KPMG

Quarterly Economic Outlook

Global and Australian Forecasts

KPMG Economics & Tax Centre

—

November 2018

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Executive Summary

Global economy

- The performance of many economies lifted in the second quarter of 2018, confirming the view that the global economy only experienced a 'growth pause' in the first quarter rather than anything more systemic.
- The pattern of growth across countries however is expected to be less synchronised than recently experienced.
- Recent growth in advanced economies has so far not created significant inflationary pressures.
- A move from accommodative monetary policy to more neutral settings, or even tightening in policy rates, are now being seen across more jurisdictions in response to concerns about an upward shift in inflation and inflationary expectations
- KPMG Economics expects global growth for this calendar year to be slightly higher at 3.8 percent,
- Our latest forecasts are marginally weaker due to a number of macroeconomic factors, including escalation of the 'trade war' between the US and China; increased uncertainty about how 'Brexit' will be implemented; and the drag on emerging economies that must manage their foreign denominated debt exposure in the face of a strengthening USD.

Australian economy

- The Australian economy recorded very strong growth of 0.9 percent during the June quarter 2018, higher than market expectations.
- The ABS also revised upwards growth in Q1 2018 to 1.1 percent, resulting in rolling four-quarter growth of 2.9 percent for the year ended 30 June 2018.
- Australia's labour market is tightening, with unemployment now 5.1 percent as at October 2018, while underutilisation is at its lowest level since 2013.
- Wages growth remains benign, recording annual growth of 2.3 percent in seasonally adjusted terms for the year ending 30 September 2018. Inflation also remains 'within the bottle', increasing at 1.8 percent on a trimmed mean basis.
- Growth expectations for FY19 and FY20 remain positive, albeit softer than last year. The extreme drought conditions and acceleration in the downturn in the housing market will weigh on growth, with GDP growth projected to moderate to 2.8 percent and 2.4 percent respectively for the next two financial years.

Australian forecasts

	FY18	FY19	FY20	FY21	FY22	FY23
GDP (Real)	2.9%	2.8%	2.4%	3.0%	2.7%	2.7%
Inflation (1)	1.5%	2.2%	2.0%	2.2%	2.4%	2.5%
Unemployment, % (1)	5.4%	5.1%	5.2%	4.9%	4.9%	5.1%
A/US (1)	0.757	0.706	0.710	0.714	0.717	0.720

(1) = Average through the year

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Global Outlook

Global Outlook

The performance of many economies lifted in the second quarter of 2018, confirming the view that the global economy only experienced a 'growth pause' in the first quarter rather than anything more systemic. Growth in developed economies is expected to moderate slightly but will remain solid into the medium term.

While global economic growth is expected to remain solid overall, the most notable change from the recent past is that the pattern of growth across countries is expected to be less synchronised. This year we have seen rising economic distress in a growing number of countries, including Venezuela, Argentina, Turkey and South Africa, with the impetus for this destabilisation coming from a mixture of internal and external factors, like oil price shocks, exchange rate movements, and trade protectionism measures.

The recent growth in advanced economies has so far not brought with it significant inflationary pressures. However, there is an expectation that as this growth continues capacity constraints will start to bite and put pressure on prices. A move from accommodative monetary policy to more neutral settings, or even tightening in policy rates, is now being seen across more jurisdictions in response to concerns about an upward shift in inflation and inflationary expectations.

KPMG Economics expects global growth for this calendar year to be 3.8 percent, slightly higher than the 3.7 percent recorded in 2017. That being said, our latest forecasts are marginally weaker due to a number of macroeconomic factors that have pulled back our short term growth expectations.

Chart 1
World GDP Growth

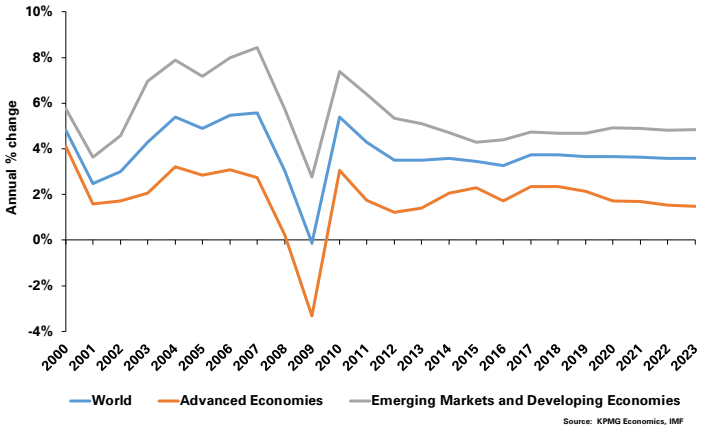
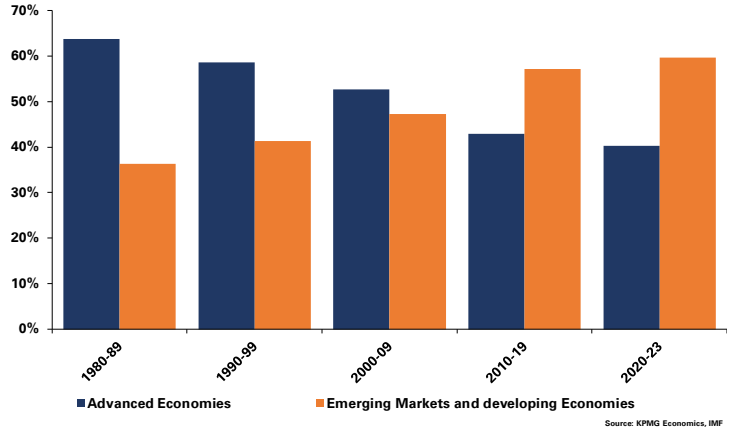


Chart 2
Share of Global Output



Global Outlook

Our latest baseline global forecasts include an imposition of tariffs already nominated by the US and China as part of their bilateral trade dispute. The higher import and export prices associated with these increased tariffs, combined with other recent data and events, has led us to revise our global growth forecast down marginally.

Our forecasts suggest that global growth is likely to have already peaked for this cycle, with an orderly slowing of growth to more moderate levels expected over the medium term. Factors allowing for this relatively steady decline, rather than a more volatile growth path, include demographic changes and the role of the Chinese government in directly managing growth in China.

In addition to the escalation of the trade-war between China and the US, other downside factors that received greater weight in our forecasts this round include: the disconnect within the British government on how 'Brexit' should practically occur and also between Britain and its European neighbours on what is an acceptable arrangement for the UK to leave the EU; and the ability of emerging economies to manage their foreign denominated debt exposure in the face of a strengthening USD caused by rising bond yields.

Up until the end of September 2018 the steady increases in the price of oil was also beginning to act as a drag on global growth. However, since the beginning of October 2018 the price of oil has collapsed from a peak of US$84.45/bbl to US$63.46/bbl on 22 November 2018. Factors influencing this significant fall include concerns over the US-China trade war, rising interest rates and the high US dollar (in which oil is priced).

