

# The Economic Outlook

Saul Eslake

16<sup>th</sup> May 2017

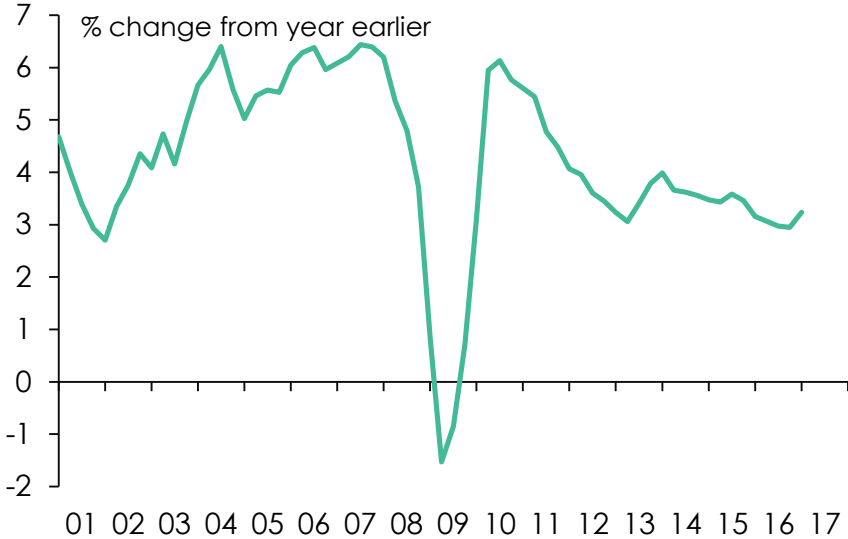


Note: Nothing in this presentation constitutes investment advice, nor should anything contained in it be interpreted as an invitation or recommendation to enter into any transaction(s).

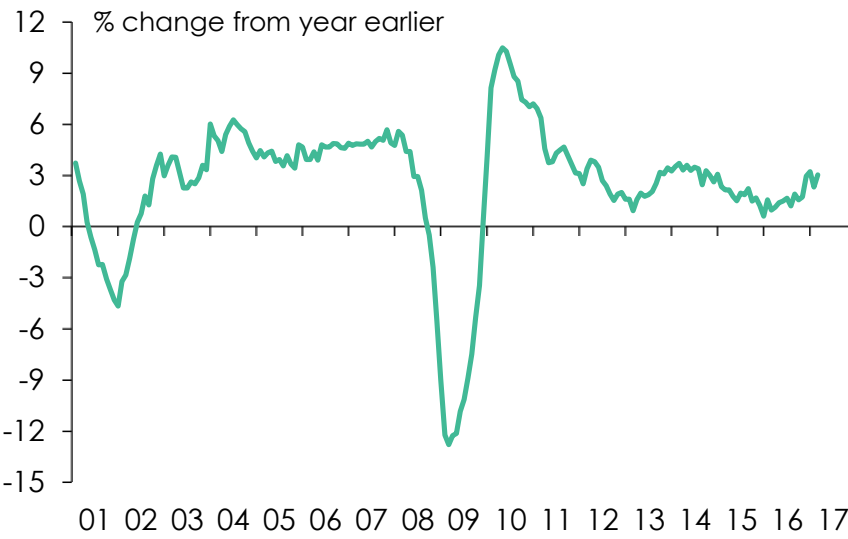
# The global economy

# The world economy is picking up – largely as a result of an upswing in ‘advanced’ economies

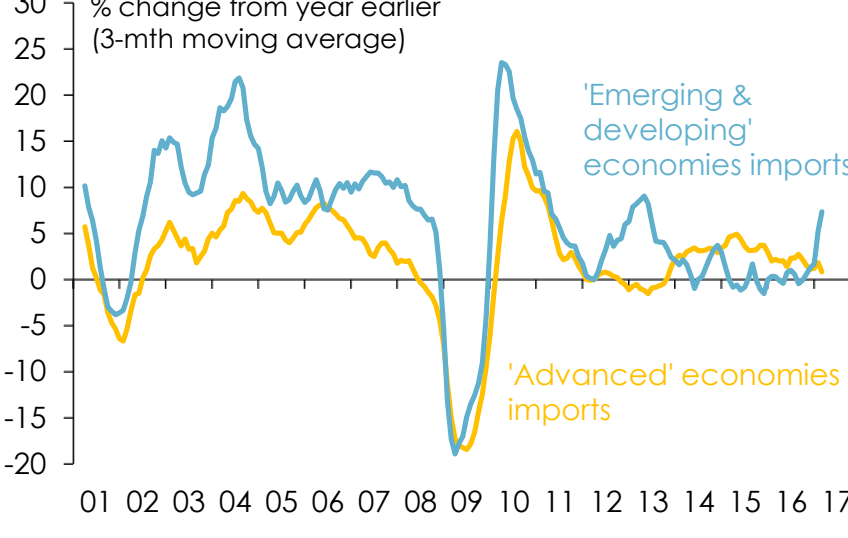
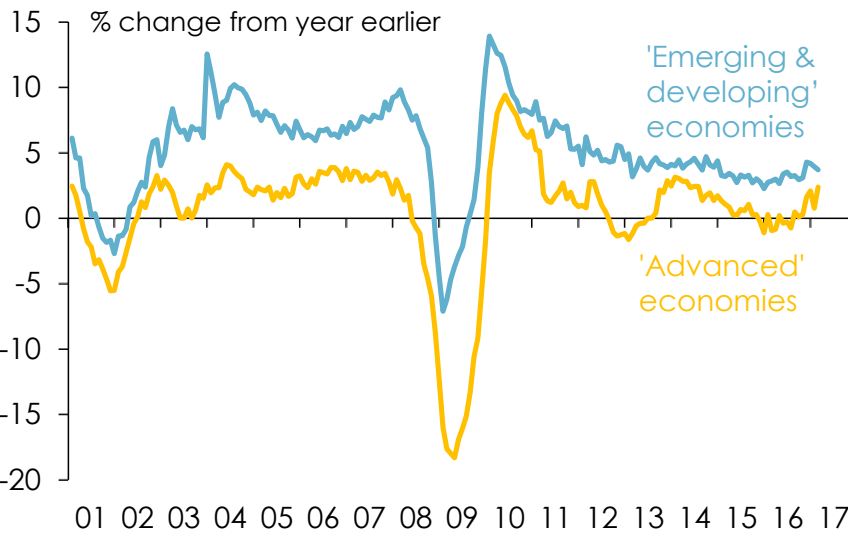
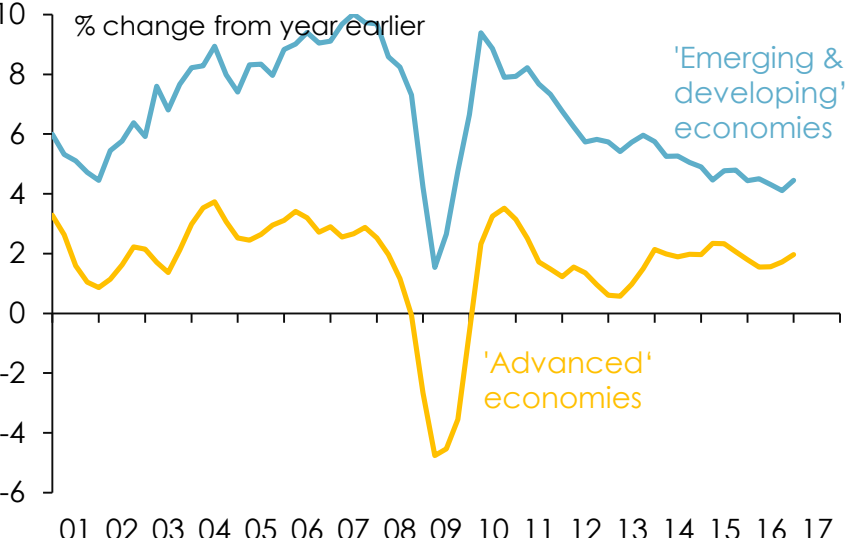
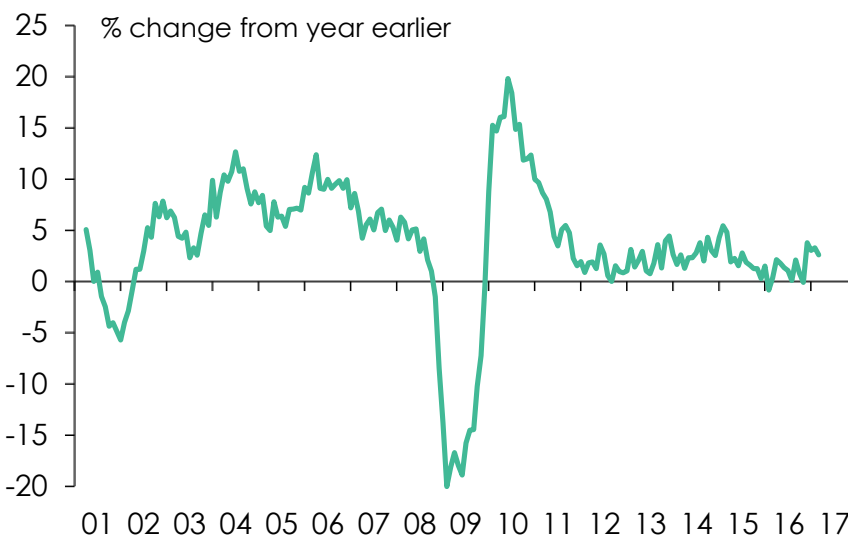
**World real GDP**



**World industrial production**



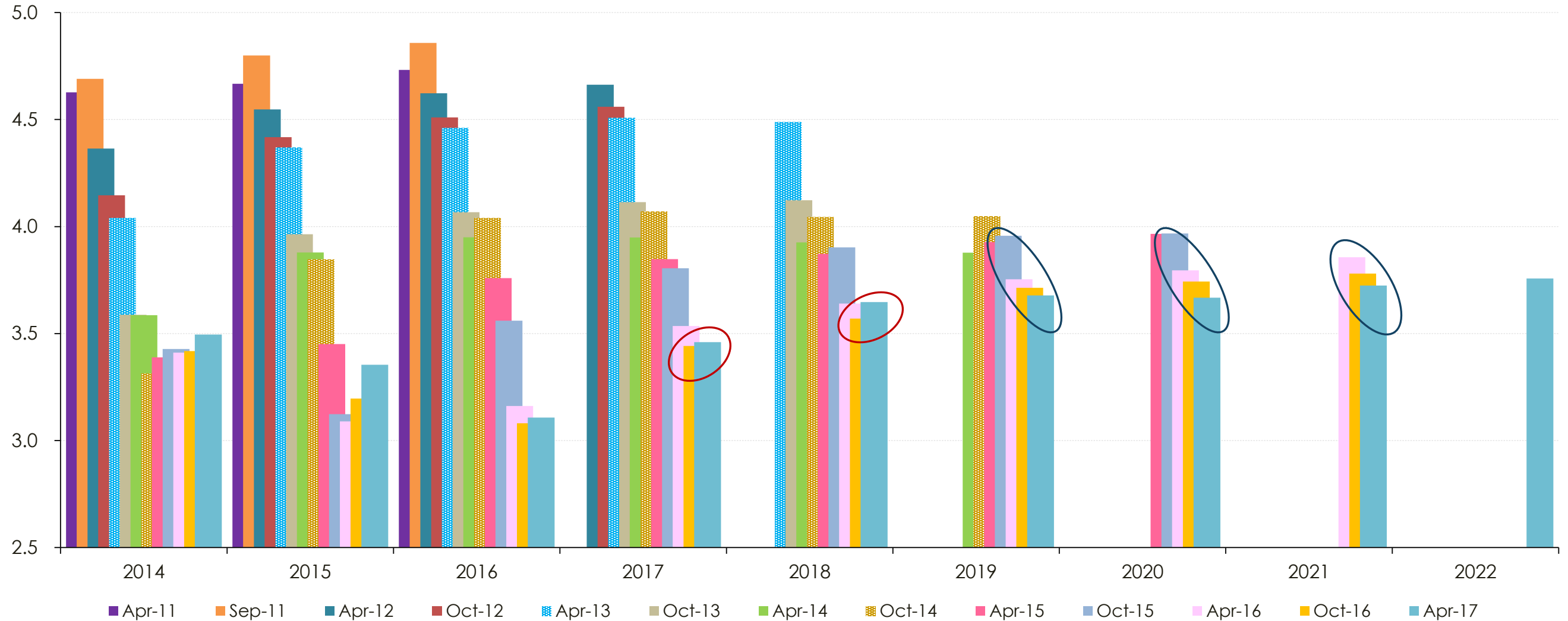
**Volume of world trade**



Note: national or regional aggregates weighted using shares of 2016 world GDP at purchasing power parities. ‘Advanced’ and ‘emerging & developing’ economies as defined by the IMF. Sources: IMF; national statistical agencies; Netherlands Economic Planning Bureau (CPB); Thomson Reuters Datastream.

# The IMF upgraded its forecasts for world economic growth for the first time in 5½ years – but continues to downgrade longer-term projections

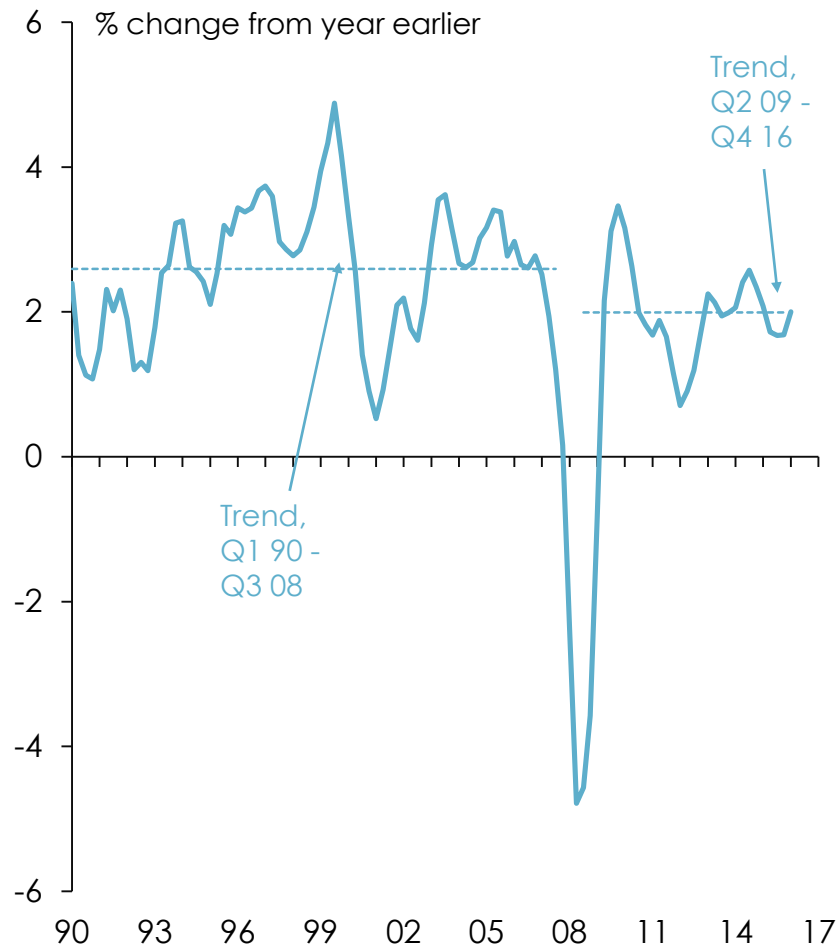
## Successive IMF World Economic Outlook forecasts of world real GDP growth



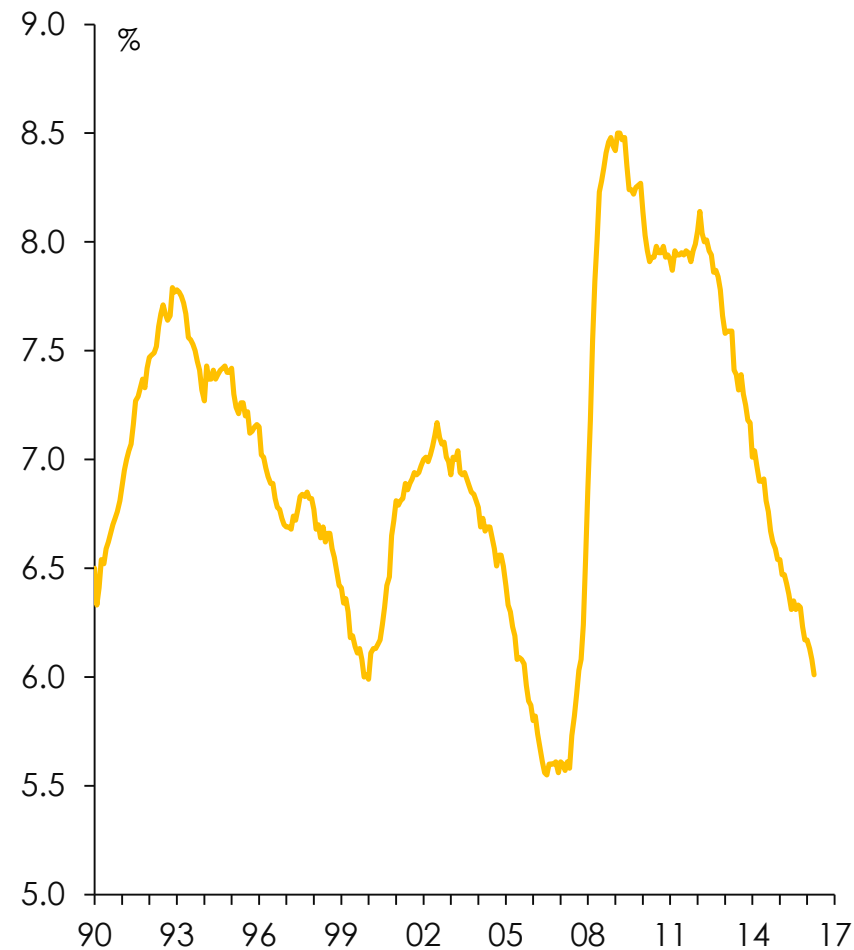
Source: International Monetary Fund, *World Economic Outlook*, April 2017 and previous issues.

# Economic growth across 'advanced' economies has been consistently weaker than expected – yet unemployment has fallen sharply

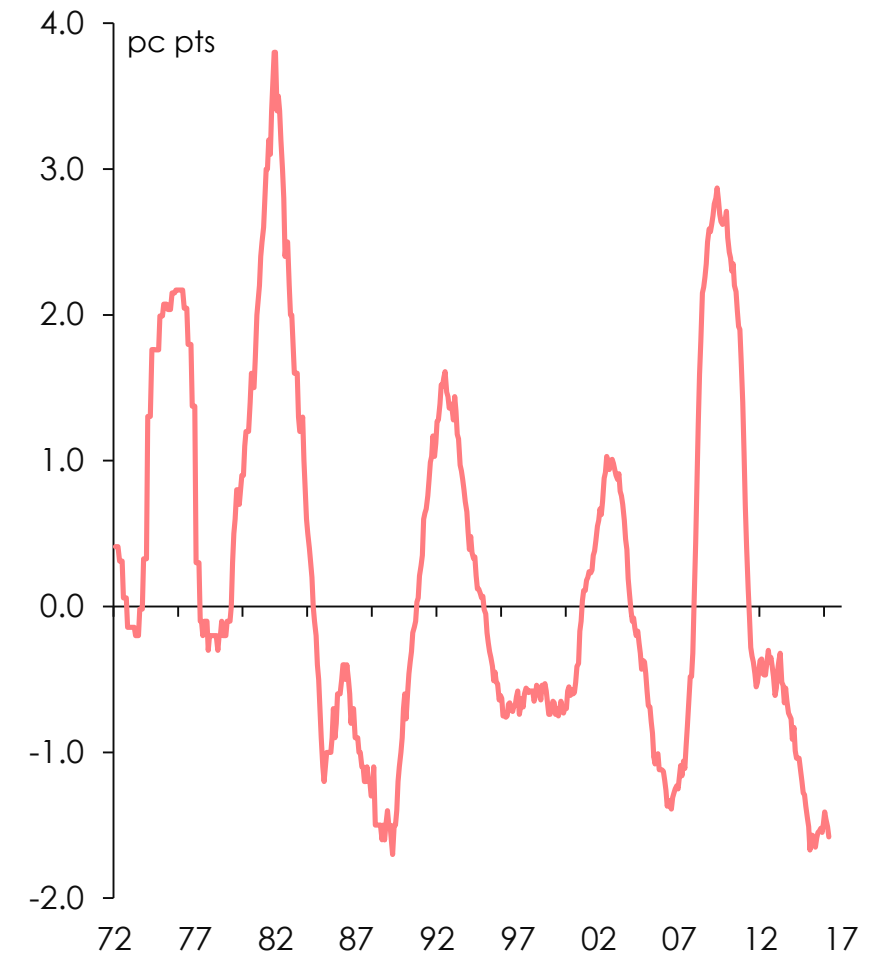
## OECD area real GDP growth



## OECD area unemployment rate



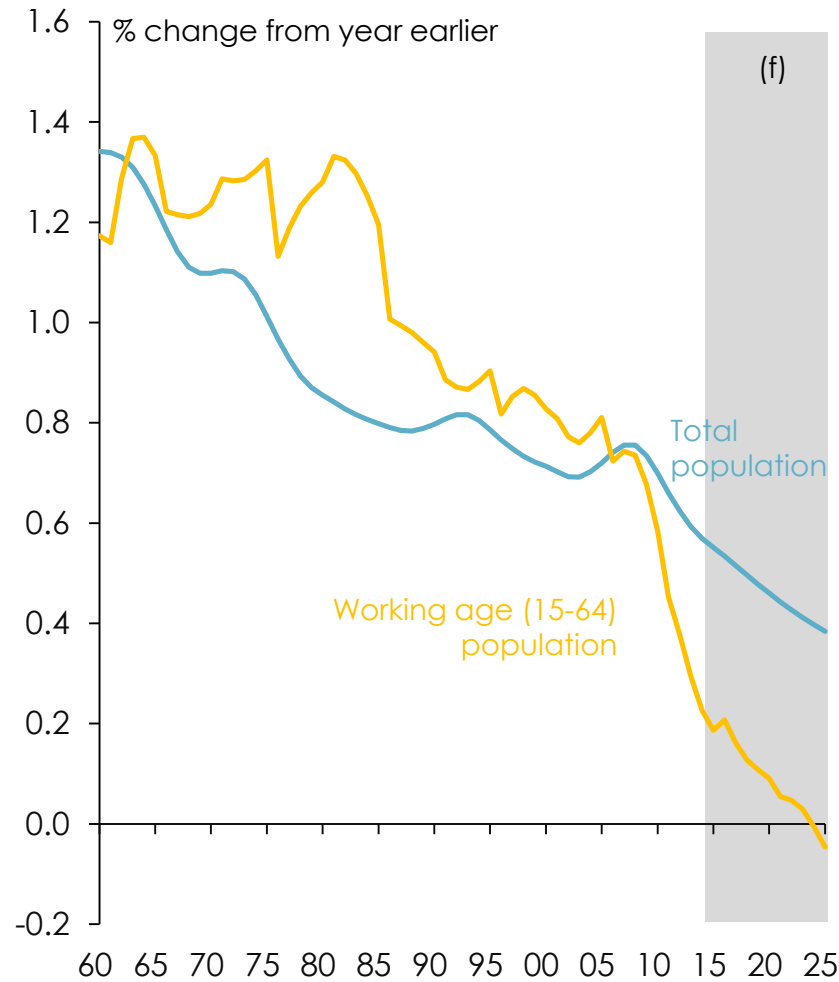
## 3-year change in OECD unemployment rate



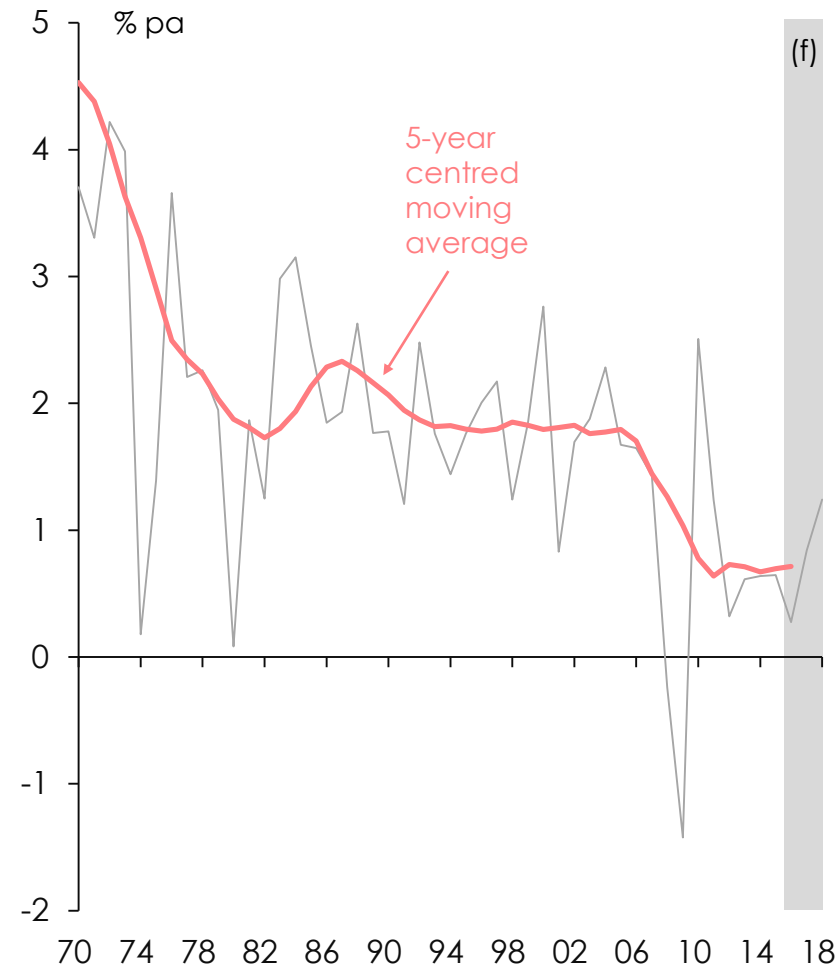
Source: Organization for Economic Co-operation & Development (OECD). The OECD comprises 34 (mostly) 'advanced' economies in North America and Europe, plus Japan, Korea, Australia, New Zealand, Mexico, Chile, Turkey & Israel.

# 'Advanced' economies aren't capable of growing as rapidly as they used to

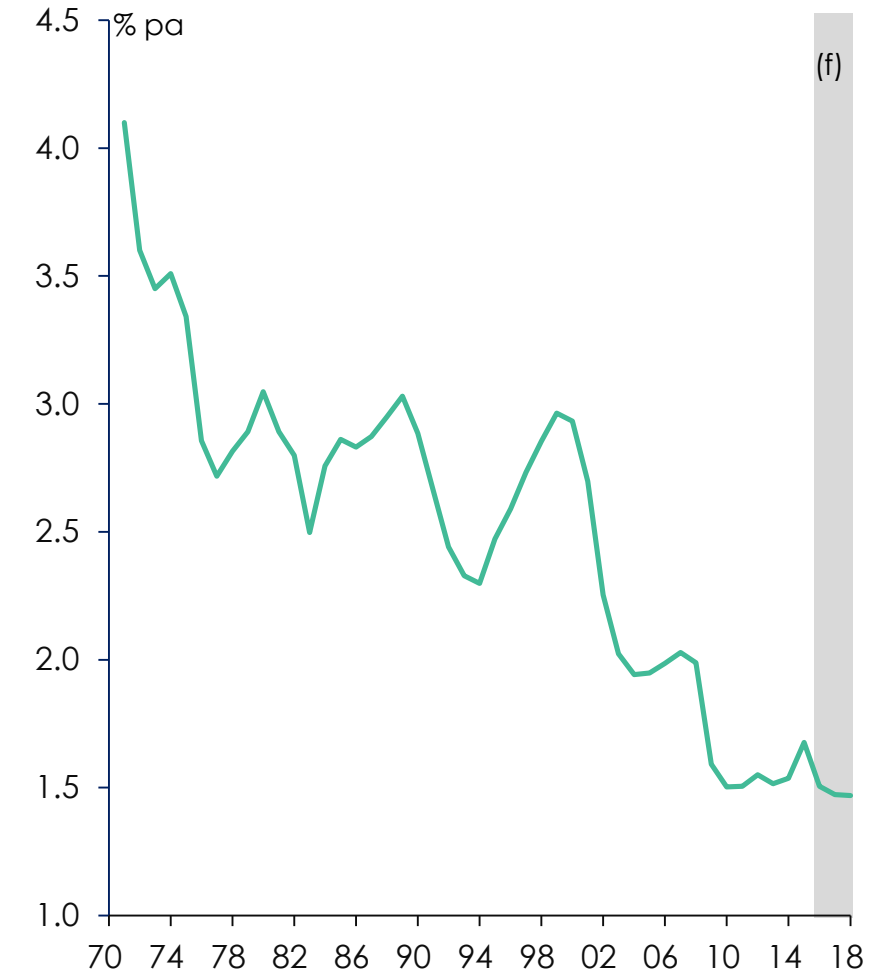
## OECD area population growth



## OECD area labour productivity growth



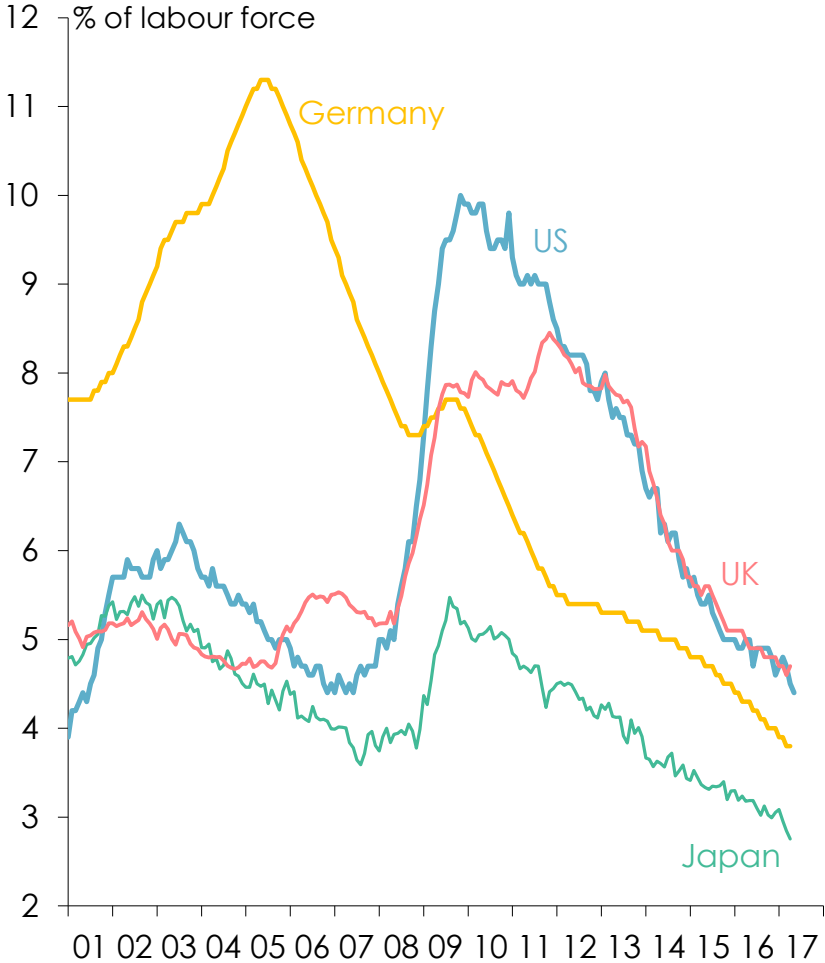
## OECD area potential GDP growth



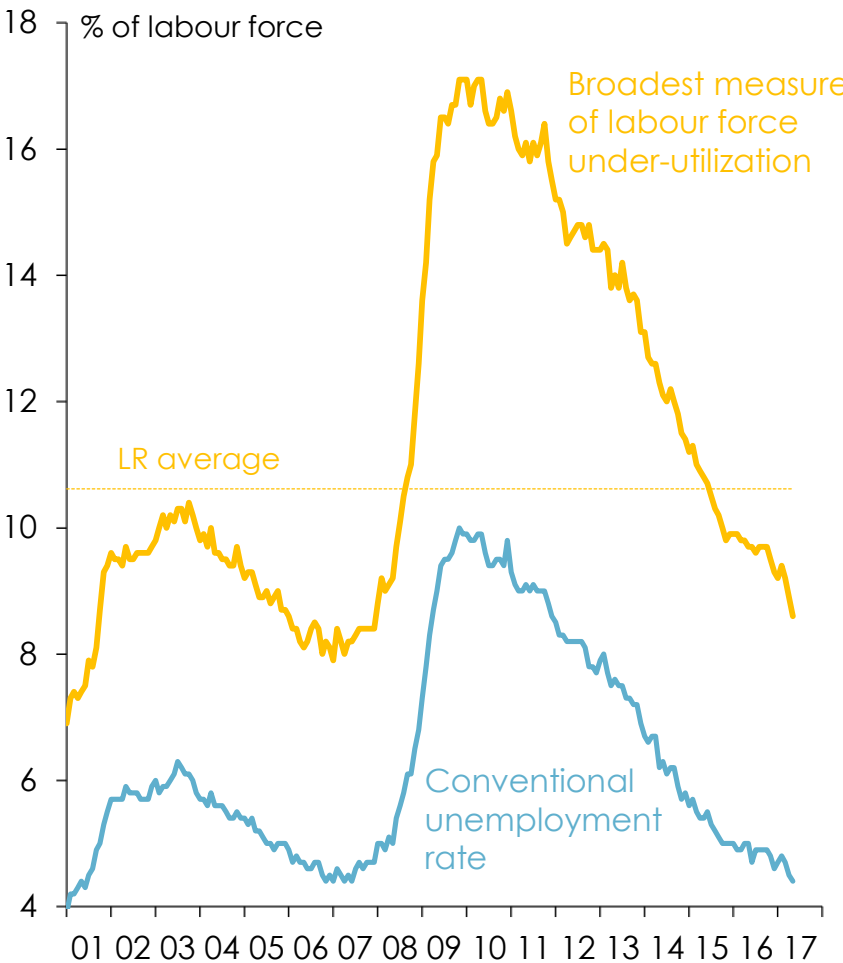
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2015 Revision*; Organization for Economic Co-operation & Development (OECD), *Economic Outlook* database. 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force.

