# ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

WEEK ENDING 10TH DECEMBER 2021

BOQ GROUP

## Key points

- **Business investment is on track to rise strongly in Australia this year;**
- **That is good news as it will boost productivity growth;**
- **Part of the reason for stronger business investment is cyclical;**
- **But there has been a sustained strong rise in spending on digitisation that is likely to continue in coming years.**

## Summary

**Typically weak economic growth would see firms' take a seat on the sidelines. But this time things really are different. Firms are looking to substantially increase the size of their capex budgets. Spending on building and structures could be strong. But budgets for equipment purchases are expected to be even stronger.**

**Stronger business investment is unambiguously a good thing. Total investment in the economy (as a proportion of GDP) has been trending down over recent years, one of the causes of slowing productivity growth. The decline of investment has mainly reflected weaker capex spending by firms'. This has been partially offset by stronger Government investment on infrastructure and defence spending.**

**One area where business investment has been consistently strong over recent years has been on IT. Spending on 'hardware' (computers) has generally been trending up although there was a period when it declined (relative to GDP) a reflection of the weaker economic outlook and the fall in capex spending more generally. But there has been a sustained strong trend rise in spending on software ('digitisation'), one that has been impervious to cyclical movements in the economy.**

**The trend rise in software spending (and IT more generally) has a lot further to run. Software spending in the US is twice as big (relative to the size of GDP) as it is in Australia. Another reason is that the rate of online spending in Australia is less than half of what is spent in China and the UK.**

**A lot of the digitisation focus to date has been about online becoming another distribution channel. But there are significant productivity gains to be made by digitising the 'Back Office'. For example, about one half of firms have no automated IT links. While about one-third have automatic links for invoicing or payments, less than one fifth have automatic links to suppliers or their logistics.**

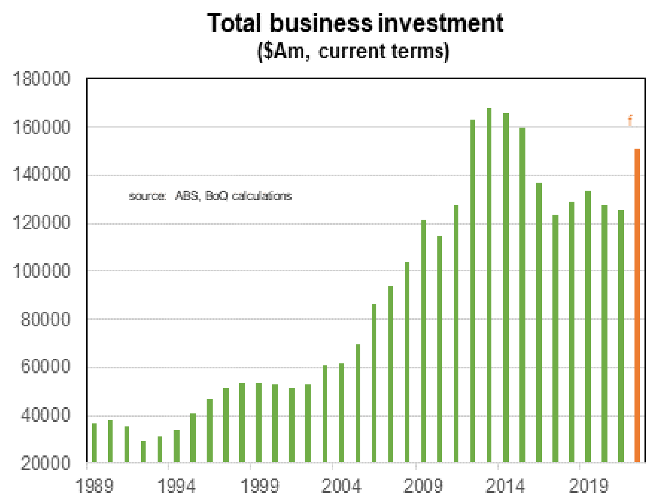
### Investing for the future

Recently we found out that the Australian economy in the September quarter recorded its third largest quarterly decline on record (data on quarterly GDP growth began in 1959). Typically such a large hit to the economy would see firms' take a seat on the sidelines until there was clear signs that business activity was on the improve. But this time things really are different. The Government and the RBA have successfully absorbed the blow to private sector incomes that typically comes from weak economic growth. This meant that once lockdowns came to an end there was plenty of money to spend.

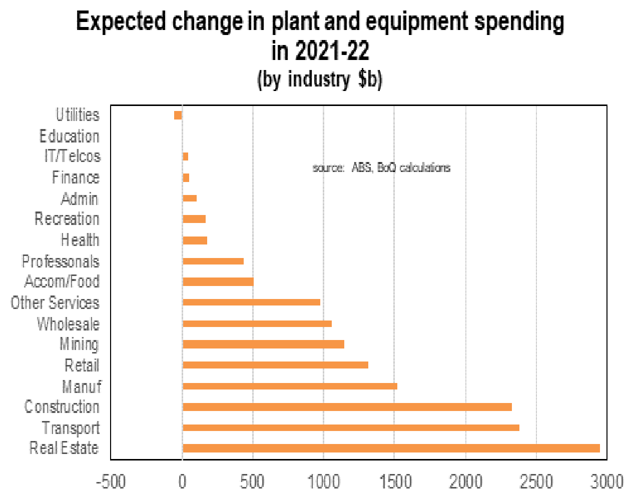
All of this extra spending has meant firms have wanted to up the size of their capex budgets. Government incentives have also played a role, as have low interest rates. Many firms have plenty of cash in the bank and profit margins in many sectors are high. Banks' are happy to lend. A recent ABS survey suggested that business investment could be up almost 20% this financial year.