Chart 3
Unemployment Rate

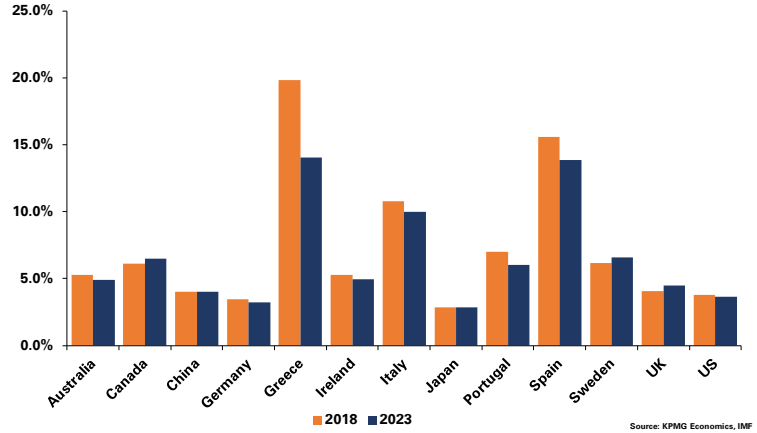
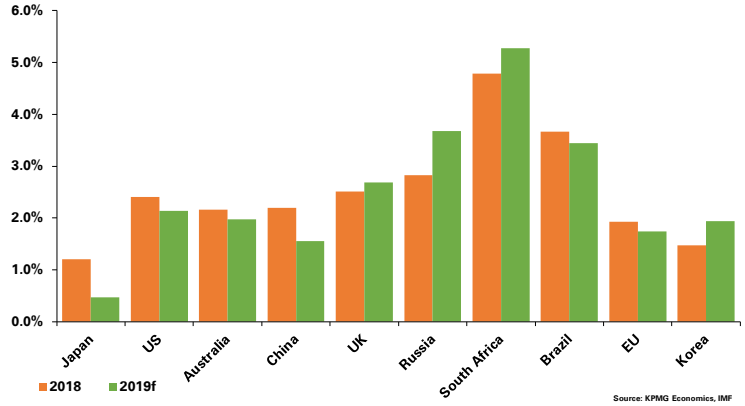


Chart 4
World Inflation



US-China 'Trade War'

Concerns about subsidies including those via state-owned enterprises, constraints on digital trade, forcing foreign investors to hand over technology, lack of IP protection are at the heart of recent US trade policy actions. And it is these concerns with the current system of international trade, which are deeper than the trade balance with China, that has led the US to take a broad range of actions, including use of tariffs as a negotiating tool, incentivising the break-up of global value chains through the 'reshoring' production, threatening to leave the WTO, and leaving the TPP.

While it remains to be seen how the US-China dispute will get resolved, this approach by the US of re-opening historic trade arrangements to 'get a better deal' has been successful. KORUS, the 6-year old US-Korea Free Trade Agreement, has also been revised in September, again at the behest of the US Administration seeking to better balance the bilateral trade between the two countries.

The key changes to the existing agreement relate to motor vehicles: extending the 25 percent import tariff in the US on pick-up trucks, Korea recognising US safety standards within a quota of US exports; in return the US has agreed to exempt South Korea from its new 25 percent tariff on global steel, although South Korea accepted a quota to limit steel exports to the United States to 70 percent of what it was previously selling.

The new NAFTA, now USMCA, Agreement has just been inked (although not yet formally ratified through respective legislative assemblies), with the biggest changes being higher rules-of-origin requirements for the auto sector, marginally greater U.S. access to the Canadian dairy market, and a scale-back of the investor-state dispute settlement (ISDS) rules.

The push by the US for systematic reform of the global trade environment and a strengthening of its position within it can also be seen in the new USMCA, which includes a clause that 'if one of the current North American Free Trade Agreement partners enters a free trade deal with a 'non-market' country such as China, the others can quit in 6 months and form their own bilateral trade pact'.

In effect this means that the Trump administration has a right of veto over any trade deal by Canada or Mexico with China, which was echoed by the White House National Economic Council Director, Larry Kudlow, who stated "The continent as a whole now stands united against what I'm going to call unfair trading practices by you know who — it starts with a C and ends with an A"

China withdrew from a planned round of trade negotiations in late September 2018 following the most recent escalation in tariffs by the US. The White Paper from the Chinese State Council's released in late September 2018 argues the US is a 'trade bully' and that the current administration's 'America First' policy has in effect abandoned trade diplomacy between the two countries that has been built up over the past 40 years.

A meeting has now been planned between President's Trump and Xi on December 1 in Buenos Aires after the G20 leaders summit. President Trump informed media on 16 November that he was optimistic about resolving the US trade dispute with China after receiving "a response to his demands from Beijing", although President Trump also noted that while the response from the Chinese Government was largely complete, it was missing "four or five big issues".

Brexit

The other key international geopolitical issue lifting global economic uncertainty is Brexit. Following an 18-month period of negotiation a 585-page draft Withdrawal Agreement, as well as a non-legally binding Political Agreement, has now been circulated to UK and EU leaders for their review and approval. If agreed to by the political leaders of the UK and the EU27, then the Withdrawal Agreement will be presented to each respective parliaments for ratification. So far the initial response in the UK has been one of political polarisation, which is unsurprising since this whole issue has been one that has evenly, and deeply divided the nation. There appears to be a number of key concerns with the Withdrawal Agreement from the perspective of both the 'leavers', or 'Brexiteers' and the 'stayers', indicating the agreement in effect keeps no one happy. These concerns include:

- There is the option to extend the transition period beyond 31 December 2020, which could in effect be extended indefinitely, resulting in the UK being bound by the EU rules and regulations without any capability to amend or adjust them in the future, but conversely solves the 'problem' of the Northern Ireland and Republic of Ireland border issue.
- The 'backstop' creation of a single customs territory between the UK and the EU until a permanent solution is established also extends the UK being bound to the rules of EU customs union, again potentially indefinitely, but also again helps diffuse the Irish border issue. Cessation of the 'backstop' solution requires the Joint Committee to sign off that it is "no longer necessary", meaning that the neither the UK nor the EU can unilaterally cancel its operation.
- While the 'backstop' diffuses the Irish border issue, it also complicates matters with respect to trade between Northern Ireland and the rest of the UK, particularly trade in agricultural products which is likely to specifically requires additional customs checks at ports and airports (compared to industrial products where checking can be done at traders' premises).
- The Withdrawal Agreement in effect confines UK citizens living within the EU at the time of Brexit to the country in which they are currently living, meaning that the current right to relocate anywhere within the EU will be gone from 31 March 2019.
- Spain will have greater influence on the governance of Gibraltar through the requirement of the UK to "reach satisfactory agreement" with Spain on the use of the Gibraltar airport. Gibraltar will now also be subject to meeting international tax transparency rules and tobacco controls.
- Fishery and aquaculture products have been excluded from the 'backstop' agreement, meaning they will not form part of the Single Customs Territory. In practice this means that each jurisdiction's sovereign fisheries remain off-limits to foreign flagged fishing vessels, and existing tariffs and quotas associated with the selling of fish in each other's markets continues until a permanent resolution is found.

At the time of writing a number of UK Cabinet Ministers had resigned following the endorsement of the Withdrawal Agreement on 14 November 2018. Uncertainty regarding whether a No-confidence motion will be progressed against Prime Minister Theresa May, and whether the UK parliament will ratify the Withdrawal Agreement regardless, is holding back the UK and the EU economies, and potentially if 'no-deal' is ultimately secured, then the prospect of flat or negative growth in the short to medium term for the region becomes more likely.

