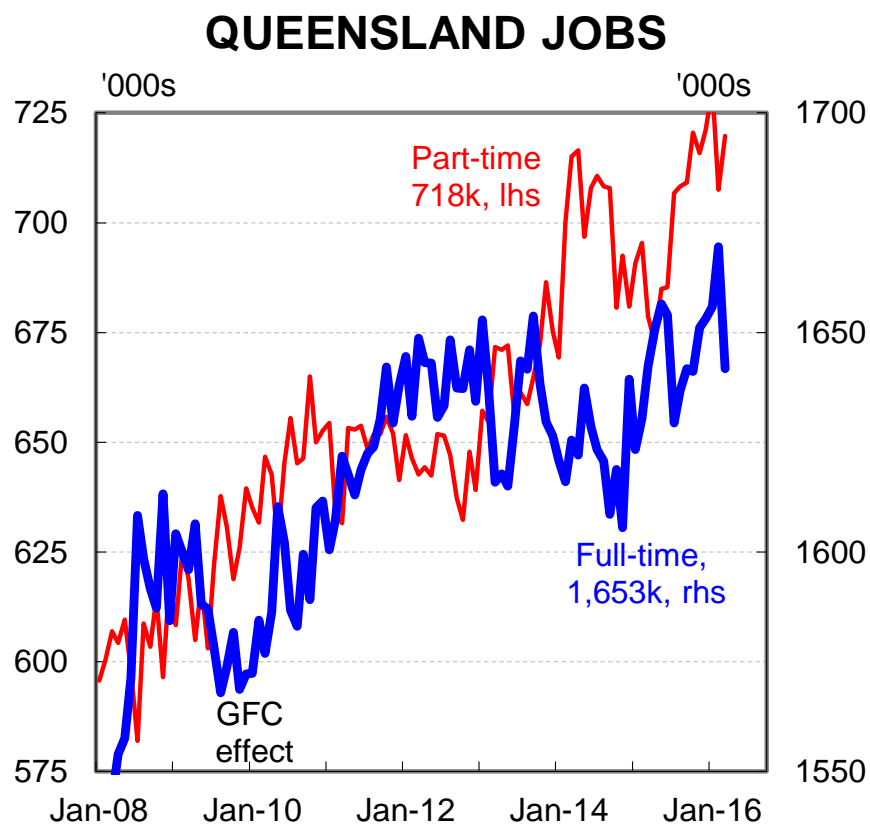


Inflation & Wages



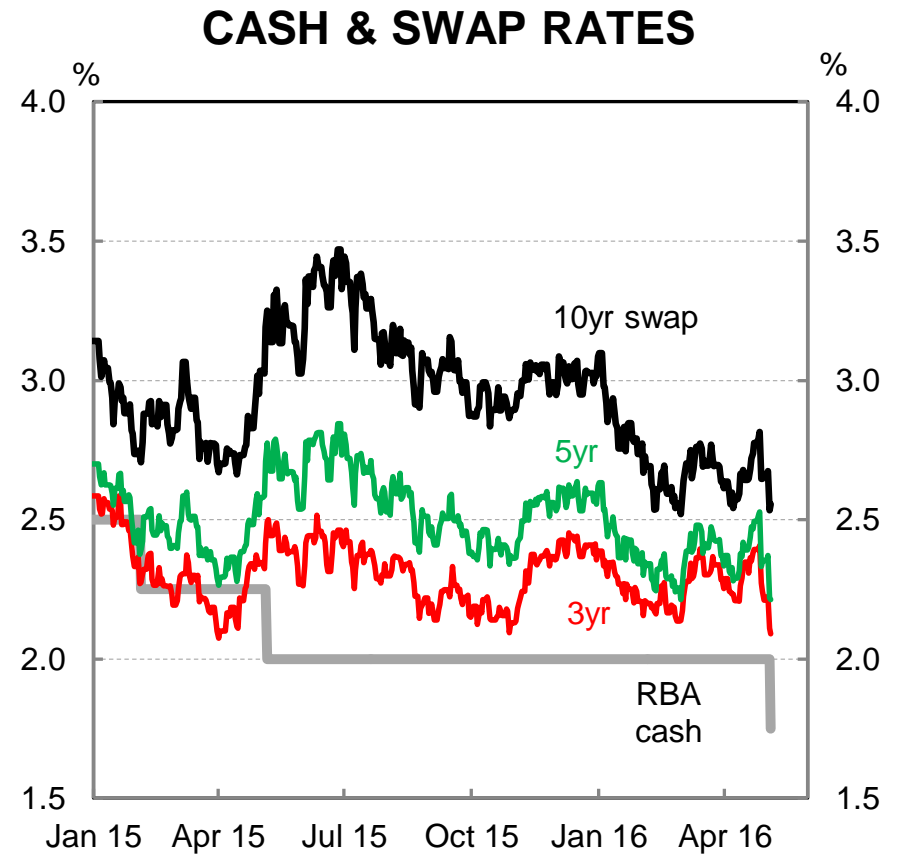
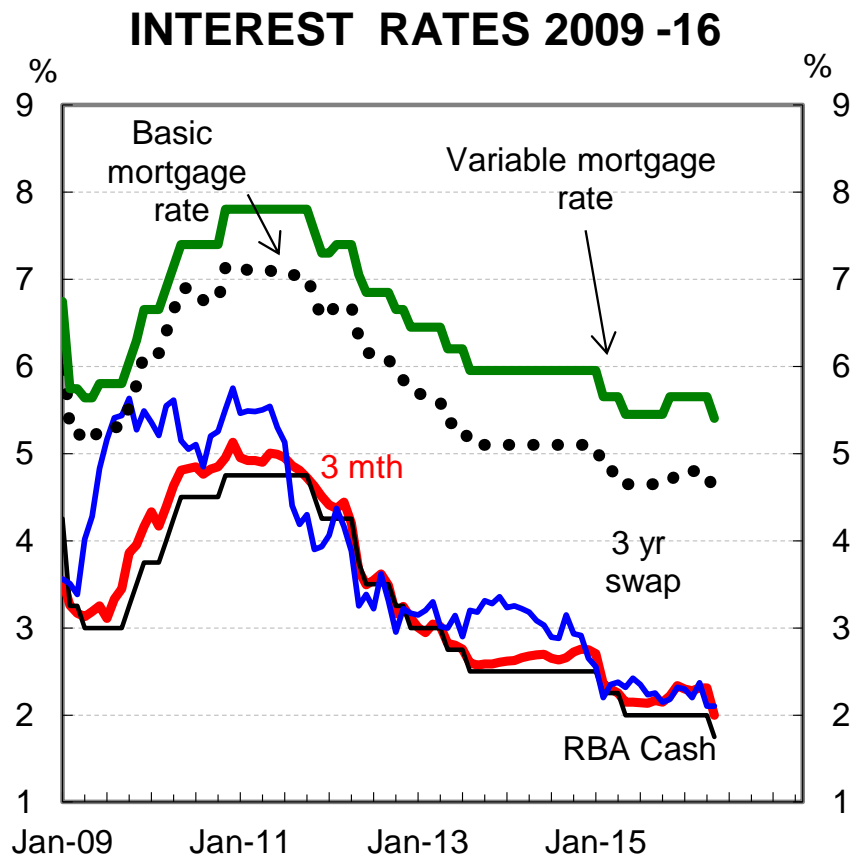
- **Wages growth headed under 2%pa – lowest in 20 years.**
- **Inflation following wages growth lower over 2016 and 2017. So RBA can cut rates.**

Queensland Jobs Market in Transition.



- Queensland's jobs growth was 40k over past year , but ALL part-time.
- Queensland's unemployment rate at 6.1% in March, past the peak of 7% in 2014.
- Jobs ads show a gradual pick-up in monthly jobs data over 2016 and into 2017.

