KPMG

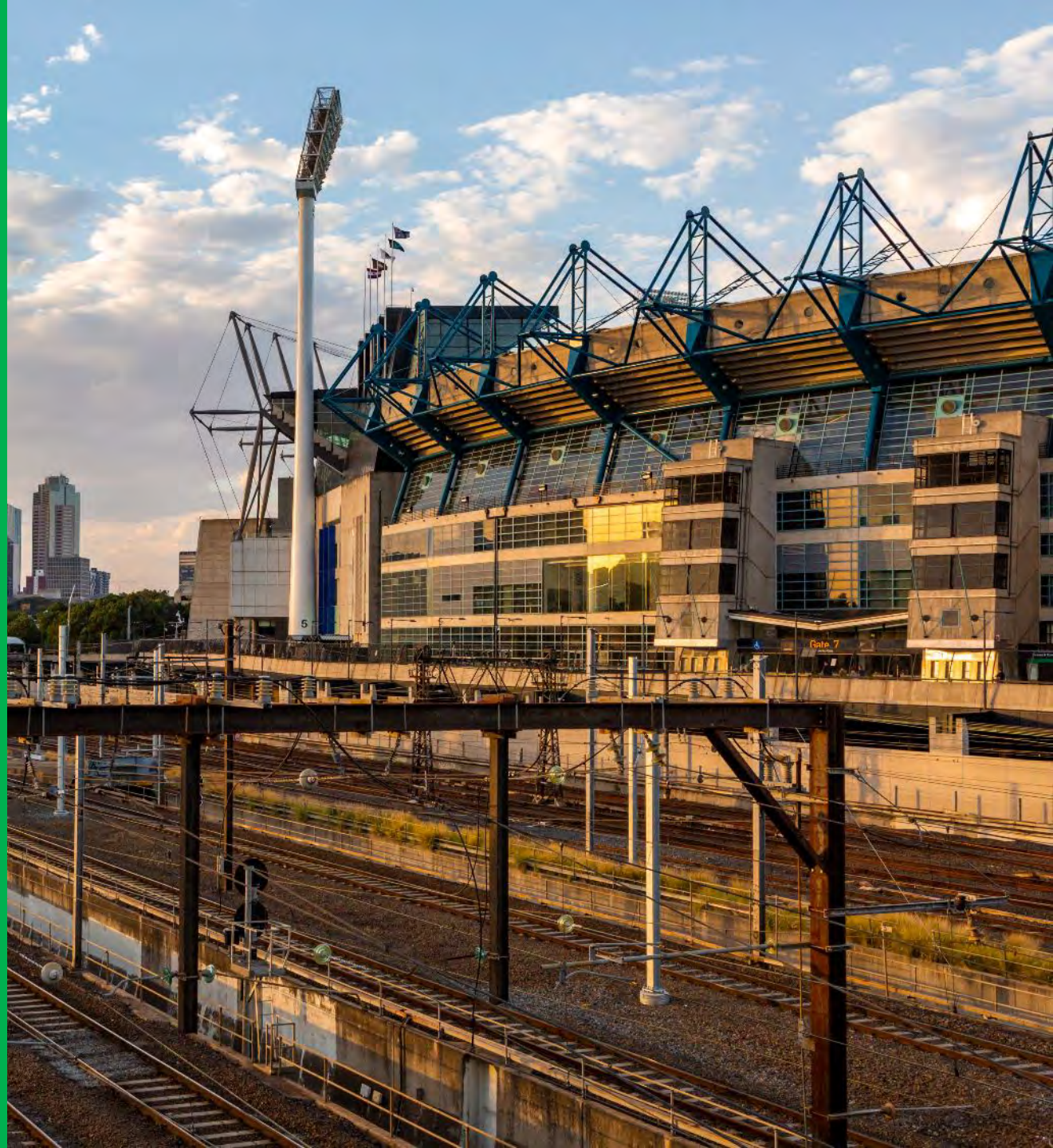
Quarterly Economic Outlook

Global and Australian Forecasts

KPMG Economics & Tax Centre

—

October 2019



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Executive Summary

Global economy

- An escalation in geopolitical risks over the past quarter is creating increased uncertainty in the short term outlook of global economic growth. Most central banks worldwide have responded with a more accommodative stance, while urging governments to join forces with fiscal support.
- Elevated uncertainty continues to drag on manufacturing and business investment in the US. The Fed expressed concerns over the challenge of incorporating trade policy uncertainty into the FOMC's framework.
- While a legislation to stop a no-deal departure from the EU was passed, the possibility of a no-deal Brexit cannot be completely ruled out. Indicators pointed to a contracting production sector and deteriorating economic sentiment in the UK.
- Diverging trends between the manufacturing and service sectors are evident in the Eurozone – the manufacturing recession is expected to persist, while the services sector may provide an upward trajectory for the economy in the area.
- The Chinese economy has continued to face softening domestic demand. The automotive sector suffered further shrinkage in production and sales of both passenger cars and commercial vehicles.
- A considerable number of Asian countries have taken a hit from the US-China trade disputes due to integrated regional supply chains.

Australian economy

- The Australian economy continued to remain weak in Q2 2019 with GDP growth falling to 1.4% y/y.
- Real aggregate gross fixed capital formation declined further by 4% y/y, with investment by the private sector and public corporations both declining by 5.2% y/y, or by 1.6% q/q and 1.3% q/q respectively.
- Consumer and business confidence did not improve despite recent stimulus, but is expected to lift over the outlook period. Housing-related sentiment in September became relatively mixed after clear positive reactions to the rate cuts observed in June, July and August.
- Strong nominal government tax receipts due to rising commodity prices and the extension of ATO's Tax Avoidance Taskforce contributed to a near balanced Budget for FY19.
- The unemployment rate in August increased slightly to 5.3% from the preceding month, despite employment growth of nearly 35,000 new jobs being created. Labour demand and supply indicators pointed to persistent spare capacity in the market.
- A current account surplus of $5.8 billion in the June quarter 2019 was posted for the first time in 44 years. However, we anticipate the trade balance to soften over the coming quarters as a consequence of slumping iron ore prices and a pull-back in agriculture commodity exports.

Australian forecasts

Year ending	Jun-19	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22
GDP (Real)	1.4%	1.9%	2.1%	2.3%	2.4%	2.5%	2.5%	2.5%
Inflation (1)	1.6%	1.5%	1.7%	1.8%	1.9%	2.0%	1.8%	1.8%
Unemployment, % (1)	5.2%	5.4%	5.3%	5.2%	5.1%	5.0%	5.0%	5.0%
A/US (1)	0.671	0.660	0.655	0.670	0.677	0.678	0.680	0.682

(1) = Value at end of the year

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Global Outlook

Overview

An escalation in geopolitical risks over the past quarter is creating increased uncertainty in the short term outlook of global economic growth. While the US-China trade war and the UK's departure from the European Union remain an on-going concern, various other actions and events over the past few weeks have pushed the needle down towards the riskier end of the global economic spectrum.

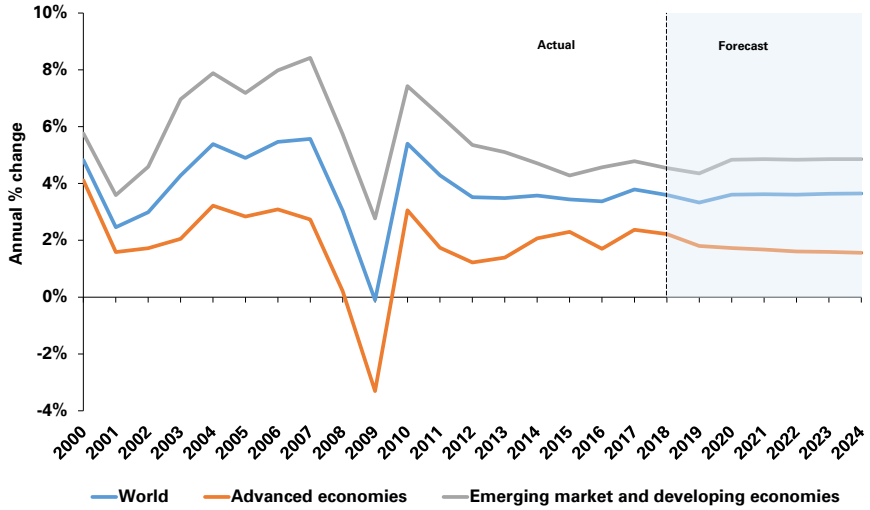
Increased political unrest in Italy and Argentina, rising trade tensions between Japan and South Korea, social unrest in Hong Kong (SAR), China, the loss of self-determination in Kashmir, economic slowdowns in Germany and Sweden, and the prospect of a military conflict involving Iran, plus the continuation of instability in Venezuela, Ukraine and the Middle East, have all combined to make the current global environment more tense, more challenging and more fragmented than any other time in the recent past.

The Global Economic Policy Uncertainty Index (based on PPP-adjusted GDP) surged by a significant 20.5% from the start of 2019 to 384 points in August. Elevated uncertainty has weighed on sentiment across the private sector, causing businesses to delay their capital investment and households to reduce consumption.

Various indicators are also pointing to a downturn in the manufacturing sector in a considerable number of economies. The global headline manufacturing Purchasing Manager's Index (PMI) has entered the contractionary territory, reaching 49.5 in August 2019. Two countries in the EU, Germany and the Czech Republic, observed the steepest declines. Manufacturing employment has gone down for four successive months in August. Survey results also showed falling new export orders in consumer, intermediate and investment goods. Similarly, latest data from CPB World Trade Monitor demonstrated the world merchandise export volume index fell by 1.4% over the 12 months to June 2019.

