# 2. THE ECONOMY

- New South Wales has recorded impressive economic growth in recent years. The economy grew by an above-trend rate averaging around 3 per cent a year over the four years to 2017-18, and experienced the fastest per capita growth of any state.
- While economic growth has moderated over the last year, this is likely to be temporary. Solid fundamentals, led by exceptionally strong labour market conditions, and a wave of policy stimulus are expected to see a return to trend growth in 2020-21 (see Table 2.1 for economic forecasts).
- A slowing housing market and soft income growth have dictated much of the moderation in economic growth. Severe drought conditions have also weighed on the rural sector.
- The household sector should start to improve from around mid-2020, as stimulus measures (including personal income tax cuts and lower interest rates), stronger wages growth and improved housing market conditions prompt a consumer-led recovery.
- The State's labour market continues to experience healthy momentum, with employment growth of 3¼ per cent forecast for 2018-19. This has facilitated a record workforce participation rate and drove the trend unemployment rate to close to its lowest level in over four decades. Solid economic growth is expected to sustain this strength in labour market conditions. Employment growth is forecast to be around 1¼ to 1½ per cent, reflecting improved productivity, while the unemployment rate is expected to stabilise at around 4½ per cent over the next two years.
- Wage pressures are finally gaining some traction. A firming national labour market and an eventual rise in inflationary pressures should foster a modest rise in wages growth to 2¾ per cent by 2020-21.
- The near-term growth outlook has softened for the national and global economies, but both are expected to improve over the forecast horizon. The anticipated recovery should stimulate demand for export-oriented firms, providing a more favourable environment for broader business hiring and investment.

*Table 2.1: Economic performance and outlook[(a)]*

| New South Wales | 2017-18 Outcomes | 2018-19 Forecasts | 2019-20 Forecasts | 2020-21 Forecasts | 2021-22 Projections | 2022-23 Projections |
|---|---|---|---|---|---|---|
| Real state final demand | 3.4 | 2½ (2¾) | 2½ (2¾) | 2½ | - | - |
| Real gross state product | 2.6 | 2¼ (2½) | 2¼ (2½) | 2½ | 2½ | 2½ |
| Employment | 3.2 | 3¼ (2¾) | 1½ | 1¼ | 1¼ | 1¼ |
| Unemployment rate [(b)] | 4.8 | 4½ | 4½ | 4½ | 4½ | 4½ |
| Sydney consumer price index | 2.0 | 1¾ | 2 | 2 (2¼) | 2¼ (2½) | 2½ |
| Wage price index | 2.1 | 2½ | 2½ (2¾) | 2¾ (3) | 3 | 3 |
| Nominal gross state product | 4.5 | 3½ (4¼) | 3¾ (4) | 4½ (4¾) | 4¾ (5) | 5 |
| Population [(c)] | 1.5 | 1.7 (1.5) | 1.6 (1.5) | 1.5 | 1.5 (1.4) | 1.5 |

(a) Per cent change, annual average unless otherwise stated. 2019 Pre-election Budget Update forecasts in parenthesis if different.
(b) Annual average, per cent.
(c) Per cent change through the year to 30 June. Forecasts are rounded to the nearest 0.1 percentage points.

*Sources: ABS 5206.0, 5220.0, 6202.0, 6401.0, 6345.0, 3101.0 and NSW Treasury*

## 2.1 Policy stimulus to facilitate a lift in economic growth

The New South Wales economy has shown exceptional strength in recent years. It has outperformed – both in the number of jobs created and in the State's contribution to national growth since 2013-14. Solid economic fundamentals, the Government's record infrastructure program, and a wave of policy stimulus should see the state's economy continue to perform well, despite near-term challenges.

While economic growth has eased this year, segments of the economy are resilient, particularly in the labour market where the unemployment rate remains low.

Soft household income growth, a slowing housing market and drought conditions have been the catalyst for a shift in momentum for the economy. As a result, growth in the New South Wales economy for 2018-19 and 2019-20 is forecast to be slightly below trend.

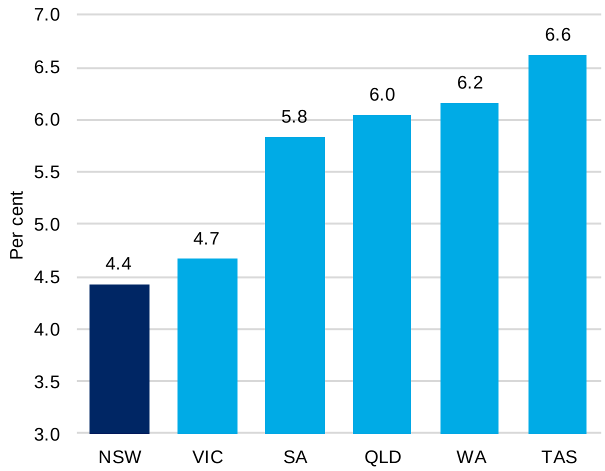
A large public infrastructure program, rising commercial building activity and a solid export sector have underpinned the State's resilience and are expected to partially offset the weakness in the household sector.

Labour market conditions are exceptionally strong. Employment growth has stayed well above average and job vacancies are at elevated levels (see Chart 2.2), prompting an 'encouraged worker effect' that has seen the workforce participation rate hit record highs - led by females (see Box 2.1). Spare capacity in the local labour market remains tight. The trend unemployment rate in New South Wales is near a four decade low, and continues to be the lowest of all the states (see Charts 2.1). However, wage pressures have remained subdued, which is a consistent theme across many developed economies.

