KPMG

Quarterly Economic Outlook

Global and Australian Forecasts

KPMG Economics & Tax Centre

January 2020

—

kpmg.com.au

Contents

Executive Summary

Global economy

- Despite some positive outcomes near the end of 2019, there remains a range of geopolitical and economic issues continuing to create tensions and pressure in various countries and regions. Inflation in general has remained low. KPMG's medium-term outlook is one of overall moderate global growth.
- The US and China have signed a phase one deal to deescalate the trade war. The December Minutes of the FoMC show an upward bias in expected settings for the Fed Funds Rate. KPMG's outlook for US growth in the next couple of years is growth at slightly above trend pace of 2.0%.
- The now re-elected UK government, the Conservative Party, pledged relatively moderate increases to current expenditure, investment spending and tax revenues. The decision to leave the EU has already negatively impacted the size of the UK economy.
- The appointment of von der Leyen and Gentiloni has lifted speculation regarding potential reforms to the EU's fiscal rules. The ECB has responded to this extended weakness in growth and inflation by easing monetary policy again during the final quarter of 2019.
- The Chinese economy has continued to slow as 2019 progressed. The People's Bank of China (PBoC) has adopted a range of measures to help stimulate the Chinese economy, including allowing the Yuan to depreciate against the US dollar and cutting the reserve requirement ratio (RRR) for major banks.
- Japan Prime Minister Abe announced a US$239bn stimulus package to offset negative influence by Typhoon Hagibis.
- The Indian economy is facing a severe demand slowdown. India surprisingly withdrew from the Regional Comprehensive Economic Partnership (RCEP) Trade Agreement at the ASEAN Summit in Bangkok in early November 2019.

Australian economy

- The Australian economy had been performing poorly even before the onset of natural disasters the country has experienced this summer.
- The 2019Q3 National Accounts show that economic growth has been very narrow with the majority of the growth occurring from exports and government spending , while private demand fell by 0.3% q/q and 0.4% over the year.
- Consumption activity remains one of the key weaknesses in the Australian economy. Household final consumption expenditure grew by 0.1% q/q during 2019Q3, and 1.2% y/y. Consumer sentiment has now fallen 6.1% since the middle of the year, when the RBA started easing the cash rate downwards.
- Total business investment fell 0.9% between the June and September quarters with a 4.2% quarterly decline in business investment in machinery and equipment. Housing investment continued to act as a drag on economic activity in the September quarter 2019.
- Comparing the Commonwealth Department of Finance November 2019 Monthly Financial Statement to MYEFO we note that the three largest expenditure by portfolio, being social security, health and education, are all tracking proportionally higher compared to the same time last year.
- The run of trade surpluses has continued unbroken since the beginning of 2018 through to November 2019. Given the positive trade results for October and November 2019 it would seem net exports will continue to positively contribute towards economic growth in 2019Q4.
- The latest Labour Force data from the ABS shows Australia recorded a very healthy monthly gain in employed persons of just under 40,000 in November, which was on the back of a 25,000 fall recorded in October.

Australian forecasts

Year ending	Jun-19	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22
GDP (Real)	1.6%	1.9%	2.1%	2.3%	2.4%	2.5%	2.5%	2.5%
Inflation (1)	1.6%	1.7%	1.7%	1.8%	1.9%	2.0%	2.2%	2.3%
Unemployment, % (1)	5.2%	5.3%	5.3%	5.2%	5.1%	5.0%	4.9%	4.8%
A/US (1)	0.701	0.699	0.675	0.680	0.687	0.698	0.700	0.702

(1) = Value at end of the year

KPMG

Global Outlook

Overview

As 2019 came to a close some of the major uncertainties impacting the world economy in recent months and years appear to be resolving themselves.

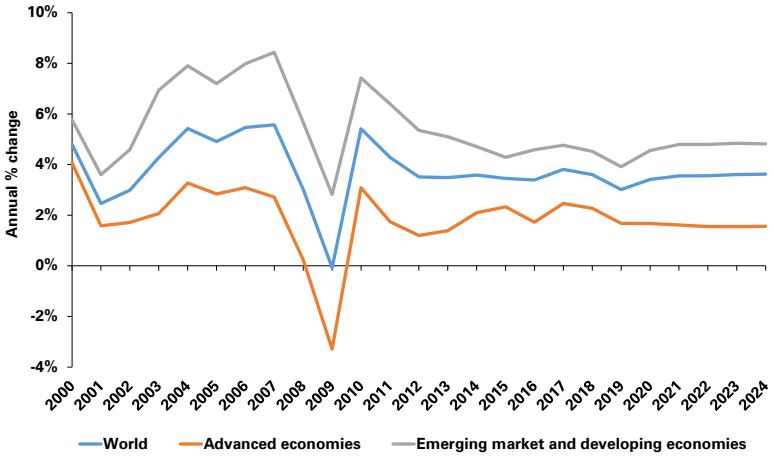
The General Election in the UK has returned the Conservative Government and Prime Minister Boris Johnson with a mandate to implement Brexit; while a Phase 1 deal between the US and China aimed at de-escalating the ongoing trade dispute was reached prior to Christmas and signed on 15 January 2020. Further, the renegotiated US, Canada and Mexico free trade deal, which is to replace NAFTA, received approval in the US Senate / Congress on 19 December 2019; a new Government under President Alberto Fernandez has been formed in Argentina with a policy framework of increasing state spending and targeting growth through stimulatory monetary and fiscal policy settings.

Despite these positive outcomes there remains a range of geopolitical and economic issues continuing to create tensions and pressure in various countries and regions, including the increasing divisions regarding the political and economic solutions for responding to climate change; general strikes in France regarding proposed pension reforms by the Macron government; continued and escalating tensions in the Middle East between Iran and the US; and the growing recognition that bifurcation is occurring in global technology between China backed and US backed IT solutions.

Although the outlook going forward looks clearer as we go into the new decade the impact of the trade dispute between China and the US, combined with challenges in various product markets, such as car manufacturing, means global industrial production and world trade growth in 2019 is likely to be lower than our previous forecasts. While some primary and secondary sectors are struggling, activity measures for the services sector (at this stage) appear to be steady.

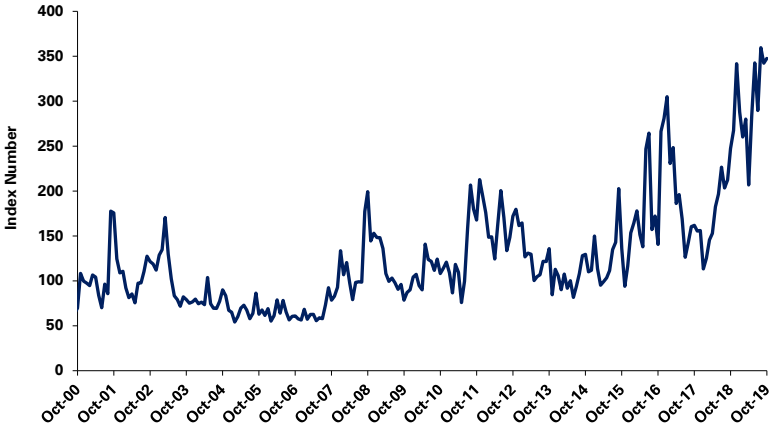
The World Trade Monitor prepared by the Netherlands Bureau for Economic Policy Analysis (CPB) suggests the volume of world trade bottomed in June 2019 and started to rise (shakily) in the next four months through to October. The pick up in trade this year has been mainly seen in exports of emerging economies, while advanced economies saw flat export volumes.

Chart 1
World GDP Growth



Source: KPMG Economics, IMF

Chart 2
Global Economic Policy Uncertainty Index



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

Overview (cont.)

Inflation in general has remained low and in many countries has continued to be below target ranges. Given the lack of wages growth and continuation of spare capacity across many economies it is likely that inflation will remain in check, at least into the short term.

Although there are various forces retarding global economic growth, some countries who have experienced recessions during this year (or still are), such as Turkey, Argentina, and Venezuela, have done so more due to domestic factors relating to troubles in the local financial sector, the adoption of sanctions and significant exchange rate depreciations.

This lower growth outcome for 2019 is yet another year where the pace of annual economic growth has disappointed even though policy rates across many advanced economies have continued at very low levels compared to historical averages.

Our forecast for global GDP growth for both 2019 and 2020 has been reduced to 3%, which represents the weakest rate of global GDP growth since the GFC.

China and India are anticipated to continue to grow at a faster pace than the average of emerging economies, although they are expected to experience slower growth rates than what they have achieved over the past three years. Economies like Vietnam, Indonesia, Mexico and Singapore are all forecast to contribute to the continued steady growth, however recessions in some countries (as noted above) demonstrate that growth experience within the group can be markedly different. While this is the case we expect global growth to strengthen a little in late 2020 and into 2021 on the back of a return to growth in emerging economies.

Our medium term outlook remains one of overall moderate global growth based on a number of pervasive structural factors, including slower credit growth across advanced countries, a mismatch in the 'creative' and 'destructive' side in the innovation growth equation, further facilitating the broader deflationary trends, and influences of asymmetric demographic changes across countries that are driving movements in international capital.

