

AUSTRALIAN MARKETS WEEKLY

Analysing corporate income and cash flow



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Analysis – Analysing corporate income and cash flow

- With business investment plumbing the depths, we have analysed trends in corporate income. Total income is growing strongly, led by a boom in mining profits as non-mining profits languish. Growth in disposable income is more measured.
- The wedge between total and disposable income mainly reflects sharply higher dividends and tax payments, more than offsetting the lowest interest payments since the 1960s. As a result, net cash flow for corporates - which is income less investment - is the best since the early 2000s.
- A return to more normal circumstances - where net cash flow is more negative as companies borrow to invest - hinges on a recovery in consumer demand to spur investment. That seems some time off given wage growth has stalled, such that more policy support is likely to be required, where some government assistance to encourage investment would be helpful.

The week ahead – Australian wages and labour market; RBNZ rate cut; Fed testimony

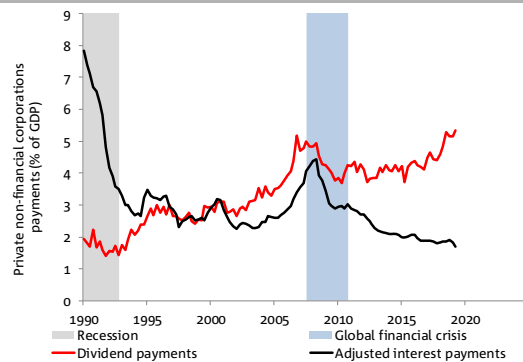
- Australian wage growth has broadly stalled and we expect slower growth in the wage price index of 0.5% in Q3, with annual growth of 2.2% (mkt: 0.5%/2.2%). Slow wage growth reflects spare capacity in the labour market, where we forecast unemployment will edge up to 5.3% in October (mkt: 5.2%), notwithstanding solid employment growth of 20k (mkt: 16k). The NAB business survey on Tuesday provides a key update on the state of the business sector. For Wednesday’s RBNZ Monetary Policy Statement we think the OCR committee will, in a finely-balanced decision, err on the side of a 25bp cut in the cash rate to 0.75% and maintain a slight easing bias. This is mainly because it remains nervous about NZ GDP growth not being as strong as it forecast in August.
- Globally, the focus remains on whether the US and China can finalise an interim trade deal. Fed Chair Powell’s semi-annual testimony is likely to be less important than usual given he recently signalled a pause unless the outlook changes materially. In China, annual growth in Thursday’s industrial production should slow to 5.4%, although the construction sector is benefiting from fiscal stimulus. German GDP is expected to be flat in Q3 after falling by 0.1% in Q2.

Key markets over the past week

	Last	% chg week	Last	bp/% chg week
AUD	0.6856	-0.4	RBA cash	0.75 0
AUD/CNY	4.80	-1.1	3y swap	0.91 0
AUD/JPY	74.8	0.0	ASX 200	6,763 1.1
AUD/EUR	0.622	0.6	Iron ore	78 -3.2
AUD/NZD	1.080	0.5	Brent oil	62.0 -0.3

Source: Bloomberg

Chart of the week: Corporates have lifted dividends



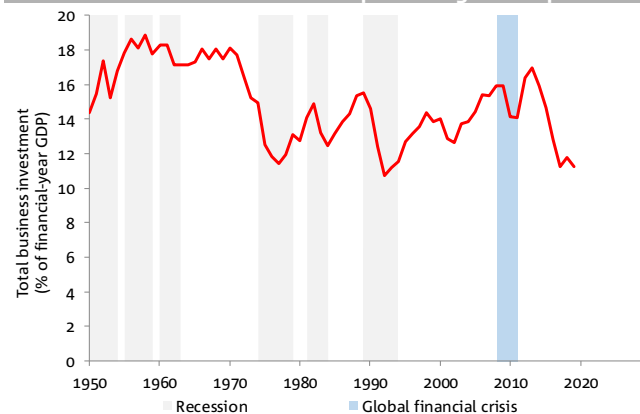
Analysing corporate income and cash flow

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Weakness in business investment contrasts with strong profit-led growth in corporate income

With business investment exceptionally weak at present – reflecting both the end of the construction phase of the mining boom and weak non-mining business investment – we have analysed recent trends in business income, concentrating on private non-financial corporations.

