

# **ECONOMIC OUTLOOK FOR 2010-11, 2011-12 AND 2012-13**

**JUNE 2011**

(THIS REPORT INCORPORATES DOMESTIC AND INTERNATIONAL DATA RELEASED UP TO  
13 JULY 2011)

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## OVERVIEW

The Australian economy is forecast to grow at an above-trend rate in 2011-12 and 2012-13, driven by the resources sector. Sustained high prices for Australia's key commodity exports underpin record mining investment intentions and strong forecast growth in non-rural commodity exports. However, several of the downside risks identified at Budget have started to crystalize.

Internationally, financial stability risks have increased and the pace of global growth has eased, reflecting increasing concerns around sovereign debt issues in Europe and recent weakness in the US. Domestic conditions have also weakened. The impact of the January floods on coal production is expected to be larger, and the recovery more protracted, than previously anticipated. More broadly, while the Budget forecasts anticipated weak growth in the non-mining economy, the deterioration in conditions has been more pronounced than expected, suggesting that the high exchange rate, tightening macroeconomic policy settings, increasing competition for labour and other inputs, weak credit conditions (reflecting both demand and supply factors) and cautious household spending behaviour are having a larger contractionary impact on the economy than previously anticipated. Weakness in the non-mining economy is evident in recent labour market outcomes, with the pace of employment growth slowing considerably in the first half of 2011. This combination of international and domestic factors has led to a downward revision to forecast growth in real GDP and employment and an upward revision to the forecast unemployment rate. The most prominent risks to Australia's growth outlook arise from fragilities in the global economy and the potential for weaker domestic conditions to further undermine business and consumer confidence.

Table 1 presents the key domestic forecasts exclusive of the impact of the Government's carbon price policy. Attachment A details the impact of the carbon price on the near-term economic outlook, consistent with *Strong growth, low pollution: modelling a carbon price*. The effects of the Government's carbon policy will be incorporated into the central forecasts from the next forecasting round.

**Table 1: Key Domestic Forecasts – June compared with Budget**

	2009-10		2010-11		2011-12		2012-13	
	Outcome (a)	Budget	June	Budget	June	Budget	June	
Real GDP (b)	2.3	2 1/4	2	4	3 3/4	3 3/4	3 1/2	
Nominal GDP (b)	2.4	8	8	6 1/4	6 3/4	5 3/4	5	
Unemployment rate (c)	5.2	5	5	4 3/4	4 3/4	4 1/2	4 3/4	
Employment (d)	2.4	2 3/4	2 1/4	1 3/4	1 1/2	1 3/4	1 1/2	
CPI (d)	3.1	3 1/4	3 1/4	2 3/4	2 3/4	3	2 3/4	
Underlying inflation (d)	2.7	2 1/2	2 1/2	2 3/4	2 3/4	3	2 3/4	
WPI (d)	3.0	4	4	4	4	4 1/4	4	
Terms of trade (b)	-4.4	19 1/4	20 1/4	- 1/4	1 1/4	-3	-6	

(a) Calculated using original data except for employment, the unemployment rate and WPI.

(b) Year average.

(c) June quarter.

(d) Through-the-year growth rate to the June quarter.

The pace of global growth appears to have slowed and the risks to global financial stability have become more acute. Concerns over the sustainability of sovereign debt positions in Greece, Portugal and Ireland have escalated over the past month, unsettling global markets. A disorderly default, or contagion to Spain or Italy, which saw them lose access to private capital markets, would be very damaging for the global economy, leading to a further loss of confidence in the ability of policymakers to manage the fallout. More generally, the pace of growth in the global economy has eased over recent months, partly due to ripple-effects from Japanese supply chain disruptions and weighed down by higher oil prices. In the United States, the protracted debate over raising the government debt

ceiling is adding to uncertainty in global financial markets and a run of softer than expected data have raised concerns about the strength of the US recovery. Consumption growth has lost momentum over recent months, the housing sector remains extremely weak and the pick-up in employment has been slow. The Chinese economy continues to expand at a strong pace, although growth in industrial production and retail sales has moderated slightly in recent months. Inflationary pressures continue to build in emerging market economies, driven by reduced spare capacity and compounded by rising food and oil prices. Despite the increasingly uncertain outlook, global and major trading partner growth forecasts remain unchanged, with weaker outcomes in the US, Japan and China offset by stronger-than-anticipated growth in other East Asian economies and the euro area core.

The Australian economy contracted in the March quarter due to the severe weather events experienced over the recent summer. The impact of the January floods on thermal coal production is now expected to be more protracted than estimated at Budget, driving a downward revision to forecast real GDP growth in 2010-11, from 2¼ per cent at Budget to 2 per cent at June JIEG. Coal production is not expected to return to full capacity until late 2011, with a number of mines still inundated with water. The slower-than-expected recovery is estimated to result in coal production losses of around 35 million tonnes in 2010-11, up from 25 million tonnes estimated at Budget. In year-average terms, however, the natural disasters in Australia and Japan are still expected to detract ¾ of a percentage point from real GDP growth in 2010-11, consistent with Budget.

Australia's medium-term growth outlook remains strong *in aggregate* due to the booming resources sector. Economic activity is expected to rebound in 2011-12, with the recovery from the recent natural disasters still expected to add ½ a percentage point to real GDP growth. More generally, the pace of economic growth is expected to build momentum over the next year as production and investment in the resources sector gathers pace. Forecast growth in mining investment has increased since Budget following a succession of recent project announcements, including BHP Billiton's \$12.8 billion expansions of its Western Australian iron ore and Queensland coal operations. Mining investment rose 21 per cent over the year to March, with the latest CAPEX survey pointing to a further 80 per cent growth in year-average terms in 2011-12 (based on long-run realisation ratios). With significant investment being undertaken to expand mine and transport infrastructure, export capacity is expected to grow strongly, albeit at a marginally slower pace than expected at Budget, with recent project delays casting doubt as to whether the projected scale of expansion can be achieved within announced timeframes.

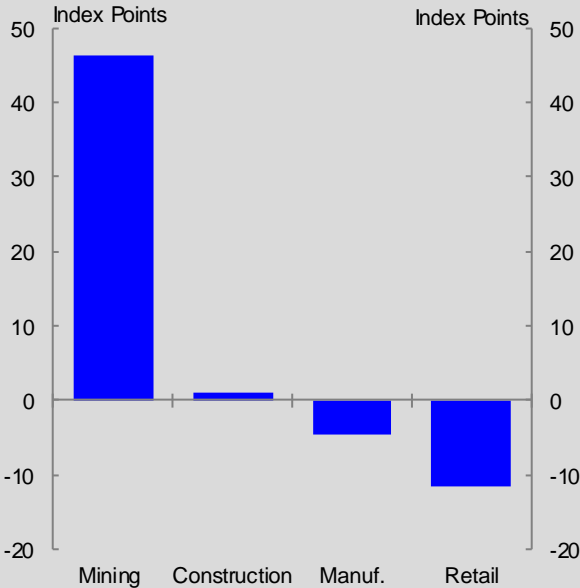
Conditions in the broader economy have weakened. While measures of overall business conditions and confidence are only slightly below their long-run averages, business surveys suggest that conditions have deteriorated significantly in the services, manufacturing and construction sectors (Box 1). For the most part, the business survey data is consistent with broader activity and labour market indicators, with the exception of the services sector where contractions in the Performance of Services Index over the past year are more difficult to reconcile. Consumer confidence is also below its long-run average, with consumer perceptions of their own finances declining to levels typically associated with economic downturns, weighed down by cost of living pressures. Weak growth in non-mining activity is impacting on the labour market, with employment growth slowing appreciably in the first half of 2011 and forward looking indicators of labour demand (such as job advertisements and business hiring intentions) falling in recent months.

