

JOINT ECONOMIC FORECASTING GROUP REPORT

ECONOMIC OUTLOOK FOR
2016-17 and 2017-18

September 2016

This report incorporates domestic and international data released up to 30 September 2016.

1. The economic outlook remains broadly in line with that presented in the 2016-17 Budget. While real GDP growth was stronger than forecast in 2015-16 at 2.9 per cent, the economic transition is occurring broadly as expected. The stronger-than-forecast outcome reflects strength in net exports, public final demand and dwelling investment. Nominal GDP grew by 2.4 per cent, which was close to the forecast.
2. The transition from the investment phase to the production phase of the mining commodities cycle is expected to continue over the forecast horizon. Net exports are forecast to make a strong contribution to growth, while a detraction continues from mining investment. Household consumption is expected to make a solid contribution to growth and support from dwelling investment is forecast to continue. Real GDP is forecast to grow by 2¾ per cent in 2016-17 and 3 per cent in 2017-18 (see Table 1). The slight upgrade to growth in 2016-17 compared with the Budget forecast reflects upward revisions to growth in dwelling investment, public final demand and net exports.
3. Household consumption grew by 3.0 per cent in 2015-16, in line with the 2016-17 Budget forecast and its strongest year-average result in five years. However, growth in the June quarter 2016 was a subdued 0.4 per cent, with a number of weather-related factors weighing on growth. Low petrol prices, low interest rates, a solid outlook for employment growth and an expected fall in the household saving rate are expected to continue to support consumption. The capacity of households to smooth consumption is relatively high, with many having solid mortgage buffers and mortgage loan delinquencies at low levels. Household consumption is forecast to grow by 3 per cent in 2016-17 and 2017-18.
4. Dwelling investment has grown strongly over the past three years, following nine years of soft growth. The recent strong growth has largely been driven by investment in new and used dwellings, particularly medium-to-high density dwellings. Dwelling investment is forecast to grow by 4½ per cent in 2016-17 and ½ per cent in 2017-18. The growth forecast in 2016-17 is an upgrade from the Budget forecast and reflects a strong investment pipeline. Approvals for medium-to-high density dwellings remain relatively high and commencements and dwellings under construction have reached new record highs.
5. Total new private businesses investment fell by 10.9 per cent in 2015-16, in line with the 2016-17 Budget forecast. This is the third consecutive year-average fall in investment and it is forecast to fall by 5 per cent in 2016-17 and to be flat in 2017-18. The transition from the investment phase to the production phase of the mining boom is expected to continue, with mining investment forecast to fall by 25 per cent in 2016-17 and 16 per cent in 2017-18. It is expected that investment in other areas of the economy will pick up, although uncertainty remains around its pace and timing. Non-mining investment is forecast to rise by 2½ per cent in 2016-17 and 4½ per cent in 2017‑18.
6. New public final demand is forecast to grow by 3 per cent in 2016-17 and 2¼ per cent in 2017-18, following growth of 3.3 per cent in 2015‑16. State and local government investment is expected to support growth in 2016-17.
7. Net exports are forecast to contribute 1 percentage point to real GDP growth in 2016-17 and ¾ of a percentage point in 2017-18. This follows a 1.5 percentage point contribution in 2015-16. Total exports are forecast to grow by 6 per cent in 2016-17 and 5½ per cent in 2017-18, supported by strong growth in non-rural commodity exports – LNG and iron ore in particular – and services exports. Total imports are forecast to grow by 2 per cent in 2016-17 and 3 per cent in 2017-18. Growth in import volumes has been subdued over the past four years, largely reflecting weakness in capital goods imports as the economy transitions through the investment-phase of the mining boom.
8. The terms of trade fell by 10.2 per cent in 2015-16, reflecting an 8.2 per cent fall in export prices and a 2.3 per cent rise in import prices. The fall in export prices largely reflected falls in non-rural commodity prices, while the rise in import prices largely reflected rises in consumption prices. The terms of trade are forecast to rise by 2 per cent in 2016-17 and to fall by ½ of a percentage point in 2017-18. The metallurgical coal price assumption is US$97 per tonne and the thermal coal price assumption is US$62 per tonne, both higher than the Budget assumptions. The iron ore price assumption remains at US$55 per tonne. The assumptions are based on averages at the beginning of August and do not reflect recent significant price rises. There is a significant near-term upside risk to the terms of trade forecast.