Firms indicate that spending on building and structures could be strong. But budgets for equipment purchases are expected to be even stronger. Equipment spending will be strong across most sectors, but particularly in the real estate, construction (reflecting the big residential construction boom) and Transport and Warehousing (due to higher demand for storage due to increased online shopping) industries.

**Businesses report they are likely to significantly boost capex spending this financial year.**

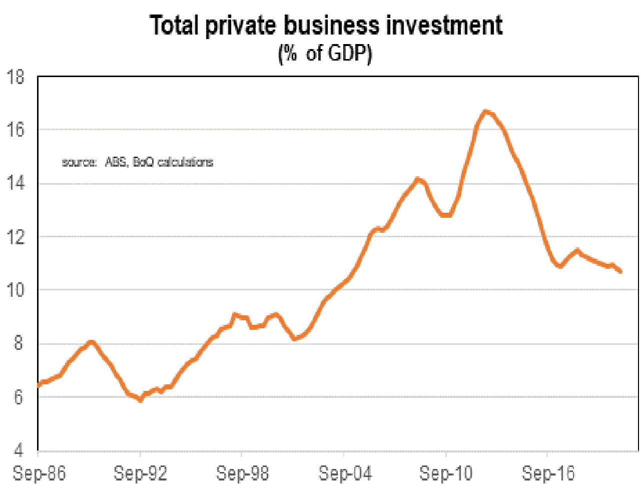



**There is likely to be strong demand for equipment across many sectors.**

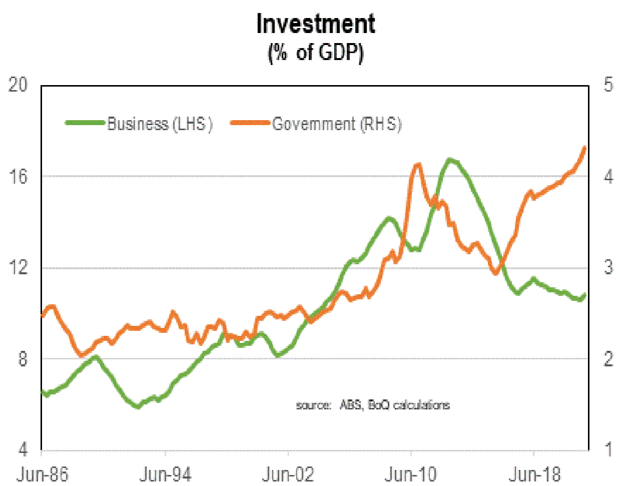



That business investment is on track to rise substantially this financial year is unambiguously a good thing. Total investment in the economy (as a proportion of GDP) has been trending down over recent years, one of the causes of slowing productivity growth. The decline of investment has mainly reflected weaker capex spending by firms'. This has been partially offset by stronger Government investment on infrastructure and defence spending. Much of the slowing of business investment was a result of the end of Australia's largest-ever mining boom and the general uncertainty about the economic outlook post-GFC.

