



MEDIA RELEASE

EMBARGOED FOR: Wednesday, November 14, 2007, 2:00pm

For further information contact:

Tony Westmore, 0419 256 339

Richard Gibbs 02 8232 3935

AUSTRALIA'S ECONOMIC EXPANSION SHOWS NO SIGNS OF FATIGUE RESULTS OF THE ABE ANNUAL SURVEY OF THE EXECUTIVE COMMITTEE

Rob Henderson, Chairman, Australian Business Economists, commented:

We are pleased to release the annual survey of financial and macroeconomic forecasts made by the majority of members of the Executive Committee of the Australian Business Economists (ABE). Some members were unable to contribute to the survey due to their positions in the public sector.

Highlights of the ABE Annual Survey of the Executive Committee

- **The Committee expects the Australian economy to perform well in 2008 and 2009, with GDP growth likely to reach 3.8% and 3.5% in each of the next two years.** While these forecasts represent a modest slowing from a very strong 4.3% growth rate in 2007, no single forecaster sees the Australian economy growing below 3.2% over the next two years. If realised, these GDP forecasts would see Australia's current economic expansion run for a further two years, taking the period since the last recession to a record 19 years.
- The composition of GDP growth is likely to shift over the next couple of years. **Tighter monetary policy should see household consumption grow at more modest rates in 2008 and 2009.** After a couple of very strong years, the rate of growth of business investment is also expected to slow. However, a pick up in dwelling investment and export volumes ensure that the headline growth numbers remain robust.
- **The committee has identified the most prominent upside risk to Australian economic growth over the next two years as coming from a stronger than expected global economy and a stronger than anticipated terms of trade.** Domestically, the primary source of upside risk to growth would be from investment; whether that be residential construction, business spending or infrastructure expansion.
- While a weaker than expected global economy, in particular a US recession, represents an important downside risk to Australian economic prospects over the forecast horizon, just about all committee members are concerned about **domestic inflation and interest rates rising by more than presently forecast.** Continued upside surprises on inflation and interest rates would have the potential to slow domestic spending and investment via the increased stress on household balance sheets.
- 2007 should see business investment grow at a stellar 13.7% rate over the year. But the outlook for 2008 and 2009 suggests that corporate Australia's capital spending plans will be more modest in nature; business investment is expected to grow at a 6.0% rate in 2008 and a 2.6% rate in 2009. Nonetheless, **sentiment towards Australia's corporate sector remains positive, reflected in a bullish forecast for the ASX200 in 2008** - the Committee expects a rise to 7175 by December of next year, a gain of around 10% from current levels.



- Growth in export volumes growth is expected to pick up considerably over the next two years. Export volumes growth is forecast to be 6.7% in 2008 and 6.5% in 2009, up from 4.2% in 2007. In contrast, growth in import volumes is expected to slow over the next couple of years, thanks largely to more modest consumption growth and slower growth in capital goods imports. The expected lift in exports and the slowing in imports should see net exports add to growth in 2009 - the first time since 2001. Alongside the improvement in Australia's net export position, **the Committee expects the current account deficit to be 4.4% of GDP by 2009, down from 5.7% in 2007.**
- **The labour market is expected to remain strong over the next couple of years.** The unemployment rate is expected to be 4.3% in December 2008, with one forecaster expecting the unemployment rate to reach 3.8% by the end of 2008. The range of forecasts for the unemployment rate at the end of 2008 is quite wide, from a low of 3.8% to a high of 5.0%. Employment growth is forecast to moderate over the next couple of years (albeit from very elevated levels), to 2.1% in 2008 and 1.7% in 2009.
- Despite the expectation that the unemployment rate will remain close to 30 year lows over the next couple of years, **the outlook for wages growth remains largely unchanged from current levels.** Economists expect the Labour Price Index to record a growth rate of 4.1% in 2008, and 3.9% in 2009. Wages are forecast to grow at an average annual rate of 4.0% this year.
- **Headline inflation is forecast to remain at the top end of the RBA's 2% to 3% target band for the next two years.** In 2008, inflation is expected to average 2.9%, while in 2009 it is expected to average 2.8%. These forecasts appear broadly consistent with those recently published by the RBA in its latest quarterly Statement on Monetary Policy. The committee expects the RBA measures of core inflation to remain elevated in 2008 and 2009. The median expectation is for core inflation of 3.1% in 2008 with a number of forecasters expecting inflation to rise as high as 3.5%. All committee members expect core inflation to fall back to within the RBA's target band by 2009.
- **All ABE Committee members are expecting the RBA to deliver at least one more 25bp rate hike by the middle of next year.** Some Committee members expect a more aggressive RBA in 2008, with half of those surveyed forecasting a 7.25% cash rate by the end of next year. But 2008 is anticipated to represent the peak in the current tightening cycle - the Committee expects the RBA to cut rates in 2009. By December 2009, the RBA cash rate is forecast to be 6.75%. The RBA cash rate is expected to rise to 7.00% in this tightening cycle with all forecasts having the 'peak' in the cash rate between 7% and 7.25%. Over the long-term, short-term interest rates are projected to be significantly lower than the current level of 6.75%. When asked what will the RBA cash rate average over the next 10 years, the median expectation of the committee came in 5.75% with all responses between 5.5% and 6%.
- **The Government's fiscal position is forecast to remain very healthy over the next few years.** A headline cash balance of around \$12.7b is expected in 2008 and 2009. The committee was asked what economic policy challenges the new government will be faced within the next term. From a cyclical perspective just about all committee members expressed a need for greater awareness of the interaction between fiscal policy and the broader economic cycle. This will be particularly problematic over the next few years as the Government and the RBA struggle with a strong external stimulus in the presence of a fully employed economy. More fundamental concerns revolve around reform of the relationship between State and Federal Governments as well as policy initiatives to address labour skills shortages.
- **Only a few committee members believe the Australian dollar can achieve parity with the \$US on the next few years.** Many others said parity was possible with only a couple of forecasters ruling it out. Indeed, the median probability attached to the expectation that the \$A can sustain a break above parity to the \$US is just 25%. Part of this expectation appears to be linked to \$US expectations. **Most committee members believe the \$US will trough against the Euro at around \$US1.50.**



