

9 August 2019

AUSTRALIAN ECONOMIC DEVELOPMENTS

This week the Reserve Bank of Australia (RBA) left the cash rate at a record low of 1.00%, after cuts of 25 basis points in each of June and July. The RBA's accompanying statement noted that labour demand is still relatively strong but there have been little inroads into spare capacity (i.e. unemployment) because labour market participation is even stronger (currently at a record high proportion of the adult population). Economic growth and inflation are slower than is desirable, but the RBA remains hopeful of a gradual lift in coming years. Global economic risks are rising due to ongoing trade and technology disputes between China and the United States and other factors. This is already causing greater volatility for the Australian dollar and commodity pricing.

Expectations for another cash rate cut from here have risen. The RBA noted in its latest statement that *"an extended period of low interest rate will be required in Australia to make progress in reducing unemployment and achieve more assured progress towards the inflation target"*.

Looking ahead, in its latest RBA forecasts (updated in its quarterly *Statement on Monetary Policy* released this week), the RBA revised down its forecasts for 2019 but the forecast for 2020 remains unchanged. The RBA now expects Australian GDP to grow by 2.5% p.a. in 2019 and 2.75% p.a. in 2020 (see table on page 8 below). The downward revision for 2019 growth reflects weak consumption growth and the housing activity downturn in the first half of 2019. However, the RBA says that there are some signs the economy is at a *"gentle"* turning point with the outlook supported by a number of developments including: lower interest rates, the recent tax cuts, a depreciation of the Australian dollar, a brighter outlook for investment in the resources sector, some stabilisation of the housing market and ongoing high levels of investment in infrastructure. It expects GDP growth to improve from 2020, after a run of *"disappointing numbers"* across most domestic activity data in the first half of 2019.

A more protracted period of slower activity means that prices and wages inflation is also looking likely to track lower and slower for longer. The RBA notes this is for a range of local and global reasons including: the slow growth in wages; the ongoing spare capacity in the economy; various government initiatives to address cost-of-living pressures on households; and the adjustment in the housing market, which has contributed to unusually low increases in rents and declines in the price of building a new home in some cities. Working in the other direction, the drought and the depreciation of the exchange rate have been pushing some prices up for food and imported goods.

New information about the local economy justify the RBA's concerns about slower activity in 2019. The [Ai Group Australian Performance of Services and Construction Indices](#) (Australian PSI® and Australian PCI®) both experienced sharp contractions in July. These Ai Group indices have shown weakness in the residential construction and retail industries throughout 2019, along with industries supplying goods and services to construction and retail (including metal products, machinery & equipment and transport & warehousing). This is consistent with other data that show declining residential building approvals, car sales and retail sales in the first half of 2019.

The ABS 'cost of living' indexes released this week provide useful supplementary detail to the Consumer Price Index (CPI, see our [CPI Economics Fact Sheet](#)). These indexes continue to show weak cost of living pressures for most household types. The cost of living for employee households rose in Q2 largely because of rising petrol prices. Since the start of the decade 'other government transfer households' (mainly disability pensioners and unemployment benefit recipients) have experienced the strongest increase in living costs, while employee households have experienced the slowest increases in living costs. This difference is due to differences in the typical 'basket' of goods and services purchased by 'government transfer' households, with more spent on healthcare, food and housing but less on household goods, travel and recreation.

More positively for the economy (and for the Government's desire to achieve a budget surplus), Australia's monthly trade surplus hit another record high in June at just over \$8 billion. This was driven by rising export earnings and falling import spending in the month. Iron ore prices drove up export earnings in June, while weak demand for both imported consumption and capital goods detracted from imports. Weak imports of consumption goods are consistent with other data showing weaker spending by Australian households. Declines in capital imports, particularly machinery & equipment imports, could signal a further weakening in business investment ahead.

Ai Group services and construction performance indices tumble in July

The [Ai Group Australian Performance of Services and Construction Indices](#) (Australian PSI® and Australian PCI®) both experienced sharp contractions in July. The Ai Group Australian PSI® fell by 8.3 points to 43.9 in July – the lowest result in four and a half years while the Ai Group-HIA Australian PCI® fell by 3.9 points to 39.1 in July, recording the construction industry's steepest overall rate of contraction in six years.