Chart 1: Business investment is plumbing the depths



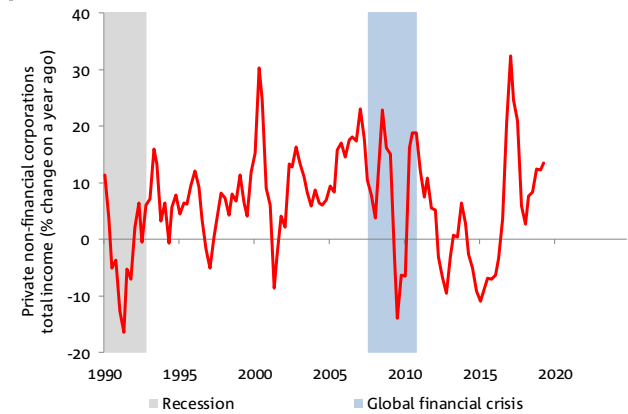
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Contrasting with the weakness in investment, non-financial corporate income is strong, growing at an annual rate of 12%. This is much faster than the growth in the overall economy, such that income has reached 22% of GDP. This is up from the recent low of 17% of GDP in 2016 and is approaching the multi-decade high of 24% attained in 2008 at the height of the mining boom.

Most of the strength in corporate income reflects profits, which are growing at an annual rate of 15%.¹ This compares with non-profit income – such as income from interest, dividends and rent – which has increased by only 2% over the past year. As a result, the profit share of GDP has increased to 20%, up from a recent low of 15% and almost back at the 21% peak reached in 2008.

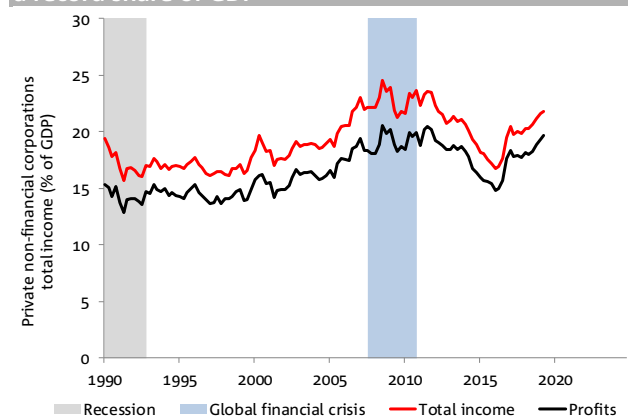
¹ Profits are defined as the national accounts measure of gross operating surplus.

Chart 2: Corporate income is growing at a rapid rate



Note: Total income = profits + non-profit income (e.g. interest income, dividends and rent on natural assets).
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Chart 3: Non-financial corporate income is approaching a record share of GDP

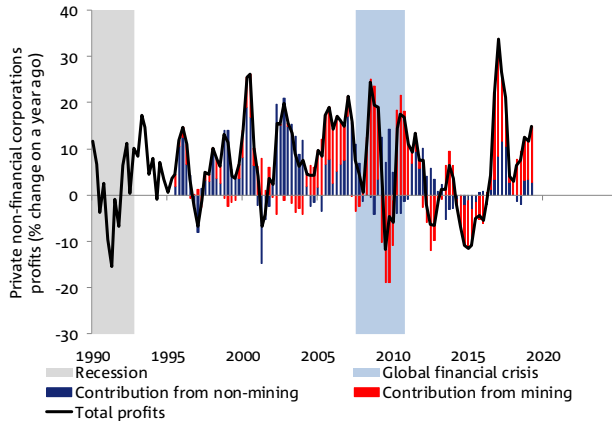


Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

The strength in profits is driven by mining as non-mining profits are languishing

