KPMG

Quarterly Economic Outlook

Global and Australian Forecasts

KPMG Economics

—

December 2017

Contents

Executive Summary

Global economy

- Global economic conditions have improved and the outlook for the global economy remains relatively strong
- KPMG Economics has revised its forecast of global economic growth in 2017 with real GDP at 3.5%, lifting to 3.7% in 2018
- Labour markets are close to full capacity in a number of key advanced economies with unemployment rates close to their natural rate (or potential)
- With the notable exception of the U.K., both headline and core inflation remain soft in advanced economies, with inflationary response to capacity constraints seemingly delayed
- The U.S. dollar has appreciated slightly against a range of currencies following expectations of tighter monetary policy and fiscal stimulus, while the Sterling has experienced the largest decline against the Euro over the quarter as a consequence of Brexit risks and uncertainty, with many economists and analysts still bearish on the outlook
- The Federal Open Market Committee (FOMC) raised the Federal Funds Rate (FFR) by 25bps in December as well as raising their economic growth forecast for 2018. A further 75bps rise in the FFR is expected in 2018
- In Q3 2017, the U.S. economy grew at an annual rate of 3.3% (seasonally-adjusted), while GDP growth in China grew 6.8% y/y in Q3 2017 and Japan's economy grew for a seventh consecutive quarter with GDP coming in at 0.6% (seasonally-adjusted) q/q (2.5% y/y)

Australian economy

- The Australian economy grew by 0.6% q/q (seasonally-adjusted) in the September quarter 2017, with growth being relatively broad-based across 17 of the 20 industries, although household final consumption expenditure grew by only 0.1% q/q
- Labour market conditions improved with the unemployment rate steady at 5.4% (seasonally-adjusted) and labour force participation up 0.3 percentage points to 65.5% in November 2017
- MYEFO shows the budget remains on-track to achieve a surplus in 2020-21
- Australia posted a current account deficit of $9.13 billion in Q3 2017, equivalent to 2.1% of GDP, although the trade surplus narrowed to $0.1 billion in October 2017
- The Australian dollar has depreciated slightly against the U.S. dollar since Q3 2017, and is currently trading at around USD 0.76c

Australian forecasts

	FY17	FY18	FY19	FY20	FY21	FY22
GDP (Real)	2.0%	3.2%	2.4%	2.4%	3.0%	2.8%
Inflation (1)	1.4%	2.1%	2.7%	2.8%	3.0%	3.2%
Unemployment, % (1)	5.6%	5.5%	5.5%	5.5%	5.2%	5.1%
A/US (1)	0.751	0.778	0.778	0.779	0.781	0.783

(1) = Average through the year

Global Outlook

As we enter the December quarter of 2017, global economic conditions have improved and the outlook for the global economy remains relatively strong. Global economic indicators including production, manufacturing and trade are at their highest levels in recent years, while business and consumer confidence remain healthy. Global growth has also continued to be broad-based across the major advanced economies with the U.S., Japan and the Euro Area seeing further improvement in economic activity over the third quarter of 2017. The latest IMF World Economic Outlook (WEO)[1] report has global growth revised up by 0.1% from the July forecasts to 3.6% and 3.7% for 2017 and 2018, respectively.

Amongst the emerging economies, China, India, ASEAN-5[2], and emerging Europe have seen a strengthening in economic activity. This is the result of stronger demand and world trade growth in advanced economies, along with supportive financial conditions domestically. Prospects for other emerging economies in Latin America and the Middle East, however, remain relatively modest. On balance, global growth is likely to remain robust going forward and KPMG Economics have revised up its forecast of global economic growth in 2017 with real GDP at 3.5%, lifting to 3.7% in 2018.

Labour markets are close to full capacity in a number of key advanced economies with unemployment rates close to their natural rate (or potential). Labour force participation rates have also increased slightly across several advanced economies and employment growth has been relatively strong. Underemployment, however, continues to be a drag on the labour market. Wage growth also continues to be relatively flat but is projected to increase gradually over 2018 as tightening of the labour market puts upward pressure on wage demands. Forward-looking indicators are also suggestive of a continuation of relatively strong employment growth over the next few quarters.

Chart 1
World GDP Growth

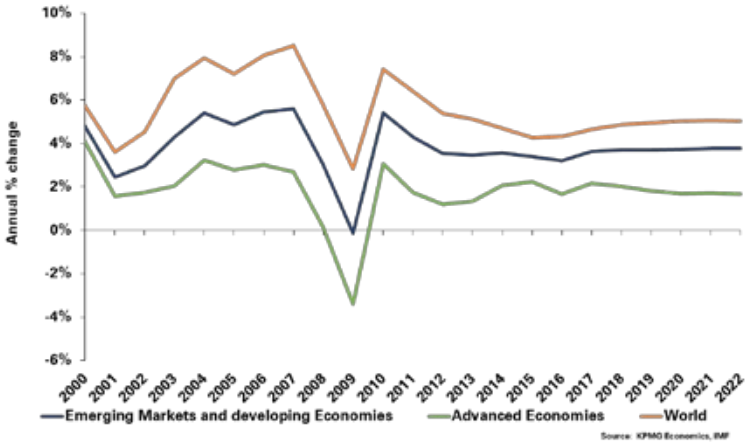
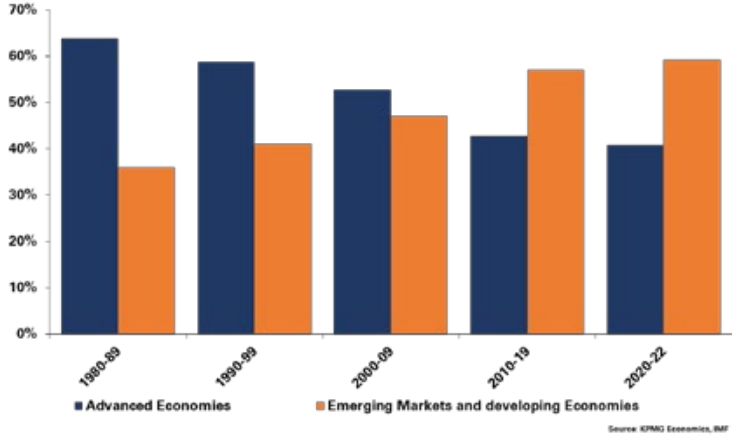


Chart 2
Share of Global Output



[1] October 2017 World Economic Outlook (WEO).
[2] The ASEAN-5 countries are Indonesia, Malaysia, Philippines, Vietnam and Thailand.

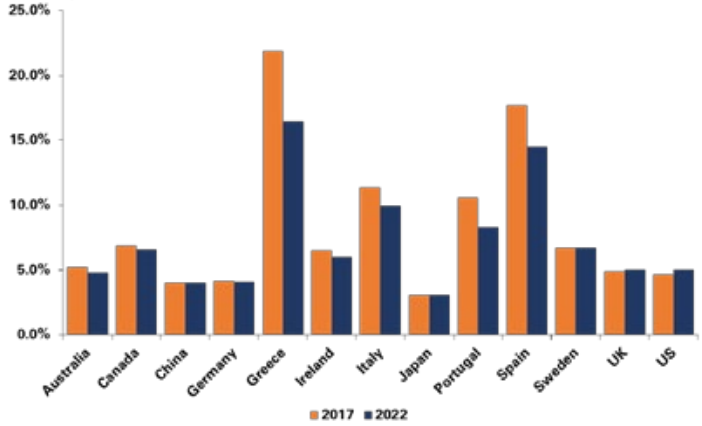
Global Outlook

Persistently low inflation in the advanced economies linger. With the notable exception of the U.K., both headline and core inflation remain soft and the inflationary response to capacity constraints seem to be delayed. Persistently low inflation is not without risks, one example being reduced flexibility in wage adjustment. The debate still rages on as to whether these observed lower-rates are permanent or transitory. Recently, in a speech at the National Economists Club in Washington, outgoing Chair of the Federal Reserve Janet Yellen stated that the lack of inflation had been an unexplainable 'surprise'.