In the context of limited inflationary pressures and sub-trend national economic growth, the Reserve Bank of Australia's (RBA) decision to cut interest rates in June reflected its intention to make faster progress in reducing the unemployment rate and lifting inflation back to within their target range. This cut to the cash rate, and market expectations for a further cut, will provide support to the economy, particularly in the consumer and housing sectors.

Lower interest rates are expected to support a stabilisation in housing market conditions from late-2019. However, current weakness in household consumption is not expected to abate until around mid-2020, as an increase in the low and middle income tax offset and stronger wages growth also start to drive a consumer-led recovery. Meanwhile, dwelling investment is forecast to detract ½ a percentage point from economic growth in 2019-20 and ¼ of a percentage point in 2020-21.

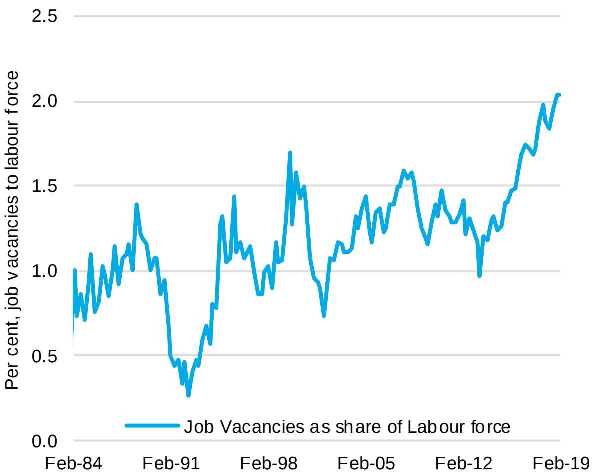
*Chart 2.1: New South Wales boasts the lowest trend unemployment rate*[(a)]




(a) Lowest of the states. Seasonally adjusted as at April 2019.

*Source: ABS* 6202.0 and NSW Treasury

*Chart 2.2: Job vacancies at an all time high, suggesting strong labour demand*[(a)]




(a) Job vacancies derived between May-09 to Nov-09.

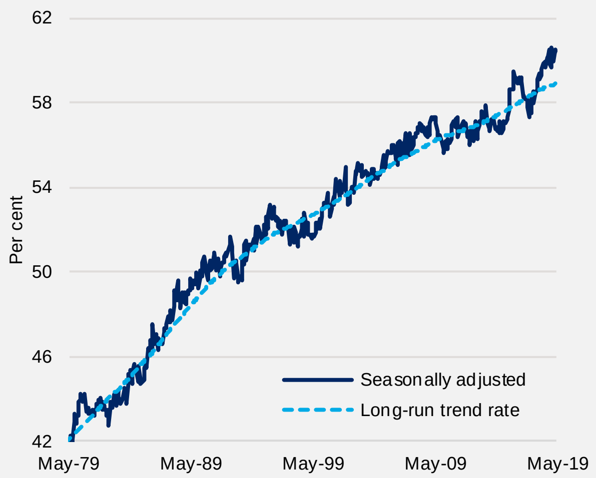
*Source: ABS 6202.0, 6354.0 and NSW Treasury*

**Box 2.1: Strong female employment growth driving workforce participation**

Favourable labour market conditions are encouraging entrants into the labour force, with women leading the way.

The female workforce participation rate has exceeded its structural long-run trend since late-2017 (see Chart 2.3). Female employment has grown at an annual average rate of 3.5 per cent over the two years to May 2019, compared to 2.7 per cent for the Rest of Australia.

*Chart 2.3: Rising female participation*[(a)]




(a) The long-run trend rate is based on underlying participation rate trends by five-year age cohort.

*Source: ABS* 6202.0 and NSW Treasury

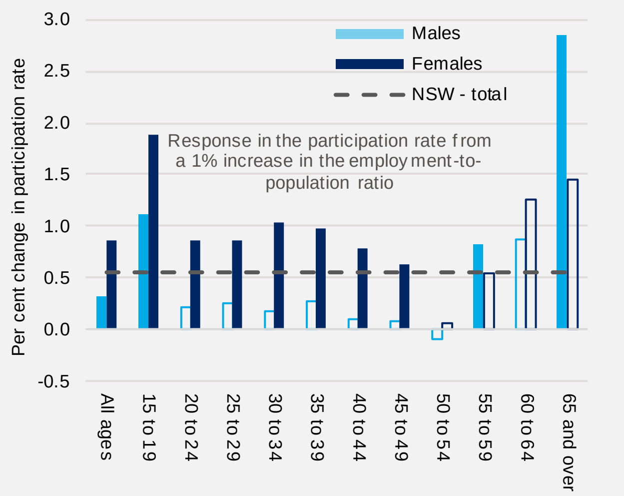
NSW Treasury research indicates that women in New South Wales are more responsive than men to changes in labour demand, particularly the 15 to 49 age group (see Chart 2.4). This broadly aligns with the change in participation rates over the last two years, with females showing the largest increase, particularly those aged 20 to 39.

The size of the cyclical component behind the increase in the participation rate gives an indication of labour market flexibility and spare capacity. By adjusting to the recent strength in labour demand, the rise in female labour supply has been an effective buffer against labour shortages.

More broadly, with the unemployment rate around estimates of full-employment, this is a sign that the New South Wales economy is providing opportunities for those who want to enter the labour force.

Achieving better outcomes for individuals with gainful employment leads to improved social outcomes, including a pathway out of poverty and reduced crime, and supports the State's economic growth.

