

THE ECONOMY – CHALLENGES AND OPPORTUNITIES

PRESENTATION TO THE SELF STORAGE ASSOCIATION OF AUSTRALASIA 2016 CONVENTION

PARK HYATT HOTEL, MELBOURNE – 31ST AUGUST 2016

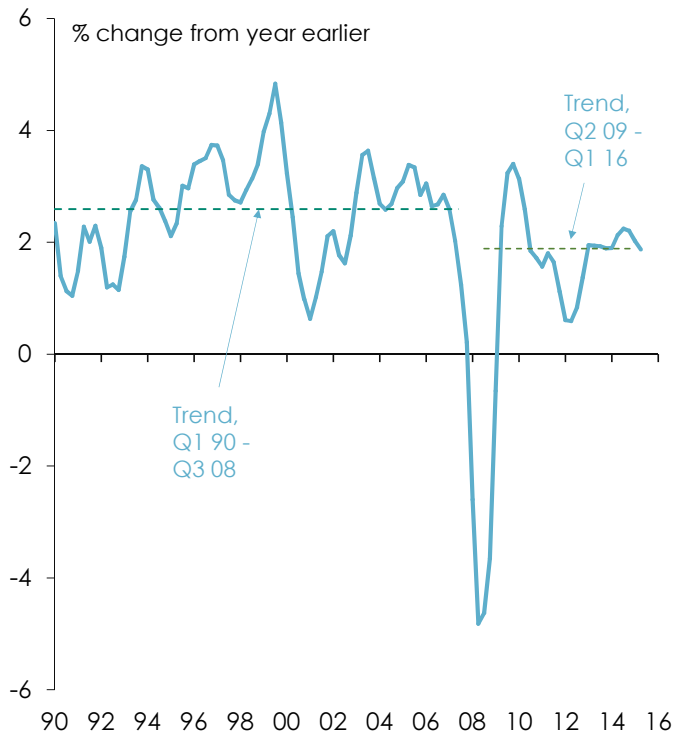
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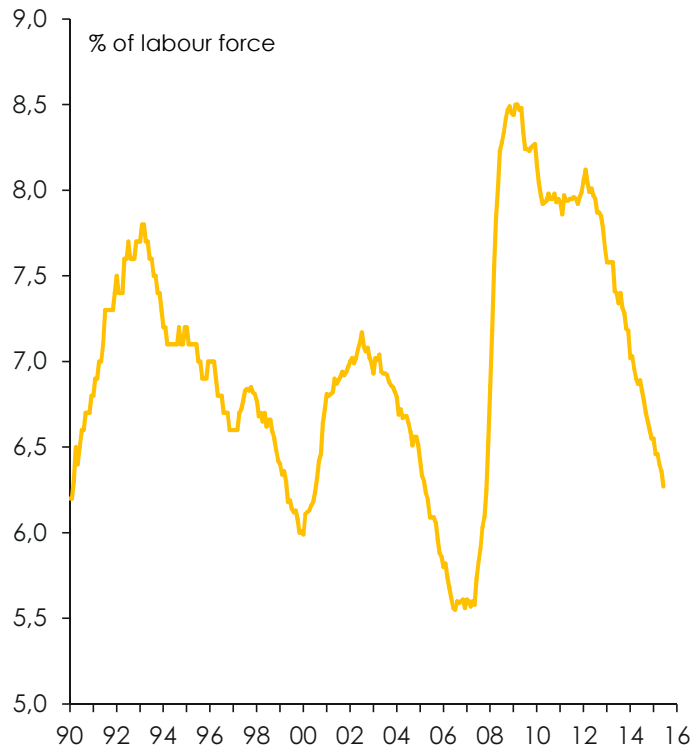
The world economy

Economic growth across 'advanced' economies has been consistently weaker than expected - yet unemployment has fallen sharply

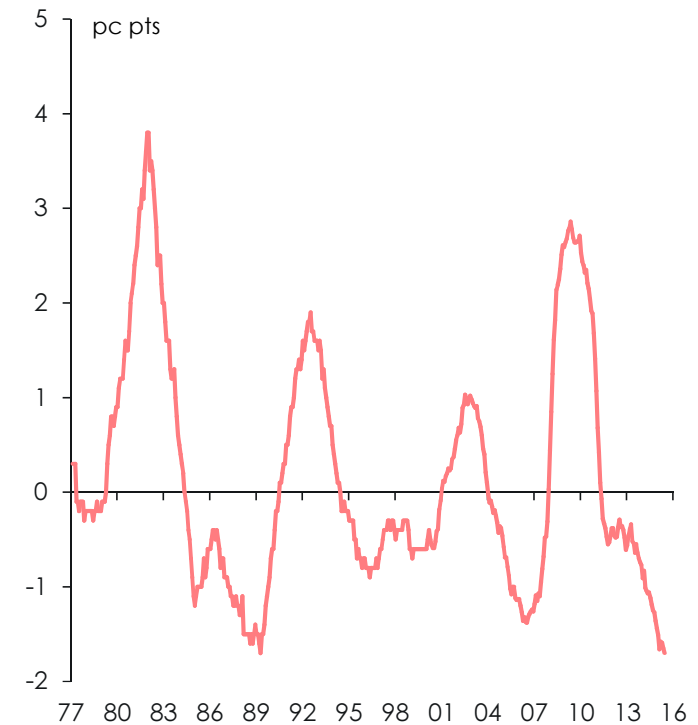
OECD area real GDP growth



OECD area unemployment rate



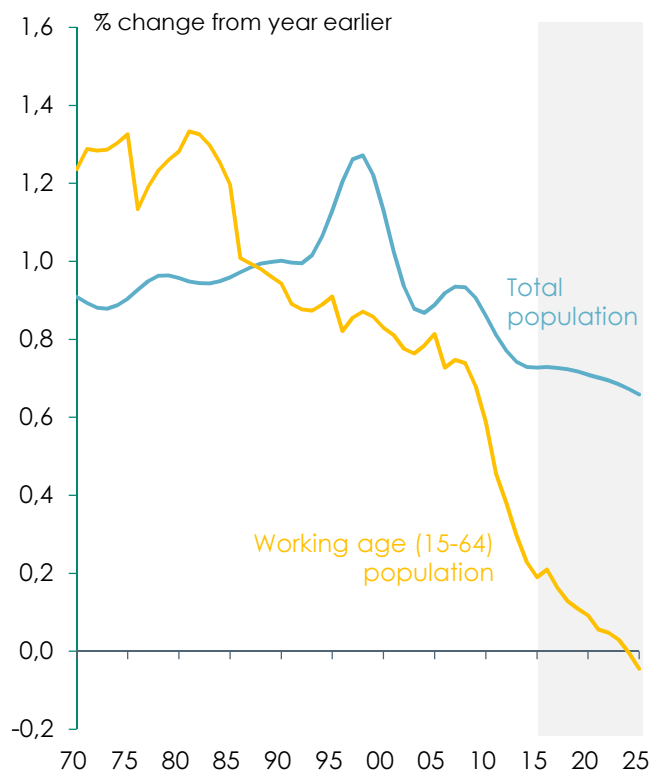
3-year change in OECD unemployment rate



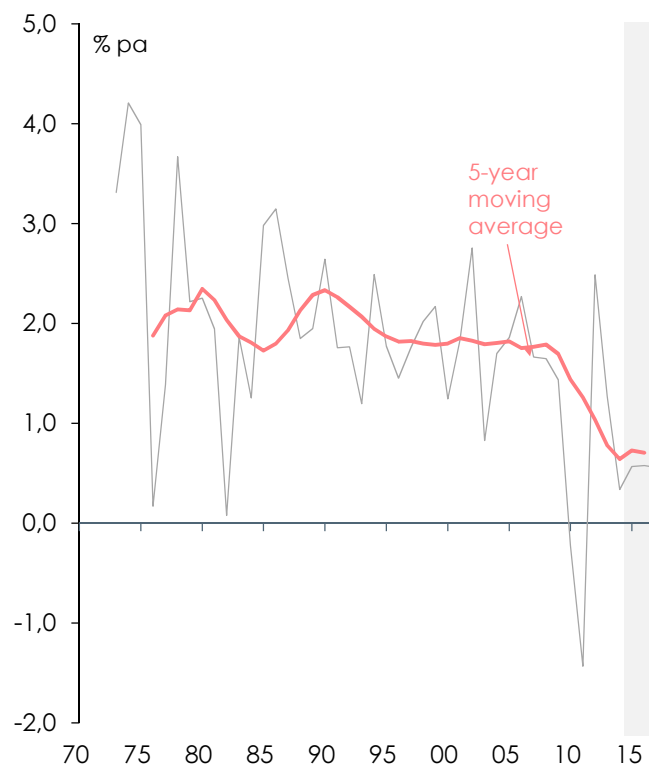
Source: Organization for Economic Co-operation & Development (OECD). The OECD comprises 34 (mostly) 'advanced' economies in North America and Europe, plus Japan, Korea, Australia, New Zealand, Mexico, Chile, Turkey & Israel.

It could be that GDP growth is being understated or it could be that 'potential growth' has slowed

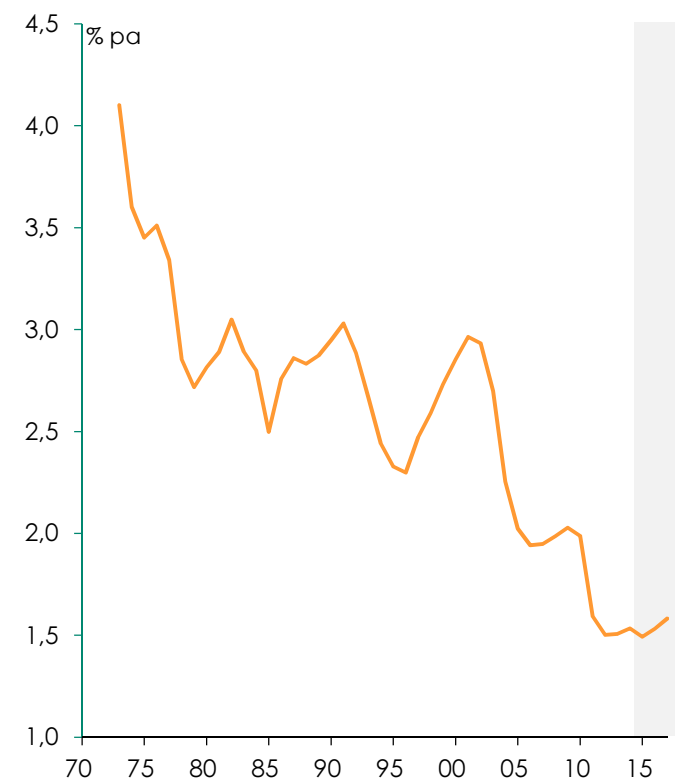
OECD area population growth



OECD area labour productivity growth



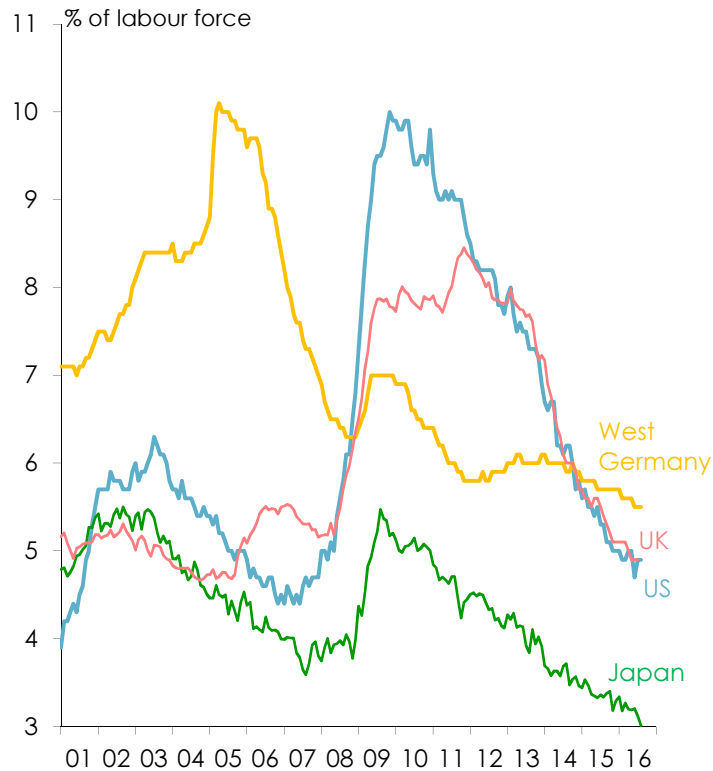
OECD area potential GDP growth



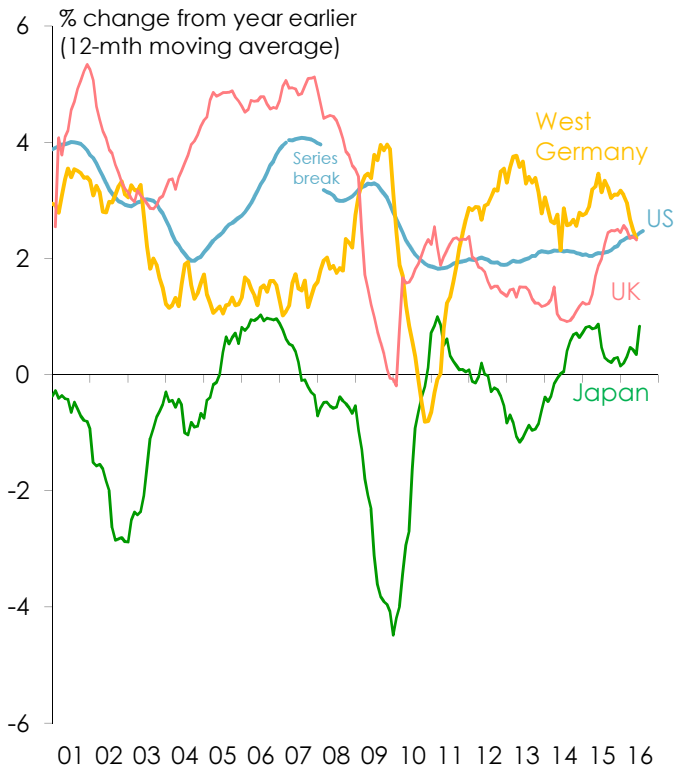
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2015 Revision*; Organization for Economic Co-operation & Development (OECD), *Economic Outlook* database. 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force.

The four largest 'advanced' economies are now more or less at 'full employment' ... so deflation risks are actually beginning to recede

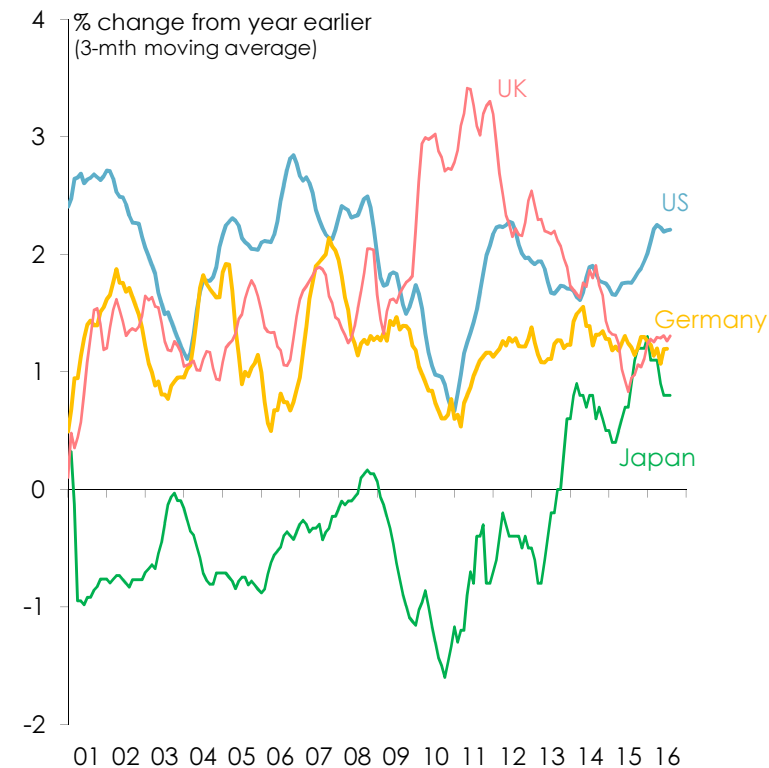
Four largest 'advanced' economies - unemployment



Wage inflation – four largest 'advanced' economies



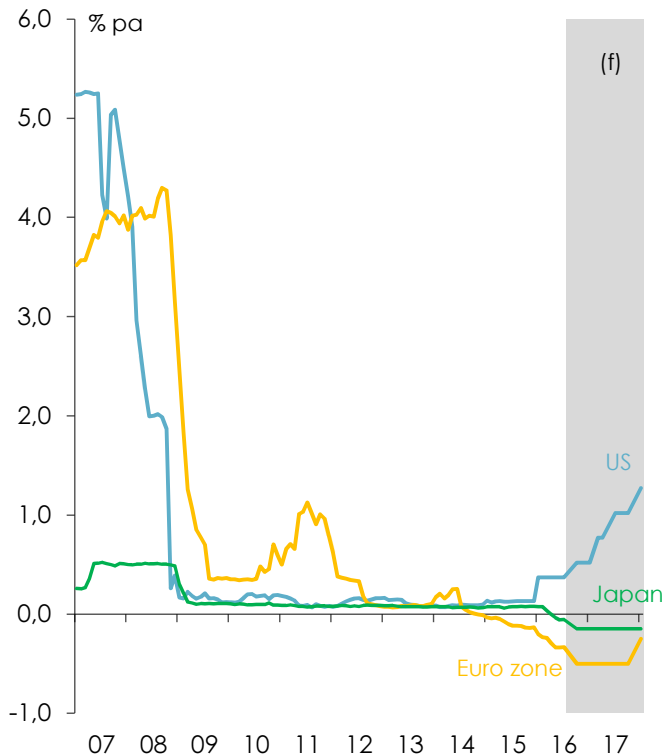
'Core' CPI inflation – four largest 'advanced' economies



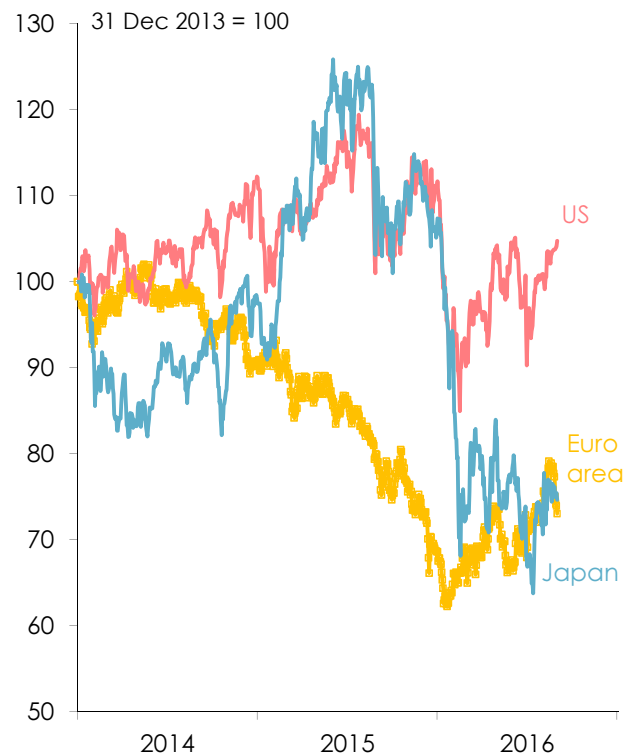
Sources: US Bureau of Labor Statistics; Japan Labour Ministry; Statistisches Bundesamt; UK Office of National Statistics; Thomson Reuters Datastream.

Interest rates need to go up in the US – and negative rates in Europe and Japan haven't turned out to be such a good idea

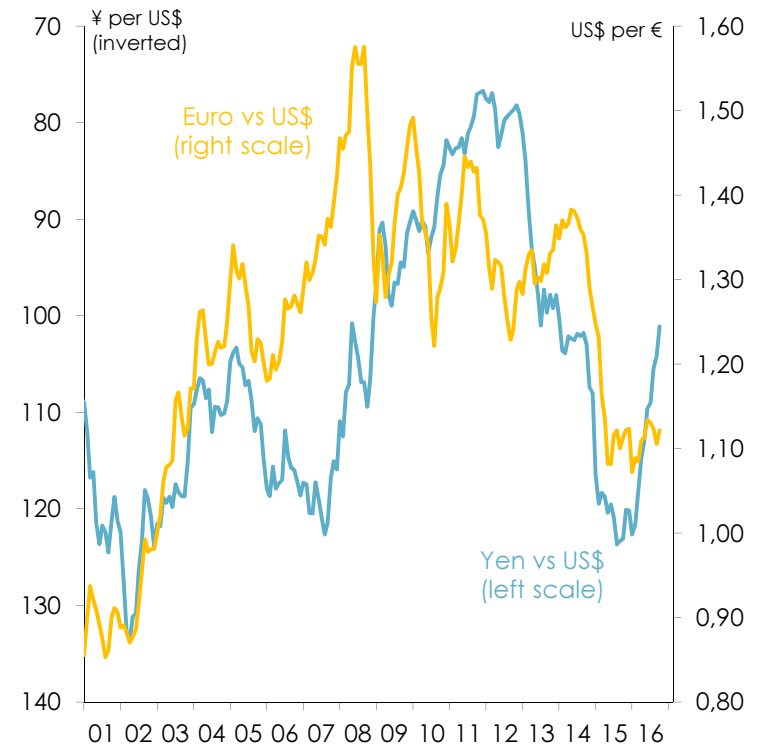
US, Euro area & Japan policy interest rates



Bank share prices



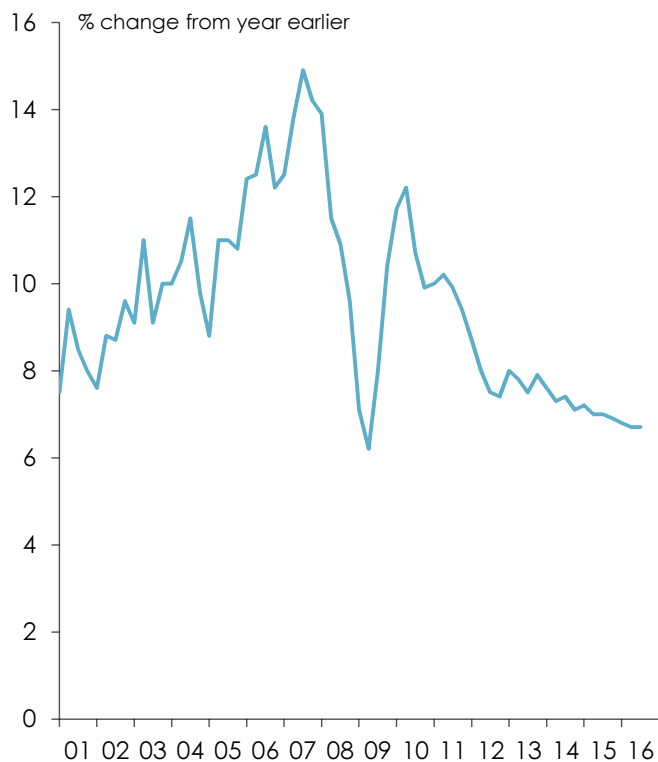
Euro and Japanese yen vs US dollar



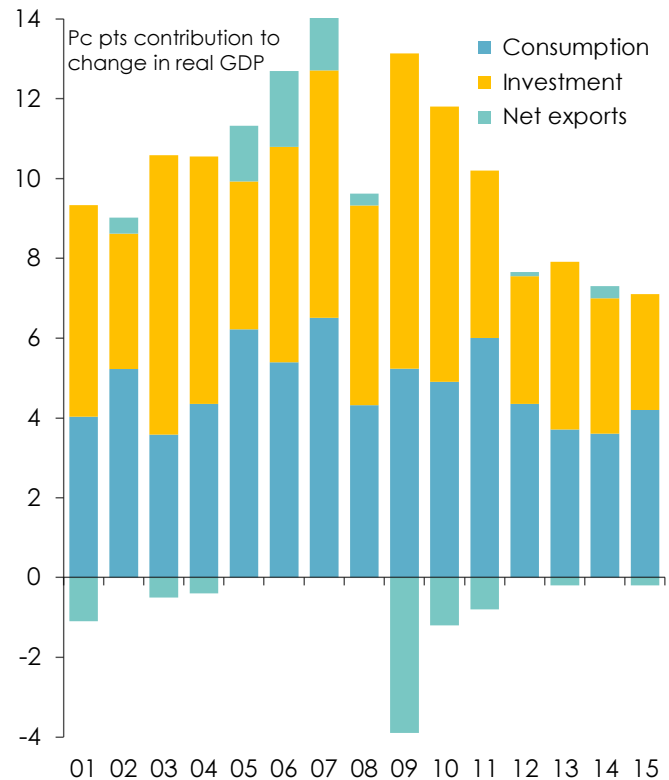
Sources: US Federal Reserve; European Central Bank; Bank of Japan; Thomson Reuters Datastream.

