

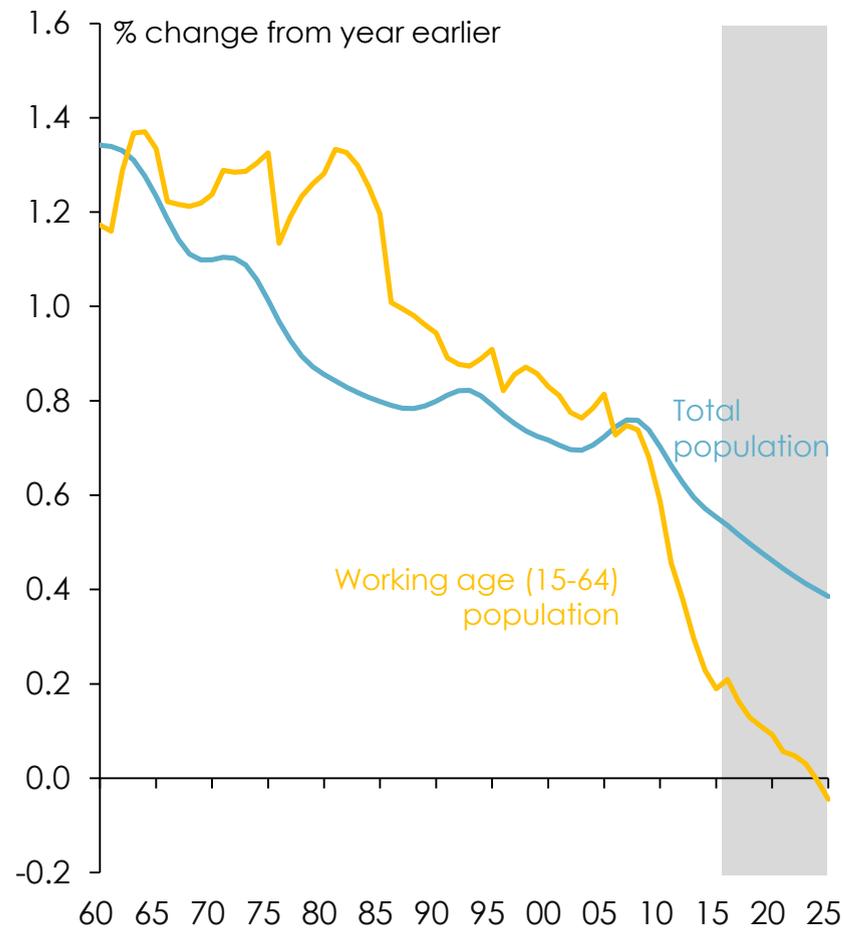
# KEY ISSUES FOR THE GLOBAL AND AUSTRALIAN ECONOMIES IN 2017

PRESENTATION TO A CEO FORUM LUNCH

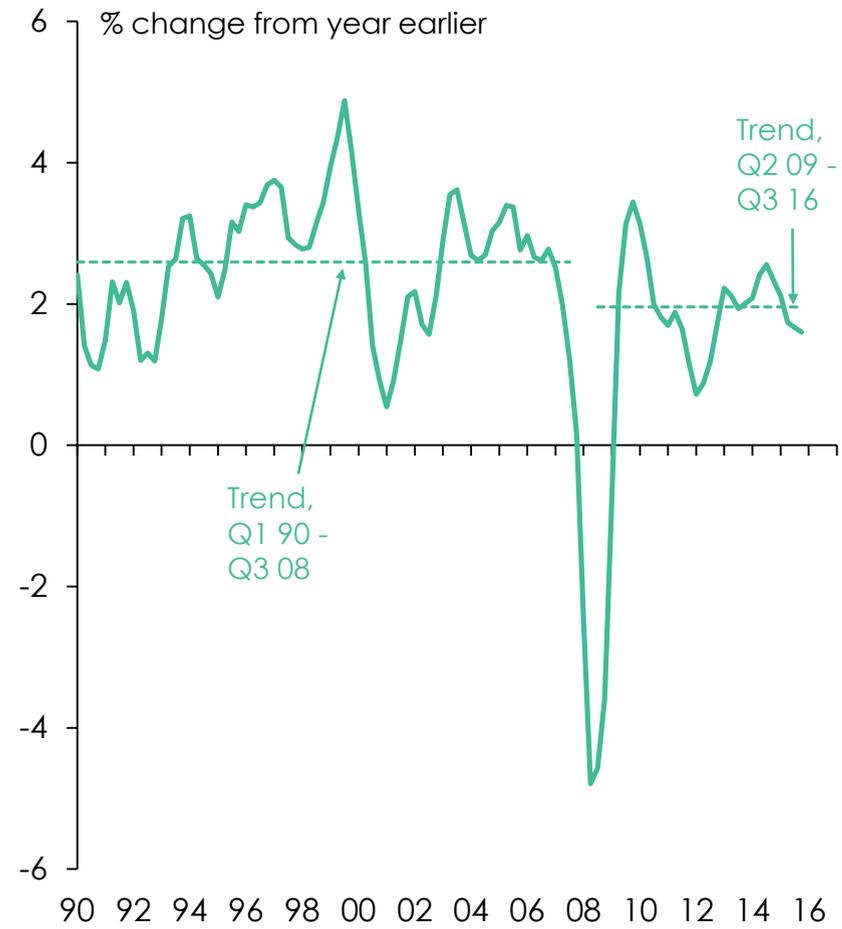
THE GLASSHOUSE, OLYMPIC PARK, MELBOURNE  
7<sup>TH</sup> FEBRUARY 2017

# Sharply slowing working-age population growth means that below-trend growth has nonetheless led to sharp falls in unemployment

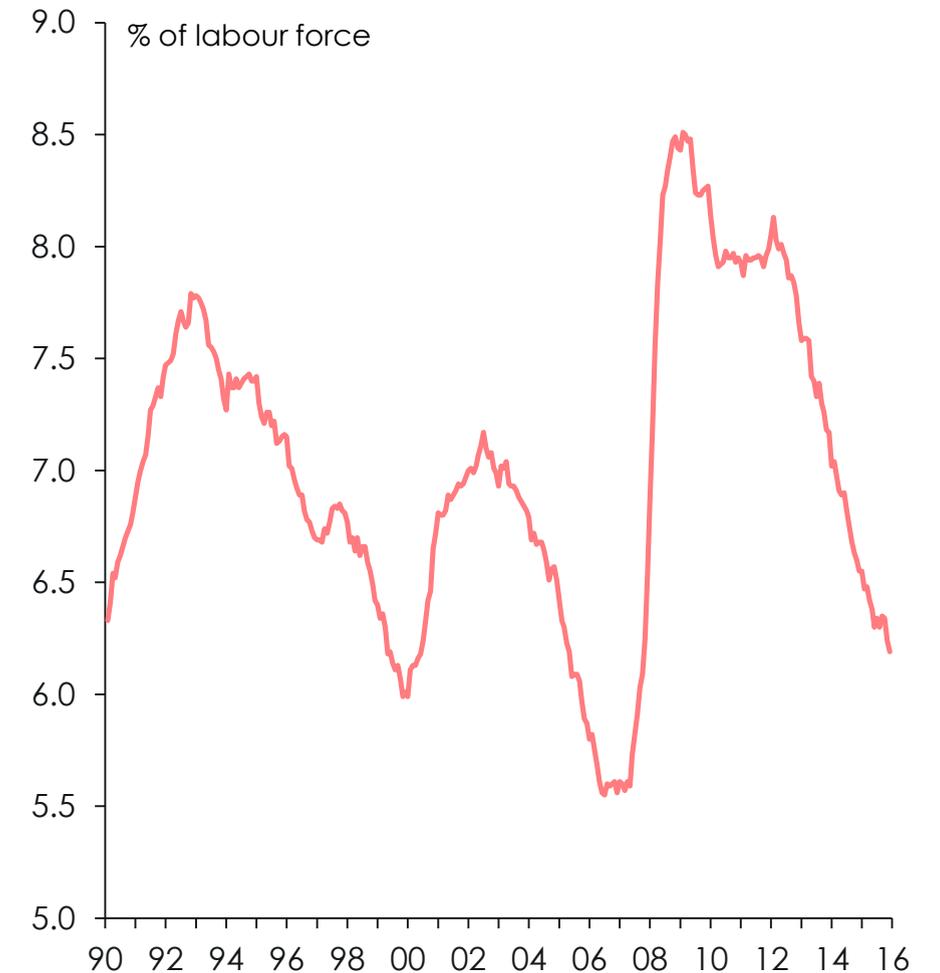
## OECD area population growth



## OECD area real GDP growth



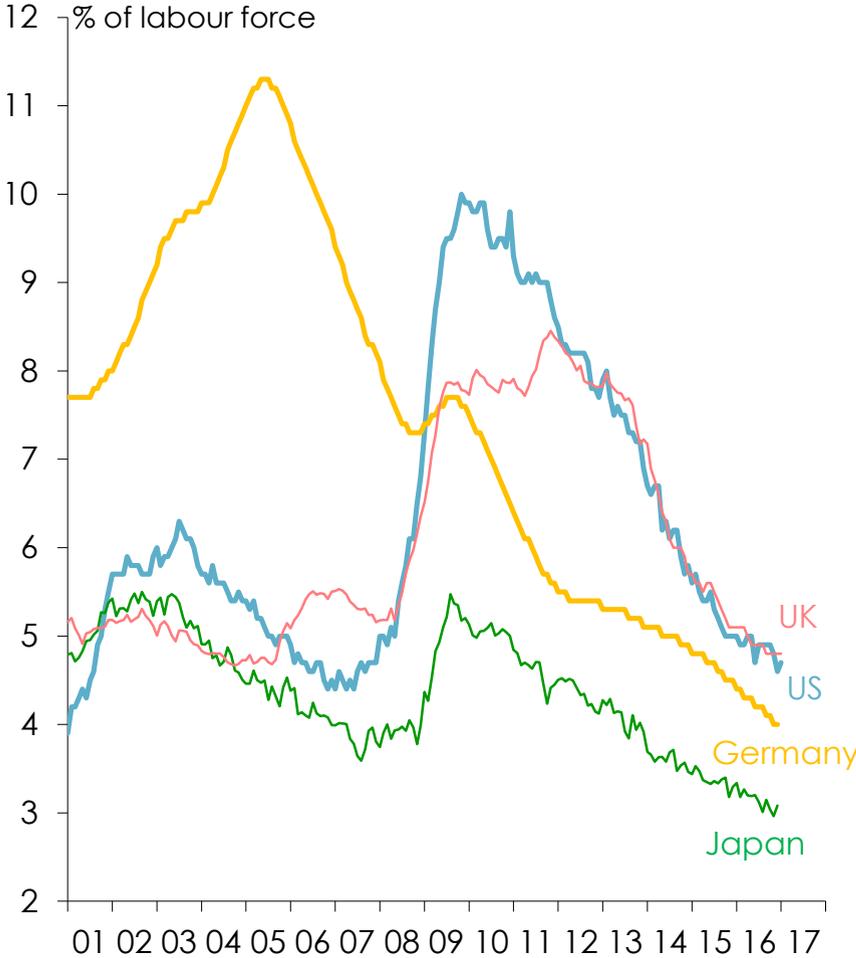
## OECD area unemployment



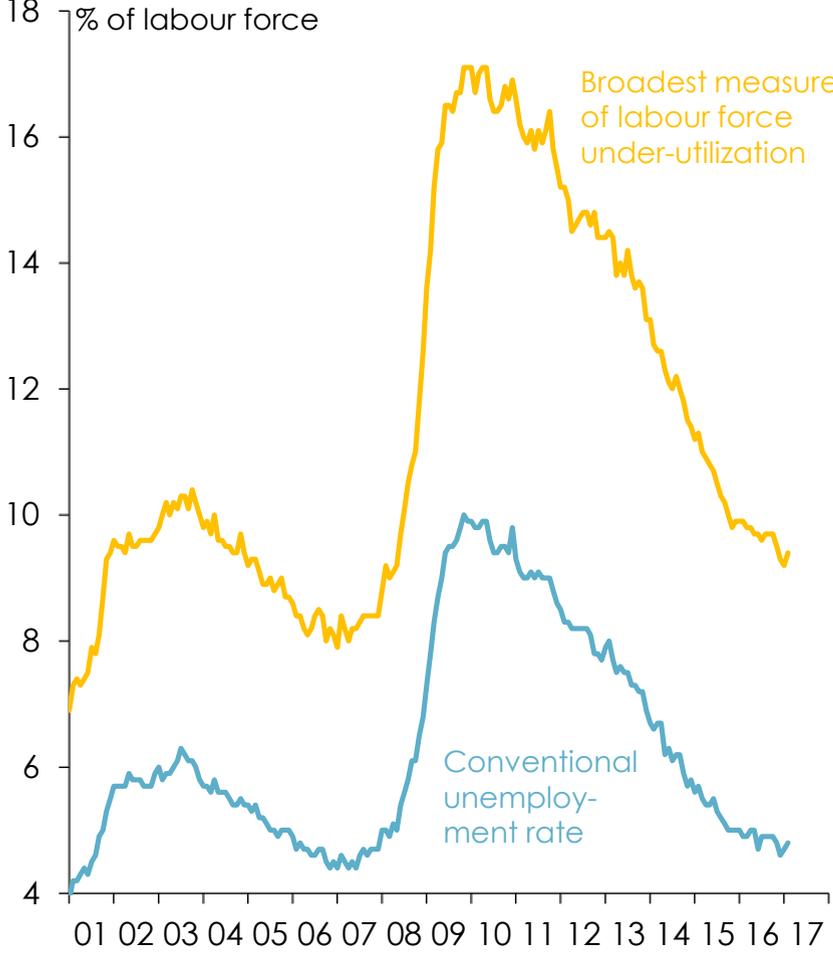
Sources: United Nations Economic & Social Affairs Division, Population Branch, *World Population Prospects – The 2015 Revision*; Organization for Economic Co-operation & Development (OECD).

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

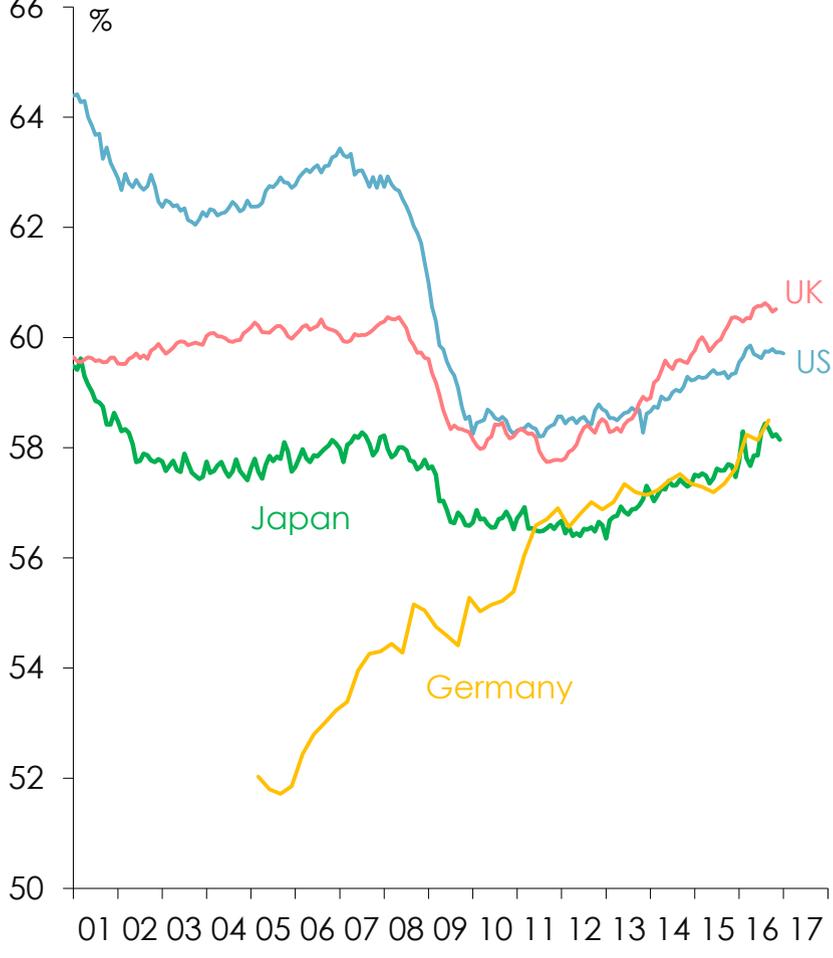
## Four largest 'advanced' economies - unemployment



## Broader measures of US 'under-employment'



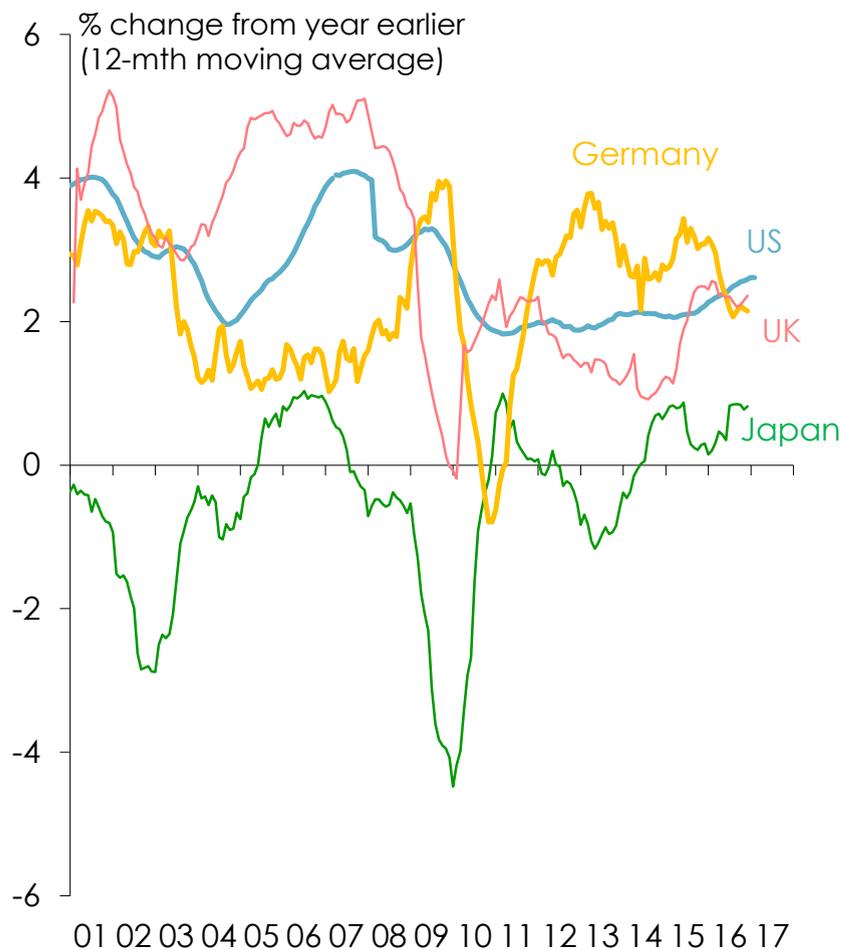
## Employment-population ratios



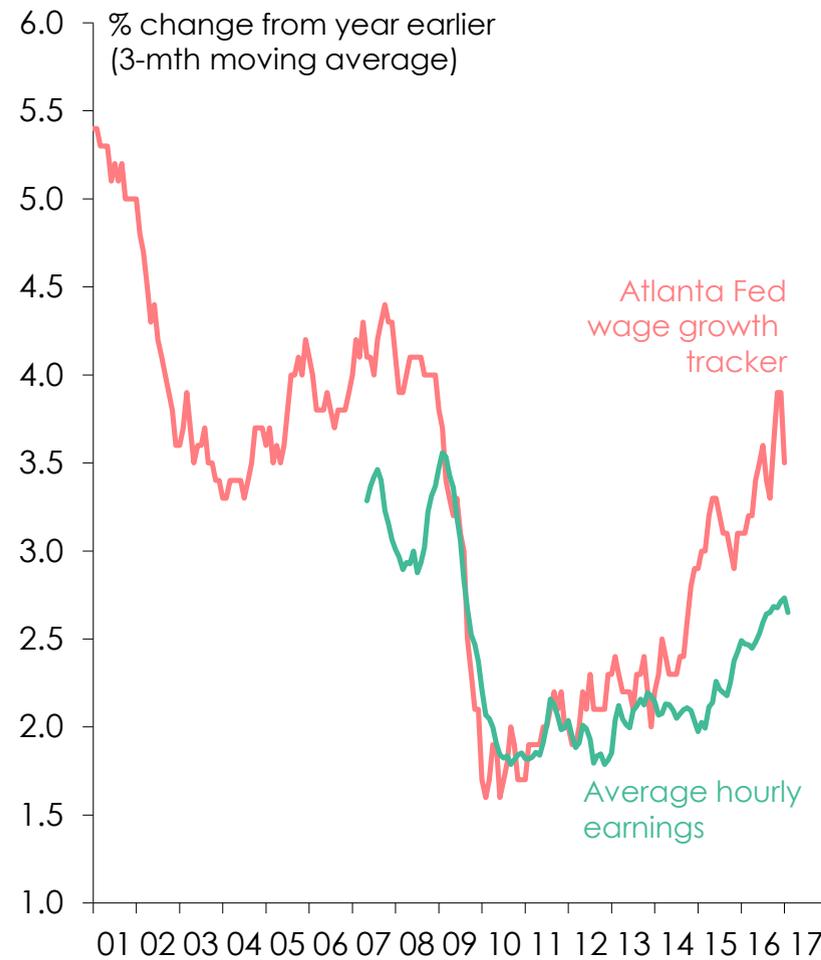
Sources: US Bureau of Labor Statistics; Japan Labour Ministry; Bundesagentur fur Arbeit; UK Office of National Statistics; Thomson Reuters Datastream.

# Inflation looks to have passed its low point in each of the four largest 'advanced' economies

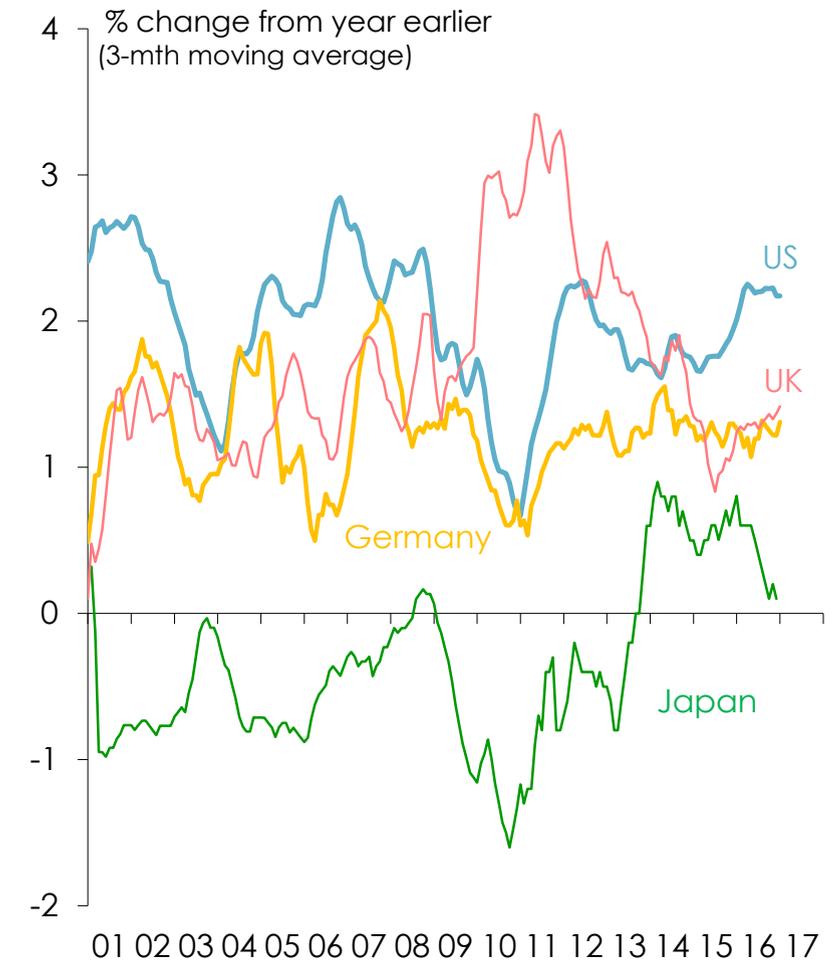
## Wage inflation – four largest 'advanced' economies



## US wage inflation – alternative measures



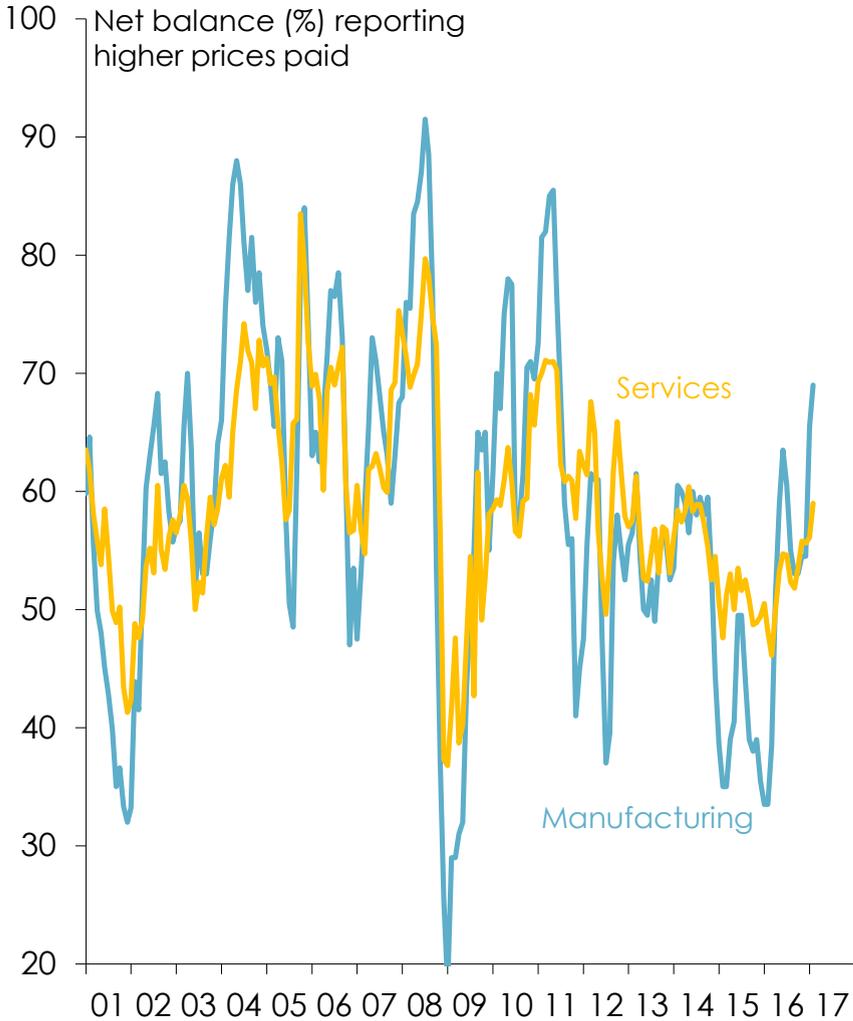
## 'Core' CPI inflation – four largest 'advanced' economies



