

MELBOURNE INSTITUTE  
Applied Economic & Social Research

# Monthly Bulletin of Economic Trends: Review of the Australian Economy

September 2017



**Outlook for Australia<sup>1</sup>**

	Actual				Forecasts				Actual	Forecast
	2016	2016	2017	2017	2017	2017	2018	2018	Financial Year 2016/17	2017/18
	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun		
<b><i>Economic Activity</i></b>										
GDP	1.9	2.4	1.8	1.8	3.3	3.1	3.5	3.2	2.0	3.3
	(-0.4)	(1.1)	(0.3)	(0.8)	(1.0)	(0.9)	(0.7)	(0.5)		
Household Consumption	2.2	2.6	2.3	2.6	2.9	2.5	2.7	2.7	2.4	2.7
	(0.3)	(1.1)	(0.5)	(0.7)	(0.6)	(0.7)	(0.7)	(0.7)		
Private Dwellings	4.9	6.2	-1.7	-2.5	-1.1	-2.5	1.2	0.7	1.6	-0.5
	(-0.9)	(1.9)	(-3.7)	(0.2)	(0.5)	(0.5)	(0.0)	(-0.3)		
New Business Investment	-9.3	-6.2	-1.4	1.5	4.3	2.4	0.1	-0.6	-3.9	1.5
	(-3.2)	(1.4)	(2.2)	(1.1)	(-0.5)	(-0.4)	(-0.1)	(0.4)		
Domestic Final Demand	1.3	1.9	2.0	2.4	3.1	2.5	2.5	2.2	1.9	2.6
	(-0.3)	(1.2)	(0.6)	(1.0)	(0.3)	(0.6)	(0.6)	(0.6)		
Imports of Goods & Services	1.1	2.8	7.8	6.5	6.3	5.8	4.5	4.5	4.5	5.3
	(1.4)	(1.6)	(2.2)	(1.2)	(1.2)	(1.1)	(1.0)	(1.1)		
Exports of Goods & Services	5.8	8.6	3.1	4.3	6.2	4.8	8.0	6.0	5.4	6.2
	(1.0)	(2.8)	(-2.2)	(2.7)	(2.8)	(1.5)	(0.8)	(0.8)		
<b><i>Inflation &amp; Financial Market</i></b>										
Underlying inflation <sup>2</sup>	1.7	1.6	1.8	1.8	2.0	1.9	1.9	1.9	1.8	1.9
	(0.4)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)		
Headline Inflation	1.3	1.5	2.1	1.9	1.7	1.6	1.7	2.0	1.7	1.8
	(0.7)	(0.5)	(0.5)	(0.2)	(0.5)	(0.5)	(0.5)	(0.5)		
90-day Bill Rate <sup>3</sup>	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7		
Trade Weighted Index <sup>4</sup>	63.5	64.7	66.1	64.5	66.5	66.4	66.4	66.4		
\$/US\$ rate (100) <sup>4</sup>	0.76	0.74	0.76	0.75	0.79	0.79	0.79	0.79		
<b><i>Labour Market</i></b>										
Unemployment Rate <sup>4</sup>	5.7	5.7	5.8	5.6	5.6	5.6	5.6	5.6	5.7	5.6
Employment Growth Rate <sup>5</sup>	1.6	0.9	1.1	1.9	2.6	3.1	3.0	2.3	1.4	2.7
	(0.2)	(0.2)	(0.5)	(1.0)	(0.8)	(0.7)	(0.4)	(0.4)		
Participation Rate <sup>4</sup>	64.8	64.6	64.7	64.9	65.2	65.4	65.3	65.2	64.8	65.3
Wage Price Index	1.9	1.9	1.9	1.9	2.0	2.1	2.0	2.0	1.9	2.0
	(0.4)	(0.5)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)		

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.

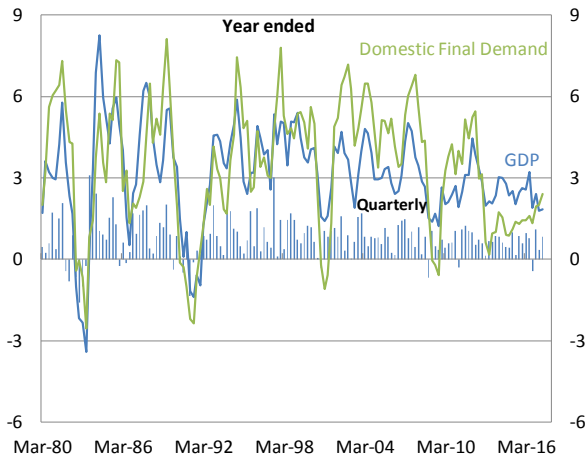
Prepared by G.Lim and T. Robinson, Macroeconomics@MI. Forecasts and data in this report were finalized on 28/09/2017.

