

Australian economy in transition

Westpac Institutional Bank
Prepared for Tractor & Machinery Association

By: Justin Smirk July 2017



200 years proudly supporting Australia

Summary from last year (July 2016)

- Financial markets experienced significant volatility over the past year; this is likely to continue with Brexit having a significant impact on the UK & Europe, but impact on global economy likely limited.
- US struggling to maintain expectations of further rate hikes; elsewhere, rate cuts and asset purchases are the focus for policy.
- China growth sound, but slowing; policy challenges mounting. Commodity prices affected by soft demand and increasing supply.
- For the Australian economy:
 - Income prospects impaired & Australia shifting focus to services. AUD critical to success.
 - Investment lacking in Australia at present; conditions robust, confidence not. Public sector supporting demand in south-east, but not elsewhere.
 - RBA to cut in August; open to doing more – if necessary.

Big Picture Backdrop

Crude Oil

Farm Commodities

Australian Economy

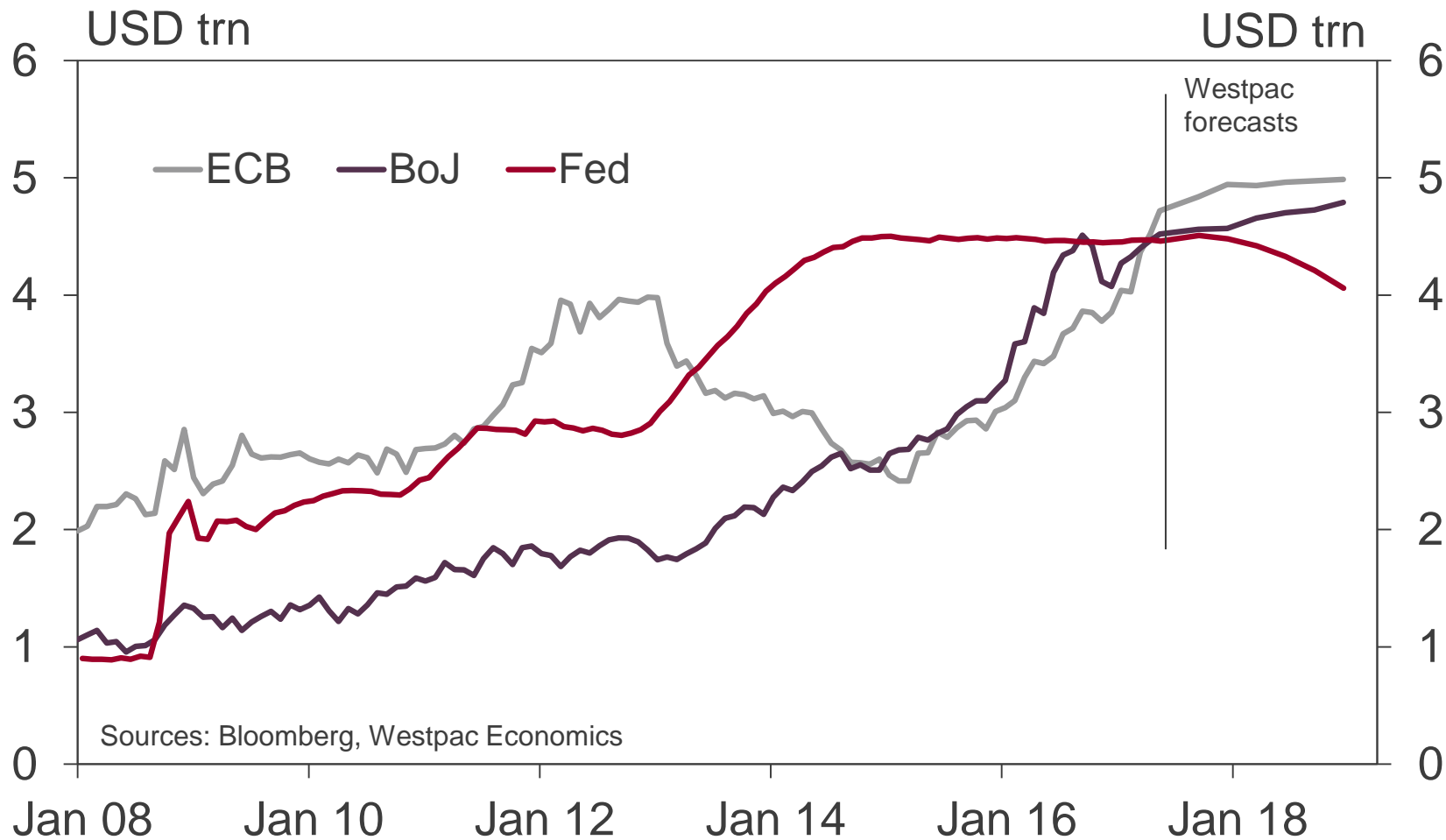
Housing

Inflation

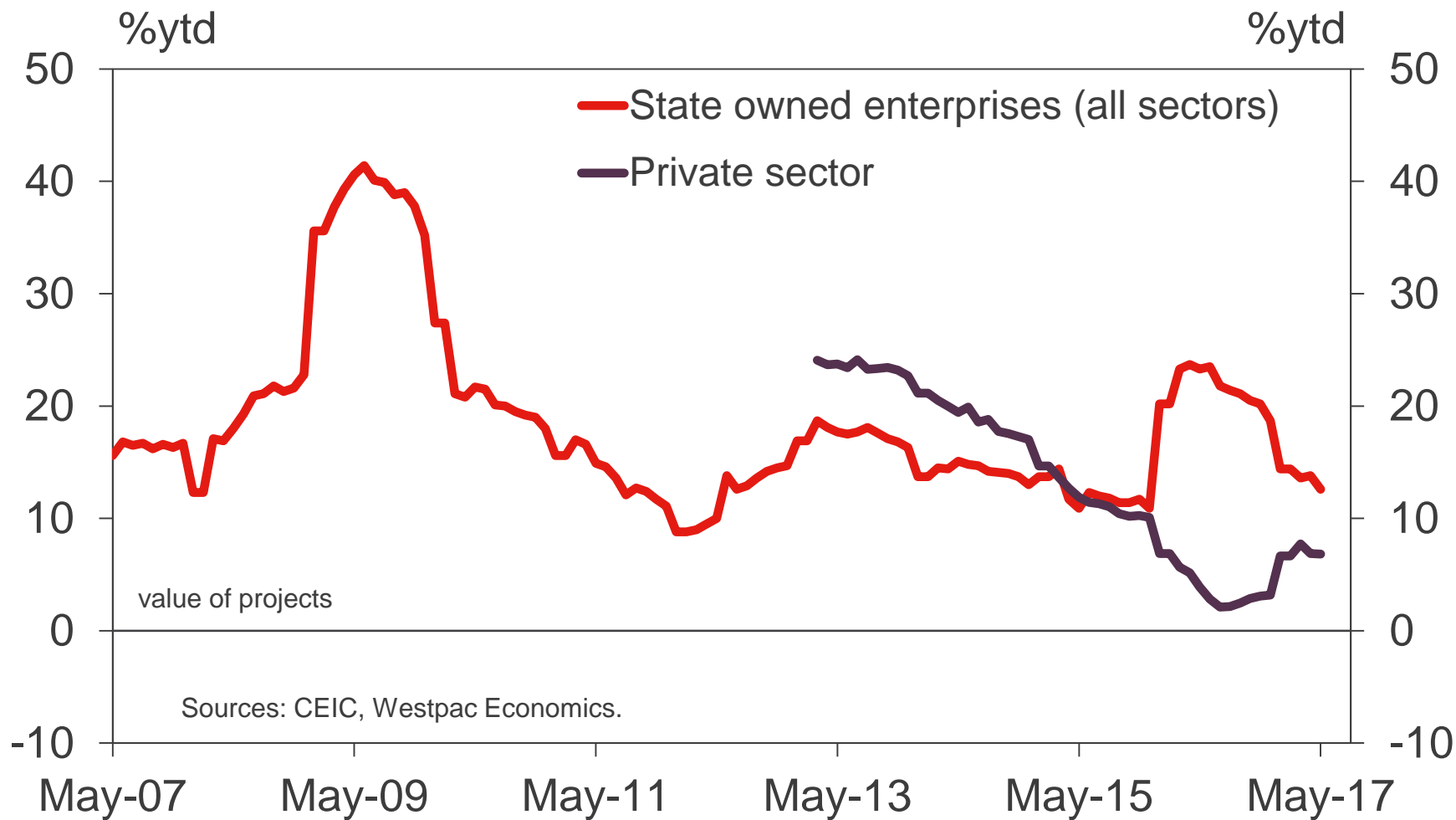
Forecasts

Big picture backdrop

Central bank balance sheets diverge



Chinese Investment: SOE & private

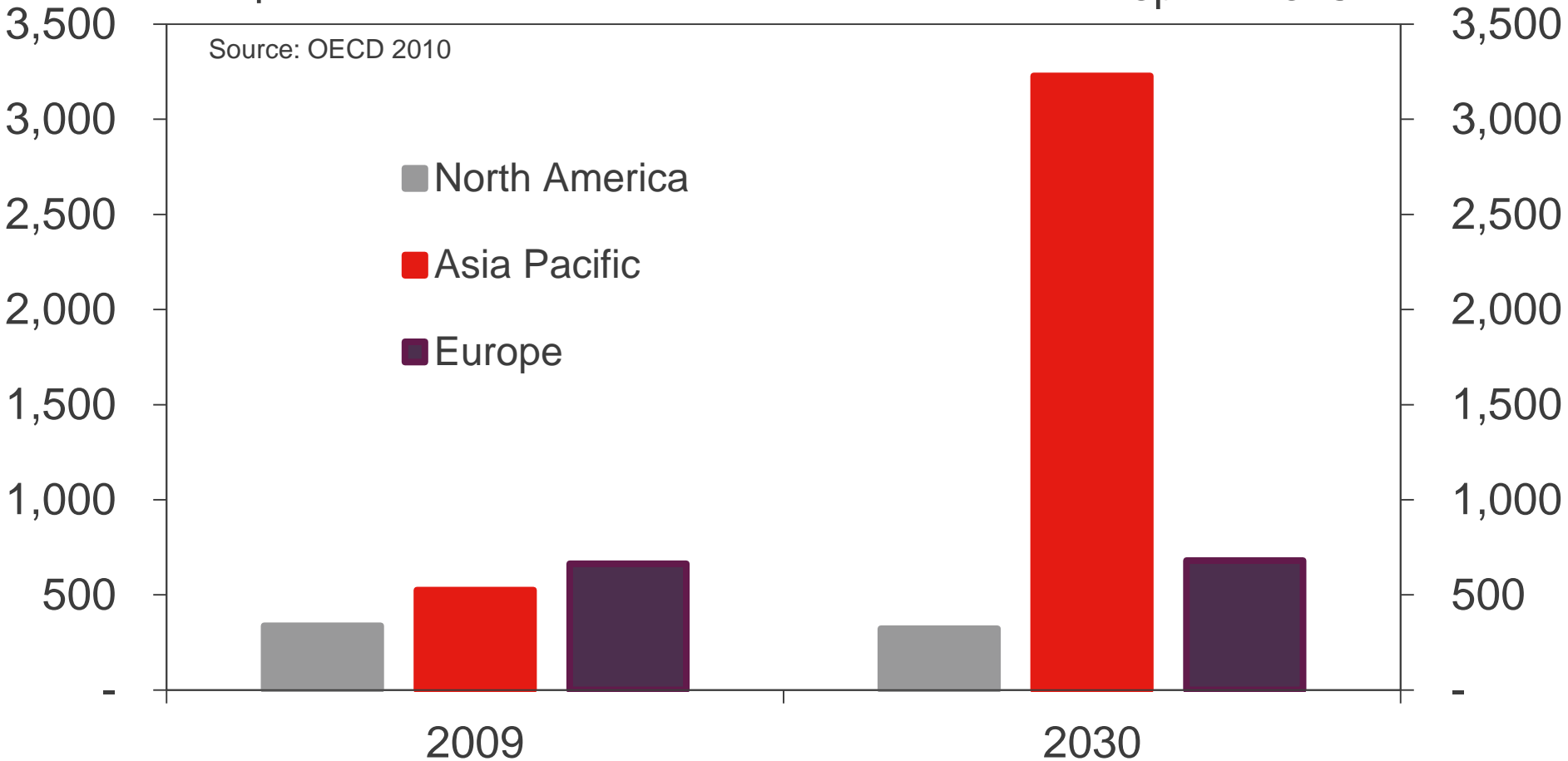


Size of the global middle class

Pop. millions

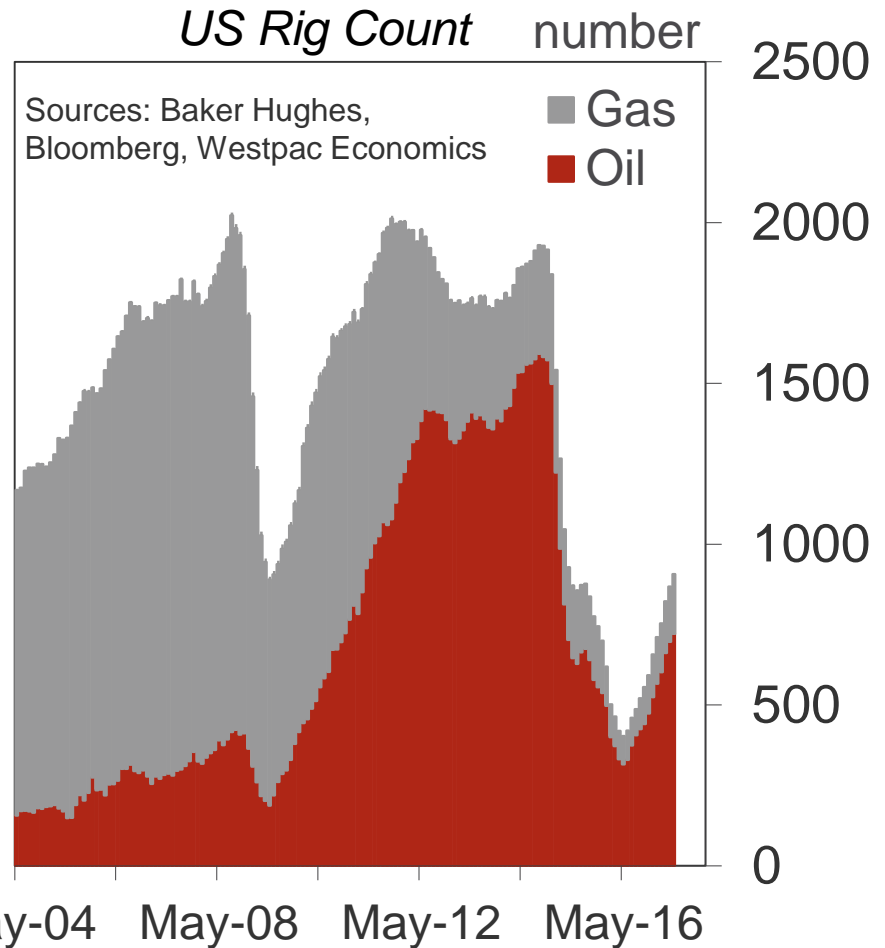
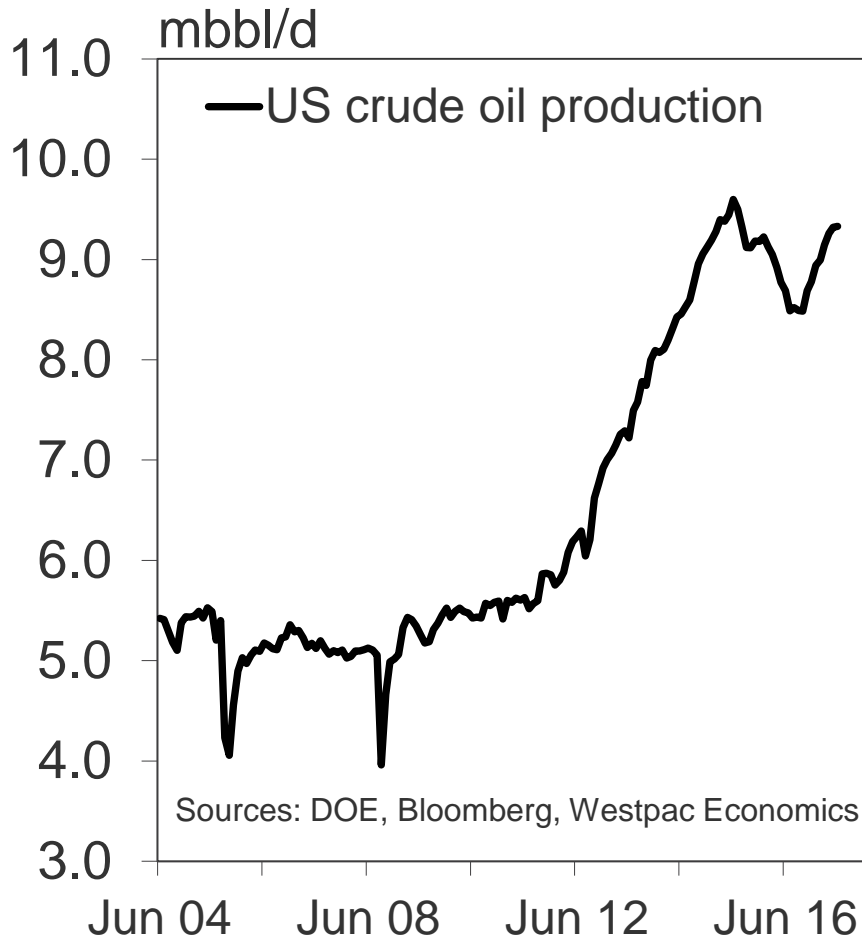
Pop. millions