Prices of oil and most other commodities have risen over the past quarter. The latest RBA's Index of Commodity Prices (preliminary estimates for November) indicate a monthly increase of 0.2% in November 2017 (SDR terms) following a decrease of 2.0% in October 2017. Global oil prices have edged up marginally with Brent Crude and WTI trading between the US$55-60/bbl range. Looking ahead, KPMG Economics forecasts oil prices to fluctuate, on average, between US$54-58/bbl for 2018.

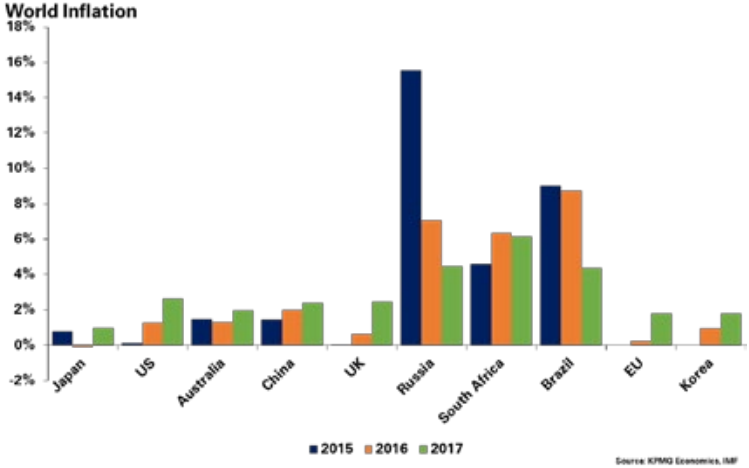
Among the major currencies, the U.S. dollar has appreciated slightly against a range of currencies following expectations of tighter monetary policy and fiscal stimulus. The British pound experienced the largest decline against the Euro over the quarter as a consequence of Brexit risks and uncertainty, with many economists and analysts still bearish on the outlook. The Euro is little changed on a trade-weighted basis since Q3 2017. The Australian dollar is currently trading around USD$0.75 against the U.S. dollar. Moving into the new year, KPMG Economics expects the Australian dollar to settle around the USD$0.77-0.78 range in 2018.

Chart 3
Unemployment Rate



Source: KPMG Economics, IMF

Chart 4
World Inflation



Source: KPMG Economics, IMF

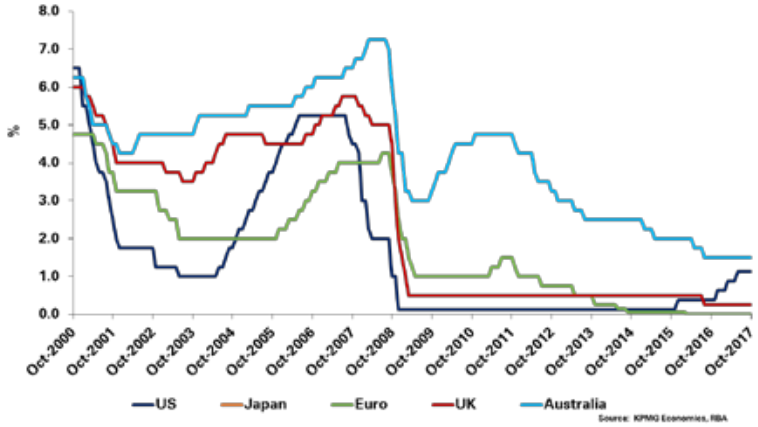
Global Outlook

Accommodative monetary policy and market conditions have continued to support growth in asset prices and valuations since the last quarter. Long-term bond yields, however, remain low despite improvements in the global economy and its outlook. The U.S. Federal Reserve commenced its balance sheet reduction program in October 2017 and have stated that they will continue to do so (conditional of the path of the economy) in a gradual and well-communicated manner. The Federal Open Market Committee (FOMC) raised the Federal Funds Rate (FFR) by 25bps in December as well as raising their economic growth forecast for 2018. A further 75bps rise in the FFR is expected in 2018. The current Fed Funds target rate lies between 1.25% and 1.50%. Jerome Powell has been nominated to be the next Chair of the Federal Reserve, a move which is likely to lead to a continuation of central bank policy.

The Bank of England's (BoE) Monetary Policy Committee voted at its November meeting to increase its policy rate by 25bps to 0.5%. The Committee also voted to maintain the stock of U.K. government bond purchase at £435 billion. The European Central Bank (ECB) held its benchmark interest rate at 0.0% and announced an extension of their asset purchase program until September 2018. The Reserve Bank of Australia (RBA), the Bank of Japan (BoJ) and the Bank of Canada have all kept their policy parameters unchanged (1.5%, -0.10%, and 1.0% respectively).

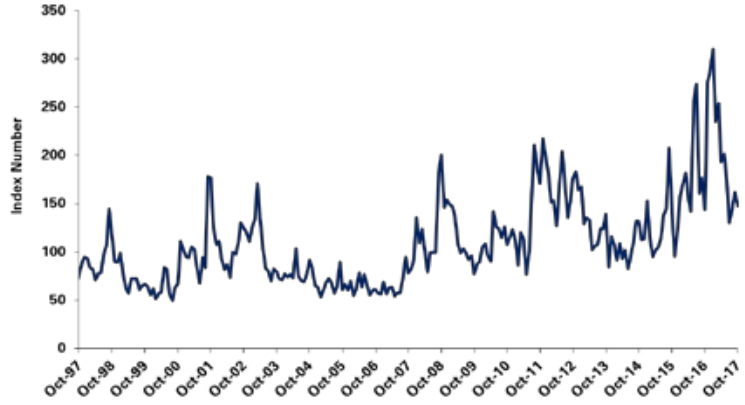
Risks to the baseline exist and the global outlook remains subject to uncertainty. Despite the U.K. and the European Union reaching an agreement in early December on Brexit separation terms paving the way for negotiations to advance on a trade deal, many uncertainties still remain – the post-Brexit Irish land border being one roadblock. Further, the effects of the unwinding (or quantitative tightening) of the balance sheets' of the major central banks is still a big unknown. Other headwinds to the global economy include heightened geopolitical tensions in the Middle East, Latin America, and North Asia which are likely to have global implications. The new Saudi Arabian leadership's approach to Iran, for instance, is shifting the balance-of-power across the Middle East and will have huge repercussions for the region.

Chart 5
Official Interest Rates



Source: KPMG Economics, RBA

Chart 6
Global Economic Policy Uncertainty Index



Source: KPMG Economics, Davis, www.policyuncertainty.com

Global Outlook

The U.S. economy grew at an annual rate of 3.3% (seasonally-adjusted) in Q3 2017. This was the highest rate of growth since Q3 2014. Growth was led by increases in personal consumption expenditure, private inventories and non-residential fixed investment. The unemployment rate dropped to 4.1% in November (the lowest rate since 2001) although the latest print on inflation at 1.6% is still below the Fed's target rate. Further fiscal stimulus could be on the cards heading into 2018 with the tax reform legislation that includes a permanent reduction in the corporate tax rate from 35% to 20%. The U.S. Senate approved the tax reform legislation in December while the House of Representatives passed the tax reform bill in November.

The European Union (EU28) and Euro Area (EA19) GDP growth were both 0.6% (seasonally-adjusted) in Q3 2017, a slight decline from the previous quarter's growth of 0.7% in both zones. Growth appears to be supported by improving business and consumer confidence. The unemployment rate in the Euro Area was 8.8% (seasonally-adjusted) in October 2017, down from 8.9% in September 2017. The EU28 unemployment rate was 7.4% (seasonally-adjusted) in October 2017, down from 7.5% in September 2017. Member States with the lowest unemployment rates in October were the Czech Republic (2.7%), Malta (3.5%), and Germany (3.6%).