## Economic Activity

- The Melbourne Institute expects domestic demand growth to gradually strengthen in the medium term.
- GDP growth was a strong 0.8 per cent in the June quarter, although over the year it increased by a sub-par 1.8 per cent (Figure 1).
- Household consumption grew by a solid 0.7 per cent in the June quarter. It contributed 0.4 percentage points to output growth (Figure 2), and the household saving ratio declined further (Figure 3). In the near-term, weak wages growth will continue to weigh on disposable income, and hence consumption, growth, although the labour market appears to be improving (see the “Labour Markets” section). Consumer sentiment, despite strengthening in September, remains subdued (Figure 4). In all, it appears unlikely that consumption growth will increase much in the near term.
- New private business investment increased for the third consecutive quarter (1.1 per cent), to be 1.5 per cent higher over the year. It added 0.1 percentage points to quarterly output growth (Figure 2). Looking forward, the June quarter ABS Capital Expenditure Survey saw firms become more positive about the outlook for non-mining investment in 2017-18, although the survey is a less reliable indicator for non-mining, rather than mining, investment (Figure 5). The NAB Monthly Survey measure of business conditions remains at a high level; business confidence is a little softer (Figure 4). The value of non-residential building approvals in recent months has increased, which is another positive sign for non-mining investment.
- Residential investment increased by 0.2 per cent, however, they remain 2.5 per cent lower over the year. In 2017, looking through the volatility, dwelling approvals have been broadly unchanged, with an upswing in approvals for houses offsetting a small decline for attached dwellings (such as apartments) (Figure 6). It appears that the anticipated downturn in residential construction may occur slowly.
- Government spending added around 0.8 percentage points to growth in the June quarter, partially due to investment spending (Figure 2).
- Exports rose by 2.7 per cent in the June quarter, to be 4.3 per cent higher over the year. Rural exports fell, whereas the other major categories of exports increased. Resource exports grew by 3.9 per cent, with a fall in coal exports (probably partially due to weather disruptions) only partially offsetting strong growth in other mineral fuels exports of more than 10 per cent (this includes LNG). Service exports also increased by 1.4 per cent, to be 5.4 per cent higher over the year. In all, exports contributed 0.6 percentage points to growth in the June quarter.
- Imports posted another solid rise in the June quarter (1.2 per cent), and are 6.5 per cent higher over the year. This growth was broad based across the categories, including capital imports, although the relationship between capital imports and business investment is weak. Imports growth subtracted 0.2 percentage points from growth; overall net exports added 0.3 percentage points to growth.
- Firms winding down inventories subtracted 0.6 percentage points from output growth in the June quarter (Figure 2).
- Growth in the Westpac-Melbourne Institute Leading Index presently is a little below trend; this signals that growth may be a little soft late this year and in early 2018 (Figure 7). This could be associated with residential investment growth softening before non-mining investment substantially picks up.
- Overall, the June quarter national accounts were quite positive, and some of the recent partial data have been likewise. The outlook for non-mining investment appears to have improved, although it is worth noting that some business sentiment measures have been more positive than consumer sentiment for a considerable period. Concerns remain about the growth prospects in the first half of 2018, as growth in residential construction and the impetus from LNG exports decrease. The Melbourne Institute anticipates that quarterly

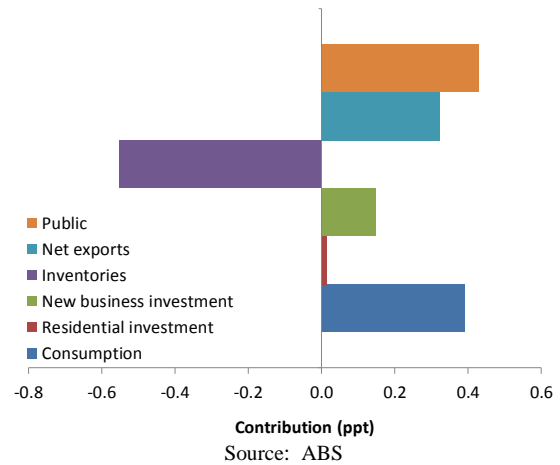
output growth will be a little below trend in the first half 2018, and increasing gradually thereafter as domestic demand growth strengthens (Figure 8).

