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Monthly Bulletin of Economic Trends: Review of the Australian Economy

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Review of the Australian Economy

- **Slow growth continued in the Australian economy in the September quarter, and this is likely to persist into 2020.**
- **The labour market remains comparatively upbeat, but little domestically-based inflationary pressures are present.**
- **Growth in the global economy in 2019 was weak. There have been a few positive signs recently, but considerable uncertainty still exists.**
- **Labour and multifactor productivity declined in Australia in 2018-19.**

Table 1: Outlook for Australia[1]

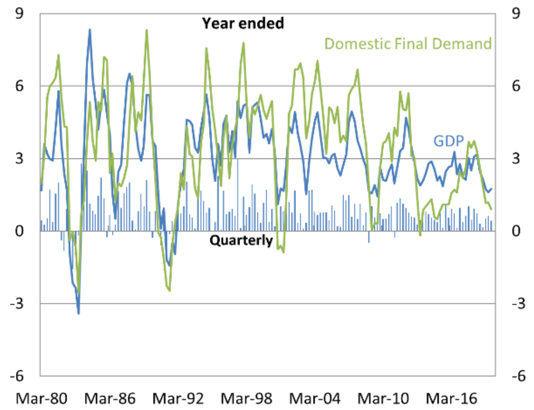
	Actual				Forecasts				Actual	Forecast
	2018	2019	2019	2019	2019	2020	2020	2020	Financial Year	
	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	2018/19	2019/20
Economic Activity										
GDP	2.1	1.7	1.6	1.7	1.8	1.7	1.5	1.6	2.0	1.7
	(0.2)	(0.5)	(0.6)	(0.4)	(0.3)	(0.4)	(0.4)	(0.6)		
Household Consumption	2.0	1.9	1.4	1.2	1.1	1.2	1.2	1.6	2.0	1.2
	(0.4)	(0.3)	(0.3)	(0.1)	(0.3)	(0.4)	(0.4)	(0.5)		
Private Dwellings	3.1	-1.9	-7.8	-9.6	-9.1	-10.0	-8.6	-8.9	0.0	-9.3
	(-3.0)	(-1.6)	(-3.7)	(-1.7)	(-2.5)	(-2.5)	(-2.3)	(-2.0)		
New Business Investment	-0.9	-1.1	-0.9	-1.7	-2.2	-3.3	-2.6	0.3	-1.0	-2.5
	(-0.1)	(0.8)	(-0.4)	(-2.0)	(-0.6)	(-0.3)	(0.3)	(0.9)		
Domestic Final Demand	1.8	1.2	1.2	0.9	0.7	0.7	0.7	1.0	1.7	0.8
	(0.1)	(0.3)	(0.3)	(0.2)	(-0.1)	(0.2)	(0.4)	(0.5)		
Imports of Goods & Services	1.3	-0.4	-2.2	-1.5	-1.5	-1.2	0.3	0.9	0.2	-1.0
	(-0.1)	(-0.1)	(-1.1)	(-0.2)	(0.0)	(0.2)	(0.3)	(0.4)		
Exports of Goods & Services	5.5	2.8	3.5	3.3	4.6	3.6	3.0	2.9	3.9	3.6
	(-0.4)	(1.7)	(1.3)	(0.7)	(0.8)	(0.8)	(0.7)	(0.6)		
Inflation & Financial Market										
Underlying inflation[2]	1.8	1.5	1.6	1.6	1.4	1.5	1.5	1.6	1.6	1.5
	(0.4)	(0.3)	(0.4)	(0.4)	(0.3)	(0.4)	(0.4)	(0.5)		
Headline Inflation	1.8	1.3	1.6	1.7	1.4	1.8	1.7	1.7	1.6	1.7
	(0.5)	(0.0)	(0.6)	(0.5)	(0.3)	(0.4)	(0.5)	(0.5)		
90-day Bill Rate[3]	2.0	1.9	1.5	1.0	0.9	0.9	0.9	0.9		
Trade Weighted Index[4]	62.0	60.9	60.2	59.2	59.4	59.0	59.0	59.0		
$A/$US rate (100)[4]	0.73	0.72	0.70	0.68	0.68	0.67	0.67	0.67		
Labour Market										
Unemployment Rate[4]	5.0	5.0	5.2	5.2	5.2	5.3	5.4	5.3	5.1	5.3
Employment Growth Rate[5]	2.3	2.2	2.5	2.5	2.0	1.6	1.2	0.9	2.4	1.8
	(0.7)	(0.6)	(0.6)	(0.6)	(0.2)	(0.2)	(0.2)	(0.3)		
Participation Rate[4]	65.6	65.7	66.0	66.0	66.0	66.0	66.0	66.0	65.7	66.0
Wage Price Index	2.3	2.3	2.3	2.2	2.1	2.0	1.9	1.9	2.3	2.1
	(0.5)	(0.6)	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)	(0.5)		

Prepared by G. Lim and T. Robinson, Macro@MI. Data in this report were finalized on 19/12/2019.
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.

