BULLETIN

26 May 2022

Australian business capex.
Capex plans “upgraded” - in part on rising costs.
Q1 real capex: -0.3%; equipment 1.2%
2022/23 plans: Est 2 $130.5bn, 15% above Est 2 a yr ago

Overview

Total capex spending dipped in Q1, edging 0.3% lower. This headline figure represents a downside surprise, Westpac forecasting a +1.1% and the market median +1.5%.

However, the key detail, equipment spending, was broadly in line with our expectation for a modest rise. It printed at +1.2% vs our forecast of 2.0%.

The downside was on Building & Structures, at -1.7%. We draw on the Construction work survey, which was soft, but not as weak as this, at -0.7%.

Capex plans were upgraded materially for 2022/23 – bringing them broadly into line with Westpac’s current forecast.

Although, we caution, that this is in value terms and it is unclear what price assumption is feeding into these plans - no doubt that part of the upgrade to capex plans reflects escalating costs.

Looking ahead, the key is around rising interest rates in response to higher inflation, which is dampening the consumer mood. How abruptly consumer spending slows will be key to the investment outlook for 2022/23.

Comments on Q1 detail and investment trends

In Q1, both mining and non-mining capex declined by 0.3%.

The non-mining result increased a broadly flat outcome on equipment, -0.1%, and a slight decline in B&S, -0.6%. For mining, the detail was, +7.7% on equipment and -3.3% on B&S.

Non-mining investment in B&S is trending higher (notwithstanding the small dip in Q1), recovering from weakness at the outset of the pandemic. Strength in approvals and a sizeable work pipeline point to further upside.

Non-mining equipment spending rallied strongly in the year to mid-2021 in response to positive fundamentals but has failed to follow through since then (constrained by disruptions and supply headwinds). We expect this stalling to be temporary, with a resumption of the upward trend to emerge in mid-2022.

In the year to June 2021, non-mining equipment spending rose by 22.6%, reversing a 16% fall the four quarters prior, to be 2.7% above the level prevailing in mid-2019. Over the past 3 quarters, spending has slipped by 3.4% - largely on the initial delta disruption. In NSW, total equipment spending is down by 13% over the past 3 quarters.

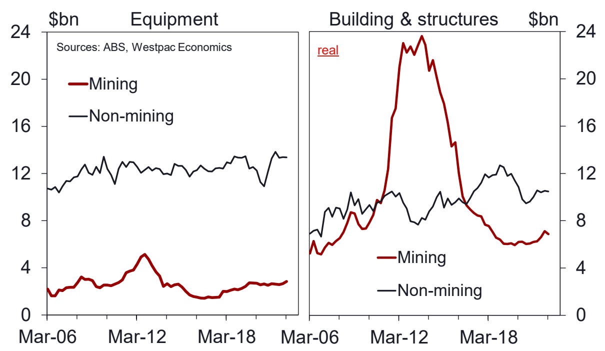
As we’ve highlighted previously, the business mood was generally upbeat throughout 2021 into 2022, albeit with brief setbacks when virus case numbers spiked. Firms have been increasing investment responding to underlying strength in demand, limited spare capacity (mainly in the goods sectors) and generous tax incentives.

Although, as noted above, with interest rates rising in response to inflation pressures and consumer sentiment weakening, the outlook has become more uncertain.

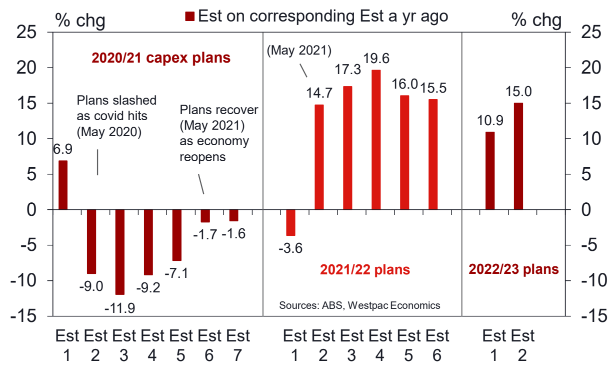
Cost pressures

The survey, along with many other indicators, confirm escalating costs and that these pressures intensified further in the March quarter.

