Economic overview

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- Strong income and population growth in emerging Asia are expected to support demand for Australian agricultural exports to 2023–24.
- Risks to growth in the short term are weighted to the downside and pose a significant threat to Australia's largest agricultural export markets.
- The Australian dollar is assumed to gradually strengthen against the US dollar over the medium term in the absence of negative shocks to global growth.

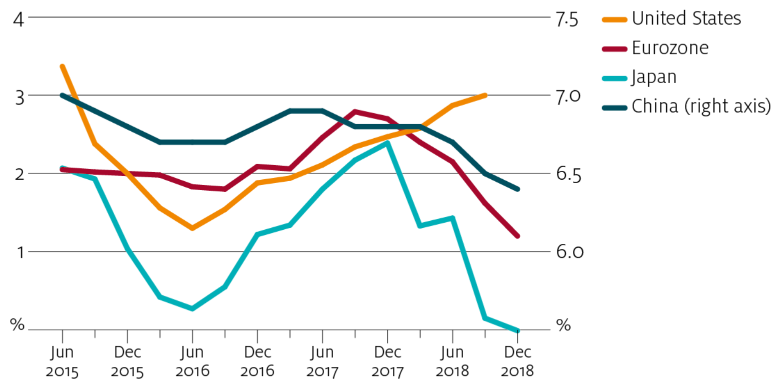
Global growth momentum faded in 2018

The global economic expansion that began in the second half of 2016 faded in 2018.

Economic growth in some large advanced economies, including the eurozone and Japan, weakened in the second half of 2018 because of softer growth in exports and declining consumer and business confidence. Economic growth also slowed in emerging and developing economies for a number of reasons. An escalation in trade tensions dampened activity in China and across Asia. Growth was also curbed by increases in interest rates in the United States and other advanced economies. Growing concerns over a slowing global economy and heightened policy uncertainty exacerbated net capital outflows from emerging markets and tightened financial conditions further. This sparked financial crises in Turkey and Argentina and affected India and Indonesia, which both have large current account deficits.

Growth was also hampered by heightened geopolitical tensions in the Middle East, including renewed US sanctions on Iran and political unrest in Latin America.

Economic growth, June quarter 2015 to December quarter 2018



Source: Organisation for Economic Co-operation and Development

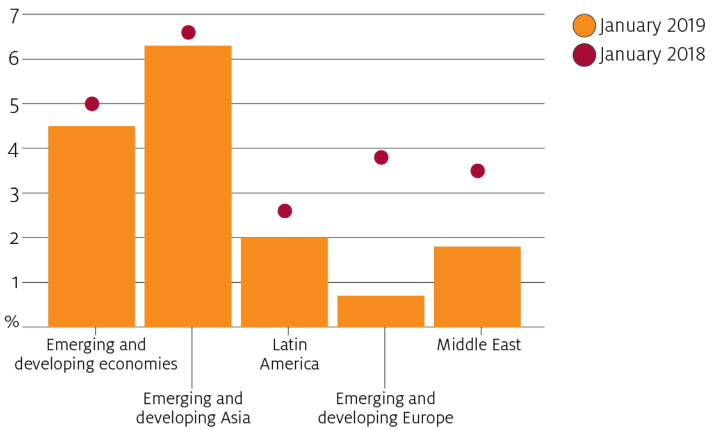
Economic activity to slow in 2019 and 2020

In preparing the agricultural commodity forecasts, global economic growth is assumed to decline from 3.7% in 2018 to 3.5% in 2019 and 3.6% in 2020.

Economic growth in major advanced economies is assumed to slow in 2019 and 2020 after a period of expansion at above-potential rates. In the United States, growth is assumed to have peaked in 2018 following a recovery from low growth in 2016. Fading fiscal stimulus and US–China trade tensions are expected to limit growth in the short term. The Japanese and eurozone economies began to slow in 2018, driven partly by softer external demand. In the eurozone, weak consumer and business confidence are expected to result in a decline in consumption and investment growth in 2019.

Economic growth assumptions for emerging and developing economies (representing 60% of the global economy) are lower than they were a year ago. This is due largely to more difficult than expected external conditions weighing on growth. In 2019 and 2020 oil prices are assumed to remain lower than in 2018 and are likely to provide some respite for net oil importing countries, including those in South-East Asia.