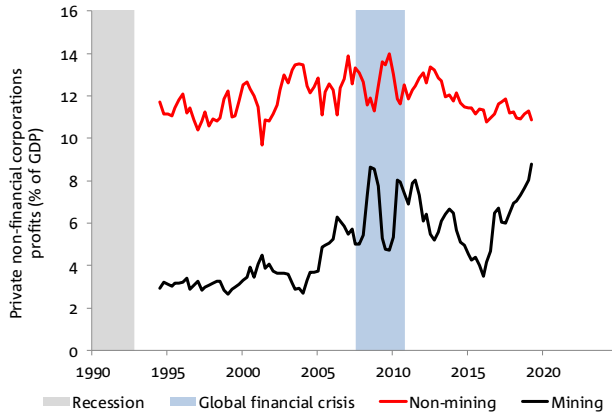
Notably, the strength in profits reflects the mining sector. Resource sector profits are booming at present, increasing by 31% over the past year, such that they now account for 9% of GDP, slightly above the all-time high achieved in 2008. Non-mining profits have also increased, but at a more moderate rate of 4%. With national income growing at an annual rate of 5%, the non-mining share of GDP continues to languish at 11%. The non-mining profit share has been stuck around this low level for about five years now, down from the peak of 14% in 2009.

Chart 4: Mining is driving the strong growth in corporate profits



Note: Quarterly estimates of mining profits were derived from the annual national accounts using the Denton procedure.
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Chart 5: Mining profits have reached a record share of GDP, while the non-mining profit share remains low

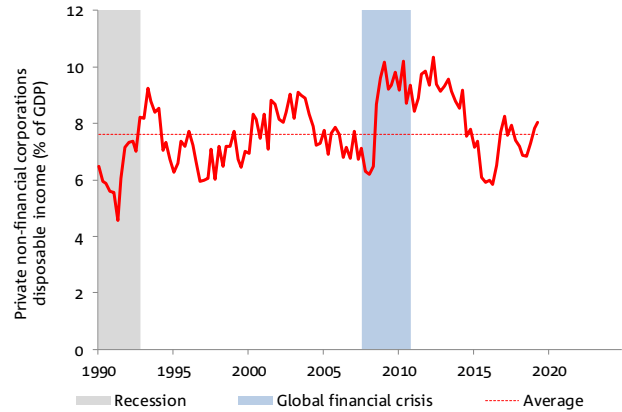


Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

The strength in corporate income has faded by the time it reaches corporate disposable income

Some of the strength in corporate income, which has seen it approach the multi-decade peak share of GDP attained in 2008, has dissipated by the time it reaches corporate disposable income. Corporate disposable income, which is income less reinvested earnings, interest, dividends, tax and other payments, has picked up to 8% of GDP. This compares with the recent low of 6% in 2016 and broadly matches the average share of the past few decades.

Chart 6: Corporate disposable income is near its long-term average

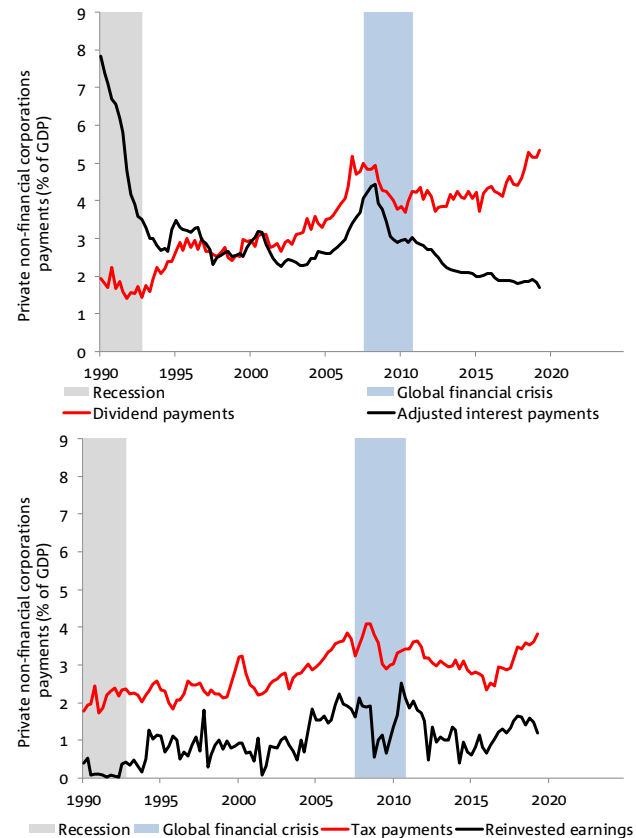


Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

This wedge between total and disposable corporate income largely reflects higher tax and dividend payments, with interest payments at their lowest level in decades and reinvested earnings only moderately above their long-run average.

