March 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*** Victoria’s **economy** rebounded strongly in the December quarter 2016, following a weather related contraction in the September quarter
* Australian **GDP** grew by 2.4 per cent in the 2016 calendar year, higher than market expectations
* Indicators of Victoria’s **manufacturing** activity improved in February
* Victorian **employment** rose by 10 600 persons in February
* The **US Fed** increased interest rates in March due to strong economic and employment data
* Global political **uncertainty** remains elevated, including around US trade policy and Brexit
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|  | Domestic developments |

Macroeconomic indicators released during the past four weeks point to ongoing strength in the Victorian economy.

Over the 2016 calendar year, Victorian **state final demand** grew by 3.4 per cent, higher than growth in national final demand. Victorian state final demand grew by 1.7 per cent in the December quarter 2016, the strongest growth rate of all the states. All components of state final demand increased in the quarter, with broad based growth in consumption, business investment and public demand.

Australian **GDP** grew by 2.4 per cent over the 2016 calendar year and 1.2 per cent in the quarter, above market expectations.

Victoria’s **trade** performance detracted from economic growth during the quarter. Export volumes fell slightly, driven by goods exports, while service exports increased modestly. This was offset by a moderate increase in the volume of Victorian imports.

Victoria's **Performance of Manufacturing Index** increased to 59.6 points in February, its highest level in nine years. A reading above 50 points indicates that manufacturing activity is expanding.

Survey measures of Victorian **business conditions** have been above average for some time and Victorian **business confidence** has increased sharply over the past few months.

Victorian **employment** rose by 0.3 per cent in February, due to gains in both full time and part-time employment. Over the year, Victorian employment rose by 97 300 persons (+3.2 per cent), the highest annual growth among the states. Victoria's unemployment rate increased to 6.1 per cent in February, partly due to a 0.3 percentage points increase in the participation rate.

Victorian **wages** grew by 0.4 per cent in the December quarter to be only 1.9 per cent higher than one year ago. Spare capacity in the labour market is one of the key factors weighing on wages growth.

The value of Victoria’s **retail sales** grew by 1.1 per cent in January 2017, the highest growth rate of all the states. Over the year, Victoria's retail sales increased by 3.8 per cent. The Victorian **Consumer Sentiment Index** fell by 2.9 per cent to 100.7 in February, but remains in optimistic territory.

Strong house price growth and ongoing demand for housing are stimulatingresidential construction. The **CoreLogic RP Data Home Value Index** for Melbourne increased by 1.5 per cent in February 2017 and by 13.1 per cent over the year.

The value of Victorian **residential building approvals** rose by 2.7 per cent in January, to be 25.8 per cent higher than one year ago, the highest annual growth of the mainland states.

The RBA held the **cash rate** unchanged at 1.5 per cent at its meeting in March. Historically low interest rates and strong population growth are expected to continue to support the Victorian economy.

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

Economic conditions in the global economy have improved in the month, mostly due to continued strength in the US economy. Growth in the Eurozone and Japan remains lacklustre. Economic and political uncertainty is elevated, including around the effects of US president Trump’s trade policies and Brexit.

The **US** **labour market** continues to improve and is now close to full employment. Total nonfarm payrolls increased by 235,000 in February and the unemployment rate was little changed at 4.7 percent.

The US Fed increased official **interest rates** by 25 basis points at its meeting in March to an upper bound of 1.0 per cent. The hike was due to ongoing strength in the economy and labour market. This was only the third interest rate hike in about a decade. The market is expecting two more rate hikes this year.

Higher US interest rates may contribute to higher global wholesale funding rates, which could put upward pressure on borrowing costs in Australia.

The European Central Bank held the benchmark refinancing rate at 0 per cent and left the pace of bond purchases unchanged at its meeting in March. Ongoing low interest rates are expected to support a gradual recovery in the **Eurozone**.

The economic data was generally positive in China during the month. January trade statistics were very strong although seasonal distortions due to the timing of the Lunar New Year may have been a factor.

Chinese manufacturing expanded as the official PMI rose to 51.6 in February, the seventh straight month of growth and the highest reading since November 2016. The increase was driven by faster rises in output, new orders and new export orders.

Economic growth in China is being supported by expansionary fiscal policy and credit growth which has been used to finance construction activity and infrastructure.

However, higher credit growth has contributed to a rise in China’s debt‑to‑GDP ratio which poses a medium term risk to the outlook.

Other emerging Asian countries have also reported improvements in trade and manufacturing activity, pointing to a potential pick up in the region.

*Note: all data reported in the newsletter is as at 17 March 2017.*

Movements in financial data over the past month

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|  | 31 Jan 2017 | 28 Feb 2017 | Change |
| AUD/USD | 0.757 | 0.769 | +1.6 per cent |
| ASX 200 | 5 621 | 5712 | +1.6 per cent |
| S&P 500 | 2 279 | 2364 | +3.7 per cent  |
| 90 day bank bill rate | 1.78 | 1.78 | No change |
| 10 year Commonwealth bond rate | 2.73 | 2.75 | +0.02 percentage points |

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

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