BULLETIN

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Business investment to stall in 2024, as firms respond to weak household demand. State trends and labour developments pointers to soft investment outlook.

The weak household demand backdrop of 2023, as high inflation and higher interest rates impacted, will lead to a reassessment by businesses. In general, firms will become more cautious in both their "hiring" and investment spending decisions.

When we refer to "hiring" decisions, firms are more likely - at least in the first instance - to respond to softer demand by adjusting hours worked rather than adjusting the size of their labour force. Following a period of labour shortages there will be some labour hoarding during the current economic downturn.

There is evidence that a more cautious approach by businesses to "hiring" and investment emerged during the second half of 2023. We anticipate that it will be a key dynamic evident during 2024 - particularly over the first half of the year, prior to policy relief.

Our central case forecast is for business investment to stall in 2024. This is in response to and mirrors the already evident stalling of household demand.

Here in this article, we discuss the near-term business investment outlook. We highlight trends in state demand and spending, as well as labour market developments - both of which are pointers to a soft patch in business investment.

Business investment to stall in 2024

Business investment grew by a robust 10% in the year to the June quarter 2023. That directly added 1.2ppts to annual domestic demand, accounting for half of the expansion in domestic demand over that period.

That strength was in the wake of a spending burst by households, up 10%yr in the September quarter, associated with the reopening from the delta lockdowns a year earlier and fuelled by earlier aggressive policy stimulus.

Move forward to the second half of 2023 and the investment cycle is turning, with a broadly flat outcome for business investment in the September quarter 2023, with spending up a tepid 0.6%.

The investment turning point is associated with the unfolding economic downturn, economic growth slowed to a crawl in the September quarter, with output up only 0.2%. It was also associated with the 1 July end to some generous investment tax incentives.

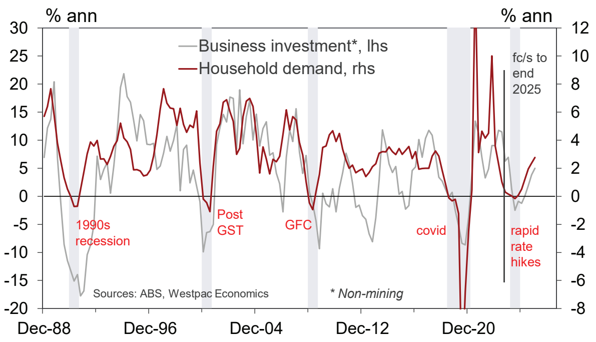
On our forecasts, total business investment will be flat throughout 2024. That stalling of business investment will likely include a slight decline in non-mining investment, in the order of -1%, offset by a modest rise in mining investment, of around 4%.

Household demand stalled in 2023

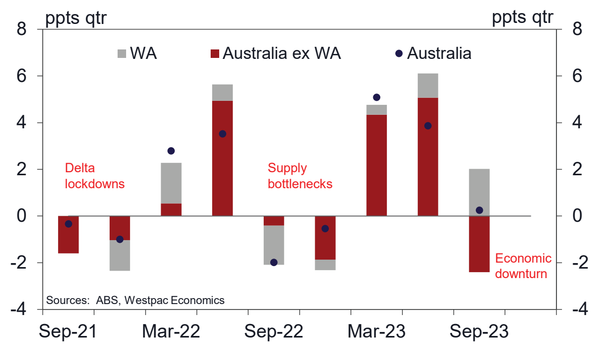
The household sector was under intense pressure in 2023 from high inflation, higher interest rates and additional tax obligations. Real household disposable income contracted sharply, leading to a flatlining of household demand in the year to the September quarter.

Flat to declining household demand is rare in the Australian context. Over the past 40 years, there are only five episodes of flat to declining household demand: the 1990s recession; post the introduction of the GST; the GFC; covid; and currently.

