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Patchy economic recovery to continue; RBA on hold until later next year

RESULTS OF ANNUAL SURVEY OF ABE EXECUTIVE COMMITTEE

The results of this survey will be discussed at the ABE Annual Conference to be held Tuesday 25 November from 1:15 pm until 5:30 pm at the Four Seasons Hotel Sydney, 199 George Street, The Rocks. For detail see abe.org.au > events.
For detail of Executive Committee membership, see page 6.

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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 Australian Business Economists (ABE). Note: some members were unable to contribute to the survey due to their positions in the public sector.

Highlights of the Annual Survey of the ABE Executive Committee

- The Committee expects **Australian economic growth to moderate slightly in 2015**, as the downturn in mining investment deepens. From an estimated growth rate of 3.1% in 2014, the median forecast is for GDP growth of 3.0% in 2015, before strengthening modestly again in 2016 to 3.2%.
- **GDP growth next year is expected to be driven by robust growth in dwelling investment and net exports. The range of forecasts for GDP next year from the Committee is wide** - ranging from 2.7% growth to as high as 3.5%. This broad range reflects the higher-than-usual uncertainty clouding the economic outlook. 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.
- **Dwelling investment is forecast to increase by 7.5% in 2015 and rise by a lower 1.4% in 2016.** Low interest rates, robust population growth and underlying pent-up demand are expected to continue to underpin the upswing in dwelling investment.
- The mining investment downturn is deepening and the export phase is kicking in. This is underscored in the strong rates of growth the Committee is forecasting for exports. Exports are expected to grow by 7.0% in 2015 and by 7.2% in 2016. Import growth is not expected to keep pace with exports, due to a softer profile for the AUD and a decline in capital imports growth. **A firm contribution to economic growth from net exports of 1.3 percentage points is expected next year and again in 2016**.
- **Household consumption is forecast to pick up modestly in 2015, from an estimated growth rate of 2.5% in 2014 to 2.7% in 2015.** Low interest rates, strong population

growth and the upswing in housing are important factors helping to underpin household consumption. However, consumer sentiment remains subdued and a risk to the outlook. Wages growth is also soft.

- **Business investment, mainly mining investment, is forecast to be the big drag on growth in the next two years.** Business investment is expected to fall 4.0% in 2015 and decline by 1.7% in 2016. The low end of estimates has business investment falling as much as 7.3% and 8.3% in 2014 and 2015, respectively.
- The international trade account will have a strong influence on the current account. **The current account deficit (CAD) as a proportion of GDP is expected to improve next year and in 2016**. The median forecast is for the CAD to be 2.9% of GDP in 2015 and just 2.2% in 2016, an improvement from 3.1% expected in 2014.
- The Australian economy has benefitted considerably from a high terms-of-trade over much of the past decade, particularly during the global financial crisis. But the terms of trade peaked in the September quarter of 2011. The Committee forecasts a **sharp fall in the terms of trade of 3.9% in 2015, followed by another fall of 2.0% in 2016**. These falls mean the economy will experience a net transfer of income to the rest of the world.
- **The Committee expects employment growth to pick up next year.** Jobs growth in 2015 is expected to lift to 1.5% and in 2016 to 1.8%, from 1.0% expected in 2014. **The unemployment rate is, therefore, expected to improve, finishing the year in 2015 at 5.9% compared with 6.2% expected at the end of 2014. In 2016, the unemployment rate is expected to fall to 5.7% by the end of the year.** There were a wide range of estimates for next year from the Committee, however: 5.7% to 6.7%. In 2016 the range of forecasts from the Committee is 5.3% to 6.3%.
- With the unemployment rate showing only modest improvement next year, the growth of the labour cost index is expected to be moderate, remaining below the RBA's unofficial 'line in the sand' of 4.5%. **The Committee estimates the labour cost index to grow by 2.9% next year and by 3.1% in 2016.** If wages grow at these estimates, it would not provide any significant pressure on inflation.
- **Headline inflation is forecast to hug close to the middle of the RBA's 2%-3% per annum target band next year and the year after. It is a similar story for underlying inflation.** Headline inflation is forecast to be 2.5% in 2015 and 2.6% in 2016 and underlying inflation is forecast to be 2.4% in 2015 and 2.6% in 2015.
- The Committee expects the **RBA to be on hold until the second half of next year.** The median forecast is for the cash rate to remain at 2.50% by the end of June next year and to reach 3.00% by the end of December next year. The range of forecasts for the cash rate for the end of next year is, however, wide at 2.50% to 3.25%.
- **The Federal Government's headline budget deficit is expected to improve over the forecast period, according to the median forecast of the Committee.** A deficit of $A32.5bn is expected in 2015/16, after an expected deficit of $A50.0bn in 2014/15. A further improvement to a deficit of $A22.0bn is forecast for 2016/17.
- **The 3-year/10-year bond yield curve is forecast to steepen to 100bp by the end of June next year, from its expected closing level of 75bp at the end of December 2014.** The steepening is due to the 10-year bond yield rising at a faster rate (from 3.5% to 4.0%) than the 3-year bond yield (from 2.75% to 3.0%) over the reference period. But in the second half of next year, the Committee expects the RBA to be tightening monetary policy, contributing to a flattening of the 3-year/10-year bond yield curve. This flattening is due to the 3-year yield rising by more than the 10-year bond yield.