Global Outlook

The US recorded annualised growth of 4.2 percent in the second quarter of 2018; a significant jump up from the lower-than-expected quarter one result of 2.2 percent. The pro-cyclical fiscal stimulus from personal and business income tax cuts and government defence spending increases legislated earlier this year are likely to add further pressure on productive capacity. Even with the US labour market experiencing a near 50-year low unemployment rate of 3.7 percent in September 2018, wage and inflation growth has remained relatively subdued so far.

This is likely to be the result of tighter monetary policy counteracting the loosening of fiscal policy settings in the US. Since the start of 2017 the US Federal Reserve has raised US policy rates six times to now sit at the mid-point between 2.00 percent and 2.25 percent. The most recent FoMC 'dot plot' shows participants, on balance, anticipate one more 0.25 percent rate rise this year, four more in 2019, two more in 2020, with one rate cut in 2021; while the long run target rate is now about 2.9 percent.

The Euro Area has seen growth soften from levels experienced in 2017, with both Q1 and Q2 this year recording GDP growth of 0.4 percent, with partial indicators also suggesting this rate of growth will continue into the September quarter. From an individual country perspective, Spain, Germany and France all recorded positive second quarter growth rates of 0.6 percent, 0.5 percent and 0.2 percent respectively. Growth was bolstered by higher fixed investment expenditure and improved exports, although imports also lifted, resulting in little change in the net export position. Annual growth is now running at about 2 percent, while medium term forecasts suggest growth will moderate with the removal of QE by the ECB and flatten out to around the low 1 percent levels.

Chart 5
Official Interest Rates

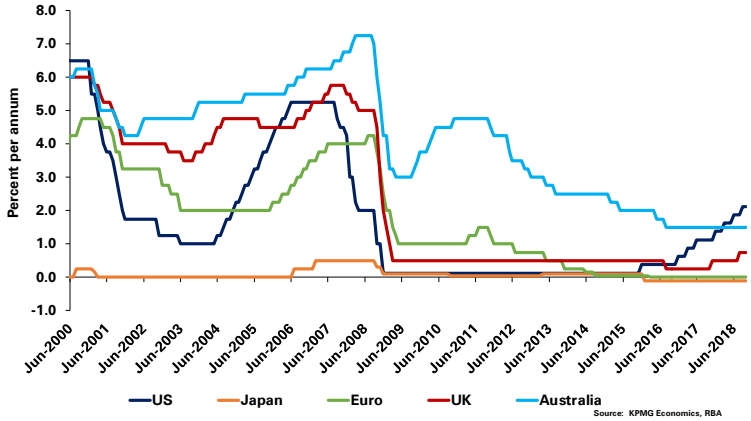
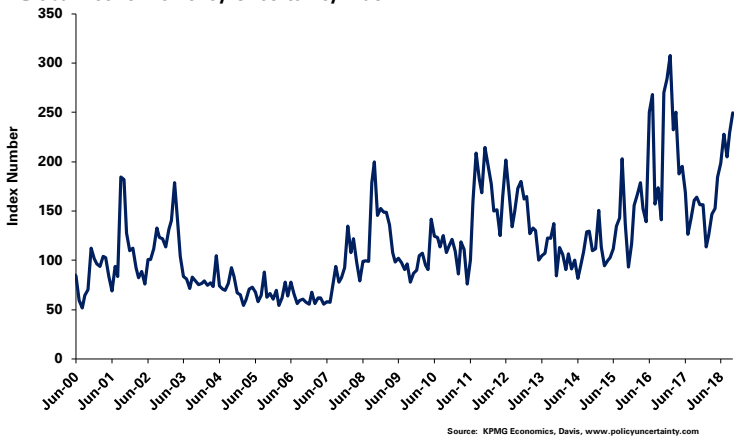


Chart 6
Global Economic Policy Uncertainty Index

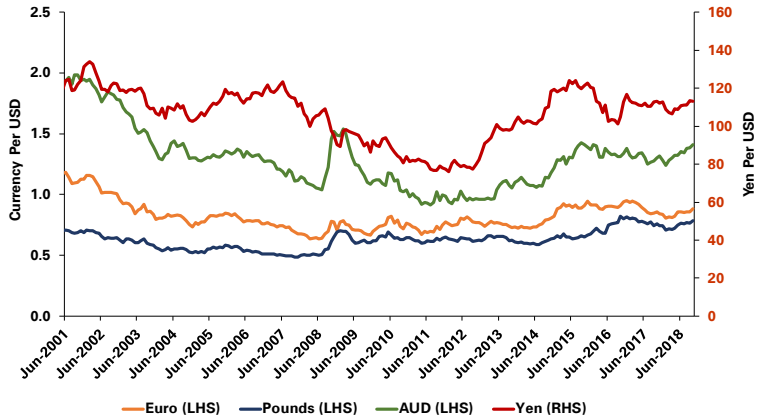


Global Outlook

Labour markets are tightening across Europe, although there remains a wide variation in unemployment rates across countries. For example, Germany's unemployment rate of 3.5 percent is at its lowest point since reunification, while Spain's unemployment rate still remains slightly above 15 percent. We are also starting to see a return to expansionary fiscal policy in some countries, with France now planning to spend €50 billion over the next 5 years on public infrastructure. Italy's new government has also proposed increased spending on pensions and welfare payments, increasing the budget deficit from a planned 0.8 percent of GDP to around 2.4 percent for the next three years. The European Commission however rejected the proposed 2019 Italian budget on the grounds it breaks the rules of the common currency bloc, with some Eurozone finance ministers suggesting the spending proposed by the populist Italian government as 'reckless policies'. Concerns regarding the stability of the political situation in Spain are also influencing short term economic forecasts, with pressure continuing to mount for another referendum on independence for the Catalonia region.

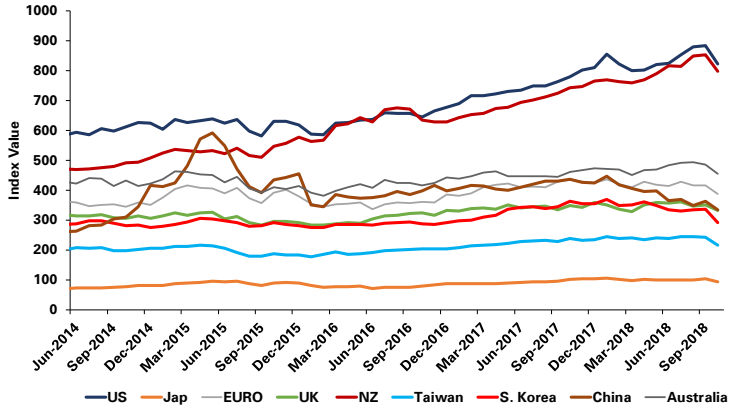
Japan's economy improved over the second quarter of 2018, with growth of 0.7 percent driven predominately by a pick-up in domestic demand. This rise is likely to reflect an element of brought-forward spending ahead of the planned tax rise from 8 percent to 10 percent in autumn next year. The BoJ has pledged to maintain official interest rates are current extremely low levels at least until after this tax adjustment works its way through the economy. The labour market in Japan is complex and puzzling in the sense that while labour shortages remain chronic due to demographic changes, wages growth remains subdued in nominal terms, and negative in real terms.

