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Applied Economic & Social Research

Monthly Bulletin of Economic Trends: Review of the Australian Economy

June 2018

THE UNIVERSITY OF MELBOURNE

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Outlook for Australia[1]

	Actual				Forecasts				Actual	Forecast
	2017	2017	2017	2018	2018	2018	2018	2019	Calender Year	
	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	2017	2018
Economic Activity										
GDP	2.0	2.8	2.4	3.1	2.7	2.9	3.2	2.9	**2.2**	**3.0**
	(1.0)	(0.5)	(0.5)	(1.0)	(0.6)	(0.8)	(0.8)	(0.7)		
Household Consumption	2.7	2.7	2.9	2.9	2.6	2.6	2.3	2.6	**2.7**	**2.6**
	(1.0)	(0.6)	(1.0)	(0.3)	(0.6)	(0.6)	(0.7)	(0.7)		
Private Dwellings	-1.2	-2.6	-5.0	-1.0	-1.8	-0.1	-0.4	-1.7	**-2.2**	**-0.8**
	(0.3)	(-2.1)	(-0.1)	(0.9)	(-0.5)	(-0.4)	(-0.4)	(-0.4)		
New Business Investment	1.4	8.7	6.0	3.1	4.0	2.1	4.0	5.5	**3.7**	**3.3**
	(0.3)	(3.1)	(-0.4)	(0.1)	(1.2)	(1.2)	(1.5)	(1.5)		
Domestic Final Demand	2.6	3.6	3.3	3.2	3.0	2.9	3.0	3.1	**3.0**	**3.0**
	(0.9)	(0.9)	(0.8)	(0.6)	(0.8)	(0.7)	(0.8)	(0.8)		
Imports of Goods & Services	6.5	8.3	7.3	4.7	6.2	4.9	4.8	5.9	**7.8**	**5.1**
	(-0.1)	(2.6)	(1.6)	(0.5)	(1.3)	(1.4)	(1.5)	(1.6)		
Exports of Goods & Services	5.2	5.1	0.2	4.6	3.2	3.9	6.8	5.6	**3.5**	**4.6**
	(2.9)	(0.7)	(-1.5)	(2.4)	(1.5)	(1.4)	(1.3)	(1.3)		
Inflation & Financial Market										
Underlying inflation[2]	1.8	1.8	1.8	1.9	1.9	2.1	2.2	2.2	**1.8**	**2.0**
	(0.5)	(0.4)	(0.4)	(0.5)	(0.5)	(0.5)	(0.5)	(0.6)		
Headline Inflation	1.9	1.8	1.9	1.9	2.3	2.3	2.2	2.3	**1.9**	**2.2**
	(0.2)	(0.6)	(0.6)	(0.4)	(0.6)	(0.6)	(0.5)	(0.6)		
90-day Bill Rate[3]	1.7	1.7	1.7	1.8	2.0	2.0	2.0	2.0		
Trade Weighted Index[4]	64.5	66.5	64.7	64.2	62.5	61.8	61.8	61.8		
$A/$US rate (100)[4]	0.75	0.79	0.77	0.77	0.76	0.74	0.74	0.74		
Labour Market										
Unemployment Rate[4]	5.6	5.5	5.4	5.5	5.5	5.5	5.4	5.4	**5.6**	**5.5**
Employment Growth Rate[5]	2.0	2.7	3.2	3.3	2.6	2.2	2.0	1.9	**2.3**	**2.5**
	(1.0)	(0.9)	(0.8)	(0.6)	(0.3)	(0.5)	(0.6)	(0.5)		
Participation Rate[4]	65.0	65.3	65.5	65.7	65.5	65.5	65.4	65.4	**65.1**	**65.5**
Wage Price Index	1.9	2.1	2.1	2.1	2.0	2.1	2.2	2.3	**2.0**	**2.1**
	(0.6)	(0.6)	(0.5)	(0.5)	(0.5)	(0.6)	(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 20/06/2018.