While the Budget forecasts anticipated weak growth in the non-mining economy, the deterioration in conditions has been more pronounced than expected, suggesting that the high exchange rate, tightening macroeconomic policy settings, increasing competition for labour and other inputs, weak credit conditions (reflecting both demand and supply factors) and cautious household spending behaviour are having a larger contractionary impact on the economy. Combined with recent weakness in the US and Japan and growing concerns in Europe, this has led to a downward revision to forecast growth in real GDP to 3¾ per cent in 2011-12 and 3½ per cent in 2012-13. Forecast employment growth has also been revised down to 1½ per cent through the year to both June 2012 and June 2013, with the unemployment rate now expected to decline only marginally over the forecast horizon, from 4.9 per cent currently to 4¾ per cent in the June quarter 2013.

**Box 1: Business Surveys**

The **National Australia Bank (NAB) Monthly Business Survey** suggests that business conditions and business confidence have fallen to below their long-run averages. Within these aggregate indexes is a marked divergence between the mining and non-mining economy. The NAB Survey suggests that conditions in the mining industry (representing 3 per cent of businesses surveyed) are almost 50 per cent above the long-run average, while conditions in the manufacturing and retail industries are around 5 and 10 percentage points below their long-run averages respectively (Chart 1).

**Chart 1: Business Conditions By Industry (Deviation from average since 1989)**



Source: National Australia Bank.

Industry specific surveys tell a consistent story, with the manufacturing, services and construction sectors all reporting weak conditions. The latest **ACCI-Westpac Survey of Industrial Trends** reported sharp falls in actual and expected conditions in the manufacturing sector in the June quarter, with both indexes at their lowest readings since the GFC. Similarly, the **AIG-PWC Performance of Manufacturing Index** has pointed to contractions in 8 of the past 10 months, with respondents citing soft domestic demand, the strong Australian dollar and increased import competition as factors inhibiting the manufacturing sector. The **AIG-Commonwealth Bank Performance of Services Index** reported that the services sector – which accounts for about three-quarters of the economy – contracted in June, with the index below the critical expansion level for 10 of the past 12 months. Likewise, the **AIG-HIA Performance of Construction Index** contracted for the thirteenth consecutive month in June, reporting weakness in the housing, commercial and engineering construction sectors.

With capacity pressures now expected to build more gradually over the forecast horizon, the forecasts for wages growth and inflation have also been revised down since Budget. After accelerating through 2010, growth in the Wage Price Index stabilised in the March quarter at only slightly above its long-run average. The Wage Price Index is forecast to increase 4 per cent in each forecast year, which is ¼ of a percentage point lower through the year to June 2013 than anticipated at Budget. Underlying inflation is expected to increase from 2½ per cent through the year to June 2011 to 2¾ per cent through the year to both June 2012 and June 2013 as the dampening influence of the recent exchange rate appreciation dissipates, the resources boom continues to place pressure on the cost of specialist labour and materials, and supported by continued strong growth in the prices of utilities and other administered items. Headline inflation is also expected to be 2¾ per cent through the year to June

2013 after spiking at 3½ per cent through the year to June 2011, due to the impact of the floods and Cyclone Yasi on fruit and vegetable prices and increased world oil prices.

The terms of trade are forecast to be higher in 2010-11 and 2011-12, with prices of Australia's bulk commodity exports remaining elevated, in part due to a more protracted return to normal operations at Queensland coal mines and supported by China's continued robust demand for Australia's key commodity exports. The terms of trade are now expected to increase 20¼ per cent in 2010-11 and 1¼ per cent 2011-12, before declining 6 per cent in 2012-13 as the impact of recent short-term supply disruptions fade and increasing global iron ore and coal supply capacity comes on line. The level of the terms of trade is expected to be broadly the same at the end of the forecast horizon as anticipated at Budget.

Nominal GDP is forecast to grow 8 per cent in 2010-11 and 6¾ per cent in 2011-12. Forecast growth in nominal GDP is ½ of a percentage point higher in 2011-12 than forecast at Budget due to the unanticipated strength in the terms of trade. However, forecast nominal GDP growth has been revised down by ¾ of a percentage point to 5 per cent in 2012-13 due to the combination of lower forecast real GDP growth and the larger anticipated decline in the terms of trade in that year, leaving the level of nominal GDP \$5½ billion lower in 2012-13 than forecast at Budget. Details on the forecast composition of income growth are at Attachment B.

While Australia's economic outlook is favourable in aggregate, the significant risks to the global recovery noted earlier would, if they eventuated, have serious negative implications for economic growth. The fragile global economy and weak conditions in the non-mining economy could further reduce confidence and undermine growth in real GDP and employment. Australia's high terms of trade also present risks, with the prospect of heightened volatility and large adjustments becoming more significant the further prices for Australia's key non-rural commodity exports are away from sustainable long-run levels.

