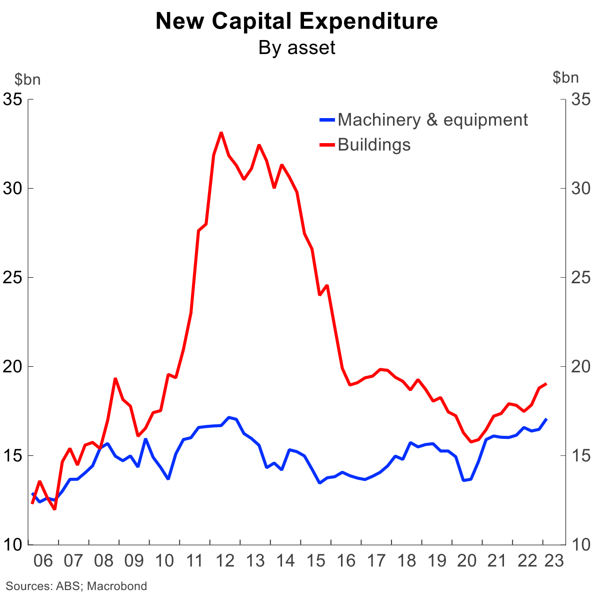
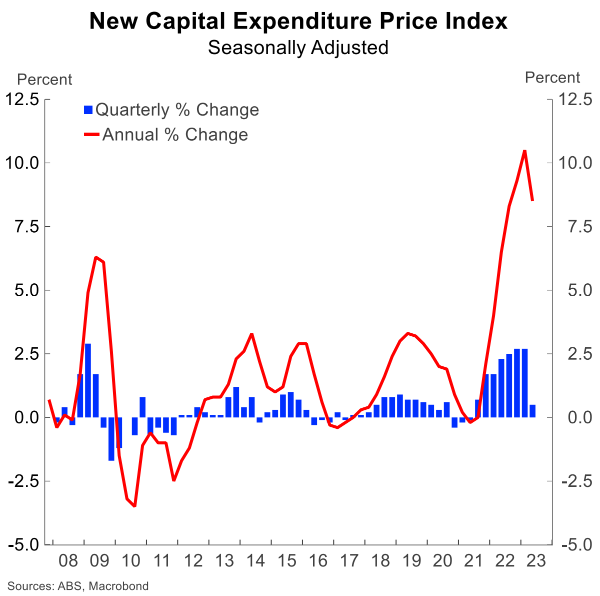
Private Capital Expenditure

Disinflationary Impulse Has Arrived!

- **New private capital expenditure (capex) jumped 2.4% in the March quarter. The December quarter was revised up to 3.0% from the initial estimate of 2.2%. Investment in machinery and equipment jumped 3.7% over the quarter, while new buildings increased by 1.3%.**
- **While the volume of investment grew strongly, the actual value invested slowed. The prices of these investment goods are showing clear signs of decelerating. In fact, prices of investment goods increased by 0.5% over the quarter – the slowest rate since March quarter of 2021 and much lower than the average rate of 2.2% recorded over the past six quarters.**
- **This suggests that the disinflationary impulse from the resolution of supply-chain disruptions has arrived. It will take time for this to flow through to domestic prices, but the scene is set for inflation to continue to ease over 2023.**
- **Capex spending could increase by 13.1% to $161.1bn in 2022-23, and by 1.7% to $163.8bn in 2023-24, if we adjust survey outcomes in line with historical norms.**
- **However, if we adjust using the realisation ratio from the most recent RBA tightening cycle (2010-11), capex would increase by 10% to $156.6bn in 2022-23, <u>and would fall by 1.9% to $153.7bn in 2023-24. Using either method, capex is expected to be weak in 2023-24.</u>**
- **The price of investment goods eased significantly over the quarter which is encouraging businesses to invest and source investment goods that have been unavailable. Looking ahead, capex is expected to be weak in 2023-24, with the outlook softening since last quarter's capex survey.**





Actual Spending

New private capital expenditure (capex) jumped 2.4% in the March quarter. The December quarter growth outcome was revised up to 3.0%, from the initial estimate of 2.2%.

The robust outcome was driven by investment in machinery and equipment, which jumped 3.7% over the Mach quarter. This comes on the back of the soft 0.6% outcome recorded over the December quarter.

Non-mining **investment in machinery and equipment** rose 3.4% in the quarter. Mining investment in machinery and equipment rose 5.2% in the quarter following a fall of 3.7% last quarter.