There has been a clear deterioration in business conditions across all industries since the middle of 2018 (except for mining which is not included in these surveys). Manufacturing remains in expansion but is at its weakest since 2016. The large services sector remains in contraction despite improvements in May and June. The construction industry is contracting at an accelerating rate as the residential building downturn continues. In combination, these three indices are indicating significantly slower conditions for non-mining businesses in 2019, compared to one year earlier (chart 1).

Across the industries in Ai Groups’ surveys, local conditions have been weakest in 2019 in:

- residential construction and its suppliers, such as metal product manufacturers; and
- retail sales and its supplier industries, such as transport & warehousing.

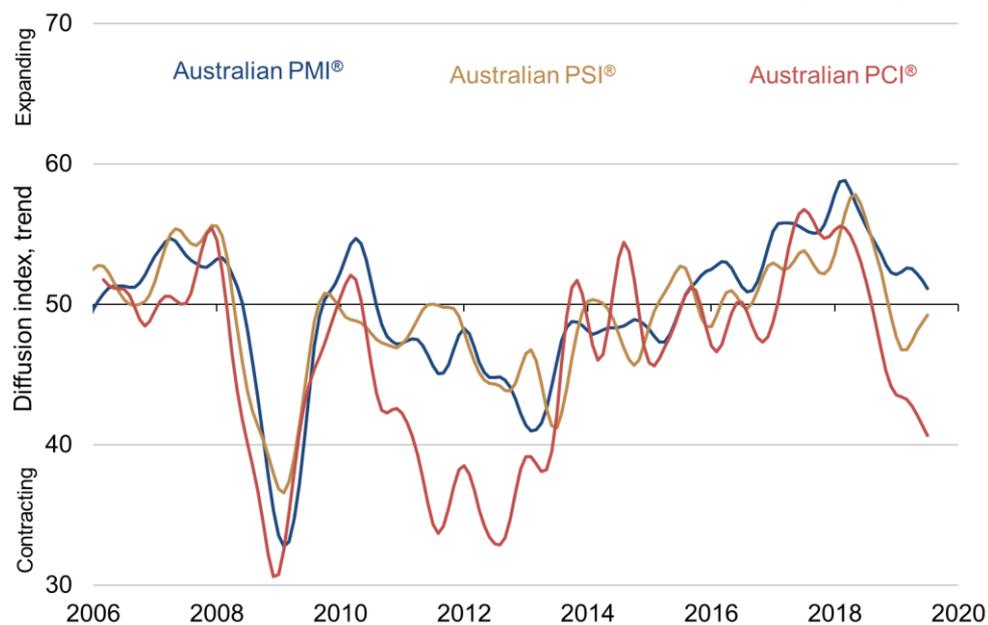
Better conditions are still evident in some industries. Bright spots in 2019 include:

- Exports of Australian consumable manufactured goods such as food, beverages, pharmaceuticals, vitamins and cosmetics;
- Local demand for healthcare, aged care and educational services;
- Local engineering construction activity, which has maintained a relatively high and stable level of activity in recent months, albeit with reports of some project delays and fewer new projects.

These results are in line with other (ABS) data confirming weak consumer spending and slowing residential construction activity in 2019 to date:

- total residential building approvals have fallen for 19 consecutive months and are now at their lowest level since May 2013 (trend)
- retail sales with real (inflation adjusted) retail sales grew by just 0.2% over the year to June 2019, which is the slowest growth since Australia’s last recession in the early 1990’s; and
- new passenger car sales were down by 2.8% p.a. to 83,184 new cars sold in July 2019, which is the lowest number since July 2011.

Chart 1: Ai Group Performance Indices (trend)



Sources: Ai Group

Living cost increases remain slow for employee households in Q2 2019

The ABS cost of living indexes provides useful supplementary detail to the Consumer Price Index (CPI, last released in July for Q2 2019). Living cost indexes (LCI) are calculated for four different types of households based on their consumption patterns: employees; age pensioners; self-funded retirees; and 'other government transfer recipient' households (including disability pensioners, unemployment and other benefit recipients).