**Table 2 – Domestic economy forecasts**

	Outcomes (a)				Forecasts				Outcomes (b)				Forecasts			
	Year average		Year average		Through the year		Through the year		Through the year		Through the year		Through the year			
	2009-10	2010-11	2011-12	2012-13	June 2010	June 2011	June 2012	June 2013	June 2010	June 2011	June 2012	June 2013	June 2010	June 2011	June 2012	June 2013
<b>Panel A - Demand and output(c)</b>																
Household consumption	2.1	3 1/4	3 1/4	3 1/2	2.6	3	3 1/2	3 3/4	2.6	3	3 1/2	3 3/4	2.6	3	3 1/2	3 3/4
Private investment																
Dwellings	2.1	3	1 1/2	2	11.3	1 1/2	1/2	3	11.3	1 1/2	1/2	3	11.3	1 1/2	1/2	3
Total business investment(d)	-4.9	4 1/2	16 1/2	16 1/2	-1.7	9	19 1/2	16	-1.7	9	19 1/2	16	-1.7	9	19 1/2	16
Non-dwelling construction(d)	-8.2	8 1/2	19	19 1/2	-3.6	8	26	16	-3.6	8	26	16	-3.6	8	26	16
Machinery and equipment(d)	-4.8	1 1/2	18 1/2	16 1/2	-2.6	12 1/2	17	19	-2.6	12 1/2	17	19	-2.6	12 1/2	17	19
Private final demand(d)	0.7	3	6	6 1/2	2.1	3 3/4	6 3/4	6 1/2	2.1	3 3/4	6 3/4	6 1/2	2.1	3 3/4	6 3/4	6 1/2
Public final demand(d)	7.0	3 3/4	3/4	-2 1/2	10.7	- 1/2	3	-6	10.7	- 1/2	3	-6	10.7	- 1/2	3	-6
Total final demand	2.1	3 1/4	4 3/4	4 1/2	4.1	2 3/4	5 3/4	3 3/4	4.1	2 3/4	5 3/4	3 3/4	4.1	2 3/4	5 3/4	3 3/4
Change in inventories(e)	0.3	0	0	0	0.6	1/2	0	0	0.6	1/2	0	0	0.6	1/2	0	0
Gross national expenditure	2.4	3 1/2	4 3/4	4 1/2	4.6	3 1/4	5 1/2	3 3/4	4.6	3 1/4	5 1/2	3 3/4	4.6	3 1/4	5 1/2	3 3/4
Exports of goods and services	5.3	1	6 1/2	5 1/2	9.0	-2	6	7 1/2	9.0	-2	6	7 1/2	9.0	-2	6	7 1/2
Imports of goods and services	4.9	9 1/2	10 1/2	10	17.6	6 1/2	11 1/2	9 1/2	17.6	6 1/2	11 1/2	9 1/2	17.6	6 1/2	11 1/2	9 1/2
Net exports(e)	0.1	-2	-1	-1 1/4	-1.6	-2	-1 1/2	-3/4	-1.6	-2	-1 1/2	-3/4	-1.6	-2	-1 1/2	-3/4
Gross domestic product	2.3	2	3 3/4	3 1/2	3.2	1 1/4	4 1/2	3	3.2	1 1/4	4 1/2	3	3.2	1 1/4	4 1/2	3
Non-farm product	2.3	1 3/4	3 3/4	3 1/2	3.2	1 3/4	3 1/4	4	3.2	1 3/4	3 1/4	4	3.2	1 3/4	3 1/4	4
Farm product	1.4	11	3	-3	6.5	-26	89	-34	6.5	-26	89	-34	6.5	-26	89	-34
Nominal gross domestic product	2.4	8	6 3/4	5	8.7	6 1/2	5 1/2	5 1/4	8.7	6 1/2	5 1/2	5 1/4	8.7	6 1/2	5 1/2	5 1/4
<b>Panel B - Other selected economic measures</b>																
External accounts																
Terms of trade	-4.4	20 1/4	1 1/4	-6	19.8	13 1/4	-8 1/2	-3 1/2	19.8	13 1/4	-8 1/2	-3 1/2	19.8	13 1/4	-8 1/2	-3 1/2
Current account balance																
\$billion	-53.2	-31 1/2	-59	-100 1/4	-4.2	-7	-20 3/4	-29 1/2	-4.2	-7	-20 3/4	-29 1/2	-4.2	-7	-20 3/4	-29 1/2
Percentage of GDP(f)	-4.1	-2 1/4	-4	-6 1/2	-1.2	-2	-5 1/2	-7 1/2	-1.2	-2	-5 1/2	-7 1/2	-1.2	-2	-5 1/2	-7 1/2
Labour market																
Employment (labour force survey basis)	1.4	3	1 1/2	1 1/2	2.4	2 1/4	1 1/2	1 1/2	2.4	2 1/4	1 1/2	1 1/2	2.4	2 1/4	1 1/2	1 1/2
Unemployment rate (per cent)(g)	5.5	5	5	4 3/4	5.2	5	4 3/4	4 3/4	5.2	5	4 3/4	4 3/4	5.2	5	4 3/4	4 3/4
Participation rate (per cent)(g)	65.3	65 3/4	65 1/2	65 1/2	65.3	65 1/2	65 1/2	65 1/2	65.3	65 1/2	65 1/2	65 1/2	65.3	65 1/2	65 1/2	65 1/2
Prices and wages																
Consumer Price Index (original)																
- headline	2.3	3	3	2 3/4	3.1	3 1/4	2 3/4	2 3/4	3.1	3 1/4	2 3/4	2 3/4	3.1	3 1/4	2 3/4	2 3/4
- underlying	3.1	2 1/4	2 3/4	2 3/4	2.7	2 1/2	2 3/4	2 3/4	2.7	2 1/2	2 3/4	2 3/4	2.7	2 1/2	2 3/4	2 3/4
Gross non-farm product deflator	0.1	6 1/4	3	1 1/2	5.4	5 1/4	1 1/4	1 3/4	5.4	5 1/4	1 1/4	1 3/4	5.4	5 1/4	1 1/4	1 3/4
Wage Price Index	3.1	3 3/4	4	4	3.0	4	4	4	3.0	4	4	4	3.0	4	4	4

(a) Calculated using original data unless otherwise specified.

(b) Calculated using seasonally adjusted data unless otherwise specified.

(c) Chain volume measure, except for nominal GDP.

(d) Excluding second-hand asset sales from the public sector to the private sector.

(e) Percentage point contribution to growth in real GDP.

(f) The outcomes and forecasts in the final four columns are the percentage of GDP in the June quarter.

(g) The outcomes and forecasts in the final four columns are the rate in the June quarter.

Note: The forecasts for the domestic economy are underpinned by several technical assumptions. The exchange rate is assumed to remain around its level at the time the forecasts were prepared, with a trade-weighted index of around 78 and a \$US exchange rate of around 107c. Domestic interest rates are assumed to rise slightly, in line with market expectations. World oil prices (Tapis) are assumed to remain around \$US119 per barrel. The farm sector forecasts are based on average seasonal conditions over the remainder of the forecast period.

Source: ABS Cat. No. 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

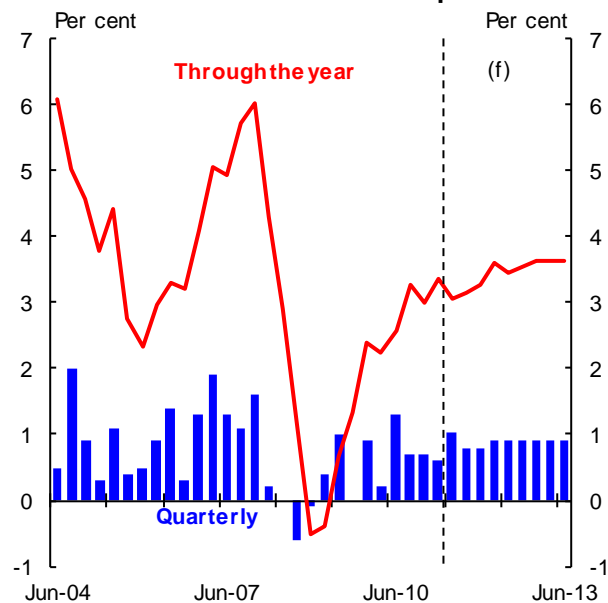
## OUTLOOK FOR THE DOMESTIC ECONOMY

Australia's economic growth is forecast to strengthen from 2 per cent in 2010-11 to 3¼ per cent in 2011-12 and 3½ per cent in 2012-13. Compared with Budget, the real GDP growth forecasts have been downgraded by ¼ of a percentage point in each of the three forecast years. In 2010-11, this largely reflects a more persistent impact of the floods and cyclones on coal production than previously anticipated. In 2011-12 and 2012-13, the downward revision to forecast real GDP growth is driven by a weaker outlook for the non-mining economy and lower public final demand, partly offset by higher expected growth in mining investment.

### Household consumption

**Household consumption** is forecast to grow 3¼ per cent in 2010-11 and 2011-12, before returning to trend growth of 3½ per cent in 2012-13, supported by rising household incomes and low unemployment (Chart 1).

**Chart 2: Household consumption**

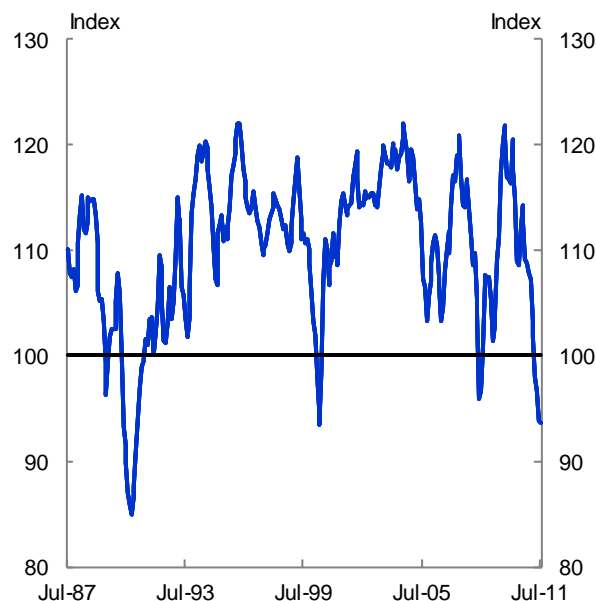


Source: ABS Catalogue Number 5206.0 and Treasury.

Forecast growth in household consumption has been revised up by ¼ of a percentage point in 2010-11 due to an upward revision to the December quarter. Household consumption growth in the March quarter was in line with the Budget forecasts, but forecast consumption growth has been revised down in the June quarter, reflecting limited evidence of the

anticipated rebound from the floods and Cyclone Yasi (Queensland retail trade spiked in February, but has grown at a steady pace since). Looking through the volatility of recent monthly retail trade data suggests stronger growth in turnover in the June quarter. However, sales of new motor vehicles have declined sharply, exacerbated by supply disruptions from the Japanese earthquake.