Source: OECD 2010

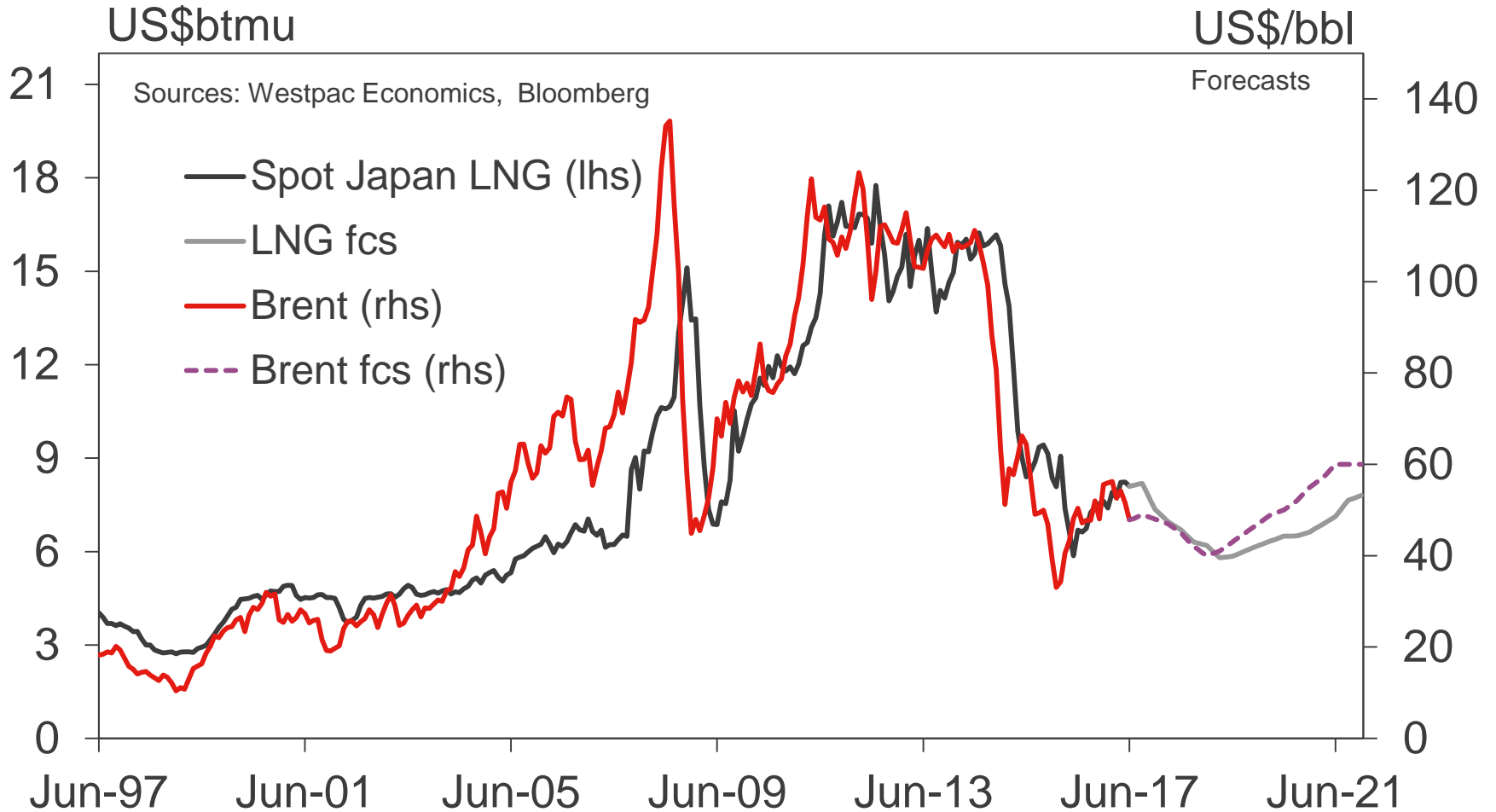


Commodities Inputs

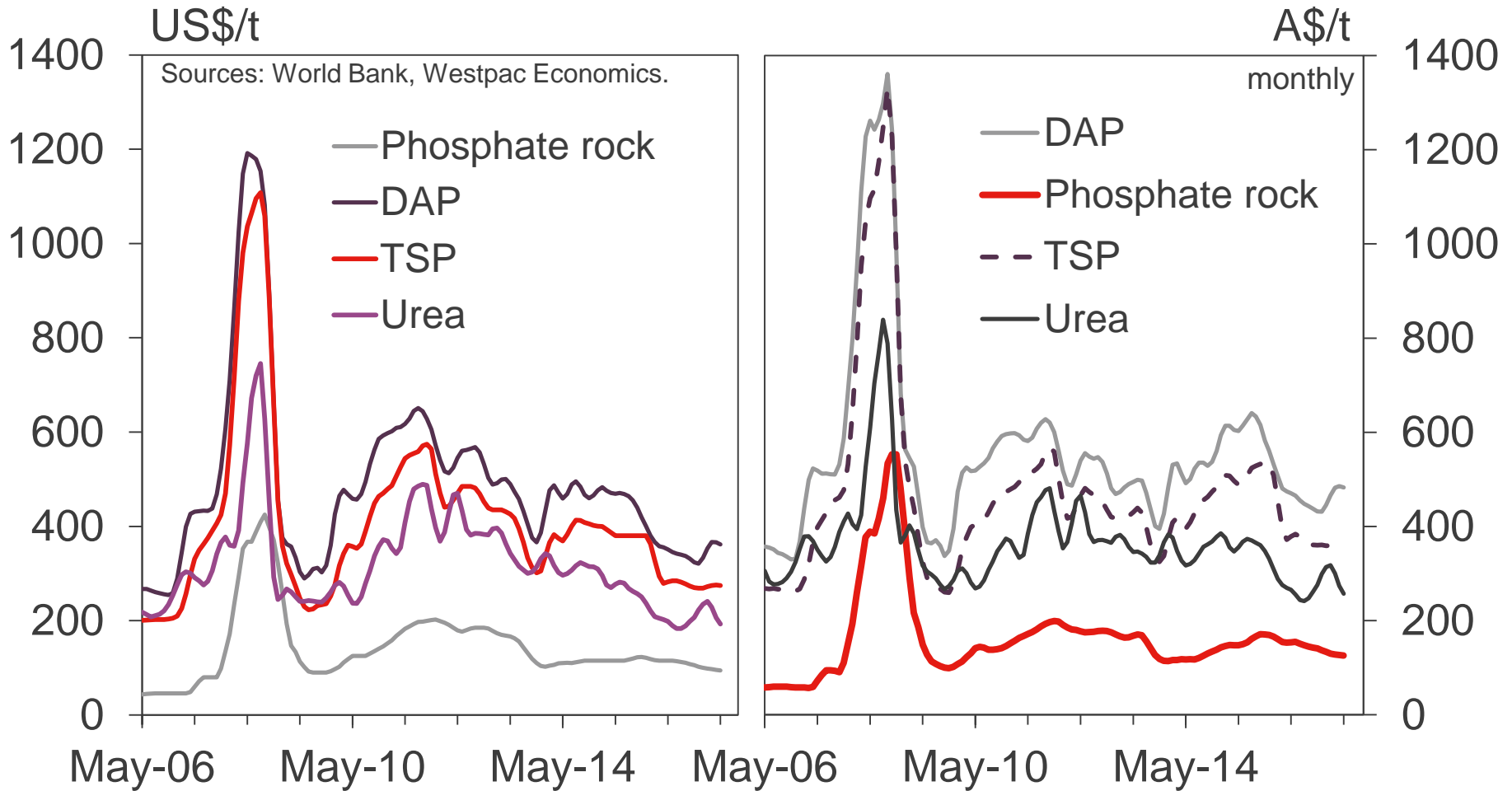
US crude oil production & rig count



Japanese LNG & Brent crude oil



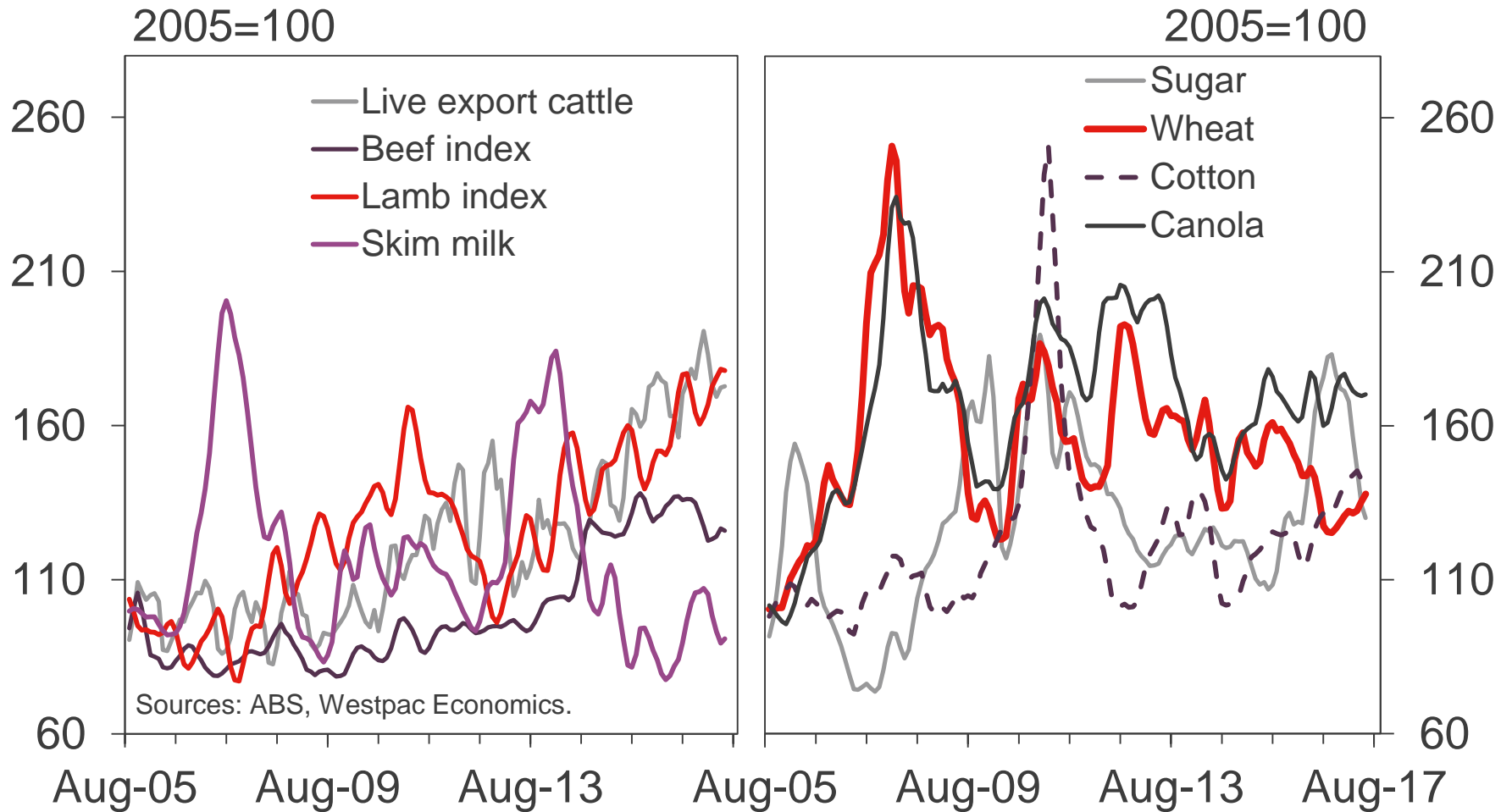
Fertiliser prices



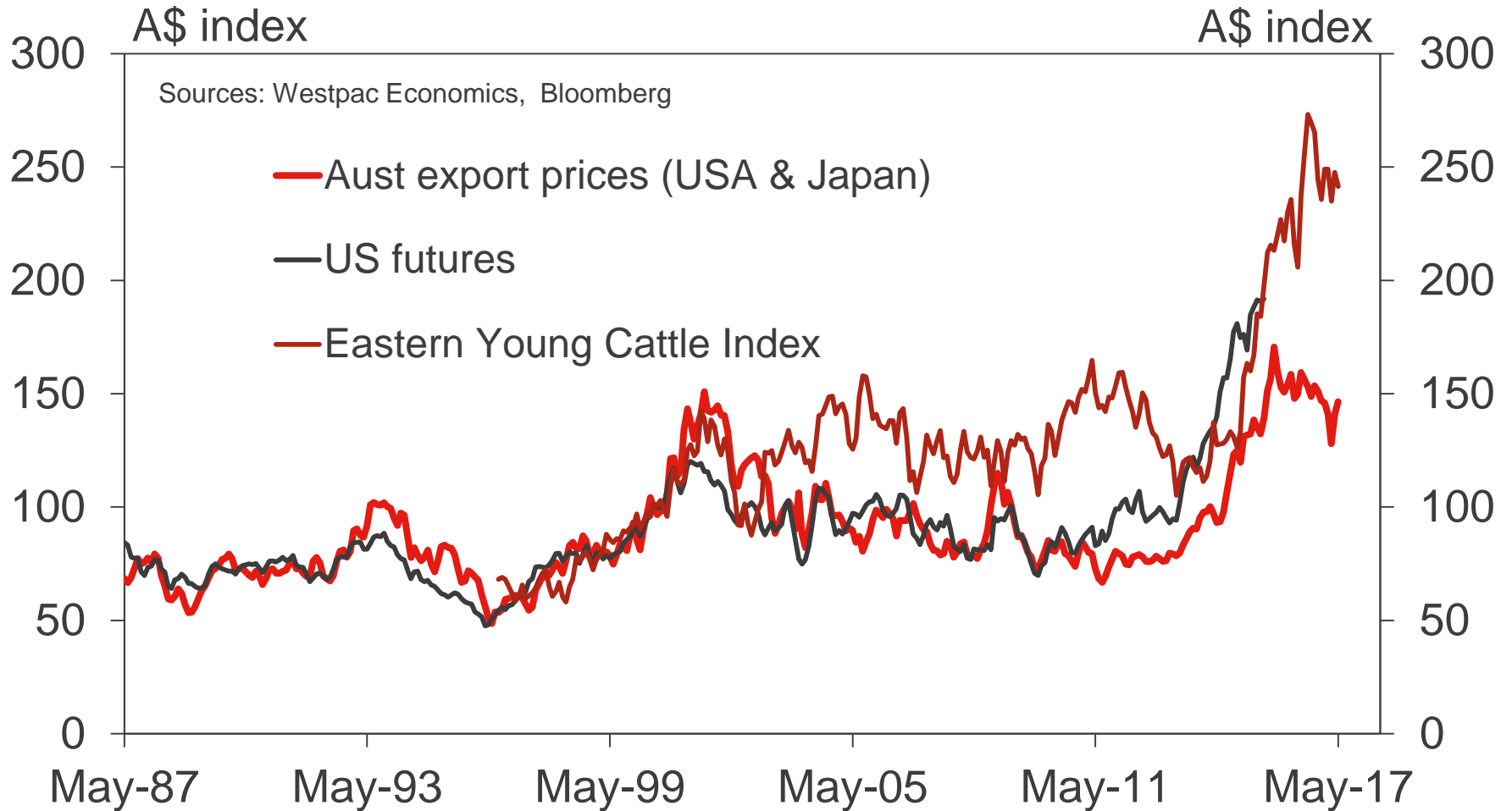
Commodities

Rural

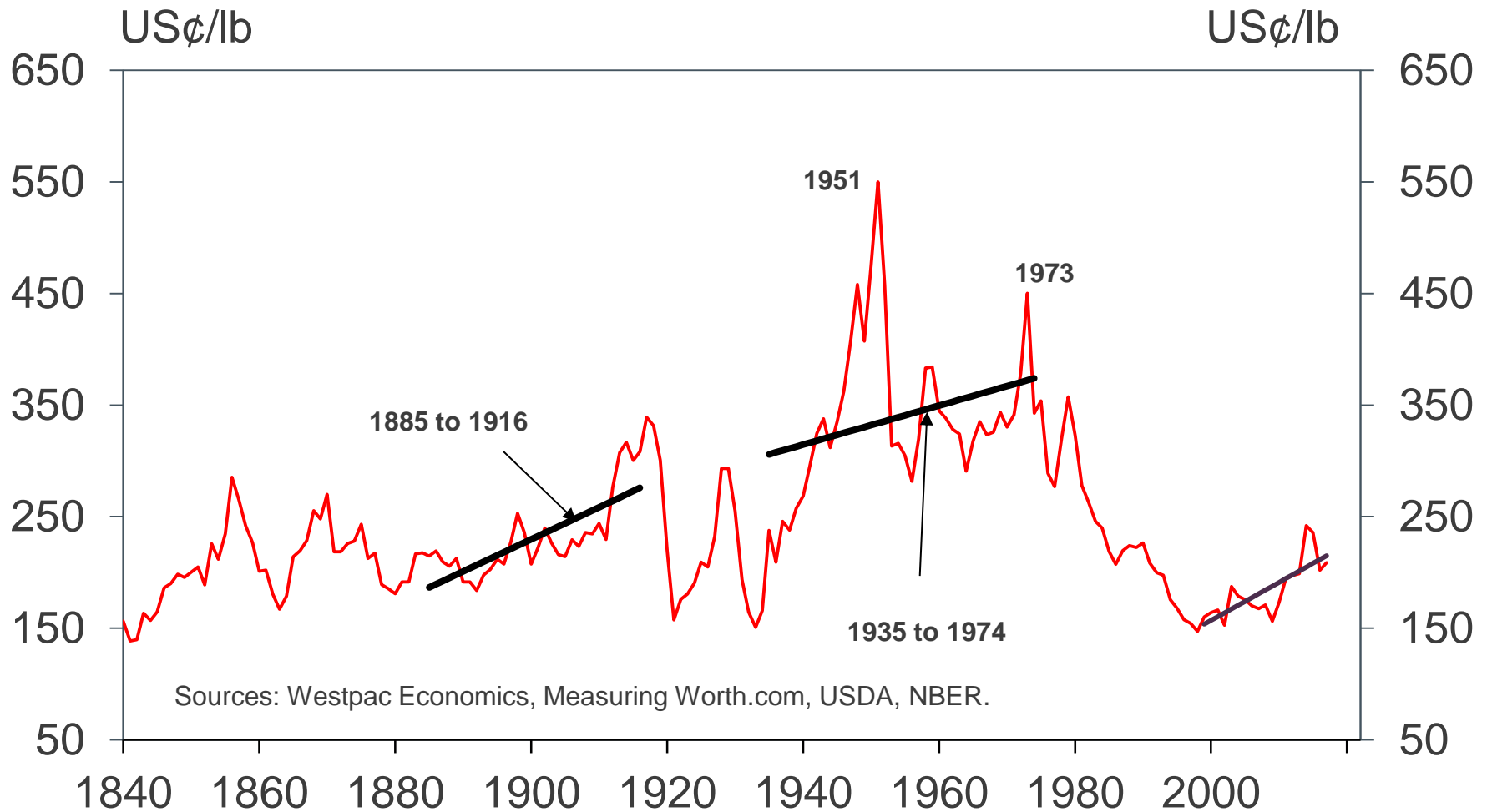
Farm commodities in Australian dollars



Beef – export vs. local prices



Beef prices in 2016 dollars



Global Wheat Market

So why are wheat prices bouncing off 10 year lows?

- *In the short term, the market is dominated by weather concerns, with dry conditions in the US, Australia and Europe. In particular dry conditions are extending through the mid-West of the US. So far the greatest impact has been in the high protein wheat market.*
- **Rising global production will keep the pressure on prices**
 - Increasing global yields due to improvement in farm level technology – i.e. no-till farming practices, crop sensors, use of GPS
 - Global demand is still increasing. However, grains demand remains unable to keep up with growing yields
 - Last year the US planted the smallest wheat acreage in 100 year but the US still grew a record crop due to a rising yields.
 - Black Sea and Russian production continues to grow increasing increasingly competing with traditional suppliers (Australia and the US)
 - Whilst futures prices have been low, Russian and South American currencies have also been low, allowing farmers to capture decent gross margins.