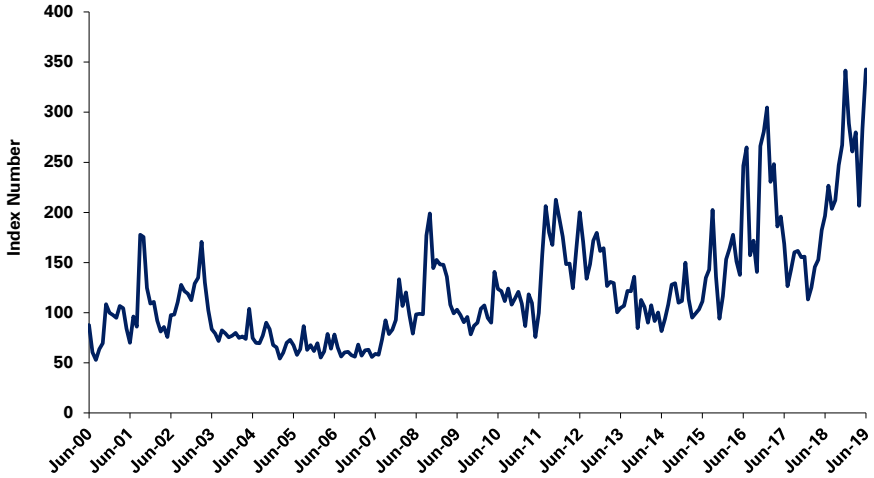
The International Monetary Fund (IMF) cited the increased trade uncertainty as a major driver for the subdued pace of global economic activity. Their World Trade Uncertainty index (GDP weighted average), built on the Economist Intelligence Unit country reports, rose sharply by 60.5% y/y in Q2 2019 and showed rising uncertainty beginning around Q3 2018 – coincidental with the tariff hike announcements by the US and China.

Chart 1
World GDP Growth



Source: KPMG Economics, IMF

Chart 2
Global Economic Policy Uncertainty Index



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

Overview

The latest OECD's Interim Economic Outlook also pointed to an increasingly 'fragile' and 'uncertain' global economy with mounting downside risks. The OECD's May 2019 Economic Outlook has been revised downwards for almost all countries, especially those most vulnerable to the weakening of world trade and investment. Trade tensions were again identified as the major factor that undermines confidence, growth and employment worldwide.

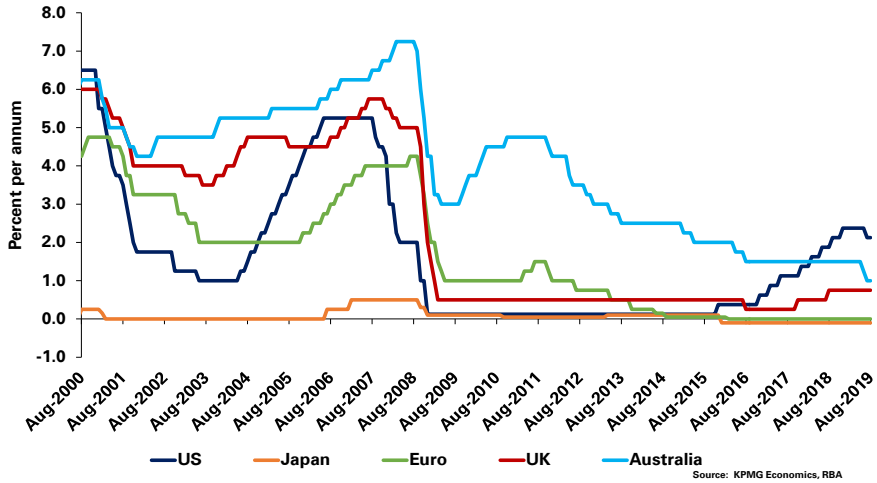
Most central banks across the globe have loosened their policy rates further to fight the persistently muted inflation and pre-empt the gloomy economic outlook. Risky asset prices rebounded, and government bond yields continued to slide. The inversion of the yield curve in a number of economies, which tends to be an indicator of a coming recession, was exacerbated, arguably due to fuelled concerns among financial market participants, further pushing long-term rates down.

Exchange rate has also been affected by the trade war and monetary responses. Against the US dollar, currencies in emerging market economies depreciated most, while those in advanced economies remained relatively stable, except for sterling, which depreciated substantially against the US dollar and the euro amid the Brexit uncertainty. While the trade threats have taken a toll on the world economy and spurred central banks to act, the US has accused some monetary decision-makers, such as the European Central Bank or People's Bank of China, of currency manipulation for their accommodative policies.

The Bank for International Settlements (BIS) commented the monetary policy may not able to counter a deeper downturn given its narrowed space, and will need support from a wise use of fiscal stimulus in countries where room for maneuver still remains.

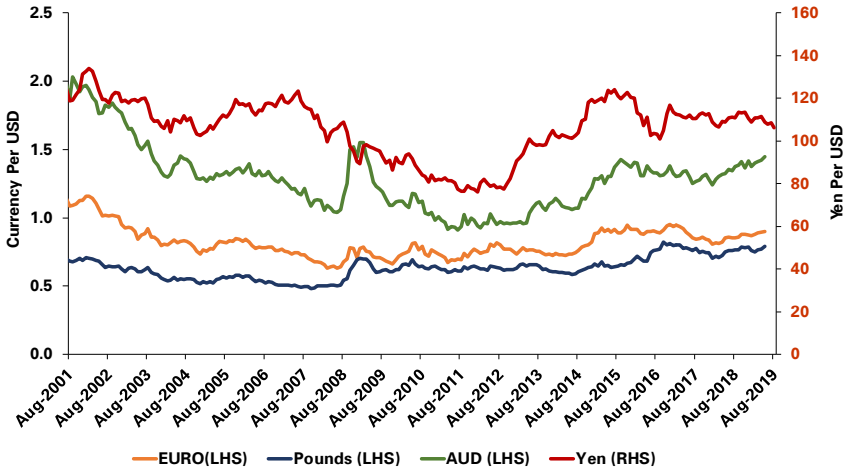
With the pervasive uncertainty in the global outlook, KPMG maintains our last forecasts of the world economic growth at around mid-3%'s towards 2023.

Chart 3
Official Interest Rates



Source: KPMG Economics, RBA

Chart 4
Exchange Rates (USD)



Source: KPMG Economics, RBA

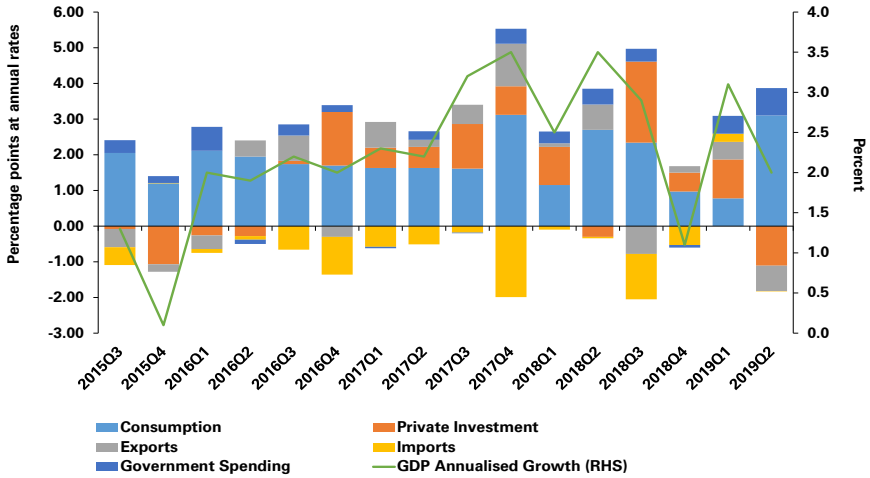
US

Real GDP growth in the US slowed down in Q2 to 2% y/y, compared to 3.1% y/y in Q1. In contrast to the solid growth in Q1, private investment and exports in Q2 decreased sharply by 6.1% y/y and 5.8% y/y respectively. Economic growth was largely supported by strong increases in personal consumption (4.7% y/y) and government spending (4.5% y/y). Labour market conditions have remained healthy with the unemployment rate unchanged at a historic low of 3.7% and 164,000 jobs added in July. The addition of new jobs was smaller than in June but significantly higher than in May.

The US-China trade tensions escalated in August when the US announced another round of tariffs on most remaining imports from China. Tariffs on a number of products such as mobile phones, laptops, toys and some footwear and clothing items have now been postponed until December. The imposition of these tariffs by the US has spurred retaliatory actions from China, such as halting purchases of US agricultural products, imposing new tariff on $75 billion worth of US imports and resuming duties on American automobiles. While the two nations' leaders have agreed to resume in-person negotiations in early October most political commenters believe the chances of a successful outcome from these next round of talks is low. This uncertainty continues to drag on manufacturing and business investment in the US; the IHS Markit's headline manufacturing PMI declined to its lowest at 50.3 in August since the trough seen during the GFC in September 2009.

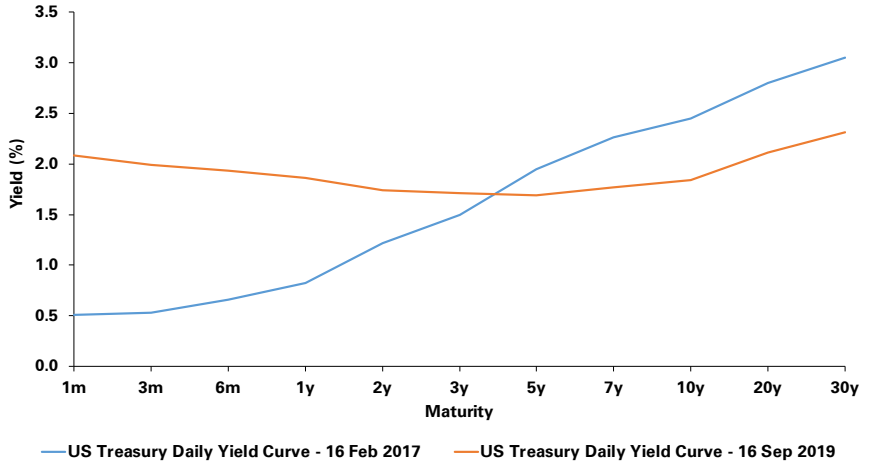
This uncertainty has also been weighing heavily on the Federal Reserve Bank; Chairman Jerome Powell has expressed his concern over the challenge of incorporating trade policy uncertainty into the Federal Open Market Committee's framework. At the July meeting, the Fed cut the funds rate by 25bp and announced to stop reducing its balance sheet size. Contrary to the widespread expectation that this would end the sustained inversion of the yield curve, the inversion became even more pronounced reflecting investors' negative sentiment about the economy. The Fed showed hesitation about further rate cuts – Powel remarked that "the economy is close to both goals" of price stability and full employment. However, with the August tariff headwinds, low inflationary pressures and weakening Chinese reminbi, KPMG expects there would be another 25bp by the end of this year.