**Chart 3: Consumer sentiment: family finances over the next 12 months (trend)**



Source: Westpac -Melbourne Institute.

Note: Trend for the latest month is based on 2-month moving average while rest are based on 3-month centred moving average.

More broadly, the underlying drivers of household consumption have weakened since Budget, prompting a ¼ of a percentage point downward revision to forecast consumption growth in 2011-12. The outlook for employment and wages growth has moderated. Personal credit growth remains weak, at 0.8 per cent through the year. Consumer sentiment has fallen to below the long-run average, with consumers' perceptions of their own finances declining to levels typically associated with economic downturns (Chart 3). Household net worth was broadly unchanged in the March quarter and is likely to have fallen in the June quarter, reflecting declines in both house and equity prices.

Households also continue to be more cautious, with the household saving ratio rising to 11.5 per cent in the March quarter and a continuing increase in the proportion of respondents to the consumer sentiment survey



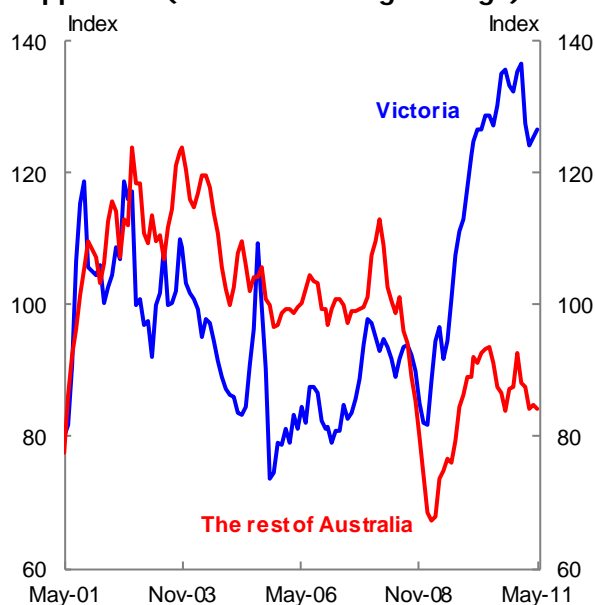
nominating deposits or paying off debt as the wisest place for savings continuing to increase. The forecasts imply a gradual decline in the household saving ratio to around 6 per cent in the June quarter 2013. By implication, were the household saving ratio to remain at its current level, household consumption growth would be lower than forecast, suggesting downside risk.

## Dwelling investment

Increased household caution is also reflected in subdued dwelling investment. Growth in **dwelling investment** is forecast to ease from 3 per cent in 2010-11 to 1½ per cent in 2011-12 and 2½ per cent in 2012-13.

Forecast growth in dwelling investment has been revised up in 2010-11 from Budget, reflecting stronger-than-anticipated growth in the March quarter. New dwelling investment grew 11.9 per cent through the year to March quarter 2011, the strongest growth in four years, underpinned by a high level of construction activity in the Victorian medium and high density market (Chart 4). This was notwithstanding a fall of 1 per cent in Queensland in the March quarter associated with the floods and Cyclone Yasi.

**Chart 4: Private sector dwelling approvals (3 month moving average)**



Source: ABS Catalogue Number 8731.0.

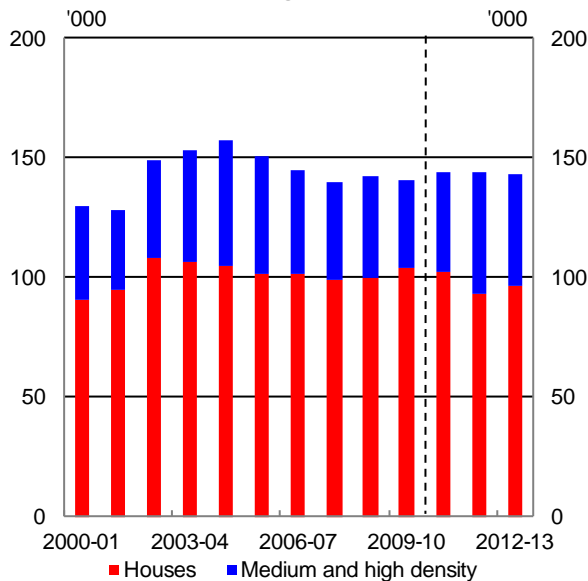
Note: Series index to 10 year average.

Dwelling construction will continue to be supported by a strong pipeline of investment in the Victorian medium and high density market and post-disaster reconstruction in Queensland. However, the substantial weakening in building approvals and housing finance for new dwellings over the past year is expected to see growth ease in 2011-12. Housing finance for new dwellings fell 6.0 per cent through the year to May and private sector dwelling approvals fell 7.9 per cent.

In the medium-term, demand for new housing is expected to be supported by low unemployment and solid growth in household incomes. However, investment conditions remain weak. According to the ABS, house prices have fallen 2.3 per cent over the past six months, with price falls most pronounced at the higher end. Auction clearance rates have fallen over the past six months and there is a substantial supply of houses for sale on the market. However, with growth in underlying demand outpacing supply in recent years (Australia's housing completions have barely grown since 2002-03, while the population has grown strongly), prices remain elevated and housing affordability is low. Standard variable mortgage interest rates are assumed to remain broadly constant at slightly above their long-run average over the forecast period, consistent with market expectations at the time the forecasts were prepared.

Supply constraints associated with planning and approval processes and land release restrictions are also expected to weigh on growth in new dwelling investment. The forecasts imply that roughly 145,000 new houses will be completed in 2011-12 and 2012-13, implying almost no growth in the number of completions over the past 5 years (Chart 5).

**Chart 5: Dwelling completions**

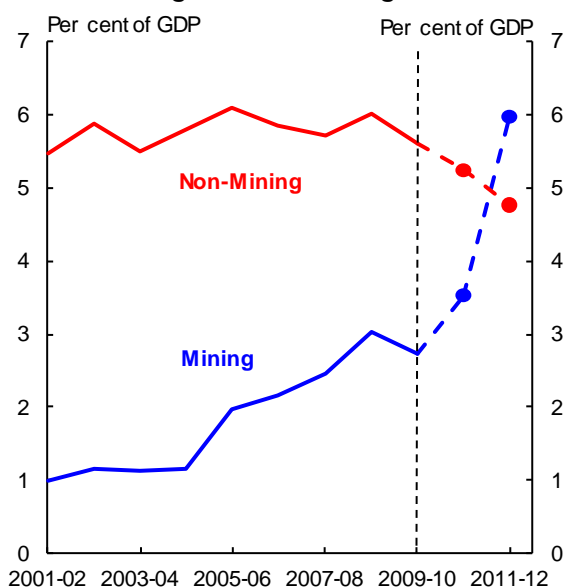


Source: ABS Catalogue Number 8752.0.

## Business investment

Business investment is rapidly gaining momentum, with sustained high prices for Australia's commodity exports driving record investment intentions in the resources sector. The business investment forecasts have been revised up following recent project announcements, with business investment expected to reach new highs as a proportion of GDP by the end of the forecast horizon, notwithstanding limited investment plans outside the resources sector (Chart 6).

**Chart 6: Mining and non-mining investment**



Source: ABS Catalogue 5625.0, 5206.0 and Treasury.

Forecast growth in **business investment** is unchanged in 2010-11, with growth of 4½ per cent expected. New business investment rose 2.8 per cent in the March quarter, weaker than anticipated at Budget. However, it was consistent with the March quarter CAPEX survey, which suggests that around \$5 billion of investment will slip from 2010-11 into 2011-12, with cyclones and heavy rains over the recent summer contributing to project delays. The latest CAPEX estimate for 2010-11 implies strong growth in mining investment in the June quarter, consistent with the recent strength of monthly machinery and equipment imports. Construction commenced on a number of resource projects in the March quarter, including the Gladstone (\$16 billion) and Curtis (\$15 billion) coal-seam gas projects and Rio Tinto's (\$8.1 billion) and Fortescue's (\$8.4 billion) iron ore expansions.

