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Australia Real GDP Likely to Increase +2.0% in 2019:4Q and +2.2% in 2020:4Q

Australia real GDP is on track to increase +2.0% y/y in 2019:4Q, and this regression model projects it increases +2.2% in 2020:4Q. GDP is lifted by the lagged effects of accommodative monetary policy, the decline in bond yields, and faster US GDP growth. But it is restrained by the lagged impact of higher oil prices and by the slowing growth in China.

The model does not capture the impact of fiscal policy which, according to IMF estimates, has been a modest drag in 2019 and will be neutral in 2020. So no adjustment has been to the model forecast for 2020. Our forecasts are a little below the private consensus forecasts of +2.3% for 2019 and +2.4% for 2020.

The RBA, which has reduced its policy rate to a record low and may ease again, is urging more support from fiscal policy. But so far the govt is reluctant to act.

Oct (IMF) -- Fiscal policy in Australia is estimated to exert a modest drag of -0.2% of GDP in 2019 and then be neutral in 2020.

Oct 22 (WSJ) -- Australian Treasury Secretary Kennedy is pushing back on calls for the government to ramp up spending to support economic growth, saying that instances in which budgetary stimulus is needed are rare and usually associated with external shocks.
Australia Indicators Have Turned Mixed

Australia’s economy has expanded for 28 consecutive years and has entered the 29th, but current indicators have turned mixed. The PMIs have diverged: The mfg PMI has declined to a below neutral 48.1% in Nov, while the svc PMI has hooked up to 53.7%. Real retail sales have flattened out over the past year but are up +0.4% y/y. OECD’s broad LEI for Australia has increased during most of 2019 but ticked down in Sep.

✓ Dec 3 (BB) -- Australia’s economy has decelerated in the past 12 months as households limit spending, and sentiment remains weak despite the increased cash flow from interest rate and tax cuts. However, the economy has kept advancing on strong population growth and state government infrastructure spending to keep pace with swelling cities. Hiring has remained resilient in the face of slowing growth.
Australia Consumer Spending Likely to Increase +1.5% in Both 2019 and 2020

Real DPI is rising but at a slow pace, restrained by slow wage increases and sluggish non-labor income. However, new low and middle income tax cuts will help. Consumer confidence has declined in recent mos, and household net worth % DPI has hooked down, partly because house prices have declined (see page 5). Household debt has also risen and is a source of concern to policymakers. Consumer spending is likely to increase +1.5% y/y in 2019:4Q and another +1.5% in 2020:4Q.

Nov 2019 (RBA) -- The broad-based slowdown in consumption is consistent with several years of low growth in household income and the sharp decline in the housing market. Household disposable income is expected to be boosted in the period ahead by the recent monetary policy easing, lowering interest payments and lower tax payments.
Australia Housing Construction Has Weakened, and House Prices Have Declined.

Mtg rates are at a record low, partly due to RBA easing (see page 8). Mtg approvals have hooked up, but residential construction has declined.

The combination of reduced affordability, weaker domestic and foreign investor demand, tightened lending standards, and macroprudential policy tools turned house prices down. A recent worry has been that house price declines could go too far, but fresh data show renewed increases.

Dec 1 (BB) -- Australia’s housing market recovery strengthened and broadened in November, as prices continued to rebound from the 2017-2019 correction. Rising house prices should begin to reverse the wealth effect that may have been weighing on spending growth over recent quarters.
Australia Capex Is Likely To Decline In 2019 and Begin To Recover in 2020

Mining investment plunged after a major round of new mines and related facilities was completed. Downward pressure from this source has probably run its course. Capacity utilization rebounded in 2019:3Q, but company earnings have fallen (also see page 9). One emerging plus is energy-related spending. Capex is likely to decline -2.0% y/y in 2019:4Q and then to increase +2.0% in 2020:4Q.

Nov 2019 (RBA) -- Business investment is expected to increase at a moderate pace over the next few years. The wind-down of the mining investment boom is largely complete, so mining investment is expected to contribute to this growth.

James West Evercore ISI Dec 3

Following several years of reduced E&P spending, natural gas drilling is slowly improving as major oil companies build backlog to supply the sizable investments made in LNG liquefaction. Spending plans are also increasing for drilling activity in the Great Australian Bight.
Australia’s largest exports include: coal, iron ore, gold, wool, aluminum, wheat, machinery, and transport equipment.

Australia’s largest trading partners are: China (32%), Japan (16%), Korea (7%), and US (5%).

Even when iron ore and other minerals prices were declining, the volume of Australia exports continued to increase. Recently, exports have slowed, but imports have declined y/y, so net exports have rebounded. The ongoing global expansion is a plus, but the increase in the A$ will hurt competitiveness -- working with a lag. Demand from China is a major uncertainty, both because it’s huge and also because of China’s trade dispute with the US.

Feb 2019 (IMF) -- Given Australia’s reliance on exports to China -- coal, iron ore, tourism, and education services -- it is particularly exposed to the downside risks from the ongoing trade tensions between China and the United States, and China’s rebalancing, potentially reinforcing each other.
RBA Has Cut Rates and May Do More

Unit labor costs have moved up recently due to negative productivity growth. But there has been persistent commentary about the unemployment rate being too high and wages rising too slowly. The CPI is running below the target band. Given this backdrop and slower GDP growth, the RBA made three easing moves totaling 75bp in 2019; since 2011, RBA has cut rates 15 times.

After the Sep rate cut, the RBA has been on hold, which continued at the Dec 3 meeting, although it could do more if necessary.

✅ Dec 3 (BB) -- Australia’s central bank kept interest rates unchanged as three cuts since June inject new life into the property market and raise the prospect of improved spending and homebuilding.

✅ Dec 3 (BB) -- RBA Governor Lowe said “it was reasonable to expect that an extended period of low interest rates will be required in Australia. The board is prepared to ease monetary policy further if needed.”
Mixed Australia Financial Conditions

Bond yields have plunged on slower growth, low inflation, and RBA easing. Stock prices are up +71% from their 2011 low and are up +17% ytd. Australia banks are financially solid.


Feb 2019 (IMF) -- Australian banks are well capitalized and profitable. Stress tests found banks to be resilient to solvency and liquidity stress but also noted the vulnerability to external funding shocks.

Investors can obtain exposure to Australian stocks -- long or short -- through iShares EWA ETF.
Rich Ross: Technical Analysis of Australia Stocks

ASX 200 - Compelling on a Breakout Above 7,000

Chart showing the ASX 200 index with a breakout above 7,000.
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