Chart 5
US GDP Growth by Component



Source: KPMG Economics, US Bureau of Economic Analysis

Chart 6
US Treasury Daily Yield Curve



Source: KPMG Economics, US Department of Treasury

UK

The uncertainty of Brexit continues to loom large over the UK economy. Before the Prorogue of Parliament, which has now subsequently been deemed to be have been 'unlawful, void and of no effect' by the Supreme Court, it passed a legislation designed to prevent a no-deal Brexit on 31 October. If an agreement is not reached between the UK and EU by 19 October, the prime minister will be legally obliged to ask the EU for an extension. However, the possibility of a no-deal Brexit does not appear, at least in all the media reports, to be not completely ruled out.

Amid recession fears, the UK economy grew faster than anticipated in July at 0.3% m/m as compared to the 0.2% contraction in real GDP observed in Q2. The agriculture sector continued to shrink by 0.06% m/m, while the production, construction and services sectors observed a slight month-on-month improvement in value added by 0.05%, 0.54% and 0.35% respectively.

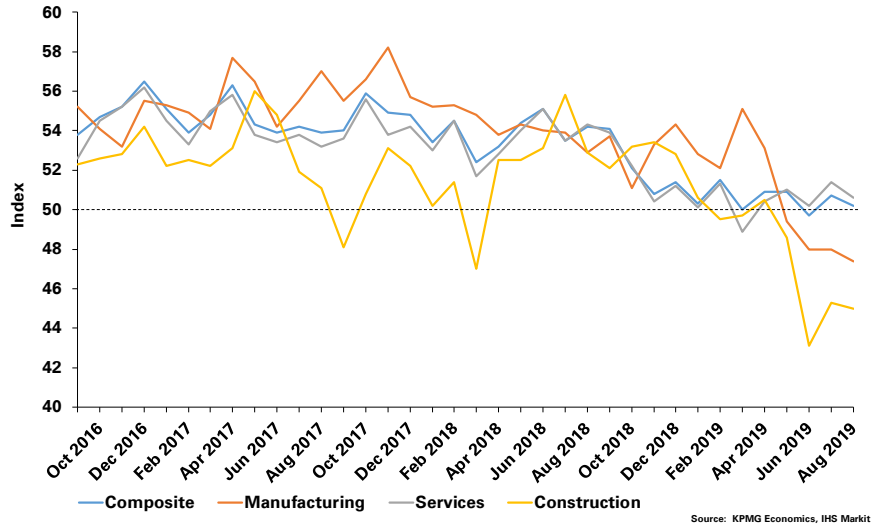
Yet, in a broader picture, the rolling three-month GDP growth to July 2019 was flat (0.0%) with positive contribution coming from the services sector only (growing by 0.2%). Meanwhile, in the production sector, the strong growth in Q1 was likely as a result of work being brought forward in anticipation of the UK's original planned date of Brexit (29 March) was followed by a 1.4% fall Q2 when the increased activity unwound and car factories brought forward their summer shut-downs. Car production continued to decline by 18.9% y/y (-10.6% m/m) in July.

The headline manufacturing PMI dipped further in the contractionary territory, down to 47.4 in August from 48.0 in July, indicating an ongoing deterioration in the manufacturing sector without signs of recovery in the near term.

In their latest Economic Outlook report KPMG UK have prepared two economic forecasts on how the UK economy is expected to perform under a 'deal' and no-deal' Brexit scenario. The differences between the two scenarios are quite stark, with real GDP expected to be+1.5% in 2020 under a 'deal' scenario compared to -1.5% under a 'no-deal' scenario. As noted by KPMG UK, "a no-deal scenario largely represents a leap into the unknown for the UK economy…the danger of [these] potential 'unknown unknowns'…is what makes no-deal so risky for the economic health of the economy".

Chart 7

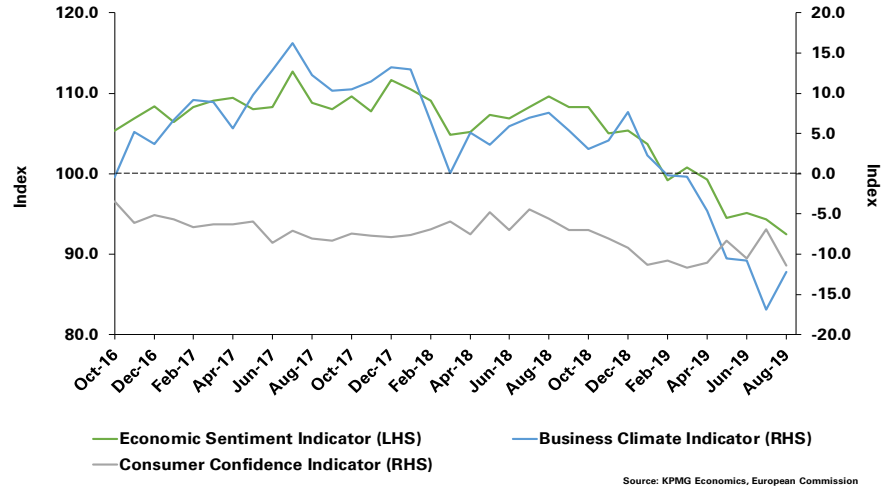
UK Purchasing Manager's Index



Source: KPMG Economics, IHS Markit

Chart 8

UK Economic Sentiment Indicators



Source: KPMG Economics, European Commission

Eurozone

The Eurozone (EU19) saw a moderate growth of 0.2% in Q2 as compared to 0.4% in Q1, with trends diverging among member states. Spain grew at a quarterly rate of 0.5% in Q2, the highest observed within the major Eurozone economies. France advanced at 0.3% q/q, experiencing a slight pick-up in the overall economic sentiment in August 2019. Meanwhile, the Italian economy stagnated in Q2 at 0% q/q growth, and Germany suffered from a 0.1% contraction in Q2 after a rebound of 0.4% in Q1.

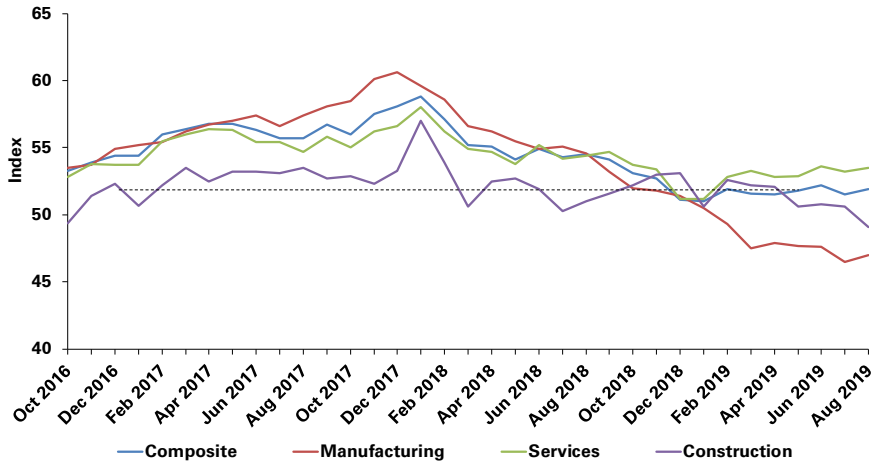
Forward indicators showed diverging trends between the manufacturing and services sectors. The manufacturing recession shows signs of persistence over the coming quarters; the Eurozone's headline manufacturing PMI has remained in the contractionary territory since the beginning of the year, albeit picking up slightly to 47 in August (from 46.5 in July). On the other hand, the headline services PMI recored 53.5 in August, up by 4.5% since January, providing an upward trajectory for the Eurozone.

The largest economy in the euro area, Germany, continues to undergo another month of stark contraction in the manufacturing sector (August PMI reading of 43.5) due to subdued demand, particularly for intermediate and capital goods. New orders, especially export orders, declined further, consistent with the worsening export expectations for the months ahead. This outcome was largely driven by uncertainty from clients, holding off their capital investment and a continued gloomy outlook for the German car industry.

On a more positive side the unemployment rate has stayed at 7.5% in July, the lowest level since July 2008. Increased tightness in the labour markets has also been matched with stronger wage growth. Combined with muted inflation, this means real incomes should rise and provide a boost to private consumption. However, given the negative consumer confidence pervading most member states, gains in income may not be fully translated into increased consumption activity.

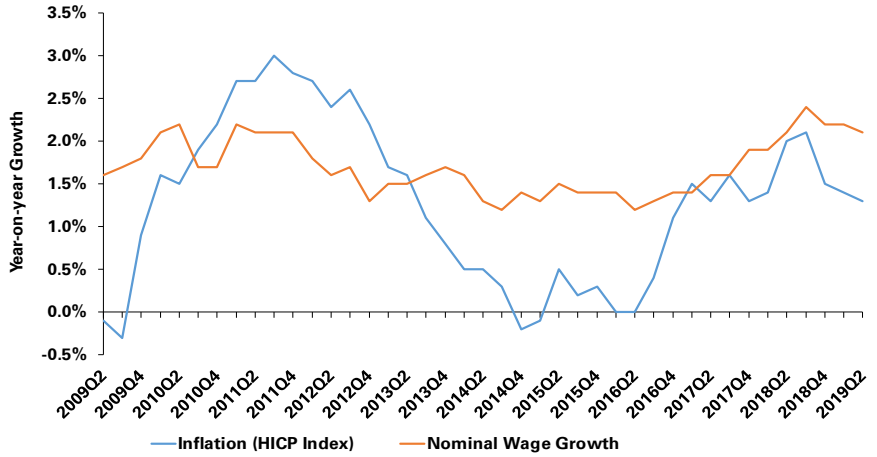
The European Central Bank (ECB) has cut its benchmark rate by 10bp to -0.5% and reintroduced Quantitative Easing (QE). In addition, the ECB President Mario Draghi also urged governments of member states to use stimulatory fiscal policies via tax cuts and increased spending.

Chart 9
Eurozone Purchasing Manager's Index



Source: KPMG Economics, IHS Markit

Chart 10
Eurozone Inflation and Nominal Wage Growth



Source: KPMG Economics, European Central Bank

China

Official GDP of China in Q2 recorded an annual growth of 6.2%, which is close to target, alternative indicators showed signs of poorer performance, especially in the manufacturing sector. The latest data published by the National Bureau of Statistics of China (NBS) showed the Chinese economy has continued to face softening domestic demand. Industrial production growth dropped from 6.3% y/y in June to 4.8% y/y in July; fixed asset investment growth in the first seven months of 2019 fell slightly to 5.7% y/y from 5.8 y/y in the first six months; and growth of investment by domestic enterprises in the first seven months (5.9% y/y) was 0.1ppt lower than in the first six months. After a pickup in May and June, growth in retail sales of consumer goods also experienced a 2.2ppt decline in July, falling to 7.6% y/y from 9.8% y/y in the previous month.

