

MELBOURNE INSTITUTE  
Applied Economic & Social Research

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

March 2018



Released on 22 March 2018

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

|   | Actual         |               |                |                | Forecasts      |                |                |                | Actual                | Forecast |
|---|----------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------------|----------|
|   | 2017<br>Mar    | 2017<br>Jun   | 2017<br>Sep    | 2017<br>Dec    | 2018<br>Mar    | 2018<br>Jun    | 2018<br>Sep    | 2018<br>Dec    | Calendar Year<br>2017 | 2018     |
| <b>Economic Activity</b>                |                |               |                |                |                |                |                |                |                       |          |
| GDP                                     | 1.9<br>(0.5)   | 2.0<br>(0.8)  | 2.9<br>(0.7)   | 2.4<br>(0.4)   | 2.8<br>(0.9)   | 2.6<br>(0.7)   | 2.6<br>(0.7)   | 3.0<br>(0.8)   | 2.3                   | 2.8      |
| Household Consumption                   | 2.3<br>(0.4)   | 2.7<br>(0.9)  | 2.7<br>(0.5)   | 2.9<br>(1.0)   | 2.9<br>(0.5)   | 2.6<br>(0.6)   | 2.7<br>(0.6)   | 2.4<br>(0.7)   | 2.7                   | 2.7      |
| Private Dwellings                       | -0.2<br>(-3.0) | -1.5<br>(0.2) | -2.2<br>(-1.7) | -5.8<br>(-1.3) | -3.8<br>(-1.0) | -4.9<br>(-1.0) | -4.0<br>(-0.8) | -3.5<br>(-0.7) | -2.4                  | -4.0     |
| New Business Investment                 | -0.8<br>(3.0)  | 1.4<br>(0.5)  | 8.7<br>(3.2)   | 5.8<br>(-1.0)  | 3.8<br>(1.0)   | 4.5<br>(1.2)   | 2.4<br>(1.2)   | 5.0<br>(1.5)   | 3.7                   | 3.9      |
| Domestic Final Demand                   | 2.3<br>(0.7)   | 2.6<br>(0.9)  | 3.6<br>(0.9)   | 3.1<br>(0.6)   | 3.1<br>(0.7)   | 2.9<br>(0.7)   | 2.6<br>(0.7)   | 2.9<br>(0.8)   | 2.9                   | 2.9      |
| Imports of Goods & Services             | 8.7<br>(2.9)   | 6.9<br>(0.8)  | 8.4<br>(2.2)   | 6.6<br>(0.5)   | 5.4<br>(1.8)   | 6.0<br>(1.3)   | 5.1<br>(1.4)   | 6.1<br>(1.5)   | 7.6                   | 5.7      |
| Exports of Goods & Services             | 3.5<br>(-1.7)  | 5.4<br>(3.0)  | 5.8<br>(1.2)   | 0.8<br>(-1.8)  | 5.1<br>(2.6)   | 3.8<br>(1.7)   | 4.1<br>(1.5)   | 7.5<br>(1.5)   | 3.8                   | 5.1      |
| <b>Inflation &amp; Financial Market</b> |                |               |                |                |                |                |                |                |                       |          |
| Underlying inflation <sup>2</sup>       | 1.8<br>(0.5)   | 1.8<br>(0.5)  | 1.8<br>(0.4)   | 1.8<br>(0.4)   | 1.7<br>(0.4)   | 1.7<br>(0.5)   | 1.7<br>(0.5)   | 1.9<br>(0.6)   | 1.8                   | 1.8      |
| Headline Inflation                      | 2.1<br>(0.5)   | 1.9<br>(0.2)  | 1.8<br>(0.6)   | 1.9<br>(0.6)   | 2.0<br>(0.5)   | 2.3<br>(0.5)   | 2.2<br>(0.6)   | 2.2<br>(0.6)   | 1.9                   | 2.2      |
| 90-day Bill Rate <sup>3</sup>           | 1.8            | 1.7           | 1.7            | 1.7            | 1.7            | 1.7            | 1.7            | 1.9            |                       |          |
| Trade Weighted Index <sup>4</sup>       | 66.1           | 64.5          | 66.5           | 64.7           | 64.7           | 63.0           | 63.0           | 63.0           |                       |          |
| \$A/\$US rate (100) <sup>4</sup>        | 0.76           | 0.75          | 0.79           | 0.77           | 0.77           | 0.75           | 0.75           | 0.75           |                       |          |
| <b>Labour Market</b>                    |                |               |                |                |                |                |                |                |                       |          |
| Unemployment Rate <sup>4</sup>          | 5.8            | 5.6           | 5.5            | 5.5            | 5.5            | 5.4            | 5.3            | 5.2            | 5.6                   | 5.4      |
| Employment Growth Rate <sup>5</sup>     | 1.1<br>(0.5)   | 1.9<br>(1.0)  | 2.6<br>(0.8)   | 3.2<br>(0.7)   | 3.2<br>(0.6)   | 2.9<br>(0.7)   | 2.7<br>(0.6)   | 2.4<br>(0.5)   | 2.2                   | 2.8      |
| Participation Rate <sup>4</sup>         | 64.7           | 65.0          | 65.3           | 65.5           | 65.6           | 65.8           | 65.7           | 65.7           | 65.1                  | 65.7     |
| Wage Price Index                        | 1.9<br>(0.6)   | 1.9<br>(0.5)  | 2.0<br>(0.5)   | 2.1<br>(0.6)   | 2.0<br>(0.5)   | 2.1<br>(0.6)   | 2.3<br>(0.6)   | 2.3<br>(0.6)   | 2.0                   | 2.2      |