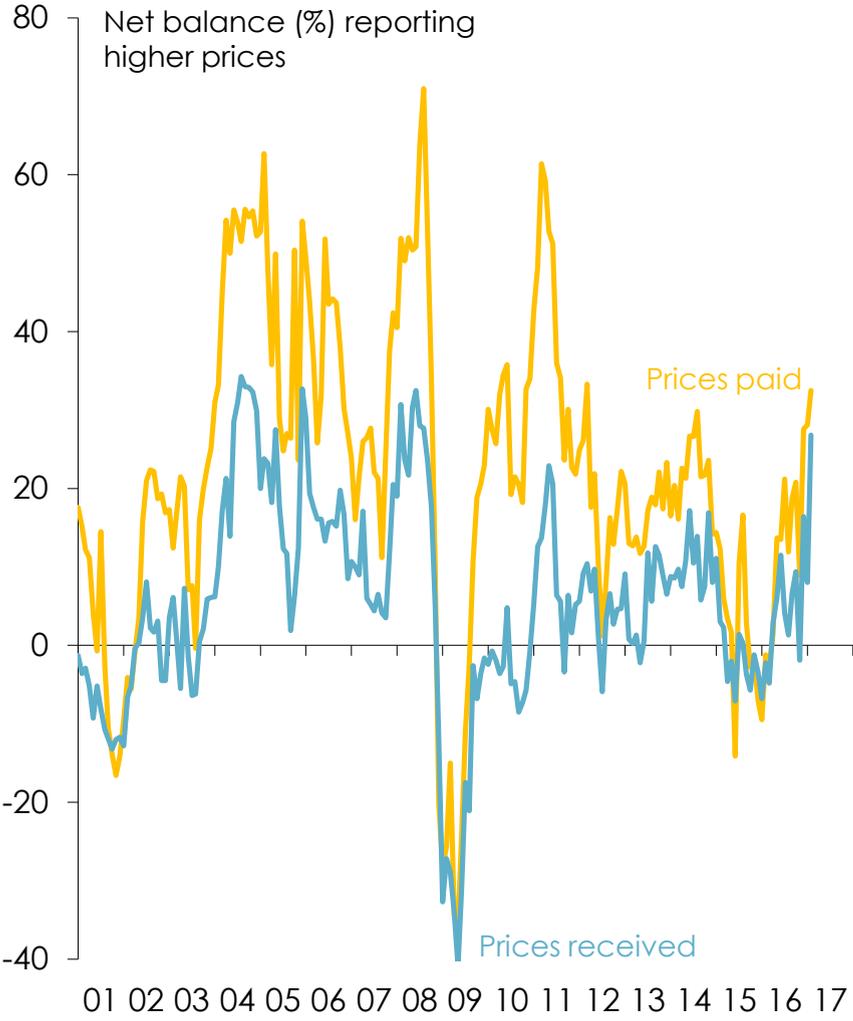
Note: The Atlanta Fed wage growth tracker measures the increase in the hourly earnings of identified individuals over 12-month intervals. It excludes those with annual earnings exceeding US\$150K, and hourly earnings less than US\$2.13. 'Core' inflation figures for Japan exclude effects of GST increase in April 2014.  
Sources: US Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; Japan Labour Ministry; Statistics Japan and Bank of Japan; Statistisches Bundesamt; UK Office of National Statistics; Thomson Reuters Datastream.

# Some other 'straws in the wind' regarding inflation

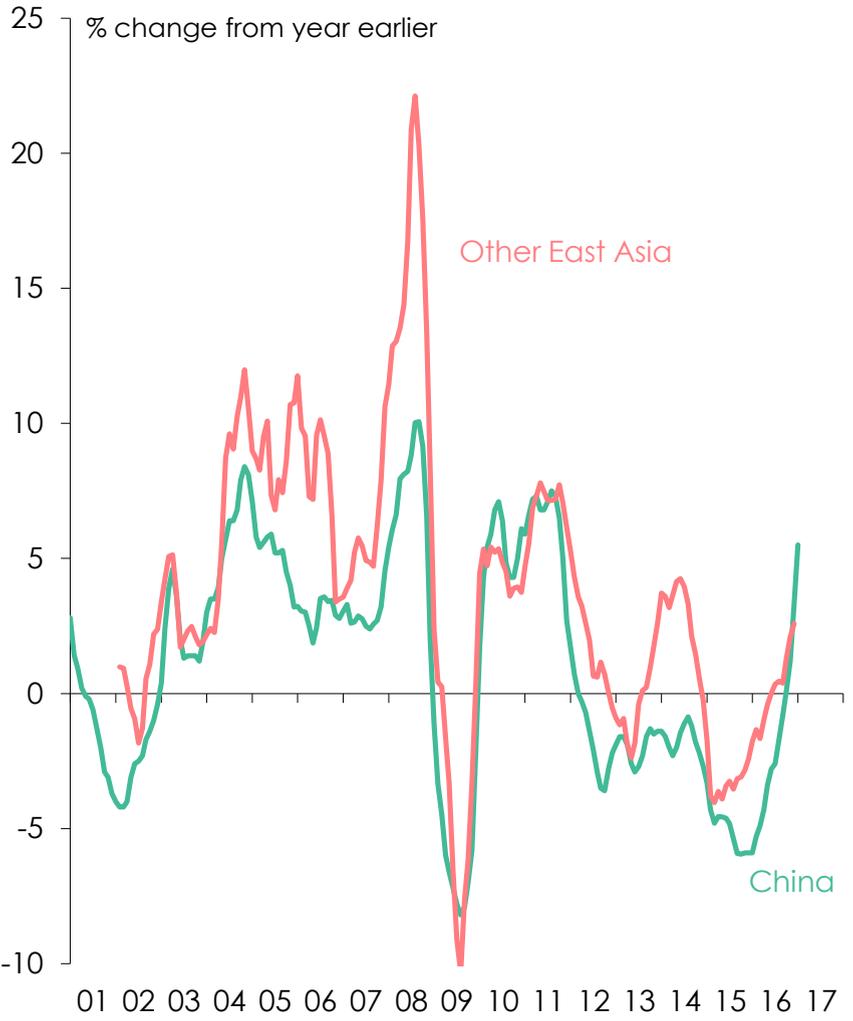
## US ISM prices paid



## Philadelphia Fed prices



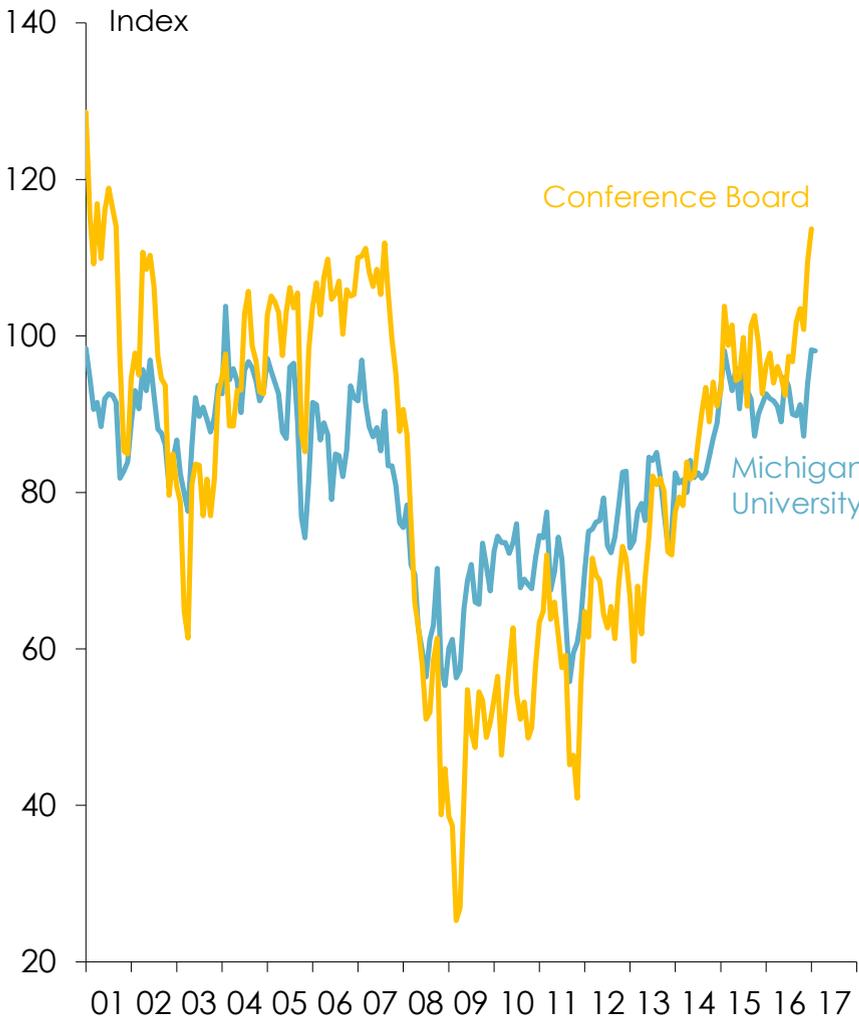
## Asian producer prices



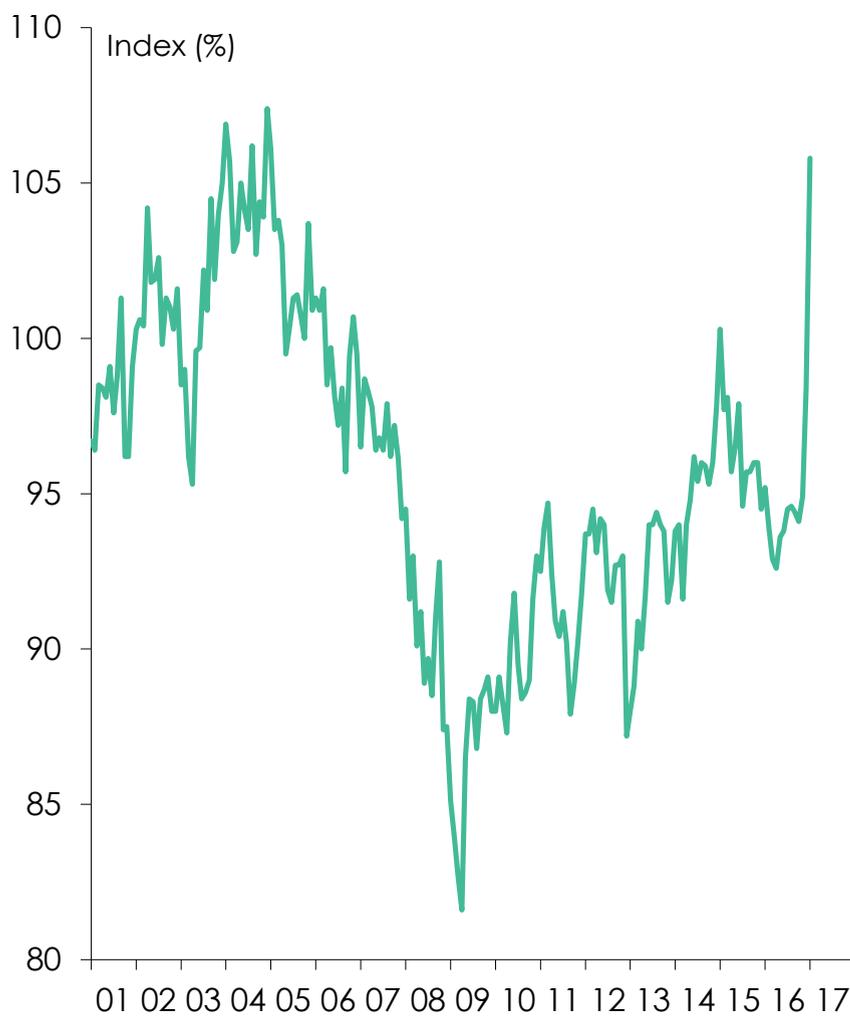
Sources: US Institute of Supply Management (ISM); Federal Reserve Bank of Philadelphia; East Asian statistical agencies and central banks.

# US consumer and business confidence have improved sharply since the election

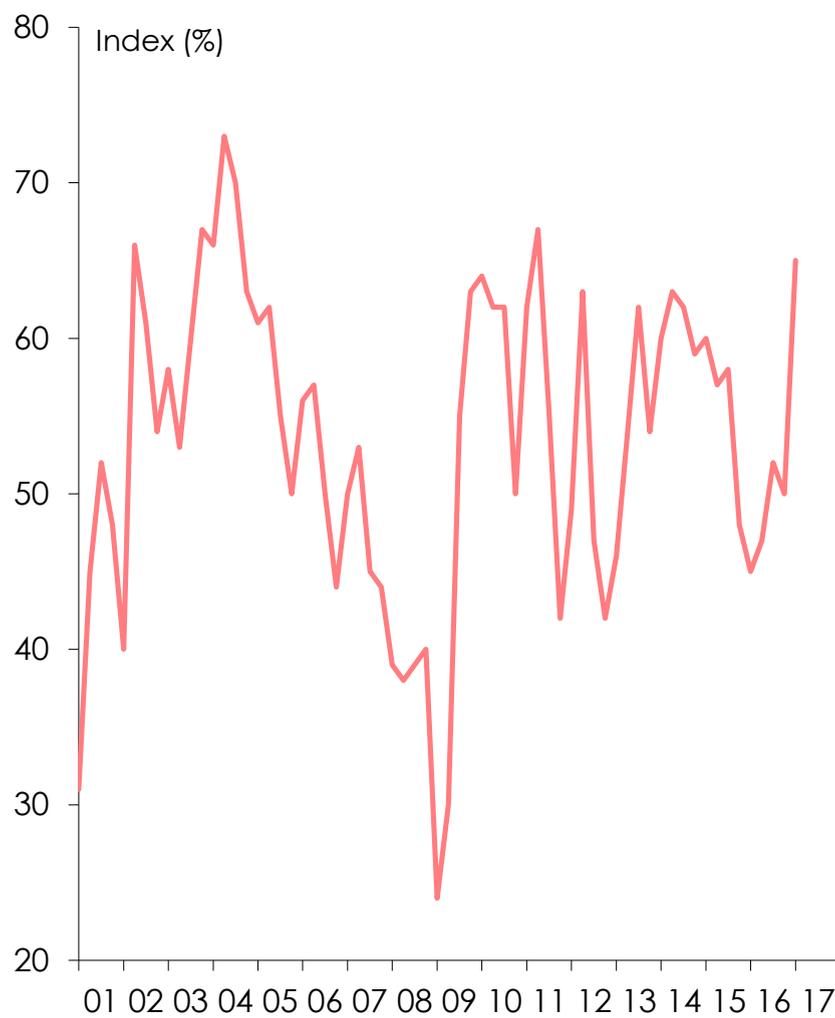
## Consumer confidence



## Small business optimism



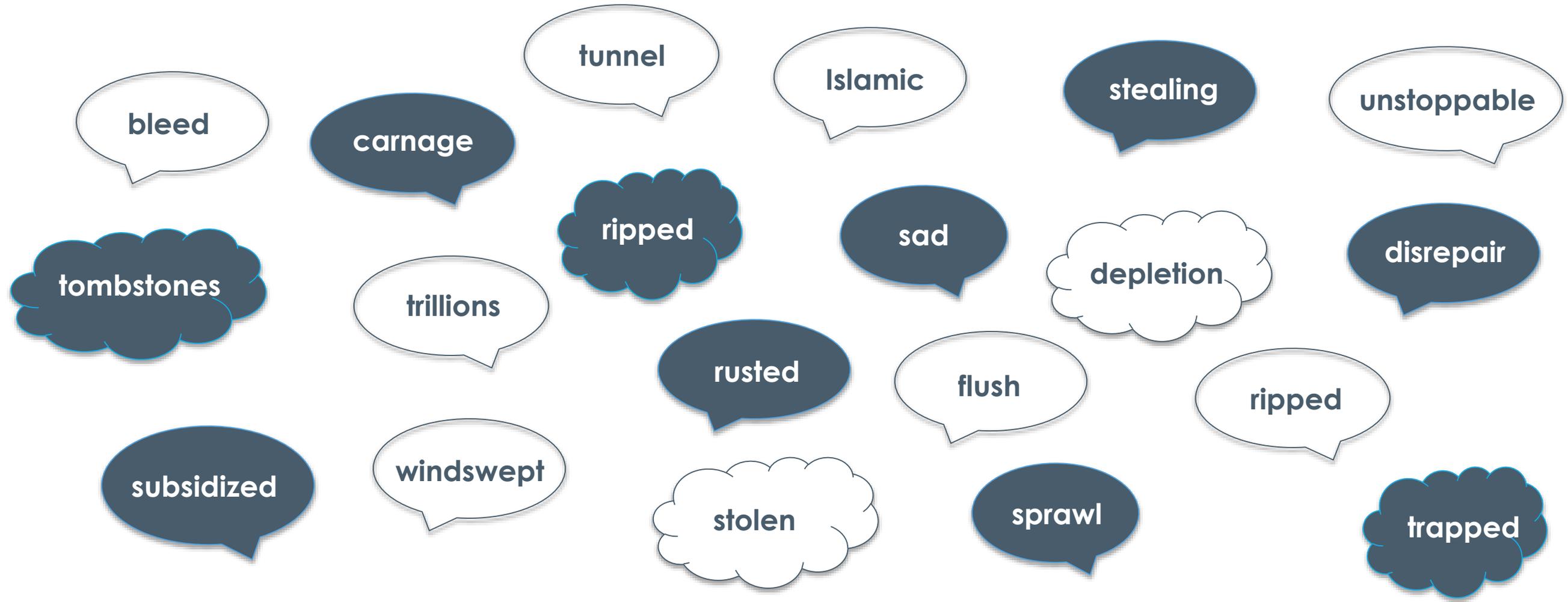
## CEO confidence



Sources: The Conference Board; University of Michigan Survey Research Center; National Federation of Small Businesses.

# Donald Trump is going to govern as he campaigned – which means he will be a very different president from almost all of his 43 predecessors

20 words that made their first inaugural address appearance in Donald Trump's inaugural



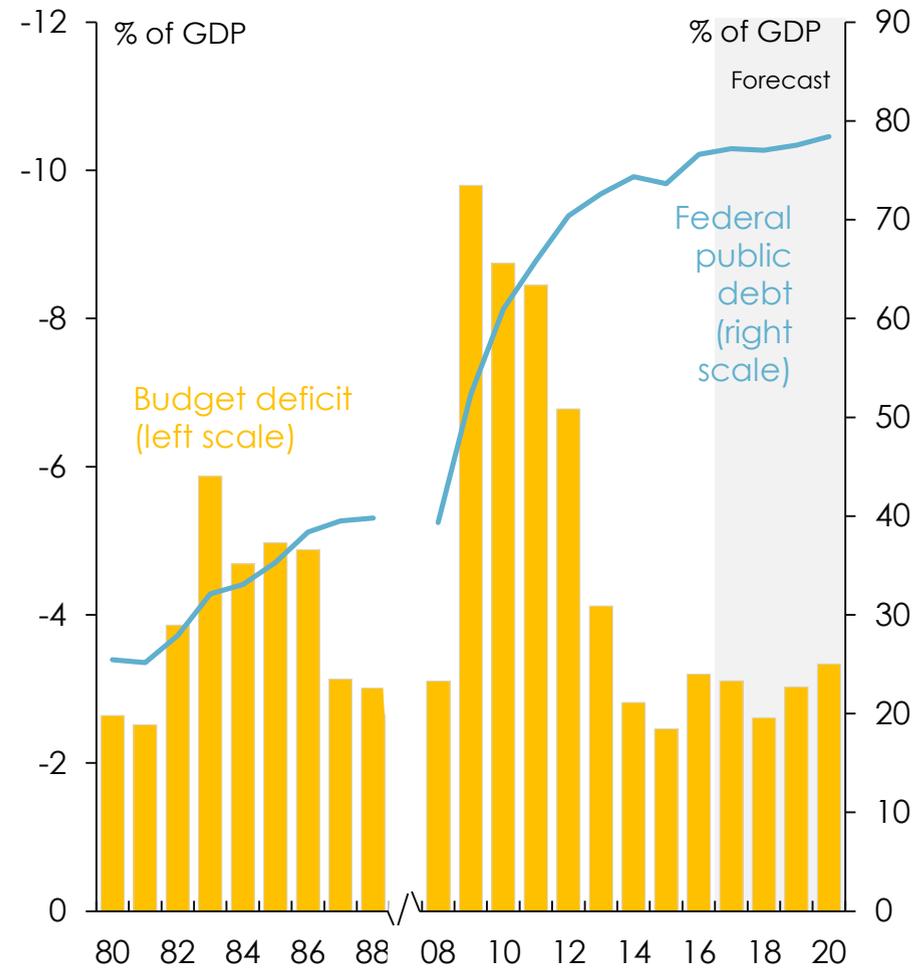
Sources: *The Washington Post*, 20<sup>th</sup> January 2017; James Fallows, *The Atlantic*, 20<sup>th</sup> January 2017.