Economic Activity

Australian Economy Grows Strongly in Early 2018

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

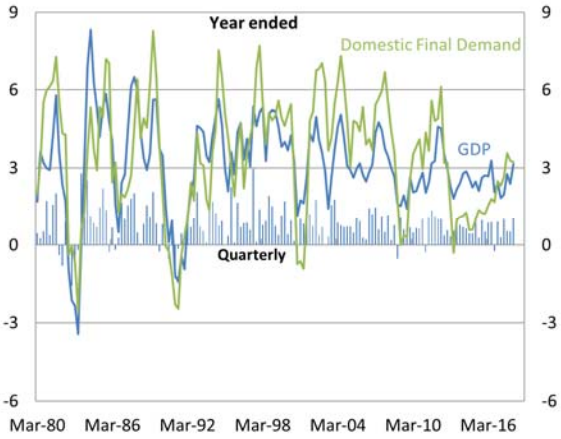
Recent Economic Growth

- GDP growth was a strong 1 per cent in the March quarter, buoyed by resource exports, and 3.1 per cent over the year (Figure 1). Looking through the volatility, trend growth in the quarter was 0.7 per cent.
- Government consumption contributed to growth, and is 5.1 per cent higher over the year (Figure 2). Household consumption increased by only 0.3 per cent in the quarter. Low wages growth, combined with weakening housing markets in Sydney and Melbourne, may have weighed on consumption growth. The saving ratio declined further in the quarter.
- An encouraging aspect was that non-mining investment increased in the quarter, although further falls in mining investment weighed on overall business investment (Figure 3).
- Residential investment increased by 0.9 per cent in the March quarter, but remains 1 per cent lower over the year. The growth reflected an increase in alterations and additions.
- Inventory accumulation added 0.2 percentage points to growth (Figure 2).
- Net exports contributed 0.3 percentage points to growth. Export volumes increased by 2.4 per cent, underpinned by growth in resource exports. This reflected increased LNG production – exports of other mineral fuels jumped by 12.2 per cent. LNG exports in real terms were larger than coal exports in the March quarter. Coal traditionally has been Australia's second largest resource export (after iron ore). Manufactured and service exports also increased, whereas rural exports fell. Imports growth was softer than in recent quarters.

Growth Prospects

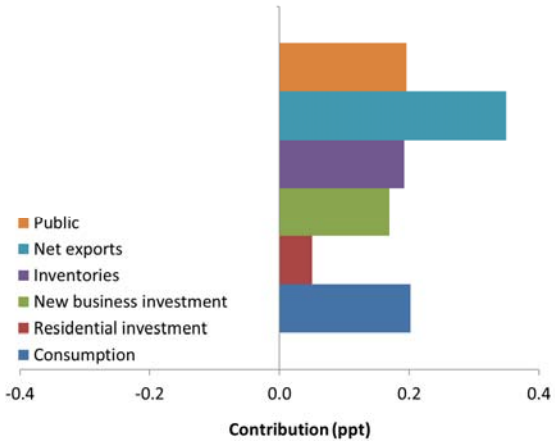
- The weak consumption growth was disappointing, although in trend terms it increased by 0.6 per cent. Consumer sentiment this year has decreased, but remains more than 6 per cent higher than a year ago. In June the Expectations Index fell by 1 per cent, largely reflecting consumers being less optimistic about economic conditions in the next 12 months and 5 years. Nevertheless, respondents remain considerably more positive about future economic conditions than they were a year ago. Subdued consumption growth appears likely to continue, given the prevailing low wages growth environment.
- The prospects for nominal private business investment, as reported by the ABS Capital Expenditure (CAPEX) survey, softened slightly, with expectations for non-mining investment in 2018/19 decreasing (Figure 4). There was a marginal improvement in the prospects for mining investment. These are early estimates for 2018/19 (the second), and historically the early estimates have tended to not be reliable. Business confidence, as measured by the NAB Monthly Business Survey, eased in May, but remains at around its long-run average level. The current conditions index also fell, but is more positive than the forward-looking confidence measure.
- Trend building approvals in April were 5.7 per cent higher than a year ago, primarily due to growth in approvals for private sector houses. Building approvals continue to suggest that only a mild downturn in residential construction is likely.
- The Westpac-Melbourne Institute Leading Index is a summary indicator of the near-term growth prospects. Currently it points to growth being around, or slightly above, trend in the near term (Figure 5).
- In summary, output grew strongly in the March quarter. However, underlying growth was around trend, and while some softening in the timely indicators has occurred, overall it appears that a continuation of around trend growth is likely. Consequently, we expect output growth of 3 per cent in 2018, an improvement from the soft 2.2 per cent in 2017 (Figure 6). Much of this anticipated improvement reflects a smaller drag from net exports, rather than a strengthening in domestic final demand growth.