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.

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## **Economic Activity**

### ***December Quarter Disappoints, but the Outlook Remains Positive***

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

#### *Recent Economic Growth*

- GDP growth was a soft 0.4 per cent in the December quarter, and 2.4 per cent over the year (Figure 1). In trend terms it was stronger; 0.6 per cent in the quarter and 2.6 per cent over the year.
- Household consumption growth was strong (1 per cent). This followed a weak September quarter; over the year it grew by a reasonable 2.9 per cent. Growth in the quarter mainly reflected increased spending on health, hotels, cafes and restaurants, and recreation and culture. The saving ratio ticked up. Consumption contributed 0.6 percentage points to output growth (Figure 2).
- Residential investment fell by 1.3 per cent, to be 5.8 per cent lower over the year, clearly signalling that the downturn in residential construction is underway. It subtracted 0.1 percentage points from growth.
- Private new business investment fell by 1 per cent, but is 5.8 per cent higher over the year. The mining sector appears to have continued to be a drag on growth, with declines in new engineering construction. A positive development, however, was that new machinery and equipment investment increased – it is 8.4 per cent higher over the year. Overall, private new business investment subtracted 0.1 percentage points from growth.
- The public sector in recent quarters has been an important source of growth and this continued in the December quarter. Both public consumption and investment increased; the public sector contributed around 0.5 percentage points to growth.
- Net exports were a major drag on growth in the December quarter (0.5 percentage points). This reflected both a fall in exports (-1.8 per cent) and modest growth in imports (0.5 per cent). The fall in exports was spread across several categories – rural and services, together with temporary supply disruptions adversely impacting coal exports.

#### *Growth Prospects*

- The improvements in the labour market which occurred throughout 2017, such as robust employment growth, will support consumption growth in the near term. Consumer sentiment has maintained the improvement which occurred late last year. In March, there was a net balance of positive responses in the Westpac-Melbourne Institute Current Conditions and Expectations indices; they are 4.2 and 2.6 per cent higher over the year respectively.
- The prospects for private business investment are encouraging. The NAB Monthly Business Survey of current conditions increased further in March, to be at a particularly high level. The strength was broad based. The more forward-looking confidence measure fell slightly, but remains above its historical average. Turning to the ABS Capital Expenditure (CAPEX) survey, this provided the 5<sup>th</sup> estimate of nominal investment in 2017/18 (Figure 3). The non-mining measure points to a substantial lift, whereas a further fall is expected for mining investment, although smaller than occurred in 2016/17. The first estimates for 2018/19 were also provided, but these usually are not reliable.
- Trend building approvals in January were 5 per cent higher than a year ago (Figure 4). This suggests that the downturn in residential construction may be relatively mild.
- While exports disappointed in the December quarter, it is worth remembering that they are volatile and that in the next 1½ years there will be substantial increases in Liquefied Natural Gas (LNG) exports as the production phase of the mining boom draws to a close.
- The Westpac-Melbourne Institute Leading Index is a summary indicator of the near-term growth prospects. Currently it points to above-trend growth occurring in the next six to nine months (Figure 5). Subsequently, with residential investment probably continuing to