Chart 3
Official Interest Rates

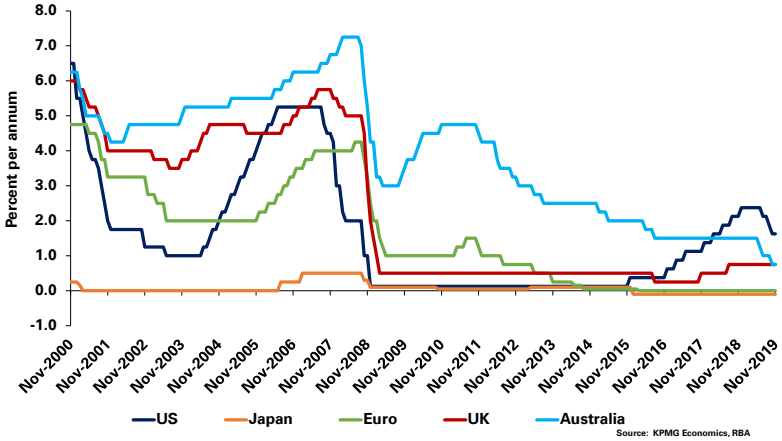
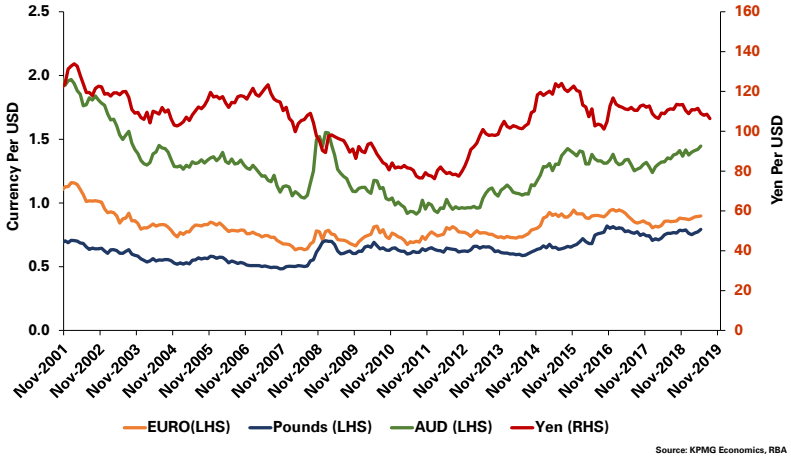


Chart 4
Exchange Rates (USD)



US

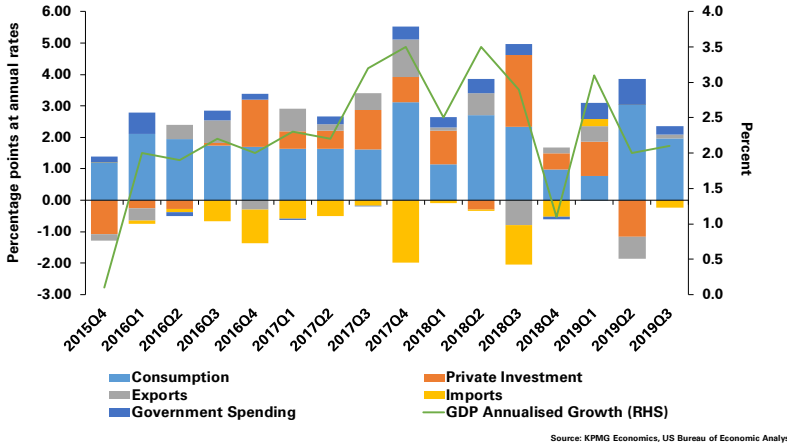
The biggest news impacting the US economy is agreement of a phase one trade deal between the United States and China which was made in principle on December 13, two days prior to the deadline for the next round of planned retaliatory tariffs.

The US Trade representative, Robert Lighthizer confirmed that the U.S. will reduce the current tariff rate to 7.5% (down from 15%) on about $120bn of goods and will cancel planned new tariffs on $156bn of Chinese goods. In return China will agree to increase its annual purchases of US manufactured goods by around $80bn, energy products by $50bn and services by $35bn as well as the extra $32bn of agricultural products. The phase one deal also incorporates some structural reforms aimed at removing "unfair trade practices", including a pledge by China to open up access to US firms to the country's financial services sector, provide greater protection to US intellectual property, and to allow a freer float for the Chinese yuan. While the phase one trade deal is a positive outcome for the global economy, tariffs of 25% will remain on nearly $250bn of Chinese exports to the US, including machinery, electronics and furniture.

Data points for 2019Q4 suggest the US is showing signs of slowing growth. The Atlanta Fed's GDPNow nowcast of 2019Q4 real GDP is 2.3 percent (as at 3 January 2020). The analysis suggests fourth-quarter growth in government spending and net exports were offset by a fall in personal consumption expenditures and gross private domestic investment. Further, business investment continues to track downwards, with data on forward capital goods orders, production of business equipment and the number of oil rigs operating all showing negative trends. In addition to these broader macro indicators idiosyncratic factors have also negatively influenced some industries, including aviation (Boeing 737Max production) and auto sectors (GM auto workers strike).

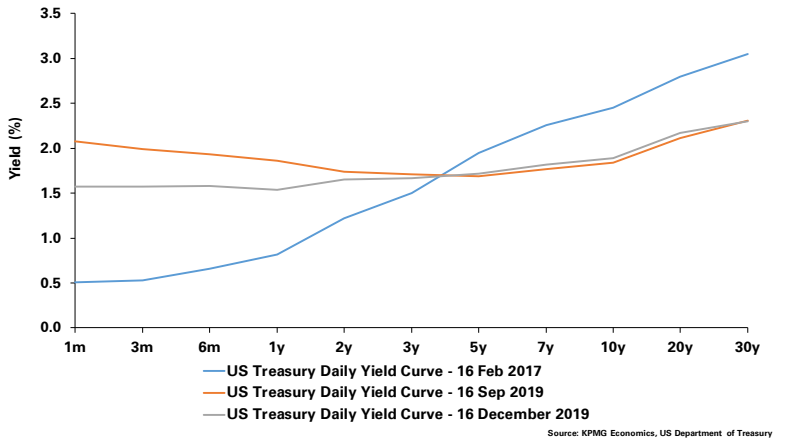
The Fed reduced the Federal Funds Rate (FFR) three times in 2019 on the expectation that easing will help cushion concerns about a sharper slowdown in the US economy caused by the trade war and to also allay concerns about a possible US recession in 2020. The December Minutes of the FoMC show a upwards bias in expected settings for the FFR, being slightly higher in 2020 and then about 2% in 2021, 2.25%.in 2022 and 2.50% in the longer term.

Chart 5
US GDP Growth by Component



Source: KPMG Economics, US Bureau of Economic Analys

Chart 6
US Treasury Daily Yield Curve



Source: KPMG Economics, US Department of Treasury

UK

The Conservative Party, led by Prime Minister Boris Johnson, has been returned to Government following the General Election on 12 December 2019. During the election campaign the now re-elected government pledged relatively moderate increases to current expenditure, investment spending and tax revenues (~£27bn per annum) compared to either Labour (~£194bn per annum) or the Liberal Democrats (~£107bn per annum).

The National Institute of Economic and Social Research (NIESR) has suggested the macroeconomic impact of the tax and spending measures proposed by the Conservative Party are likely to be small due to the modest spending profile. Overall the proposed spending is expected to lift GDP by 0.2% over the period 2020 to 2024; with a similar associated increase in the consumer price level.

In terms of economic performance in 2019, the latest Office of National Statistics (ONS) estimates of UK GDP (in volume terms) shows the economy grew by 0.3% in 2019Q3, and 1.0% annually; and represents the slowest rate of annual growth since 2010Q1. Household consumption, government consumption and net trade contributed positively to GDP growth, while gross capital formation contracted during the quarter. On a sector basis the service and construction sectors provided positive contributions to GDP growth, while the production sector recorded flat output in the quarter.

The latest monthly data suggests the UK economy is on course to grow by 0.1% in the fourth quarter of 2019; resulting in an annualised GDP growth rate of 1.3% for the whole year and down slightly from 1.4 per cent in 2018.

It cannot be understated how the uncertainty associated with Brexit has impacted the UK economy. Various commentators have suggested the decision to leave the European Union has already resulted in the UK economy being around 2½% smaller than had the economy progressed on a business-as-usual trajectory from 2016. Over the longer term its also been estimated that compared to staying within the EU the UK economy will be around 3%-4% lower under the UK-EU FTA negotiated by Prime Minister Johnson prior to the recent election.

Chart 7
UK Purchasing Manager's Index

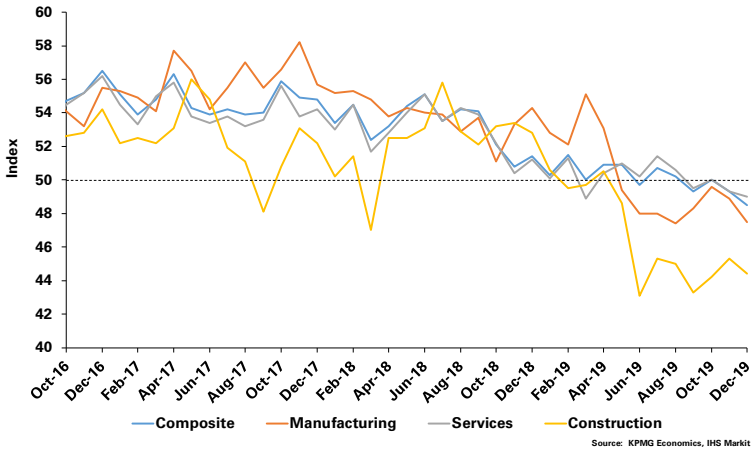
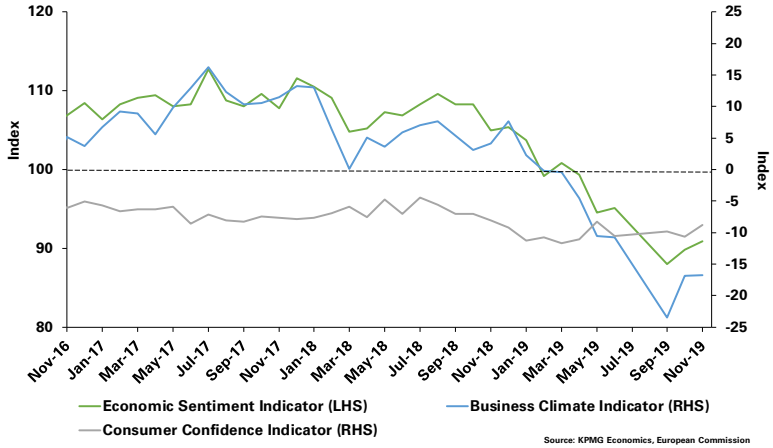


Chart 8
UK Economic Sentiment Indicators



Eurozone

A new EU Commission took office on 1 November 2019. Ursula von der Leyen, most recently a German cabinet minister, replaced Jean-Claude Junker as President of the EU Commission, while Paolo Gentiloni, the former Italian Prime Minister, has been appointed as Commissioner for Economic and Financial Affairs, Taxation and Customs. The appointment of von der Leyen and Gentiloni to these most senior roles has lifted speculation regarding potential reforms to the EU's fiscal rules, vis-à-vis increasing the importance of government investment and pro-growth fiscal policies.

