# 1. International Economic Developments

Global economic conditions have picked up since the middle of 2016 and appear to be stronger in early 2017 than they have been in recent years (Graph 1.1). Major trading partner growth is forecast to be around its long-run average this year before easing slightly in 2018.

The strengthening in economic activity has been broad based. Economic growth in China has retained its earlier momentum in 2017, supported by accommodative financial conditions and fiscal policy. Growth in the major advanced economies picked up throughout 2016, to be around or above their potential growth rates; accommodative monetary policies and less contractionary fiscal policies should support growth being above potential in these economies over the period ahead. Growth in east Asia increased in late 2016 supported by stronger conditions in China and the major advanced economies, and the associated increase in global trade.

**Graph 1.1**
**Global Economic Activity***


* Major trading partners (MTP) GDP is export-weighted; sentiment is PPP GDP-weighted; industrial production is weighted by world IP shares at market exchange rates

** Deviation from post-2005 average

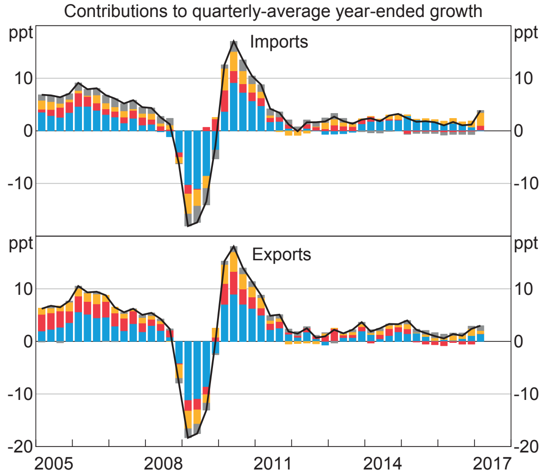
Sources: ABS; Bloomberg; CEIC Data; IMF; Markit Economics; OECD; RBA; Thomson Reuters

Consumer sentiment and survey measures of business conditions have both increased sharply since late 2016. Growth in industrial production has also edged higher, especially in Asia. Consumption growth in Australia's major trading partners has been relatively stable and investment growth has picked up in some economies.

Merchandise trade growth has increased further in 2017. The pick-up in both exports and imports has been broad based (Graph 1.2). China has been an important source of increased demand, while imports by commodity-exporting emerging economies have stabilised recently after having declined for several years. This expansion in global trade could be derailed, however, if protectionist policies are introduced.

Headline inflation in the advanced economies rose sharply in late 2016 and early 2017,

**Graph 1.2**
**Merchandise Trade Volumes***
Contributions to quarterly-average year-ended growth

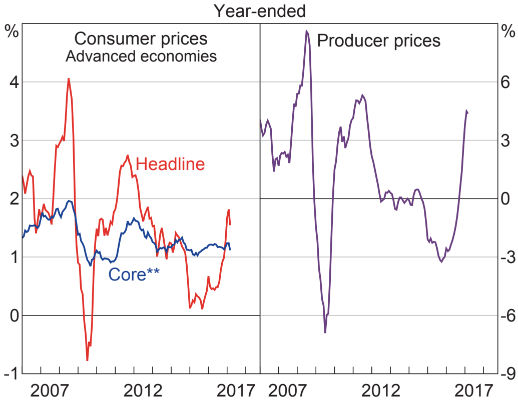



* March quarter 2017 is an estimate

** Excludes Japan and China

Sources: CBP Netherlands; CEIC Data; RBA following the increase in oil prices during 2016 (Graph 1.3). However, with oil prices now declining, headline inflation also appears to have peaked recently and is likely to decline in coming quarters. Core inflation measures generally remain low. However, a number of factors suggest underlying inflationary pressures are likely to pick up in the period ahead, including the ongoing tightening in labour markets in the major advanced economies, which has seen some measures of wage growth edge higher. The sharp rise in producer price inflation since mid 2016 has largely been driven by the increase in oil and other commodity prices over this period and should contribute to some increase in upstream price pressures. Stimulatory fiscal policy in the United States at a time of limited spare capacity would also be likely to add to inflationary pressures there.