Figure 1: Growth
(per cent)



Source: ABS

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

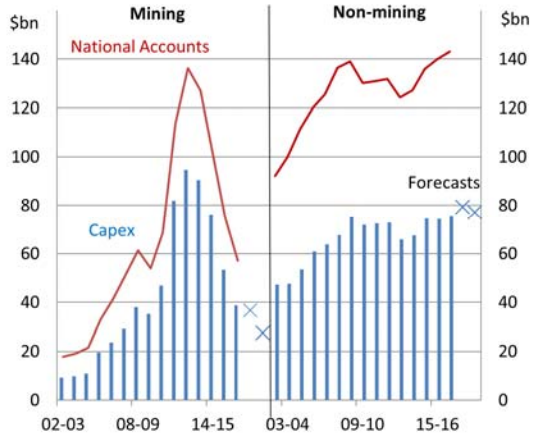


Source: ABS

Figure 3: Business Investment Growth
(Year-ended)

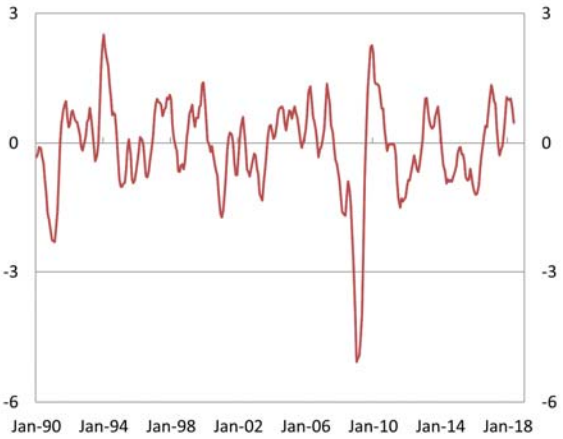
Source: ABS
Note: Experimental estimates

Figure 4: Capex Survey
(Nominal)



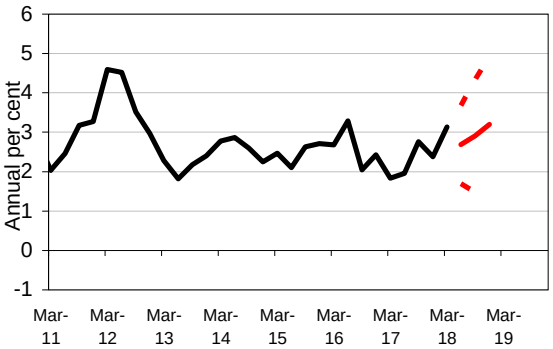
Source: ABS, Melbourne Institute

Figure 5: Westpac-Melbourne Institute Leading Index (smoothed)



Source: Melbourne Institute

Figure 6: 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 Outlook Remains Positive, But United States' Trade Policy Increases Uncertainty

Commodity Prices

- The terms of trade, namely the ratio of export to import prices, increased by 3.3 per cent in the March quarter, but remain 2.6 per cent lower over the year (Figure 7). The RBA Index of Commodity Prices in A$ has subsequently fallen, largely due to lower bulk commodity prices.
- Crude oil prices have moved higher, with Brent up by more than 8 per cent since end March. Supply-side factors, such as Venezuala's economic implosion, have contributed to the price increases.