subtract from growth, the prospects for non-mining investment become of particular importance, and as discussed above there are reasons to be optimistic.

- In summary, growth disappointed in the December quarter. This, however, does not significantly alter the prospects for a strengthening in growth in 2018 (Figure 6), supported by an improving global economy (see the “International Economy” section).

*Are Current Conditions Consistent with a Recession?*

- Australia’s population growth recently has been robust (Figure 7). Consequently, on a per capita basis Australia’s growth outcomes look softer (Figure 8). It has even been suggested that while not in a recession “[we might as well be](#)”.
- Recessions occur when economic activity persistently declines, i.e. there is negative growth. Declines in Real GDP per capita will occur more frequently than declines in real GDP. This reflects that trend growth for real GDP is higher (as on average the population grows). Consequently, recessions will occur more frequently if defined using per capita GDP.
- Economic conditions consistent with a recession will differ depending on the definition used.
- Many economic indicators are not at levels consistent with a conventionally defined recession. As an example, Table 2 compares several to their average level in 1991, a period which includes Australia’s last recession.

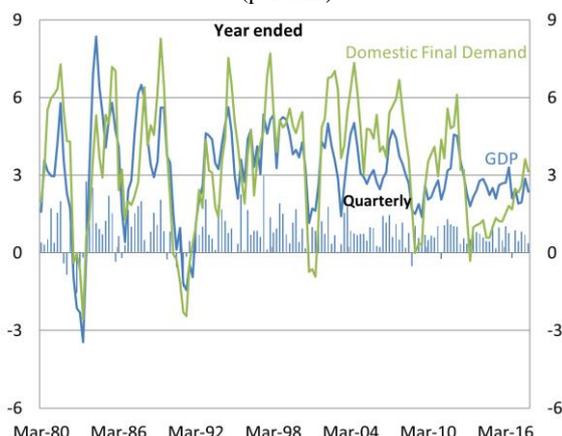
**Table 2: Economic Indicators During Recessions**

|                       | 1991 Average | Most recent |
|-----------------------|--------------|-------------|
| Consumer sentiment    | 81.1         | 103.0       |
| Unemployment rate     | 9.6          | 5.5         |
| Underutilisation rate | 15.4         | 13.7        |

Source: Melbourne Institute, ABS, calculations

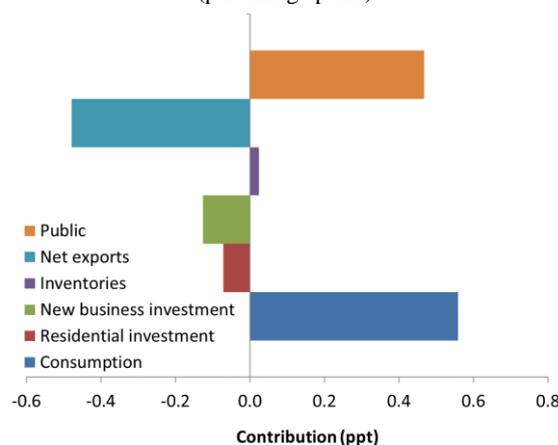
- The current unemployment rate is markedly lower. A caveat is that the Non-Accelerating Inflation Rate of Unemployment is often thought to have declined since the early 1990s (e.g. [Cusbert 2017](#)). Even taking this into account, or using the underutilisation rate, there currently is less slack in the labour market than occurred in 1991.
- The number of optimistic respondents in the Westpac-Melbourne Institute Consumer Sentiment Survey currently outstrips the pessimists. This would not occur in a recession.
- Recessions are severe. There are aspects of weakness in the Australian economy, such as wages growth. Viewed on a per capita basis Australia’s economic situation is less positive. It is not, however, consistent with a conventionally defined recession.