IMF revisions to growth forecasts, emerging and developing economies, 2019



Note: Forecasts are from the IMF World Economic Outlook Update
Source: International Monetary Fund

Monetary policy normalisation in the major advanced economies is assumed to continue, although more slowly than in 2018. This is largely because of weaker global demand. Stronger than expected interest rate rises are a risk to the economic outlook. This could spark asset price volatility similar to that of 2018 and dampen economic growth in emerging and developing economies that have large foreign debt liabilities.

A sharp slowdown in economic growth in China is another risk to global economic growth that would have significant implications for the Republic of Korea, Singapore and South-East Asia. These economies are highly integrated into global value chains. Despite recent negotiations, any escalation in US–China trade tensions could further disrupt regional production networks and investment.

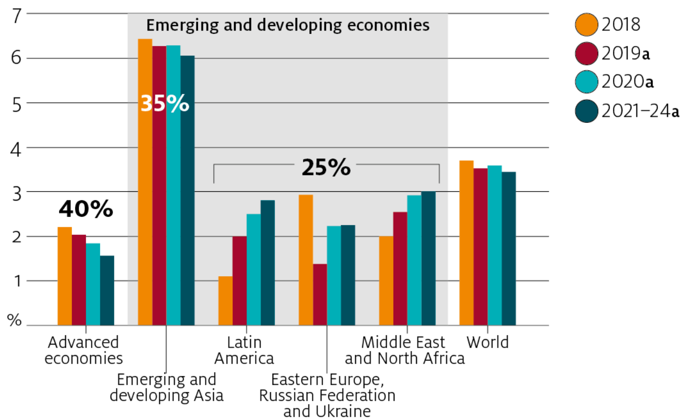
Other risks to global economic growth in the short term include the possibility of heightened geopolitical tensions and armed conflict, particularly in the Middle East.

Medium-term global growth prospects constrained

Between 2021 and 2024 global economic growth is assumed to slow to average 3.4%. The slowdown is partly driven by advanced economies (representing 40% of the global economy). The United States, Japan and the eurozone are all assumed to return to their potential rates of growth after a few years of expansion above capacity.

Economic growth is also assumed to ease in emerging Asia over the outlook period. This is largely driven by an assumed decline in Chinese gross domestic product (GDP) growth from 6.6% in 2018 to 5.4% in 2024. This is in contrast to strong growth in India, which is benefiting from recent reforms and a young population. Economic growth in South-East Asia is expected to remain stable at around 5.2% over the outlook period.

Regional economic growth and shares of world GDP, 2018 to 2024



a ABARES assumption.
Note: Percentages represent share of global economy, measured in purchasing power parity.
Sources: ABARES; International Monetary Fund

Growth in the other emerging and developing economies (representing the remaining 25% of the global economy) is assumed to be relatively low over the medium term compared with historical averages. A range of ongoing issues in these regions are weighing on their growth potential. Political uncertainty and financial crises in several Latin American countries are assumed to restrict growth in the region. In Eastern Europe, economic growth in Turkey is assumed to recover only gradually, and potential growth in the Russian Federation is expected to remain low in the absence of structural reform. Growth projections for the Middle East and North Africa are also fairly low because of ongoing armed conflict.

Strong income and population growth in Australia's export markets

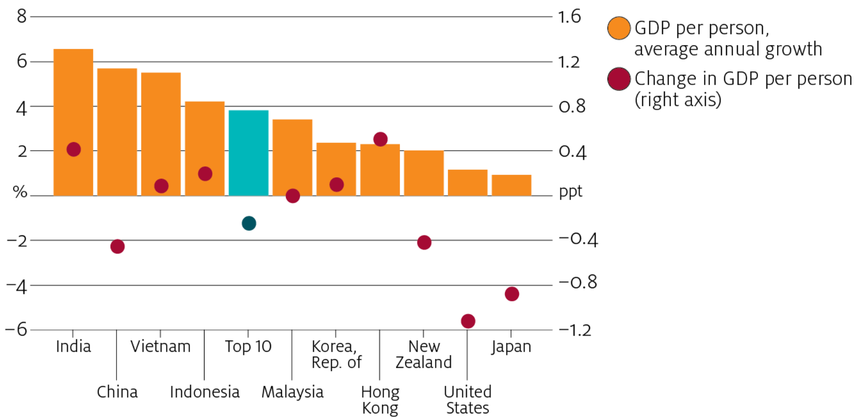
World income growth, measured by GDP per person, is assumed to average 2.5% over the outlook period. Income growth in advanced economies is assumed to decelerate from 1.7% in 2019 to 1.2% in 2024. This is in line with economic growth returning to potential in these economies.