*Chart 2.4: Females more responsive to changes in labour demand*[(a)]




(a) Non-shaded bars indicate coefficients are insignificant at the 10 per cent threshold.

*Source: ABS 6291.0.55.001 and NSW Treasury*

Over the long run, the female participation rate has trended upwards. This reflects structural factors such as greater workplace flexibility, access to paid parental leave and child care, a lower fertility rate, higher education levels and the shift in demand to more labour-intensive service industries. These include industries that tend to employ a higher proportion of females, including education and health, with participation in the latter seeing added support from the National Disability Insurance Scheme more recently.

A sustained increase in female participation has been a key driver in the rise of the State's productive capacity and living standards, along with productivity and population growth.

Non-residential construction activity is expected to partially offset falls in dwelling construction over the next two years. The public sector will be a major driver, assisted by the State's record $93.0 billion capital spending program over the next four years. This investment should bolster employment growth and improve productivity growth in the longer term.

The combined impact of recovering household consumption, smaller declines in housing construction activity and ongoing strength in the non-residential construction sector are expected to nudge economic growth back to trend from 2020-21. An expected recovery from drought and ongoing above-trend population growth will provide additional support.

External demand conditions should improve as the national and global economies strengthen. Greater economic integration with Asia, solid growth potential for our major trading partners, a lower Australian dollar and elevated commodity prices are all encouraging for the longer-term outlook (see Chapter 4 economic blueprint).

## 2.2 New South Wales, the jobs capital of Australia

### Strong employment growth, a record participation rate and full-employment

Over the past year, the labour market has achieved a trifecta of strong employment growth, a record high workforce participation rate and close to the lowest trend unemployment rate in four decades. Employment growth is expected to be elevated at around 3¼ per cent in 2018-19, double its long-run average, despite softening economic activity.

Job vacancies have reached an all-time high, reflecting the strong demand for labour. Consequently, the unemployment rate has drifted lower to 4½ per cent, around estimates for full-employment. However, the underemployment rate remains elevated, suggesting a willingness to work more hours and potentially some skills mismatch.

Other leading indicators of labour demand, such as job advertisements and business surveys of hiring intentions, are mixed and overall suggest employment growth may moderate in the near-term. This has occurred in the construction industry, where labour demand has softened as conditions in the housing market have weakened. That said, the construction industry remains the State's second-largest employer of full-time workers, and the expected pickup in non-residential construction will likely provide some offset.

## 2.3 Public and business investment to support the construction sector

### Dwelling construction eases amid slowing housing market conditions

Dwelling investment has been an important driver of the State's economic growth in recent years. However, dwelling construction has likely passed its peak for this cycle, with activity currently 9 per cent below its mid-2018 record high. That said, dwelling construction in the past year has remained near decade highs when measured as a share of state final demand.

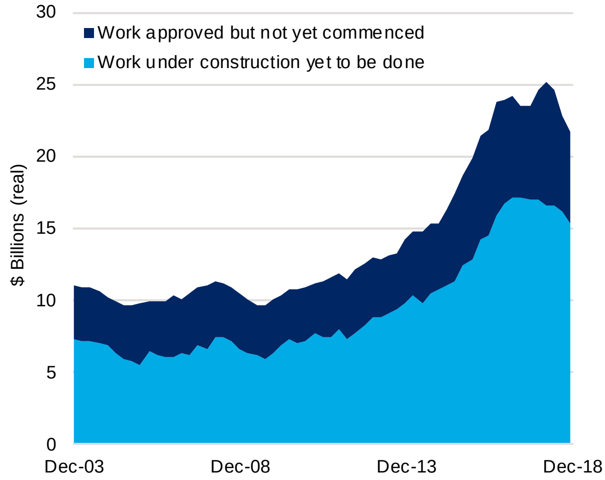
Declining house prices (see Box 2.2) and lower transaction volumes have had an impact on building approvals and commencements, although an elevated pipeline of dwellings under construction should allow for an orderly slowdown in activity in the near-term (see Chart 2.5).

The flow of new residential projects being approved has declined and the stock of projects waiting for approval has also fallen. This suggests a lower level of activity once the existing pipeline is worked through. Developer sentiment has fallen in line with house prices and other impediments, including stricter pre-sale and credit requirements. Given these conditions, approvals are expected to fall further, especially for apartments (see Chart 2.6)

Dwelling commencements have also fallen. Apartment commencements, which make up the largest share of the pipeline, fell 22 per cent in the final quarter of 2018 (see Chart 2.6).

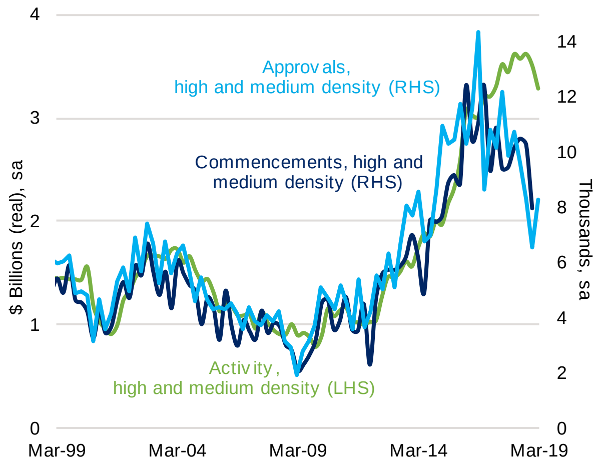
Expectations for ongoing strong population growth and a stabilisation in house prices from late-2019 should encourage the commencement of more projects. How conditions in the housing market evolve over the next 12 months will be important for dwelling investment and household consumption.