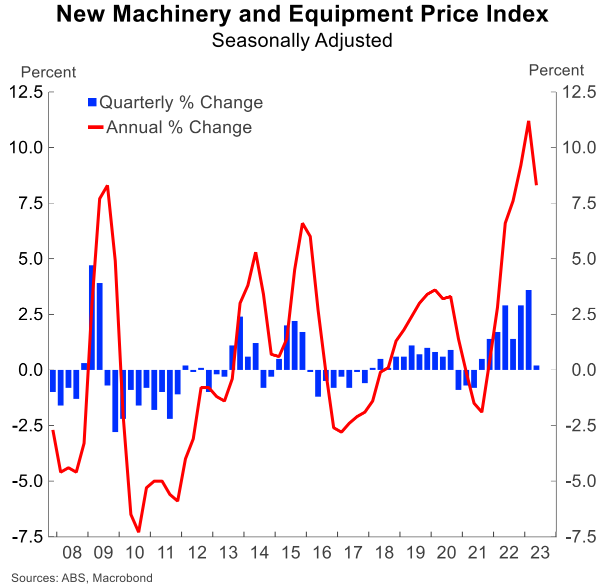
Businesses may be responding to the deceleration in prices and greater availability of machinery and equipment which has resulted from the resolution of supply-chain disruptions, particularly after China's reopening. Furthermore, the generous instant asset write-off and loss carry-back schemes are likely to support machinery and equipment spending until expiry on 30 June this year.

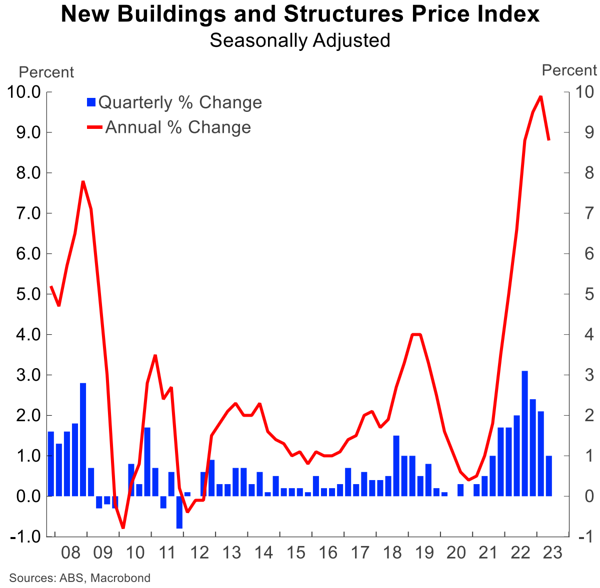
Investment in new buildings jumped 1.3% from the upwardly revised growth of 5.3% (from 3.6%) recorded last quarter. Non-mining **investment in buildings and structures** rose 2.0% in the quarter, following an increase of 4.7% last quarter. Mining investment in buildings and structures rose 0.3% in the quarter following an increase of 6.3% last quarter. The greater availability of materials and greater labour supply from the record increase in net overseas arrivals is helping to reduce price pressures and is supporting increased investment.

Prices of investment goods

While the volume of investment grew strongly, the actual value invested slowed markedly. In nominal terms, capex spending grew by 2.9% over the quarter, down sharply from the 5.9% recorded over the December quarter.

This is because the prices of these investment goods are now showing clear signs of decelerating. <u>In fact, prices increased on average by 0.5% over the quarter – the slowest rate since March 2021 and much lower than the average quarterly rate of 2.2% recorded over the past 6 quarters.</u>





<u>The prices of machinery and equipment increased by a minor 0.2% over the quarter, compared with an average quarterly growth of 2.3% over the past 6 quarters.</u> We import high share of our machinery and equipment. A higher exchange rate or a deceleration in global prices could underpin this outcome. On a trade-weighted basis, the Australian Dollar declined over the quarter,

which would have put upward pressure on these prices. The result was, therefore, driven by disinflation in global prices coinciding with China's reopening.

The price of buildings and structures increased by 1.0% over the quarter, compared with an average quarterly growth of 2.2% over the past 6 quarters. This possibly reflects the greater availability of construction resources and easing labour supply shortages. Though, price pressures remain elevated in this category.

By Industry

Spending rose 1.7% in the mining sector, while non-mining capex increased a more pronounced 2.7% in the quarter.