- The **Australian dollar is forecast to finish 2014 at US$0.8800 and then depreciate and end next year at $US0.8300.** The range of median forecasts is, however, a very wide $US0.8000-$US0.9200. The softer profile is consistent with the moderation expected by the Committee in Australia's terms of trade.
- **The ASX200 share market index is forecast to be 2.9% higher by the middle of next year, from the 5,613 level the Committee expects the ASX 200 index to be at the end this year.** The ASX200 is then expected to rally a further 3.5% in the second half of next year to finish 2015 at 5,975. The high end of the forecasts includes the ASX 200 reaching the 6,150 level in 2015; the ASX 200 has not breached the psychological barrier of 6,000 since the 10th of January 2008.
- The Committee was also asked to provide their **long-term forecasts for the economy**. The median forecast for GDP growth in 2017 was 3.1%, a little above the long-term trend rate for the economy. The unemployment rate is expected to be at 5.4% at the end of 2018 and the cash rate at 4.00%. Meanwhile, headline and underlying inflation were expected to grow by 2.50%, on average, in 2018. Finally, at the end of 2017 the Australian dollar was expected to be at $US0.8000 and the ASX 200 index at a near all-time high of 6,800.

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

- **Nearly all Committee members expect the US Federal Reserve to begin raising the Federal funds target rate in 2015. Most of the Committee expect the first rate hike to occur in Q2 2015.** Only one Committee member did not expect the Fed to hike rates next year. However, the path of rate tightening is expected to be gradual, and the Fed funds rate is expected to stay low into 2016 in comparison to previous tightening cycles. Most Committee members expect a Fed funds rate of between 2% and 2.5% for the end of 2016. Communicating the normalisation of policy was commonly cited as one of the key challenges for the Fed, as it had the potential to disrupt financial markets. Another concern raised included the impact of the appreciating US dollar on Australian economic growth. Most Committee members thought that the inflation outlook would be benign, although one member pointed out that this could change with the falling unemployment rate.
- Policy normalisation by the Fed was also seen as contributing to the risk of increased market volatility. **Most Committee members saw that the recent lift in volatility would persist** and was a return to more 'normal' levels. The uncertainty following the end of quantitative easing (QE) undertaken by the Fed was also seen as a reason for higher volatility. Some Committee members, however, saw that the improving global economy should see concerns subside and lead to an easing in volatility.
- **Most Committee members do not expect the the asset-backed securities purchase program, recently launched by the European Central Bank (ECB), to be enough to boost growth and inflation in the euro zone region.** The impact of monetary policy was viewed as limited due to the need for structural reform, fiscal restraint and deleveraging. While many Committee members expected the ECB to resort to purchasing sovereign bonds, there were questions over whether it will be able to. Hurdles that were mentioned included the legality of sovereign bond purchases, political hurdles and the difficulty in purchasing sovereign bonds over individual markets. Not all Committee members were downbeat on Europe. A few Committee members thought the current stimulatory measures will help, particularly in encouraging greater lending activity. Other positives that were cited included a weaker euro and a stronger US economy.
- **Most Committee members expect China to grow at close to 7% next year**. The key risk to the outlook was from a downturn in the property market. Another concern was

managing financial liberalisation. The range of forecasts from the Committee for GDP growth next year in China was 6.0% to 7.4%.

- Committee members were asked about their **assessment of the rotation of Australian economic growth**. There were a wide range of views as to whether this rotation was meeting expectations. However, a common theme throughout responses was that the transition occurring in the economy remained uneven or patchy. A lack of confidence was blamed for holding back non-mining investment. Weak demand was also another frequent answer. Political uncertainty was also cited as a reason by a few Committee members.
- There was also a variety of responses in regards to the housing market. **The majority of Committee members thought that a significant correction in housing was unlikely**, although a few committee members saw that risks of a correction within housing were rising. A couple of responses tied the risk of a sharp correction to a significant lift in the unemployment rate, but Committee members did not expect for this to occur. Most Committee members pointed out the fundamentals supporting housing demand including low interest rates and strong population growth. On the use of macro-prudential policy (MPP), most Committee members thought that it would have a limited impact, although a few saw it as being useful. These measures were viewed as not the best way to address the problem as demand was coming from overseas. One member also pointed out that they didn't target supply issues. MPP was also seen as a temporary measure by some Committee members.
- **The bulk of the Committee believe that the unemployment rate is close to a peak. Most Committee members expect the unemployment rate peak to be 6.25%.** The range of forecasts was 6.1%-7.0%.
- **The Committee believes that on balance other sources of growth outside of resource exports will need to be found to offset the drag to GDP growth from** the deepening mining capex fall. The **real pothole from the mining capex downturn is also seen to be in the labour market and in incomes**.
- The Committee believes **consumers are failing to respond to the large positive wealth effects this year because wealth effects are only one part of the demand equation. Soft wages growth and job security fears are also weighing on consumer spending**.
- The **bulk of the Committee expects the RBA to raise rates next year**. There was one Committee member that expected a cut not a hike. **The timing of the first rate hike is largely forecast to occur in the second half of next year**. **The neutral cash rate was mostly viewed as now being lower than in the past, at around 3.75% to 4%.** The range of forecasts for the neutral cash rate is 3% to 4%.
- The **consensus forecast for the bottom of the Australian dollar's trading range for 2015 is around US$0.8200.** The worst-case scenario from all of the Committee's forecasts sat at US$0.7600.