# The four largest 'advanced' economies are now more or less at 'full employment'

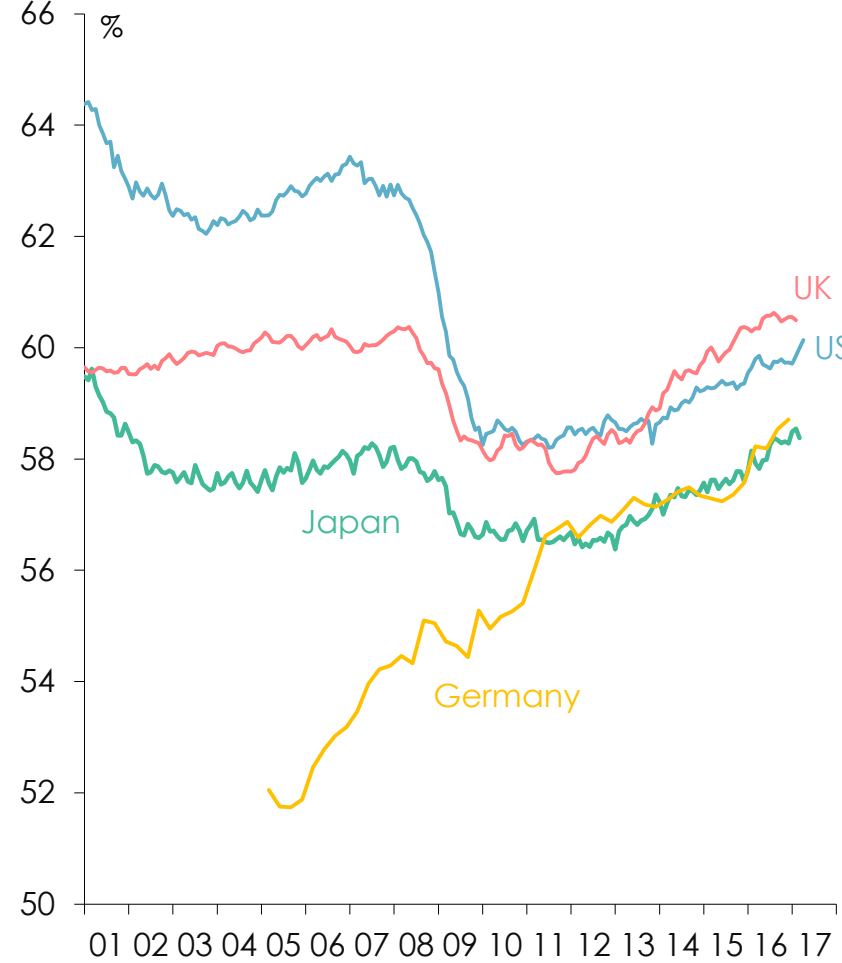
## Four largest 'advanced' economies - unemployment



## Broader measures of US 'under-employment'



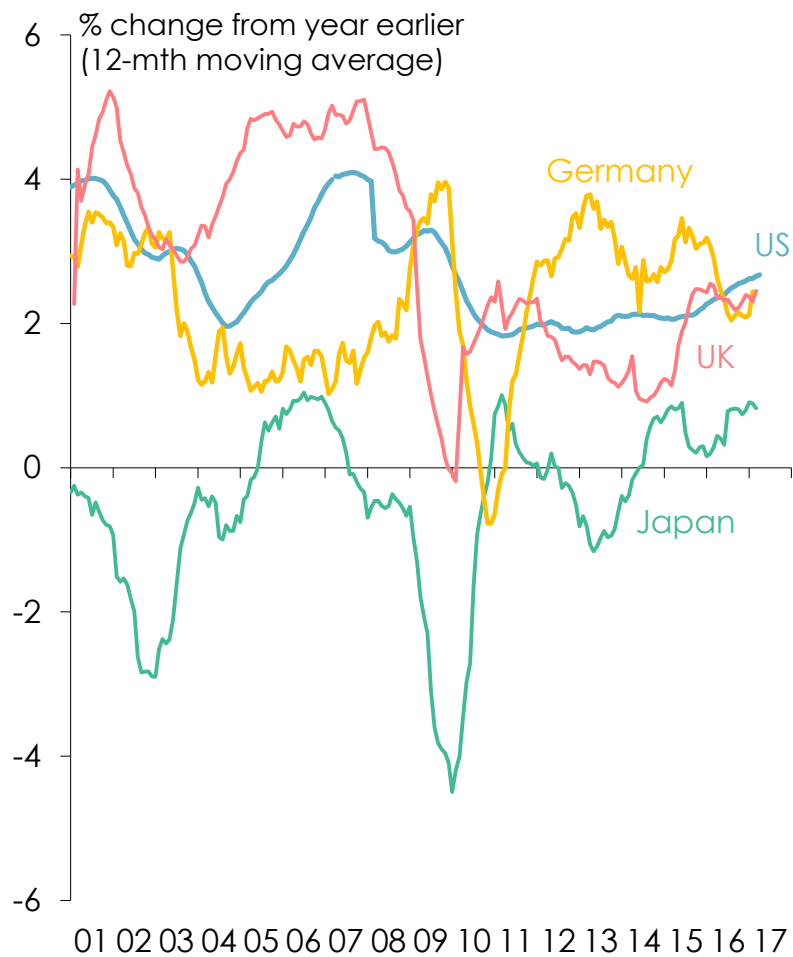
## Employment-population ratios



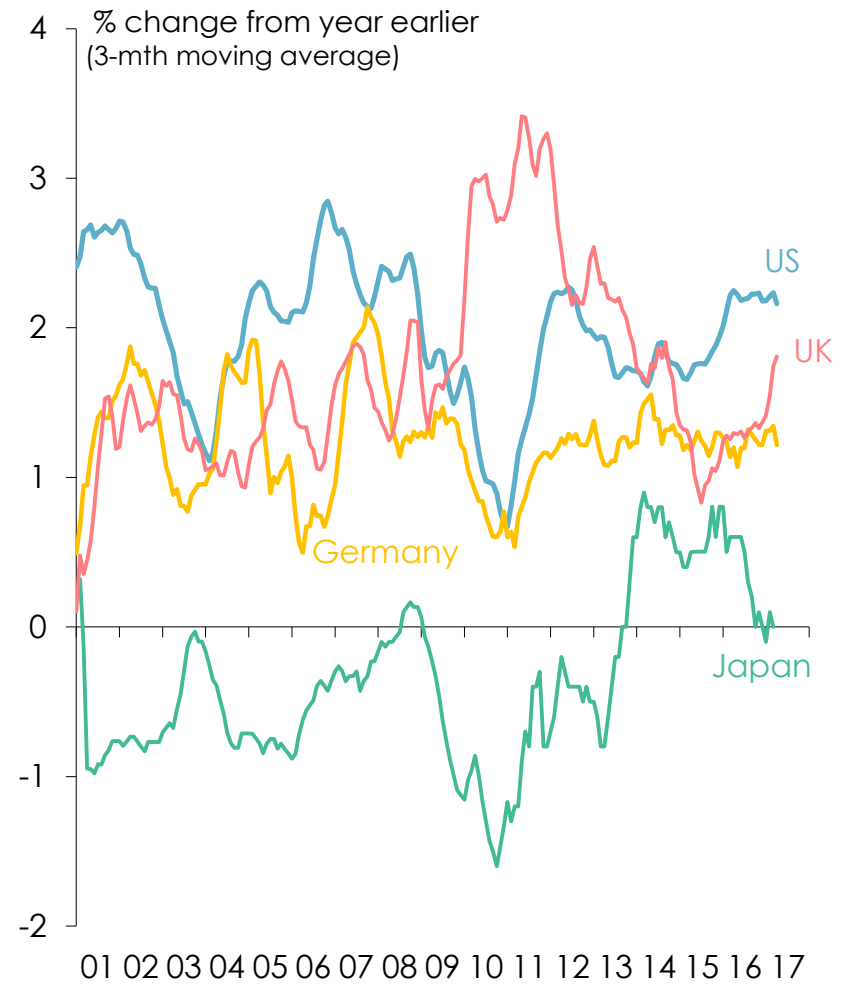
Sources: US Bureau of Labor Statistics; Japan Labour Ministry; Bundesagentur fur Arbeit; UK Office of National Statistics; Thomson Reuters Datastream.

# Inflation looks to have passed its low point in each of the four largest 'advanced' economies – and is picking up in Asia, too

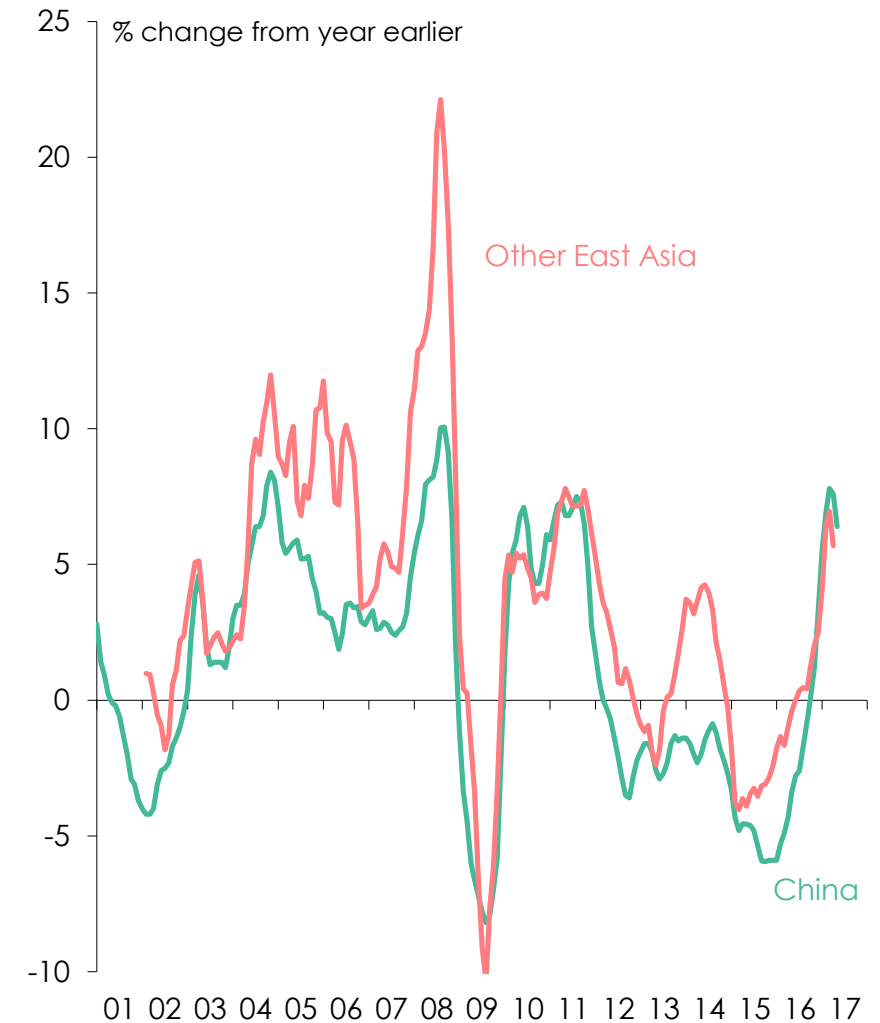
## Wage inflation – four largest 'advanced' economies



## 'Core' CPI inflation – four largest 'advanced' economies



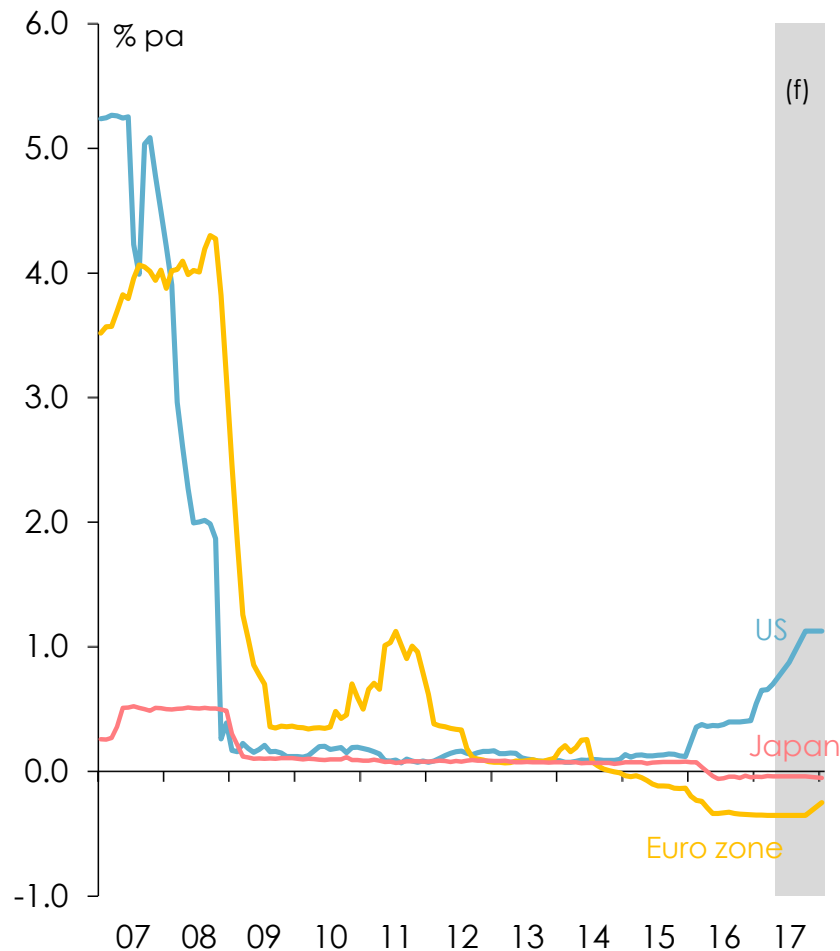
## Asian producer prices



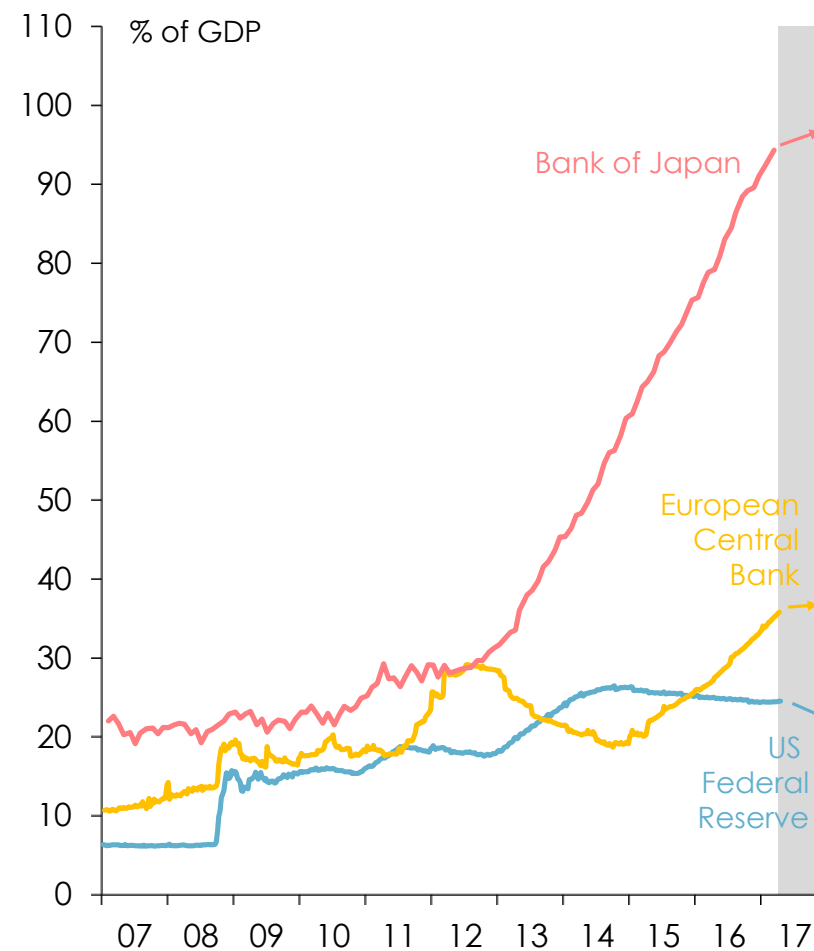


# So the long down-trend in interest rates has come to an end – as bond markets began to sense from the middle of last year

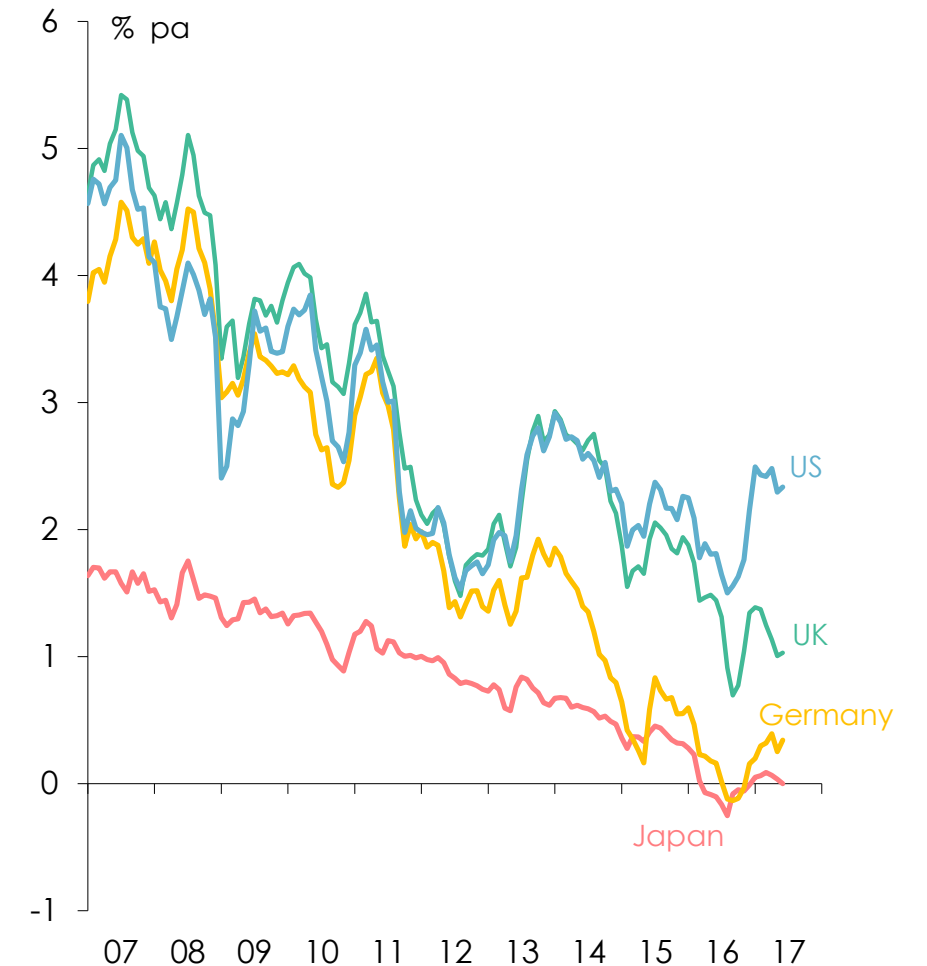
## Major central bank policy interest rates



## Major central bank balance sheets



## 10-year bond yields

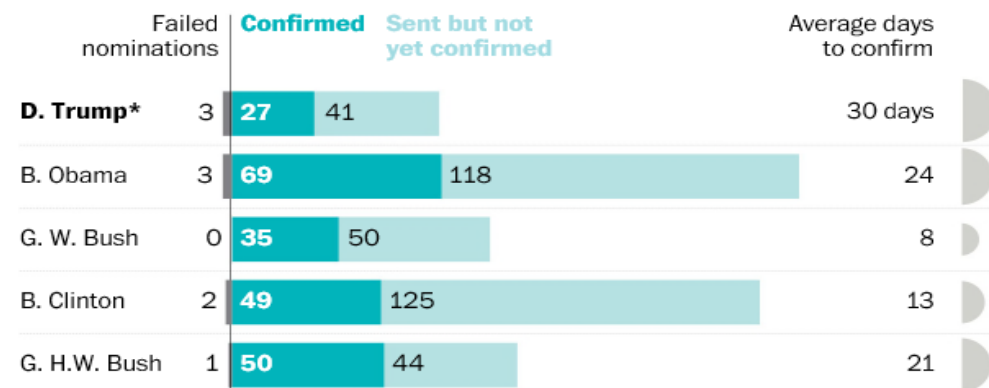


Source: Thomson Reuters Datastream; US Federal Reserve; European Central Bank; Bank of Japan.

# The Trump Administration's first 100 days haven't been a great success

## Lack of preparation

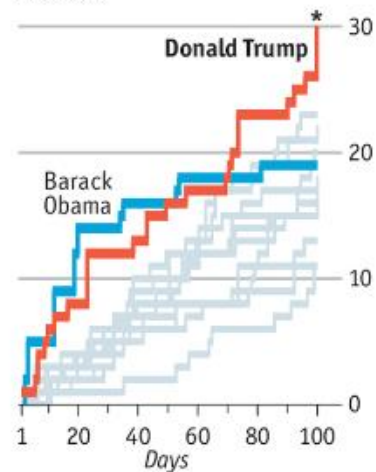
### Presidential appointments in the first 100 days



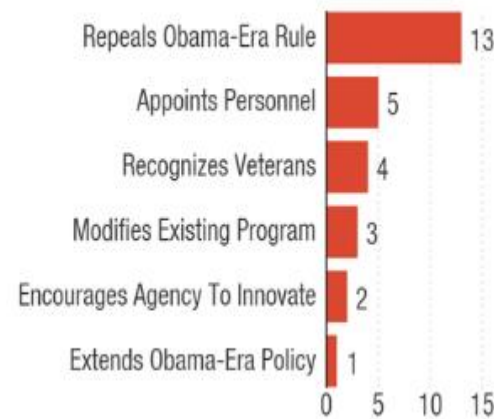
\*Totals include some posts that are not being tracked as 'key positions' in the appointee database. Trump data as of 3:30 p.m. on April 28, or 99 days into the presidency.

## Lack of legislative achievements

### Executive orders issued 1953-2017



### Types Of Laws Signed By Trump



## Lack of detail

**2017 Tax Reform for Economic Growth and American Jobs**

*The Biggest Individual And Business Tax Cut In American History*

**Goals For Tax Reform**

- Grow the economy and create millions of jobs
- Simplify our burdensome tax code
- Provide tax relief to American families—especially middle-income families
- Lower the business tax rate from one of the highest in the world to one of the lowest

**Individual Reform**

- Tax relief for American families, especially middle-income families:
  - Reducing the 7 tax brackets to 3 tax brackets of 10%, 25% and 35%
  - Doubling the standard deduction
  - Providing tax relief for families with child and dependent care expenses
- Simplification:
  - Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers
  - Protect the home ownership and charitable gift tax deductions
  - Repeal the Alternative Minimum Tax
  - Repeal the death tax
- Repeal the 3.8% Obamacare tax that hits small businesses and investment income

**Business Reform**

- 15% business tax rate
- Territorial tax system to level the playing field for American companies
- One-time tax on trillions of dollars held overseas
- Eliminate tax breaks for special interests

**Process**

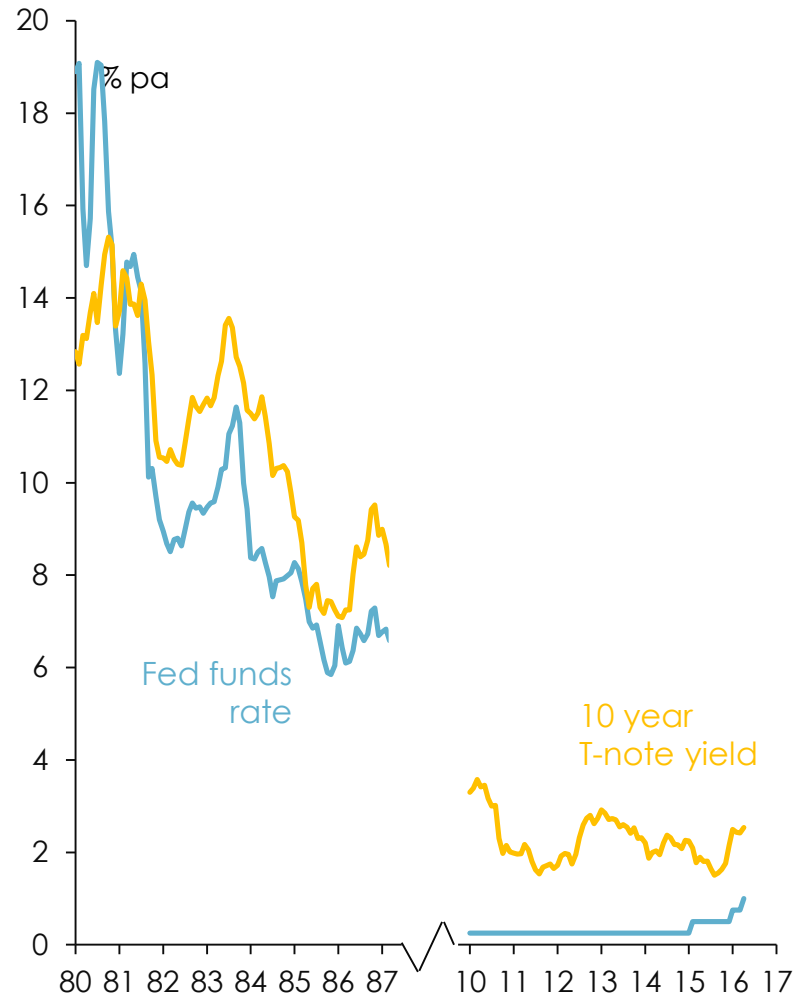
- Throughout the month of May, the Trump Administration will hold listening sessions with stakeholders to receive their input and will continue working with the House and Senate to develop the details of a plan that provides massive tax relief, creates jobs, and makes America more competitive—and can pass both chambers.

## Mixed record on promises

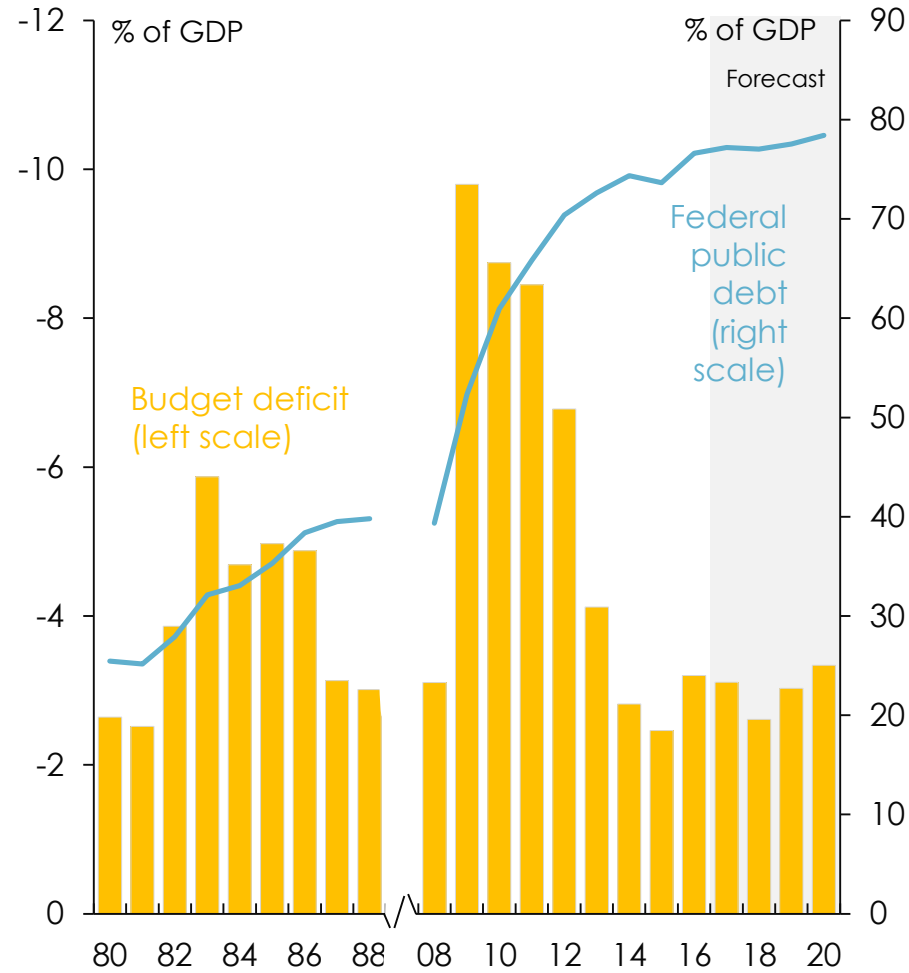
- Conservative judge appointed to US Supreme Court
- Significant changes in environmental regulation
- Failed to repeal 'Obamacare'
- So far hasn't done much on trade
  - Has withdrawn from TPP
  - Intentions re NAFTA unclear
  - Backed away from labelling China a 'currency manipulator' or imposing across-the-board tariffs on imports from China
  - Key trade policy personnel yet to be confirmed
- Appears to have reversed campaign position on 'foreign entanglements'
  - Military strikes on Yemen, Syria and Afghanistan
  - Possible action against North Korea
  - NATO 'relevant' after all
- Nothing thus far on infrastructure spending

