MELBOURNE INSTITUTE
Applied Economic & Social Research

Monthly Bulletin of Economic Trends: Review of the Australian Economy

December 2017

THE UNIVERSITY OF MELBOURNE

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Outlook for Australia[1]

	Actual				Forecasts				Actual	Forecast
	2016	2017	2017	2017	2017	2018	2018	2018	Financial Year	
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	2016/17	2017/18
Economic Activity										
GDP	2.4	1.8	1.9	2.8	2.9	3.2	2.8	2.9	**2.0**	**2.9**
	(0.9)	(0.4)	(0.9)	(0.6)	(0.9)	(0.7)	(0.5)	(0.7)		
Household Consumption	2.7	2.1	2.4	2.2	2.2	2.4	2.2	2.6	**2.4**	**2.2**
	(0.9)	(0.4)	(0.8)	(0.1)	(0.8)	(0.6)	(0.6)	(0.6)		
Private Dwellings	7.8	-0.3	-2.3	-2.3	-5.2	-2.4	-2.6	-2.3	**2.6**	**-3.1**
	(2.6)	(-3.4)	(-0.5)	(-1.0)	(-0.4)	(-0.5)	(-0.7)	(-0.7)		
New Business Investment	-6.2	-0.8	1.4	7.5	5.1	2.5	2.5	1.5	**-4.0**	**4.4**
	(1.8)	(3.0)	(0.5)	(2.0)	(-0.5)	(0.5)	(0.5)	(1.0)		
Domestic Final Demand	2.3	2.2	2.4	3.2	2.8	2.8	2.6	2.7	**2.1**	**2.8**
	(1.0)	(0.7)	(0.8)	(0.6)	(0.7)	(0.7)	(0.6)	(0.7)		
Imports of Goods & Services	3.2	8.7	6.5	7.7	7.1	6.0	7.2	6.8	**4.8**	**7.0**
	(2.4)	(2.7)	(0.5)	(1.9)	(1.8)	(1.7)	(1.6)	(1.5)		
Exports of Goods & Services	7.8	3.3	5.3	6.4	6.2	10.4	8.7	8.2	**5.4**	**7.9**
	(2.7)	(-1.6)	(3.3)	(1.9)	(2.5)	(2.3)	(1.7)	(1.5)		
Inflation & Financial Market										
Underlying inflation[2]	1.6	1.8	1.8	1.8	1.9	1.9	1.8	1.9	**1.7**	**1.8**
	(0.5)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)	(0.5)	(0.5)		
Headline Inflation	1.5	2.1	1.9	1.8	1.9	2.0	2.4	2.3	**1.7**	**2.0**
	(0.5)	(0.5)	(0.2)	(0.6)	(0.6)	(0.6)	(0.5)	(0.6)		
90-day Bill Rate[3]	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.9		
Trade Weighted Index[4]	64.7	66.1	64.5	66.5	64.7	64.7	64.7	64.7		
$A/$US rate (100)[4]	0.74	0.76	0.75	0.79	0.77	0.77	0.77	0.77		
Labour Market										
Unemployment Rate[4]	5.7	5.8	5.6	5.5	5.4	5.3	5.2	5.2	**5.7**	**5.4**
Employment Growth Rate[5]	0.9	1.1	1.9	2.6	3.0	3.2	2.6	2.2	**1.4**	**2.8**
	(0.2)	(0.5)	(1.0)	(0.8)	(0.6)	(0.7)	(0.4)	(0.5)		
Participation Rate[4]	64.7	64.7	65.0	65.3	65.4	65.5	65.6	65.5	**64.8**	**65.4**
Wage Price Index	1.9	1.9	1.9	2.0	2.0	2.0	2.1	2.2	**1.9**	**2.0**
	(0.5)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)		

1: Actual in black and forecasts in blue; values in parentheses are quarterly growth rates.

2: As measured by the Reserve Bank's trimmed mean measure of inflation.

3: Average over last month in quarter.

4: Average of 3-months in the quarter.

5: Calculated from quarterly employment numbers that are averaged over the 3 months in the quarter.

Prepared by G.Lim and T. Robinson, Macroeconomics@MI. Forecasts and data in this report were finalized on 19/12/2017.

Economic Activity

Improving Outlook for Growth in the Australian Economy

- The Melbourne Institute expects output growth to strengthen in 2018.