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

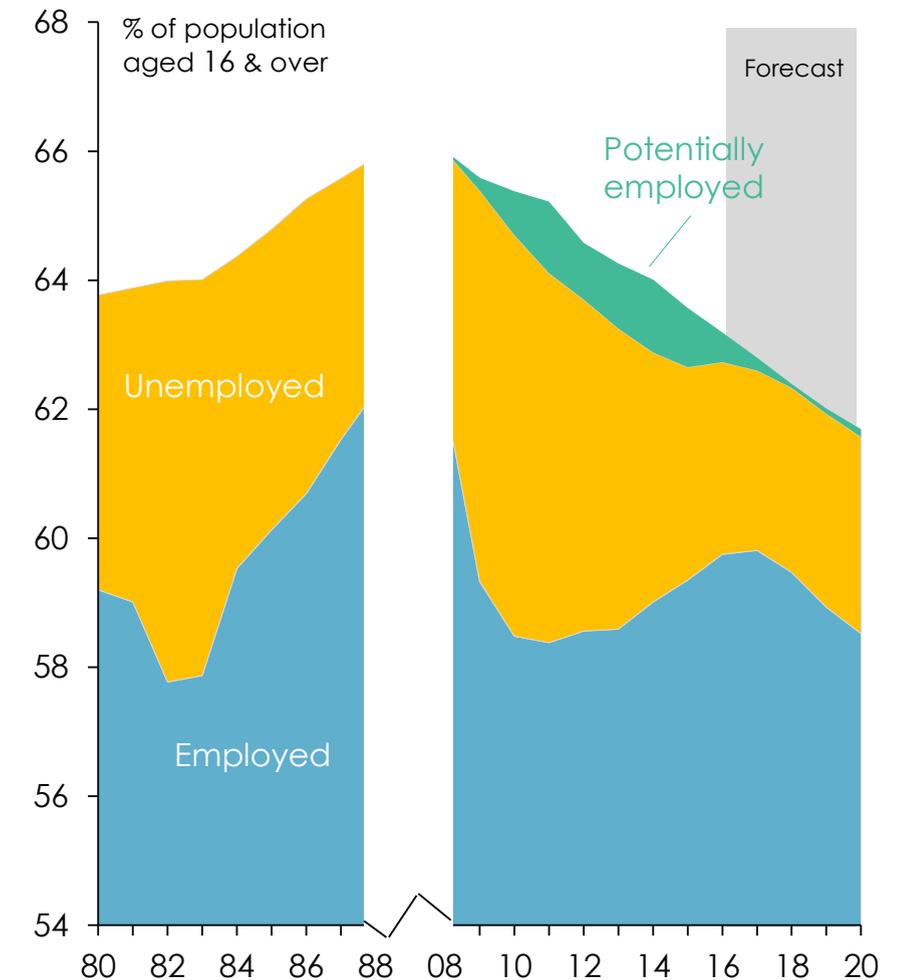
## Interest rates



## Federal budget and debt



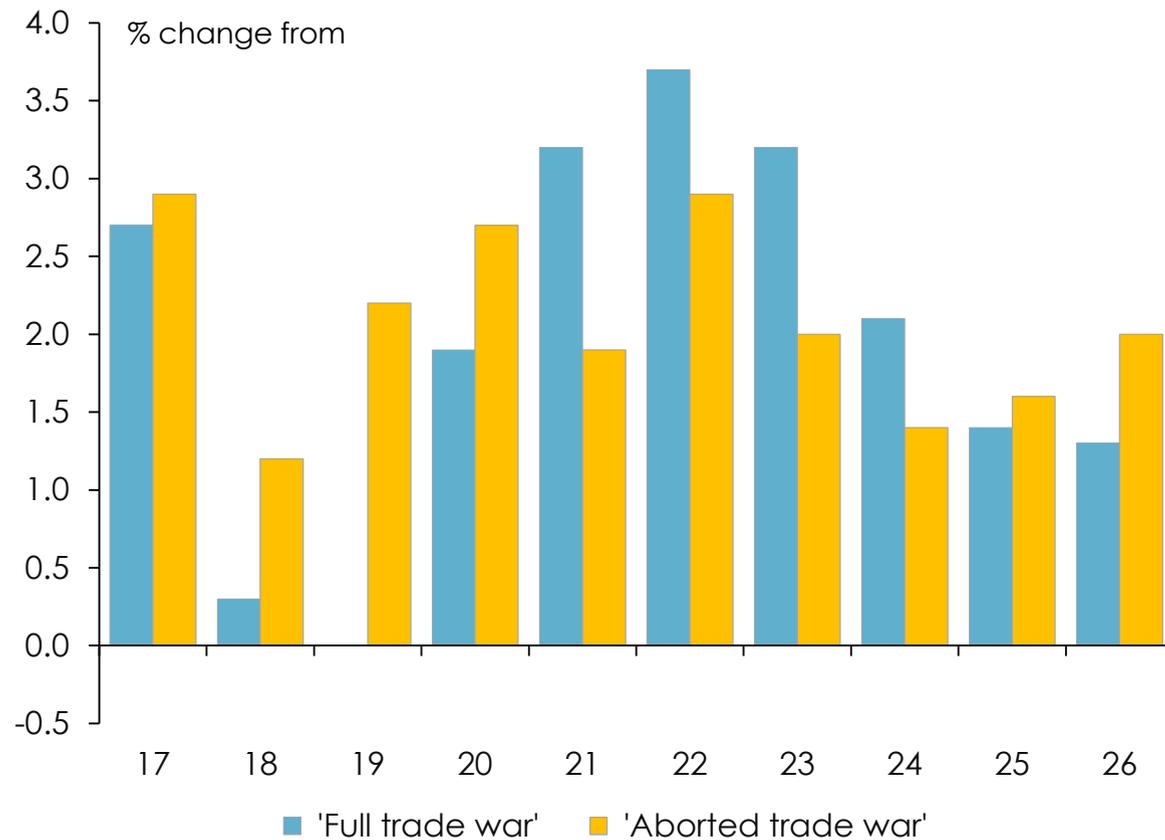
## Labour supply



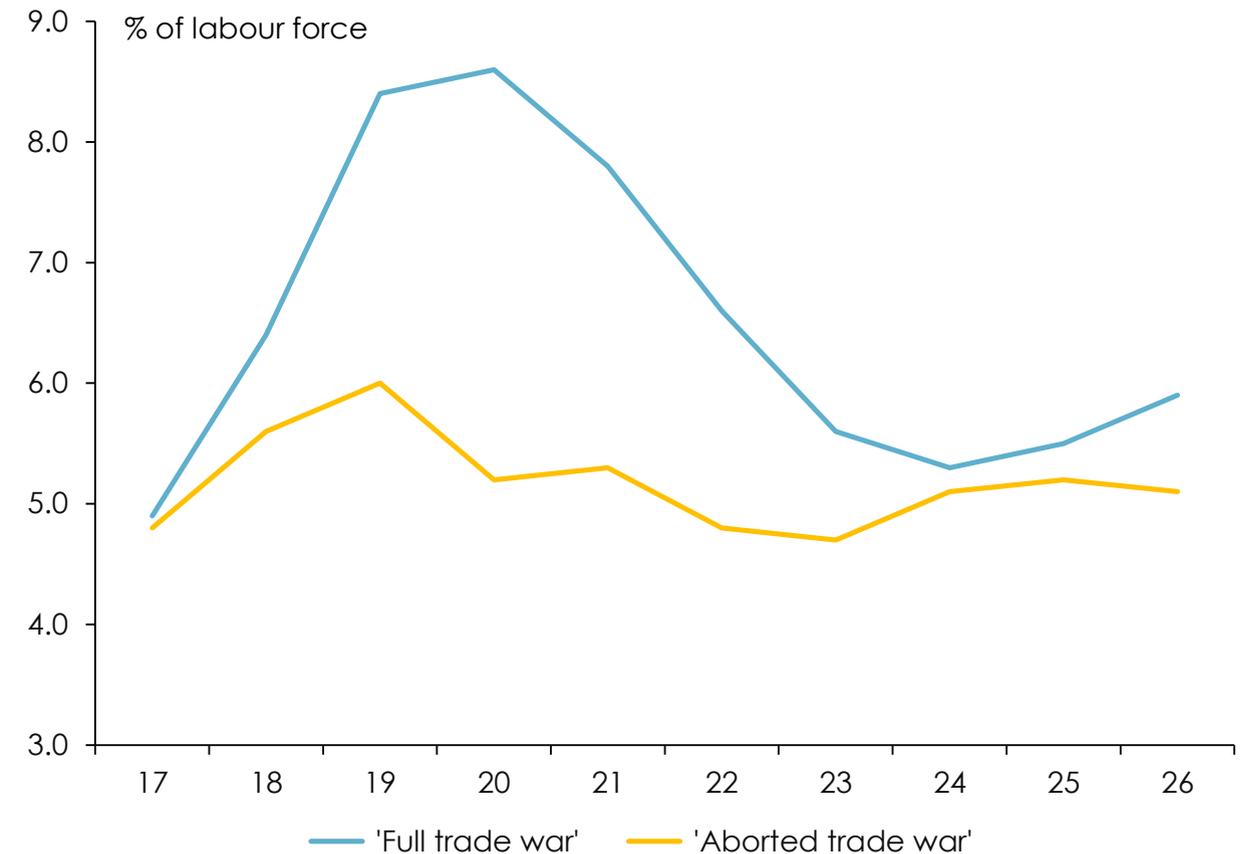
Sources: US Federal Reserve; US Congressional Budget Office.

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

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



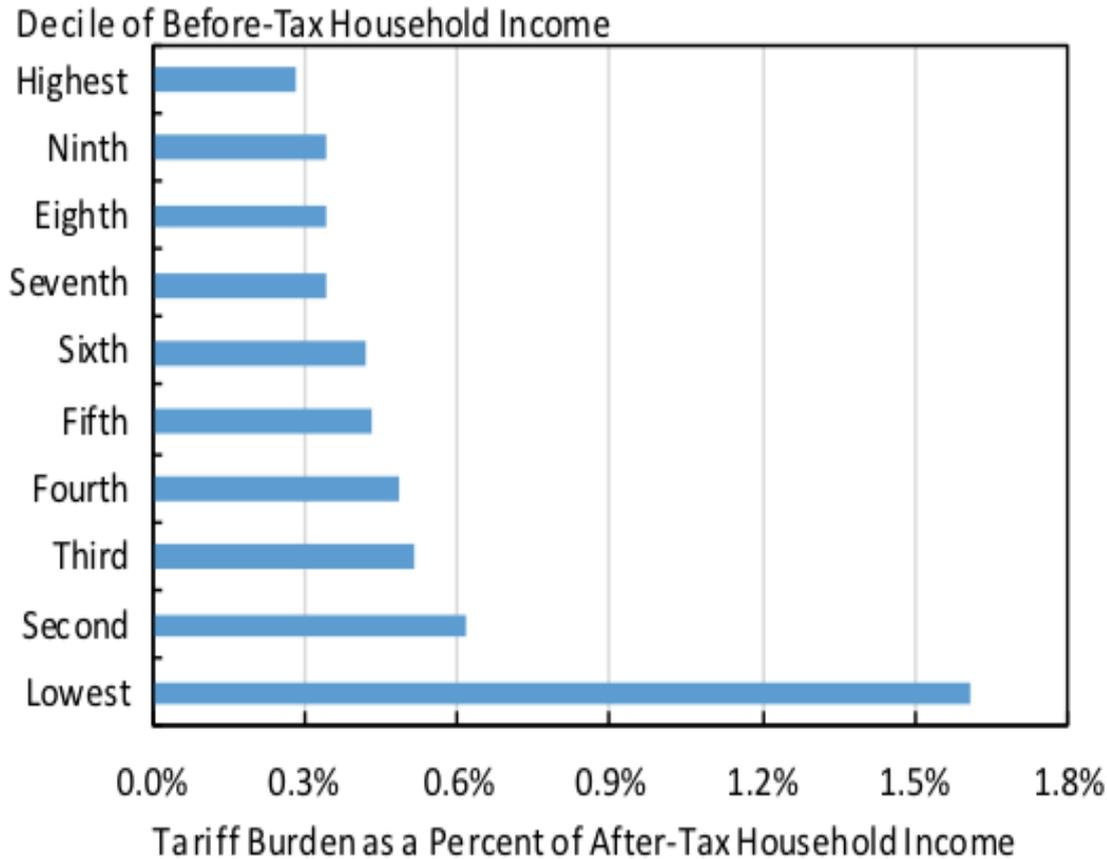
## Simulated levels of US unemployment under 'trade war' scenario



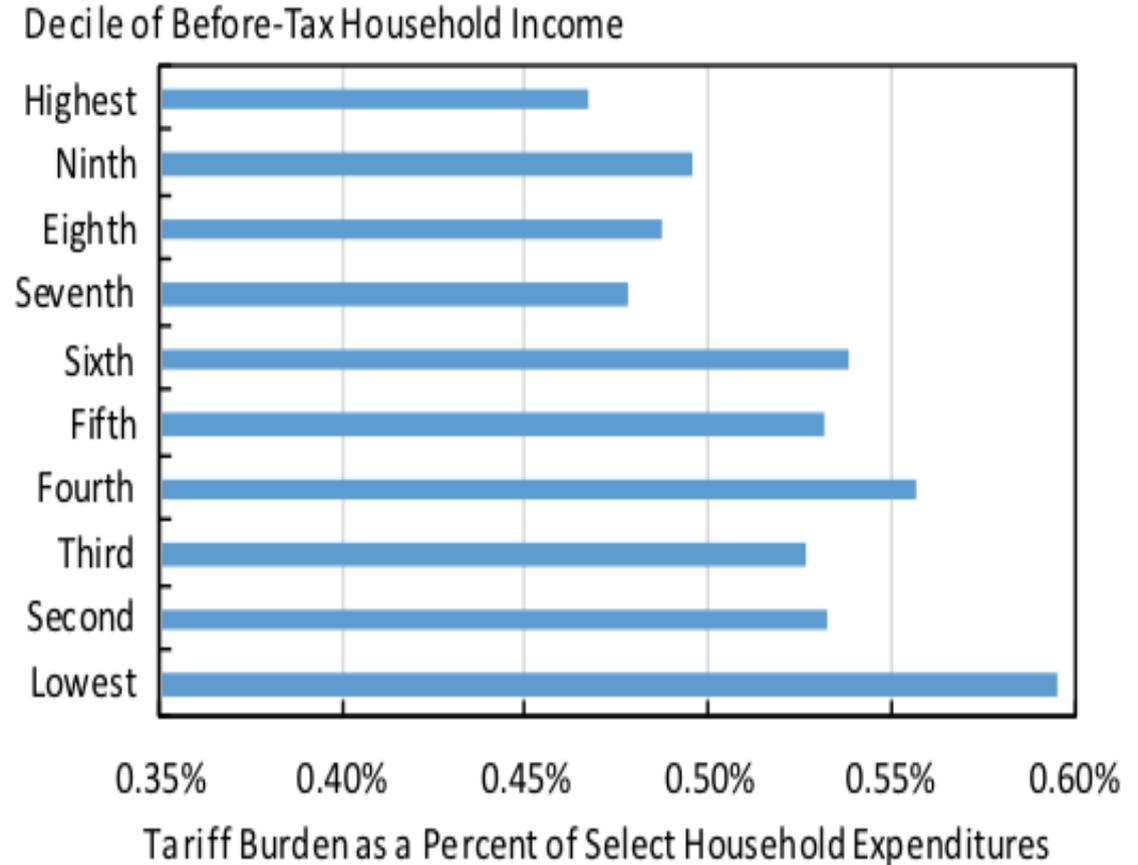
Note: 'full trade war' scenario assumes US imposes 45% tariff on non-oil imports from China and 35% on non-oil imports from Mexico, and China & Mexico impose similar tariffs on imports from US. 'Aborted trade war' assumes US tariffs are imposed for only a single year, because China and Mexico concede 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.

# Increased tariffs would hurt the poorest households hardest

## Tariff burden relative to after-tax income



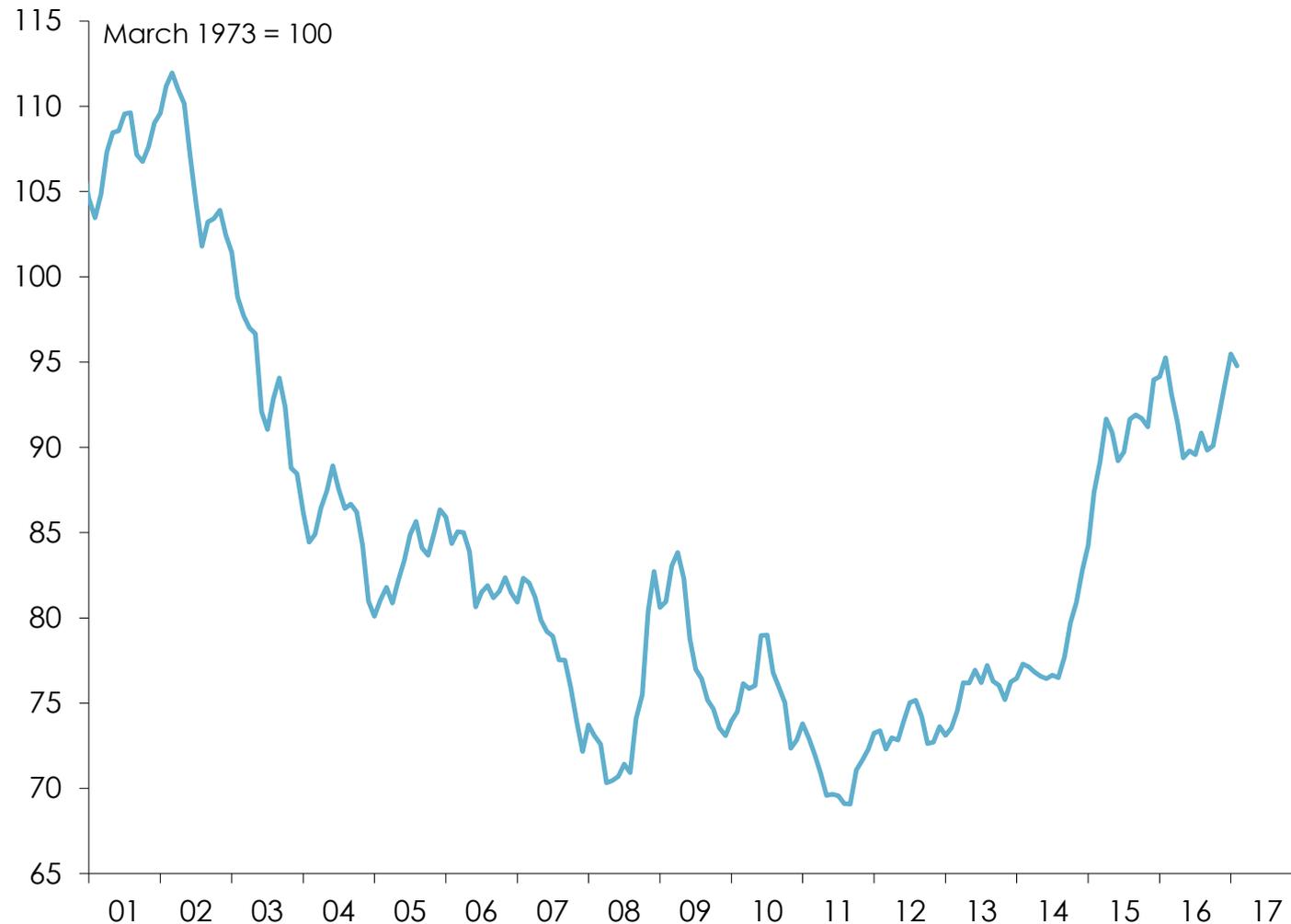
## Tariff burden relative to expenditures excluding mortgage, rent & utilities



Source: Jason Furman, Katheryn Russ and Jay Shambaugh (Obama Administration Council of Economic Advisors), [voxeu.org](https://voxeu.org), 12<sup>th</sup> January 2017.

# 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’

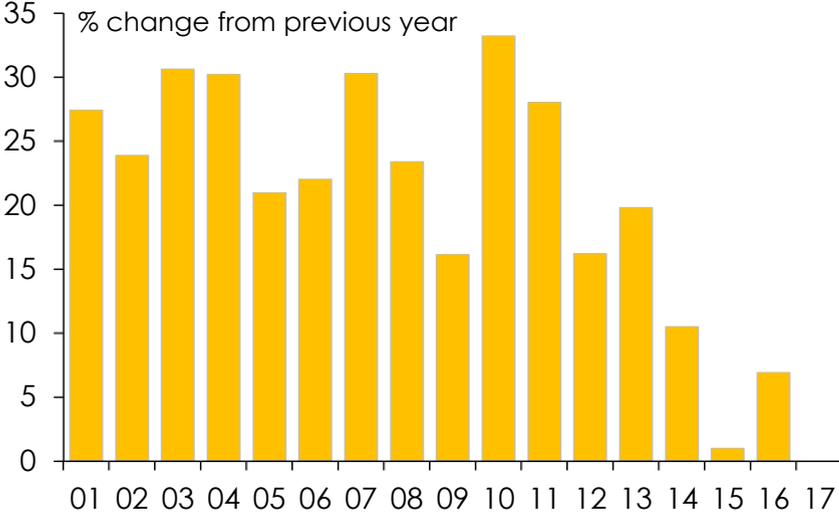
# A series of potential political risks for the EU in 2017

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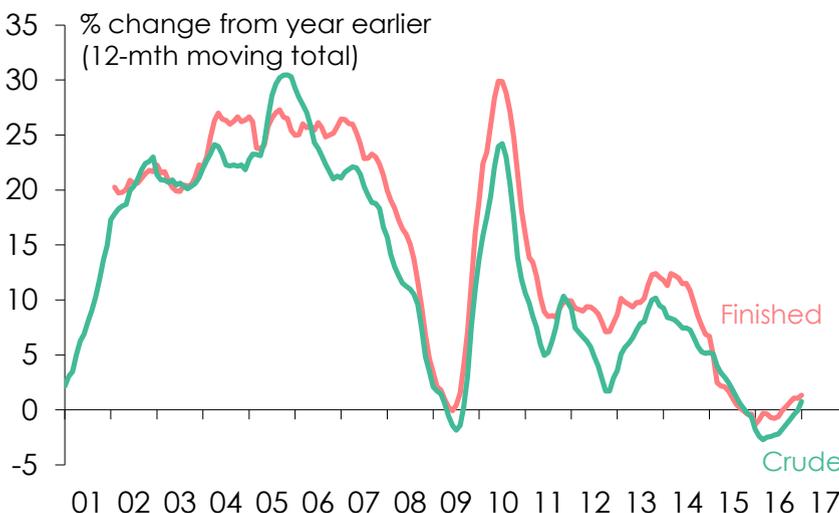
- ❑ **24<sup>th</sup> January – UK Supreme Court ruling on Article 50**
  - whether this can be done without a Parliamentary vote
- ❑ **2<sup>nd</sup> March – elections for Northern Ireland Assembly**
- ❑ **15<sup>th</sup> March – elections for the Dutch House of Representatives**
  - the PVV ('Party for Freedom') of Geert Wilders advocates leaving the EU
- ❑ **End March – deadline set by UK PM Theresa May for triggering Article 50**
  - the formal mechanism for beginning the UK's departure from the EU
- ❑ **23<sup>rd</sup> April and (if required) 7<sup>th</sup> May – French Presidential election**
  - likely to be a contest between National Front's Marine Le Pen, who advocates 'Frexit', and Republicans' François Fillon, who wants better ties with Vladimir Putin
- ❑ **24<sup>th</sup> September (earliest) to 22<sup>nd</sup> October (latest) – German federal parliamentary elections**
  - at which Chancellor Angela Merkel's coalition is expected to remain in office in some form, but attention will focus on whether the Alternative für Deutschland (AfD) party led by Frauke Petry will gain enough votes to enter the Bundestag
- ❑ **Possibly – Italian parliamentary elections**
  - Populist M5S ('Five Star Movement') led by Beppe Grillo advocates Italian exit from the EU

# Chinese authorities have reversed the declines in the property sector and residential construction which occurred late 2015 and early 2016

