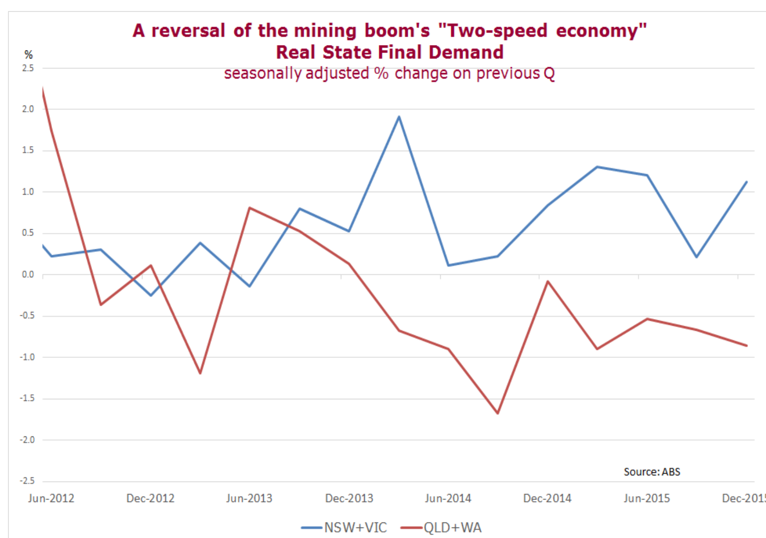
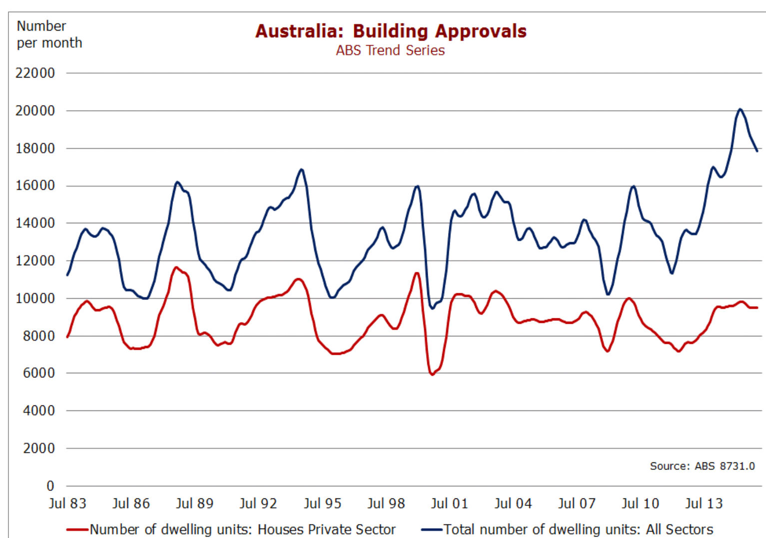
The View From The Outer

David Jarman – Chief Investment Officer

Australian GDP growth: As good as it gets for a while?

After discussion in recent months as to whether the likely sustainable trend rate of Australian economic growth has slowed, along came the December quarter National Accounts showing growth through 2015 had picked up to 3.0%. Certainly that helped rationalise the buoyant labour market in late 2015, but the weakness in wages growth and the relative strength in lower paid more labour intensive sectors of the economy is also a factor. Despite the current strength in the household sector in NSW and Victoria two traditional forward looking indicators (ABS Building Approvals and the ABS Private New Capital Expenditure survey) suggest optimism re domestic growth in 2016/17 should be tempered.