Global Growth Outlook

- The OECD in its May Economic Outlook left its forecasts similar to the previous release, pointing to growth being stronger in 2018 and 2019 than last year (Figure 8). They noted the pick up in both investment and trade; the low level of the OECD unemployment rate; and the supportive role that fiscal policy has played in many countries. However, they also noted several risks to the outlook, including the shift towards protectionism, and financial volatility possibly associated with monetary policy returning to more conventional levels in many nations.
- The IMF in its April World Economic Outlook maintained its forecasts of 3.9 per cent for world output growth in both 2018 and 2019.
- Recent economic data for the US have been positive, despite GDP growth of only 0.5 per cent in the March quarter (2.5 per cent year-ended). Retail sales, for example, grew by a strong 0.8 per cent in May. Non-farm payroll employment increased by 223,000 in May, and the diffusion index (which measures the share of industries increasing employment) continued to trend up. The unemployment rate fell to 3.8 per cent, although the prime-age participation rate ticked down. Business conditions are positive, with both the manufacturing and non-manufacturing ISM survey indices at expansionary levels. Nowcasts point to output growth increasing in the June quarter; the Atlanta Federal Reserve anticipate an annualized rate of 4.7 per cent, whereas the New York Fed anticipate 2.98 per cent.
- Inflation in the US recently has has picked up. The headline CPI increased by 2.8 per cent over the year to May, with energy prices playing a sizable role. Nevertheless, core CPI inflation has also increased to 2.2 per cent
- The Federal Reserve Open Markets Committee (FOMC) in the US increased the federal funds rate target range by 25 basis points to 1.75 – 2 per cent. The accompanying projections indicate a total of four interest rate increases in 2018.
- The shift towards protectionism in the US has led to some countries, such as Canada, to signal retaliatory actions are likely. President Trump announced tariffs on Chinese imports will be implemented in July, and China, like Canada, has retaliated with plans to raise tariffs. Subsequently President Trump has announced a further 10 per cent tariff of $200 billion on Chinese exports, which led to falls in the Chinese stock market and the possibility of further retaliatory actions.
- The Chinese economy grew by 6.8 per cent over the year to the March quarter. Some indicators point to growth being softer in the June quarter – for example, cumulative investment in fixed assets in the first five months of 2018 was up 6.1 per cent year-on-year, compared to 8.6 per cent at the same time in 2017. Nominal retail sales disappointed, increasing by 8.5 per cent year-ended, which was slower than the 9.4 per cent pace achieved in April, and below market expectations. Industrial production growth also slowed in May, driven by the manufacturing sector.
- The People's Bank of China did not match the Federal Reserve's interest rate increase in June, and injected liquidity by lending 200 billion yuan (US$31 billion) to banks through its medium-term lending facility (MLF). The Bank's governor encouraged investors to be calm

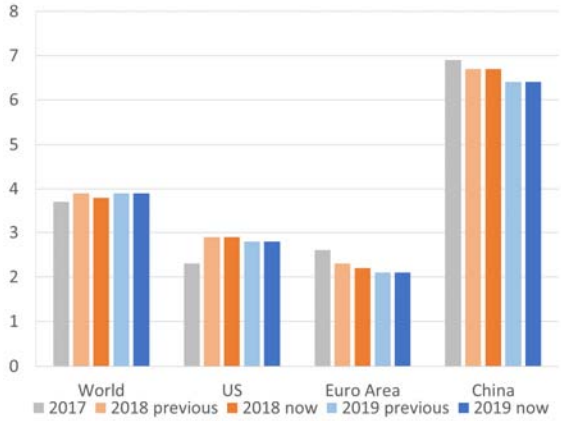
despite the trade dispute with the US. In April it cut required reserve ratios for banks by 100 basis points.

- Euro area growth slowed in the March quarter to be 0.4 per cent (down from 0.7 per cent in December 2017), and was 2.4 per cent year ended. Consumption growth increased in the quarter, but net exports subtracted and fixed investment growth softened. The slowing was broad based across the member countries. Some indicators, such as PMIs, suggest that this sluggishness has continued in the June quarter.
- Annual inflation in the euro area increased to be 1.9 per cent May, up from 1.3 per cent. Oil prices played an important role; an exclusion-based core measure was more modest at 1.1 per cent, although still higher than in April (0.7 per cent).
- The ECB announced that it will phase out its bond purchase program this year, reflecting an assessment that "…the median market expectations for net purchases beyond September 2018 were small. It follows that the contribution to our inflation outlook from expected future net purchases as also modest". The ECB also provided forward guidance that key policy interest rates will remain unchanged until at least the summer of 2019.
- Political instability in Italy led to a sharp widening in spreads (e.g. to German 10-year bonds) in May. While these have subsequently narrowed, they remain elevated.
- In summary, global growth prospects continue to be positive. However, the shift towards protectionist policies by the US and subsequent retaliatory actions have increased the uncertainty surrounding the outlook.

Figure 7: Terms of Trade and Commodity Prices
(March Quarter 2015 = 100)

Source: ABS, RBA
Note: Commodity prices in SDR

Figure 8: OECD Forecasts
(per cent)



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

Labour Markets, Inflation and Monetary Policy

Labour Market Little Changed

- The Melbourne Institute expects the unemployment rate to be little changed in the near term. Inflation is anticipated to increase only gradually.