**Graph 1.3**
**Global Inflation***
Year-ended

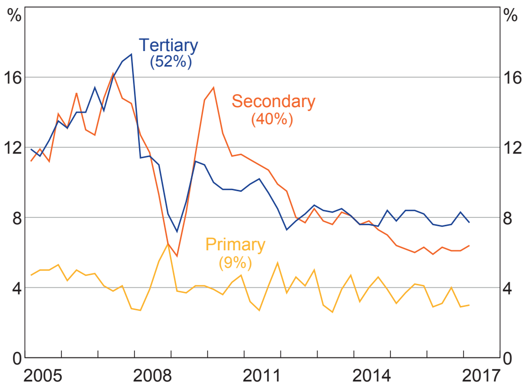



* Selected economies; PPP GDP-weighted
** Excludes food and fuel
Sources: CEIC Data; Eurostat; IMF; RBA; Thomson Reuters

## China and Asia-Pacific

In March, the Chinese Government announced a GDP growth target for 2017 of 'around 6.5 per cent or higher if possible', similar to the 6.5–7 per cent objective in 2016. In related policy documents, the authorities emphasised a focus on stable growth, maintaining employment and preventing financial stability risks. Growth in China picked up in the second half of 2016 and looks to have retained this momentum into 2017. Overall, year-ended growth was supported by resilient growth in the services (tertiary) sector and a modest pick-up in growth in the industrial (secondary) sector (Graph 1.4). On the expenditure side, there was further evidence of rebalancing: the contribution of investment to growth declined noticeably, while the contribution of consumption rose.

**Graph 1.4**
**China – GDP Growth by Sector***
Year-ended



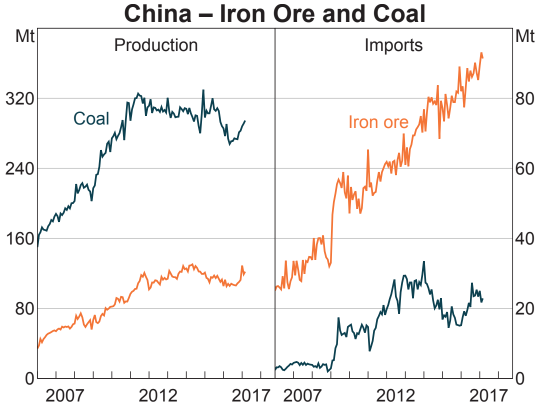

* Numbers in parentheses show 2016 shares of GDP
Sources: CEIC Data; RBA

The pick-up in growth since mid 2016 has been supported by property construction and infrastructure investment. Demand from these end-use sectors has boosted steel production, which in turn has driven demand for iron ore and coking coal. Chinese production of coal and iron ore, as well as imports of iron ore, continue to rise (Graph 1.5). Rapid increases in commodity prices over the past year have flowed through to Chinese producer price inflation, which remains elevated in year-ended terms despite slowing in recent months. Underlying consumer price inflation measures have also increased a little over the past year, but headline consumer price inflation remains subdued because of declining food prices.

The Chinese residential property market has remained a driver of growth in 2017 (Graph 1.6).

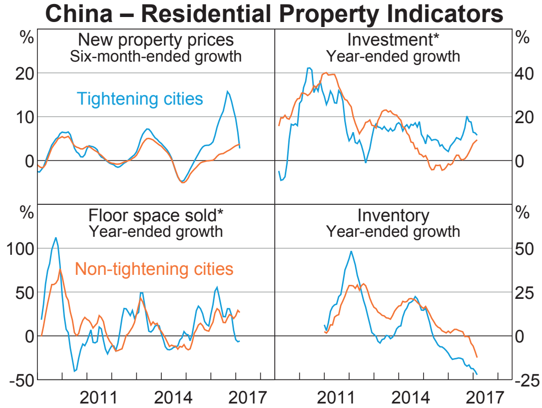
Following rapid increases in property prices in 2016, more cities have introduced tightening measures (such as restrictions on purchase and reduced loan-to-value ratios) and others have tightened existing policies further to dampen speculative activity and slow growth in property prices. While price growth had been slowing sharply in cities with tightening measures, there was a broad-based rise in property price growth in March. The area of floor space sold has remained at a high level in recent months and inventory levels have declined further. This has reduced inventory-to-sales ratios in most regions, which could provide scope for further residential construction.