# Three reasons why Trump's fiscal policies may not have the same impact on economic growth as Reagan's

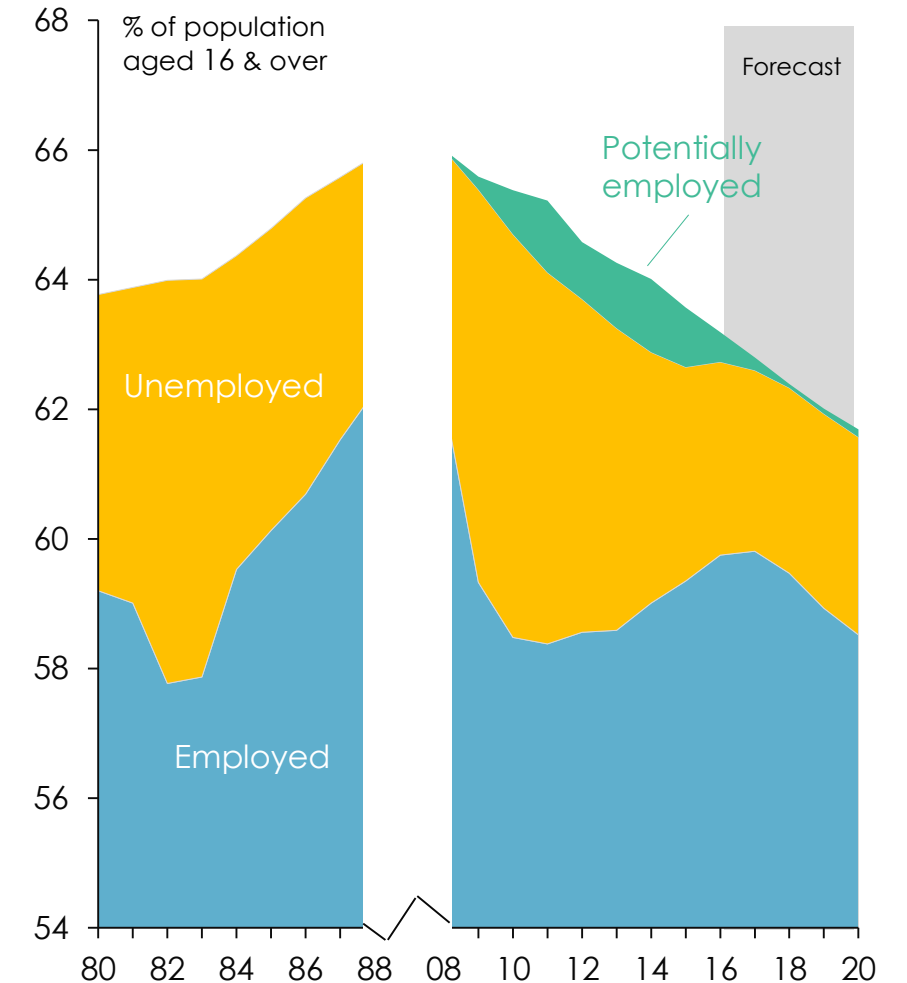
## Interest rates



## Federal budget and debt



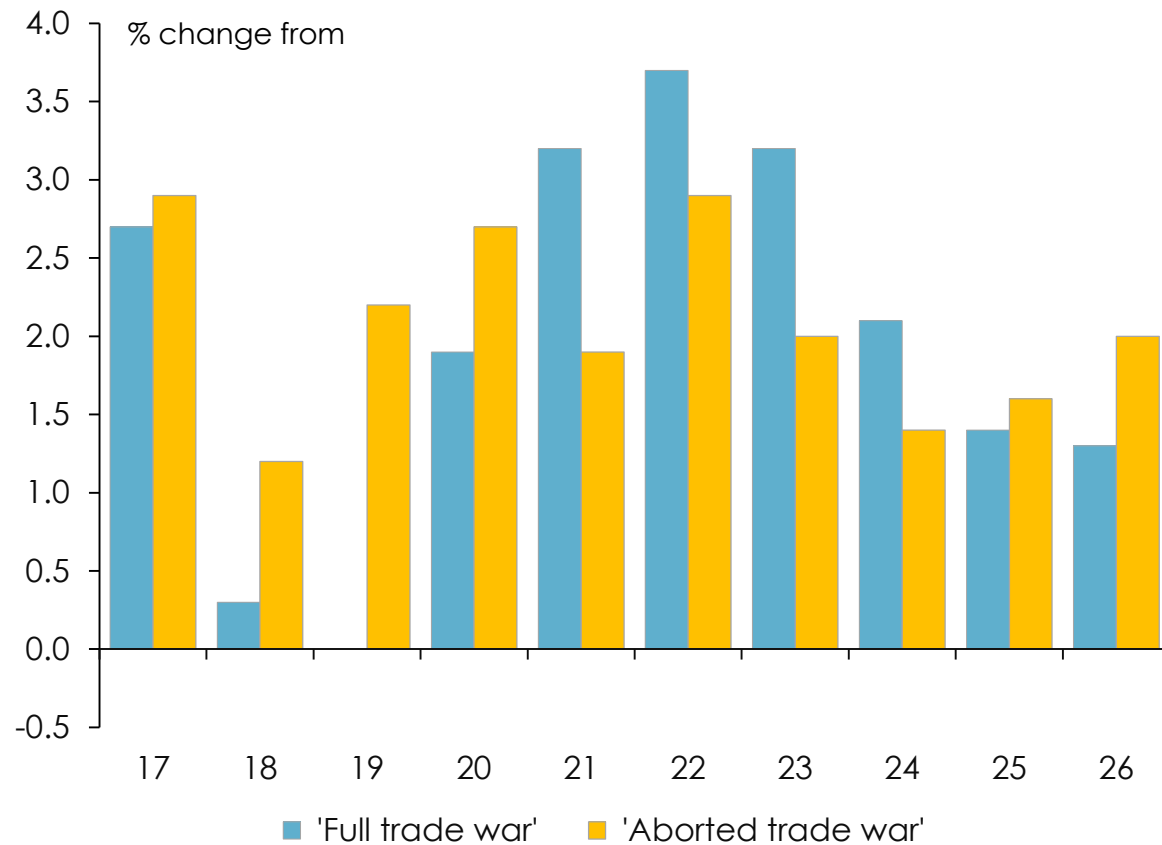
## Labour supply



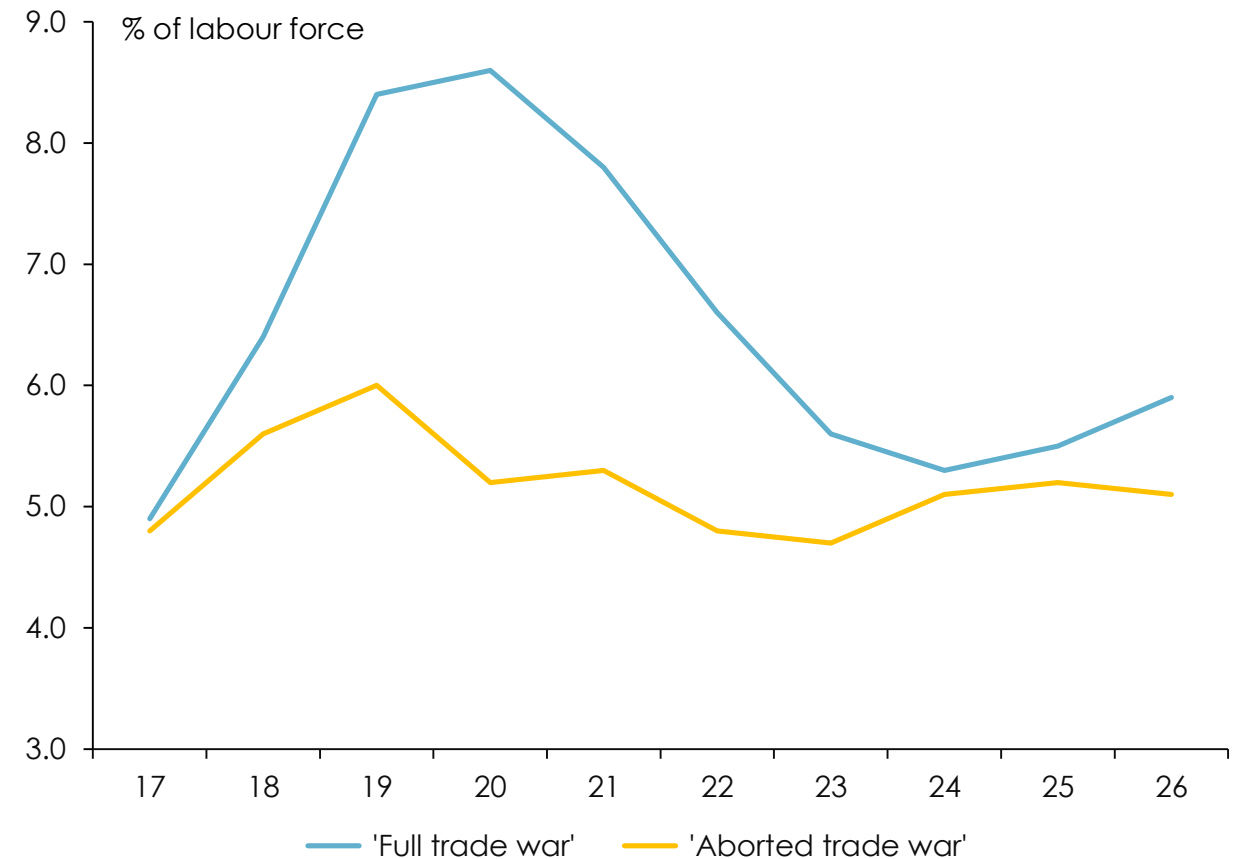
Sources: US Federal Reserve; US Congressional Budget Office.

# A full-blown 'trade war' would send the US economy into recession

## Simulated changes in US real GDP under 'trade war' scenarios



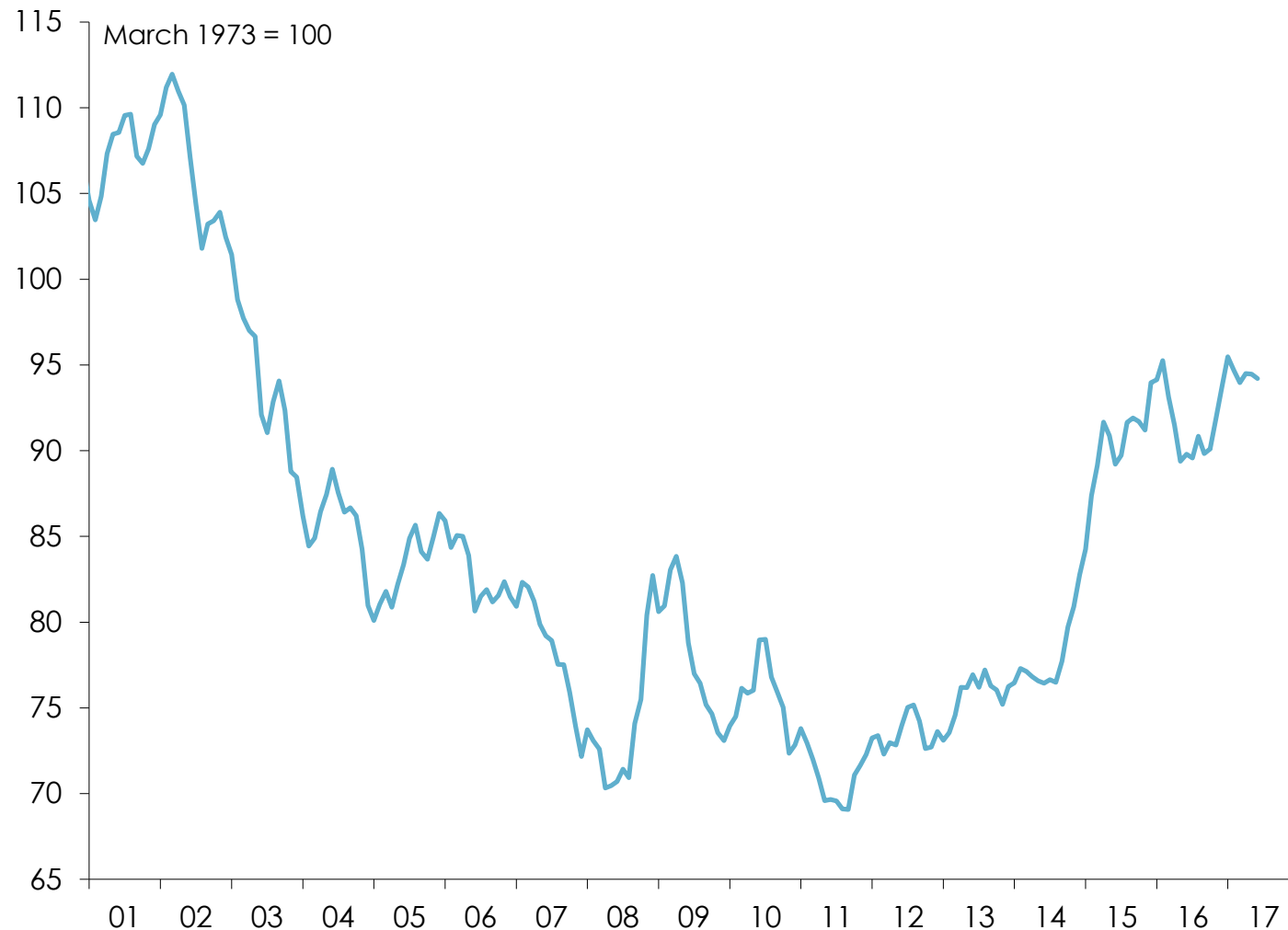
## Simulated levels of US unemployment under 'trade war' scenario



Note: 'full trade war' scenario assumes US imposes 45% tariff on non-oil imports from China and 35% on non-oil imports from Mexico, and China & Mexico impose similar tariffs on imports from US. 'Aborted trade war' assumes US tariffs are imposed for only a single year, because China and Mexico concede to US demands, the US Congress overturns the action, or President Trump loses in the courts, or the public outcry is such that the administration is forced to stand down  
Source: Marcus Noland, Sherman Robinson and Tyler Moran, 'Impact of Clinton's and Trump's Trade Policies, in Peterson Institute for International Economics, Briefing 16-6, ['Assessing Trade Agendas in the US Presidential Campaign'](#), September 2016.

# The US dollar will either rise further, or fall a lot – depending in large part on what Trump does

## US dollar vs other major currencies



- ❑ If Trump sticks to his ‘pro-growth’ agenda (tax cuts together with increased spending on defence and infrastructure) then the US dollar will probably keep rising
  - in response to rising US inflation and interest rates
- ❑ If Trump pursues a highly protectionist trade policy, and/or seeks to politicize the Federal Reserve, then the US dollar will likely fall (and potentially fall a lot)
  - because those kind of actions will undermine confidence in the US financial system, and the US dollar, as a ‘safe haven’

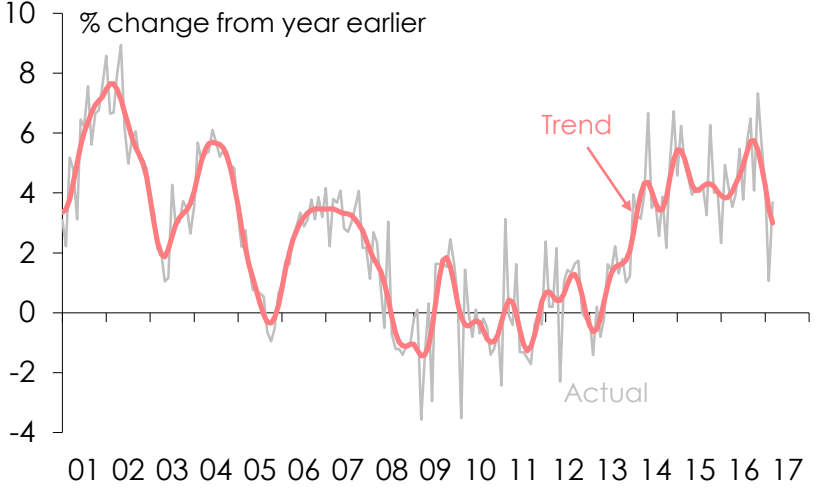
Source: US Federal Reserve; Thomson Reuters Datastream.

# Last year's Brexit hit sterling and confidence, but so far the dire warnings about economic consequences have not been borne out

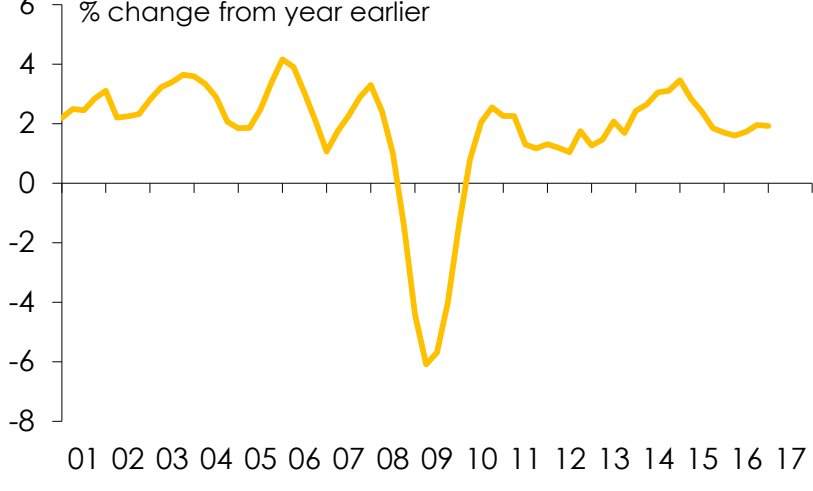
**Sterling vs US\$**



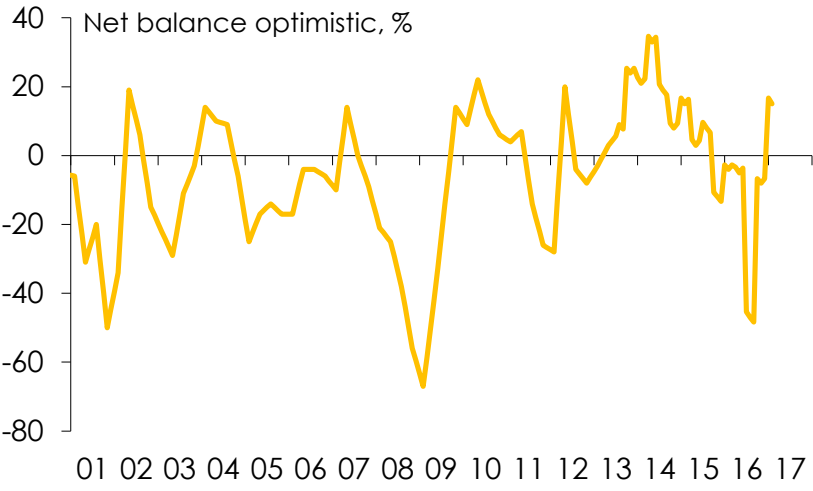
**Retail sales volume**



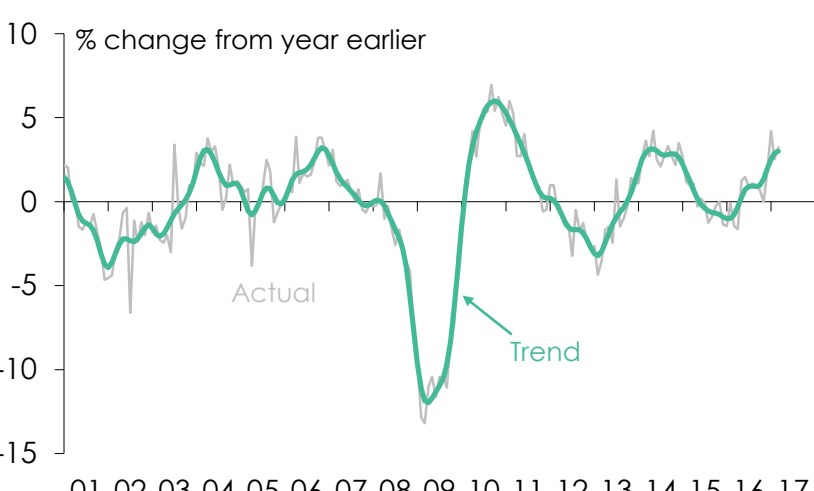
**Real GDP**



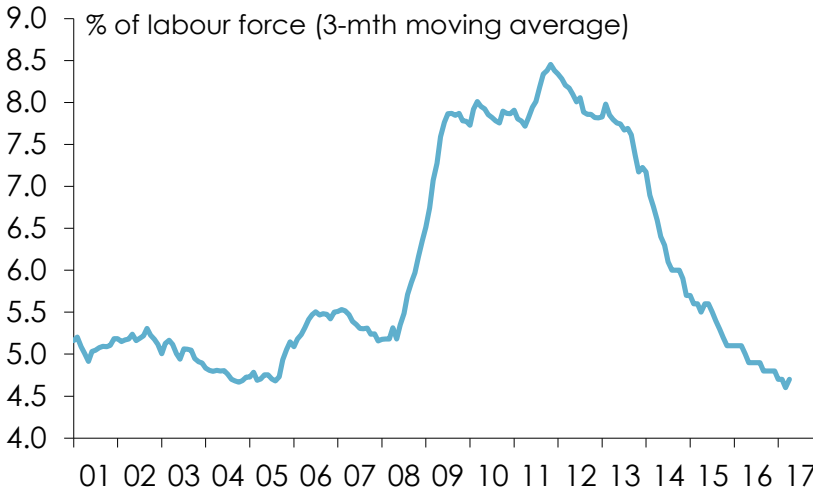
**Business confidence**



**Manufacturing production**



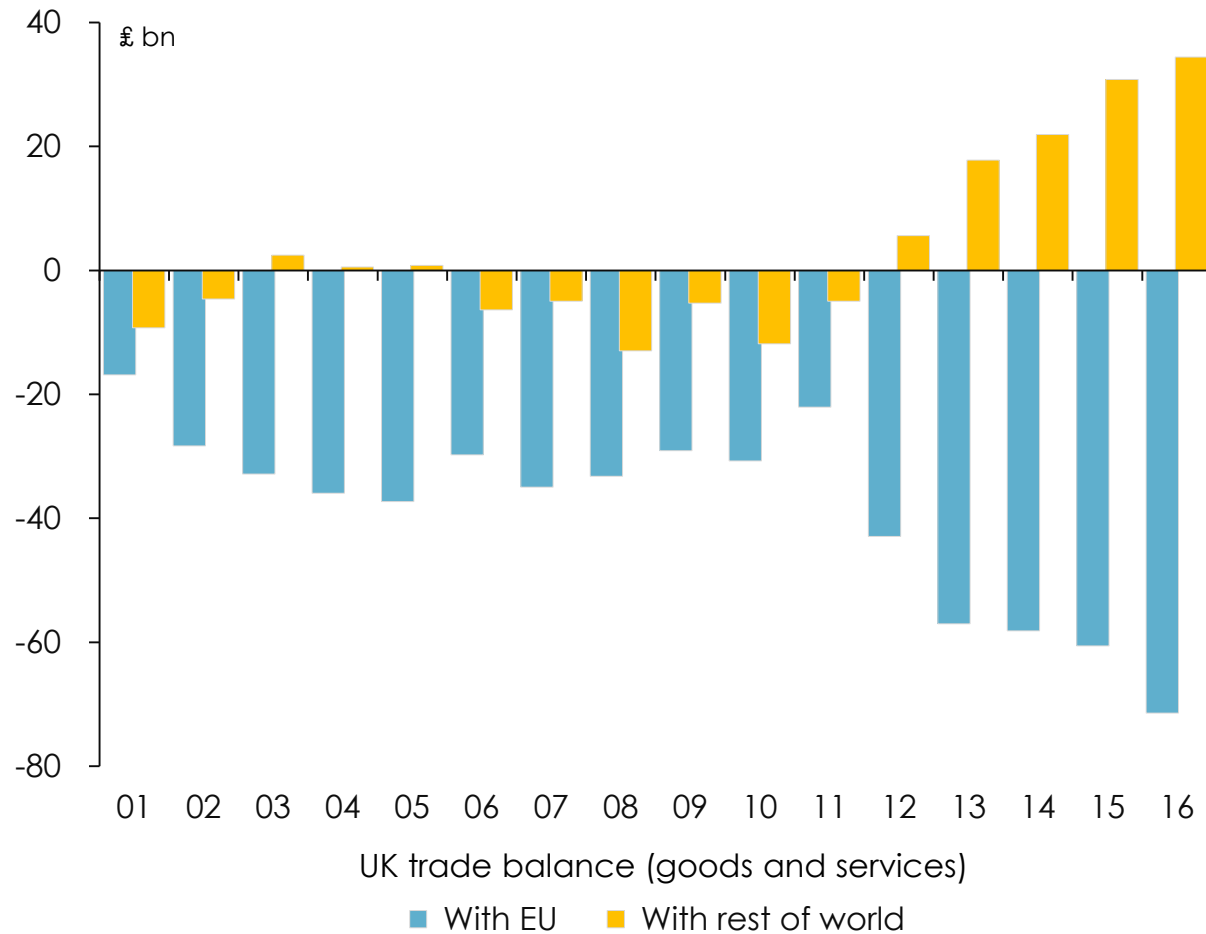
**Unemployment**



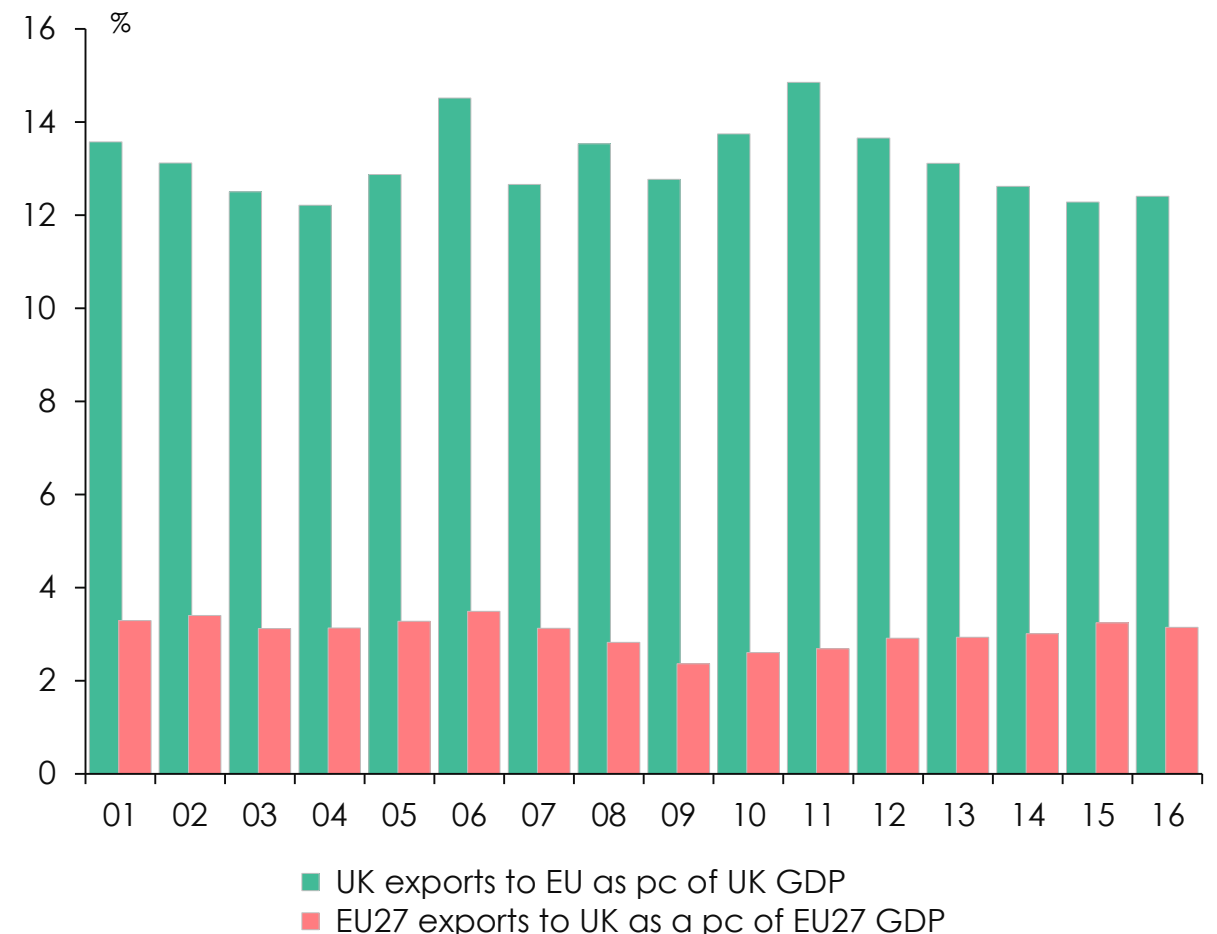
Sources: Thomson Reuters Datastream; Confederation of British Industry; UK Office for National Statistics.

# 'Brexiters' think that the EU 'needs' the UK more than the UK 'needs' the EU – but in fact UK-EU trade matters more to the UK than to the rest of the EU

## UK balance of trade on goods and services – EU and rest of the world



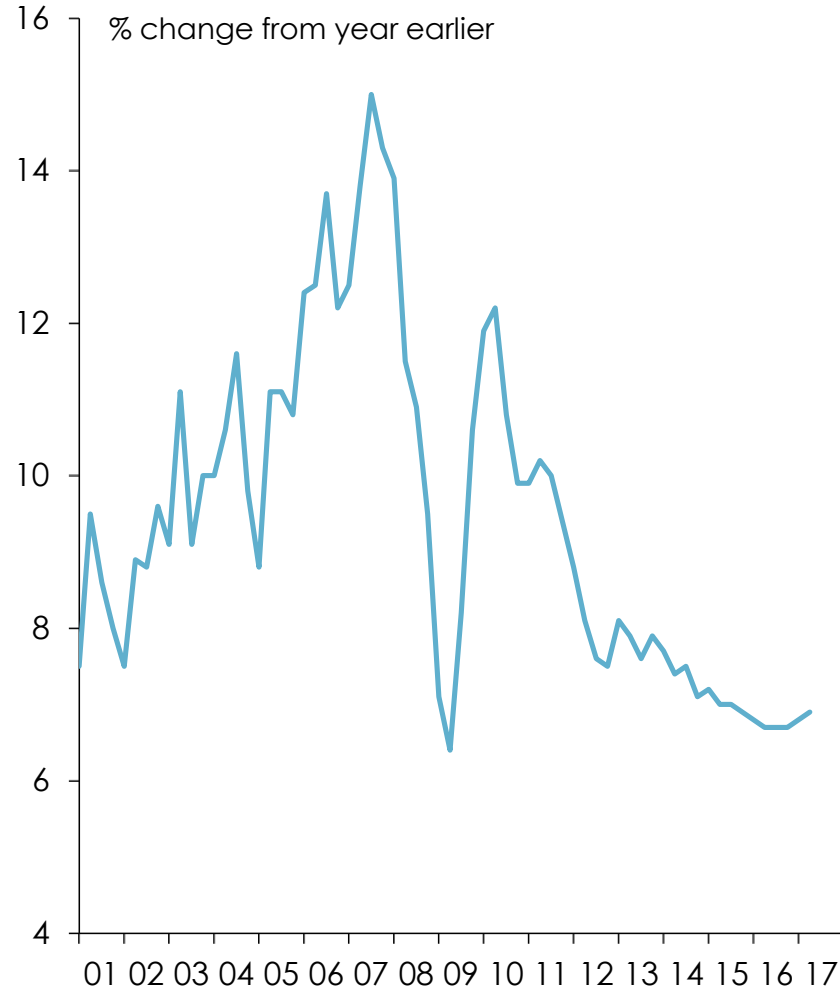
## UK-EU trade as a pc of UK and EU ex-UK GDP



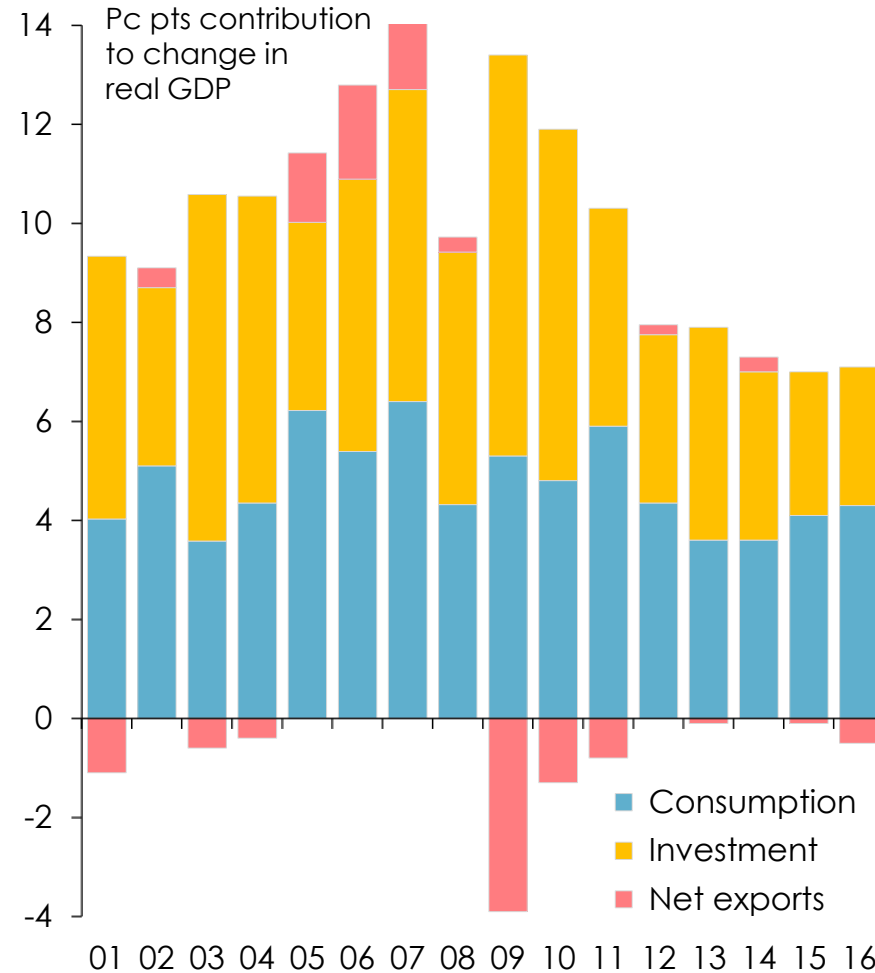
Sources: UK Office for National Statistics; Eurostat.