**The strong rise in business investment follows a period of slower spending.**

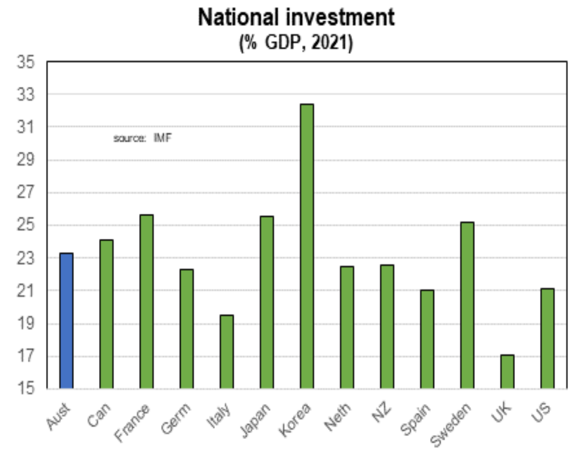



**This has been partly offset by a strong rise in infrastructure and defence capital spending.**

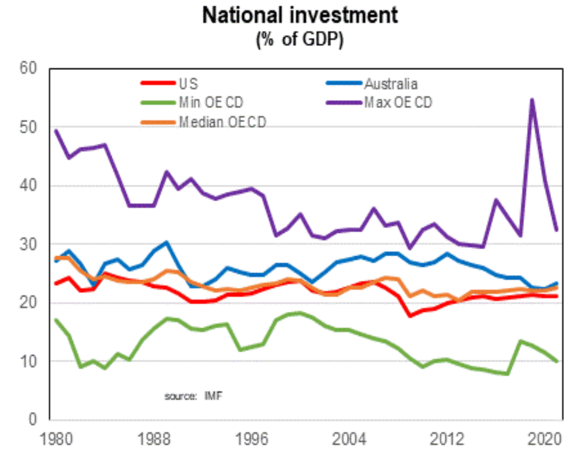



While Australia's national investment rate has declined over recent years it has remained above most OECD countries. That typically is the case as Australia has historically enjoyed faster economic growth, stronger population increase and has a larger mining sector (mining is a very capital intensive sector). Investment rates are higher in Japan and South Korea (larger manufacturing sectors) and smaller in the UK (bigger service sector, particularly finance).

**Australia will do relatively more investment than many other OECD countries this year.**

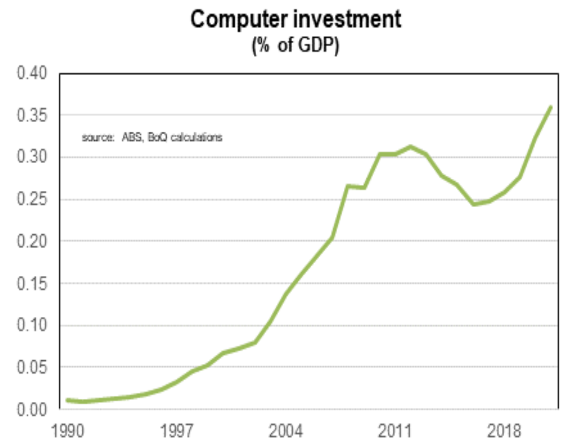



**And that has been the case for some time.**

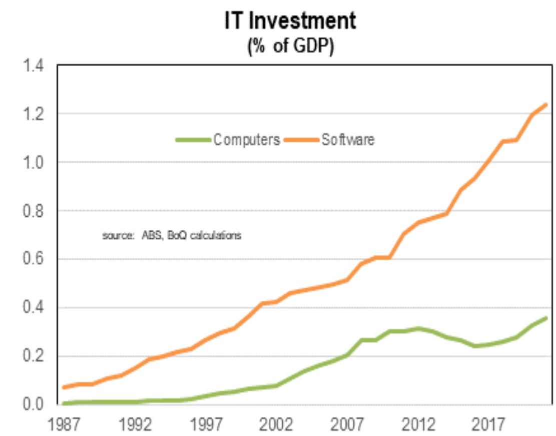



While business investment has been weak over recent years' one area where it has been consistently strong has been on IT. Spending on 'hardware' (computers) has generally been trending up although there was a period when it declined (relative to GDP) a reflection of the weaker economic outlook and the fall in capex spending more generally. But there has been a sustained strong trend rise in spending on software ('digitisation'), one that has been impervious to cyclical movements in the economy. To date software spending has been strongest in the faster-growing service sectors (Finance, Professionals, IT), as well as the Government.