- **Dividend payments** have reached 5% of GDP, slightly exceeding the multi-decade peak reached in 2006.
- **Interest payments**, which are adjusted by the Bureau of Statistics to exclude the estimated cost of financial intermediation, have fallen to 2% of GDP, which is the lowest level since the late 1960s.
- **Tax payments** are dominated by company income tax and have reached 4% of GDP, matching the peak reached in 2008.
- **Reinvested earnings** have fallen to 1% of GDP, in line with their long-run average.

Chart 7: Dividend and tax payments are high, while interest payments are extremely low



Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

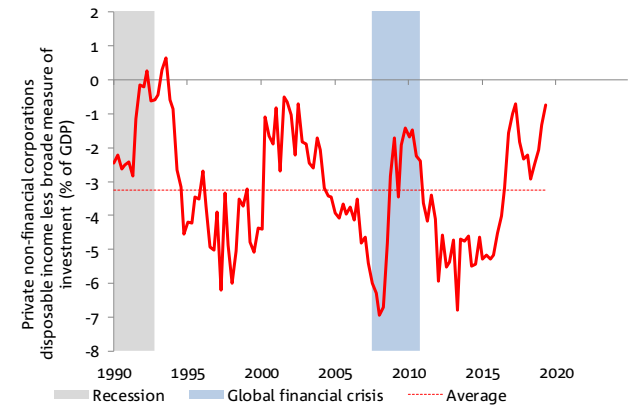
The strength in corporate income has faded by the time it reaches corporate disposable income

Although corporate disposable income has been held back by companies lifting dividends and paying more tax, the net cash flow position of corporates is actually close to balance given weak business investment. Net cash flow – which equals corporate saving less investment – is normally strongly negative at about -3% of GDP as companies borrow to invest. At present, net cash flow has shrunk to -1% of GDP, which is the smallest shortfall since the economic slowdown of the early 2000s.

We are unable to split net cash flow by sector due to a lack of historical data on tax, dividends and interest payments, but we suspect that the bulk of the

turnaround reflects the resource sector where mining investment has fallen to near pre-boom levels and profits are booming on the expansion in production and still-high commodity prices. That said, there may have been some improvement in the net cash flow of non-mining companies given both non-mining investment and profits are weak.

Chart 8: The net cash flow of corporates is the best in years



Note: Net cash flow position = net lending = corporate disposable income – gross investment. Corporate disposable income also excludes net capital transfers. Gross investment = gross fixed capital expenditure + change in inventories + net acquisition of non-produced, non-financial assets. Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

A turnaround in cash flows requires stronger demand to spur investment

In our view, a return to normal times for non-mining businesses, where corporate net cash flow is more negative as companies borrow from other sectors in the economy to invest, likely hinges on a sustained pick-up in consumer spending to drive a recovery in investment.

Unfortunately, an acceleration in consumption looks some time off given wage growth has stalled on the back of spare capacity in the labour market. Further policy support seems necessary – easier monetary policy will likely be delivered, although a better option would be timely additional fiscal stimulus from government.

Also, it is worth noting that the current boom in mining profits should ease given the temporary boost to iron ore prices from supply disruptions in Brazil.