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



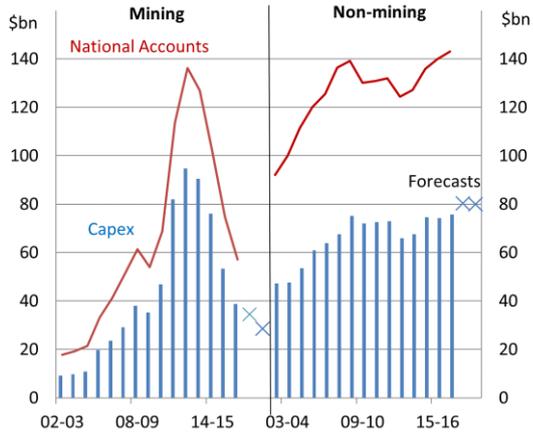
Source: ABS

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



Source: ABS

**Figure 3: Capex Survey**  
(Nominal)



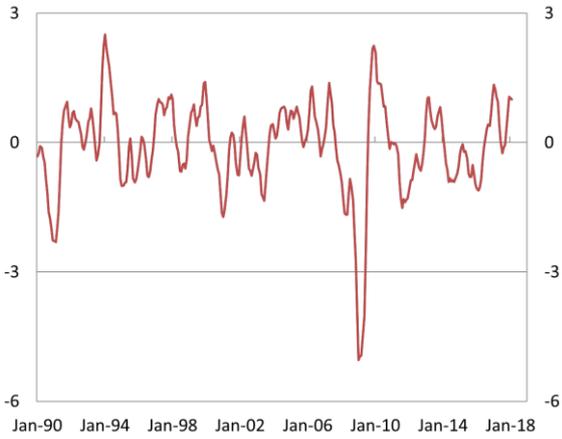
Source: ABS

**Figure 4: Building Approvals**  
(Trend, '000)



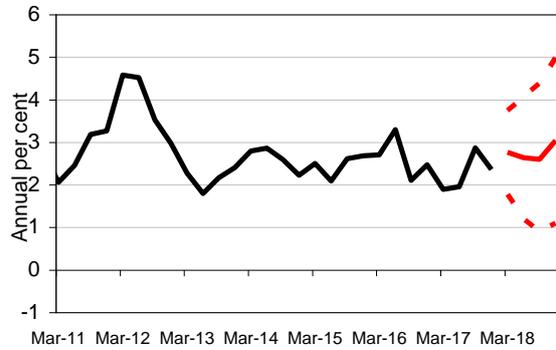
Source: ABS

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



Source: Melbourne Institute

**Figure 6: Growth in real GDP (per cent)**  
(actual and forecast)



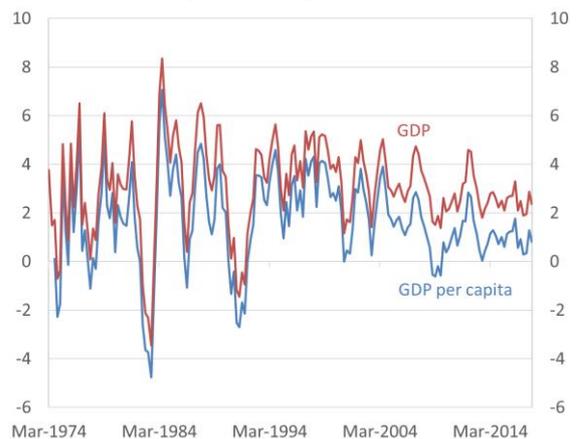
The dashed lines are the 90% confidence bands.