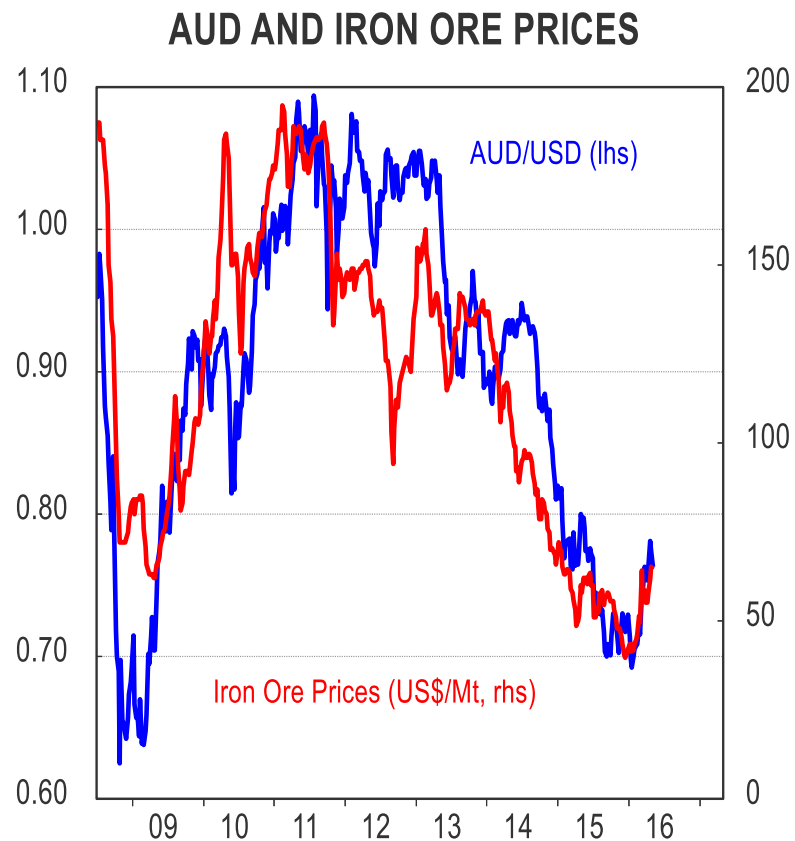
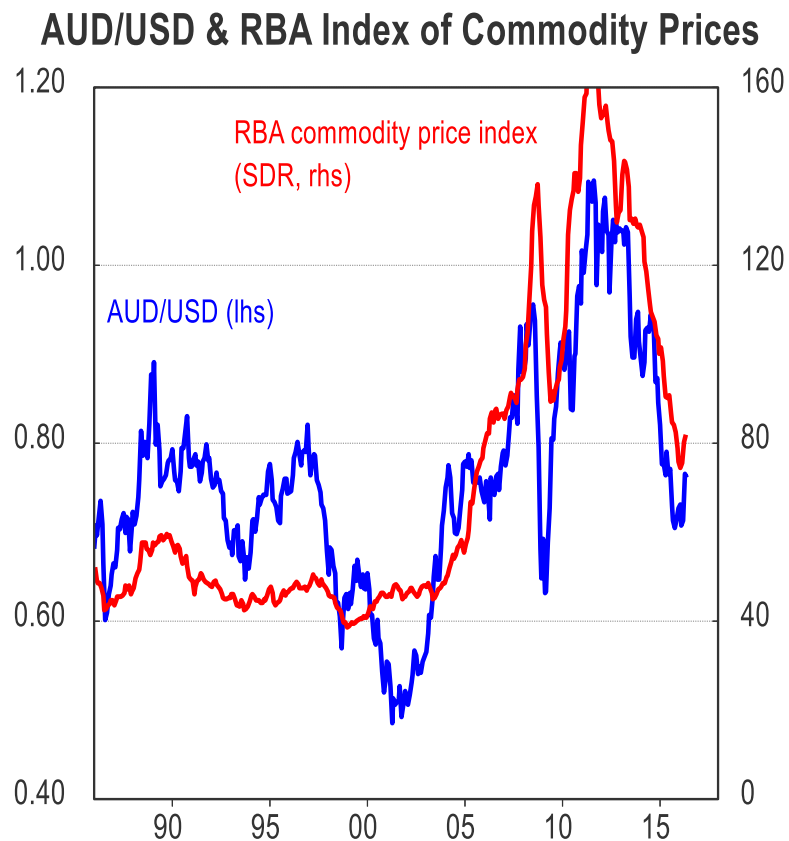
Interest Rates – Lower Levels Coming



- RBA cut cash rate to 1.75% on 3 May 2016. Another cut soon because of low inflation.
- Swap rates should fall further when cash rates fall.