In emerging and developing economies, income growth is assumed to increase from 3.5% in 2019 to 3.7% in 2020 and remain at that rate over the projection period. This is because of an assumed acceleration in income growth in India, resilient income growth in South-East Asia and gradual recoveries in Latin America, the Middle East and Turkey.

Incomes in Australia's main export markets are assumed to increase by an average of 3.8% per year to 2023–24. This strong growth relative to the world average reflects the strength of the economies that import Australian agricultural products (for more details see the Australian agricultural overview).

Of Australia's largest agricultural export markets, average annual income growth is assumed to be strongest in China, India, Indonesia and Vietnam. Income growth is expected to accelerate in India and Indonesia over the outlook period and remain relatively constant in Malaysia and Vietnam. Income growth in China is expected to decelerate by 0.5 percentage points over the same period.

Income growth in Australia's export markets, 2019 to 2024



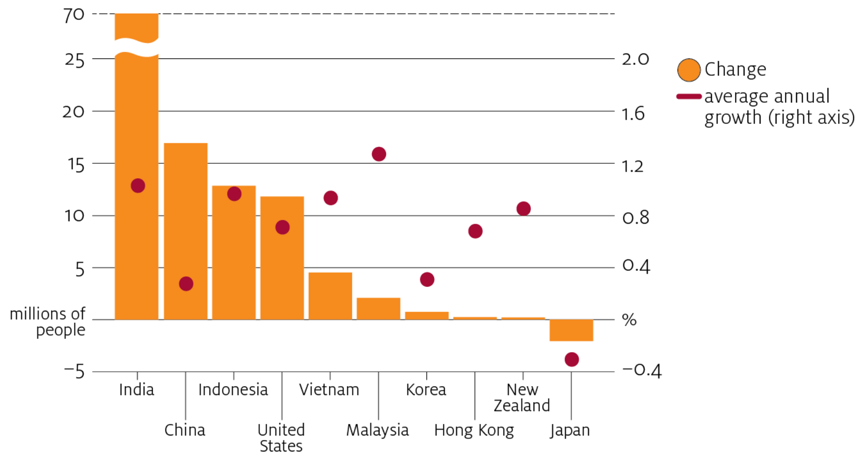
a ABARES assumption.
Sources: ABARES; International Monetary Fund; UN Population Division

Another important indicator of import demand, particularly for agricultural products, is population growth. Of Australia's 10 largest export markets, Malaysia is assumed to have the strongest annual average rate of population growth over the projection period. Its population is assumed to increase by 1.2% per year. This is followed by India, Indonesia and Vietnam.

These indicators suggest that growth in import demand for agricultural goods in these markets could remain strong and possibly increase amid a general slowing of global economic activity in other regions.

China is by far Australia's largest market for agricultural exports, but assumed strong growth in income and population in India and South-East Asia suggests potential for further export growth is weighted towards these regions.

Population growth in Australia's export markets, 2019 to 2024



a ABARES assumption.
Sources: ABARES; International Monetary Fund; UN Population Division

Australian agricultural export markets

China

Economic growth in China is assumed to increase by 6.2% in 2019 and 2020. Trade tensions with the United States and ongoing structural adjustment within the Chinese economy are assumed to weigh on economic activity.

In 2018 the economy grew by 6.6%, down from 6.9% in 2017. Growth in the industrial sector began to decelerate in the second half of 2018. The manufacturing Purchasing Managers' Index fell below 50 in December 2018 for the first time in 2 years, indicating that the manufacturing sector is contracting. Tighter financial conditions and increased uncertainty around economic conditions are likely to have contributed to lower growth in the services sector in 2018.

Chinese authorities have increased public spending via a range of targeted measures designed to stimulate growth and offset the impact of US trade measures on the economy. The Central Bank also lowered the required reserve ratio during 2018 and into 2019, allowing banks to lend more.