EU28 headline inflation declined 0.1% to 1.7% in October while core inflation fell by 0.2% to 1.1%. In the Euro Area, headline inflation increased 0.1% to 1.5% in October 2017 from the previous month while core inflation stayed at 0.9%. Economic growth in Europe is projected to be robust over the next quarter consistent with leading indicators of economic activity. Headwinds in the form of political instability could curtail Europe's economic momentum. The recent election in Germany delivered a difficult result for Chancellor Angela Merkel to form government although leaders from the Social Democrats (previous partners in the coalition) have agreed to exploratory talks in the coming weeks. The Italian general election is also one to look out for in early 2018 (elections have to be held by May and will possibly be held in March) with Italy's debt problem and banking system the focus, economically. Poland's Prime Minister Beata Szydlo has resigned, with Finance Minister Mateusz Morawiecki nominated to replace her.

Chart 7
Output Gap by Country

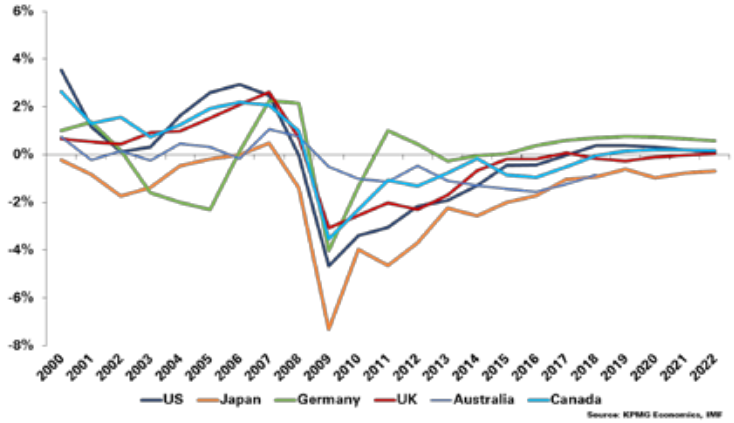
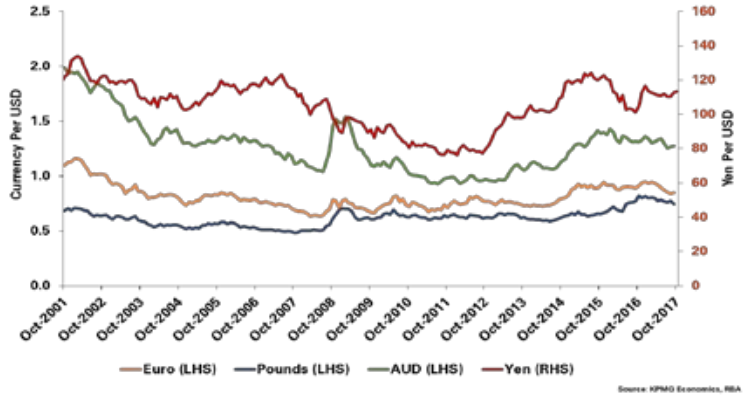


Chart 8
Exchange Rates (USD)

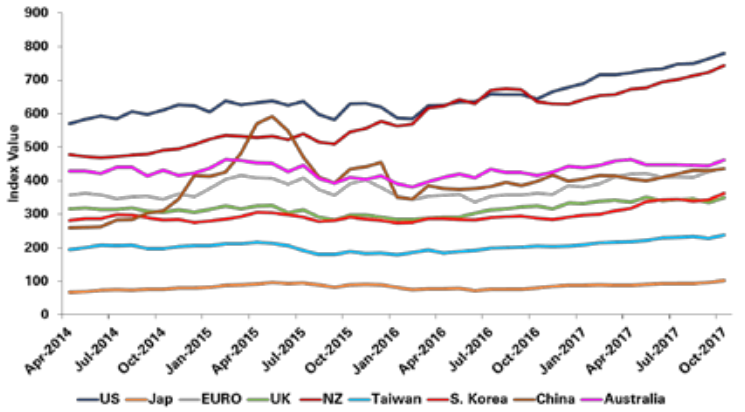


Global Outlook

Economic growth in the U.K. has remained modest at 0.4% (seasonally-adjusted) in Q3 2017 – a 0.1% increase from Q2 2017. Services remained the strongest contributor to GDP growth while household expenditure also strengthened. Business investment growth softened to 0.2% in Q3 2017 in the wake of uncertainty on the Brexit outcomes. CPI inflation rose 3.1% (y/y) in November 2017, up from 0.1% from 3.0% in September. This is the highest inflation rate since March 2012 with rising prices for a range of recreational and cultural goods and services. The depreciation of sterling has also contributed to imported inflation. Notably, the Governor of the BoE will now have to write a letter to the Chancellor of the Exchequer explaining why the central bank has missed its inflation target. On balance, the Monetary Policy Committee at the Bank of England (BoE) projects inflation to fall back over the next year and approach its 2% target by the end of the forecast period. Market participants, businesses, and investors still remain concerned about the growth prospects of the U.K. primarily due to the uncertainty surrounding the outcome of the Brexit talks.

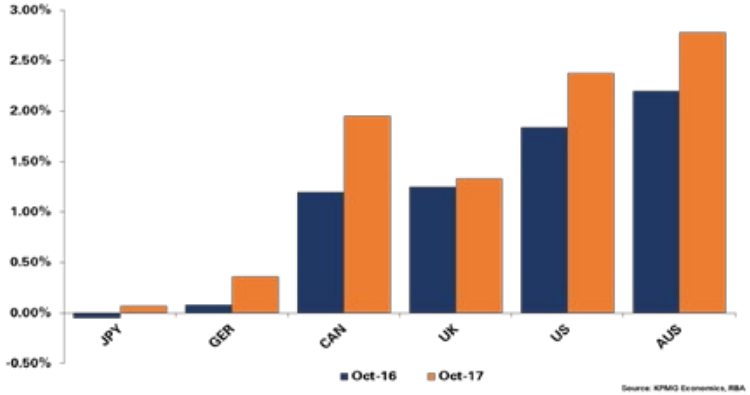
GDP growth in China grew 6.8% y/y in Q3 2017 – a slight decline from the 6.9% y/y growth in the previous quarter. Retail sales, exports and industrial production were the main drivers of economic growth in China in Q3 2017 while fixed asset investment saw its weakest gain. The 19th Party Congress re-established President Xi Jinping for his second five-year term as CCP General Secretary and further cemented his grip on the ability to set Party direction and policy for the next half-decade and beyond. The Chinese authorities are also currently focused on reducing financial risk and are reigning in credit expansion to safeguard the stability of the financial sector. For 2017, the Chinese government expects the economy to grow by around 6.5% - slightly lower than the 6.7% growth in 2016. China's main annual economic policy meeting (the annual Central Economic Work Conference) in December is also likely to set a slightly lower growth target for 2018 (the growth target is traditionally announced in March the following year) in the presence of tighter financial regulation and increased risk of credit defaults.