**Figure 1: Growth**  
(per cent)



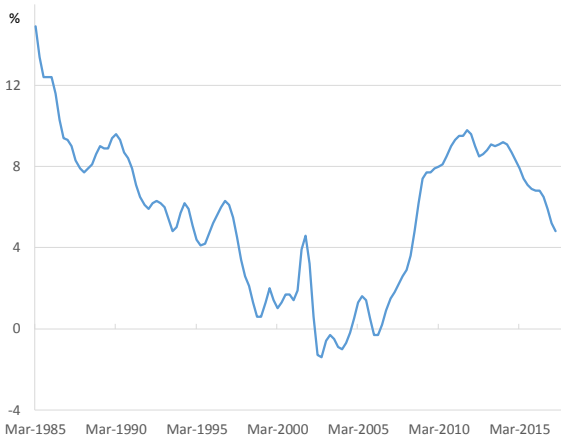
Source: ABS

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



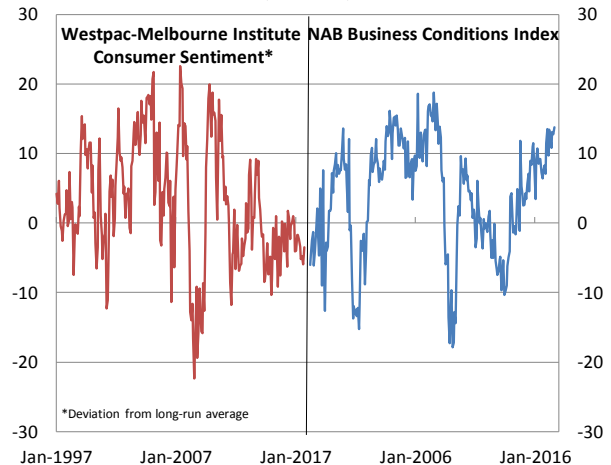
Source: ABS

**Figure 3: Household Saving Ratio**  
(trend, per cent)



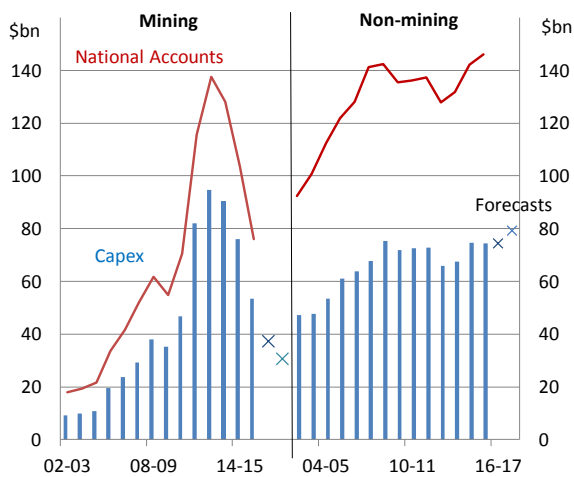
Source: ABS

**Figure 4: Sentiment**  
(Number)



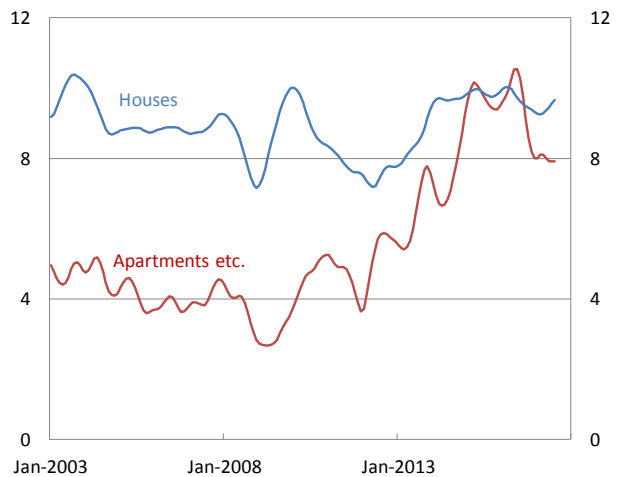
Sources: Melbourne Institute, RBA

**Figure 5: Capex Survey**  
Nominal



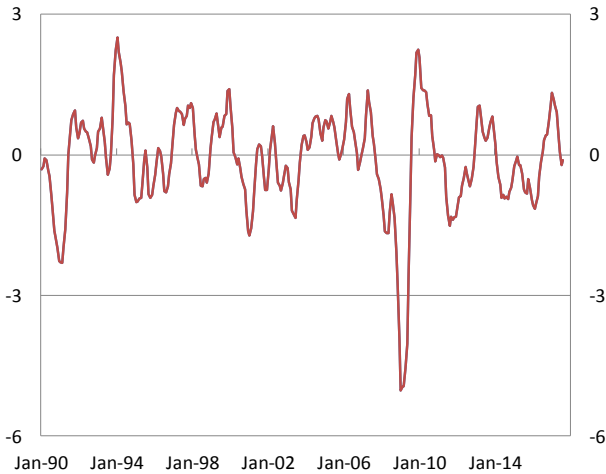
Source: ABS, Melbourne Institute

**Figure 6: Building Approvals**  
(Trend, '000)

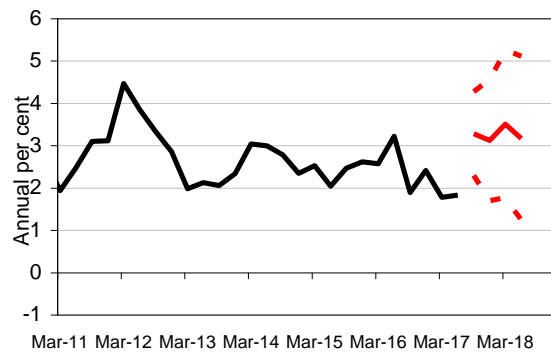


Source: ABS

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



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



The dashed lines are the 90% confidence bands.