The Eurozone recorded weak, albeit positive, growth in the 3rd Quarter of 2019 of 0.2% for the EA19 and 0.3% for the broader EU-28 region, translating into annualised growth of 1.2% and 1.3% for each of the two economic geographies respectively. The weakest quarterly economic growth occurred in Norway (0.0%), Germany (0.1%), Italy (0.1%) and Lithuania (0.1%), with the highest growth occurring in Poland (1.3%) and Hungary (1.1%).

The ECB has responded to this extended weakness in growth and inflation by easing monetary policy again during the final quarter of 2019, which included the restarting the asset purchase programme (APP) at a monthly pace of €20 billion from 1 November. The ECB signalled purchases would continue until around the time that the ECB decided to withdraw monetary stimulus by raising rates again, which was interpreted by financial markets as an open-ended commitment to further quantitative easing.

The political crisis impacting Italy resolved itself with the establishment of a new coalition government still under the leadership of Prime Minister Giuseppe Conti but now includes the centre-left Democratic party and the Five Star movement. The new government has established a less confrontational relationship with the European Commission regarding fiscal deficit targets, which while challenging is now more achievable given borrowing costs (measured by the spread over equivalent bond issued by Germany) for the Italian government have fallen sharply since August as the market has recognised that country-specific political risks have eased and sovereign bond yields across developed nations have generally fallen.

Chart 9
Eurozone Purchasing Manager's Index

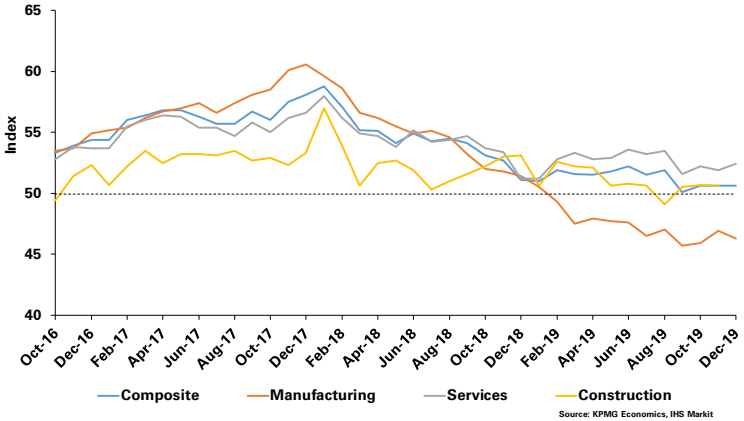
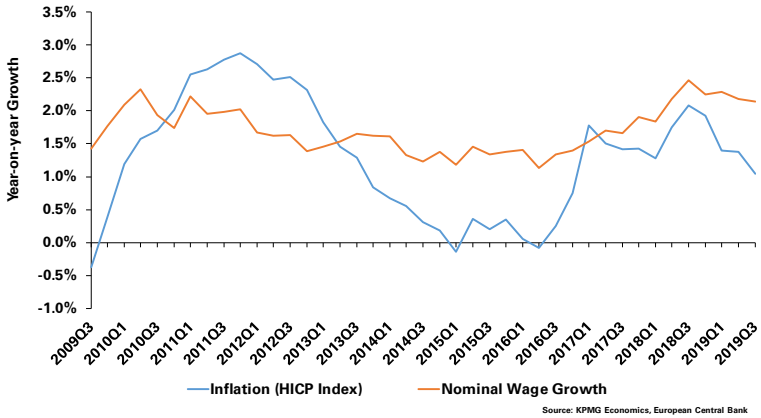


Chart 10
Eurozone Inflation and Nominal Wage Growth



China

The Chinese economy has continued to slow as 2019 progressed, with quarter-on-quarter GDP growth (seasonally adjusted) of 1.5% for 2019Q3, or 6.0% on an annual basis – the lowest annual growth rate recorded for the country since 1992.

A useful measure in understanding the state of Chinese industrial production supply-demand (im)balances is its producer price index (PPI). By November 2019 China's PPI had recorded an annual decline of 1.4%, but more importantly the PPI had recorded 6 consecutive months of decline, which some commentators suggest is a reliable indicator of Chine being in "industrial recession".

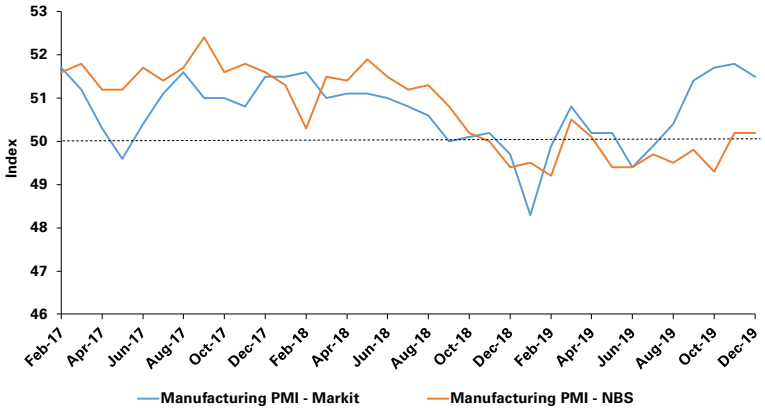
The People's Bank of China (PBoC) has adopted a range of measures to help stimulate the Chinese economy, including allowing the Yuan to depreciate against the US dollar (trading at above 7 for most of the period August to December 2019); and cutting the reserve requirement ratio (RRR) for major banks by 50bps, effective 6 January, which will release nearly 1 trillion Yuan into the real economy.

The Chinese government has also implemented tax reforms aimed at supporting local governments. China's State Council announced in early October 2019 reforms to the application and distribution of the national consumption tax. The CSC reforms include shifting the collection of the consumption tax to the wholesale/retail stage (as opposed to the production/import stage) for certain consumer goods; and allocating a higher proportion of consumption tax receipts to local governments.

Annual inflation has jumped to 3.8% (in October 2019), representing the fastest rate of growth in consumer prices in almost eight years. The primary cause of this rise in inflation has been a spike in pork prices which has been caused by an outbreak of African swine fever (which has resulted in around 40% of the China pig population being culled). Prices of pork, the staple meat in China, have more than doubled in the past year, according to the NBS, which in turn has also pushed up prices of other meats and sources of protein.

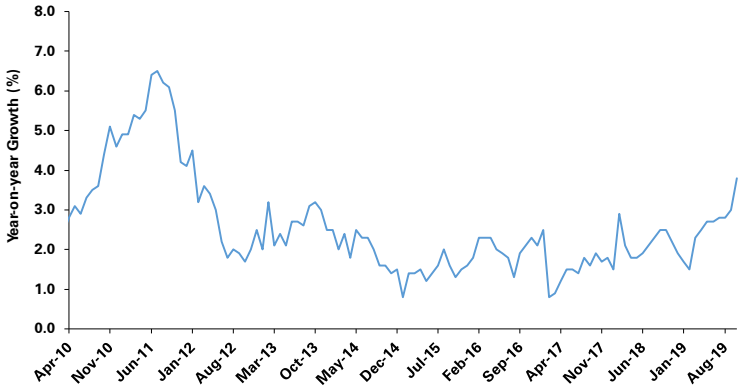
Our medium term forecasts for China reflect a range of structural factors, including a decline in the working age population, high debt levels limiting credit growth, financial market barriers limiting a transfer of activity from the public sector to the private sector, and challenges in achieving similar growth in export markets.