China's sustainable economic growth rate is slowing – and the 'mix' of Chinese growth is changing

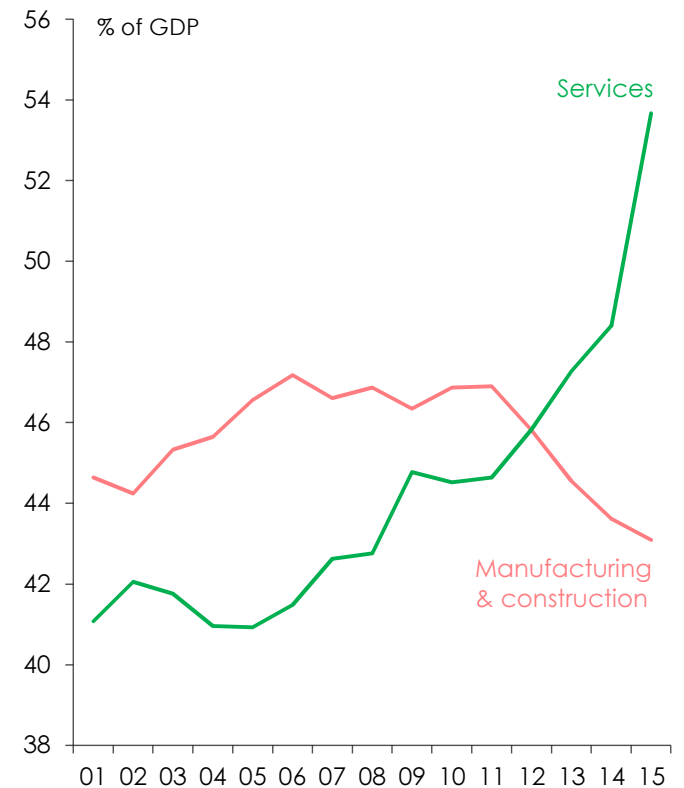
China real GDP



Contributions to annual growth in GDP



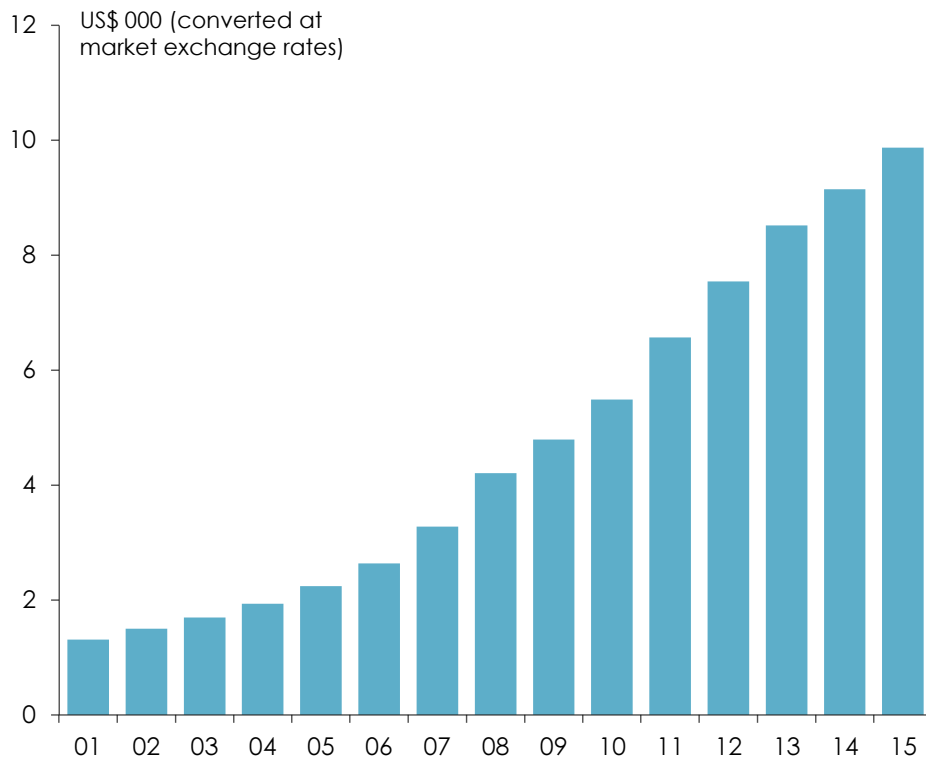
Major sector shares of GDP



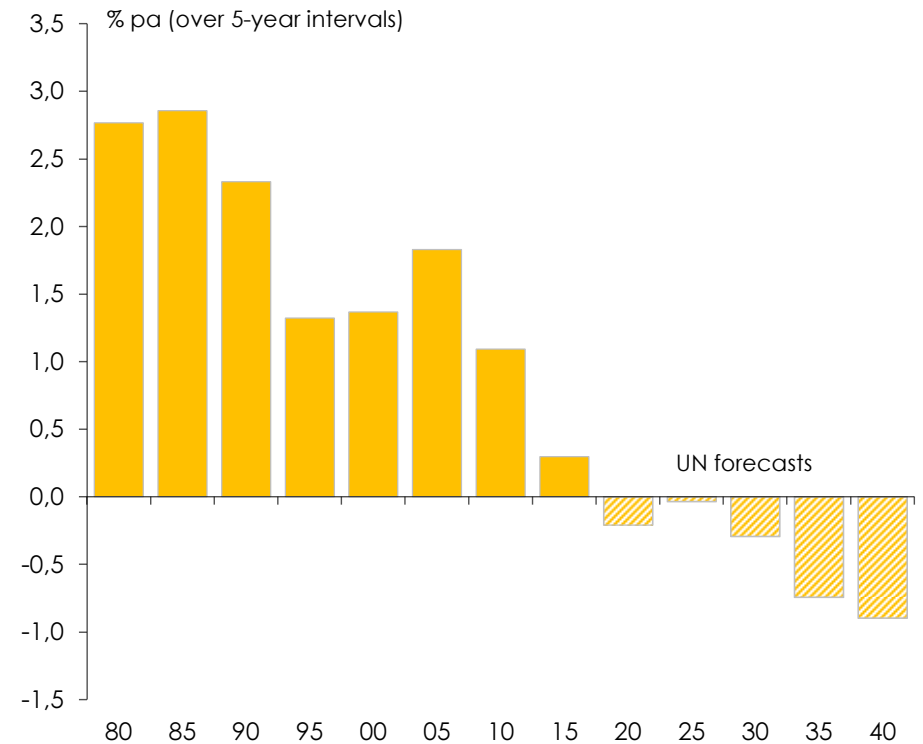
Source: China National Bureau of Statistics (NBS).

Chinese workers aren't so cheap any more: and there will be fewer of them from now on

Average wages of Chinese urban workers



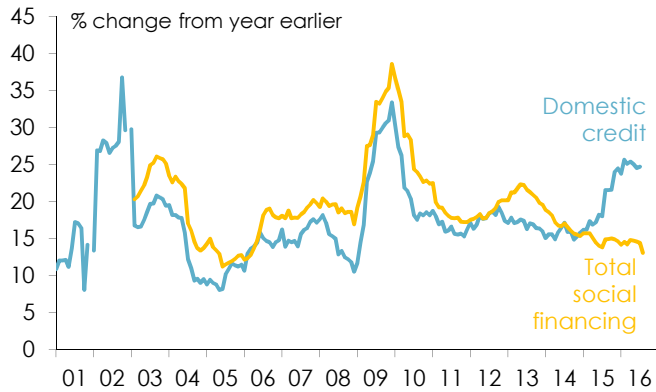
Growth rate of China's working-age population



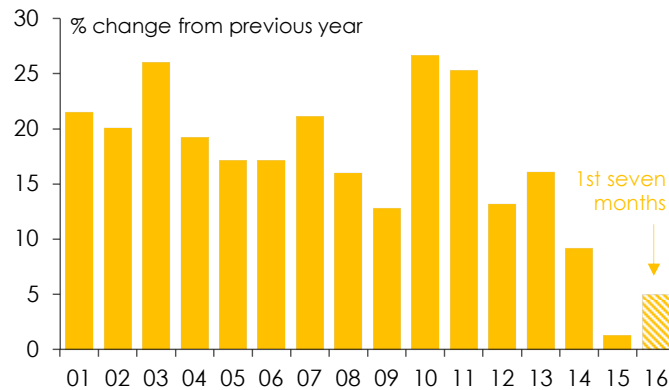
Sources: China National Bureau of Statistics; United Nations Economic & Social Affairs Division, *Population Prospects*.

Chinese authorities have launched another round of monetary stimulus, which seems to have had some effect in the first half of this year

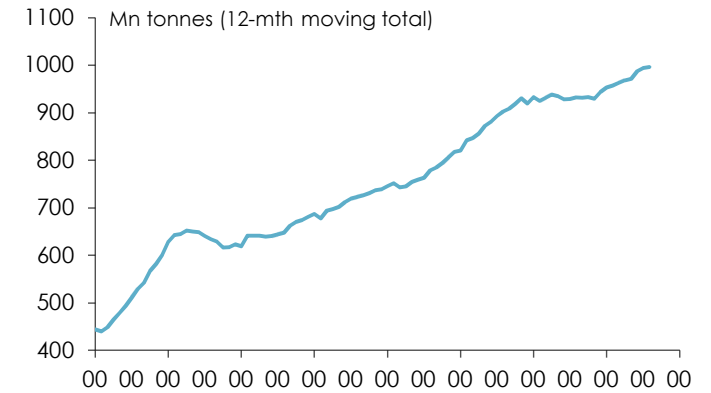
Credit growth - total



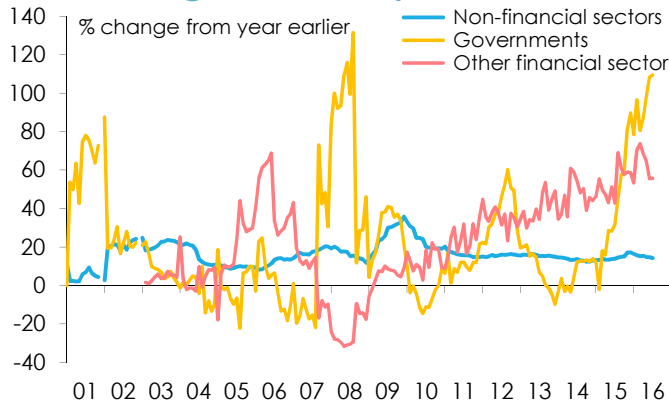
Floor space under construction



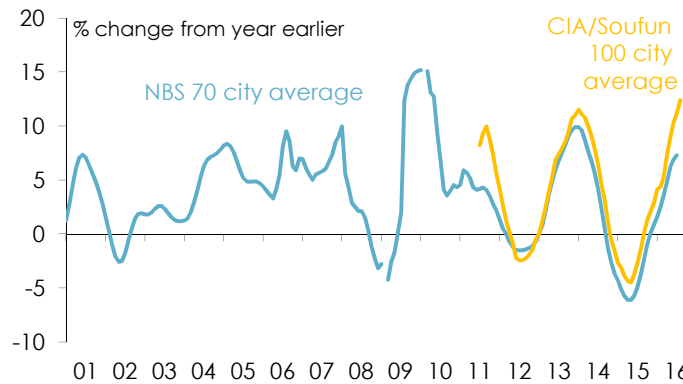
Iron ore imports



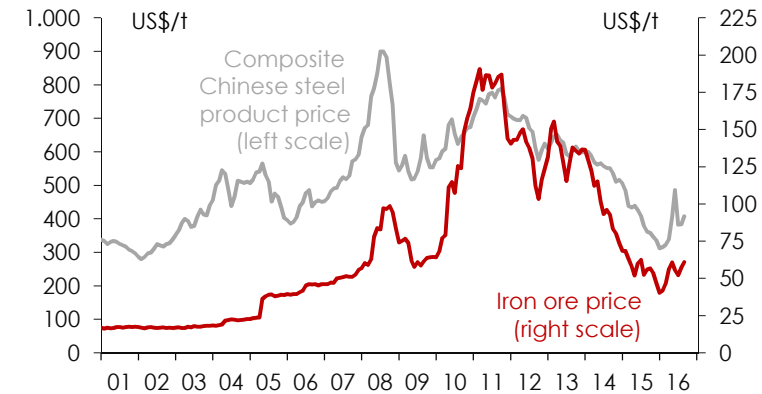
Credit growth - by sector



Urban property prices



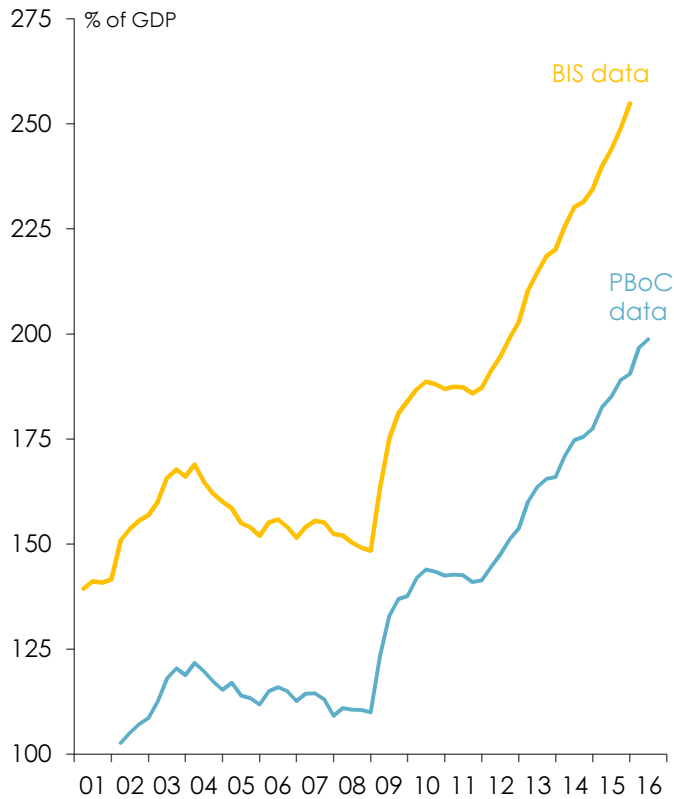
Steel and iron ore prices



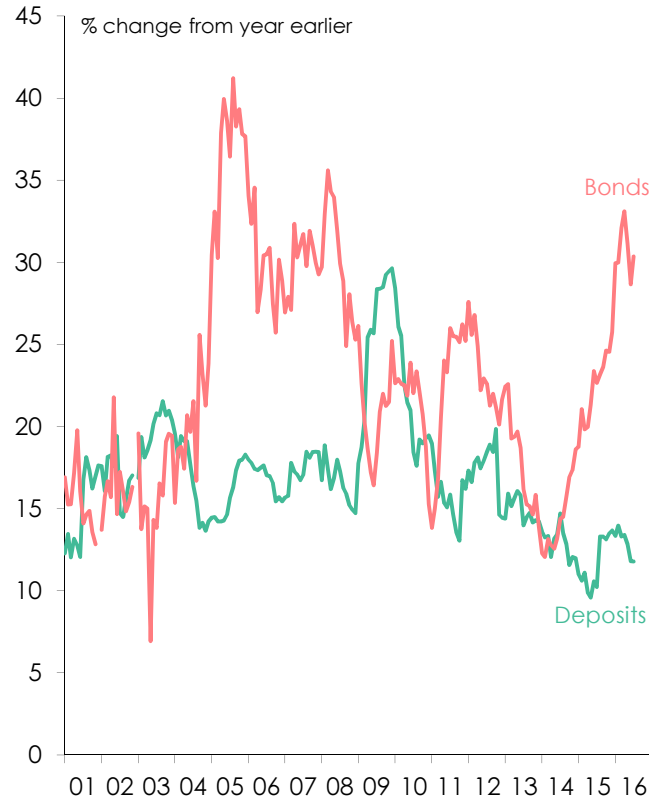
Sources: People's Bank of China; China National Bureau of Statistics; China Index Academy (CIA) & Soufun; Caixin & Markit Economics; MySteel; Thomson Reuters Datastream.

But these measures are increasing the risks inside the Chinese financial system

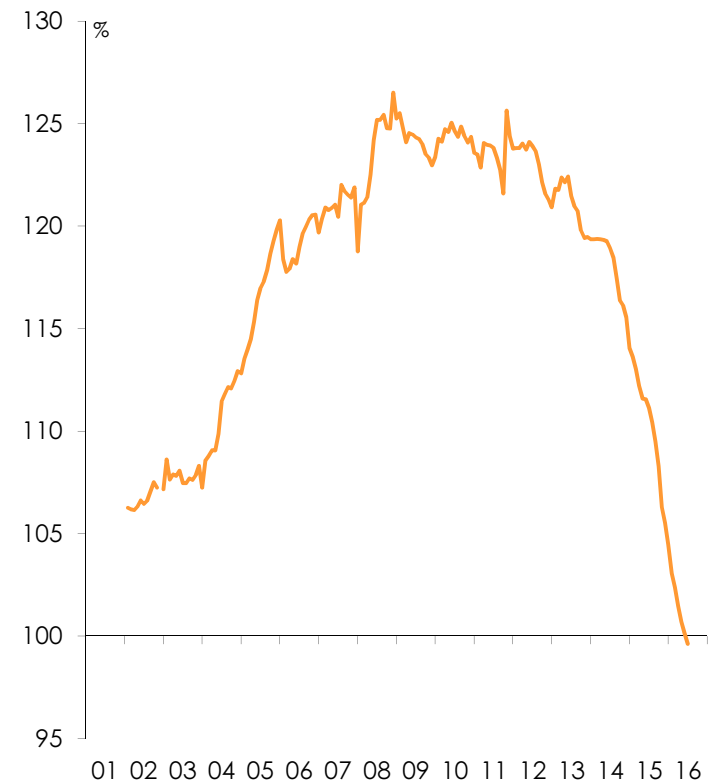
China debt outstanding as a proportion of GDP



China bank funding



China banks deposit-to-loan ratio



Sources: People's Bank of China (PBoC); Bank for International Settlements (BIS).

Will America switch
from 'Yes we can' ...



... to 'I alone can'
?



What might a Trump presidency mean for Australia?

❑ A shock to global financial markets – and to Australia's

- financial markets are assuming that Hillary Clinton will win – just as they assumed that Britain would vote to stay in the EU
- a different outcome could likewise produce sharp movements on financial markets (after all, there's more at stake)

❑ An abrupt decline in business confidence – in the US and elsewhere

- notwithstanding US business' traditional alignment with the Republican Party, most American business leaders don't want a Trump Presidency – any more than they would have wanted Bernie Sanders in the White House

❑ Possibly, a large fall in the US dollar

- foreigners have over US\$30 trillion (170% of US annual GDP) invested in the US
- if foreign investors seek to reduce their exposures to the US, the US\$ could fall significantly
- in such circumstances, the A\$ (along with other freely-floating currencies) could rise sharply against the US\$
- which, as the RBA has said after each recent Board meeting, would 'complicate' the adjustments currently under way in the Australian economy

❑ A 'trade war' with China – and possibly Japan

- a Trump Administration would declare China (and potentially Japan) a 'currency manipulator' – opening the way for the imposition of tariffs of up to 45% on imports from China (and possibly Japan)
- such measures would be intended to cause a sharp drop in Chinese (and Japanese) exports to the US – which would in turn likely result in those economies weakening – with adverse consequences for Australia's exports to them
- it's hard to believe that China and Japan wouldn't retaliate in some (equally damaging way)

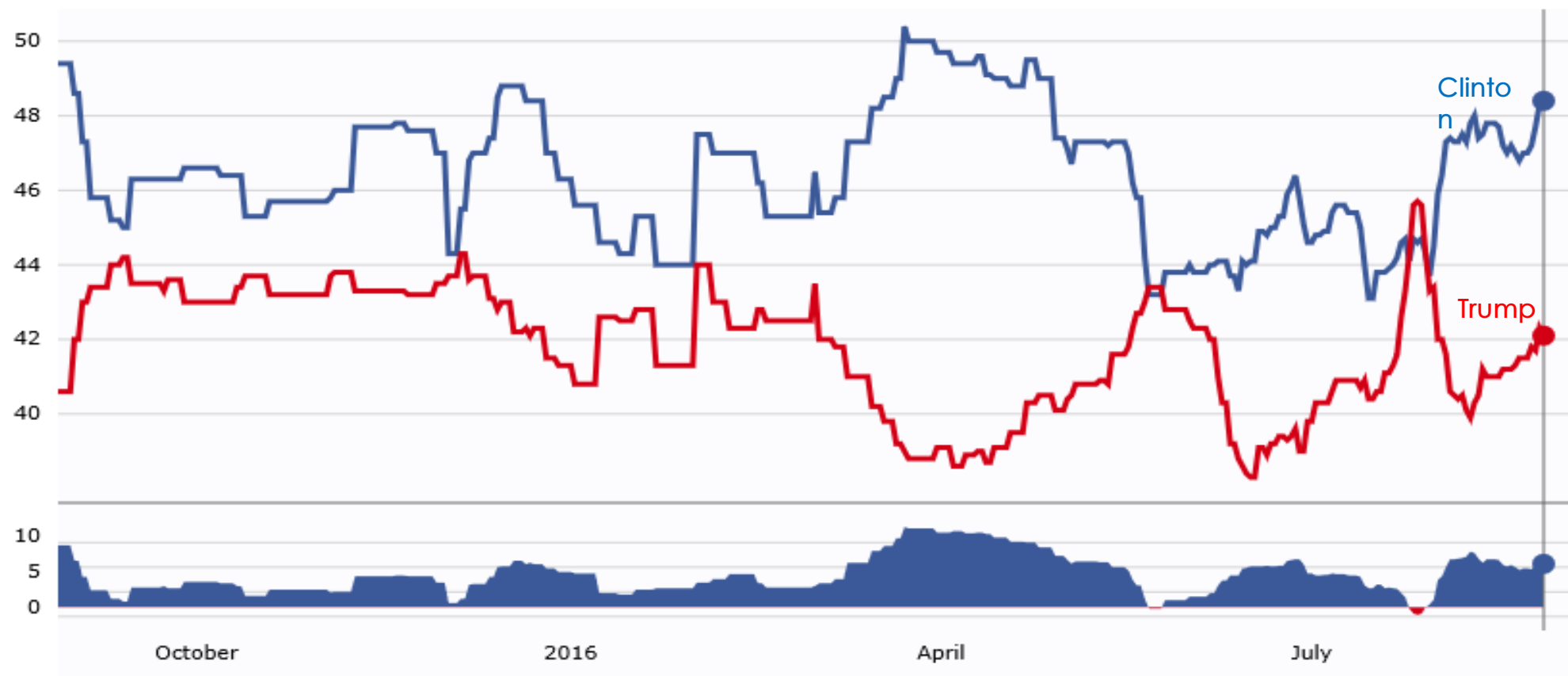
❑ 'Trade wars' can lead to real wars

- Australia would be a big loser from any armed conflict between its biggest trading partner and its most important ally

Opinion polls currently give Hillary Clinton a clear lead over Donald Trump – as they did ‘Remain’ over ‘Leave’ in the UK referendum

US presidential voting intentions

27 August 2016



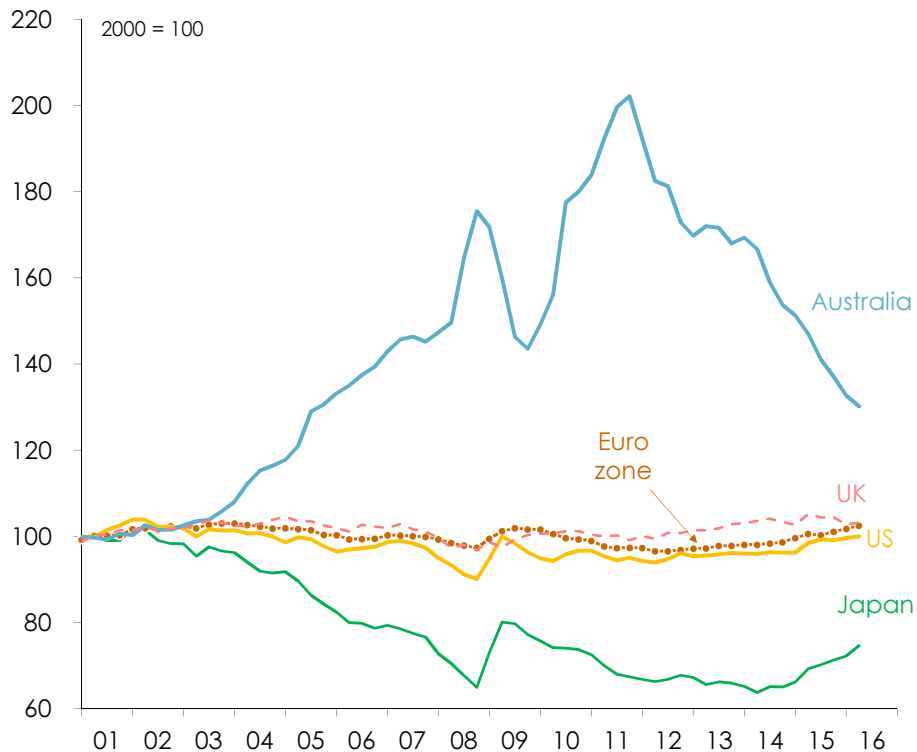
Source: RealClearPolitics.