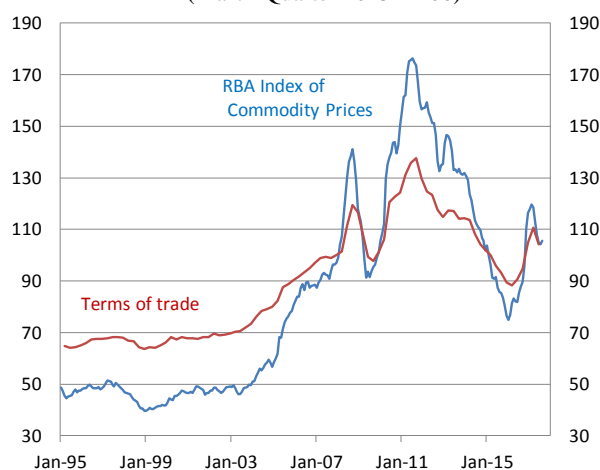
### International Economies, Commodity and Financial Markets

- The terms of trade fell by 6 per cent in the June quarter, although this follows strong growth in the March quarter due to cyclone-related disruptions to coal supply (Figure 9). The terms of trade are 14.9 per cent higher over the year. Bulk commodity prices, which are an important determinant of the terms of trade, have increased in the September quarter to date, although in local currency terms this has been moderated by the appreciation of the A\$.
- The OECD in its [Interim Economic Outlook](#) noted a broadening in the “short-term momentum”, and in particular growth in the euro area being stronger than expected. The forecast for world growth in 2018 was revised up by 0.1 percentage points (ppts) from the June Economic Outlook; contributing to this were improvements in the outlook for the euro area (0.1 ppts), China (0.2 ppts), and Russia (0.5 ppts) (Figure 10). On the flipside, forecasts for Russia were revised down by 0.5 ppts.
- Growth in the US in the June quarter in the second estimate was revised up to  $\frac{3}{4}$  per cent, and 2.2 per cent over the year. Consumption growth was a strong 0.9 per cent, and business investment growth moderated only slightly, whereas residential investment fell.
- In the US nowcasts of the September quarter GDP point to some slowing in the rate of growth, with the [Atlanta Federal Reserve](#) relatively optimistic (2.1 per cent seasonally adjusted annualized rate (saar)) compared to the [New York Fed](#) (1.6 per cent saar). Contributing to this slowing were the August retail sales figures (a fall of 0.2 per cent) and industrial production (-0.9 per cent), which were both adversely effected by Cyclone Harvey. Consequently, some of this softening may be temporary.
- Non-farm payroll employment increased by 156,000 people in August, and the unemployment rate was 4.4 per cent, a level it has been around since April this year. Likewise both the participation rate and the employment to population ratio were little changed.
- The Federal Open Market Committee (FOMC) has maintained its target range for the Federal Funds rate of 1 to 1¼ per cent. In June the [FOMC](#) outlined its plan to gradually unwind the Fed’s holdings of Treasury and agency securities through lessening the reinvestment of principal payments; it was recently announced that this will begin in October.
- The Chinese economy grew by 1.7 per cent in the June quarter, to be 6.9 per cent higher over the year.
- Recent Chinese data has suggested some moderation in the pace of growth may be have occurred in the September quarter. Retail sales grew 10.1 per cent year-ended, down from

10.7 per cent or higher several months ago. Similarly industrial production growth slowed, and the non-manufacturing PMI also softened. S&P downgraded the its rating of Chinese sovereigns from A+ to A-, reflecting concerns about the pace of deleveraging being too slow.

- Growth in Chinese new home prices in tier 1 cities in year-ended terms has slowed markedly this year.
- Turning to Japan, the second estimate of June GDP growth was revised down to 0.6 per cent (previously 1 per cent), although in year-ended terms it was revised down only slightly to be 1.4 per cent. This was the strongest growth since early 2015, and reflected broad-based strength in domestic demand.
- GDP increased in the Euro Area by 0.6 per cent in the June quarter, to be 2.3 per cent higher over the year. Like Japan, this largely reflected domestic demand growth – household consumption grew by 0.5 per cent, and gross fixed capital formation increased by 0.9 per cent, following a fall in the March quarter.
- In the UK output growth remained weak, increasing by 0.3 per cent in the June quarter, to be only 1.7 per cent higher over the year. This soft June quarter outcome was supported by increased Government spending, with growth in both consumption and capital expenditure slowing. CPI inflation, however, was 2.9 per cent in August, and core inflation (exclusion-based) was only slightly weaker (2.7 per cent). The recent [Monetary Policy Committee \(MPC\) minutes](#) noted that “a majority of members judge that, if the economy continues to follow a path consistent with the prospect of a continued erosion of slack and a gradual rise in inflationary pressure then, with the further lessening in the trade-off that this would imply, some withdrawal of monetary stimulus is likely to be appropriate in the coming months...”.
- Global economic policy uncertainty has fallen over 2017 to date (Figure 11).
- In summary, it appears that in recent months the global economy has continued to improve (Figure 12), with the possible exceptions of China and the UK, and overall this is likely to support growth in the Australian economy.