Chart 11
China Manufacturing PMIs



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

Chart 12
Consumer Price Index Growth (All Items)



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

Other Economies

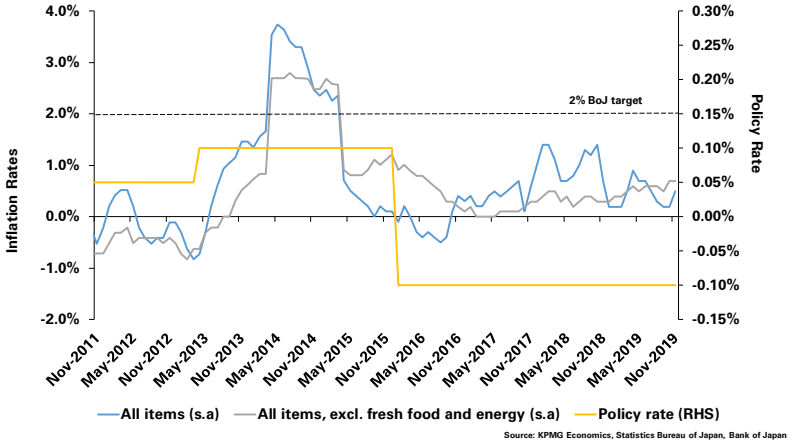
The second preliminary release of GDP data shows Japan's economy grew faster than initially estimated in the third quarter of 2019, up nearly 0.4% q/q and 1.7 y/y on a seasonally adjusted basis. The Japanese economy benefitted from a significant uplift in expenditure on private non-residential investment activity (+1.8% q/q) and private consumption (0.5% q/q); most likely as a consequence of brought forward spending to miss the increase in sales tax (from 8% to 10%) that took effect in October. The external sector, however, continued to detract from economic growth due to the direct trade tensions with South Korea and indirect effects associated with the U.S. and China trade war.

While there has been solid annual economic growth year-to-date the final quarter of the 2019 is looking weaker due to a variety of factors. The Jibun Bank Japan Manufacturing PMI recording 48.8 in December 2019 (virtually no change the November index value); Typhoon Hagibis, which hit Japan in October, will also have negatively impacted consumption and investment activity for the nation. To offset these negative influence in early December Prime Minister Abe announced a US$239bn stimulus package, about half has been earmarked for "fiscal measures", with the remaining allocated to "fresh local and central government spending".

The Indian economy is facing a severe demand slowdown, with annual growth slowing to 4.5% y/y in the third quarter of 2019; the fifth consecutive quarter where GDP growth followed a downwards trajectory. Factory output and exports have continued to decline; in particular India's automotive industry (which contributes around 7% of India's GDP) experiencing a sharp fall throughout 2019. To support growth the finance ministry reduced the headline corporate tax rate from 30% to 22%. The Reserve Bank of India also decreased the policy rate by 25bp in October, which followed an (unconventional) 35bp reduction in September.

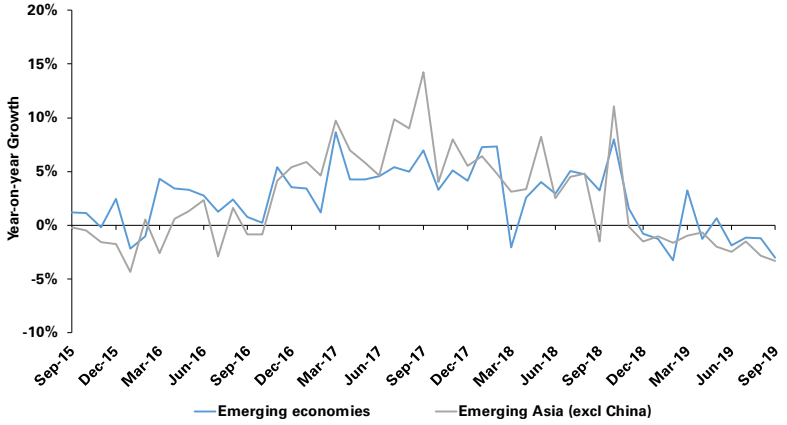
India surprisingly withdrew from the Regional Comprehensive Economic Partnership (RCEP) Trade Agreement at the ASEAN Summit in Bangkok in early November 2019. It has been suggested this decision was undertaken to shore up domestic political support for the BJP from the Hindu nationalist organisation, the Rashtriya Swayansevak Sangh, who stated in a submission to Prime Minister Modi that "RCEP will have adverse far-reaching effects on India's manufacturing, agriculture and dairy [industries]".

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	2.3%	1.6%	1.6%	1.8%	1.8%	1.8%
Americas						
Brazil	1.1%	0.8%	1.7%	2.1%	2.5%	2.6%
Canada	1.9%	1.6%	1.7%	2.2%	1.8%	1.7%
Latin America	1.0%	1.3%	2.5%	2.6%	2.7%	2.7%
Mexico	2.0%	0.8%	2.0%	2.1%	2.5%	2.7%
USA	2.5%	2.1%	2.1%	1.9%	1.8%	1.7%
Europe						
EMU	1.9%	1.1%	1.3%	1.5%	1.4%	1.4%
France	1.7%	1.3%	1.5%	1.6%	1.7%	1.7%
Germany	1.5%	0.6%	1.0%	1.2%	1.2%	1.2%
Greece	1.9%	1.6%	2.1%	1.5%	1.5%	1.7%
Ireland	8.3%	4.6%	2.6%	3.0%	3.4%	3.7%
Italy	0.7%	0.1%	0.4%	0.7%	0.6%	0.7%
Russian Federation	2.3%	1.0%	1.4%	2.2%	2.3%	2.1%
UK (Deal Scenario)	1.4%	1.4%	1.4%	1.5%	1.6%	1.7%
Africa	3.6%	2.9%	2.9%	2.7%	2.7%	3.0%
South Africa	0.7%	0.4%	1.4%	1.4%	1.4%	1.5%
Middle East	1.9%	2.0%	2.6%	2.9%	3.4%	3.6%
Asia						
China	6.6%	6.2%	5.8%	5.7%	5.5%	5.4%
East Asia	4.3%	4.3%	4.3%	4.5%	4.7%	4.7%
Hong Kong (S.A.R)	3.0%	0.7%	2.2%	2.3%	2.4%	2.4%
Indonesia	5.2%	4.9%	4.5%	4.3%	3.9%	3.9%
India	7.4%	5.9%	6.3%	6.5%	6.6%	6.7%
Japan	0.8%	0.9%	0.2%	0.5%	0.7%	1.0%
Singapore	3.2%	0.6%	1.8%	2.1%	3.2%	3.7%
South Korea	2.7%	1.7%	2.1%	2.4%	2.8%	3.2%
Taiwan	2.6%	2.3%	2.4%	2.2%	2.1%	2.2%
Vietnam	7.1%	8.8%	6.5%	5.8%	5.0%	4.7%
Oceania						
New Zealand	2.8%	2.7%	2.4%	2.5%	2.5%	2.4%
World	**3.6%**	**3.1%**	**3.1%**	**3.3%**	**3.4%**	**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%	4.8%
Canada	2.3%	1.7%	2.0%	1.8%	1.6%	1.9%
Latin America	6.0%	6.2%	2.7%	3.5%	3.5%	3.4%
Mexico	5.0%	4.1%	3.2%	3.2%	3.0%	3.0%
USA	2.4%	1.9%	1.8%	2.1%	2.0%	2.1%
Europe						
EMU	1.7%	1.4%	1.8%	1.7%	1.7%	1.6%
France	1.5%	1.2%	1.4%	1.6%	1.5%	1.4%
Germany	1.9%	1.4%	1.8%	1.8%	1.8%	1.9%
Greece	0.7%	0.9%	0.2%	1.6%	1.5%	1.7%
Ireland	0.7%	1.0%	1.4%	1.7%	1.8%	1.9%
Italy	1.1%	0.7%	1.2%	1.5%	1.4%	1.4%
Russian Federation	2.8%	4.9%	3.3%	3.9%	4.0%	3.9%
UK (Deal Scenario)	2.5%	1.9%	2.0%	2.0%	2.0%	2.0%
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	3.0%	1.3%	0.9%	2.0%	2.3%	2.7%
Hong Kong (S.A.R)	2.5%	2.4%	2.3%	2.1%	2.0%	2.0%
Indonesia	3.2%	3.4%	3.5%	3.4%	3.1%	3.1%
India	3.5%	3.2%	4.0%	4.2%	3.1%	3.1%
Japan	1.0%	1.0%	1.3%	1.1%	1.1%	1.2%
Singapore	0.4%	1.4%	0.6%	1.5%	1.5%	1.5%
South Korea	1.5%	1.5%	1.6%	1.8%	1.9%	1.6%
Taiwan	1.5%	1.0%	1.2%	1.4%	1.4%	1.3%
Vietnam	3.5%	3.0%	3.2%	3.6%	3.6%	3.8%
Oceania						
New Zealand	1.6%	1.5%	1.9%	2.1%	1.8%	1.9%

KPMG

Australian Outlook

Overview

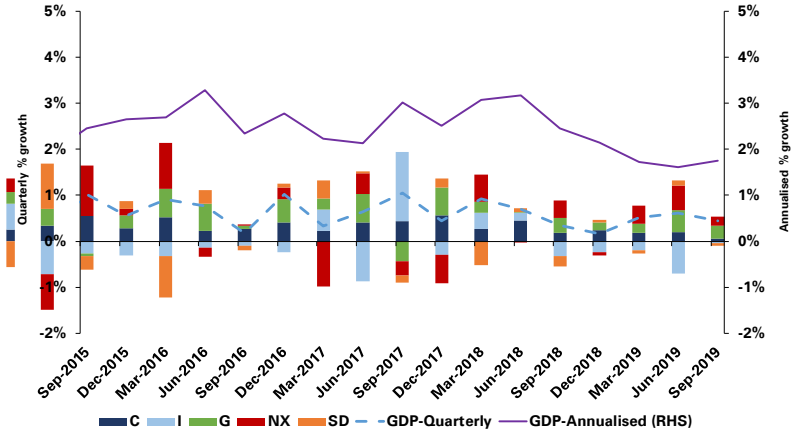
This summer most of Australia has been in the grip of the worst natural disasters the country has experienced in decades. Fires to date have destroyed nearly 2,000 houses and burnt more than 2 million hectares of bush land have come on top of the worsening drought conditions that have affected much of rural Australia for the past few years.