Kieran Davies

CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
Monday 11 November 2019								
NZ	REINZ House Sales YoY	Oct		--		3.3	10 to 15 Nov	
UK	Industrial Production MoM	Sep		0.2		-0.6	9.30	20.30
UK	GDP QoQ	3Q P		0.4		-0.2	9.30	20.30
UK	GDP YoY	3Q P		1.1		1.3	9.30	20.30
Tuesday 12 November 2019								
NZ	ANZ Truckometer Heavy MoM	Oct		--		2.4	21.00	8.00
NZ	Net Migration SA	Sep		--		3530	21.45	8.45
AU	NAB Business Conditions	Oct		--		2	0.30	11.30
NZ	2Yr Inflation Expectation	4Q		--		1.86	2.00	13.00
UK	Jobless Claims Change	Oct		--		21.1	9.30	20.30
UK	ILO Unemployment Rate 3Mths	Sep		3.9		3.9	9.30	20.30
GE	ZEW Survey Current Situation	Nov		-26		-25.3	10.00	21.00
US	NFIB Small Business Optimism	Oct		102		101.8	11.00	22.00
Wednesday 13 November 2019								
NZ	Food Prices MoM	Oct		--		0	21.45	8.45
AU	Westpac Consumer Conf Index	Nov		--		92.8	23.30	10.30
JN	PPI YoY	Oct		-0.1		-1.1	23.50	10.50
AU	Wage Price Index QoQ	3Q	0.5	0.5		0.6	0.30	11.30
AU	Wage Price Index YoY	3Q	2.2	2.2		2.3	0.30	11.30
NZ	RBNZ Official Cash Rate	Nov 13	0.75	0.75		1	1.00	12.00
GE	CPI MoM / YoY	Oct F		0.1 / 1.1		0.1 / 1.1	7.00	18.00
UK	CPI MoM / YoY	Oct		0.1 / 1.7		0.1 / 1.7	9.30	20.30
US	CPI MoM / YoY	Oct		0.3 / 1.7		0 / 1.7	13.30	0.30
US	Fed's Powell addresses Joint Economic Committee of Congress						16.00	3.00
Thursday 14 November 2019								
NZ	RBNZ Governor speaks before parliament on monetary policy statement						19.10	6.10
AU	RBA's Bullock takes part in Melbourne panel						22.50	9.50
JN	GDP SA QoQ	3Q P		0.2		0.3	23.50	10.50
JN	GDP Deflator YoY	3Q P		0.5		0.4	23.50	10.50
AU	Consumer Inflation Expectation	Nov		--		3.6	0.00	11.00
AU	Employment Change	Oct	20	18		14.7	0.30	11.30
AU	Unemployment Rate	Oct	5.3	5.2		5.2	0.30	11.30
AU	Participation Rate	Oct	66.2	66.1		66.1	0.30	11.30
CH	Retail Sales YoY	Oct		7.8		7.8	2.00	13.00
CH	Fixed Assets Ex Rural YTD YoY	Oct		5.4		5.4	2.00	13.00
CH	Industrial Production YoY	Oct		5.4		5.8	2.00	13.00
GE	GDP SA QoQ	3Q P		0		-0.1	7.00	18.00
GE	GDP WDA YoY	3Q P		0.5		0.4	7.00	18.00
EC	GDP SA QoQ	3Q P		0.2		0.2	10.00	21.00
EC	GDP SA YoY	3Q P		1.1		1.1	10.00	21.00
US	PPI Final Demand MoM	Oct		0.3		-0.3	13.30	0.30
US	Fed's Clarida speaks at Cato Institute in Washington						14.00	1.00
US	Fed's Powell appears before house budget committee						15.00	2.00
US	Fed's Daly speaks at economic policy conference						16.45	3.45
US	Fed's Williams speaks at economic policy conference						17.00	4.00
US	Fed's Bullard speaks in Louisville						17.20	4.20
Friday 15 November 2019								
NZ	BusinessNZ Manufacturing PMI	Oct		--		48.4	21.30	8.30
AU	RBA's Debelle speaks at FINSIA event on regulation						1.30	12.30
JN	Industrial Production MoM	Sep F		--		1.4	4.30	15.30
EC	CPI MoM	Oct F		0.2		0.2	10.00	21.00
EC	CPI YoY	Oct F		0.7		0.8	10.00	21.00
US	Empire Manufacturing	Nov		6		4	13.30	0.30
US	Retail Sales Advance MoM	Oct		0.2		-0.3	13.30	0.30
US	Industrial Production MoM	Oct		-0.3		-0.4	14.15	1.15
Upcoming Central Bank Interest Rate Announcements								
New Zealand, RBNZ		Nov 13	0.75	0.75		1.00		
Australia, RBA		Dec 3	0.50	0.75		0.75		
US, Federal Reserve		Dec 11	1.5/1.75	1.5/1.75		1.5/1.75		
Europe, ECB		Dec 12	-0.50	-0.50		-0.50		
Japan, BoJ		Dec 19	-0.10	-0.10		-0.10		
UK, BOE		Nov 7	0.75	0.75		0.75		