Chart 7
Exchange Rates (USD)



Source: KPMG Economics, RBA

Chart 8
Share Price Index



Source: KPMG Economics, RBA

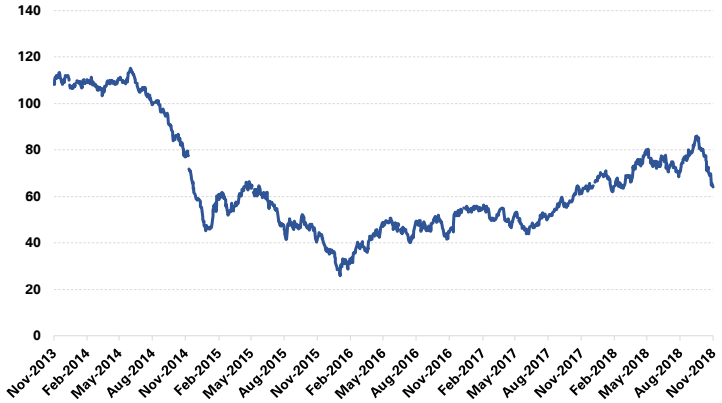
Global Outlook

The Chinese economy recorded an annualised growth rate of 6.5 percent in the third quarter of 2018, buoyed by the adoption of more accommodative monetary policy settings (due to a loosening of banks' capital and liquidity constraints) and expansionary fiscal policies (including tax cuts and increased 'efficient' government investment). These measures are more likely to enable the Chinese economy to continue to grow in the short term as per these CCP plans despite the expected disruption caused by the 'trade war' with the US. Continued strong growth combined with higher import prices (due to a combination of higher import tariffs and the recent devaluation of the Yuan) may however add to near term inflationary pressures. Consumer prices have already been rising due to higher fresh food prices brought about by adverse weather events and pig disease. Inflation is now above 2 percent and is expected to nudge closer to 3 percent in the coming months.

India's economy is growing at over 8 percent on an annualised basis; although this strong growth figure reflects the softness experienced by the Indian economy at the start of 2017 due to the testing domestic reforms that were implemented at that time (currency demonetistaion and tax reforms). While the base effect may take some of the shine away from this extraordinary growth figure, the Indian economy is nonetheless expected to continue to grow at close to 8 percent for this year and around mid-7 percent next year. The strong growth outlook has prompted the Bank of India to increase interest rates by 25bp in both July and August to now be at 6.5 percent ; the first rate hike since the beginning of 2014. The first half of 2018 did however see a notable widening in Indian's current account deficit in part due to the simultaneous effects of an increase in the oil price and the depreciation in the Indian rupee.

Chart 9

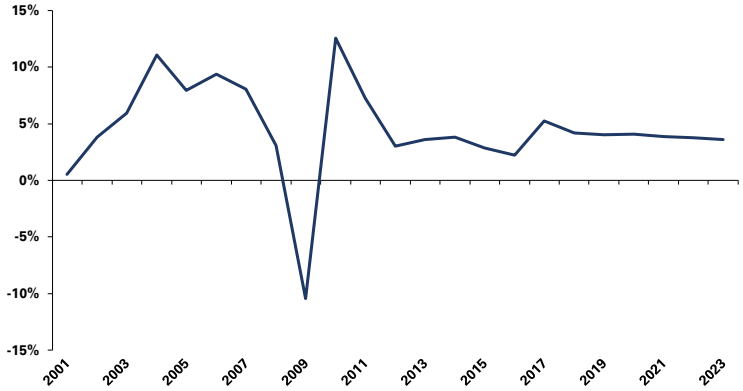
Brent Crude Oil Price (USD/bbl)



Source: FRED, KPMG Economics

Chart 10

World Export Growth



Source: KPMG Economics, IMF

Global Outlook

Growth in Real GDP

Year End December	2017	2018	2019	2020	2021	2022
OECD	2.5%	2.5%	2.2%	1.9%	1.9%	1.8%
Americas						
Brazil	1.0%	1.5%	2.1%	2.4%	2.4%	2.5%
Canada	3.0%	2.0%	2.3%	2.1%	1.9%	1.7%
Latin America	1.3%	2.1%	2.0%	2.2%	2.4%	2.5%
Mexico	2.3%	2.3%	2.4%	2.4%	2.7%	2.7%
USA	2.2%	2.8%	2.6%	2.1%	1.9%	1.8%
Europe						
EMU	2.5%	2.2%	2.0%	1.5%	1.4%	1.3%
France	2.3%	1.7%	1.9%	1.5%	1.5%	1.5%
Germany	2.5%	2.0%	1.8%	1.2%	1.4%	1.3%
Greece	1.3%	1.9%	2.0%	1.8%	0.8%	0.5%
Ireland	7.2%	6.8%	3.9%	3.3%	3.6%	3.4%
Italy	1.6%	1.2%	1.2%	1.2%	1.1%	1.1%
Russian Federation	1.5%	1.8%	2.4%	2.3%	2.7%	2.2%
UK	1.7%	1.2%	1.4%	1.6%	1.7%	1.8%
Africa	3.1%	3.0%	3.5%	3.3%	3.3%	3.4%
South Africa	1.2%	0.9%	2.0%	2.0%	2.2%	2.2%
Middle East	2.2%	3.4%	3.9%	3.6%	3.4%	3.2%
Asia						
China	6.9%	6.7%	5.9%	6.1%	5.9%	5.8%
East Asia	6.6%	4.2%	4.1%	4.0%	3.9%	3.8%
Hong Kong	3.8%	3.6%	3.2%	2.2%	2.7%	2.8%
Indonesia	5.1%	4.8%	5.5%	5.3%	4.8%	4.5%
India	6.2%	6.9%	7.2%	7.0%	6.9%	6.8%
Japan	1.7%	1.1%	1.1%	0.7%	0.8%	0.9%
Singapore	3.6%	3.0%	3.0%	3.7%	3.3%	3.6%
South Korea	3.1%	2.9%	3.0%	2.7%	2.9%	3.1%
Taiwan	2.9%	2.8%	2.6%	2.2%	2.3%	2.5%
Vietnam	6.7%	6.7%	5.8%	5.0%	4.9%	4.6%
Oceania						
New Zealand	2.7%	2.5%	3.2%	2.8%	2.6%	2.5%
World	3.8%	**3.8%**	**3.7%**	**3.6%**	**3.5%**	**3.5%**

