Economic Outlook

The following is a reprint of Part II of the Economic Outlook from the Mid-Year Economic and Fiscal Outlook 1999-2000.

Despite some continuing adverse fallout from the Asian crisis, economic growth in Australia is expected to remain very solid in 1999-2000 at around 3½ per cent, up from the 3 per cent growth forecast at Budget, with strong growth in employment and a declining unemployment rate. Growth of 3½ per cent compares very favourably with expected growth rates in most developed economies and follows the very robust growth of around 4½ per cent in both 1997-98 and 1998-99.

The upward revision to the growth forecast since Budget reflects an improving world outlook, together with continuing strength in domestic demand, particularly household consumption, and a firmer labour market than had been anticipated.

The outlook for world economic growth has improved noticeably in recent months. On the back of an improvement in Japan and recovery in most Asian economies, world output in 1999 is expected to be around ¾ of a percentage point stronger than forecast at Budget. Growth is expected to remain strong in the US and this will continue to underpin world economic activity in 1999. In 2000, world growth is expected to lift further, reflecting stronger recoveries in Japan, Europe and most of the Asian economies. A similar result is expected overall in 2001, although growth in the US is anticipated to moderate.

In 2000-2001, economic growth in Australia is expected to be a strong 3¾ per cent, with employment growth remaining firm at around 2 per cent, raising the prospect of further declines in unemployment. Net exports are expected to increase significantly as the world economy continues to strengthen, with services exports also receiving a boost from the Olympics. On the other hand, overall domestic demand is forecast to grow at a steadier rate than in recent years. Some components of demand will be supported by a modest fiscal stimulus compared with fiscal settings in 1999-2000, in part associated with the Government's tax package, *The New Tax System*. However, the impact on activity in 2000-2001 will be offset to some extent by the unwinding of an expected bring-forward of consumption expenditure and residential construction into the latter part of 1999-2000, ahead of the tax changes.

The ¼ percentage point increase in official interest rates in early November, and the modest upward trend in long-term interest rates since their low point in 1998, will also have a steadying influence on some components of domestic demand in 2000-2001.

The changes to indirect tax arrangements flowing from the Government's tax package, *The New Tax System*, are estimated to raise consumer prices by around 2¾ per cent through the year to the June quarter 2001. With ongoing inflation estimated to be around 2½ per cent over that period, consumer prices are forecast to increase by around 5¼ per cent through the year to the June quarter 2001.

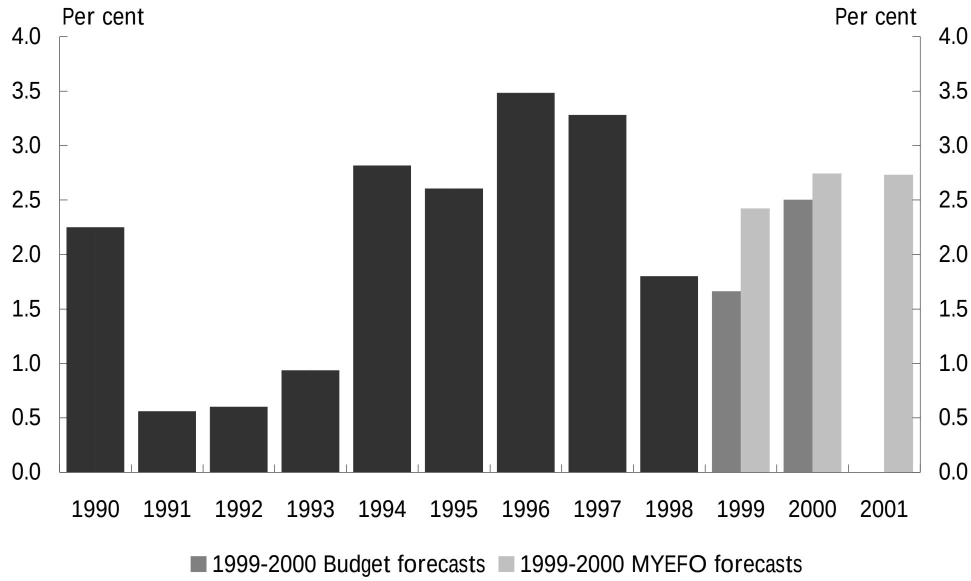
International economic outlook[1]

The outlook for the world economy has improved noticeably in recent months, although the higher rates of growth expected in the world economy are still below those of the mid-1990s (see Chart 1) and a little below the longer-term average. In the near term the outlook now seems less uncertain than at Budget, although risks remain.

World output is now expected to grow by 2½ per cent in 1999 (measured on a market exchange rate basis), compared with 1¾ per cent forecast at Budget. The improved outlook largely reflects an upturn in East Asia, with growth in Japan earlier in the year and recovery well under way in Korea. Growth is expected to remain strong in the US and this will continue to underpin world economic activity in 1999.

1 Since the MYEFO forecasts were finalised, the US has released a comprehensive revision to their National Accounts. The methodological changes have moderately increased the long-term average rate of growth, with revisions extending back to 1959.

Chart 1: World GDP growth at market exchange rates



As a result of strengthening growth in Japan, Europe and most Asian economies, world output is expected to increase by 2¾ per cent in 2000. Growth in the US, however, is expected to moderate, reflecting emerging constraints on the supply side of the economy, particularly in the labour market.

These trends are expected to continue in 2001, with overall growth in world output forecast to remain around 2¾ per cent. Growth in the US and Europe is expected to be around trend and Japan's economic growth is expected to continue to gather momentum.

A more detailed breakdown of the outlook by major country and region is shown in Table 1.