Forecast growth in new business investment has been revised up from 16 per cent to 16½ per cent in 2011-12 and from 14½ per cent to 16½ per cent in 2012-13. The value of resource projects that are committed or already under construction has risen \$5.4 billion since Budget, with Fortescue Metals Group's \$8.4 billion expansion of its iron ore operations moving from the committed stage to under construction and BHP Billiton's \$12.8 billion coal and iron ore expansions receiving final investment approval. The March quarter CAPEX survey suggests 80 per cent growth in mining investment in 2011-12 based on long-run realisation ratios. However, the June JIEG forecasts are based on lower realisation ratios, consistent with the project delays observed to date and with the aggregate scale of mining investment plans raising the likelihood that shortages of specialist labour and equipment will become more acute.

The March quarter CAPEX survey suggests that investment intentions outside of the resources sector remain weak, implying modest growth of 3.4 per cent in manufacturing investment in 2011-12 based on long-run realisation ratios. That said, business surveys point to a stronger pipeline of investment, with investment intentions in both the NAB and CBA-ACCI surveys at around

long-run average levels, seemingly at odds with conditions in the non-mining economy.

In terms of the components, growth in **new machinery and equipment** investment is expected to accelerate from 1½ per cent in 2010-11, to 18½ per cent in 2011-12 and 16½ per cent in 2012-13 as the mining investment boom builds momentum. Growth in new machinery and equipment investment in 2012-13 is also expected to be supported by the introduction of the small business car tax deduction for new motor vehicles purchased from 1 July 2012. However, this may result in some small businesses delaying motor vehicle investment until 2012-13, possibly impacting on investment activity in 2011-12. **New engineering construction** is expected to grow 17½ per cent in 2010-11, 28½ per cent in 2011-12 and 26½ per cent in 2012-13.

**Chart 7: Private non-residential building work yet to be done (nominal)**



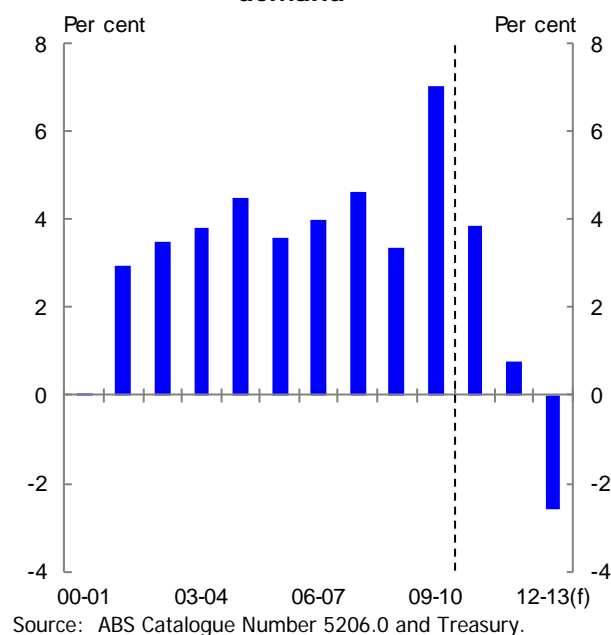
Growth in **non-residential building** investment has been revised downwards since Budget. While declining vacancy rates and modest growth in building approvals in recent months suggest the sector is stabilising, the pipeline of activity remains low and credit conditions remain tight in the commercial property market (Chart 7). The winding down of activity under the Building the Education Revolution is expected to drive a decline in non-residential building investment of 5 per cent in 2010-11. Investment is then

expected to grow 2 per cent in 2011-12 and 3½ per cent in 2012-13, underpinned by demand for new office space associated with solid employment growth.

## Public final demand

The withdrawal of fiscal stimulus and the fiscal consolidation plans of the Commonwealth and State governments are expected to result in public final demand growth declining sharply over the next two years. After peaking at 7 per cent growth in 2009-10, **public final demand** is expected to grow 3¾ per cent in 2010-11 and ¾ per cent in 2011-12, before falling 2½ per cent in 2012-13 (Chart 8).

**Chart 8: Growth in new public final demand**



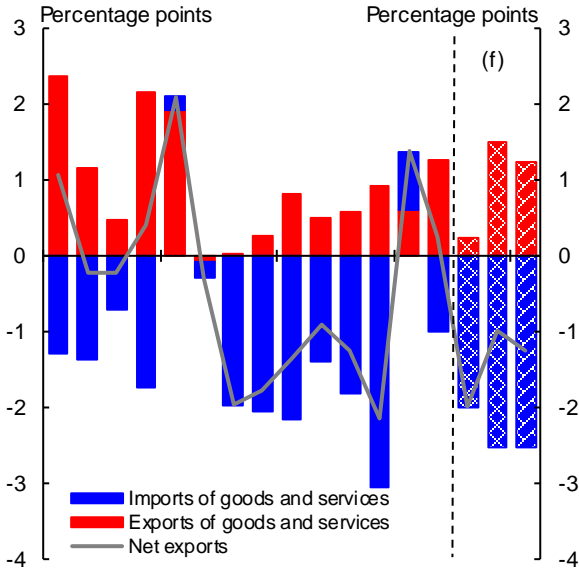
Forecast growth in public final demand has been revised down in 2011-12 and 2012-13 since Budget, largely driven a revised investment profile for the NBN (implying less investment across the forecast horizon than estimated at Budget). Forecast growth in Commonwealth Government expenditure also incorporates information received since the Budget for the multijurisdictional sector (principally lower sales of goods and services by universities), resulting in higher forecast growth in Commonwealth Government consumption in 2010-11.

The withdrawal of the Government's fiscal stimulus continued to detract from growth in the March quarter, and further detractions are expected in the June quarter and in 2011-12. The withdrawal of stimulus is expected to detract around 1 percentage point from GDP growth in 2010-11 and ½ of a percentage point in 2011-12.

**Exports, imports and the current account deficit**

**Net exports** are expected to detract 2 percentage points from real GDP growth in 2010-11, compared with 1 percentage point at Budget, reflecting a larger and more protracted reduction in coal exports due to the floods. Net exports are then expected to detract 1 percentage point from real GDP growth in 2011-12 and 1¼ percentage points in 2012-13 (Chart 9). This is a larger detraction from growth in 2012-13 than forecast at Budget, with forecast growth in capital imports revised higher in line with higher mining investment.

**Chart 9: Net exports – contribution to GDP growth**



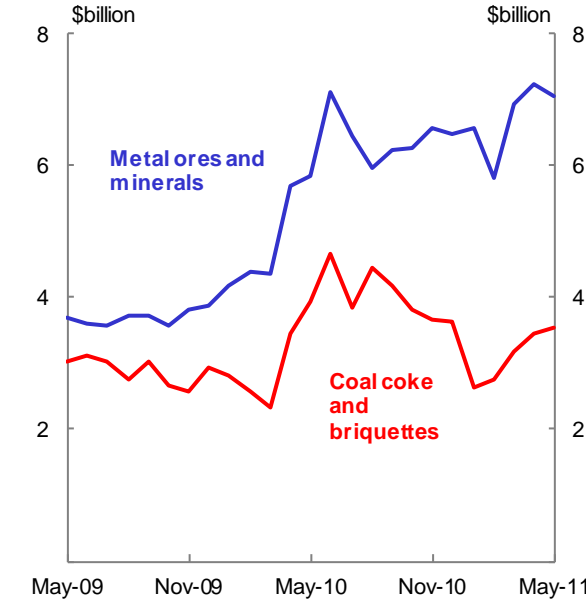
Source: ABS Catalogue Number 5206.0 and Treasury.