# China's growth has slowed a lot; it's no longer driven by net exports; and it isn't running big current account surpluses any more

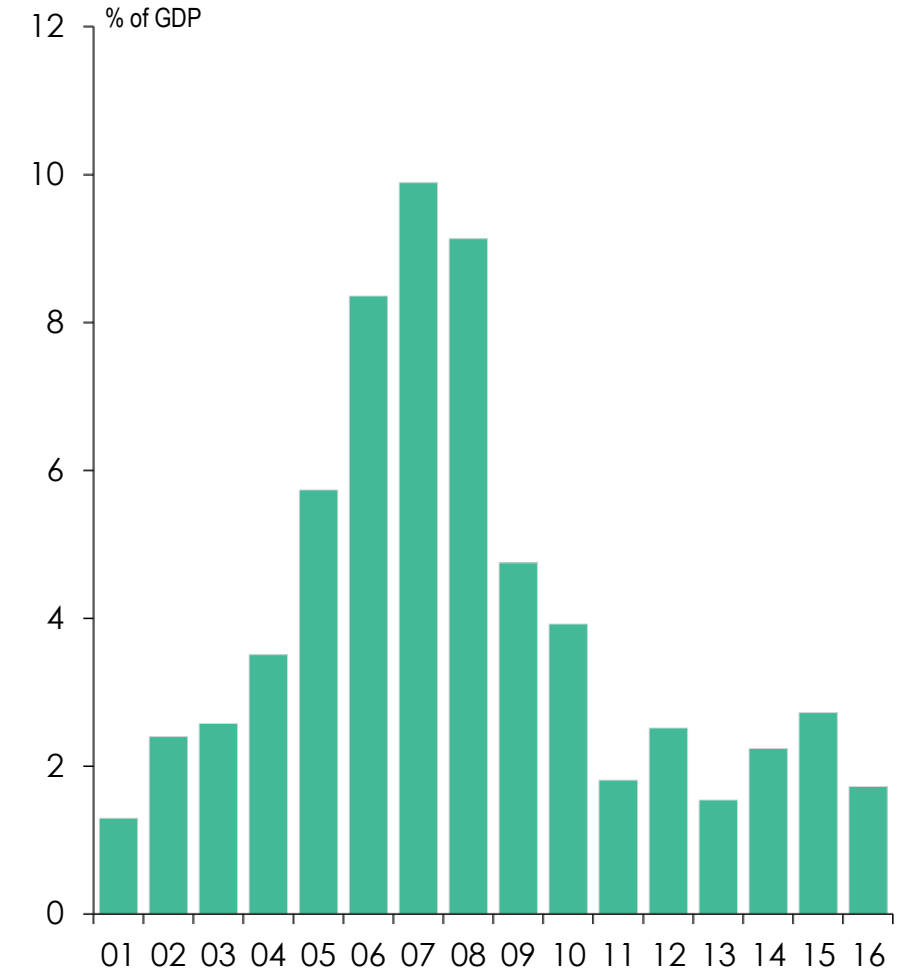
## China real GDP growth



## Contributions to Chinese real GDP growth



## Chinese current account surplus

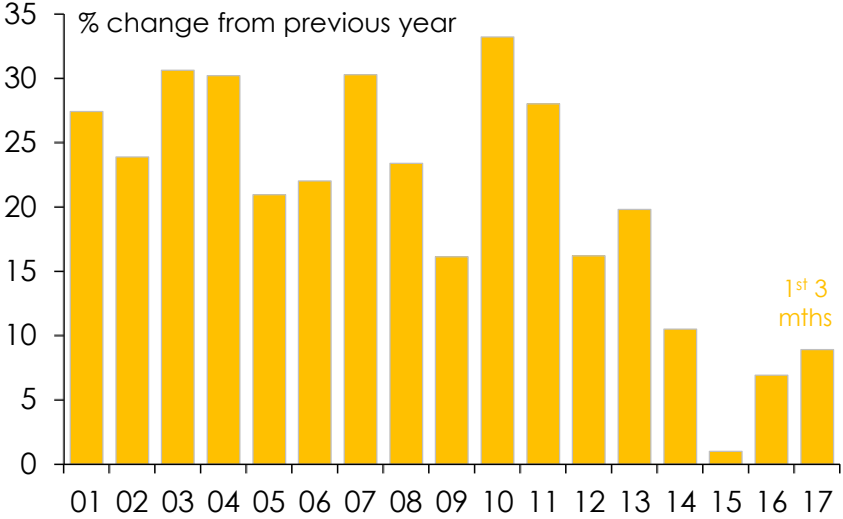


Source: China National Bureau of Statistics.

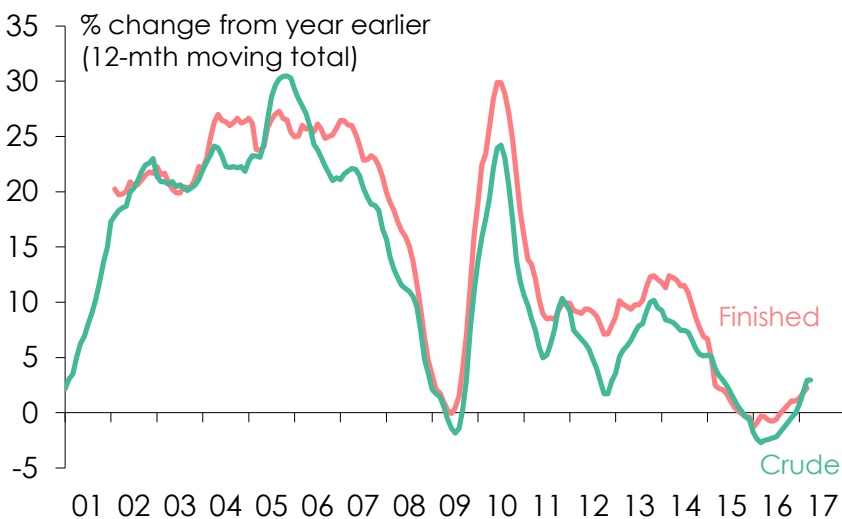


# The monetary stimulus which revived China's property sector last year now seems to have been partially withdrawn

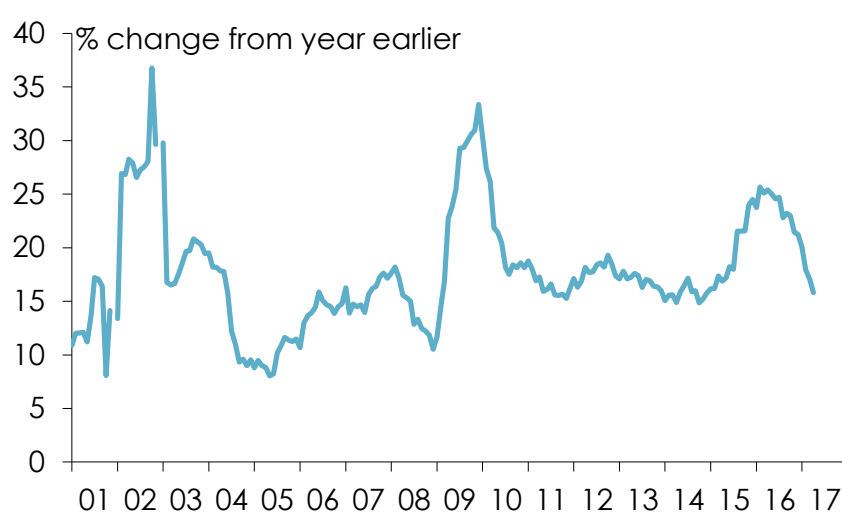
## Real estate investment



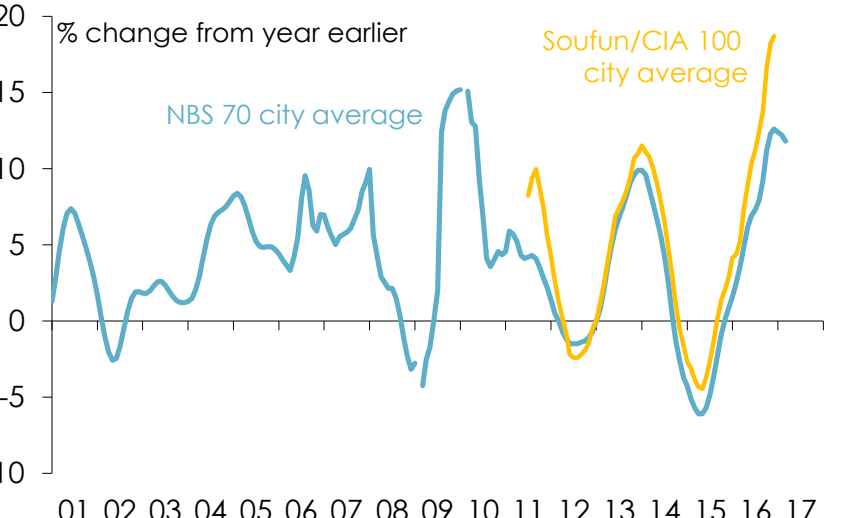
## Steel production



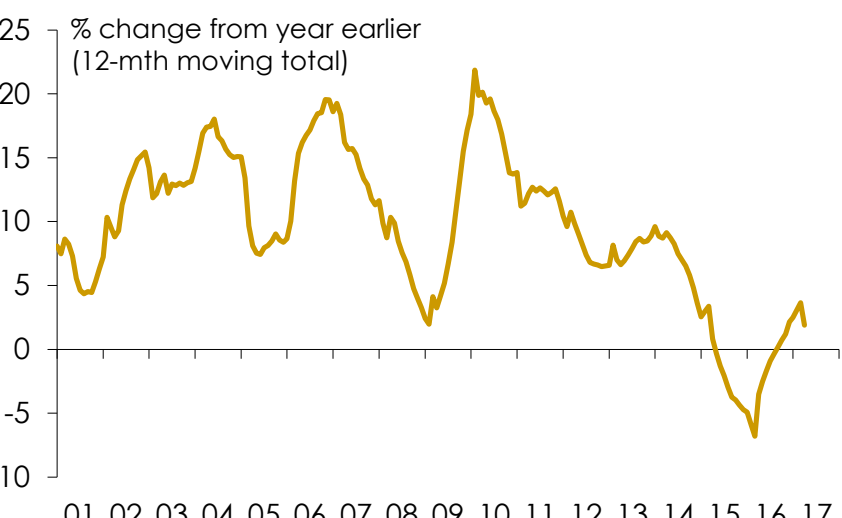
## Credit growth



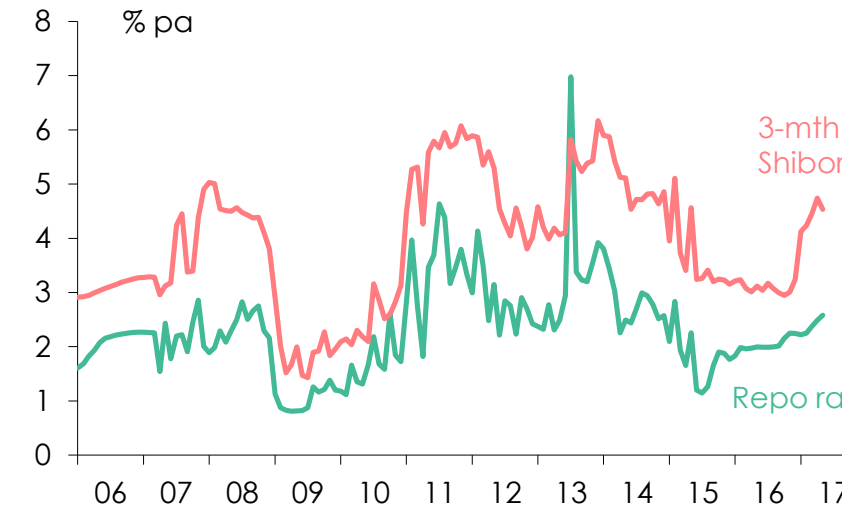
## Urban property prices



## Cement production

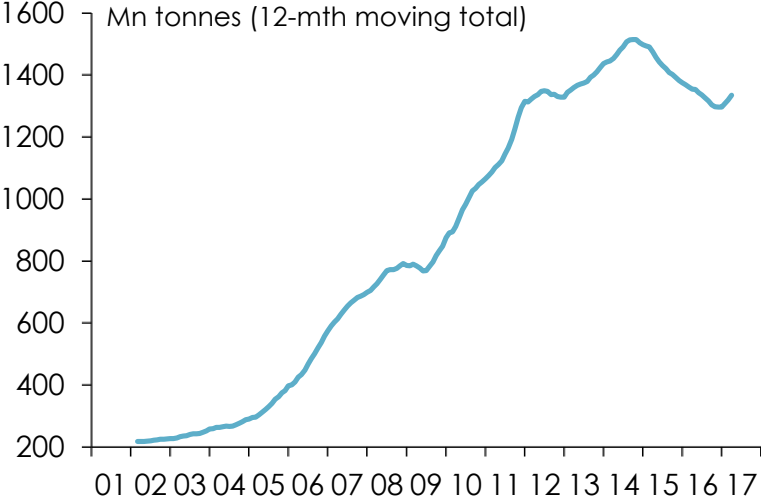


## Short term interest rates

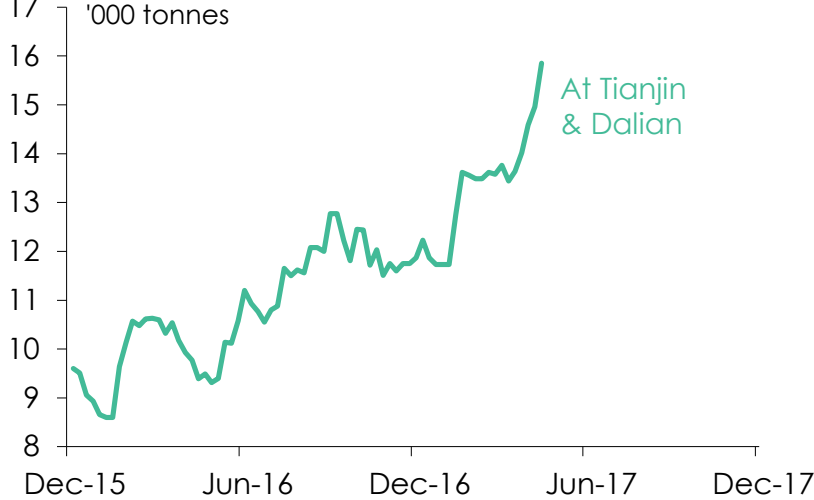


# So the 'mini-boom' in iron ore prices now seems to be over

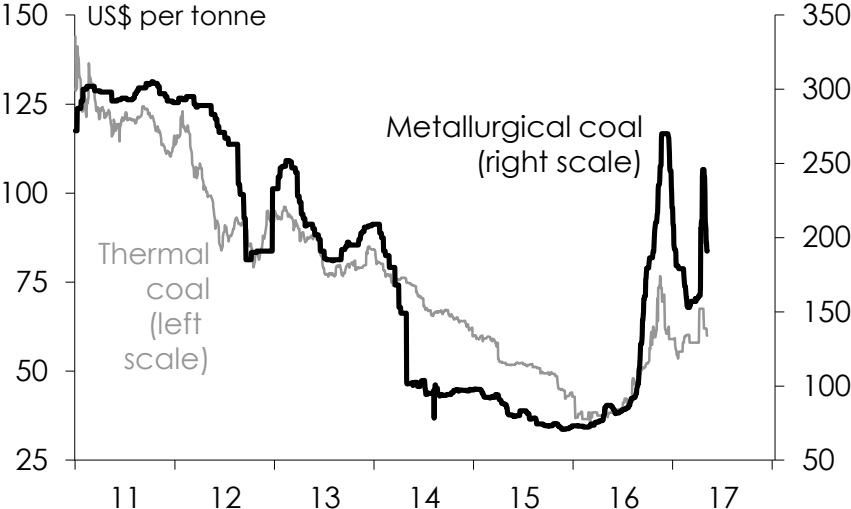
## Chinese iron ore production



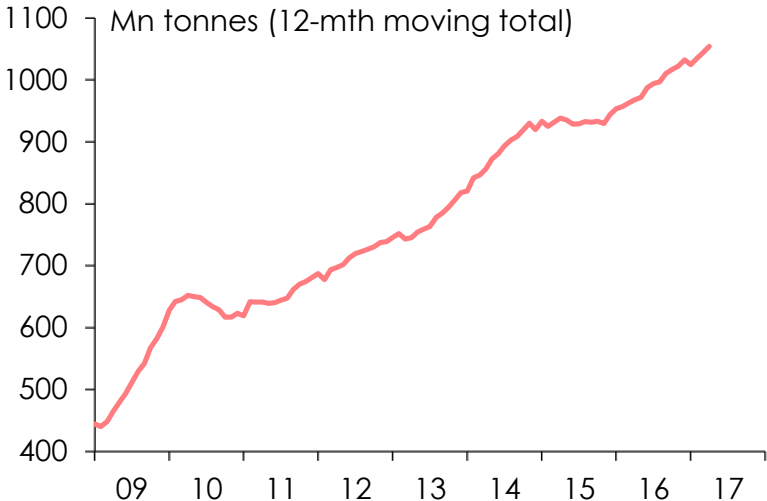
## Chinese iron ore inventories



## Coal spot prices



## Chinese iron ore imports



## Iron ore spot prices



Sources: China National Bureau of Statistics; China Customs Information Centre; Thomson Reuters Datastream.

# Chinese Stats Bureau doesn't just publish economic statistics, it explains why the economy is doing so well



The screenshot shows the website of the National Bureau of Statistics of China. The header features the bureau's logo and name. A navigation bar includes links for Home, Data, Communiqués, Legal Framework, Classifications & Methods, Press Release (highlighted), International Cooperation, and Understanding Statistics. The main content area displays the title of a press release, its date and time, and options for printing and email. The text of the press release is partially visible, starting with a paragraph about the beginning of 2017.

## National Bureau of Statistics of China

Home Data Communiqués Legal Framework Classifications & Methods **Press Release** International Cooperation Understanding Statistics

### A Good Start for China's National Economy in the First Quarter of 2017

National Bureau of Statistics of China 2017-04-17 10:00

Print E-Mail Large Medium Small

*National Bureau of Statistics of China  
17 April 2017*

Since the beginning of 2017, under the leadership of the Central Committee of the Communist Party of China with General Secretary Xi Jinping as the core, people from all regions and departments implemented the arrangements made by the CPC Central Committee and the State Council, adhered to the general working guideline of making progress while maintaining stability, steered the new normal in economic development with the new development philosophy, and advanced the supply-side structural reform. As positive changes kept emerging and major indicators performed better than expected, the national economy maintained the momentum of steady and sound development from the second half of last year, getting off to a good start in 2017 and laying a solid foundation for accomplishing the whole-year growth target.

Next step, we should rally closely around the CPC Central Committee with General Secretary Xi Jinping as the core, put in practice the guiding principles of the Central Economic Work Conference and the arrangements made in the Report on the Work of the Government, stick to the general working guideline of making progress while maintaining stability, implement the new development philosophy, insist on the mainline of supply-side structure reform, appropriately expand the aggregate demand, effectively shape social expectations, strengthen the role of innovation in driving development, "roll up our sleeves to work harder", so as to sustain the good momentum for a steady and sound development of national economy.

# Perhaps the Australian Bureau of Statistics should do the same ...

**Australian Bureau of Statistics**

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**ANALYSIS**

As a result of strong economic management by the Turnbull Government and despite persistent obstruction by the Senate ...

**AUSTRALIAN ECONOMY GROWS BY 1.1%**

In chain volume seasonally adjusted terms, Australian Gross Domestic Product (GDP) grew by 1.1% in the December quarter 2016, following a contraction of 0.5% in the September quarter. Through the year growth is positive at 2.4%.

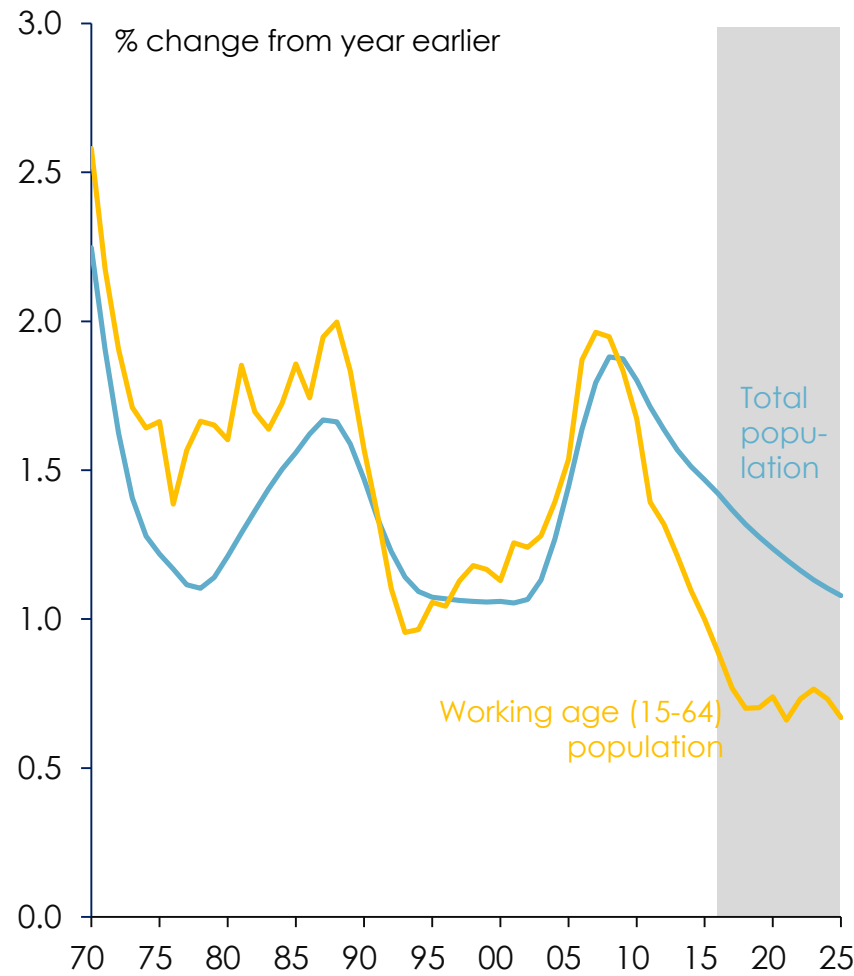
**GROSS DOMESTIC PRODUCT, Volume measures: Seasonally adjusted**

Year	Quarter	GDP Growth (%)
2008	1	1.5
2008	2	1.2
2008	3	1.0
2008	4	1.5
2009	1	1.8
2009	2	2.5
2009	3	3.0
2009	4	4.5
2010	1	3.5
2010	2	3.0
2010	3	2.5
2010	4	2.0
2011	1	2.5
2011	2	3.0
2011	3	3.5
2011	4	4.0
2012	1	3.5
2012	2	3.0
2012	3	2.5
2012	4	2.0
2013	1	2.5
2013	2	2.0
2013	3	1.5
2013	4	1.0
2014	1	1.5
2014	2	1.0
2014	3	0.5
2014	4	0.0
2015	1	0.5
2015	2	1.0
2015	3	1.5
2015	4	2.0
2016	1	2.4
2016	2	1.1
2016	3	0.5
2016	4	0.0

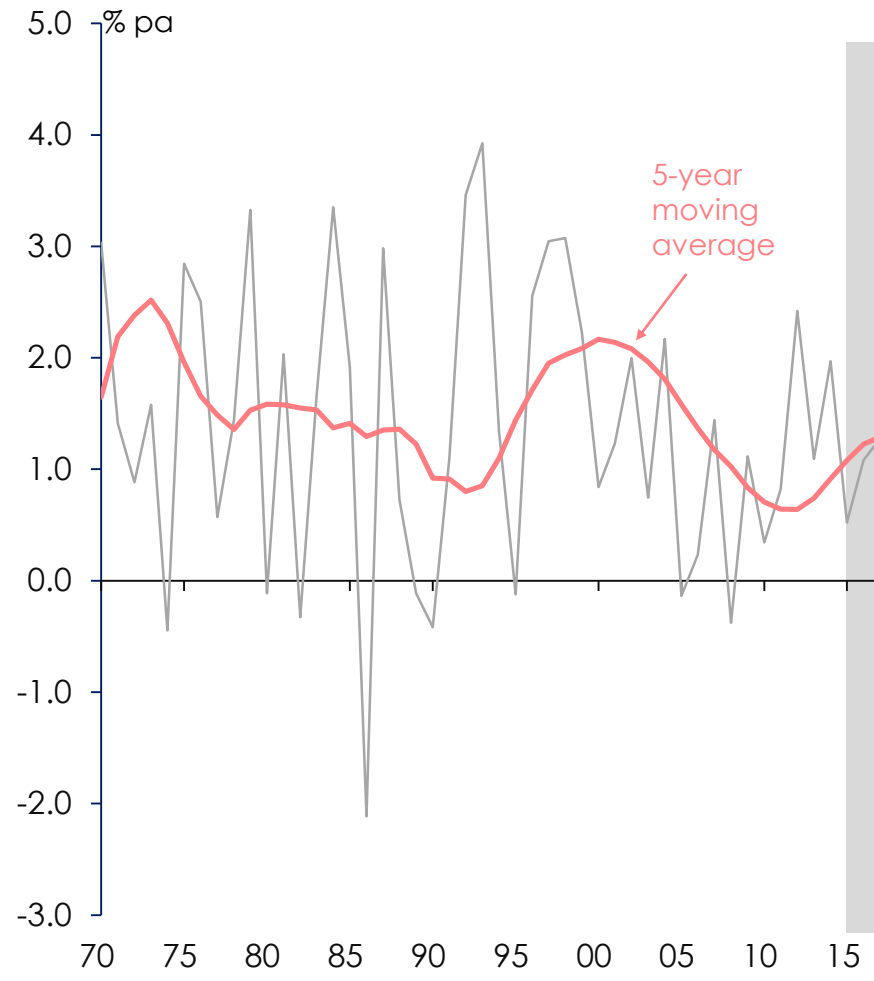
# The Australian economy

# 'Potential' growth is also slowing in Australia, although not by as much as in other 'advanced' economies, thanks largely to our immigration intake

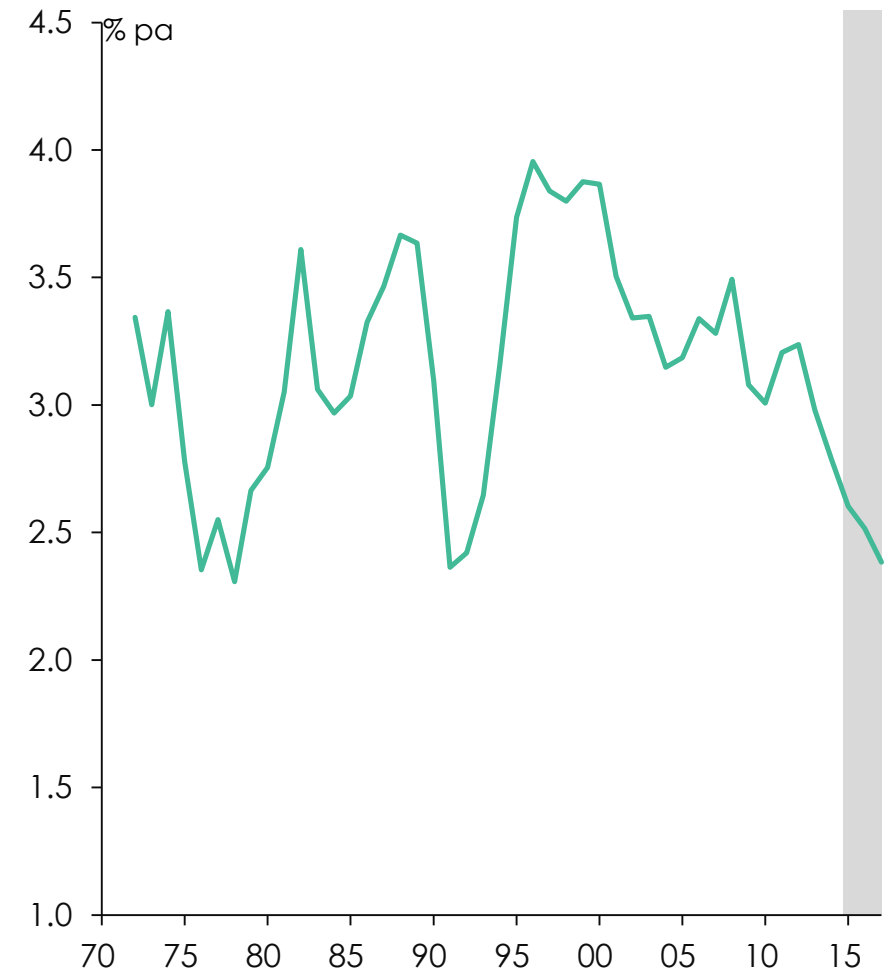
## Australian population growth



## Australian labour productivity growth



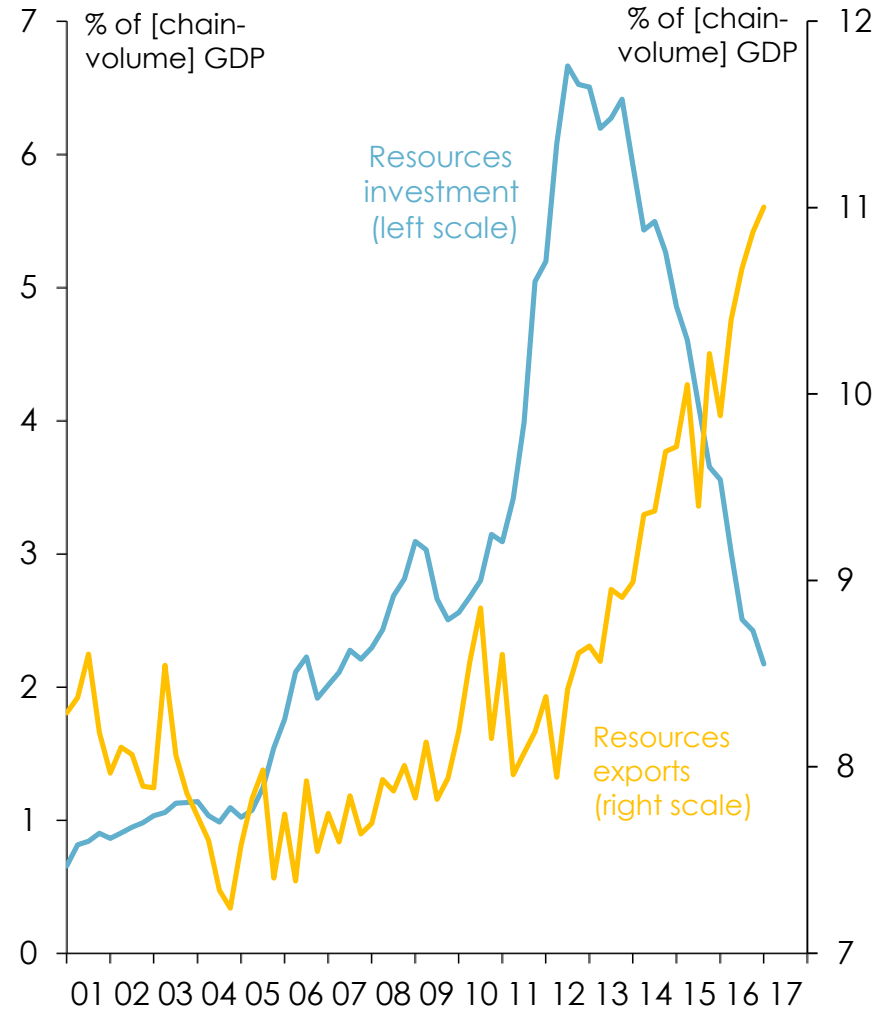
## Australian potential GDP growth



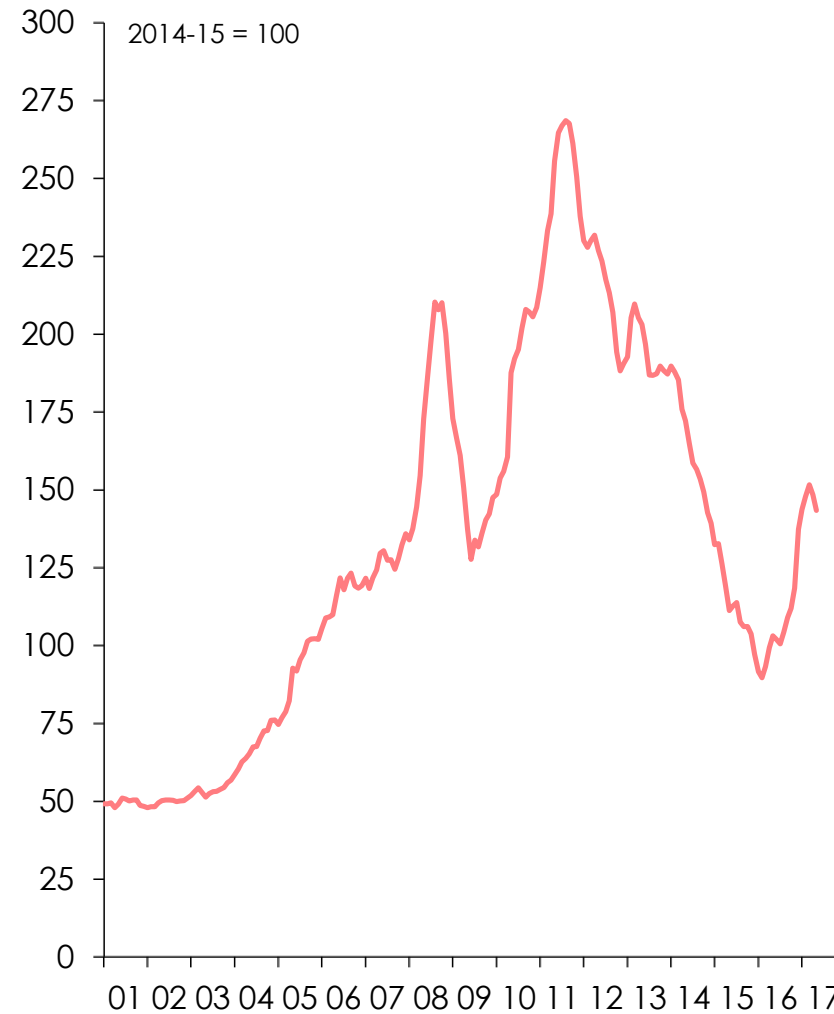
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2015 Revision*; Organization for Economic Co-operation & Development (OECD), *Economic Outlook* database. 'Potential growth' means growth in the level of real GDP assuming full employment of the available labour force.

