Australian Government
The Treasury

JOINT ECONOMIC FORECASTING GROUP REPORT

ECONOMIC OUTLOOK FOR 2017-18 and 2018-19

September 2017

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

1. The encouraging signs that the global outlook is firming have continued and the domestic economy has performed broadly as expected since the 2017-18 Budget. Real GDP grew by 1.9 per cent in 2016-17, with a smaller-than-expected detraction from business investment and a stronger-than-expected contribution from public final demand, which offset weaker contributions from net exports and dwelling investment. Real GDP growth is forecast to lift as the drag from mining investment diminishes, growth in household consumption improves and exports continue to grow strongly. Non-mining business investment is also forecast to strengthen. Real GDP is forecast to grow by 2¾ per cent in 2017-18 and 3 per cent in 2018-19.

2. Global growth is forecast to be 3½ per cent in 2017, 3½ per cent in 2018 and 3¾ per cent in 2019. This is a slight upgrade to the Budget forecast of 3¼ per cent in 2017. Major trading partner growth is forecast to be 4¼ per cent in 2017, 4 per cent in 2018 and 4 per cent in 2019 – this is also ¼ of a percentage point higher in 2017 compared with the Budget. In advanced economies, business investment and industrial production have strengthened. Unemployment rates for the US, the euro area and Japan are now around or below estimates of full employment. The Chinese economy has continued to perform solidly and growth among the ASEAN-5 economies has remained relatively robust.

3. The forecasts have been updated to reflect recent data on commodity prices. The iron ore price is assumed to be flat at US$55 per tonne. The metallurgical coal price is assumed to fall through the September and December quarters of 2017 to reach US$120 per tonne at the beginning of 2018. Thermal coal prices are assumed to be flat at US$85 per tonne. The oil price assumption (Malaysian Tapis) is US$52 per barrel and the exchange rate assumption is 79 US cents and a TWI of 67.

4. Household consumption is forecast to grow by 2¾ per cent in 2017-18 and 3 per cent in 2018-19, unchanged from the Budget. Household consumption is expected to be supported by solid labour market outcomes and an increase in wage growth. While strong rises in electricity prices are expected to have a dampening impact on consumption growth, it remains the case that consumer price inflation is forecast to be 2 per cent through the year to the June quarter 2018 and 2¼ per cent through the year to the June quarter 2019. The household saving rate is also expected to continue to fall through the forecast period – from 5.6 per cent in 2016-17 to 3¼ per cent in 2018-19.

5. Dwelling investment is forecast to fall by 1 per cent in 2017-18 and by 1½ per cent in 2018-19, which is a bring-forward of the decline in dwelling investment since the Budget. Building approvals have softened since around mid-2016, with significant falls in approvals for medium-to-high density dwellings. While the pipeline of construction work is expected to provide support to dwelling investment in the near-term, the work appears to be completing slightly sooner than anticipated and has not provided as much support to investment as expected. As a result, dwelling investment is now forecast to decline in both 2017-18 and 2018-19, but the size of the decline remains modest.

6. Total new private business investment is forecast to be flat in 2017-18 and grow by 3 per cent in 2018-19. Mining investment is expected to continue to fall over the forecast horizon as large resource projects are completed, while non-mining business investment is expected to pick-up. Non-mining business investment is estimated to have increased by a stronger-than-expected 4.8 per cent in 2016-17. It is forecast to grow by 4½ per cent in both 2017-18 and 2018-19, supported by strengthening demand, solid business conditions and low financing costs. Non-mining business investment is also expected to benefit as negative spill-overs from the mining sector wane. There are early signs that global business investment is starting to lift. Mining investment as a share of GDP is forecast to fall to 2¾ per cent in 2018-19, while non-mining business investment is forecast to be 9½ per cent as a share of GDP.

7. Public final demand is forecast to grow by 4 per cent in 2017-18 and 3 per cent in 2018-19, following growth of 4.6 per cent in 2016-17. Public final demand is expected to be supported by both investment and consumption expenditure, with the National Broadband Network, National Disability Insurance Scheme and strong investment by the States and Territories all expected to contribute to growth.

8. The contribution to growth from net exports is expected to be flat in 2017-18 and ¼ of a percentage point in 2018-19. The contribution to growth in 2017-18 is weaker than forecast at the Budget due to lower growth in non-rural and rural commodity exports. There has been some slippage in the expected timing of LNG exports as a result of project delays, while rural exports are expected to be affected by drier-than-average seasonal conditions. Service exports are expected to continue to make a solid contribution to growth, supported by growing Asian demand for tourism and education.