**Figure 7: Population Growth**  
(year-ended, per cent)



Source: ABS

**Figure 8: GDP and GDP per Capita Growth**  
(year-ended, per cent)



Source: ABS

## **International Economies, Commodity and Financial Markets**

### ***Global Growth Outlook Improves***

#### *Commodity Prices*

- The terms of trade, namely the ratio of export to import prices, rose marginally in the December quarter, although it is 1 per cent lower over the year (Figure 9).
- The RBA Index of Commodity Prices in A\$ has subsequently increased. In February it was 9.2 per cent higher than in December, with higher export prices for the bulk commodities. Rural prices have also increased.

#### *Global Growth Outlook*

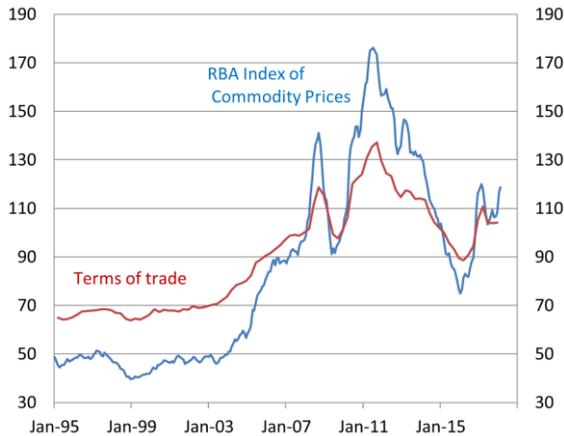
- The OECD in its [March Economic Outlook](#) revised up its forecasts for global growth in 2019 to be 3.9 per cent (Figure 10). In particular, their forecast for the US was boosted by 0.7 percentage points compared to the November Economic Outlook, with the tax reductions and announced government spending contributing factors. Growth is also anticipated to be stronger in the Euro area, particularly Germany.
- The IMF in its [January World Economic Outlook](#) also were more optimistic, with world output growth forecasts in both 2018 and 2019 revised up by 0.2 percentage points to 3.9 per cent.
- The US economy grew by 0.6 per cent in the December quarter, to be 2.5 per cent higher over the year. Private inventory investment subtracted from growth and contributed to a slowing in growth from the September quarter. Nowcasts of growth in the March quarter are divergent; the [Atlanta Federal Reserve](#) anticipate an annualized rate of 1.8 per cent, whereas the [New York Fed](#) is much stronger at 2.7 per cent.
- The labour market continues to provide a positive signal on the state of the US economy. The unemployment rate has been stable since October last year at 4.1 per cent, and initial jobless claims, a leading indicator, recently have been particularly low.
- President Trump announced new tariffs on steel and aluminum imports. Tariffs have also been placed on washing machines and solar panels. It is too early to assess whether there will be a shift towards protectionism in other nations as a response.
- The Chinese economy grew by 6.9 per cent in 2017. A target of 6.5 per cent growth in 2018 has been announced by the Government, together with a fiscal deficit target of 2.6 per cent of GDP (down from 3 per cent). Industrial production grew by a stronger-than-expected 7.2 per cent year-ended in January-February (considered together due to the Lunar New Year), and fixed asset investment growth increased.
- The Euro area continues to display momentum. Euro area GDP growth grew by 0.6 per cent in the December quarter, to be 2.7 per cent higher over the year. Trade and investment made the largest positive contributions to growth, namely 0.4 and 0.2 percentage points.

#### *Monetary Policy Worldwide*

- The Federal Open Market Committee (FOMC) met for the first with new chairman Jerome Powell. With CPI inflation ticking up to 2.2 per cent year-ended in February, and the state of the labour market, the Fed funds rate was increased to 1.50-1.75 per cent, and it is likely that further tightenings will occur this year.
- While the ECB left policy unchanged in March, it changed the accompanying statement, removing the easing bias due to improved outlook for the economy.
- A new Governor, Yi Gang, has been announced for the Peoples' Bank of China. Yi has been at the People's Bank for two decades, suggesting a continuation in its current policy priorities.
- Inflation in the UK in February eased to 2.7 per cent year-ended in February. Nevertheless, a further tightening in monetary remains possible in the near term.