# The resources investment boom is over – but the rebound in commodity prices has pushed Australia’s trade balance back into surplus

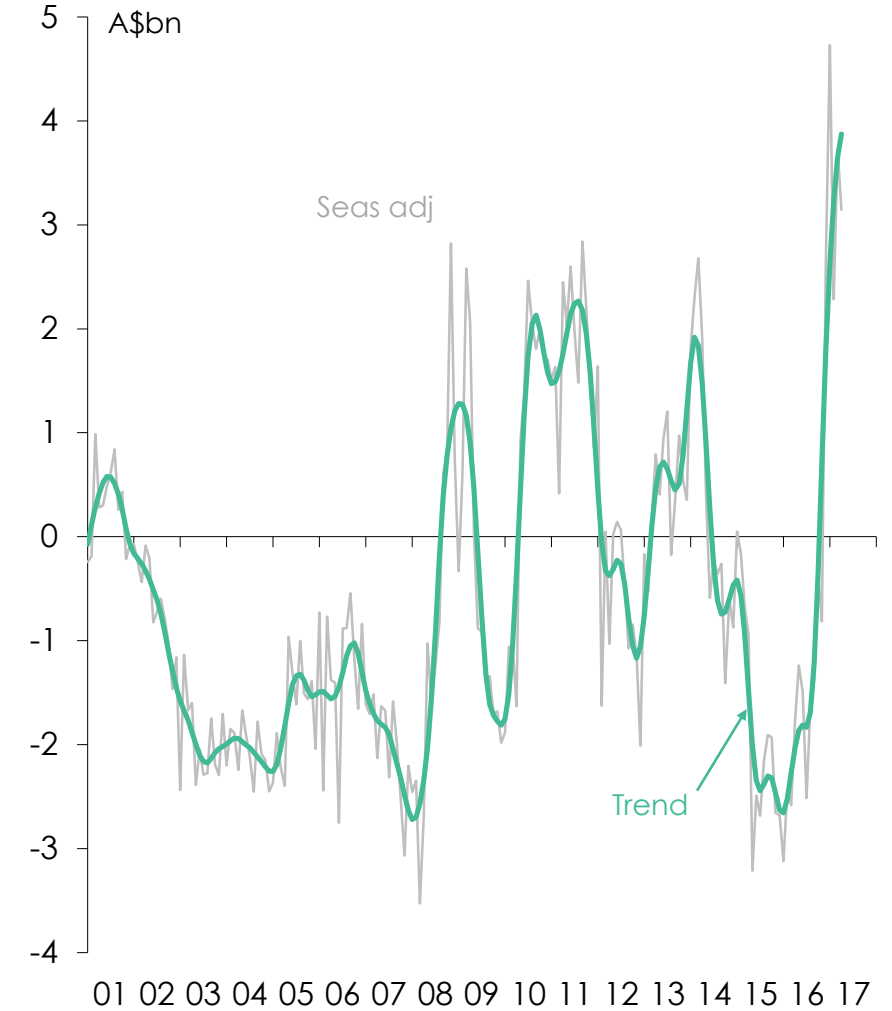
## Australia’s resources investment & export volumes



## Australia’s resources export prices



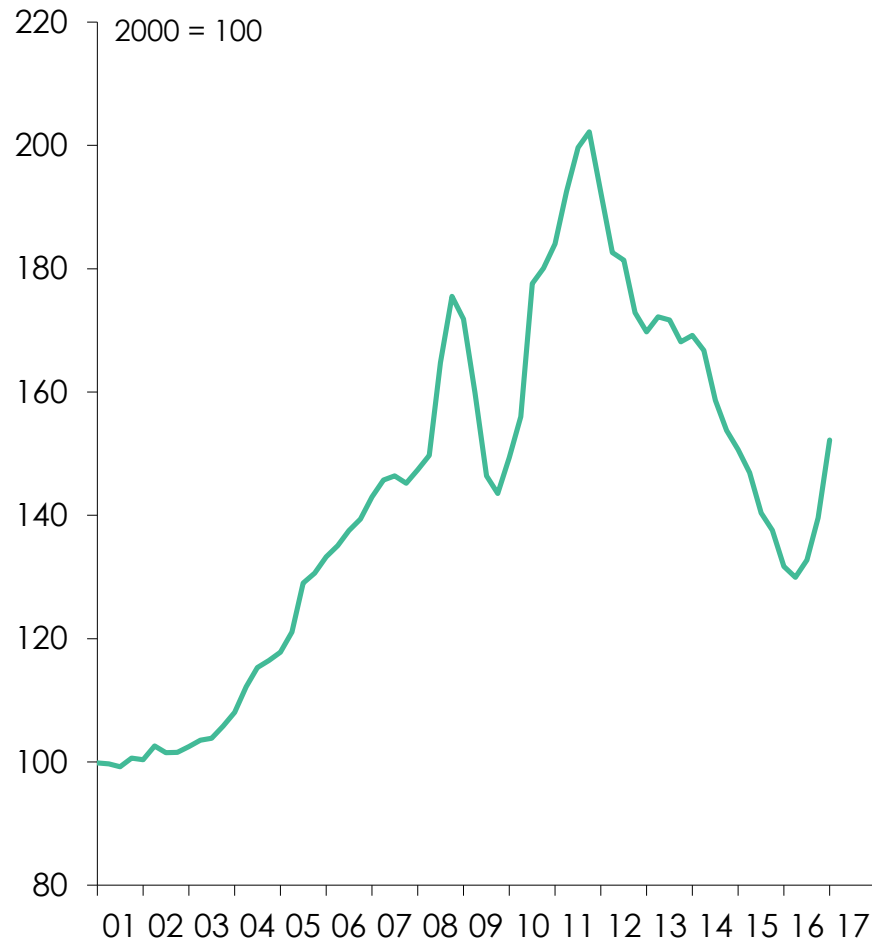
## Australia’s merchandise trade balance



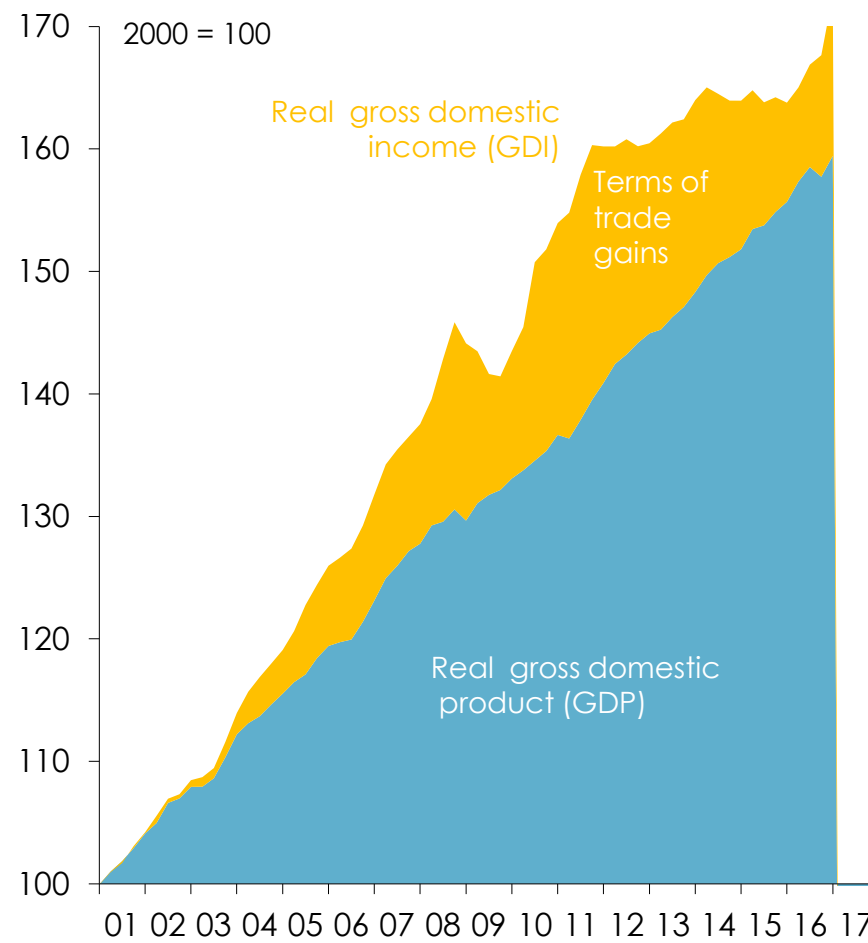
Note: Resources investment includes exploration expenditure.  
Sources: ABS; RBA.

# The recent rebound in commodity prices has provided a boost to national income – but it isn't going to last

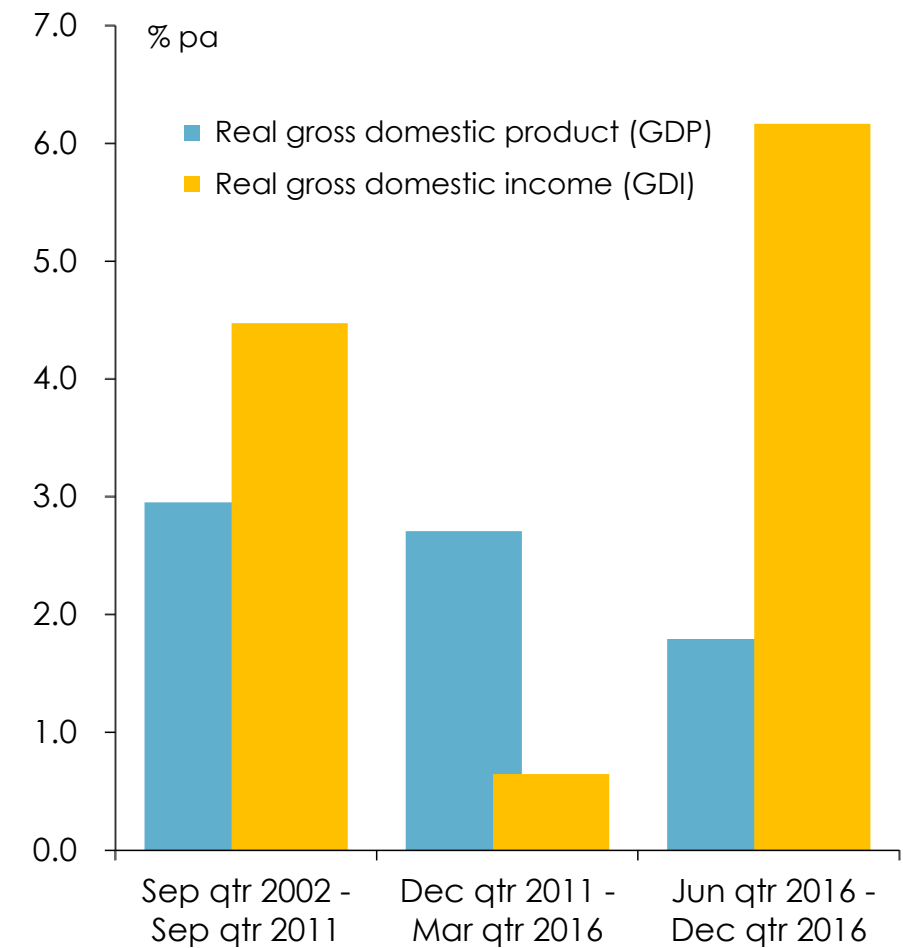
## Australia's terms of trade (ratio of export to import prices)



## Gains in real income arising from changes in the terms of trade



## Growth in real gross domestic income (GDI) vs real GDP

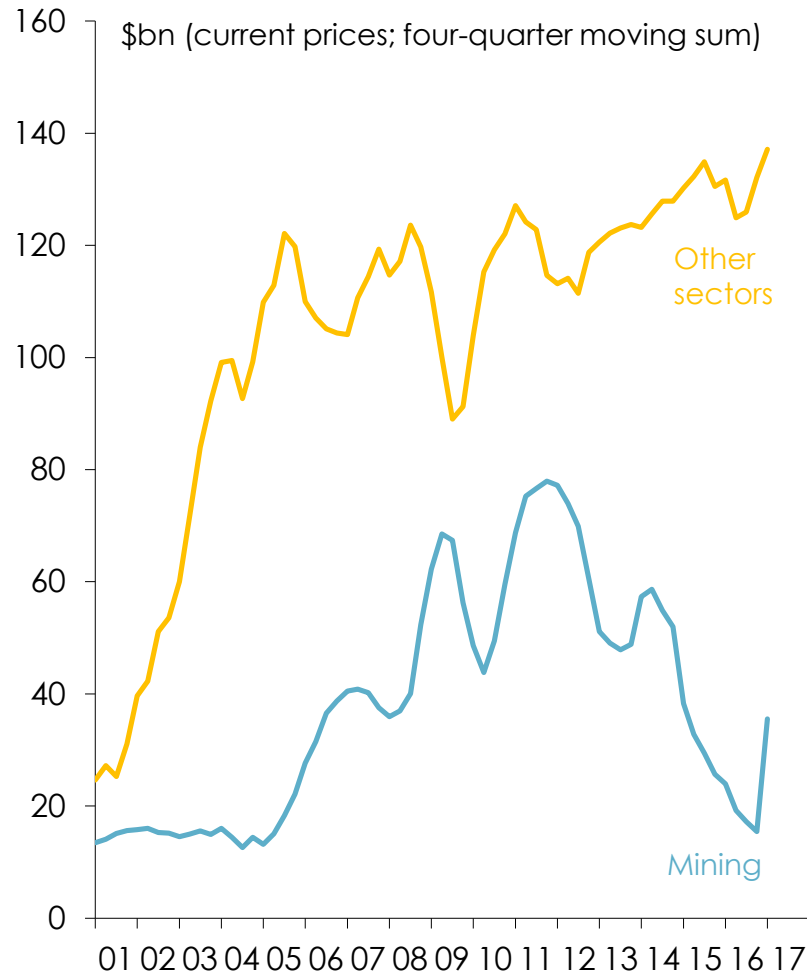


Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services. Real gross domestic income (GDI) is real gross domestic product (GDP) adjusted for income gains or losses arising from changes in the terms of trade. Source: ABS.

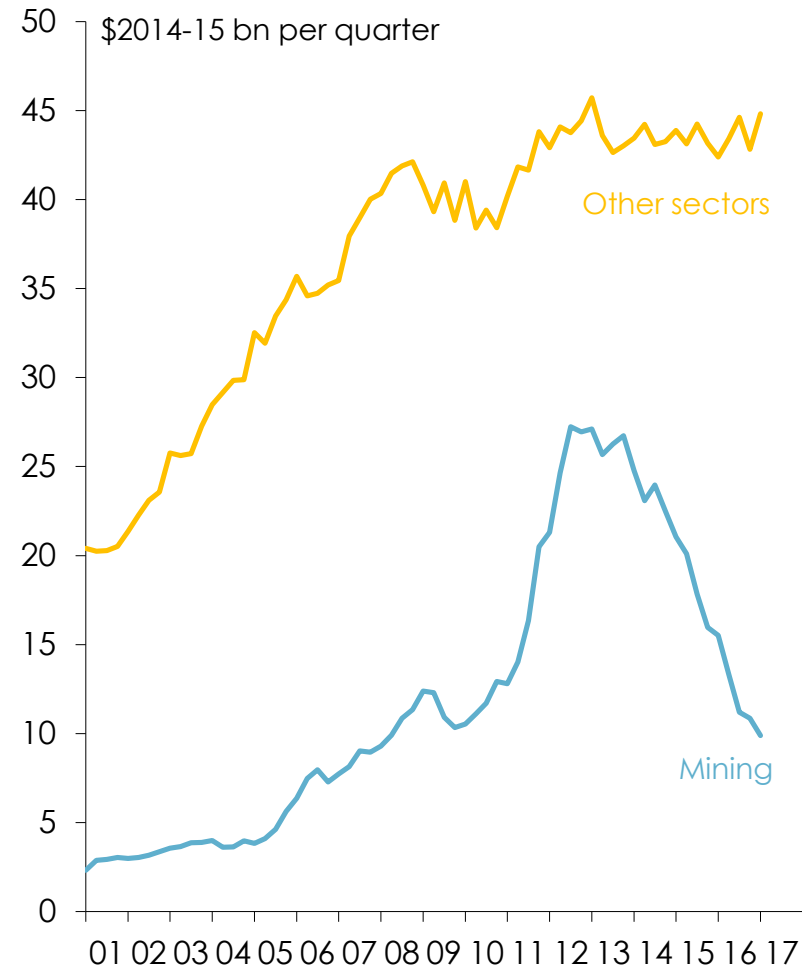


# Much of the recent uptick in national income growth has gone to profits – but that hasn't resulted in higher investment or employment

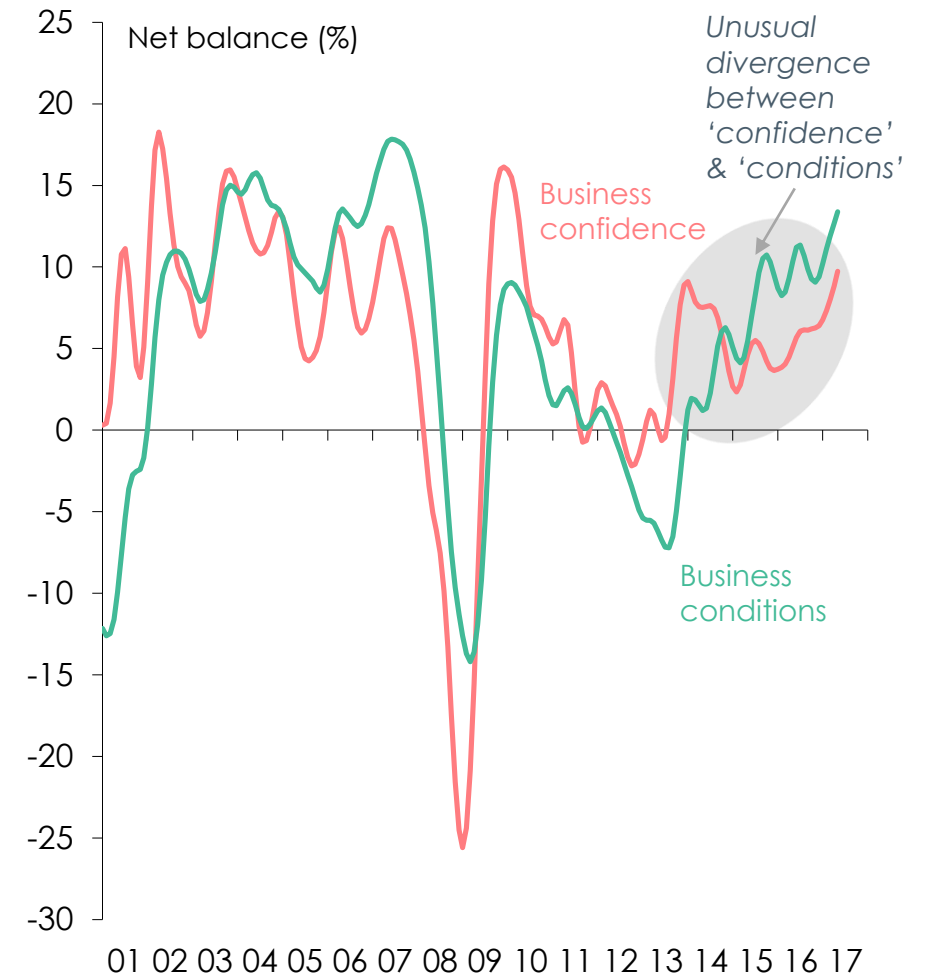
## Pre-tax company profits



## Business investment



## Business conditions and confidence

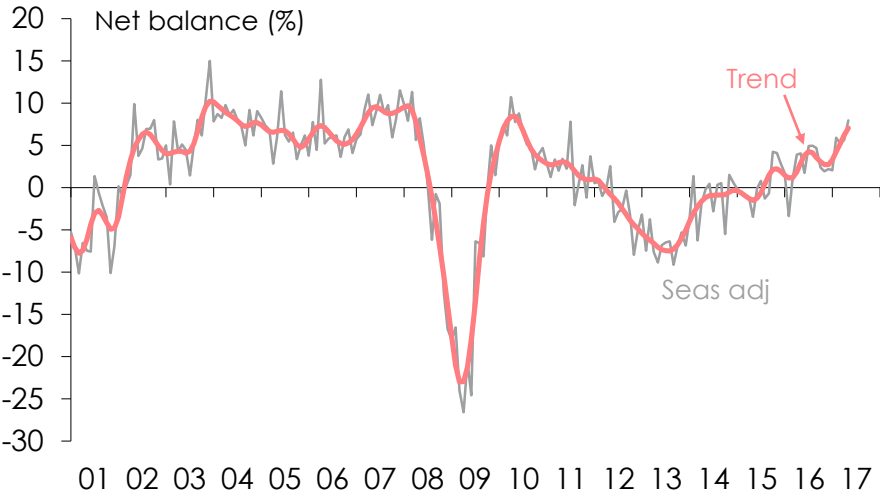


Note: 'Other sectors' in the company profits survey exclude banks and other deposit-taking intermediaries, insurance and super funds, education & training, and health care & social assistance. Mining investment includes buildings & structures and plant, equipment & machinery from the capex survey plus exploration expenditure; investment by 'other sectors' is the national accounts measure of total new business investment minus this estimate of mining investment.

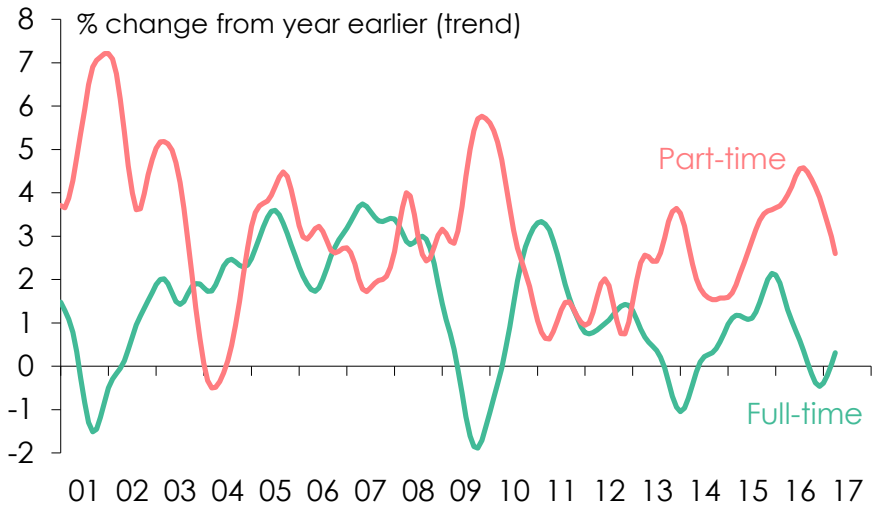
Sources: ABS; National Australia Bank [Monthly Business Survey](#).