GMT: Greenwich Mean Time; AEDT: Australian Eastern Daylight Time

FORECASTS

Economic Forecasts																				
	Annual % change				Quarterly % change															
	2018	2019	2020	2021	2018				2019				2020				2021			
Australia Forecasts	2018	2019	2020	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.6	1.4	1.7	2.3	0.5	0.8	0.3	0.4	0.3	0.4	0.3	0.3	0.4	0.5	0.6	0.5	0.6	0.6	0.6	0.6
Underlying Business Investment	1.2	-2.1	0.2	1.9	0.7	-0.8	-2.1	0.1	-0.2	-0.6	-0.3	-0.5	0.1	0.1	1.1	0.5	0.4	0.4	0.2	0.4
Residential Construction	4.8	-8.6	-8.1	-0.9	3.3	2.8	0.1	-2.8	-2.2	-4.4	-2.7	-2.4	-2.1	-1.3	-1.7	-0.5	0.1	0.2	0.5	0.8
Underlying Public Spending	4.3	4.2	3.8	3.6	1.4	-0.1	2.1	0.8	1.1	1.4	0.4	0.8	1.1	1.1	0.9	0.9	0.8	0.8	0.8	0.9
Net Exports (a)	0.8	1.6	-0.1	-0.2	0.6	0.0	0.4	-0.2	0.4	0.6	0.3	0.3	0.0	0.0	-0.1	0.0	0.0	0.0	-0.1	0.0
Inventories (a)	0.1	-0.4	0.1	0.1	0.0	0.2	-0.3	0.2	-0.1	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Domestic Demand (q/q %)	-	-	-	-	0.9	0.5	0.4	0.2	0.1	0.3	0.2	0.2	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7
Dom Demand (y/y %)	2.8	0.9	1.7	2.6	3.5	3.3	2.5	2.0	1.2	1.0	0.8	0.8	1.2	1.4	1.9	2.2	2.5	2.6	2.7	2.8
Real GDP (q/q %)	-	-	-	-	1.0	0.7	0.3	0.1	0.5	0.5	0.5	0.5	0.6	0.5	0.7	0.6	0.6	0.6	0.6	0.7
Real GDP (y/y %)	2.7	1.7	2.2	2.5	3.1	3.1	2.6	2.2	1.7	1.4	1.6	2.0	2.1	2.1	2.3	2.4	2.4	2.6	2.5	2.6
CPI headline (q/q %)	-	-	-	-	0.4	0.4	0.4	0.5	0.0	0.6	0.4	0.6	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.7
CPI headline (y/y %)	1.9	1.5	1.8	2.2	1.9	2.1	1.9	1.8	1.3	1.6	1.6	1.6	2.0	1.7	1.8	1.9	2.0	2.1	2.3	2.3
CPI underlying (q/q %)	-	-	-	-	0.5	0.5	0.4	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
CPI underlying (y/y %)	1.9	1.4	1.5	1.9	1.9	1.9	1.8	1.8	1.5	1.4	1.4	1.3	1.5	1.5	1.5	1.6	1.7	1.9	2.0	2.0
Private wages (q/q %)	-	-	-	-	0.5	0.6	0.5	0.6	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Private wages (y/y %)	2.1	2.3	2.5	2.8	1.9	2.1	2.1	2.3	2.4	2.3	2.3	2.3	2.4	2.5	2.6	2.6	2.7	2.7	2.8	2.8
Unemployment Rate (%)	5.3	5.2	5.4	5.5	5.5	5.6	5.1	5.0	5.0	5.2	5.2	5.3	5.3	5.4	5.5	5.5	5.5	5.4	5.4	5.5
Terms of trade	2.0	3.2	-7.9	1.8	3.3	-1.3	1.1	3.0	3.1	1.5	-4.4	-4.7	-2.6	-0.6	0.9	-0.2	1.2	0.6	-0.1	-0.1
Current Account (% GDP)	-2.1	0.3	-1.0	-0.8	-2.2	-2.7	-2.2	-1.4	-0.2	1.2	0.5	-0.3	-0.9	-1.1	-1.0	-1.0	-0.8	-0.7	-0.8	-0.9

