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Cautious Optimism on the Domestic Economic Outlook
Division over the RBA Cash Rate Outlook

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 24 November from 1:00 pm until 5:15 pm at the Four Seasons Sydney, 199 George Street, The Rocks. For detail see abe.org.au > events.
For detail of Executive Committee membership, see page 6.

For media enquiries contact: Stephen Halmarick 0411 049 693 or Besa Deda 0404 844 817

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 lift in 2016**, driven by strength in net exports and solid growth in household consumption. Dwelling investment will also add to growth, but business investment is expected to remain weak. From an estimated growth rate of 2.3% in 2015, the median forecast is for GDP growth of 2.7% in 2016, strengthening further in 2017 to 3.0%.
- **The range of forecasts for GDP growth next year from the Committee is wide, ranging from 2.5% to 3.9%.** This broad range reflects the higher-than-usual uncertainty clouding the economic outlook. A significant rise in dwelling investment, very strong growth in exports, and only a modest contraction in business investment are likely required to deliver a growth forecast at the higher end of the forecast range.
- Low interest rates and strong population growth have supported dwelling investment. **Dwelling investment is forecast to grow by 2.2% in 2016, before shrinking by 1.4% in 2017.** This follows estimated growth in dwelling investment of 9.7% in 2015. The pipeline of dwelling investment remains strong, suggesting residential construction is likely to remain at an elevated level.
- While the mining investment downturn continues, increased production capacity is driving exports. **The Committee expects export volumes to grow by 7.4% in 2016 and by 6.9% in 2017.** Import growth is not expected to be as strong over the forecast period due to tame domestic demand and the low Australian dollar. A solid contribution to economic growth from net exports is expected in 2016 and 2017, of 1.3 and 1.1 percentage points, respectively.

- Low interest rates, a housing upswing and an improving labour market have lent support to household consumption. Soft wages growth, however, has limited growth in household spending. **Household consumption growth is forecast to pick up modestly in coming years, to 2.7% in 2016 and 3.0% in 2017.**
- Business investment, mainly mining investment, is forecast to continue dragging on economic growth over the next two years. **Business investment is expected to fall 6.5% in 2016, slowing to a decline of 1.6% in 2017**, as the mining investment downturn runs its course and non-mining investment picks up.
- **The current account deficit (CAD) as a proportion of GDP is expected to improve next year and again in 2017.** The international trade account will have a strong influence on the outcome. The median forecast from the Committee is for the CAD to be 3.4% of GDP in 2016 and 2.6% of GDP in 2017. These forecasts compare favourably to the outcome of 4.1% of GDP expected for this year.
- The Australian economy was the beneficiary of a stronger terms-of-trade from 2003 until 2011, which assisted the economy during the global financial crisis. Since September 2011, the terms of trade has fallen sharply. **The Committee expects the terms of trade to fall a further 3.1% in 2016, before picking up by 2.4% in 2017.**
- **The Committee expects employment growth to remain moderately firm.** Following employment growth of 0.7% in 2014 and expected growth of 1.7% in 2015, the median forecast of the Committee is for 1.7% growth in 2016 and an expansion of 1.8% in 2017. The average pace of job growth over the past decade has been 1.8%. **The Committee expects the unemployment rate to finish 2016 at 6.2%, before falling to 5.8% by the end of 2017**. The range of forecasts for the unemployment rate by the end of 2016 ranged from 5.7% to 6.3%. For the end of 2017, the range was 5.5%-6.2%.
- The **Committee expects only modest growth in wages over the next two years.** The Committee expects the labour price index to rise by 2.5% in 2016, following estimated growth of 2.3% in 2015. For 2017, an increase of 2.8% is the median forecast of the Committee.
- **The Committee's expectations for both headline and underlying inflation are anchored closely to the mid-point of the RBA's 2-3% per annum target range. T**he median forecast for headline inflation growth in 2016 is 2.5%, before rising to 2.6% in 2017. Meanwhile, the median forecast for underlying inflation growth is 2.3% in 2016 and 2.5% in 2017.
- **The Committee expects the RBA to leave the cash rate on hold at 2.00% for all of 2016.** However, the range of forecasts for the cash rate at the end of 2016 ranges between 1.50% and 2.25%, indicating that the Committee is divided on whether the next move is up or down. The Committee expects that the cash rate will not be raised until 2017.
- **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 A$35.0bn is expected in 2015/16, after an estimated deficit of A$37.9bn in 2014/15. A further improvement to a deficit of A$26.0bn is forecast for 2016/17.
- The **three-year/ten-year bond yield curve is forecast to steepen** to 92 basis points by the end of June next year, from its current level of 77 basis points (i.e. as at 20 November 2015). However, the Committee then expects the curve to flatten over the second half of 2016 and over 2017, as the market begins to price in expectations for RBA rate hikes. Both three-year and ten-year yields are expected to rise over the next two years, corresponding to a pick-up in domestic growth and inflation as well as higher US interest rates.