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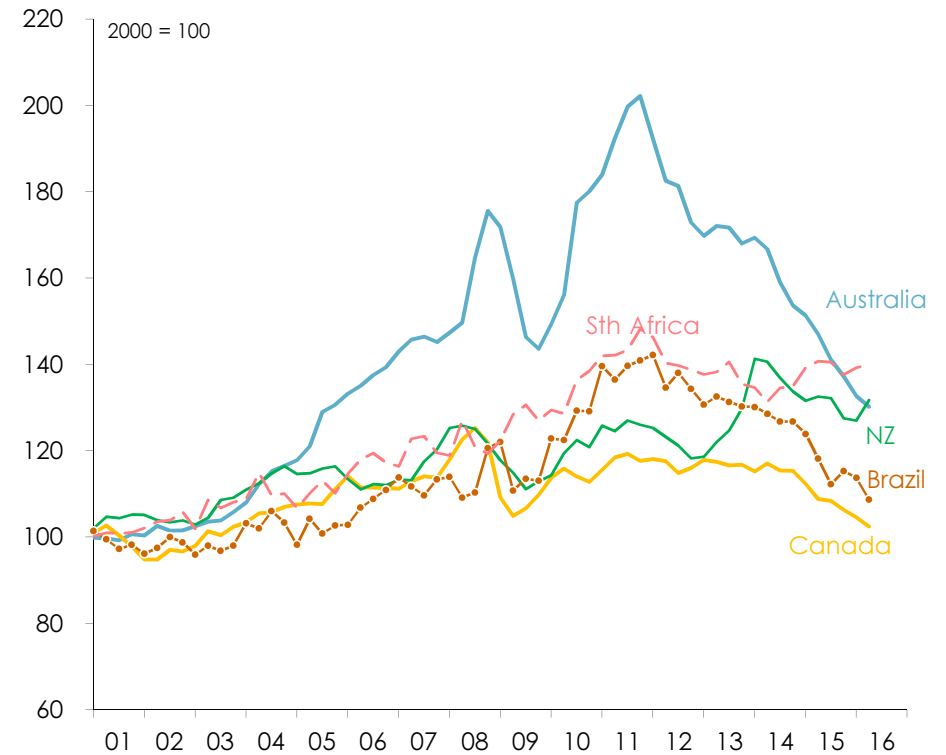
Australia

Australia probably derived more benefit from Chinese growth and industrialization than any other nation on earth

'Terms of trade' – Australia vs other 'advanced' economies



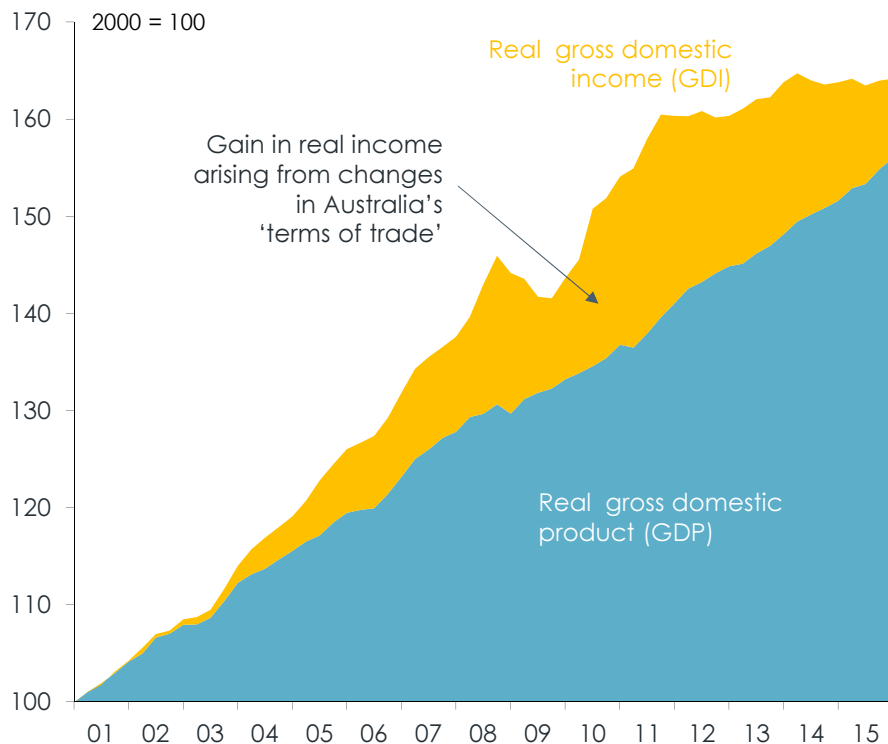
'Terms of trade' – Australia vs other commodity-exporting economies



Note: The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services.
Sources: ABS; US Bureau of Economic Analysis; Eurostat; UK Office for National Statistics; Japan Economic & Social Research Institute; Statistics NZ; Statistics Canada; Statistics South Africa; Instituto Brasileiro de Geografia e Estatística; author's calculations.

The huge rise in Australia's 'terms of trade' represented a substantial addition to Australia's real income – which is now receding

Gains in real gross domestic income arising from changes in 'terms of trade'



Growth in real gross domestic income (GDI) vs real gross domestic product (GDP)

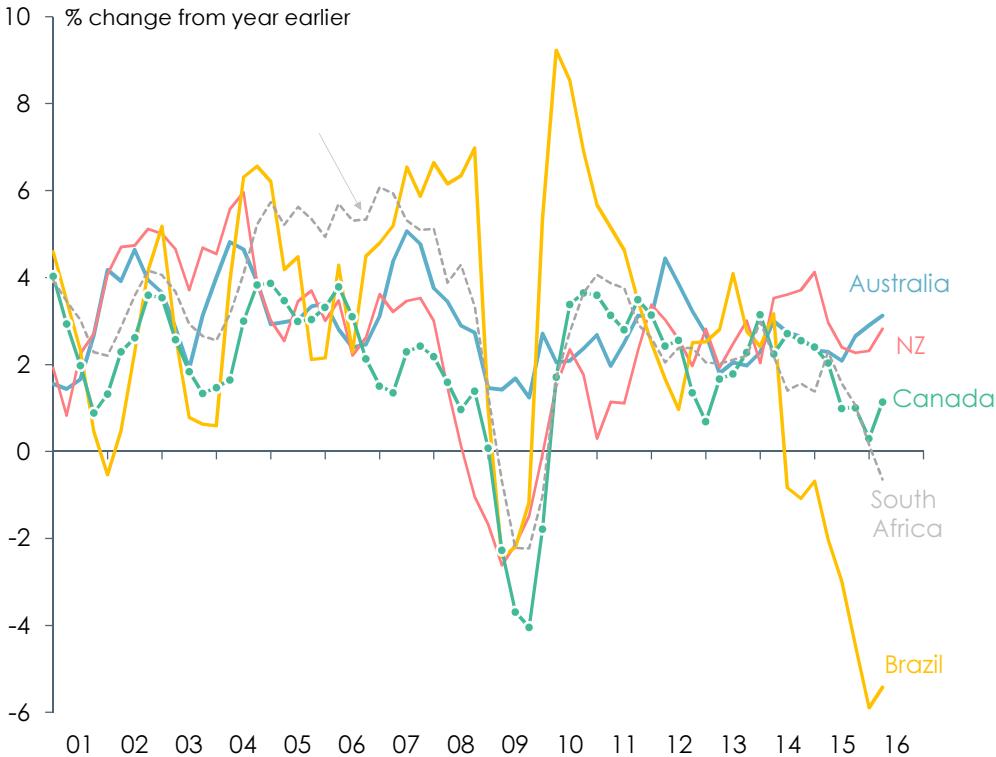


Note: The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services. Real gross domestic income (GDI) is real gross domestic product (GDP) adjusted for income gains or losses arising from changes in the terms of trade.

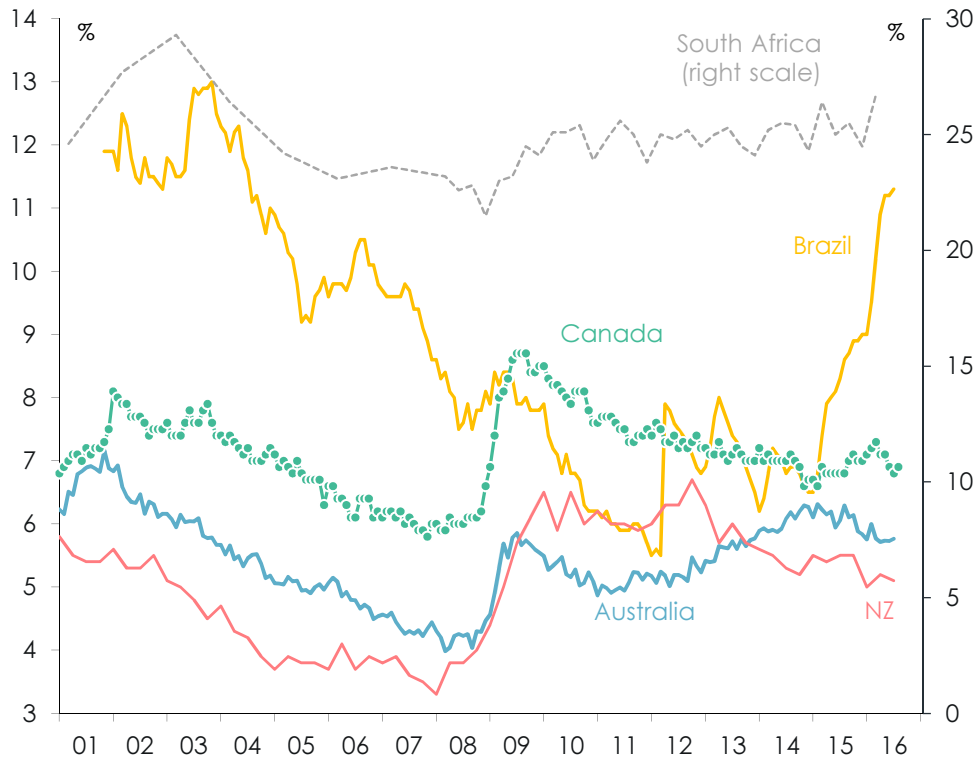
Source: ABS.

Australia is faring better than most other commodity-exporting economies despite experiencing a sharper fall in its terms of trade

Australia and other commodity exporters – real GDP growth



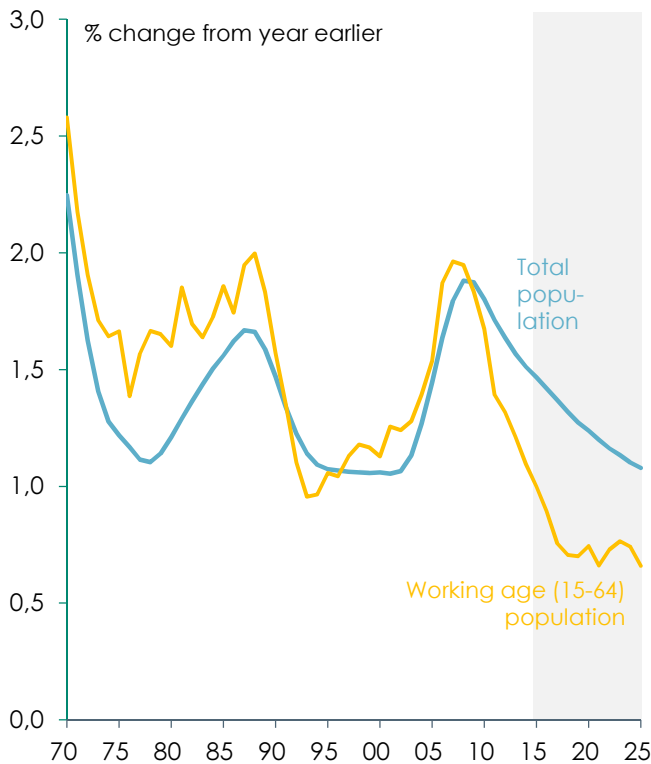
Australia and other commodity exporters - unemployment



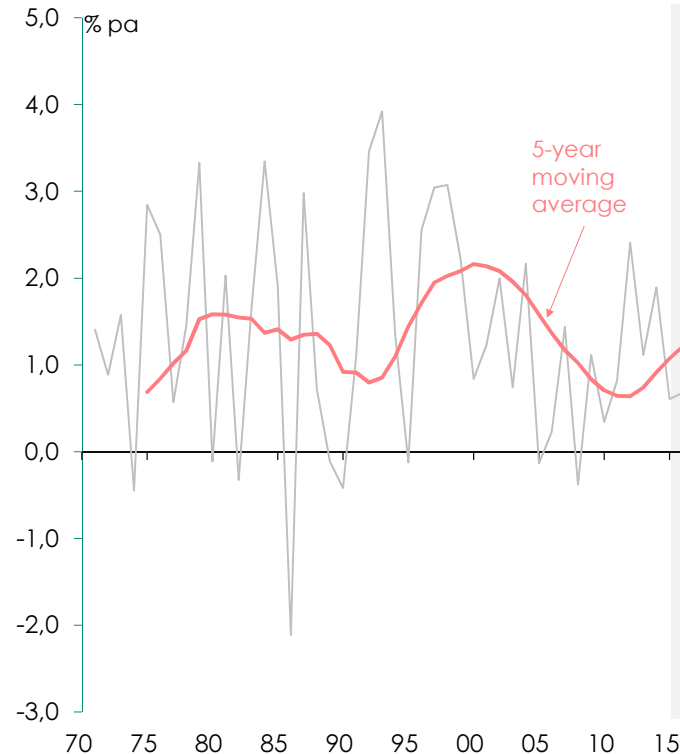
Sources: ABS; Statistics NZ; Statistics Canada; Instituto Brasileiro de Geografia e Estatistica; Statistics South Africa.

Australia is experiencing the same forces of slowing and ageing population, and slower productivity growth, as other 'rich' countries

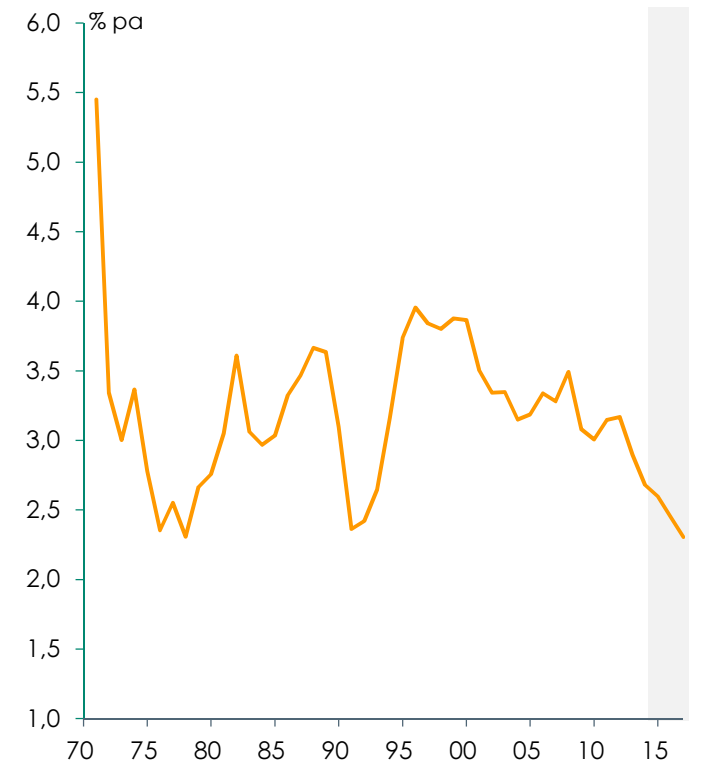
Australian population growth



Australian labour productivity growth



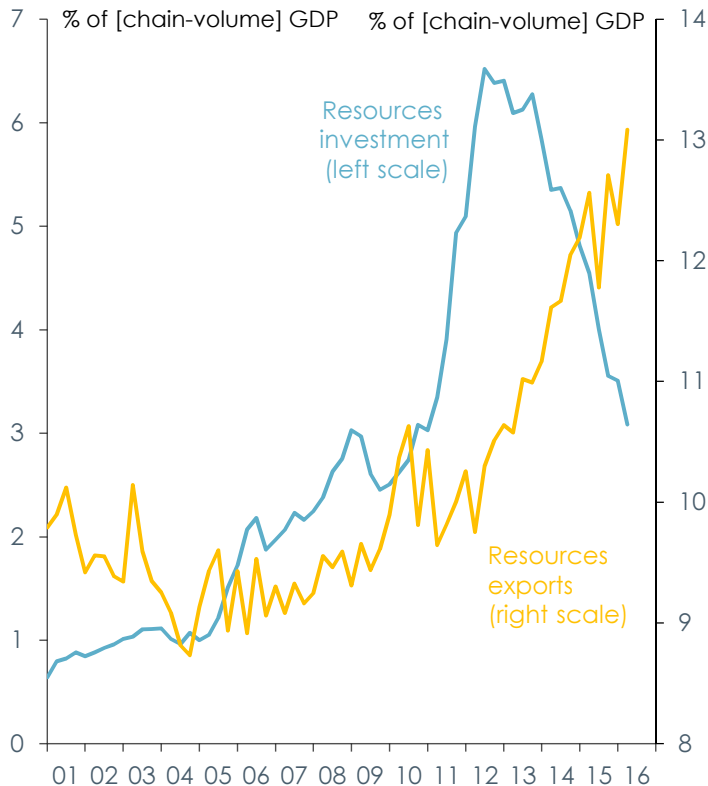
Australian potential GDP growth



Sources: United Nations Economic & Social Affairs Division, Population Branch; Organization for Economic Co-operation & Development (OECD). 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force.

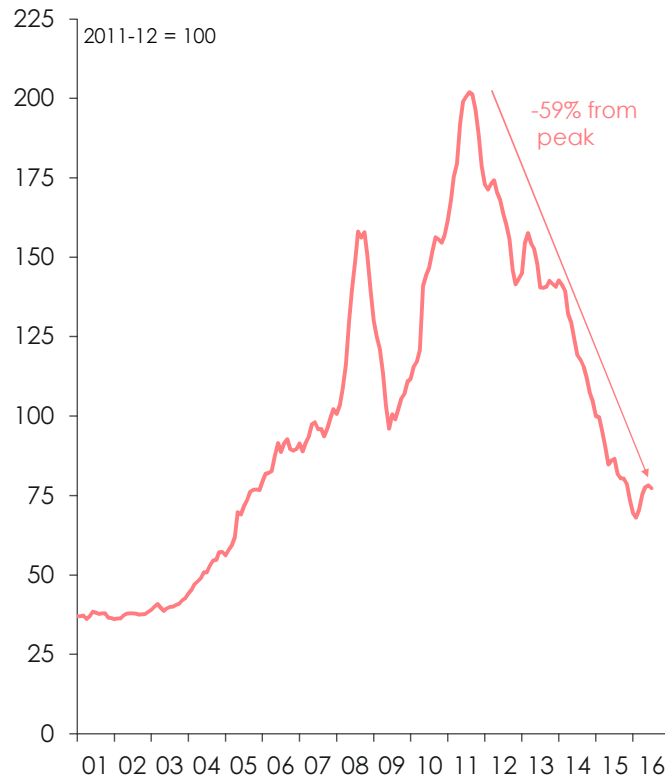
The resources investment boom is over – and while resources exports are rising, they are at falling prices and don't employ as many workers

Australia's resources investment & export volumes

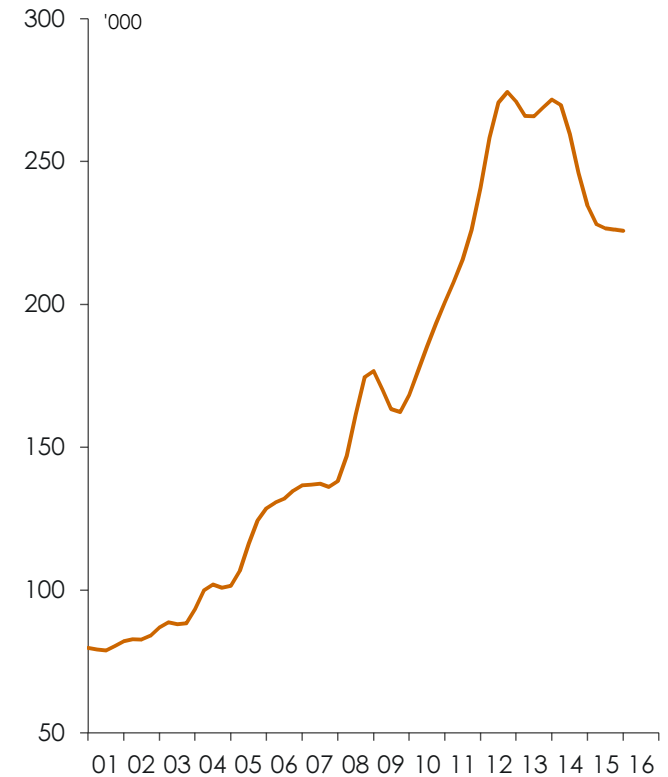


Note: Resources investment includes exploration expenditure.
Source: ABS.

