Australian Business Economists

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Australian Economy Likely to Lose Altitude in 2013
But the RBA Expected to Keep a Steady Hand

RESULTS OF ANNUAL SURVEY OF ABE EXECUTIVE COMMITTEE

The results of this survey will be discussed by the ABE Executive Committee at our Annual Conference to be held in Sydney this afternoon. See detail at end of release or visit abe.org.au > events

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Stephen Halmarick, Chairman, Australian Business Economists, commented:

I am pleased to release the annual survey of financial and macroeconomic forecasts made by members of the Executive Committee of the Australian Business Economists (ABE). Please note that 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 Australian economic growth to decelerate in 2013, as the pace of growth in business investment slows and the combined influences of cautious consumer spending and a fragile world economy take a firmer hold. From an estimated growth rate of 3.6% in 2012, **median GDP growth is forecast to fall to a sub-trend rate of 2.8% in 2013, before strengthening modestly in 2014.**

- **The range of forecasts for GDP next year** is notably wide, ranging from just 0.7% growth to as much as 3.2%. This broad range reflects the stage of the economic cycle and the lingering heightened uncertainty that is gripping the global economy. A significant lift in the non-mining segment of the economy is required to deliver a growth rate at the higher end of the forecast range.

- **GDP growth is expected to continue to be driven by robust growth in business investment**. It is forecast to increase by a further 9.3% in 2013. While this is a firm rate of growth, it is down considerably from an estimated 16.0% pace in 2012. In 2014, growth in business investment is expected to fall again to be just 0.8%.

- **Household consumption is forecast to slow in 2013, from an estimated growth rate of 3.8% in 2012 to 2.8%.** The on-going caution among consumers that includes a desire to save more and pay down debt together with the intensifying competition from online spending are weighing on household consumption. However, low interest rates should help limit the downside and eventually lead to an improvement in household consumption. Furthermore, households' balance sheets have been strengthening and should provide some cushioning for any negative domestic or global growth shocks. The Committee expects household consumption growth to improve in 2014.

- Dwelling investment is forecast to improve moderately in 2013 and again in 2014. The Committee estimates there will be a fall of 5.4% in 2012 before an improvement of 3.0% and 5.7% growth is posted in 2013 and 2014, respectively. Low interest rates, rising rental yields and an improvement in conditions in the established housing market are among factors expected to spur the projected lift in dwelling investment.

- With a large proportion of Australia's capital equipment being imported and with the relatively strong level of the Australian dollar, **overall imports are expected to stay relatively strong next year**. For 2013 import growth (6.6%) is expected to outpace export growth (6.0%), leading to a drag on economic growth over the year of 0.5 percentage points. For 2014 the situation is expected to be reversed; export growth should outpace import growth, leading to a small positive contribution to GDP.

- The trade accounts will have a strong influence on the current account. **The current account deficit as a proportion of GDP is expected to worsen by the middle of next year** and again by the end of next year, before an improvement takes place in the following year.

- The Australian economy has benefitted considerably from the benefits a high terms-of-trade has delivered over the past decade, particularly during the global financial crisis. But the terms of trade looks to have peaked in the September quarter of 2011. Moreover, the Committee forecasts a **sharp fall in the terms of trade this calendar year of nearly 9%, followed by another fall of 5.5% next year**. These falls will mean the economy is likely to lose some of its insulation that the terms of trade provide.

- The Committee expects **employment growth to expand modestly next year**, despite a forecast softening in the economy. Jobs growth in 2013 is expected to be 1.0%, up from estimated growth of 0.6% in 2012. It is forecast to accelerate again to 1.6% in 2014.

- **The unemployment rate is not expected to improve until 2014 when the stronger growth in jobs growth is projected to flow through**. The unemployment rate is forecast to stay flat at 5.5% next year, before falling slightly to 5.4% in 2014. Perhaps the more telling feature of the labour data is the wide range of estimates for next year from the Committee: 5.2% to 6.4%. The large variability in forecasts for next year likely reflects the high level of the exchange rate and the consequent pressures on companies to boost competitiveness through other means. In 2014 the range of forecasts from the Committee narrows and notably does not include any forecasts of 6% or higher.

- With the unemployment rate showing little improvement next year, the **growth of the labour cost index is expected to decline from 3.7% in 2012 to 3.5%**. However, the projected decline is small, reflecting the expectation the unemployment rate will not be substantially far from historically low levels next year. These forecasts for wage growth are restrained and should not put any significant pressure on inflation.