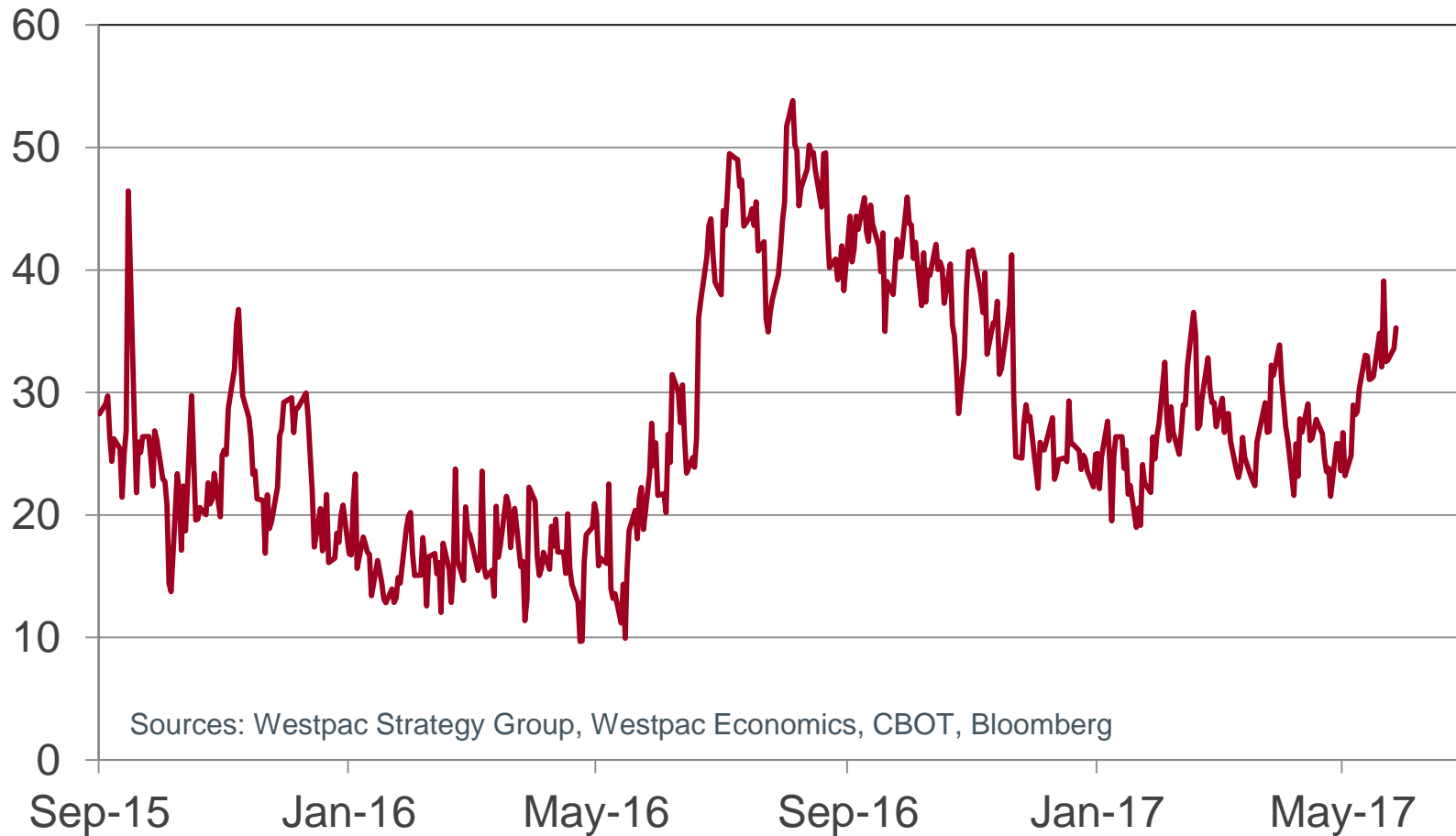
CBOT Wheat Futures

10 year CBOT Wheat Futures US¢/bu



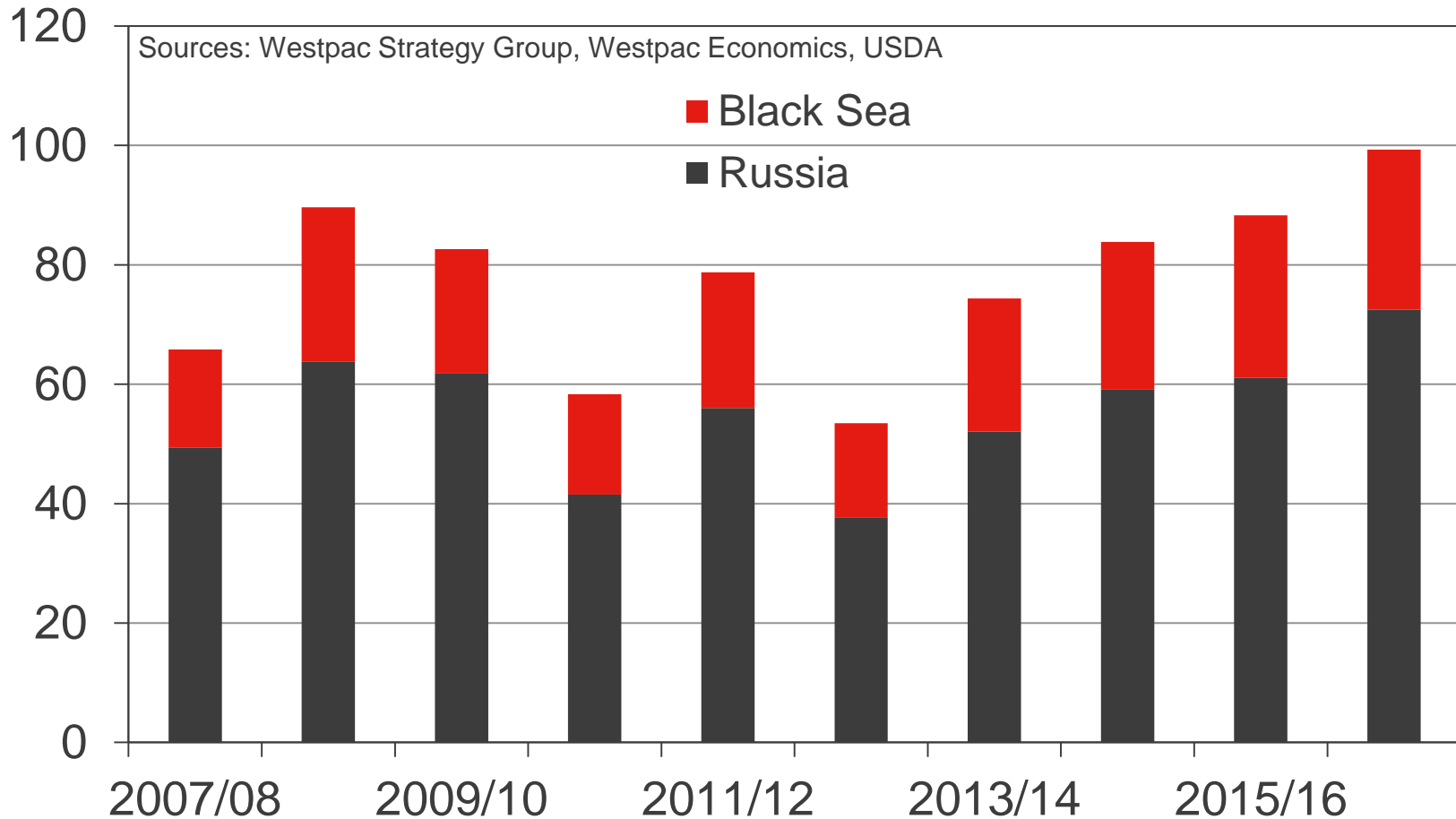
Spread between ASX & CBOT wheat

ASX Milling Wheat (APW1 in USD) versus CBOT Wheat in USD



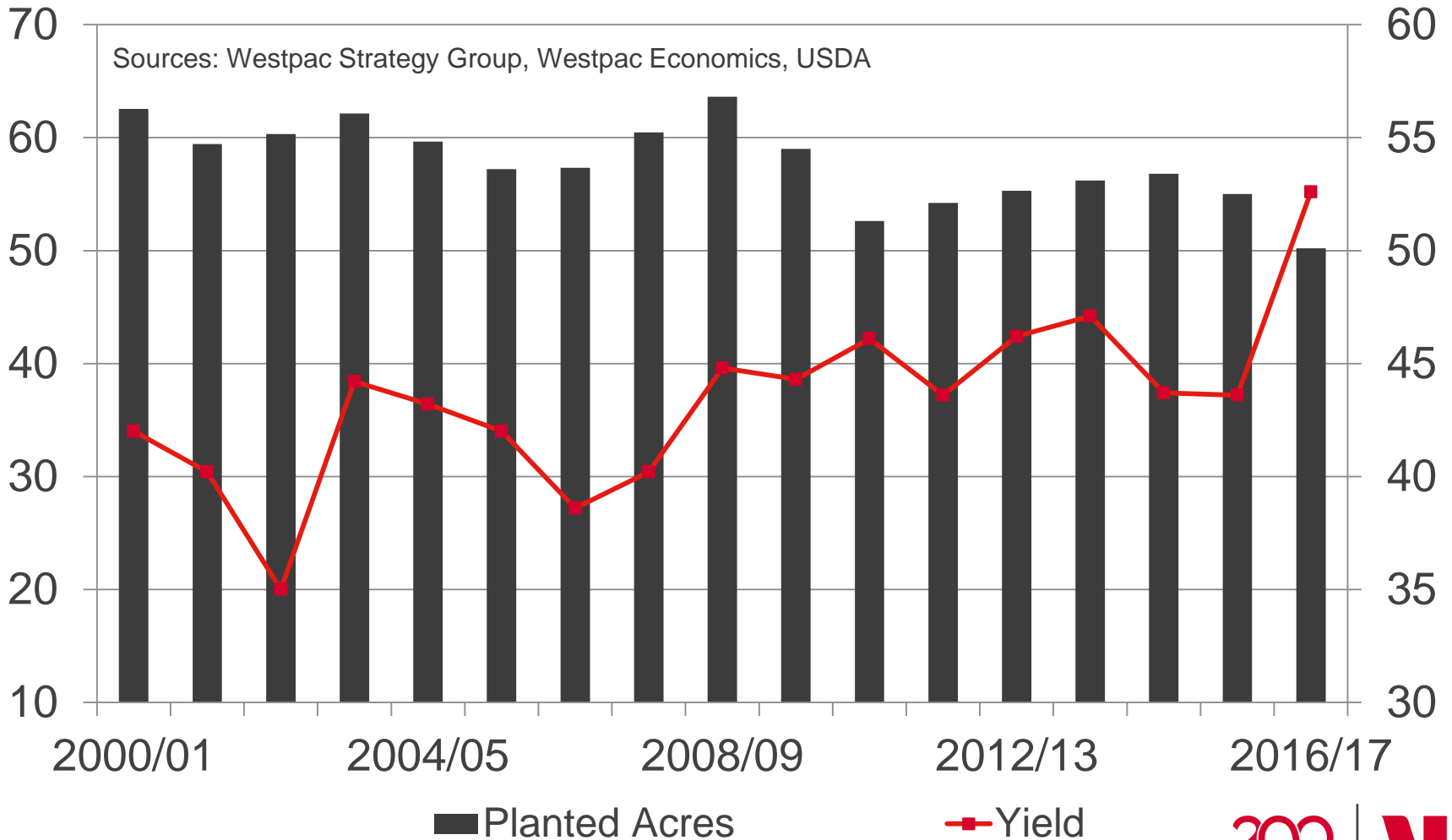
The rise of Russia and the Black Sea

Russian and Black Sea Wheat production



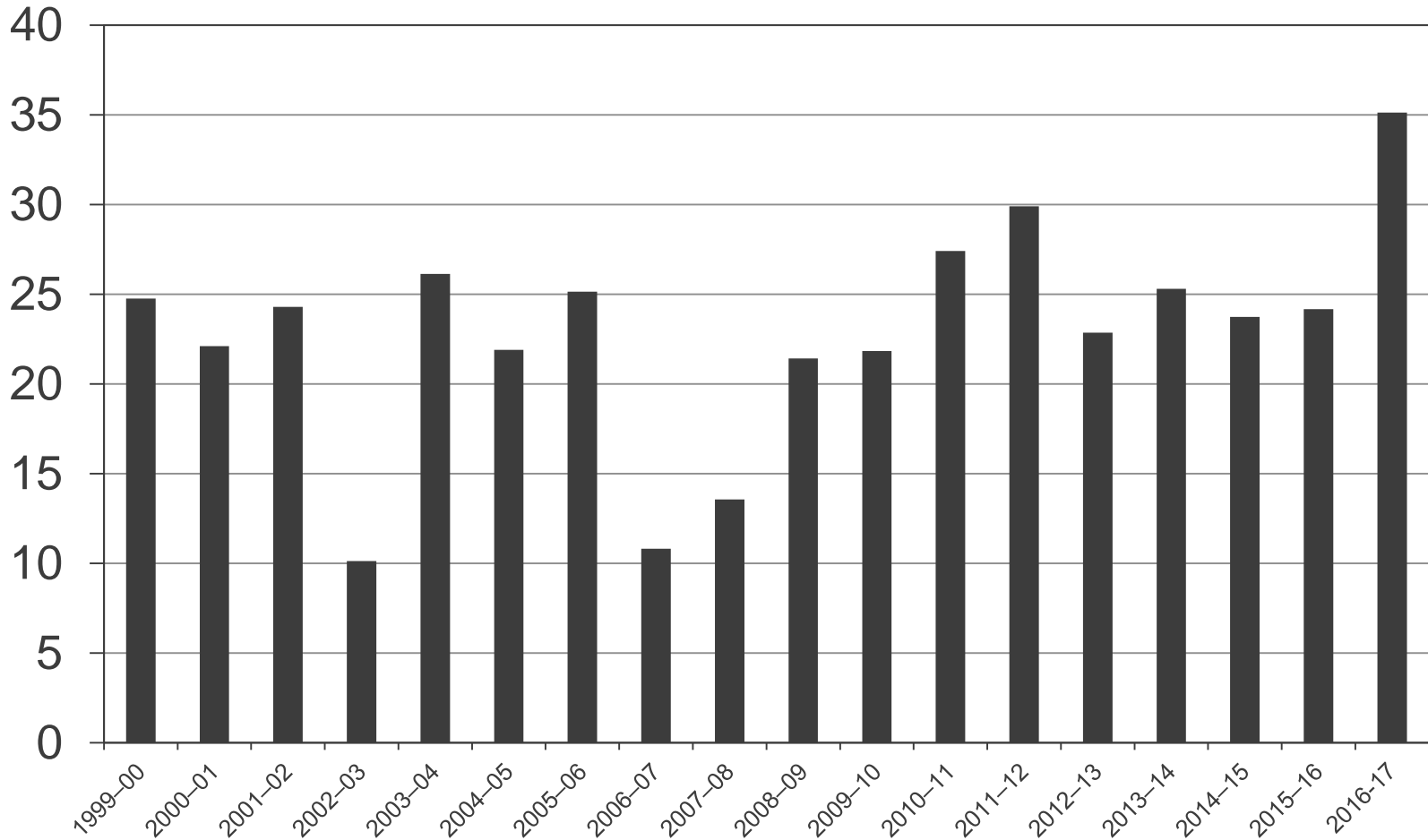
US wheat acreage versus yield

Smallest planted acres in 100 years but yields continue to improve



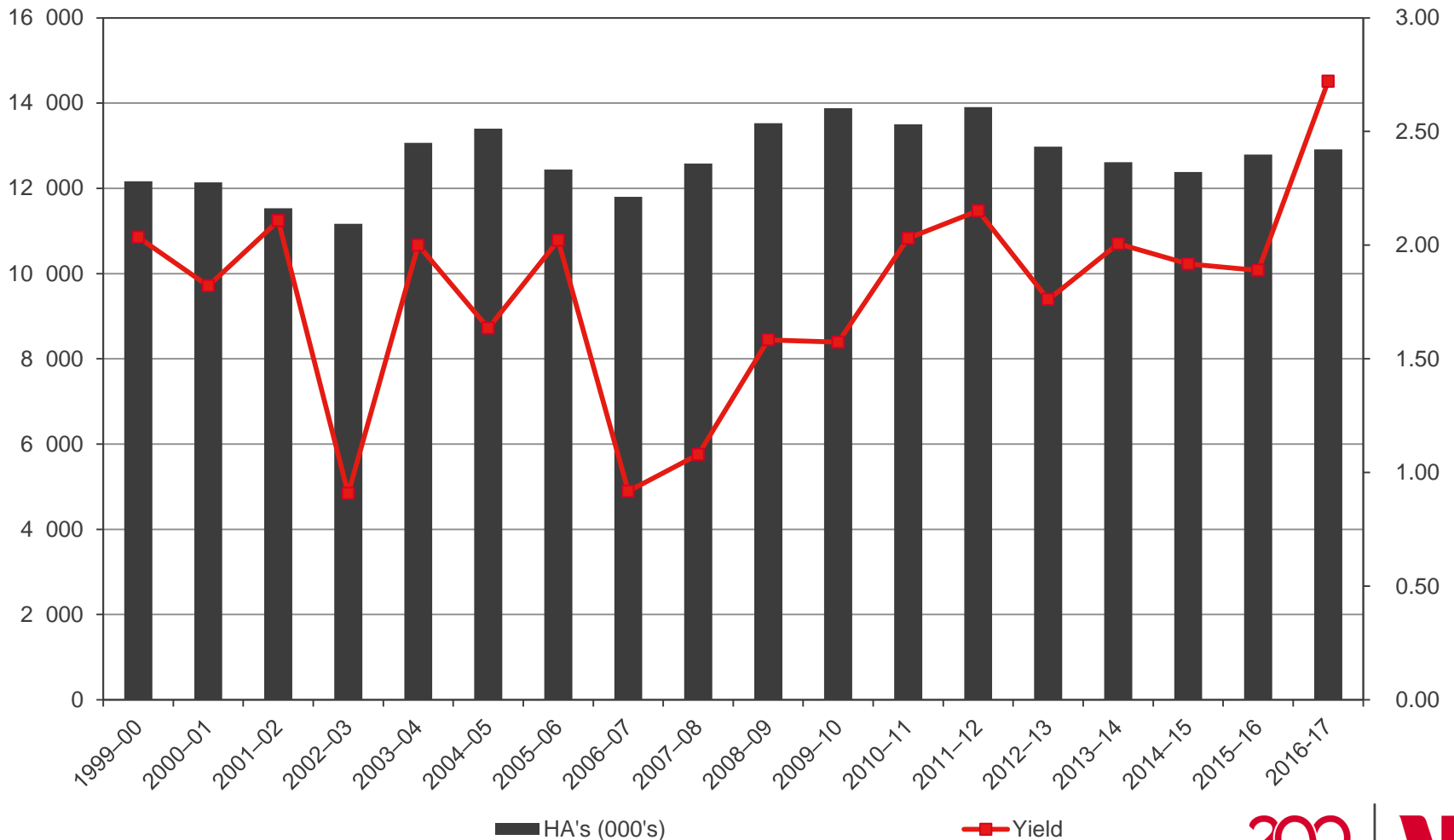
Australian Wheat Production

Australian Wheat Production in MMT (Source: ABARE)