Chart 9
Share Price Index



Source: KPMG Economics, RBA

Chart 10
10 Year Government Bond Yields



Source: KPMG Economics, RBA

Global Outlook

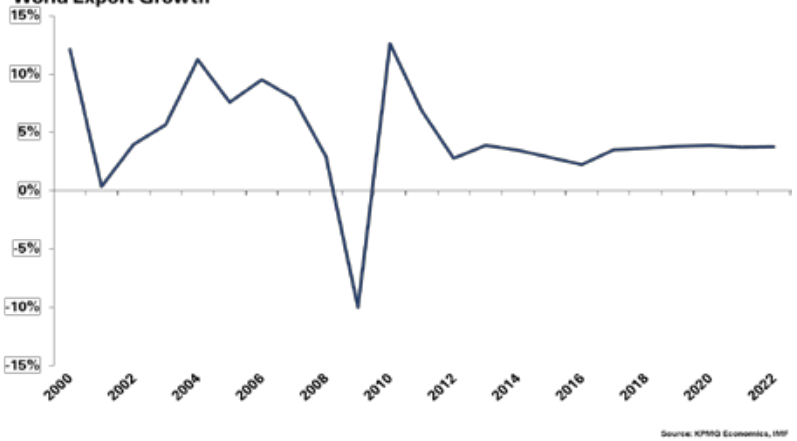
India's GDP growth advanced 6.3% (seasonally-adjusted) in Q3 2017 – up from 5.7% (seasonally-adjusted) in the previous quarter. This was primarily driven by gross fixed capital formation but was partially offset by a slowdown in household consumption and government spending. These are early signs that the Indian economy has shaken off the effects of demonetisation (in 2016) and the GST implementation in the middle of 2017. Inflation rose 3.6% (y/y) in October 2017 – 0.3% higher than September's print figure and was driven by the rising cost of food and fuel. The Reserve Bank of India (RBI) kept its repo rate unchanged at 6% and reverse repo rate at 5.75%.

Japan's economy grew for a seventh consecutive quarter with GDP coming in at 0.6% (seasonally-adjusted) q/q (2.5% y/y) in Q3 2017. This was significantly stronger than the preliminary estimate of 0.3% growth. Economic activity was supported by net exports and business expenditure but government expenditure was flat. The unemployment rate remains at record low levels of 2.8% in October 2017 (unchanged from July 2017) but upward pressure on wages or prices are still yet to materialise. Consumer prices rose just 0.2% (y/y) in October 2017 – the lowest rate since March 2017. Prices of food declined while transport and communication costs remained flat. Core inflation, however, was up 0.8% y/y on October 2017. A slight change in the 'tone' of monetary policy in Japan has also been observed recently with the 'downplaying' of its 2% inflation target. Despite this, however, no change is expected in the BoJ's monetary policy in the near future.

Russia's economy grew by 1.8% (annual) in Q3 2017 down from 2.5% (annual) in the previous quarter. GDP growth came in a little lower than expected despite a rally in oil prices. Russia's unemployment rate stood at 5.1% in October 2017 (0.1% increase from the previous month) while inflation slowed to 2.5% (y/y) in November 2017 from 2.7% the month prior. Russian President Vladimir Putin has announced he would present his re-election candidacy for the country's 2018 presidential election scheduled for March 2018.

Chart 11
Index of Selected Commodites And Exchange Rate

Chart 12
World Export Growth



Global Outlook

Growth in Real GDP

Year End December	2017	2018	2019	2020	2021	2022
OECD	2.2%	2.1%	2.0%	1.8%	1.7%	1.6%
Americas						
Brazil	0.5%	1.0%	1.9%	2.3%	2.4%	2.5%
Canada	3.1%	2.2%	2.1%	1.7%	1.4%	1.3%
Latin America	2.2%	3.2%	3.0%	2.9%	2.6%	2.3%
Mexico	2.5%	2.2%	2.3%	2.5%	2.6%	2.6%
USA	2.1%	2.3%	2.1%	1.9%	1.7%	1.7%
Europe						
EMU	2.1%	1.9%	1.7%	1.4%	1.3%	1.3%
France	1.7%	1.7%	1.6%	1.5%	1.4%	1.4%
Germany	2.0%	1.8%	1.7%	1.4%	1.3%	1.2%
Greece	1.1%	2.4%	1.8%	1.6%	1.6%	1.8%
Ireland	4.0%	3.6%	2.7%	2.1%	1.7%	1.6%
Italy	1.4%	1.2%	1.2%	1.0%	1.0%	1.0%
Russian Federation	1.5%	1.9%	2.2%	1.6%	1.3%	1.4%
UK	1.9%	1.5%	1.6%	1.8%	1.9%	1.9%
Africa	2.6%	3.5%	2.9%	3.3%	3.6%	3.8%
South Africa	0.7%	1.7%	2.4%	2.4%	2.4%	2.6%
Middle East	2.4%	2.7%	2.2%	2.5%	2.6%	2.7%
Asia						
China	6.8%	6.5%	6.0%	5.7%	5.6%	5.5%
East Asia	3.8%	4.7%	4.6%	4.5%	4.4%	4.4%
Hong Kong	3.3%	2.1%	2.2%	2.1%	2.1%	2.1%
Indonesia	4.9%	5.3%	4.7%	4.7%	4.4%	4.3%
India	6.8%	7.6%	7.2%	7.0%	6.8%	6.7%
Japan	1.5%	1.0%	0.8%	0.6%	0.7%	0.8%
Singapore	2.8%	3.1%	1.9%	1.8%	2.4%	3.2%
South Korea	2.9%	3.2%	3.3%	3.4%	3.5%	3.6%
Taiwan	2.2%	2.4%	2.8%	2.8%	2.7%	2.7%
Vietnam	6.7%	6.7%	5.9%	6.1%	5.7%	5.4%
Oceania						
New Zealand	2.7%	3.2%	2.9%	2.5%	2.0%	2.1%
World	3.5%	**3.7%**	**3.5%**	**3.3%**	**3.3%**	**3.3%**

Annual Inflation

Year End December	2017	2018	2019	2020	2021	2022
OECD	2.2%	2.4%	2.2%	2.2%	2.1%	1.9%
Americas						
Brazil	2.8%	3.8%	5.2%	5.9%	5.7%	5.4%
Canada	1.3%	1.6%	1.6%	1.8%	1.9%	1.9%
Latin America	5.3%	3.0%	4.1%	4.8%	4.6%	4.0%
Mexico	6.2%	4.7%	3.2%	3.1%	3.1%	2.8%
USA	1.6%	2.4%	2.2%	2.0%	1.8%	1.5%
Europe						
EMU	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%
France	1.1%	1.3%	1.5%	1.6%	1.6%	1.6%
Germany	1.6%	1.5%	1.4%	1.4%	1.4%	1.4%
Greece	2.0%	1.1%	1.5%	2.0%	2.3%	2.3%
Ireland	2.3%	1.3%	1.5%	1.6%	1.6%	1.6%
Italy	1.4%	1.9%	1.9%	1.7%	1.7%	1.6%
Russian Federation	3.3%	3.9%	4.6%	4.4%	4.2%	4.1%
UK	2.4%	2.7%	2.5%	2.1%	2.2%	2.1%
Africa	8.6%	7.7%	7.0%	6.5%	5.9%	5.3%
South Africa	4.8%	5.4%	5.9%	5.5%	4.4%	3.4%
Middle East	10.7%	7.7%	5.9%	4.8%	3.9%	3.2%
Asia						
China	1.7%	2.1%	2.8%	2.9%	3.2%	3.5%
East Asia	2.7%	3.4%	3.9%	4.0%	4.0%	4.0%
Hong Kong	3.0%	2.1%	2.1%	2.5%	2.8%	3.2%
Indonesia	5.1%	5.1%	5.2%	4.9%	4.7%	4.6%
India	3.6%	5.2%	5.2%	5.1%	5.1%	4.9%
Japan	-0.2%	0.8%	1.0%	1.2%	1.4%	1.4%
Singapore	0.9%	1.6%	1.9%	2.1%	2.6%	2.9%
South Korea	2.4%	2.1%	1.9%	2.0%	2.0%	2.0%
Taiwan	0.0%	0.3%	1.0%	1.5%	1.7%	1.8%
Vietnam	4.0%	5.5%	6.2%	5.9%	4.8%	4.2%
Oceania						
New Zealand	1.8%	1.8%	2.9%	2.7%	2.4%	2.6%

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Australian Outlook

Australian Outlook

The Australian economy grew by 0.6% q/q (seasonally-adjusted) in the September quarter of 2017 following an upwards revised 0.9% q/q growth in Q2 2017. On an annualised basis, the Australian economy grew at 2.8% y/y increasing from 1.9% y/y in Q2 2017. Growth has been relatively broad-based with 17 of the 20 industries recording positive growth.