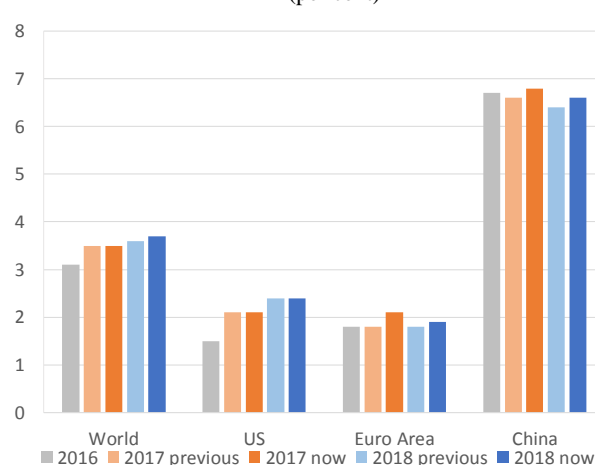
**Figure 9: Terms of Trade and Commodity Prices**  
(March Quarter 2015 = 100)



Source: ABS, RBA

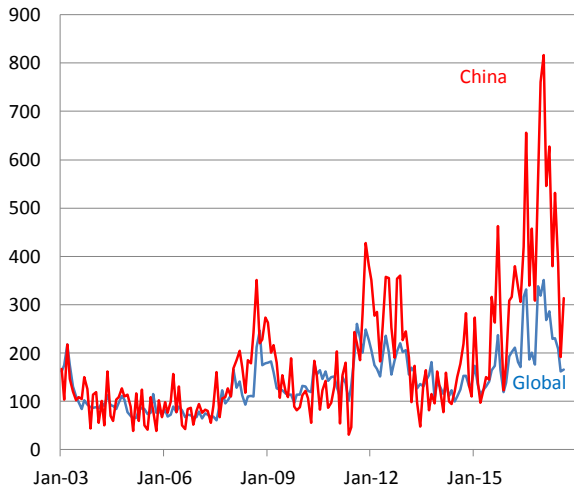
Note: Commodity prices in SDR

**Figure 10: OECD Forecasts**  
(per cent)



Source: [OECD Global Economic Outlook](#)

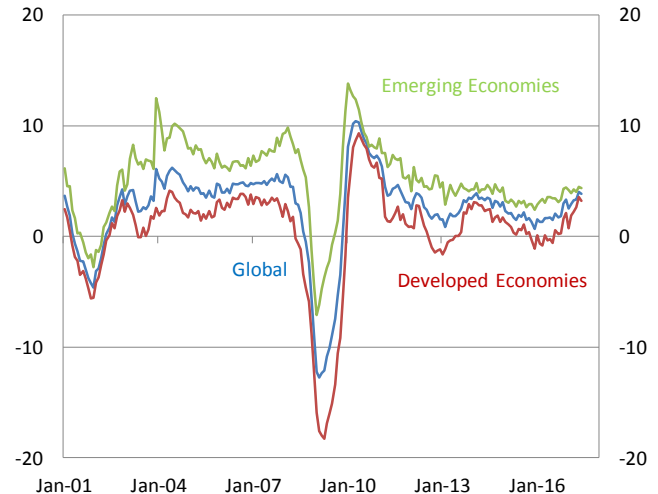
**Figure 11: Economic Policy Uncertainty**  
(2003-2005 = 100)



Source: <http://www.policyuncertainty.com/index.html>

Note: Global uncertainty based on current-price GDP

**Figure 12: Industrial Production Growth**  
(Year-ended, %)



Source: CPB World Trade Monitor

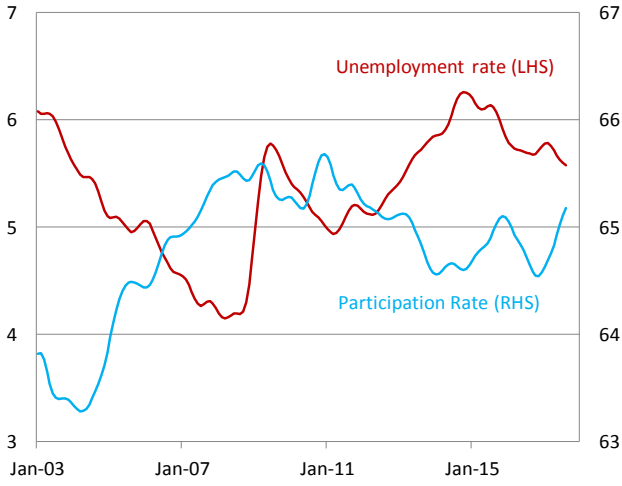
### Labour Markets, Inflation and Monetary Policy

- The Melbourne Institute expects the unemployment rate to improve slightly in the medium term.
- The unemployment rate was unchanged at 5.6 per cent in August. It is only slightly below its level at the same time last year. Nevertheless, the recent trends in the labour market have been positive. For example, the participation rate increased by 0.2 percentage points in August, and is 0.6 percentage points higher over the year (Figure 13).
- Employment growth has strengthened. Employment increased by 54,200 people in August, to be a strong 2.7 per cent higher in year-ended terms. Much of the increase in August was in full-time employment (40,100 people); roughly three quarters of the increase in employment since the same time last year has been in full-time positions (Figure 14).
- A summary indicator of the state of labour market is the employment to population ratio. This has improved noticeably in recent months (Figure 15).
- The underutilization rate is a broader measure of slack in the labour market than the unemployment rate as it additionally includes the underemployed, namely those who are working fewer hours than they desire. Note that this is a heads measure, counting the number of people that are underemployed, rather than the additional number of hours desired (i.e. a volume measure). In August the underutilization rate decreased by 0.2 percentage (Figure 16). Trend total hours worked increased 0.2 per cent in August.
- Forward indicators of the labour market have also improved. The ANZ Job Advertisements Index increased by 2 per cent in August, its sixth increase in a row. It is now more than 13 per cent higher over the year. The employment sub index of the NAB Monthly Business Survey also improved in August, and is at an above-average level.
- The fall in the terms of trade weighed on real net national disposable income, which fell by 1 per cent in the June quarter, although it remains 4 per cent higher over the year.
- Similarly, nominal GDP fell by 0.1 per cent, but remains 6.3 per cent higher over the year (Figure 17). Compensation of employees increased by 0.7 per cent, whereas private non-financial gross operating surplus (a measure of company profits) fell by 4.3 per cent.
- Inflationary pressures remain slight (Figures 18 to 20). Measures of inflation expectations are low, and while year-ended import growth has strengthened the appreciation is likely to dampen this going forward. Growth in unit labour costs over the year was negligible.