Annual Inflation

Year End December	2017	2018	2019	2020	2021	2022
OECD	2.2%	3.3%	2.7%	2.6%	2.5%	2.2%
Americas						
Brazil	2.7%	4.5%	4.7%	4.5%	4.2%	4.1%
Canada	1.1%	2.6%	2.0%	1.8%	1.9%	1.7%
Latin America	3.1%	4.6%	2.1%	3.0%	3.3%	3.1%
Mexico	6.7%	4.3%	2.8%	3.3%	3.2%	2.7%
USA	1.8%	2.3%	2.2%	1.9%	1.8%	1.7%
Europe						
EMU	1.4%	2.1%	1.7%	1.8%	1.8%	1.7%
France	1.4%	2.3%	1.7%	1.8%	1.7%	1.5%
Germany	1.5%	2.2%	1.8%	1.9%	1.8%	1.7%
Greece	0.0%	1.5%	0.9%	2.6%	3.0%	2.5%
Ireland	1.6%	1.4%	1.5%	1.8%	1.9%	1.8%
Italy	1.1%	1.7%	1.3%	1.4%	1.6%	1.5%
Russian Federation	2.4%	4.2%	3.2%	4.1%	4.3%	4.3%
UK	2.7%	2.5%	2.0%	2.0%	2.0%	2.0%
Africa	11.0%	7.7%	6.0%	5.8%	5.3%	4.7%
South Africa	4.5%	5.9%	5.0%	6.2%	5.6%	4.4%
Middle East	8.6%	9.3%	6.7%	5.6%	4.3%	3.4%
Asia						
China	1.7%	2.6%	2.3%	2.3%	2.3%	2.2%
East Asia	3.3%	4.8%	5.0%	5.3%	4.8%	4.0%
Hong Kong	2.7%	3.4%	2.6%	2.5%	2.8%	3.0%
Indonesia	3.7%	3.9%	4.1%	3.7%	3.3%	3.2%
India	4.5%	5.1%	4.0%	5.2%	4.9%	4.6%
Japan	0.4%	0.9%	1.4%	1.3%	1.3%	1.3%
Singapore	0.4%	0.9%	1.7%	2.2%	2.6%	2.8%
South Korea	1.4%	2.4%	1.6%	2.1%	2.1%	2.0%
Taiwan	0.3%	1.9%	0.9%	2.0%	2.2%	2.0%
Vietnam	4.0%	5.5%	3.3%	3.5%	3.6%	3.6%
Oceania						
New Zealand	1.5%	2.1%	2.0%	2.0%	2.0%	2.0%

KPMG

Australian Outlook

Australian Outlook

The Australian economy recorded very strong growth of 0.9 percent during the June quarter 2018, higher than market expectations including our own. Not only did the June quarter see strong growth, the ABS revised upwards growth in Q1 2018 to 1.1 percent , resulting in rolling four-quarter growth of 2.9 percent for the year ended 30 June 2018.

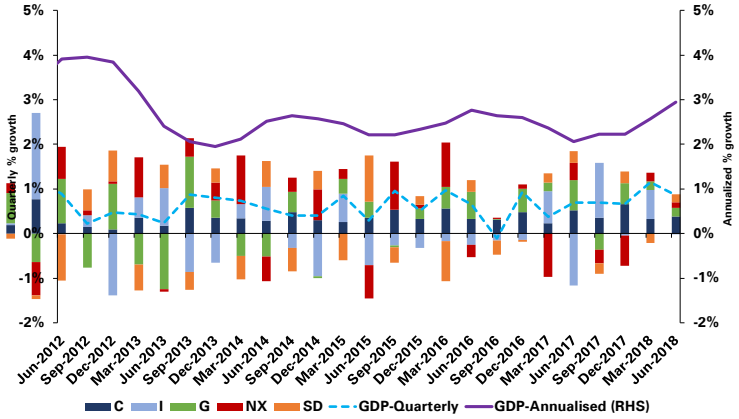
Australia's robust economic performance continues to be underpinned by household consumption, with government expenditure contributing about one-quarter of FY18's economic growth. Although inconsistent across quarters, aggregate investment activity has added positively towards domestic economic growth over the past 12 months, while higher imports has reduced the contribution of net exports to GDP growth.

Australia's labour market is tightening. Unemployment has continued to trend downwards and is now 5.1 percent (as at October 2018), while hours worked has also maintained a steady increase in recent months, which in combination has resulted in underutilisation in Australia's labour market falling to its lowest level in 5 years.

Despite these improvement in the labour market, wages growth still remains benign, recording annual growth of 2.3 percent in seasonally adjusted terms for the year ending 30 September 2018. Inflation also remains 'within the bottle', increasing at 1.8 percent on a trimmed mean basis.

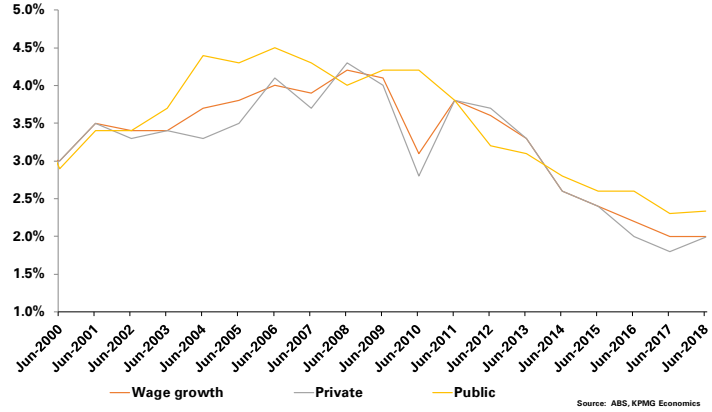
Growth expectations for FY19 and FY20 remain positive, albeit softer than last year. Influences such as the extreme drought conditions and the acceleration in the downturn in the housing market are expected to result in aggregate GDP growth moderating to 2.8 percent and 2.4 percent respectively for the next two financial years.

Chart 11
GDP Growth by Component



Source: KPMG Economics, ABS

Chart 12
Private and Public Wage Growth



Source: ABS, KPMG Economics

Government

The Final Budget Outcome for the Commonwealth Government showed the 2017-18 Budget finishing the year with a deficit of $10.1 billion. This considerably stronger-than-expected result was primarily driven by lower-than-forecast expenditures, and marginally higher tax receipts. The single largest variations between actual and budgeted expenditure in the last financial years were associated with assistance to people with a disability (-$3.9 billion) and assistance to state, territory and local governments (+2.3 billion).

Analysis of Commonwealth Monthly Financial Statements prepared by the Department of Finance reveals actual company income tax receipts and personal income tax receipts are about $4.3 billion and $1.4 billion higher respectively than the budget profile.

As at the end of September 2018, 24.1 percent of the general government expenditures for 2018-19 financial year had been spent, which compares to 24.9 percent for the same time last year. The largest amount of comparative underspend are in Health and Social Security and Welfare, while General Public Services is well above the 2017-18 spend levels. The lower social security and welfare payments are likely to be less than expected due to a stronger than anticipated labour market, given the Budget had forecast the unemployment rate to be 5.25 percent for 2018-19.

The Commonwealth Government General Government Sector has net debt of about $351 billion as at the end of September 2018. The Australian Office of Financial Management notes there are $536 billion of Government Securities on issue as at 16 November 2018. Of this, $495 billion are Treasury Bonds which have an associated interest cost of $17.7 billion per annum, which implies an average coupon rate of 3.58 percent across all the bonds on issue.