**Investment on computers is back on the rise in Australia.**

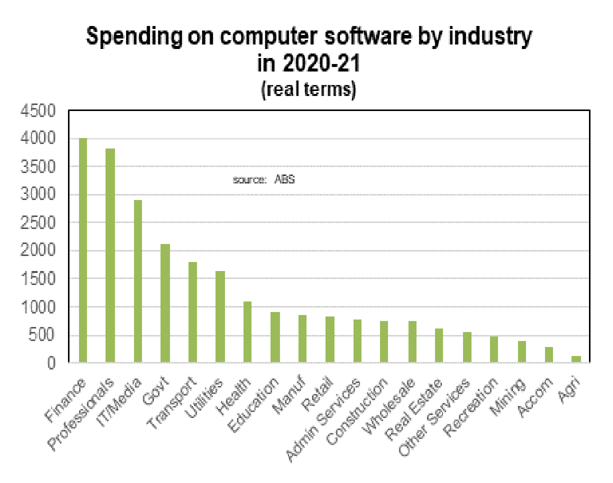



**But spending on software has been rising strongly for decades.**

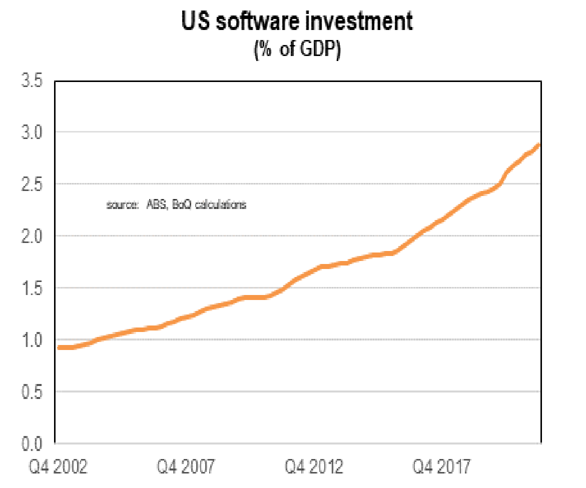



There are plenty of reasons to think this trend rise in software spending (and IT more generally) has a lot further to run. Software spending in the US is twice as big (relative to the size of GDP) as it is in Australia, although that may partly reflect that the US has a substantially larger technology sector.

**Spending on software to date that has mainly happened in the service industries.**




**Software spending is substantially higher in the US.**

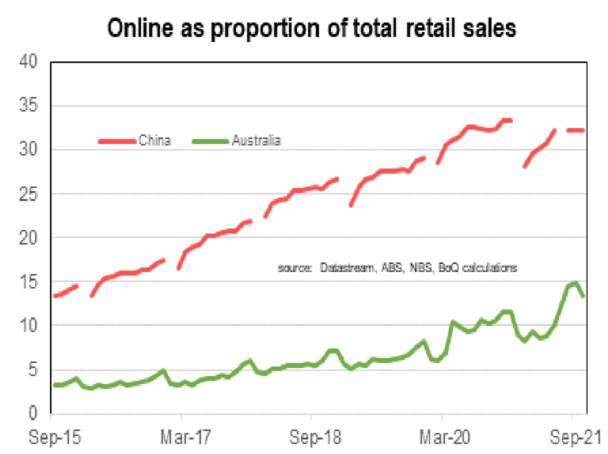



Another reason to expect a rise of spending on digitisation is the increasing proportion of household spending that is occurring online. While that rate of spending has risen sharply in Australia (particularly since the pandemic) it is less than half of what spent in China and the UK (although the proportion of online sales is around the same pace as in the US).

