Financial Year 2012-2013
Australia's changing economy

Snapshot

There's a changing of the guard in the Australian economy with the demise of the mining investment boom and the gradual move towards growth in the non-mining sectors of the economy.

It was a different story this time last year when the mining boom was still a reality, delivering strong economic figures for Australia. Nevertheless, at that time global sharemarkets were struggling to gain traction.

The year has been one of contrasting and conflicting trends. In the first 10 months of the 2012-13 financial year, sharemarkets around the globe made healthy strides. At one point the Australian index hit a high of 5200, albeit a long way from the November 2007 peak of 6873 but a very strong rebound. Globally, the standout performer was Japan with a 44 per cent jump despite the sharp correction from its 15627 high on May 22.

S&P/ASX200 Index 2012-2013 as at 27th June 2013

The adverse sentiment that hit world markets in May and June was on the back of concerns about the challenges facing Japan's growth strategy, worries about the winding back of quantitative easing in the US and continued concern about the rate of progress in Europe. In addition, simply because of the strong run-up on markets, a technical correction was not unexpected.

Snapshot

Australian Key Indices as at 25th June 2013	
GDP annual growth rate	2.6%
RBA cash rate	2.75%
Inflation	2.5%
Unemployment	5.5%
Consumer confidence index	102.2

Share Market (% Change) 1st July 2012 – 25th June 2013	
Australia (All Ords)	+12.0%
US (Dow Jones)	+14.6%
UK (FTSE 100)	+9.5%
China (SSE Composite)	-11.8%
Japan (Nikkei 225)	+44.0%

Note – Price Indices: excluding dividends

Global growth

While the transition to a non-mining driven economy is taking time to evolve, the Australian economy is still holding up reasonably well against other western economies.

Gross domestic product is currently growing at 2.6 per cent[1], inflation is at 2.5 per cent and unemployment is 5.5 per cent.

In contrast OECD predictions for real GDP growth in calendar 2013 is 1.9 per cent for the US, 1.6 per cent for Japan, and 1.2 per cent for the UK. While these figures may appear low, they still reflect a recovery.

Growth has been strongest in the US and Britain is also showing signs of recovery. In Japan, Abenomics (named after the prime minister Shinzo Abe) is expected to make its mark, although there are some clear challenges in delivering results. The Eurozone, however, remains in recession.

Meanwhile growth is expected to slow in the key BRIC countries – Brazil, Russia, India and China – often viewed as the new powerhouses of the global economy. The World Bank views this slowing in growth as merely being the "new normal", saying these economies are not slowing because of inadequate demand but rather because of the bubble phenomenon in the pre-GFC period.

1 Note, this is referring to the trend rate as opposed to the seasonally adjusted rate which is 2.5%.

Weaker Australian dollar

The weaker Australian dollar will play a major part in switching the focus in Australia to the non-mining economy. But it may take time to filter through.

In a matter of weeks, the dollar has fallen over 10 per cent to around US93c after being close to $1.06 in mid May. In June last year the dollar was just above parity.

The slide in the currency is more on the back of the strength of the US dollar than any inherent weakness in our dollar. The greenback's appeal has grown as the US economy recovery continues and with Federal Reserve chairman Ben Bernanke talking of a tightening in quantitative easing. In addition, the move towards lower interest rates in Australia has also stymied the flow of overseas funds into Australia.

Indeed, the slide in the Australian dollar has been a contributory factor to the recent fall on the local sharemarket.

The general view is that the Australian dollar has entered a bear phase and some commentators believe it could fall

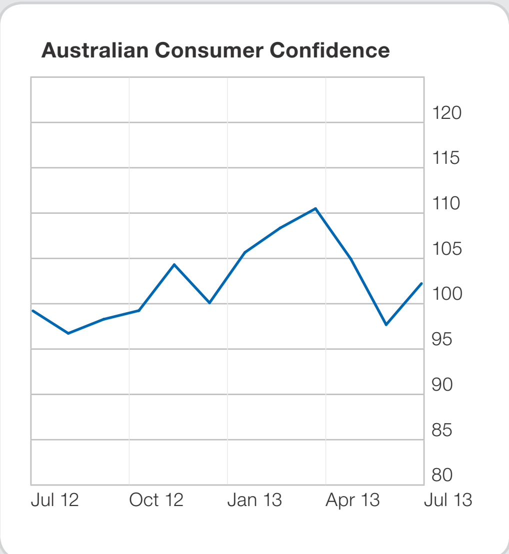
Aussie Dollar as at 26th June 2013

to as low as US85c by year-end. While this may seem low, it is still well above the US65c mark where it traded at the beginning of 2009, as the global financial crisis hit its stride.