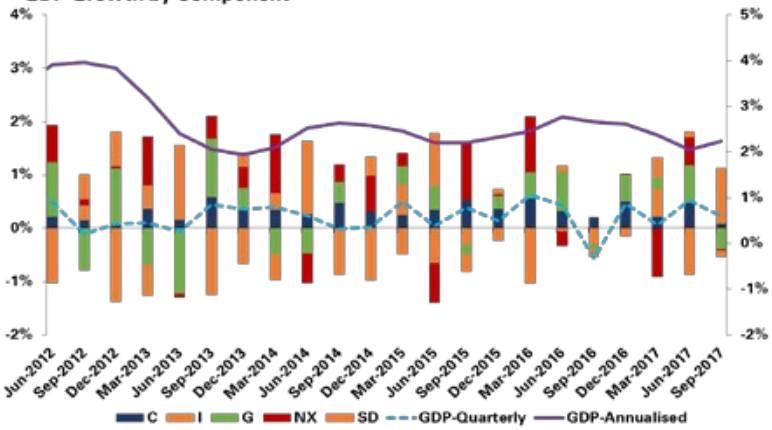
Non-dwelling construction was strong contributing 0.9 percentage points to GDP growth while the export sector added a further 0.4 percentage points. Household consumption added 0.1 percentage points to growth while change in inventories added a further 0.2 percentage points to GDP growth. in the September quarter. Government expenditure as a contribution to growth remained relatively flat in the September quarter of 2017.

Labour market conditions improved with the unemployment rate falling to 5.4% (seasonally-adjusted) in October 2017 – down from 5.4% in September 2017. The Australian economy added 3,700 (seasonally-adjusted) jobs in October 2017 bringing the total number of employed people to 12.3 million. This increase in employment, however, was the lowest increase for the year and below economists' expectations. Labour costs increased marginally with Australia's seasonally-adjusted Wage Price Index growing by 0.5% q/q (2.0% y/y) in Q3 2017.

Headline inflation rose 1.8% y/y in Q3 2017 (0.6% q/q) with underlying inflation at around 1.8% y/y (trimmed mean basis). Inflation remains contained and under the RBA's medium-term target of 2.5%. The RBA's official cash rate (OCR) is accommodative at 1.5% and is expected to remain so for the better half of 2018.

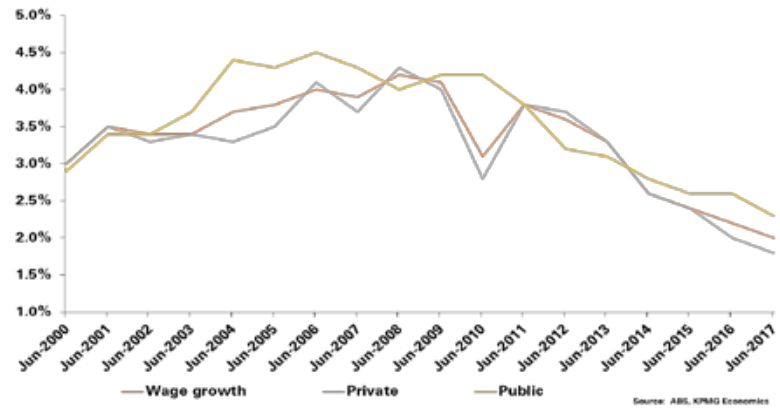
Looking ahead to 2018, KPMG Economics' forecasts for the Australian economy have been revised up with real GDP expected to grow at around 3.2% for FY2018.

Chart 13
GDP Growth by Component



Source: KPMG Economics, ABS

Chart 14
Private and Public Wage Growth



Source: ABS, KPMG Economics

Government

Government expenditure grew by 0.2% q/q (seasonally-adjusted) in Q3 2017, down from 1.2% q/q (seasonally-adjusted) in Q2 2017. This was driven by a decline on non-Defence expenditure (-1.1% q/q) while Defence expenditure rose 3.3% q/q. National government expenditure decreased 0.1% q/q in Q3 2017 (down from 1.5% q/q in Q2 2017) and State government spending grew by 0.4% q/q (down from 0.9% q/q in Q2 2017).

The Federal Government's debt-to-GDP position remains at around 40%. As at September 2017, the total face value of Commonwealth Government Securities (CGS) on issue stood at $508 billion, up from $501 billion in June 2017. According to the Australian office of Financial Management (AOFM), Gross Treasury Bond issuance in 2017-18 is expected to be around $80 billion. After accounting for maturities ($31 billion) and buybacks ($15 billion), net issuance will be around $34 billion.

The Mid-Year Economic and Fiscal Outlook (MYEFO), which provides an update on the economic and fiscal outlook from the previous Budget as well the current budgetary position, was released on 18 December 2017. MYEFO 2017-18 reported that the Government is delivering on its fiscal strategy and that the budget remains on-track to achieve a surplus in 2020-21 (projected surplus of $10.2 billion in 2020-21). The key takeaway is that, since the Budget (2017-18) in May, the Underlying Cash Balance (UCB) has recorded an improvement of around $9.3 billion in total across the forward estimates. The forecast deficit for 2017-18 has improved by 0.3 percentage points to 1.3% of GDP from 1.6% of GDP in May.

Other key MYEFO 2017-18 updates include a real GDP growth forecasts of 2.5% in 2017-18 (down from the 2.75% forecast in the May Budget) and 3% in 2019-20 (unchanged from May Budget), Wage Price Index to grow 2.25% (revised down from 2.5% in May) in 2017-18, and the unemployment rate stabilising at 5.5% in 2017-18 (revised down from a forecasts of 5.75% in May). In addition, company tax forecasts have been revised up due to stronger-than-expected collections and increased company profitability.

Chart 15
Budget Aggregates - MYEFO 2017-18

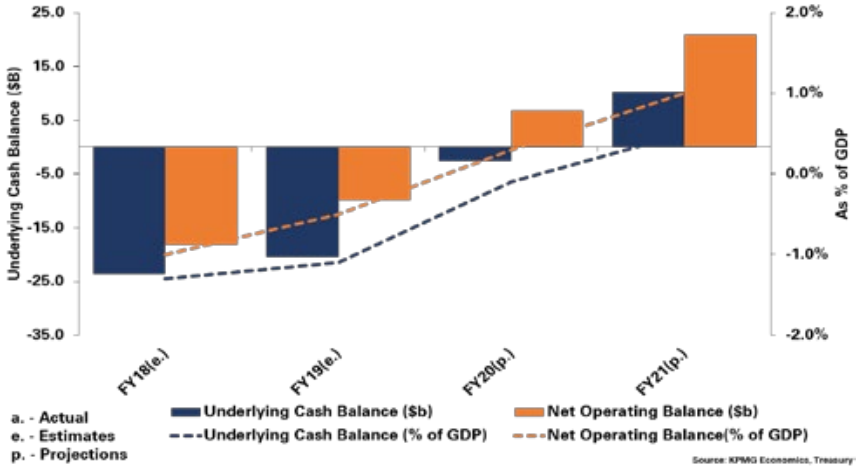
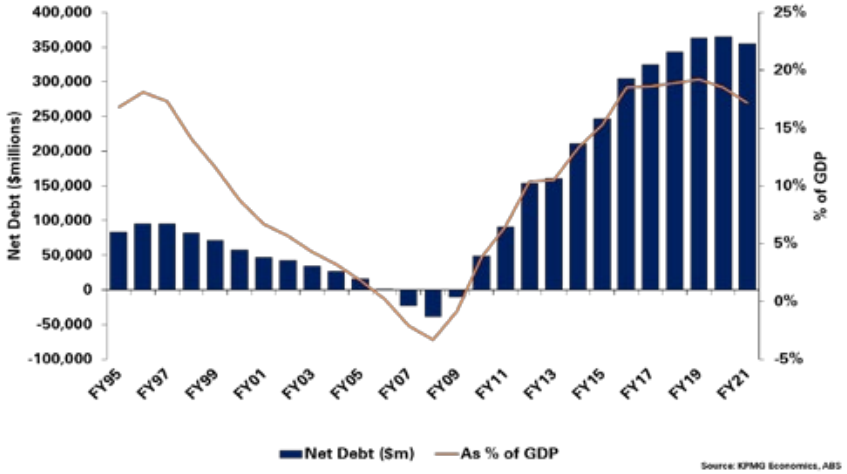


