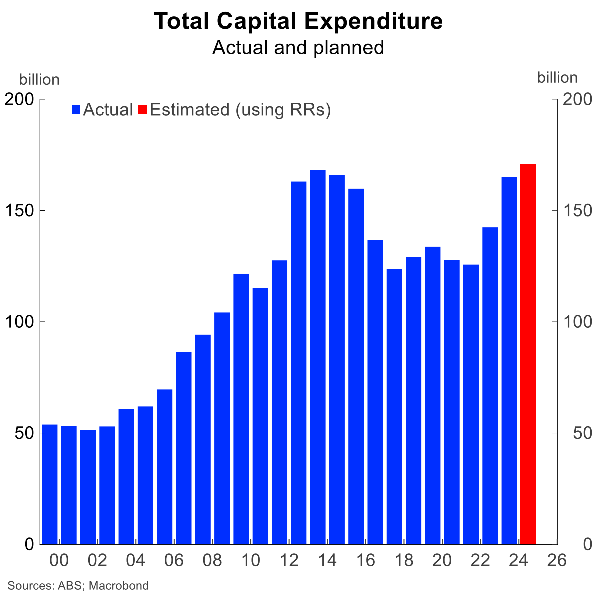
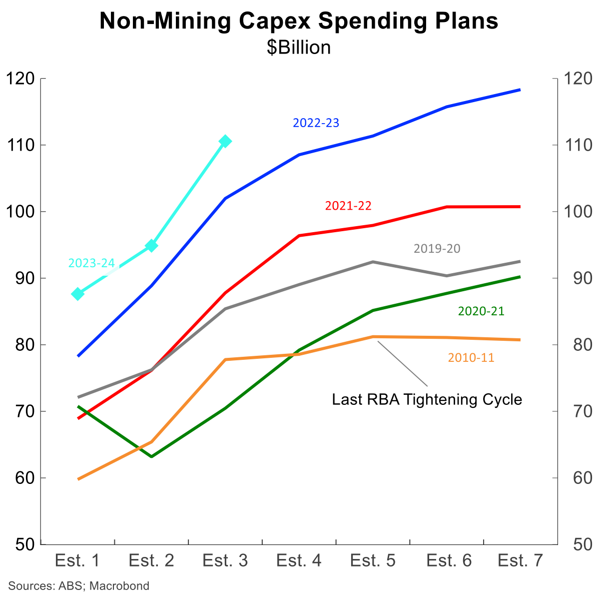
Thursday, 31 August 2023

Private Capital Expenditure

Plans Point to Record Biz Spend in ‘23-24

- **Higher interest rates are biting on households, evidenced by consumer spending pulling back. But businesses are yet to show any such restraint. In the June quarter, new private capital expenditure (capex) jumped 2.8% with gains across all assets and sectors.**
- **Next week, we receive an update on broad-based economic activity in the June quarter via the national accounts release. It is likely to suggest there is a rotation of growth drivers underway from households to the external sector and businesses.**
- **In annual terms, capex jumped 10.8%, the strongest uplift in 18 months. Elevated levels of capacity utilisation and strong growth in employment are driving a need to invest, coupled with a last-minute rush to take advantage of generous government tax incentives.**
- **We received the third estimate for what businesses intend to spend for 2023-24 and the outcomes suggest business spend continues to keep up. The capex plan for 2023-24 was $157.8 billion, which at first blush suggests a marked decrease from the $165.1 billion of spending in 2022-23. However, capex plans and expectations evolve over time.**
- **Trying to adjust for these changes using 5-year realisation ratios, expected capex spend lifts to $177.0 billion, which is a solid 7.2% increase on 2022-23. Breaking this down further, non-mining capex (i.e. business spend) is expected to grow by 10.2% and reach a record high of around $130.4 billion in 2023-24.**





Actual Spending

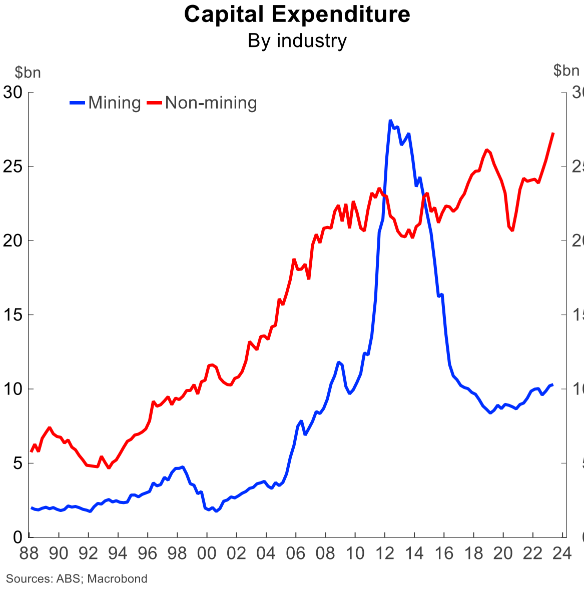
Businesses are showing few signs of restraint, despite evidence consumers are tightening their belts as higher interest rates bite. Elevated levels of capacity utilisation and strong growth in employment are likely supporting the need for businesses to invest.