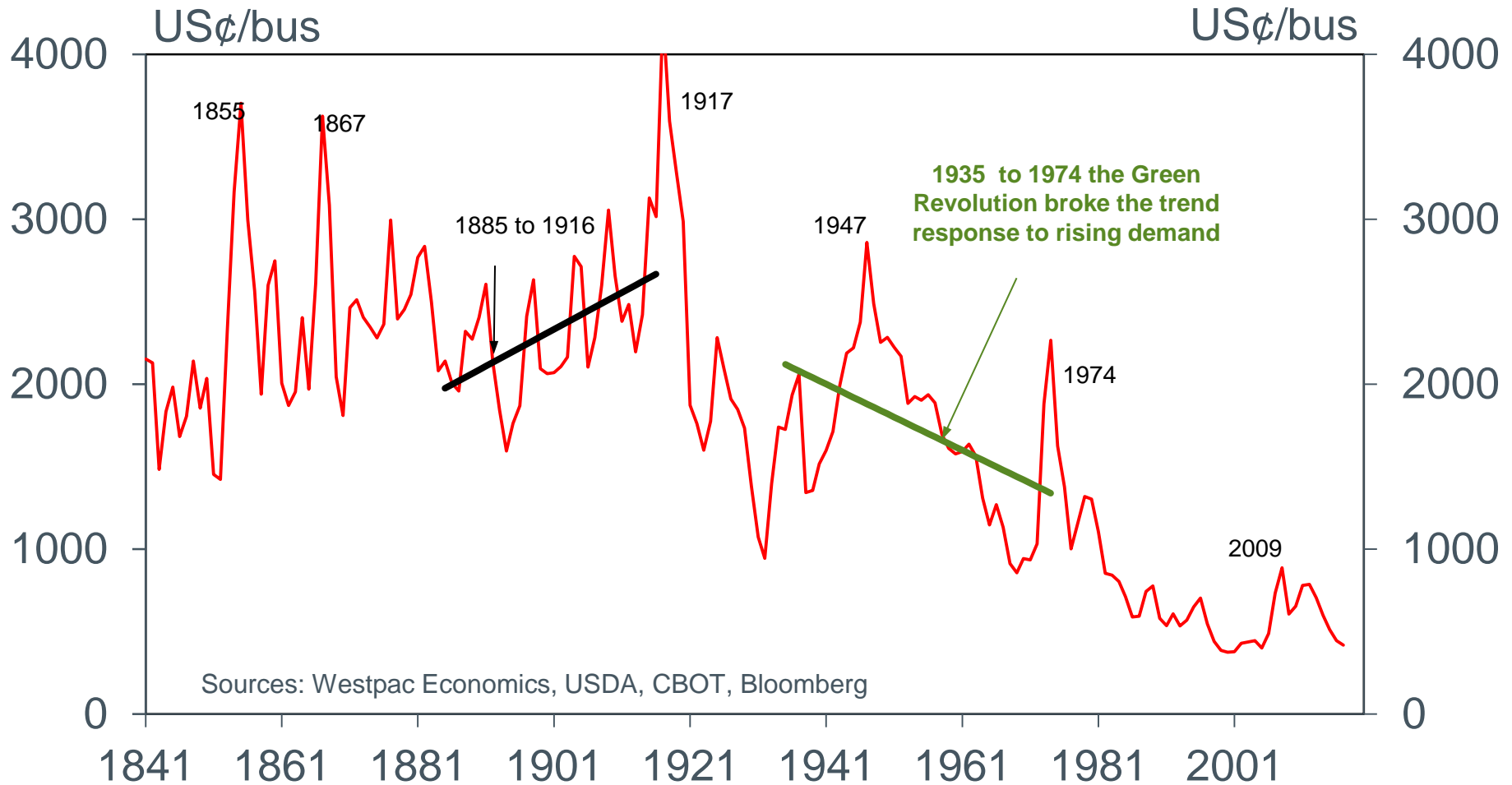


Australian Wheat Production

Australian Wheat Yield versus Acreage (Source: ABARE)



Wheat price in 2016 dollars



You don't need a tractor to get a phone



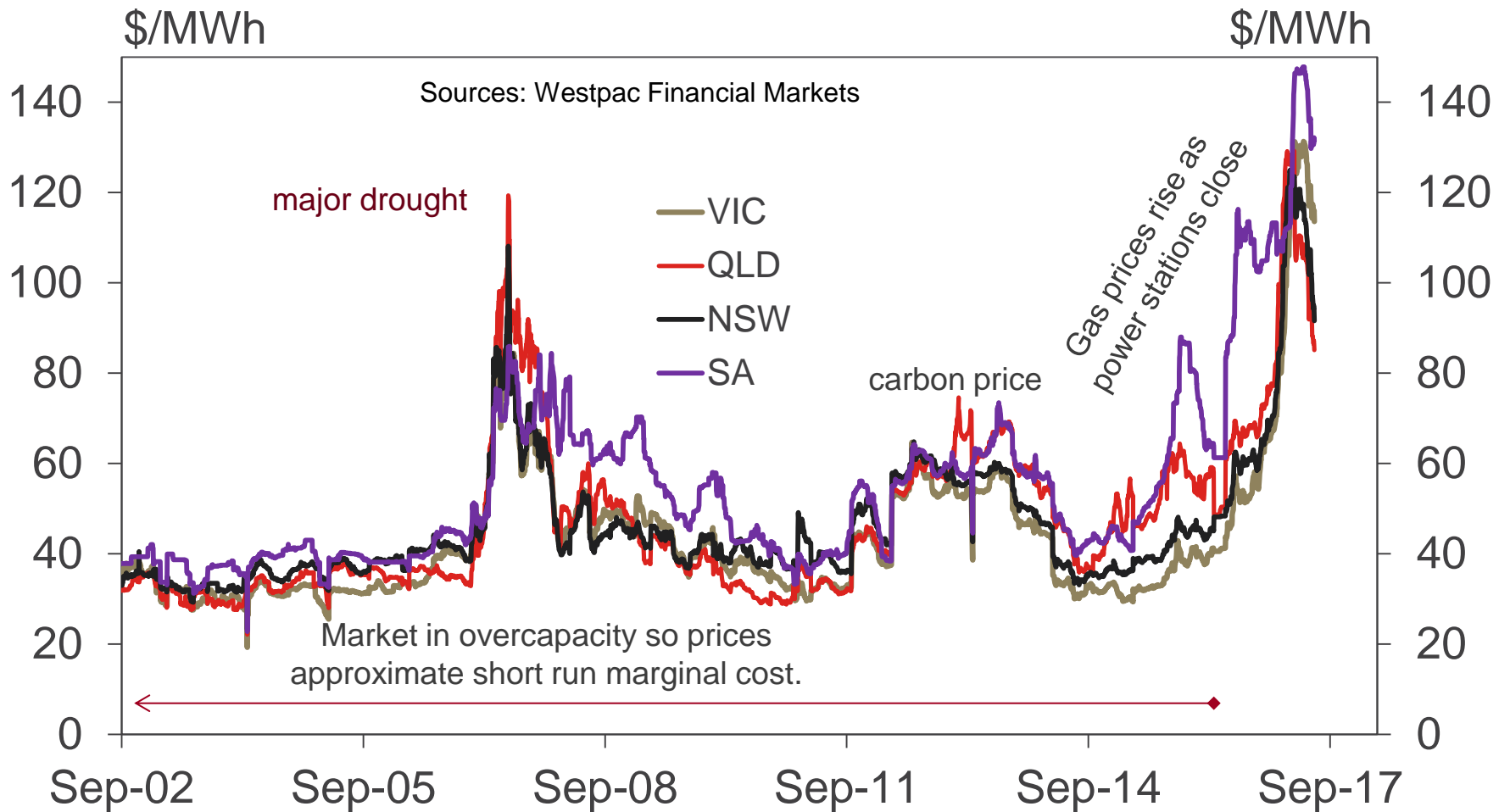
- Ag commodities are set for the best decade in a generation but change is coming faster than ever.
- High protein, high value products will continue to be supported by rising demand.
- Staple foods, grains & starches, will be constrained by technological improvement and slower growth in demand.
- Clean food from know origins will increasingly attract a premium.