  Recent Economic Growth

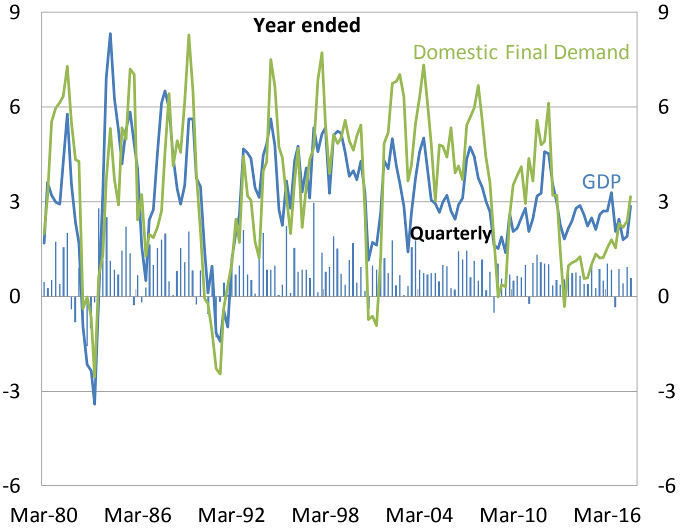
- GDP growth was a subdued 0.6 per cent in the September quarter, although it was a reasonable 2.8 per cent higher over the year (Figure 1).
- Household consumption growth disappointed, increasing by only 0.2 per cent in the quarter. Weak wages growth weighing on disposable income growth, despite ongoing good employment growth, probably was a contributing factor. Consumption contributed 0.1 percentage points to growth (Figure 2).
- A positive development was the 2 per cent increase in new private business investment, which contributed 0.3 percentage points to growth. This included a 1.1 per cent increase in new machinery and equipment investment, which suggests that non-mining business investment increased. This is important as an alternative source of growth is needed as the residential construction downturn became more certain, with a 1 per cent fall.
- The public sector has been an important source of growth in recent quarters. In the September quarter, it subtracted around 0.4 percentage points, although over the year it has contributed 1 percentage point.
- Net exports did not contribute to output growth in the September quarter. This was partially due to imports posting another solid increase (0.4 per cent). After a period of weakness imports growth has increased in the past year, probably reflecting the pick-up in public demand and improvement in private business investment.

  Growth Prospects

- There have been mixed influences on the outlook for consumption. On one hand, it was weak in the September quarter. On the other, consumer sentiment has recently strengthened. Both the Westpac-Melbourne Institute Current Conditions and Expectations indices improved in December; the latter is now above 100, signaling more people are optimistic than pessimistic about conditions in the next 12 months, and is 6.7 per cent higher than a year ago (Figure 3). Weak growth in wages, however, will continue to weigh on the consumption outlook and it will be important to see whether this improved sentiment is maintained.
- The September quarter Capital Expenditure survey pointed to a small improvement in the outlook for nominal private non-mining business investment, which was a good outcome as the improvement that occurred in the June quarter was maintained (Figure 4). Nominal mining investment is expected to fall further in the coming financial year, but the anticipated decline is relatively modest compared to the past.
- Trend building approvals strengthened further in October, to be 4.2 per cent higher over the year (Figure 5). Approvals for both houses and other dwellings (such as apartments) have increased over the year. This is encouraging as it suggests that the residential construction downturn may not be that severe.
- Further substantial increases in LNG exports are forecast by the Office of the Chief Economist at the Department of Industry. LNG will become Australia's second biggest resource and energy export in 2018-19 (Figure 6) offsetting, to some extent, the end of increases in resources production stemming from the mining boom. Australia is fast becoming the second biggest LNG exporter in the world (behind Qatar).
- The Westpac-Melbourne Institute Leading Index provides a summary indicator of Australia's near-term growth prospects, and it points to above trend growth (Figure 7). Further out it is uncertain whether this pace of growth can be maintained unless there is solid growth in private non-mining business investment to offset the likely decreasing impetus of LNG exports and subdued consumption growth.

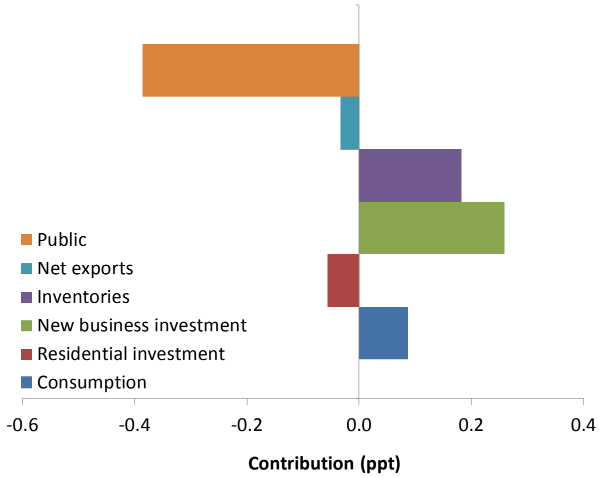
- In summary, the Melbourne Institute anticipate that output growth will be stronger in 2018, however, whether this pick-up in momentum can be maintained is uncertain (Figure 8).