Chart 13
General Government Expenditure by Main Function
Percentage of Budget Forecast spent as at the end of September

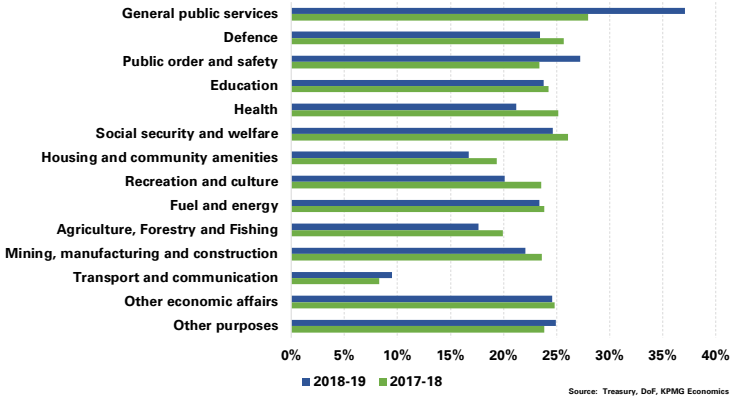
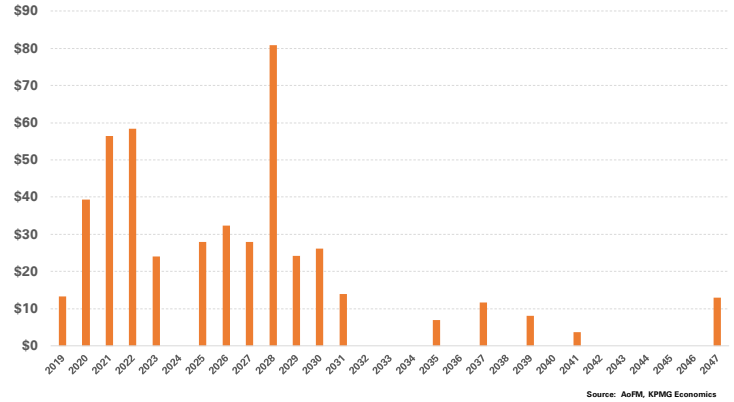


Chart 14
Commonwealth Treasury Bonds on Issue
Value by Financial Year Maturity Date ($ Billion)



Production

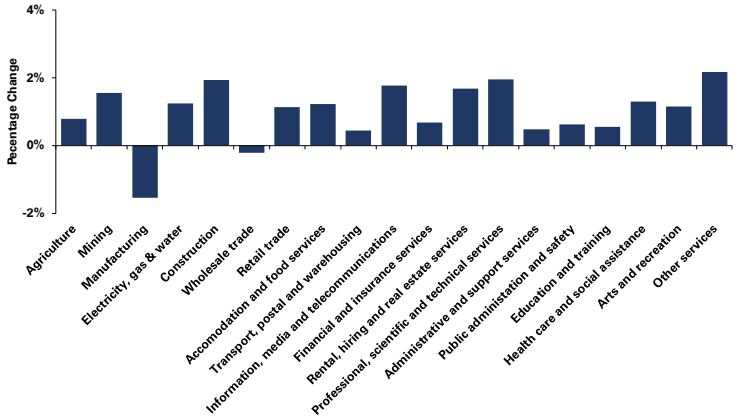
Industry Gross Value Added, excluding Ownership of Dwellings, grew by nearly 1 percent between the March and June quarters of 2018, and 2.7 percent year-on-year. The industries experiencing the largest quarterly and annual growth include Other Services (2.2 percent q-q; 7.3 percent y-y), Construction (1.9 percent, 5.5 percent), Professional, scientific and technical services (1.9 percent, 4.5 percent) and Mining (1.5 percent, 5.1percent). Manufacturing recorded the largest quarterly decline of all the sectors, down 1.5 percent, to now represent only 6.3 percent of total Australian IGVA.

The agricultural sector turned around in the June quarter 2018, recording quarterly growth of 0.8 percent, following declining GVA throughout calendar year 2017 and the first quarter of this year. Unfortunately drought conditions worsened as 2018 progressed, with ABARES noting that growing season rainfall has been 40 percent lower this year compared to the 20-year average. This is expected to result in a much smaller winter crop for the Eastern Australia wheat-sheep zone, down 53 percent relative to the 20-year average. NSW is expected to be even harder hit, with winter crop production forecast to be lower by 65 percent for the 2018-19 year. Livestock production has also been negatively impacted, although the market impact has been notably less severe, suggesting farmers have opted to use supplementary feed rather than to sell their stock for processing. This is reinforced by the fact that cattle numbers in feedlots are at record numbers.

While prices for thermal and metallurgical coal moved in opposite directions during the June quarter 2018. The coal industry recorded its highest rate of growth during the past year compared to anytime over the last 3 years predominately due to a lack of disruptions to production activity caused by extreme weather events or industrial disputes.

Chart 15

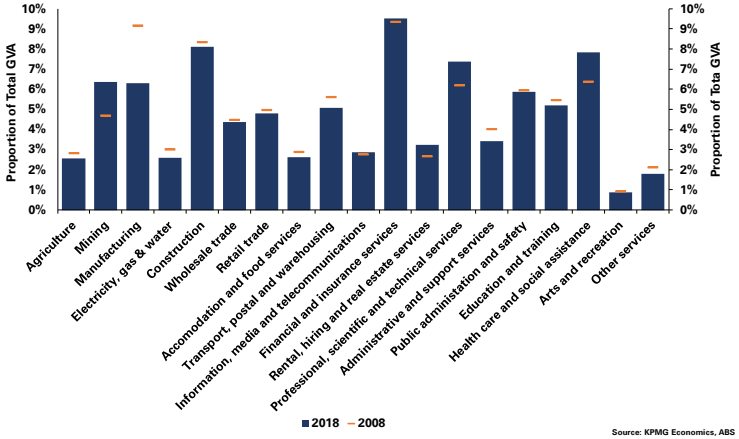
Quarterly Growth in Gross Value Added, June Quarter 2018



Source: KPMG Economics, ABS

Chart 16

Share of Gross Value Added by Industry, FY2008 vs. FY2018



Source: KPMG Economics, ABS

Consumption

Household final consumption expenditure grew 0.7 percent q/q (seasonally-adjusted) in Q2 2018. Spending on alcoholic beverages, clothing and footwear, and communications all grew by 1.6 percent between the March and June quarters 2018.

Rent and other dwelling services represents 20.3 percent of total household final consumption expenditure, followed by recreation and culture (10.3 percent) and food (9.5 percent). Over the past 10 years the pattern of household consumption has also changed, with spending being influenced by both changes in tastes and prices. For example, household expenditure on cigarettes and tobacco has fallen in real terms by nearly 50 percent between 2008 and 2018, while spending on communications has increased in real terms by 50 percent. The cost of both private and public transport has also materially declined over the past 10 years, with the purchase and operating costs of vehicles falling 6.6 percent and 10.0 percent respectively in real terms, while the cost of transport services is nearly 13 percent lower today in real terms than a decade ago.

Consumer sentiment, as measured by the Westpac-Melbourne Institute Index of Consumer Sentiment, rose 2.8 percent in November to 104.3 from 101.5 in October. This result marks the 12th consecutive month where the number of optimist's outweighed the number of pessimists, which is a notable turnaround from the previous year, where pessimists outweighed optimists in 11 out of the 12 months.

Within the latest result respondents were indicating a high degree of positivity towards their own financial position, despite the fact that housing prices are declining in several markets around the country and equity prices continue to slide from their peak late August 2018.