Chart 16
Australian Government Net Debt - MYEFO 2017-18



Production

The Finance and Insurance Services industry continues to be the largest industry, accounting for 9.5% of the economy's Gross Value Added. Construction (8.0%), Health Care and Social Assistance (7.6%) and Mining (6.4%) make up the top four largest industries within the Australian economy, accounting for just under 32% of GVA.

GVA growth in Q3 2017 was relatively broad-based with 17 of the 20 industries recording positive growth for the quarter. Growth was driven by Manufacturing (2.5% q/q), Electricity, Gas, Water and Waste Services (1.9% q/q), Mining (1.1% q/q), Processional, Scientific and Technical Services (0.7% q/q), Construction (0.6% q/q), and Retail Trade (0.1% q/q).Agriculture, Forestry and Fishing (-4.1% q/q), Rental Hiring and Real Estate Services (-1.4% q/q), and Information, Media and Telecommunications (-1.3% q/q) all experienced contractions in GVA over Q3 2017.

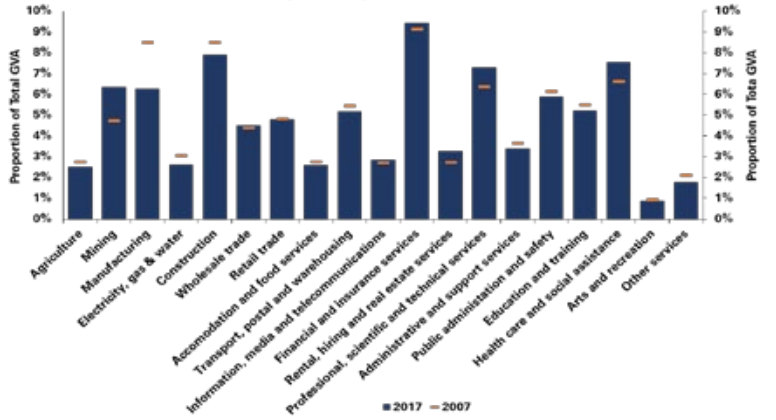
The December 2017 ABARES Australian Crop Report forecasts a rise in the total area planted to summer crops by 13%, reaching 1.5 million hectares in 2017-18. Total winter crop production is projected to decrease by 41% in 2017-18 to 34.9 million tonnes reflecting expected falls in yields from exceptionally high yields in 2016-17. Winter production in 2017-18 is forecast to be 2% below the 10 year average to 2015-16. For the major winter crops, wheat production is forecast to decrease by 42% to 20.3 million tonnes, barley production is forecast to decrease by 40% to 8.0 million tonnes and canola production is forecast to decrease by 31% to 2.9 million tonnes.

Total summer crop production is forecast to increase by 23% to around 4.8 million tonnes. The 2017-18 production forecast is a downward revision of 4.0% from ABARES forecast published in the September 2017 edition of the Australian Crop Report. For the major summer crops, grain sorghum area is forecast to increase by 61% to 636,000 hectares, cotton area is forecast to decrease by 10% to 500,000 hectares and rice area is forecast to decrease by 2% to 80,000 hectares.

Chart 17
Gross Value Added Growth, September Quarter

Source: KPMG Economics, ABS

Chart 18
Share of Gross Value Added by Industry, 2007 vs. 2017



Source: KPMG Economics, ABS

Consumption

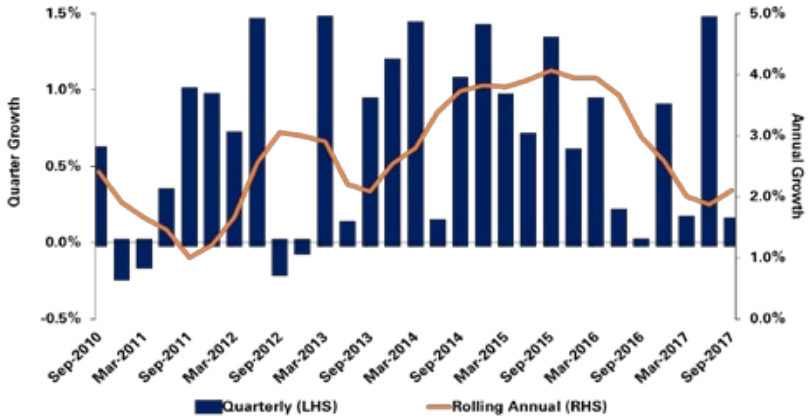
Household final consumption expenditure grew 0.1% q/q (seasonally-adjusted) in Q3 2017, and 2.6% on a rolling 12-month basis. This was driven by Electricity, gas and other fuel (1.4%), Insurance and other financial services (1.3%), Food (1.0%), and Transport services (0.8%). Declines in household consumption expenditure were led by Health (-1.0%), Alcoholic beverages (-0.9%), Hotels, cafes and restaurants (-0.9%), and Furnishings and household equipment (-0.8%).

Retail trade growth increased again in October 2017, following a 0.1% increase in September 2017. Month-on-month, seasonally-adjusted October 2017 figures reveal growth of 0.5% (0.1% q/q). All categories recorded positive growth in the October quarter of 2017 with cafes, restaurants and takeaway food (1.7%) leading the charge. On a quarterly basis, growth was led by Food (0.9%), Clothing, footwear and personal accessory retailing (0.7%), and Other retailing (0.7%). The largest quarterly decline was observed the Household goods (-1.6%) and Department stores (-1.4%) category.

Household borrowing has continued to rise and debt growth has outpaced incomes and assets in the last financial year (2015-16). A recent study by the ABS on 'Household Debt and Over-Indebtedness in Australia has found that the mean household debt has increased by 83% in real terms since 2003-04 while the mean asset value increased by 49% and gross income by 38%. Households in the capital city regions were also more likely to be over0indebted than those in the rest of the state. The recent September 2017 National Accounts figures released by the ABS, however, reveals that the household saving ratio increased for the first time in five years to 3.2 in Q3 2017 from 3.0 in Q2 2017.

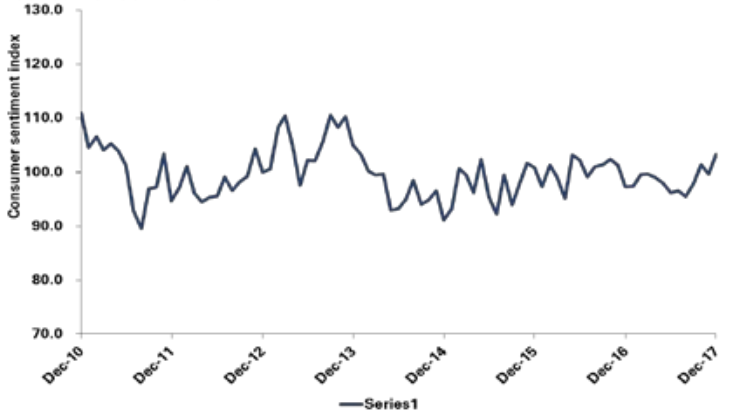
Consumer sentiment, as measured by the Westpac-Melbourne Institute Index of Consumer Sentiment, rose 3.6% in December to 103.3. The number of optimists now outnumber the number of pessimists within the 1,200 survey respondents. According to the survey, all five components of the Index improved in December 2017. In particular, the 'Economic Conditions' sub-index rose 5% while 'Economic Conditions next 5 years' rose 3.4%.

