Economic overview

Matthew Howden and Kirk Zammit

- Prospects for economic growth in some of Australia's key agricultural export markets have been lowered but remain firm overall.
- The Australian dollar is assumed to be US70 cents in 2019–20.

Global economic outlook

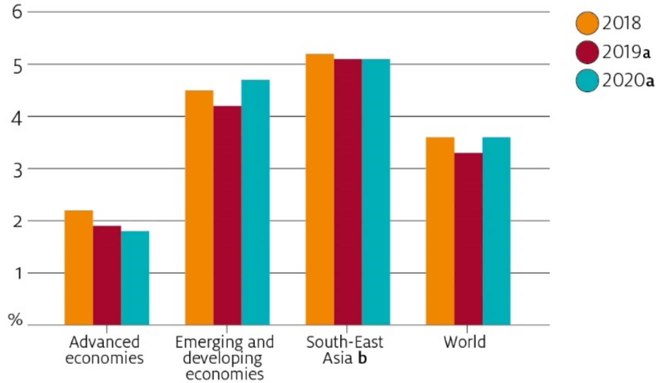
Global economic growth is assumed to be 3.3% in 2019 and 3.6% in 2020. Economic growth in 2019 has been revised down by 0.2 percentage points since [Agricultural commodities: March quarter 2019](). The downward revision reflects lower growth expectations across both advanced economies and emerging and developing economies.

The slowdown in global economic growth began in the second half of 2018, partly in response to economic policy uncertainty and trade disputes. Prolonged trade negotiations between China and the United States and between the European Union and the United Kingdom continue to affect business and consumer confidence and the real economy. Increasing trade tensions between China and the United States could slow global economic growth further.

Localised factors, such as budget problems in Italy, industrial weakness in Germany and civil unrest in a number of countries, are also expected to reduce growth in 2019. Economic crises in South America and conflicts in the Middle East and North Africa have resulted in significant revisions to growth assumptions for these regions.

There are some upside risks to the global growth outlook. Major advanced economies have tempered interest rate rises in response to weakening economic conditions. This has eased the tightening in financial conditions over 2018 and could lead to an increase in investment and consumption. Also, indicators of economic activity in China suggest that growth is stabilising as new fiscal measures begin to stimulate demand in the industrial and services sectors.

Regional economic growth, 2018 to 2020



a ABARES assumption. **b** Indonesia, Malaysia, the Philippines, Thailand and Vietnam.
Sources: ABARES; International Monetary Fund

Economic developments in agricultural export markets

The downward revision to global economic growth in 2019 reflects a reassessment of growth and the balance of risks in several of Australia's major export markets.

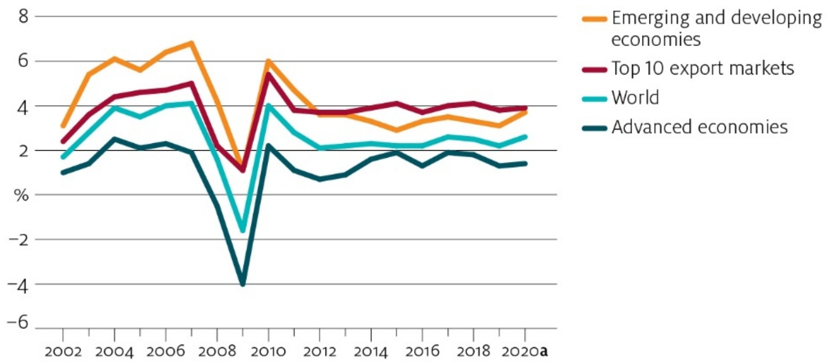
China is Australia's largest export market. In 2017–18, 25% of total agricultural exports (valued at $13 billion) were exported to China. Downside risks to income growth in China appear to have increased, following an escalation in trade tensions in May 2019. Lower growth could result in lower demand for Australian agricultural exports (see Agricultural overview). However, various fiscal measures implemented by Chinese authorities are providing support to the economy. In March 2019 the National People's Congress set a new economic growth target of between 6% and 6.5% for 2019.