9. The labour market is expected to be supported by a pickup in domestic demand growth and continued subdued wage growth. Following growth of 2 per cent through the year to the June quarter 2016, employment is forecast to grow by 1¾ per cent through the year to the June quarters of 2017 and 2018, while the participation rate is forecast to remain flat at 64¾ per cent over the forecast horizon. The unemployment rate is forecast to be around 5½ per cent in the June quarters of 2017 and 2018.
10. The outlook for wages and prices growth is subdued, reflecting recent weaker-than-expected outcomes, lower inflation expectations, subdued domestic demand and spare capacity in the labour market. The Wage Price Index is forecast to grow by 2¼ per cent through the year to the June quarter 2017 and 2½ per cent through the year to the June quarter 2018. Headline consumer price inflation is forecast to be 1¾ per cent through the year to the June quarter 2017 and 2 per cent through the year to the June quarter 2018. Recent inflation outcomes have been affected by competitive pressures in the retail sector and downward pressure from import prices, petrol prices and rents.
11. Nominal GDP growth is forecast to be 4¼ per cent in 2016-17 and 4½ per cent in 2017-18. The forecast is unchanged in 2016-17 from the Budget forecast, with stronger growth in real GDP and the terms of trade providing an offset to weaker wage growth and domestic price pressures. In addition to a weaker outlook for wage growth and domestic prices in 2017-18, the terms of trade are forecast to weigh on nominal GDP growth in that year as a result of a more subdued outlook for non-mining export prices.
12. The domestic economy is performing well in a global economic environment that remains fragile and the struggle to regain momentum continues. Global growth is forecast to be 3 per cent in 2016, 3¼ per cent in 2017 and 3½ per cent in 2018, while major trading partner growth is forecast to be 3¾ per cent in 2016 and 4 per cent in 2017 and 2018. This is a downward revision of ¼ of a percentage point in each forecast year for global growth compared to the 2016-17 Budget and a ¼ of a percentage point downgrade to major trading partner growth in 2016.
13. The downward revision to global growth largely reflects downward revisions to the advanced economies. The US economy is forecast to grow by 1½ per cent in 2016 and 2 per cent in 2017 and 2018, while the euro area is forecast to grow by 1½ per cent in 2016 and 1¼ per cent in 2017 and 2018. More importantly for the forecast of major trading partner growth, the forecast for growth in other East Asia has been downgraded by ¼ of a percentage point in 2016 to 3¾ per cent, largely reflecting weaker‑than‑expected outcomes in the first half of 2016. The outlook for growth in China and India is unchanged.
14. The global economic environment – which continues to be characterised by bouts of financial market volatility, weak business investment, subdued wage and price pressures and a heavy reliance on accommodative monetary policy settings – remains a downside risk to the Australian economy. The outlook for China is particularly important for the domestic outlook. Since the Budget, major economic indicators continue to suggest that conditions in the Chinese economy are moderating, broadly in line with expectations. The main challenge for the Chinese economy will be in managing structural reform as the economy transitions and the dynamics of debt build-up.
15. In addition, there are a number of risks around the domestic economy. Most notably, continued subdued income growth may begin to weigh more heavily on the household sector. While the subdued growth in household consumption in the June quarter 2016 was affected by a number of weather-related factors, further data are required to assess whether there may have also been some slowing in momentum. There is also uncertainty around the outlook for dwelling investment given the significant number of medium-to-high density dwellings that are due for completion over the forecast horizon. The recovery in non-mining business investment also remains a key risk to the domestic outlook, with indicators remaining mixed and uncertainty around the timing and pace of the increase in non-mining business investment. On the other hand, a depreciation of the exchange rate would provide upside risk to the domestic economy by providing further support to the domestic sectors of the economy.

**Table 1: Domestic economy forecasts**