Sluggish growth persists, despite the policy stimulus...

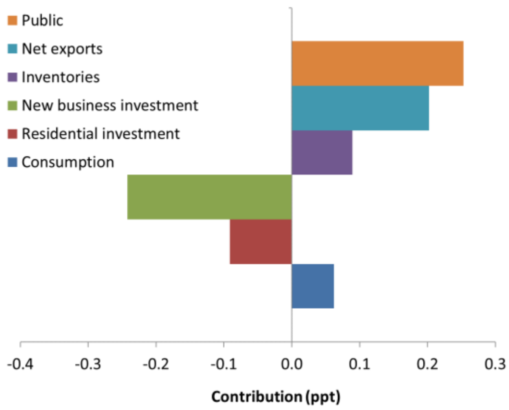
- The Australian economy grew by a weak 0.4 per cent in the September quarter, to be 1.7 per cent higher over the year (Figure 1).
- Household consumption growth was an anaemic 0.1 per cent; it is 1.2 per cent higher over the year. This is despite the tax cuts, instead there was a sharp rise in the household saving ratio. To put the weakness into context, the average quarterly rate since 2010 is more than 0.6 per cent. Alternatively, Government consumption growth was, again, robust.
- The downturn in housing construction continued, and lower mining investment dragged down overall private business investment. Alternatively public investment grew solidly, although it is volatile and this followed several weak quarters.
- Taken together, the combination of weak consumption growth, falling residential and new private business investment but robust public spending meant that domestic final demand growth was entirely driven by the public, rather than the private sector.
- Net exports once again played an important role in supporting overall output growth (Figure 2). Exports grew by 0.7 per cent, with an increase in exports of metal ores and services more than offsetting falls in coal and drought-affected rural exports. A negative aspect is that the positive contribution was also due to a small fall in imports, which are 1.5 per cent lower over the year due to the depreciation in the exchange rate, and weakness in domestic demand.
- The 2019-20 Mid-year Economic and Fiscal Outlook (MYEFO) reiterated the Government's priority is for a budget surplus in 2019-20 onwards, despite calls from a large number of economists for additional fiscal stimulus. A surplus of 0.3 per cent of GDP is now anticipated for 2019-20, compared with the forecast of 0.4 per cent made at Budget time and in the Pre-election Economic and Fiscal Outlook (PEFO), with lower receipts a contributing factor.
- The Government's forecasts for output growth in 2019-20 were lowered to 2¼ per cent, down from 2¾ per cent at PEFO. The weakness in the Australian economy is not expected to persist; the forecasts for 2020-21 were unchanged at 2¾ per cent. The profile for wages growth was flattened; the growth rate previously anticipated for 2019-20 is now expected to occur in 2020-21.
- Overall, many of the trends evident earlier this year in the Australian economy persisted in the September quarter. However, it was stark how weak consumption growth was, especially given the recent fiscal and monetary stimulus. While it takes time for the full effects of these policies changes to flow through, it suggests further stimulus may well be necessary.

Figure 1: Growth
(chain volume, per cent)