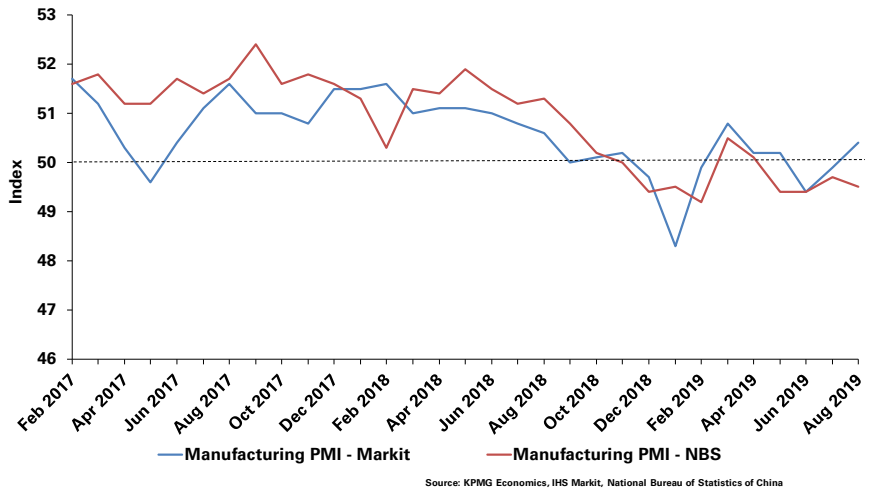
Capital Economics' China Activity Proxy (CAP) index, which includes a number of partial indicators including construction activity, electricity output, freight and passenger traffic and seaport volumes, suggests GDP growth for China is lower than official statistics are suggesting. The CAP Index for August 2019 suggests the Chinese economy is growing at annual rate of around 5.6%.

The NBS's manufacturing PMI has indicated a contraction in recent months with readings consecutively below 50 since April this year. Although the IHS Markit's headline manufacturing PMI suggested marginal improvement in production in August, the sub-indices showed little sign of recovery in overall demand (notably foreign demand) and business confidence amid the trade war uncertainty.

The automotive sector continued to suffer from shrinking production and sales in both passenger cars and commercial vehicles. According to the latest data from the China Association of Automobile Manufacturers (CAAM), in July, overall vehicle production dropped by 11.9% y/y (-5% m/m), and sales decreased by 4.3% y/y (-12.1% m/m).

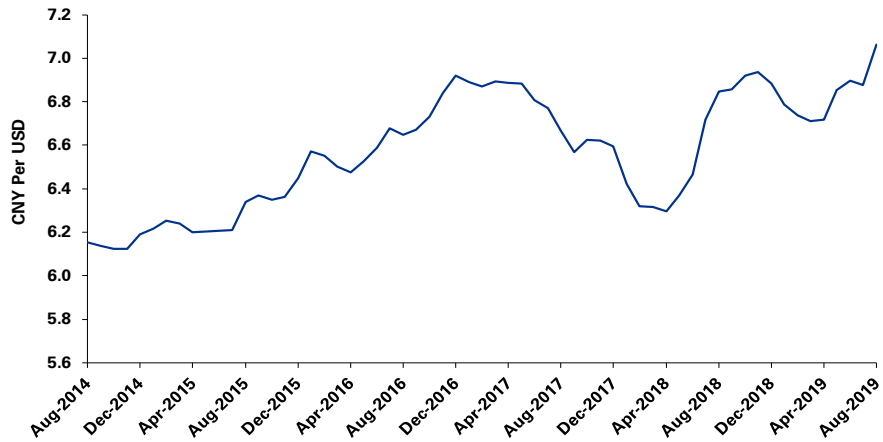
Chinese renminbi has depreciated sharply amid the intensification of the trade war, and was trading at CNY7.15 per USD at the end of September 2019, which is down nearly 7% since the end of January 2019. The Governor of the PBOC, Dr Yi Gang, has also noted that despite the current economic slowdown and trade tensions, China will not be "in a rush to roll out massive rate cuts or QE like some other central banks".

Chart 11
China Manufacturing PMIs



Source: KPMG Economics, IHS Markit, National Bureau of Statistics of China

Chart 12
Exchange Rate (Renminbi)



Source: KPMG Economics, Federal Reserve Bank of St. Louis

Other Economies

The Japanese economy continued to grow at a sluggish pace at 0.3% in Q2, down from 0.6% in Q1 due to weak trade and decelerating growth in capital expenditure. Downside risks were added to the outlook, including the trade war, global economic slowdown and the fiscal tightening in the form of consumption tax hike in Q4.

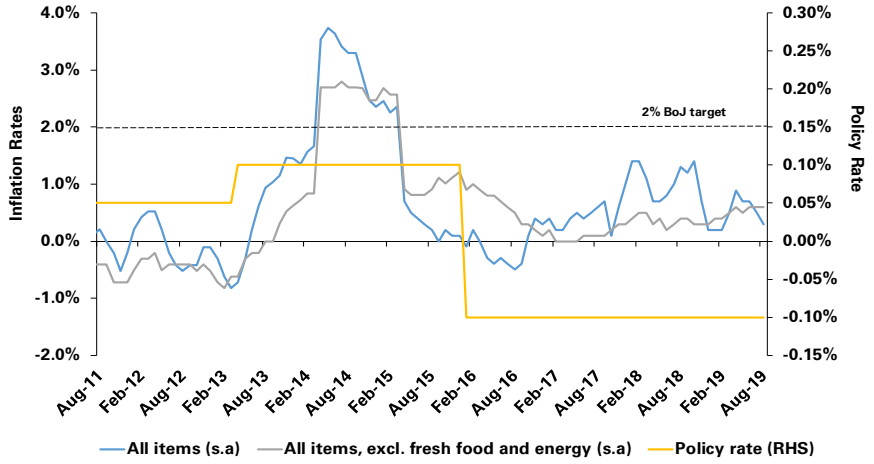
The headline inflation dropped by 2ppt to 0.3% y/y in August, well below the Bank of Japan's (BoJ) 2% target, despite flat levels of unemployment. Core consumer price index (excluding fresh food and energy) rose sluggishly 0.6% y/y, virtually unchanged from the previous month. The BoJ remains under pressure to ease their policy even further, while revising the forward guidance to state their commitment to the current stance until at least the spring of 2020.

Hong Kong (SAR), China, has now entered its fourth consecutive month of mass protests. Annual GDP growth in Q2 reached the lowest level of expansion for a decade with falling expenditure on machinery, equipment and intellectual property products (-12.4%) and expenditure on building and construction (-10.6%). Despite the $2.4 billion fiscal stimulus, political unrest, combined with the tensions between US and China is having substantial negative ramifications with respect to tourism and sentiment in the country.

The US-China disputes have also taken a toll on most emerging market economies. Year-on-year growths in merchandise export volume in the emerging Asian market economies (excluding China) have been consecutively negative since September 2018. Export performance in the Latin America has also been weak with the latest merchandise export volume index falling by 3.5% y/y in July 2019.

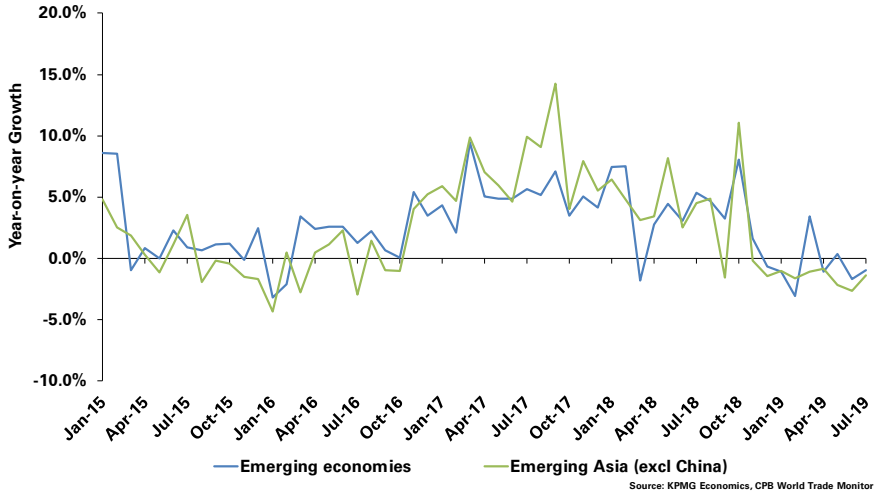
India's GDP growth rate dropped by 0.8ppt to 5% y/y in Q2 – marking the slowest pace of growth since March 2013 as private consumption and investment remained subdued. The Reserve Bank of India has cut their benchmark rate four successive times this year to now be 5.4%. The minutes of the latest Monetary Policy Committee meeting suggest a relatively high chance of another cut over the coming months. Monetary loosening is also expected to be widespread among other emerging market economies to bolster the faltering growth amid the escalation of trade tensions.