**Total exports** are expected to increase 1 per cent in 2010-11, 6½ per cent in 2011-12 and 5½ per cent in 2012-13.

**Non-rural commodity exports** are expected to increase by a modest ½ a per cent in 2010-11, before growing strongly over the next two

years, with growth of 11½ per cent expected in 2011-12 and 8 per cent expected in 2012-13. While production of iron ore has returned to pre-disaster levels, thermal and metallurgical coal production is not expected to return to full capacity until late 2011, with a number of mines still inundated with water (Chart 10). The slower-than-expected recovery is estimated to result in coal production losses of around 35 million tonnes in 2010-11, up from 25 million tonnes estimated at Budget. Growth in non-rural commodity exports is expected to rebound in 2011-12 as mining operations return to full capacity, and continue to grow strongly in 2012-13 as mine and infrastructure capacity expands.

**Chart 10: Coal and iron ore export values**



Source: ABS Catalogue Number 5368.0.

The outlook for **rural exports** is largely unchanged from Budget. Rural exports are expected to grow 9 per cent in 2010-11, 1 per cent in 2011-12 and 3 per cent in 2012-13. Rural exports are expected to be supported through the remainder of 2011 by the rundown of grain inventories built up during the January floods.

**Services' export** forecasts have been downgraded since Budget, with recent declines in international student commencements and tourist arrivals suggesting that the high exchange rate is having a larger contractionary influence than previously anticipated. Services exports are expected to fall 2½ per cent in 2010-11 and

1½ per cent in 2011-12, before rising by a moderate 1½ per cent in 2012-13.

Forecast growth in exports of **elaborately transformed manufactures** (ETMs) has also been downgraded since Budget. ETMs have recorded weak growth since the start of the GFC and this is expected to continue, with the high exchange rate also having a larger contractionary influence on this sector than previously anticipated. Quarterly declines are expected in the near term, followed by very modest growth in 2012-13. This translates to year-average growth of 2 per cent in 2010-11, 0 per cent in 2011-12 and 2 per cent in 2012-13.

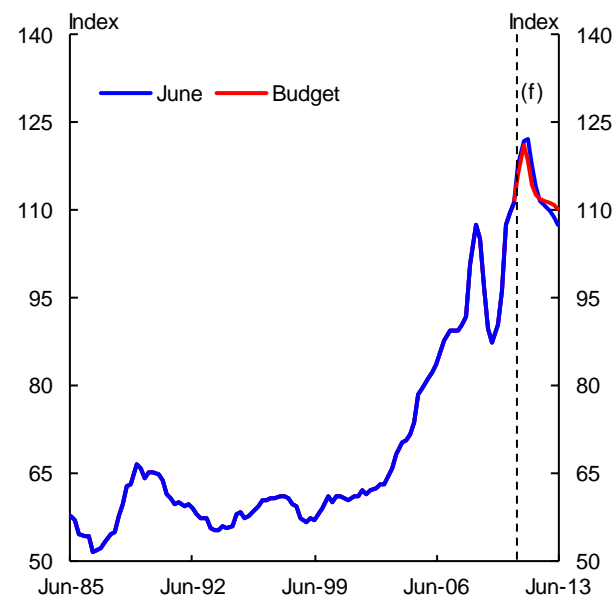
**Import** volumes are expected to increase strongly over the forecast period, supported by the high exchange rate and capital equipment imports associated with the mining investment boom. Higher forecasts for mining investment has flowed through to stronger capital imports, particularly in 2012-13. Import volumes are expected to increase 9½ per cent in 2010-11, 10½ per cent in 2011-12 and 10 per cent in 2012-13.

The **terms of trade** forecasts for 2010-11 and 2011-12 have been upgraded slightly since Budget, with prices for Australia's key non-rural commodities remaining higher than anticipated (Chart 11). Delays in mine recovery operations in Queensland have helped to sustain metallurgical coal prices, while demand for iron ore from China and the rest of developing Asia remains solid. That said, a large proportion of metallurgical coal has been exported below prevailing spot prices and the June quarter contract price, suggesting that a number of mines that declared force majeure during the floods may be honouring the terms of March quarter contracts when prices were lower. The terms of trade are forecast to grow 20¼ per cent in 2010-11 and 1¼ per cent in 2011-12 to reach a record high. They are then expected to fall 6 per cent in 2011-12 as short term influences, such as flood disruptions, fade and significant new global supply of coal and iron ore comes on line. The terms of trade is expected to be at around the same level in 2012-13 as forecast at Budget.

The **current account** deficit is expected to narrow sharply to 2¼ per cent of GDP in

2010-11. This is a slightly larger deficit than expected at Budget, due to the larger anticipated impact of the recent natural disasters on non-rural commodity exports. The current account deficit is then expected to widen to 4 per cent of GDP in 2011-12 and 6½ per cent of GDP in 2012-13, as prices of Australia's key non-rural commodities ease and import volumes increase strongly.

**Chart 11: Terms of Trade**  
(2008-09 = 100)



Source: ABS Catalogue Number 5206.0 and Treasury.

## Employment, wages and inflation

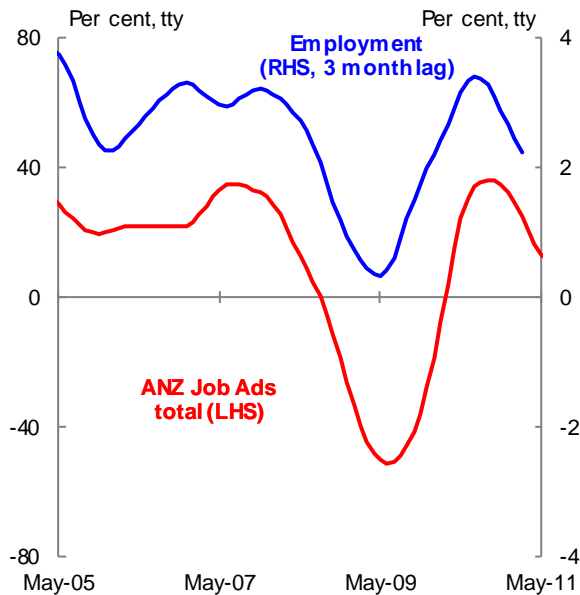
The labour market outlook has weakened since Budget, consistent with the downward revision to forecast real GDP growth. Forecast **employment growth** has been revised down to 1½ per cent through the year to the June quarter of 2012 and the June quarter of 2013. This is ¼ of a percentage point lower through both years than forecast at Budget.

After surging in 2010, employment growth has slowed significantly in the first half of 2011 (employment rose 176,000 persons in the second half of 2010, compared to 46,000 in the first half of 2011). While the Queensland labour market is recovering from recent natural disasters broadly as anticipated, June quarter employment growth was weaker than expected at the national level. Forward looking labour demand indicators, including job advertisements and surveyed hiring intentions, have also eased in recent months



(Chart 12). While economic growth is set to pick up over the next two years, driven by the rapid expansion of the mining and related sectors, these sectors employ only a small fraction of the total workforce. Therefore, demand for labour is not expected to be as strong as the aggregate real GDP growth forecasts might suggest.

**Chart 12: Employment growth and ANZ jobs advertisements growth (trend)**



Source: ABS Catalogue Number 6202.0 and ANZ Job Advertisement Series.