The AUD & Iron Ore Prices

Commodity prices



- Commodities are Australia's largest export and the BIG influence on AUD/USD.
- Commodity prices are bottoming-out. The price of iron ore has lifted since late 2015.

CBA Interest Rate & AUD/USD Forecasts

Forecasts

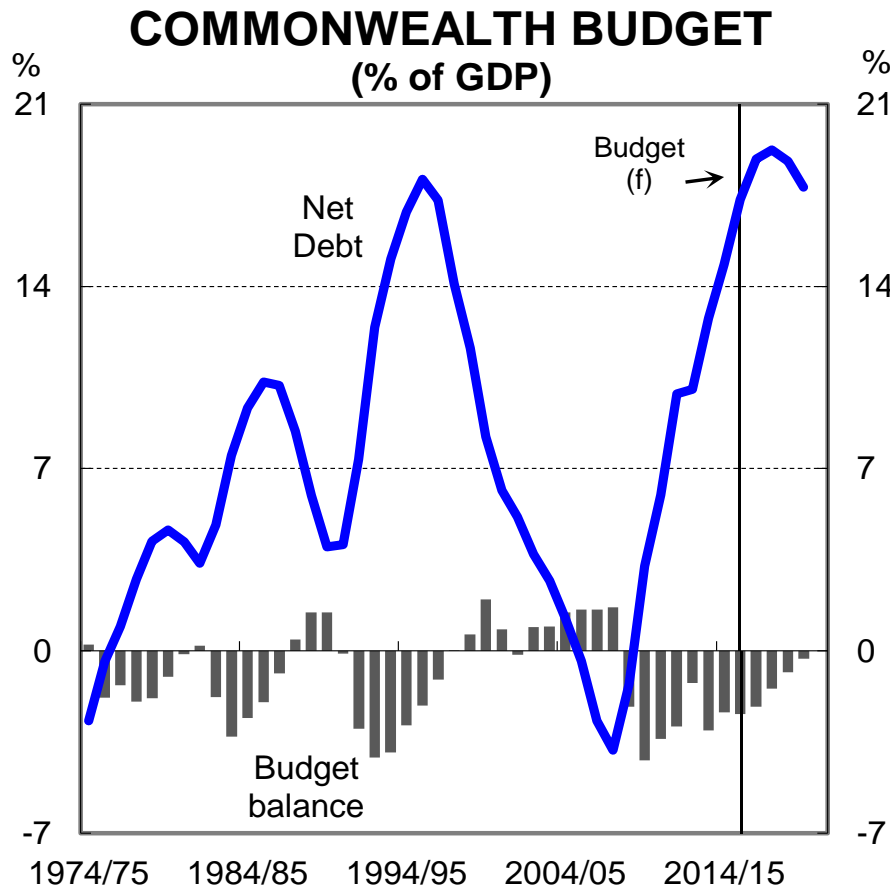
| | Market | | Jun'16 | Sep'16 | Dec'16 | | Jun'17 |
|-----------|-----------------|--|-------------|-------------|-------------|--|-------------|
| Australia | RBA cash | | 1.75 | 1.5 | 1.25 | | 1.25 |
| | 90-day bills | | 2.0 | 1.6 | 1.3 | | 1.3 |
| | 3-year bonds | | 1.5 | 1.3 | 1.3 | | 1.3 |
| | 10-year bonds | | 2.3 | 2.3 | 2.3 | | 2.3 |
| | | | | | | | |
| | 2-year swap | | 2.2 | 2.1 | 2.1 | | 2.3 |
| | 10-year swap | | 2.7 | 2.6 | 2.6 | | 2.8 |
| | | | | | | | |
| USA | Fed funds | | 0.75 | 1 | 1¼ | | 1¾ |
| | 2-year bonds | | 1.2 | 1.4 | 1.6 | | 2.0 |
| | 10-year bonds | | 2.4 | 2.5 | 2.6 | | 2.7 |
| | | | | | | | |
| FX | AUD/USD | | 0.72 | 0.69 | 0.72 | | 0.73 |
| | AUD/EUR | | 0.62 | 0.61 | 0.62 | | 0.64 |
| | | | | | | | |