Economic growth in South-East Asia was adjusted downwards by 0.2 percentage points in 2019 to reflect weaker exports, particularly to China. In 2017–18 Australian agricultural exports to this rapidly expanding region were valued at $7 billion. Economic growth in this region is vulnerable to a weakening in exports stemming from the US–China trade war and trade policy uncertainty. An increase in risk aversion in global financial markets could lead to rising capital outflow and declining exchange rates. This would reduce demand for imports such as agricultural goods. However, strong domestic economic growth and a postponement of monetary policy tightening in the United States should support growth in the region.

Economic growth in the eurozone has been revised down by 0.3 percentage points (to 1.3%) in 2019 and 0.2 percentage points (to 1.5%) in 2020. This follows weak growth in the March quarter 2019, when eurozone GDP growth slowed to 1.2% year-on-year. A combination of deteriorating business and consumer confidence, disruptions in the car manufacturing sector in Germany and civil unrest in some countries including France are weighing on economic growth. Uncertainty about the United Kingdom's departure from the European Union will continue to affect business confidence and deter investment, following an agreement in April to further postpone the departure until 31 October 2019.

Income growth, measured by GDP per person, is a driver of import demand. Income growth has been revised down for 2019 in both advanced economies and emerging and developing economies. However, income growth assumptions for Australia's main trading partners, such as those in South-East Asia, remain favourable and growth is expected to continue at a faster rate than in other regions.

Income growth in Australia's top 10 export markets and selected economies, 2002 to 2020



a ABARES assumption.
Source: ABARES; International Monetary Fund

Australian economy

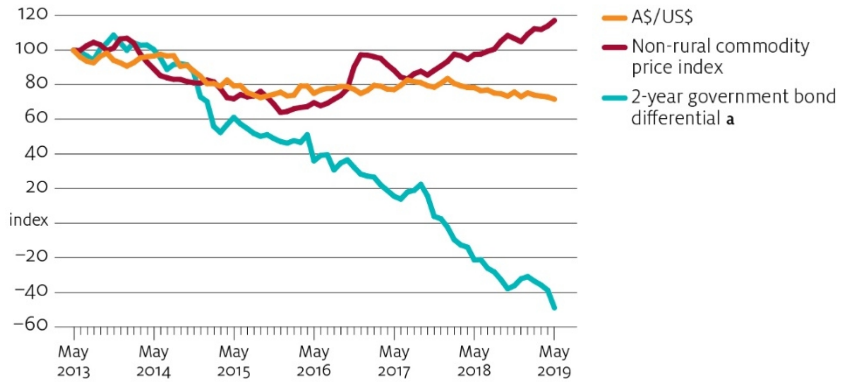
The Australian economy is assumed to grow by 2.3% in 2018–19 and 2.8% in 2019–20. This has been revised down since [Agricultural commodities: March quarter 2019](). Growth in 2018–19 has been constrained by slower than expected household consumption growth, and seasonal factors such as drought and flooding in eastern states disrupting both agricultural and mineral exports. Despite subdued economic growth, labour market activity has been stronger. Continued growth in employment and a gradual rise in wages will help to support a gradual increase in household incomes. Assumed strong population growth is expected to continue to drive domestic food consumption and demand for Australian agricultural products. About 30% of agricultural goods are consumed domestically.

The softer expectations for economic growth and weak growth in inflation have contributed to a downward revision to inflation assumptions. In 2018–19 inflation is assumed to be 1.7% and accelerate to 2% in 2019–20. Since March 2015 headline inflation has remained below the Reserve Bank of Australia's target band of between 2% and 3%.

Persistent low inflation has raised market expectations of a further reduction in the official interest rate to a record low. But similarly lowered expectations for monetary policy tightening in other major advanced economies has dampened the effect that this has had on the Australian dollar. The Australian dollar is estimated to have averaged US72 cents in 2018–19 and is assumed to depreciate to average US70 cents in 2019–20.