Growth is assumed to decline to 5.4% by 2024. This slowdown represents China's continuing transition to a consumption and services-driven economy from one that was reliant on exports and heavy industry.

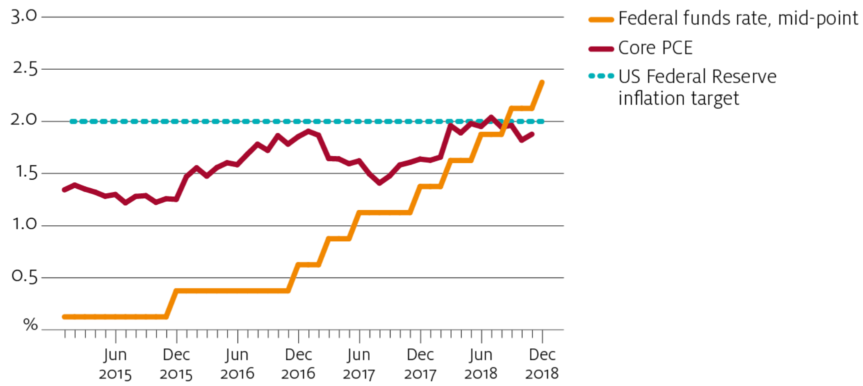
United States

The US economy increased by 3% year-on-year in the September quarter 2018, the fastest rate of growth since 2015. Economic growth is assumed to slow to 2.5% in 2019 and 2% in 2020.

The US economy has performed very strongly in recent years. In 2018 household consumption was supported by tight labour market conditions. The unemployment rate fell to 3.7% in September, its lowest rate in decades, and wage growth accelerated noticeably in the second half of the year. Increased government spending and corporate tax cuts implemented at the beginning of 2018 also stimulated economic activity. The US Federal Reserve responded to these strong economic conditions by increasing interest rates 4 times in 2018.

In 2019 and 2020 economic growth is assumed to weaken as fiscal stimulus fades and trade tensions with China continue. Interest rates are also assumed to increase further in 2019 but at a more gradual pace. The government shutdown is expected to temporarily affect economic activity in the March quarter 2019.

Core inflation and federal funds rate mid-point, United States, January 2015 to December 2018



Source: US Bureau of Economic Analysis; US Federal Reserve
Note: Core inflation is the price index for personal consumption expenditure excluding food and energy.

Over the medium term, economic growth in the United States is assumed to gradually decline to 1.7%, in line with estimates of the US potential growth rate.

Japan and the Republic of Korea

The Japanese economy grew by 0.9% in 2018. In 2019 growth is assumed to accelerate to 1% and then slow to 0.8% in 2020.

In 2019 Japanese economic growth is assumed to be supported by increased private consumption as consumers bring forward purchases of durable goods ahead of a scheduled increase to consumption taxes in October. In 2020 the tax increase will temporarily reduce demand, but the 2020 Olympic Games in Tokyo will support economic activity. In addition, the Bank of Japan has indicated that it will keep interest rates low.

Between 2021 and 2024 economic growth is assumed to average 0.5% per year, despite improvements in labour force participation in recent years. This mainly reflects an ageing population and shrinking workforce.

Growth in the Republic of Korea slowed in 2018 to 2.8% because of a decline in private investment. It is assumed to remain low in 2019 at 2.6%, reflecting weaker demand globally, before lifting to 2.8% in 2020 and 2021, as domestic conditions improve. Between 2022 and 2024 economic growth is assumed to average 2.6% as a decline in the working-age population detracts from growth.

The economies of Japan and Korea face risks associated with current trade tensions between the United States and China. Both economies have highly trade-exposed economies, with manufacturing sectors that are integrated into global supply chains.

Eurozone and the United Kingdom

In 2018 the eurozone grew by 1.8%. In 2019 economic growth is assumed to slow to 1.6% before recovering moderately in 2020 to 1.7%.

Economic growth in 2019 is assumed to be lower because of a broad-based reduction in private consumption, slowing industrial production and weaker export demand. Growth in some countries will be further inhibited by idiosyncratic factors such as the introduction of new automotive standards in Germany, civil unrest in France and financial stress in Italy. Growth in 2020 is assumed to accelerate modestly as the effects of these disruptions wane and economies stabilise.