**Graph 1.5**
**China – Iron Ore and Coal**




Sources: CEIC Data; RBA; WIND Information

**Graph 1.6**
**China – Residential Property Indicators**

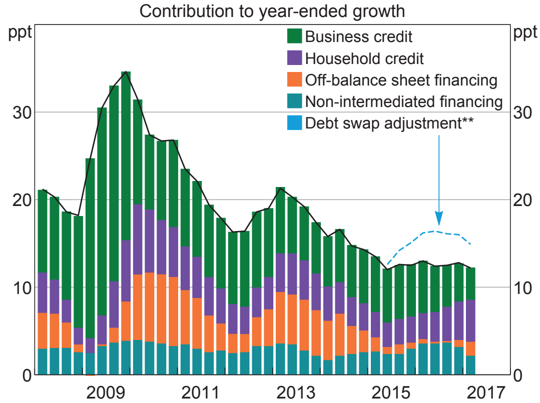



* Smoothed

Sources: CEIC Data; CRIC; RBA

Financial conditions in China remain accommodative. Total social financing (TSF) continues to grow at a rapid pace, despite some easing recently. Growth in bank lending to households (mainly mortgages) has increased further, while growth in corporate credit has fallen (Graph 1.7). A target of 12 per cent for TSF growth in 2017 has been announced, which is slightly below the target of 13 per cent growth for 2016.

**Graph 1.7**
**China – Total Social Financing***
Contribution to year-ended growth




* Seasonally adjusted by RBA

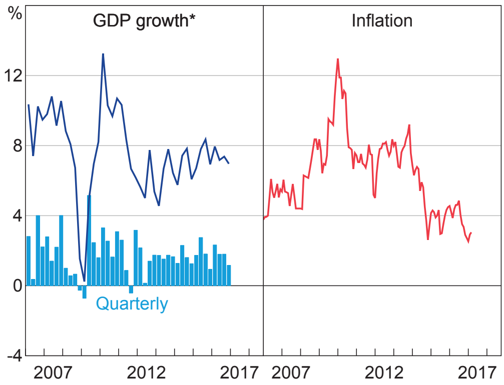
** Upper bound estimate of year-ended growth adjusting for the impact of local government bond issuance to pay off debt previously included in TSF

Sources: CEIC Data; RBA

In November 2016, the Indian Government replaced its two highest-denomination banknotes in an effort to combat counterfeiting and the use of 'black money'. The demonetisation scheme caused some temporary cash shortages and was widely expected to detract from growth in the December quarter. However, the impact was lower than anticipated (Graph 1.8). Falling food prices have weighed on consumer price inflation since mid 2016, which remains below the Reserve Bank of India's medium-term inflation target of 4 per cent.

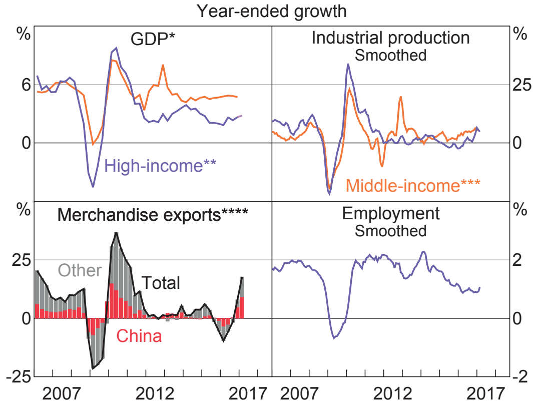
The pick-up in global trade since late 2016 has supported stronger growth in the east Asia region, particularly in the more trade-dependent high-income economies; consistent with this,