Figure 1: Growth
(per cent)



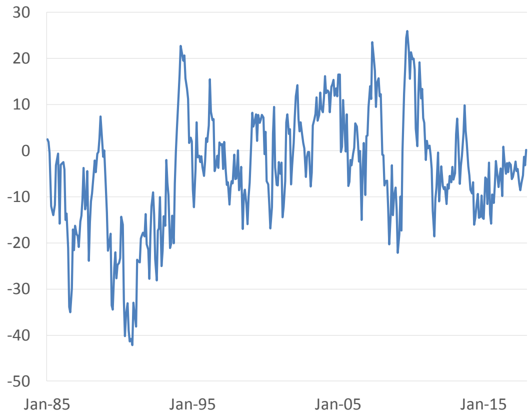
Source: ABS

Figure 2: Contributions to Quarterly Real GDP Growth
(percentage point)



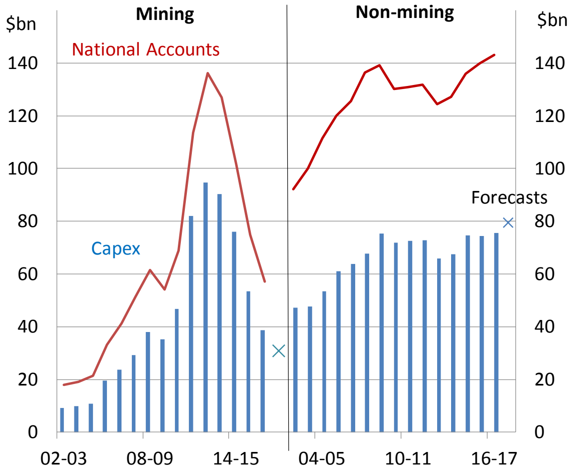
Source: ABS

Figure 3: Westpac-Melbourne Institute Consumer Expectations Index
(Number, deviation from long-run average)



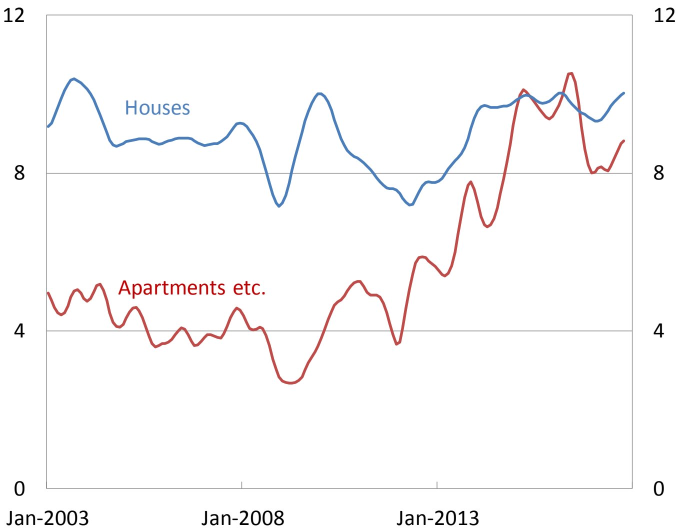
Source: Melbourne Institute

Figure 4: Capex Survey
(Nominal)



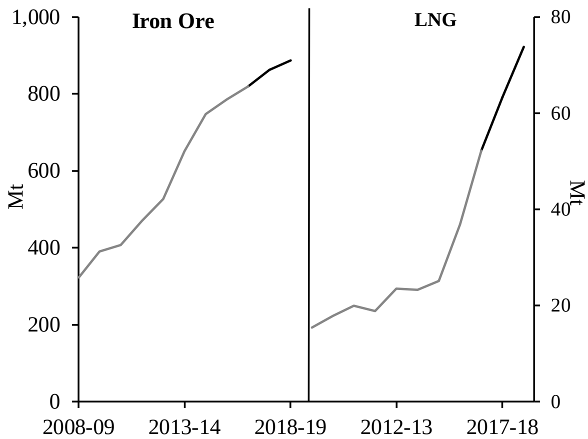
Source: ABS

Figure 5: Building Approvals
(Trend, '000)