The LCI for employee households rose by 0.5% in Q2 2019 (slightly less than the 0.6% rise in the CPI). Over the last year the LCI for employee households rose in line with CPI at 1.6% p.a. The main contributor to the rise in Q2 was automotive fuel. The rise in petrol prices was due to rising world oil prices flowing through to consumers. Health costs also contributed to inflation in Q2, driven by the annual increase in private health insurance premiums on 1 April. At the same time however, prices fell for food and beverages. An increase in the local supply of bananas, apples, citrus fruits and winter vegetables drove down the prices of fruit and vegetables.

Changes in living costs for the other types of households were driven by similar factors as for employee households. Self-funded retiree households experienced higher price rises in Q2 2019 (0.7% q/q) because they a higher proportion of their spending goes towards private health insurance. Living costs for age pensioners and recipients of other government transfers rose at a stronger rate than for employee households because a higher proportion of their spending goes towards healthcare, housing and transport (with rising prices) and less on household goods, recreational services and international travel (falling prices).

Table 1: Living cost (LCI), prices (CPI) and wages (WPI), 2019

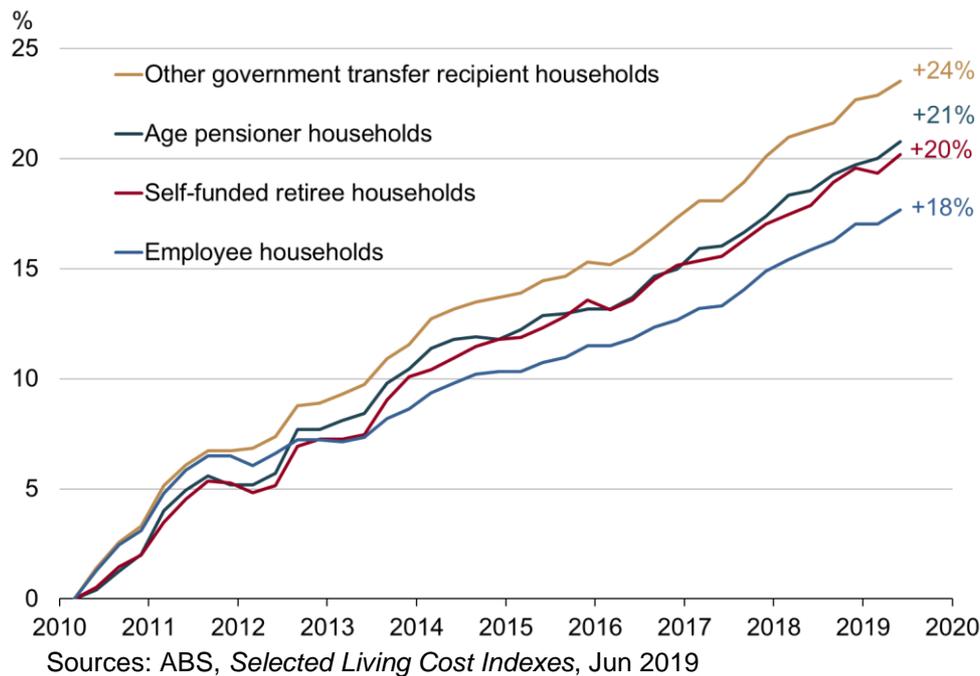
Pricing indexes	Jun-19		Mar-19	
	q/q	y/y	q/q	y/y
Living cost indexes	-	-	-	-
Employee households	0.5	1.6	0.0	1.4
Age pensioner households	0.6	1.9	0.3	1.4
Other government transfer recipient households	0.5	1.9	0.2	1.6
Self-funded retiree households	0.7	2.0	-0.2	1.6
Headline CPI	0.6	1.6	0.0	1.3
Core CPI	0.4	1.4	0.2	1.5
WPI All	NA	NA	0.5	2.3
WPI Private	NA	NA	0.4	2.3

N/A = Wages data for Q2 2019 will be released on 14 August 2019.