**Graph 1.8**
**India – GDP Growth and Inflation**
Year-ended




* Seasonally adjusted by RBA
Sources: CEIC Data; RBA

**Graph 1.9**
**East Asia – Economic Indicators**
Year-ended growth

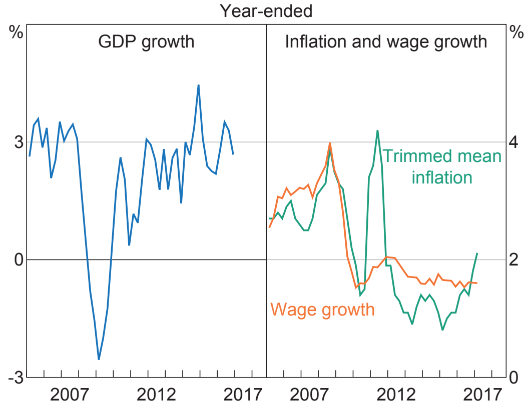



* Estimate for March quarter 2017
** Hong Kong, Singapore, South Korea and Taiwan
*** Indonesia, Malaysia, Philippines and Thailand
**** Values; excludes intraregional trade; estimate for March quarter 2017
Sources: CEIC Data; IMF; RBA; UN

industrial production has increased noticeably in these economies since late 2016. While the increase in the region's exports has been broad based by destination, it has been especially pronounced in exports to China (Graph 1.9). This increase in activity brings growth in the high-income east Asian economies to around estimates of potential, following below-trend growth over recent years. Growth in domestic final demand has improved recently, as a result of higher investment, although consumption growth remains weak and employment growth has slowed. In the middle-income east Asian economies, growth has been stable over recent years, supported by resilient domestic demand. Monetary and fiscal policies across the region remain accommodative, which is also expected to continue to support economic activity.

The New Zealand economy grew at an above-average pace in 2016, driven by record-high immigration and accommodative monetary policy (Graph 1.10). Growth slowed in the second half of 2016 because of a temporary fall in exports following adverse weather conditions and an easing in growth in residential investment. Employment growth remains strong and the unemployment rate is low. Despite this, the

**Graph 1.10**
**New Zealand – Economic Indicators**
Year-ended



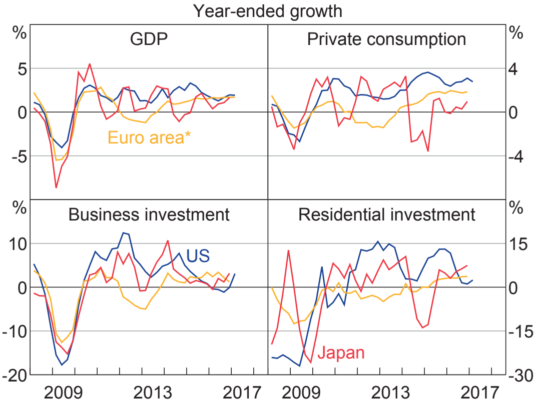

Sources: RBA; Thomson Reuters

additional labour supply from rising participation and record-high net immigration are keeping wage pressures contained. Inflation has been increasing since early 2016, reflecting higher oil prices and capacity pressures in some parts of the economy and it returned to the Reserve Bank of New Zealand's target band in late 2016.

## Major Advanced Economies

GDP growth in the major advanced economies has been at or above estimates of potential growth over recent years, supported by accommodative monetary policy and, more recently, less contractionary fiscal policies (Graph 1.11). That said, potential growth rates across most advanced economies have declined relative to previous decades because of population ageing, lower productivity growth and slower capital accumulation. During 2016 there was a further gradual absorption of spare capacity; as a result, the United States, Japan and some euro area countries are now around estimates of full employment.