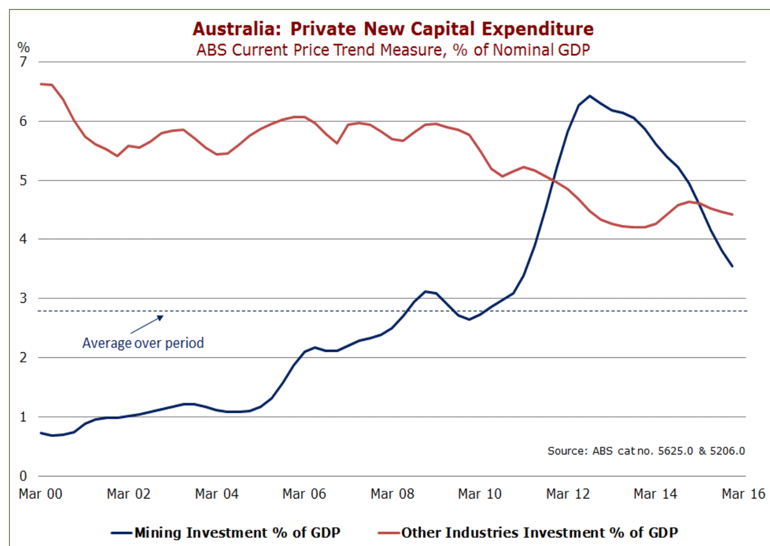


During the decade of the mining boom, the loss of competitiveness associated with the appreciating exchange rate, together with rising interest rates disproportionately impacted the non-mining states.

The situation is now reversed. Amongst the four major states, Final Demand is now very strong in NSW/Victoria, but has been declining in Queensland/WA in each of the last nine quarters. The lower exchange rate is supporting growth in services exports such as tourism and education while historically low interest rates supported the housing boom.

Looking forward, the ABS trend measure of the total number of Dwelling Units Approved peaked in March 2015 and by January had declined by 11%. A number of factors are at play: the base effect of the historically unprecedented level of approvals (driven by multi-unit developments), a tougher prudential approach to lending, out-of -cycle interest rate increases by the major banks and the emerging oversupply in the apartment market.

Dwelling construction has a high multiplier effect through the economy. As it declines, albeit from high levels, we expect slowing employment growth. As housing completions subsequently roll over, this will impact demand for household goods and furniture, for example.



The second partial indicator to note is the ABS Private New Capital Expenditure survey, which provided initial estimates for the 2016/17 year. The first survey estimate for Total Capital Expenditure in 2016/17 is 19.5% below the corresponding estimate for the 2015/16 year.

Within this, Mining Capital Expenditure is expected to decline by 36.2% on the same basis. Whilst always difficult to assess what "realisation ratio" to apply, the outlook remains very weak. The chart opposite highlights that despite the magnitude of the fall thus far, the decline in Mining Capex likely has much further to run given the industry's current excess capacity, balance sheet constraints and commodity prices levels.

The volatility we have seen in risk markets so far in 2016 has led to ongoing reflection upon the risks this may spill-over into the real economy. We are reasonably sanguine on this score globally, although domestically we note the ongoing risk of further Terms of Trade declines in the medium term. (That is, we are wary of the magnitude of the recent bounce across key commodities). The Terms of Trade remains above long term averages while the supply and demand outlook for key Australian commodities like iron ore and coal appears poor. Ongoing Terms of Trade weakness reduces Nominal GDP and Real Net National Disposable Income (all else equal). In retrospect, the world underestimated the degree to which it depended upon China's debt fuelled expansion post the Global Financial Crisis (GFC).

Conclusion and Monetary Policy Implications: We do not wish for the above commentary to sound unduly pessimistic on the Australian growth front; rather a slowing from recent levels in what is a low growth world. The economy is responding to the weakness in the Australian dollar, the household sector in Melbourne/Sydney is buoyant, while despite price weakness, export volume growth has held up thus far. There is, however, the risk that demand growth slows when dwelling construction turns down alongside still declining private capex. Given the multiplier effect of the labour intensive building industry, an interest rate easing may well be needed to support the household sector. This is still someway off, but if, as is quite likely, building approvals continue to decline, in the second half of this year the RBA may look to use some of the "insurance" currently there in the form of a 2.0% cash rate. Underlying inflation is near the bottom of the RBA target range and most unlikely to be a policy constraint.

The Australian Dollar: The Australian dollar is currently trading at USD 0.76 for the first time since last July. The recent rally reflects: 1) a weaker US dollar; 2) the strong rebound from low levels in key commodity prices; 3) renewed confidence in risk assets; and 4) interest rate differentials (diminished easing expectations here post the GDP data alongside negative interest rates from the ECB and BOJ and a seemingly dovish Fed). The commodity rally appears overdone and the US Dollar should stabilise after a weaker start to the year. Given the prospects of a cash rate cut here later this year, we expect the AUD/USD to weaken over the remainder of 2016.