# Employers are cautious about additional hiring, especially of full-time workers – and about granting wage increases

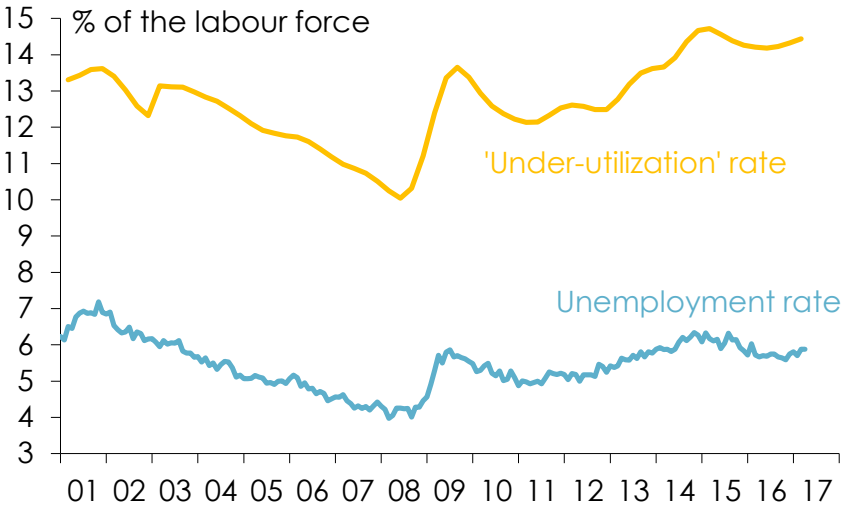
### Employer hiring intentions



### Full- vs part-time employment



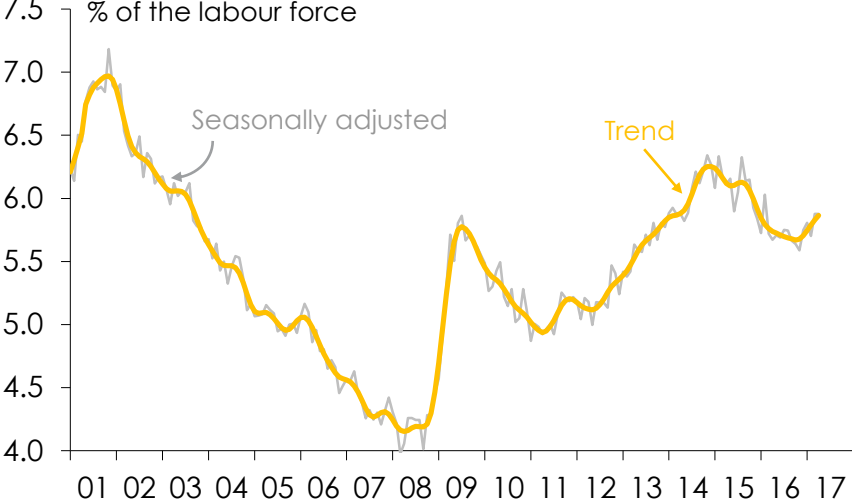
### Labour force under-utilization



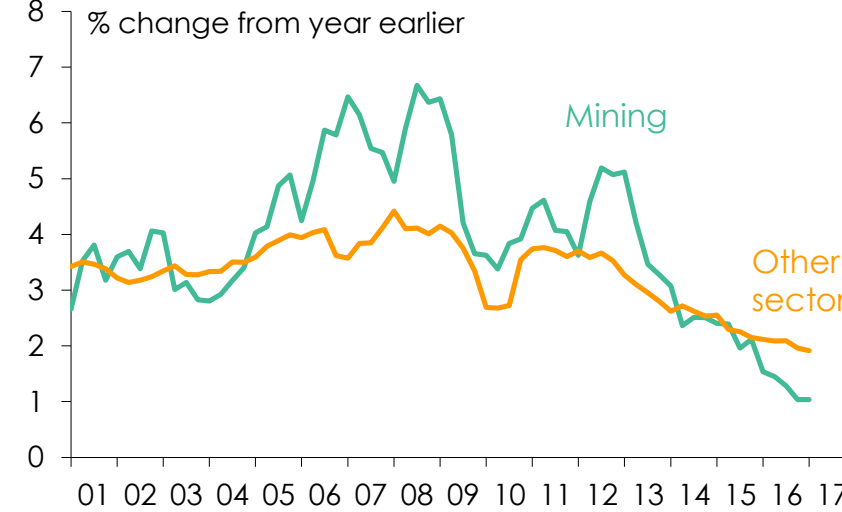
### Employment growth



### Unemployment rate

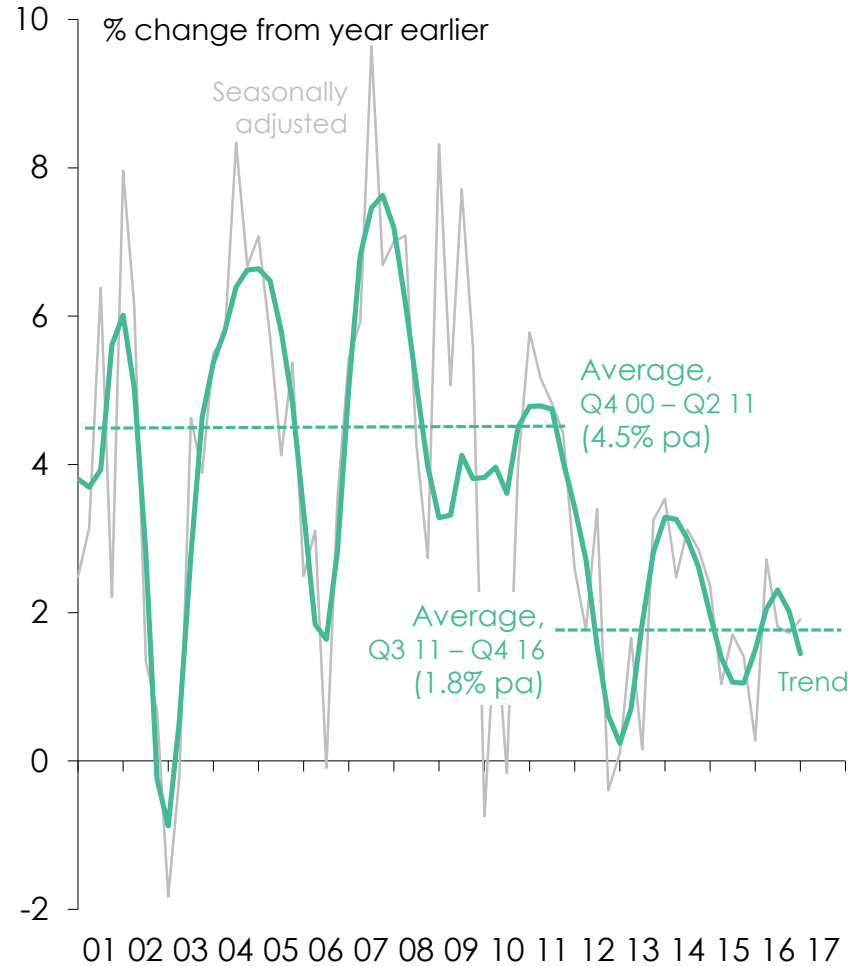


### Wage cost index

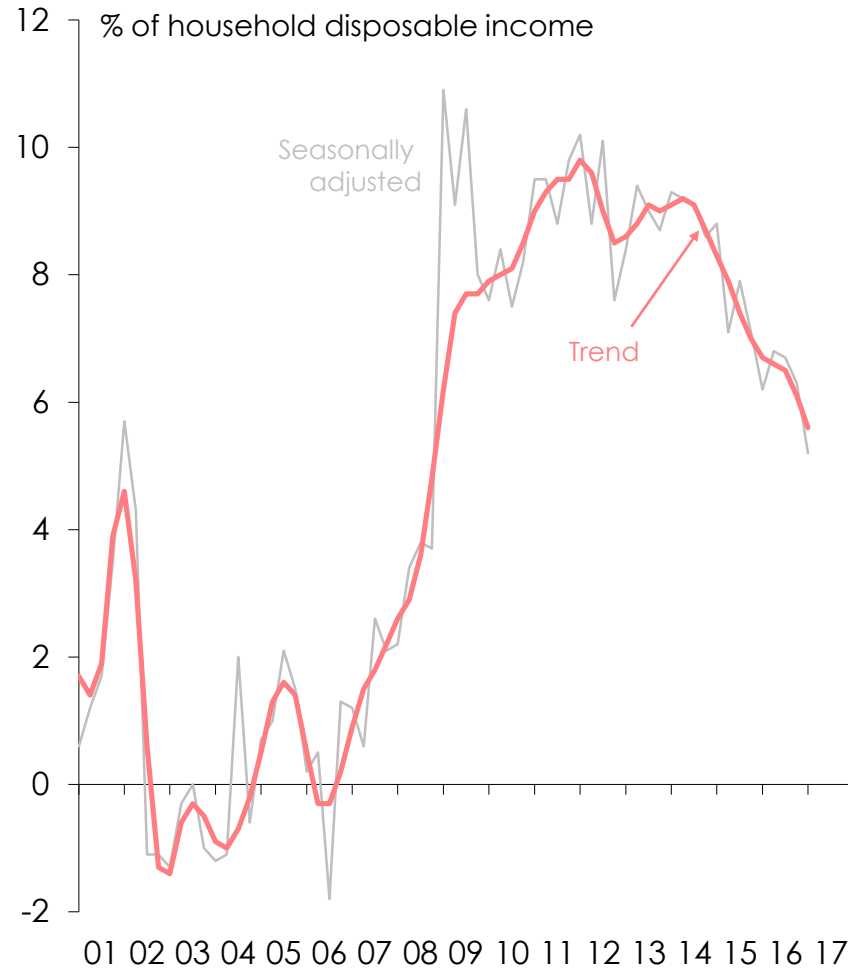


# Weak income growth and debt repayment continue to detract from growth in consumer spending

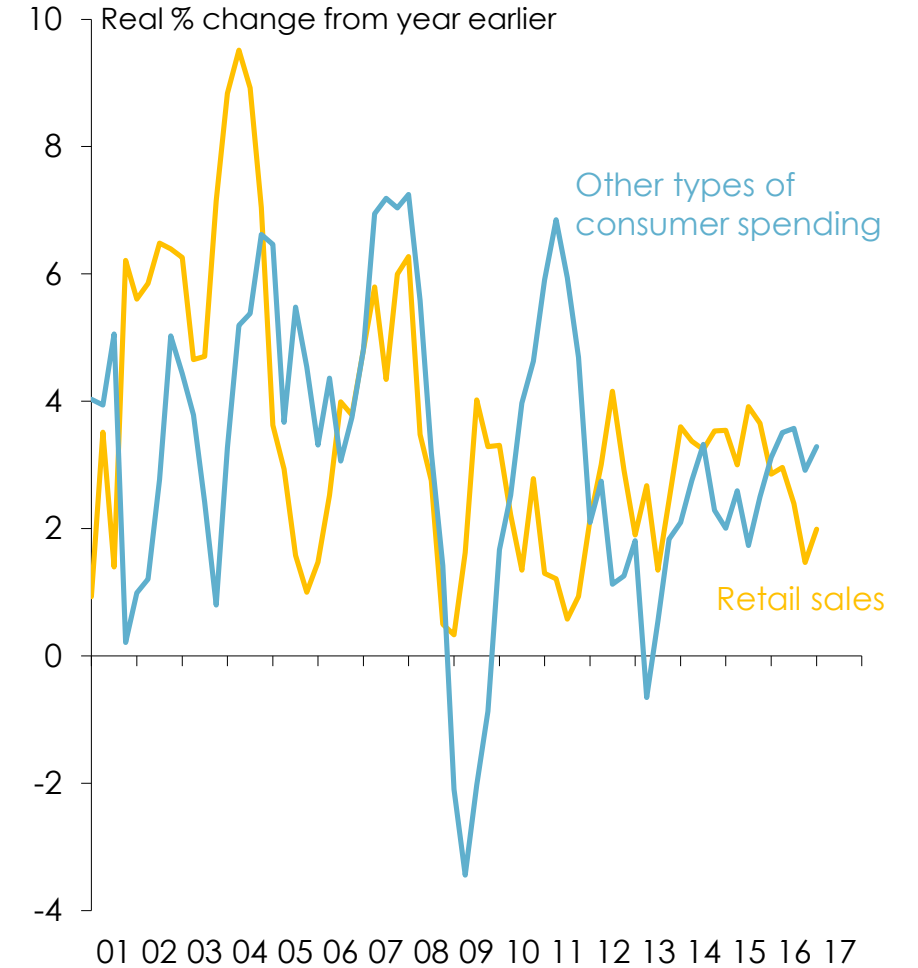
## Real household disposable income



## Household saving rate



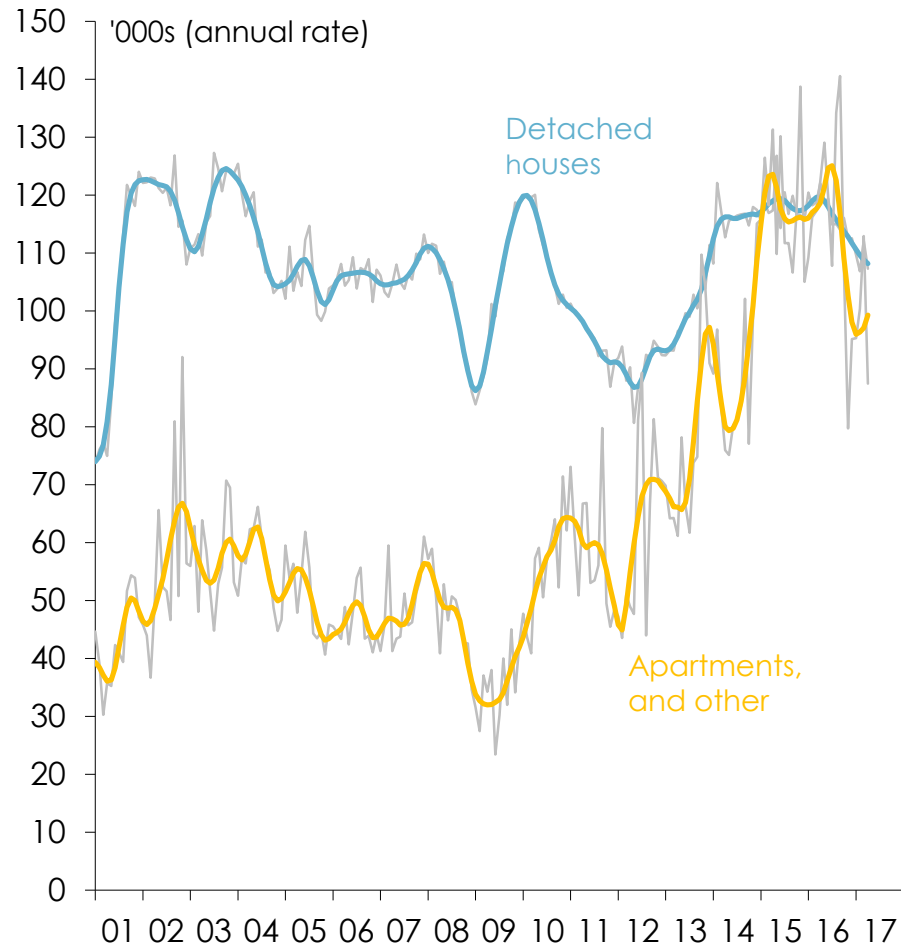
## Consumer spending



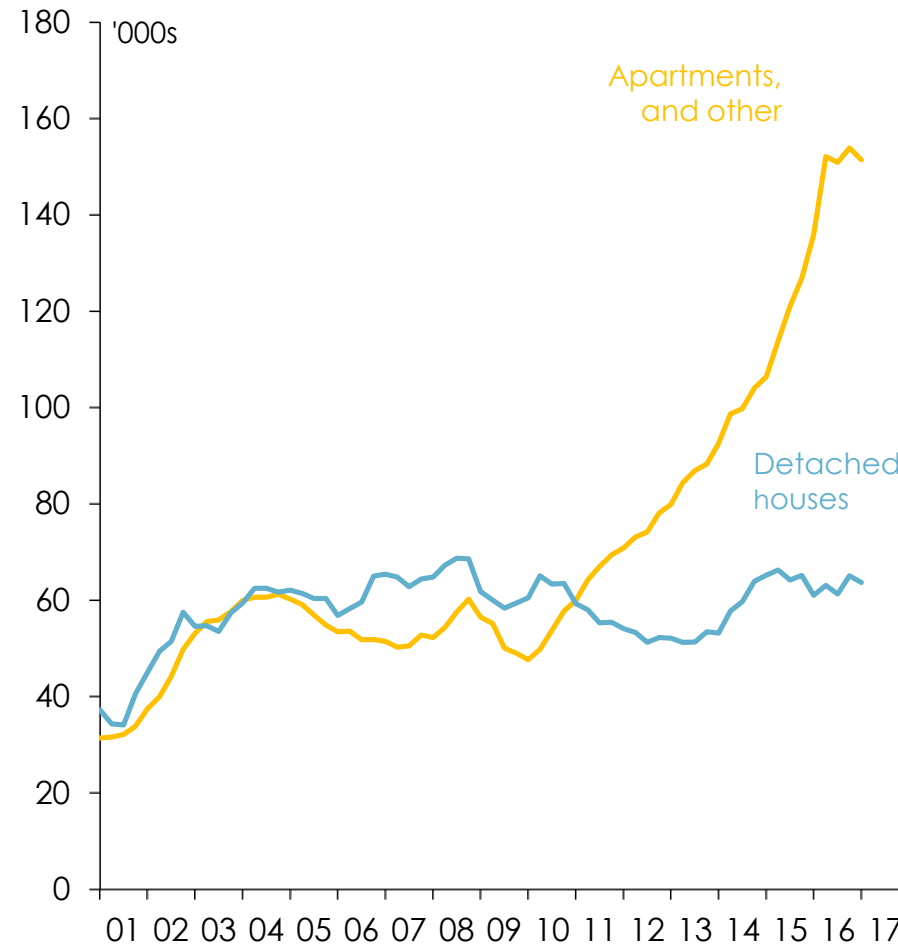
Source: ABS.

# Housing activity is probably close to peaking – although there is still a large ‘pipeline’ of work yet to be completed

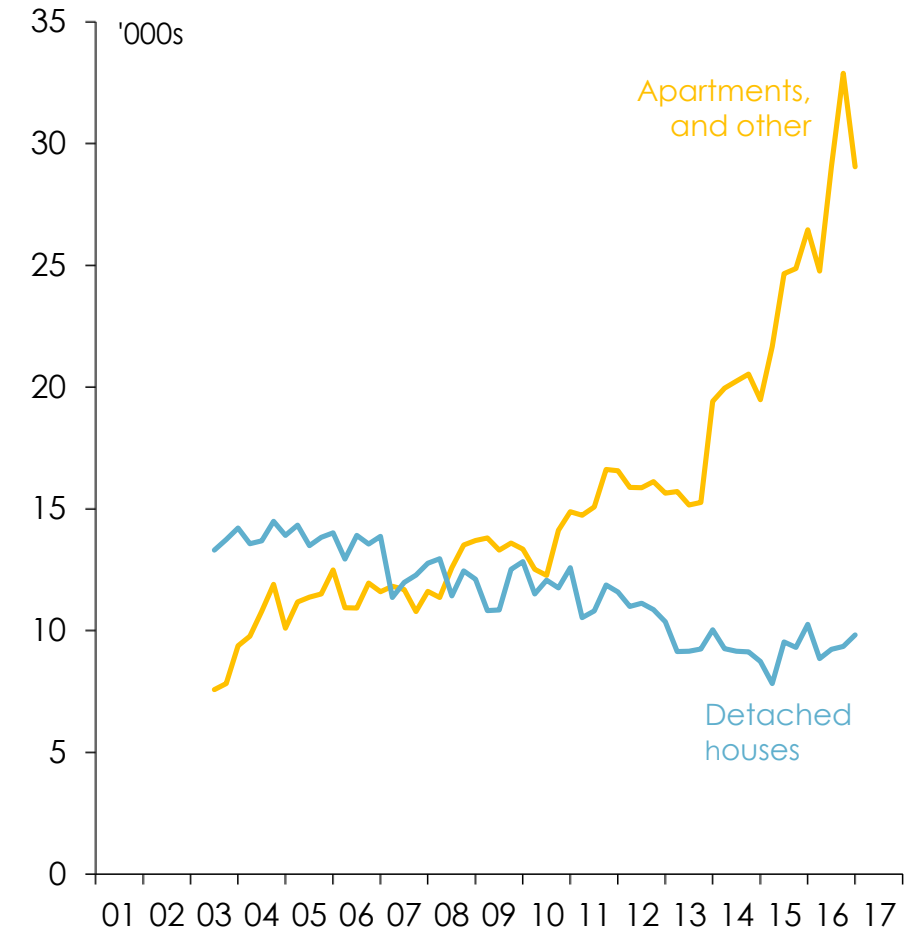
## Private residential building approvals, by type of dwelling



## Residential buildings under construction



## Dwellings approved but not yet commenced



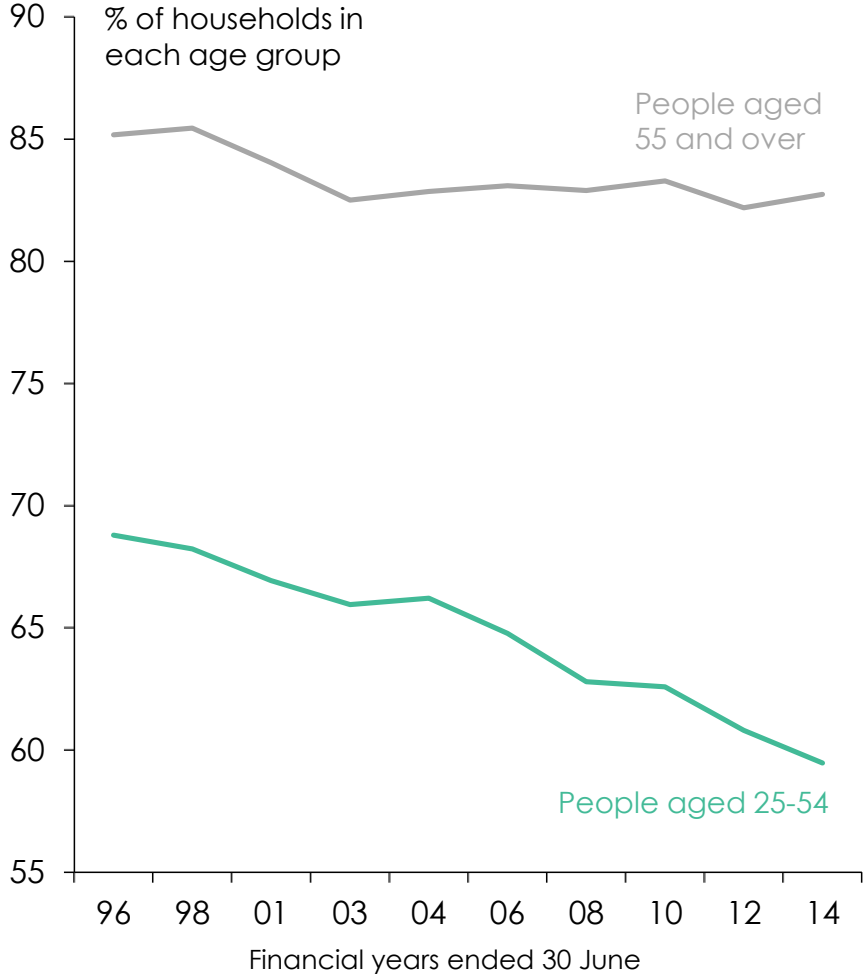
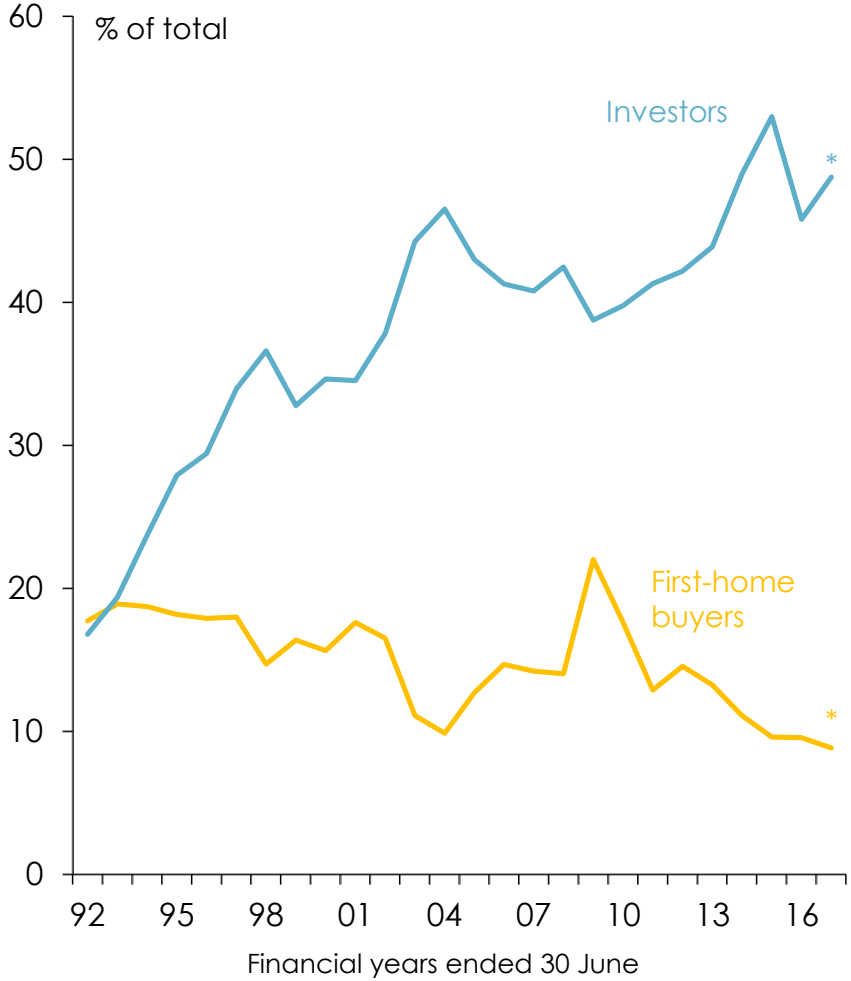
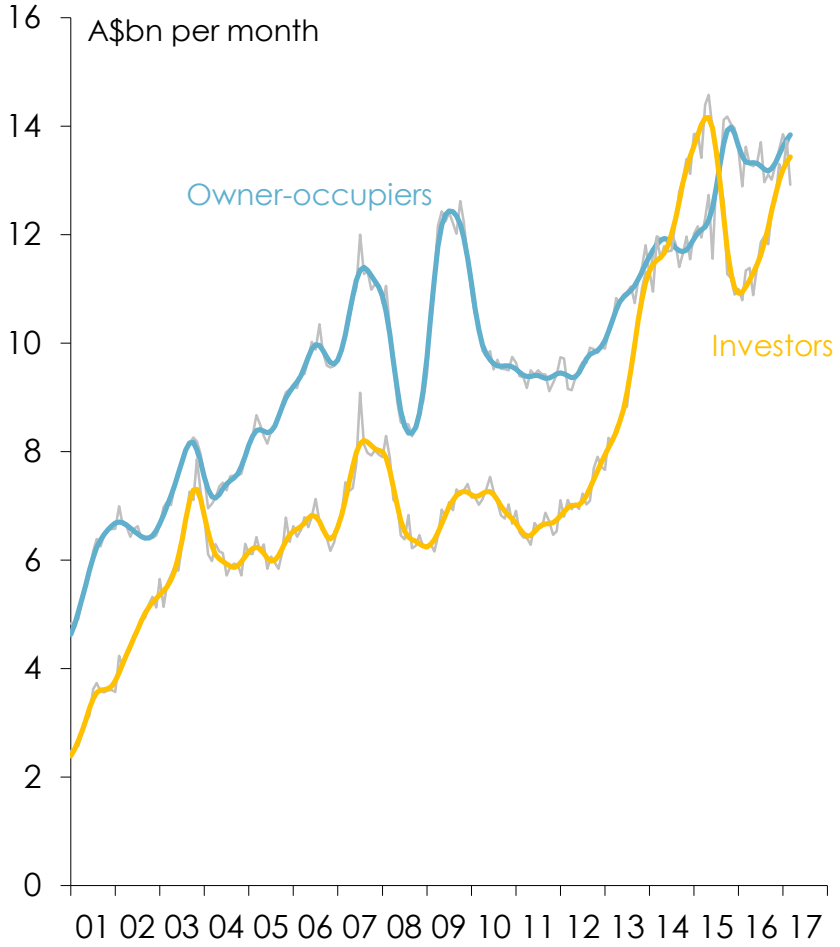
Note: grey lines in first chart above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'. Source: ABS.

# Rapid growth in demand (mainly for existing dwellings) from investors has pushed up prices and squeezed would-be home-buyers out

## Finance commitments for residential property purchases

## Mortgage lending to first-time buyers and investors

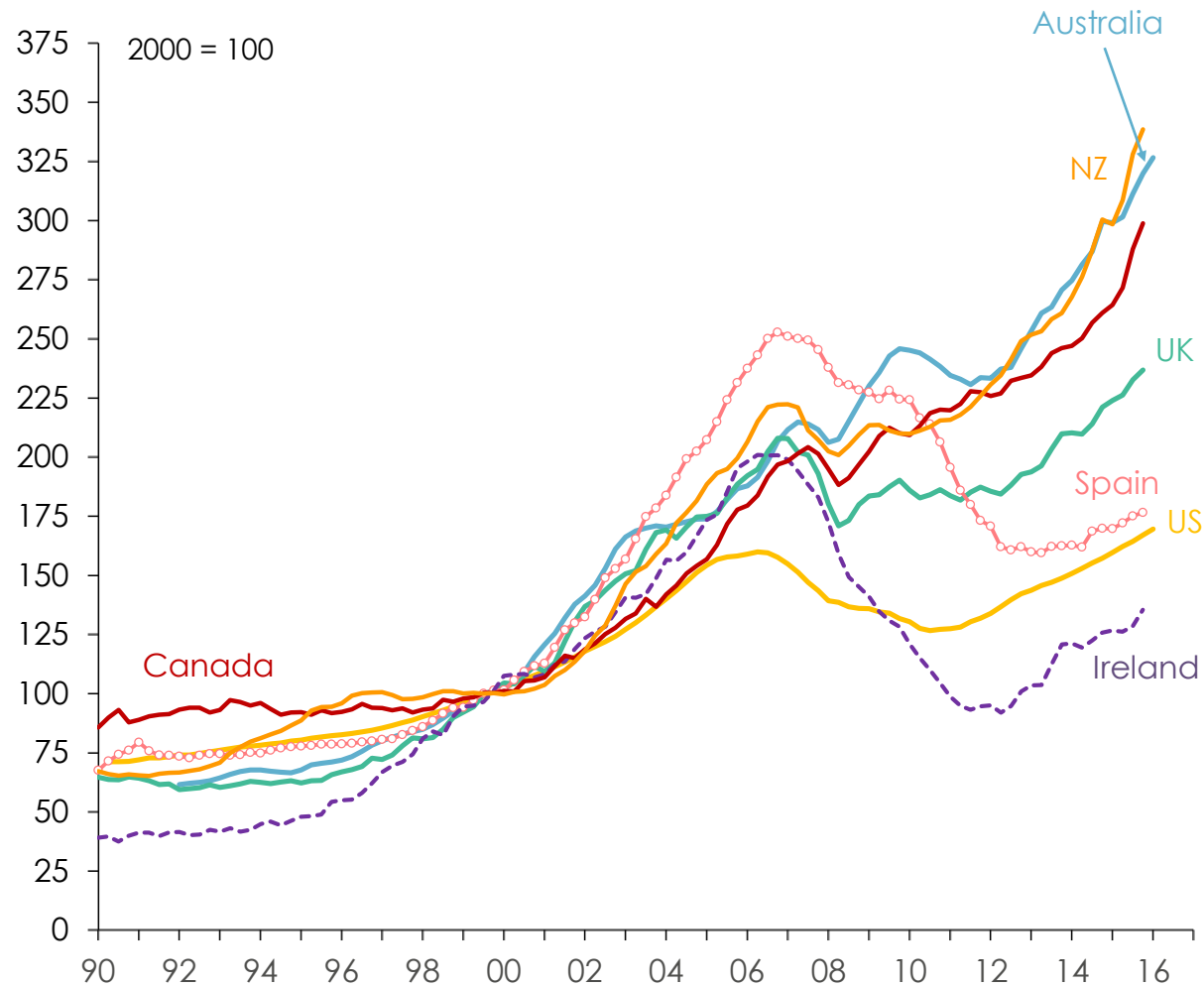
## Home ownership rates by age group



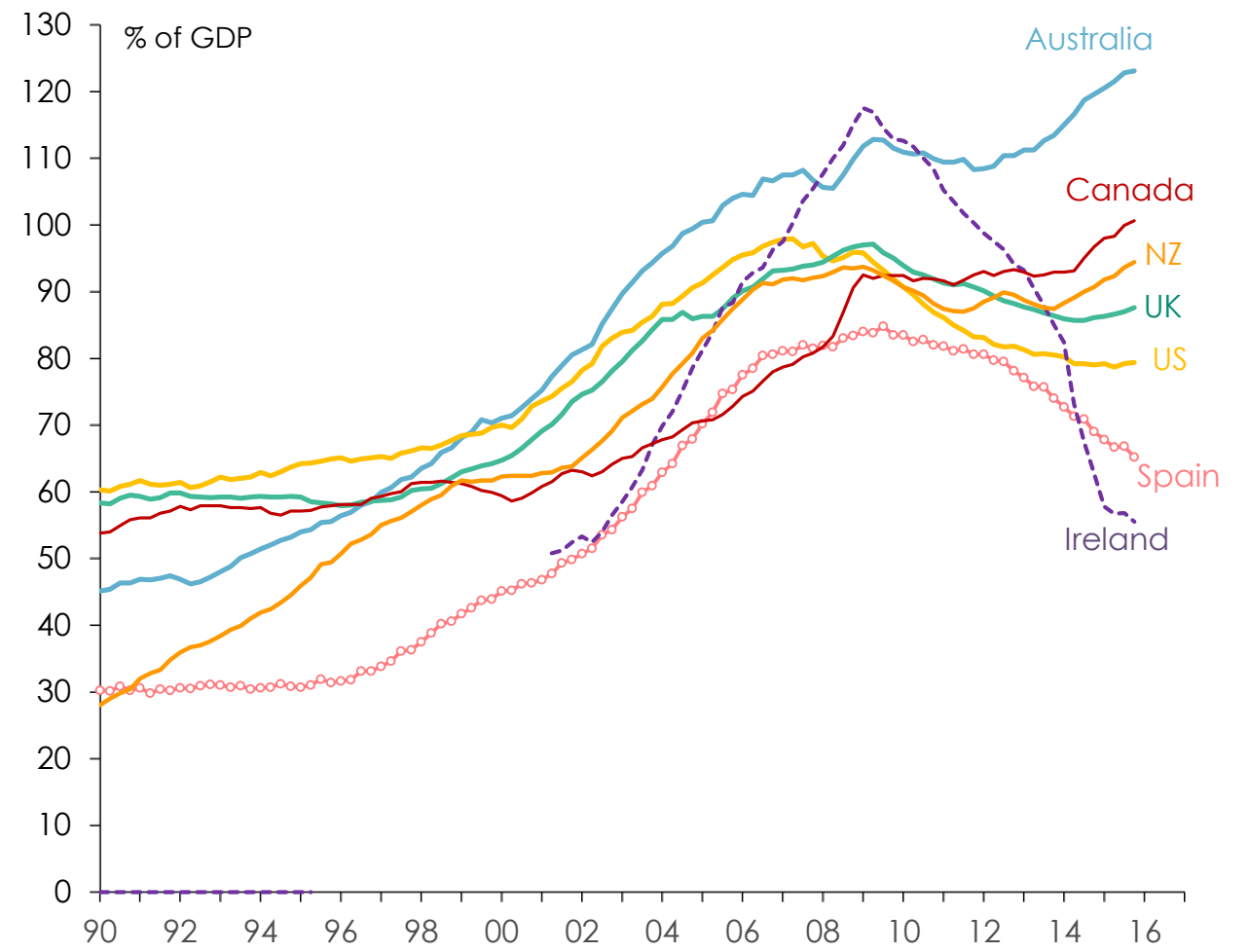
Note: grey lines in first chart above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'. Source: ABS.

# Australia now has relatively high residential property prices (by international standards) and very high levels of household debt

## House prices – Australia vs other 'advanced' economies



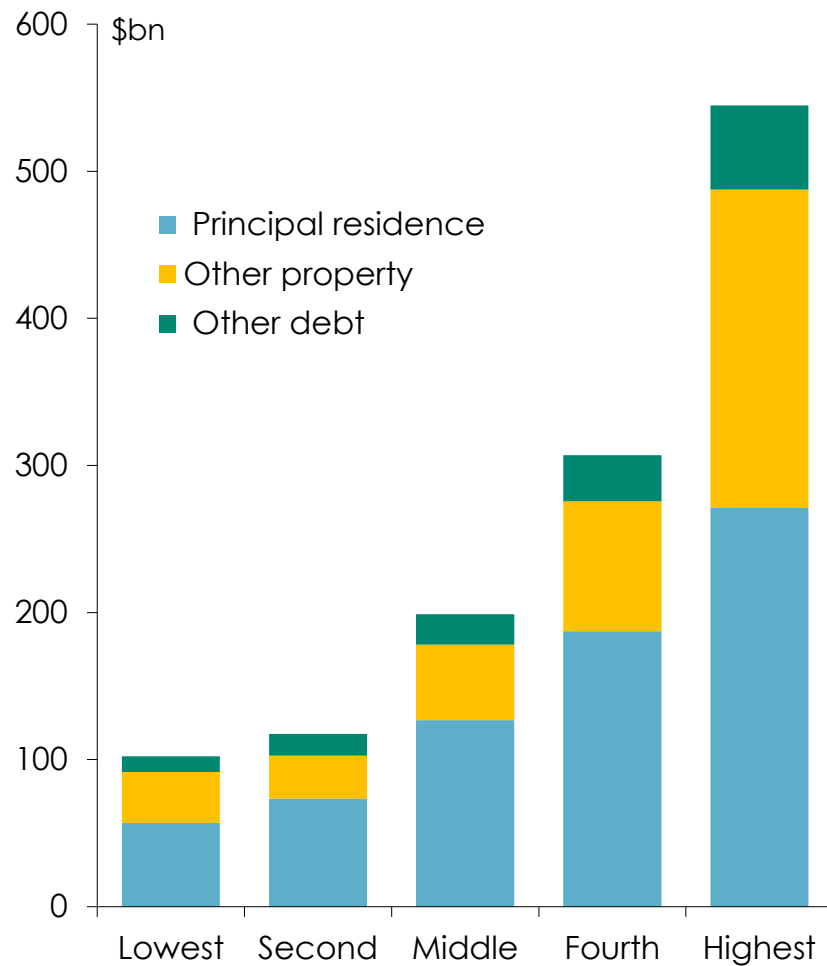
## Household debt – Australia vs other 'advanced' economies



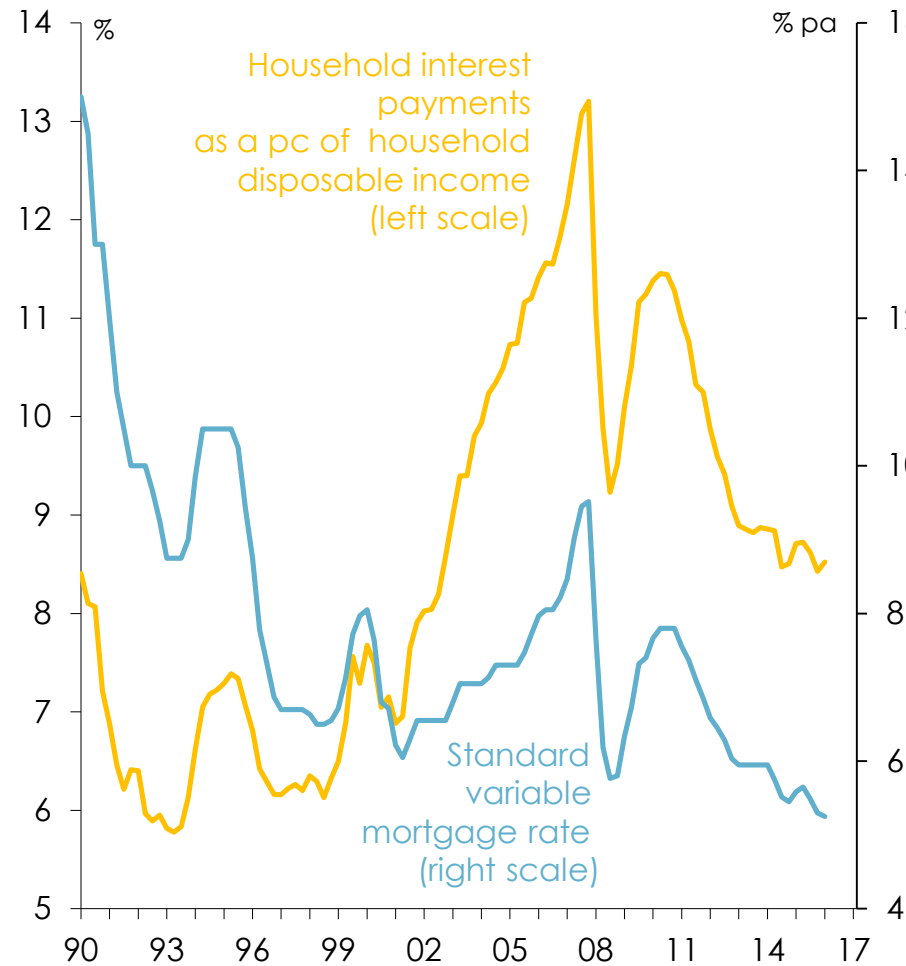
Sources: [RP Data - Core Logic](#); S&P, [CoreLogic Case-Shiller Home Price Indices](#); Bank for International Settlements (BIS), [residential property price series](#) and [credit to the non-financial sector](#) database.