**Graph 1.11**
**Major Advanced Economies – GDP and Components**
Year-ended growth



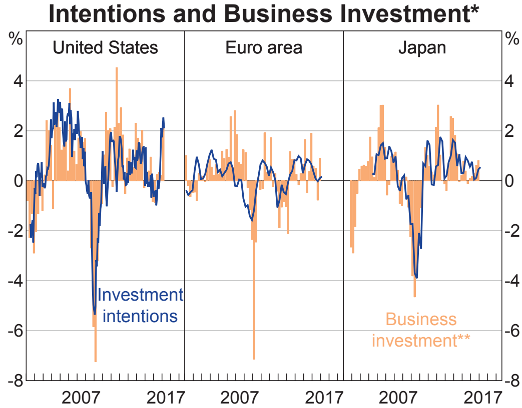

* For euro area, business investment is public and private non-residential investment; data exclude Ireland due to measurement issues

Sources: RBA; Thomson Reuters

Private consumption has been a key driver of growth in the United States and the euro area over recent years, despite temporary weakness in US consumption growth in the March quarter. Consumption growth has been supported by robust employment growth, low borrowing costs, recovering housing prices and above-average consumer confidence. In Japan, private consumption growth has been generally subdued. Consumer confidence has increased in all three economies in recent months, to be above average. Residential investment growth has also picked up across the major advanced economies.

Surveyed business confidence and conditions have been very strong in recent months in the major advanced economies and business investment is showing signs of recovery, following several years of weak growth (Graph 1.12). In the March quarter, US business investment increased strongly, with much of this increase concentrated in the energy sector. US corporate investment intentions have increased since late 2016, which has been largely attributed to an expectation of tax reforms and a roll-back of regulations, as well as the expected recovery in the energy sector. In the euro area, business investment has grown a little since early 2015, driven by growth in machinery and equipment investment. While this marks the first period of sustained growth since the global financial crisis, both residential and business investment remain well below pre-crisis levels and muted investment intentions suggest investment will continue to grow only modestly. Japanese business investment is only a touch above its pre-crisis level. The Japanese economy has been supported by the increase in global trade, and has recorded its largest merchandise trade surplus in seven years.

**Graph 1.12**
**Major Advanced Economies – Capex Intentions and Business Investment***



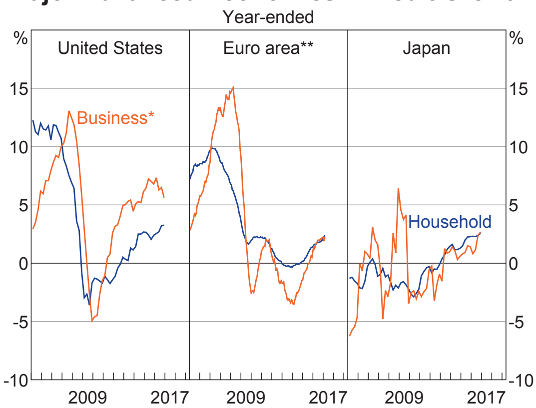

* Investment intentions mapped to national accounts investment growth

** Quarterly growth; euro area excludes Ireland due to measurement issues; smoothed for Japan

Sources: RBA; Thomson Reuters

Household and business sector credit growth has generally increased in the major advanced economies in recent years, consistent with the increasing durability of the recovery (Graph 1.13). In 2016, credit to euro area non-financial corporations saw its first full year of growth since the height of the euro area sovereign debt crisis. Japanese household credit has grown at its fastest pace in around two decades.

### Graph 1.13
### Major Advanced Economies – Credit Growth



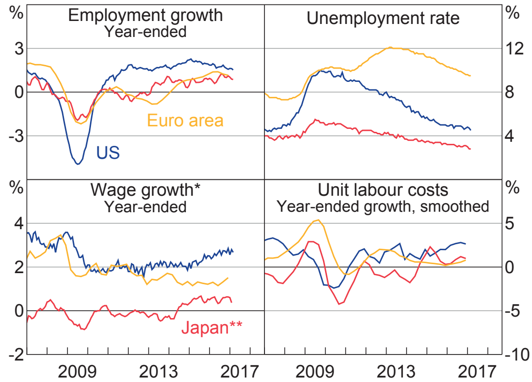

* Private non-financial corporations

** Adjusted for loan sales and securitisation

Sources: ECB; RBA; Thomson Reuters

Labour markets in the major advanced economies continue to improve; employment growth has been robust and there have been some increases in labour force participation (Graph 1.14). There has been some moderate pick-up in wage growth in the United States and Japan; this includes part-time wages in Japan, where tighter labour market conditions are likely to manifest first given the greater flexibility of that sector. Survey data in the United States and recent negotiations between labour unions and large employers in Japan suggest that wage growth is not expected to increase much further over the coming year. Unit labour costs, on the other hand, have grown at above-average rates in the United States and Japan in line with low productivity growth. The improvement in the euro area labour market has