Table 1: ABE Survey of the Executive Committee, Summary

All forecast variables are annual average % change

	2013	2014 (e)	2015 (f)			2016 (f)		
	Actual	*Median*	**Median**	Low	High	**Median**	Low	High
National Accounts								
Private Consumption	2.0	2.5	2.7	1.7	3.8	3.0	1.2	3.7
Dwelling Investment	1.8	9.1	7.5	1.5	10.5	1.4	-1.5	5.5
Business Investment*	-2.2	-5.0	-4.0	-7.3	0.9	-1.7	-8.3	4.2
Inventory (ppt contribution)	-0.6	0.0	0.2	0.1	0.5	0.0	-0.4	0.3
Exports	6.6	7.2	7.0	4.2	10.1	7.2	2.8	12.0
Imports	-2.0	-0.4	2.0	-2.1	4.8	2.6	-4.2	7.4
Net Export (ppt contribution)	1.8	1.7	1.3	0.9	1.8	1.3	0.4	2.4
GDP	2.3	3.1	3.0	2.7	3.5	3.2	2.8	3.9
Labour and Inflation								
Employment	1.0	1.0	1.5	0.8	1.6	1.8	1.1	2.1
Unemployment Rate (end period)	5.9	6.2	5.9	5.7	6.7	5.7	5.3	6.6
Labour Price Index	2.8	2.6	2.9	2.6	3.0	3.1	2.9	3.6
Headline CPI	2.4	2.6	2.5	2.0	2.8	2.6	2.3	3.0
Underlying CPI	2.5	2.6	2.4	2.1	2.9	2.6	2.4	3.0
Other								
Terms of Trade	-1.0	-6.9	-3.9	-7.1	4.5	-2.0	-8.0	3.0
Current Account Deficit (% of GDP)	-3.3	-3.1	-2.9	-4.0	-1.5	-2.2	-3.8	-0.4
Headline Cash Budget ($Abn)**	-21.0	-50.0	-32.5	-42.0	-29.8	-22.0	-34.0	-17.0

	2013	Dec 2014 (e)	Jun 2015 (f)			Dec 2015 (f)		
	Actual	*Median*	**Median**	Low	High	**Median**	Low	High
Financial (all end period)								
Cash Rate	2.50	2.50	2.50	2.50	3.25	3.00	2.50	3.75
3-year Government Bond Yield	2.95	2.75	3.00	3.00	4.10	3.75	3.20	4.50
10-year Government Bond Yield	4.24	3.50	4.00	3.60	4.50	4.30	3.70	4.60
AUD/USD	0.89	0.88	0.85	0.80	0.92	0.83	0.78	0.94
ASX 200 Index	5,320	5,613	5,775	5,600	6,000	5,975	5,775	6,150

	2017 (f)
	Median
Longer-Term Outlook:	
GDP	3.10
Unemployment Rate (end period)	5.38
Headline CPI	2.50
Underlying CPI	2.50
Cash Rate (end period)	4.00
AUD/USD (end period)	0.80
ASX 200 (end period)	6,800

Notes:
* Excluding second hand asset purchases
** Financial year (2014 is 2013/14 and so on)
*** Actual Budget outcome for 2013-14

ABE Executive Committee 2014

Chairman
Mr Stephen Halmarick Head of Economic & Market Research, Colonial First State Global Asset Management

Secretary
Mr Warren Hogan Chief Economist, ANZ

Treasurer
Mr Scott Haslem Chief Economist, Australasia, UBS

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

Committee Members

Mr Warren Bird	Director, Investment Committee Member and Investment Writer
Mr Kieran Davies	Chief Economist, Barclays Australia and New Zealand
Ms Besa Deda	Chief Economist, St.George Bank
Mr Adam Donaldson	Head of Fixed Income Research, Commonwealth Bank of Australia
Mr Alex Erskine	Managing Director and Founder, Erskinomics Consulting Pty Ltd
Mr Bill Evans	Chief Economist, Westpac Banking Corporation
Mr Tom Ford	Director, Resimac Limited
Mr Tim Harcourt	JW Neville Fellow in Economics & Professor UNSW Business School
Dr Alex Heath	Head of Economic Analysis, Reserve Bank of Australia
Mr Robert Henderson	Retired Markets Economist
Mr Peter Jolly	Global Head of Research, National Australia Bank
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
Mr Brian Redican	Chief Economist, NSW Treasury Corporation
Mr Stephen Walters	Chief Economist, Australia and New Zealand, J.P. Morgan
Mr Geoff Weir	Managing Director, Financial Sector Services Pty Ltd

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