Source: ABS

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

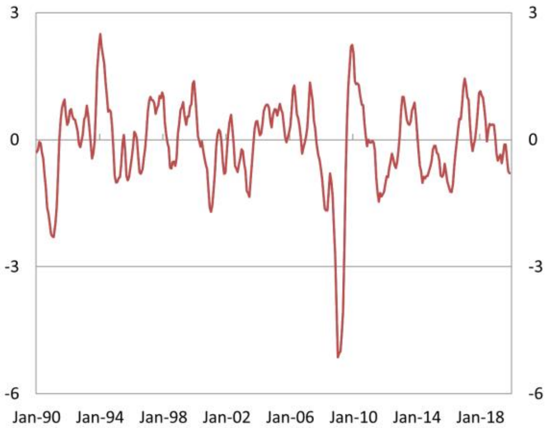


Source: ABS

Near-term growth prospects are soft…

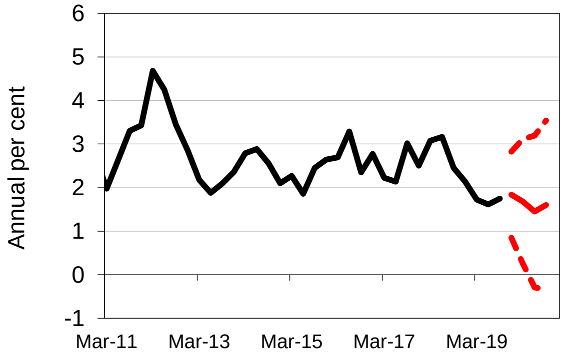
- *Household Consumption:* The Westpac-Melbourne Consumer Sentiment Index in recent months has provided a somewhat mixed signal on the outlook for consumption growth. The overall Consumer Sentiment Index has declined since September, although expectations for family finances in the next 12 months – a component typically thought to be relatively informative about future consumption – has strengthened. Since the middle of 2019, however, the latter has weakened considerably.
- Soft household consumption growth is reflected in the retail sector reporting the weakest trend conditions of any sector in the November NAB Business Survey. Interestingly, however, according to the more forward-looking confidence measure the retail sector is relatively optimistic. Retail trade turnover was flat in October. New auto sales continued to decline in November, and were nearly 10 per cent lower than a year ago. Overall, we have made further downward revisions to our already low consumption forecasts.
- *Residential investment:* Trend building approvals, a leading indicator for residential investment, have continued to fall, but at a slower pace. Year-ended growth in housing credit has eased further. However, as the fall in the September quarter was less than we had forecast, we have not significantly revised the profile.
- *Business Investment:* The November NAB Monthly Business Survey suggests that both current business conditions and confidence have stabilised, but at low levels. The 4th update of investment intentions in 2019/20 the ABS Capital Expenditure (CAPEX) survey, adjusted for historical patterns of over/under estimation using realisation ratios, suggests that nominal investment intentions have weakened in both mining and non-mining sectors. The survey also indicates that only mining investment will grow in 2019/20. We have lowered our business investment forecasts, reflecting the downbeat prospects for the non-mining sector.
- *Trade:* While there have been some positive signals recently about the US-China trade dispute and global growth prospects, we have left our export forecasts unchanged. Net exports, however, are expected to make a larger positive contribution until mid next year, as we have revised down our already weak import forecasts, reflecting the lower consumption profile.
- *Leading Index:* The Westpac-Melbourne Institute Leading Index combines 8 partial indicators. It has weakened recently and points to below-trend growth in the near term (Figure 3).
- *Overall growth prospects:* The Melbourne Institute expects weak growth to persist until at least mid 2020 (Figure 4).

Figure 3: Westpac-MI Leading Index
(trend, 6-month annualised, per cent)



Source: Melbourne Institute

Figure 4: Growth Forecasts
(year-ended)

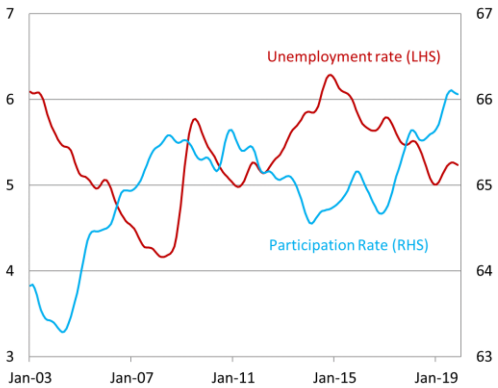


Source: ABS, Melbourne Institute

The labour market remains relatively strong, but weakness in some leading indicators …