*Chart 2.5: Large pipeline of work to support near-term housing activity*




*Source: ABS 8752.0 and NSW Treasury*

*Chart 2.6: Commencements suggest bigger drop in construction activity looming*




*Source: ABS 8755.0, 8752.0, 8731.0 and NSW Treasury*

## Record public investment to partially offset housing construction weakness

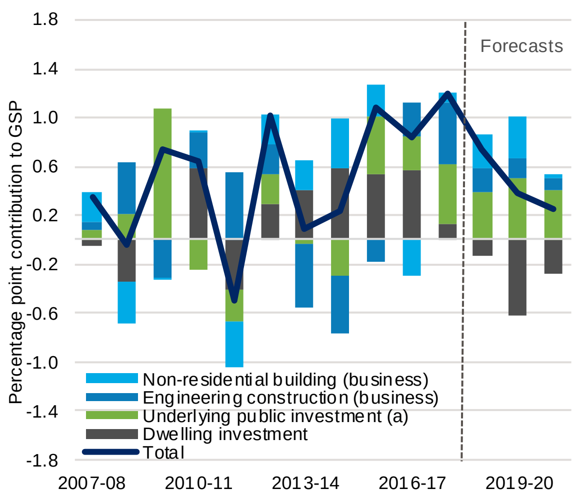
Public demand has been a source of strength for the economy, accounting for almost three-quarters of the growth in state final demand over the past year.

Government consumption has been a key driver, supported by the expansion of State front line services and the Commonwealth's rollout of the National Disability Insurance Scheme. This has added to employment, with industries that deliver social services contributing around a quarter of the growth in employment over the past three years.

The Government's infrastructure program is also doing the heavy lifting on the investment front, partly offsetting the drag from housing construction (see Chart 2.9). Public investment is expected to contribute ½ a percentage point per year to economic growth over the next two years, around five times its historical average. This should bolster employment in construction and its supporting services, including engineers and project managers, though the scale of the program could add to pressures on available capacity to deliver projects.

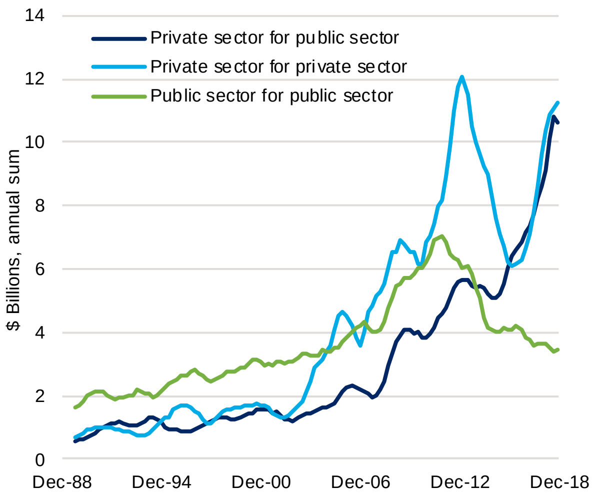
In addition to the direct contribution during the construction phase, investment in transport, education and health-related infrastructure, in the long term, should significantly improve the productive capacity of the economy. These investments will reduce travel times and provide new and upgraded facilities and technologies for students and patients.

*Chart 2.7: Non-residential construction to partially offset dwellings drag*




*Source: ABS 5206.0 and NSW Treasury*

*Chart 2.8: Private sector delivering a large share of publicly-led infrastructure*



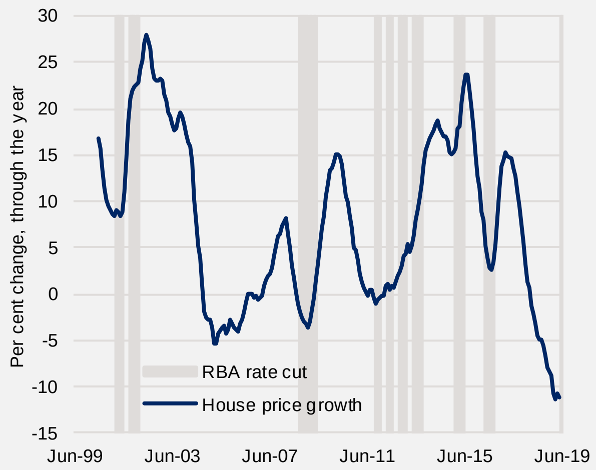

*Source: ABS 8762.0 and NSW Treasury*

Businesses are directly benefiting from this strong investment in public infrastructure. Almost 60 per cent of the engineering work done in New South Wales over the past year was commissioned by the public sector, with over 75 per cent of that delivered by the private sector (see Chart 2.8). This has contributed to elevated levels of capacity utilisation among businesses and should flow into other investment, such as capital expenditure on equipment.

### Box 2.2: Housing market to see some relief

Sydney house prices have continued to decline from their peak in mid-2017. In May 2019, median house prices were 14 per cent below their peak, marking the largest nominal decline since the early 1980s[1].