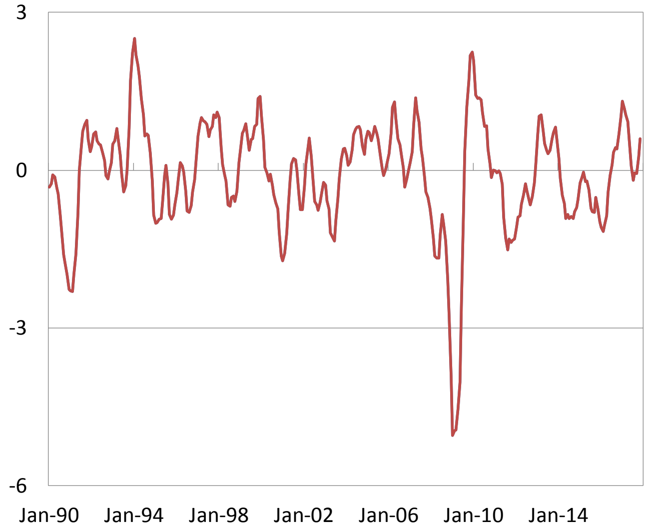
Source: ABS

Figure 6: Selected Resource and Energy Exports
(Mt)



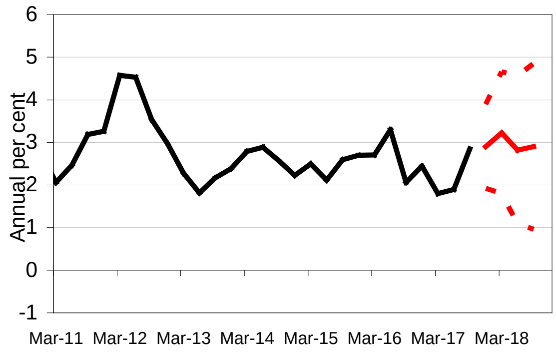
Note: Black denotes forecasts.
Source: Office of the Chief Economist, Department of Industry, Resources and Energy Quarterly, Sept. 2017

Figure 7: Westpac-Melbourne Institute Leading Index (smoothed)



Source: Melbourne Institute

Figure 8: Growth in real GDP (per cent)
(actual and forecast)



The dashed lines are the 90% confidence bands.

International Economies, Commodity and Financial Markets

Global Growth Upswing and Withdrawal of Monetary Policy Stimulus Continues

Commodity Prices

- The terms of trade, namely the ratio of export to import prices, fell by 0.4 per cent in the September quarter, but remains 9.7 per cent higher over the year (Figure 9).
- More recently, the RBA Index of Commodity Prices in A$ has increased, although this was influenced by the depreciation in the exchange rate. In SDR terms the Index was nearly 2 per cent lower in November than in September, due largely to lower bulk commodity prices.

Global Growth Outlook

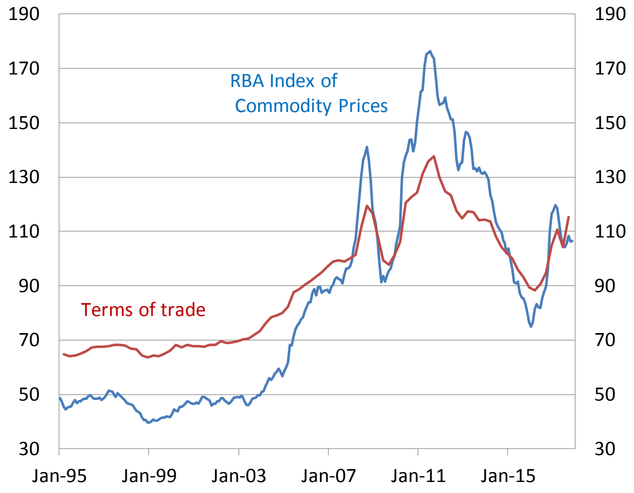
- The OECD in its November Economic Outlook revised up its forecasts for global growth in 2018 to be 3.7 per cent (Figure 10), with stronger growth in the US and the Euro area compared to the forecasts in the September Interim Economic Outlook. Growth, is expected to slow slightly in 2019, reaching 3.6 per cent.
- The IMF in the October World Economic Outlook similarly revised up its world growth forecasts for 2018 to 3.7 per cent.
- Growth in the US in the September quarter was a robust 3.3 per cent annualized, despite the impact of several hurricanes. Nowcasts of growth in the December quarter point to this momentum continuing; the Atlanta Federal Reserve anticipate 3.3 per cent, whereas the New York Fed are even stronger at 4 per cent.
- Growth in China was little changed in the September quarter at 6.9 per cent year-ended, only slightly down from its pace in the June quarter. This is despite policies that have been introduced targeting the housing market due to concerns about rapid house price growth in some cities and indebtedness. More recently, fixed asset investment growth has continued to slow, whereas growth in exports has increased and retail sales growth has been reasonable. Taken together these suggest output growth is likely to moderate only slightly in the near term.
- Euro area GDP growth grew by 0.6 per cent in the September quarter, to be 2.6 per cent higher over the year. This was its strongest growth since early 2011.

