Snapshot

End of Financial Year

Economic Review 2013-2014

Charting a steady course

To paraphrase Mark Twain, reports of the death of the mining boom have been greatly exaggerated. The mining investment boom may be over, but Australia's mining exports are on a roll, boosting economic growth and underpinning the strong Aussie dollar.

Australia is currently enjoying the third and final act of the mining boom. Act one began a decade ago with a leap in commodity prices on the back of demand from China and other rapidly developing economies. This was followed by capital investment to boost Australia's mining capacity.

Now the investment in mines, ports and railways by resource giants BHP Billiton, Rio Tinto, Fortescue and others has paid off. As Treasurer Joe Hockey put it last month: "Our miners are exporting their socks off and thank God because it's having an impact".

Australian Key Indices as at June 2014	
GDP annual growth rate	3.5%
RBA cash rate	2.5%
Inflation	2.9%
Unemployment	5.8%
Consumer confidence index	93.2

Share Market (% Change) July 2013 – June 2014	
Australia (All Ords)	+12.7%
US (Dow Jones)	+12.9%
UK (FTSE 100)	+7.1%
China (SSE Composite)	+2.1%
Japan (Nikkei 225)	+9.0%

Note – Price Indices: excluding dividends

Solid growth

Australia's mineral exports surged in the March quarter, accounting for the lion's share of economic growth. Iron ore export volumes reached new record highs which more than made up for a fall in iron ore prices. In June, the iron ore price was hovering around a two-year low of US$92 a tonne.

On an annual basis, gross domestic product (GDP) rose by 3.5 per cent in the March quarter.

But the good news is tempered by the realisation that the boom can't last forever and other sectors of the economy need to do more of the heavy lifting. Indeed, there are encouraging signs that rebalancing is underway in sectors that are sensitive to interest rates.

In the March quarter housing construction rose strongly, at an annual rate of 8 per cent as investors piled into the local property market.

Global growth

Australia's export boom comes against a backdrop of a slowly improving global economy. The International Monetary Fund forecasts global economic growth of 3.6 per cent in 2014, led by developed nations.

In the March quarter, the US grew at an annual rate of 2 per cent while the UK and Japan grew at about 3 per cent. The Eurozone as a whole grew by 0.9 per cent after being in negative territory for several years.

China's growth slipped to a still robust 7.4 per cent but the IMF expects a further slight decline this year and next. There are concerns that a massive oversupply of new apartments and a slump in the property market will act as a drag on growth. In fact, China's slowing property market is credited as one of the negative factors dragging down iron ore prices.

By contrast, India is on the march with annual growth of 4.6 per cent in the March quarter tipped to rise to 5.4 per cent by the end of 2014 and a further one per cent in 2015.

Sharemarkets

Shares continue to be the big winners from low interest rates and cheap credit that have been a feature since equity markets hit rock bottom in 2009 in the wake of the global financial crisis.

In the last 12 months European markets have bounced back strongly on the back of slowly improving economic conditions. The recent decision by the European Central Bank to offer negative deposit rates also put a skip in the step of European bourses.

Shares rose 23 per cent in Germany, 18 per cent in France, 39 per cent in Spain and 42 per cent in the former basket case, Greece.

Japan's policy shift to aggressive quantitative easing provided support for its share market which was up a solid 9 per cent. Despite a tapering back of monetary stimulus in the US, shares closed the year up 12.9 per cent after a record-breaking run.

As the graph below shows, the local market posted a solid gain of 13 per cent as investors showed a willingness to take on more risk in the pursuit of dividend income well in excess of bank term deposit rates. Further price appreciation will depend on profit growth and a pick-up in demand outside the mining and construction sectors.

Australian Stock Market (S&P/ASX 200)

> "If the Australian dollar continues to climb back towards parity, rates could be on hold for a while longer to aid consumer confidence and support growth in non-mining sectors of the economy."