EVANS & PARTNERS

GENERAL RESEARCH DISCLAIMER, WARNING & DISCLOSURES

This document is provided by Evans and Partners ABN 85 125 338 785, holder of AFSL 318075.
Please see our website at www.evansandpartners.com.au/uploads/default/source/2015/04/58751.ResearchConflictofInte.pdf for important information regarding Evans and Partners research.

The information is **general advice only** and does not take into consideration an investor's objectives, financial situation or needs. Before acting on the advice, investors should consider the appropriateness of the advice, having regard to the investor's objectives, financial situation and needs. If the advice relates to a financial product that is the subject of a Product Disclosure Statement (e.g. unlisted managed funds) investors should obtain the PDS and consider it before making any decision about whether to acquire the product.

The material contained in this document is for information purposes only and does not constitute an offer, solicitation or recommendation with respect to the purchase or sale of securities. It should not be regarded by recipients as a substitute for the exercise of their own judgment. Investors should be aware that past performance is **not an infallible indicator** of **future** performance and future returns are not guaranteed.

Any opinions and/or recommendations expressed in this material are subject to change without notice and Evans and Partners is not under any obligation to update or keep current the information contained herein. References made to third parties are based on information believed to be reliable but are not guaranteed as being accurate.

This document is provided to the recipient only and is not to be distributed to third parties without the prior consent of Evans and Partners.

EVANS AND PARTNERS DISCLOSURE OF INTERESTS

Evans and Partners and its respective officers and associates may have an interest in the securities or derivatives of any entities referred to in this material. Evans and Partners does, and seeks to do, business with companies that are the subject of its research reports.

EVANS AND PARTNERS CORPORATE RELATIONSHIP DISCLOSURE

Company	Nature of Relationship
AUI	The Issuer has appointed Evans and Partners as Broker to an on-market buy-back. Accordingly, Evans and Partners is unable to give Sellers advice in respect to a sale of this security. Evans and Partners has been appointed as Placement Agent in respect of the company's renounceable rights issue and will receive fees for acting in this capacity.
AYUHB	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months.
BENPF	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months.
CIE	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months.
CGL	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months. A director of Evans and Partners Pty Ltd is a director of The Citadel Group Limited.
DUI	The Issuer has appointed Evans and Partners as Broker to an on-market buy-back. Accordingly, Evans and Partners is unable to give Sellers advice in respect to a sale of this security.
EAI	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months
IGL	Evans and Partners arranged, managed or co-managed a public offering of the company or its affiliates in the past 12 months.
MGC	Evans and Partners arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months.
MQG	A director of Evans and Partners Pty Ltd is a director of Macquarie Group Limited.
MQGPB	Evans and Partners arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months.
NAB	Evans and Partners arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months.
SWM	A director of Evans and Partners Pty Ltd is a director of Seven West Media Limited.
TGG	Evans and Partners Pty Ltd was appointed as Sponsoring Broker in relation to the 1 for 4 pro-rata entitlement offer (and any subsequent shortfall) of Templeton Global Growth Fund Limited (TGG) and will receive fees for acting in this capacity.

RESEARCH ANALYST CERTIFICATION

I, David Jarman hereby certify that all the views expressed in this report accurately reflect our personal views about the subject investment theme and/or company securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

RESEARCH ANALYST DISCLOSURE OF INTEREST

I, David Jarman, and/or entities in which I have a pecuniary interest, have an exposure to the following securities and/or managed products: BHP, CBA, CSL, CYB, DXJ, EAI, HEWG, IEU, IVV, NAB, S32, WOW, Evans & Partners International Managed Fund (Unhedged), Cooper Investors Brunswick Fund, IML Equity Income Fund and Macquarie Asia New Stars No.1 Fund.

DISCLAIMER Except for any liability which cannot be excluded, Evans and Partners, its directors, employees and agents accept no liability or responsibility whatsoever for any loss or damage of any kind, direct or indirect, arising out of the use of all or any part of this material. All information is correct at the time of publication; additional information may be available upon request.