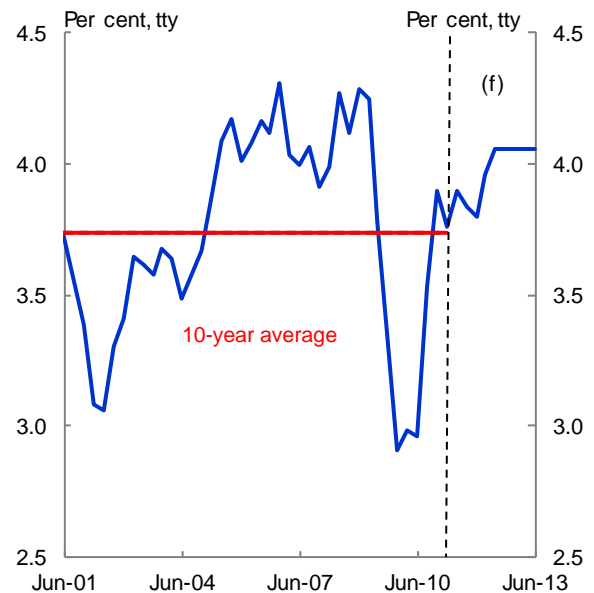
After peaking at 66.0 per cent, the participation rate fell to 65.6 per cent in June. Consequently, the forecast **participation rate** has been revised down to 65½ per cent across the forecast horizon, down from 66 per cent at Budget. Nevertheless, weaker forecast employment growth is still expected to translate to a more gradual decline in the unemployment rate, from 4.9 per cent currently to 4¾ per cent by the June quarter 2013.

The **Wage Price Index** is expected to grow by a solid 4 per cent in each forecast year (Chart 13). Forecast wages growth has been revised down by ¼ of a percentage point in 2012-13, consistent with lower expected employment growth and a more gradual forecast decline in the unemployment rate.

After accelerating through 2010, wages growth has stabilised in the first half of 2011. The Wage Price Index (WPI) increased 3.8 per cent through the year to March, only marginally

above its 10-year trend average and consistent with growth in Average Weekly Ordinary Time Earnings (AWOTE) over the same period. Further, according to DEEWR's Trends in Federal Enterprise Bargaining, the Average Annualised Wage Increase for agreements certified in the December quarter, at 3.8 per cent, was lower than in the September quarter. Shortages of specialised labour in the resource and construction sectors are generating localised wage pressures, with recent wage agreements in the order of 5-10 per cent in some specific professions. Elsewhere in the economy, however, firms are generally providing increases of around 3-4 per cent, with no evidence of accelerating wage pressures.

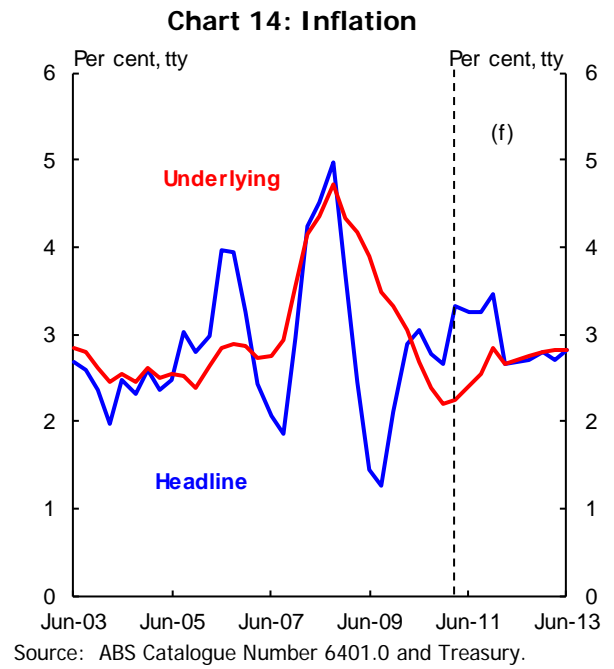
**Chart 13: Wage Price Index growth**



Source: ABS Catalogue Number 6345.0 and Treasury.

The forecasts for **headline and underlying inflation** have also been revised down since Budget, with capacity pressures now expected to build more gradually over the forecast horizon. Underlying inflation is forecast to rise from 2½ per cent through the year to June 2011 to 2¾ per cent through the year to both June 2012 and June 2013, as the dampening influence of the exchange rate appreciation dissipates, the resources boom places pressure on the cost of some labour and materials, and supported by continued strong growth in the price of utilities and other administered items. Headline inflation is also expected to be 2¾ per cent in the June 2013 after spiking at

3¼ per cent in June 2011, due to the impact of flooding and Cyclone Yasi on fruit and vegetable prices and recent increases in world oil prices (Chart 14).



## OUTLOOK FOR THE INTERNATIONAL ECONOMY

**Table 1: International GDP growth forecasts<sup>(a)</sup>**

	2010	2011		2012		2013	
	Actual	Budget	June	Budget	June	Budget	June
United States	2.9	3	2 1/2	3	3	n.p.	2 3/4
Euro area	1.7	1 1/2	1 1/2	1 1/2	1 1/2	n.p.	1 3/4
Japan	4.0	1/4	0	2 1/2	3	n.p.	1
China	10.3	9 1/2	9 1/4	9	9	n.p.	8 3/4
India	10.4	8 3/4	8 1/4	8 1/4	7 3/4	n.p.	8 1/4
Other East Asia (b)	7.6	5	5 1/2	5	5	n.p.	5
Major Trading Partners	6.6	4 1/2	4 1/2	5	5	n.p.	4 3/4
World	5.1	4 1/4	4 1/4	4 1/2	4 1/2	n.p.	4 1/2

(a) Calculations for World, euro area and other East Asia growth rates use GDP weights based on purchasing power parity (PPP). Calculations for Major Trading Partners use export trade weights.

(b) Other East Asia is: Korea, Taiwan, Hong Kong, Singapore, Indonesia, Malaysia, Thailand, Vietnam and the Philippines.  
n.p - Not published.

Source: National statistical publications, IMF, Thomson Reuters and Treasury.

### World outlook and risks

The outlook for the global recovery is more uncertain compared to Budget. However, the forecast for 2011 global growth is unchanged at 4¼ per cent. This reflects stronger-than-expected March quarter outcomes for the euro area and a number of East Asian economies, being offset by weaker-than-expected growth in the United States and Japan. MTP growth forecasts are also unchanged.

The global outlook remains subject to significant downside risks. The threat of financial contagion from the euro area periphery sovereign debt crisis has intensified and market concerns over sovereign debt have spread to Italy. Uncertainty over the shape of further financial assistance to Greece and questions over the ability of Portugal and Ireland to return to the markets within their bailout timeframes has prompted a number of credit rating downgrades that have unsettled markets. Furthermore, despite oil prices easing since the end of April, ongoing unrest in the Middle East and North Africa means upside risks to oil prices persist.

After the sharper than expected contraction in March quarter Japanese GDP, partial data since the 11 March earthquake indicate the recovery in Japanese sentiment, spending and supply chains may occur more quickly than expected and therefore the impact on global activity may be relatively short lived. Accordingly, the forecast for Japan's 2011

growth has been revised down only ¼ of a percentage point to zero.

An additional concern for the global outlook is the debate over raising the US Federal Government debt ceiling. While the debt ceiling is likely to be raised, the protracted nature of the debate raises the risk, albeit slight, that an agreement may not be reached by the 2 August deadline. Such an outcome risks causing a marked disruption to global financial markets.

The debt ceiling debate adds to existing concerns about the strength of the US recovery. Severe weather and rising oil prices weighed on March quarter US growth, highlighting the fragility of the recovery, while partial data for the June quarter so far have been weaker than expected. As a consequence growth for 2011 has been revised down to 2½ per cent.

Emerging economies continue to grow strongly, and overheating remains a risk. China continues to tighten policy settings, in response to persistent inflationary pressures, and India is in the early stages of what is expected to be a substantial tightening of monetary policy.

The slight downward revision to 2011 Chinese growth reflects the expected impact on activity from power shortages caused by the ongoing drought (hydroelectricity), and the inability of power producers generally to pass on higher prices to businesses and consumers, causing power producers to cut supply.