Sources: ABS, *Selected Living Cost Indexes*, Jun 2019; ABS, *Consumer Price Index*, Jun 2019; ABS, *Wage Price Index*, Mar 2019

Since the start of this decade, living costs for employee households have increased more slowly than for other household types. Other government transfer households (disability pensioners, unemployed people and other welfare recipients) have experienced the highest increase in living costs since the start of the decade, with a cumulative rise of 24%. This was followed by age pensioners (21%), self-funded retirees (20%) and employee households (18%).

Chart 3: Cumulative change in living cost indexes since 2010



Australia achieves largest trade surplus on record in June

External demand for Australian goods and services (mainly resources exports) remain buoyant. In June, Australia’s monthly trade surplus rose to a record \$8.0 billion, with export earnings rising by 1.4% to \$42.4 billion and import costs falling by 3.6% to \$34.3 billion. This trade surplus is \$1.8 billion larger than in May 2019, which was the previous record. The quarterly trade surplus grew to \$19.0 billion in Q2, from \$15.1 billion in Q1 2019, driven by higher prices for iron ore and other commodities. Net exports are likely to have contributed to GDP growth in Q2 2019. The ABS will release its estimates of GDP in Q2 2019 in the first week of September 2019.

Export earnings were higher in June due to resource exports (+2.3% m/m to \$25.6bn) including iron ore earnings and coal. Iron ore earnings were higher largely because of higher prices, while the increase in coal earnings was largely because of higher quantities (more shipment volumes rather than an increase in prices). Export earnings for rural goods fell by 4.3% in June because of large falls in export earnings from wool & sheep skins and cereal grains due to the drought.

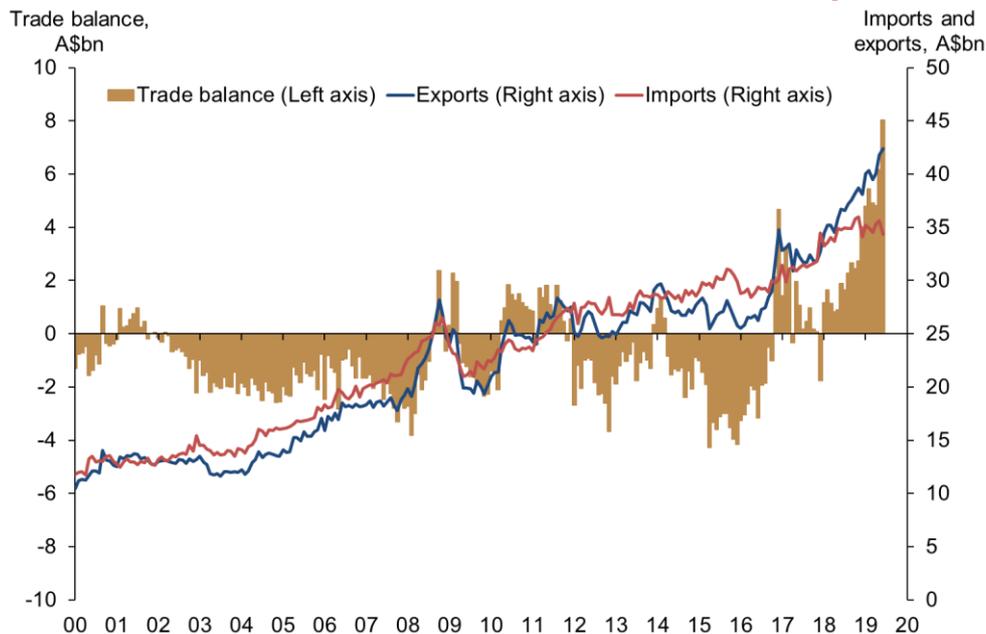
The value of imports fell by 3.6% m/m to 34.3 billion in June, with falls in imports of capital goods (mainly goods for business investment), intermediate goods and consumption goods (mainly household goods). This could be a response to the lower Australian dollar, which makes imports more expensive and thus less attractive. Up until June the Australian dollar was hovering around \$0.70 USD. It has since fallen below \$0.68 USD.