Australia's resources export prices

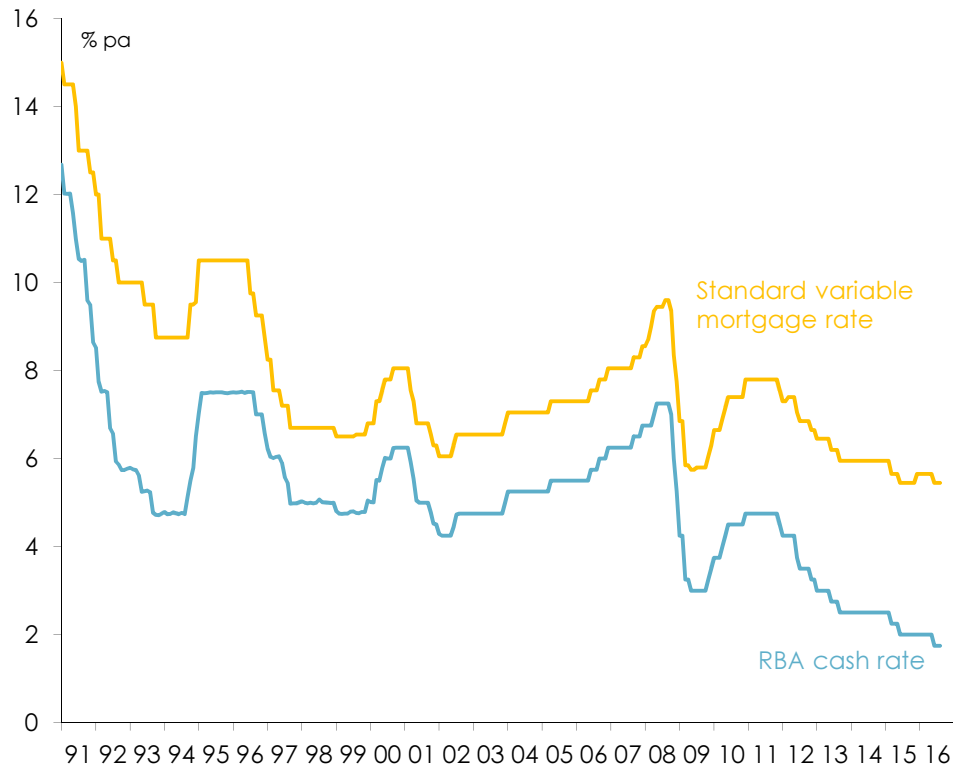


Australia's mining sector employment

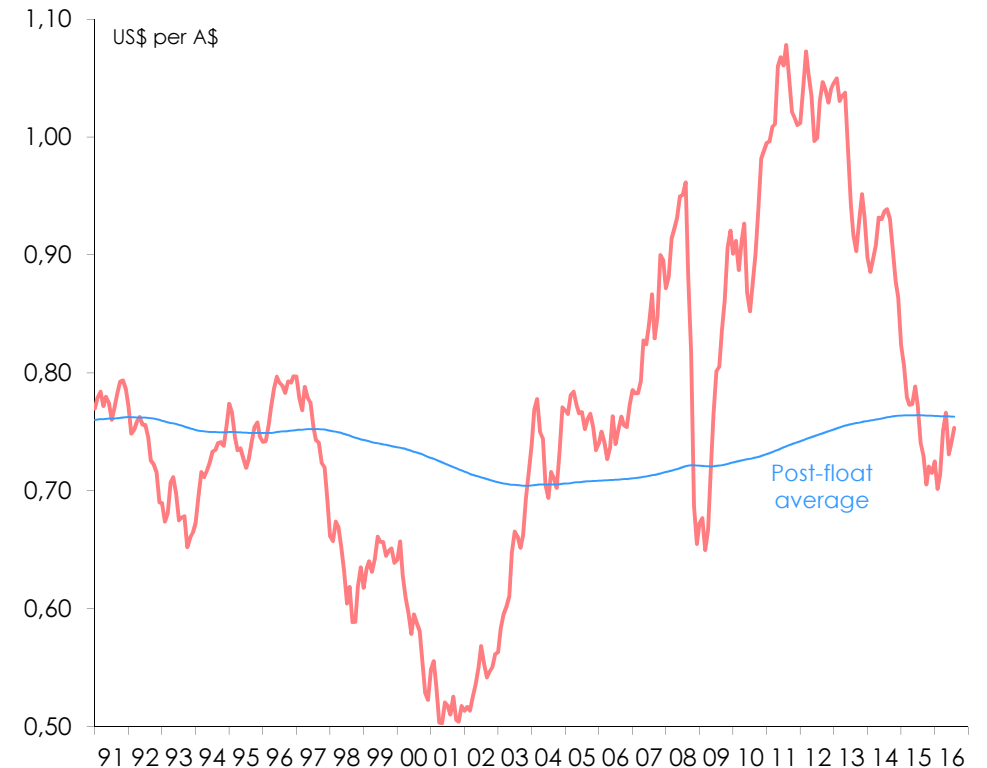


Australia is relying on record-low interest rates and a (now) below-its-long-term-average Australian dollar to support economic growth

Australian interest rates



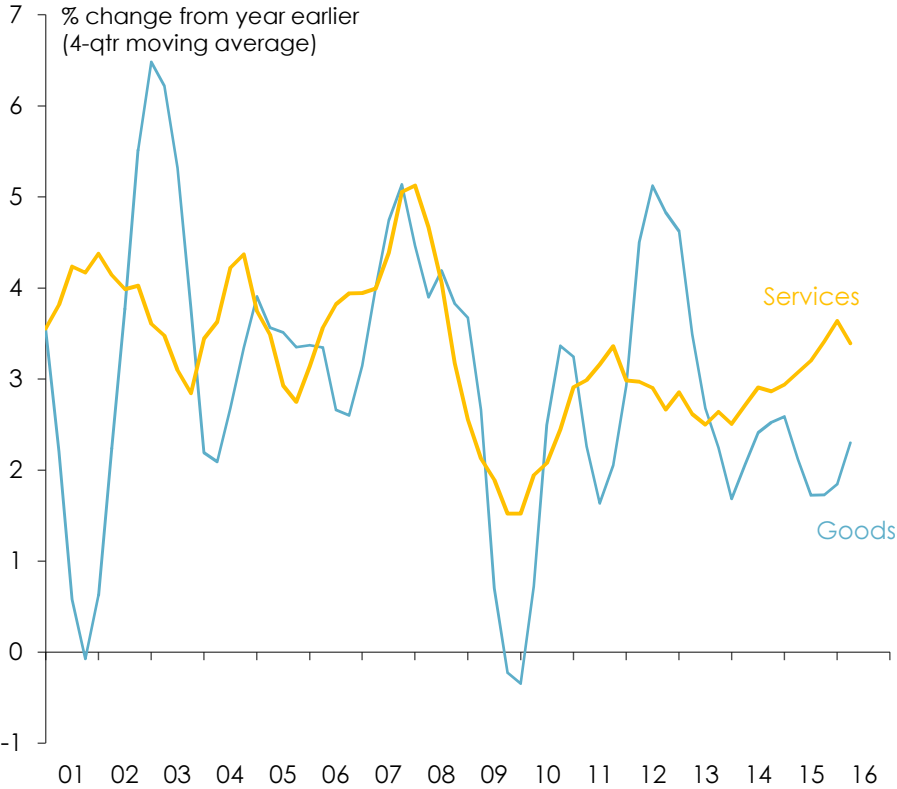
Australian dollar



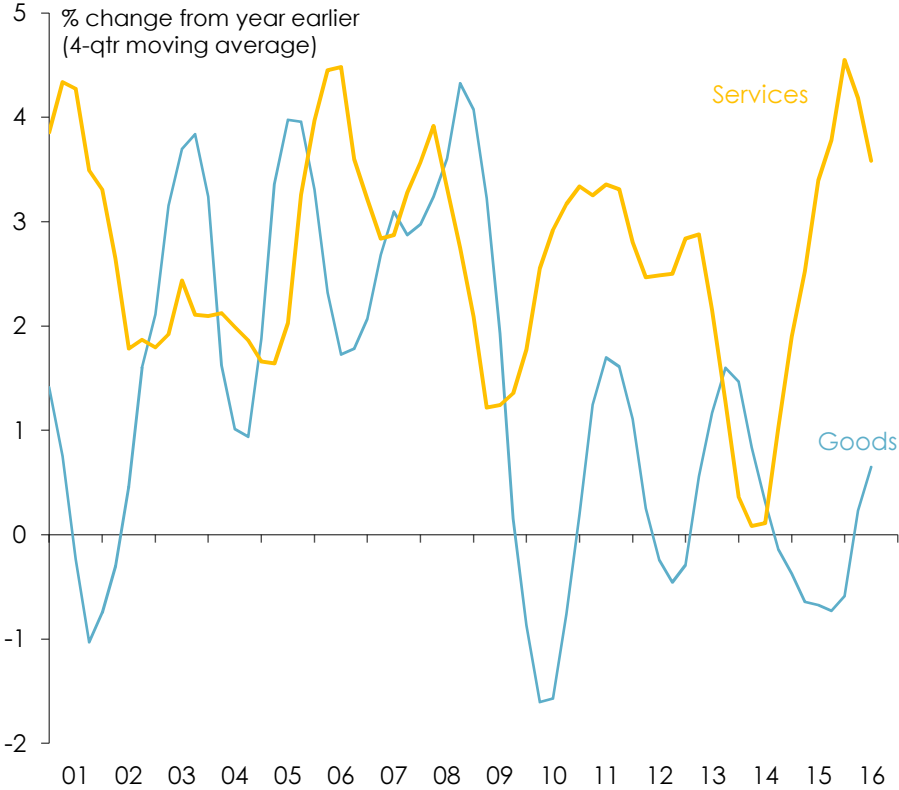
Source: Reserve Bank of Australia.

The end of the mining boom together with lower interest rates and a lower A\$ is driving a shift from goods to services

Output (real gross value added)



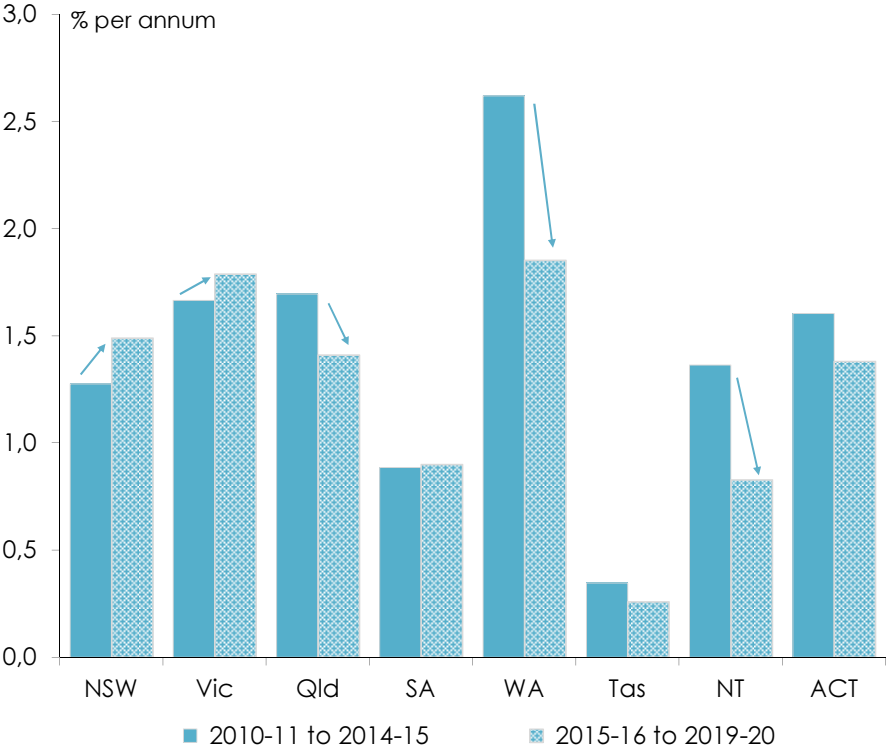
Employment



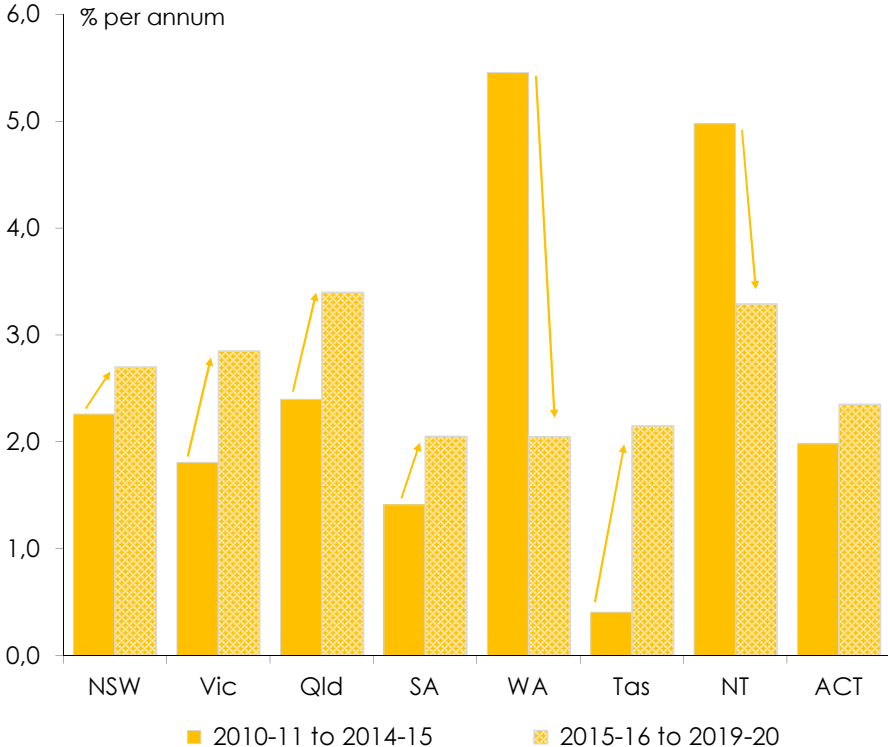
Note: 'Goods' includes construction – it isn't possible to separate residential and non-residential construction output and employment from the published data. 'Goods' also excludes agriculture, forestry and fishing. Source: ABS.

The ongoing shift in the drivers of national economic growth has important implications for the pattern of growth across Australia

Population growth by State and Territory



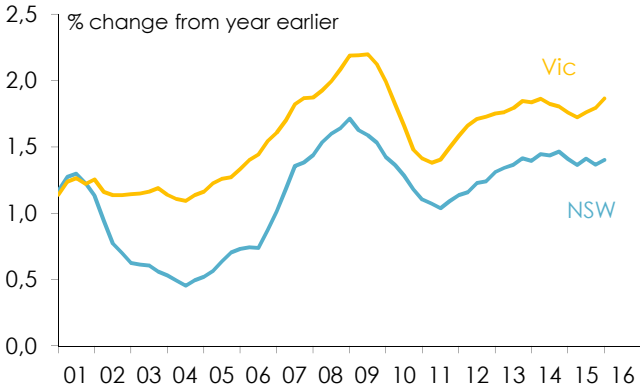
Economic growth by State and Territory



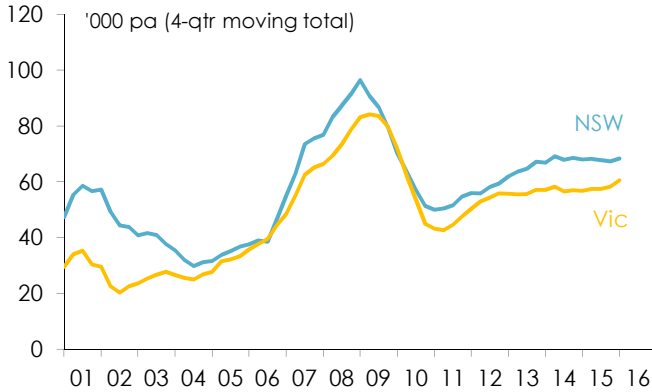
Note: 'Economic growth' measured by changes in real gross state product.
Sources: Commonwealth Treasury, 2015-16 Budget Paper No. 3; 2015-16 State and Territory Budget Papers.

Shift in population growth from the west and north to the south-east reflects changes in both overseas and interstate migration

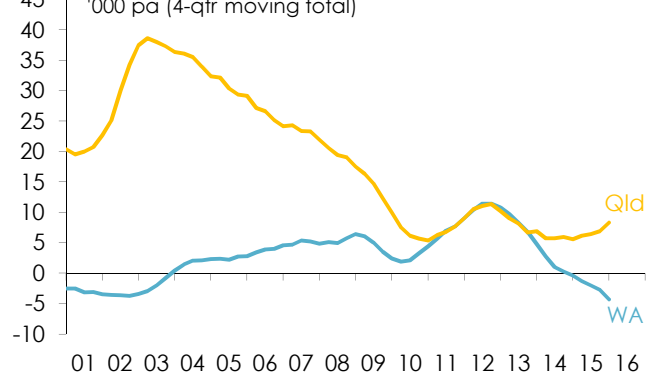
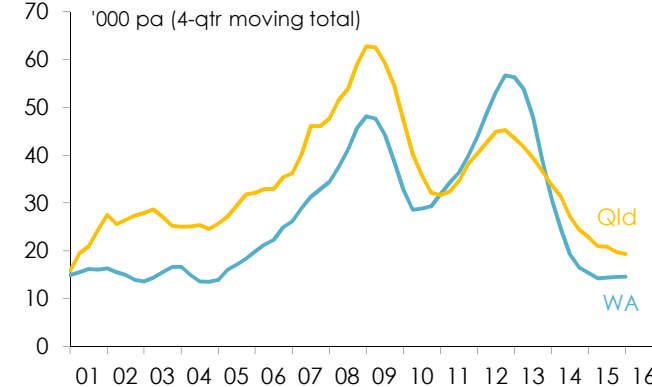
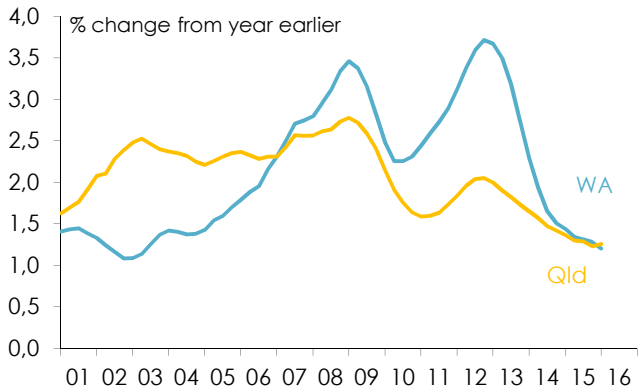
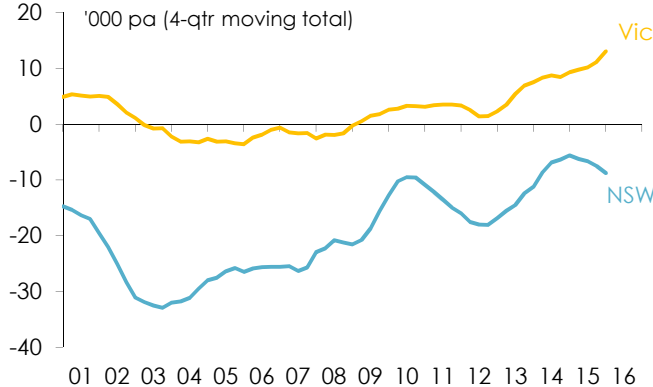
Population growth



Net overseas migration



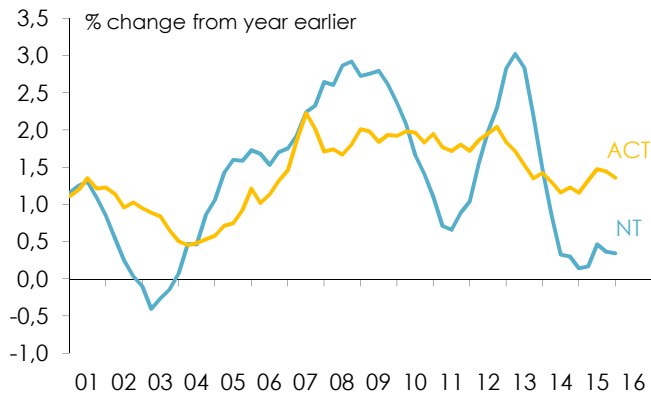
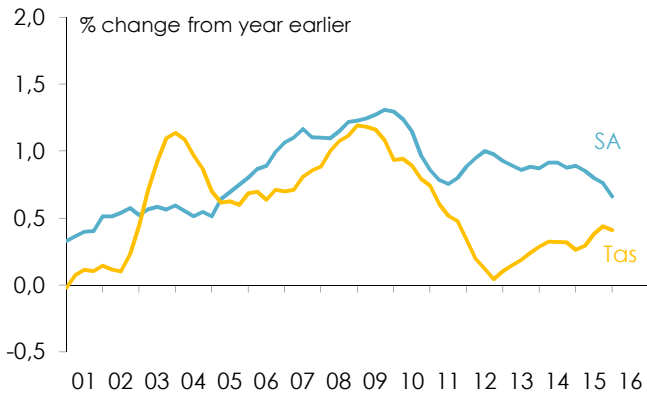
Net interstate migration



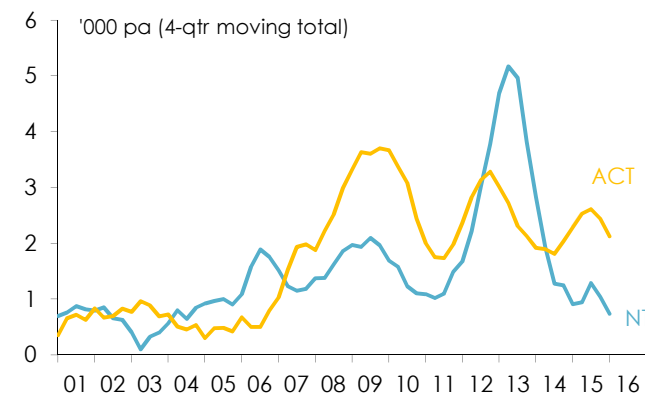
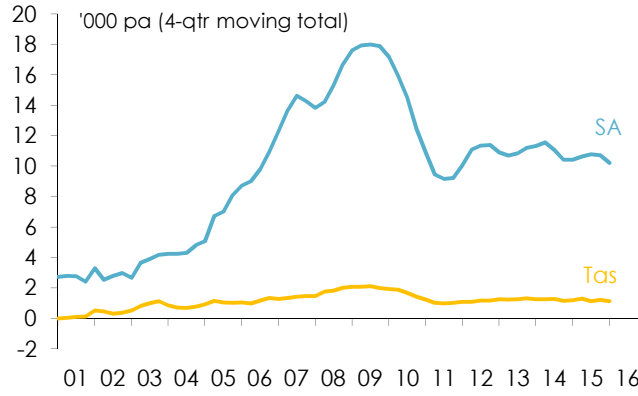
Source: ABS.

Shifts in population growth drivers have been less pronounced for the smaller States and Territories – apart from the Northern Territory

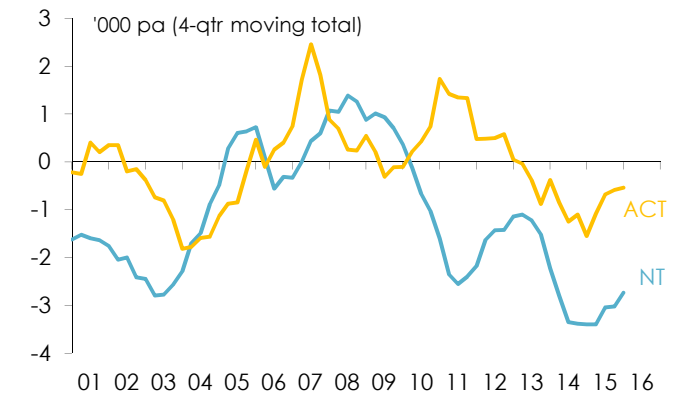
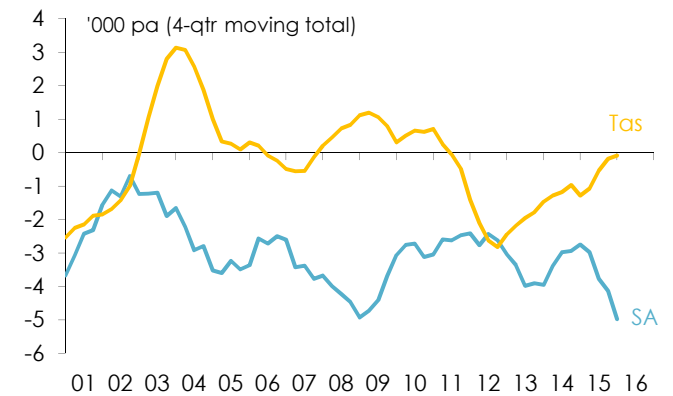
Population growth



Net overseas migration



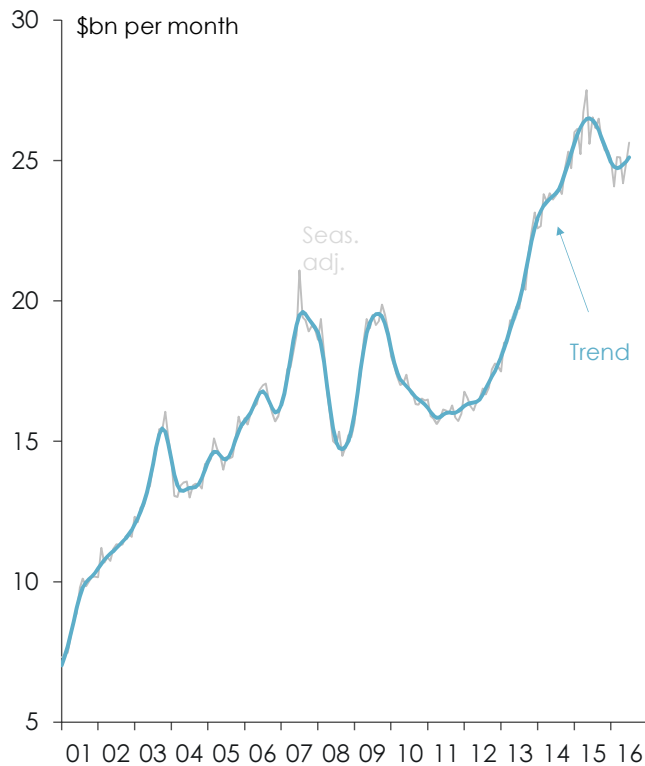
Net interstate migration



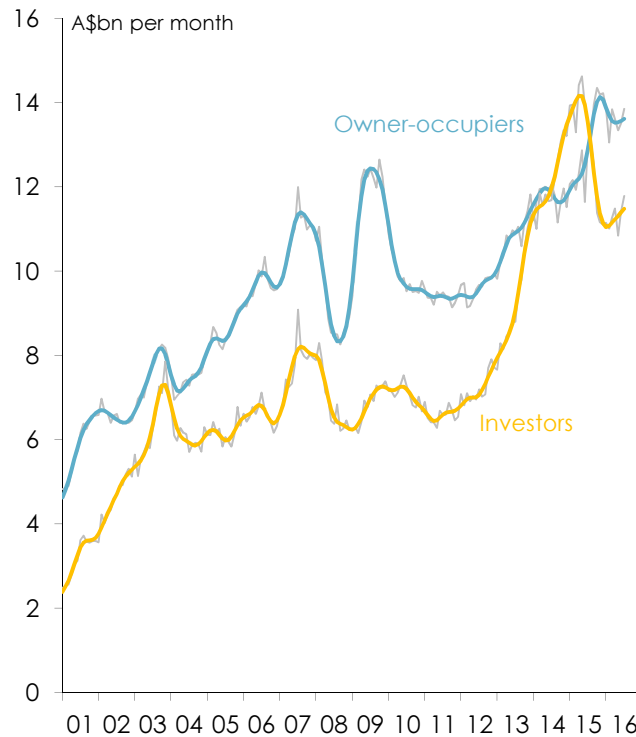
Source: ABS.