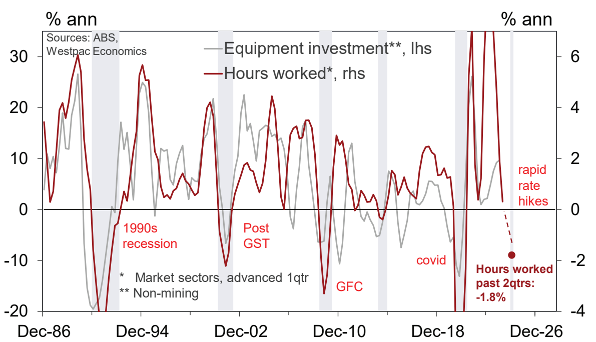
Businesses to respond to weak household demand



Equipment spending (ex WA), Q3 decline



Declining hours worked a pointer to investment



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In each of the past four instances of flat household demand businesses across the non-mining economy responded by reducing investment spending (see chart above).

In this episode we anticipate a stalling of total business investment. That flat headline masks a likely uneven outlook by asset, and as noted above, an expected small decline in non-mining investment offset by a modest rise for mining. The more cyclically sensitive equipment spending segment is likely to slip, down in the order of 5% in 2024. Offsetting this, a further but modest rise in construction, around +1.5%, and an expansion in intellectual property products (computer software and mining exploration) up by almost 6%.

Equipment spending, divergent trends by state

Business investment was broadly flat in the September quarter 2023, up a tepid 0.6%. Interestingly, the detail for the September quarter indicated an emerging softening in the cyclical segments of investment spending.

Non-mining investment, which is more cyclical than mining investment, weakened in the quarter, contracting by 2.0%. Annual growth slowed abruptly from 11.5% at June to 6.3% in September (including an increase of only 1.1% over the past half year).

Mining investment spiked 9.6% higher in the September quarter, an oversized outcome in the context of a more modest trend ~ annual growth to June was 5.7%.

The cyclically sensitive equipment spending segment was broadly flat in the September quarter, inching 0.2% higher. Even that soft outcome was an unconvincing result. Outside of the mining state of WA, equipment spending contracted in the quarter, declining by -2.9%. That fall of 2.9% was offset by a spending spike in WA, a jump of 11.5%, a result unlikely to be repeated.

It is apparent that the current economic downturn in 2023 is generally more pronounced in the non-mining states - which are feeling the impacts of higher interest rates more acutely. It is likely that any equipment spending cuts will be led by these regions.

Declining hours worked a pointer to investment prospects

Recent data confirms a cooling of the labour market as the impacts from the flat-lining of household demand are felt.

Firms are reducing the hours worked by their employees in the face of patchy demand. The Labour Force survey reports that hours worked contracted in the September quarter, down by -0.8%, and then contracted further in the December quarter, down -0.4%.

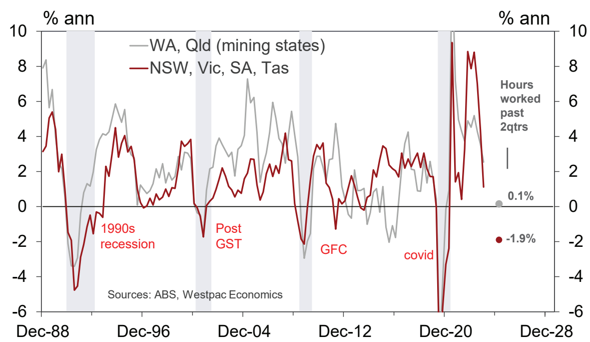
The decline in hours worked over the second half of 2023, down -1.3% (or -1.8% for the market sectors), reflects a marked shift in economic momentum. It comes after strength over the previous year, when hours worked grew by 6%. In short, policymakers efforts to cool the economy are gaining traction. That decline in hours worked over the past half year is more apparent in the non-mining states, down -1.9%, while for the mining states, hours worked stalled, an outcome of +0.1%.

Looking ahead, the risk is that weakness in hours worked extends over the first half of 2024 - with output growth to remain anaemic.

What does this mean for the business investment outlook? We anticipate that as firms reduce hours worked in the face of patchy demand, so too they will tend to trim equipment spending.

Over the past forty years, there have been only five episodes in which hours worked (by the market sectors) turned negative on an annual basis. On each of these occasions equipment spending by the non-mining economy also turned negative on an annual basis. These periods were: the 1990s recession; post the GST introduction; the GFC; covid; and a soft spot in 2014.

Hours worked by region



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