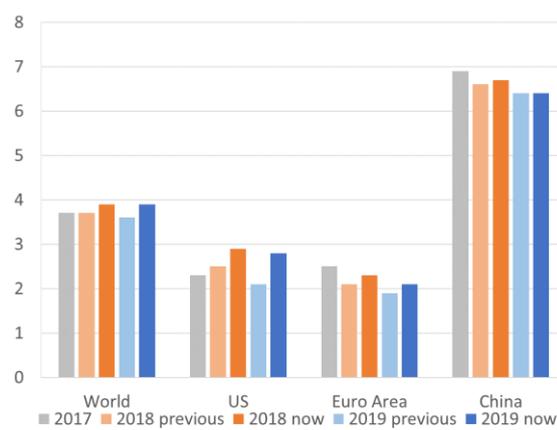
- In summary, global growth prospects have improved further, and a gradual tightening in monetary policy is likely in several nations.

**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 December Economic Outlook

## **Labour Markets, Inflation and Monetary Policy**

### ***Labour Market Developments Continue to be Positive***

- The Melbourne Institute expects the unemployment rate to gradually improve and inflation to remain subdued.

### ***Recent Labour Market and Inflation Developments***

- Labour market indicators have continued to be positive. The unemployment rate in January was 5.5 per cent, 0.2 percentage points lower than a year ago (Figure 11). The participation rate was 65.6 per cent, 1 percentage point higher than in January 2017.
- Employment increased by 16,000 people in January, to be 3.3 per cent higher than a year ago. While full-time employment fell, it has increased by 293,200 people since January 2017, compared to 110,000 for part-time employment (Figure 12).
- As the unemployment rate recently has been broadly unchanged, the lift in labour force participation has resulted in the employment-to-population ratio increasing to around 62 per cent, its highest level since early 2012.
- Wages growth improved marginally in the December quarter, to be 2.1 per cent higher over the year (Figure 13). Public sector wages growth outstripped that in the private sector.
- The headline CPI increased by 0.6 per cent in the December quarter, to be 1.9 per cent higher over the year. The largest increases were in automotive fuel, tobacco and domestic holiday travel and accommodation. Underlying inflation measures were more subdued – the trimmed mean increased by 0.4 per cent. It is 1.8 per cent higher over the year, below the bottom of the Reserve Bank of Australia’s (RBA) target band (Figure 14).

### ***Prospects for the Labour Market and Inflation***

- Timely indications suggest that the labour market will continue to improve. The ANZ Job Advertisements Index fell by 0.3 per cent, although this follows a 6.2 per cent jump in January. The Index is a solid 13.3 per cent higher over the year. The NAB Monthly Business Survey Employment Index increase strongly in February.
- The increase in wages growth in the December quarter was slight. Nevertheless, we continue to expect a gradual improvement. The Westpac-Melbourne Institute Unemployment Expectations Index is 11.6 per cent lower over the year. This indicates that less people are expecting the unemployment rate to increase in the future. The Index tends to lead wages growth.

- Inflation expectations are a key determinant of nominal wages growth and recently they have been unchanged at low levels.
- Labour productivity declined by 0.7 per cent in the December quarter, and is 1 per cent lower over the year, which is likely to be weighing on wages growth.
- The exchange rate on a trade-weighted basis has depreciated slightly from its December quarter average.
- Underlying inflation is expected to remain subdued in the near term.

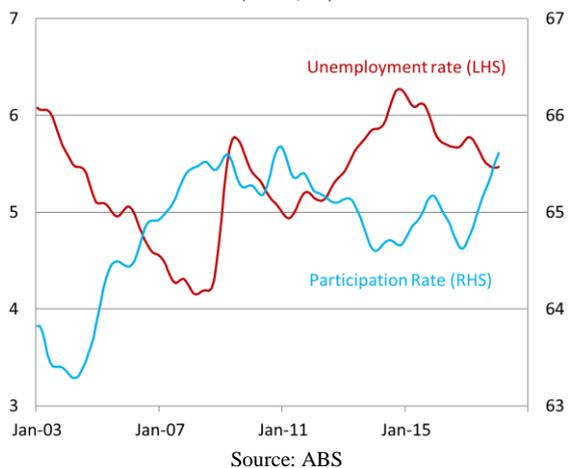
*Monetary Policy*

- The RBA has kept monetary policy unchanged in 2018 to date, in part due to the subdued outlook for core inflation.