Withdrawal of Monetary Policy Stimulus

- With the strengthening of global growth, several countries have withdrawn some of the monetary stimulus that was introduced during the Global Financial Crisis.

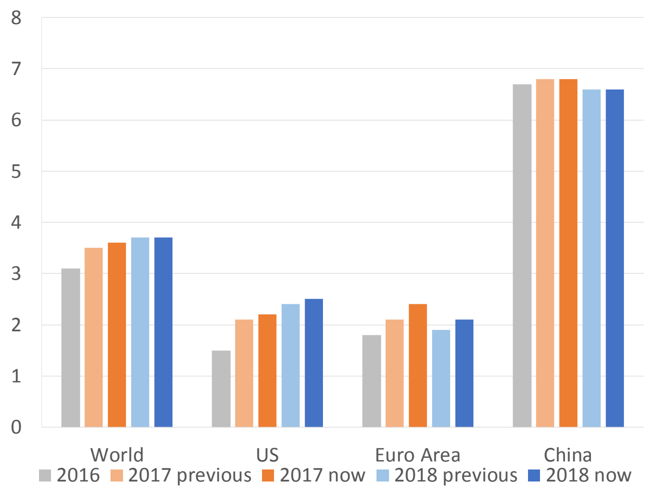
- The Federal Open Market Committee (FOMC) increased its federal funds target range to 1¼ to 1 ½ per cent in December. In recent months the unemployment rate has dropped to 4.1 per cent and core inflation has been slightly below target. The projections of the board members point to further gradual increases in the Federal Funds rate occurring in the next two years.
- The Peoples' Bank of China tightened monetary policy following the Federal Reserve's announcement.
- The Bank of England tightened policy in November. This was the first tightening in around a decade. However, it took the benchmark rate to just 0.5 per cent, and only unwound a cut related to the Brexit announcement. CPI inflation was 3.1 per cent in November – its highest rate in around in six years – and the Bank of England have flagged that further gradual tightenings of policy will be required.
- The ECB alternatively held rates unchanged in December with inflation only 1.5 per cent in November. The ECB, however, revised up its nowcast for growth in 2017, and previously flagged that its bond purchasing program will slow next year.
- Long rates remain very low in many countries.
- In summary, global growth prospects have continued to improve. Monetary policy stimulus is being removed in several countries, and further gradual policy tightenings in several nations appear likely.

Figure 9: Terms of Trade and Commodity Prices
(March Quarter 2015 = 100)



Source: ABS, RBA
Note: Commodity prices in SDR

Figure 10: OECD Forecasts
(per cent)



Source: OECD Global Economic Outlook
Note: Previous is September Interim Economic Outlook

Labour Markets, Inflation and Monetary Policy

The Labour Market Strengthens, Small Improvement in the Fiscal Outlook, and the Housing Market Cools

- The Melbourne Institute expects the unemployment rate to improve in the medium term.

Recent Labour Market and Inflation Developments

- The unemployment rate in November was 5.4 per cent, which while unchanged from October is 0.3 percentage points lower than a year ago (Figure 11). The participation rate increased by 0.3 percentage points, to be 0.7 percentage points stronger than a year ago. Taken together, these imply that the labour market has improved considerably in the last year and less slack currently exists.

- Broader measures of slack deliver a similar message. Labour underutilization, which includes those underemployed as well as the unemployed, decreased by 0.3 percentage points in the December quarter (Figure 12).
- Growth in full-time employment continues to outstrip part-time employment (41.9k and 19.7k respectively) (Figure 13). The increase in full-time employment over the past year is nearly four times that in part-time positions (304.6k vs. 78.8k).
- Despite the strengthening labour market, wages growth has remained weak (Figure 14). In the September quarter the Wage Price Index increased by 0.5 per cent, to be 2 per cent higher over the year.
- Inflation also remains low. In the September quarter the headline CPI increased by 0.6 per cent, to be 1.8 per cent higher over the year. Underlying CPI posted a more modest increase, namely 0.4 per cent, but also is 1.8 per cent higher over the year (Figure 15).