Strong Aussie dollar

The Aussie dollar has held stubbornly firm this year and there is even talk in some quarters that it could be heading back towards parity with the US dollar. As the graph below shows, the Aussie dollar hovered around US94c in June after trading in an 11c band over the past 12 months, the lowest volatility in eight years.

History shows that it is a mug's game to try and predict currency movements. What we can say with confidence is that there is strong support for the dollar at current levels.

There are good reasons for this. Australia is one of only a dozen countries in the world with a triple-A credit rating. Despite being viewed as low risk, it has some of the most attractive interest rates on offer.

Interest rates

Australia's 10-year government bond rate of 3.54 per cent is roughly 1 per cent higher than the US and UK and more than 2 per cent higher than the 10-year German bund.

The gap is even starker at the short end of the money market. The Reserve Bank has held Australia's official cash rate steady at 2.5 per cent for 10 months, but even at this historically low level it is a world-beater. Of the major developed nations, Canada comes closest with a cash rate of one per cent while the US and Eurozone are close to zero.

Residential Property

The Australian property market has been performing strongly since June 2012, fuelled by low interest rates, a shortage of supply, and solid demand from local and overseas investors.

While prices took a breather in May, demand for well-located property remains solid.

In the year to May, house prices across all capital cities rose 10.3 per cent, led by Sydney (up 15.4 per cent) and Melbourne (9.6 per cent).

Australian Dollar

Employment

The strong property market is also supported by a healthy employment market. Despite a barrage of news about job losses there is a subtle shift underway in employment trends that point to better times ahead.

In May, the unemployment rate was steady at 5.8 per cent, only slightly above the level a year ago. The good news is that in the first five months of 2014 there were 95,000 full-time jobs created, the highest number in seven years. Although this was partly offset by a fall in part-time jobs, it is an encouraging sign of a strengthening job market.

The one black spot is Australia's high youth unemployment, which is twice the national average at 12.4 per cent. One-in-three unemployed Australians is aged 15-24.

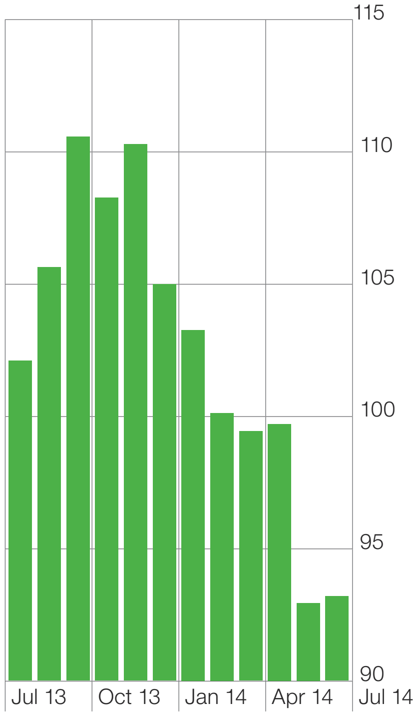
Consumer sentiment

One of the main restraints on higher rates of growth and employment is the rather glum mood of the nation. The Westpac-Melbourne Institute Index of consumer sentiment plunged in May after the Federal Budget to end the year 8.8 per cent below its level a year ago.

While consumer spending picked up in the six months to April, and household savings fell slightly, Australians snapped their wallets shut after the release of the budget, as the graph clearly illustrates.

But sentiment is just that. If the economy and the jobs market continue to improve, pessimism could quickly turn to optimism.

Australian consumer confidence



By comparison, business confidence remains steady. According to the NAB Monthly Business Survey, optimism is highest in the construction industry on the back of strong residential building commencements and lowest in the mining industry which is transitioning to the next phase of the mining boom.

Looking ahead

Most observers believe the next move in interest rates is likely to be up, but the Reserve Bank is in no hurry. If the Australian dollar continues to climb back towards parity, rates could be on hold for a while longer to aid consumer confidence and support growth in non-mining sectors of the economy.

While this transition is underway, Australia's long mining investment boom should continue to pay dividends as global growth picks up.

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