In 2018 the UK economy grew by 1.4% and is assumed to increase to 1.5% in 2019 and 1.6% in 2020. The United Kingdom's departure from the European Union is scheduled for 29 March 2019. It is unclear what form the relationship between the parties will take after that date. If no agreement is in place by this deadline, growth in the United Kingdom is expected to be lower.

From 2021 to 2024 annual economic growth in the eurozone is assumed to average 1.5%. Low productivity growth and unfavourable population demographics are assumed to limit growth.

South-East Asia and India

Economic growth in South-East Asia is assumed to increase by 5.3% in 2019 and 5.2% in 2020. Economic growth is assumed to be stable at around 5.2% per year over the outlook period.

Strong growth in domestic demand, including government-led infrastructure investment and government policy reforms, is assumed to support economic activity across the region in 2019 and 2020.

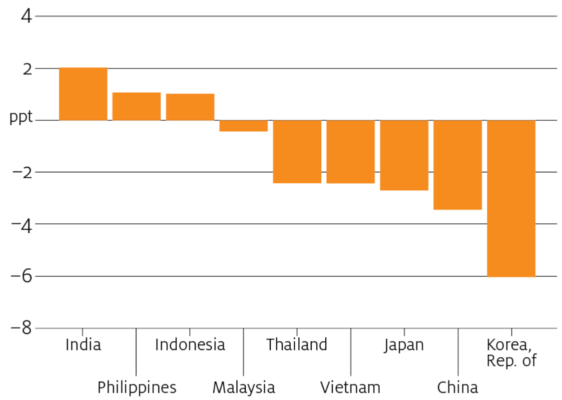
However, the external environment is complicating the outlook. Risks to the outlook over the short term include higher US interest rates, an increase in trade tensions and softer global export demand. These events already tested the resilience of the region in 2018 and highlighted the region's ability to withstand negative external shocks and contagion in financial markets from other emerging and developing economies.

Economic growth in India is assumed to accelerate over the outlook period from an estimated 7.5% in 2018 to 8.2% by 2023. India faces similar external pressures to South-East Asia. However, the decline in oil prices since November 2018 is likely to provide some respite in the short term.

Strong growth for South-East Asia and India during the outlook period is due in part to the relatively young population in this region. India, Indonesia and the Philippines have a particularly high proportion of young people. Working-age populations (15 to 64 years) in these countries will increase substantially in coming decades.

Recent productivity-enhancing reforms in India have improved business conditions and are expected to benefit growth over the medium term.

Change in working-age population share of total population, 2015 to 2025



Note: Working-age population includes people of 15 to 64 years.
Source: UN Population Division

Australian economy

Economic growth is estimated to be 2.8% in 2018–19 and to accelerate to 3% in 2019–20. Growth is assumed to be supported by increasing household and government consumption as well as business investment. Between 2019–20 and 2023–24 the Australian economy is assumed to grow by 3% per year, 0.25 percentage points higher than its potential growth.

Risks to the outlook for the Australian economy stem from both domestic and external drivers. Persistently low wage growth and high levels of household debt could lead to slower than expected household consumption growth. Property values could also stifle household consumption if they fall sharply. Business investment faces the risk of slower growth if business conditions deteriorate. External risks include the possibility of a faster than expected economic slowdown in China, which would reduce demand for Australian exports.

Australian dollar assumed to appreciate gradually over the medium term

The Australian dollar is assumed to average US72 cents in 2018–19 and have a trade-weighted value of 62. In 2019–20 it is assumed to increase to US73 cents, but the trade-weighted value will remain at 62. Over the outlook period, the dollar is assumed to average US74 cents and have a trade-weighted value of 61.

These exchange rate assumptions are based on the relationship between the Australian dollar, Australian terms of trade and the interest rates of major economies, particularly the United States. In 2018–19 an assumed appreciation of the terms of trade, driven by strong commodity prices, will offer some support to the Australian dollar. This may be offset by an assumed increase in US interest rates and risk aversion in financial markets.