It is too early to quantify with any degree of accuracy the impact these events will have on the national economy; it is almost certain that data for 2019Q4 and 2020Q1 will show the economy has been negatively impacted by the fires, which are ongoing, but the full impact is likely to play out over a much longer time frame. In the short term lower consumption and lower business activity maybe be counteracted by higher government spending, but the net effect of these two counterbalancing effects is still likely to be negative. Those impacts, combined with the loss of biological assets and a pause in investment activity as the authorities seek to bring these natural disasters under some semblance of control, suggests economic activity for Australia is highly likely to be lower than previously forecast.

Even before this terrible summer the Australian economy had been performing poorly relative to our recent history. GDP data for 2019Q3 was weak, recording a lift in annual growth from 1.6% to 1.7%. While this result still confirms the RBA Governor Lowe's assessment that the economy has reached a "gentle turning point" quarterly growth actually softened from 0.6% q/q in 2019Q2 to 0.4% in 2019Q3. Notably domestic final demand remains extremely soft, with consumer spending virtually flat over the quarter as households sought to increase their savings rather than spending the rise they enjoyed in their household disposable income (due to tax cuts as opposed to wages growth).

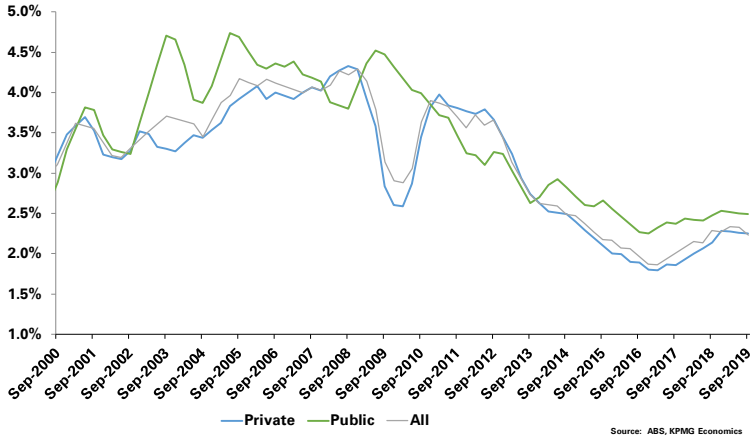
All of these factors suggest that the RBA will continue with its downwards trajectory for the cash rate early into the new year; most likely with another 25bp reduction in February and another one around the middle of the year. As per its own advice this brings the cash rate into the 0.25% territory - the RBA's self assessed lower bound – which is the rate nominated for potential adoption of quantitative easing. KPMG's central case remains that QE is unlikely to be implemented by the RBA, but this is likely to be a close call.

Chart 15
GDP Growth by Component



Source: KPMG Economics, ABS

Chart 16
Private and Public Wage Growth, Annual Change



Source: ABS, KPMG Economics

Production

The 2019 Q3 National Accounts show that economic growth has been very narrow with the majority of the growth occurring from exports and government spending , while private demand fell by 0.3% q/q and 0.4% over the year.

This weakness in the private sector is broadly based across the whole private economy: home building is down sharply (–9.6%y/y); consumer spending is declining in per capita terms (-0.4%y/y); and business investment is lower (–1.7%yr). Farm GDP continued to decline, with it now 18% lower than what it was two years ago, which has stripped nearly 0.5ppt off aggregate GDP.

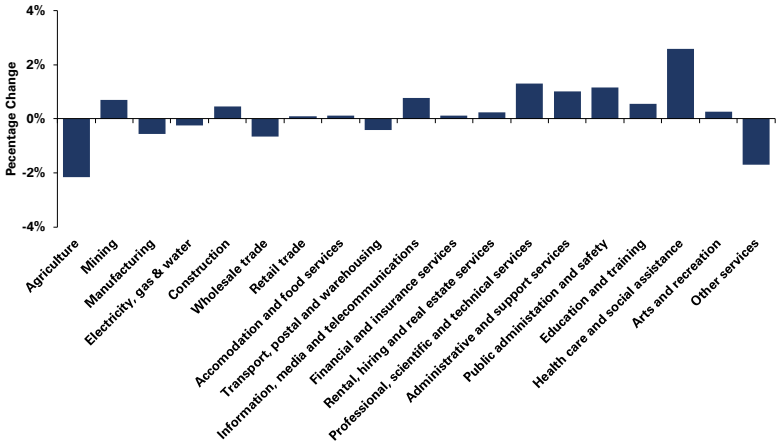
As already mentioned, the continuation of drought conditions and the fires in rural Australia will continue to depress farm GDP. ABARES has already concluded that prospects for Australia's winter crop outlook is concerning due below average rainfall and above average temperatures in most cropping regions, with Western Australia and southern New South Wales experiencing the most adverse spring conditions. Of the key winter crops, wheat production is forecast to fall by 8%; barley production is forecast to increase by 4%; and canola production is forecast to fall by 4%.

On an industry contribution basis Healthcare and Social Assistance recorded the largest quarterly growth (2.6% q/q), followed by Professional Services (1.3% q/q) and Public Administration and Safety (1.2% q/q). Strong public spending, especially in the three largest portfolios of social security and welfare, health and education, combined with iron ore mining production, are the key components of current growth of the Australian economy. The Construction sector added positively to economic growth during the quarter, suggesting the weakness within the industry may have bottomed in 2019Q2. The weakest industry sectors during Q3 were Agriculture; Manufacturing; Wholesale Trade; Transport Postal and Warehousing; and Other Services.

The Services sector continues to rise in importance in the make-up of the Australian economy, with the sector now representing nearly 73% of total industry GVA (for the year ending September 2019). Australia's secondary sector, comprising construction and manufacturing activities, continues to decline in relative importance, down from representing nearly 20% of all IGVA at the beginning of the new century to now just under 15%.

Chart 17

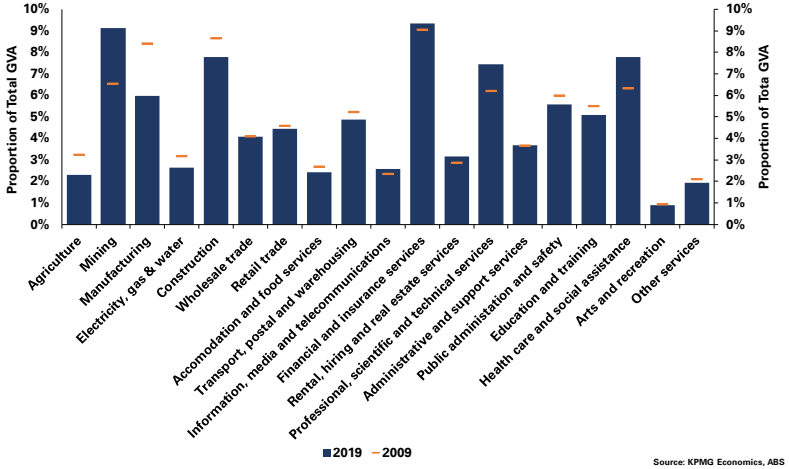
Quarterly Growth in Gross Value Added, September Quarter 2019



Source: KPMG Economics, ABS

Chart 18

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



Source: KPMG Economics, ABS

Consumption

Consumption activity remains one of the key weaknesses in the Australian economy. Household final consumption expenditure grew by 0.1% q/q during 2019Q3, and 1.2% y/y. Discretionary spending categories, including Cigarettes and tobacco (-2.9% q/q; -7.6% y/y); Motor vehicle purchases (-1.0% q/q; -4.9% y/y); Alcoholic beverages (-0.5% q/q; -0.6% y/y) and Hotels, cafes and restaurants (-0.9% q/q, -0.2% y/y), continue to experience the largest reductions.

Consistent with the national accounts, ABS Business Indicators data shows the Retail Trade industry recorded a decline in (real, seasonally adjusted) sales of goods and services of 1.6% between 2019Q2 and 2019Q3, and 2.2% year-on-year. Sales of goods and services in the Accommodation and Food Services sector was also weak, recording growth of only 0.2% and 0.6% over the quarter and year respectively.

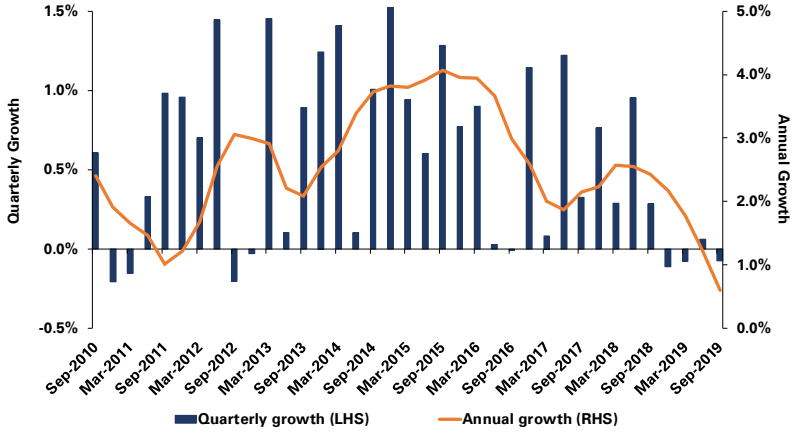
On the other hand, from the latest ABS monthly Retail Turnover data, sales (seasonally adjusted) in November grew at a relatively strong rate (0.9% m/m; 3.2% y/y) as compared to the sluggishness observed during the year, particularly in H2. The annualised growth in November 2019 sales was also higher than the corresponding month in 2018 (2.7% y/y).