Chart 13
Japan's Inflation and Policy Rates



Source: KPMG Economics, Statistics Bureau of Japan, Bank of Japan

Chart 14
World Merchandise Export Index



Source: KPMG Economics, CPB World Trade Monitor

Global Outlook

Growth in Real GDP

Year End December	2018	2019	2020	2021	2022	2023
OECD	2.2%	1.9%	1.8%	1.8%	1.8%	1.8%
Americas						
Brazil	1.2%	1.4%	2.2%	2.4%	2.3%	2.4%
Canada	1.7%	1.7%	1.6%	1.9%	1.8%	1.7%
Latin America	0.5%	1.1%	2.0%	2.1%	2.4%	2.6%
Mexico	1.6%	1.7%	2.0%	2.2%	2.3%	2.5%
USA	2.9%	2.8%	1.9%	1.9%	1.8%	1.8%
Europe						
EMU	1.8%	1.4%	1.5%	1.6%	1.4%	1.4%
France	1.2%	1.3%	1.3%	1.7%	1.5%	1.5%
Germany	1.5%	0.8%	1.0%	1.5%	1.3%	1.2%
Greece	2.1%	1.7%	2.1%	1.9%	0.9%	0.7%
Ireland	6.8%	3.9%	3.1%	3.0%	3.0%	3.0%
Italy	0.0%	0.4%	0.8%	0.9%	0.9%	0.9%
Russian Federation	2.9%	1.9%	1.3%	1.6%	1.8%	1.8%
UK (Deal Scenario)	1.4%	1.3%	1.5%	1.7%	1.9%	1.9%
Africa	3.2%	2.9%	3.3%	3.4%	3.5%	3.7%
South Africa	0.8%	1.0%	1.6%	1.6%	1.7%	1.7%
Middle East	2.7%	1.0%	3.0%	3.3%	3.2%	3.0%
Asia						
China	6.4%	6.2%	6.2%	5.8%	5.5%	5.5%
East Asia	4.2%	4.1%	4.0%	3.9%	3.8%	3.8%
Hong Kong (S.A.R.)	3.1%	2.7%	2.9%	2.8%	2.6%	2.5%
Indonesia	5.2%	5.1%	5.0%	7.1%	6.8%	6.8%
India	5.8%	7.6%	7.0%	6.9%	6.8%	6.8%
Japan	0.3%	0.3%	1.2%	0.5%	0.6%	0.9%
Singapore	3.2%	2.6%	2.8%	3.5%	3.4%	4.0%
South Korea	3.0%	2.5%	2.8%	3.0%	2.9%	3.2%
Taiwan	2.6%	2.3%	2.5%	2.5%	2.4%	2.4%
Vietnam	6.1%	6.6%	6.6%	6.2%	6.1%	6.0%
Oceania						
New Zealand	3.0%	2.6%	2.8%	2.8%	2.8%	2.8%
World	3.6%	**3.3%**	**3.4%**	**3.5%**	**3.5%**	**3.5%**

Annual Inflation

Year End December	2018	2019	2020	2021	2022	2023
OECD	2.6%	2.1%	2.4%	2.2%	2.0%	2.0%
Americas						
Brazil	3.5%	3.5%	4.1%	4.0%	3.8%	3.8%
Canada	2.3%	1.7%	2.0%	1.8%	1.8%	1.9%
Latin America	6.0%	6.2%	5.0%	3.5%	3.5%	3.4%
Mexico	5.0%	4.1%	3.2%	3.2%	3.0%	3.0%
USA	2.4%	1.9%	2.3%	1.9%	2.0%	2.0%
Europe						
EMU	1.7%	1.4%	1.8%	1.8%	1.8%	1.7%
France	1.3%	1.6%	1.8%	1.9%	1.9%	1.8%
Germany	1.9%	1.4%	1.8%	2.0%	1.8%	1.9%
Greece	0.7%	0.9%	1.4%	1.6%	1.5%	1.5%
Ireland	0.7%	1.0%	1.4%	1.7%	1.7%	1.8%
Italy	1.1%	0.7%	1.2%	1.5%	1.5%	1.5%
Russian Federation	2.8%	5.1%	4.1%	3.6%	3.9%	3.9%
UK (Deal Scenario)	2.5%	1.9%	2.0%	1.9%	1.9%	1.9%
Africa	8.3%	7.4%	6.7%	6.3%	6.0%	4.0%
South Africa	4.5%	4.9%	5.2%	5.3%	5.4%	5.4%
Middle East	10.2%	9.5%	9.0%	8.3%	8.0%	7.9%
Asia						
China	1.9%	1.9%	2.0%	2.3%	2.4%	2.5%
East Asia	2.7%	2.5%	2.9%	3.3%	3.4%	3.4%
Hong Kong (S.A.R.)	2.5%	2.4%	2.3%	2.2%	2.2%	2.3%
Indonesia	3.2%	3.4%	3.5%	3.4%	3.1%	3.1%
India	3.5%	3.2%	4.0%	4.2%	4.1%	4.0%
Japan	1.0%	1.0%	1.3%	1.2%	1.2%	1.2%
Singapore	0.4%	1.4%	1.4%	1.5%	1.5%	1.5%
South Korea	1.5%	1.5%	1.6%	1.8%	1.9%	2.1%
Taiwan	1.5%	1.0%	1.2%	1.4%	1.4%	1.3%
Vietnam	3.5%	3.0%	3.2%	3.5%	3.6%	3.8%
Oceania						
New Zealand	1.6%	1.5%	1.9%	1.9%	2.1%	2.2%

Australian Outlook

Overview

The Australian economy recorded soft conditions in the second quarter of 2019 with GDP growth falling further to 1.4% y/y, in line with KPMG forecasts in the July's Quarterly Economic Outlook. On a quarterly basis GDP growth was 0.5% q/q in Q2 2019. Contributors to the fall in year-on-year GDP growth included a 5.2% y/y decline in both private investment and investment by public corporations. On a positive note the trade balance continued to improve in the June quarter as exports grew by 2.9% y/y (compared to 2.2% in Q1 2019) and imports fell by 2.8% y/y (compared to -0.7% in Q1 2019).

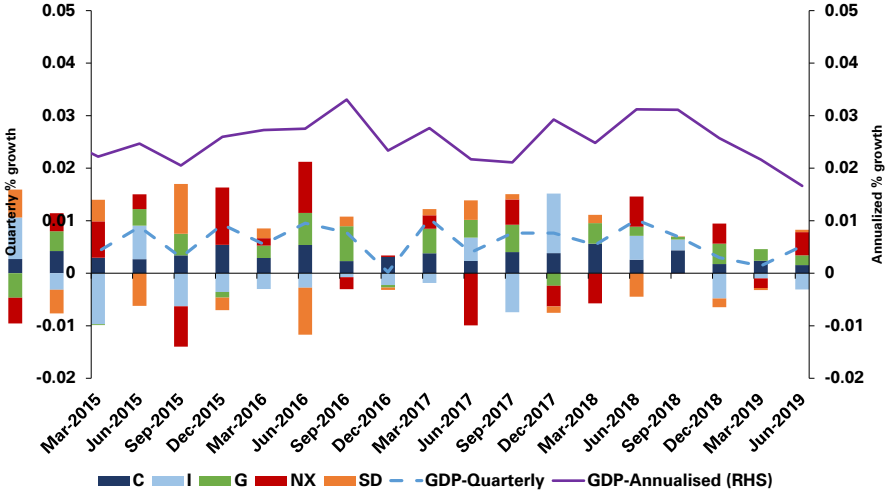
Growth in household consumption in the near future is expected to remain soft due to weakening employment growth and continued marginal real wage growth. Further signs of turnaround in the housing markets signal positive wealth effects on private consumption. Recent interest rate cuts and fiscal easing through tax rebates for low to middle income earners are expected to take effect later in the year and provide a stimulus to the sluggish economy.

Housing investment is expected to remain weak in the short term, while business investment is anticipated to turn around in 2020 with positive growth returning as business confidence regains momentum. Government consumption and investment will continue to support growth, but unless new programs are announced, will dissipate towards the end of 2022.

Although current economic conditions are weak, KPMG remains optimistic that growth will pick up gradually over the outlook period. The recent easing of monetary policy and the fiscal stimulus in the form of tax cuts and public spending are predicted to support economic growth and inflation (1.6% as at the June quarter 2019) as the year progresses. We expect the cash rate to fall to a low of 0.25% by mid-2020 and stay at these low levels for a period of time until signs of inflation edging closer to target and lower unemployment are evident as per the RBA's forward guidance.

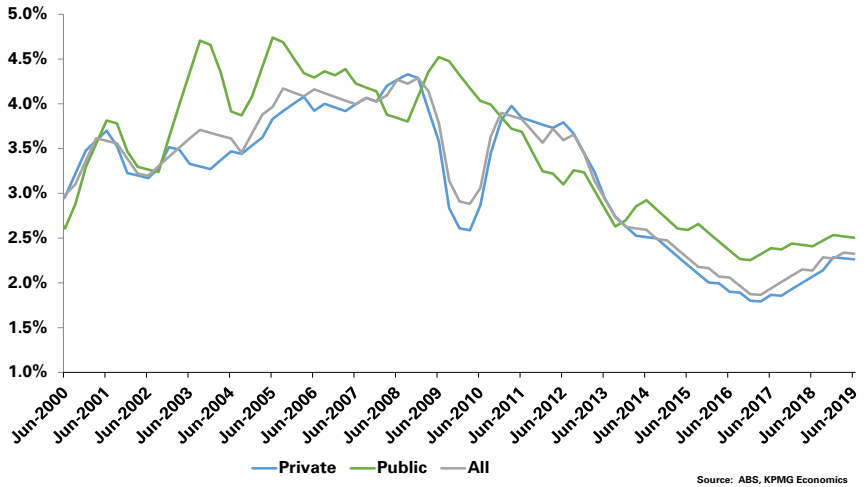
Annual GDP growth is projected to rise to 1.9% in the second half of 2019 and continue to increase gradually through to 2022, where it reaches 2.6%.

Chart 15
GDP Growth by Component



Source: KPMG Economics, ABS

Chart 16
Private and Public Wage Growth



Source: ABS, KPMG Economics

Production

Total Industry Gross Value Added, excluding Ownership of Dwellings, advanced by 0.5% q/q or 1.4% y/y in Q2. In this quarter, the sector with the largest quarterly decline was the Agriculture, Forestry and Fishing industry (-2.1% q/q; -8.1% y/y), while Mining posted the largest growth at 3.4% q/q or 6.2% y/y. Despite the downturn in the last quarter, Accommodation and Food Services increased by 1.5% q/q. Meanwhile, gross value added by the Arts and Recreation Services industry slightly decreased by 0.1% after observing a healthy growth of 2.3% in Q1.

From an industry output perspective, the structure of the economy has not changed significantly since last year. Financial and insurance services (10.3%); mining (9.6%); health care and social assistance (8.8%); construction (8.4%); and professional, scientific and technical services (8.2%) generated 45% of the gross industry value added (excluding ownership of dwellings) for the June quarter. However, the share of the construction in gross value added has been shrinking since the June quarter 2018, down from 9.2% last year to 8.4% in Q2 2019.