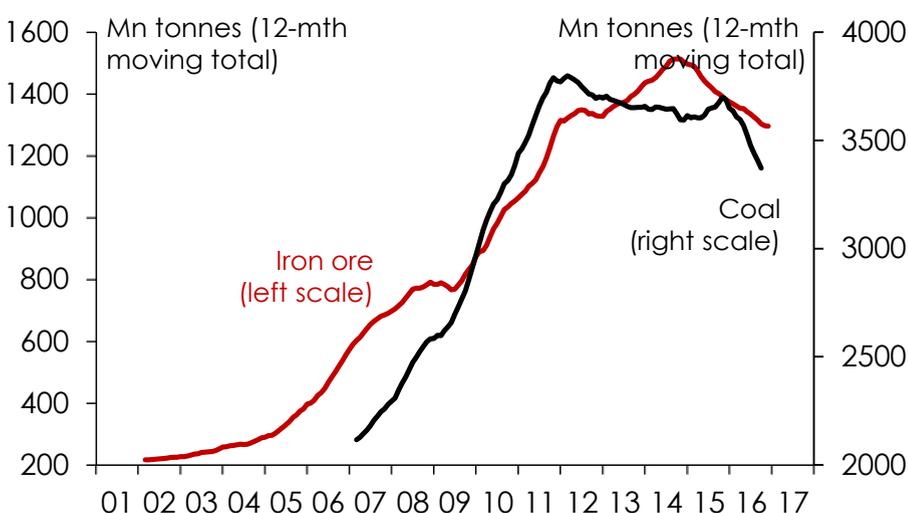
## Floor space under construction



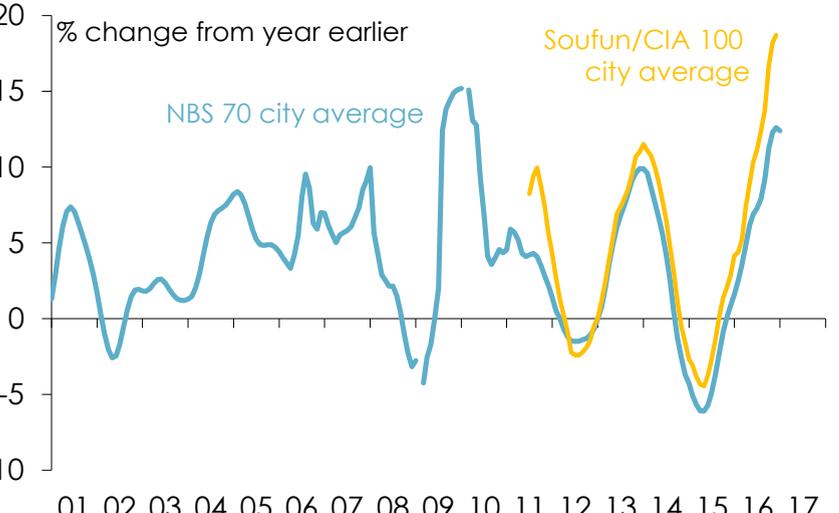
## Steel production



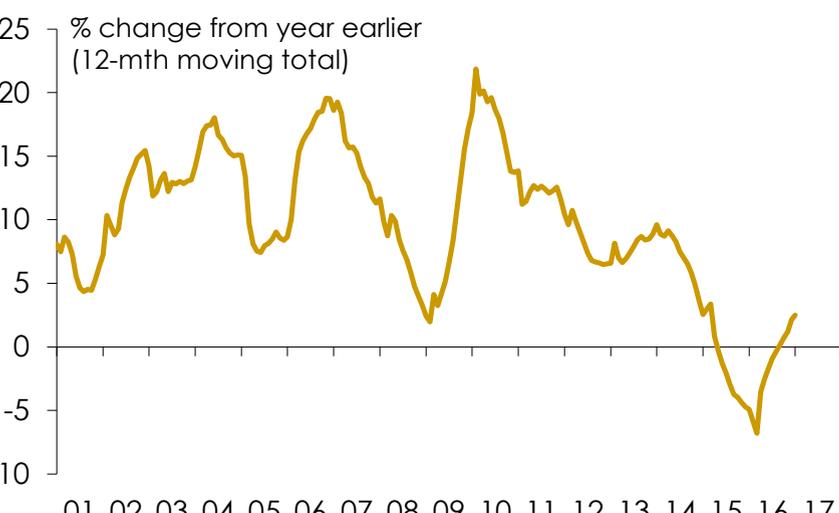
## Iron ore and coal production



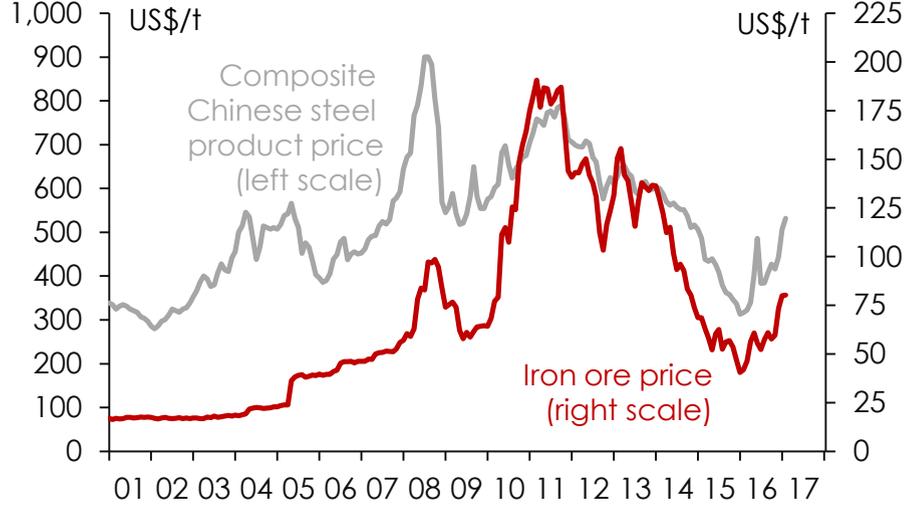
## Urban property prices



## Cement production



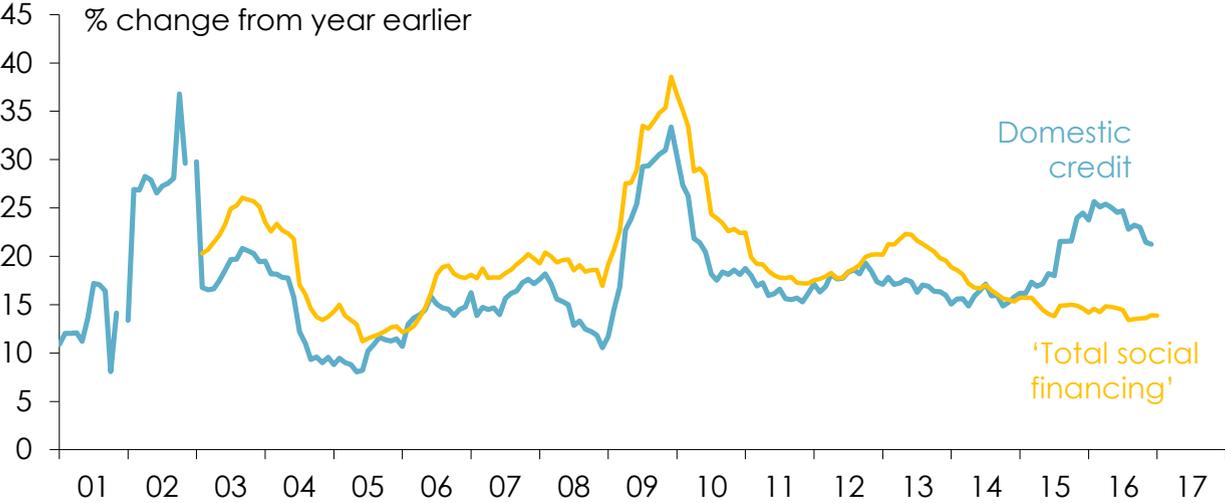
## Iron ore and steel prices



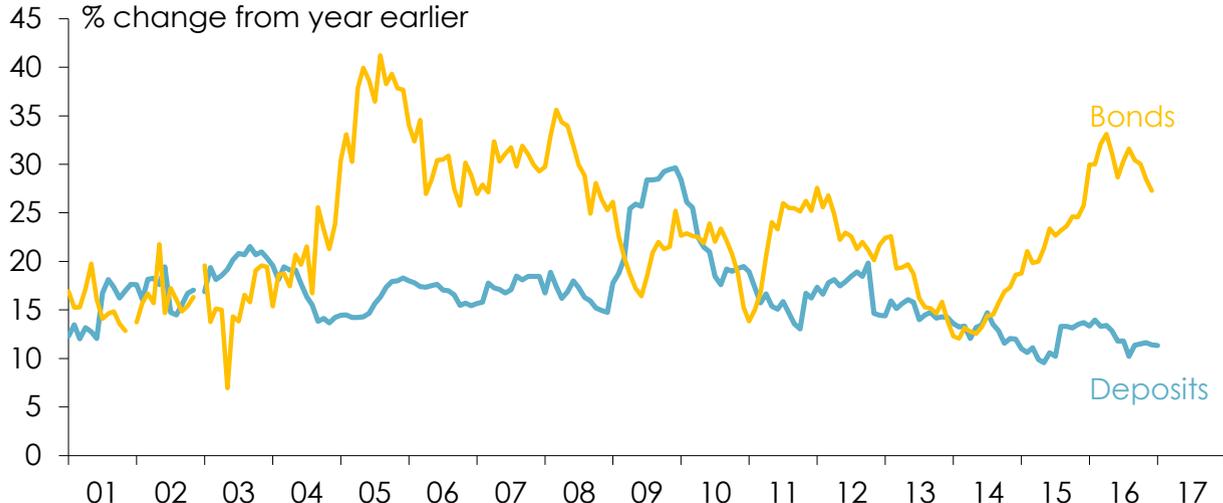
Sources: China National Bureau of Statistics; China Index Academy (CIA) & Soufun; Thomson Reuters Datastream.

# The most recent round of Chinese monetary stimulus has been financed in a way which has increased the risks in the financial system

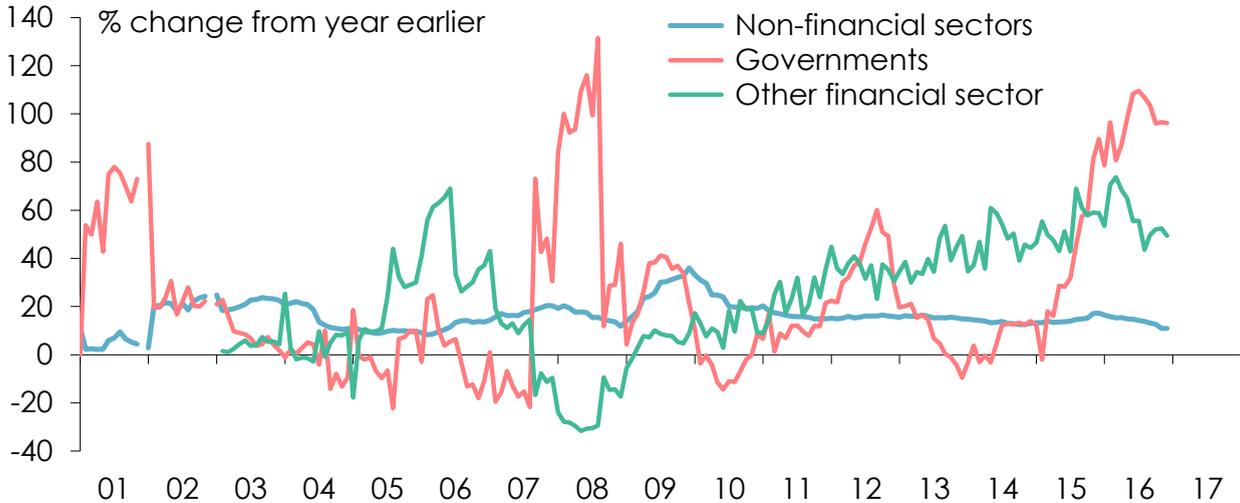
## Credit growth - total



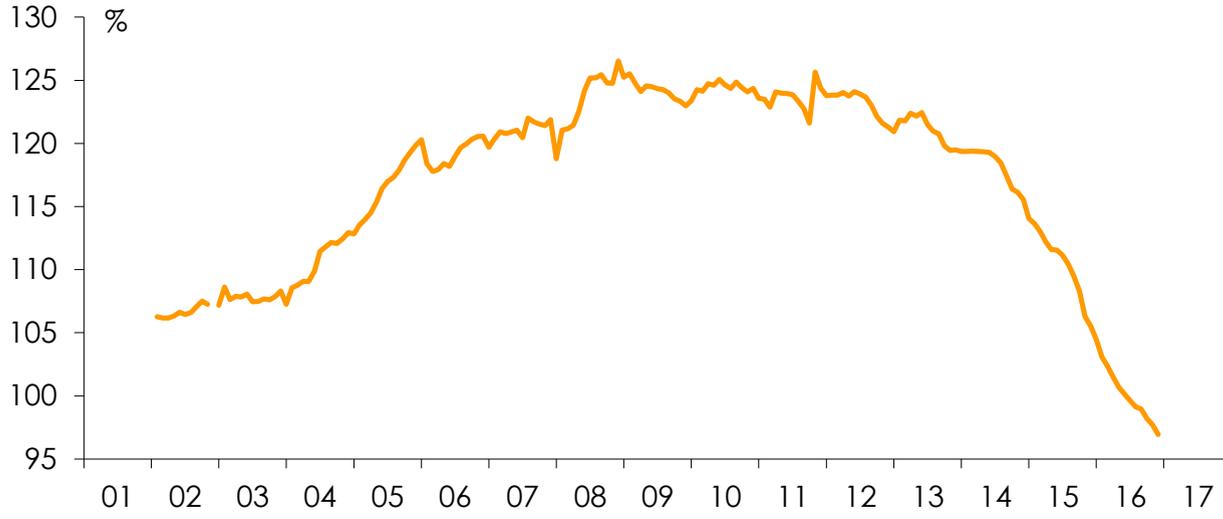
## Banking system liabilities



## Credit growth - by sector



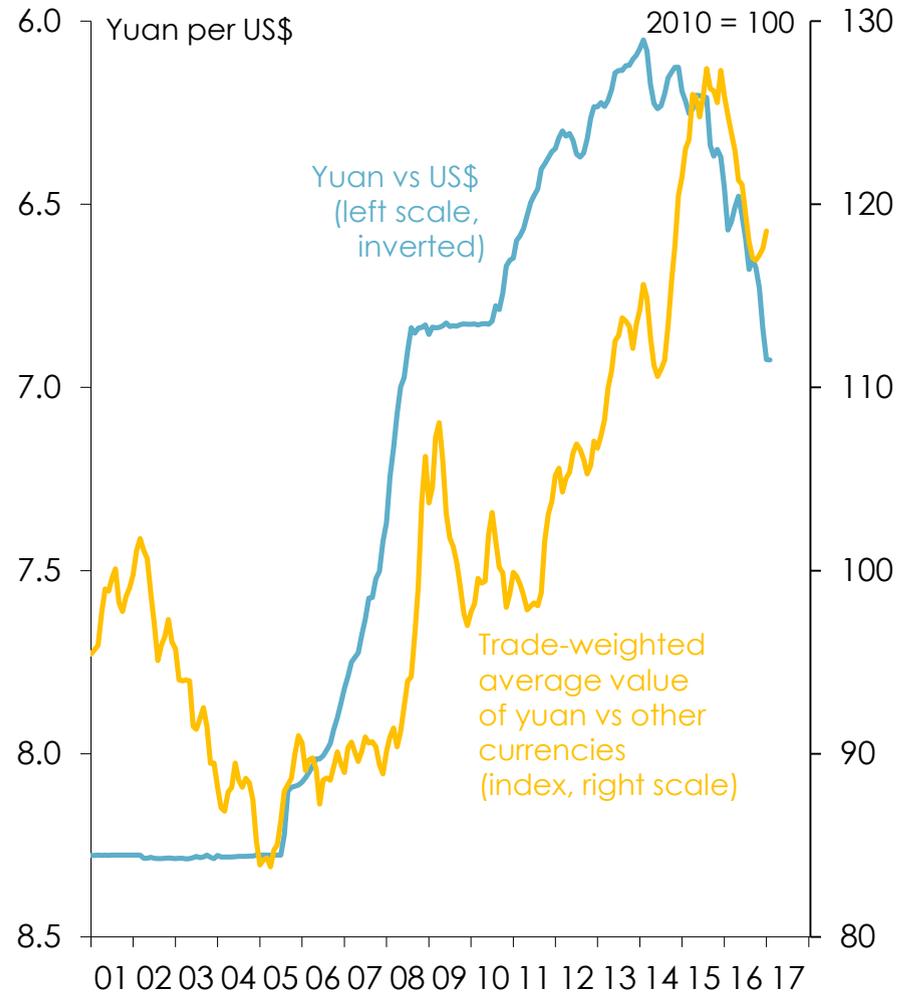
## Banking system deposits-to-loans ratio



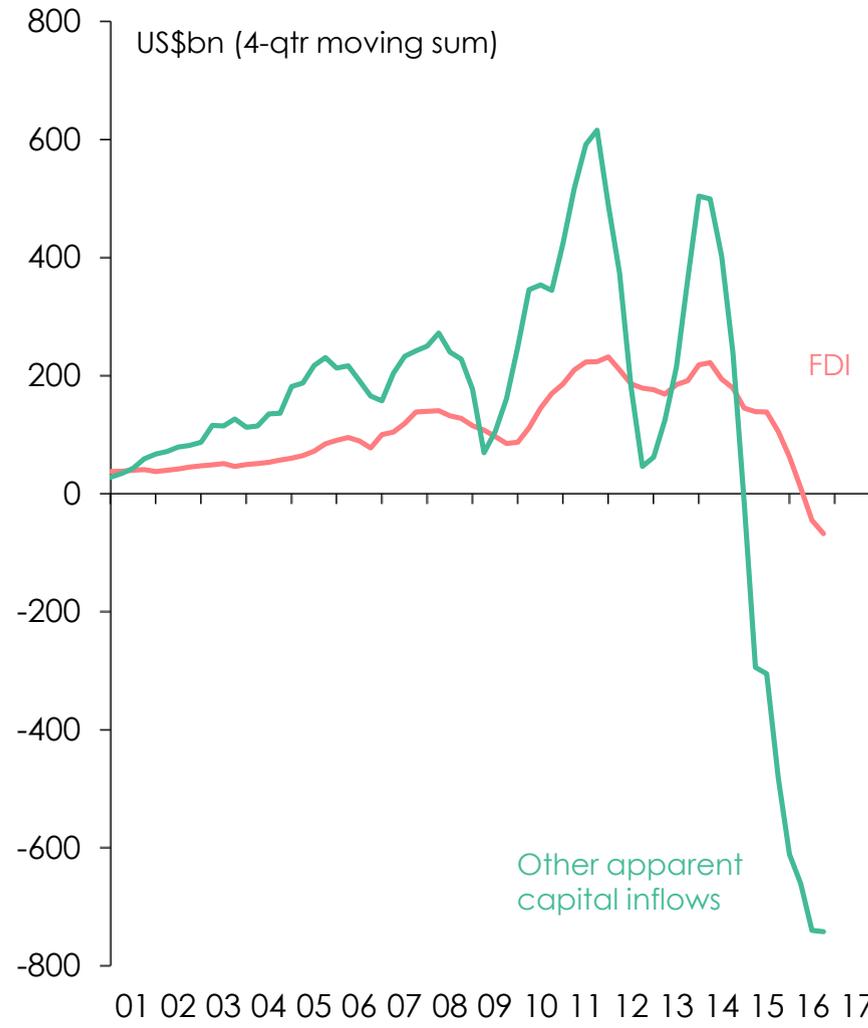
Sources: People's Bank of China; Thomson Reuters Datastream.

# China has been 'manipulating' its currency – to stop it falling, rather than to make it cheaper

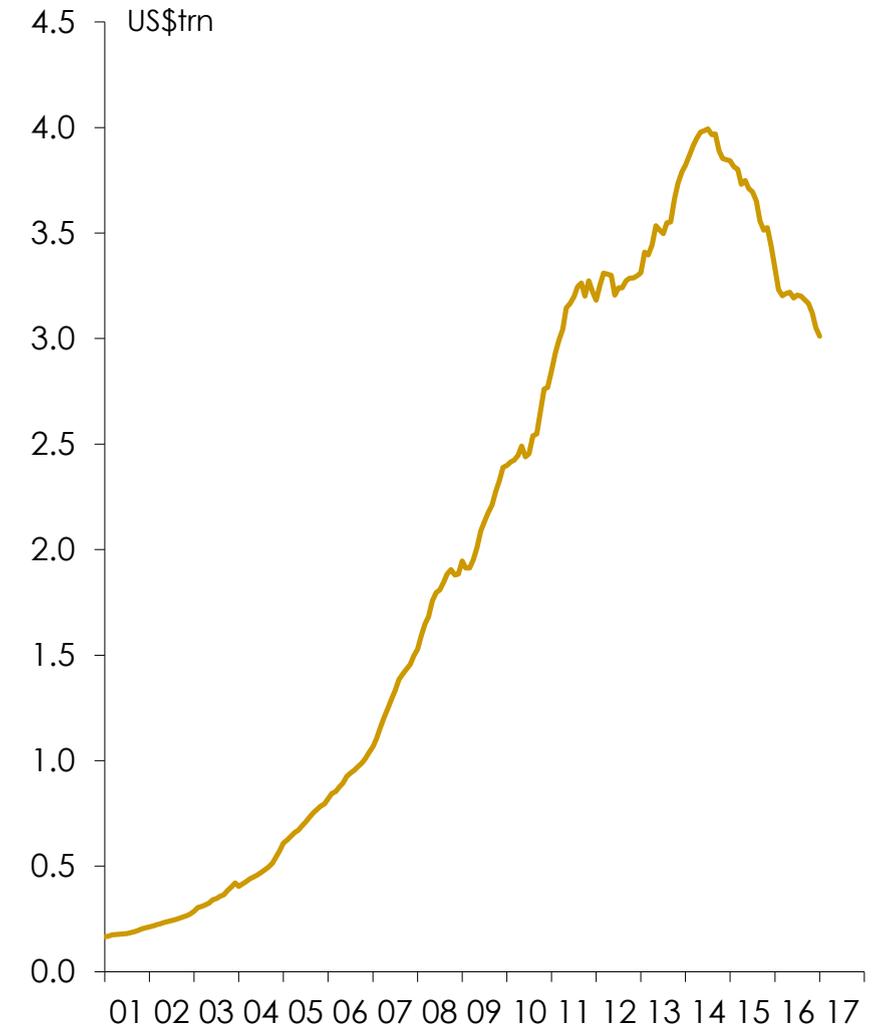
## Chinese yuan vs US dollar



## Net apparent capital inflow



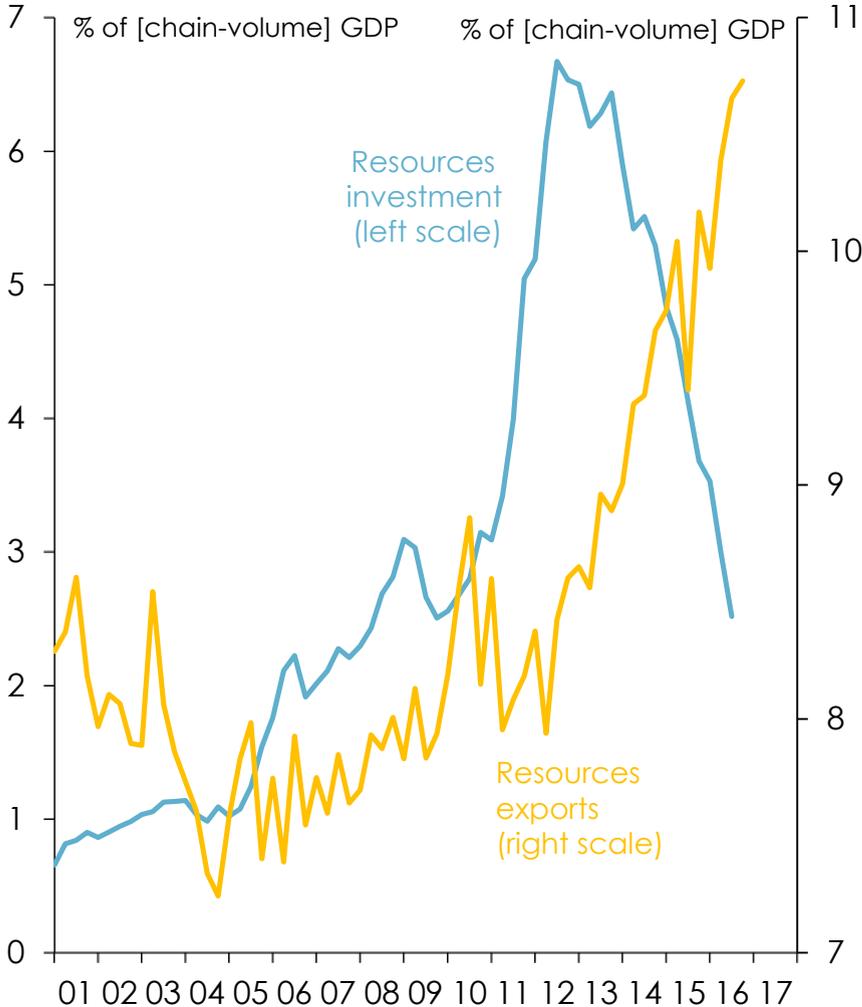
## PBoC FX reserves



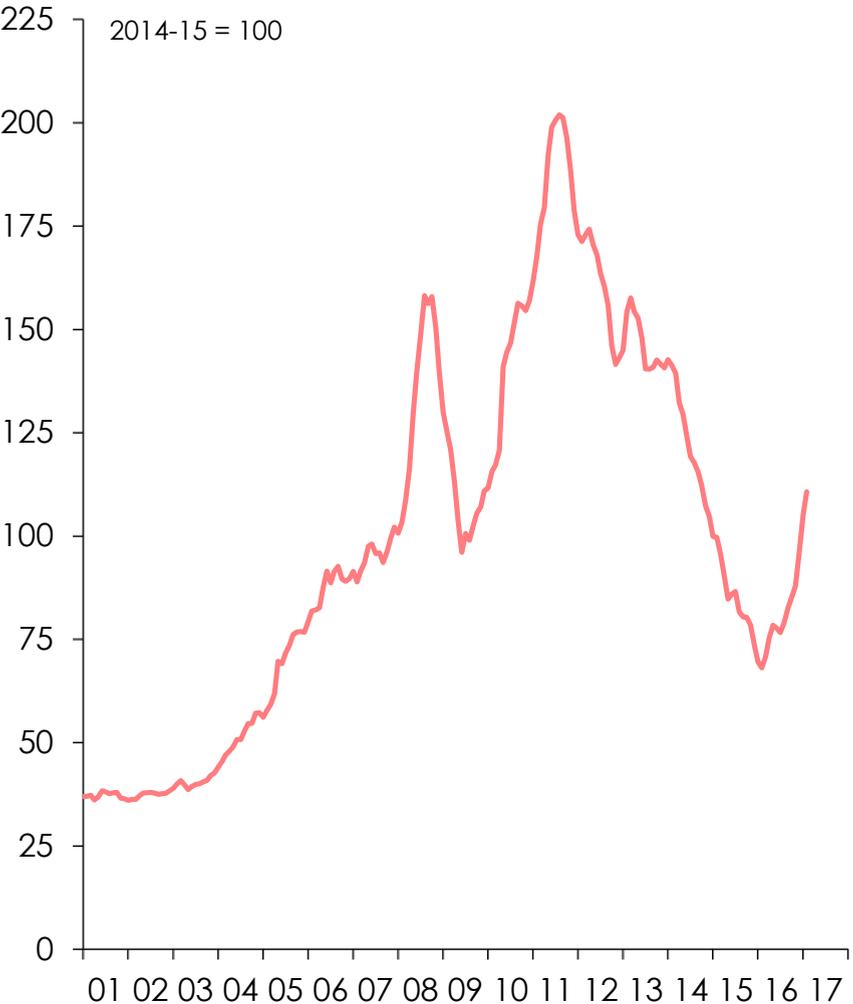
Note: 'Other apparent capital inflows' = current account balance minus capital account balance, change in FX reserves and net FDI.  
Sources: People's Bank of China; Bank for International Settlements; China National Statistics Bureau.