The NAB Online Retail Sales Index shows November sales improved after contracting in October. This may reflect the impact of the 'Black Friday' sales event. NAB has noted that while it is recognised that online retail sales are more volatile than the wider retail sales index, volatility in month-to-month sales has been even greater than average fluctuations over the past nine months.

The Westpac-Melbourne Institute Index of Consumer Sentiment fell 1.9% in December to 95.1, down from 97.0 in November. Consumer sentiment has now fallen 6.1% since the middle of the year, when the RBA started easing the cash rate downwards. The index has now been below 100, the level that represents the balance point in the survey between pessimists and optimists, continuously for the past 6 months.

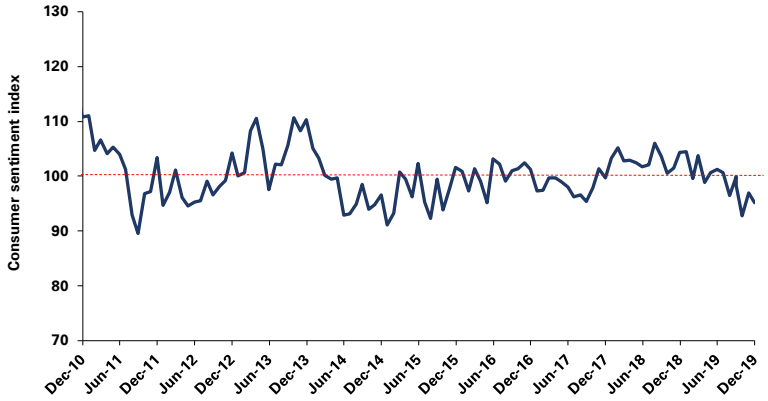
All of these surveys and indexes confirm private spending within the economy is very weak, reflecting the collective effects of high household debt, low consumer confidence, falling household wealth (on the back of declining house prices) and a soft outlook for the labour market.

Chart 19
Retail Sales, Australia



Source: KPMG Economics, ABS

Chart 20
Consumer Confidence



Source: , Westpac-Melbourne Institute, KPMG Economics

Investment

While total business investment fell 0.9% between the June and September quarters, a 4.2% quarterly decline in business investment in machinery and equipment (both new and second-hand) swamped the otherwise positive results for all the other types of business investment. Positive signs include two-consecutive quarters of growth in investment in intellectual property assets; a positive, albeit small, contribution by non-residential building construction and solid uplift in investment in computer software.

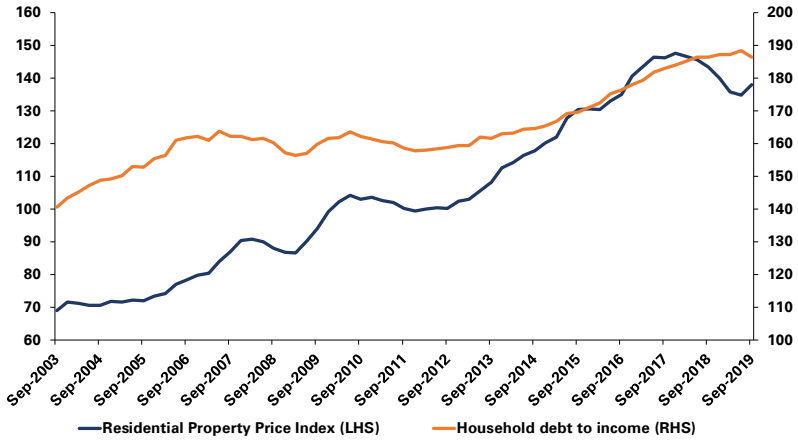
Housing investment continued to act as a drag on economic activity in the September quarter 2019. Total residential investment fell 2.8% in the quarter, down 11.0% over the past year. Our view is that while the downturn in the housing market has bottomed, the lag between the planning and completion of new construction activity will mean investment in residential property is unlikely to make a positive contribution to overall economic growth for another 18 months to 2 years.

Business confidence has been trending downwards since the first quarter of 2019. The NAB business confidence index in Australia fell 2 points between October and November, and now sits at 0 – significantly below its long-run average of 6. Confidence fell across all industries, except remarkably in the retail and wholesale sectors (maybe on the back of a good Black Friday trading result).

The NAB survey also showed a weakening in forward-looking indicators as well, with a softening across forward orders, capacity utilisation, and planned capital expenditure. This is a little surprising given there appears to be a strong pipeline of non-residential construction work to be done, and the expectations in the latest ABS survey of new private capital expenditure showed a slight improvement over FY19 outcomes.

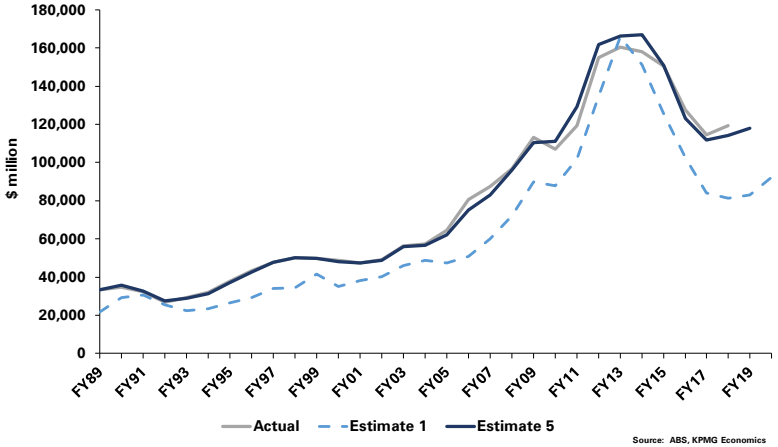
Analysis by the Commonwealth Department of Industry also suggests that activity within the resources and energy sectors may be near the bottom of its investment cycle. The Department confirmed that several major resources and energy projects were completed during the twelve months to October 2019, but the decline in the value of committed projects resulting from these completions has been largely offset by Final Investment Decisions (FIDs) associated with about $3.3bn worth of new projects, including the Adani Carmichael coal mine and five gold projects.

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

Government

The Government's Mid-Year Economic and Fiscal Outlook (MYEFO) was released in mid-December and in our opinion presents a straightforward assessment of the current economic challenges facing the nation. The Government has wound back some of the key economic parameters from its April Budget, including real wages growth, inflation, unemployment and nominal GDP, and has adjusted associated revenue estimates accordingly for these changes.

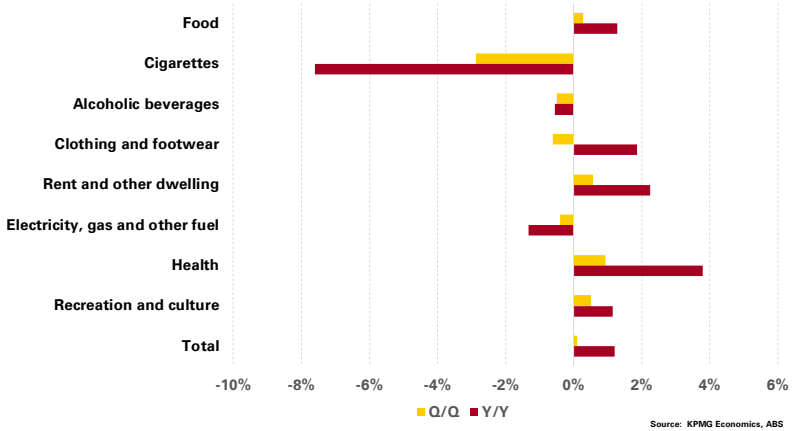
However, it has also assumed various expenditure savings that, given those adjusted economic circumstances, look optimistic, especially now following the bushfires. For example, personal benefit payments – which include welfare payments for veterans, children and the disabled – have been forecast to decline by more than $1.3bn compared to the Budget. While payments to the unemployed have been forecast to increase by $500m (reflecting the fact that more people will be unemployed for longer, or newly unemployed) the savings predominantly reflect a reduction of nearly $700m in payments to the disabled.

Looking at the revenue side more specifically, KPMG notes that the tax receipts remain surprisingly high. Income taxes might have been expected to drop a little given softer nominal wage growth, and the likelihood of lower employment growth to come; corporate income taxes projections look ambitious, given the year to date drop of $1.6bn – which means CIT would have to increase by $900m over the remainder of the year; but GST looks about right given drop off in consumption spending.

We believe the real question marks surrounding MYEFO relate to the expenditure side of the government accounts. Comparing the Commonwealth Department of Finance November 2019 Monthly Financial Statement to MYEFO we note that the three largest expenditures by portfolio, being social security, health and education, are all tracking proportionally higher compared to the same time last year, 42.4%, 42.9% and 42.3% respectively compared to 40.5%, 38.9% and 42.1% respectively by the end of October 2018.

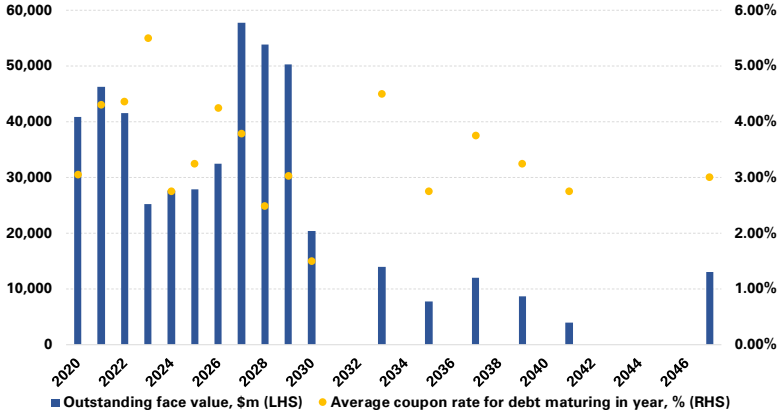
Even prior to the current bushfire disaster, which will require additional spending by the Government than that already announced, we considered the best case estimate for a surplus was about $2bn. Clearly even this wafer thin surplus estimate is now in doubt.