*Chart 2.9: Interest rate cuts should support a stabilisation in house prices*



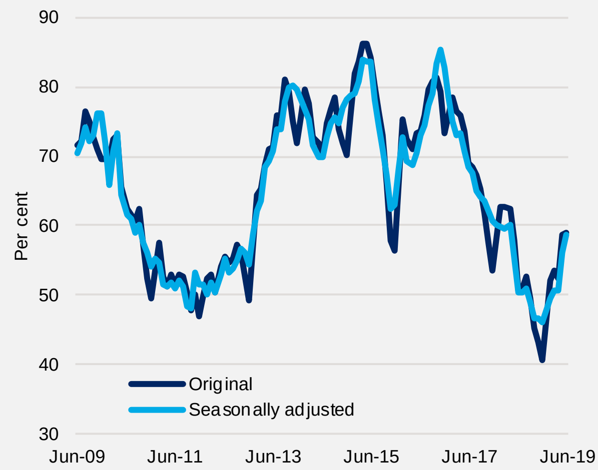

*Source:* CoreLogic, RBA and NSW Treasury

Sydney rents fell for only the second time on record in the March quarter 2019. The Sydney rental vacancy rate has also been steadily increasing to around 3.5 per cent, which is a level consistent with further downward pressure on rental price growth.

Housing finance commitments have also been weak, but there are some recent positives in the housing market which point to a stabilisation from late-2019.

The pace of house price declines appear to have moderated in April and May 2019. At the same time, auction clearance rates have shown a marked improvement from the very low rates seen earlier this year (see Chart 2.10). Albeit, the volume of auctions are still well below that of previous years.

*Chart 2.10: Auction clearance rates have shown some improvement(a)*




(a) Excludes January where insufficient data available.
*Source: CoreLogic and NSW Treasury*

The outcome of the Federal election and recent (and prospective) RBA interest rate cuts appear to have lifted housing market sentiment. The election outcome has removed the uncertainty around changes to negative gearing and capital gains tax discounts.

The Federal government's First Home Loan Deposit Scheme should compliment the state's First Home Owner Grant and First Home Buyers Assistance scheme.

Further, the Australia Prudential Regulation Authority has begun consulting on the possiblity of loosening minimum debt serviceability requirements. If implemented, this would increase the borrowing capacity of many buyers.

These recent developments have helped partially offset downside risks to the housing market and increased the likelihood of house prices stabilising from late-2019.

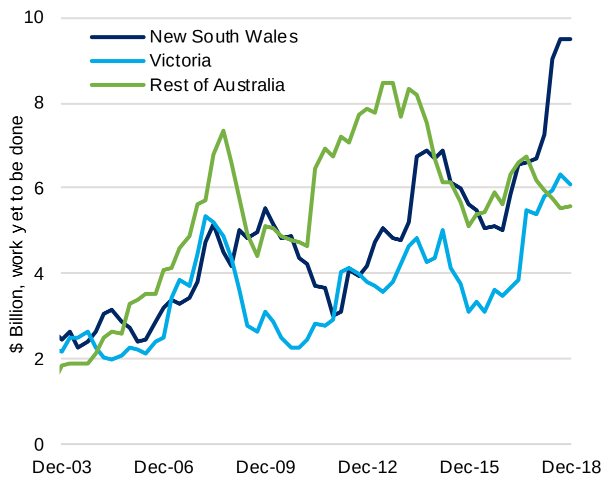
## Strong fundamentals continue to support business investment

The solid run in business investment is expected to continue, providing a major driver of economic growth. While some broad leading indicators, such as surveyed business conditions and investment intentions, have eased over the past year in line with weaker demand, they remain around average levels. Furthermore, the pipeline of infrastructure and non-residential building projects is elevated and fundamental drivers in several sectors indicate a favourable investment environment.

[1] Consistent house price data are only available since the early 1980s.

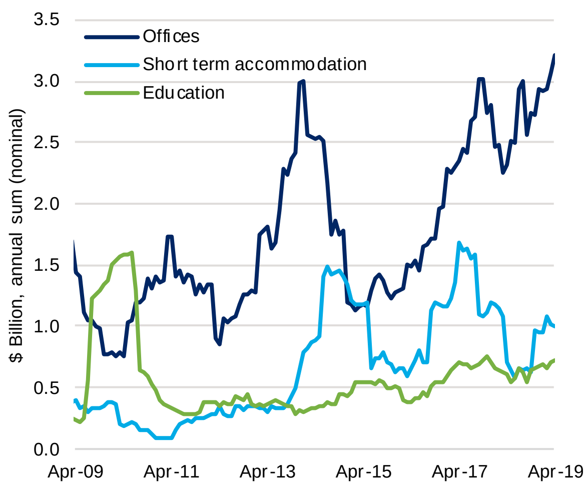
Non-residential building, led by the commercial sector (particularly office buildings), is expected to be the standout performer, underpinned by a record pipeline of projects and strong fundamentals (see Chart 2.11). Office approvals in the past year were at record levels (see Chart 2.12), consistent with low office vacancy rates, high commercial property prices and rents, and strong employment growth in the services sector. Short-term accommodation and education approvals have also risen, supported by solid exports of services.

*Chart 2.11: Record pipeline of private non-residential building*




*Source: ABS 8752.0 and NSW Treasury*

*Chart 2.12: Private non-residential building approvals remain elevated*



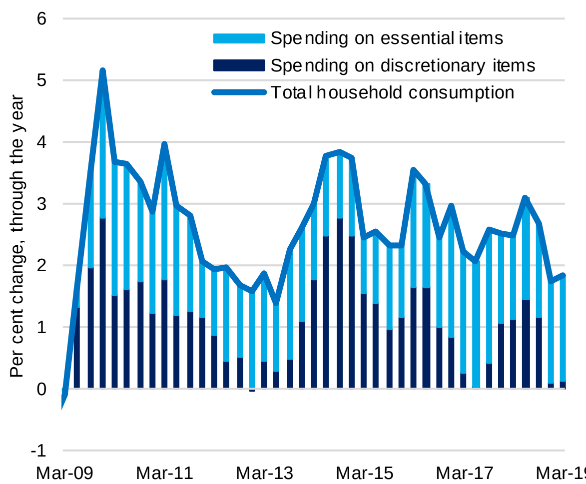

*Source: ABS 8731.0 and NSW Treasury*

## 2.4 Faster income growth expected to lead consumer recovery

### Household spending has pulled back

Household consumption growth has slowed over the past year, following a significant squeeze on household wealth and weakness in income growth. Consumers initially displayed resilience to weakening housing market conditions. The impact of declining house prices and housing transactions materialised in the second half of 2018, however, and has continued into 2019. Household consumption grew by just 1.8 per cent through the year to the March quarter 2019.

