July 2017

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| 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*** Victoria’s population growth accelerated in 2016.
* Victorian labour market conditions remain strong and business sentiment rose in June.
* The 2016 Census reveals a falling share of home ownership in Victoria.
* Melbourne's house price growth was the highest among the mainland state capitals in July.
* Inflation was weaker than expected in the June quarter.
* US Fed Chair Janet Yellen lays ground for the Fed to unwind crisis-era stimulus.
* The AUD strengthened to a two year high against the weakening of the USD and expectations of a strengthening in commodity prices.
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|  | Domestic developments |

Economic indicators released in the past month point to continued strength in the labour market and business sentiment.

Victoria’s **population growth** was revised upward based on the 2016 Census. Even off this higher base, Victoria’s population increased by a multi‑decade high of 2.4 per cent in the year to December 2016, faster than any other state.

Victorian **labour market conditions** remain strong. Employment in Victoria grew for the fifth consecutive month in June. Over the year, Victorian employment rose by 3.2 per cent (97 800 persons), the highest annual increase among the states. The unemployment rate is slightly higher because the labour force participation rate also increased over the year to 66.0 per cent.

The June monthly **NAB business survey** pointed to strength in both business conditions and confidence. **NAB business conditions** rose 5 points to +17 index points and **business confidence** remains positive, up 2 points to +6 index points over the month.

The **2016 Census** data reveals a falling share of home ownership in Victoria. The proportion of Victorians owning a home fell 2.5 percentage points to 67.6 per cent in the five years to 2016. The number of unoccupied private dwellings increased by 12.9 per cent to 278 629 over the same time period. In 2016, there were 2 520 912 estimated private dwellings in Victoria.

Residential property prices continue to rise. The **CoreLogic RP Data Home Value Index** for Melbourne increased by 13.7 per cent over the year to June. Melbourne's annual price growth for residential property was the highest of all state capitals.

**Melbourne’s consumer price index** rose by 0.1 per cent in the June quarter, and by 2.2 per cent over the year. This result was weaker thanexpected, partly due to the muted impact on fresh produce prices associated with Cyclone Debbie.

Despite strong growth in household consumption in the latest national accounts, Victorian **consumer sentiment** decreased by 0.4 per cent to 97.3, however the index remains higher than the national average of 96.6 in July. Views on the economic conditions over the next 12 months improved slightly, up 1.1 per cent to 92.5 in July.

Victoria’s **Performance of Manufacturing Index** has signalled expansion in manufacturing for the past five months – albeit the June survey showed a modest weakening by 2.1 points to 54.2 in June.

The RBA left the **cash rate** unchanged at 1.50 per cent. It noted that the unchanged policy stance is consistent with sustainable growth in a low inflation environment. The RBA noted its estimate of the neutral real interest rate as approximately 1 per cent. This equates to a neutral nominal cash rate of around 3.5 per cent for monetary policy to be neither expansionary or contractionary.

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

Economic activity indicators in the US continue to improve. GDP growth has accelerated in the June quarter, primarily driven by stronger consumption growth. The composite **Purchasing Managers Index (PMI)** rose 0.3 points to 54.2 in July, the highest reading since January.

The US labour market remains solid. **Non‑farm payrolls** increased by 222 000 in June. The unemployment rate and the participation rate both increased slightly in June. The broadest measure of underutilisation in the labour market increased 0.2 percentage points to 8.6 per cent.

**The US Federal Reserve** policy rate was kept on hold this month given soft inflation readings (1.4 per cent in May) and the recent uptick in spare capacity in the US labour market. The unwinding of the balance sheet is expected to occur ‘relatively soon’.

Federal Open Market Committee (FOMC) Chair Janet Yellen **testified before US Congress in July.** The US policy rate is close to its neutral level and would not require a significant series of rate hikes to remove excess accommodation. Gradual rate hikes over the next few years are likely, but the Fed will need to monitor CPI closely. It is anticipated that the FOMC will start reducing the balance sheet from September.

**China** recorded stronger economic growth than expected in the June quarter. Retail sales and industrial output also pointed to a robust economy. Inflation was 1.5 per cent higher over the year to June and was in line with expectations. Manufacturing also accelerated in June with the manufacturing PMI exceeding expectations at 51.7 index points.

**The AUD strengthened** to a two-year high of 79 cents in July**.** Thiswas partly due to strong economic data in China and expectations of a strengthening in commodity prices, as well as a weaker USD that reflected softer CPI data and expectations of a more gradual normalisation in US monetary policy.

The **ECB policy statement** was unchanged as headline and core inflation remain weak. The outlook for growth improved on the back of stronger labour market conditions and higher business and consumer confidence.

**The Bank of Japan** kept its policy stance unchanged despite lowering its inflation forecast. Inflation is now expected to reach its 2 per cent official target by March 2020. This delay reflects ongoing weakness in Japan’s inflation pressures.

The **International Monetary Fund (IMF)** slightly lowered its forecasts for US and UK economic growth this year. This followed weaker than expected UK economic growth in the first half of this year. Downgrades for the US are the result of growing uncertainty on the timing and nature of anticipated fiscal policy stimulus. The IMF continues to forecast that the global economy will grow by 3.5 per cent in 2017 and 3.6 per cent in 2018.

*Note: All data reported in the newsletter is as at 26 July 2017.*

Movements\* in financial data over the past month\*\*

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|  | 30-Jun-17 | 31-May-17 | Change |
| AUD/USD | 0.7691 | 0.7450 | +3.2 per cent |
| ASX 200 | 5,721 | 5,725 | -0.1 per cent |
| S&P 500 | 2,423 | 2,412 | +0.5 per cent  |
| 90 day bank bill rate | 1.72 | 1.73 | -0.01 percentage points |
| 10 year Commonwealth bond rate | 2.41 | 2.54 | -0.13 percentage points |

*Notes: \*Changes are based on the movement in unrounded figures. \*\*Month-end dates are the last trading day of the month.*

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