February 2017

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| **Scope:** This monthly newsletter outlines economic and financial developments in Victoria, nationally and globally. | **By David Martine, Secretary, Department of Treasury and Finance**  |  |

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|  **Highlights*** Pace of economic growth in Victoria remains strong, albeit some indicators have moderated.
* Residential building approvals continue to grow, although at a slower rate.
* Victorian consumers continue to be optimistic.
* Victoria added almost 120,000 new jobs over 2016, encouraging labour force participation.
* The IMF has left its global growth estimates unchanged, but has raised its estimate of US growth.
* Uncertainty about the possible global consequences of US economic and trade policy decisions remain.
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|  | Domestic developments |

Recent macroeconomic indicators point to ongoing strength in the economy, albeit some indicators have moderated.

Residential investment continues to grow, although at a slower rate. The value of **residential building approvals** grew by an average of 6.7 per cent over the year to December 2016. Ongoing demand for detached housing plus alterations and additions is being partially offset by the moderation in apartment construction.

Demand for residential construction is supported by continued population growth, low interest rates and high house price inflation which encourages new investment. The CoreLogic Home Value Index for Melbourne grew by 11.8 per cent over the year to January 2017. The monthly outturn indicates some moderation in annual price growth from the previous month, but remains high.

Strong house price growth is reducing housing affordability. According to the Housing Industry Association, housing in Melbourne is more affordable than in Sydney, but less affordable than the other capital cities.

Consumer sentiment remains resilient. The **Consumer Sentiment Index** for Victoria increased by 5.7 per cent to 103.7 in January, and has been optimistic in 8 out of the past 12 months.

That said, retail spending has moderated over the calendar year. Annual growth in the value of Victorian **retail trade** averaged 3.3 per cent over the second half of 2016, down from an average of 5.0 per cent in the first half of the year.

The forward indicators for business investment are mixed. The pipeline for non‑residential building is starting to pick up. The value of non‑residential building approvals increased by an average of 17.5 per cent over the year to December 2016. However, weakness in the engineering pipeline is expected to weigh on aggregate non‑dwelling construction.

Strong economic growth in Victoria over 2015‑16 is contributing to the demand for labour. **Employment** increased by 4.0
per cent (118,500 persons) over the year to December 2016, driven primarily by increasing full‑time employment.

Solid employment growth is one of the factors encouraging Victorians back into the workforce. The **participation rate** increased to 65.9 per cent, its highest level since February 2011. The **unemployment rate** has been broadly stable, averaging 5.8 per cent over the 2016 calendar year.

There are tentative signs that strong employment growth is translating into price pressure with annual non‑tradable inflation in Melbourne increasing to 2.3
per cent in the December quarter. Annual tradable inflation in Victoria decreased to 0.2 percent over the year to the December 2016 quarter, despite a quarterly increase that was driven by higher fuel prices. Melbourne’s annual inflation rate is currently 1.5 per cent.

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| H:\temp\Economic Policy Newsletter\Stockmarket.png | Global developments |

The **US** recorded annualised GDP growth of 1.9 per cent in the December quarter, below the September quarter annualised growth of 3.5 per cent. Consumption growth slowed from previous quarters but was still robust. Residential investment returned to positive growth and business investment showed some further improvement.

The **US labour market** continues to improve, with strong employment growth of 227,000 persons in January. However, there has been a slowdown in trend employment growth as the US moves closer to full employment. The unemployment rate rose 0.1 percentage points to 4.8 per cent in January, partly due to a rise in workforce participation.

**Chinese GDP** growth came in at 6.8 per cent over the year to the December quarter, following three consecutive annual gains of 6.7 per cent. Industrial production was steady while growth in the service sector picked up. Retail sales and export volumes both grew at a similar pace as in the September quarter. Infrastructure investment growth declined in the quarter, however, manufacturing and property investment picked up. Growth in the services sector continued to outperform headline GDP growth, increasing by 8.3 per cent over the year.

In the January 2017 *World Economic Outlook Update* the **International Monetary Fund (IMF)** left global growth projections unchanged at 3.4 per cent in 2017 and 3.6 per cent in 2018 compared to forecasts in the October 2016 *World Economic Outlook.* While the IMF increased their US growth expectations (by 0.1 per cent to 2.3 per cent in 2017

and by 0.4 per cent to 2.5 per cent in 2018) they note the uncertainty about the impact of US President Trump’s economic and trade policies.

Some commentators believe that **Trump's proposals** on trade agreements and tariffs, together with policy responses by other countries, could have a negative impact on global growth. Other analysts point to the positive flow‑on effects of Trump’s domestic economic agenda (such as tax cuts and increased infrastructure spending) that will be stimulatory for the US economy, benefiting countries that export to the US.

Another source of risk to the global economy and financial markets surrounds uncertainty with regard to **the Brexit process**. A protracted period of

exit negotiations could dampen UK capital spending and economic activity. In light of the recent decision by the Supreme Court, the UK parliament has voted overwhelmingly in favour of invoking Article 50 and beginning the formal process of leaving the EU.

Recent central bank decisions relating to monetary policy have been broadly as expected by analysts. The US Federal Reserve left the target range for the federal funds rate unchanged at 0.50 to 0.75 per cent following its meeting held over 31 January to 1 February. The RBA also left the target cash rate unchanged at 1.50 per cent at its meeting held on 7 February.

*Note: all data reported in the newsletter is as at 10 February 2017.*

Movements in financial data over the past month

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|  | 30 Dec 2016 | 31 Jan 2017 | Change |
| AUD/USD | 0.72 | 0.76 | +4.6 per cent |
| ASX 200 | 5 666 | 5621 | ‑0.8 per cent |
| S&P 500 | 2 239 | 2279 | +1.79 per cent  |
| 90 day bank bill rate | 1.81 | 1.77 | ‑0.04 percentage points |
| 10 year Commonwealth bond rate | 2.76 | 2.72 | ‑0.04 percentage points |

*Note: Changes are based on the movement in unrounded figures.*

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