

# Economic Outlook

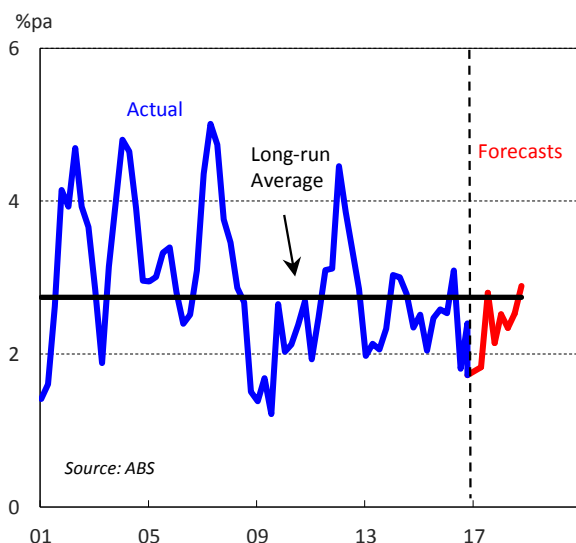
Wednesday, 23 August 2017

## The Australian and Global Economic Outlook:

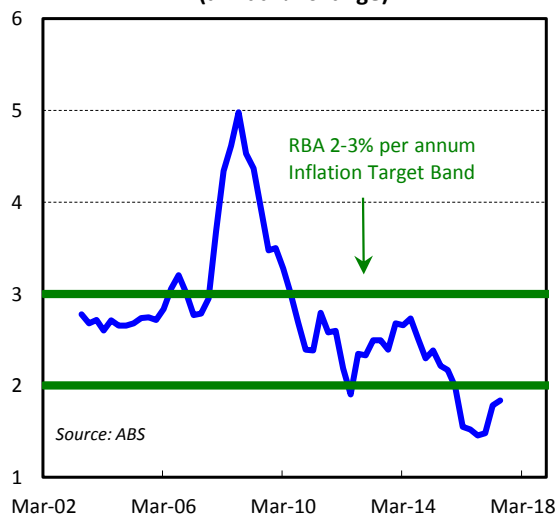
- Australia's economy has enjoyed 25 ½ years of economic growth without a recession. It is an impressive achievement, with Australia having overtaken the Netherlands' previous record for the longest stretch of economic growth. Nonetheless, the recent pace of economic growth has been lacklustre and the economy faces headwinds in the year ahead.
- In the current economic climate, the health of the labour market and activity in the housing market are the key economic indicators to watch. After disappointing for most of last year, the labour market improved in recent months. Housing activity has been strong, particularly in Sydney and Melbourne.
- In contrast to a slower pace of domestic economic growth, the prospects for global economic growth have improved.

Australia's economy has enjoyed 25 ½ years of economic growth without a recession. It overtook the record set by the Netherlands for the longest stretch of economic growth. Despite the enviable stretch of economic growth in Australia, the pace of economic growth remains lacklustre and there are headwinds the economy will have to navigate. The Australian economy grew 1.7% in the year to the March quarter, its slowest since the September quarter 2009. This is below the economy's potential growth rate and the average growth of 2.6% over the past decade. Australia is shuffling to the finish line, to claim the growth record.

**Australian Economic Activity**



**Underlying Consumer Prices (annual % change)**



Consumer spending is a large component of the economy, but it has been subdued and is likely to remain so for some time. High levels of household indebtedness, coupled with wage growth at a record low, suggest consumers will have to dig further into their savings to maintain, let alone boost, consumer spending.

Housing activity has been strong, particularly in Sydney and Melbourne. The pace of dwelling price growth has moderated in recent months, although it remains strong. Ongoing strength in dwelling price growth has worsened affordability and increased household indebtedness, but has also encouraged the supply of new dwelling investment. Dwelling investment has helped underpin economic growth over the last few years. A slowdown in approvals suggests the positive impact of dwelling investment on economic growth is likely to reverse in coming quarters, providing a significant headwind for the Australian economy.

But just as some drivers of economic growth have eased, others have started to look more encouraging.

Last year employment growth was soft, defying positive signals from leading employment indicators, which suggested jobs growth should be stronger. After disappointing for most of last year, the labour market improved in recent months. In 2016, jobs growth averaged an increase of a meagre 9k per month growth. So far in 2017 an average of almost 29k new jobs have been created each month. Encouragingly, that growth has been concentrated in full-time jobs, highlighting the strengthening in labour market conditions. The unemployment rate fell to 5.6% in July, from 5.8% a year earlier. The pickup in the labour market will help support consumer spending, although very low wages growth will remain a drag on spending.