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

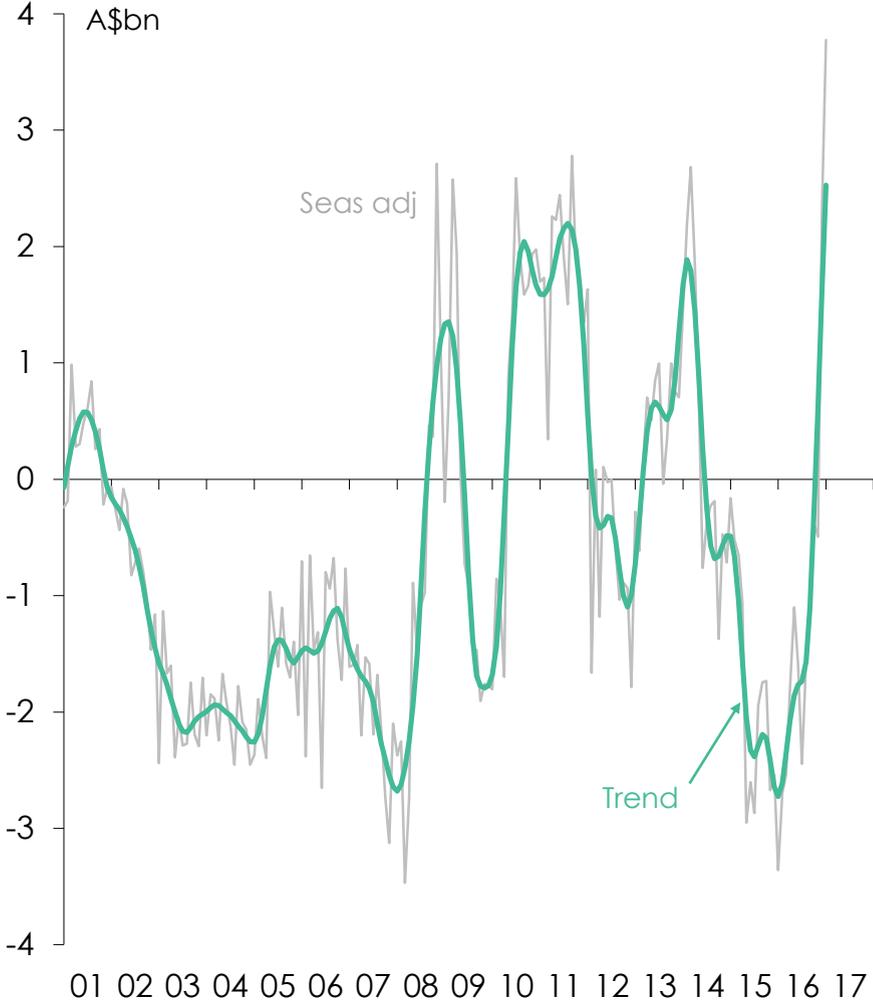
## Australia’s resources investment & export volumes



## Australia’s resources export prices



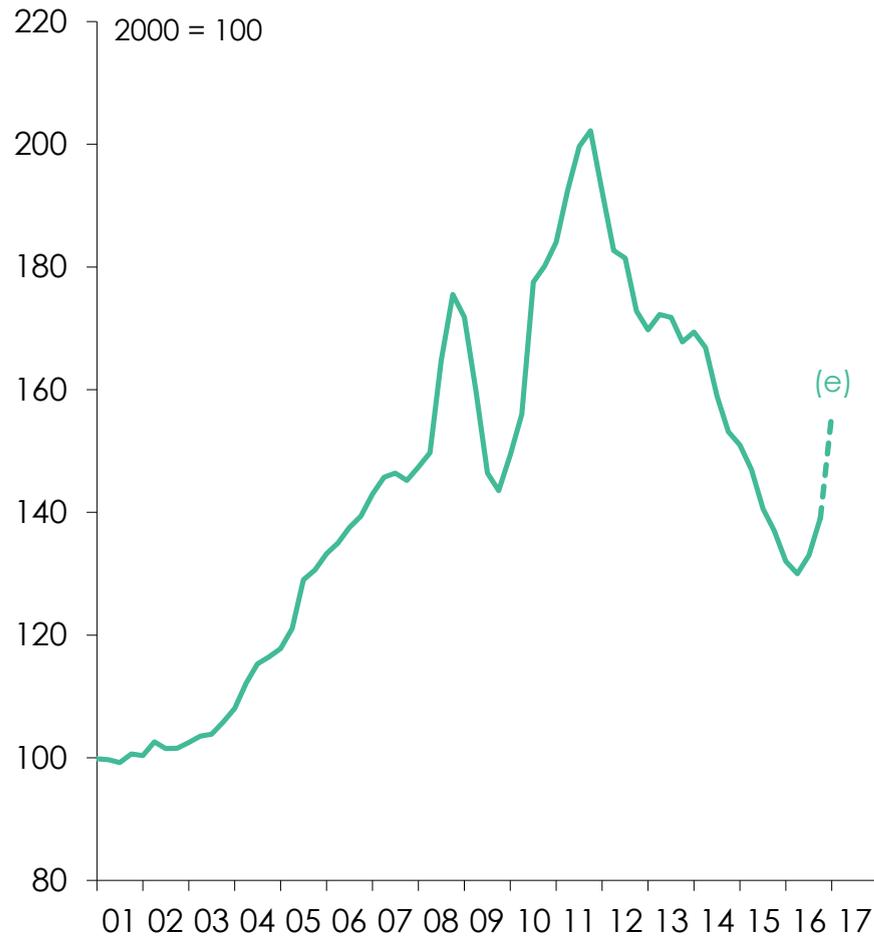
## Australia’s merchandise trade balance



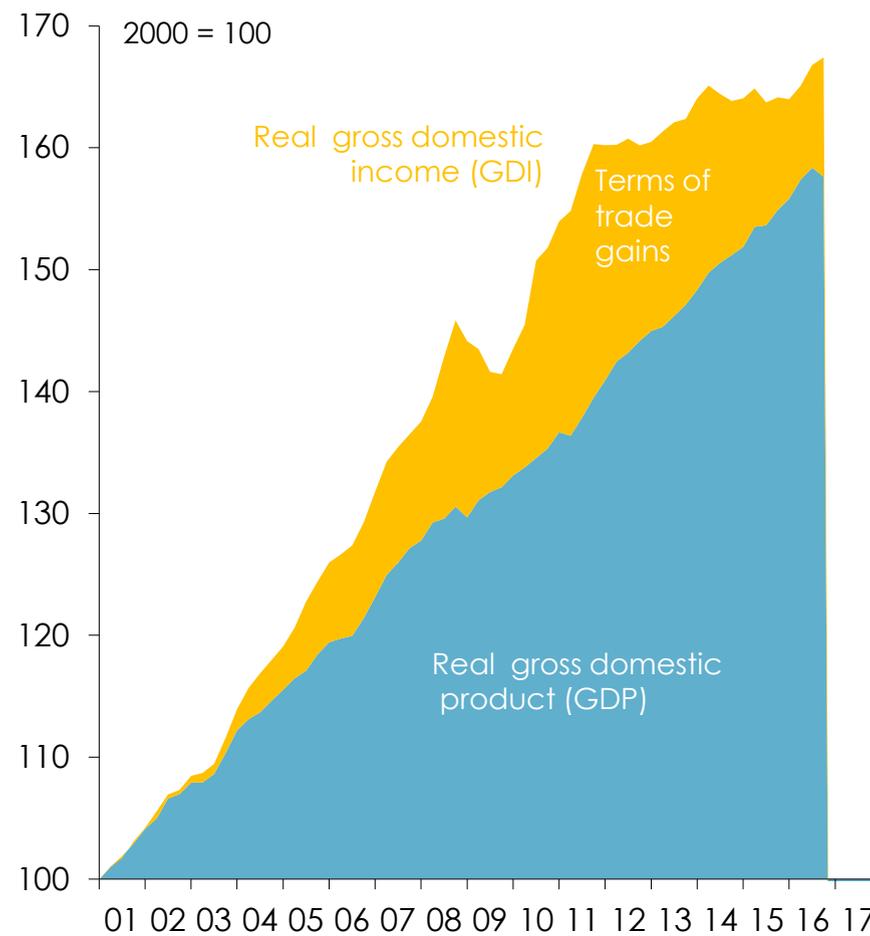
Note: Resources investment includes exploration expenditure.  
Sources: ABS; RBA.

# Will the rebound in commodity prices be a 'get out jail free' card for the Australian economy – like it was after the financial crisis?

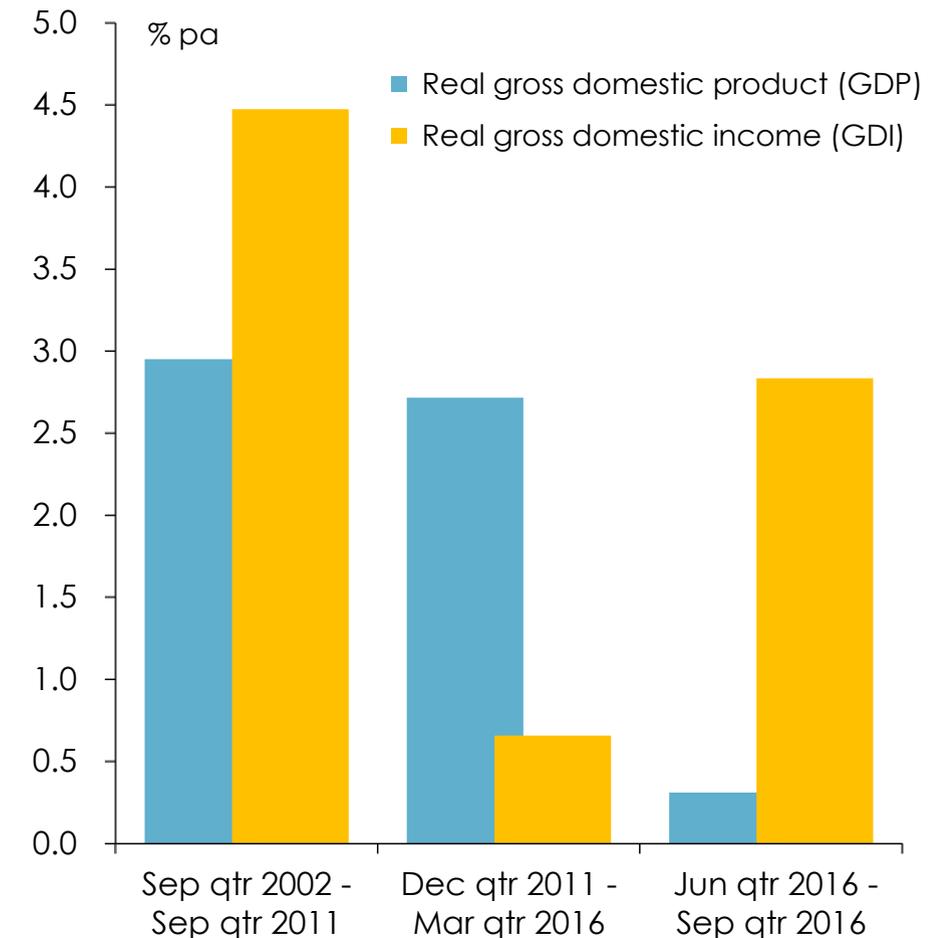
## Australia's terms of trade (ratio of export to import prices)



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



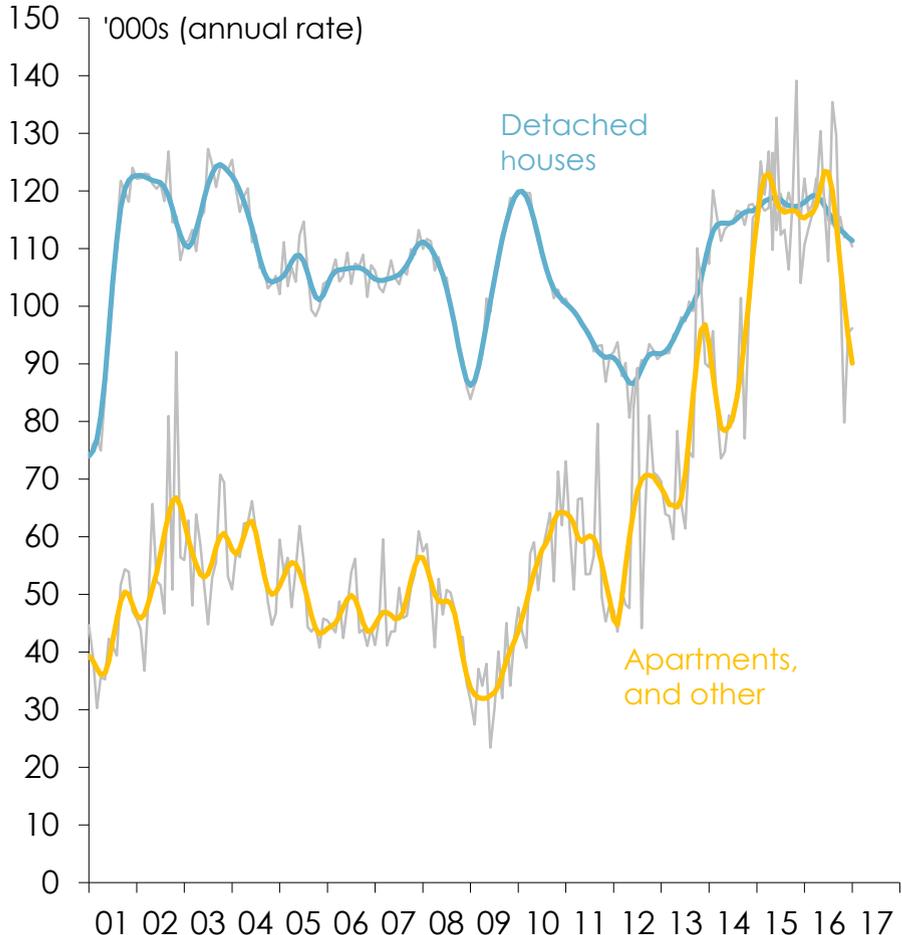
## Growth in real gross domestic income (GDI) vs real GDP



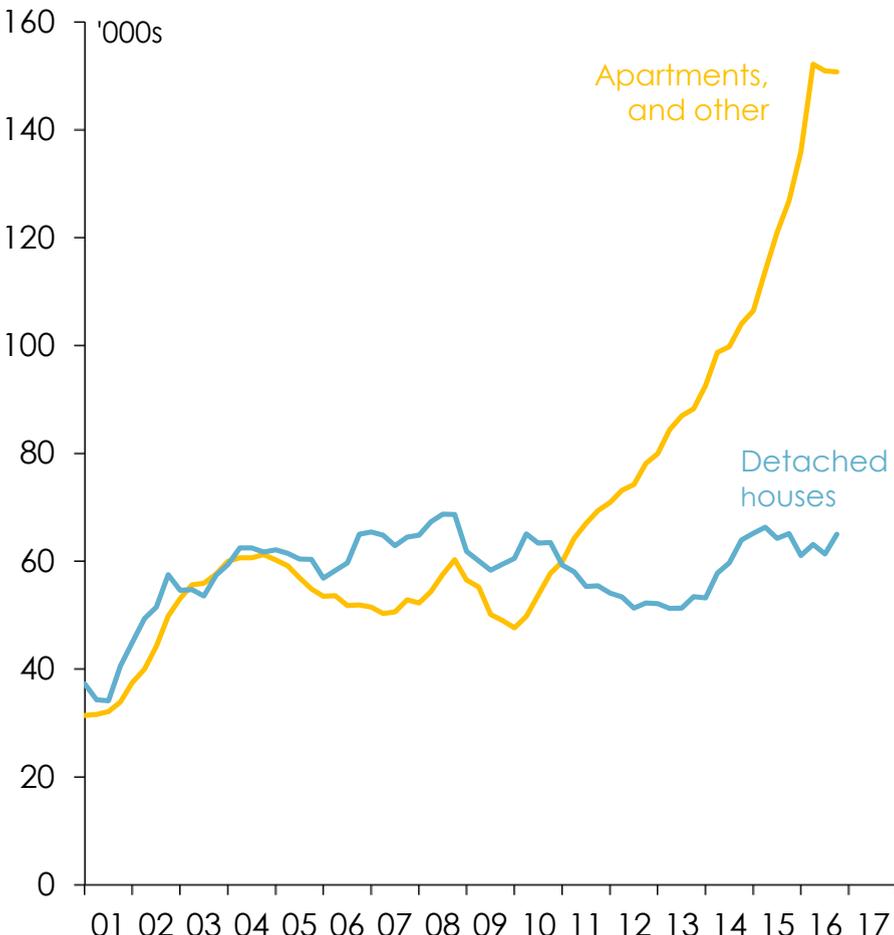
Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services. Real gross domestic income (GDI) is real gross domestic product (GDP) adjusted for income gains or losses arising from changes in the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

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

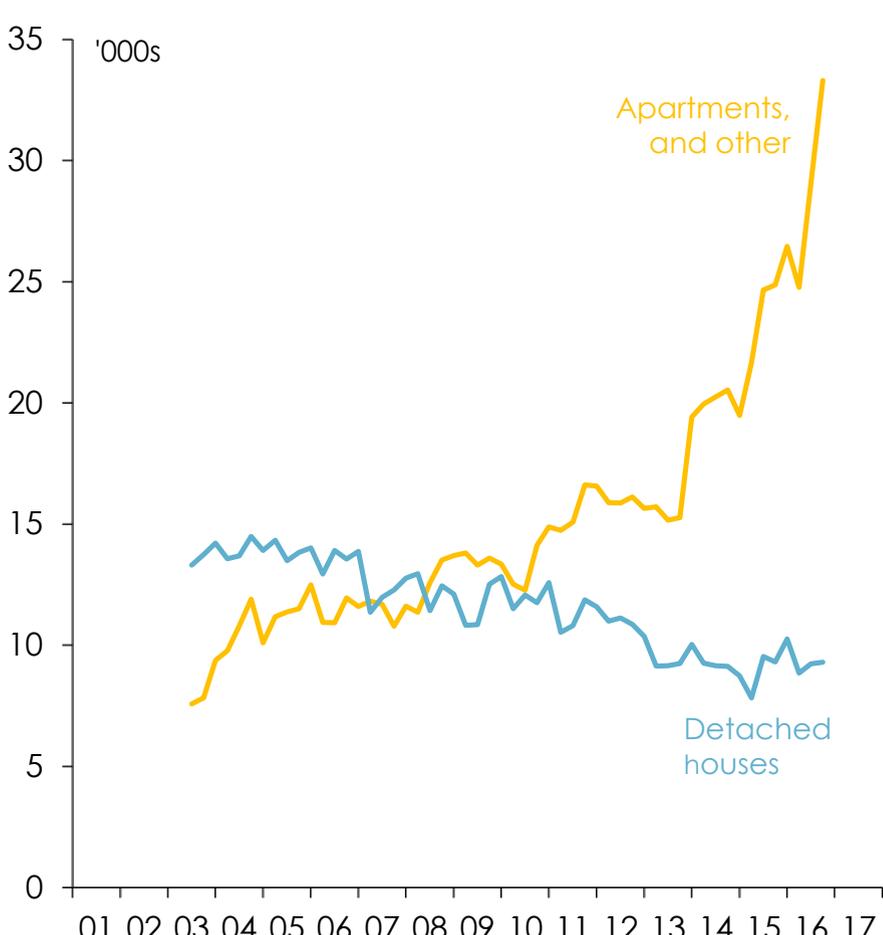
## Private residential building approvals, by type of dwelling



## Residential buildings under construction



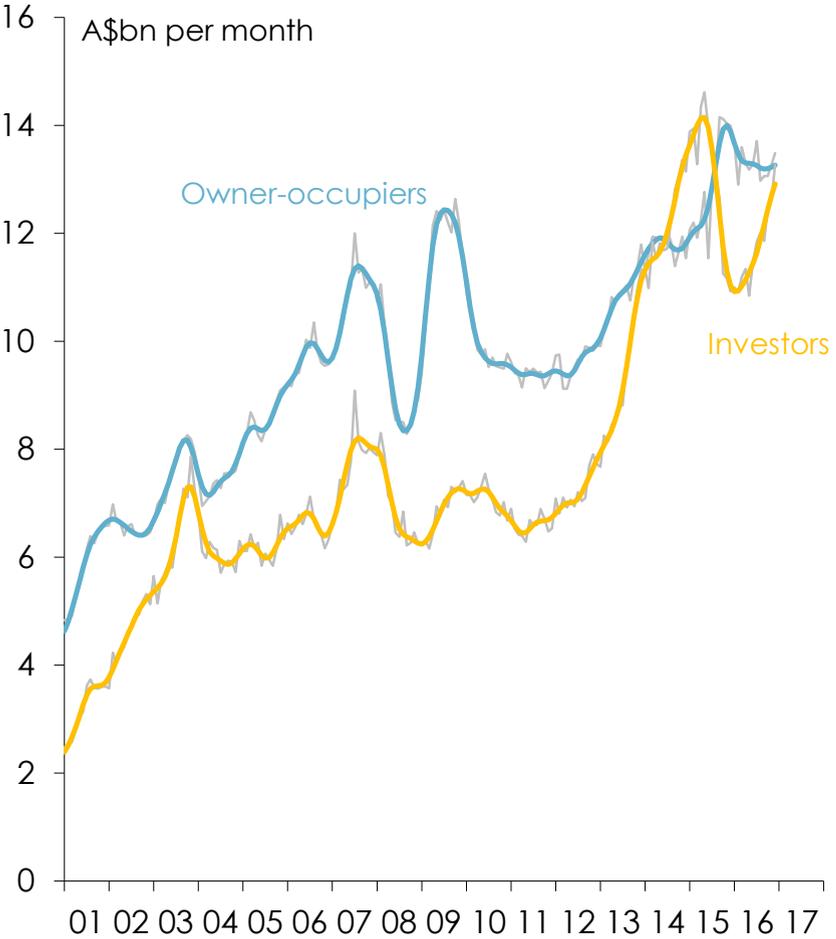
## Dwellings approved but not yet commenced



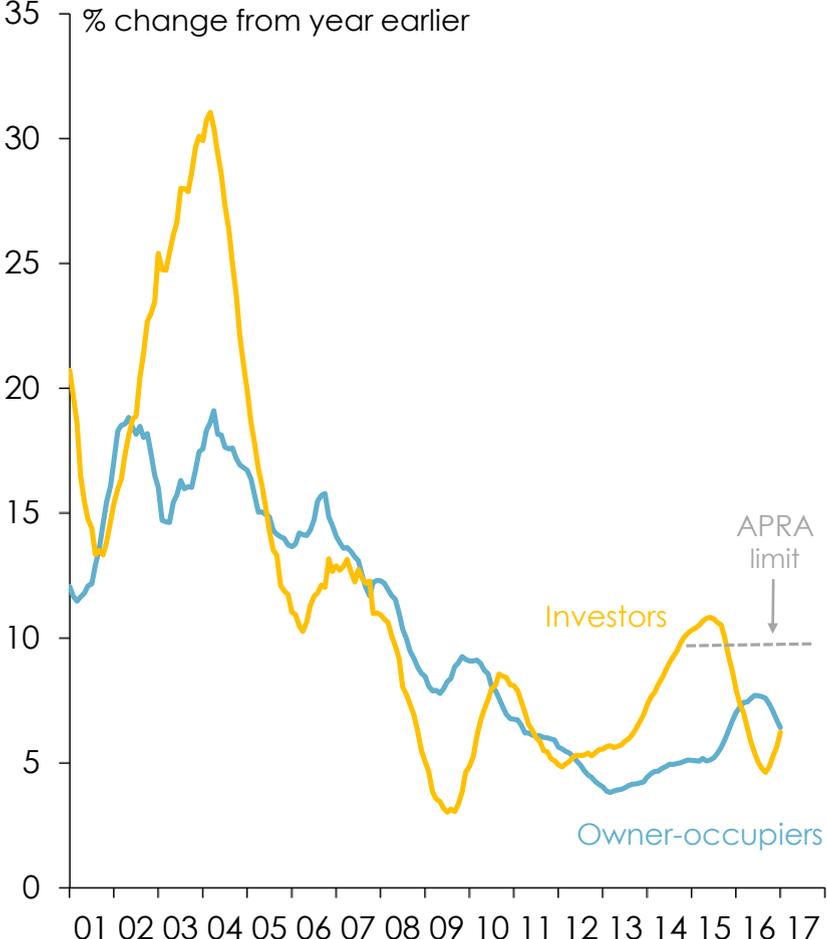
Note: grey lines in first chart above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'. Source: ABS.

# Reserve Bank and APRA will be keeping an eye on the apparent rebound in lending to investors

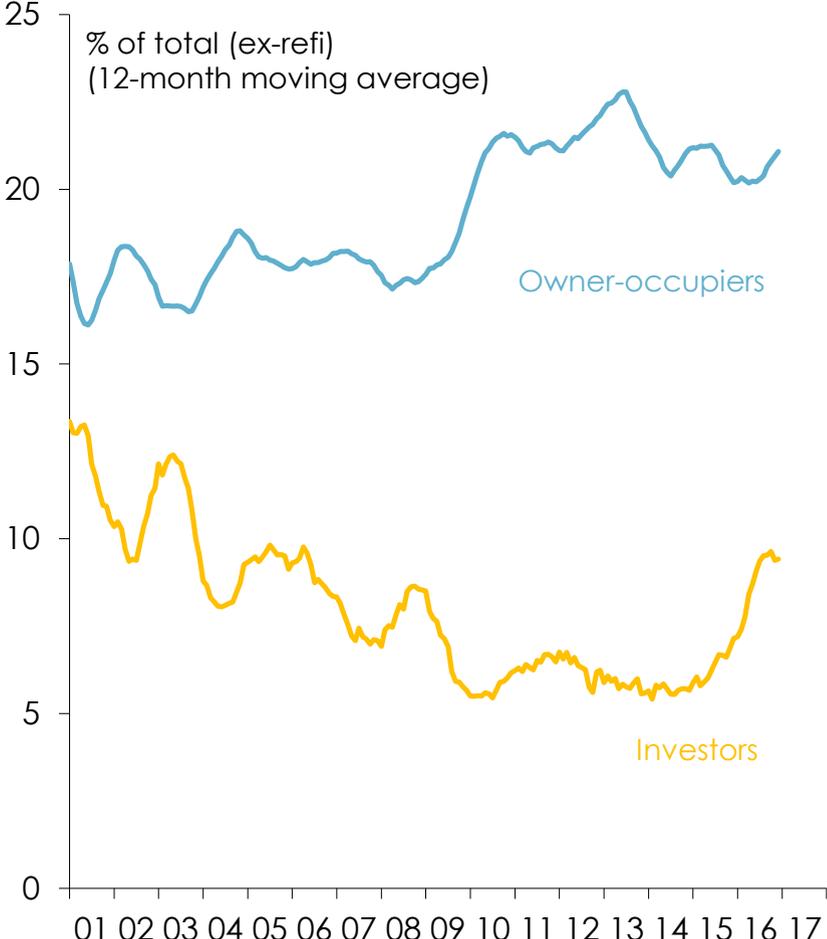
## Finance commitments for residential property purchases



## Housing finance outstanding by type of borrower



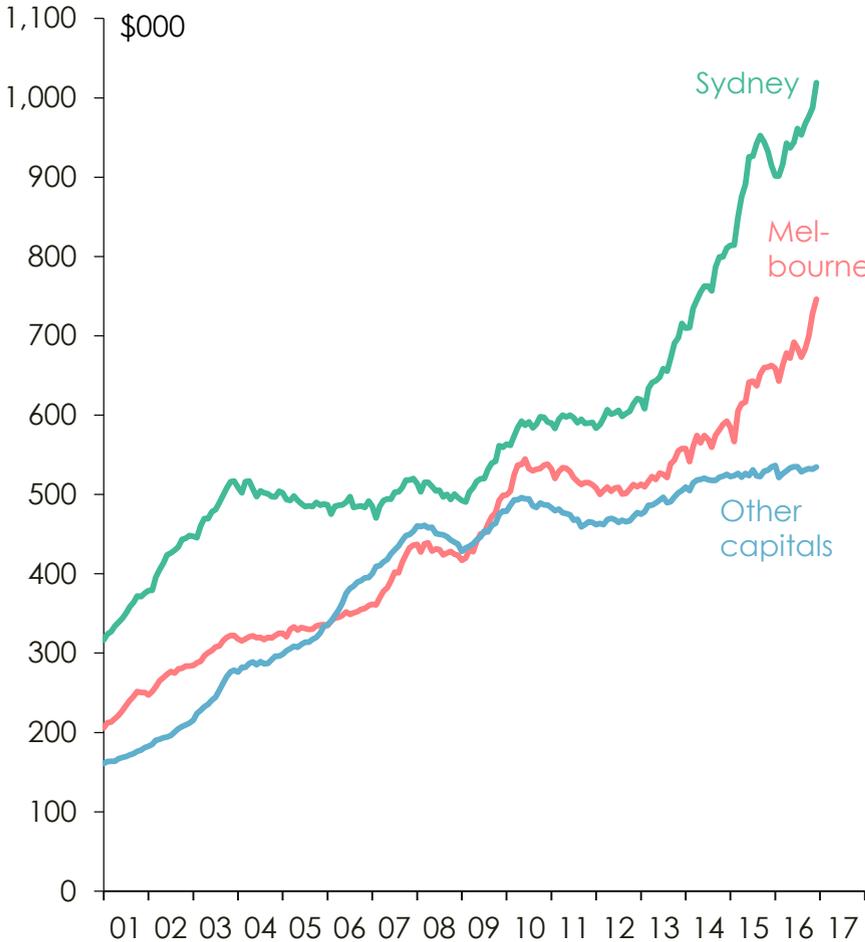
## Lending for purchase of new housing, by type of borrower



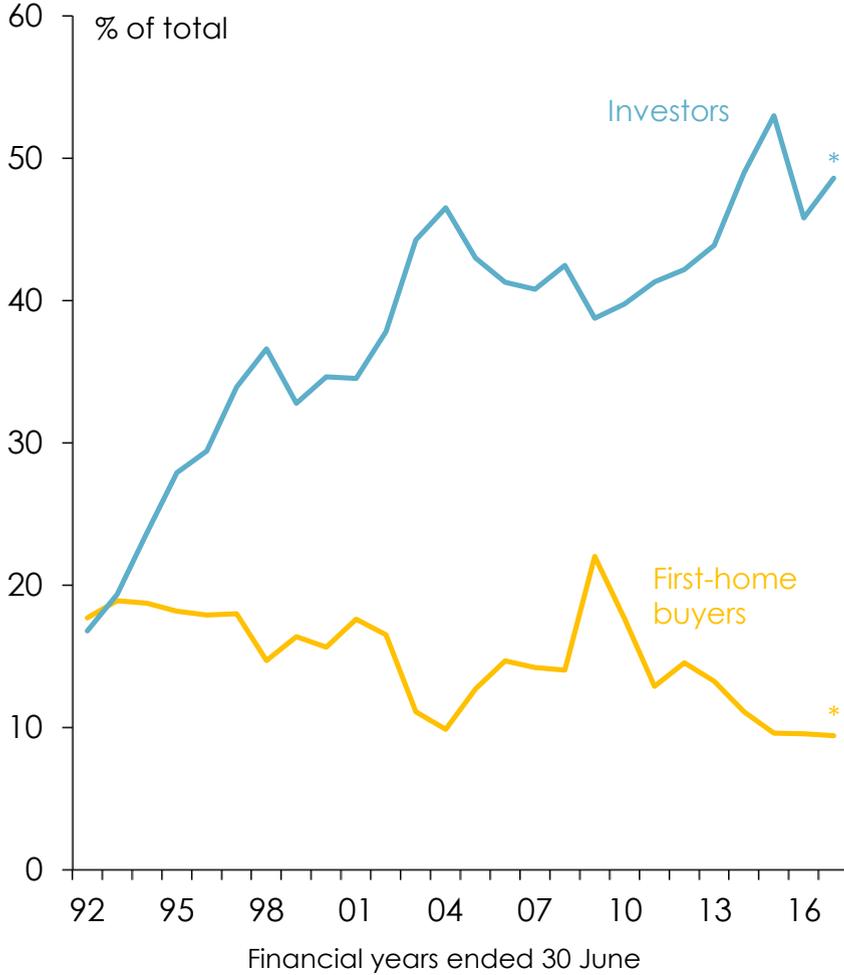
Note: grey lines in first chart above show seasonally adjusted data; thicker coloured lines are the ABS 'trend estimates'. Source: ABS.