- The other major measure of wages is the Wage Price Index, and this remains very weak (Figure 20). In the June quarter private sector wages increased by only 0.4 per cent, to be 1.8 per cent higher over the year; public sector wages grew slightly more strongly.
- The exchange rate on a trade-weighted basis has appreciated in the June quarter. In the September quarter to date it is around 3 per cent above its June quarter average, although it remains below the levels reached at the peak of the mining boom (Figure 21).
- Underlying CPI inflation, which the RBA focusses on, increased by 0.5 per cent in the June quarter, although over the year at 1.8 per cent it remains below the bottom of the RBA's target band (Figure 22).
- Headline inflation increased by only 0.2 per cent in the quarter, although on a seasonally-adjusted basis it was 0.4 per cent. The increases in some fruit and vegetable prices due to Cyclone Debbie (such as tomatoes) were outweighed by falls in the (seasonal) price falls of some other fruits, such as oranges. The main contributor to non-seasonally adjusted headline inflation was health related, namely increases in private health insurance premiums.
- Residential property prices increased on average by 1.9 per cent in the June quarter, to be 10.2 per cent higher over the year. This however, masks differences across the capitals. In Sydney and Melbourne, the prices of both houses and attached dwelling increased sizably, whereas apartment prices were flat in Brisbane, weighed down by new supply, and both apartment and house prices fell in Perth and Darwin, as adjustments following the mining boom continue (Figures 23 and 24).
- Monetary policy has been unchanged this year. In the [minutes](#) to the July meeting it was noted that the Board discussed that the neutral real rate had declined since 2007, and is estimated to presently be around 1 per cent. This, combined with the inflation target of 2.5 per cent, points to a neutral nominal rate of around 3.5 per cent. A subsequent RBA Bulletin [article](#) provided further discussion of the methodology used. The upshot is that once the tightening cycle commences it will probably be more moderate than in the past.
- Overall, the labour market data this year has been positive and points to a strengthening economy. To date increases in the participation rate have dampened falls in the unemployment rate stemming from decent employment growth. Looking forward, we expect the unemployment rate to remain broadly unchanged in the near to medium term (Figure 25). The low inflation environment is likely to also be contributing to the low nominal wages growth, and consequently any increase in wages growth may be gradual. The appreciation in the exchange rate is likely to provide some offset to the effect on inflation of any strengthening in wages growth. Consequently the Melbourne Institute expects underlying inflation to remain around the bottom of the RBA's target band in 2018 (Figure 26).

