DECEMBER 2016

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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*** Victorian **state final demand** rose 2.5 per cent over the year, despite contracting in the September quarter.
* Victorian **employment growth** was flat in November, but full-time employment rose strongly.
* Victoria continues to record the fastest **annual population growth** across all jurisdictions, driven by net overseas migration.
* The **US Federal Reserve** raised interest rates for only the second time since the GFC.
* The Italian referendum resulted in a ‘no’ vote, as voters rejected proposed changes to the composition and powers of Parliament.
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|  | Domestic developments |

The September quarter **national accounts** indicate that Victorian state final demand rose 2.5 per cent over the year. Victoria, WA and Tasmania contracted in the quarter.

In Victoria, increases in household consumption (0.3 per cent) and underlying public investment (5.4 per cent) were offset by dwelling investment (-5.7 per cent), and underlying business investment (-1.0 per cent) in the September quarter.

Victorian **employment** was essentially flat in November, despite a strong rise in full-time employment (up 16,900 persons or +0.8 per cent). Aggregate hours worked rose by 1.2 per cent. The annual pace of total and full-time job creation in Victoria continues to lead the nation.

The **unemployment rate** rose 0.3 percentage points to 6.0 per cent in November, its highest level since February 2016. This was associated with a further increase in the labour force participation rate.

The Victorian **Budget Update 2016-17** was tabled on
13 December, showing a budget surplus of $1.7 billion in 2016-17. Net debt as a percentage of GSP is projected to fall to 4.5 per cent in the same year.

Economic growth is expected to remain above trend at
3 per cent in 2016-17. Employment growth was revised up to 2.75 per cent in the same year.

The 2016-17 Commonwealth **Mid-Year Economic and Fiscal Outlook** (MYEFO)downgraded key economic forecasts for 2016-17 and 2017-18, including growth in GDP, employment and wages. Volatile commodity prices remain a key risk to the economic and revenue forecasts. As the recent strengthening in prices is not expected to be sustained, the Commonwealth has assumed a fall in the coal and iron ore price from recent highs. While MYEFO still assumes a return to surplus in 2020-21, the budget deficit is expected be on aggregate $10.3 billion worse than at Budget time. Rating agency Standard and Poor’s revised the Commonwealth from stable to negative watch in July, and left the rating unchanged following the MYEFO release.

Victoria’s annual **population** growth rate accelerated to 2.1 per cent over the year to June 2016. This remains the highest rate of growth across all jurisdictions, largely driven by net overseas migration. On an annual basis, Victoria’s share of
net overseas migration reached a new record, increasing to 35.7 per cent of the national total.

Following a high result in September, the value of Victoria’s **building approvals** fell sharply in October (-36.0 per cent). This was driven by falls in both residential and non-residential approvals. Monthly results can be volatile, with Queensland the only state to record growth for the month.

According to REIA’s latest report, **housing affordability** in Victoria improved slightly in the September quarter. However its Home Loan Affordability Indicator suggests Victoria remains the second-least affordable jurisdiction in the country, after New South Wales.

The value of Victoria’s **retail sales** grew by 0.5 per cent in October, third highest among the states. Victoria's annual retail sales growth rate remains slightly below the national average of 3.5 per cent.

Victorian consumer sentiment moved into pessimistic territory in December, falling 3.5 per cent but remains above the national average. Westpac noted that the likely reasons behind this fall in confidence were related to renewed concerns around the economy, interest rates, and the labour market.

The latest NAB monthly business survey results show that Victorian business conditions fell by 1 point in November but are equal second highest of the states. Business confidence remained steady at +2 index points.

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| H:\temp\Economic Policy Newsletter\Stockmarket.png | Financial markets |

Financial markets have been bullish since the **US** election on 8 November. Stock markets have rallied, bond yields have risen and the US dollar has appreciated against the major currencies. Most of this was driven by market participants expecting fiscal policy to be more expansionary and possibly inflationary, under a Trump presidency.

The **US Federal Reserve** lifted interest rates in December, for only the second time since the GFC. Market participants had already priced in a near certain increase, following the release of positive economic data. The Federal Reserve's "dot plot", a chart used to signal its outlook for the path of interest rates, indicate
3 more rate rises in 2017.

Global markets were largely unmoved, after voters sided with no change in the **Italian referendum**. Voters rejected proposed reforms to the constitution which were intended to make the legislative process more streamlined.

This shifted focus away from the country’s increasingly fragile banking system, which poses a more immediate risk to stability in Europe.

The **European Central Bank** (ECB) surprised financial markets when it announced the decision to scale back its monthly asset purchases, a tool it has used to stimulate demand.

However, the ECB stated it stands ready to support the euro zone economy, which is forecast to grow by a modest 1.7 per cent this year and in 2017.

The pace of economic growth in the **UK** has been revised down from 2.2 per cent to 1.4 per cent in 2017.

The Autumn Statement 2016, UK’s first major economic statement since Brexit, forecast the budget deficit to rise by
 £122 billion in the next 5 years, with government net debt peaking at 90 per cent of GDP in 2017-18.

At its December meeting, the RBA left the cash rate unchanged at 1.5 per cent.

November trade data for **China** suggests a modest recovery in domestic and global demand. China’s trade surplus narrowed from US $49 billion to US $45 billion in the month, led by a 6.7 per cent increase in imports. The outlook however remains uncertain because of a potentially more protectionist US trade policy stance.

Movements in financial data over the past month

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|  | 21 Nov 2016 | 20 Dec 2016 | Change |
| AUD/USD | 0.73 | 0.73 | 0.0 per cent |
| ASX 200 | 5 351  | 5 591 | +4.5 per cent |
| S&P 500 | 2 198  | 2 271 | +3.3 per cent  |
| 90 day bank bill rate | 1.75 | 1.78 | +0.03 percentage points |
| 10 year Commonwealth bond rate | 2.63 | 2.85 | +0.22 percentage points |

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

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