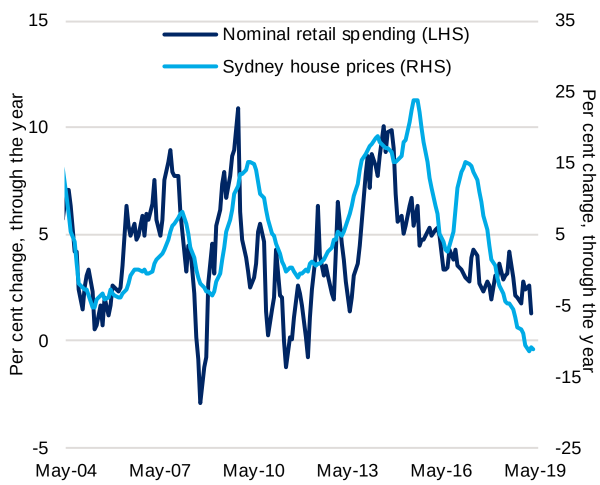
*Chart 2.13: Household discretionary consumption has pulled-back[(a)]*




*Source: ABS 5206.0 and NSW Treasury*

(a) Discretionary spending: tobacco, alcohol, clothing, furnishings, vehicles, recreation and culture, hotels, cafes and restaurants.

*Chart 2.14: Falling house prices are weighing on consumer spending*




*Source: CoreLogic, ABS 5206.0 and NSW Treasury*

There has been a noticeable slowdown in discretionary spending since mid-last year (see Chart 2.13). This is consistent with discretionary spending being more sensitive to changes in wealth and housing transactions. Partly offsetting this slowdown has been continued demand for essential goods and services.

While consumer spending is significantly more responsive to changes in income compared with changes in wealth, the magnitude of the declines in house prices appears to have impacted consumer spending (see Chart 2.14) more than was previously anticipated.

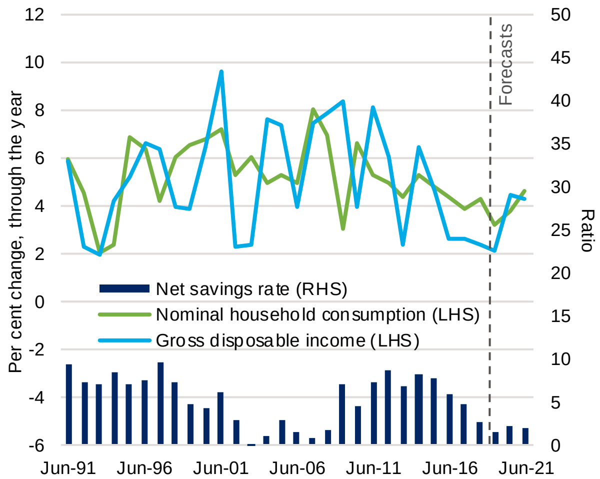
## Policy stimulus and wages growth should lift consumption going forward

In recent years, consumers have supported their spending in the face of subdued income growth, by lowering their savings rate (see Chart 2.15). This has been facilitated by large increases in household wealth as the value of assets, such as housing, experienced robust growth. With house prices falling, consumer spending will have to rely more on future growth in household disposable income.

Fiscal and monetary policy stimulus should help to invigorate household disposable incomes in the near-to-medium term. The Commonwealth Government's low-and-medium-income tax offset will provide a lift to disposable income in 2019-20. Easing monetary policy will also provide a boost by lowering households' interest payments, though the impact is partially offset by those households reliant on interest income.

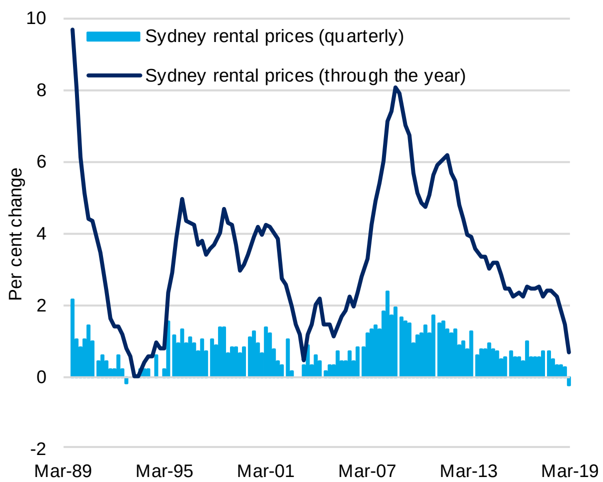
National labour market conditions are expected to facilitate a gradual increase in wages growth, which will help to slowly lift income growth in the out years. This should provide a backstop for household spending at a time when support to growth from policy stimulus will begin to wane.