CBA Australian Economic Forecasts – May 2016

| | 2012/13 <i>(a)</i> | 2013/14 <i>(a)</i> | 2014/15 <i>(a)</i> | 2015/16 <i>(f)</i> | 2016/17 <i>(f)</i> | 2017/18 <i>(f)</i> |
|-------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Economic Activity | | | | | | |
| Private final demand | 1.9 | 1.6 | 1.0 | 0.6 | 1.0 | 2.0 |
| <i>Of which: Household spending</i> | 1.6 | 2.6 | 2.7 | 2.9 | 2.9 | 3.0 |
| Dwelling investment | -1.8 | 5.1 | 7.9 | 8.2 | 1.9 | -1.5 |
| Business investment | 3.9 | -3.7 | -6.6 | -10.7 | -7.1 | -0.5 |
| Public final demand | 0.5 | 0.4 | -0.2 | 1.8 | 1.7 | 2.1 |
| Domestic final demand | 1.6 | 1.3 | 0.8 | 0.9 | 1.2 | 2.0 |
| Inventories (contrib to GDP) | -0.1 | -0.3 | 0.1 | 0.0 | 0.1 | 0.0 |
| GNE | 1.5 | 1.1 | 0.9 | 0.9 | 1.3 | 2.1 |
| Exports | 5.6 | 5.8 | 6.5 | 6.8 | 8.1 | 8.1 |
| Imports | 0.6 | -1.8 | 0.0 | -0.5 | 1.9 | 3.6 |
| <i>Net exports (contrib to GDP)</i> | <i>0.9</i> | <i>1.6</i> | <i>1.4</i> | <i>1.6</i> | <i>1.4</i> | <i>0.0</i> |
| GDP | 2.4 | 2.5 | 2.2 | 2.8 | 2.6 | 3.2 |
| Prices & Incomes | | | | | | |
| CPI | 2.3 | 2.7 | 1.7 | 1.7 | 2.0 | 2.3 |
| Underlying CPI | 2.4 | 2.6 | 2.3 | 2.0 | 2.4 | 2.4 |
| WPI | 3.3 | 2.6 | 2.4 | 2.3 | 2.6 | 3.0 |
| Nominal GDP | 2.3 | 4.0 | 1.5 | 2.9 | 3.7 | 5.2 |
| Real h/hold disposable income | 0.5 | 2.2 | 1.9 | 1.5 | 2.0 | 2.6 |
| Labour Market | | | | | | |
| Employment | 1.2 | 0.5 | 1.2 | 2.3 | 1.8 | 2.0 |
| Unemployment rate | 5.4 | 5.8 | 6.2 | 5.9 | 5.7 | 5.4 |
| External Accounts | | | | | | |
| Current Account: \$bn | -59.4 | -51.1 | -49.7 | -75.8 | -66.1 | -54.5 |
| <i>% of GDP</i> | <i>-3.9</i> | <i>-3.2</i> | <i>-3.7</i> | <i>-4.6</i> | <i>-3.8</i> | <i>-3.0</i> |

The Budget & Net Debt

Is the AAA safe?



- The forecasts show further rises in net debt, albeit at a slowing pace.
- Commonwealth net debt is expected to peak at 19.2% of GDP in 2017/18.
- Some budget metrics are nearing uncomfortable levels for the ratings agencies.
- Our assessment is that the threat to Australia's AAA/Aaa sovereign ratings is real.
- Ratings agencies have us on the edge of a change to lower credit ratings.

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