- The Committee expects the Australian dollar to end 2016 at USD0.6800, slightly down from its current level of USD0.7193 on 20 November. **The Committee is in agreement that the AUD will weaken over the coming year, although by varying degrees.** The range of forecasts for the end of next year is USD0.62-USD0.70 and for the end of 2017 USD0.64-USD0.78. Prospects of a policy tightening from the US Federal Reserve and expectations the terms of trade will continue to fall are consistent with the weaker currency forecasts.
- **The ASX200 share market index is forecast to be 7% higher (at 5,625) by the middle of next year and nearly 11% higher (at 5,825) by the end of next year** from its closing level of 5,256 on 20 November. The ASX200 is then expected to increase a further 1.3% over 2017 to 5,900.
- The Committee was also asked to provide **long-term forecasts for the economy**. The median forecast for GDP growth in 2020 was 2.8%, in line with the ten-year average. The unemployment rate is expected to be at 5.5% at the end of 2020 and the cash rate at 3.5%. Headline and underlying inflation were expected to grow by 2.50%, on average, in 2020; this is the midpoint of the RBA's inflation target band. Finally, at the end of 2020 the Australian dollar was expected to be at $US0.7500 and the ASX 200 index to reach an all-time high of 7,000.

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

Most of the Committee was generally optimistic on the outlook for China. Growth in China was still expected to slow, but most Committee members estimated growth of 6.0-6.5% per annum in coming years. Structural change occurring within the Chinese economy was cited as being behind an expected slowdown in growth. The Committee was also upbeat in the authorities' ability to support the economy.

The majority of Committee members **expect the US Federal Reserve to raise the Federal funds target rate by 25 basis points next month**. By the end of next year, forecasts for the Federal funds target rate range between 1.0% and 1.5%, suggesting three to four rate hikes of 25 basis points over the course of 2016.

Most Committee members did not expect much impact on the Australian economy from the recent tightening of domestic bank lending conditions. Where members did, the impact on the housing market was only expected to be marginal. A few members pointed out that the housing market was already showing signs of softening.

The majority of Committee members did not think that **recent out-of-cycle mortgage rate hikes affected the RBA outlook**. Indeed, most Committee members were of the view the RBA was comfortable with tighter lending conditions within the housing market. However, a few members of the Committee did expect there was an increased chance that the RBA will lower the cash rate.

Most Committee members do not expect national house prices to fall in 2016. Members expect the pace of growth in house prices to slow from the current rate, however. Committee members are forecasting stable to modest growth next year for housing prices. Members indicated that while national demand/supply dynamics are now less favourable, there remains decent fundamental support. Some members indicated they expected stronger housing price growth in Sydney and Melbourne compared to other capital cities. Further, a couple of Committee members indicated that the **outlook for apartment prices was less favourable**. Apartment prices are expected to be flat or lower, as more supply comes on to the market.

Members identified a variety of **factors holding back private non-mining business investment** in Australia. It was stressed that a lack of demand from consumers does not justify an increase in investment, particularly given underutilised capacity in the economy. An investment overhang in some areas related to the mining boom also exists. One member identified the services-intensive nature of the current growth cycle. Others cited the sluggish nature of risk appetites because of the global growth outlook. Several members also indicated hurdle rates for investment by corporates remained high; corporates have not yet adjusted to the lower return environment. Some members also noted the cost of capital was not an issue, rather a lack of confidence. A few Committee members noted the recent change in the political atmosphere is a positive development.

Committee members believe the new Turnbull-led Coalition government should push very firmly on reform. Members identified the GST, taxes on property investment (including negative gearing and capital gains), superannuation concessions and the company tax rate as areas that should be top of the reform agenda. The Tax White Paper is seen as an important policy initiative in this respect. One member suggested the States should be obligated to remove some taxes in exchange for higher GST revenue. Other areas of reform identified for the Federal government were climate change, carbon pricing, the high effective marginal tax rates for people moving from welfare to work and women returning to the workforce after having children. A couple of Committee members expressed concern that industrial relations reform could worsen the current trends in income distribution.

The **Committee was split on the question of whether or not the jobless rate in Australia had peaked**; a little over half thought that the unemployment rate had peaked and would decline slowly during 2016 and 2017. Some Committee members highlighted that the unemployment rate in some of the important age cohorts (the young, 15-24 year olds, and the largest age cohort, 25-34 year olds) had already started to decline. The rest of the Committee expected the unemployment rate to rise to around 6.5% during 2016.

The bulk of the Committee attached a probability of 20% that Australia would enter recession in the next two years. The highest probability given was 35% and the lowest was 10%.

The Committee was asked to name their **top event risk for 2016**. The majority of the Committee viewed the key event risk coming from offshore developments. **A hard landing in China or an unruly devaluation in the Chinese yuan were the most frequently noted event risks.** Policy decisions in the G4 economies were also another much mentioned event risk among the Committee. Some Committee members highlighted the potential asset price dislocations that higher US interest rates could cause. But others worried that the US might be forced to ease monetary policy and this action would ripple through the global economy and markets.