Technological change is leapfrogging

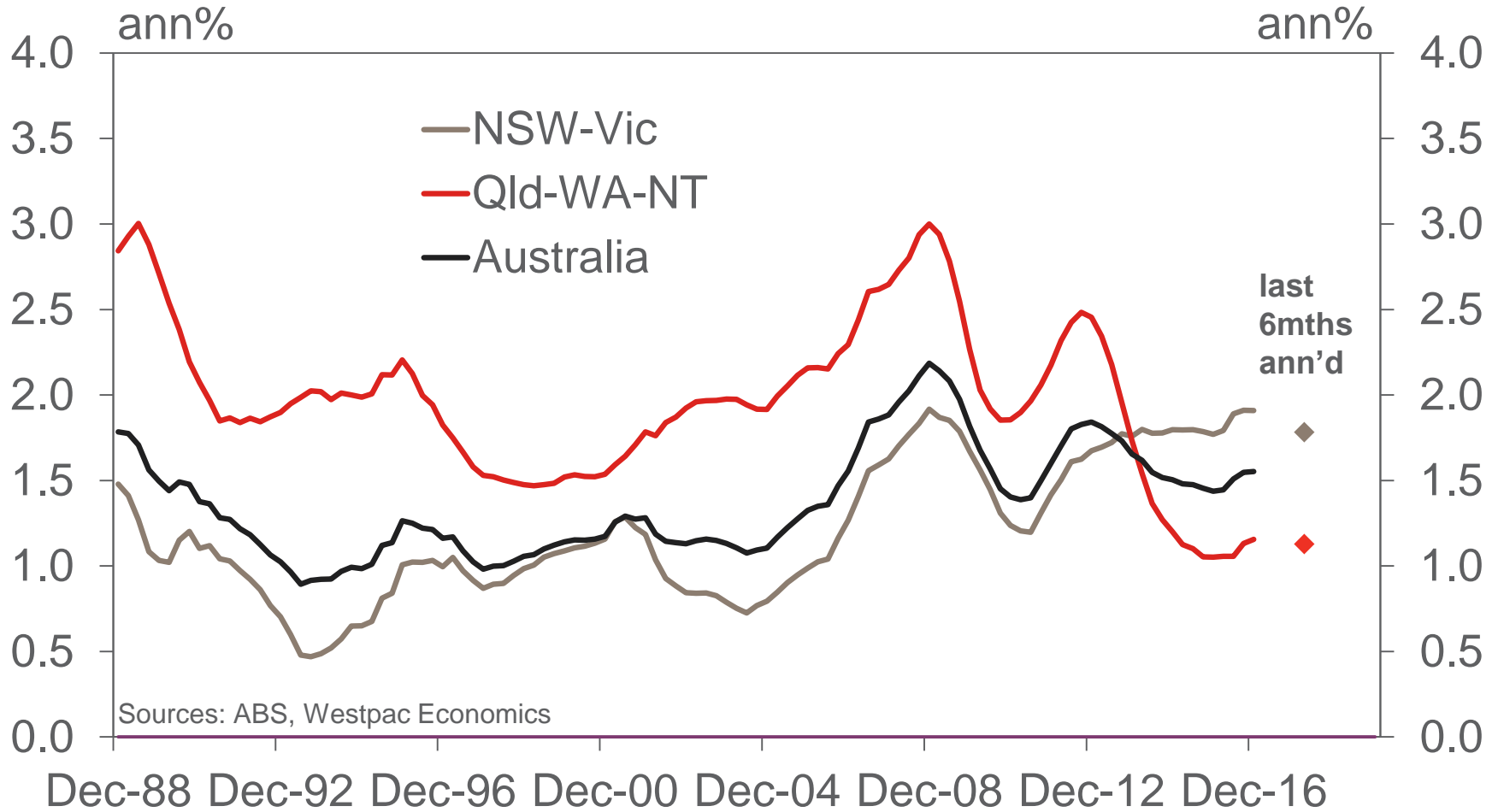


Australian Economy

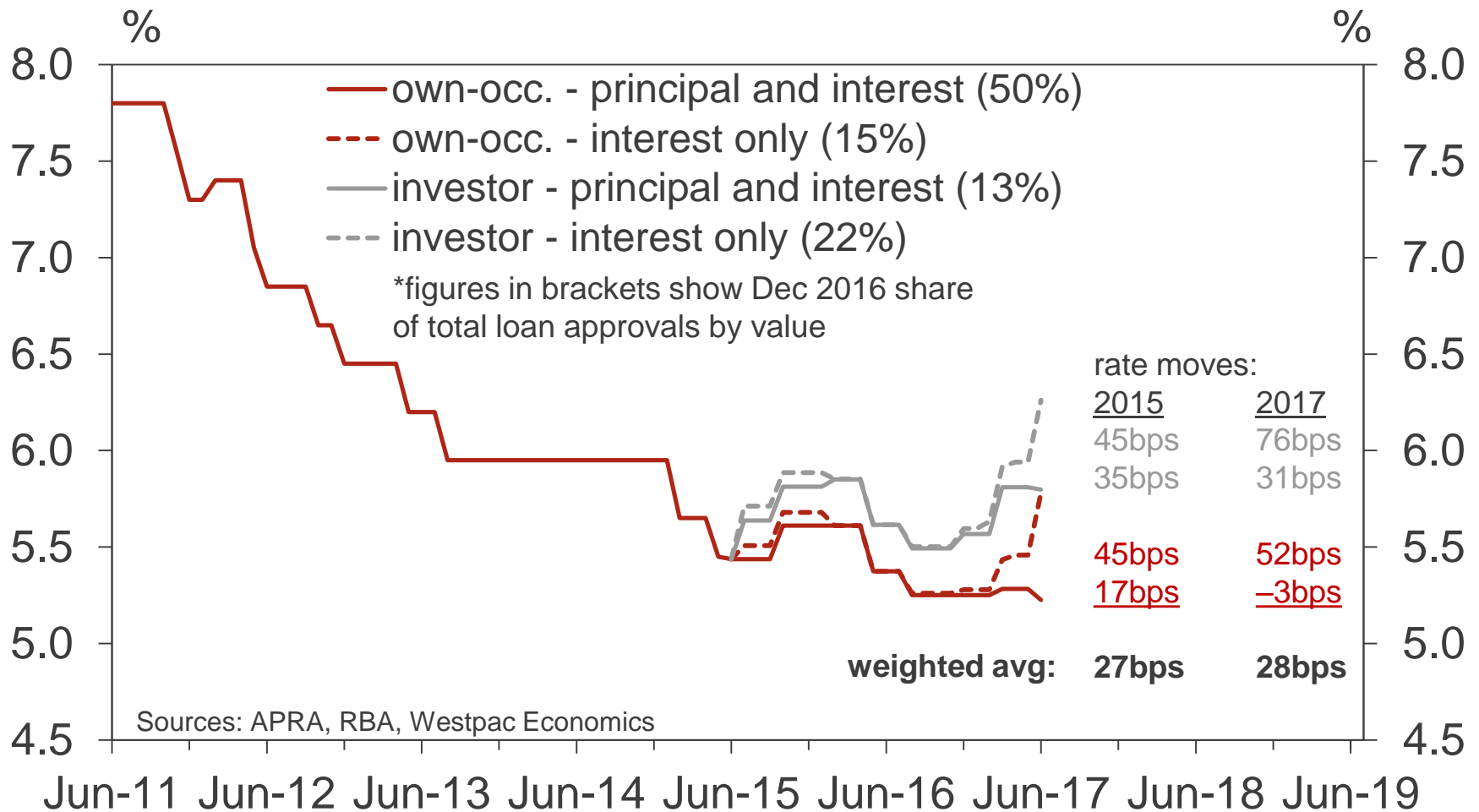
Wholesale electricity futures



Population growth

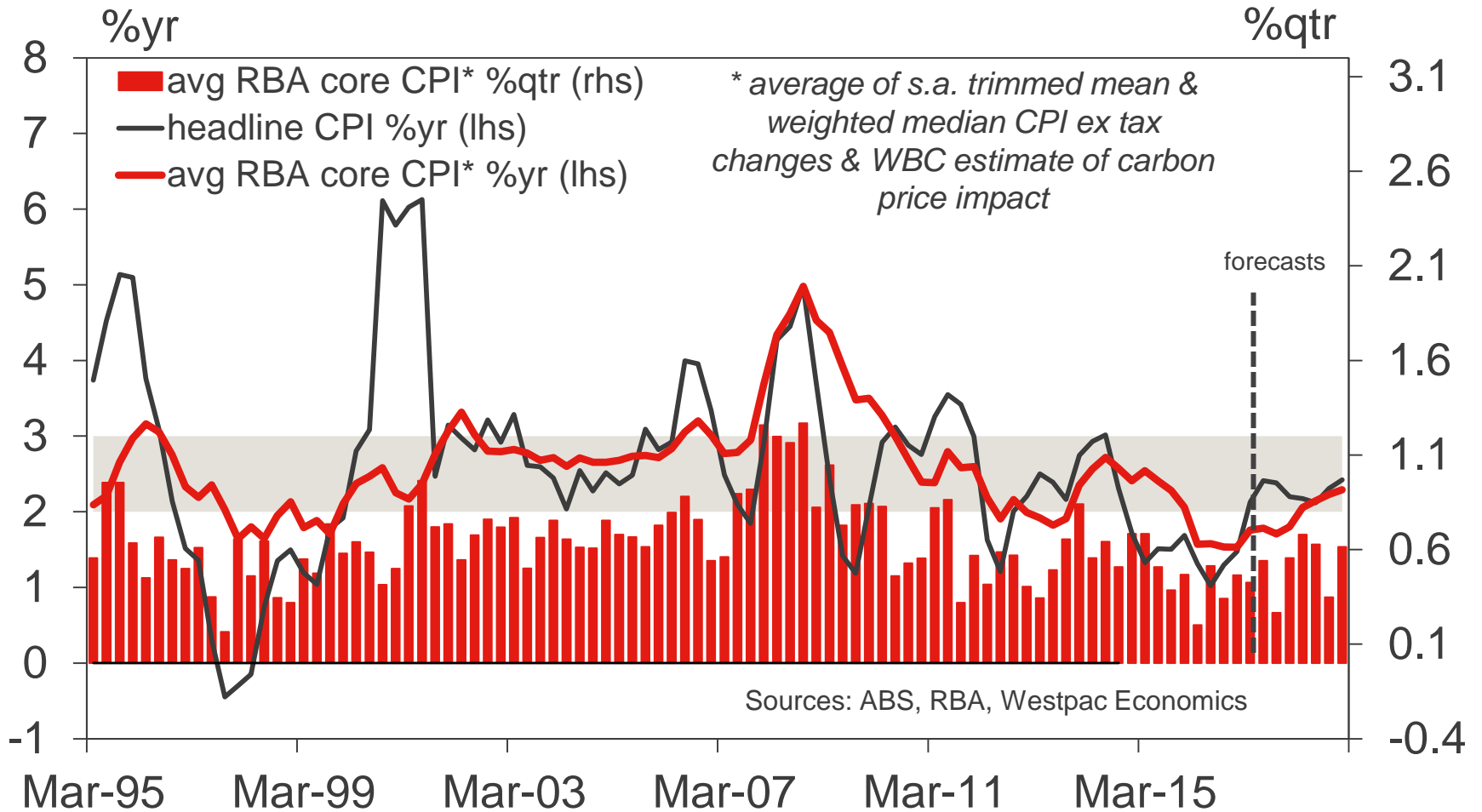


Mortgage interest rates: 'tiering'



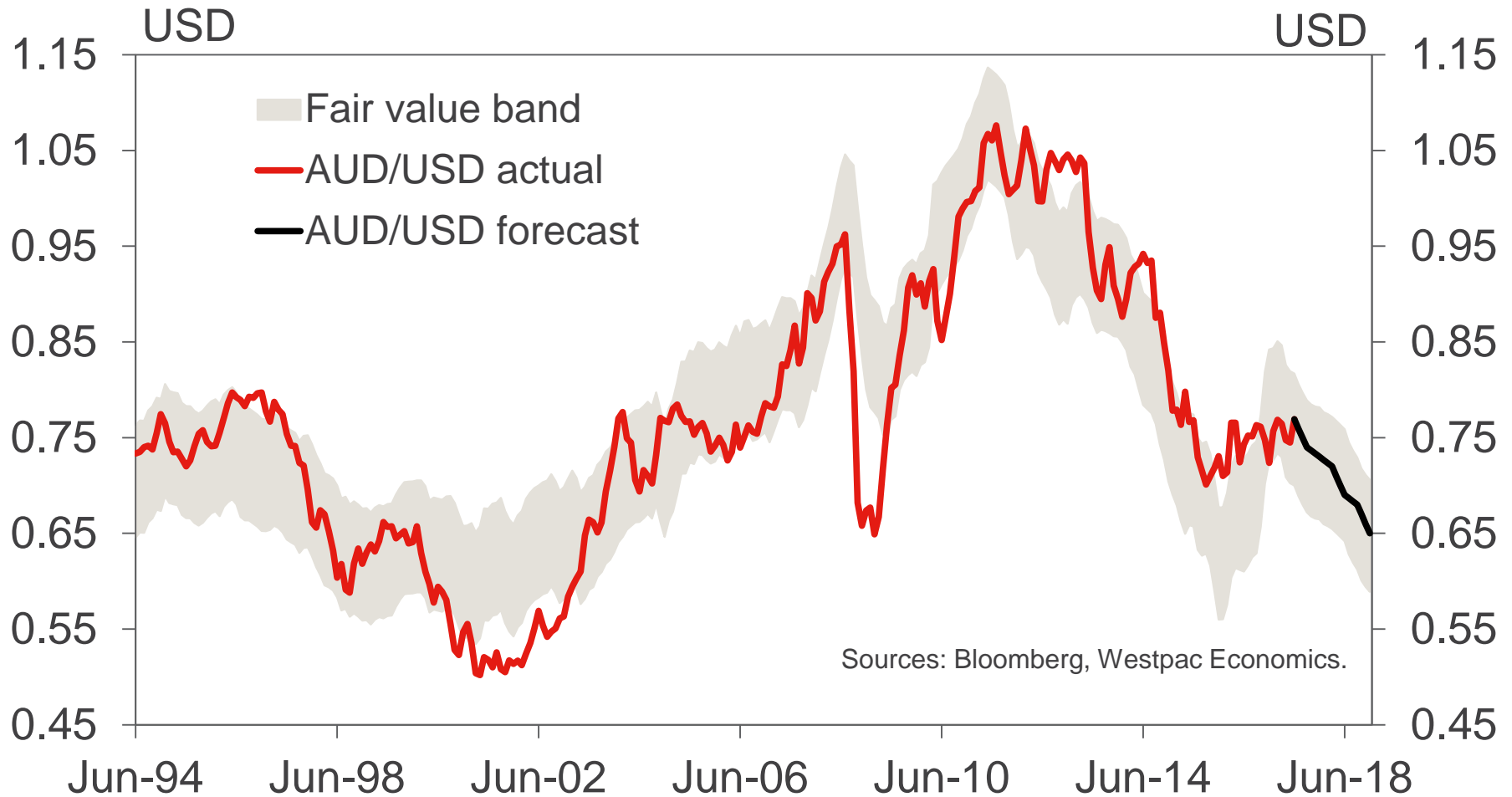
Inflation

CPI – headline and core

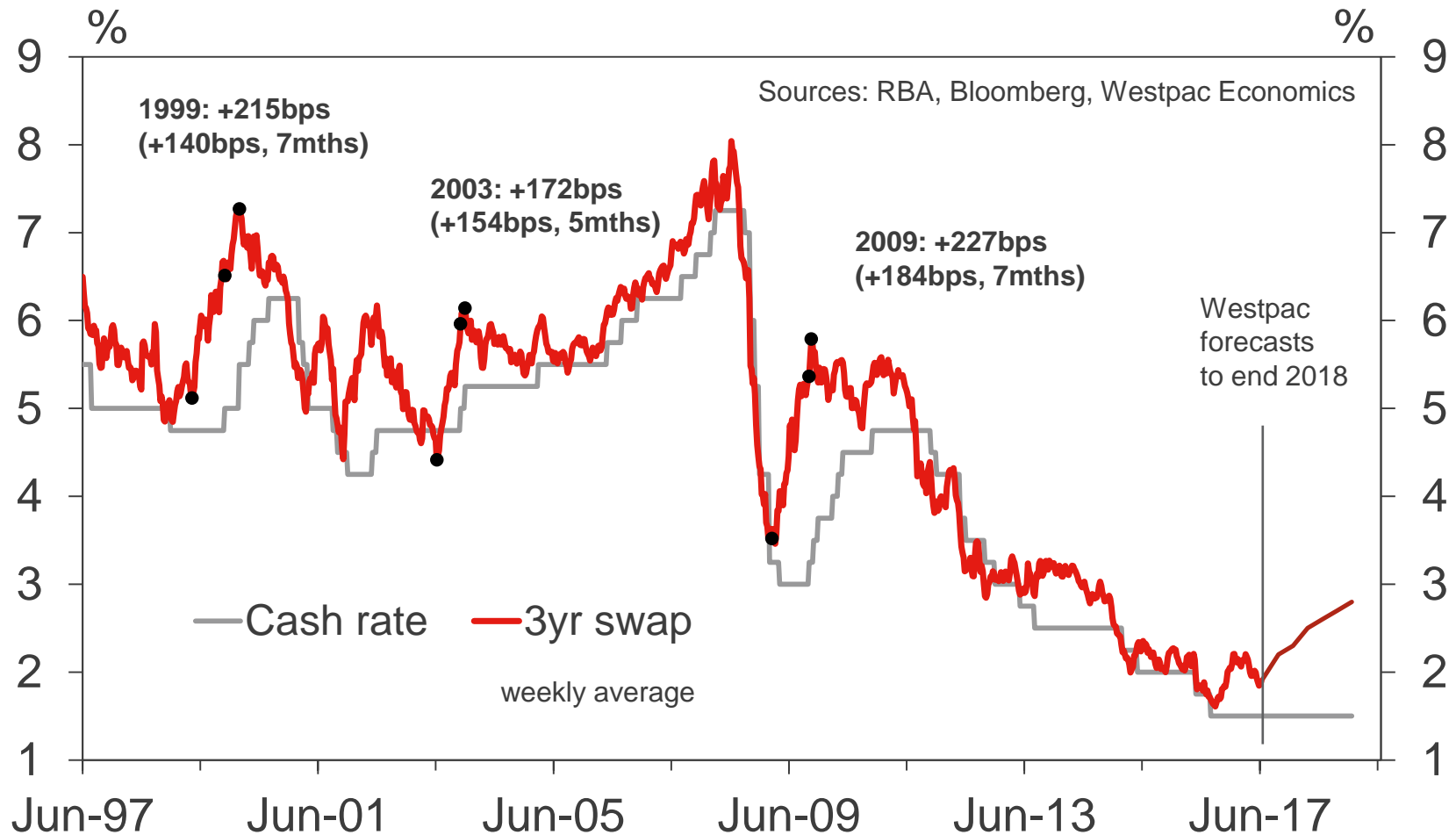


Forecasts

AUD trading into the mid band



RBA cash rate & 3 year swap



Current Forecasts – June 2017

	Latest	Jun-17	Dec-17	Jun-18	Dec 18
RBA Cash	1.50	1.50	1.50	1.50	1.50
Aus 10yr	2.50	2.75	3.05	3.25	3.40
3yr swap	1.98	2.20	2.50	2.30	2.80
Fed Funds	0.875	1.125	1.375	1.625	1.875
US 10yr	2.28	2.55	2.85	3.10	3.30
AUD/USD	0.7471	0.73	0.73	0.69	0.65

Growth risks to present themselves in 2018

- The year started strongly but is set to moderate as rates rise in the US, liquidity tightens in Europe & Japan and growth slows in China.
- The unwinding the mining boom has faded while the growth in exports associated with that investment continues, lower AUD supportive.
- Housing prices, and household debt, hit record highs. House price inflation to disappear by year's end. Slow growth in wages means consumption continues below trend.
- Inflation well contained so energy shocks more of a potential risk to business activity than underlying inflation.
- Construction cycle is very mature & growth set to slow next year.
- Business confidence soft, sales are modest and political risks remain but population growth has picked up a little.
- RBA on hold, market rates being dragged higher, AUD heading down to US65¢.

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