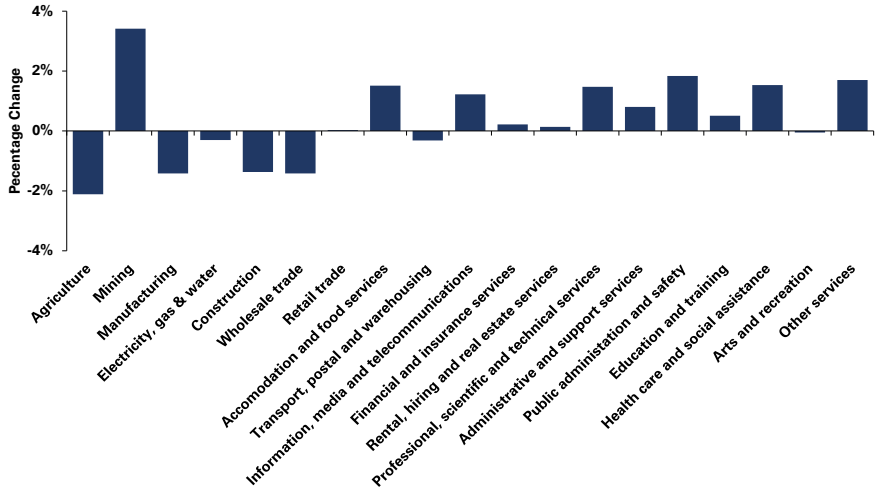
Unfavourable seasonal conditions in several cropping regions, particularly in New South Wales and Queensland, led to a downward revision of ABARES forecasts of winter crop production to 33.9 million tonnes in 2019-20. The area planted to summer crops is forecast to reduce by 28% in 2019-20 to reflect low soil moisture and the likelihood of poor seasonal conditions in spring in Queensland and northern New South Wales.

The manufacturing industry has contracted by 3.0% y/y in Q2. The latest Commonwealth Bank Manufacturing PMI survey signalled further moderation in growth of the manufacturing sector over the coming months with the headline index down to 50.9 in August from 51.6 in July. Overall new orders grew at the second weakest rate in the survey history, leading Australian producers to reduce purchasing activity for the first time in four months. The NAB indices of business confidence and conditions deteriorated in August to below long-run average levels.

The iron ore prices have slumped recently due to softening demand by steel markets and recovering supplies of iron ores after disruptions in Brazil. Prices of other commodities also trended downwards. It is expected prices of iron ore, thermal and coking coal, and oil will decrease further next year as a consequence of the trade war dampening sentiment.

Chart 19

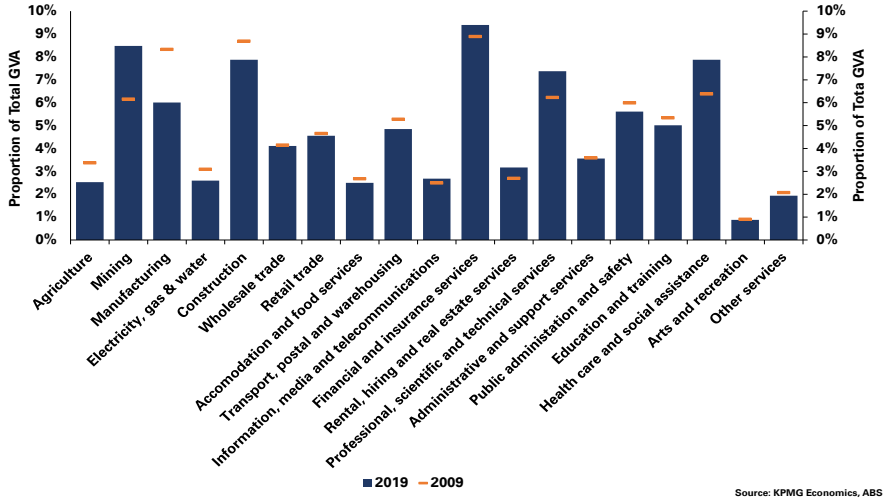
Quarterly Growth in Gross Value Added, June Quarter 2019



Source: KPMG Economics, ABS

Chart 20

Share of Gross Value Added by Industry, FY2009 vs. FY2019



Source: KPMG Economics, ABS

Consumption

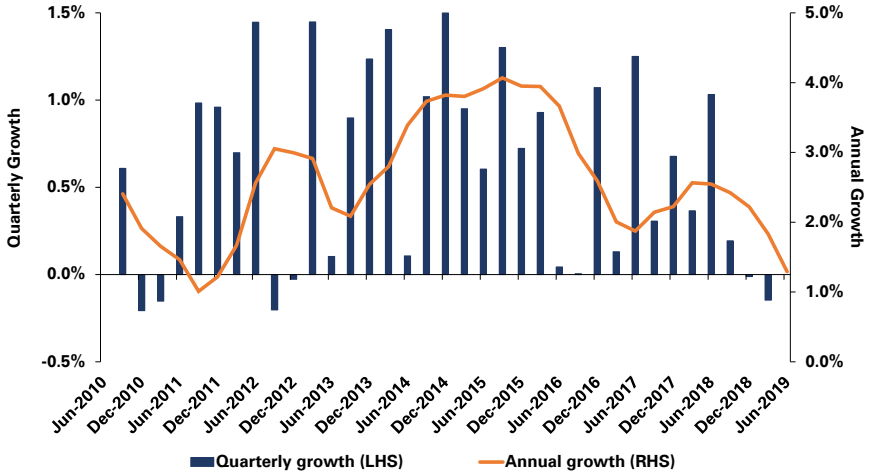
Household final consumption expenditure grew weakly by 0.4% q/q (seasonally-adjusted) in Q2 2019, albeit up from the 0.3% q/q in the previous quarter. 'Purchase of vehicles' experienced the sharpest decline in both quarterly and annualised terms (-3.0% q/q; -5.2% y/y). Consumption expenditure in 'Cigarettes and tobacco' continued to fall by 0.9% q/q (-5.2% y/y). Although more volatile in nature than other consumption group groups, consumption of 'electricity, gas and other fuel' fell by 0.8% q/q in Q2 despite a 1.6% increase in Q1, 2019 – however, compared to the same period last year, consumption in this category also declined by 2.1%.

The July 2019 retail sales data showed a continuation of sluggishness in consumer expenditure, with sales declining 0.1% m/m in July, after slight improvement in the previous two months. Retail sales over 12 months to July 2019 experienced a slower growth of 2.4% as compared to the annualised growth data over the same period in 2018. Clothing, footwear and personal accessory; department store retailing; other retailing; and cafes, restaurants and takeaway food services saw a slight monthly decline in sales of 1.0%, 0.2%; 0.4% and 0.6% respectively.

Other sales data also showed a consistent trend. Data from the Federal Chamber of Automotive Industries revealed total sales for August 2019 recorded a 10.1% drop over the same month last year, with the Passenger Vehicle market down by 16.7%, Sports Utility Vehicles down by 5.4%, Light Commercial vehicles down by 8.6% and Heavy Commercial vehicles down by 14.3%.

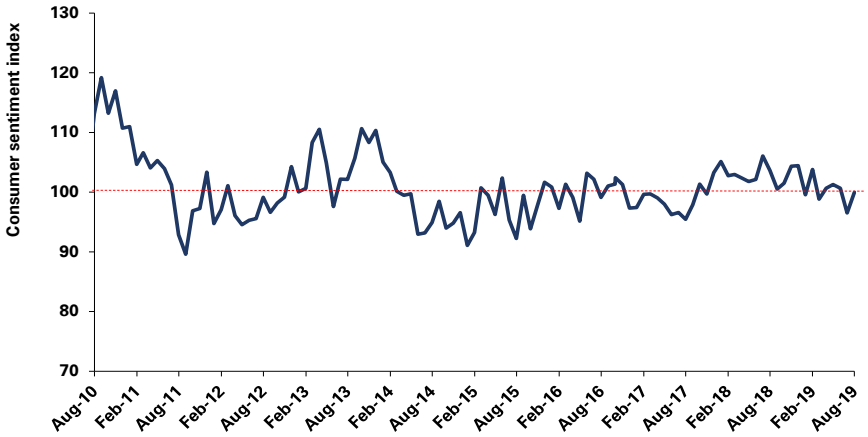
Despite recent cash rate cuts and fiscal stimulus from the Federal government, consumer sentiment, as measured by the Westpac-Melbourne Institute Index fell 1.7% in September to 98.2, down from 100 recorded in June. This result was largely influenced by growing concerns about the state of the global and Australian economies, employment, and current finances. Housing-related sentiment was relatively mixed after positive reactions to interest rate cuts observed in June, July and August. The index of 'time to buy a dwelling' decreased 2.9% m/m to 123.3 in September, but on an annualised basis, this posted a 19.1% increase. The index remained higher than the long-term average of 120 and close to a five-year high. House price expectations advanced by 3.9% (19.1% y/y) in September, up by an impressive 45.8% since May.

Chart 21
Retail Sales, Australia



Source: KPMG Economics, ABS

Chart 22
Consumer Confidence



Source: KPMG Economics, Westpac-Melbourne Institute

Investment

Real aggregate gross fixed capital formation (GFCF) declined further in Q2 by 4.0% y/y (-1/7% q/q), with GFCF by the private sector and public corporations both declining by 5.2% y/y (-1.6% q/q and -1.3% q/q respectively), while that by the national, state and local governments combined grew at a moderate rate of 2.7% y/y (however, down by 2.7% q/q) as compared to the 9.3% y/y in Q1.

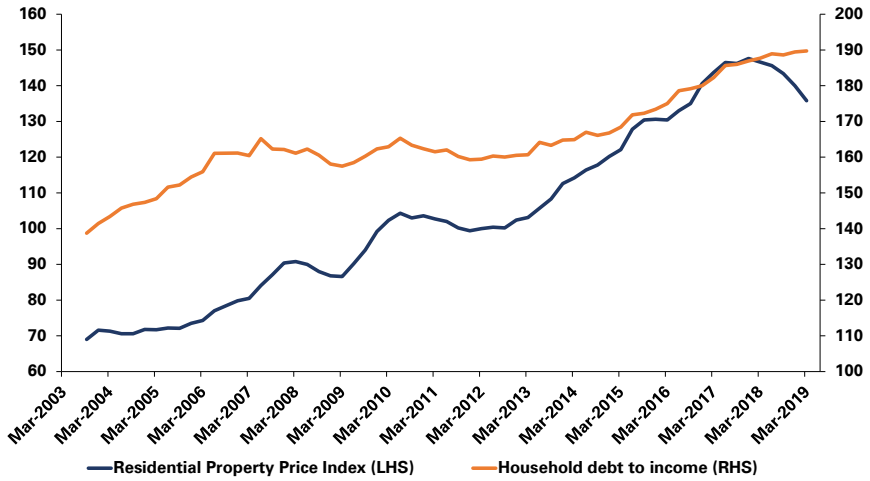
General government gross fixed capital expenditure by State and Local Government was down considerably by $525m in the June quarter. In contrast Federal Government investment expenditure increased by $55m as a $166m increase in defence spending was offset by a fall of $111m in non-defence spending. Federal public corporations increased their fixed capital spending marginally by $4m, while State and Local public corporations continued to pare back their fixed capital spending by $74m.