Source: NAB Group Economics; (a) Contributions to GDP growth

Exchange Rate Forecasts						
	11-Nov	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Majors						
AUD/USD	0.686	0.69	0.68	0.69	0.70	0.71
NZD/USD	0.63	0.65	0.65	0.65	0.66	0.67
USD/JPY	109.1	110	109	109	108	110
EUR/USD	1.10	1.12	1.14	1.16	1.16	1.17
GBP/USD	1.28	1.33	1.35	1.35	1.35	1.33
USD/CNY	7.00	7.00	7.05	7.00	6.90	6.85
USD/CAD	1.32	1.30	1.31	1.30	1.30	1.31
USD/CHF	1.00	0.99	0.98	0.96	0.96	0.96

Australian Cross Rates						
	11-Nov	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/NZD	1.08	1.06	1.05	1.06	1.06	1.06
AUD/JPY	74.8	76	74	75	76	78
AUD/EUR	0.62	0.62	0.60	0.59	0.60	0.61
AUD/GBP	0.54	0.52	0.50	0.51	0.52	0.53
AUD/CNY	4.80	4.83	4.79	4.83	4.83	4.86
AUD/CAD	0.91	0.90	0.89	0.90	0.91	0.93
AUD/CHF	0.68	0.68	0.67	0.66	0.67	0.68

Interest Rate Forecasts						
	11-Nov	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australian Rates						
RBA cash rate	0.75	0.50	0.50	0.50	0.50	0.50
3 month bill rate	0.93	0.60	0.60	0.60	0.60	0.60
3 Year Swap Rate	0.91	0.90	0.90	0.95	0.95	1.00
10 Year Swap Rate	1.45	1.25	1.25	1.30	1.35	1.45
Offshore Policy Rates						
US Fed funds	1.75	1.75	1.75	1.75	1.75	1.75
ECB deposit rate	-0.50	-0.60	-0.70	-0.70	-0.70	-0.70
BoE repo rate	0.75	0.75	0.75	0.75	0.75	1.00
BoJ excess reserves rate	-0.10	-0.20	-0.20	-0.30	-0.30	-0.30
RBNZ OCR	1.00	0.75	0.50	0.50	0.50	0.50
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	13.0	12.50	12.00	12.00	12.00	12.00
10-year Bond Yields						
Australia	1.29	1.10	1.10	1.10	1.10	1.20
United States	1.94	1.70	1.70	1.70	1.70	1.80
New Zealand	1.39	0.95	0.95	1.05	1.10	1.30

Sources: NAB Global Markets Research; Bloomberg; ABS

Global GDP				
	2018	2019	2020	2021
Australia	2.7	1.7	2.2	2.5
United States	2.9	2.2	1.6	1.8
Eurozone	1.9	1.1	1.1	1.4
United Kingdom	1.4	1.2	1.2	1.5
Japan	0.8	1.0	0.2	0.9
China	6.6	6.3	6.0	5.8
India	6.8	5.7	6.8	7.1
New Zealand	2.9	2.1	2.4	2.0
World	3.6	3.1	3.2	3.5

Commodity prices (\$US)					
	11-Nov	Dec-19	Mar-20	Jun-20	Sep-20
Brent oil	62.0	70	70	75	75
Gold	1462	1450	1483	1518	1547
Iron ore	na	76	72	68	71
Hard coking coal*	137	170	165	160	155
Thermal coal	70	90	93	90	88
Copper	5911	6300	6225	6150	6125
Aus LNG**	10	12	12	12	12

* FOB quarterly contract prices (thermal coal is JFY contract)

** Implied Australian LNG export prices

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