Chart 23
Change in Real Household Final Consumption Expenditure, September Quarter 2019



Source: KPMG Economics, ABS

Chart 24
Australian Treasury Bonds on Issue by Maturity ($m) and Average Coupoun Rate (% pa)



Source: KPMG Economics, AOFM

Net exports

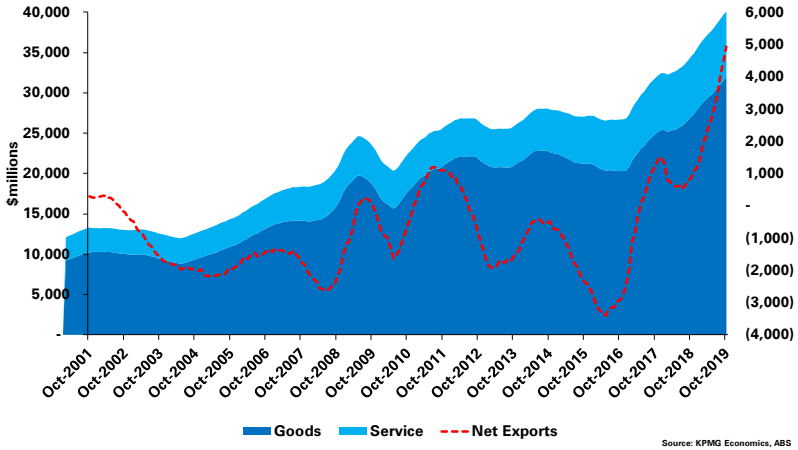
Net exports were a major contributor to economic growth in the September quarter 2019, adding 0.2ppt to GDP on the back of solid increases in resources exports, particularly LNG exports (up 23%) and services exports. While the LNG export growth kicker more so reflects the ramp up in production of the newly completed Prelude and Ichthys projects, net exports of services are likely to continue to increase in relative importance as the exchange rate stabilises around US$0.70 for the near future.

The latest data on Australia's trade balance shows the run of trade surpluses has continued unbroken since the beginning of 2018 through to November 2019. The November data shows the monthly value of Australia's exports ($40.9bn) benefited from a jump in the value of commodity exports, especially in metal ores and fuels (LNG) which were up $0.4bn and $0.2bn respectively, and also services (+$1.1bn). Conversely, the value of imports to Australia declined by just under 3% to $35.1bn, in part the result of a fall in consumer transport equipment (cars) by $0.5bn.

Australia's exports to the UK have risen by just over 200% in the 12 months to November 2019 compared to the previous cumulative 12 months to November 2018, and are more valuable to the Australian economy than exports to the US. The trade data also shows dips in exports to those countries highlighted in the global section of this report suffering from various economic and geo-political challenges, such as Hong Kong (-34% y/y export growth), Argentina (-28%), Italy (-21%) and India (-16%). Against these falls Australia's exports to Asian markets continues to improve, with positive export growth experienced between Australia and Malaysia (+31% y/y), Singapore (+28%), Vietnam (28%), China (+27%), Taiwan (23%), Korea (+10%) and Japan (+6%).

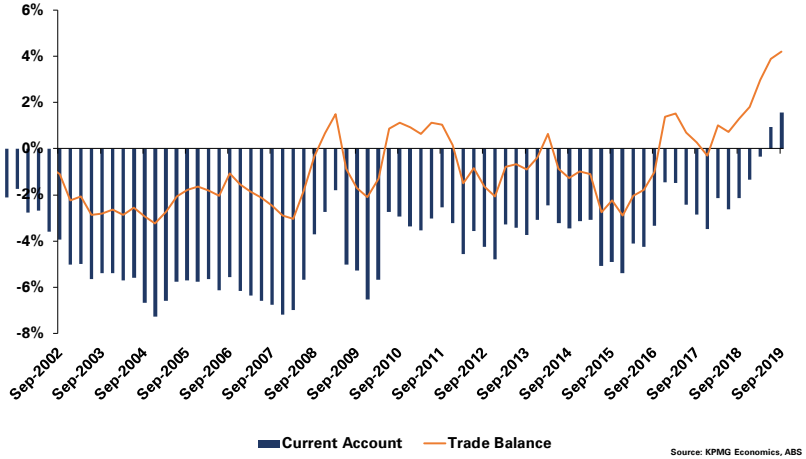
Given the positive trade results for October and November 2019 it is expected net exports will continue to positively contribute towards economic growth in 2019 Q4.

Chart 25
Rolling Annual: Exports by Type



Source: KPMG Economics, ABS

Chart 26
Current Account and Trade Balance



Source: KPMG Economics, ABS

Labour market

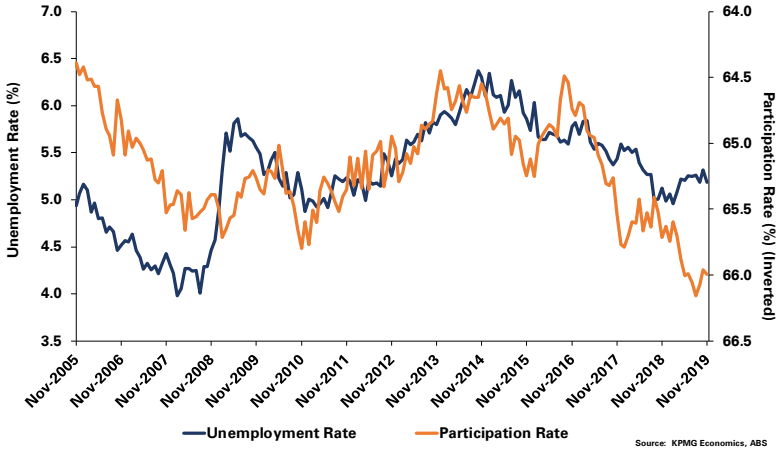
Australia's labour force is closing in on 13 million and is likely to hit this milestone in the first couple of months of 2020. The latest Labour Force data from the ABS shows Australia recorded a very healthy monthly gain in employed persons of just under 40,000 in November, which was on the back of a 25,000 fall recorded in October. The split of new employment was heavily biased towards part time employment, which is consistent with historical fluctuations in Australia's labour market where employers seek to manage the summer holiday and Christmas peak period with temporary staff.

While the increase in employment in November was substantial, annual employment growth is only running at about 2.0%, well down from 2.8% annual growth recorded earlier in the year in May. While the rate of growth is weaker it still helped reduce unemployment and underemployment rates to 5.2% and 8.3% respectively, given the participation rate remained steady at 66.0% across the two months.

The detailed ABS labour force data also shows the Private Sector has returned to be the driving force for employment growth. Of the 256,000 new jobs created over the 12 months to November 2019, the private sector was responsible for 228,000, of which 145,000 were full time and 83,000 were part time. Of the new private sector jobs the majority were created in the Health Care and Social Assistance industry (97,000), followed by Professional, Scientific and Technical services (75,000) and Education and Training (42,000). Conversely more than 10,000 jobs were lost in each of the Wholesale Trade (30,000), Transport, Postal and Warehousing (21,000), Retail Trade (19,000), Agriculture, Forestry and Fishing industry (14,000), Electricity, Gas, Water and Wastewater services (10,000) sectors during the past 12 months.

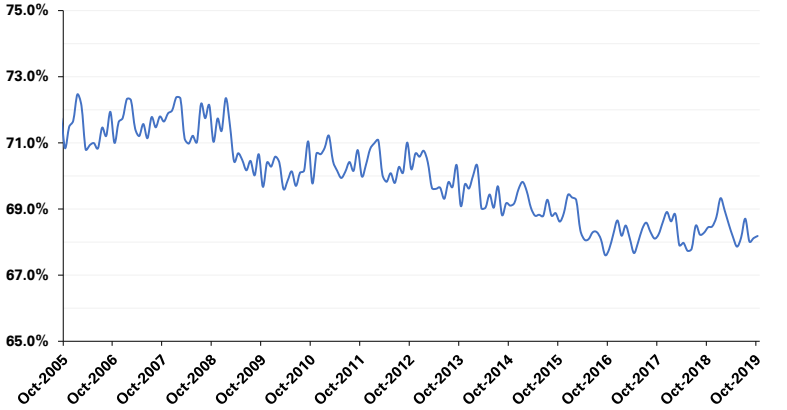
While the November labour force data showed strong results, the ANZ Australian Job Ads series fell 6.7% m/m in December (seasonally adjusted), and are tracking down nearly 20% over the year. This was the largest monthly decline since May, which itself was negatively impacted by public holidays and the Federal Election. ANZ has noted that the number of job ads fell away at a rate faster than anticipated even considering seasonality effects, suggesting the escalating bushfire crises was starting to have an impact on the employment market.