# Reserve Bank and APRA will be keeping an eye on the apparent rebound in lending to investors

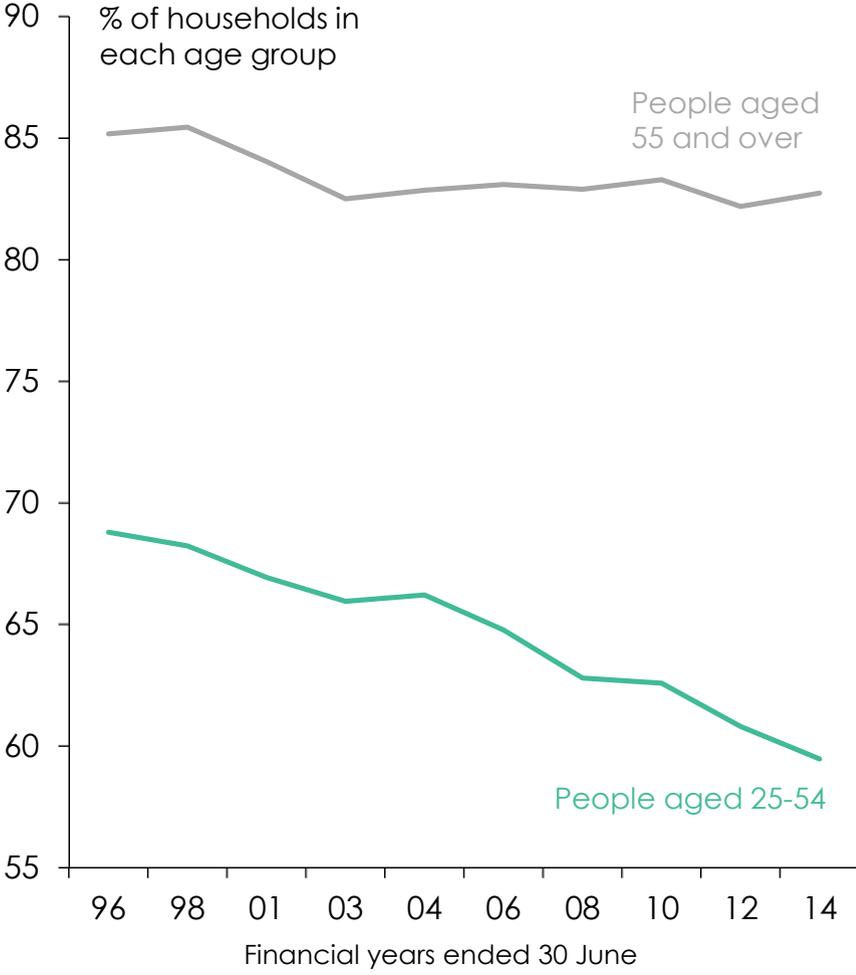
## Capital city residential property prices



## Mortgage lending to first-time buyers and investors



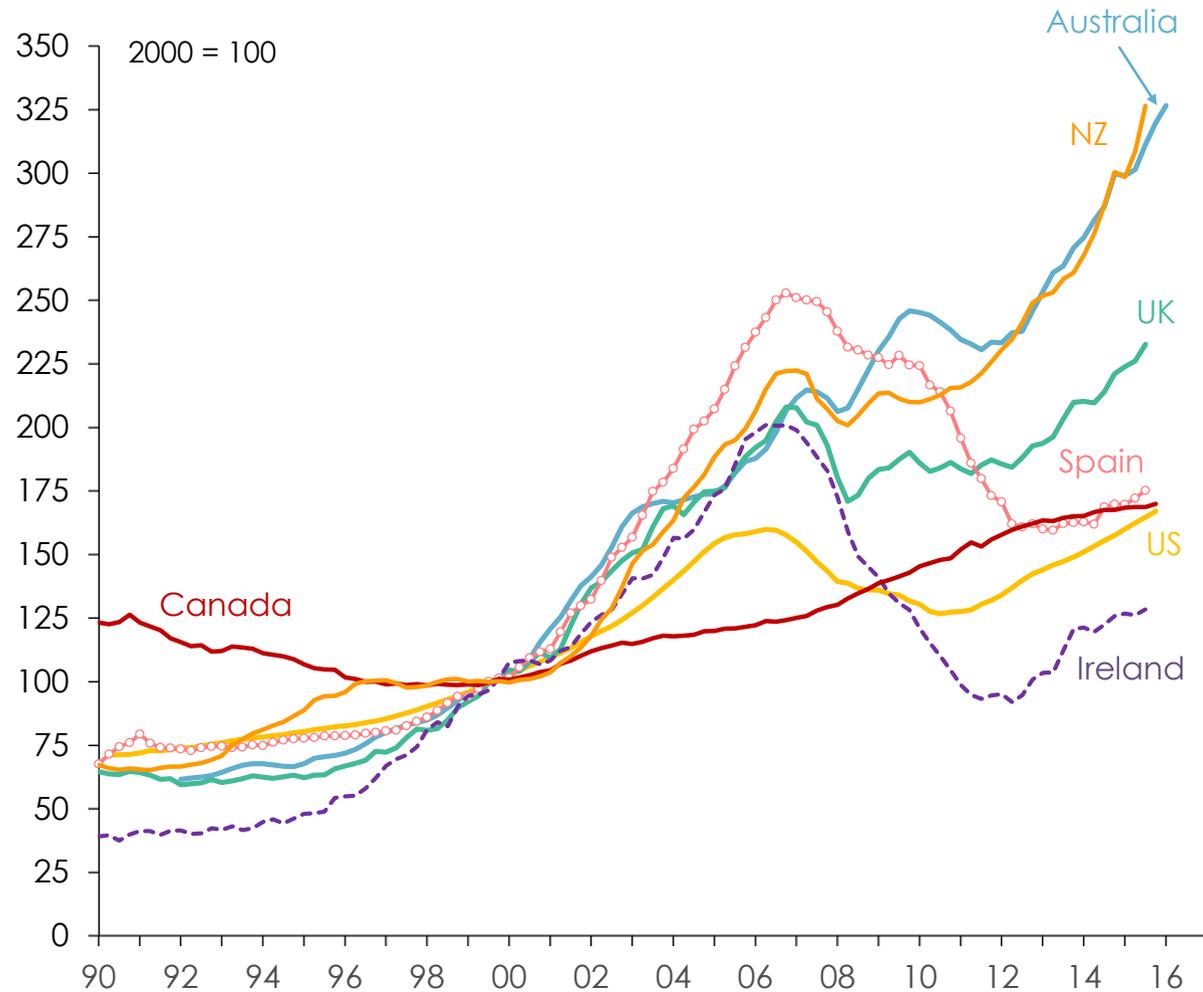
## Home ownership rates by age group



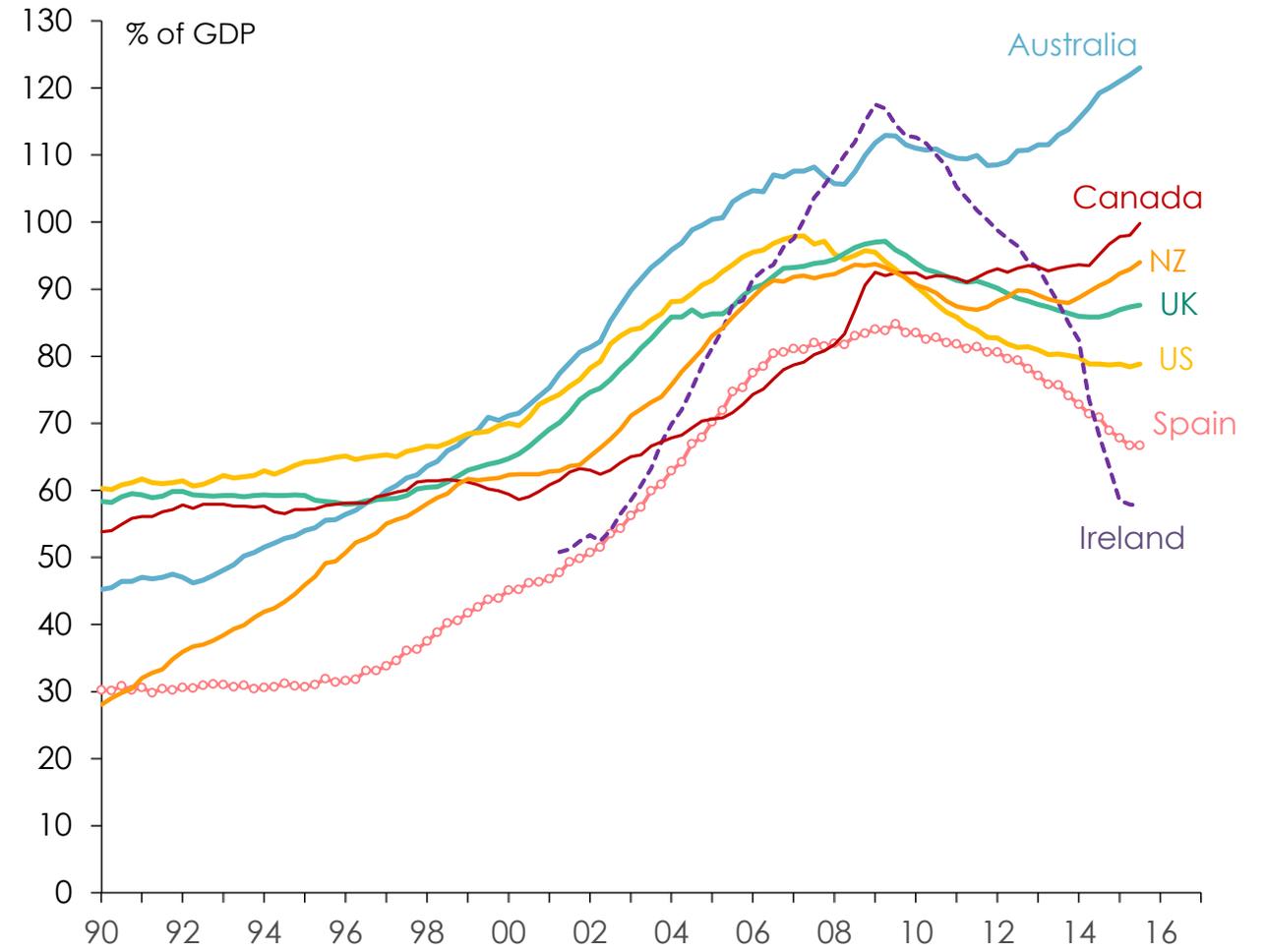
Note: \* 2016-17 data are for July-November 2016.  
Sources: CoreLogic; ABS.

# 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



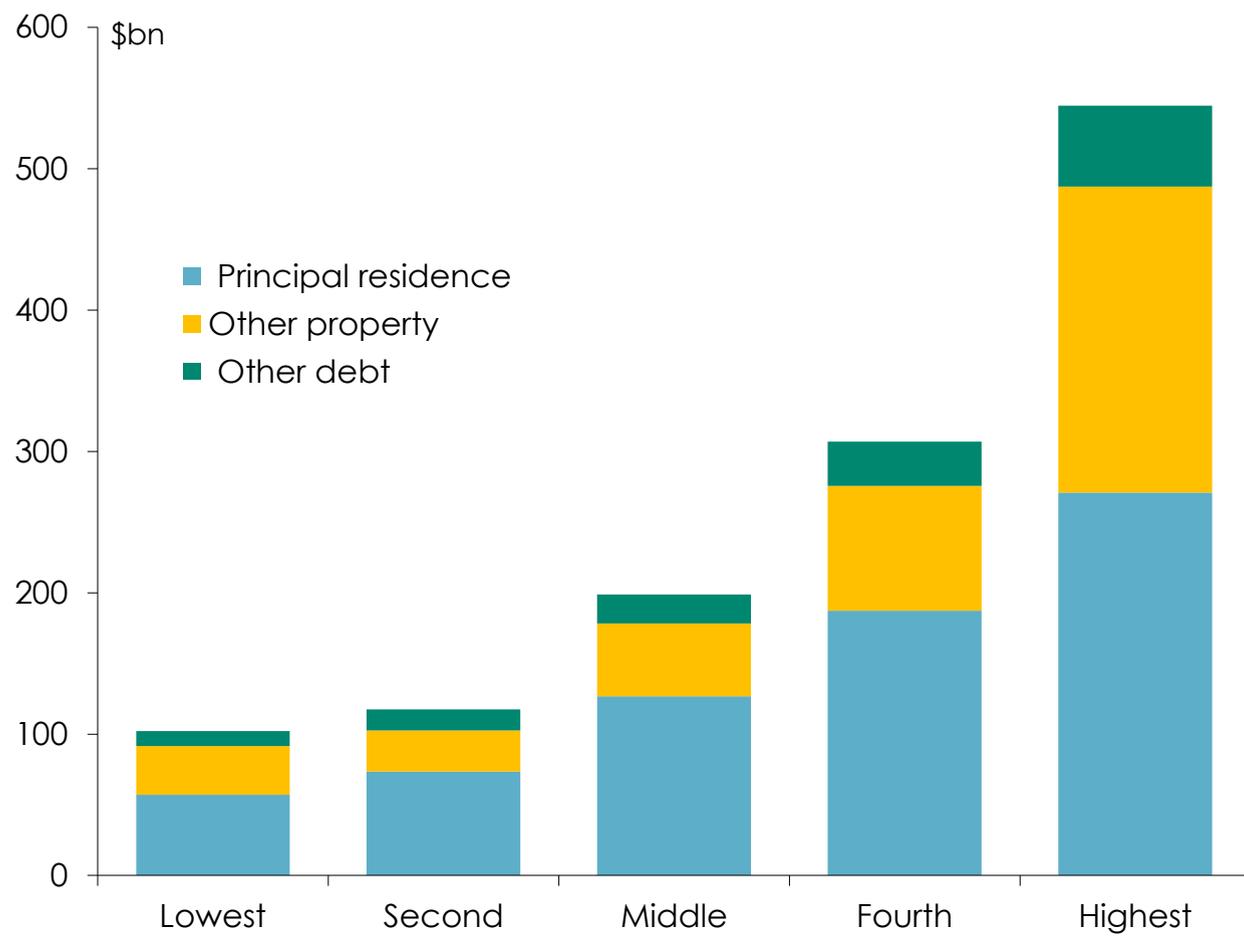
## Household debt – Australia vs other 'advanced' economies



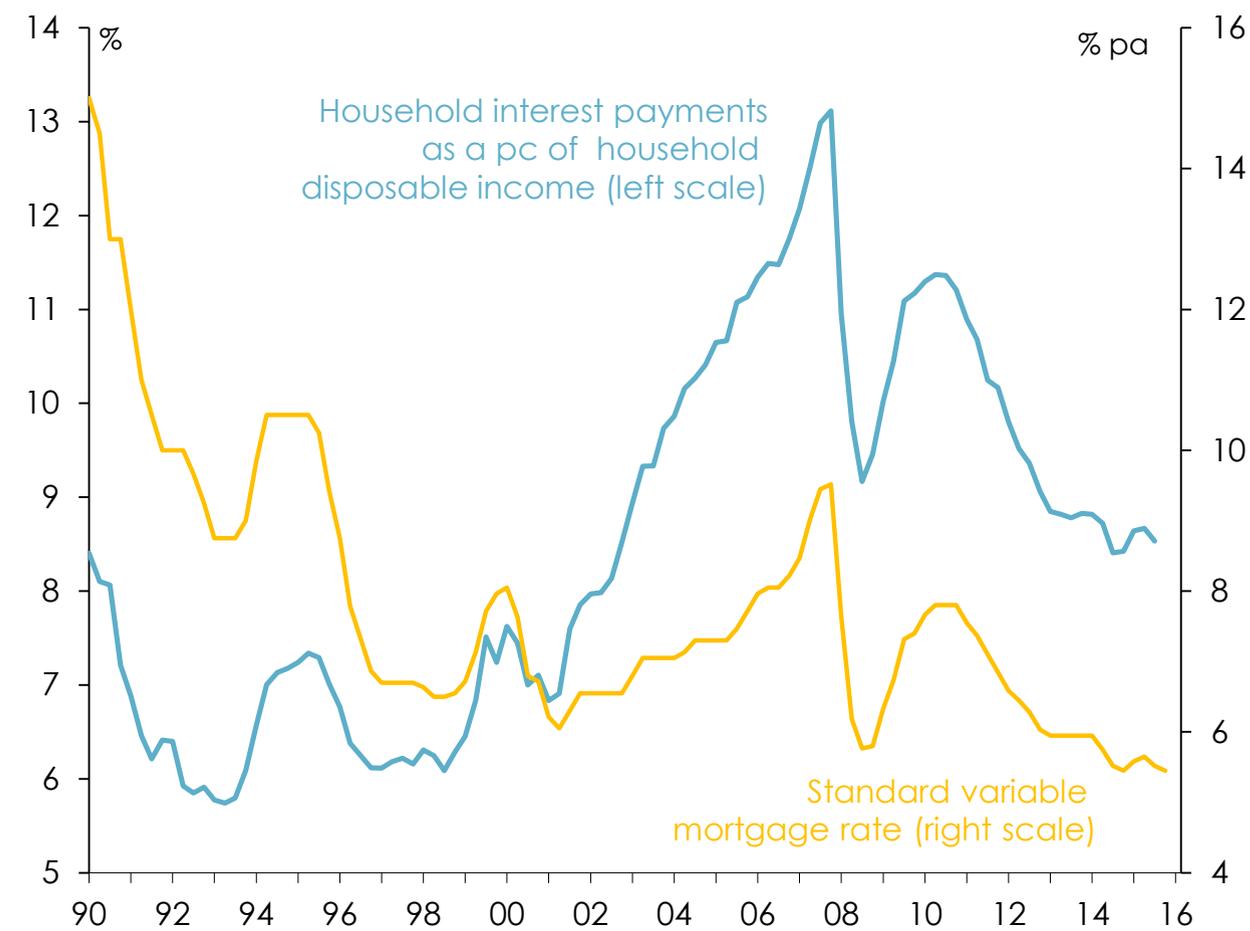
Sources: [RP Data - Core Logic](#); S&P, [CoreLogic Case-Shiller Home Price Indices](#); Bank for International Settlements (BIS), [residential property price series](#) and [credit to the non-financial sector](#) database.

# 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



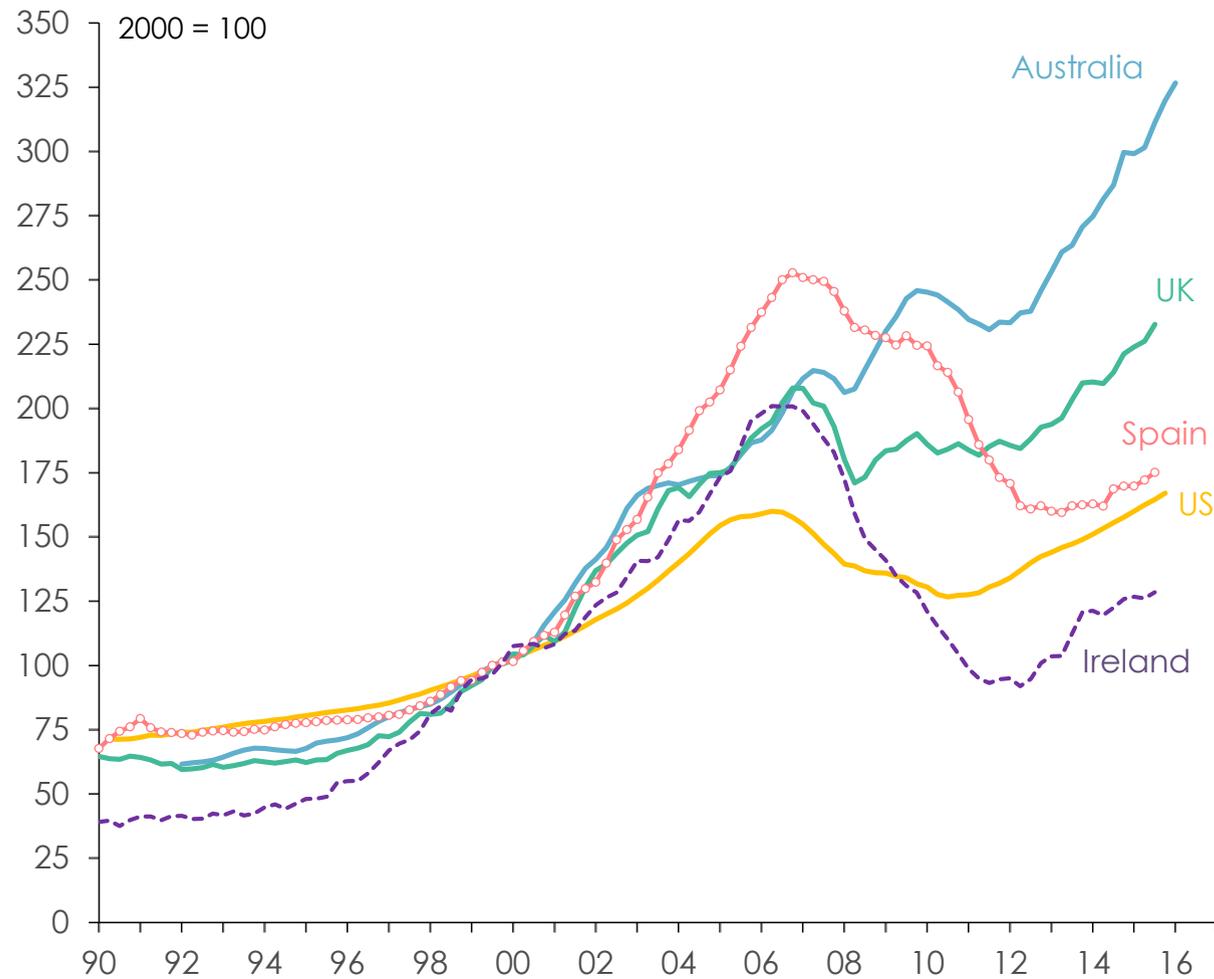
## Household debt service ratio and interest rates



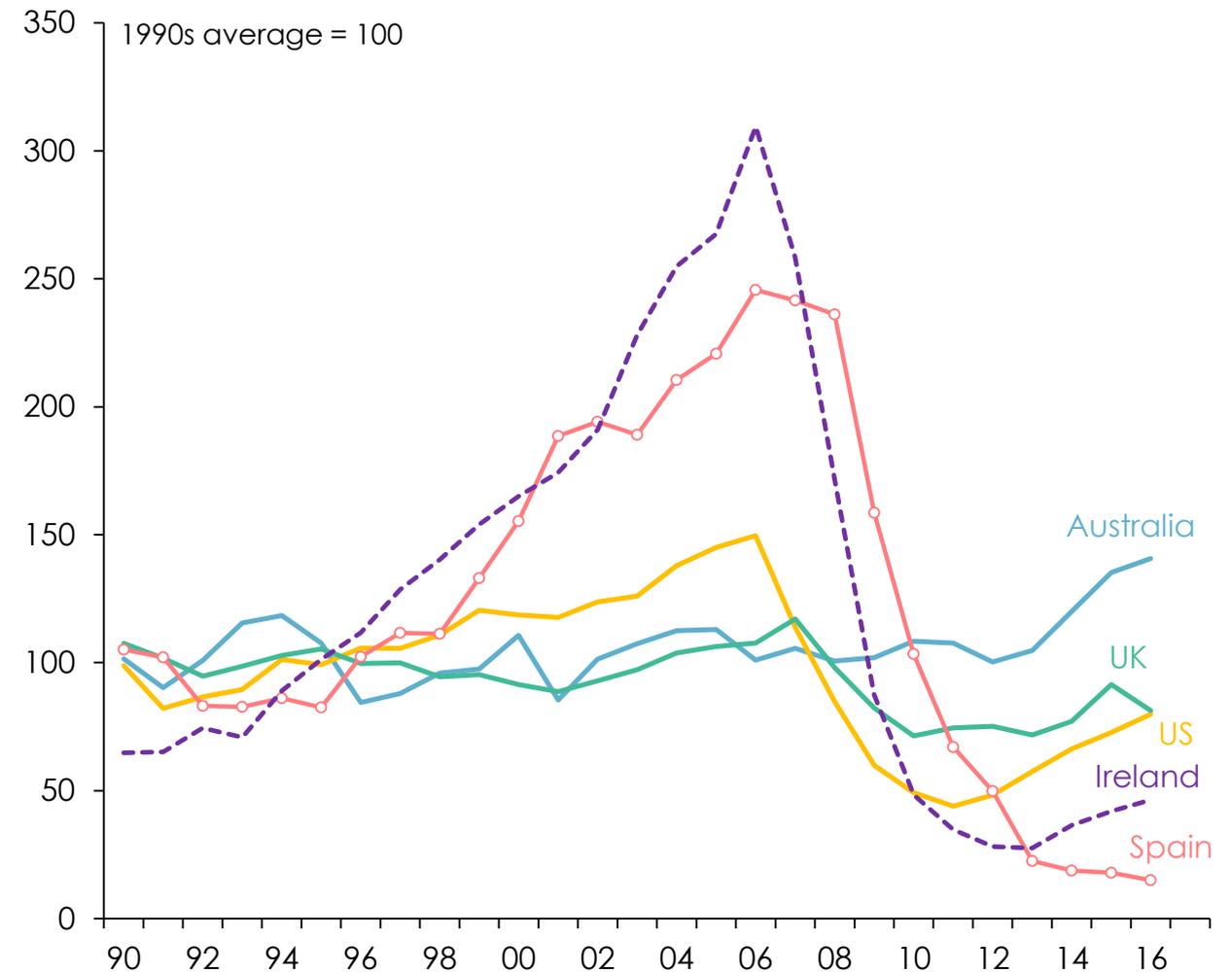
Sources: ABS; RBA.

