Australian Business Economists

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STRONGER ECONOMIC GROWTH WITH HIGHER INTEREST RATES RESULTS OF ANNUAL SURVEY OF ABE EXECUTIVE COMMITTEE

The results of this survey will be discussed by a panel of ABE Executive Committee members at our Forecasting Conference to be held in Sydney this afternoon. See 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). Note that 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 Australia's economic growth rate to accelerate. From an estimated growth rate of 1.2% in 2009, **median GDP growth is forecast to rise to 2.6% in 2010 followed by 3.5% in 2011.**

- **The increased growth rate in 2010 is expected to come from positive private consumption, dwelling construction, business investment and inventories.** The fact that private consumption will not detract from growth implies no hangover following the Commonwealth Government's handouts. Net-exports are forecast to detract from GDP growth in 2010 and 2011, thanks to import growth outpacing that of exports. **The main drivers of growth in 2011 are expected to be private consumption, dwelling and business investment.**

- **Employment growth is expected to recover, increasing by 1.0% in 2010 and 2.2% in 2011.** This results in the unemployment rate falling to 5.7% in 2011, but not before increasing marginally to 6.2% in 2010 from an estimated 5.9% in 2009. Wage inflation, as measured by the labour price index, is forecast to increase by 3.0% in 2010 and 3.7% in 2011.

- **Inflation is forecast to move to 2.5%, the middle of the RBA's target band, in 2010 and increase by 2.7% in 2011**. The relatively benign performance of headline inflation did not remove concerns a number of Committee members held about the upside risks to the inflation outlook as the economy recovers.

- **On the upside, the main risk to Australian economic growth is expected to come from the large amount of capital expenditure and investment spending in the pipeline** that could lead to capacity constraints in downstream materials and labour sectors in the short-term. Australia is starting the next economic upswing with less spare capacity following the mild downturn. Committee members were also wary of better than expected employment outcomes and consumers re-leveraging household balance sheets and boosting aggregate demand sooner than expected. This would present upside inflation risks, some of which would be mitigated by the strength of the AUD and yearly inflation's lagged response to the previous slowdown. But there remained a concern over domestically generated inflation pressures by the end of 2010 and into 2011.

- **There was less of a consensus on the downside risks.** A few Committee members noted that there remained some risks from the still weak global economy. A few others members were keeping an eye on Australian confidence indicators, as monetary policy increases to a more normal setting. Individual concerns were also reported around the removal of the domestic stimulus and the financial markets ability to fund credit creation.

- **On balance, Committee members held the view that the nascent global recovery would be sustained.** The substantial weight of global policy stimulus would likely ensure an improvement in global growth indicators by stimulating private demand. But the global recovery will be uneven. Growth will be concentrated in developing Asia, which is a positive for Australia. Other economies, most notably the US, UK and Europe will take longer to return to trend-like growth rates. Looking ahead over the next few years, a return to above trend global growth was unlikely.

- **Committee members were asked whether they believed if Australia was relying too much on India and China, ie, putting all our eggs in one basket.** The consensus view was 'no' and that it was much better to be relatively more integrated with the economies that were growing strongly. That said, Australia might have to put up with more variability in its economic growth trajectory because of relatively greater volatility in the commodity cycle than traditionally seen in services and manufacturing. However, these industries remained important and government polices should be used to improve the productivity and competitiveness of the manufacturing and non-tradeable sectors. This however, does not imply support for protectionist policies that hinder necessary structural adjustments.

- At the same time, it is important for Australia not to forget its trading relationships with the US, UK and Europe. Furthermore, with all the discussion around China and India it is also important to remember that there was a solid domestic base for the Australian economy. We had little imbalances coming into the global financial crisis, highly effective fiscal and monetary policies and a strong banking sector with no material exposure to toxic assets.

- **On domestic fiscal policy, it was felt by the majority of the Committee that the Federal Government did not need to be more active in reviewing and reducing the stimulus measures.** The stimulus to the consumer has passed, while the stimulus in the form of infrastructure and capital expenditure would add to the productive capacity of the economy in the long-run. In the short-run though, the large scale projects would compete for resources with other activities. A few Committee members were of the opinion that if the Federal Government did not wind back their planned spending sooner, the RBA would do the heavy lifting for them instead.

- **The Committee was almost unanimous in the view that the economic forecasts contained in the Mid Year Economic and Fiscal Outlook (the MYEFO) were too pessimistic.** It was felt that the Federal Budget and the economy would do better than the official government forecasts had predicted and that government revenues would be revised higher at subsequent Budgets.

- **As the Budget eventually moves back into surplus, the Federal Government needs to re-focus attention on issues of microeconomic reform.** These issues include improving the efficiency of government expenditures and the taxation system (noting the Henry Review), long-term infrastructure investment in transportation links and supply chains, encouraging workforce participation that includes reducing high effective marginal tax rates for welfare recipients and further preparing the economy for the effects of the ageing population. Debt reduction was also seen as a priority, but only to a level that would allow for the efficient functioning of the debt market. This was particularly the case given the draft prudential reforms being considered by APRA and the potential for an increase in demand for government bonds. A few Committee members believed that the Federal Government should consider banking excess revenues from the resources boom in a sovereign wealth fund, on intergenerational equity considerations to pay for the demographic challenges that lie ahead.

- **The RBA's cash rate target was forecast to rise to a median rate of 4.75% for 2010 and 5.50% for 2011.** Most Committee members believe that 5.50% would be the peak for the cash rate in the current cycle. A few Committee members felt that a higher cash rate was appropriate. Those that believed this were the ones that generally had a higher than median forecast for economic growth and/or inflation in 2011.