Chart 27
Unemployment and Participation Rates



Source: KPMG Economics, ABS

Chart 28
Proportion of full-time to total Employment



Source: KPMG Economics, ABS

Forecast Assumptions

Changes in key assumptions impacting KPMG's Economics forecasts since September 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

- No effect of the bushfire disaster has been factored into our forecasts
- 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)	1.6%	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	-0.5%	-1.0%	1.0%	2.0%	2.4%	2.5%	3.0%	3.1%
Housing	-9.1%	-8.9%	-8.1%	-5.0%	-2.5%	-1.0%	1.2%	4.0%
Government								
Consumption	6.3%	5.2%	4.4%	3.7%	3.6%	3.5%	2.6%	1.8%
Investment	0.5%	4.2%	5.5%	4.4%	4.2%	4.0%	3.0%	2.1%
Total domestic demand	1.2%	1.3%	1.7%	2.0%	2.3%	2.4%	2.4%	2.4%
Exports	3.5%	3.1%	2.0%	2.8%	3.0%	3.0%	3.0%	3.2%
Imports	-2.2%	-0.3%	-0.1%	1.5%	2.2%	3.0%	2.7%	2.7%
Inflation (1)	1.6%	1.7%	1.7%	1.8%	1.9%	2.0%	2.2%	2.3%
Real Personal Disposable Income	2.6%	2.8%	2.8%	2.9%	2.8%	2.6%	2.6%	2.4%
Unemployment, % (1)	5.2%	5.3%	5.3%	5.2%	5.1%	5.0%	4.9%	4.8%
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	0.3%	0.5%	0.1%	-0.4%	-0.8%	-1.2%	-1.9%	-2.0%
A/US (1)	0.701	0.699	0.675	0.680	0.687	0.698	0.700	0.702
Terms of Trade (1)	109.1	111.8	106.8	102.9	100.8	96.2	95.7	93.0
(1) = Value at end of the period								

Australian Macroeconomic Dashboard

	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	3-year average[1]	10-year average[1]	10-year std. dev.[1]
Fiscal																
Federal Government expenditure (%Y-Y)	6.8	6.5	4.4	2.2	11.1	3.6		9.3	3.3	7.5	1.8	4.1				
Indirect tax (%Y-Y)	16.4	-6.4	-0.9	-3.4	-1.1	2.4		27.7	3.3	1.2	-3.9	6.5				
Employment																
Employment growth (%Y-Y)	2.2	2.1	2.2	2.3	2.5	2.8	2.2	2.5	2.5	2.5	2.0	2.0		2.5	1.8	0.8
Unemployment rate (%)	5.0	5.1	5.0	5.1	5.2	5.2	5.3	5.2	5.3	5.2	5.3	5.2		5.4	5.5	0.4
Participation rate (%)	65.6	65.7	65.6	65.7	65.9	66.0	66.0	66.1	66.2	66.1	66.0	66.0		65.5	65.2	0.4
ANZ Job Ads (%Y-Y)	4.3	-3.8	-4.4	-6.1	-5.6	-14.9	-9.0	-9.1	-11.4	-10.4	-11.3	-12.6	-18.8			
Inflation																
Consumer Price Index (%Y-Y)	1.8	1.8	1.8	1.3	1.3	1.3	1.6	1.6	1.6	1.7	1.7	1.7		1.8	2.1	0.7
Wage Price Index (%Y-Y)	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.2	2.2	2.2		2.1	2.7	0.7
Consumer																
Motor vehicle sales (%Y-Y)	-14.9	-7.4	-9.3	-7.1	-8.1	-8.1	-9.6	-2.8	-10.1	-6.9	-9.1	-9.8	-3.8			
Retail sales (%Y-Y)	2.7	2.9	3.2	3.3	2.8	2.5	2.6	2.4	2.5	2.6	2.3	3.2		2.8	3.4	1.2
Sales volume of petroleum products (%Y-Y)	-1.1	-0.1	-1.6	-2.4	-1.4	-3.0	-3.5	-0.4	-2.6	1.9	-0.1			1.5	1.9	3.6
Consumer Confidence Index	104.4	99.6	103.8	98.8	100.7	101.3	100.7	96.5	100.0	98.2	92.8	97.0	95.1	100.2	101.1	5.9
Air passenger traffic (%Y-Y)	-2.1	-0.3	-0.9	-3.2	1.4	0.5	-0.2	0.2	0.2	2.1				1.2	2.1	2.9
Foreign short-term visitor arrivals (%Y-Y)	4.7	2.0	3.9	-0.5	0.2	7.8	2.8	2.9	4.3	2.3	1.1			5.0	5.6	3.9
Industry																
Crude steel production (%Y-Y)		-5.1	-9.4	-11.9	-5.2	-4.7	-6.2	-16.8	-1.1	5.9	10.8	6.6				
Business Confidence Index	2.9	3.6	2.0	-0.2	0.7	7.1	2.2	3.8	1.1	-0.2	2.0	0.1		6.3	4.8	4.2
Business Condition Index	2.2	6.9	5.3	7.4	3.8	2.0	4.4	3.3	1.2	2.3	4.0	4.2		11.5	5.5	7.0
PMI Manufacturing Index	54.0	53.9	52.9	52.0	50.9	51.0	52.0	51.6	50.9	50.3	50.0	49.9	49.2	53.7	53.9	2.2
PMI Services Index	52.7	51.0	48.7	49.3	50.1	51.5	52.6	52.3	49.1	52.4	50.1	49.7	49.8	53.2	53.3	2.5
PMI Composite Index	52.9	51.3	49.1	49.5	50.0	51.5	52.5	52.1	49.3	52.0	50.0	49.7	49.6	53.2	53.4	2.5
Foreign trade																
Export growth (%Y-Y)	16.4	16.4	14.7	12.0	16.5	17.0	15.4	16.3	12.0	14.6	6.0			14.5	7.5	11.3
Import growth (%Y-Y)	-0.9	6.3	4.9	1.5	5.9	2.6	-1.1	0.8	-0.5	3.3	1.6			7.0	5.0	5.4
Capital goods imports (%Y-Y)	-5.8	9.6	9.6	3.5	4.3	10.5	-5.3	-0.4	-15.2	7.6	-0.6			8.0	6.0	13.3
Banking																
Currency in circulation (%Y-Y)	3.8	4.7	4.2	4.6	3.2	4.1	3.8	3.9	4.4	4.1	4.4	4.3		4.2	5.5	2.0
M3 (%Y-Y)	2.5	2.7	3.2	3.9	4.3	4.0	3.9	2.5	1.9	2.2	2.4	2.7		4.2	6.3	2.2
Deposit growth (%Y-Y)	2.4	2.6	3.1	3.9	4.4	4.0	3.9	2.5	1.9	2.2	2.3	2.7		4.2	6.3	2.3
Housing credit (%Y-Y)	4.7	4.4	4.2	4.0	3.8	3.7	3.5	3.3	3.2	3.1	3.0	2.9		5.3	6.0	1.3
Owner-occupier housing credit (%Y-Y)	6.5	6.2	5.9	5.6	5.5	5.3	4.9	4.9	4.8	4.8	4.8	4.7		6.8	6.3	1.6
Investor housing (%Y-Y)	1.1	1.0	0.9	0.7	0.6	0.5	0.5	0.3	0.1	-0.1	-0.2	-0.3		2.3	5.4	3.0
Other personal credit (%Y-Y)	-2.1	-2.8	-2.6	-2.8	-2.8	-3.2	-3.5	-3.5	-3.8	-4.5	-4.7	-4.9		-1.9	-0.3	1.6
Business credit (%Y-Y)	4.7	5.0	5.1	4.9	4.4	4.5	4.1	3.9	3.5	3.3	2.7	2.5		3.9	2.6	3.2
Credit to deposit ratio (%)	143.7	143.1	142.8	142.0	141.8	141.8	141.8	142.6	142.6	142.5	142.1	141.8		141.2	145.9	7.8
10 year Commonwealth Govt bond yields (%)	2.4	2.3	2.1	2.0	1.9	1.7	1.4	1.3	1.0	1.0	1.0	1.2	1.2	2.3	2.7	0.8

[1] The 3-year average is calculated from January 2017 to the latest data point, the 10-year average and standard deviation from January 2010 to the latest data point. If there is not sufficient data over the stated horizon in a series and the series exhibit high volatility, these values are left blank for that series (e.g. indirect tax).

Caution should be taken when interpreting the assigned signals of a number of indicators, including Federal Government expenditure, indirect tax, import growth, and banking indicators. For example, too high or too low import growth is not necessarily desirable.

negative | watch | neutral | positive

KPMG Economics & Tax Centre

Key contacts

Dr Brendan Rynne
Partner, Chief Economist
Melbourne
Tel: 03 9288 5780
bjrynne@kpmg.com.au

Grant Wardell-Johnson
Lead Tax Partner
Sydney
Tel: 02 9335 7128
gwardelljohn@kpmg.com.au

Dr Michael Malakellis
Principal Director
Brisbane
Tel: 07 3233 9592
mmalakellis@kpmg.com.au

KPMG does not make any statement in this report as to whether any forecasts or projections included in this report will be achieved, or whether the assumptions and data underlying any prospective economic forecasts or projections are accurate, complete or reasonable. KPMG does not warrant or guarantee the achievement of any such forecasts or projections. Any economic projections or forecasts in this report rely on economic inputs that are subject to unavoidable statistical variation. They also rely on economic parameters that are subject to unavoidable statistical variation. While all care has been taken to account for statistical variation, care should be taken whenever considering or using this information. There will usually be differences between forecast or projected and actual results, because events and circumstances frequently do not occur as expected or predicted, and those differences may be material. Any estimates or projections will only take into account information available to KPMG up to the date of this report and so findings may be affected by new information. Events may have occurred since this report was prepared, which may impact on it and its findings.

The information contained herein is of a general nature and is not intended to address the specific circumstances of any particular individual or entity

kpmg.com.au

Designed by Australian Creative Services | 445536074DTL - Wrike