# 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



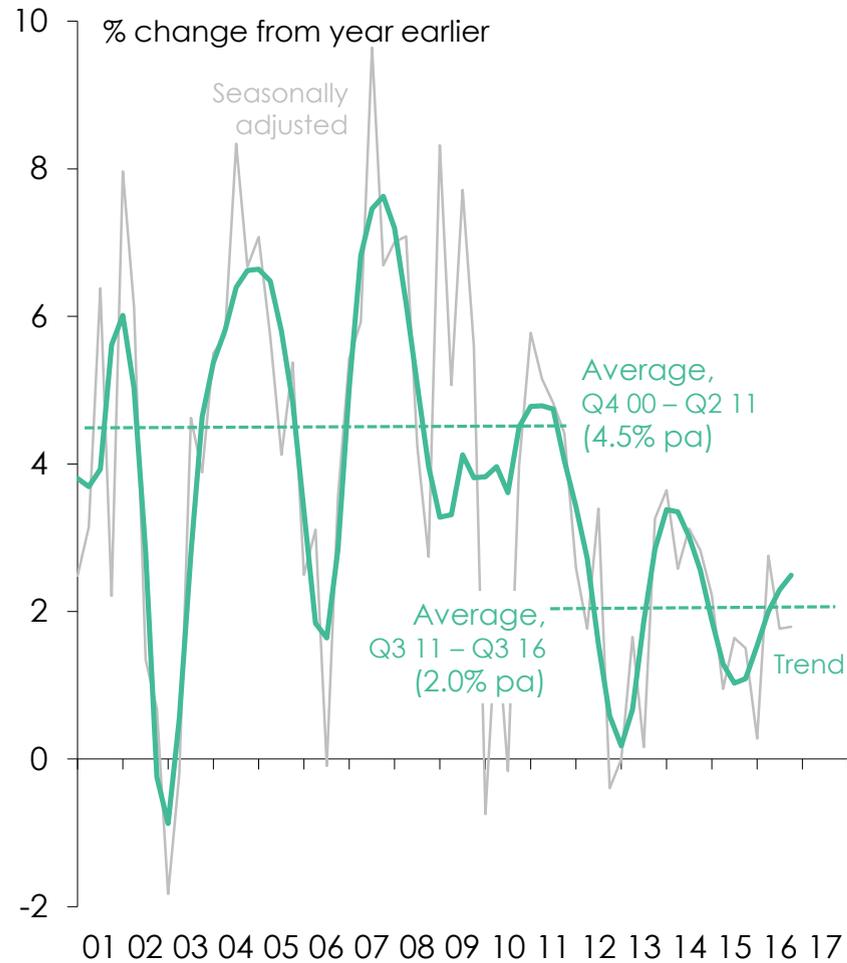
## Housing completions – Australia and other selected 'advanced' economies



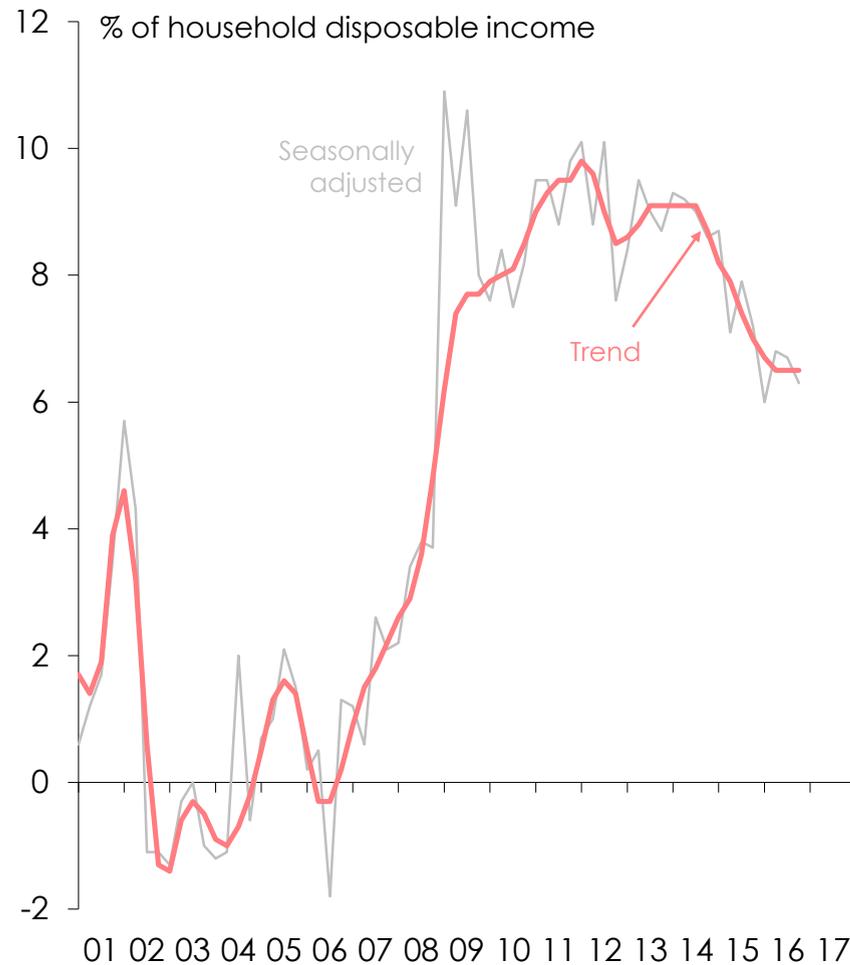
Sources: [RP Data - Core Logic](#); S&P, [CoreLogic Case-Shiller Home Price Indices](#); Bank for International Settlements (BIS), [residential property price series](#) database; ABS; US Commerce Department; UK Office of National Statistics; Instituto Nacional de Estadística d'España; Ireland Central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

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

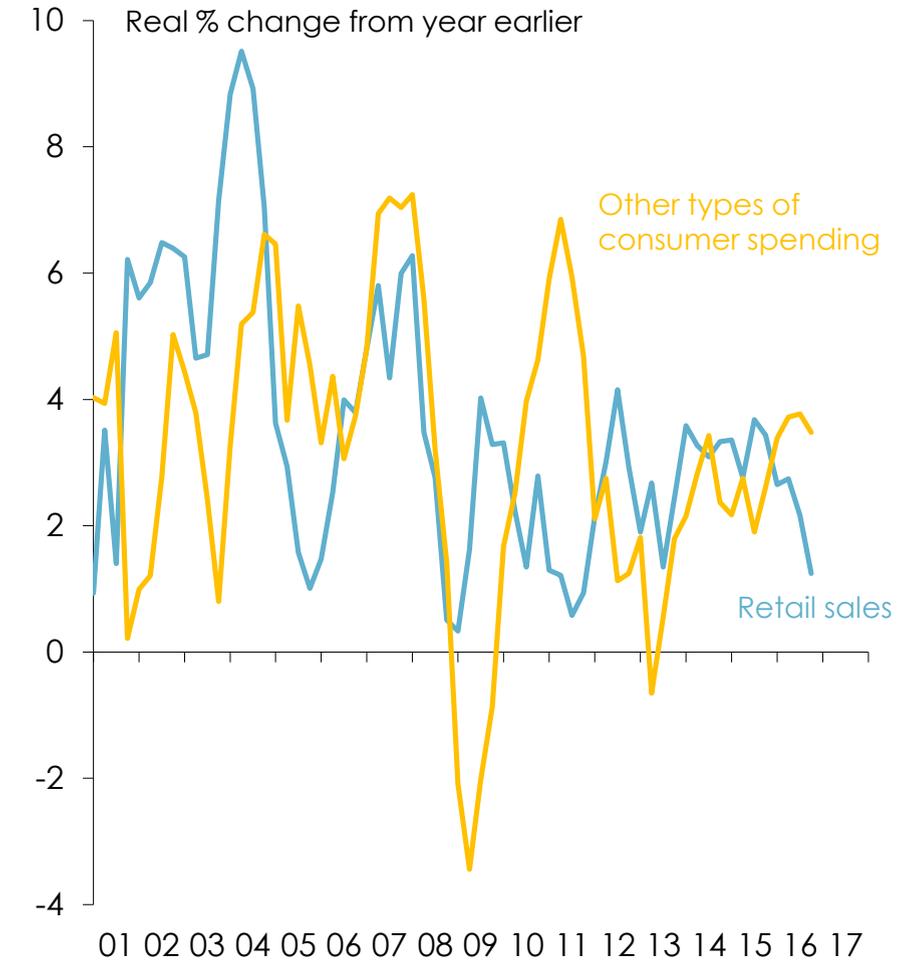
## Real household disposable income



## Household saving rate



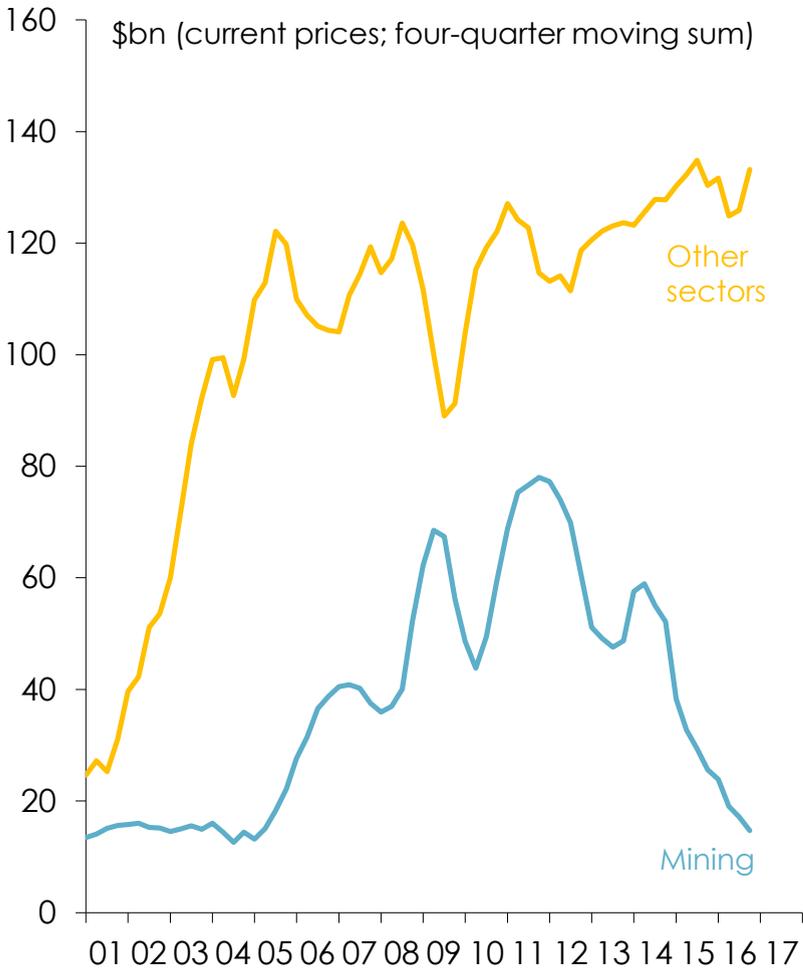
## Consumer spending



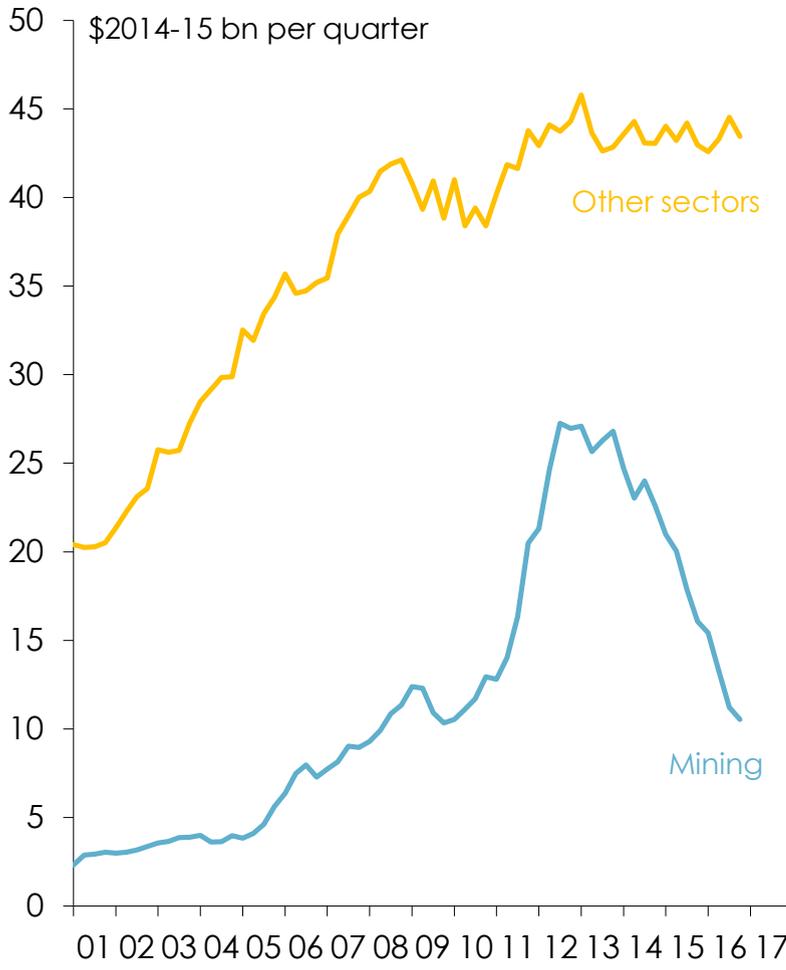
Source: ABS.

# Weak profits growth together with economic and political uncertainty are weighing on business confidence and business investment

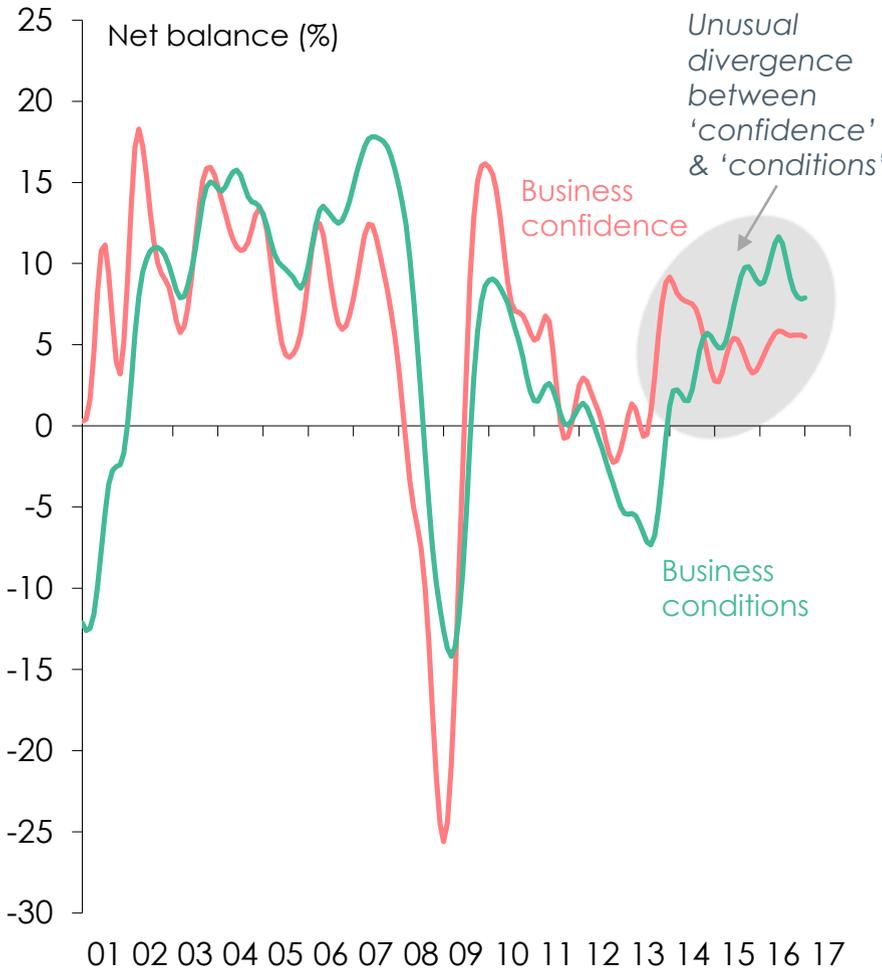
## Pre-tax company profits



## Business investment



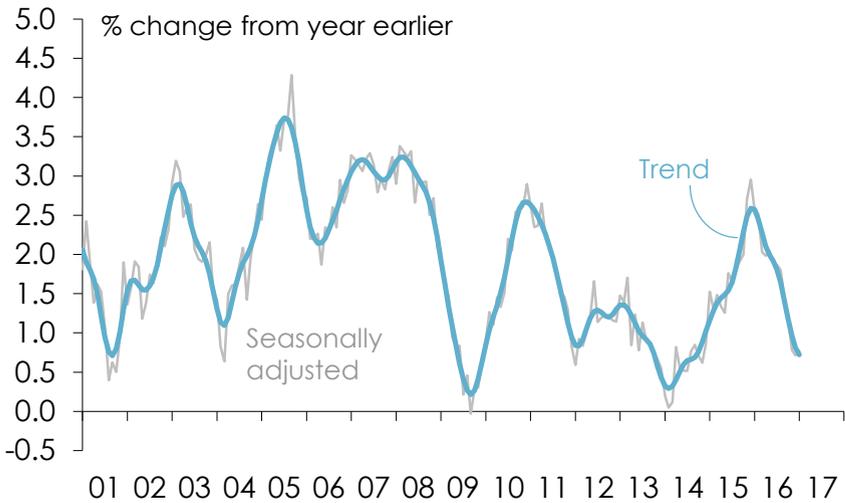
## Business conditions and confidence



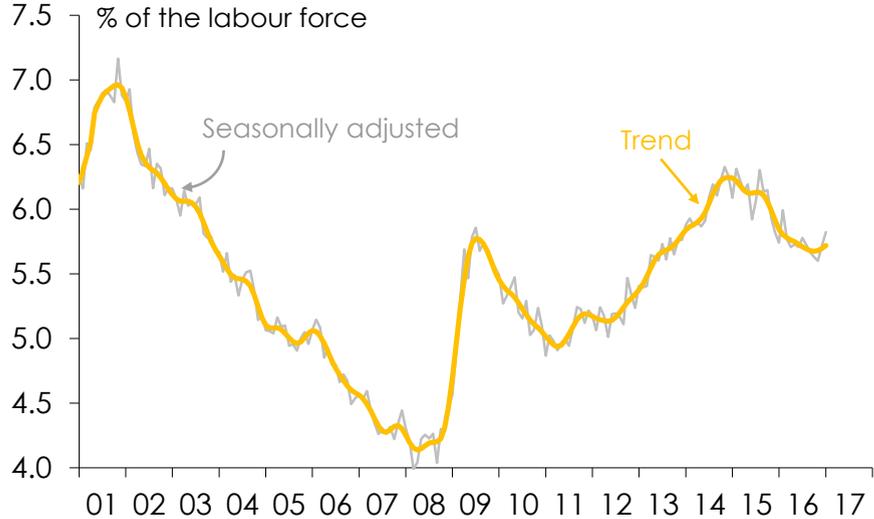
Note: 'Other sectors' in the company profits survey exclude banks and other deposit-taking intermediaries, insurance and super funds, education & training, and health care & social assistance. Mining investment includes buildings & structures and plant, equipment & machinery from the capex survey plus 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](#).