Chart 19
Retail Sales, Australia



Source: KPMG Economics, ABS

Chart 20
Consumer Confidence



Source: , Westpac Melbourne Institute, KPMG Economics

Investment

Private investment in Australia edged up 1.0% q/q (seasonally-adjusted) in the September quarter of 2017. Year-on-year, total new capital expenditure grew by 2.3% (seasonally-adjusted). Expenditure on buildings and structures rose 1.2% q/q (seasonally-adjusted) while expenditure on equipment, plant and machinery increased 2.2% q/q (seasonally-adjusted) in Q3 2017. Total Gross Fixed Capital Formation in Australia also increased 1.8% (seasonally-adjusted) in Q3 2017.

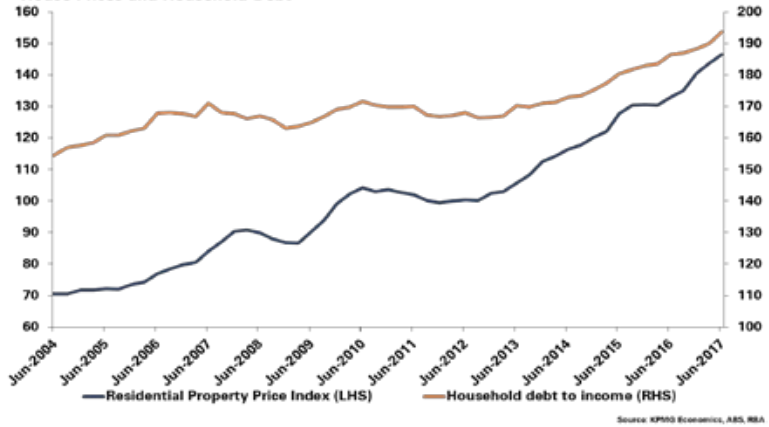
The number of dwelling approvals decreased by 1.5% m/m (seasonally-adjusted) in September 2017, although there was a rise in 'private dwellings excluding houses' (2.6%). Dwelling approvals declined the most in Queensland (-17%), with Victoria (-1.9%) also experiencing a decline in approval rates. All other states and territories recorded positive growth rates in dwelling approvals with Western Australia (27.1%), Tasmania (16.6%), and New South Wales (10.7%) leading the way.

The HIA New Home Sales indicator declined 6.1% m/m in September 2017 following a 9.1% rise in August 2017 reflecting a drop in sales volumes over the past month. The decline was driven by a drop in sales of multi-units (-16.7%) and new detached houses (-4.5%) and partially reflects policies put in place by RBA and APRA on the housing sector.

The NAB Business Confidence Index declined to 6 in November 2017, down from a relative high of 9 in October 217. The Business Conditions sub-component of the Index fell to 12 points from a record high of 21 in October 2017. Declines in the Index were driven by a pullback in trading conditions and profitability which decreased from 30 to 16 and 26 to 15, respectively.

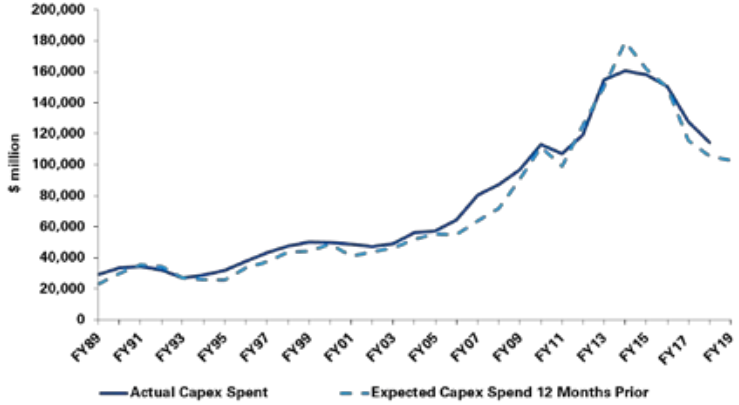
Services and Manufacturing PMIs are still in the expansionary range (above 50). The AIG Performance of Manufacturing Index in Australia rose 6.2 points to 57.3 in November 2017 (from October 2017) while the Australian Performance of Services Index edged up to 51.7 in November 2017 from 51.4 in October 2017.

Chart 21
House Prices and Household Debt



Source: KPMG Economics, ABS, RBA

Chart 22
Actual and Expected Private New Capital Expenditure



Source: ABS, KPMG Economics

Labour Market

The labour market in Australia remains relatively healthy. Employment increased by 61,600 (seasonally-adjusted) persons from October to November 2017, bringing the total number of employed persons to 12,403,000. The proportion of full-time employed persons also edged up slightly with the domestic labour force comprising around 8.43 million full-time employed persons (approximately 69% of the total employed labour force) and 3.87 million part-time employed persons (approximately 31% of the total employed labour force).

The unemployment rate remained at 5.4% (seasonally adjusted) in November 2017, with 'monthly hours worked' increasing by 0.6% to 1,740.9 million hours. The latest published data on underemployment (August 2017), reveals that the underemployment rate is around 8.6% (seasonally-adjusted) while the underutilisation rate stands at 14.1% over the August quarter.

The labour force participation rate increased by 0.3 percentage points to 65.5% in the month of November 2017 - beating expectations and is the highest the participation rate has been for the year. This is a positive signal for the labour market signalling the return of discouraged workers and first-time participants into the labour force. Wage growth, once again, remains relatively subdued. The Wage Price Index rose by 0.5% (seasonally-adjusted) in the September quarter of 2017 with wages in both the private and public sector increasing by 0.5%

Forward-looking indicators signal moderate growth in the labour market over the next quarter. The ANZ Job Advertisements Series showed an increase of 1.5% m/m in the number of job advertisements in November 2017, and a 12.1% increase on an annualised basis. This suggests positive and improving labour market conditions in Australia, closing the gap on spare capacity in the labour market.

KPMG Economics forecast for the unemployment rate is little change at 5.5% for FY2018.

Chart 23
Unemployment and Participation Rates

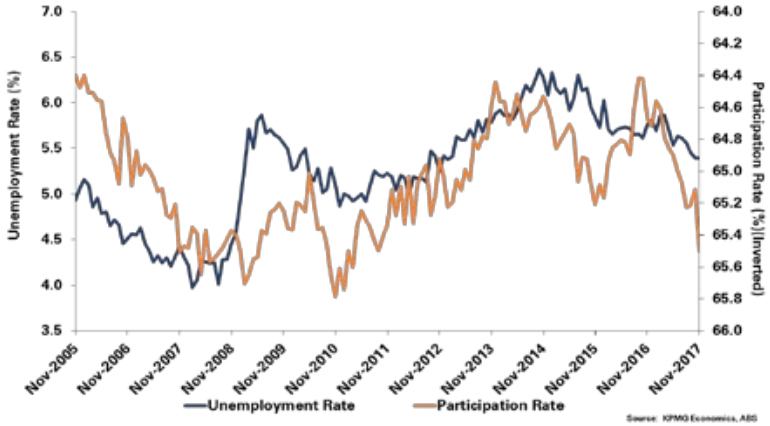
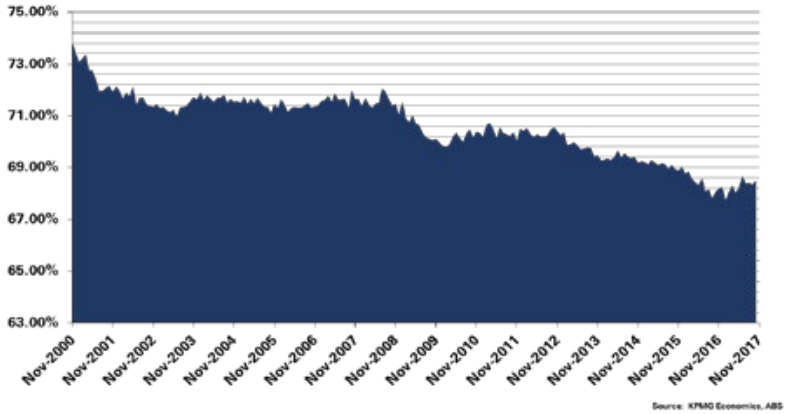