9. The unemployment rate is forecast to be 5½ per cent in the June quarter of 2018 and 5¼ per cent in the June quarter of 2019, which is ¼ of a percentage point lower in both years compared with the Budget. This reflects recent positive labour market outcomes. Following growth of 1.9 per cent through the year to the June quarter 2017, employment is expected to grow by 1¾ per cent through the year to the June quarter 2018 and by 1½ per cent through the year to the June quarter 2019. The participation rate is forecast to be 65 per cent in the June quarter of 2018 and 64¾ per cent in the June quarter of 2019.

10. The outlook for wage growth and consumer price inflation is unchanged from the Budget. Wage growth, as measured by the Wage Price Index, is forecast to be 2½ per cent through the year to the June quarter 2018 and 3 per cent through the year to the June quarter 2019. Wage growth is forecast to pick-up in line with strengthening domestic demand, a fall in the unemployment rate and rising inflation. The headline Consumer Price Index is forecast to grow by 2 per cent through the year to the June quarter 2018 and 2¼ per cent through the year to the June quarter 2019. Downward pressure on inflation is expected to come from subdued growth in rents and heightened competition in the retail sector, while upward pressure is expected to come from electricity prices. The updating of the weights to the expenditure classes in the Consumer Price Index in the December quarter 2017 release is also likely to reduce measured inflation, but the size of the effect is difficult to estimate.

11. Following growth of 6.0 per cent in 2016-17, nominal GDP is expected to grow by 4 per cent in both 2017-18 and 2018-19. Following growth of 3.9 per cent in 2016-17, the GDP deflator is expected to grow by 1¼ per cent in 2017-18 and 1 per cent in 2018-19. The terms of trade are forecast to fall by 2½ per cent in 2017-18 and by 4 per cent in 2018-19, after growing by 14.6 per cent in 2016-17 as a result of strong rises in commodity prices.

12. There are a number of uncertainties for both the international and domestic forecasts. While current adjustments to US monetary policy have been anticipated by markets, faster-than-expected tightening in US monetary policy could lead to tighter world financial conditions and disruptions in markets. High levels of debt in some euro area countries could also pose a risk, and risks to the Chinese economy remain in the medium-term with high levels of debt and overcapacity in some sectors. Further, the global outlook remains subject to uncertainty from geopolitical risks.

13. There are both upside and downside risks to the domestic forecasts. Labour market conditions have recently been stronger-than-expected and business conditions and confidence have improved. However, there is uncertainty around the impact of the prolonged period of subdued income growth on household consumption and a change in households' attitudes toward saving or a change in the factors that have driven the decline in the household savings rate over the past few years could lead to household consumption being weaker than forecast. A larger-than-expected fall in dwelling investment could also have implications for the attitudes of households toward saving. In addition, commodity prices remain volatile and subject to policy changes in China and are a key uncertainty for the outlook for nominal GDP.

Table 1: Domestic economy forecasts

Per cent[a]	2016-17 Outcomes[b]	2017-18 Sep-JEFG	2018-19 Sep-JEFG
Gross Domestic Product			
Real gross domestic product	**1.9**	**2 3/4**	**3**
Household consumption	2.4	2 3/4	3
Dwelling investment	1.6	-1	-1 1/2
Total business investment[c]	-3.9	0	3
Mining investment	-22.0	-12	-3
Non-mining investment	4.8	4 1/2	4 1/2
Private final demand[c]	1.1	2	2 1/2
Public final demand[c]	4.6	4	3
Change in inventories[d]	0.2	0	0
Gross national expenditure	2.1	2 1/2	2 3/4
Exports of goods and services	5.4	2 1/2	4 1/2
Imports of goods and services	4.5	3	2 1/2
Net exports[d]	0.2	0	1/4
Nominal gross domestic product	**6.0**	**4**	**4**
Prices and wages			
Consumer price index[e]	1.9	2	2 1/4
Wage price index[f]	1.9	2 1/2	3
GDP deflator	3.9	1 1/4	1
Labour market			
Participation rate (per cent)[g]	64.9	65	64 3/4
Employment[f]	1.9	1 3/4	1 1/2
Unemployment rate (per cent)[g]	5.6	5 1/2	5 1/4
Balance of payments			
Terms of trade	14.6	-2 1/2	-4
Current account balance (per cent of GDP)	-1.7	-2 1/4	-2 1/2
Other			
Household savings ratio	5.6	4 1/4	3 1/4
External factors			
Major trading partner growth[h]	4.0	4 1/4	4
Iron ore ($US/t, FOB)[i]	57	55	55
Metallurgical coal ($US/t, FOB)[i]	190	120	120
Thermal coal ($US/t, FOB)[i]	77	85	85
Assumptions			
Exchange rate (AUD/USD)[i]	75	79	79
Trade weighted index (TWI)[i]	65	67	67
Oil price (Tapis) ($US/barrel)[i]	51	52	52
Cash rate (per cent)[i]	1.50	1.58	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) Reported in calendar years (i.e. 2017-18 = 2017).
(i) Level for the June quarter.

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