Recent Labour Market and Inflation Developments

- The labour market in recent months has been little changed. The unemployment rate dipped to 5.4 per cent in May, but on a trend basis it remained at 5.5 per cent, a level it has been at since late last year (Figure 9).
- Employment growth has slowed in 2018 to date. This slowing has been mainly been in full-time positions (Figure 10). Nevertheless, in May employment was 2.5 per cent higher than a year ago. The flat trend unemployment rate and slower employment growth is reconciled by the participation rate ceasing to rise (Figure 9). The trend participation rate for those aged 15-64 has been flat throughout 2018.

- The trend employment-to-population rate dipped in May, but remains substantially higher than the levels achieved in recent years.
- The trend underutilisation rate, which is a broader measure of slack than the unemployment rate as it also includes the number of people working less hours than they desire, was unchanged at 13.9 per cent in the June quarter.
- Wages growth decreased slightly in the March quarter, but unchanged in year-ended terms (Figure 11).
- Two factors that are likely to be weighing on wages growth are low inflation expectations and subdued labour productivity growth. Some measures of inflation expectations have strengthened in the June quarter; for example, the Melbourne Institute's survey of consumers, and the Reserve Bank of Australia's survey of union officials. It is, however, too early to know whether this increase will be sustained. Labour productivity grew by 1.5 per cent in the March quarter, although this reflects the weak December quarter, and it is only 0.2 per cent higher over the year.
- The headline CPI increased by 0.4 per cent in the March quarter, to be 1.9 per cent higher over the year. Housing, transport and education made the largest contribution to growth. Increases in the prices of gas, other household fuels, and electricity, all contributed to the increase in the housing group.
- The Reserve Bank of Australia (RBA) focuses underlying inflation as it provides a better gauge of the prospects for inflation in the future. The trimmed-mean measure increased by 0.5 per cent in the March quarter, to be 1.9 per cent higher over the year, remaining below the bottom of the RBA's target band (Figure 14).

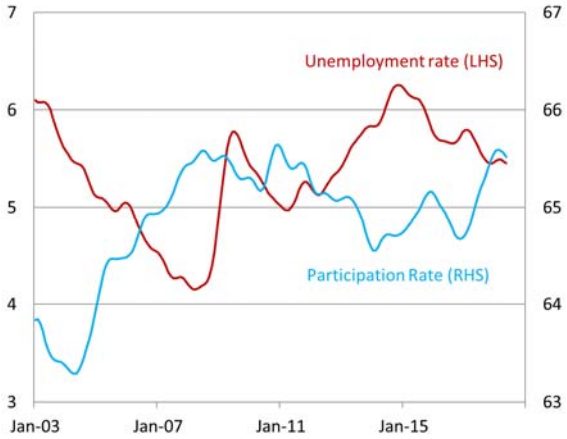
Prospects for the Labour Market and Inflation

- Timely indicators suggest that some loss of momentum has occurred in the labour market. The trend estimate of the ANZ Job Advertisements Index grew by 0.4 per cent in May, to be 10.1 per cent higher over the year, compared with 12.5 per cent in December 2017. The Westpac-Melbourne Institute Unemployment Expectations Index increased by 5.7 per cent in June, signaling that more respondents expect the unemployment rate to increase than previously, although it remains 9.6 per cent lower than a year ago.
- The AUD/USD exchange rate has depreciated by around 3.4 per cent since late March. The increase in the Federal Funds rate and prospects for further increases are likely to be contributing factors. Alternatively, on a trade-weighted basis the exchange rate is little changed.
- Underlying inflation is expected to remain subdued in the near term.