# Over two-thirds of Australian household debt is owed by the top 40% of households – and at current interest rates debt-service burdens are low

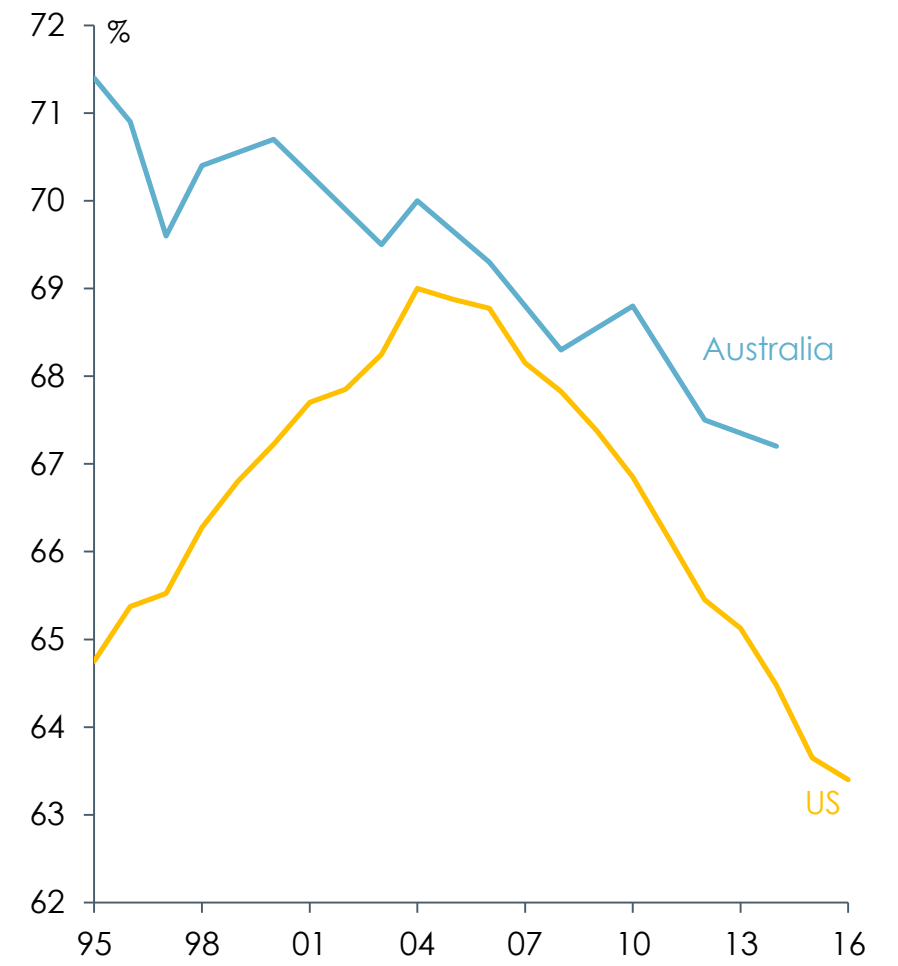
## Household debt, by income quintile, 2013-14



## Household debt service ratio and interest rates



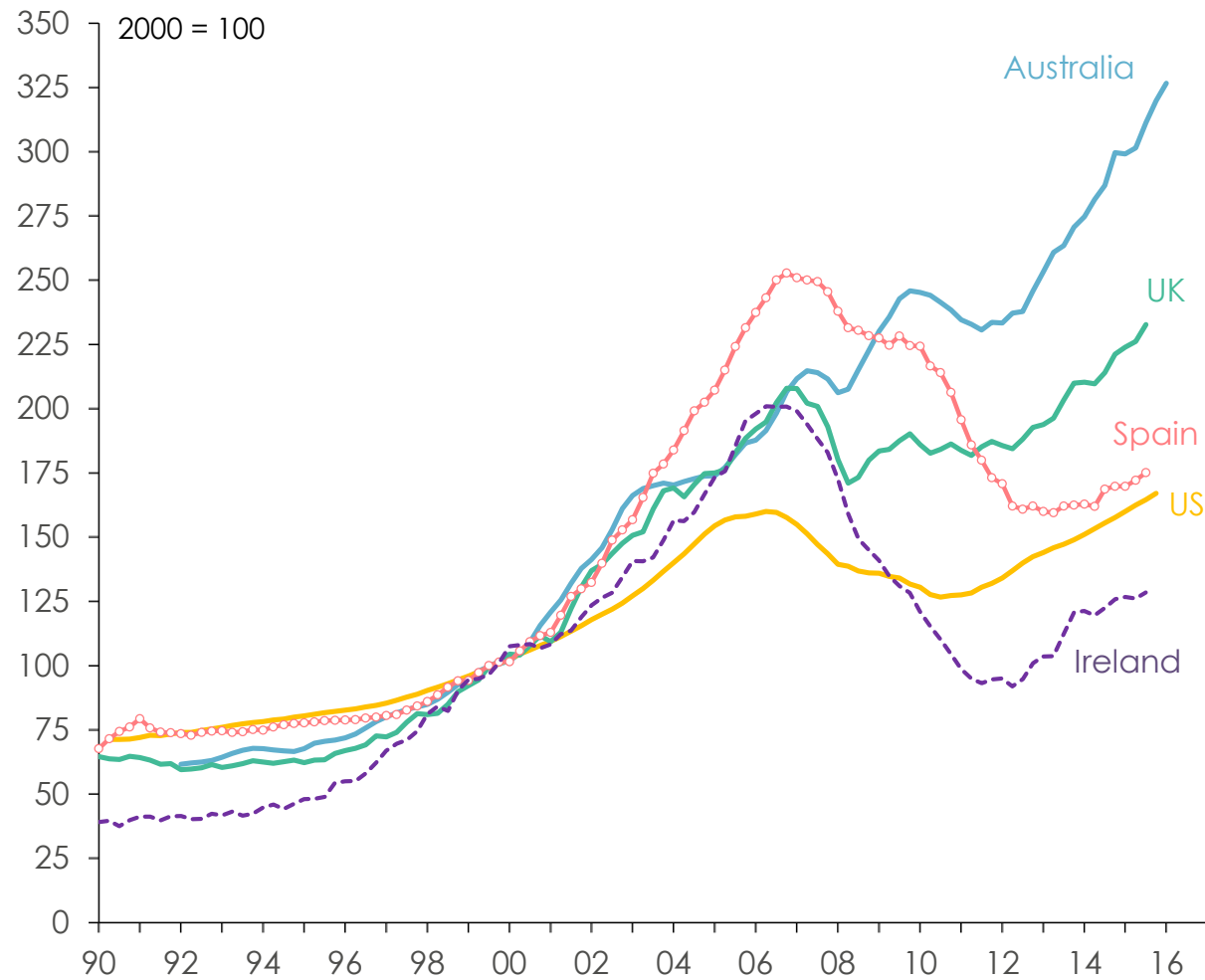
## Australia vs US home ownership rates



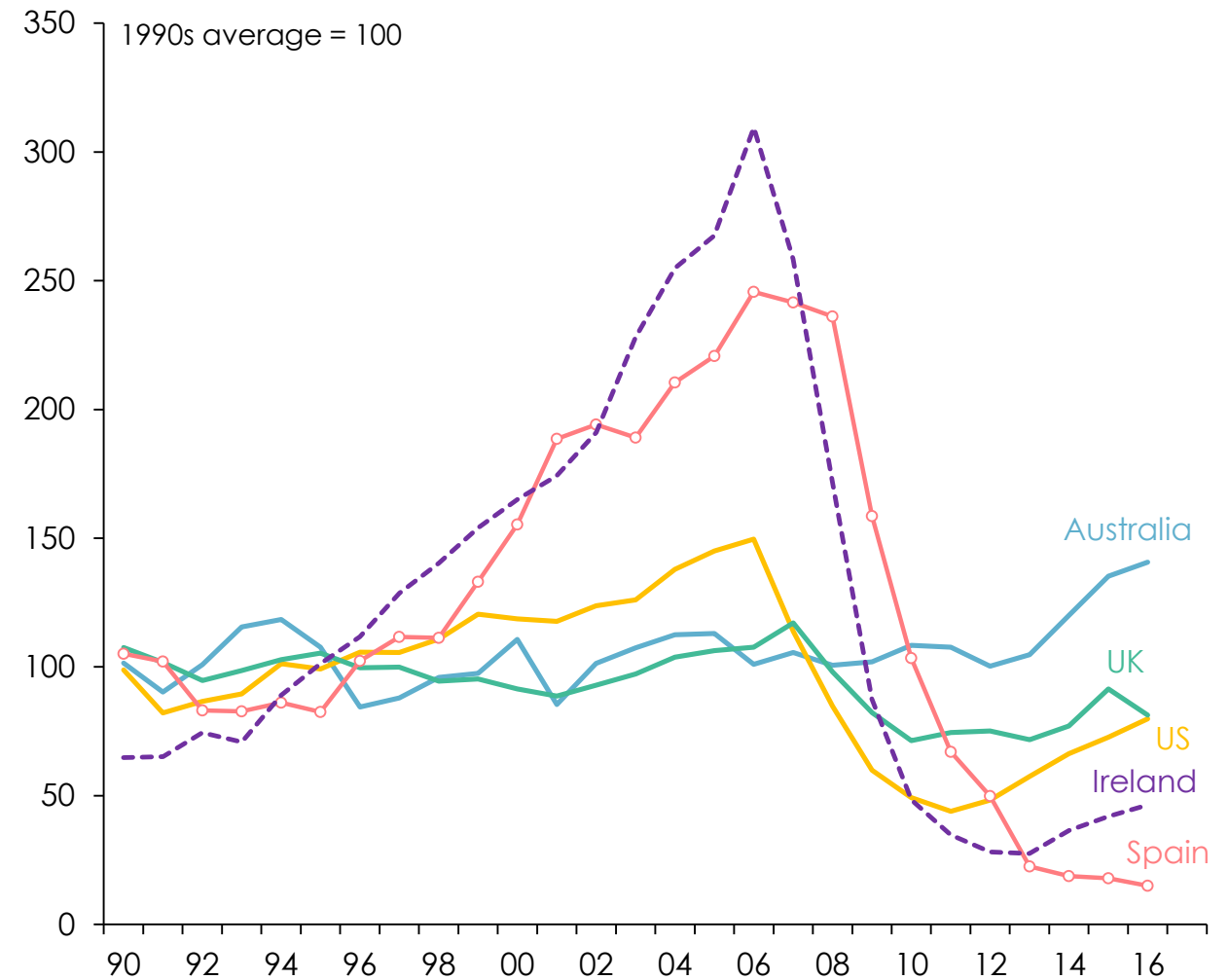
Sources: ABS; RBA; US Commerce Department.

# Countries which have experienced 'housing busts' have done so after periods in which growth in housing supply outstripped housing demand

## House prices – Australia vs other 'advanced' economies



## Housing completions – Australia and other selected 'advanced' economies



Sources: [RP Data - Core Logic](#); S&P, [CoreLogic Case-Shiller Home Price Indices](#); Bank for International Settlements (BIS), [residential property price series](#) database; ABS; US Commerce Department; UK Office of National Statistics; Instituto Nacional de Estadística d'España; Ireland Central Statistics Office.



# The 2017-18 Federal Budget



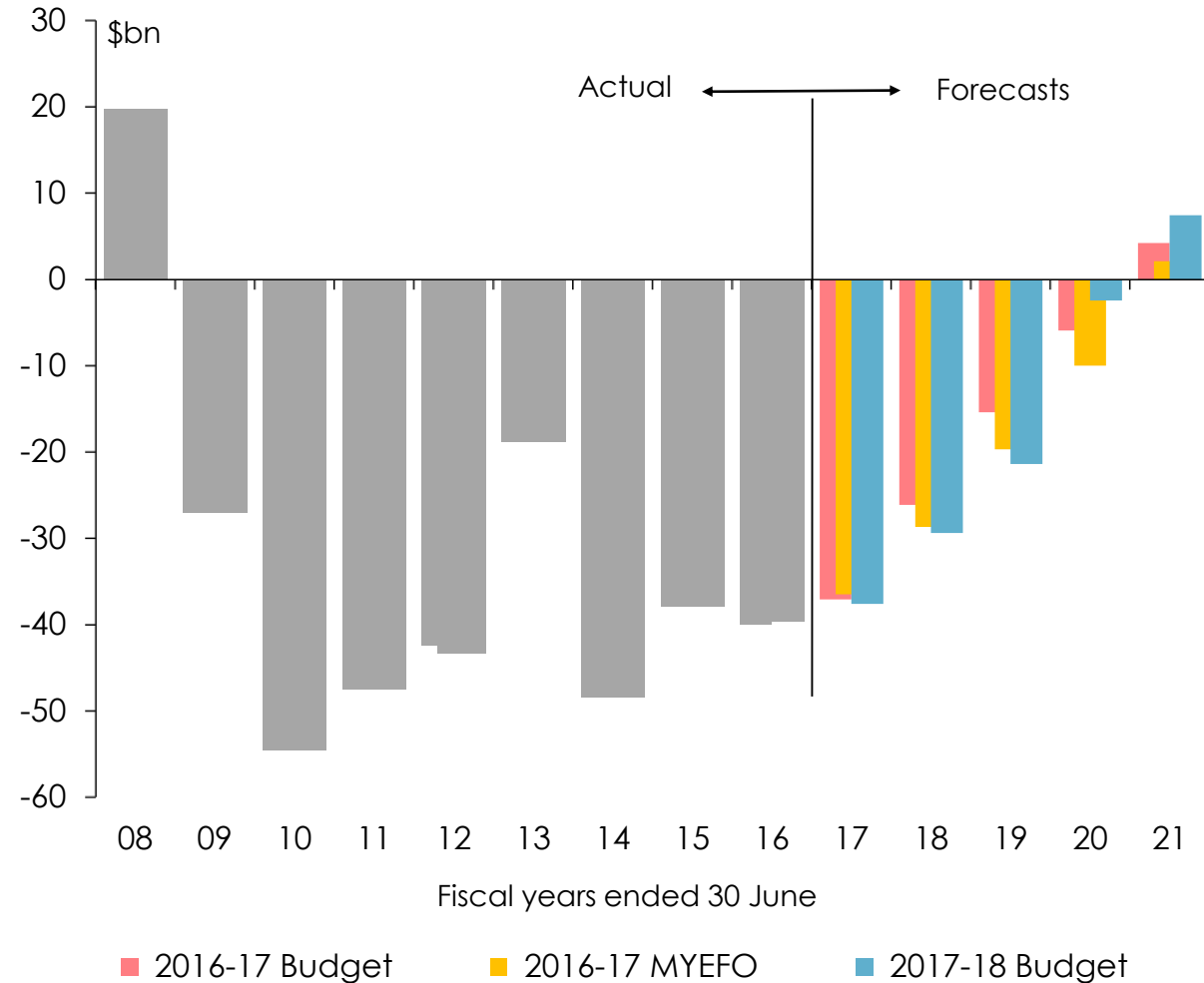
# The 2017-18 Budget has two principal objectives

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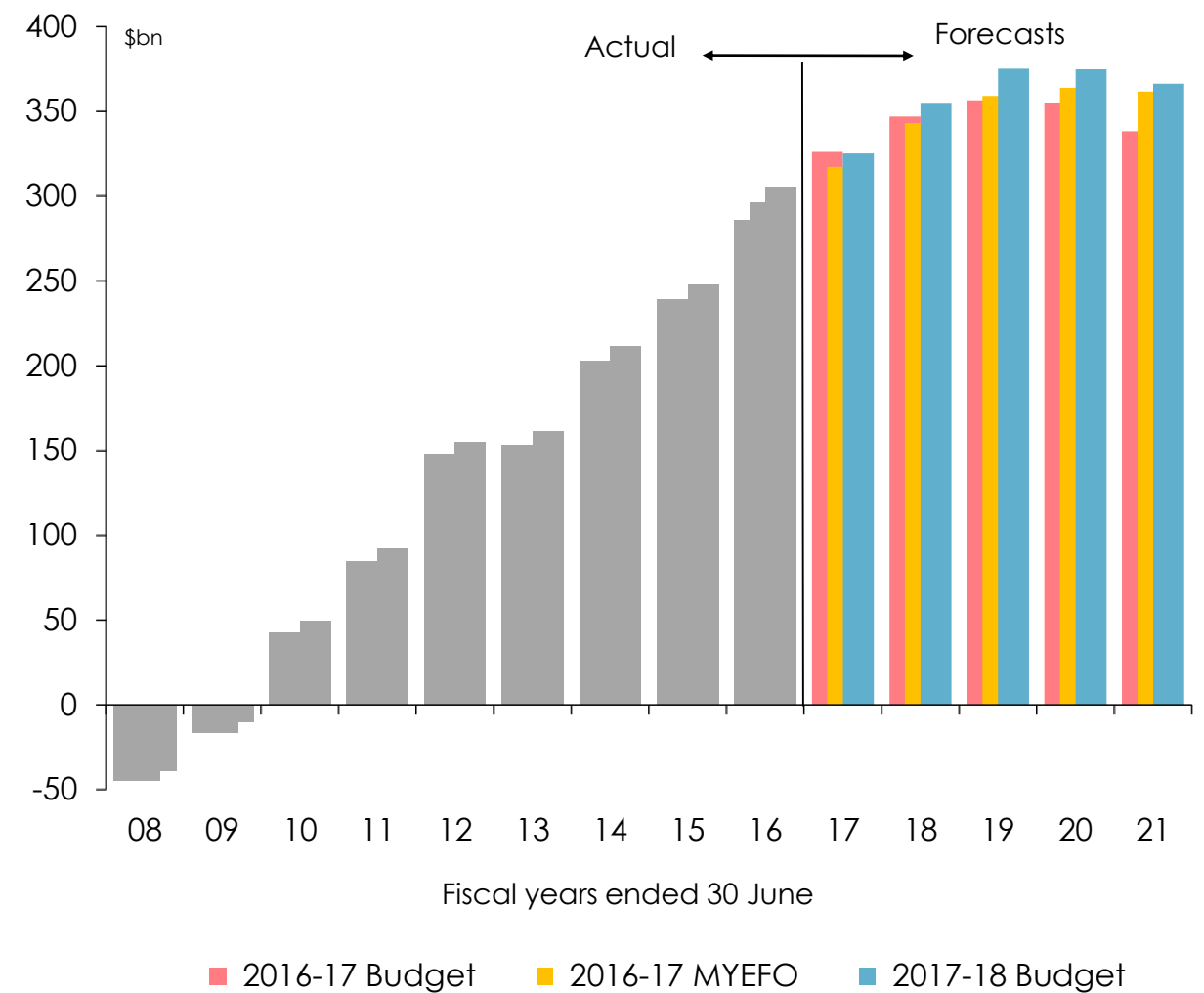
- ❑ **To put as much distance as possible between the current Government and its predecessor (the Abbott Government, not the Rudd-Gillard Governments)**
  - hence the abandonment of the so-called 'zombie' measures left over from the 2014 Budget, which both the Abbott and Turnbull Governments had been unable to get through the Senate
  - instead the path back to surplus is to be achieved with less reliance on spending cuts and more reliance on revenue increases
  - and a way has been cleared for the Government to accept the advice of the RBA, IMF, and OECD (among others) that borrowing for 'well-chosen' infrastructure projects can be a 'Good Thing', especially when monetary policy has reached the limits of what it can do
  
- ❑ **To neutralize as many of the Opposition's "lines of attack" on the Government as possible, ahead of an election that must be called some time between August 2018 and May 2019**
  - hence the levy on and increased regulation of banks, the tax on employers of temporary foreign workers, new taxes on foreign property investors, etc.
  - hence the efforts to 'guarantee' funding for Medicare and the NDIS, and 'Gonski 2.0'
  - the only significant points of difference on key aspects of economic policy now are negative gearing and the CGT discount, the tax cut for companies with turnover exceeding \$10mn, and the banking royal commission

# Budget deficits will be slightly larger in the next two years than previously forecast, but a surplus is still projected for 2020-21

## 'Underlying' cash balance



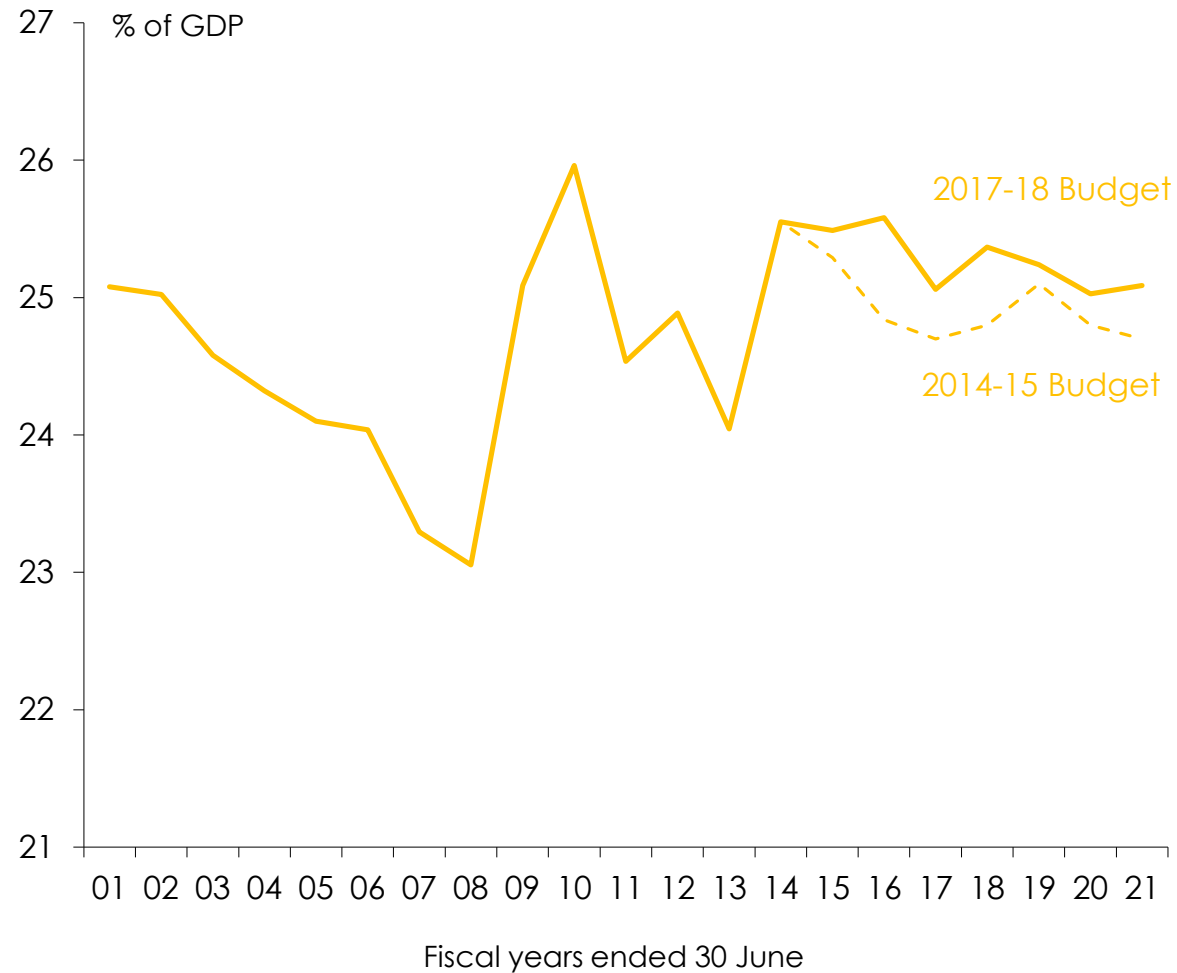
## Net debt



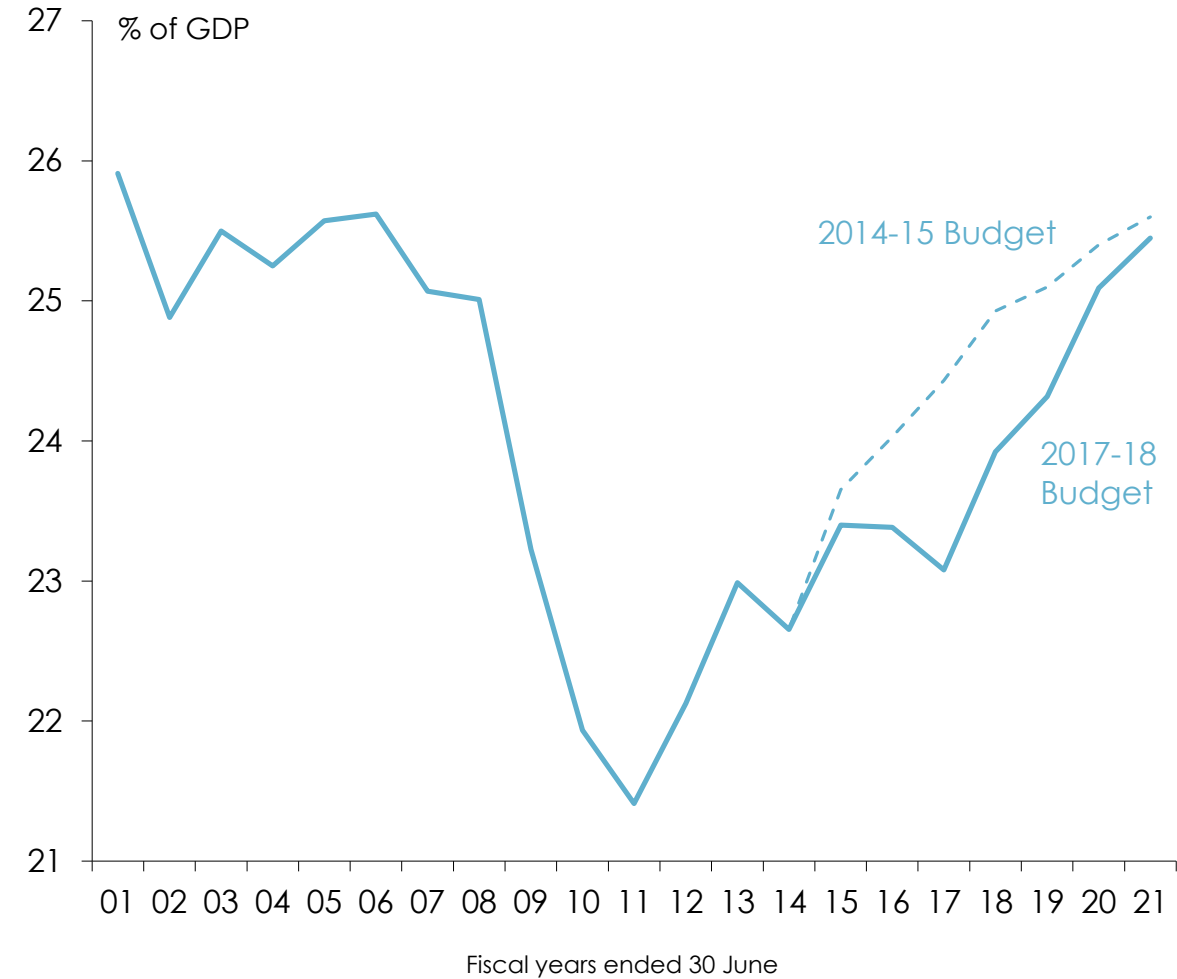
Note: 'MYEFO' = Mid-Year Economic and Fiscal Outlook. Historical figures for net debt were revised in the 2017-18 Budget as a result of the reclassification of Australia's subscriptions to some international financial institutions. Sources: Budget and MYEFO Papers

# The return to surplus now owes less to cuts in spending, and more to increases in revenue, than was envisaged in the 2014-15 Budget

## Payments



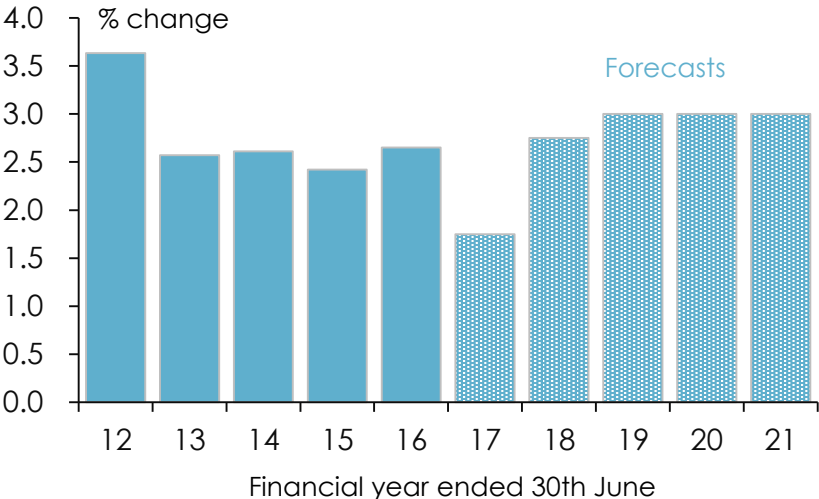
## Receipts



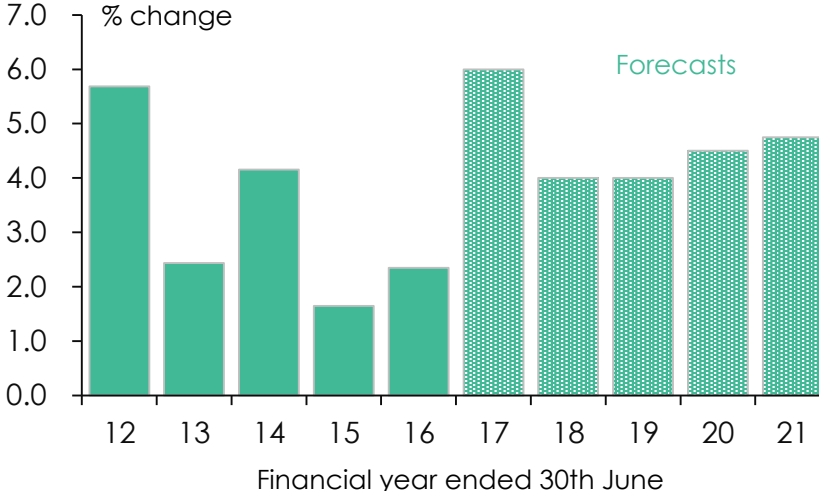
Sources: 2014-15 and 2016-17 Budget Papers.