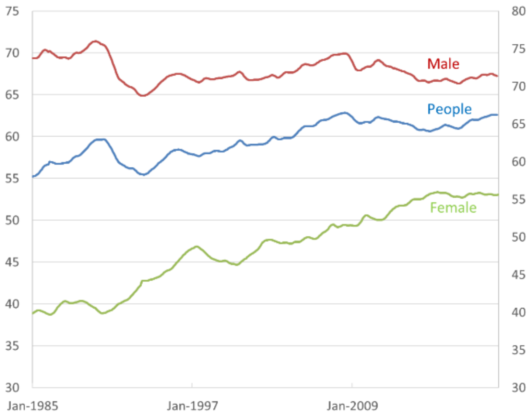
- The labour market continues to provide a more positive reading on the state of the economy than the activity indicators.
- The trend unemployment rate declined marginally in November to be 5.2 per cent, although it is 0.2 percentage points higher than a year ago. The participation rate likewise was constant, and is 0.5 per cent higher than a year ago.
- Together these implied an unchanged employment-to-population ratio, which is at a high level by historical standards (Figure 6).
- Recently employment growth has slowed, and growth in part-time employment has outstripped that in full-time employment (Figure 7).
- Looking forward, the ANZ Job Advertisements Index point to a further slowing in employment growth, whereas the NAB Monthly Business Index Survey recently has been broadly unchanged, and is a relatively optimistic component of the (admittedly downbeat) survey.
- *Labour-market prospects:* A considerable degree of uncertainty surrounds the outlook for the labour market. This reflects: (i) job advertisements would suggest that employment growth should be weaker than observed, (ii) the high level of the participation rate. If the latter were to drift lower the unemployment rate would be less impacted by slower employment growth. In all, the Melbourne Institute forecasts a small increase in the unemployment rate in the near term, before gradually drifting lower (Figure 8).

Figure 5: Labour Market
(trend, per cent)



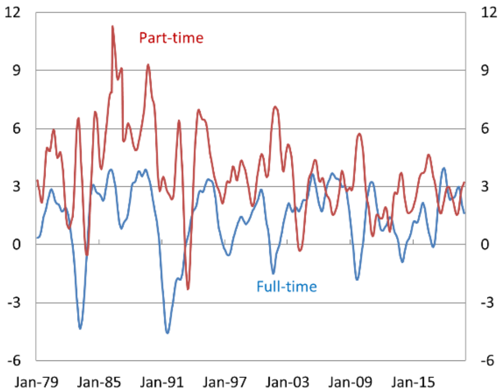
Source: ABS.

Figure 6: Employment to Population Ratio
(trend, per cent)



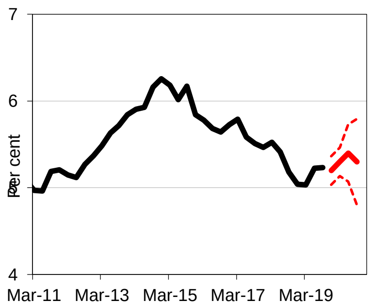
Source: ABS.

Figure 7: Employment Growth
(trend, year-ended, per cent)



Source: ABS.

Figure 8: Unemployment rate
(per cent)



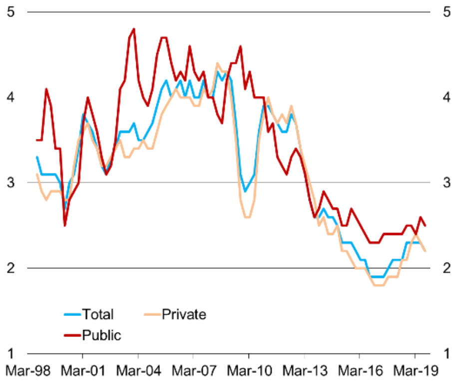
Source: ABS, Melbourne Institute.

The dashed lines are the 90% confidence bands.

Subdued inflation likely to persist…

- The CPI rose 0.5 per cent in the September quarter, to be 1.7 per cent higher over the year. On a seasonally-adjusted basis quarterly inflation was weaker (0.3 per cent).
- The Reserve Bank focusses on measures of underlying, rather than headline, inflation. These are intended to give a better indication of the inflation which is likely to persist in the future. The trimmed mean was lower than headline inflation in the September quarter (0.4 per cent), and 1.6 per cent over the year. The weighted-median CPI was even weaker.
- Low wages growth has been a characteristic of the Australian economy in recent years. Private sector wages growth was steady at 0.5 per cent in the September quarter, taking year-ended growth to 2.2 per cent (Figure 9). Unit labour costs are productivity–adjusted wages and are an important determinant of inflation. Quarterly non-farm unit labour costs growth was slightly stronger than wages growth (0.6 per cent). Disappointingly labour productivity fell and was only 0.1 per cent higher than a year ago. Import prices are another important determinant of inflation, and these increased by 1 per cent in the September quarter, supported by the depreciation in the A$.
- Developments in inflation expectations measures have been mixed. The Melbourne Institute consumer expectations for one year ahead, and the NAB Business Survey's measure for 3-months ahead, both fell in the September quarter. Alternatively, the RBA's surveys of both union officials and market economists' expectations in in the December quarter edged higher.
- *Inflation prospects:* The Melbourne Institute Monthly Inflation Gauge points to soft headline and underlying inflation continuing in the December quarter. More generally, there is little domestic inflationary pressure at present; any pressure seems more likely to stem from the depreciation of the exchange rate. The Melbourne Institute expects near-term underlying inflation to remain below the bottom of the RBA's target band (Figure 10).
- *Monetary policy prospects:* The low inflation and weak growth outlook makes a further cut from the RBA likely, possibly as soon as February next year, taking the cash rate to 0.5 per cent. Subsequently, absent a major negative shock, the RBA is likely to pause, in order to assess the impacts of its recent policy actions. It will maintain its forward guidance that rates will remain low for an "extended period". This further anticipated cut will take the RBA closer to the limits of conventional monetary policy. In our opinion fiscal policy could do more to support the economy in the near term – this means moving beyond increasing or bringing forward infrastructure spending, which is long-term in nature. Measures that have a high fiscal multiplier in the short run, such as boosting Newstart payments, should be undertaken.