Another factor is that Australian consumers are cutting back their spending more generally, as indicated by weak local retail and car sales and the recent results in the Australian PSI®. This is reflected in a 5% m/m fall in consumption goods imports, driven by falling imports of ‘non-industrial

transport equipment’ (essentially cars and bikes) which fell \$230 million to \$1.7 billion.

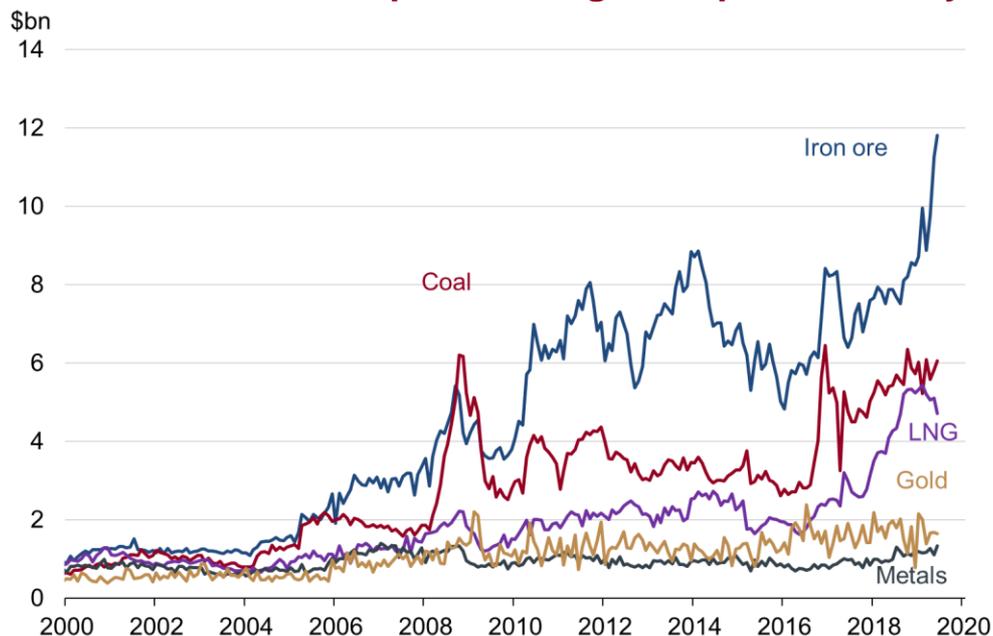
Of more concern to the longer-term outlook, capital goods imports fell by 8.7% m/m to \$6.2 billion in June and have been flat since early 2019. This suggests lower business investment in machinery & equipment in Q1 and Q2 of 2019, compared to 2018 and earlier years.

Chart 4: Australia’s trade balance, nominal \$bn per month



Source: ABS *International Trade in Goods and Services Australia*, Jun 2019.

Chart 5: Nominal resource export earnings \$bn per month, by category



Source: ABS *International Trade in Goods and Services Australia*, Jun 2019.

This week's data and events, 5 August – 9 August 2019

Day	Date	Data/event	Data period	Result
Mon	5 Aug	Ai Group Australian PSI®	Jul (M)	43.9 points
Tue	6 Aug	RBA Board Meeting	Aug (M)	Cash Rate 1.00%
		ABS International Trade in Goods and Services	Jun (M)	Exports \$42.4bn Imports \$34.3bn
Wed	7 Aug	Ai Group Australian PCI®	Jul (M)	39.1 points
		ABS Lending to Households and Businesses	Jun (M)	Lending to business -16.5% m/m, -4.4% p.a.
		ABS Selected Living Cost Indexes	Jun (Q)	Employee living cost index: 0.5% q/q, 1.6% p.a.
Fri	9 Aug	RBA Statement on Monetary Policy	Aug (Q)	-
		Appearance of RBA Governor, Philip Lowe, before the House of Representatives' Standing Committee on Economics	Aug (M)	N/A

M = monthly. Q = quarterly. H = half-yearly. A = annual. All data are seasonally adjusted unless otherwise noted.