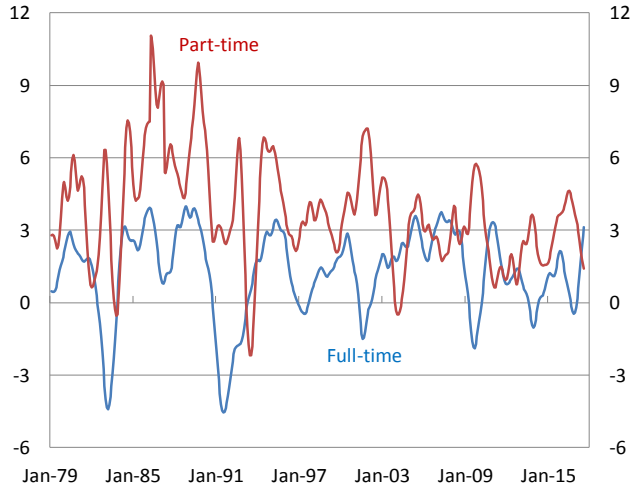


**Figure 13: Labour Market**  
(trend, %)



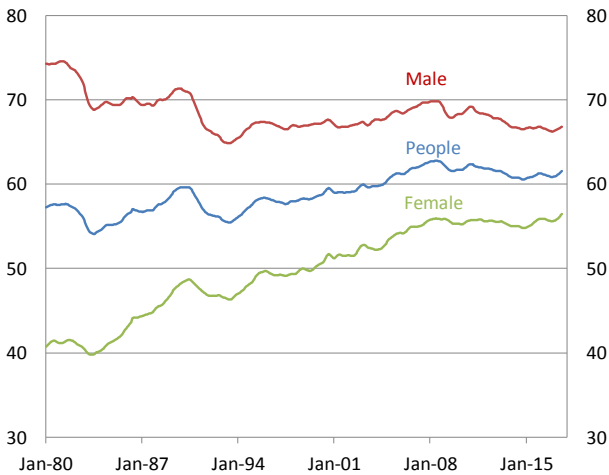
Source: ABS

**Figure 14: Employment Growth**  
(trend, year-ended, %)



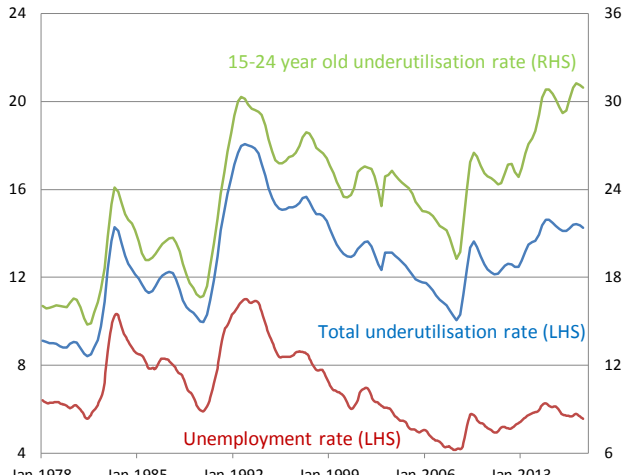
Source: ABS

**Figure 15: Employment-to-Population Ratio**  
(trend, %)



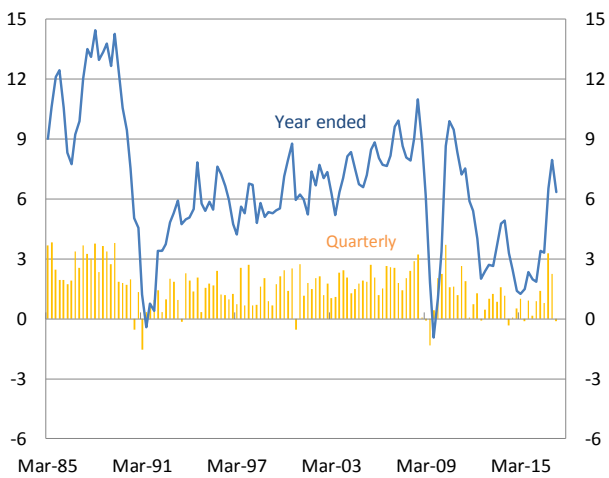
Source: ABS

**Figure 16: Labour Underutilization**  
(trend, %)



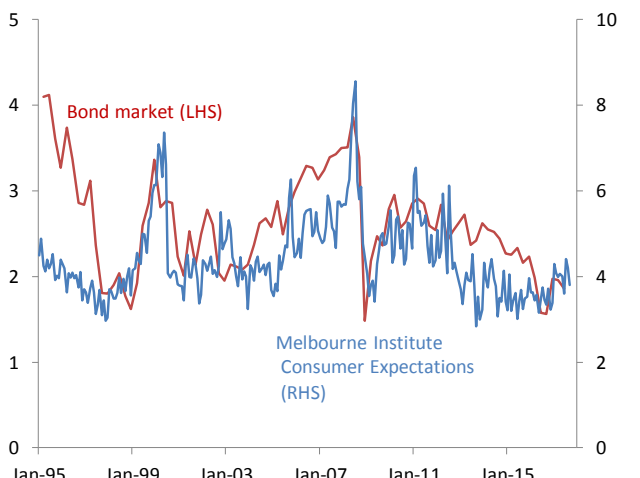
Source: ABS

**Figure 17: Nominal GDP Growth**  
(per cent)



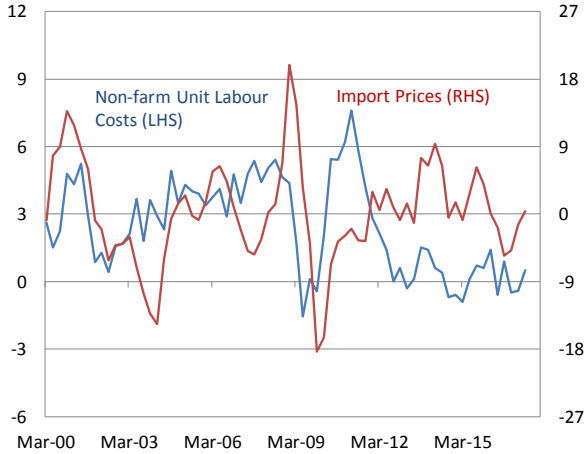
Source: ABS

**Figure 18: Inflation Expectations**  
(per cent)



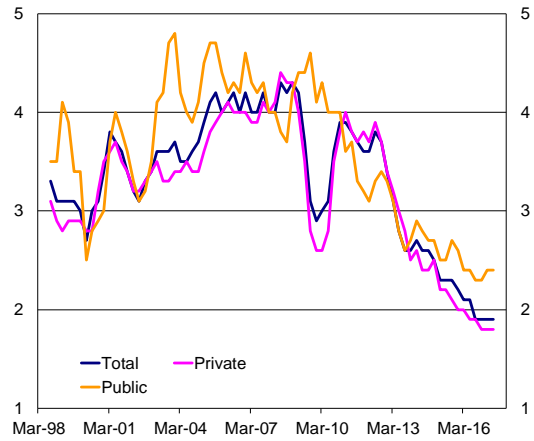
Sources: Melbourne Institute, Reserve Bank of Australia.