Prospects for the Labour Market and Inflation

- Timely indications suggest that the labour market will continue to improve. The ANZ Job Advertisements Index increased by 1.5 per cent in November, and is more than 12 per cent higher over the year; the NAB Monthly Business Survey Employment Index is also optimistic.
- While wages growth has remained weak, the strengthening labour market points to a gradual improvement. Similarly, the Westpac-Melbourne Institute Unemployment Expectations Index has recently strengthened, and this tends to lead developments in wages. On the other hand, low inflation expectations and productivity growth are likely to continue weighing on wages growth (Figure 16). The Melbourne Institute measure of consumer inflation expectations recently has improved, but remains low.
- Underlying inflation is expected to gradually drift higher, although the Melbourne Institute Monthly Inflation Gauge suggests stronger prospects. Headline inflation may outstrip underlying inflation a little in the near term, supported by the depreciation in the exchange rate and higher crude oil prices.

Monetary Policy

- Partially reflecting the benign outlook for core inflation, the Reserve Bank kept monetary unchanged in December.

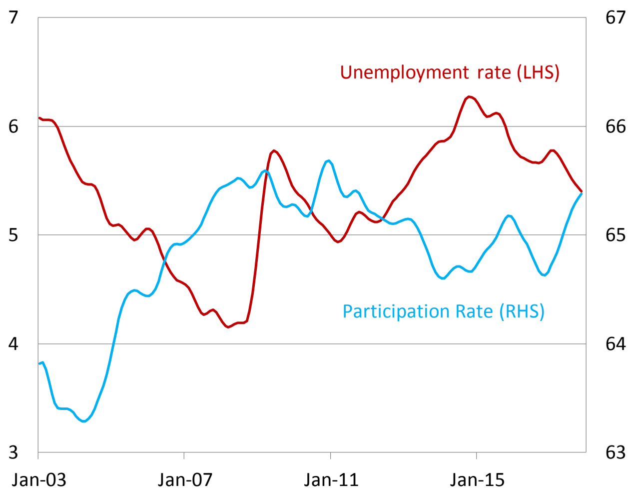
Small Improvement in the Fiscal Outlook

- The Mid-Year Economic & Fiscal Outlook (MYEFO) updated the Budget forecasts. Revenues in the current fiscal year are now expected to be stronger, with higher company and superannuation tax collections playing an important role.
  - The underlying cash balance is now expected to be -1.3 per cent of GDP in 2017/18, compared to -1.6 per cent anticipated in the May Budget.
  - Further out there is little change; a slight deficit is still expected in 2019/20 (-0.1 per cent of GDP).
- The near-term wages growth forecasts have been lowered to 2¼ per cent in 2017/18 (previously 2½ per cent), although upward revisions to the employment growth forecasts dampen the impact on revenues.
- The GDP growth forecasts for 2017/18 were lowered a touch to be 2½ per cent, reflecting the soft consumption growth in the September quarter. Growth is forecast to reach 3 per cent in 2018/19, with business investment playing an important role.
- Savings measures which were announced in MYEFO include:
  - Increasing the waiting periods for migrants before they can access welfare payments (such as Family Tax Benefit) to three years.
  - For universities, the Commonwealth Grant Scheme will be frozen at 2017 levels for two years.
  - Lowering HELP repayment thresholds for tertiary students.

Housing Market Cools

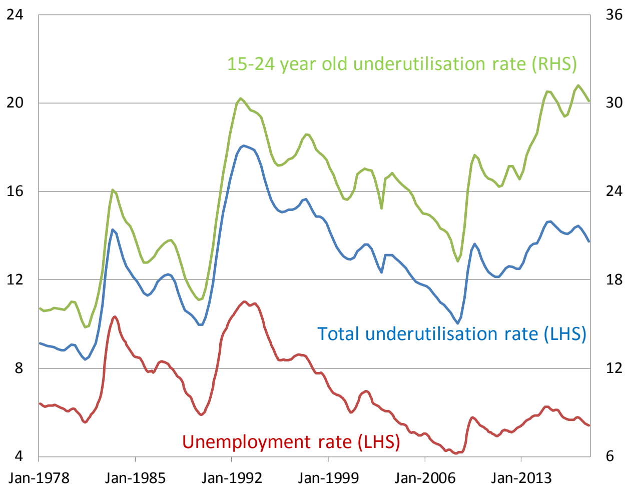
- Turning to the housing market, there have been signs that it is cooling, with residential property prices decreasing by 0.2 per cent on average in the capital cities in the September quarter, but they remain 8.3 per cent higher over the year (Figures 17 & 18).
  - The largest falls in the quarter were in Darwin (-2.6 per cent) and Sydney (-1.4 per cent). Darwin prices are lower over the year (-6.3 per cent), whereas Sydney's remain 9.4 per cent higher. Perth prices continued to decline in the September quarter (-1 per cent).
  - The fall was driven by attached dwellings (such as apartments) (-0.8 per cent); house prices were flat. While once again the largest falls were in Darwin and Sydney, declines were more widespread.
- More timely indicators, such as auction clearance rates, suggest that the cooling has continued, at least in Sydney.
- Overall, the most encouraging aspects of the Australian economy this year have been the strengthening in the labour market and the improvement in prospects for private non-mining business investment. The former suggests that wages growth may gradually increase in the future. Nevertheless, the Melbourne Institute expects underlying inflation to remain around the bottom of the RBA's target band in 2018 (Figure 20).