Ongoing high prices for Australian exports have maintained upward pressure on the Australian dollar. The RBA non-rural commodity price index for bulk commodities (iron ore, metallurgical and thermal coal) has continued to increase strongly, and was 20% higher year-on-year in May 2019. However, prices are assumed to fall during 2019–20, lowering Australia's terms of trade, and weakening the Australian dollar. Furthermore, ongoing concerns over global economic growth in financial markets and potential flare-ups in trade disputes are likely to continue to have a strong downward influence on the Australian dollar.

Australian dollar, selected exchange rate determinants, May 2013 to May 2019



Note: All indicators are expressed as indexes.
a Difference between the 2-year US Treasury and Australian Government Securities yields.
Source: ABARES; Reserve Bank of Australia; US Federal Reserve

Australian Government
Department of Agriculture
ABARES

Key macroeconomic assumptions

	unit	2017	2018	2019 a	2020 a
Economic growth					
World b	%	3.8	3.6	3.3	3.6
Advanced economies	%	2.4	2.2	1.9	1.8
United States	%	2.2	2.9	2.5	2.0
Japan	%	1.9	0.8	1.0	0.8
Eurozone	%	2.4	1.8	1.3	1.5
Germany	%	2.5	1.5	0.8	1.4
France	%	2.2	1.5	1.3	1.4
Italy	%	1.6	0.9	0.1	0.9
United Kingdom	%	1.8	1.4	1.2	1.4
Korea, Rep. of	%	3.1	2.7	2.6	2.8
New Zealand	%	2.6	3.0	2.5	2.9
Singapore	%	3.9	3.2	2.3	2.4
Taiwan	%	3.1	2.6	2.5	2.5
Emerging and developing economies	%	4.8	4.5	4.2	4.7
Emerging Asia	%	6.6	6.3	6.1	6.2
South-East Asia c	%	5.4	5.2	5.1	5.1
China d	%	6.8	6.6	6.2	6.2
India	%	6.9	7.3	7.3	7.5
Latin America	%	1.2	1.0	1.4	2.4
Middle East and North Africa	%	1.8	1.4	1.3	3.2
Eastern Europe	%	6.0	3.6	0.8	2.8
Russian Federation	%	1.5	2.3	1.6	1.7
Ukraine	%	2.5	3.3	2.7	3.0
GDP per person e					
Advanced economies	%	1.9	1.9	1.7	1.3
Emerging and developing economies	%	3.4	3.5	3.5	3.7
Emerging Asia	%	5.5	5.5	5.5	5.4
South-East Asia c	%	4.2	4.2	4.1	4.1
Inflation					
United States	%	2.1	2.5	2.2	2.3
Interest rates					
US prime rate g	%	4.1	4.9	5.2	5.2
Australia	**unit**	**2016–17**	**2017–18**	**2018–19 a**	**2019–20 a**
Economic growth	%	2.3	2.9	2.3	2.8
Inflation	%	1.7	1.9	1.7	2.0
Interest rates h	% pa	3.7	3.7	3.8	3.6
Australian exchange rates					
A$/US$	US$	0.75	0.78	0.72	0.70
TWI for A$ i	index	64.8	64.5	61.5	60.0

a ABARES assumption. **b** Weighted using 2018 purchasing-power-parity valuation of country gross domestic product by the International Monetary Fund. **c** Indonesia, Malaysia, the Philippines, Thailand and Vietnam. **d** Excludes Hong Kong. **e** Expressed in purchasing power parity**. g** Commercial bank prime lending rates in the United States. **h** Large business weighted-average variable rate on credit outstanding. **i** Base: May 1970 = 100.

Sources: ABARES; Australian Bureau of Statistics; Indian Ministry of Statistics and Programme Implementation; International Monetary Fund; Reserve Bank of Australia; US Bureau of Labor Statistics; US Federal Reserve