# Many aspects of labour market conditions remain soft despite a gradual downward drift in the unemployment rate

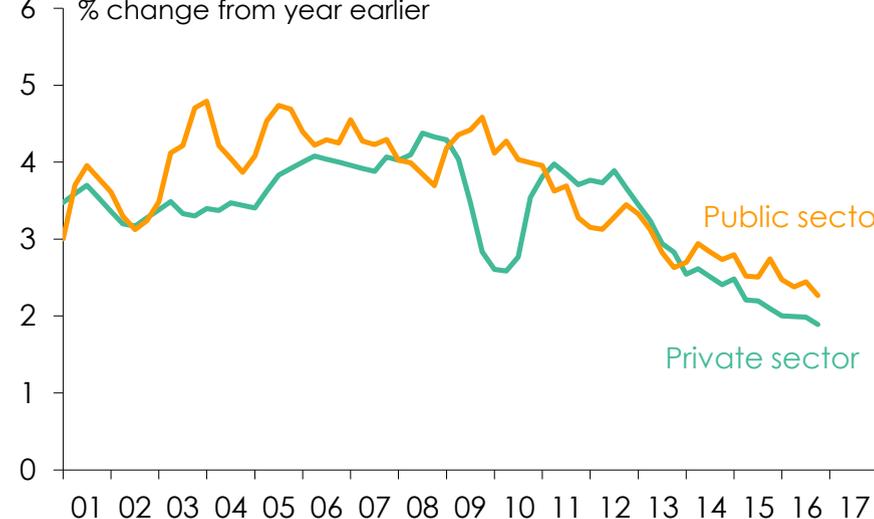
## Employment growth



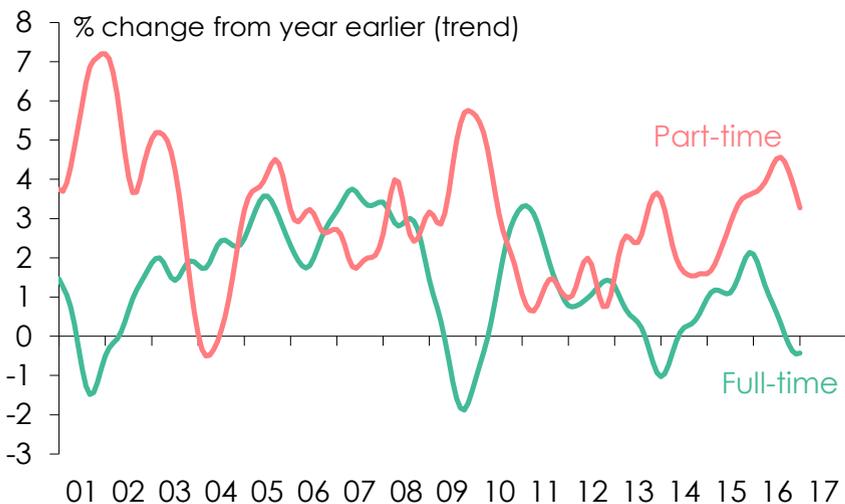
## Unemployment rate



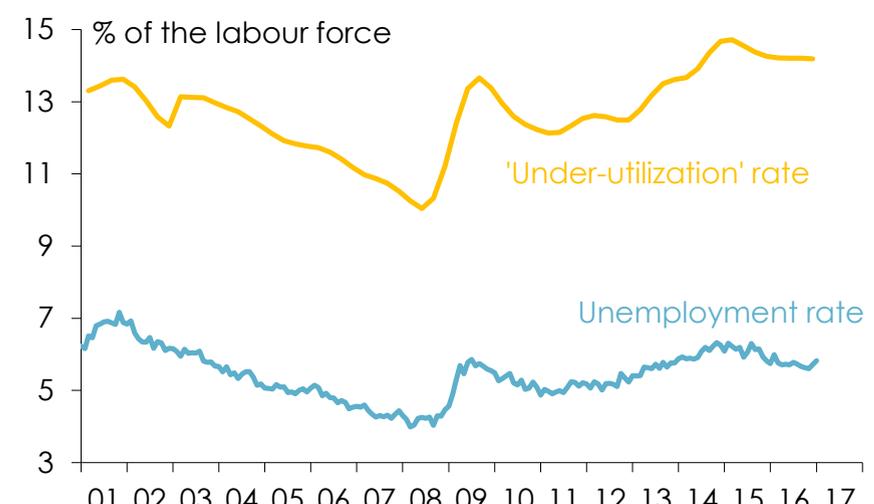
## Wage cost index



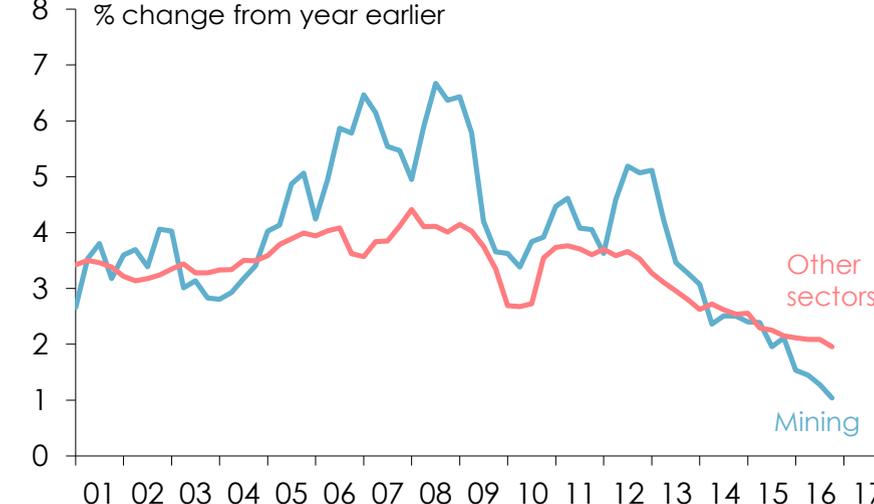
## Full- vs part-time employment



## Labour force under-utilization



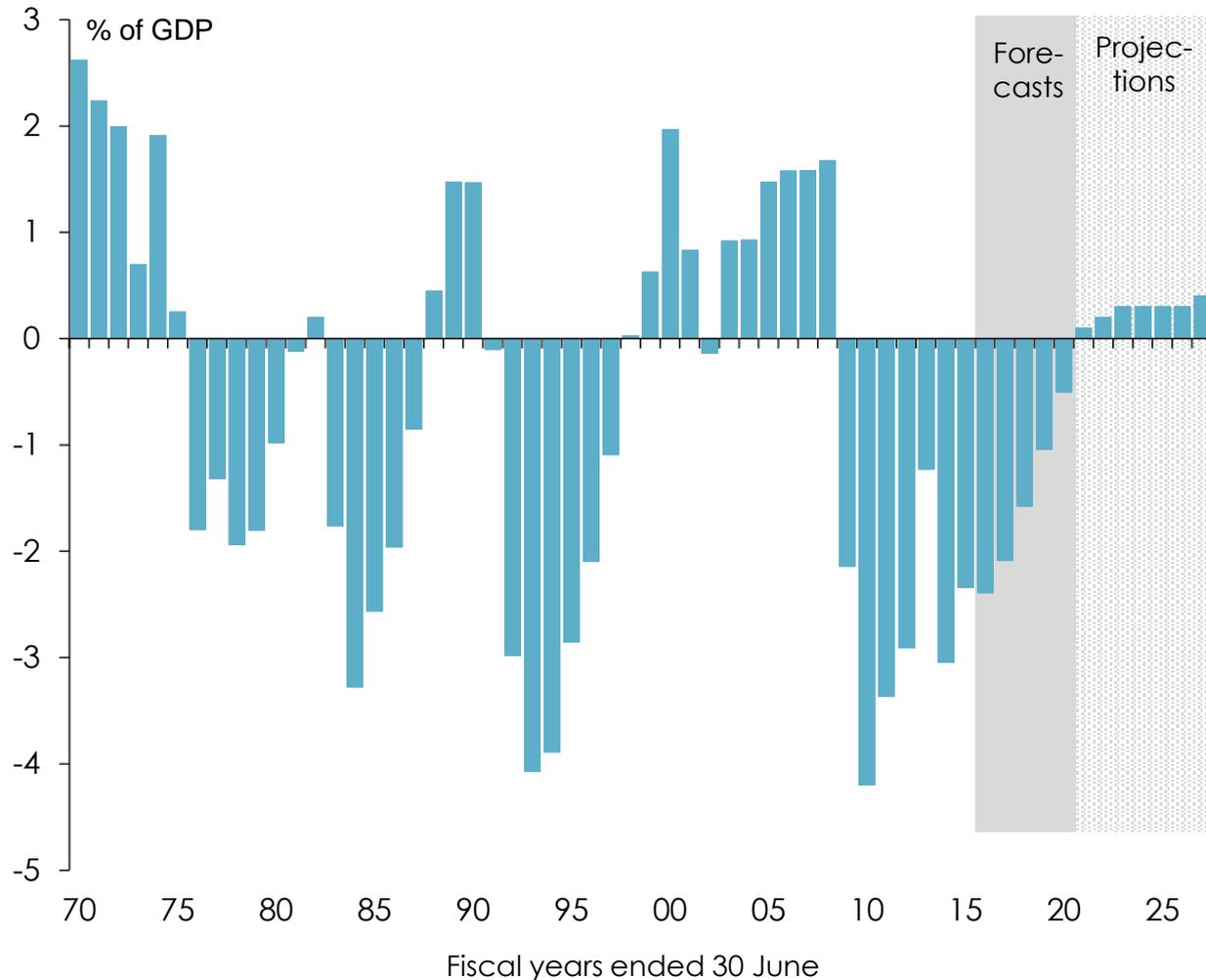
## Wages – mining vs other sectors



Sources: ABS.

# The Government has little room to manoeuvre in seeking to improve Australia's growth prospects

## Australian Government 'underlying' budget balance

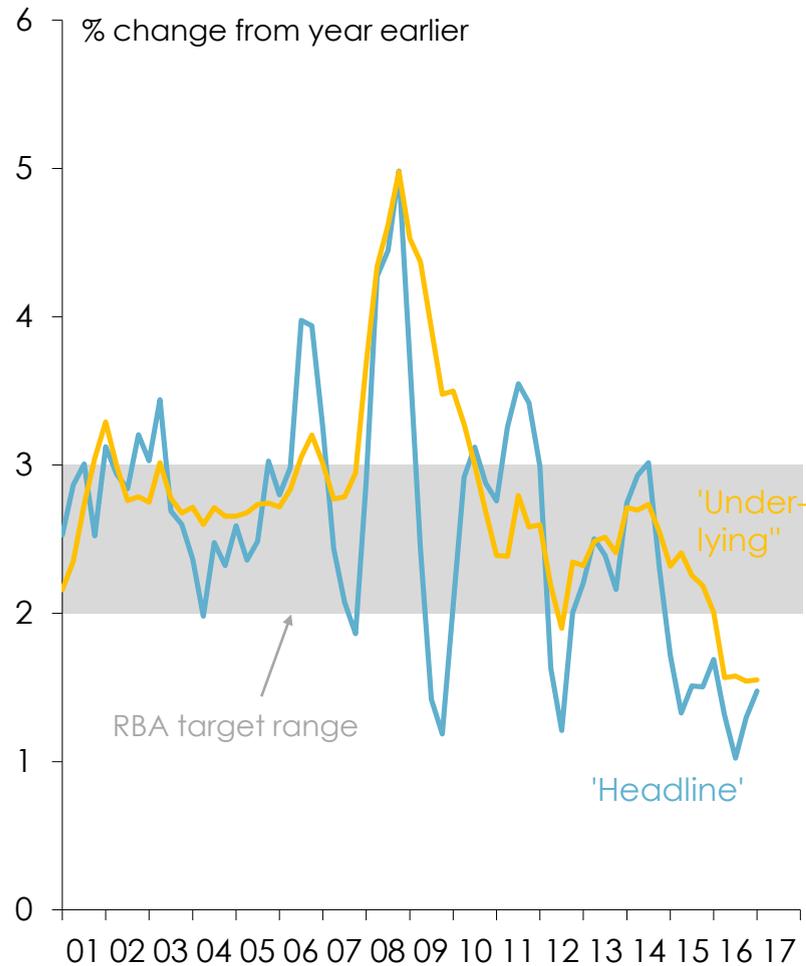


- ❑ The Government's scope for using fiscal policy is hamstrung by its commitment to returning the budget to surplus, and the ongoing difficulty it is having in achieving that objective
  - the goal of a surplus in 2020-21 is now reliant on income from the Future Fund which from that year onward can be counted towards the 'bottom line'
- ❑ The Government has a very thin economic policy agenda
  - its 'signature' policy initiative, the 10-year cut in the company tax rate, is unlikely to be enacted in full
  - and the bit that will get through, the tax cut for small business, will be ineffective
- ❑ The Government is in a weak political position
  - with a wafer-thin majority in the lower house, and relying on fractious minor parties and independents to get legislation through the Senate
  - surprisingly beholden to its own conservative wing
  - and seemingly petrified of One Nation et al

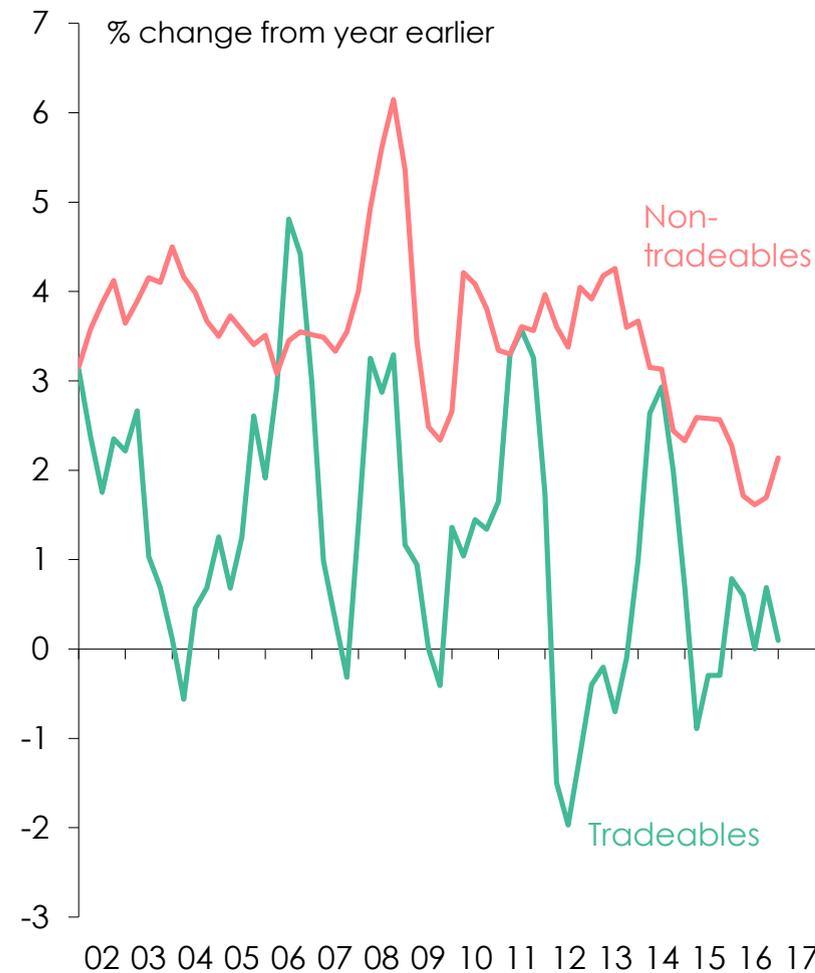
Source: Australian Government, 2016-17 Mid-Year Economic and Fiscal Outlook.

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

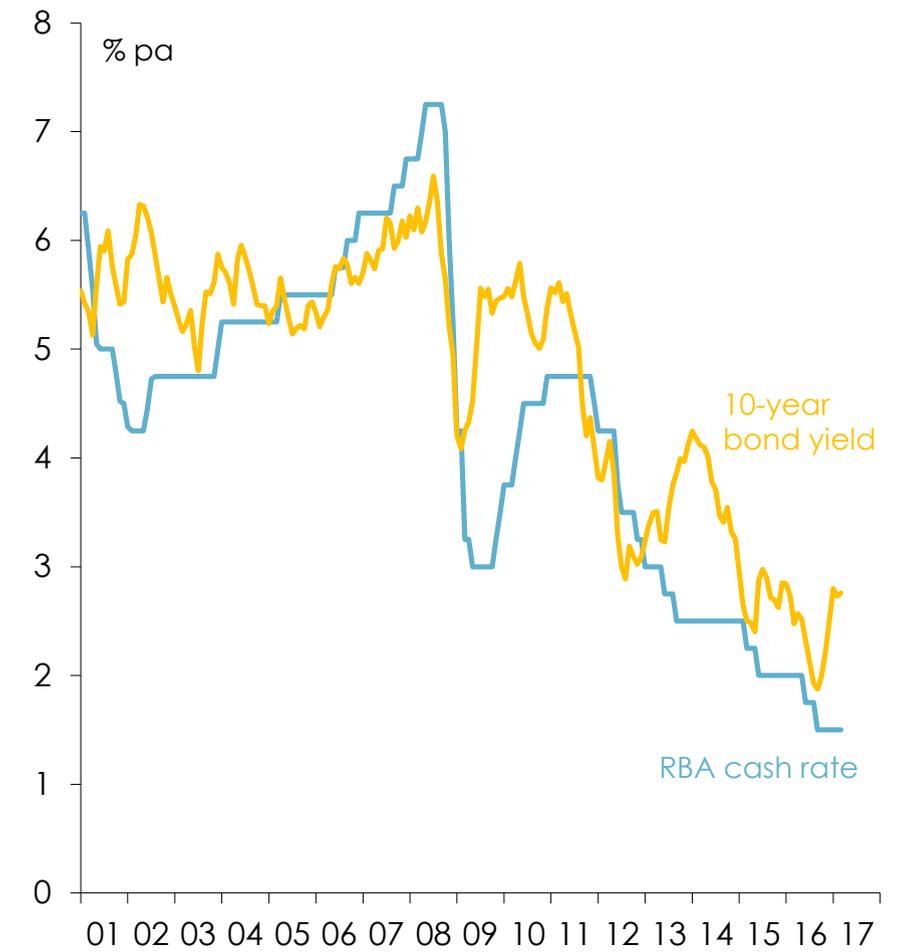
## Consumer price inflation



## External vs domestic influences on prices



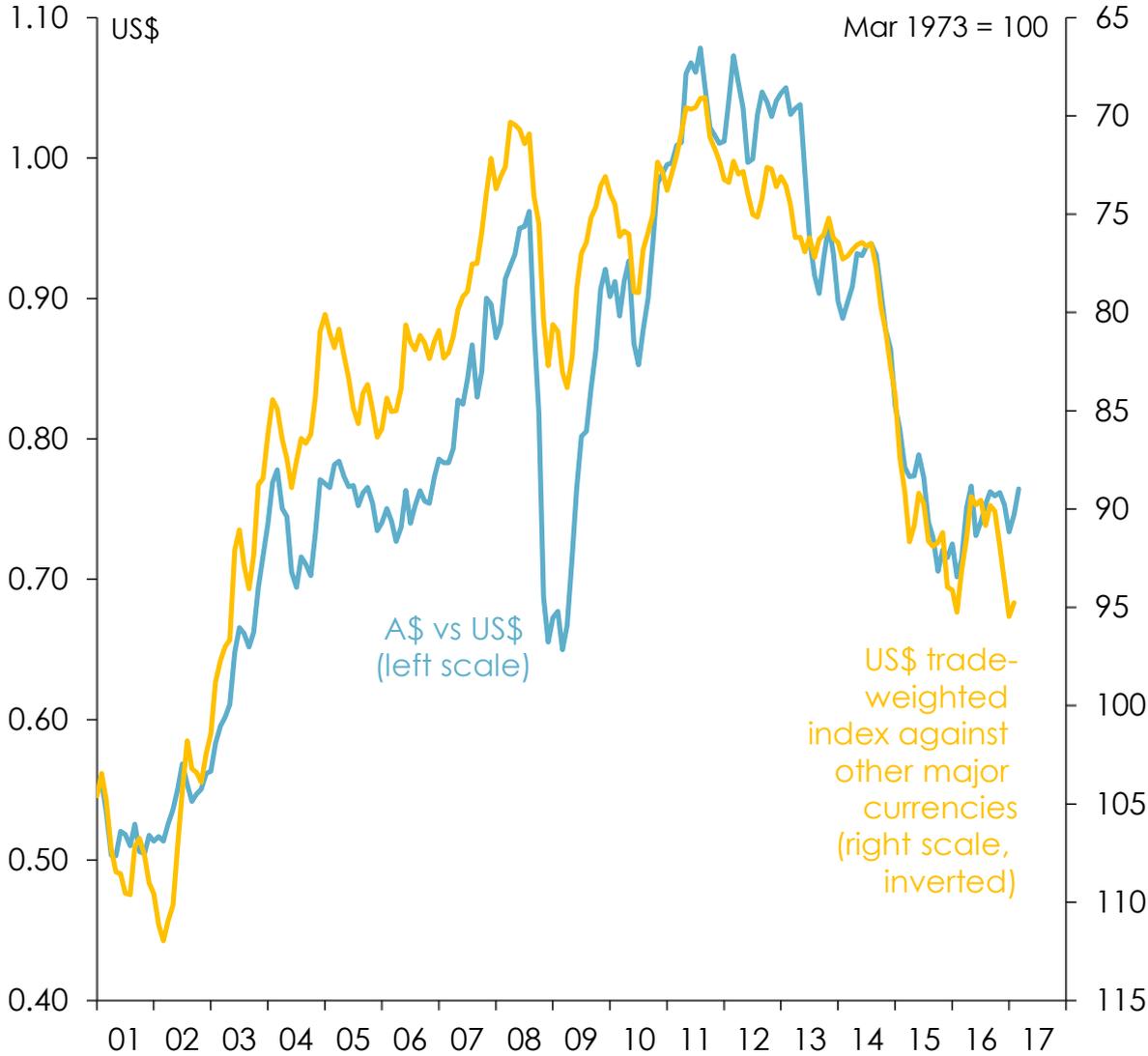
## Interest rates



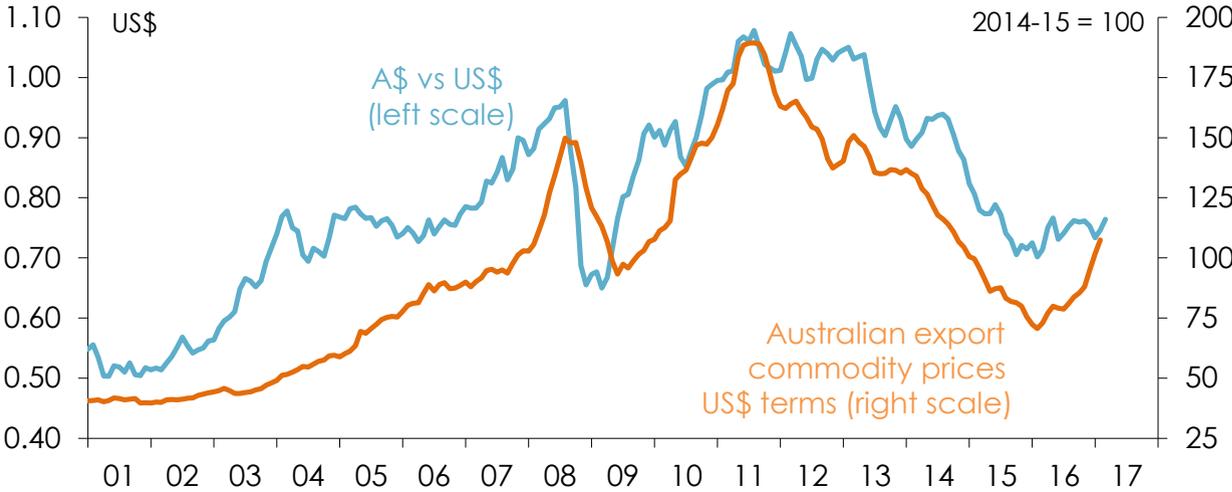
Source: ABS; RBA.

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

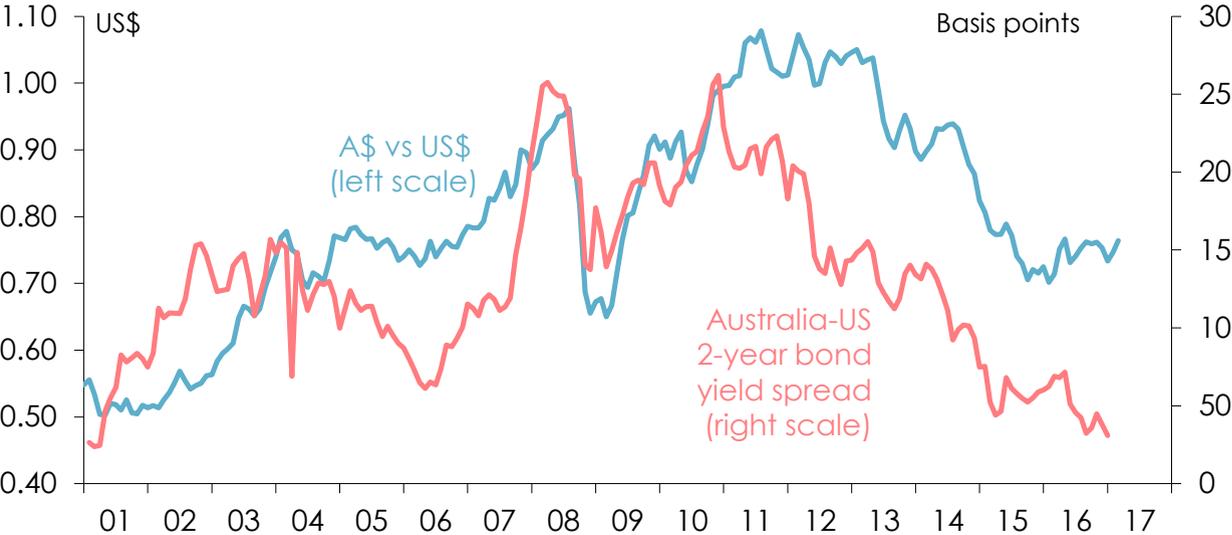
## A\$-US\$ and US\$ vs other currencies



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



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

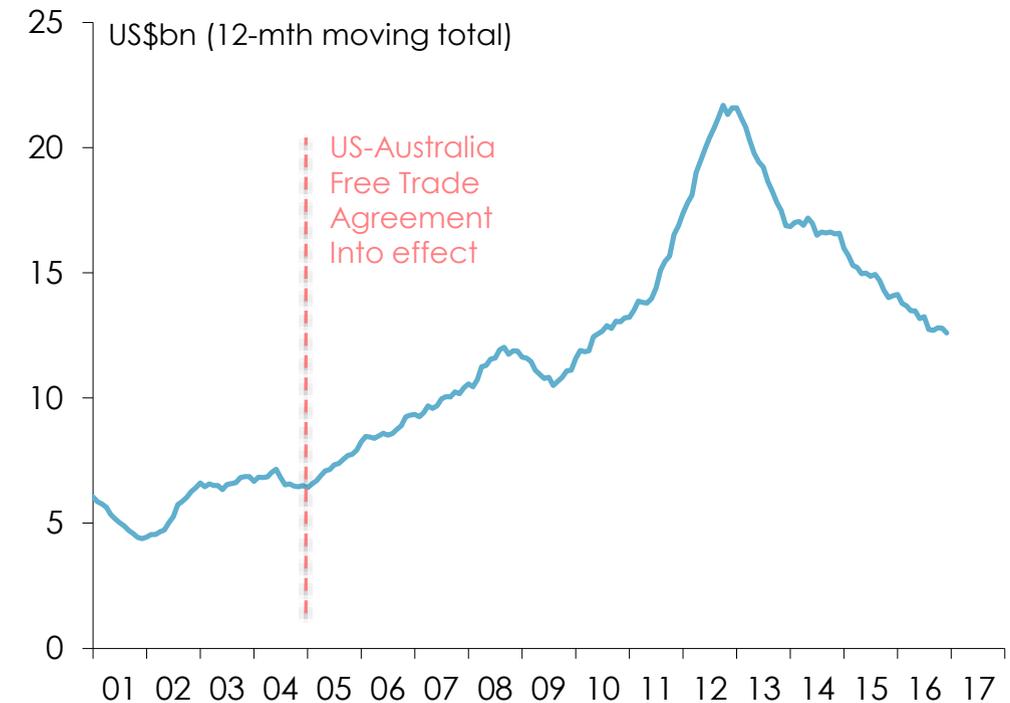


Sources: Thomson Reuters; US Federal Reserve; Reserve Bank of Australia

# What Mr Turnbull should have said to President Trump

- ❑ “Mr President, you and your advisors regard the US’ trade deficits with China, Japan, Mexico, and Canada as evidence that those countries have been ‘cheating’ and ‘taking advantage’ of you”
- ❑ “Well Mr President, have a look at these figures – from your own Commerce Department – which show that you are running a US\$12bn a year surplus with us”
- ❑ “You guys are really screwing us – bigly”
- ❑ “And that so-called free trade agreement, that one of our previous Administrations signed – your surplus with us has more than doubled since it started in 2005 – how did we ever agree to such a dumb deal?”
- ❑ “Your surplus with us increased to more than US\$20bn over the seven years since that deal – that’s yuuuuge!”
- ❑ “Even today your surplus with us is still more than twice as big as it was when this so-called ‘deal’ was done. You still won’t take any of our sugar, you won’t let private companies buy our fast ferries, you still impose limits on how much Aussie beef and lamb your people can eat. Sad!”

## US trade balance with Australia



Source: US Commerce Department.