Figure 9: Wage Price Index
(year-ended, per cent)



Source: ABS.

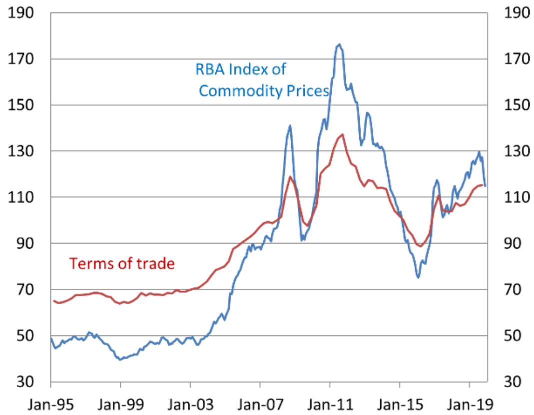
Figure 10: Underlying CPI Inflation
(actual and forecast)

Source: ABS, Melbourne Institute
The dashed lines are the 90% confidence bands

Some positive signs, but considerable uncertainty still surrounds the global growth outlook

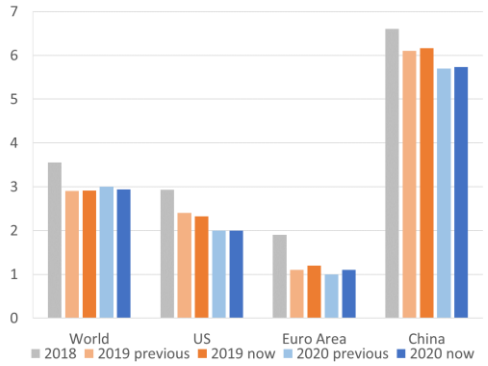
- The terms of trade - the ratio of export to import prices – posted another small increase in the September quarter. More recently, the RBA Index of Commodity Prices has fallen. Australia's terms of trade closely follows developments in commodity prices, and therefore appears likely to fall in the near term, which will weigh on income growth.
- Turning to growth in the major overseas economies, in the US in the September quarter it was 0.5 per cent, akin to the June quarter. Consumption made the largest contribution, while business investment was a drag on growth. More recently employment growth has been strong, although this in part reflects the conclusion of a strike at General Motors. The unemployment rate in November edged down to a very low 3.5 per cent. Some timely activity indicators are less positive: the Non-Manufacturing Institute for Supply Management (ISM) Index, which surveys purchasing managers, weakened in November, but is still in expansionary territory, whereas the Manufacturing index suggests that sector is shrinking.
- The trade war with China may well be weighing on the US manufacturing sector. Recently some progress has been made, with an agreement to not proceed with further tariffs and to continue to negotiate. Net exports in recent quarters have tended to subtract from growth. The October trade data were more positive, although this is partially is due to a fall in imports. Nowcasts from the Atlanta Fed and the New York Fed give divergent readings on likely growth in the December quarter: the former suggests a similar pace to the September quarter, whereas the latter is much weaker (an annualised rate of 0.69 per cent).
- The Chinese economy grew by 1.5 per cent in the September quarter, which is slightly less than in the June quarter, with year-ended growth falling to 6 per cent. Recently some more timely data for China have been positive: year-ended growth in industrial production strengthened considerably in November, as did retail sales. Whether this momentum will be maintained is uncertain. Recently further stimulus measures have been mooted for 2020.
- The election of a Conservative government in the UK adds impetus to Brexit.
- The OECD in its November Economic Outlook marginally revised down its 2020 global growth forecasts (Figure 12). The OECD highlighted the decline in international trade which has occurred, together with heightened uncertainty, is weighing on business investment.
- *Global growth outlook:* While there have been some positive developments in both the US and China, it is too early know whether these will gain traction. The OECD currently forecast 2019's low world growth to persist for the next two years.