Chart 17
Household Final Consumption Expenditure, Proportion of Spend by Categorey, 2008 and 2018

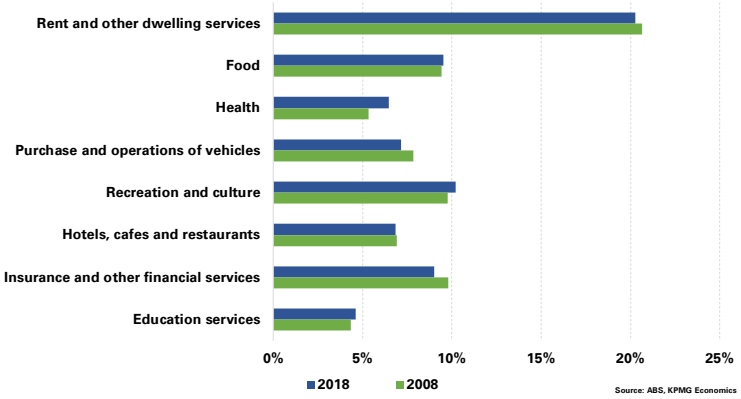
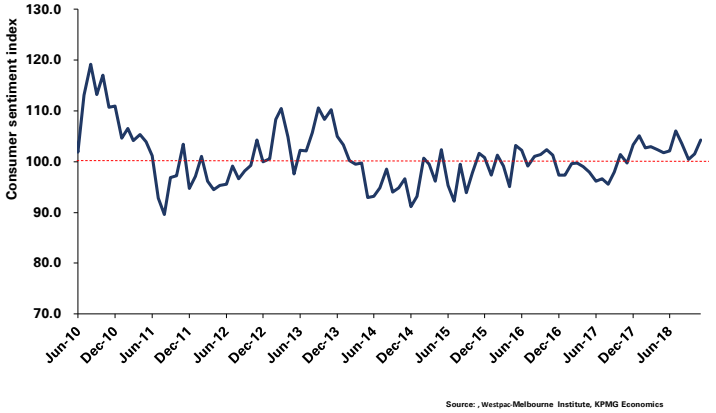


Chart 18
Consumer Confidence



Investment

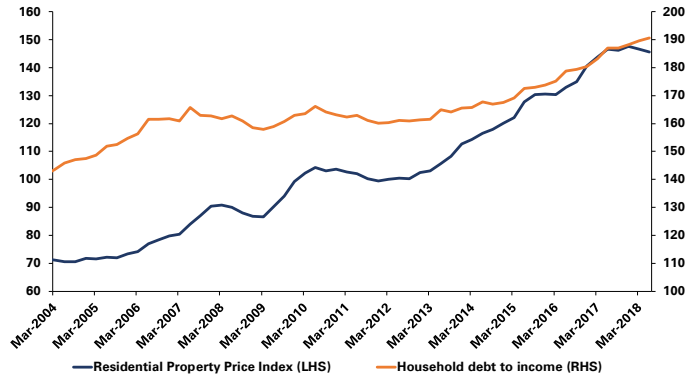
Aggregate gross fixed capital formation was flat in real terms between the March June quarters, and unusually, both private and public gross fixed capital formation each recorded 0 percent real quarterly growth as well.

Private dwelling investment grew 1.7 percent q-q and 3.8 percent y-y, while private business investment fell 0.7 percent q-q, but was up 9.9 percent y-y. Capital spending by public corporations was down 5.8 percent q-q and 4.3 percent y-y, while general government non-defence investment spending was also down 5.3 percent q-q, but was higher by 4.4 percent y-y. Inventories also contracted by 6.6 percent between the March and June quarters.

The number of dwelling approvals fell by 5 percent between the June and September quarters across Australia, with the largest quarterly falls in South Australia (-20.9 percent), Victoria (-7.4 percent) and Western Australia (-6.8 percent). On a rolling 12-month basis the number of building approvals is nearly 7,000 higher in the year to September 2018 compared to the same period in 2017. However, New South Wales and Western Australia both recorded falls in dwelling approvals, about 3,500 and 2,400 respectively, while Victoria achieved an increase in dwelling approvals of just over 10,800.

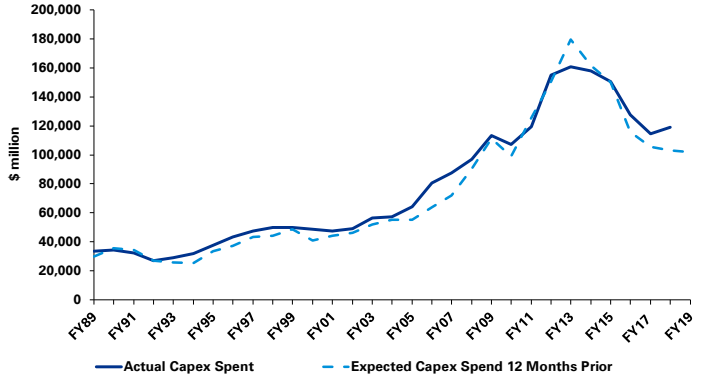
The property market has continued to soften, with an increasing number of jurisdictions now recording falls in average prices for residential dwellings. New South Wales and Victoria continue to experience the sharpest falls in residential property prices of all jurisdictions, falling 2.5 percent in nominal terms over the last 6 months. On an established house price basis, the falls are more pronounced, especially in Sydney where median prices have fallen nearly 10 percent over the first half of 2018, and the volume of transactions also declined by 25 percent.

Chart 19
House Prices and Household Debt



Source: KPMG Economics, ABS, RBA

Chart 20
Actual and Expected Private New Capital Expenditure



Source: ABS, KPMG Economics

Labour Market

The labour market in Australia continues to improve. Since the beginning of the calendar year employment has increased by 216,000 (seasonally-adjusted) persons, bringing the total number of employed persons to nearly 12.7 million. Interestingly there appears to be a reversal in the trend towards part time employment, with the proportion of full-time employed persons increasing in each of the past 5 months, up from a recent low of 68.1 percent to now be 68.6 percent of the total employed labour force.

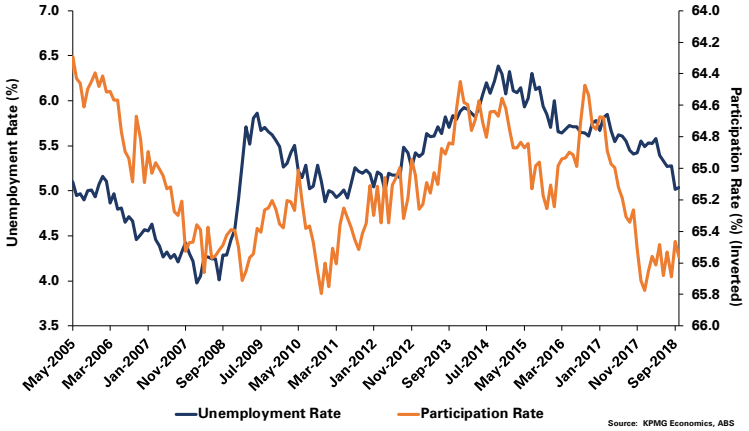
We have seen this phenomenon of the ratio of part-time to full-time employment reaching a low point of around 68 percent three times in the last 3 years, only to see the ratio rebound, albeit it slightly. This pattern does however raise the question whether there is a minimum ratio, such as 1:2, for part-time to full-time workers in the Australian economy given its current structure.

The unemployment rate stayed steady at 5.0 percent (seasonally adjusted) in October 2018. The number of unemployed persons looking for full-time work fell by 5,200 to 445,400, while the number of unemployed persons only looking for part-time work increased by 9,800 to 226,700. Monthly hours worked in all jobs also increased by 0.3 percent over the month of October 2018 to 1,764.4 million hours.