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Key macroeconomic assumptions for Australia

	unit	2016–17	2017–18	2018–19 a	2019–20 a	2020–21 a	2021–22 a	2022–23 a	2023–24 a
Economic growth	%	2.3	2.8	2.8	3.0	3.0	3.0	3.0	3.0
Inflation	%	1.7	1.9	2.1	2.3	2.5	2.5	2.5	2.5
Interest rates **b**	% pa	3.7	3.7	3.9	4.2	4.5	4.7	5.1	5.1
Nominal exchange rates									
A$/US$	US$	0.75	0.78	0.72	0.73	0.74	0.74	0.74	0.74
Trade-weighted index									
for A$ **c**	index	64.8	64.5	62.1	62.1	61.7	61.2	60.8	60.4

a ABARES assumption. **b** Large business weighted-average variable rate on credit outstanding. **c** Base: May 1970 = 100.
Sources: ABARES; Australian Bureau of Statistics; Reserve Bank of Australia

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Key world macroeconomic assumptions

	unit	2017	2018 a	2019 a	2020 a	2021 a	2022 a	2023 a	2024 a
Economic growth									
World b	%	3.7	3.7	3.5	3.6	3.5	3.4	3.4	3.4
Advanced economies	%	2.3	2.2	2.0	1.8	1.7	1.5	1.5	1.6
United States	%	2.2	2.8	2.5	2.0	1.7	1.5	1.6	1.7
Japan	%	1.9	0.9	1.0	0.8	0.7	0.5	0.5	0.5
Eurozone	%	2.4	1.8	1.6	1.7	1.6	1.5	1.4	1.4
Germany	%	2.5	1.5	1.3	1.6	1.5	1.3	1.2	1.2
France	%	2.3	1.5	1.5	1.6	1.6	1.6	1.6	1.6
Italy	%	1.6	1.0	0.6	0.9	0.8	0.7	0.7	0.7
United Kingdom	%	1.8	1.4	1.5	1.6	1.6	1.6	1.6	1.6
Korea, Rep. of	%	3.1	2.8	2.6	2.8	2.8	2.7	2.6	2.6
New Zealand	%	3.0	3.1	3.0	3.1	3.1	2.6	2.5	2.5
Singapore	%	3.6	2.9	2.5	2.7	2.7	2.7	2.6	2.6
Taiwan	%	2.9	2.7	2.4	2.3	1.9	1.9	1.9	1.9
Emerging and developing economies	%	4.6	4.6	4.5	4.7	4.7	4.7	4.7	4.6
Emerging Asia	%	6.3	6.4	6.3	6.3	6.2	6.1	6.0	5.9
South-East Asia **c**	%	5.3	5.3	5.3	5.2	5.2	5.2	5.3	5.3
China **d**	%	6.9	6.6	6.2	6.2	6.0	5.8	5.6	5.4
India	%	6.2	7.5	7.8	7.9	8.1	8.1	8.2	8.2
Latin America	%	1.3	1.1	2.0	2.5	2.7	2.8	2.9	2.9
Middle East and North Africa	%	1.8	2.0	2.5	2.9	3.0	3.0	3.0	3.0
Eastern Europe	%	6.0	3.8	0.7	2.4	2.5	2.6	2.7	2.7
Russian Federation	%	1.5	1.7	1.6	1.7	1.6	1.3	1.2	1.2
Ukraine	%	2.5	3.5	2.7	3.0	3.2	3.3	3.4	3.4
GDP per person e									
Advanced economies	%	1.9	1.9	1.7	1.3	1.3	1.2	1.2	1.2
Emerging and developing economies	%	3.4	3.5	3.5	3.7	3.7	3.7	3.7	3.7
Emerging Asia	%	5.5	5.5	5.5	5.4	5.4	5.3	5.3	5.3
South-East Asia **c**	%	4.2	4.2	4.1	4.1	4.2	4.3	4.3	4.2
Inflation									
United States	%	2.1	2.5	2.2	2.3	2.2	2.2	2.0	2.0
Interest rates									
US prime rate **g**	% pa	4.1	4.9	5.6	6.1	6.1	6.1	6.1	6.1

a ABARES assumption. **b** Weighted using 2017 purchasing power parity (PPP) 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.

Sources: ABARES; Indian Ministry of Statistics and Programme Implementation; International Monetary Fund; United Nations Population Division; US Bureau of Labor Statistics; US Federal Reserve