Record-low interest rates have stimulated a substantial rise in housing demand – leading in turn to further escalation of housing prices

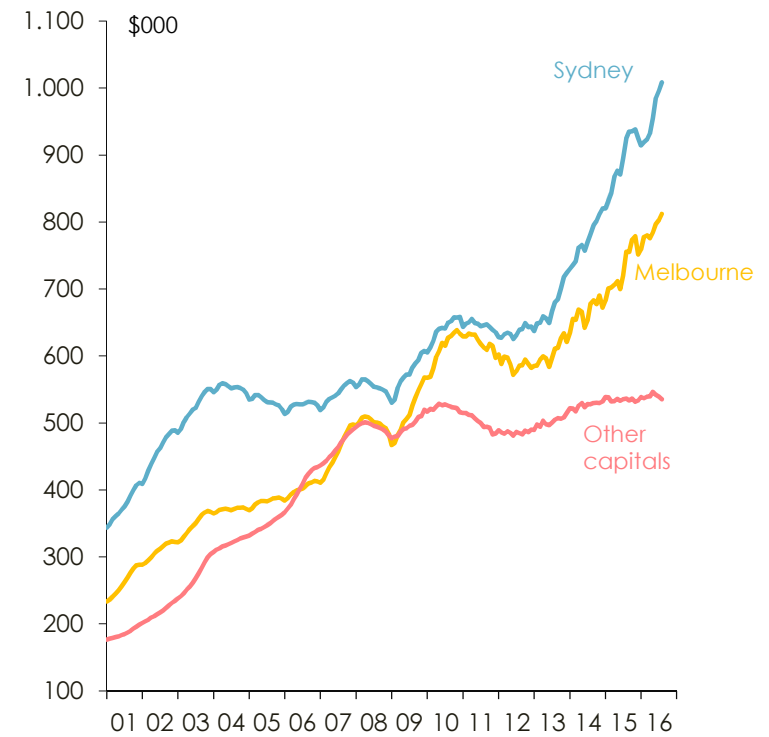
Lending for housing



Lending for housing, by type of borrower



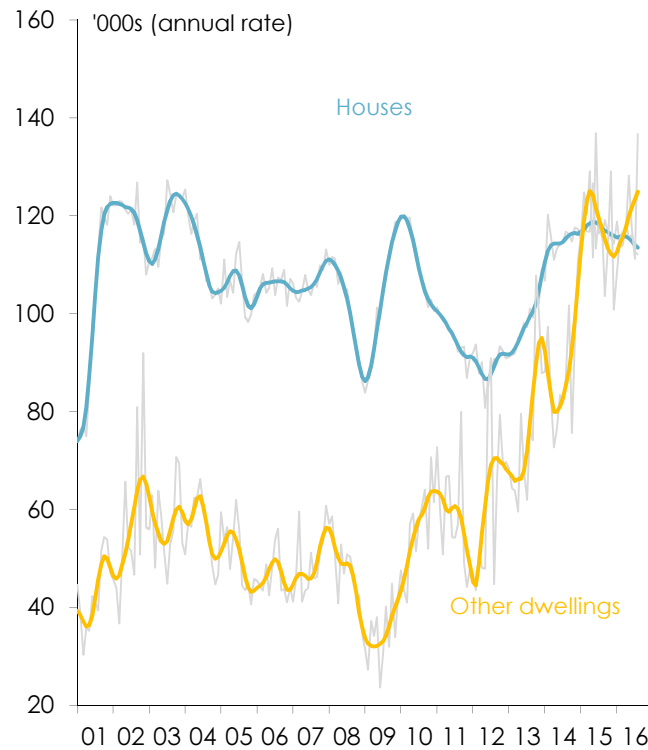
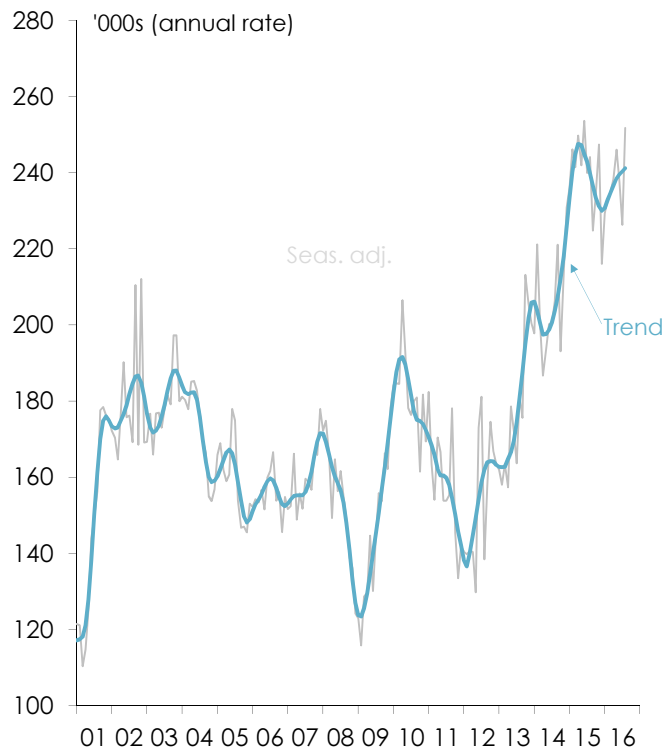
Capital city residential property prices



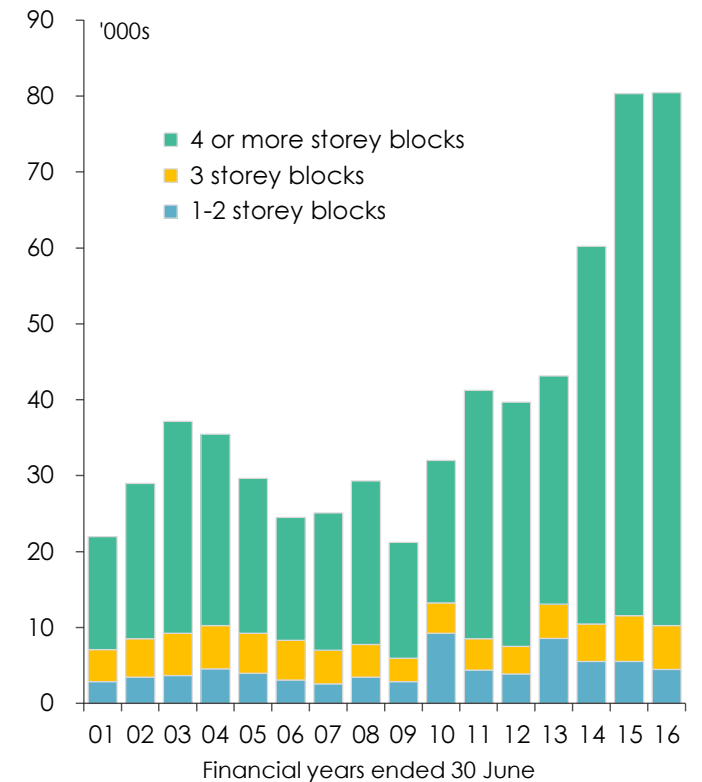
Note: grey lines in first and second charts above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'.
Sources: ABS; CoreLogic – RP Data.

Housing supply is also now rising more strongly – with more than half of the increase occurring in the form of high-rise apartments

Residential building approvals Private residential building approvals, by type of dwelling



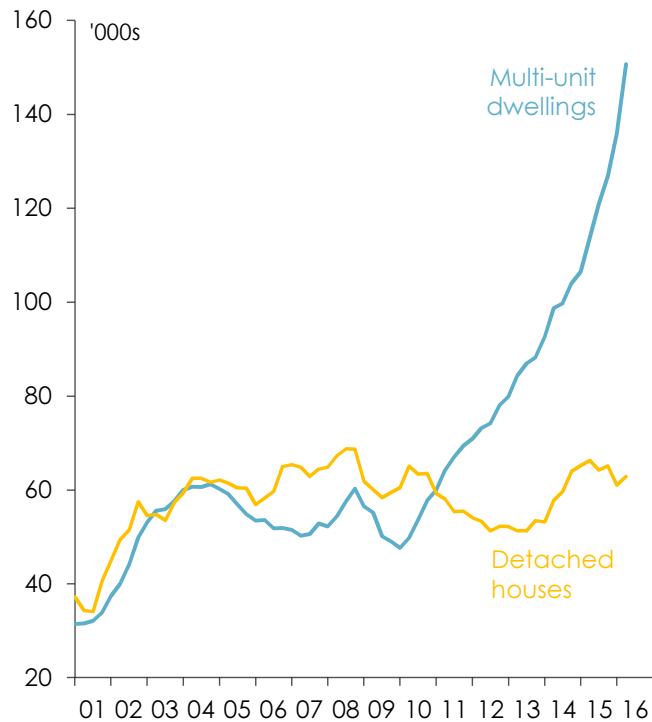
Approvals of 'other dwellings', by size



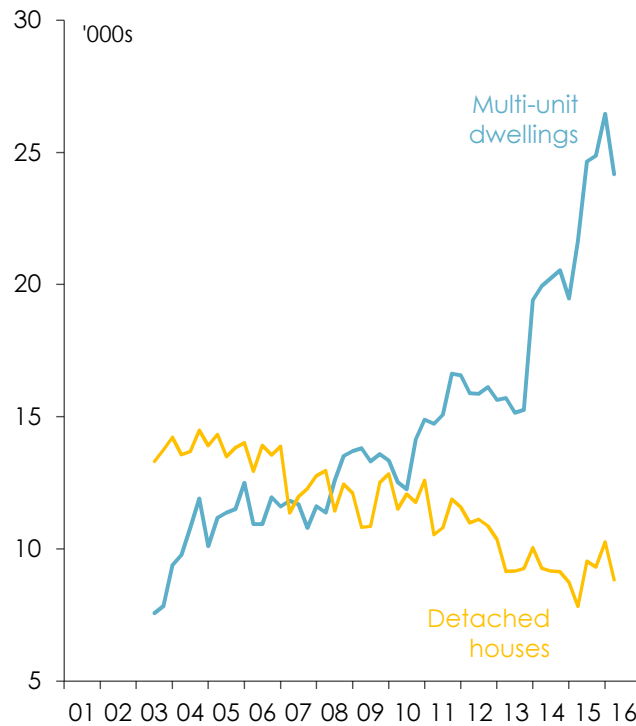
Note: grey lines in first and second charts above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'.
Source: ABS.

There is a considerable pipeline of work yet to be started, or completed, on multi-unit residential building

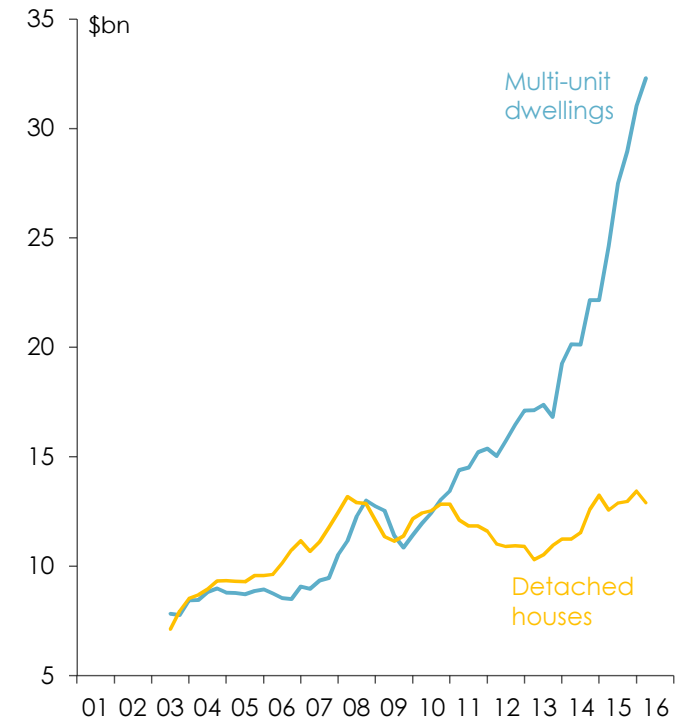
Residential buildings under construction



Residential building approved but not yet commenced



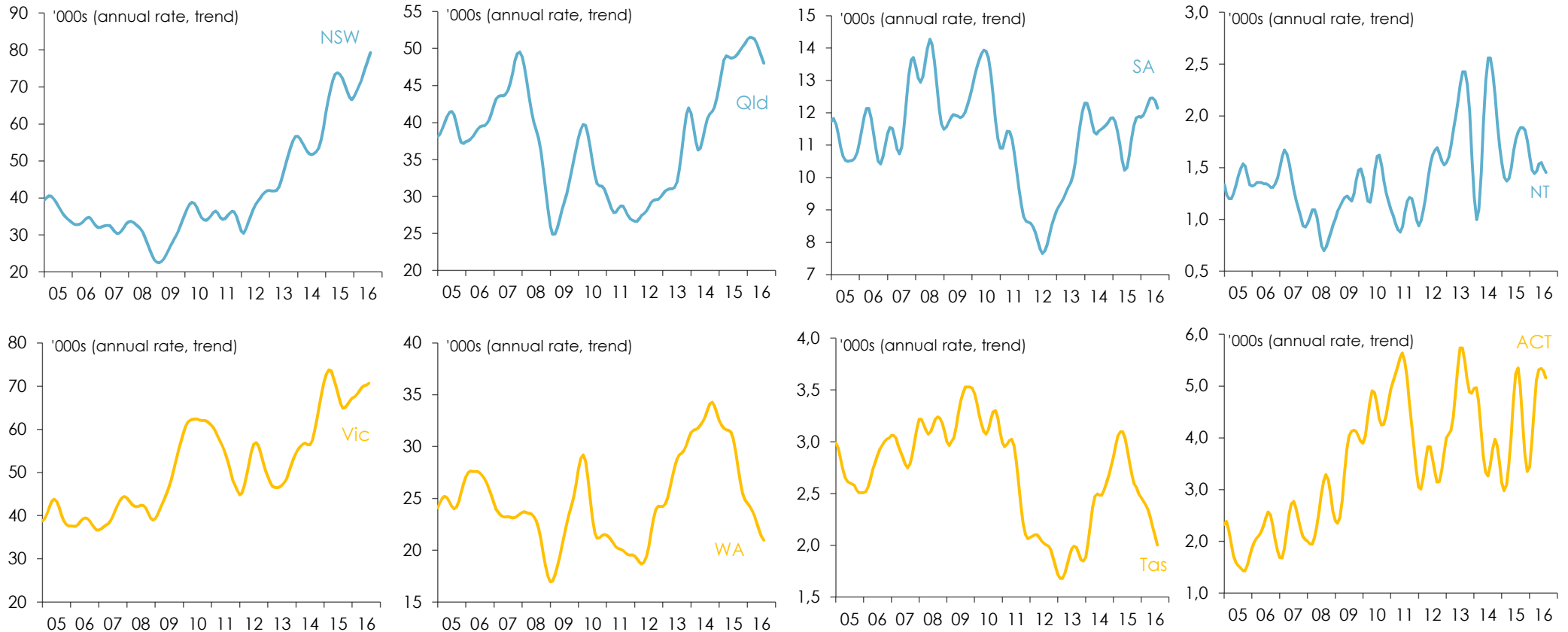
Value of residential building work yet to be done



Note: Data are for private sector projects only.
Source: ABS.

Housing activity has fallen sharply in WA and Tasmania, probably peaked in Qld but is still rising in NSW, Victoria and SA

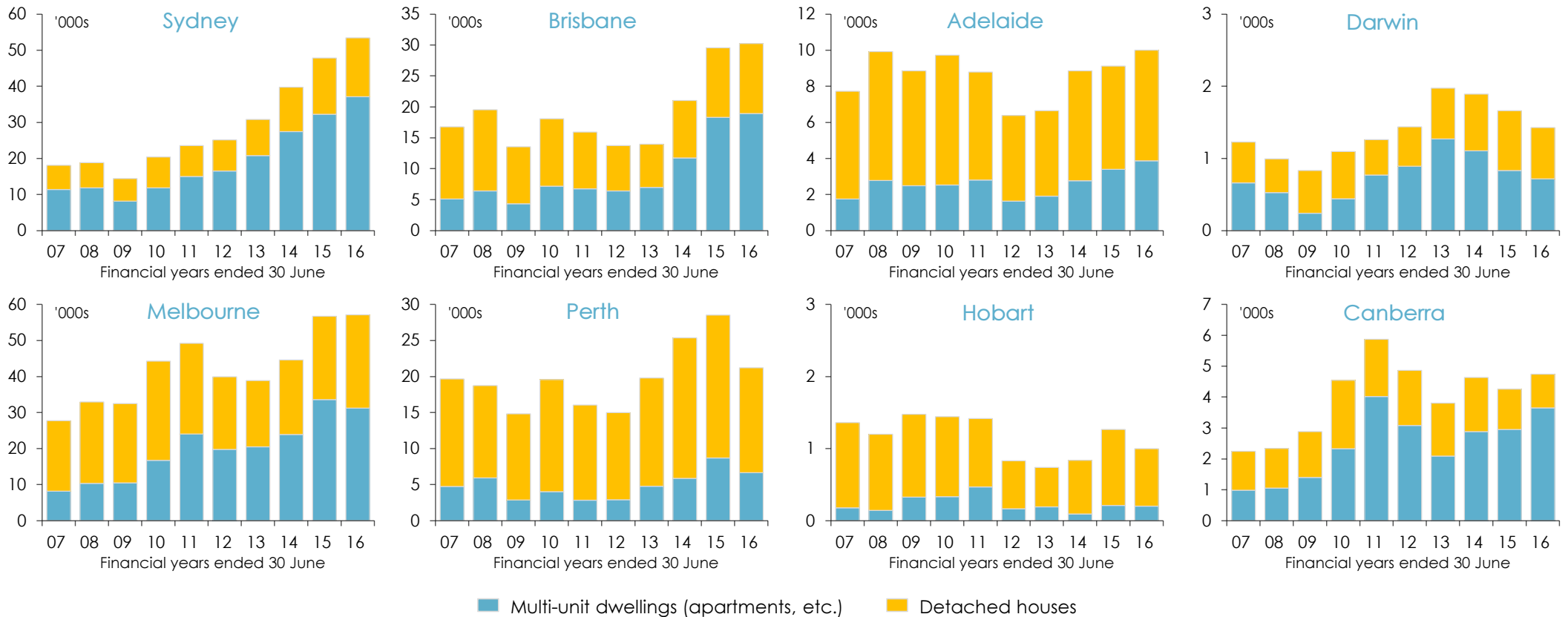
Residential building approvals by State and Territory



Source: ABS.

Apartments are now the dominant form of new housing in Canberra, Sydney, Brisbane, Melbourne and Darwin

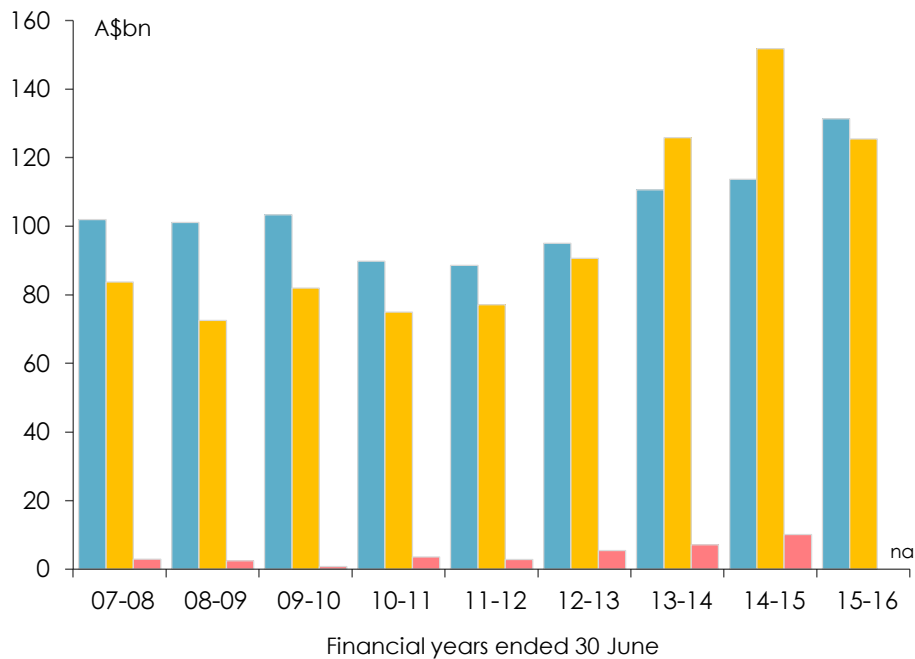
Capital city residential building approvals, by type



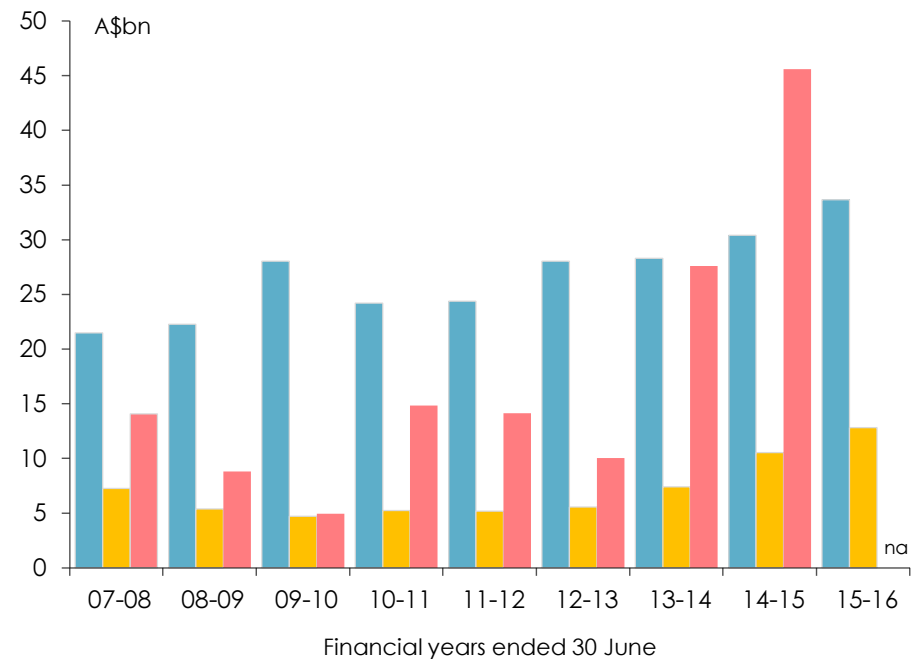
Source: ABS.