### Graph 1.14
### Major Advanced Economies – Labour Markets




* Average hourly earnings for the US; compensation per employee for the euro area; full-time base wages for Japan

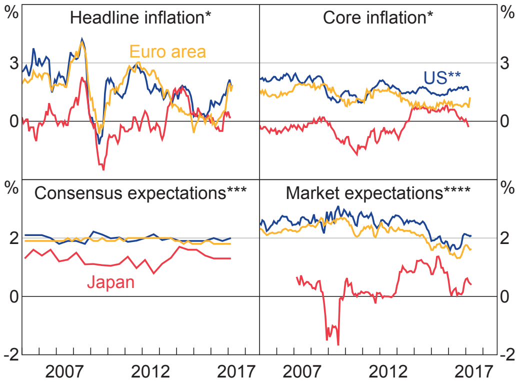
** Smoothed for employment growth and wage growth

Sources: ECB; Eurostat; RBA; Thomson Reuters

been more gradual, but unemployment has still declined to its lowest rate in nearly eight years.

As discussed above, headline inflation in the United States and the euro area and, to a lesser extent, Japan, increased in late 2016 reflecting higher oil prices, though with oil prices now declining, the effect on headline inflation is starting to dissipate (Graph 1.15). Core inflation has remained low, particularly in the euro area and Japan; idiosyncratic factors appear to have contributed to some volatility in the latest figures. Market-based measures of inflation expectations rebounded in the United States and the euro area in 2016, reflecting the rise in oil prices and prospects of stimulatory fiscal policy in the United States. Economists' longer-term measures of inflation expectations have been more stable at levels close to each central bank's inflation target, suggesting they are relatively well anchored. In Japan, inflation expectations remain low; short-term expectations are around levels that prevailed before the Bank of Japan started its quantitative easing and announced its inflation target in 2013, although long-term market expectations have moved a little higher since late 2016.

Graph 1.15
**Major Advanced Economies – Inflation and Long-run Expectations**
Year-ended




* PCE inflation for the US; CPI for the euro area and Japan; Japan data exclude the effects of the consumption tax increase in April 2014
** US expectations adjusted to reference PCE inflation
*** Euro area series is from the Survey of Professional Forecasters
**** Monthly average of inflation expectations from five and ten-year inflation swaps; latest observation is an average of the month to date
Sources: Bloomberg; Consensus Economics; ECB; RBA; Thomson Reuters

In the United Kingdom, growth since the mid-2016 vote to leave the European Union has been more resilient than expected. While investment growth has slowed somewhat, consumption growth has picked up and net exports have made a strong positive contribution. Surveyed business conditions and consumer confidence are at or above average, suggesting continued moderate growth. The sharp depreciation of the sterling has put upward pressure on inflation and is expected to continue to do so for a while. Formal negotiations on the terms of the withdrawal from the European Union began in late March.

## Commodity Prices

Developments in global commodity prices have been varied since the previous *Statement*, reflecting a range of commodity-specific factors. The prices of iron ore and oil have declined, while coking coal prices have risen sharply (Table 1.1; Graph 1.16). The prices of rural commodities and base metals are little changed. Notwithstanding recent developments, commodity prices increased over 2016 and early 2017, resulting in a sizeable rise in Australia's terms of trade, but are expected to decline over the forecast period (see the 'Economic Outlook' chapter).