Chart 24
Proportion of full-time to total Employment



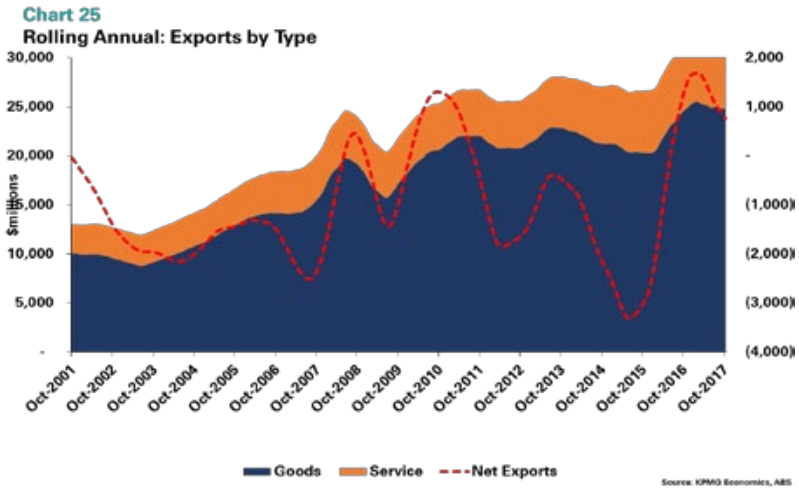
Net Exports

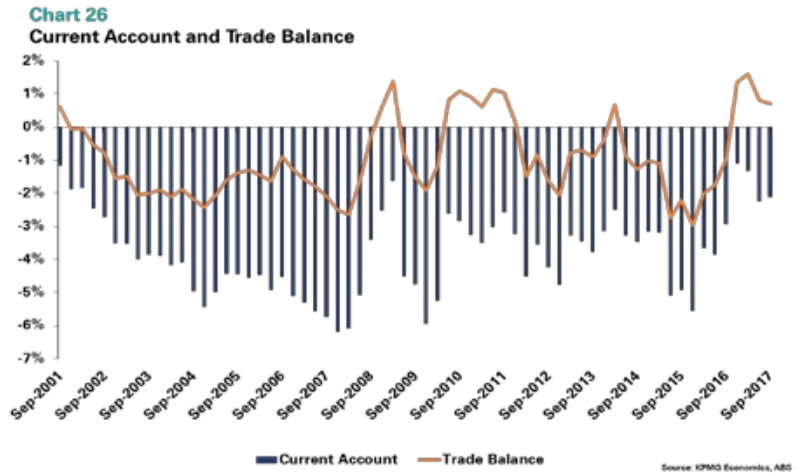
The Australian economy posted a current account deficit of $9.13 billion in Q3 2017, equivalent to 2.1% of GDP. The trade surplus also narrowed $0.1 billion in October 2017 from a downward revision of $1.6 billion in September 2017. This was the smallest trade surplus since April 2017 as the value of exports declined to $31.87 billion in October 2017 (from $32.77 billion in September 2017) while imports increased to $31.77 billion in October 2017 from $31.17 billion the month before.

Export of goods contributed $24.56 billion while export of services contributed $7.31 billion to the trade balance. Imports of goods and services rose 2.0% to $31.77 billion, with imports of goods contributing $24.38 billion and import of services contributing $7.39 billion.

Demand for Australian exports are expected to remain strong over the next quarter supported by healthy demand for commodities and a weaker Australian dollar. For the month of November 2017 (preliminary estimates), the RBA's Index of Commodity Prices indicate an increase of 0.2% (SDR terms), following a decrease of 2.0% in October 2017. Over the year, the index has decreased by 3.3% in SDR terms and 1.6% in Australian dollar terms. Australia's Terms of Trade (ToT) increased to 114.70 index points in Q3 2017 from 103.60 in Q2 2017. KPMG Economics forecast for the ToT for FY 2018 is little changed at around 96.

The Australian dollar has depreciated slightly against the U.S. dollar since Q3 2017, and is currently trading at around USD 0.76c. This has come on the back of a generally stronger U.S. dollar. On a trade-weighted basis, the Australian dollar is also marginally lower since Q3 2017 with the Index at around 63.6 in November 2017 compared with 66.2 in September 2017. KPMG Economics have forecasts the AUD/USD exchange rate settling around the USD$0.77-0.78 range in 2018.





Forecast Assumptions

Changes in key assumptions impacting KPMG's Economics forecasts since November 2016 include:

Global

- A rise in 10-year bond yields in most jurisdictions through 2017;
- A tightening in the spread between sovereign bonds and corporate bonds, suggesting the margin for corporate borrowing compresses;
- Oil prices stabilising to trade in a tight range of US$54/bbl to $58/bbl until the end of 2018;
- Equity prices to retreat from recent high's once the 'sugar hit' from the commencement of the Trump Administration in the US wear's off.

Australia

- Residential construction activity to soften in 2017 and 2018 due to a moderation in non-housing construction;
- Non-mining business investment to continue to steadily rise, although the decline in mining investment will continue to swamp aggregate investment such that negative growth remains in FY17;
- Household consumption activity to be limited by high debt levels, anemic wages growth and moderate employment growth;
- Limited fiscal reforms in Australia, thereby keeping the effective corporate tax rate and effective personal income tax rate the same as in FY16, with government spending also to be maintained at levels forecast in the recent MYEFO statement.

Australian Outlook

	FY17	FY18	FY19	FY20	FY21	FY22
GDP (Real)	2.0%	3.2%	2.4%	2.4%	3.0%	2.8%
Private Consumption	2.4%	2.6%	2.7%	2.7%	3.1%	2.8%
Investment						
Business	-6.3%	6.8%	2.7%	3.3%	4.6%	5.9%
Housing	1.3%	-1.7%	1.7%	2.0%	2.5%	1.7%
Government						
Consumption	3.6%	3.5%	3.0%	2.9%	2.3%	2.3%
Investment	14.3%	2.5%	-7.6%	-6.5%	-1.5%	0.0%
Total domestic demand	1.8%	3.0%	2.2%	2.3%	2.9%	2.9%
Export volumes	5.4%	6.7%	5.9%	5.0%	4.3%	3.3%
Import volumes	4.5%	5.5%	4.8%	4.3%	4.1%	3.7%
Inflation (1)	1.4%	2.1%	2.7%	2.8%	3.0%	3.2%
Real Personal Disposable Income	1.4%	2.8%	2.8%	3.0%	3.0%	2.8%
Unemployment, % (1)	5.6%	5.5%	5.5%	5.5%	5.2%	5.1%
Government Balance as % of GDP	-1.6%	-0.6%	-0.3%	-0.3%	-0.3%	-0.6%
Govt. debt as % of GDP	45.2%	45.4%	43.7%	41.9%	39.8%	38.0%
Current account as % of GDP	-1.7%	-2.0%	-0.8%	-0.1%	0.0%	-0.2%
A/US (1)	0.751	0.778	0.778	0.779	0.781	0.783
Terms of Trade (1)	97.0	96.2	95.3	95.0	94.6	94.0

(1) = Value at end of the year

KPMG Economics

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