Foreign investors appear to have been financed more new dwelling construction than domestic investors in recent years

Financing of the purchase of established dwellings



Financing of the purchase of new dwellings

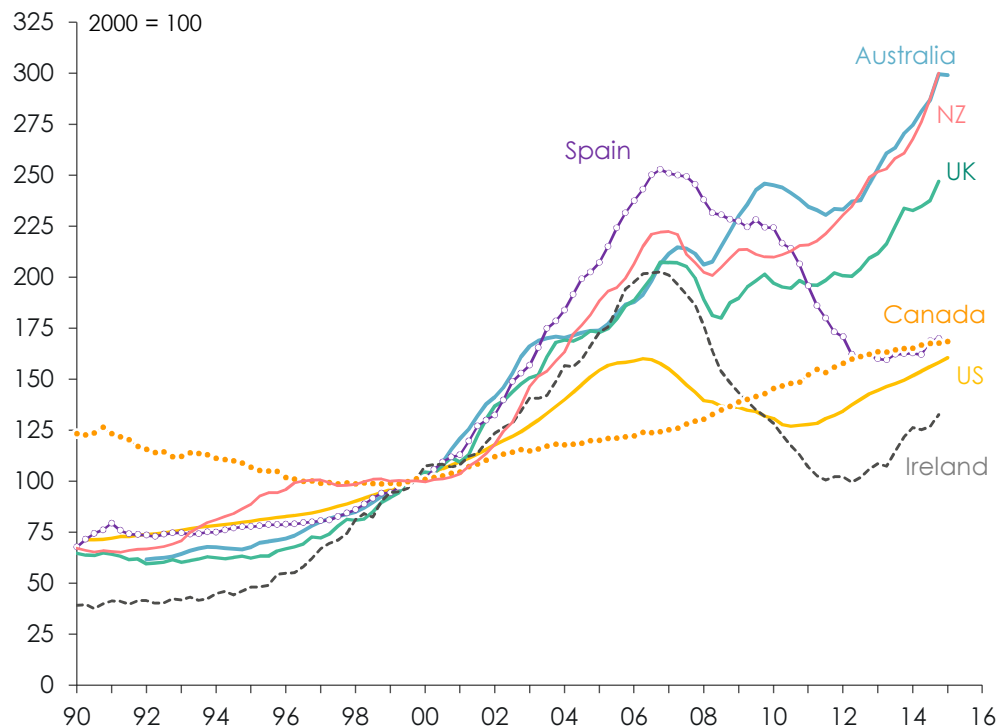


■ Australian owner-occupiers (borrowing)
 ■ Australian investors (borrowing)
 ■ Foreigners (FIRB approvals)

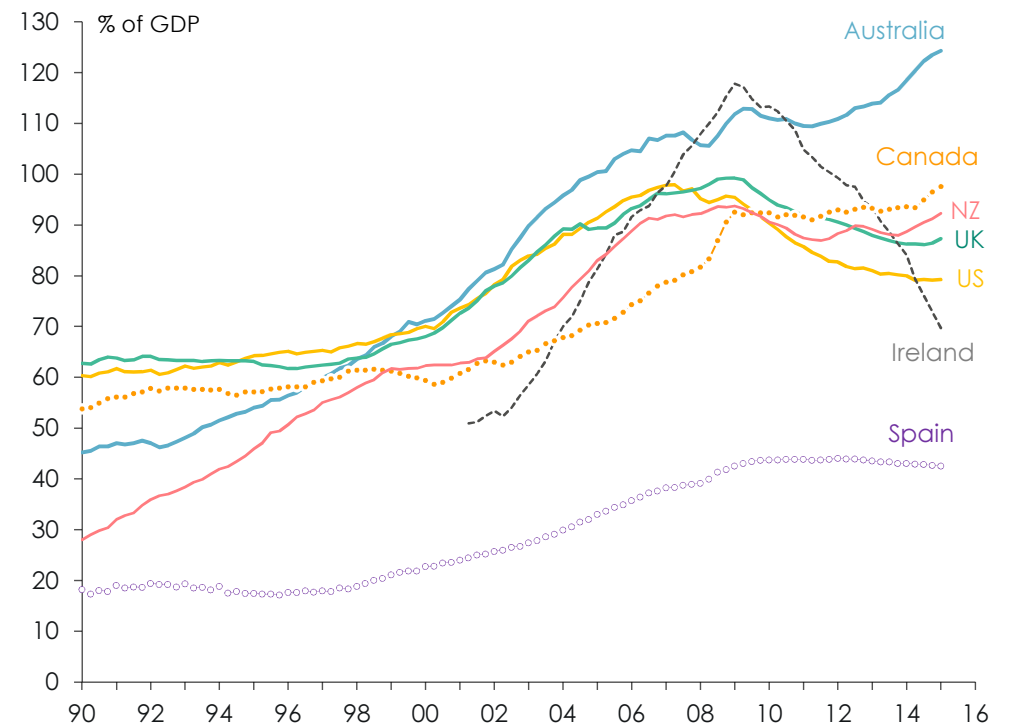
Note: Data for Australian purchases are for borrowing only (ie exclude deposit or other equity). Data on foreign purchases are FIRB approvals granted in the year indicated, which may not be the same year as that in which purchase occurs (if it does at all). *Sources:* ABS; Foreign Investment Review Board (FIRB) Annual Reports.

Australia now has relatively high residential property prices (by international standards) and very high levels of household debt

House prices – Australia vs other 'advanced' economies



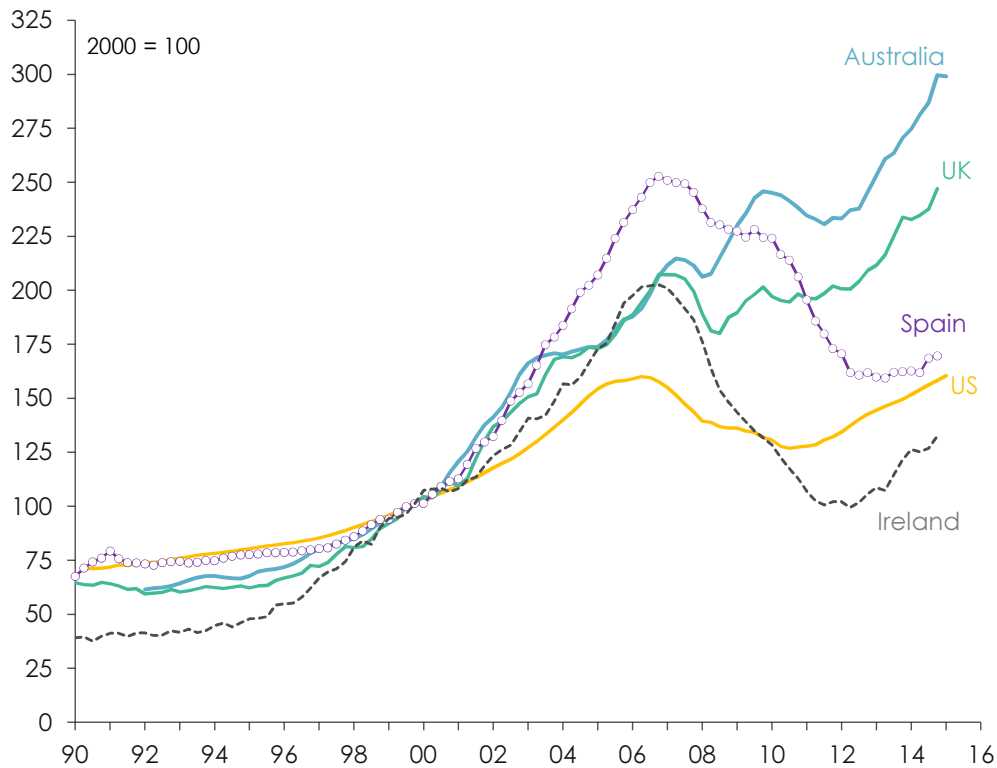
Household debt – Australia vs other 'advanced' economies



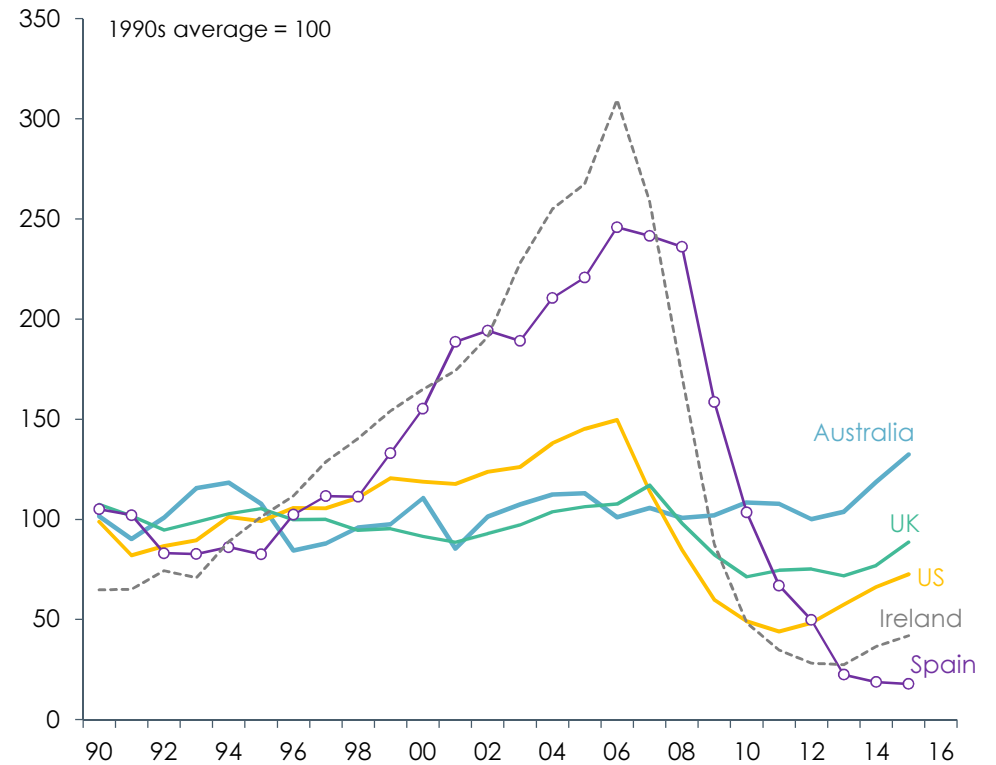
Sources: RP Data-CoreLogic; S&P; Bank for International Settlements (BIS).

Overseas experience suggests that housing 'busts' occur when demand declines abruptly after an extended period of rapid growth in supply

House prices – Australia and other selected 'advanced' economies



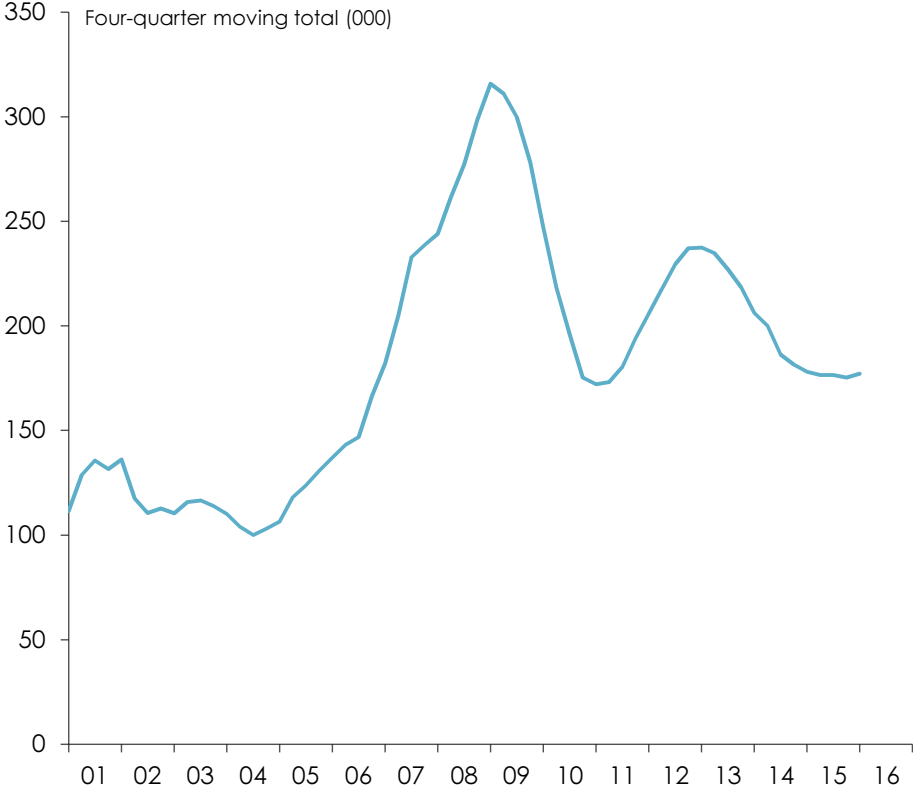
Housing completions – Australia and other selected 'advanced' economies



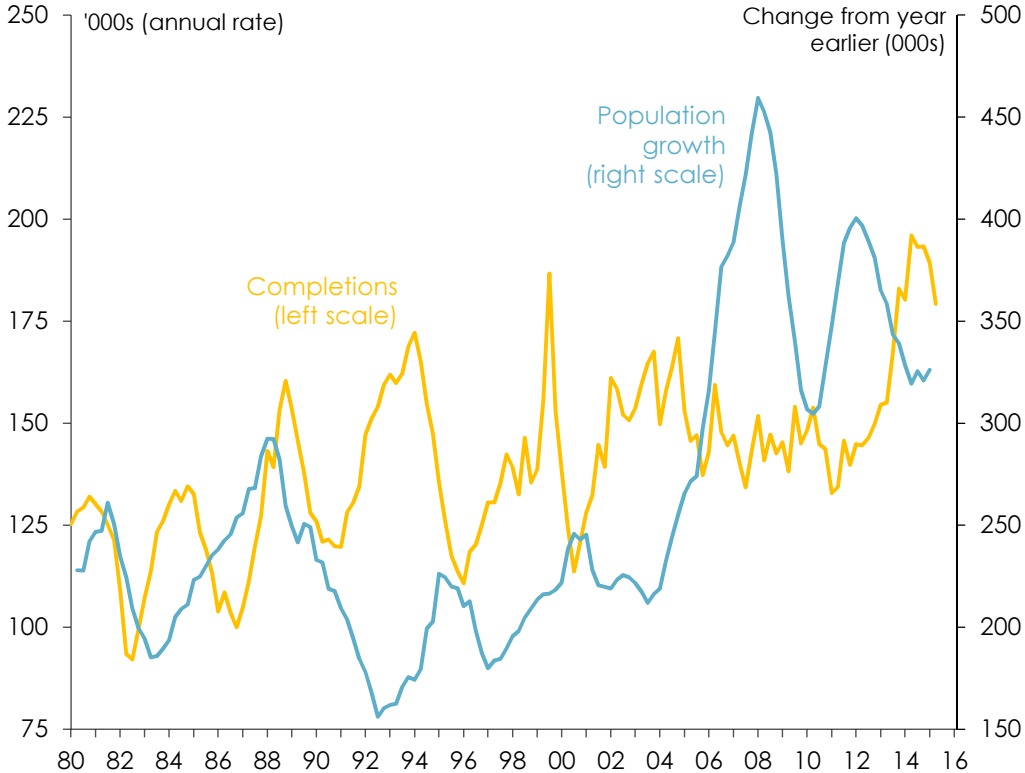
Sources: ABS; US Commerce Department; UK Office for National Statistics; Eurostat; CoreLogic; S&P; Bank for International Settlements;

The supply-demand balance in Australia's housing market could change quite significantly over the next three years

Net immigration to Australia



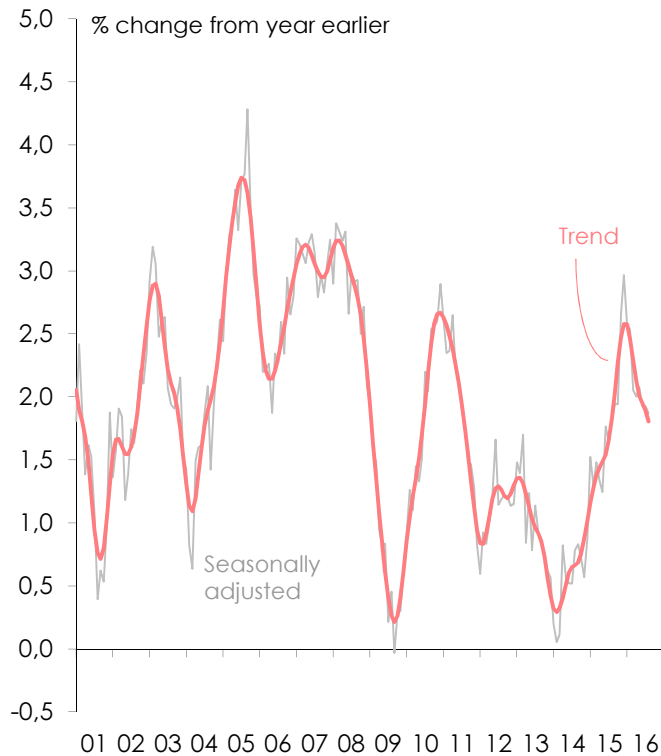
Housing completions vs population growth



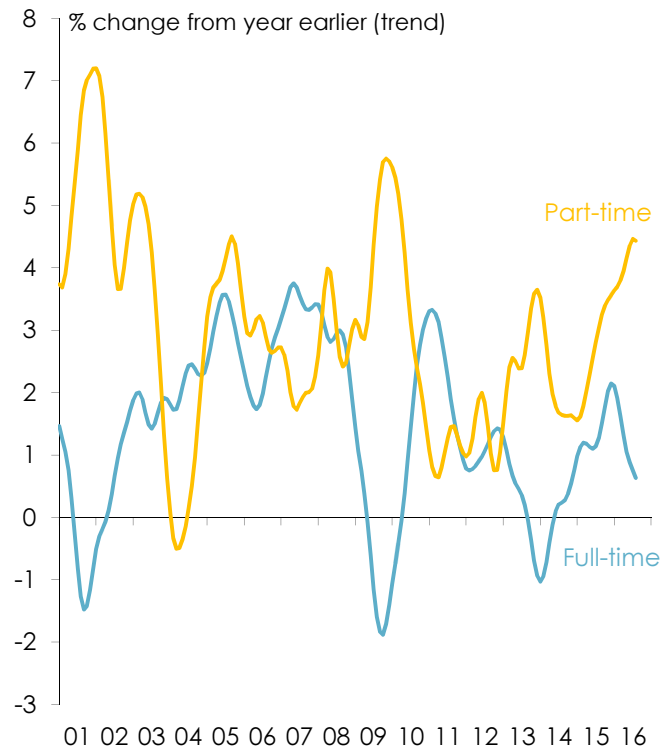
Source: ABS.

Employment growth has picked up, but much of it has been part-time – which combined with low wages growth implies weak income growth

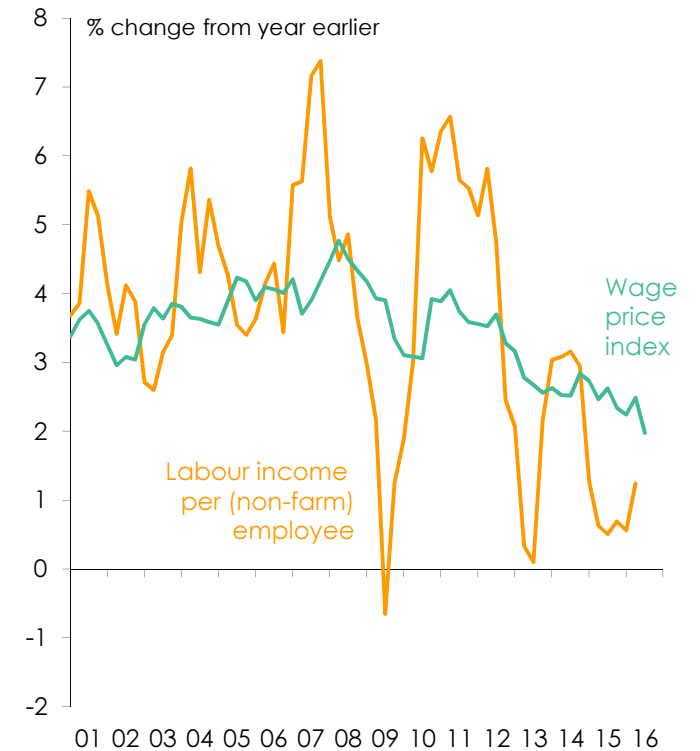
Employment



Full-time vs part-time employment



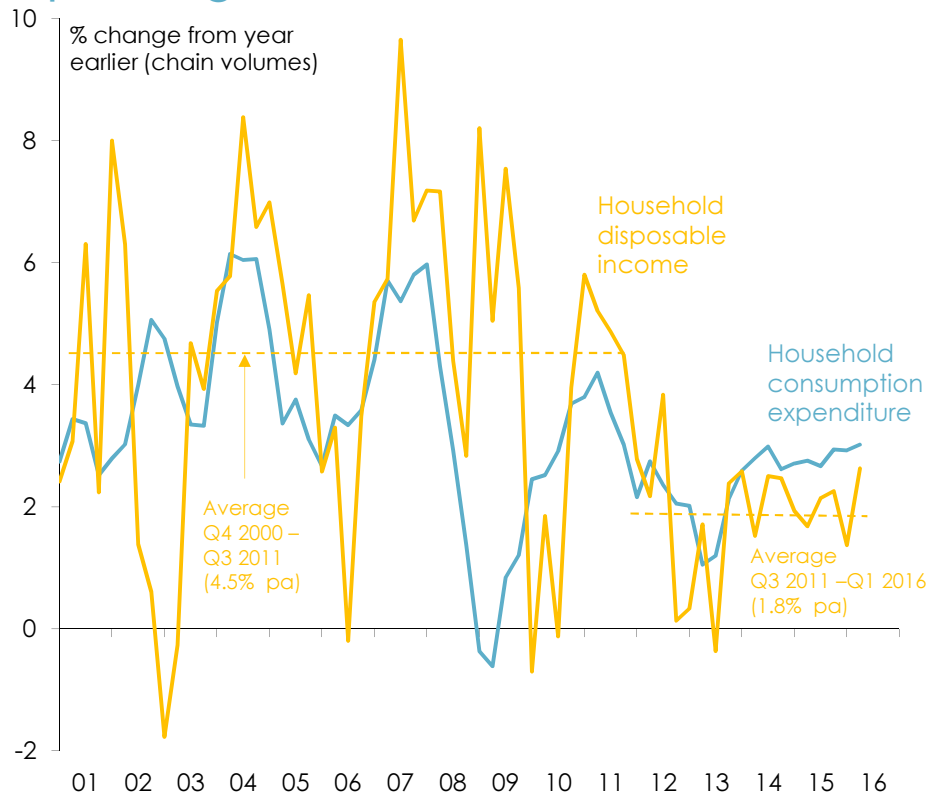
Wages growth



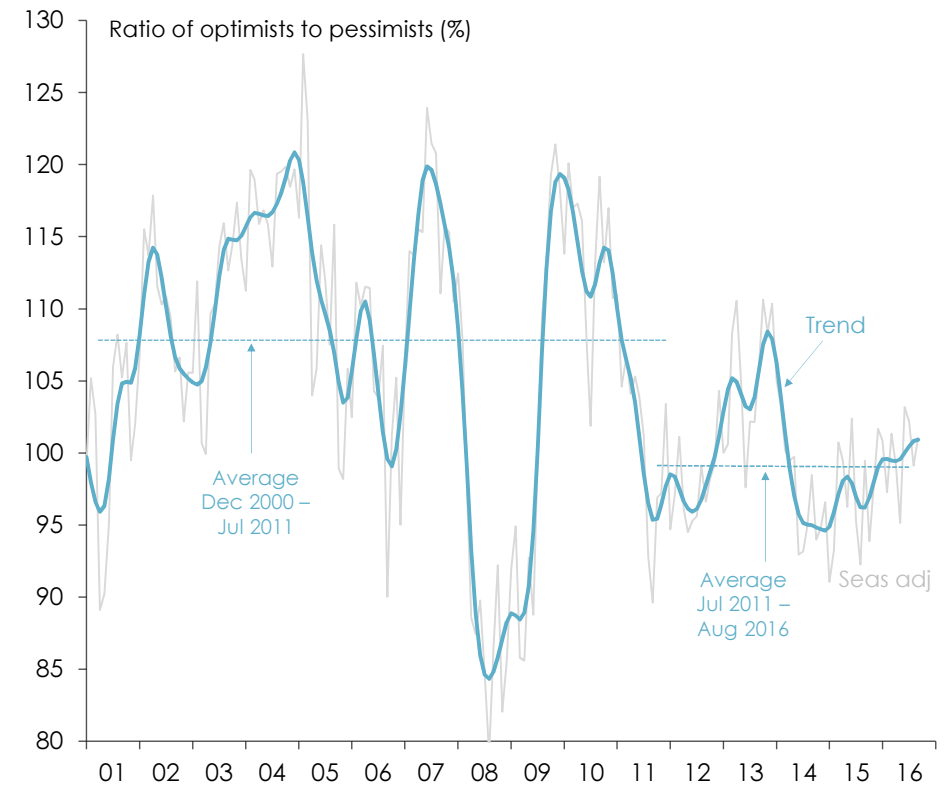
Source: ABS.