Figure 11: Labour Market
(trend, %)



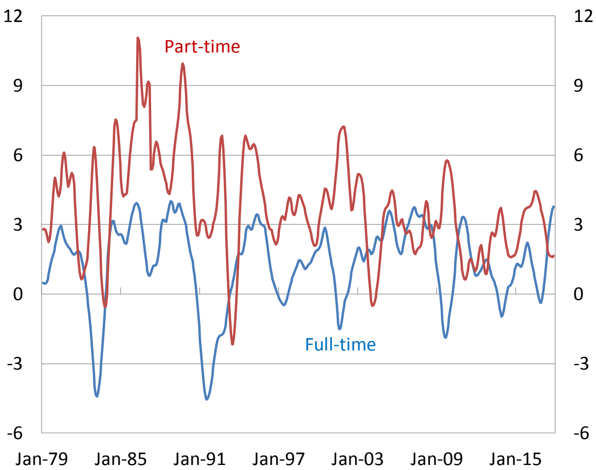
Source: ABS

Figure 12: Labour Underutilization
(trend, %)



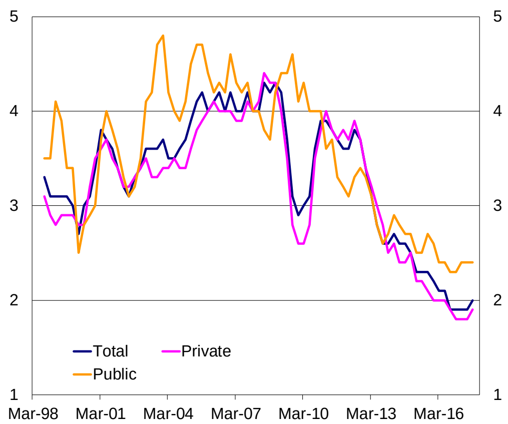
Source: ABS

Figure 13: Employment Growth
(trend, year-ended, %)



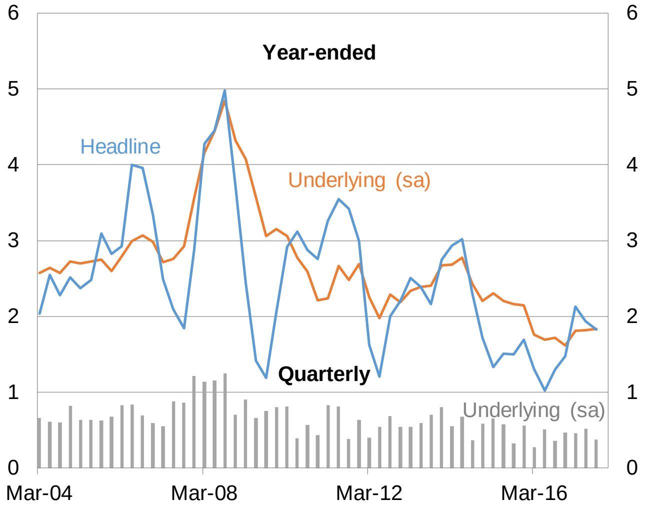
Source: ABS

Figure 14: Wage Price Index
(year-ended, %)



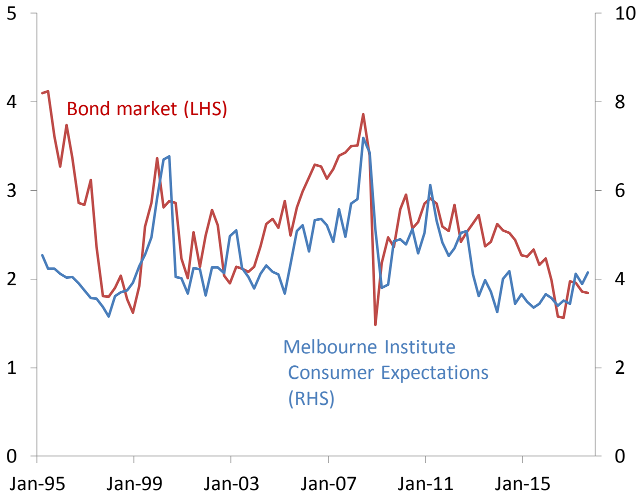
Source: ABS

Figure 15: CPI Inflation
(per cent)