- **The committee does not expect the US economy to experience recession in the next 18 months.** That said the survey revealed a median expectation of the probability of a US recession in the next 18 months at 30%. Committee members expect the financial disruptions associated with the sub-prime crisis and the squeeze on wholesale debt markets to remain an issue for financial markets for some time to come. Most committee members believe the credit squeeze is largely the result of easy money and excessive leverage in certain parts of the financial system, but that the system is fundamentally sound and as such, represents a key risk factor for the US economy going forward.
- **It is a unanimous expectation that the next move in the Federal funds rate is down** although the extent of easing forecast for 2008 varies from one more 25bp cut to at least another 150bp of cuts. The median expectation for the Federal funds rate at the end of 2008 is 4% with most forecasts between 3.75% and 4.25%.
- **A strong consensus is centred on Chinese economic growth being maintained at around 10% to 11% for the next 2 years.** In fact, not one committee member has a point forecast for Chinese economic growth of below 10% in 2008 or 2009. When asked if they are expecting a material slowdown in Chinese economic growth over the next 3 years, responses ranged from “no slowdown” to “some moderation”. This suggests that a significant slowing in Chinese economic growth in the next few years would represent a genuine shock to expectations.
- **Oil prices are expected to remain elevated over the next few years although most committee members expect some modest price moderation from the recent high levels.** The committee expects the US dollar oil price (WTI) to decline to \$US75bl by the end of 2008 and then \$US65bl by the end of 2009. No one expects the oil price to be below \$US50bl over the next few years. Indeed, when asked what the probability of oil moving back below \$US50bl over the next 3 years, the median expectation was just 25%. Taking into consideration the committees expectation for the \$A/\$US exchange rate over the year few years; these forecasts suggest domestic petrol prices are unlikely to move down substantially from current levels.

ABE Executive Committee 2007

Chairman

Mr Robert Henderson Chief Economist Markets, nabCapital

Secretary

Mr Stephen Halmarick Director and Co-Head, Economic & Market Analysis Australia & NZ, Citigroup

Treasurer

Mr Warren Hogan Head of Markets Research, ANZ

Assistant Secretary & Treasurer

Mr Scott Haslem Chief Economist, UBS

Committee Members

Ms Besa Deda Currency Strategist, Commonwealth Bank of Australia

Mr Alex Erskine Managing Director, Erskinomics Consulting Pty Limited

Mr Bill Evans General Manager Economics, Westpac Banking Corporation

Mr Tom Ford Chairman, Resimac Limited

Mr Richard Gibbs Division Director & Head of Economics, Macquarie Bank

Mr Tim Harcourt Chief Economist, Australian Trade Commission

Mr David Plank Fixed Interest Strategist & Head of GM Research Aust/NZ, Deutsche Bank

Dr Tony Richards Head of Economic Analysis, Reserve Bank of Australia

Mr Geoff Weir Strategist, GTS Group, Goldman Sachs JBWere

Mr Josh Williamson Senior Strategist, TD Securities