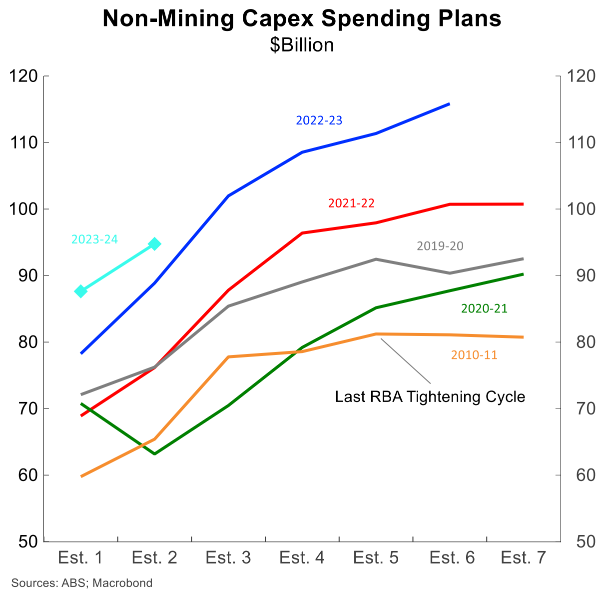
Across the non-mining industries, 12 of 16 industries reported an increase in capex in the March quarter. There were particularly large spikes in spending in Administration & Support (12.3%), Manufacturing (8.9%) and Transport, Postal & Warehousing (7.1%).

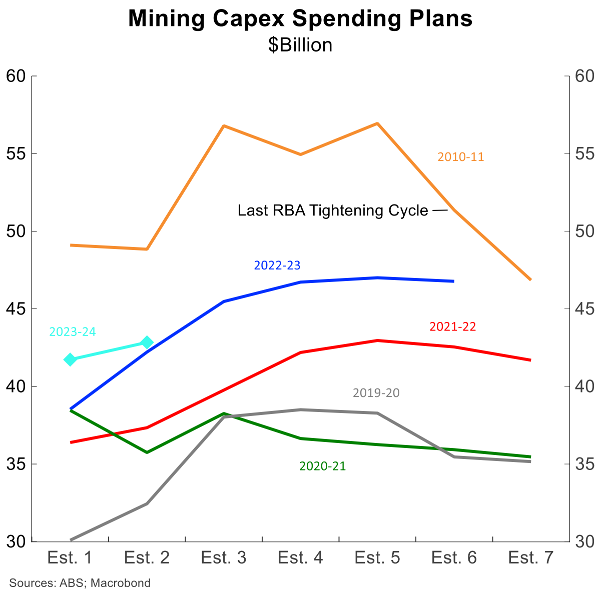
On the other side of the ledger, spending declined in construction (-19.1%), Professional Scientific & Tech Services (-6.3%), Finance & Insurance (-3.7%), and Accommodation and Food Services (-2.8%).

Spending Plans

We received fresh estimates of business spending plans for 2022-23 and the second estimate of spending plans for the 2023-24 year. The updated estimate (Estimate 6) published today for 2022-23 was $162.6 billion. The new estimate for 2023-24 (Estimate 2) was $137.6 billion. This is a nominal estimate which incorporates changes in both the prices and volumes of investment goods.

Capex expectations tend to be biased with businesses systematically under predicting how much capex they end up spending. To correct for this bias, we apply a long run average "realisation ratio" which has been shown to minimise the forecasting errors particularly when compared with other averages such as the 3- and 10-year averages.





Using the long run average realisation ratio, we estimate spending in 2022-23 could reach as high as $161.1 billion, which would be 13.1% higher than spending in 2021-22. While the long run realisation ratio does well on average, we are currently not in an "average" period. The RBA has embarked on an aggressive tightening cycle, inflationary pressures are high, and the global economy is entering a downturn.

If we apply the realisation ratio from the most recent RBA tightening cycle (September 2009 to November 2010 when the cash rate increased from 3.00% to 4.75%), our estimate for capex spending in 2022-23 drops to $156.6 billion, representing an increase of 10% on spending in 2021-22.

When it comes to the 2023-24 year, we estimate capex spending could reach as high as $163.8 billion, which would be 1.7% higher than expected spending in 2022-23.

<u>If we apply the realisation ratio from the most recent RBA tightening cycle, our estimate for capex spending in 2023-24 drops to $153.7 billion, representing a fall of 1.9% on spending in 2023-24.</u> Using either method, capex is expected to be weak in 2023-24.

Outlook

The price of investment goods eased significantly over the quarter. This will provide a disinflationary impulse that will feed through to domestic prices. It may also be encouraging businesses to invest and source the goods that have been unavailable due to supply-chain disruptions.

Looking ahead, investment is expected to be softer in 2023-24 compared to what was expected just a quarter ago. In fact, using the ratio from the most recent RBA cycle points to a possible fall of 1.9% in 2023-24.

This is not surprising. Rising interest rates and a sharp slowdown in activity will weigh on spending – and this is reflected in capex expectations.

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