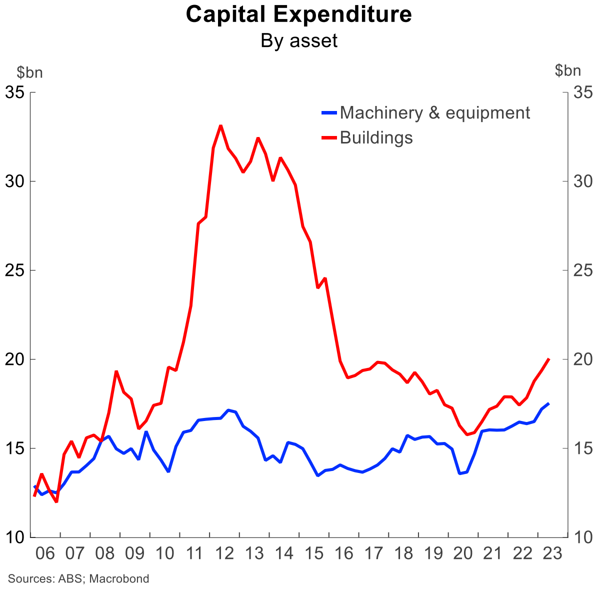
During the June quarter, businesses also had their final opportunity to take advantage of the generous government tax incentives, namely, the loss carry-back scheme and immediate expensing. Both these schemes expired on 30 June with the immediate expensing measure been replaced by a less generous measure. Businesses may also be responding to the improvement in supply chains and the moderation in prices of materials.

Capex rose by 2.8% in the June quarter and follows two solid increases in the previous two quarters.

Machinery and equipment rose by 1.9% in the quarter, which is the category most likely to benefit from the tax incentives and lifted 6.4% on the year, marking the fastest annual pace since the end of 2021.

Capex in buildings and structures led the charge in the quarter, rising 3.5%, after 3 strong quarterly gains, and jumping 15.0% on a year ago – the fastest year-on-year rate in nearly 11 years.





By Industry

Spending was strongest in the 'other' sector, which is comprised mostly of service-related industries. Other investment jumped 3.8% in the June quarter, making it four consecutive quarters that capex has risen by more than 3% in this sector. On a year ago, growth is at a near two-year high of 14.5%.

Manufacturing capex lifted by 1.1% and mining by 0.9% in the June quarter.

Stripping capex of mining and the gains are even stronger. Non-mining capex rose 3.5% in the June quarter and follows a year of quarterly rises of 3%-plus. In annual terms, growth shot up to a near two-year high of 14.2%.

Construction lifted by a massive 30.5% over the quarter following two consecutive quarters of sharp falls, with capex still down 4.4% compared to a year ago. This increase was driven by machinery and equipment.

Capex was broad based. Across the non-mining industries, 11 of 16 industries reported an increase in capex in the June quarter. There were particularly large spikes in spending in Construction (30.5%), Accommodation and Food Services (26.4%) and Arts & Recreation (14.6%).

On the other side of the ledger, spending declined in Administrative and Support Services (-18.8%), Other Services (-11.3%) and Retail Trade (-8.0%).

Spending Plans

We received fresh estimates on what businesses plan to spend in the 2023-24 financial year. We received the third estimate today where there are a total of six estimates provided before an actual outcome is known.

The third estimate revealed that businesses plan to spend $157.8 billion in 2023-24, down from $165.1 billion in 2022-23.

However, business plans change and evolve over the six estimates. In fact, capex expectations can be biased with evidence that non mining businesses systematically under predict how much capex they will end up spending. To correct for this bias, we apply a 5-year average "realisation ratio", which helps minimise forecasting errors.

When we apply realisation ratios, the story is one of an ongoing strong business spend. The adjustment reveals that capex could be $177.0 billion – a 7.2% increase on 2022-23.

Breaking this down further, non-mining capex (i.e. business spend) is expected to grow by 10.2% and reach a record high of around $130.4 billion in 2023-24. On the other hand, mining capex is expected to increase by a subdued 0.8% in 2023-24 to $47.1 billion.

If these plans come to fruition, then it suggests the economy may be more resilient and the business sector may help the economy avoid a hard landing and maintain unemployment at low levels. The latter carries the risk of wage pressures building up; however, our analysis suggests the peak in quarterly wages growth is hitting right now.

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