Wage growth, once again, remains relatively subdued. The Wage Price Index rose by 2.3 percent y/y (seasonally-adjusted) in the September quarter of 2018. On a quarterly basis, wages rose 0.6 percent, with wages in the private sector growing by 0.5 percent and those in the public sector increasing by 0.6 percent.

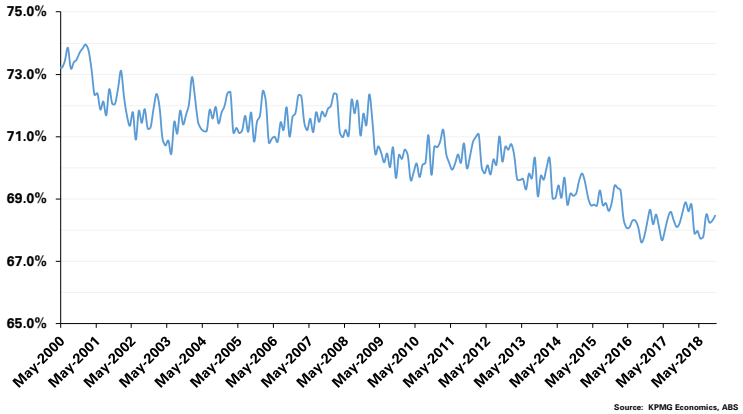
The ANZ Job Advertisements series increased 0.2 percent in October following a decline of 0.7 percent in September. Overall annual growth softened to 3.6 percent in October, which represents the slowest annual growth in the series since April 2015.

Chart 21
Unemployment and Participation Rates



Source: KPMG Economics, ABS

Chart 22
Proportion of full-time to total Employment



Source: KPMG Economics, ABS

Net Exports

The Australian economy posted a current account deficit of $13.5 billion in the June quarter 2018, an increase of $1.8 billion from the previous quarter. The trade surplus has expanded further in the September quarter 2018, up from $4.2 billion to $7.3 billion. This was the highest quarterly trade surplus since the commencement of the ABS data series in July 1971.

Export of goods contributed $87.4 billion while export of services contributed $24.1 billion to the trade balance. Imports of goods and services declined 1.0 percent to $104.2 billion, with imports of goods accounting for $79.8 billion and import of services representing the balance of $24.4 billion.

The Australian dollar has depreciated by 7.7 percent against the U.S. dollar since the beginning of 2018, and is currently trading at around USD 0.724c. On a trade-weighted basis, the Australian dollar is only marginally lower over the same time period, with the Index around 3.7 percent lower for the year. This smaller depreciation on a TWI basis reinforces the point that the softer USD/AUD exchange rate more so reflects a major appreciation in the USD as opposed to a major depreciation in the AUD.

Demand for Australian exports are expected to remain strong over the next quarter supported by the weaker exchange rate. The RBA's Index of Commodity Prices increased by 3.0 percent (SDR terms) over the month of October 2018 following four consecutive months of soft growth. Over the year, the index has increased by 13.1 percent in SDR terms and 22.3 percent in Australian dollar terms.

Australia's Terms of Trade (ToT) decreased from 119.1 to 117.6 index points during the second quarter of 2018.

Chart 23
Rolling Annual: Exports by Type

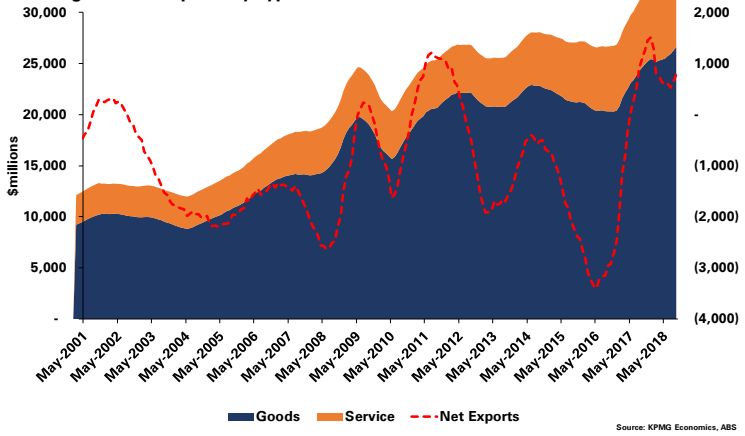
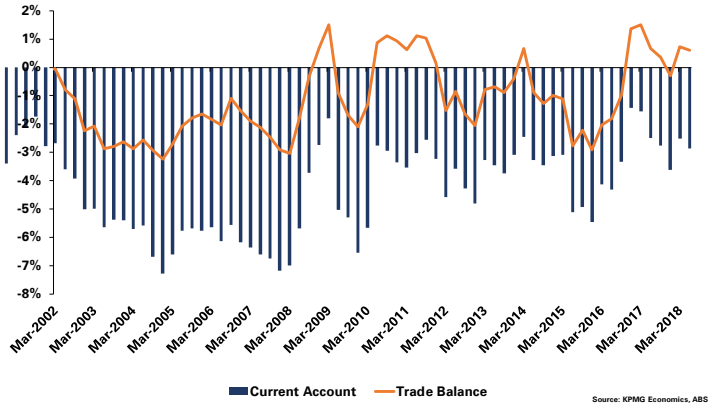


Chart 24
Current Account and Trade Balance



Australian Outlook

	FY18	FY19	FY20	FY21	FY22	FY23
GDP (Real)	**2.9%**	2.8%	2.4%	3.0%	2.7%	2.7%
Private Consumption	**3.0%**	2.5%	2.3%	2.3%	2.1%	2.3%
Investment						
Business	**8.7%**	3.2%	5.4%	4.1%	2.9%	2.1%
Housing	**-0.3%**	-5.0%	-3.5%	4.5%	3.5%	2.9%
Government						
Consumption	**4.4%**	4.3%	4.2%	3.7%	3.5%	2.6%
Investment	**0.7%**	2.0%	3.9%	3.0%	2.2%	1.6%
Total domestic demand	**3.7%**	2.5%	2.7%	3.0%	2.6%	2.3%
Export volumes	**3.4%**	4.6%	2.7%	4.2%	3.1%	4.7%
Import volumes	**6.9%**	3.1%	5.2%	4.0%	2.4%	3.0%
Inflation (1)	**1.5%**	2.2%	2.0%	2.2%	2.4%	2.5%
Real Personal Disposable Income	**2.8%**	1.9%	2.8%	2.7%	2.7%	2.6%
Unemployment, % (1)	**5.4%**	5.1%	5.2%	4.9%	4.9%	5.1%
Government Balance as % of GDP	**-0.4%**	-0.4%	-0.9%	-0.9%	-1.0%	-0.9%
Govt. debt as % of GDP	**42.2%**	43.0%	43.0%	42.3%	41.4%	40.4%
Current account as % of GDP	**-2.9%**	-1.2%	-1.5%	-1.7%	-1.7%	-1.4%
A/US (1)	**0.76**	0.71	0.71	0.71	0.72	0.72
Terms of Trade (1)	**117.6**	118.4	117.9	117.6	117.4	117.5

(1) = Value at end of the year

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