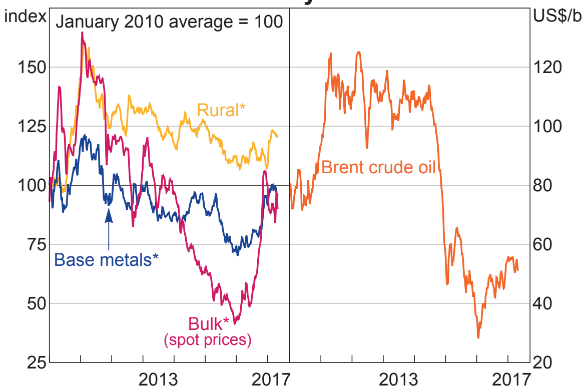
The spot price of iron ore has fallen sharply since the previous *Statement*, but remains well above its trough in late 2015; a fall has been expected for some time (Graph 1.17). Prices were supported through late 2016 and into 2017 by Chinese infrastructure spending and property construction. Prices declined alongside reports that Chinese steel mills started to draw down on inventories, which reduced activity in the spot market. Further

**Table 1.1: Commodity Price Growth(a)**
SDR, per cent

| | Since previous *Statement* | Over the past year |
|---|---|---|
| Bulk commodities | –4 | 47 |
| – Iron ore | –22 | 9 |
| – Coking coal | 29 | 130 |
| – Thermal coal | 0 | 64 |
| Rural | 1 | 11 |
| Base metals | –1 | 26 |
| Gold | 0 | 0 |
| Brent crude oil(b) | –9 | 12 |
| RBA ICP | –5 | 40 |
| – Using spot prices for bulk commodities | –3 | 33 |

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodities prices are spot prices
(b) In US dollars
Sources: Bloomberg; IHS; RBA

## Graph 1.16
### Commodity Prices




* RBA Index of Commodity Prices (ICP) sub-indices; SDR

Sources: Bloomberg; RBA

## Graph 1.17
### Chinese Steel and Iron Ore Spot Prices


* Average of hot rolled steel sheet and steel rebar prices

** Free on board basis

Sources: Bloomberg; RBA

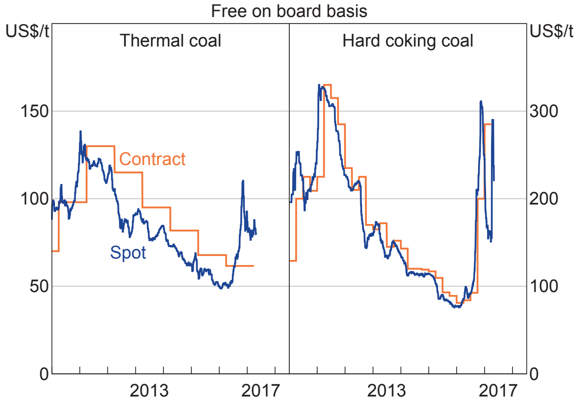
declines in the iron ore price are widely expected as low-cost global supply continues to come online over the next year or so and because demand from China is expected to wane.

The spot price of premium hard coking coal has been volatile over the past six months (Graph 1.18). Earlier this year, prices declined from their mid-November peak as seaborne supply returned to more normal levels following supply disruptions in late 2016. More recently, prices increased sharply after Cyclone Debbie damaged key railway networks and shut down coal shipping ports in the Bowen Basin in Queensland, although trading in the spot market at that time was very limited. The region is estimated to account for more than half of the global seaborne coking coal market and around one-third of Australia's coal exports. Coking coal contract negotiations for the June quarter have been delayed, as producers wanted to assess the impact of the cyclone before agreeing to a price.

The spot price of thermal coal has been relatively stable in the year to date. In March, Chinese authorities announced that the '276 working day policy' would not be reintroduced, but that they would still target a reduction in overcapacity in the Chinese coal industry. Thermal coal exports are expected to be less affected by Cyclone Debbie. A benchmark price for the 2017 Japanese fiscal year contract is yet to be agreed. However, the majority of Australia's thermal coal exports are understood to be sold on the spot market.

Oil prices are lower since the previous *Statement*, but remain well above their low level in early 2016 (Graph 1.16). Since the start of the year, members of both the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries have been generally implementing the agreed production cap. However, increases in US crude oil production have weighed on oil prices. ✠

## Graph 1.18
### Coal Prices
Free on board basis




Sources: Department of Industry, Innovation and Science; IHS; RBA