The largest falls in private capital formation were associated with the housing sector (investment in dwellings down by 9.1% y/y) and non-dwelling construction (GFCF in non-dwelling construction down by 9.3% y/y). New engineering construction activity remains weak, contracting by 14.8% y/y. The fall off in real spending on R&D activity continues to persist with a decline of 0.1% q/q (-0.5% y/y). The uninterrupted downward trend in R&D investment since the March quarter 2017 is worrying for innovation in an economy already struggling for productivity growth.

The number of dwelling approvals across Australia has been on a steep decline, dropping by 25% in June and 28.5% in July. The main driver of this downturn was the private sector dwelling approvals, contributing more than 100% and 92.5% of the monthly decline in the number of dwelling approvals in June and July. Dwelling approvals are anticipated to dip further as presales become more difficult and there are still supply overhangs.

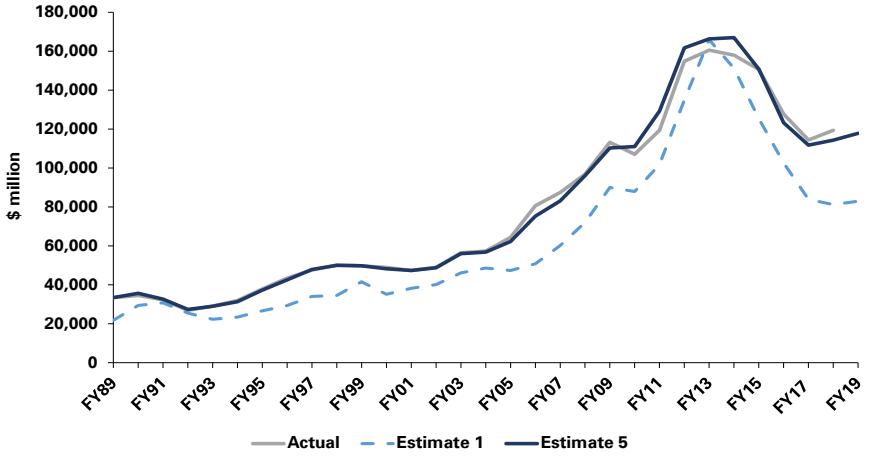
House prices have picked up since mid-August. As at 15 September 2019, the daily Corelogic home property value index of five capital city aggregate increased 1.3% over a month for all dwellings even though home value was still 5.2% lower than a year ago. This represented a considerable growth acceleration compared to the 0.5% increase over the same period in August. Analysis of the monthly indices showed dwelling values have risen over a month period leading to 31 August 2019 in most capital cities, except for Adelaide (-0.2%), Perth (-0.5%) and Darwin (-1.2%).

Chart 23
House Prices and Household Debt



Source: KPMG Economics, ABS, RBA

Chart 24
Actual and Expected Private New Capital Expenditure



Source: KPMG Economics, ABS

Government

Public expenditure grew by 1.6% q/q (seasonally adjusted) in Q2 2019, up from 0.8% q/q (seasonally adjusted) in Q1. This was driven by an accelerated increase in consumption by governments at all levels (2.7% q/q, as compared to 0.9% q/q in Q1) and national government investment (1.2% q/q, reversed from -3.7% q/q in Q1). National government expenditure increased by 2.6% q/q in Q2 2019 (up from 2.5% q/q in Q1) and State and local government spending grew by 1.2% q/q (down from 1.3% q/q in Q1).

The Budget 2019-20, released on 2 April 2019, predicted an underlying cash surplus of $7.1 billion for 2019-20, the first in more than a decade of deficits. This outlook appears achievable given the Final Budget Outcome released in September shows an underlying cash balance of -$0.7 billion for 2018-19, an outcome nearly $3.5 billion better than April's Budget estimate.

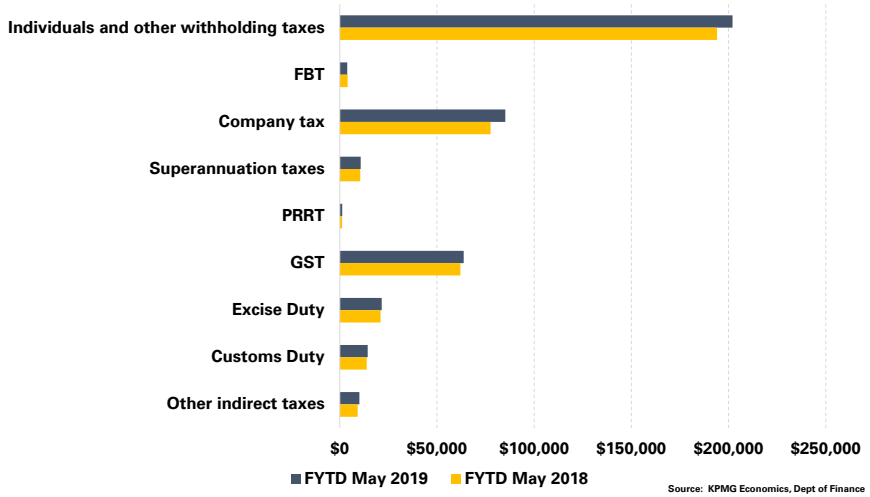
The government has seen very strong nominal GDP results driven by rising commodity prices that improved the terms of trade. In addition, the spend on extending the ATO's Tax Avoidance Taskforce has seen tax as a percentage of income surged to more than 15% over the second quarter, the highest since 2005.

The Federal Government net debt was equivalent to 19.2% of GDP in 2018-19. According to the Australian office of Financial Management (AOFM), Gross Treasury Bond issuance to date in FY20 has totaled $9.3 billion, with issuances in this financial year is expected to be around $58 billion.

The Budget has delivered tax rebates of up to $1,080 to households across the nation, the largest fiscal stimulus since 2009. However, recent signs showed the economy has not responded as positively as anticipated to the stimulus. A pipeline of infrastructure, with 103 initiatives already sitting on the priority list, is expected to utilise the spare capacity in the economy, boosting household income growth.

Chart 17

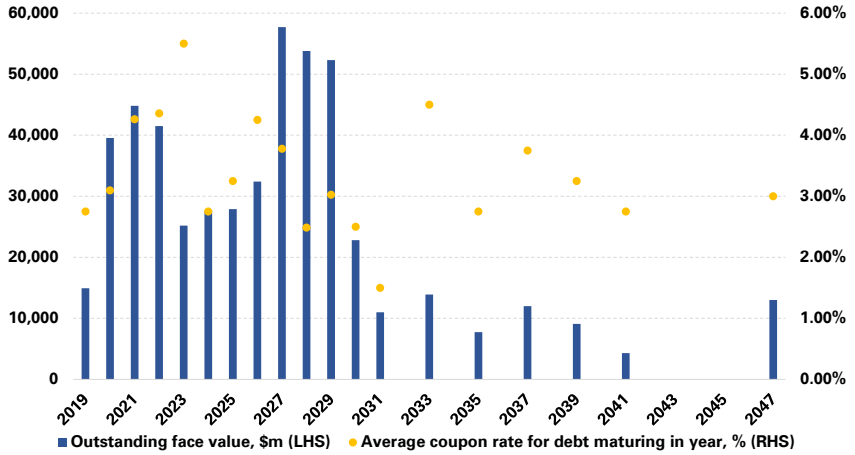
Commonwealth Government Tax Receipts by Type, $'000m



Source: KPMG Economics, Dept of Finance

Chart 18

Australian Treasury Bonds on Issue by Maturity ($m) and Average Coupoun Rate (% pa)



Source: KPMG Economics, AOFM

Net exports

For the first time in 44 years, the Australian economy posted a current account surplus of $5.9 billion (seasonally-adjusted) in the June quarter 2019, representing about 1.2% of GDP. This indicated a turnaround of nearly $7.0 million on the deficit of $1.1 million observed in the preceding quarter. The trade surplus has expanded further in Q2 2019, up from $14.8 billion to $19.9 billion, comprising 4.0% of GDP. In addition, the primary income deficit was reduced by $1,573 million, which may be a sign of a lack of investment opportunities in the country.

The top 10 exports of goods and services made up more than 66% of total exports from Australia as at the June quarter 2019. These included iron ores and concentrates (16.4%), coal (14.8%), natural gas (10.6%), education services (8.0%), personal travel services (4.7%), gold (4.0%), aluminium ores and concentrates (2.4%), beef (2.0%), crude petroleum (1.8%) and copper ores and concentrates (1.3%). Notably, natural gas exports were worth $50 billion in the FY2019, soaring by 61.7% over a 12-month period. The importance of natural gas to Australia's overall trade balance will continue – the country's LNG production is predicted to surpass that of Qatar next financial year thanks to the recent commissioning of the Ichthys and Prelude LNG mega-plants.

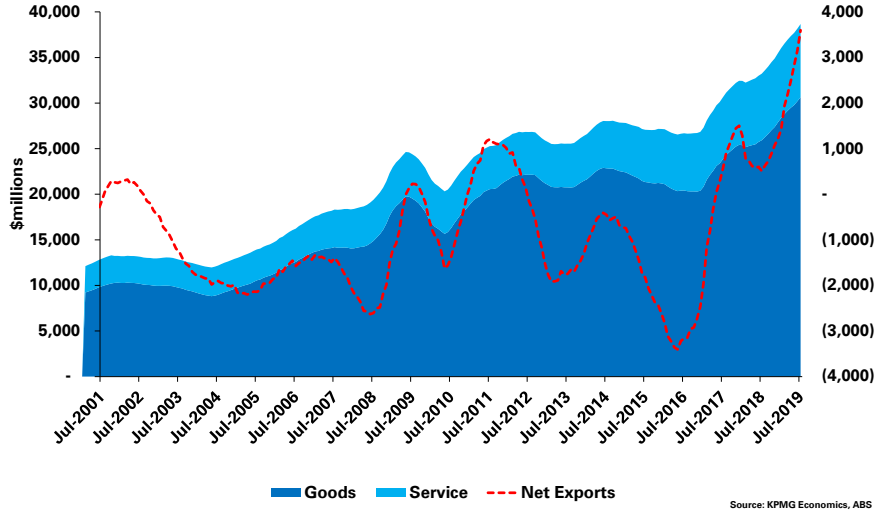
KPMG expects Australia's overall trade balance, which has been positive since March 2017, will soften during the remainder of 2019 as a consequence of slumping iron ore prices. A pull-back in agriculture commodity exports caused by unfavourable seasonal conditions can also contribute negatively to the trade outcome.