*Chart 2.15: Household spending has been rising faster than incomes*




*Source: ABS 5220.0 and NSW Treasury*

*Chart 2.16: Housing costs have become a material drag on inflation*




*Source: ABS 6401.0 and NSW Treasury*

Stronger income growth and a stabilisation in housing market conditions should see consumption growth improve in 2020-21, becoming a key driver in returning economic growth to a trend rate.

## Box 2.3: The State's role in boosting productivity

Productivity is the most important determinant of improvements in living standards and underpins growth in wages and household incomes. Productivity grows when the value of the economy's output grows by more than the inputs.

Labour productivity, defined as total output in the economy per hour worked, is the most commonly used productivity measure.

There are several drivers of labour productivity, including:

- improved skills for workers
- increased capital input – investment in assets and technology
- innovation and technological change – so people and assets work smarter together, which increases multifactor productivity (MFP).

Weak productivity growth has been a problem for many advanced economies over recent decades, including Australia, and New South Wales has been no exception to the trend.

Chart 2.17 shows the contributions of increased capital and labour inputs, multi factor productivity, and changes in the terms of trade to growth in per capita income. Labour productivity growth averaged 2.8 per cent annually in New South Wales between 1994-95 and 1998-99, but slowed to an average of 0.8 per cent between 2003-04 and 2011-12, and has averaged 0.9 per cent annually since 2011-12.

Despite weakening labour productivity growth in the 2000s, living standards were bolstered by a surge in our terms of trade between 2003-04 and 2011-12, linked to the mining boom. This allowed for higher wages, and cheaper imports. However, the terms of trade have now receded, and wage growth has declined since around 2012.

The economy also faces the demographic challenge of an ageing population, which will likely lead to a fall in the labour force participation rate over the next few decades. As a result, we will need to increase productivity growth to sustain robust growth in per capita incomes.

The Government established the NSW Productivity Commission in 2018 and appointed Peter Achterstraat as the Productivity Commissioner.

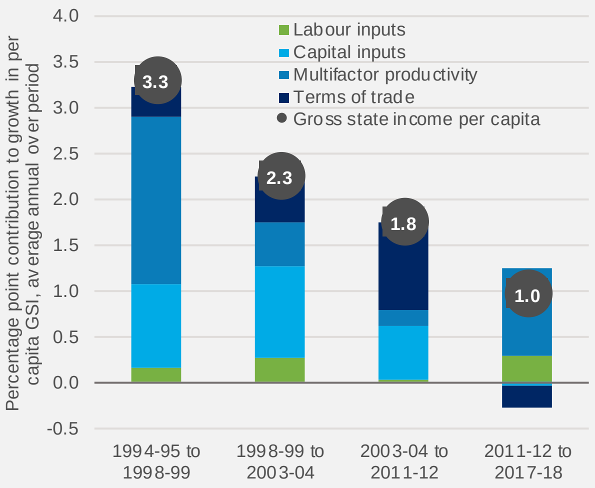
The Commission has already made some progress on the Government's goal of making it easier to do business in New South Wales by saving business owners' time and money through the introduction of a streamlined payroll tax system. From 1 July 2019, payroll tax will become a set-and-forget affair for thousands of businesses, rather than a monthly hassle.

The Productivity Commission is currently developing a Productivity White Paper, which will identify reform priorities for the economy to support business investment and innovation, create quality jobs, and attract businesses and skilled migrants.

Many key productivity levers sit with states, including planning regulation, economic infrastructure, energy and water policy, vocational skills development, and state taxes.

The Government is prioritising increasing productivity growth, because we know that it is crucial to a strong economy, which shares the benefits of growth throughout our community and ensures high living standards for future generations.

*Chart 2.17: Higher productivity growth is the key to driving per capita income growth*




*Source: ABS 5220.0, 6202.0, 6291.0.55.003, 5260.0.55.002.*
Note: 'Productivity cycles', as defined by the ABS.

### Improving labour market to spur faster wages growth and inflation

Wages growth is expected to make a modest comeback over the next two years, providing a basis for higher household income growth and inflation. This improvement is consistent with solid labour market conditions (nationally and locally), fewer wage freezes, larger bonus payments, higher advertised salaries and improving productivity growth (see Box 2.3).

The wage price index has seen a gradual trend upwards. Private sector wages maintained a growth rate of 2.3 per cent through the year to the March quarter 2019, the equal fastest rate in four-and-a-half years. Job level micro-data reveals that a higher share of employees have received wage increases after an extended period of wage freezes. This has supported much of the pick-up in aggregate wages growth over the past two years.

The national unemployment rate should trend lower again once the national economy regains some momentum in 2020-21. This reduced labour market spare capacity is forecast to continue spurring faster wages growth, with the wage price index forecast to rise 2¾ per cent in 2020-21 (revised from 3 per cent at the 2019 Pre-election Budget Update).

The expectation remains for inflation to rise in line with faster wages growth and a lower Australian dollar, albeit gradually. Multiple factors, however, have constrained inflation recently. A large fall in petrol prices at the end of 2018 and the first quarterly fall in Sydney rents since 1992 (see Chart 2.16) saw headline inflation fall in the March quarter 2019. Elevated housing rental vacancy rates and falling advertised rental prices, suggest rental price growth will likely remain weak for some time. This slowdown in rents, as well as government cost-of-living initiatives and intense retail competition will likely see further downward pressure on inflation, improving consumers' purchasing power.

## 2.5 Solid export demand despite global and national challenges

### Near-term outlook for the national and global economies has weakened

The International Monetary Fund (IMF) has cut its outlook for global growth to 3.3 per cent in 2019 (from 3.9 per cent in April 2018), the lowest rate since the Global Financial Crisis, with around three quarters of the world's economies projected to slow. This comes amid a challenging environment of trade tensions, geopolitical uncertainty and tightening financial conditions in emerging markets. Stuttering global trade growth has implications for the State's key commodity and service exports.