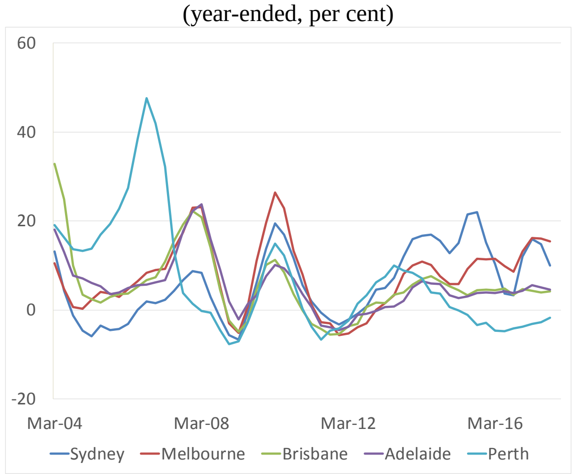
Source: ABS

Figure 16: Inflation Expectations
(per cent)



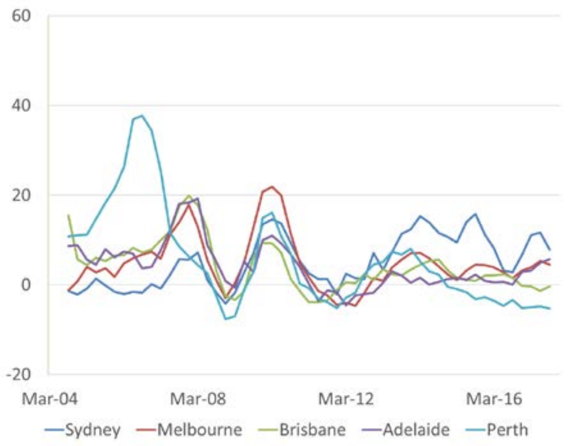
Sources: Melbourne Institute, Reserve Bank of Australia.

Figure 17: Growth in Established House Prices
(year-ended, per cent)



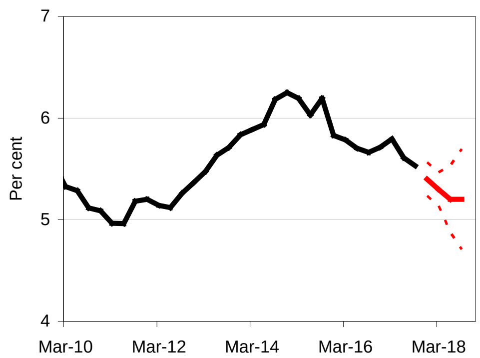
Source: ABS

Figure 18: Growth in Attached Dwelling Prices
(year-ended, per cent)



Source: ABS

Figure 19: Unemployment Rate
(actual and forecast)



The dashed lines are the 90% confidence bands.

Figure 20: Underlying CPI Inflation
(actual and forecast)

The dashed lines are the 90% confidence bands.

	Precision of (year-end) Forecasts				
	2017 Dec	2018 Mar	2018 Jun	2018 Sep	Financial Year 2017/18
	Australia				
Economic Activity					
GDP	0.6	0.9	1.1	1.2	**0.7**
Consumption	0.5	0.8	1.0	1.1	**0.7**
Dwelling	2.3	2.4	2.5	2.8	**1.9**
Business Investment	5.2	6.0	6.7	7.5	**4.6**
Import	2.5	4.2	5.8	6.6	**3.7**
Export	2.6	3.4	4.0	4.4	**2.9**
Inflation & Financial Market					
Underlying Inflation	0.1	0.2	0.3	0.4	**0.3**
Headline Inflation	0.3	0.4	0.5	0.7	**0.6**
90 day bill		0.3	0.5	0.7	**0.6**
Trade Weighted Index		3.3	3.7	3.9	**2.3**
Labour Market					
Unemployment Rate		0.1	0.2	0.3	**0.3**
Employment		0.2	0.4	0.5	**0.5**
Participation Rate		0.2	0.3	0.4	**0.3**
Wage Price Index	0.4	0.5	0.6	0.7	**0.4**

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Melbourne Institute
Monthly Bulletin of Economic Trends

The *Melbourne Institute Monthly Bulletin of Economic Trends* provides forecasts of the state of the Australian economy. Variables forecasted include: the growth in GDP, consumption and the unemployment rate as well as the outlook for inflation, the 90-day bill rate and the exchange rate. The forecasts are generated using judgement and econometric techniques which combine both historical information and forward information contained in, for example, consumer expectations and leading indexes of economic activity.

For information on the data contained in the report contact the Melbourne Institute, The University of Melbourne, on (03) 8344 2196.

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