Australia's Terms of Trade (ToT) have remained at elevated levels with the seasonally adjusted ToT up 1.5% to 111.6 in the June quarter of 2019. As supply shortage issues for iron ore are being resolved and growth in Chinese steel production eases, the ToT is expected to decline over the outlook period.

The recent rate cuts have taken an effect on the currency. The Australian dollar has depreciated further against both the U.S. dollar and on a TWI basis, down from US$0.715 and 60.7 at the end of February 2019 to US$0.672 and 58.9 by the end of August 2019. With more policy loosening in sight, the Australian dollar is predicted to remain at sub-US$0.70 levels for the immediate future.

Chart 27

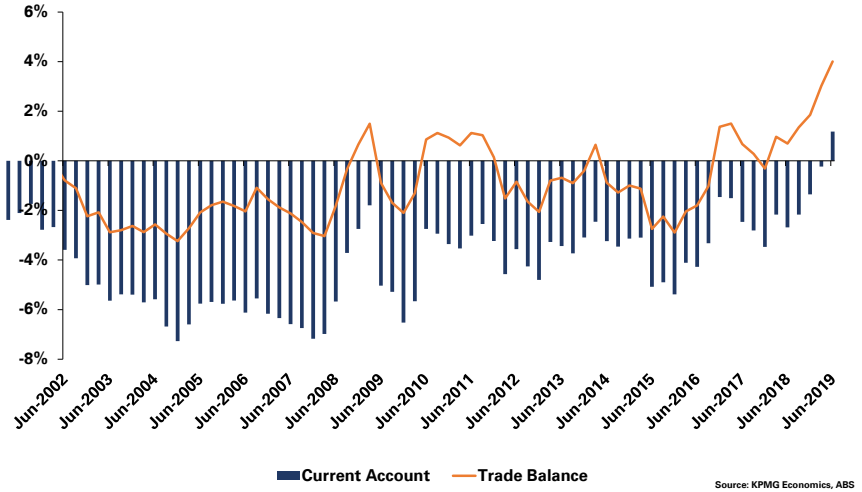
Rolling Annual: Exports by Type



Source: KPMG Economics, ABS

Chart 28

Current Account and Trade Balance



Source: KPMG Economics, ABS

Labour market

Latest monthly labour data as at August 2019 showed the labour market in Australia remained healthy with nearly 311,000 new jobs (seasonally adjusted) added to the economy over the 12 months to August 2019. The unemployment rate in August increased slightly to 5.3% from the preceding month despite an addition of 34,700 jobs.

On the labour supply side, the participation rate increased from 65.7% in January 2019 to 66.2% in August 2019 – the highest participation rate recorded for Australia since the start of the ABS series in 1978.. The proportion of full-time to total employment dropped by 0.4ppt from 68.6% in January 2019 to 68.2% in June 2019. This was consistent with the upward trend in the seasonally-adjusted underemployment rate from January 2019 to July 2019, which was up by 5.0%.

On the labour demand side, after an improvement in June and July, the number of job ads per week (seasonally-adjusted ANZ Job Advertisements series) fell 2.8% in August, which meant a downward push to annual growth to -11.4%. Wage growth remained relatively subdued in the June quarter with seasonally adjusted Wage Price Index increasing by 2.3% y/y in the private sector and 2.6% y/y in the public sector.

More disaggregated data on a quarterly basis provide further insight into employment by (private/public) sector and industry.[1] After the rebound in the first half of the year, the private sector experienced a loss of 82,000 jobs over the three months to August 2019. This deepened the recent trend where the majority of new jobs were generated in the public sector. Over the 12-month period ending in August 2019, 96.5% of the new jobs were in the public sector.

Most of employment growth of the public sector over this 12-month period occurred in the 'education and training' industry (94,400 jobs or 31.3% of new jobs). The private sector grew fastest in the 'professional, scientific and technical services' industry (80,400 jobs or more than 100% of new jobs).

Forward indicators suggest labour demand will be soft. With spare capacity persisting in the labour market we expect the unemployment rate to rise peaking around 5.4% in 2021 before moderating in 2022 when the economy regains momentum.

[1] Seasonally adjusted data are not available for this dataset.

Chart 25
Unemployment and Participation Rates

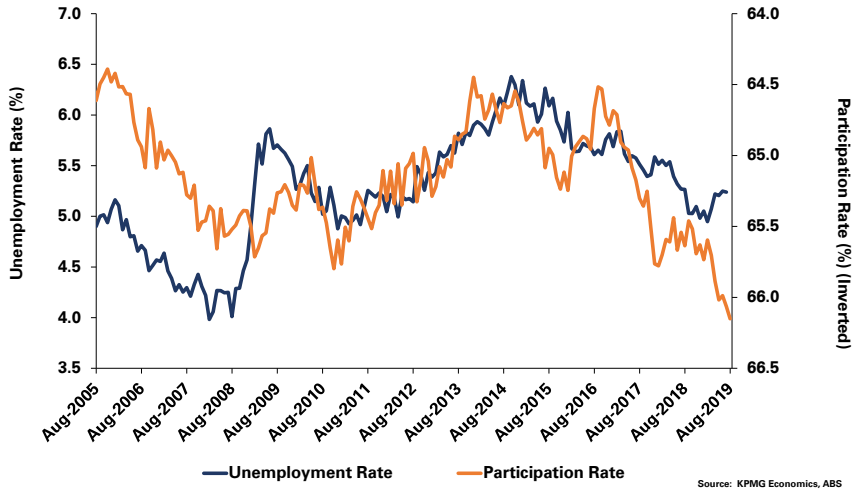
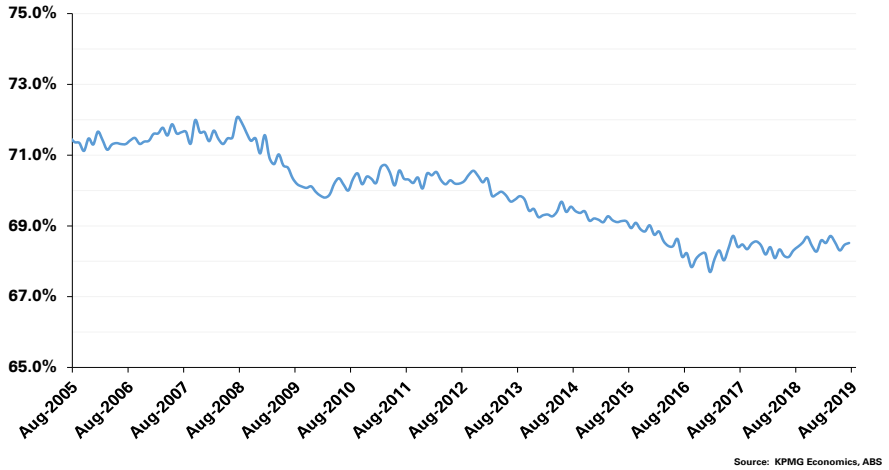


Chart 26
Proportion of full-time to total Employment



Forecast Assumptions

Changes in key assumptions impacting KPMG's Economics forecasts since June 2019 include:

Global

- Short term interest rates have peaked in the US and Eurozone and will now ease, but rates will stay steady in the UK until certainty surrounding Brexit is achieved..
- A 'soft' Brexit scenario will be implemented.
- Corporate bond spreads converge to their long run averages.
- Oil prices to follow the path identified by the US Energy Information Administration (US EIA).

Australia

- Residential construction activity to moderate in 2019 and 2020
- RBA to reduce the cash rate to 0.25% by mid-2020
- Business investment to remain soft for the remainder of 2019 and then steadily rise.
- Limited further fiscal reforms in Australia, with government recurrent spending also to be maintained at levels forecast in the April 2019 Budget Papers.
- Government investment spending to lift to help balance the softer short term private sector investment activity

Australian Outlook

Year ending	Jun-19	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22
GDP (Real)	**1.4%**	1.9%	2.1%	2.3%	2.4%	2.5%	2.5%	2.5%
Private Consumption	**1.4%**	1.5%	1.8%	2.0%	2.2%	2.3%	2.3%	2.3%
Investment								
Business	**-1.2%**	-1.0%	1.0%	1.8%	2.4%	2.5%	3.0%	3.1%
Housing	**-9.1%**	-8.9%	-8.1%	-7.3%	-4.1%	-0.2%	2.0%	4.0%
Government								
Consumption	**6.2%**	5.2%	4.4%	3.7%	3.6%	3.5%	2.6%	1.8%
Investment	**0.7%**	4.2%	5.5%	4.4%	4.2%	4.0%	3.0%	2.1%
Total domestic demand	**1.0%**	1.4%	1.7%	2.0%	2.3%	2.4%	2.4%	2.4%
Exports	**2.9%**	4.1%	3.6%	3.4%	3.1%	3.0%	2.8%	2.8%
Imports	**-2.8%**	-1.5%	-0.5%	1.0%	1.8%	3.0%	3.2%	3.4%
Inflation (1)	**1.6%**	1.5%	1.7%	1.8%	1.9%	2.0%	1.8%	1.8%
Real Personal Disposable Income	**2.6%**	2.8%	2.8%	2.9%	2.8%	2.6%	2.2%	1.9%
Unemployment, % (1)	**5.2%**	5.4%	5.3%	5.2%	5.1%	5.0%	5.0%	5.0%
Government Balance as % of GDP	**0.0%**	0.2%	0.3%	0.3%	0.4%	0.5%	0.8%	0.3%
Govt. debt as % of GDP	**43.2%**	43.0%	42.9%	42.9%	42.8%	42.7%	42.4%	42.9%
Current account as % of GDP	**1.3%**	5.6%	4.1%	2.4%	1.3%	0.0%	-0.4%	-0.6%
A/US (1)	**0.671**	0.660	0.655	0.670	0.677	0.678	0.680	0.682
Terms of Trade (1)	**111.8**	110.0	106.8	102.9	103.4	104.7	106.2	107.9

(1) = Value at end of the period

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