

# Australian CAPEX: Investment plans point to construction surge

## Q2 real CAPEX: -4.0%; (mkt 2.3%)

### 2010/11 intentions: \$223bn

- The key message from the ABS CAPEX survey is the very upbeat investment outlook. These investment plans for 2010/11 are much stronger than we expected. As for Q2, actual CAPEX spending disappointed.
- Total private business CAPEX spending surprised on the low side in Q2, coming in at -4.0% (v's mkt 2.3%, Westpac 4.0%).
- Equipment spend was -4.1% (vs mkt 4.0%, Westpac 4.0%). This will subtract 0.3ppts off Q2 GDP growth.
- Building and structures spending fell by 3.9% in Q2. However, the construction work data (which feeds into the national accounts) was positive, with infrastructure activity +5.1% and non-residential building work +2.0%.
- We will need to trim our Q2 GDP forecast of 1.2%qtr, 3.1%yr in response to the downside on equipment. Most likely we'll move to 0.9%qtr, 2.8%yr.
- As for the business investment outlook, CAPEX plans for 2010/11 have gone from strength to strength. The 3rd estimate was \$123bn, upgraded from an originally reported \$103.9bn (revised to \$105bn).
- The 3rd estimate implies a 28% rise in the value of investment in 2010/11. That's an upgrade from the 19% rise implied 3 months ago.
- For the RBA, the 2010/11 CAPEX plans reinforce a generally positive outlook for the economy and that investment will be a key growth driver - particularly investment by the mining sector, boosted by the recent commencement of work on the \$43bn Gorgon project.

#### Q2 CAPEX

Business CAPEX, which has been choppy over the last year, fell by 4.1% in the June quarter.

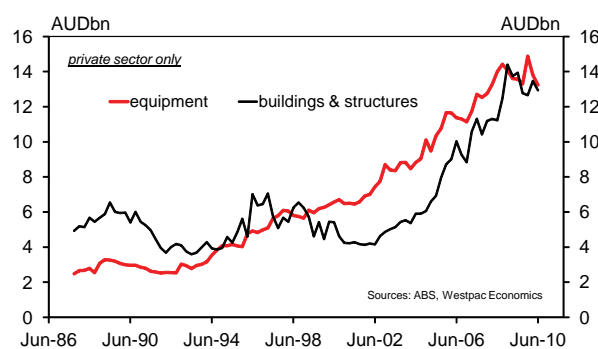
On an industry basis, the surprise in the period was a 10.9% drop in investment by the services sector. At this stage we're inclined to interpret this as a one-off. A source of comfort is that the services sectors are planning to lift investment in 2010/11 - albeit off a lower starting point than we previously expected.

Detailed data for the services sectors reveal that in Q2 about a third of the fall was explained by wholesale & retail, and a further third was explained by rental hiring & real estate services. Weakness in these sub-sectors may have been a reaction to sub-

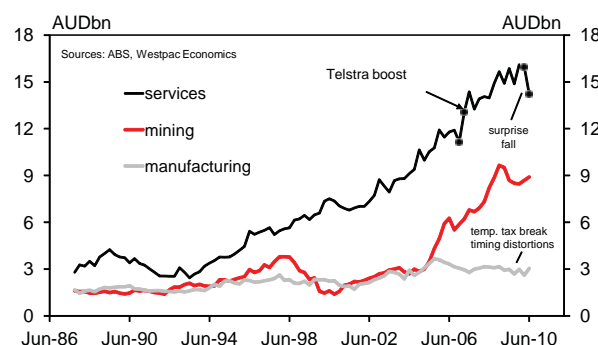
#### Private new CAPEX Jun qtr

Qtrly sa, <i>real</i>	Level, \$bn		% ch	
	Q2	qtr	yr	
Total	26.2	-4.0	-4.8	
Equipment	13.2	-4.1	-2.8	
Building	12.9	-3.9	-7.2	
Services	14.2	-10.9	-10.2	
Manufacturing	3.0	16.5	2.1	
Mining	8.9	2.6	2.6	

#### Real capital expenditure (CAPEX survey)



#### Investment by industry (CAPEX survey)



par consumer spending growth and to the cooling of the established housing market under the weight of the RBA's rapid fire 6 rate hikes over a period of just 8 months.

The positive for the services sectors is that the RBA left rates steady over the last three months and may well be on hold for the remainder of 2010. It is notable that the Westpac-MI Consumer Sentiment Index rebounded over July and August to 119. We expect consumer spending to gain some momentum in response to this stabilisation of interest rates.