Business investment has weighed on economic growth in recent years as mining investment has declined, while the pick-up in non-mining investment has been lacklustre. In the March quarter business investment lifted for the first time in eleven quarters. It is too early to call the turning point, however, with the ABS survey of businesses capital spending intentions suggesting this improvement may not yet be firmly entrenched. If we look to surveyed business conditions, however, these paint a more positive picture.

Increased production capacity for Australia's key commodity exports has boosted export volumes in recent years. Australia's trade position and incomes have benefited from strong commodity prices over the past year. High commodity prices were widely viewed as unsustainable and have now come off these highs.

Inflation remains beneath the RBA's 2-3% target band in underlying terms, although it has lifted from recent lows. Low inflation is not unique to Australia, it has been the global experience in recent years. While inflation globally received a boost from higher energy prices earlier this year, the impact of this has been reversed in recent months, leaving inflation looking decidedly soft. Wages growth remains at a record low, and equal to the rate of headline inflation over the year to the June quarter, indicating real wages have not increased over the past year.

The Federal Budget, handed down in May, is forecasting a deficit in 2017-18. This would be the tenth consecutive deficit, with a return to surplus not forecast until 2020-21. This budget is not expected to have a significant impact on growth, given it didn't promise big increases in spending or involve large spending cuts.

Demographics play a key role in the longer term prospects for an economy. Despite economic growth travelling at a sub-par pace in recent years, the outlook for Australian economic growth is relatively positive, when taking into account demographic factors. According to the World Bank,

Australia's population grew by 1.4% in 2016, which is higher than many countries and will boost demand. It compares favourably to some other major economies including India (1.1%), UK (0.8%), US (0.7%), China (0.5%) and Japan (-0.1%).

Australia's population is older than in some other countries, thanks to improving healthcare and increasing life expectancy. The average age of the population tends to be younger in poorer countries. The proportion of Australia's population aged over 65 years was 15% in 2016, according to the World Bank. This compares to Japan (27%), UK (18%), US (15%), China (10%) and India (6%).

### **Global Economy**

US economic growth has continued at a solid pace. The labour market in the US reflects the improvement in the US economy. The US economy added an average of 187k jobs each month in 2016. The pace of jobs growth has edged down to an average 184k per month so far this year. The unemployment rate has fallen from a high of 10.0% in 2009, to 4.3% in July this year. As full employment is neared, the potential for continued large monthly increases narrows. At this stage, however, the underemployment rate remains elevated, indicating some part-time workers would like to work more hours, so there is still some slack in the US labour market.

While the unemployment rate is now below the level widely believed to signal full employment (5.0%), inflation has failed to rise in a sustainable manner, reflecting continued underlying slack in the labour market. The PCE core measure of inflation (the Fed's preferred measure) has fallen in recent months, from 1.80% in the year to January, to 1.50% in the year to June. It is now further below the Fed's 2% inflation target, despite ongoing gains in employment and a decline in the unemployment rate (and underemployment rate) over that period.

Economic growth in China has been stronger than expected in recent months, despite continued policy tightening by Chinese authorities. Activity in the property market has slowed as the economy rebalances from manufacturing and business investment towards growth driven by consumers and the services sector. This trend has also been reflected in slower growth in fixed asset investment. Domestic demand remains solid and global demand is improving, supporting economic growth in China.

Despite better than expected economic growth, China's economy faces risks in the medium term. These include high corporate debt and overcapacity in the State sector. Chinese authorities have been working to manage these risks by supporting debt restructuring.

Euro zone economic growth has shown some improvement. GDP growth has slowly lifted, business investment has strengthened and consumer confidence is above its long-term average. There are still challenges, including still high unemployment, although it fell to 9.1% in June, the lowest in more than eight years. Unemployment among young people is particularly concerning, with the unemployment rate at 18.7%. Inflation in the Eurozone also remains stubbornly low, having fallen to 1.3% in the year to June, from 1.9% in the year to April. It is now further below the European Central Bank target of just under 2 percent.

### **Risks**

On the domestic front, the major risk to economic growth is the high level of household indebtedness and its impact on consumer spending. Globally, there is a risk that recent improvements in economic conditions prove unsustainable. China's economy still faces risks from its high level of indebtedness, including the risks inherent in the shadow banking system. China's growth trajectory could face challenges in the medium term, as authorities attempt to divert growth from investment and manufacturing, towards consumers.

Despite the potential risks to economic growth, we expect Australia's economic growth to

continue, although at a sub-par pace. In the current economic climate, the health of the labour market and activity in the housing market are the key economic indicators to watch. The labour market has shown encouraging signs recently, while house price growth remains at strong levels nationally. Globally, the recent pickup in the pace of economic growth is expected to be maintained, providing support to Australia's economy.