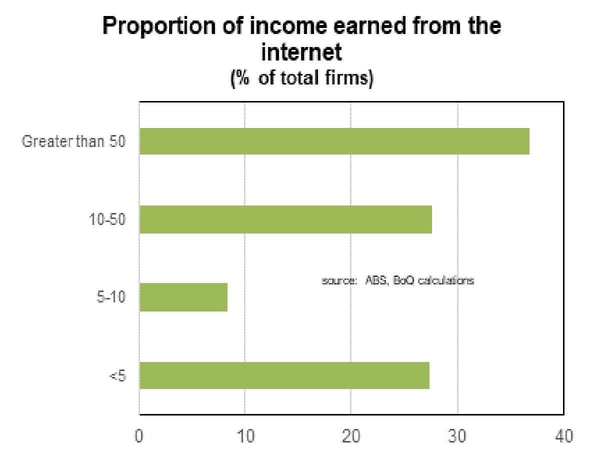
Firms are also benefitting in this change in consumer behaviour, with over one-half of companies earning at least 10% of their revenue from online (small firms in particular benefit from online sales). But over one quarter of firms earn less than 5% selling online. The proportion of firms receiving orders online is lower than the proportion of firms doing the ordering. That proportion is particularly low in agriculture and mining, probably reflecting that there are few buyers for the products sold.

A lot of the digitisation focus to date has been about online becoming another distribution channel. But there are significant productivity gains to be made by digitising the 'Back Office'. For example, about one half of firms have no automated IT links. While about one-third have automatic links for invoicing or payments, less than one fifth have automatic links to suppliers or their logistics.

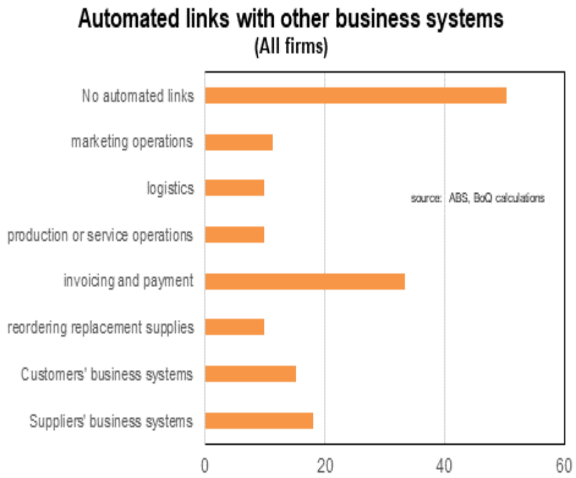
**Online spending has increased strongly in Australia. But it is well behind what is happening in China**



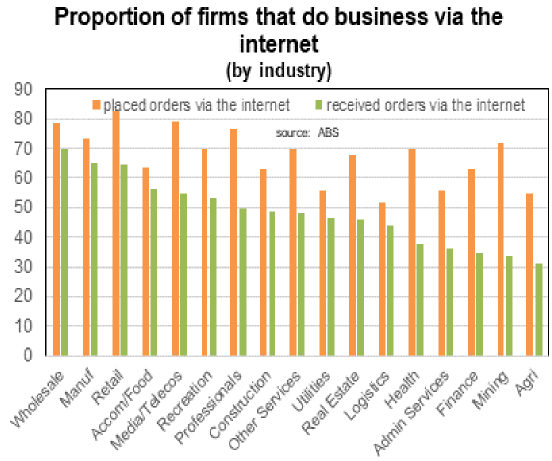

**A growing number of firms are earning more of their income from the internet.**



**There remains scope for digitisation to improve efficiency in the 'back office'.**




**Firms have been better about placing than receiving orders over the internet.**




Business investment is on the rise in Australia. Mostly that reflects the strong cyclical improvement in the economy at a time of very low interest rates, easy access to finance and government incentives. After a period of weak capex spending this rise of investment is welcome as it will play an important role in boosting Australia's productivity growth.

But beyond the cyclical shift of business investment there is the trend story of the strong rise of spending on digitisation. Spending on software has jumped particularly sharply over the past decade. And there are good reasons to think that further strong rises are likely over the next decade.

This is my last note for the year. I wish everyone a fantastic festive season, and a wonderful 2022.

We live in interesting times.

Regards

**Peter Munckton**
**Chief Economist**
**Bank of Queensland**