# Some of the economic forecasts underpinning the Budget look optimistic, particularly with regard to wages growth

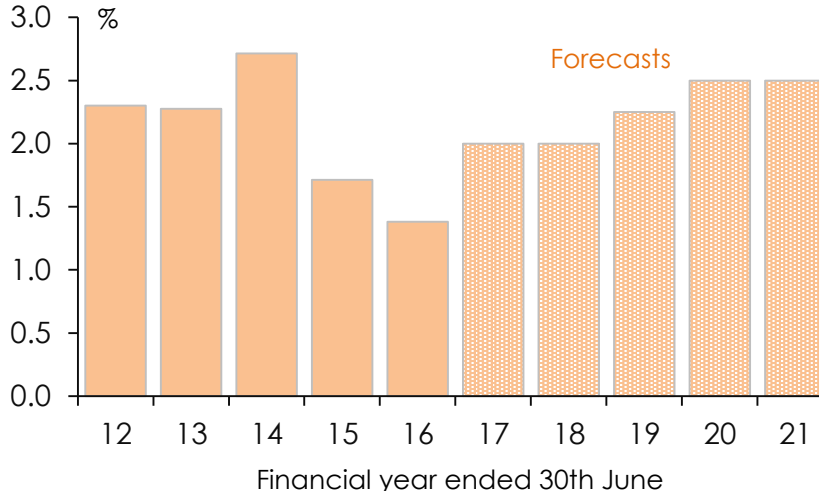
### Real GDP



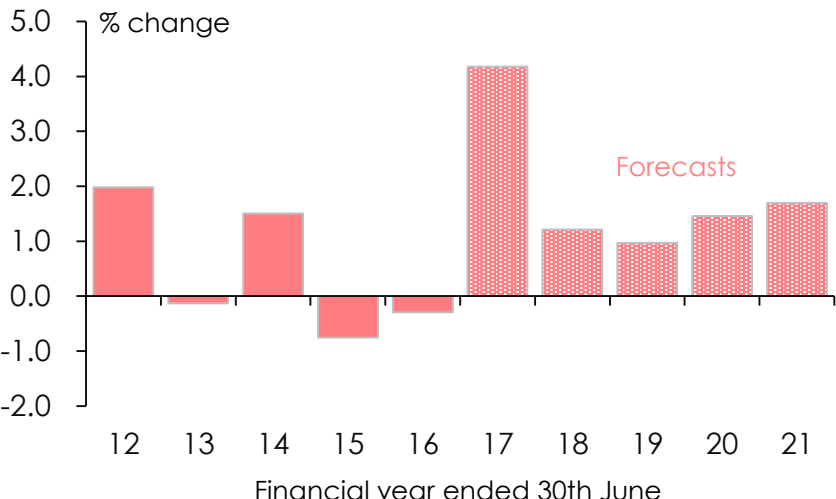
### Nominal GDP



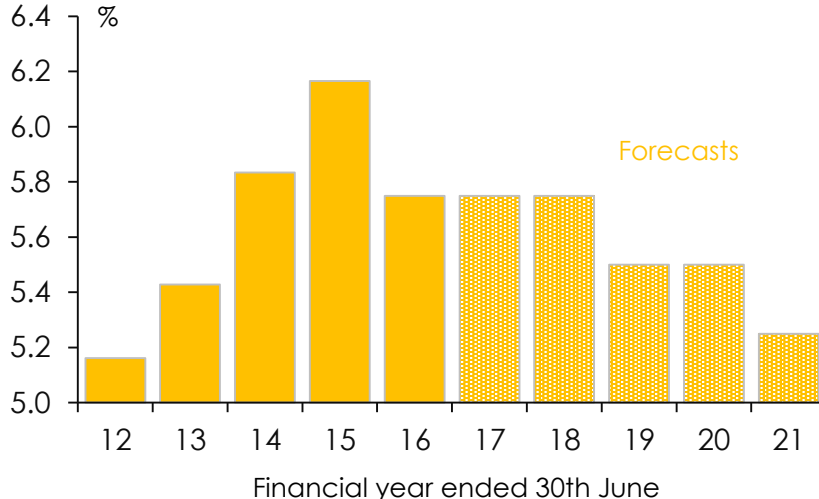
### Consumer prices



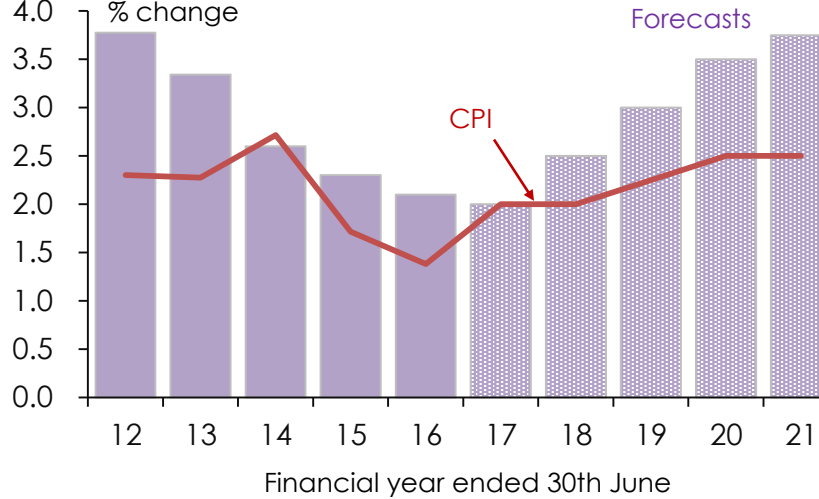
### GDP price deflator



### Unemployment

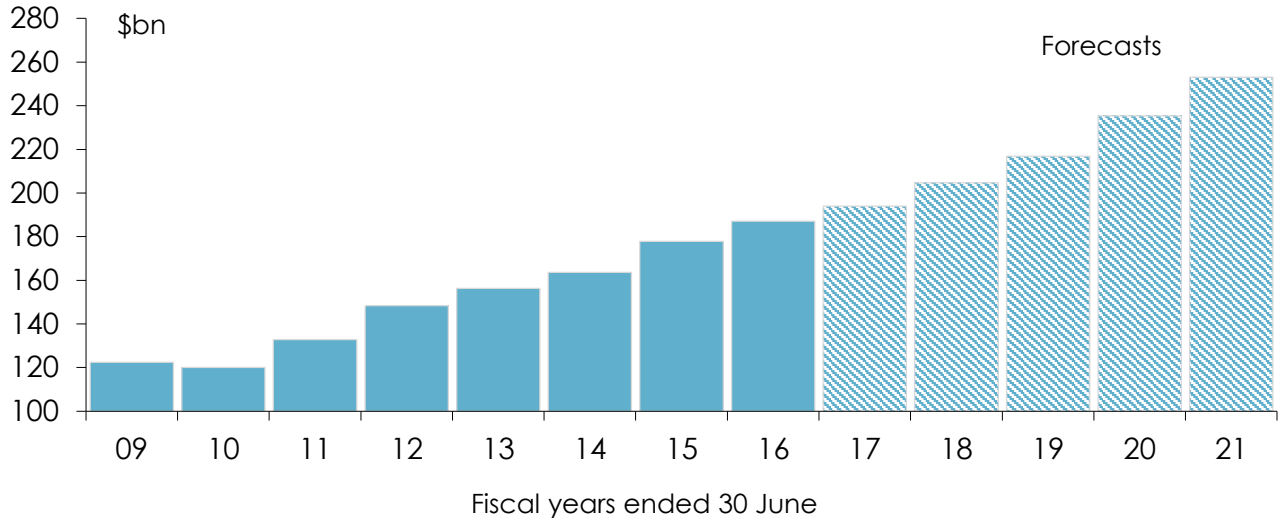


### Wages

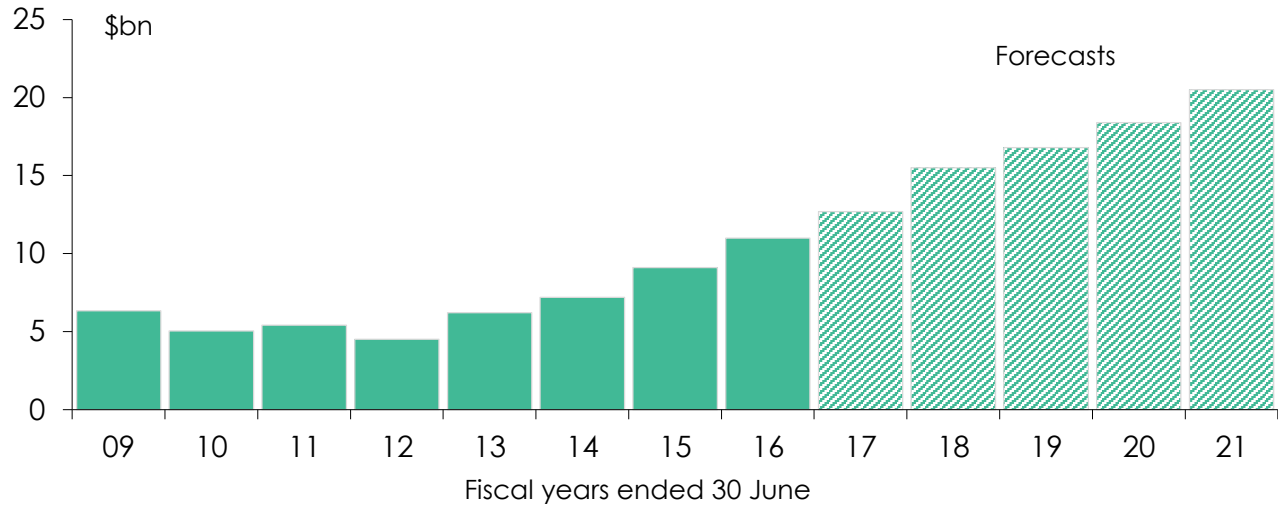


# As a result, some of the Budget revenue forecasts could (again) prove optimistic

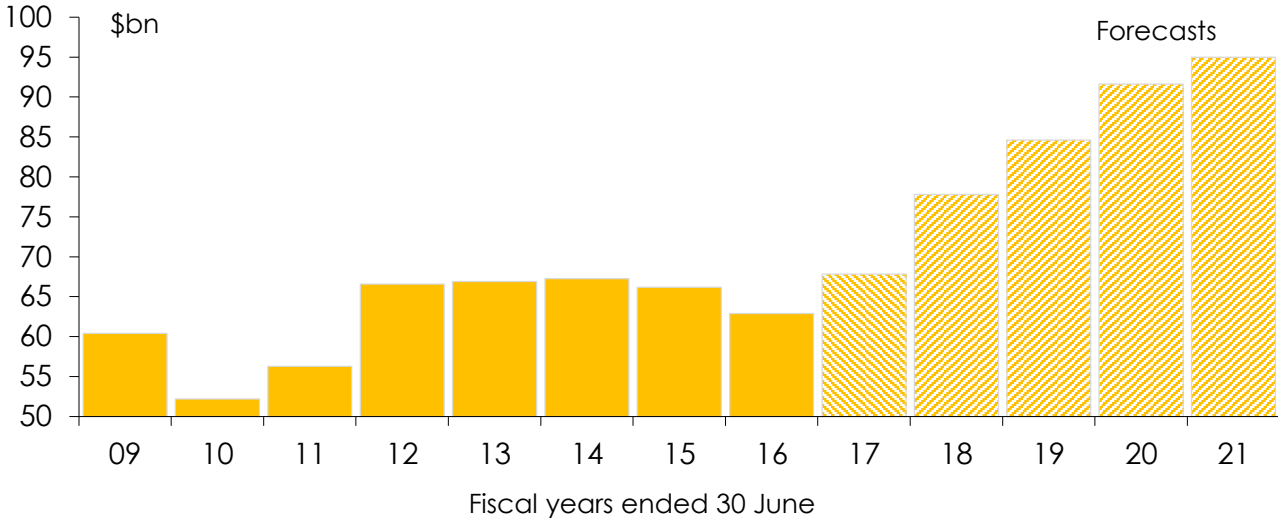
## Personal income tax revenue



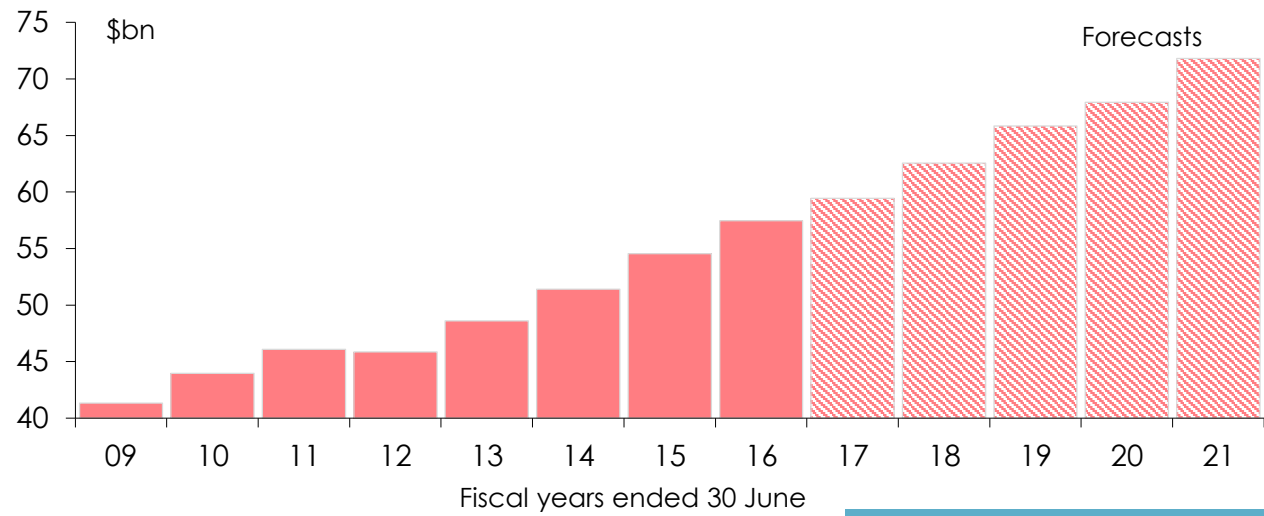
## Capital gains tax revenue



## Company tax revenue

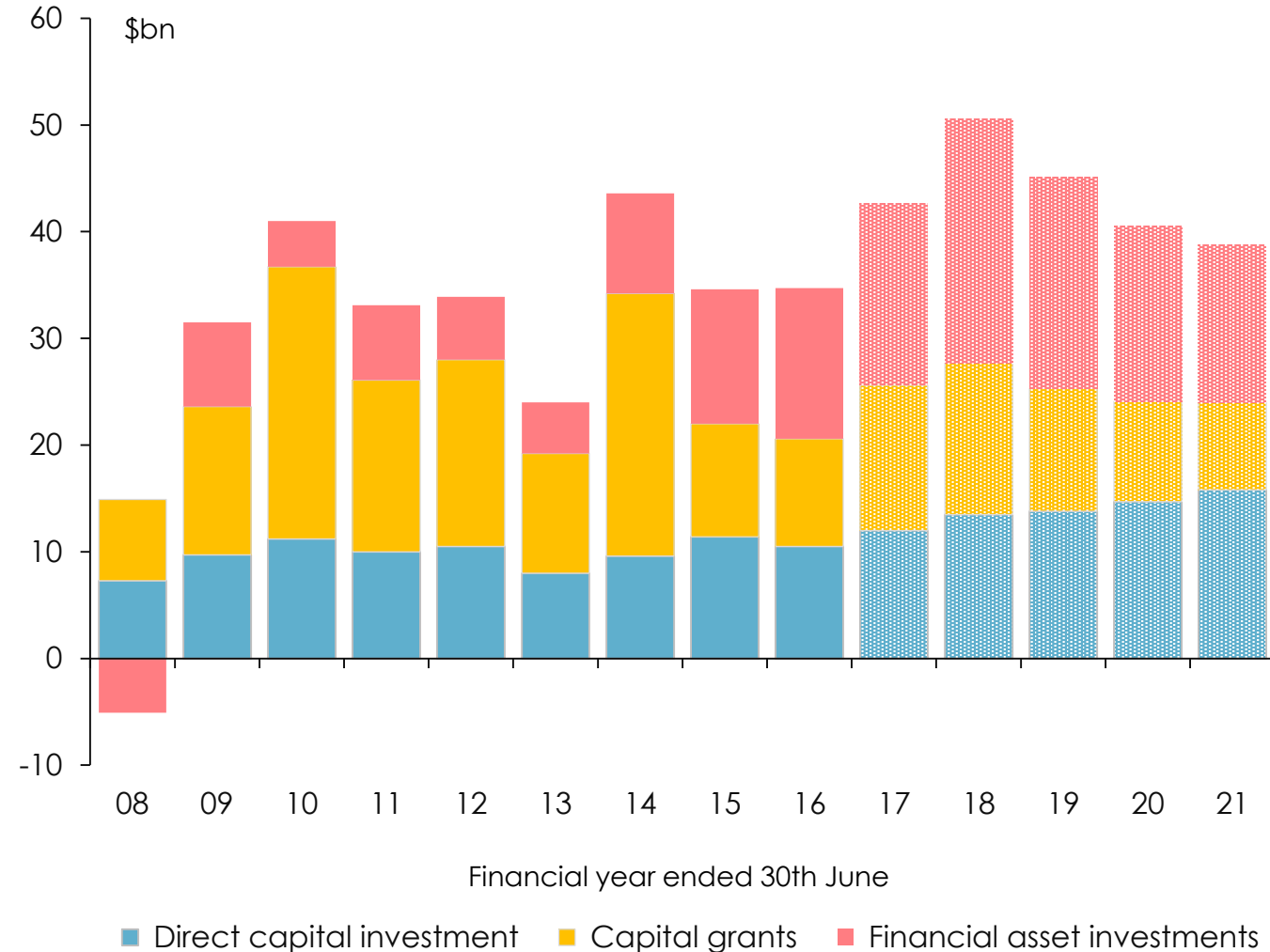


## GST revenue



# Increased infrastructure spending – funded in part by ‘good debt’ – is another feature of the 2017-18 Budget

## Commonwealth Government capital spending



Source: 2016-17 Budget Papers. Statement No. 4.

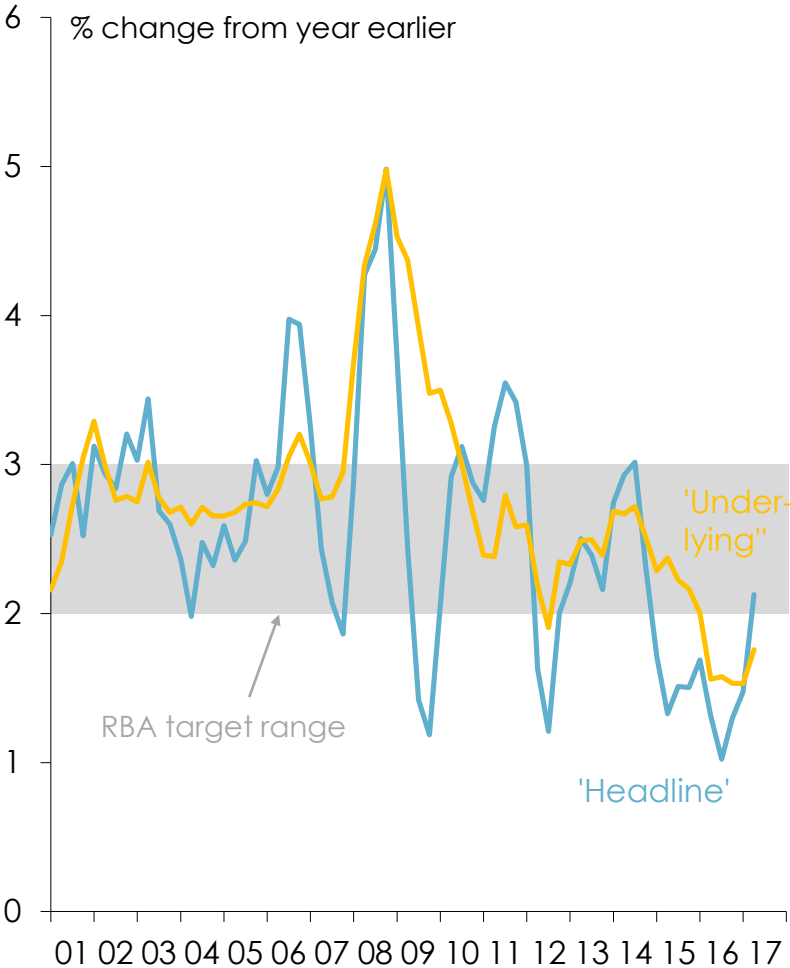
- ❑ The ‘budget reset’ has allowed the Government to accept the advice of the RBA, the IMF and the OECD (among others) that borrowing in order to fund ‘well targeted’ and ‘appropriately governed’ infrastructure investment can be ‘good policy’
- ❑ The Budget provides for almost \$51bn of capital spending in 2017-18, and \$175bn over the four years to 2020-21 ...
- ❑ ... although on current plans, the level of capital spending peaks in 2017-18
- ❑ The ‘headline’ infrastructure projects announced in the Budget will be funded ‘off-budget’ through government-owned companies (similar to the NBN)
- ❑ Not all of the proposed investments would pass the ‘rigorous project assessment and program evaluation’ that the Budget says should apply to ‘all government spending’

# Interest rates and the currency



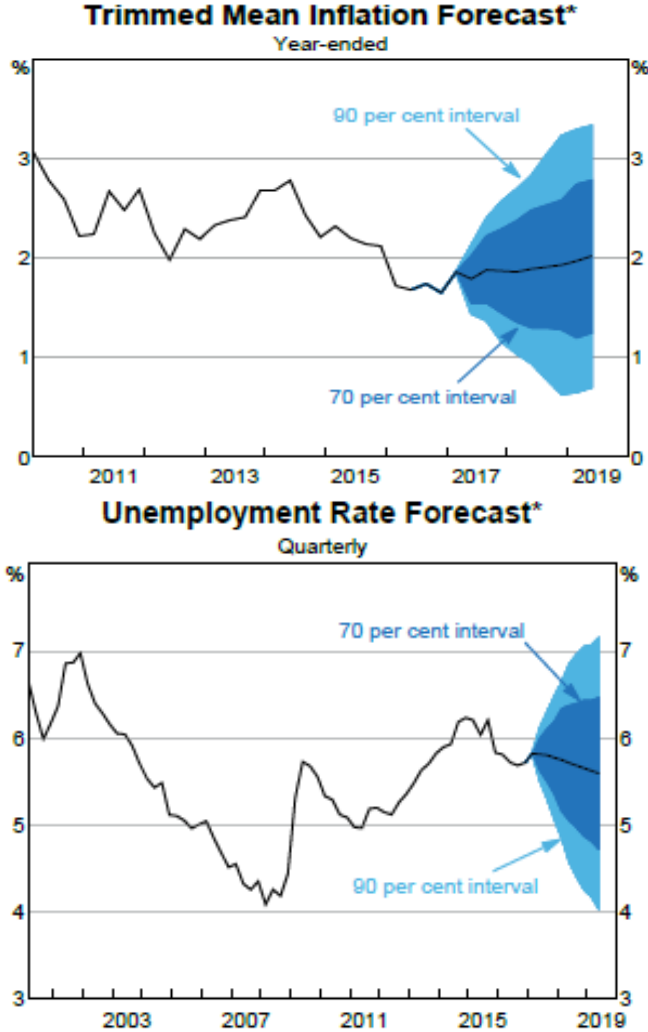
# Unlikely to be any repeat of last year's inflation surprises, but it will probably be early next year before the RBA starts raising rates

## Consumer price inflation



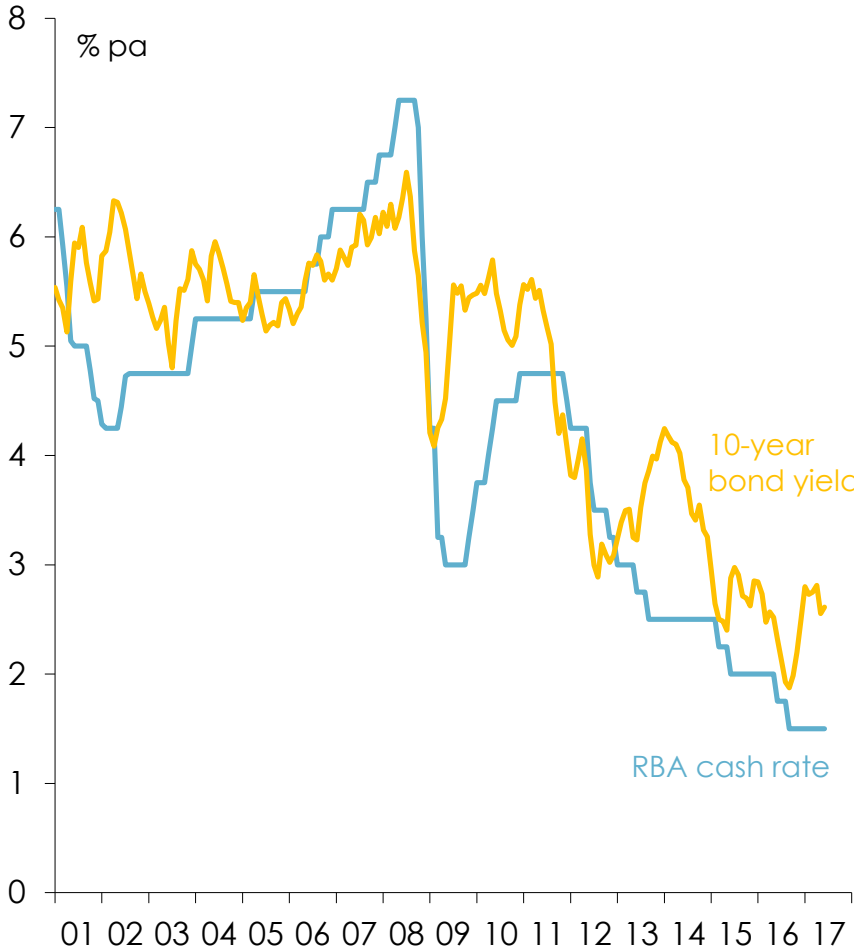
Source: ABS; RBA.

## RBA forecasts



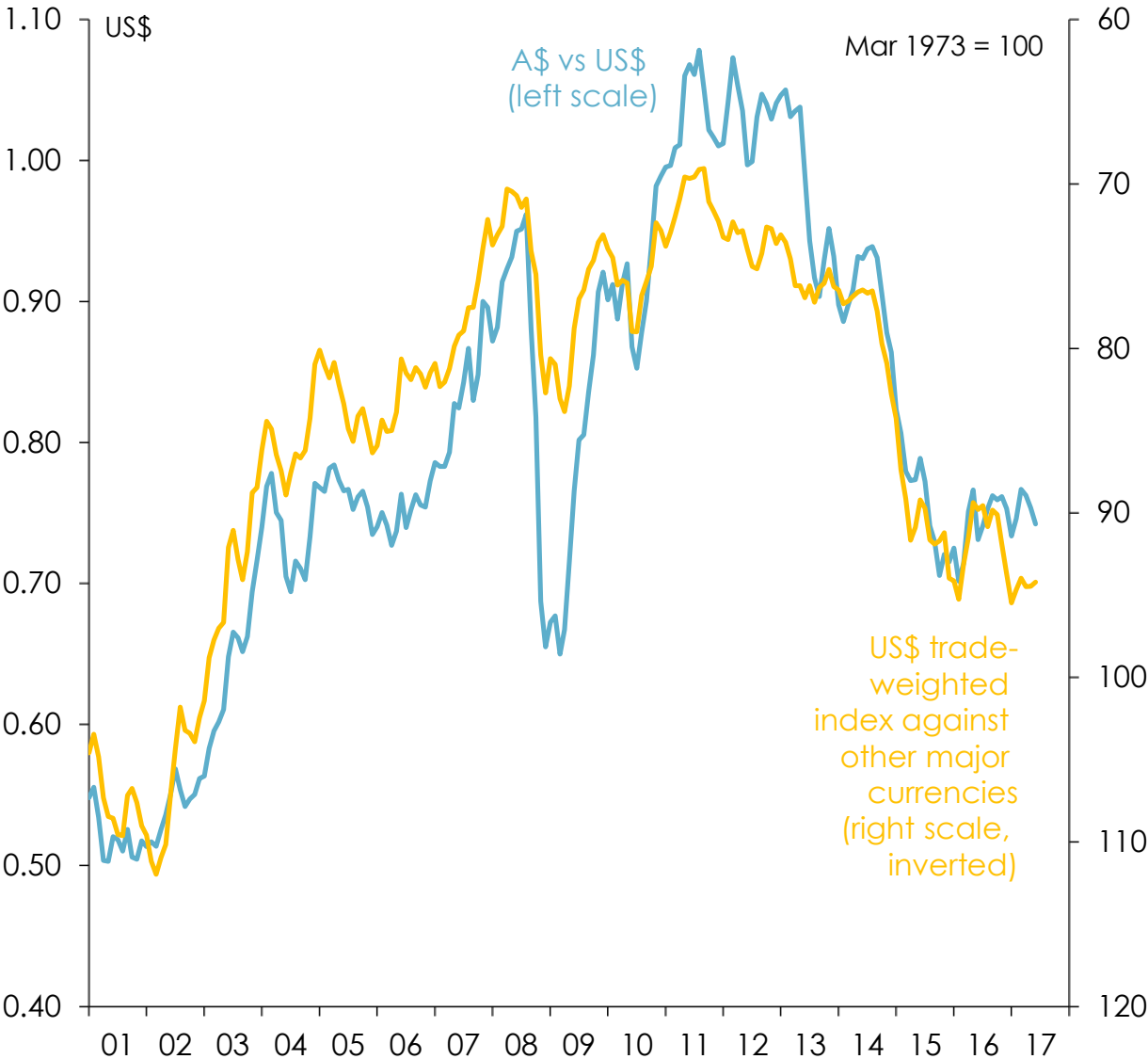
\* Confidence intervals reflect RBA forecast errors since 1993

## Interest rates

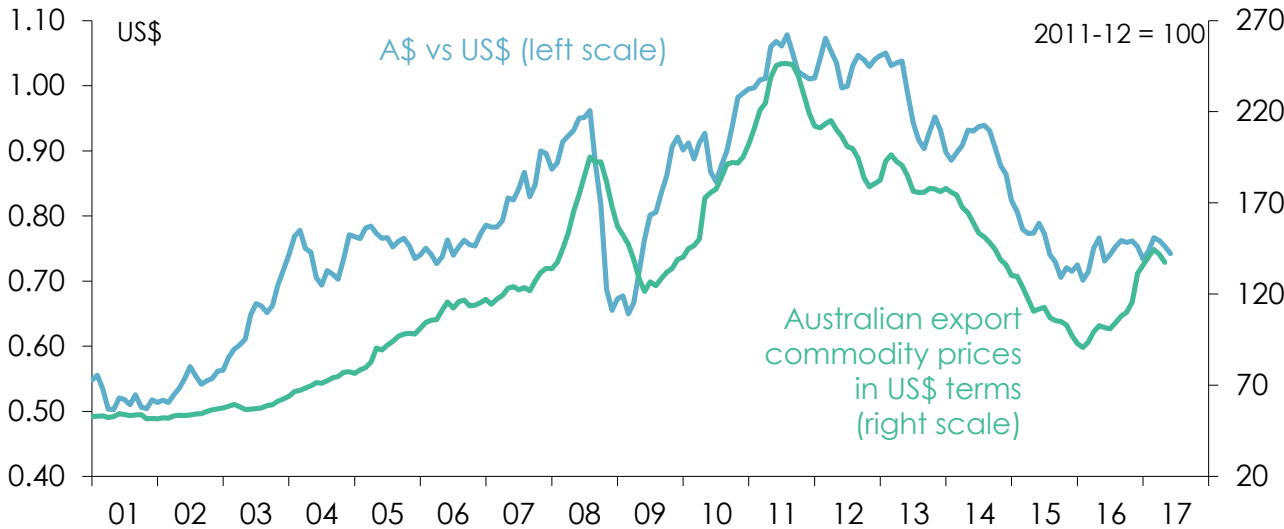


# Outlook for A\$ depends crucially on what the US\$ does – although commodity prices and interest rate spreads may also be important

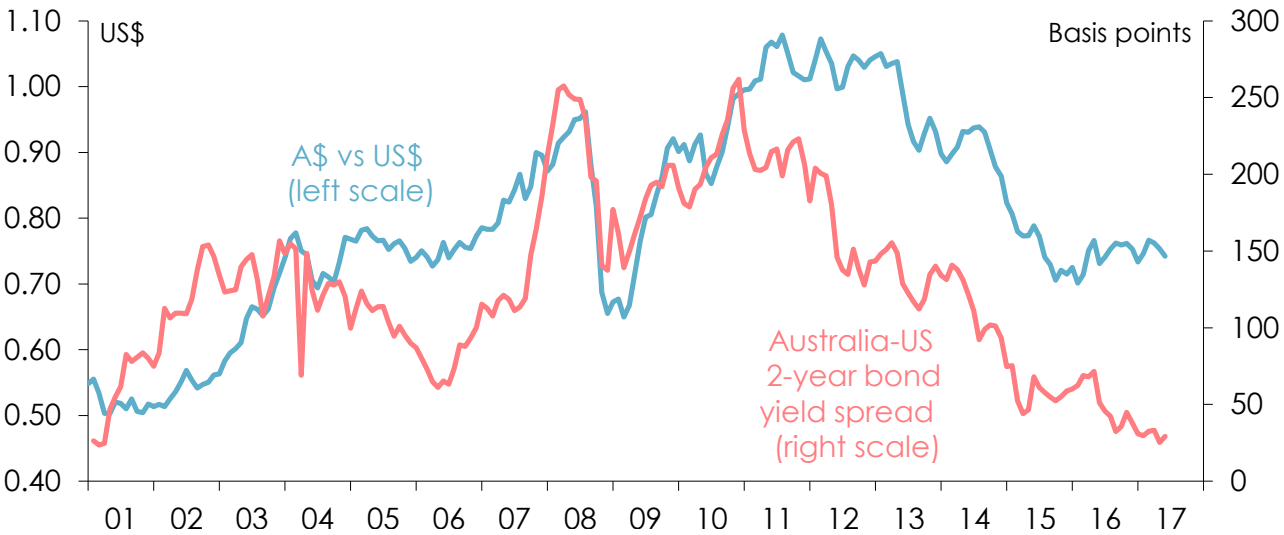
## A\$-US\$ and US\$ vs other currencies



## A\$-US\$ vs commodity prices



## A\$-US\$ vs interest rate spreads



Sources: Thomson Reuters; US Federal Reserve; Reserve Bank of Australia.