On the need to tackle the drift to greater income and wealth inequality, the reform mentioned most often was **the need for taxation reform**. The right mix of tax and welfare policies was viewed as important in ensuring a fair distribution of income throughout society. Within the tax reform agenda, many Committee members noted that the removal of negative gearing would be a positive development in the long-term wealth distribution of housing. Tackling home affordability was viewed as a key plank of reform need to address the rising gap between the rich and the poor. Greater support for families and individuals at risk of homelessness and domestic violence was another often mentioned topic. So too, was the inequality in women's wages and the high cost of childcare. With all these key issues, the Committee agreed a coherent macro response should be established.

Table 1: Australian Business Economists (ABE) Annual Survey of the Executive Committee

All forecast variables are annual average % change unless otherwise stated

	2014	2015 (e)			2016 (f)			2017 (f)		
	Actual	**Median**	Low	High	**Median**	Low	High	**Median**	Low	High
National Accounts										
Household Consumption	2.4	2.5	2.3	2.6	2.7	2.3	2.9	3.0	2.5	3.3
Dwelling Investment	8.0	9.7	1.8	10.9	2.2	-0.1	7.0	-1.4	-7.2	1.5
Business Investment*	-5.8	-7.0	-8.1	-1.3	-6.5	-8.2	-0.8	-1.6	-3.0	5.1
Inventory (ppt contribution)	0.0	0.0	0.0	0.3	0.1	-0.3	0.1	0.0	0.0	0.1
Exports	6.7	6.0	4.5	9.5	7.4	3.9	12.0	6.9	5.7	9.5
Imports	-1.7	1.2	0.3	4.6	0.5	-1.8	2.9	3.2	1.0	6.6
Net Export (ppt contribution)	1.7	1.0	0.5	1.3	1.3	0.9	2.4	1.1	0.4	1.5
GDP	2.7	2.3	2.2	2.7	2.7	2.5	3.9	3.0	2.7	3.2
Labour and Inflation										
Employment	0.7	1.7	0.8	1.9	1.7	1.1	2.4	1.8	1.4	2.5
Unemployment Rate (end period)	6.1	6.2	6.0	6.3	6.2	5.7	6.3	5.8	5.5	6.2
Labour Price Index	2.5	2.3	2.0	2.4	2.5	1.8	2.9	2.8	2.2	3.1
Headline CPI	2.5	1.6	1.5	2.0	2.5	2.0	2.9	2.6	2.3	2.8
Underlying CPI	2.5	2.3	2.2	2.4	2.3	2.1	2.6	2.5	2.3	2.8
Other										
Terms of Trade	91.7	82.6	80.0	83.1	80.0	78.5	81.0	81.9	76.7	85.9
Current Account Deficit (% of GDP)	-3.0	-4.1	-10.0	-3.0	-3.4	-4.8	-2.2	-2.6	-4.3	5.0
Headline Cash Budget ($Abn)**	48.5	37.9	37.9	38.9	35.0	28.0	45.0	26.0	20.0	44.0
	20 Nov 15	**Jun-16 (f)**			**Dec-16 (f)**			**Dec-17 (f)**		
	Actual	**Median**	Low	High	**Median**	Low	High	**Median**	Low	High
Financial (all end period)										
Cash Rate	2.00	2.00	1.50	2.00	2.00	1.50	2.25	2.75	1.50	3.00
3yr Government Bond Yield	2.13	2.08	1.65	2.30	2.30	1.70	2.80	3.00	2.20	3.30
10yr Government Bond Yield	2.90	3.00	2.65	3.30	3.08	2.70	3.45	3.53	0.65	3.70
AUD/USD	0.719	0.675	0.640	0.700	0.680	0.620	0.700	0.710	0.640	0.780
ASX 200	5,256	5,625	5,300	6,000	5,825	5,500	6,200	5,900	5,800	6,000
		2020 (f)								
		Median	**Low**	**High**						
Longer-Term Outlook										
GDP		2.8	2.7	3.3						
Unemployment Rate (end period)		5.5	5.0	5.7						
Headline CPI		2.5	2.4	2.5						
Underlying CPI		2.5	2.4	2.5						
Cash Rate (end period)		3.5	2.5	4.0						
AUD/USD (end period)		0.750	0.700	0.740						
ASX 200 (end period)		7,000	6,500	7,500						

Notes:
* Excluding second-hand assets
** Financial year

ABE Executive Committee 2015

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

Secretary
Mr Scott Haslem — Chief Economist, Australasia, UBS

Treasurer
Mr Joshua Williamson — Senior Economist and Director, Citi

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Mr Stephen Walters — Chief Economist, Australia and New Zealand, J.P. Morgan

Committee Members

Mr Warren Bird	Executive Director, Treasury and Investments, Uniting Financial Services
Ms Besa Deda	Chief Economist, St George Bank
Mr Adam Donaldson	Head of Fixed Income Research, Commonwealth Bank of Australia
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
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Australian Business Economists ABN 60 959 647 104
PO Box 7267 Bondi Beach 2026 Australia
tel: 0419 256 339 fax: 02 9365 6067
email: info@abe.org.au web: abe.org.au