Slow growth in household disposable income has weighed on consumer confidence and spending

Real household disposable income and spending



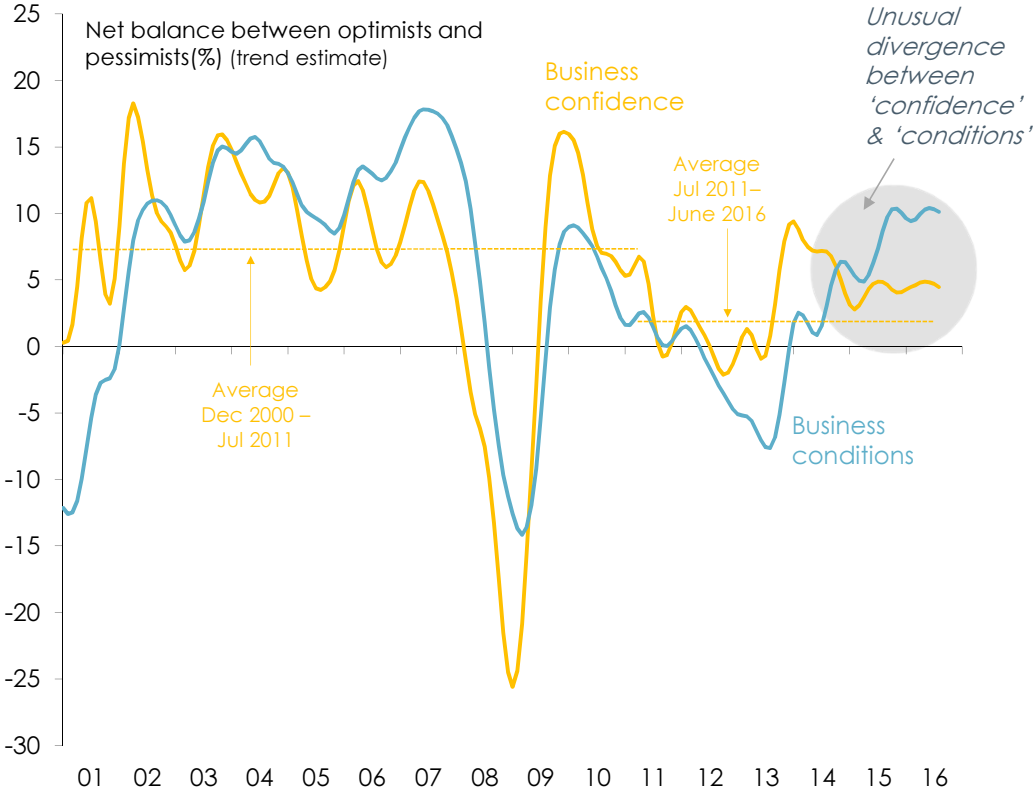
Consumer confidence



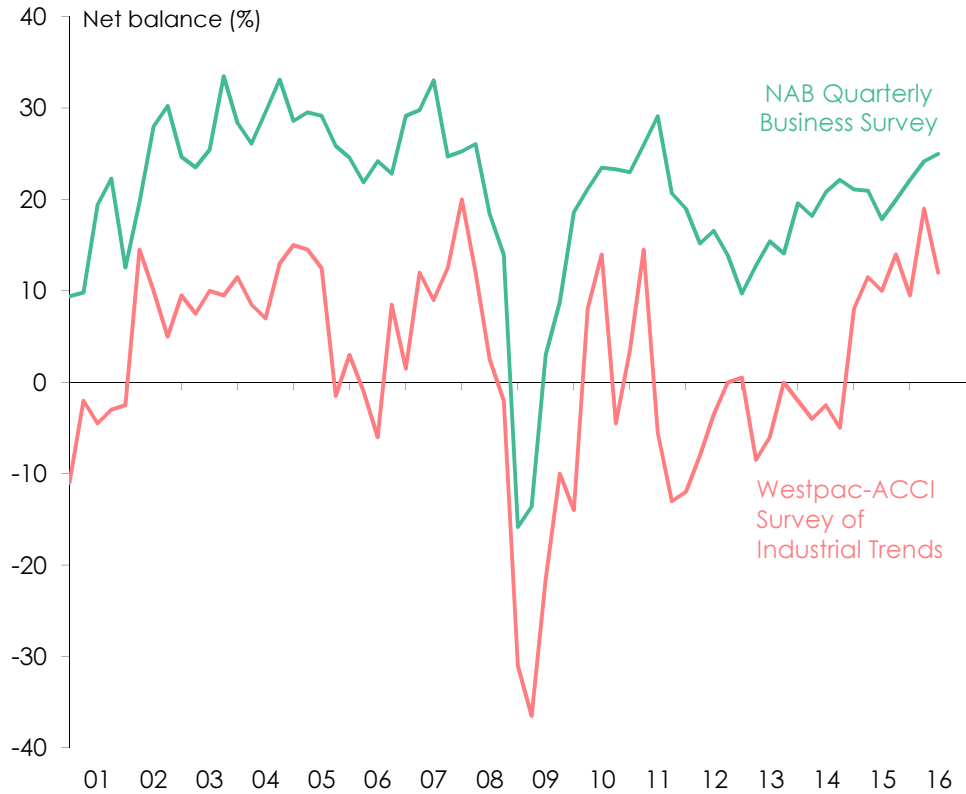
Source: ABS.

Persistently weak business confidence is probably undermining business investment intentions

Business confidence and conditions



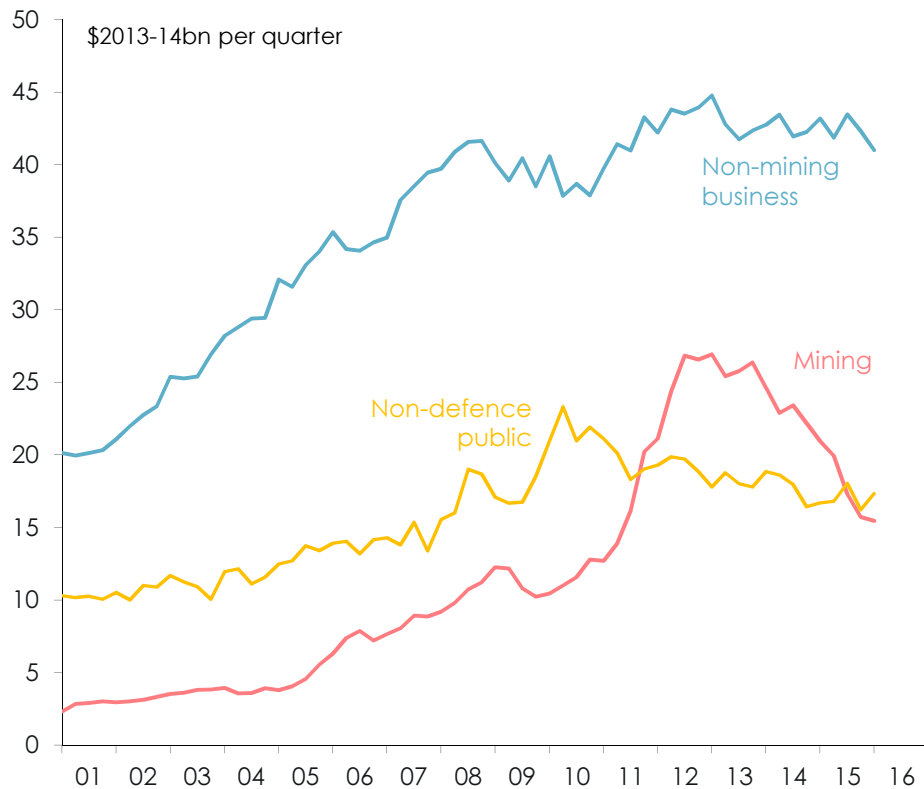
Business survey capex intentions



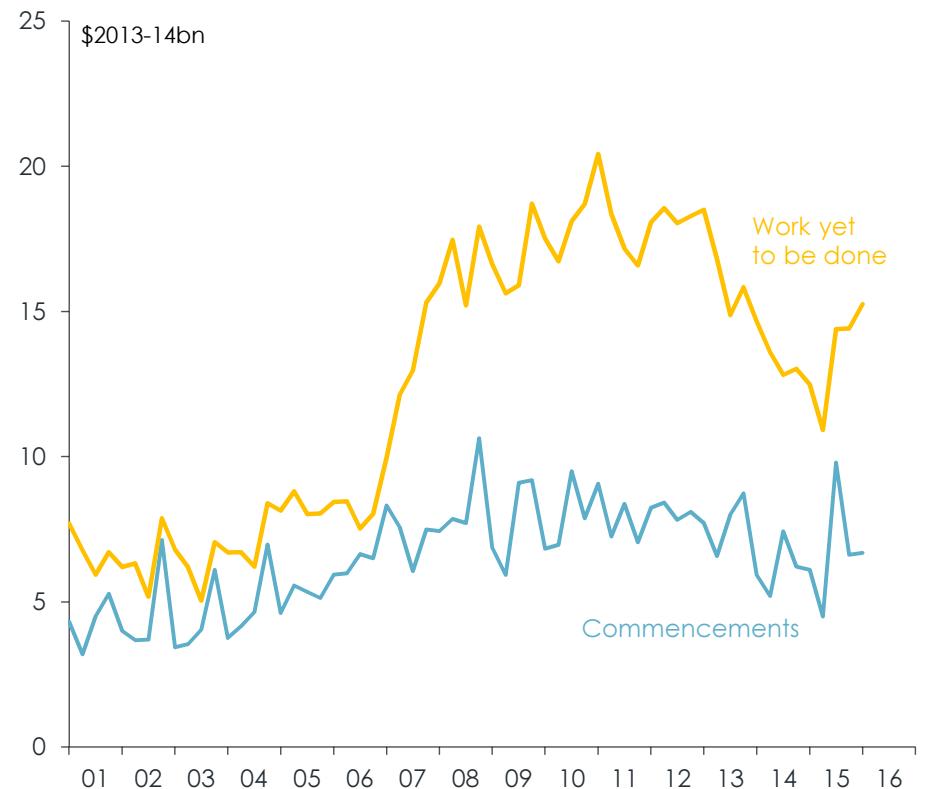
Source: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry

Improved business confidence would help lift non-mining business investment - infrastructure investment would help too

Capital investment, by sector



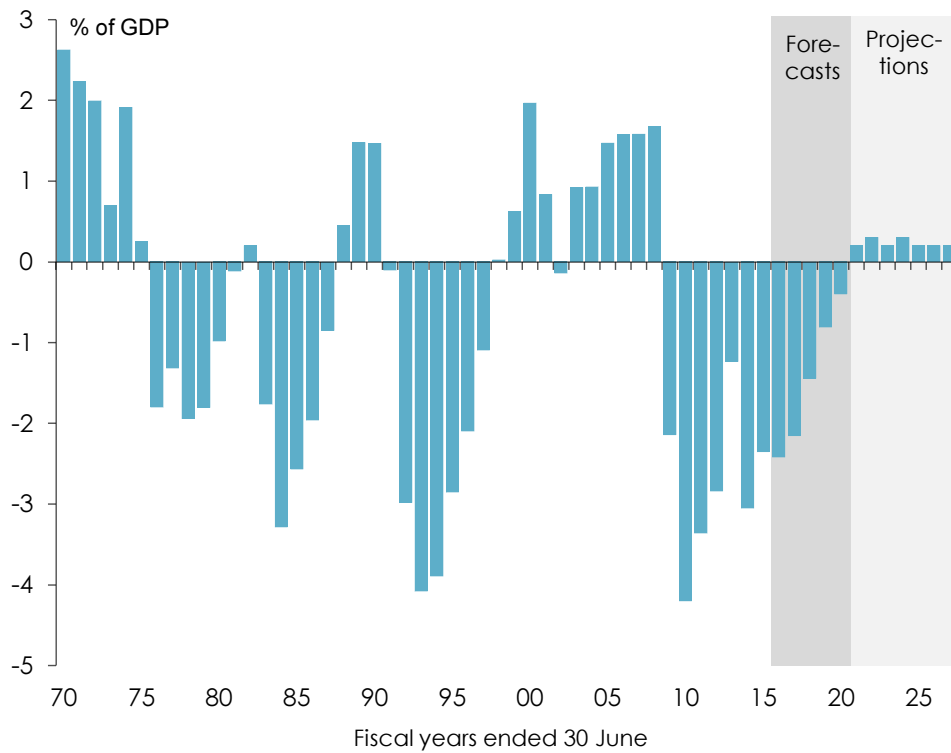
Public sector infrastructure spending



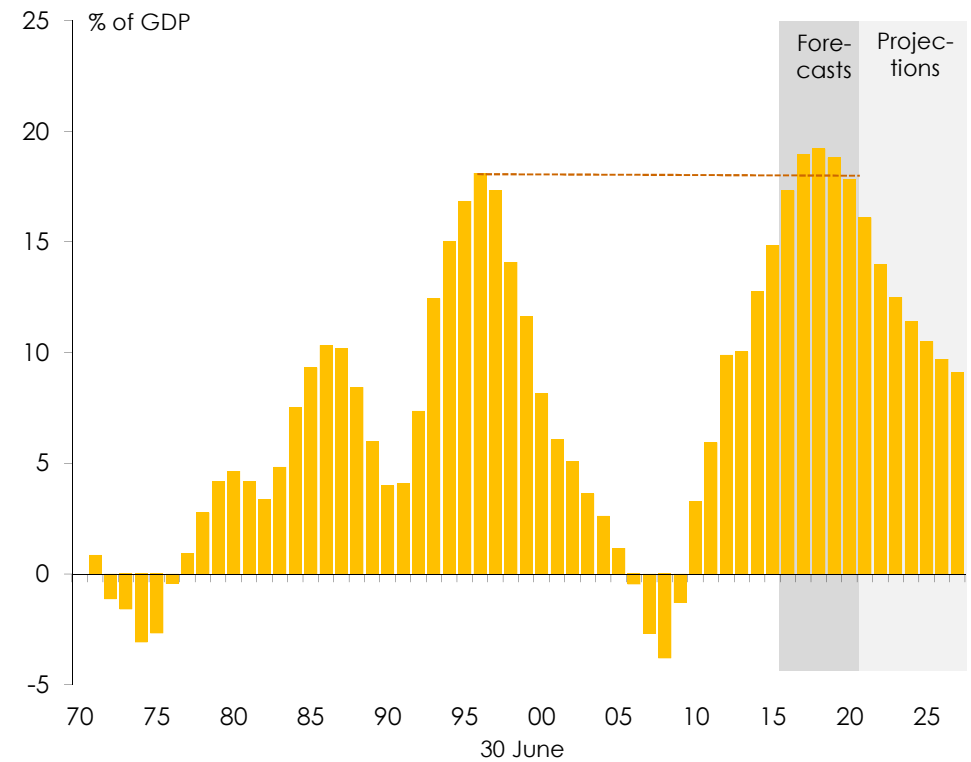
Note: Public sector infrastructure spending includes work done by the private sector for the public sector. Source: ABS.

Australia's longest-ever run of budget deficits isn't over yet

Australian Government 'underlying' budget balance



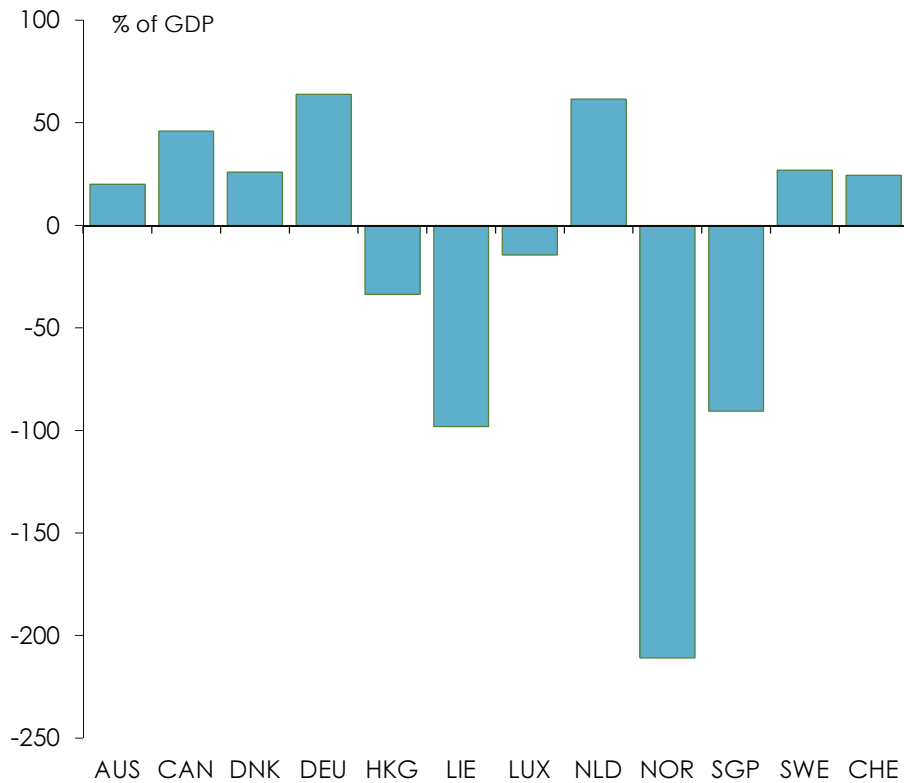
Australian Government net debt



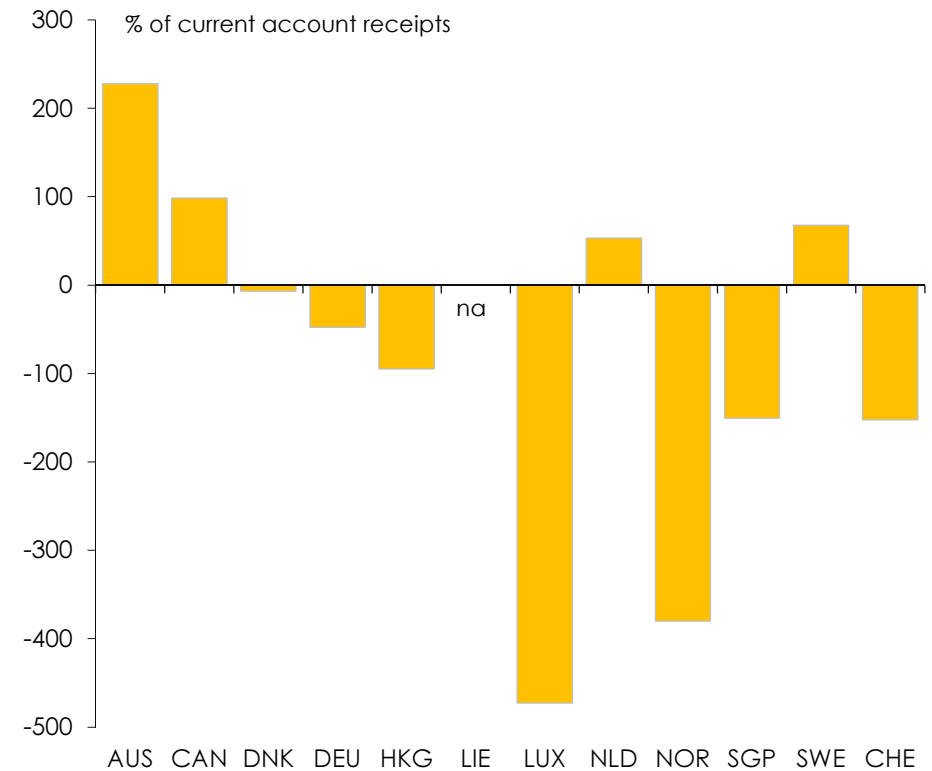
Source: Australian Government, 2016-17 Budget Paper No. 1.

Australia's public sector debt is still quite low - but Australia has a lot of foreign debt by comparison with other AAA-rated countries

'General government' net debt – AAA-rated countries, 2016



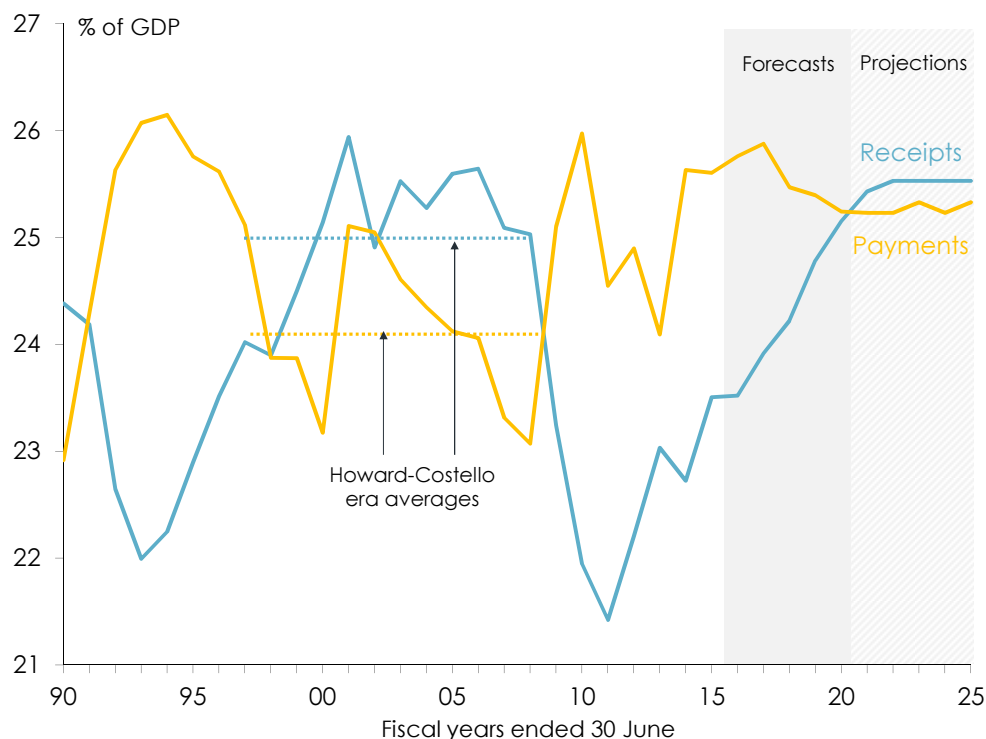
Net foreign debt – AAA-rated countries, 2016



Note: DEU = Germany; LIE = Liechtenstein; LUX = Luxembourg; NLD = Netherlands; CHE = Switzerland.
Source: Standard and Poor's.