- **Bonds yields were also forecast to rise.** The 3-year Government bond yield would increase to 5.55% in 2010 (from near 4.75% currently) before moving to 5.75% in 2011. The 10-year bond yield is also forecast to increase and should peak at 6.00% in 2010 (from near 5.5% currently) and remain there in 2011. These changes, though, were mild when compared to the extent of the yield increases that have occurred since early 2009.

- **The median forecast for the Australian dollar included a peak of $US0.96 by June 2010 (from near $US0.9155 currently), $US0.91 by the end of 2010 and $US0.85 by the end of 2011.** Forces pushing the AUD higher included elevated commodity prices and higher interest rate differentials. There will still be a cycle for the AUD implying some ongoing further volatility in currency markets. **While Committee members did not forecast the level of the AUD beyond 2011, most felt that the AUD was entering a new structural phase that would see it remain well above its post-float average for at least the next decade.**

- **The ASX 200 is expected to rally over the next two years.** The median forecast was 5300 points by the end of 2010 (from near 4,650 currently) and 5750 points by the end of 2011. No one on the Committee forecast the ASX 200 to retrace its low and a few members look for it to hit at least 6000 points by the end of 2011.

ABE Executive Committee 2009

Chairman	
Mr Stephen Halmarick	Head of Investment Markets Research, Colonial First State
Secretary	
Mr Warren Hogan	Acting Chief Economist, ANZ
Treasurer	
Mr Scott Haslem	Chief Economist, UBS
Assistant Secretary & Treasurer	
M**r Josh Williamson**	Senior Economist Investment Research & Analysis, Citi

Committee Members

Mr David Bassanese	Economics Analyst, The Australian Financial Review
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	General Manager Economics, Westpac Banking Corporation
Mr Tom Ford	Chairman, Resimac Limited
Mr Richard Gibbs	Global Head of Economics, Macquarie Capital Securities (Australia)
Mr Tim Harcourt	Chief Economist, Australian Trade Commission
Mr Robert Henderson	Chief Economist Markets, National Australia Bank
Mr David Plank	Head of Macro Research and Strategy Australia/New Zealand, Deutsche Bank
Dr Tony Richards	Head of Economic Analysis, Reserve Bank of Australia
Mr Alex Schuman	Senior Economist, New South Wales Treasury Corporation
Mr Stephen Walters	Chief Economist, J. P. Morgan
Mr Geoff Weir	Managing Director, Financial Sector Services Pty Ltd

Table 1: ABE Survey of the Executive Committee, Summary
(All forecast variables are annual average % change unless otherwise stated)

	2008	2009	2010			2011		
	Actual	*Estimate*	**Median**	Low	High	**Median**	Low	High
National Accounts								
Private Consumption	*2.6*	1.4	**2.6**	1.4	3.5	**3.5**	2.9	4.2
Dwelling Investment	*2.8*	-6.9	**8.6**	1.0	9.9	**5.0**	0.4	10.8
Business Investment*	*13.8*	-3.6	**2.0**	-1.2	6.2	**8.2**	4.4	12.2
Inventories (ppt contribution)	*-0.6*	-0.5	**0.7**	0.1	1.1	**0.0**	-0.5	0.2
Exports	*3.8*	2.3	**5.1**	1.5	7.7	**6.1**	4.5	9.9
Imports	*11.4*	-8.7	**10.2**	4.5	14.5	**8.2**	6.7	12.3
Net Export (ppt contribution)	*-1.9*	2.8	**-1.0**	-2.0	-0.4	**-0.5**	-1.2	-0.1
GDP	*2.4*	1.2	**3.2**	2.9	3.5	**3.4**	3.0	4.2
Labour and Inflation								
Employment	*1.3*	0.2	**1.0**	0.2	1.2	**2.2**	1.3	2.4
Unemployment Rate (end period)	*4.6*	5.9	**6.2**	5.5	6.5	**5.7**	5.1	6.2
Labour Price Index	*4.3*	3.6	**3.0**	2.8	3.6	**3.7**	3.0	4.0
CPI	*3.7*	1.8	**2.5**	2.1	2.6	**2.7**	2.4	3.1
Other								
Current Account Deficit (% of GDP)	*-2.6*	-4.4	**-4.4**	-5.5	6.5	**-4.5**	-5.1	6.5
Headline Cash Budget ($Abn)**	*-31.3*	-27.0	**-39.7**	-43.0	-2.3	**-20.0**	-32.0	-1.3

		Jun-10	Dec-10			Dec-11		
	Actual	Median	**Median**	Low	High	**Median**	Low	High
Financial (all end period)								
Cash Rate	*4.25*	4.25	**4.75**	4.50	5.50	**5.50**	5.00	6.25
3yr Government Bond Yield	*3.07*	5.25	**5.55**	5.25	6.20	**5.75**	5.50	6.40
10yr Government Bond Yield	*3.99*	5.75	**6.00**	5.60	6.30	**6.00**	5.75	6.50
AUD/USD	*0.70*	0.96	**0.91**	0.90	0.98	**0.85**	0.80	0.95
TWI	*55.6*	73.7	**72.9**	68.1	75.0	**69.0**	62.1	72.0
ASX 200	*3722*	5000	**5300**	4500	5600	**5750**	4850	6200

*Excluding second hand asset purchases
**For financial year (2008 is 2008/09)

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