**Figure 19: Inflation Determinants**  
(year-ended, %)



Source: ABS

**Figure 20: Wage Price Index**  
(year-ended, %)



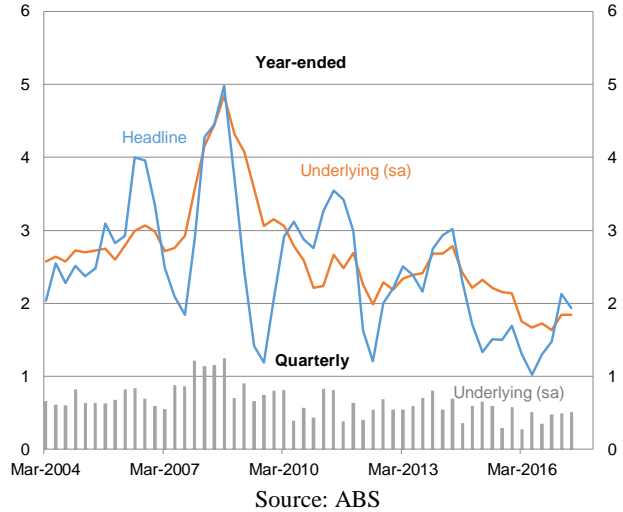
Source: ABS

**Figure 21: Nominal Trade-Weighted Index**  
(May-1970=100)



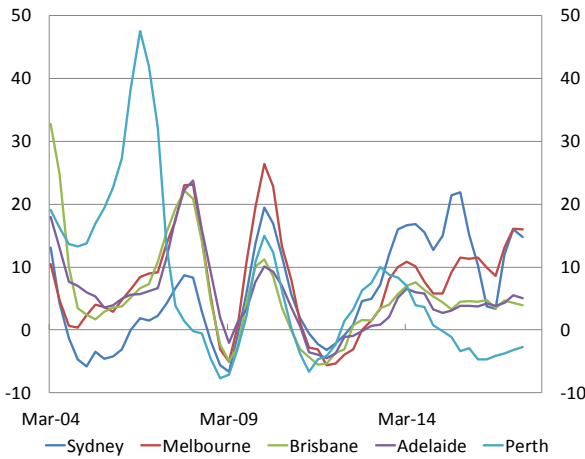
Source:RBA

**Figure 22: CPI Inflation**  
(per cent)



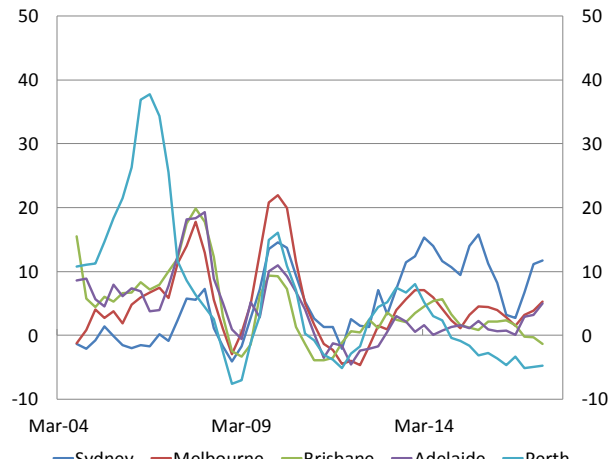
Source: ABS

**Figure 23: Growth in Established House Prices**  
(year-ended, per cent)



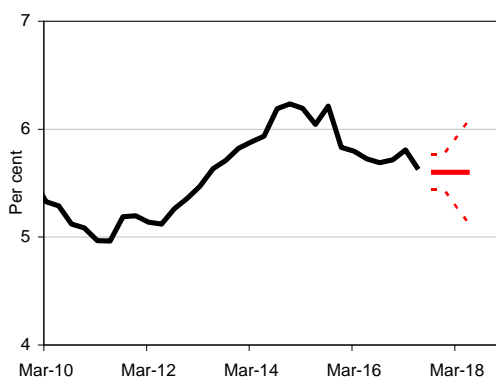
Source: ABS

**Figure 24: Growth in Attached Dwelling Prices**  
(year-ended, per cent)



Source: ABS

**Figure 25: Unemployment Rate**  
(actual and forecast)



The dashed lines are the 90% confidence bands.

**Figure 26: Underlying CPI Inflation**  
(actual and forecast)



The dashed lines are the 90% confidence bands.

	Precision of (year-end) Forecasts				Financial Year 2017/18
	2017	2017	2018	2018	
	Sep	Dec	Mar	Jun	
<b>Australia</b>					
<i><b>Economic Activity</b></i>					
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
<i><b>Inflation &amp; Financial Market</b></i>					
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
<i><b>Labour Market</b></i>					
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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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.

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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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