Australian Government
The Treasury

TSY/AU

JOINT ECONOMIC FORECASTING GROUP REPORT

ECONOMIC OUTLOOK FOR 2016-17, 2017-18 and 2018-19

March 2017

This report incorporates domestic and international data released up to 24 March 2017.

1. The economic outlook remains broadly in line with the December 2016 JEFG. Real GDP growth is forecast to be 2 per cent in 2016-17 and to increase over the forecast period as the drag from mining investment dissipates and as growth in household consumption and non-mining business investment increases. Real GDP growth is forecast to be 2¾ per cent in 2017-18 and 3 per cent in 2018-19.
2. Global growth is forecast to be 3¼ per cent in 2017, 3½ per cent in 2018 and 3¾ per cent in 2019, while major trading partner growth is forecast to be 4 per cent in each year. Conditions in the global economy have continued to improve in recent months. In the United States, consumption continues to support growth, there has been a pick-up in business confidence and the labour market remains close to full employment. Infrastructure spending and tax cuts are expected to support growth, while potential trade policies are adding uncertainty to the outlook. Growth in China remains solid and the Chinese GDP growth forecast has been upgraded to 6½ per cent in 2017. There has been some stabilisation in the growth of fixed asset investment, and industrial production and retail sales have been relatively stable.
3. The forecasts have been updated to reflect recent data on commodity prices. The iron ore price is assumed to decline from its recent average of US$85 per tonne FOB through the June and September quarters of 2017 to reach US$60 per tonne in the December quarter 2017. The metallurgical coal price is assumed to decline from its recent average of US$161 per tonne FOB through the September and December quarters of 2017 to reach US$120 per tonne in the March quarter 2018. Thermal coal prices are assumed to be US$79 per tonne. The oil price assumption (Malaysian Tapis) is US$57 per barrel and the exchange rate assumption is US 76 cents and a TWI of 66.
4. In line with these assumptions for commodity prices, the terms of trade are now forecast to increase by 17¼ per cent in 2016-17, compared with 15¾ per cent at December 2016 JEFG. The terms of trade are then forecast to fall by 4 per cent in 2017-18 and by 3¼ per cent in 2018-19. Nominal GDP is expected to grow by 6¼ per cent in 2016-17, supported by the rising terms of trade, and then to grow by 3½ per cent in 2017-18 and 4¼ per cent in 2018-19 as the terms of trade falls.
5. Household final consumption expenditure is forecast to grow by 2½ per cent in 2016-17, 2¾ per cent in 2017-18 and 3 per cent in 2018-19, which is ¼ of a percentage point lower in the first two years compared with the December 2016 JEFG. Household consumption has grown at below-average rates since the global financial crisis and the household saving rate has fallen reflecting a slowing in income growth since the crisis. Subdued income growth is expected to persist over the forecast horizon and the household saving rate is expected to fall further.
6. Dwelling investment is forecast to grow by 4½ per cent in 2016-17, 1½ per cent in 2017-18 and to fall by 4 per cent in 2018-19. It appears that the building approvals cycle may have peaked in mid-2016, with significant falls in medium-to-high density approvals and a sustained fall in house approvals occurring over the second half of 2016. However, there remains a strong pipeline of work-to-be-done and this is expected to support growth in dwelling investment in the near-term.
7. Total new private business investment is forecast to fall by 6 per cent in 2016-17, to be flat in 2017-18 and to rise by 3 per cent in 2018-19. Mining investment is expected to continue to fall over the forecast horizon as the remaining LNG investment projects continue to wind-down, while non-mining business investment is forecast to pick-up. Non-mining business investment is expected to be supported by a strengthening in aggregate demand and low financing costs. In addition, it is also expected to benefit from a reduction in negative spill-overs from the mining sector, with activity in some non-mining businesses likely being affected by the significant transition occurring in the mining sector.

8. The net export contribution to real GDP growth is forecast to be ¾ of a percentage point in 2016-17 and ¼ of a percentage point in 2017-18 and 2018-19. Resource exports – particularly iron ore and LNG – are expected to grow strongly over the forecast horizon as the last of the major projects reach capacity. Services exports are also expected to make a solid contribution to growth, supported by the lower exchange rate and Asian demand for tourism and education. Rural exports are forecast to grow strongly in 2016-17, reflecting the strong winter crop, and fall in 2017-18 with a return to more average seasonal conditions. Import volumes are forecast to rise by 3 per cent in each of the forecast years.

9. The labour market is expected to be supported by a pick-up in domestic demand and continued subdued wage growth. Following growth of 1.9 per cent through the year to the June quarter 2016, employment is forecast to grow by 1 per cent through the year to the June quarter 2017 and 1½ per cent through the year to the June quarters of 2018 and 2019. The participation rate is forecast to remain at 64½ per cent, while the unemployment rate is forecast to be around 5¾ per cent in the June quarters of 2017 and 2018 and 5½ per cent in the June quarter 2019.