- **Headline inflation is forecast to brush the top of the RBA's 2-3% per annum target band next year, before some moderation occurs in 2014.** However, underlying inflation is expected to stay well within the RBA's target band at 2.6% in both 2013 and 2014.

- The Committee expects the **RBA to keep a steady hand over the next two years.** The cash rate is expected to end 2014 at 3%, from the current cash rate of 3%. The most interesting aspect of the cash-rate analysis is the wide range of forecasts, likely reflecting the greater-than-usual uncertainty attached to the world economy. In 2013, the range of cash rate forecasts from the Committee is 2.50% to 3.50% and in 2014 they are 3.00% to 4.00%.

- **The Federal Government's headline budget deficit is expected to shrink over the forecast period.** The improvement in the Government's bottom line should result in the deficit of $43.4 billion in 2011-12 narrowing to a deficit of $7 billion for 2012-13. The **Committee doesn't expect the budget to to be in balance until 2013-14 compared with the Government's forecasts that rest on a return to a surplus in 2012-13**. The range of Budget outcomes forecast by the Committee are, however, relatively wide. In 2012-13, the range is a deficit of $20.0 billion to a modest surplus of $0.1 billion. For 2013-14, the range is a deficit of nearly $8 billion to a surplus of $1.0 billion.

- **The 3-year/10-year bond yield curve is forecast to steepen to 62bp by mid next year, from its closing level of 50bp on 3 December 2012. It is then forecast to flatten from the middle of next year to 50bp by the end of next year.** The steepening is due to the 10-year bond yield rising at a faster rate (from 3.08% to 3.25%) than the 3-year bond yield (from 2.58% to 2.60%). Meanwhile, the flattening is due to the 10-year bond yield rising at a slower rate (from 3.25% to 3.40%) than the 3-year bond yield (2.60% to 2.90%). **The flattening becomes more pronounced in 2014 and leads the curve to invert by the end of 2014** to -3bp (3-year 4.03%, 10-year 4.00%). This inversion is very slight. If the inversion continues into 2015 and is sustained, it could be providing an early indication of a forthcoming sharp slowdown in the economy.

- The **Australian dollar is forecast to appreciate** by just over two US cents to US$1.04 by the **middle of next year. But then a reversal is expected over the remaining forecast period**, causing the AUD/USD to fall to parity at the end of 2013, before falling just under parity at the end of 2014 (at US$0.99).

- **Australian equities as measured by the ASX 200 index are forecast to be 16% higher by the middle of next year, from the 4,095 level recorded at the end of June 2012**. The median forecast for the ASX 200 is 4,750 points by June 2013, before rising to 4,775 points by December 2013 and 4,900 points by December 2014. The high end of the forecasts includes a break above 5,000 for the ASX 200 in 2014; the ASX 200 has not broken above this critical psychological level since April of 2010.

This year the Committee was also asked a number of special questions around both the local and global economic outlook.

- **The Committee overwhelmingly believes that it is unlikely the Federal Government will achieve its objective of returning the budget to surplus by 2012-13** without a further tightening of fiscal policy. **But any further fiscal contraction is viewed as putting more policy responsibility on the RBA.** The Government's growth forecasts that the budget rests on are also seen to be optimistic. The Committee believes it will **not be a significant issue to financial markets if a surplus is not delivered** by 30 June 2013, so long as the fiscal consolidation plan remains in place over the medium term. The impact of missing the surplus by the promised deadline is considered to be a **political downside rather than an economic downside**, provided the miss is not significant that it shakes the medium-term budget strategy.

- One of the biggest immediate risks facing the global economy is viewed as the US fiscal cliff (a sharp fiscal contraction), which is set to occur in January 2013 under the current US legislation. **All committee members agreed that if the US plunged off this fiscal cliff, it would fall into recession, substantially damaging confidence in the US and globally, and posing a significant threat to the global economy**. The Committee believes the **US will avoid this risk**, even if it resembles the eleventh-hour negotiations of last year. But most committee members believe the US will avoid the fiscal cliff only through some sort of band-aid solution or short-term fix that will have the effect of not dealing with the crux of the problem but pushing the problem out into the future. This band-aid solution could still involve some discretionary fiscal tightening. While the US fiscal cliff is significant and a concern, the Committee felt so too is the lack of a longer term credible plan for fiscal repair and consolidation.

