**May 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*** The Victorian **labour market** continues to perform well. Employment increased in ten of the past twelve months and the participation rate is the equal highest on record.
* Annual growth in national wages was below the rate of inflation in March. The national CPI increased by 2.1 per cent over the year but annual **wage growth** was 1.9 per cent.
* The IMF upgraded their forecasts for 2017 **world GDP** from 3.4 per cent to 3.5 per cent. The upgrade was driven by expectations of stimulus fiscal policy in the US and China, and a cyclical recovery in global trade.
* The **US** announced a plan to cut the corporate tax rate to 15 per cent from 39.6 per cent.
* Moody's downgraded China’s credit rating from Aa3 to A1 (AA- to A+).
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|  | Domestic developments |

Macroeconomic indicators released during the past month show solid Victorian economic conditions.

The Melbourne **consumer price index** (CPI) rose strongly in the March quarter 2017 but the increase was driven by factors which are likely to be temporary such as fuel and electricity price rises. Melbourne’s CPI rose by 0.9 per cent, higher than the national increase of 0.5 per cent. The national CPI recorded an annual increase of 2.1 per cent, moving inflation into the RBA’s target band for the first time since 2014 but subdued wages growth is expected to contain inflation in the near term.

The annual growth rate in the national **wage price index**, which has been weakening over the past three years, posted its lowest annual increase on record at 1.9 per cent in the March quarter 2017, below the inflation rate. Victoria, with a stronger labour market, recorded its first annual increase in wages growth since 2014 to 2.0 per cent over the year to the March quarter 2017.

**Employment** in Victoria grew for the third consecutive month in April, increasing by 18 600 persons. The labour force participation rate is at the equal highest on record with January 2011. The **unemployment rate** remained steady at 6.1 per cent.

Conditions for business investment in Victoria remain strong. Victorian **business conditions** from the NAB survey are positive at +8 index points in April and **business confidence** rose by 6 points to +12 index points.

Property prices continue to rise with the **CoreLogic RP Data Home Value Index** for Melbourne increasing by 0.5 per cent in April 2017 and by 15.3 per cent over the year. Melbourne’s unit prices fell in April by 0.9 per cent.

While the March value of **residential building approvals** was weak, overall growth remains robust. The value of Victorian residential building for the 12 months to March 2017 grew by 8.9 per cent compared with the preceding 12 months.

**Retail sales** growth has been weak across most of the nation. Victoria's volume of retail sales grew by 1.7 per cent over the year to the March quarter 2017 compared with 4.6 per cent one year prior. The annual growth rate nationally fell from 7.2 per cent to 1.2 per cent.

The **cash rate** was unchanged at 1.50 per cent in May 2017 with the Board of the Reserve Bank of Australia noting that the improvement in global conditions has contributed to higher commodity prices, improving Australia’s terms of trade.

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

The IMF upgraded its forecast for 2017 **world GDP** from 3.4 per cent to 3.5 per cent. The upgrade was driven by expectations of stimulatory fiscal policy in the US and China, and a cyclical recovery in global trade. A broad-based pick-up in the global economy since last year has also improved the outlook for Europe and Japan.

The **US Government** announced a plan to cut the corporate tax rate to 15 per cent from 39.6 per cent. However, the plan is light on details, making it difficult to ascertain the magnitude of the impacts.

Some weakness in US stocks in May 2017 has resulted from allegations against the **US President** for obstruction of justice and calls for his impeachment. The overall impact has been described as “muted”.

The US labour market remains vibrant. **Non-farm payrolls** increased by 211 000 in April 2017 and the unemployment rate declined to 4.4 per cent, its lowest level since May 2007.

Other US economic indicators were more subdued. The annual growth in **US GDP** for the March quarter 2017 of 0.7 per cent was substantially lower than the previous quarter’s growth of 2.1 per cent. This reflected a deceleration in consumer spending, downturns in inventory investment and in state and local government spending.

**China** unveiled its “**One Belt, One Road**” initiative encompassing infrastructure spending of $1.3 trillion spanning more than 60 countries. Although Australia is not geographically located on the “Belt and Road”, the initiative potentially creates opportunities for Australian industries such as engineering, architecture and finance.

**China’s GDP** increased by 6.9 per cent over the year to the March quarter 2017, after recording a 6.8 per cent annual increase to the December quarter. **Industrial production** growth returned to a more normal level at 6.5 per cent over the year to April 2017 after jumping to 7.6 per cent in March.

More recently published indicators of China’s economic activity were less positive, pointing to a moderation in the growth outlook. China’s **purchasing managers’ index** of factory activity fell to a six month low of 51.2 in April, from a multi-year high of 51.8 in March. China’s **CPI** grew 1.2 per cent over the year to April 2017, its third consecutive month of annual growth below 2.0 per cent.

The **French election** concluded on 7 May 2017 with Emmanuel Macron voted in as President. Macron is described as a centrist and has a reform agenda for France’s welfare and pension system.

In **Japan**, household spending continues its decline, falling by 1.3 per cent despite negative interest rates aimed at stimulating the economy. This is the thirteenth consecutive monthly fall in household spending.

*Note: all data reported in the newsletter is as at 18 May 2017.*

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

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|  | 28-Apr-17 | 31-Mar-17 | Change |
| AUD/USD | 0.7475 | 0.7644 | -2.2 per cent |
| ASX 200 | 5,924 | 5,865 | +1.0 per cent |
| S&P 500 | 2,384 | 2,363 | +0.9 per cent  |
| 90 day bank bill rate | 1.74 | 1.79 | -0.05 percentage points |
| 10 year Commonwealth bond rate | 2.58 | 2.70 | -0.12 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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