**Jo Horton, Senior Economist**

Ph: 02-8253-6696

## Forecasts

End Period:	2017				2018			
	Q1	Q2	Q3 (f)	Q4 (f)	Q1 (f)	Q2 (f)	Q3 (f)	Q4 (f)
<b>Interest Rates:</b>								
RBA Cash Rate, %	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW, %	1.79	1.71	1.75	1.75	1.80	1.80	1.85	1.90
3 Year Swap, %	2.07	2.10	2.15	2.40	2.45	2.50	2.55	2.60
10 Year Bond, %	2.70	2.60	2.75	2.85	2.90	2.90	3.05	3.10
<b>USD Exchange Rates:</b>								
AUD-USD	0.7629	0.7689	0.7800	0.7800	0.7800	0.8000	0.8100	0.8200
USD-JPY	111.39	112.39	110.00	110.00	110.00	108.00	108.00	106.00
EUR-USD	1.0652	1.1426	1.1600	1.1600	1.1400	1.1600	1.1800	1.2000
GBP-USD	1.2550	1.3025	1.3000	1.3000	1.3000	1.3200	1.3400	1.3600
USD-CHF	1.0026	0.9579	0.9700	0.9700	0.9600	0.9600	0.9500	0.9500
USD-CAD	1.3318	1.2964	1.2800	1.2800	1.2600	1.2600	1.2400	1.2400
NZD-USD	0.7006	0.7333	0.7400	0.7400	0.7400	0.7600	0.7700	0.7800
USD-CNY	6.8872	6.7809	6.8000	6.8000	6.7000	6.7000	6.6000	6.6000
USD-SGD	1.3971	1.3762	1.3800	1.3800	1.3800	1.3700	1.3700	1.3600
<b>AUD Exchange Rates:</b>								
AUD-USD	0.7629	0.7689	0.7800	0.7800	0.7800	0.8000	0.8100	0.8200
AUD-EUR	0.7160	0.6730	0.6720	0.6720	0.6840	0.6900	0.6860	0.6830
AUD-JPY	85.00	86.40	85.80	85.80	85.80	86.40	87.50	86.90
AUD-GBP	0.6080	0.5900	0.6000	0.6000	0.6000	0.6060	0.6040	0.6030
AUD-CHF	0.7650	0.7370	0.7570	0.7570	0.7490	0.7680	0.7700	0.7790
AUD-CAD	1.0160	0.9970	0.9980	0.9980	0.9830	1.0080	1.0040	1.0170
AUD-NZD	1.0890	1.0490	1.0540	1.0540	1.0540	1.0530	1.0520	1.0510
AUD-SGD	1.0658	1.0582	1.0764	1.0764	1.0764	1.0960	1.1097	1.1152

\* Note that the AUD cross exchange rates have been rounded.

	2015-16	2016-17 (f)	2017-18 (f)	2015	2016	2017 (f)	2018 (f)
GDP, %	2.7	1.9	2.5	2.4	2.5	2.1	2.6
CPI (Headline), %	1.4	1.7	2.0	1.5	1.3	2.0	2.1
CPI (Underlying), %	1.8	1.6	2.0	2.2	1.5	1.9	2.0

## Contact Listing

**Chief Economist**

Besa Deda  
[dedab@banksa.com.au](mailto:dedab@banksa.com.au)  
(02) 8254 3251

**Senior Economist**

Josephine Horton  
[hortonj@banksa.com.au](mailto:hortonj@banksa.com.au)  
(02) 8253 6696

**Senior Economist**

Janu Chan  
[chanj@banksa.com.au](mailto:chanj@banksa.com.au)  
(02) 8253 0898

The information contained in this report (.the Information.) is provided for, and is only to be used by, persons in Australia. The information may not comply with the laws of another jurisdiction. The Information is general in nature and does not take into account the particular investment objectives or financial situation of any potential reader. It does not constitute, and should not be relied on as, financial or investment advice or recommendations (expressed or implied) and is not an invitation to take up securities or other financial products or services. No decision should be made on the basis of the Information without first seeking expert financial advice. For persons with whom BankSA has a contract to supply Information, the supply of the Information is made under that contract and BankSA's agreed terms of supply apply. BankSA does not represent or guarantee that the Information is accurate or free from errors or omissions and BankSA disclaims any duty of care in relation to the Information and liability for any reliance on investment decisions made using the Information. The Information is subject to change. Terms, conditions and any fees apply to BankSA products and details are available. BankSA or its officers, agents or employees (including persons involved in preparation of the Information) may have financial interests in the markets discussed in the Information. BankSA owns copyright in the information unless otherwise indicated. The Information should not be reproduced, distributed, linked or transmitted without the written consent of BankSA.

---

Any unauthorized use or dissemination is prohibited. Neither BankSA- A Division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ACL 233714, nor any of Westpac's subsidiaries or affiliates shall be liable for the message if altered, changed or falsified.

---