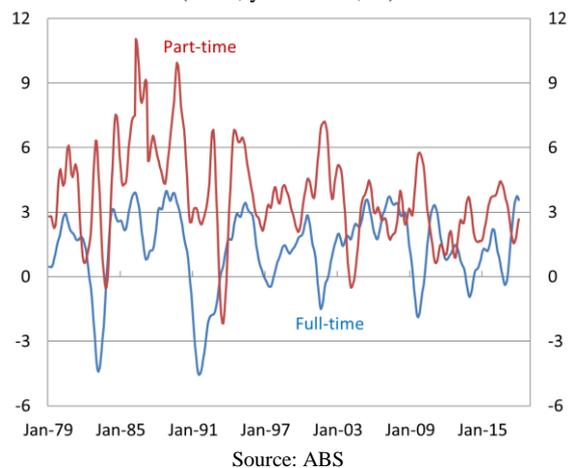
*Housing Market Developments Mixed Across the Capitals*

- Turning to the housing market, developments in the December quarter varied considerably across the States. Residential property prices fell marginally in Sydney, but rose by 2.6 per cent in Melbourne. Hobart continue to post strong gains – 3.9 per cent in the quarter, and 13.1 per cent over the year (Figures 15 & 16). In more detail:
  - *House prices:* Mirroring developments in the overall index, house prices decreased slightly in Sydney in the December quarter (-0.2 per cent), whereas it grew in Melbourne and increased by 4 per cent in Hobart. In Perth house prices increased by 1.3 per cent, and are now only 1.3 per cent lower over the year.
  - *Attached dwellings (apartments etc.):* Nationwide growth in apartment prices was less than in houses (0.6 per cent compared with 1.1 per cent). Prices were flat in Sydney, but fell in Perth by 1.2 per cent, to be 0.2 per cent lower over the year. Melbourne prices increased by 2.6 per cent.
- Overall, output growth in the December quarter was disappointing. Nevertheless, there are positive signs, including the labour market, a strengthening global economy and the indicators for non-mining business investment. Inflation expectations remain soft, and it is likely that the strengthening in wages growth will be a protracted process. Underlying inflation is expected to remain subdued in 2018 (Figure 18).

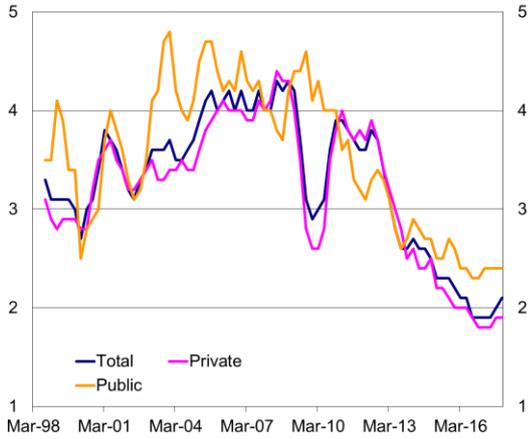
**Figure 11: Labour Market**  
(trend, %)