- The Committee agreed that **the RBA should not be actively intervening to force a depreciation of the Australian dollar.** Instead, market forces should determine the appropriate level. An increasingly important and large determinant of the AUD's value is capital flows, which the RBA has little control over. Many Committee members remarked that Australian fixed-income products are attracting large capital inflows, which is underpinning a stronger AUD than otherwise would be the case**. If the RBA were to intervene, the view of the Committee is it would have only limited, if any, short-term success. If it were to intervene, it was also deemed that selecting a target for the AUD would be a problem** because determining a fair value for the AUD has its inherent difficulties. **One committee member also questioned whether the AUD was indeed exacerbating the patchwork nature of Australia's economy**, given that many exporters are also importers.

- **The Committee, on balance, believes the slowdown in China is consistent with that of a soft landing** rather than a hard landing. The likelihood of a soft landing is viewed as having risen significantly over the past month due to the improvement generally witnessed in the economic data. But no Committee member is completely ruling out the possibility of a hard landing. There were also some sharply divergent views; one committee member highlighted there was a risk that China performs better than expected next year while another committee member highlighted the worrying signs of excess. The latter noted that in his last recent visit to a hotel in Guangzhou, there was 300 staff to only 20 guests.

- The Committee believes that the **peak in the prices phase of the mining boom is over and the peak in the investment phase will follow soon. Most committee members expect the peak in mining investment has not yet occurred and will take place around the middle of next year.** A few members believed the peak would be in late 2013 or in 2014. **The export phase of the mining boom was largely viewed as having much longer to run.** It was also highlighted by one Committee member that the global under-investment in infrastructure over much of the past 30 years means that it is unlikely commodity prices would fall to the levels seen before the onset of the mining boom.

- The **Committee largely expects the unemployment rate to peak at is 5.80% with the timing being in late 2013.** This projected peak is only modestly above the current unemployment rate of 5.40%. There was some variability around the responses from Committee members; the **range was as low as 5.70% and as high as 6.80%.** By far the bulk of respondents expected the peak to occur next year. The more pessimistic forecasters expected the peak to occur late in 2013 or early in 2014. (Note that this question relates to forecasts for the peak in the unemployment rate whereas forecasts in the table, described on page 2, refer to median forecasts at specific points in time).

- One of the more difficult questions asked of the ABE Committee was if Europe was the Japan of the 21st century. The fact that both Europe and Japan will end 2012 in recession it was argued made this question valid. There was **some broad agreement that peripheral Europe might be the Japan of the 21st century, but as one committee member pointed out Japan is also the Japan of the 21st century**. Both peripheral Europe and Japan are not expected to grow much over the next five years. **Germany was generally viewed differently** and in a more positive light than the rest of Europe, despite having structural issues in its economy that need to be addressed over the long term. While there was some broad agreement that peripheral Europe might be another Japan, there was general consensus that peripheral Europe would not take as long as Japan in dealing with its core problems.

- The Committee believe that **Australians approaching retirement age and saving for their retirement incomes should have a greater asset allocation to bonds and other fixed-income securities. However**, the Committee also highlighted that current bond pricing meant that **now was not a good time to do any significant re-weighting towards bonds**. A greater allocation to fixed-income products is viewed as helping to spread risk and lower volatility in portfolios.

Table 1: ABE Survey of the Executive Committee, Summary

All forecast variables are annual average % change unless otherwise stated, all actual data is as at 30 November 2012

	2011	2012 (e)	2013 (f)			2014 (f)		
	Actual	*Median*	**Median**	Low	High	**Median**	Low	High
National Accounts								
Private Consumption	*3.3*	3.8	**2.8**	2.0	3.3	**3.3**	2.4	3.5
Dwelling Investment	*1.3*	-5.4	**3.0**	-1.0	6.7	**5.7**	3.0	11.4
Business Investment*	*17.1*	16.0	**9.3**	0.5	10.1	**0.8**	-11.2	7.1
Inventories (ppt contribution)	*0.4*	0.0	**0.0**	-1.0	0.2	**0.0**	-0.1	0.3
Exports	*-1.3*	5.2	**6.0**	4.2	8.3	**7.8**	3.6	9.5
Imports	*11.4*	7.5	**6.6**	2.5	8.9	**5.5**	0.7	6.6
Net Export (ppt contribution)	*-2.7*	-0.7	**-0.5**	-1.3	1.0	**0.3**	-3.1	1.7
GDP	*2.1*	3.6	**2.8**	0.7	3.2	**3.1**	2.0	3.5
Labour and Inflation								
Employment	*1.7*	0.6	**1.0**	0.1	1.3	**1.6**	1.3	2.0
Unemployment Rate (end period)	*5.2*	5.5	**5.5**	5.2	6.4	**5.4**	5.0	5.9
Labour Price Index	3.7	3.7	**3.5**	2.6	3.8	**3.6**	3.5	3.8
CPI	*3.3*	1.9	**3.0**	2.5	3.3	**2.7**	2.4	3.0
Underlying CPI	*2.6*	2.3	**2.6**	2.4	3.0	**2.6**	2.2	2.8
Other								
Terms of Trade	*13.9*	-8.6	**-5.5**	-10.6	2.5	**0.0**	-6.2	2.0
Current Account Deficit (% of GDP)	*-2.3*	-3.8	**-4.7**	-5.4	5.2	**-3.6**	-5.9	5.2
Headline Cash Budget ($Abn)**	*-47.7*	-43.4	**-7.0**	-20.0	0.1	**0.0**	-7.9	1.0