Australia has a revenue problem, as well as a spending problem – and the Government doesn't have much of a mandate to fix either of them

Federal government spending and revenue as pc of GDP



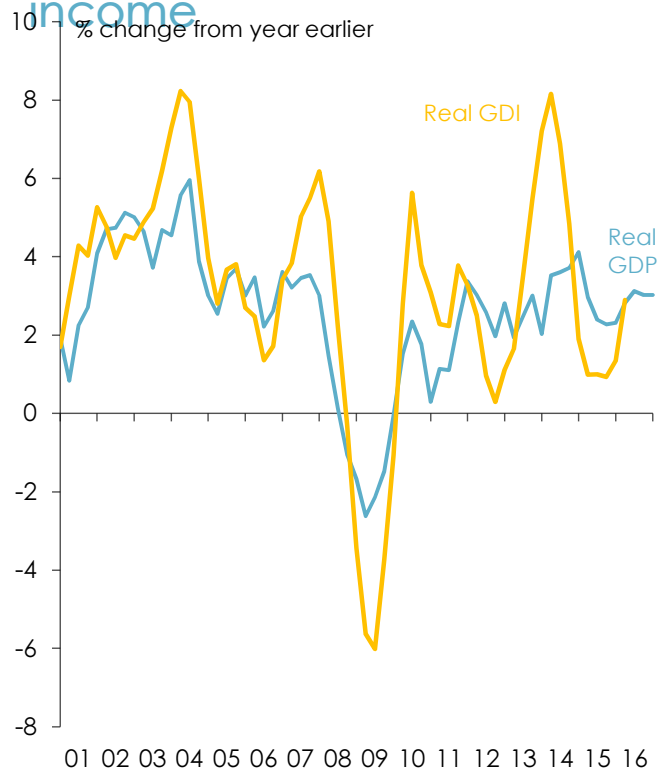
Source: Australian Government, 2016-17 Budget Paper No 1, *Budget Strategy and Outlook*.

- ❑ Government spending in 2016-17 is forecast to be almost 1 pc pt of GDP above the average for the Howard-Costello years, while revenues will be more than 1 pc pt of GDP below the Howard-Costello average
- ❑ More than three-quarters of the projected improvement in the budget bottom line between 2016-17 and 2020-21 comes from increased revenues – and that in turn depends on optimistic assumptions about growth, and 'bracket creep'
- ❑ The Government didn't seek – and hasn't received – a mandate for significant spending cuts or revenue reforms, apart from the company tax cuts which it will have difficulty getting passed by the Senate
- ❑ The National Party now has a more powerful position within the Coalition, the Coalition has a weaker position in the House of Representatives, and protectionists & populists have a more powerful position in the Senate – none of which augurs well for good economic policy

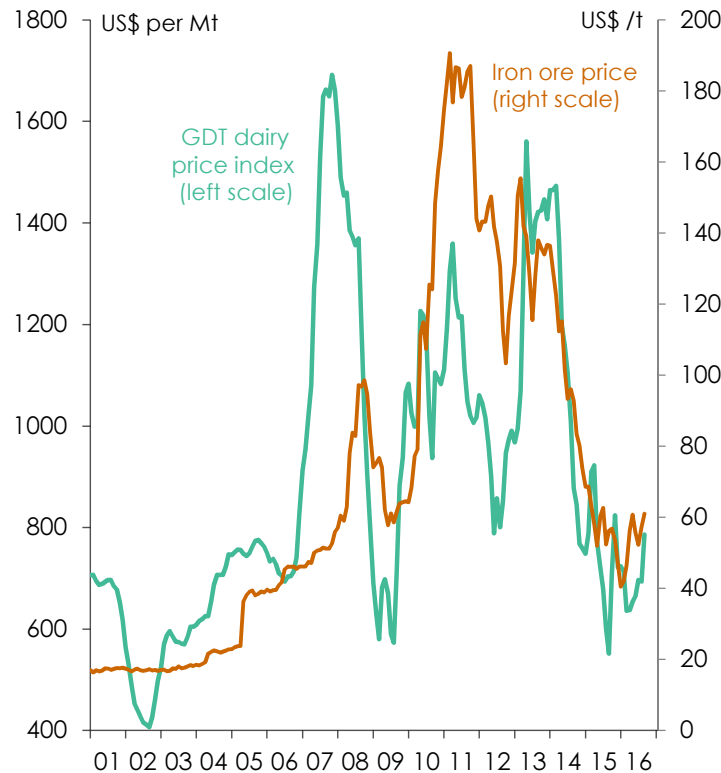
New Zealand

New Zealand is fairly successfully weathering the aftermath of its commodity boom

New Zealand real gross domestic product and income



Dairy product vs iron ore prices



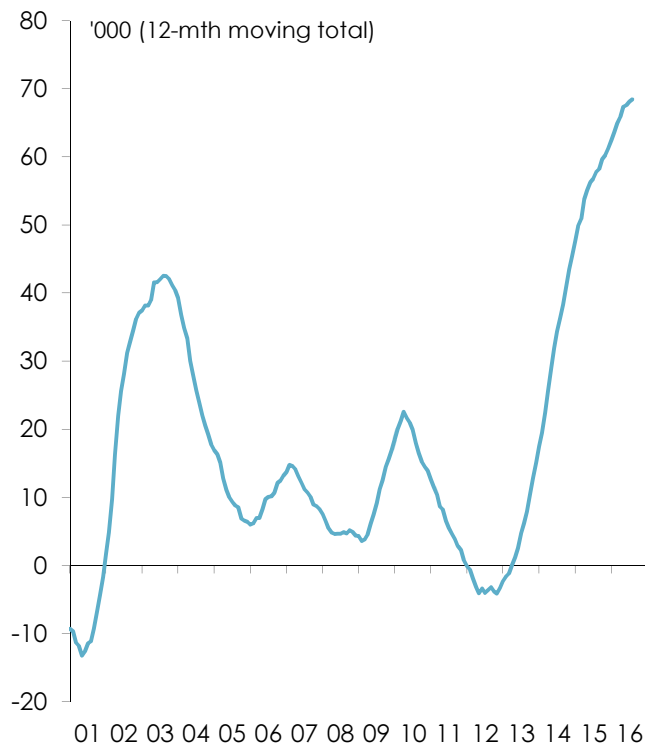
New Zealand unemployment rate



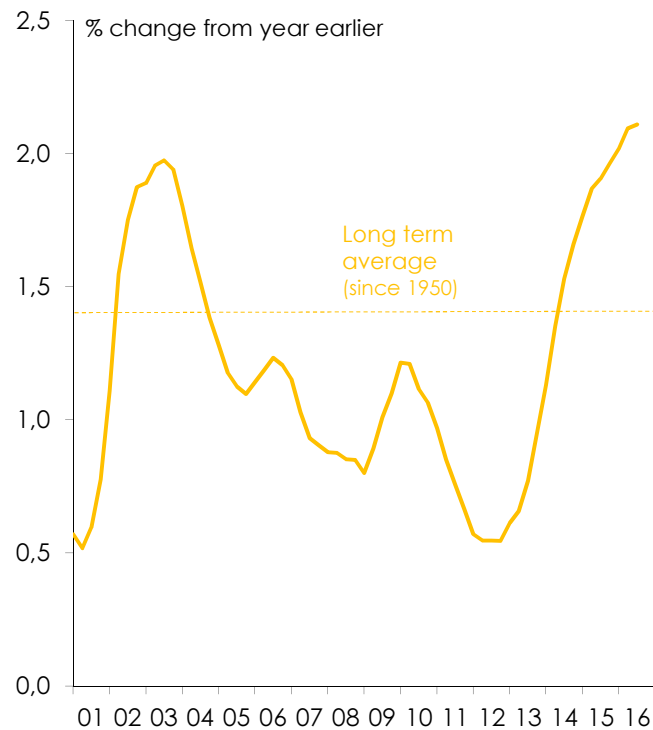
Note: Real gross domestic income (GDI) is real GDP plus net income gains (or losses) arising from changes in the terms of trade (the ratio of export to import prices).
Sources: Statistics NZ; Global Dairy Trade; Thomson Reuters Datastream.

New Zealand is also experiencing an almost unprecedented surge in immigration - and a tourism boom

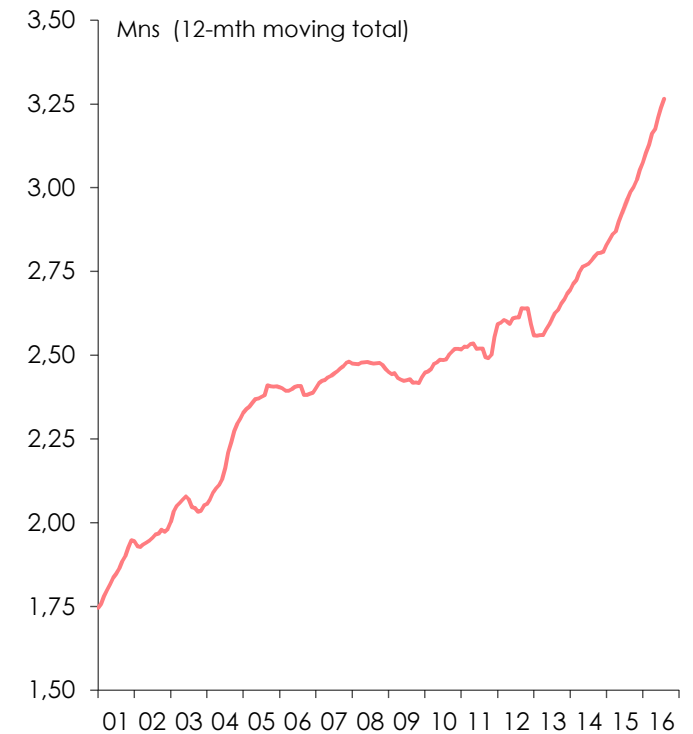
Net long-term and permanent immigration to New Zealand



New Zealand population growth



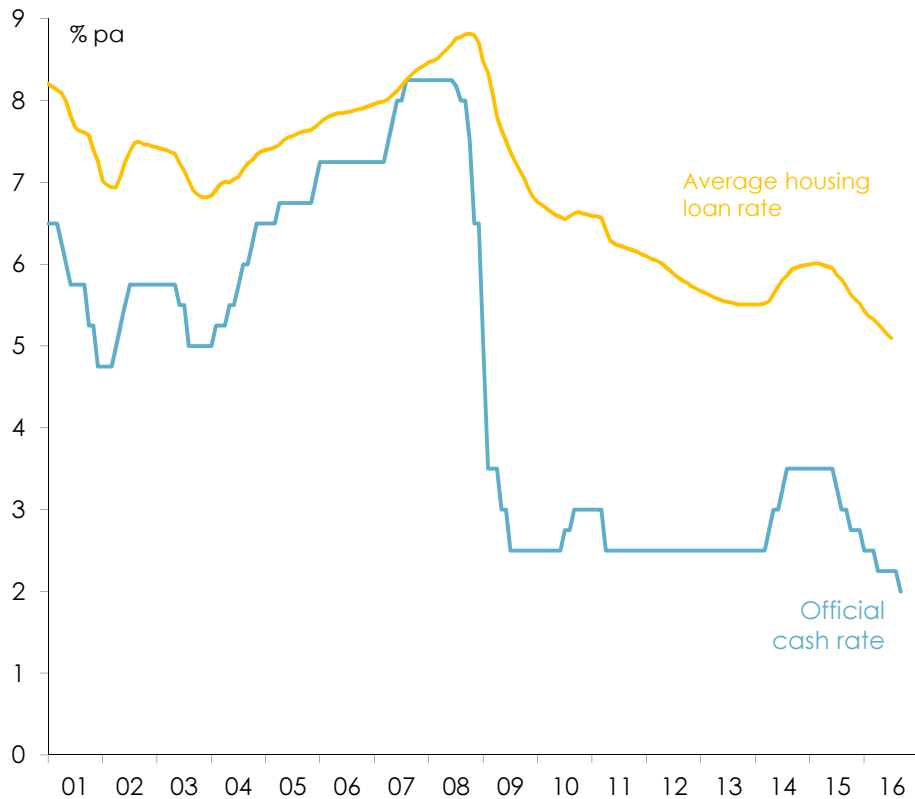
New Zealand short-term overseas visitor arrivals



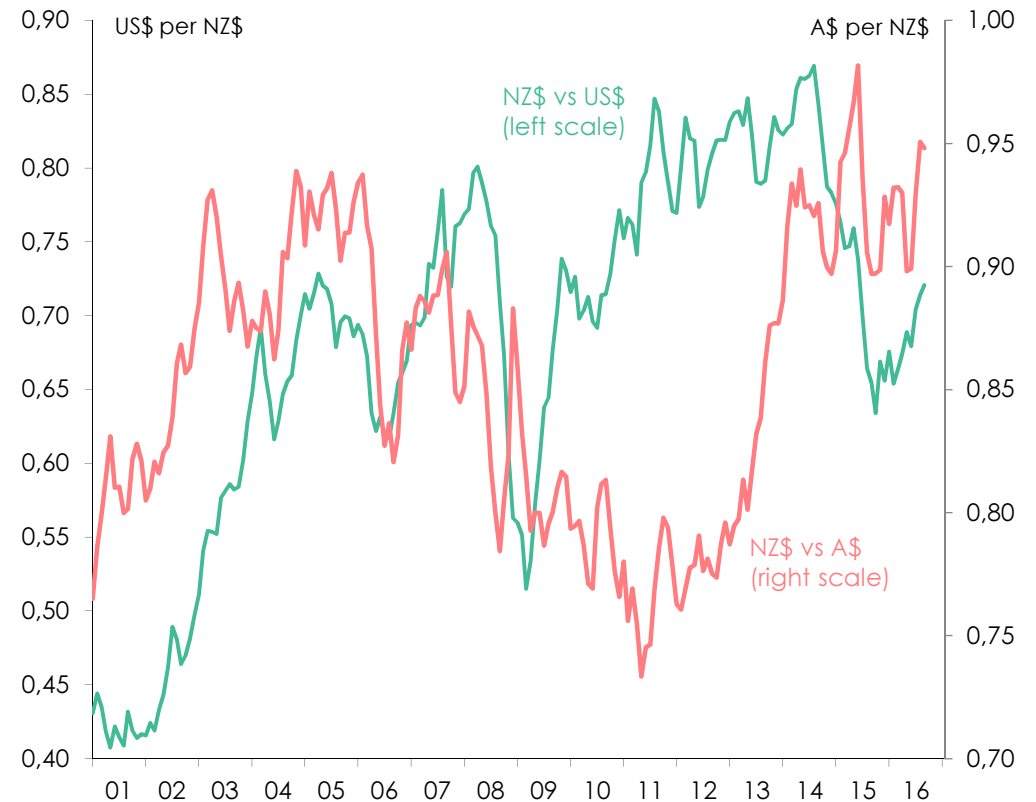
Source: Statistics NZ.

New Zealand interest rates are also now at record lows – although the NZ has remained stubbornly strong

New Zealand interest rates



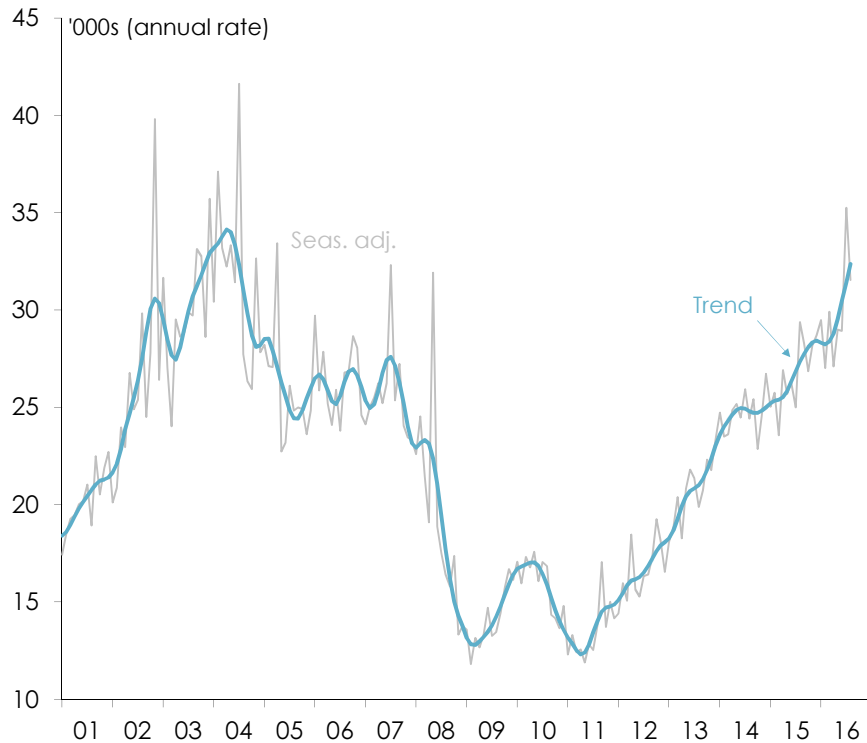
New Zealand dollar



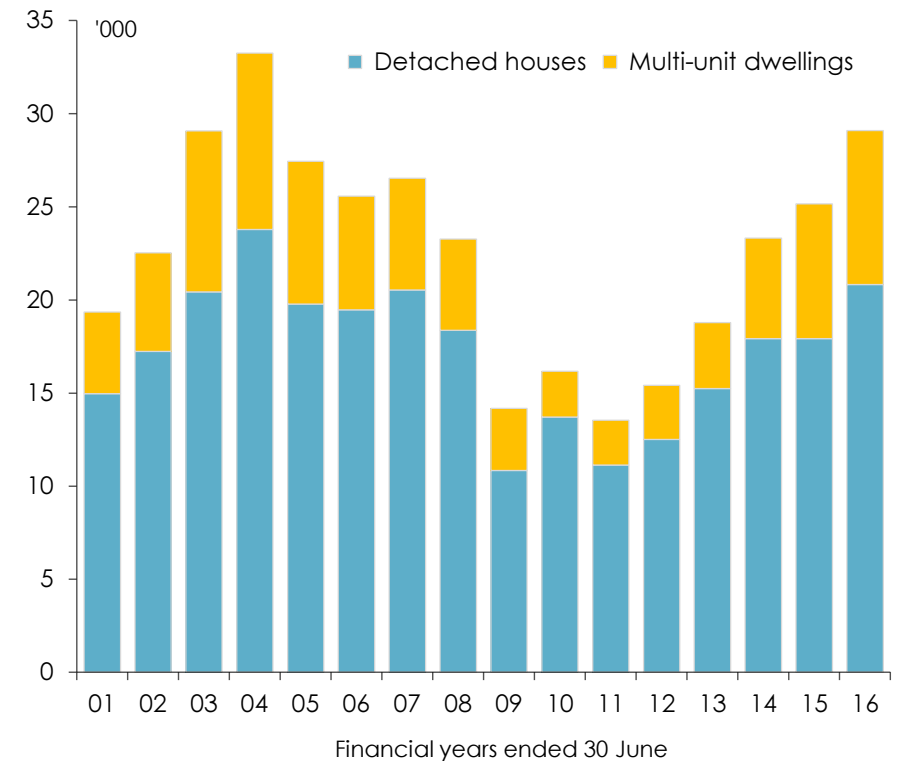
Source: Reserve Bank of New Zealand; Thomson Reuters Datastream.

Not surprisingly New Zealand is experiencing a housing construction boom - but unlike in Australia most of it is in detached dwellings

Dwelling consents (residential building approvals)



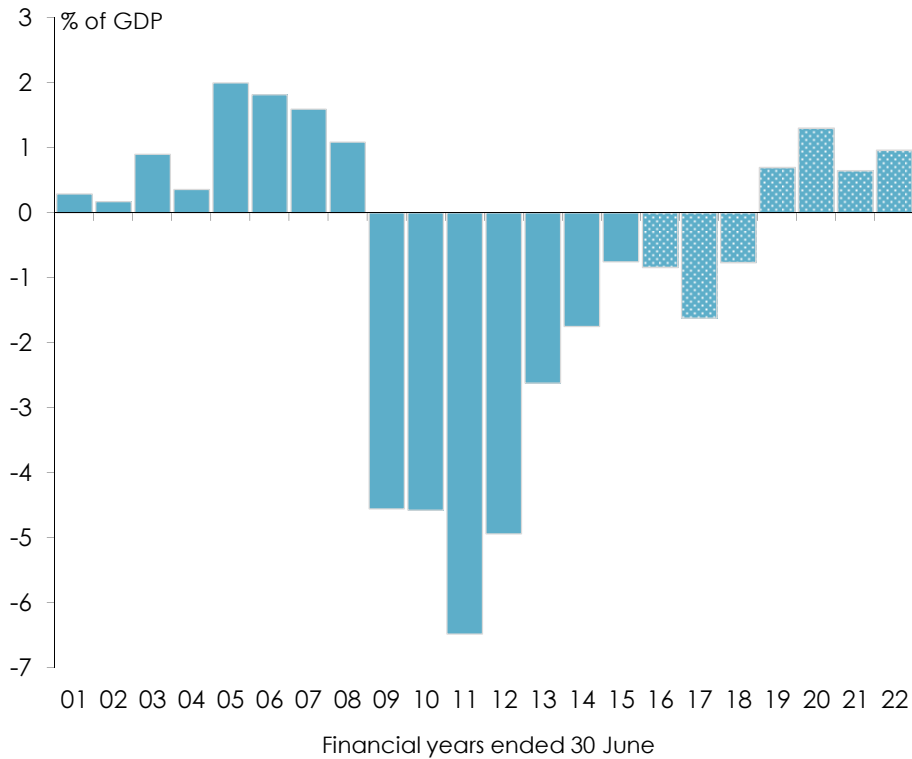
Dwelling consents by category of building



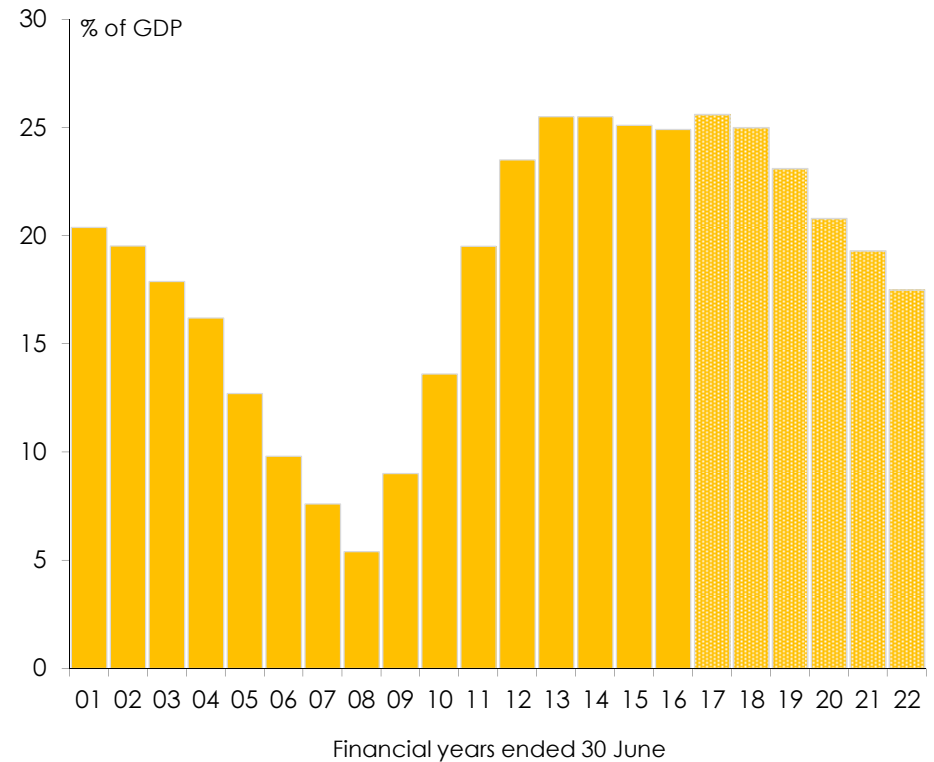
Source: Statistics New Zealand.

Something which New Zealand has and Australia doesn't is a competent, popular government

New Zealand Government 'residual cash balance'



New Zealand Government 'core Crown net debt'



Source: New Zealand Treasury

Questions?

bettercallsaul.com.au

SAUL ESLAKE

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