Figure 11: Terms of Trade
(March Quarter 2015 = 100)



Sources: RBA, ABS

Figure 12: OECD Growth Forecasts
(Year-on-Year, per cent)



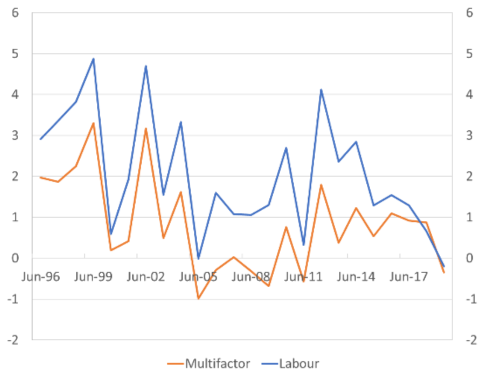
Source: OECD

Note: Previous is the September Economic Outlook Update

Australia's Recent Productivity Performance

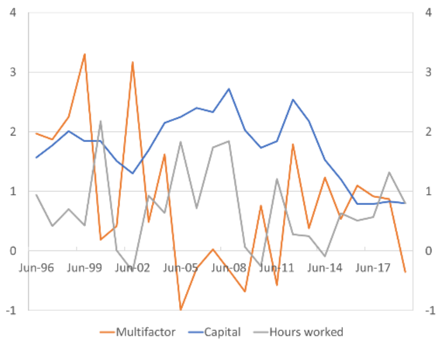
- It's commonly said that there are three Ps that underly economic growth: Population, Participation and Productivity. Productivity growth also is an important factor influencing real wages growth. So, one possible contributing factor to the prolonged period of weak wages growth is that Australia has been experiencing weak productivity growth.
- There are numerous aspects that make measuring productivity difficult. To name a few: measuring outputs is difficult in some sectors, e.g. health care; and measuring the size of the capital stock, and its contribution to production, is difficult.[1] Nevertheless, the ABS produces the following estimates for the market sector:
    - *labour productivity:* Output per hour worked, and,
    - *multi-factor productivity:* Output after taking into account both hours worked and the flow of productive services from the capital stock. Essentially a residual.
- Both labour and multi-factor productivity declined in 2018-19 (Figure 13).
- Population growth and the high participation rate have underpinned growth in the labour input in recent years, which slowed 2018-19, but remained above average. Alternatively, investment, and hence growth in the capital input, has been weak. While declining mining investment has ceased to be a substantial drag it was after the mining boom, growth in capital deepening (increases in the capital to labour ratio) has been below-trend, weighing on labour productivity (Figure 14). Part of this may be due to a long-term shift in the economy towards the less capital-intensive service sector; another factor recently may be the drought.
- Much of the discussion of the need for fiscal stimulus, including by the RBA Governor, has focused on infrastructure spending. This has the benefit of potentially increasing productivity growth. However, such projects take many years to complete and therefore may only boost productivity growth with a lag. Measures to encourage business investment might serve better as short-term instruments of fiscal stimulus. However, many possible policies to increase productivity growth are microeconomic in nature; essentially they involve reforming individual markets so as to increase their efficiency.
- In summary, Australia's productivity outcomes recently have been weak, and it is a factor contributing to the low real wages growth. Infrastructure investment is desirable but has limitations in achieving the twin goals of providing short-term stimulus and boosting near-term productivity growth.

Figure 13: Productivity Growth
(Per cent)



Source: ABS.

Figure 14: Contributions to Output Growth
(Percentage points)



Sources: ABS.

[1] Other issues include that the production structure can differ across sectors, making disaggregated analysis necessary. There can also be quality changes to the inputs, e.g. peoples' education levels increasing, which may be hard to capture.

Table 2: Forecast Precision

	Precision of (year-end) Forecasts				
	2019	2020	2020	2020	Financial Year
	Dec	Mar	Jun	Sep	2019/20
	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		0.2	0.3	0.4	**0.3**
Headline Inflation		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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