	Jun-12	Jun-13 (f)	Dec-13 (f)			Dec-14 (f)		
	Actual	Median	**Median**	Low	High	**Median**	Low	High
Financial (all end period)								
Cash Rate	*3.50*	3.00	**3.00**	2.50	3.50	**3.00**	3.00	4.00
3-Year Government Bond Yield	*2.42*	2.60	**2.90**	2.60	3.80	**4.03**	3.00	4.90
10-Year Government Bond Yield	*3.04*	3.25	**3.40**	2.85	4.00	**4.00**	3.20	5.10
AUD/USD	*1.02*	1.04	**1.00**	0.97	1.04	**0.99**	0.93	1.04
ASX 200	*4,095*	4,750	**4,775**	4,650	4,900	**4,900**	4,750	5,150

*Excluding second hand asset purchases

**Financial year (2013 is 2012/13 and so on)

ABE Executive Committee 2012

Chairman
Mr Stephen Halmarick — Head of Investment Markets Research, Colonial First State Global Asset Management

Secretary
Mr Warren Hogan — Chief Economist, ANZ

Treasurer
Mr Scott Haslem — Chief Economist, UBS

Assistant Treasurer and Secretary
Mr Joshua Williamson — Senior Economist and Director, Citi

Committee Members

Ms Besa Deda	Chief Economist, St.George Bank
Mr Adam Donaldson	Head of Debt Research, Commonwealth Bank of Australia
Mr Alex Erskine	Chief Economist, Australian Securities & Investments Commission
Mr Bill Evans	Chief Economist, Westpac Banking Corporation
Mr Tom Ford	Chairman, Resimac Limited
Mr Brian Redican	Senior Economist, Macquarie Group
Mr Tim Harcourt	JW Nevile Fellow in Economics & Professor, University of New South Wales
Mr Robert Henderson	Chief Economist, Markets, National Australia Bank
Dr Jonathan Kearns	Head of Economic Analysis, Reserve Bank of Australia
Ms Su-Lin Ong	Managing Director, Head of AU/NZ Economics & Fixed Income Strategy, RBC Capital Markets
Mr David Plank	Head of Macro Research and Strategy Australia/New Zealand, Deutsche Bank
Ms Jenny Sillar	Policy Advisor, Office of the Treasurer, NSW Government
Mr Gavin Stacey	Head of Strategy, Barclays Australia and New Zealand
Mr Stephen Walters	Chief Economist, J. P. Morgan
Mr Geoff Weir	Managing Director, Financial Sector Services Pty Ltd

Annual Conference - Wednesday 05 December 2012
Sheraton on the Park Sydney

1:15 Welcome

1:30 *Australia as a safe haven*

Professor Warwick McKibbin, Crawford School of Public Policy
Australian National University

Mr Quentin Grafton, Chief Economist and Executive Director
Bureau of Resources and Energy Economics

Mr Kumar Palghat, Managing Director
Kapstream Capital

4:00 *The outlook for the economy and financial markets*

Mr Scott Haslem, Chief Economist, UBS
Mr Adam Donaldson, Head of Debt Research, Commonwealth Bank of Australia
Mr Stephen Walters, Chief Economist, J.P. Morgan
Mr David Bassanese, Economics & Finance Columnist, *Financial Review*

4:45 *The outlook for politics and government*

Ms Laura Tingle, Political Editor, *Financial Review*

The conference will be followed by our Annual Dinner featuring Dr Philip Lowe, Deputy Governor of the Reserve Bank of Australia on the topic “What is normal?”. Dr Lowe’s speech will commence at 8:20 pm. There will be no live broadcast. Dr Lowe will take questions from the floor.

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