Manufacturing investment has been extremely volatile over the last year as temporary tax breaks created timing distortions. Manufacturing investment rebounded in Q2, as we anticipated. This expectation, along with evidence that imports of capital goods moved higher in the quarter, underpinned our forecast for equipment investment to rise in the period. The rebound in manufacturing investment in Q2 was particularly strong, up 16.5%. The experience of the three previous quarters was: -9.8% Q3, +11.2% Q4 and -12.6% in Q1.

Investment by the mining sector is now trending higher, up 2.6% in Q2 after a 2.8% rise in Q1. Prior to that, mining investment fell in each of the quarters during 2009 as a lagged response to lower global commodity prices during 2008.

**CAPEX intentions 2010/11**

In the wake of today's survey, you could be forgiven for asking, how high will investment plans for 2010/11 go? The 3rd estimate was an astonishing \$123bn. That's up from an originally reported 2nd estimate of \$103.9bn (revised to \$105bn).

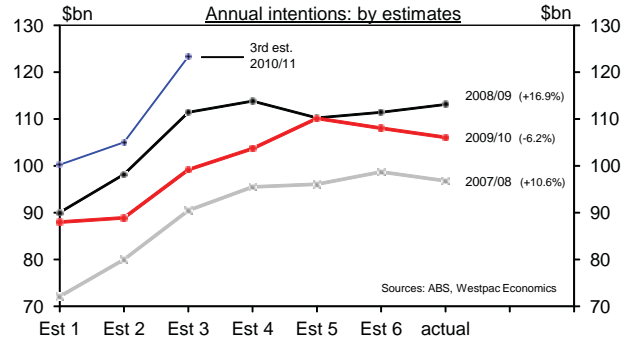
The 3rd estimate implies a 28% rise in the value of investment in 2010/11. That's upgraded from +19% implied 3 months ago. (This is calculated by applying the average 10 year realisation ratio).

Our forecast is for total business investment (which is about twice the size of business investment covered by the CAPEX survey) to rise by 10% in real terms in 2010/11. We'll need to review our forecast in light of this survey. Although, we are mindful that global uncertainties and the current political limbo are negatives.

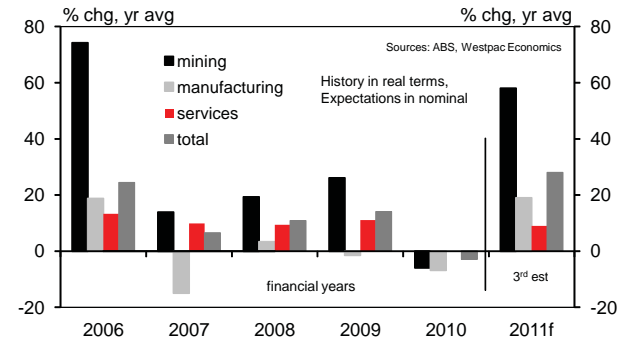
In terms of the timing of the CAPEX survey, the 3rd estimate for 2010/11 was conducted during July - a time of heightened global uncertainty. The 2nd estimate was conducted during April - ie prior to the Henry Tax Review release and the Government's announcement of a new tax on mining.

Despite the new mining tax and global uncertainties, mining investment plans for 2010/11 were upgraded to \$55bn. That implies a 58% surge, upgraded from 44% three months ago. (Although, note that with revisions, the 2nd est. now implies +55%). This follows an 8% fall in mining investment in 2009/10 and, if achieved, would be the strongest annual rise since the 81% jump in 2005/06. The ramping up of work on the \$43bn Gorgon project, which commenced in 2009Q4 and will take about four years to build, is a major factor. Although, these plans point to strength beyond Gorgon.

**CAPEX plans**



**CAPEX plans by industry**



Services sector investment plans of \$54bn imply growth of 9%, up from -1% three months ago. That's after a 5% fall in 2009/10.

Manufacturing investment plans of \$14bn imply growth of 19%, unchanged from that of three months ago. Such an outcome would be a strong rebound from the 8% fall in 2009/10. A plus is that the manufacturing sector is a major beneficiary of the current upswing in building activity (in part due to the boost from Federal Government's stimulus package and due to an upturn in housing construction).

In terms of investment plans by asset class, the equipment number of \$49bn now looks more plausible. This implies a 6% rise in equipment spending in 2010/11, whereas three months ago plans implied a fall of -2% (which was overly pessimistic in our view).

Building & structures plans of \$75bn imply growth of 41% - almost in line with the 48% achieved in 2005/06 and follows a 9% dip in 2009/10.

**Andrew Hanlan**, Senior Economist, ph (61-2) 8254 9337