Next week's data and events, 12 August – 16 August 2019

Day	Date	Data/event	Data period due for release	Previous release
Tue	13 Aug	NAB Business Survey	Jul (M)	Jun (M): Conditions: 3 points Confidence: 2 points
Wed	14 Aug	ABS Wage Price Index	Jun (Q)	Mar (Q): +0.5% q/q, +2.3% p.a.
Thu	15 Aug	ABS Labour Force	Jul (M)	Jun (M): emp growth 2.6% p.a., unemp. rate 5.2% (trend)
		ABS Average Weekly Earnings	May (H)	Nov (H): Average weekly ordinary time earnings \$1605.50
		ABS Overseas Arrivals and Departures	Jun (M)	May (M): Visitor arrivals 816,600; Resident returns 974,500
		RBA Speech by Guy Debelle, Deputy Governor – <i>Risks to the Outlook</i>	Aug (M)	N/A

M = monthly. Q = quarterly. H = half-yearly. A = annual. B = Biennial. All data are seasonally adjusted unless otherwise noted.

Australian economy: latest indicators

Economic activity, investment and employment			Prices, wages and interest rates		
Real GDP growth, % p.a.	Mar (Q)	1.8% ▼	Headline CPI, % p.a.	Jun (Q)	1.6% ▲
Real Business Investment % p.a.	Mar (Q)	-1.9% ▲	Core CPI, % p.a.	Jun (Q)	1.4% ▼
Employment growth, % p.a. trend	June (M)	2.6% -	WPI, % p.a.	Mar (Q)	2.3% -
Unemployment rate, % trend	June (M)	5.2% -	RBA cash rate, %	Aug (M)	1.00 -

Australian Industry Group monthly performance of industry indices

Australian PMI®	Jul (M)	51.3 ▲
Australian PSI®	Jul (M)	43.9 ▼
Australian PCI®	Jul (M)	39.1 ▼

M = monthly. Q = quarterly. All data are seasonally adjusted unless otherwise noted.

Arrows represent direction of movement relative to last observation. Sources: ABS various data, Ai Group.

Australian economy: latest full-year growth rates and government forecasts

RBA, SoMP (August 2019)	Jun 19 e/f	Dec 19 f	Jun 20 f	Jun 21 f		
GDP, % change p.a., year end	1.7	2.4	2.7	3.0		
Unemployment rate, %, year end	5.2(e)	5.2	5.2	5.1		
Inflation (CPI), % change p.a., year end	1.6(e)	1.7	1.7	2.0		
Wages (WPI), % change p.a., year end	2.3	2.3	2.3	2.4		
Treasury, Federal Budget 2019-20 (Apr 2019)	18-19 f	Dec 19 f	19-20 f	20-21 f	21-22 p	22-23 p
GDP, % change p.a., year average	2.25	N/A	2.75	2.75	3.0	3.0
Household consumption, % p.a., year average	2.25	N/A	2.75	3.0	-	-
Dwelling investment, % p.a., year average	0.5	N/A	-7.0	-4.0	-	-
Business investment, % p.a., year average	1.0	N/A	5.0	4.5	-	-
Employment growth, % p.a., year end	2.0	N/A	1.75	1.75	1.5	1.5
Unemployment rate, %, year end	5.0	N/A	5.0	5.0	5.0	5.0
Inflation (CPI), % change p.a., year end	1.5	N/A	2.25	2.5	2.5	2.5
Wages (WPI), % change p.a., year end	2.5	N/A	2.75	3.25	3.5	3.5
Terms of trade, % change p.a., year end	4.0	N/A	-5.25	-4.75	-	-

e = estimate. f = forecast. p = projection. Sources: ABS various data; RBA *Statement on Monetary Policy* (SoMP), latest quarter; Australian Treasury, *Federal Budget 2019-20* (April 2019).

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