## ATTACHMENT A: IMPACT OF CARBON POLICY ON AUSTRALIA'S NEAR-TERM ECONOMIC OUTLOOK

This attachment details the impact of the Government's carbon price policy on the near-term economic outlook, adjusting the June JIEG forecasts for deviations from the reference case in the modelling undertaken for *Strong growth, low pollution: modelling a carbon price*. The effects of the Government's carbon policy will be incorporated into the central forecasts from the next forecasting round.

According to the modelling, the introduction of a carbon price reduces forecast real GDP growth by  $\frac{1}{4}$  of a percentage point in 2012-13, to  $3\frac{3}{4}$  per cent. This largely occurs through a  $\frac{3}{4}$  percentage point reduction in business investment, partly offset by a  $\frac{1}{4}$  percentage point reduction in imports growth. In net terms, the introduction of the carbon price and the associated household compensation package and personal income tax reforms are not expected to have a material impact on aggregate real household consumption growth in 2012-13. The key aggregates are summarised in Table A1.

**Table A1: Key Domestic Forecasts – Inclusive of Carbon Policy**

	2009-10	2010-11	2011-12	2012-13	
	Outcome (a)	June	June	June	w/carbon policy
Real GDP (b)	2.3	2	3 $\frac{3}{4}$	3 $\frac{1}{2}$	3 $\frac{1}{4}$
Nominal GDP (b)	2.4	8	6 $\frac{3}{4}$	5	5 $\frac{1}{2}$
Unemployment rate (c)	5.2	5	4 $\frac{3}{4}$	4.8	5.0
Employment (d)	2.4	2 $\frac{1}{4}$	1 $\frac{1}{2}$	1 $\frac{1}{2}$	1 $\frac{1}{2}$
CPI (d)	3.1	3 $\frac{1}{4}$	2 $\frac{3}{4}$	2 $\frac{3}{4}$	3 $\frac{1}{2}$

(a) Calculated using original data except for employment, the unemployment rate and WPI.

(b) Year average.

(c) June quarter.

(d) Through-the-year growth rate to the June quarter.

The introduction of a carbon price raises aggregate price levels. Forecast growth in the non-farm GDP deflator is  $\frac{1}{2}$  of a percentage point higher in 2012-13 due to the policy change. The imposition of the carbon price is estimated to increase the CPI by  $\frac{3}{4}$  of a percentage point in the September quarter 2012, raising the headline inflation forecast to  $3\frac{1}{2}$  per cent through the year to the June quarter 2013.

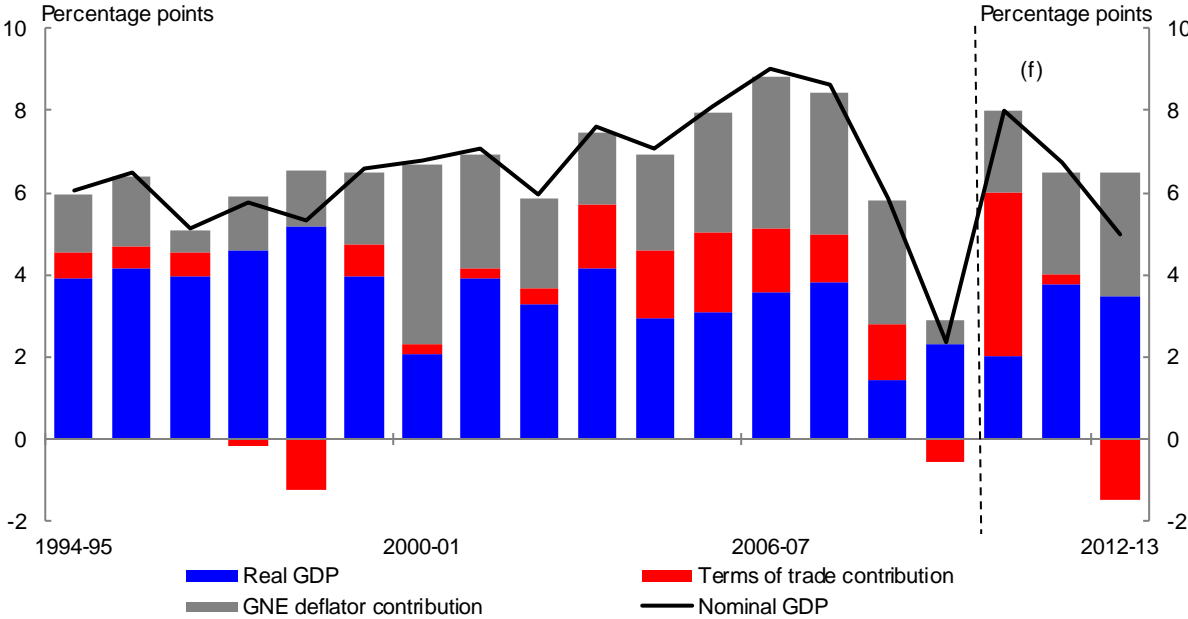
Overall, forecast nominal GDP growth is  $\frac{1}{2}$  of a percentage point higher in 2012-13 due to the policy change, growing by  $5\frac{1}{2}$  per cent on a policy-inclusive basis. Total corporate gross operating surplus (GOS) grows by  $\frac{1}{4}$  of a percentage point less in 2012-13 under the carbon policy, with growth expected to be 2 per cent. Compensation of employees (COE) is expected to grow more strongly due to higher nominal wages growth. COE is expected to increase  $6\frac{3}{4}$  per cent in 2012-13, which is  $\frac{1}{4}$  of a percentage point faster than the policy-exclusive forecast.

The impact of the carbon price on employment is expected to be minimal, with employment growth forecast to be  $1\frac{1}{2}$  per cent through the year to June 2013 in rounded terms, including and excluding the carbon policy. The increase in the unemployment rate is estimated to be less than  $\frac{1}{4}$  of a percentage point.

## ATTACHMENT B: FORECAST GROWTH IN NOMINAL GDP

Nominal GDP is forecast to grow 8 per cent in 2010-11 and 6¾ per cent in 2011-12. Forecast growth in nominal GDP is ½ a percentage point higher in 2011-12 than at Budget due to the unanticipated strength in the terms of trade. However, nominal GDP growth has been revised down by ¾ of a percentage point to 5 per cent in 2012-13 due to the combination of lower forecast real GDP growth and the larger anticipated decline in the terms of trade in that year, leaving the level of nominal GDP \$5½ billion lower in 2012-13 than forecast at Budget.

Chart 15: Components of nominal GDP growth



Source: ABS Catalogue Number 6401.0 and Treasury.

Total corporate gross operating surplus (GOS) is expected to grow 10¾ per cent in 2010-11, 8¾ per cent in 2011-12 and 2¼ per cent in 2012-13. Growth in GOS was weaker than anticipated in the March quarter, falling 4.1 per cent, with mining profits down 6.8 per cent. Forecast growth in GOS has been revised down in 2010-11, reflecting a larger estimated impact of the floods on coal production, but is expected to be stronger than anticipated at Budget in 2011-12 as mining production returns to pre-flood levels and consistent with the upward revision to the terms of trade forecasts in 2010-11 and 2011-12. Forecast growth in GOS has then been revised down in 2012-13, consistent with weaker forecast growth in real GDP and the larger anticipated decline in the terms of trade in that year.

Compensation of employees (COE) is forecast to grow 7½ per cent in 2010-11, 6½ per cent in 2011-12 and 6 per cent in 2012-13. Growth in COE was higher in the March quarter than expected at Budget, reflecting a sharp increase in average earnings. However, growth in COE has been revised down in both 2011-12 and 2012-13, consistent with the downward revision to forecast growth in wages and employment.

Gross mixed income (GMI), which includes the wages and profits of farm and other unincorporated enterprises, is forecast to grow 5¾ per cent in 2010-11, 3 per cent in 2011-12 and 3¾ per cent in 2012-13.