However, a weaker Australian dollar is pivotal to the switch to growth in the non-mining sector of the economy with manufacturing, tourism, exporters (including miners) and companies with overseas earnings all benefitting.

Some doubts

Interestingly, there has been some talk that Australia has up to a 20 per cent chance of falling into a recession. A recession is defined as two consecutive quarters of negative growth. While that is a higher percentage than in the recent past, it is still controllable and can just as easily be seen as an 80 per cent chance of a recession not occurring.



Even if growth were to be negative, it would cap the end of 21 years of uninterrupted economic growth in Australia - a time when much of the rest of the world struggled with recession.

According to Treasury at the time of the budget release in May, the forecast for economic growth in 2013-14 is 2.75 per cent.

Clearly the GDP figure is down on the 4.3 per cent in June 2012, but it is still reasonably sound.

Why is GDP slowing?

The slowing in our economy is largely a result of the end of the mining investment boom. This follows slower growth in Asia's leading economies. In China, for instance, GDP is now down around 7.7 per cent compared with double-digit growth just three years ago. This slowdown has had an impact on commodity prices which has led to a fall in Australia's terms of trade.

Interest rates

Interest rates in Australia have come down from 3.5 per cent last June to 2.75 per cent with expectation of further cuts before the end of the financial year although the recent better-than expected employment figures have reduced the possibility slightly.

The Reserve Bank cut rates by 25 basis points three times during the last financial year in a bid to stimulate the economy.

Consumer confidence on the rise

Lower interest rates have helped to bolster consumer confidence. The Melbourne Institute-Westpac Bank Consumer confidence index moved up to 102.2 in June. This translates to a slight majority of economically optimistic Aussies compared to pessimistic. This figure is 6.9 per cent higher than June last year, although still below average.

Some commentators believe this renewed confidence will prove short-lived on fears about the outlook for employment. This probably explains why the higher confidence has not translated into greater retail sales. Retail sales grew over the year by only 3.2 per cent.

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Similarly credit card debt fell 3.1 per cent in the year to April – the largest drop since records began 19 years ago. This reflects the growing propensity to save in Australia, a trend that started emerging before the global financial crisis. The household savings ratio is now standing around the 10 per cent mark. This compares starkly with household saving in negative territory in the years 2002-05.

Employment

Despite the concerns about unemployment, the statistics continue to defy expectations. In June last year the rate stood at 5.1 per cent. While there has been a deterioration over the last 12 months, the current rate of 5.5 per cent is still below forecasts. It seems that despite the number of high-profile job cuts, there are still plenty of employers taking on new staff, albeit favouring contract and part-time over full-time. The general outlook for employment over the next 12 months is for it to rise to about 6 cent. At this level it is still comfortably below some of our overseas counterparts. OECD figures show the UK at 8 per cent and the US at 7.5 per cent while Greece and Spain are a staggering 27.8 per cent and 27.3 per cent respectively. And when it comes to youth unemployment, the figure is more than 50 per cent in these two countries.

Property

In May, the cut in the official cash rate to 2.75 per cent, set the record for the lowest interest rates in 53 years. Some economists predicted this would result in a rise in home values. Instead according to RP Data-Rismark, house prices rose initially by 0.38% in the week of the RBA's rate cut, but fell consistently each week thereafter nationally.

Despite this, auction clearance rates have increased and not all sellers have had to discount their properties too heavily to sell. Rismark's chief executive, Ben Skilbeck, says this is a reflection of more realistic seller expectations than of increased buyer interest, reflecting a flat or declining market.

Where to from here?

Despite talk about the Australian economy struggling, the figures hold up remarkably well. The lower Australian dollar is definitely a good news story when it comes to the switch from a mining-investment-driven economy to the rest of the economy.

Our GDP is still the envy of most other industrialised countries, as are our employment numbers. In addition, low interest rates should add stimulus to the economy going forward.

But world economies continue to be in a state of transition in the post GFC era. A changing economic landscape is inevitable – how business adapts to these changes is what matters.

Please call us if you would like to discuss this article or have any questions about your investment mix in light of these changing times.

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