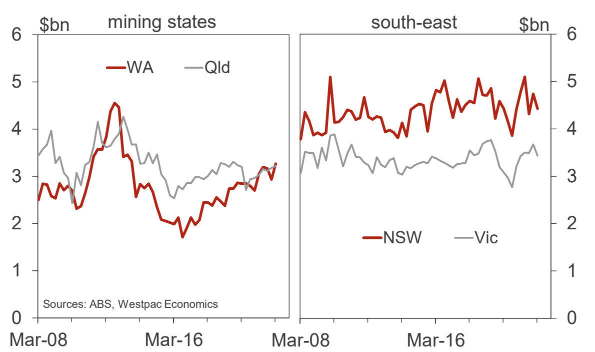
CAPEX: by industry by asset



Capex plans: positive



Equipment (capex survey): state view



Andrew Hanlan, Senior Economist

By way of perspective, in the capex survey, costs rose by 2.2% in the quarter to be 6.6% higher than in the March quarter 2021. In year average terms, the rise in prices is a more modest 3.2% - but that figure is set to lift.

The omicron wave compounded supply headwinds in the March quarter, around shortages of labour and materials, adding to price pressures in the period.

As to what price view is embedded in capex plans, unfortunately that is a known unknown - the survey does not provide this information.

Capex plans 2021/22 - "unchanged"
Estimate 6 was $142.8bn. We interpret this as "unchanged" from the outlook implied by Estimate 5 (which was $140.9bn). We had viewed the risks to the downside, on potential slippage.

We calculate, based on average realisation ratios (RRs), that Est 6 implies that capex spending in the 2021/22 financial year will be about 14% higher than the year before. That is unchanged from Est 5, which we calculated implied a rise of +13.7%.

Westpac's forecast for the value of total business investment (on a national accounts basis) for 2021/22 is +8.5%. When we review our forecasts, we may need to upgrade this nominal figure to allow for larger price increases.

2022/23 plans - "upgraded", in part due to rising costs
Estimate 2 printed at $130.5bn, which is 15% above Est 2 a year ago.

We calculate that Est 2 implies that the value of capex will rise by around 10% in 2022/23 - representing an upgrade from Est 1 (which was $116.8bn), an implied +3%.

This upgrade to the dollar value of capex spending will likely include an element of higher costs as well as higher real investment.

Westpac is forecasting a rise of around 10% in the total value of business investment (on a national accounts basis). Here too, we may need to review and allow for larger price increases. In real terms, our current forecast is an increase in the order of 7%, led higher by equipment spending, as well as increased spending on software (an asset class not captured by the capex survey).

As we have cautioned before, Est 1 and Est 2 are at times, an unreliable guide to actual capex spending. Recall, for a given financial year, there are 7 estimates of capex plans, with the figure revised each 3 months, until the outcome.

Q1 GDP forecast
We confirm our Q1 GDP forecast of +0.2%qtr, 2.5%yr.

This factors in a rise in consumer spending in the order of 2%, which acts to offset a large net export subtraction, an estimated -1.4ppts, (imports up very strongly, a catch-up from softness over the second half of 2021 associated with the delta lockdowns, and exports edging lower).

There are downside risks to this view – relating to hours worked and a view on productivity.

The Labour Force Survey reported that hours worked declined in Q1, down by a sizeable -1.2%.

We are making a couple of key judgements.

We anticipate that the National Accounts estimate of hours worked will not be as weak as the LFS (a rerun of the Q1 2021 experience, when the figures were a +0.2% LFS and a +0.9% National Accounts).

The issue is that the LFS can be an inaccurate guide if the choice of reference period is unrepresentative of conditions for the full month – a particular problem with the holiday January survey.

We also anticipate that output will outperform hours worked, a rise in productivity – as often occurs when there are temporary disruptions leading to softness in hours worked (which was the case in Q1, the omicron wave and wet weather).

Of course estimated productivity swings from quarter to quarter.

For instance, productivity was squeezed when the economy reopened strongly in Q4 2021 and the labour intensify hospitality sector strengthened. Total hours worked across the economy rose sharply in Q4 2021, up by 4.3% in the National Accounts, while output underperformed, expanding by 3.4%.

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