Monetary Policy

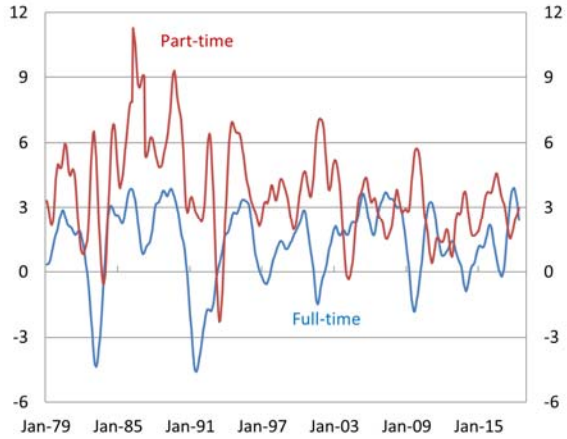
- The RBA has kept monetary policy unchanged in 2018 to date, restrained by the subdued outlook for inflation. Minutes of the most recent Board meeting noted that lending standards for residential mortgages have tightened, and the demand for credit has eased.
- Residential property prices in the capital cities in aggregate fell by 0.7 per cent in the March quarter. The largest fall occurred in Sydney (-1.2 per cent); prices also decreased in Melbourne, Brisbane, Perth and Darwin. Growth was strongest in Hobart – 4.3 per cent in the March quarter, and more than 14 per cent over the year.
- Overall, the strong growth outcome in the March quarter does not fundamentally change the outlook. While the labour market has lost some momentum, in the near term the unemployment rate is likely to be little changed (Figure 13). Higher energy prices may add to headline inflation; core inflation is expected to increase only modestly, reaching the bottom of the RBA's target band (Figure 14).

Figure 9: Labour Market
(trend, %)



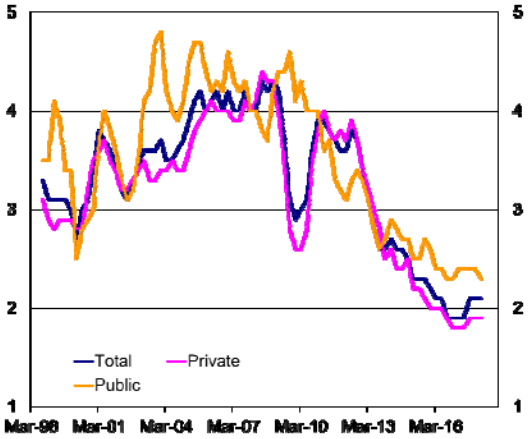
Source: ABS

Figure 10: Employment Growth
(trend, year-ended, %)



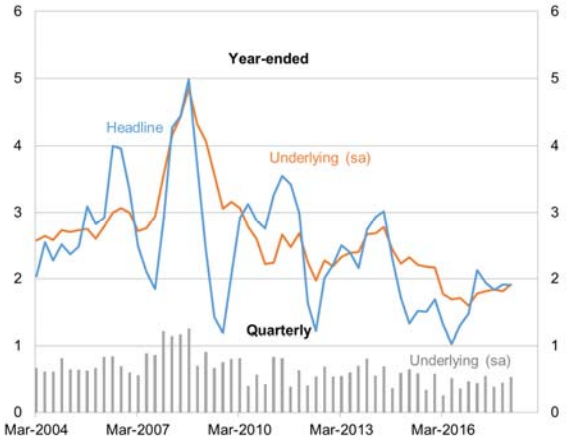
Source: ABS

Figure 11: Wage Price Index
(year-ended, %)



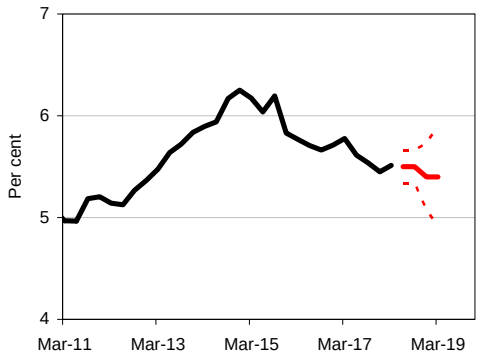
Source: ABS

Figure 12: CPI Inflation
(per cent)



Source: ABS

Figure 13: Unemployment Rate
(actual and forecast)



The dashed lines are the 90% confidence bands.

Figure 14: Underlying CPI Inflation
(actual and forecast)

The dashed lines are the 90% confidence bands.

Precision of (year-end) Forecasts					
	2018	2018	2018	2019	**Calender Year**
	Jun	Sep	Dec	Mar	**2018**
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	**0.3**
Headline Inflation		0.3	0.4	0.5	**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	0.1	0.2	**0.3**
Employment		0.1	0.2	0.4	**0.5**
Participation Rate		0.1	0.2	0.3	**0.3**
Wage Price Index	0.5	0.5	0.6	0.7	**0.4**

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