More positively, global growth is expected to rise towards the end of 2019, helped by the expectation of a more accommodative monetary policy stance in major economies. It also reflects China's ramp up of stimulus to counteract the negative impact of its escalating trade tensions with the United States. Global growth is projected to tick up to around 3.6 per cent in 2020, before stabilising at around this trend rate.

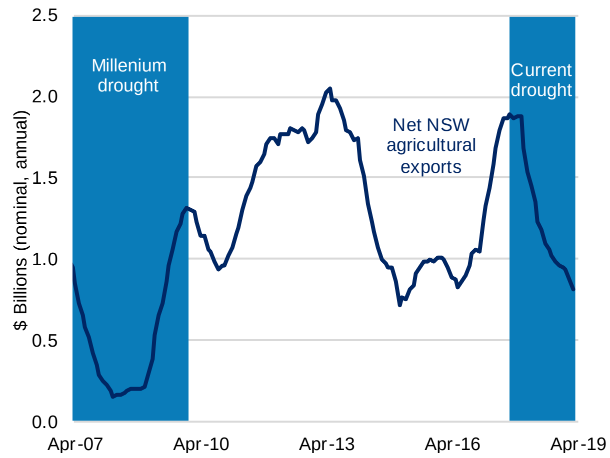
Closer to home, subdued national economic conditions will also be less supportive for New South Wales businesses, while drought conditions will continue to weigh on the rural sector.

Overseas export growth has remained strong this year, despite the State facing severe drought conditions. A rebound in resource exports and strong growth in advanced manufactured goods and service exports have offset significant declines in rural exports. Rural export volumes are expected to decline by a fifth in 2018-19 and remain below 2017-18 levels over the next two years (see Chart 2.18). The severity of the drought has led the Commonwealth Department of Agriculture to approve overseas wheat importation for the first time since 2007.

### Longer-term export drivers remain favourable, particularly for services

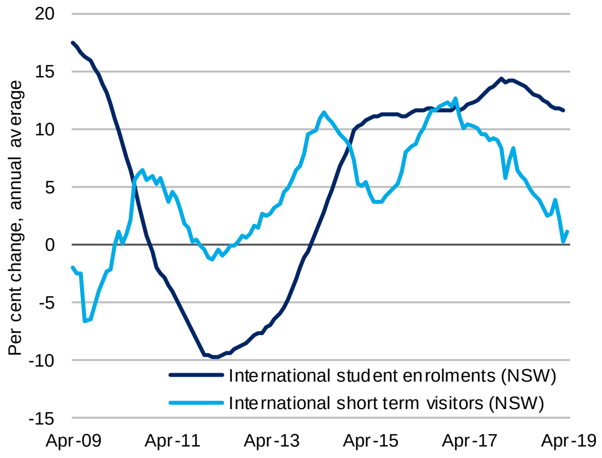
While the growth in service exports has been robust, more timely indicators suggest it may not have fully escaped the recent shift in global economic conditions. Growth in student enrolments has slowed modestly (see Chart 2.19). A more acute slump can be seen in overseas visitor arrivals, where growth has slowed. This slowdown in international students and visitors is broad-based across most countries, but with a material slowdown from China.

*Chart 2.18: Agricultural exports hit by persistent drought conditions*




Source: ABS.Stat and NSW Treasury

*Chart 2.19: Education and tourism temporarily slowing*




Source: ABS, DET and NSW Treasury

Growth in services exports is expected to moderate in the near-term, but then rebound along with improving economic conditions for our major export partners. A lower exchange rate will provide support, while the long-term growth drivers, such as growing demand from an emerging Asian middle class will help to fuel export growth for many years.

How global demand for New South Wales service exports evolves over the next few years will have significant implications for the broader state economy. The service sector has not only been a direct driver of economic growth, but a critical force behind employment and business investment, particularly for sectors like education, short-term accommodation and recreation and entertainment.

## 2.6 Risks to the economic outlook

Trade tensions between the United States and China appear to be more entrenched and likely to persist. The recent escalation of trade tensions are not incorporated in the current IMF forecasts for global growth, and therefore are a clear downside risk. That said, if global trade differences are resolved expediently, there should be some upside to global growth.

Adding to the trade risks is the possibility that China may seek to head-off a ballooning current account deficit by curtailing imports such as outbound tourism and international education. A development that could have significant implications for the New South Wales economy. However, China still has many other options for addressing its external balance. Additionally, any unexpected policy stimulus designed to revitalise growth in the Chinese economy, will help bolster demand for commodity exports, and support national income growth.

Domestic risks remain focused around conditions in the housing market, slowing construction activity and a cautious consumer that has not seen substantive real wages growth in some time (Appendix F provides a sensitivity analysis of the economic impacts from a negative house price shock). The response of households to lower interest rate expectations and any change to lending standards, could be either larger or smaller than currently expected.

A weaker-than-anticipated wage recovery, driven by an unexpected rise in the unemployment rate, and a sharper deterioration in housing activity, could exacerbate the slowdown in household consumption. That said, there is potential for wages and workforce participation to surprise to the upside (see Appendix F), particularly as spare capacity in the national labour market begins to tighten and inflationary pressures start to build.

Persistent drought conditions are another source of uncertainty, although the unpredictability of weather patterns means a risk to either the upside (a quicker-than-expected recovery) or the downside if dry conditions continue to impact crops and livestock.