10. The outlook for wages growth remains subdued in the near-term, reflecting spare capacity in the labour market, and is expected to pick-up as domestic demand strengthens. Similarly, the near-term outlook for inflation is subdued, also reflecting heightened competition in the retail sector and low rent inflation. On the other hand, it is anticipated that electricity prices will place upward pressure on inflation. The Wage Price Index is forecast to grow by 2 per cent through the year to the June quarter 2017, 2½ per cent through the year to the June quarter 2018 and 3 per cent through the year to the June quarter 2019. Headline inflation is forecast to be 1¾ per cent through the year to the June quarter 2017, 2 per cent through the year to the June quarter 2018 and 2¼ per cent through the year to the June quarter 2019.

11. There are a number of uncertainties for the forecasts, with the key risks remaining similar to those identified in the December 2016 JEFG report. There remain signs that the global outlook is improving, but it is difficult to gauge the impact of the new US Administration's policies on the US economy, with trade measures having the potential to impact global growth. In addition, high levels of debt and overcapacity in some sectors remain a risk to the Chinese economy and the authorities continue to face the policy challenge of balancing support for the real economy and maintaining exchange rate stability.

12. Domestically, commodity prices are a key uncertainty for the nominal economy and there are risks around the momentum in household consumption and around dwelling investment, with a significant number of medium-to-high density dwellings due for completion over the forecast horizon. Household incomes have grown at lower average rates since the global financial crisis and labour market outcomes have been mixed across different regional areas and across full-time and part-time employment. An increase in uncertainty for households or income growth that is more subdued than forecast are risks to the forecast for household consumption. A more rapid decline in dwelling investment than forecast would also constrain growth. The timing and pace of the recovery in non-mining business investment also remains a risk to the domestic outlook, with indicators remaining mixed.

Table 1: Domestic economy forecasts

Per cent(a)	2015-16 Outcomes(b)	2016-17 Mar-JEFG	2017-18 Mar-JEFG	2018-19 Mar-JEFG
Gross Domestic Product				
Real gross domestic product	**2.6**	**2**	**2 3/4**	**3**
Household consumption	2.9	2 1/2	2 3/4	3
Dwelling investment	10.6	4 1/2	1 1/2	-4
Total business investment(c)	-10.3	-6	0	3
Mining investment	-27.5	-21	-12	-3
Non-mining investment	1.4	1 1/2	4 1/2	4 1/2
Private final demand(c)	0.8	1	2 1/4	2 1/2
Public final demand(c)	3.4	4	2 1/2	3
Change in inventories(d)	-0.1	0	0	0
Gross national expenditure	1.3	1 3/4	2 1/2	2 3/4
Exports of goods and services	6.7	6	4	4
Imports of goods and services	-0.3	3	3	3
Net exports(d)	1.4	3/4	1/4	1/4
Nominal gross domestic product	**2.3**	**6 1/4**	**3 1/2**	**4 1/4**
Prices and wages				
Consumer price index(e)	1.0	1 3/4	2	2 1/4
Wage price index(f)	2.1	2	2 1/2	3
GDP deflator	-0.3	4 1/4	3/4	1 1/4
Labour market				
Participation rate (per cent)(g)	64.8	64 1/2	64 1/2	64 1/2
Employment(f)	1.9	1	1 1/2	1 1/2
Unemployment rate (per cent)(g)	5.7	5 3/4	5 3/4	5 1/2
Balance of payments				
Terms of trade	-10.2	17 1/4	-4	-3 1/4
Current account balance (per cent of GDP)	-4.4	-1 1/4	-1 1/2	-1 3/4
Other				
Household savings ratio	6.7	5 1/2	4 1/2	3 1/4
External factors				
Major trading partner growth(h)	4.0	4	4	4
Iron ore ($US/t, FOB)(i,j)	51	78	60	60
Metallurgical coal ($US/t, FOB)(i)	91	161	120	120
Thermal coal ($US/t, FOB)(i)	51	79	79	79
Assumptions				
Exchange rate (AUD/USD)(i)	75	76	76	76
Trade weighted index (TWI)(i)	63	66	66	66
Oil price (Tapis) ($US/barrel)(i)	47	57	57	57
Cash rate (per cent)(i)	1.84	1.50	1.67	1.75

(a) Percentage change on preceding year unless otherwise indicated.

(b) Calculated using original data unless otherwise indicated.

(c) Excluding second-hand asset sales.

(d) Percentage point contribution to growth in GDP.

(e) Through-the-year growth rate to the June quarter.

(f) Seasonally adjusted, through-the-year growth rate to the June quarter.

(g) Seasonally adjusted rate for the June quarter.

(h) Report in calenadr years (i.e. 2015-16 = 2015)

(i) Level for the June quarter

(j) Iron ore prices are assumed to fall from US$85 per tonne through the June and September quarters 2017 to reach $US60 per tonne in the December quarter 2017

Source: ABS cat. no. 5204.0, 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.