**Figure 12: Employment Growth**  
(trend, year-ended, %)

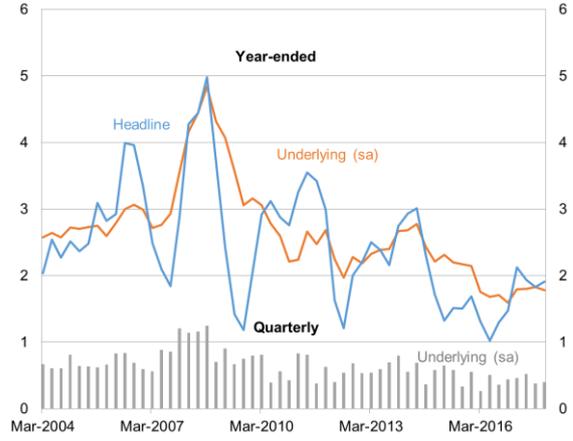


**Figure 13: Wage Price Index**  
(year-ended, %)



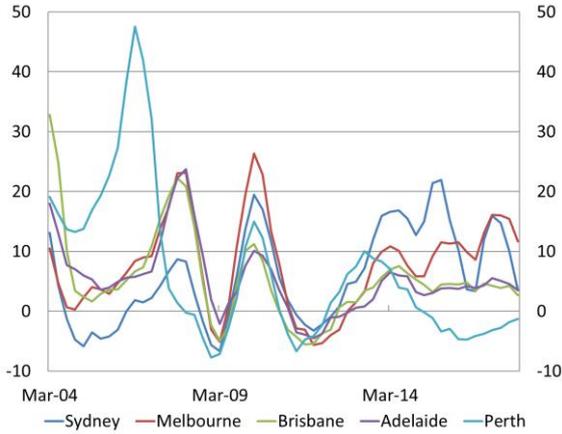
Source: ABS

**Figure 14: CPI Inflation**  
(per cent)



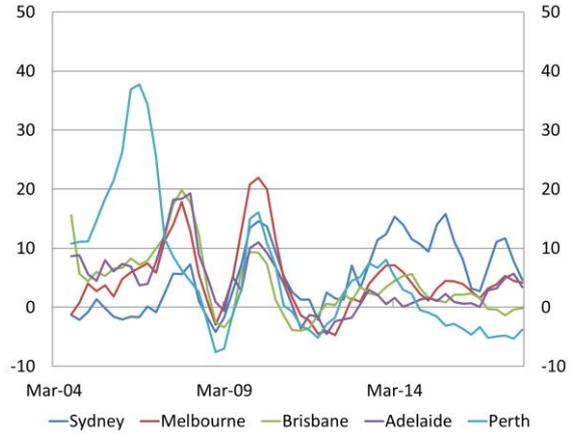
Source: ABS

**Figure 15: Growth in Established House Prices**  
(year-ended, per cent)



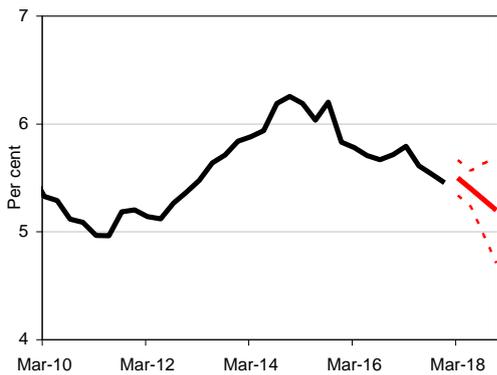
Source: ABS

**Figure 16: Growth in Attached Dwelling Prices**  
(year-ended, per cent)



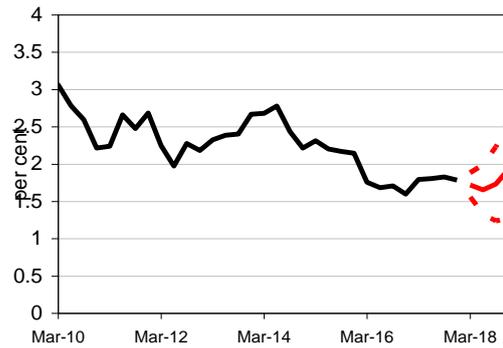
Source: ABS

**Figure 17: Unemployment Rate**  
(actual and forecast)



The dashed lines are the 90% confidence bands.

**Figure 18: Underlying CPI Inflation**  
(actual and forecast)



The dashed lines are the 90% confidence bands.

Monthly Bulletin of Economic Trends – March 2018

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

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