



ECONOMICS: AUSTRALASIAN PERSPECTIVES

COMMODITY DOWNSIDE STILL DOMINATES

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Falling commodity prices and their spillover to incomes and spending remain central to the economic debate in Australia and New Zealand. It would not surprise us to see the RBA reinstitute its easing bias at the next policy meeting, and there's a reasonable chance the RBNZ could soon follow the RBA down the rate cut path—perhaps as early as June.

Capex Disappoints Again

There's a bit more optimism creeping into the consensus view on the Australian economy, as we discussed a month ago (*Australia: Has The Story Changed?* Australasian Perspectives, May 1, 2015). The delivery of the government's Budget Statement in mid-May provided a further push in that direction, with its focus on tax breaks for small businesses—even though a standard analysis would suggest that the budget was mildly contractionary, not stimulatory.

In any case, this incipient optimism received a nasty knock from the capital expenditure (capex) data this week, a survey providing a gauge of likely business investment spending in the year or so. The estimates confirm that the mining capex cliff has arrived—after a 20% drop in the current fiscal year, spending is likely to be cut by another 30% next year (*Display 1*). This is not a surprise, as a number of big projects in the liquefied natural gas (LNG) and iron ore sectors will have been completed, and there is virtually nothing else in the pipeline. Still, reality bites.

The real shock, however, was in the areas outside of mining sector. Spending in the

manufacturing sector is expected to fall 25%, marking the lowest level in nominal terms since mid-1980s, while spending in other sectors (mainly services) is expected to be down 10%. So much for the “rebalancing”.

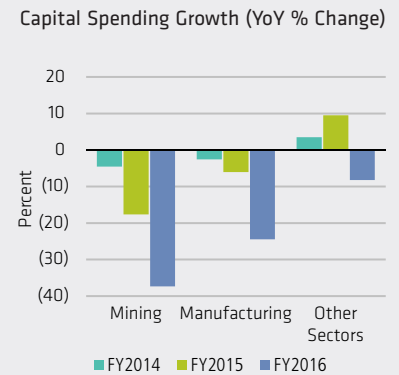
This bleak picture is reinforced by April's credit growth figures. Business lending looks to have stalled again after a burst of strength earlier in 2015. The next business confidence reading from the National Australia Bank, due out on June 9, will make for an interesting reading.

The bottom line, though, is to reinforce our view that Australia's adjustment path remains very rocky. It would not surprise us to see the Reserve Bank of Australia reinstitute its easing bias at the next policy meeting.

Commodities Starting to Drag in NZ, Too

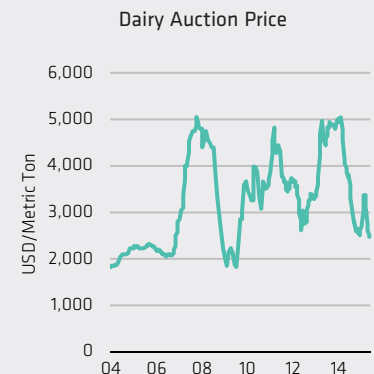
Across the Tasman in New Zealand, something similar is unfolding. After peaking in early 2014, dairy prices have been under consistent downward pressure (*Display 2*). While there was some recovery earlier this year, that has now been fully reversed. These lower prices are being reflected in Fonterra's payout to dairy

Display 1
Capital Spending Plans Slump



Actual figures for FY2014, AB estimates for FY2015 and FY2016 based on 1Q:2015 Capex Survey. Source: Australian Bureau of Statistics and AB

Display 2
Milk Price Revisits Lows



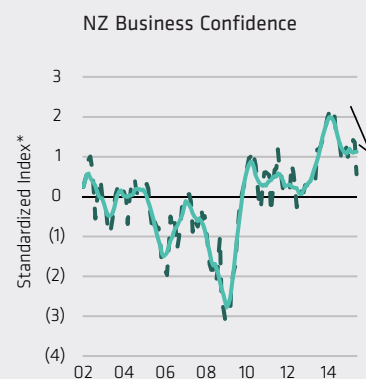
Through May 19, 2015
Source: GlobalDairyTrade

farmers—NZ\$4.40/kgMS this season and NZ\$5.25/kgMS next. That compares to a payout above the \$8 mark in the 2013/2014 season. To put that in context, the implied income squeeze is worth something like 3% of gross domestic product. That's a substantial shift.

And there are signs that this is now spilling over to broader business confidence

(Display 3). The combination of very low inflation—with the core consumer price index running below the bottom end of the Reserve Bank of New Zealand's (RBNZ) target band—and these sort of early warning signals on growth, may be enough to force the RBNZ's hand into easing in June, despite continuing worries about house price inflation. ■

Display 3
Low Dairy Prices Start to Hit
Business Sentiment



Through May 2015
*Average of trading activity, profitability and employment sub-indices. NZ data seasonally adjusted by AB.
Source: Australia and New Zealand Banking Group, CEIC Data, Datastream and National Australia Bank

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