Table 1: International GDP growth forecasts

	1997	1998	1999	2000	2001
	Actual	Actual	Forecast	Forecast	Projection
United States	3.9	3.9	3 3/4	2 1/2	2 1/2
European Union(a)(b)	2.5	2.6	2	2 3/4	2 3/4
Japan	1.4	-2.8	3/4	1	1 1/4
Non-Japan East Asia(a)(c)	6.2	-0.5	5 3/4	6	5 3/4
World(a)	**3.3**	**1.8**	**2 1/2**	**2 3/4**	**2 3/4**
MTP Countries(d)	3.9	-1.2	3 1/4	3 1/2	3 1/2

(a) European Union, Non-Japan East Asia and World GDP growth rates are calculated using GDP weights based on market exchange rates. The weights used in the forecasts are a 3-year moving average up to 1998.
(b) European Union economies are Germany, France, the United Kingdom, Italy, Belgium, the Netherlands, Greece, Denmark, Sweden, Luxembourg, Austria, Spain, Portugal, Finland and Ireland.
(c) Non-Japan East Asia economies are Korea, Singapore, Taiwan, Hong Kong, China, Indonesia, Malaysia, Thailand and the Philippines.
(d) Major Trading Partner (MTP) growth is calculated using weights based on merchandise exports as a percentage of total exports to MTP countries over the three fiscal years to 1998-99.

The US economy has maintained momentum through 1999, as expected at Budget. However, growth is expected to moderate over the forecast horizon on the back of recent increases in interest rates and a tightening in supply conditions.

The economic downturn in Japan is showing signs of bottoming out. After recording an annualised growth rate of 3.2 per cent in the first half of 1999, the Japanese economy is now expected to grow by about ¾ per cent in 1999 (compared with the Budget forecast of a 1 per cent contraction). This upward revision largely reflects strong growth recorded earlier in 1999, supportive macroeconomic policies since 1998 and signs of continued improvements in economic conditions in recent months. Growth is expected to continue to gain strength in Japan through 2000 and 2001, although there is a wide range of risks in light of uncertainties about the impact of corporate and financial sector restructuring on private demand and the likely level of fiscal stimulus.

The recent economic recovery in most of the Non-Japan East Asian economies is expected to gather pace, with some expected to recover very strongly (notably Korea), albeit from relatively low bases. As the bounce-back in activity in the region to date has been stronger than was expected, the Non-Japan East Asian economies are expected to grow by around 5¾ per cent in 1999 (against 3¼ per cent anticipated at Budget), and maintain a similar growth rate over the next two years.

The European economy is also showing signs of improvement after experiencing a slowing over the second half of 1998. Export demand has improved and domestic demand remains robust, supported by ongoing high levels of consumer confidence and improving industrial activity. In turn, business confidence has improved in recent months and indicates a more positive outlook for business conditions. Europe's growth rate is expected to accelerate over the second half of this year through to the next, giving a forecast growth rate of 2 per cent for 1999 and 2¾ per cent for 2000. Growth in Europe is expected to remain at 2¾ per cent in 2001.

Domestic forecasts

In framing the forecasts for the domestic economy, the exchange rate is assumed, as is usual practice, to remain unchanged from the average level reached in recent months. The farm sector forecasts are based on an assumption of average seasonal conditions for the remainder of 1999-2000 and in 2000-2001.

The forecasts for activity and inflation in both 1999-2000 and 2000-2001 take into account the changes to indirect taxes, and the general reductions in income tax rates and increases in social welfare payments, flowing from the Government's tax package, *The New Tax System*. Account is also taken of the temporary Defence — East Timor levy which will apply in 2000-2001. On balance, there is estimated to be a modest overall fiscal stimulus in 2000-2001 of around ¼-½ percentage point of GDP, relative to the fiscal settings in 1999-2000.

While the major elements of *The New Tax System* will take effect at the start of 2000-2001, some impact on activity is likely to be felt in the latter part of 1999-2000. In particular, a net bring-forward of household consumption and a bring-forward of residential investment seem likely in the latter part of 1999-2000 in anticipation of price changes flowing from the indirect tax changes, with these bring-forwards being unwound in 2000-2001. Working in the opposite direction, some plant and equipment investment that might otherwise have occurred in 1999-2000 could be delayed until 2000-2001 as business seeks to take advantage of the price changes for plant and equipment flowing from the revised indirect tax arrangements.

The forecasts incorporate the ¼ percentage point increase in official interest rates in early November, which is expected to have a small moderating influence on growth in domestic demand, particularly in 2000-2001. Long-term interest rates are assumed to remain around their average level of recent weeks. This is somewhat above the lows reached by long-term interest rates in 1998 and is likely to also have a moderating influence on domestic demand and asset prices in the period ahead.

The forecasts also include the estimated effects of the Sydney Olympics on economic activity. The main impact of the Olympics on services exports (particularly tourism and international broadcasting rights) and household consumption expenditure (particularly ticket sales) is likely to be recorded in the September quarter 2000. However, this will be partially offset by a decline in public authority stocks in that quarter, unwinding the stock accumulation of the preceding few years associated with the Olympics.

Domestic economy — 1999-2000

The forecasts for 1999-2000 are summarised in Table 2. Economic growth is expected to be around 3½ per cent, revised up from the Budget forecast of 3 per cent. The upward revision reflects a more optimistic world growth outlook as well as evidence of continuing strength in domestic demand, particularly household consumption, and in the labour market.

Table 2: Domestic economy forecasts[(a)]

	1998-99 Outcomes (b)	1999-2000 Budget Forecasts	Revised 1999-2000 Forecasts
	Year Average	Year Average	Year Average
Panel A - Demand and Output(c)			
Private consumption	4.5	3 3/4	4 1/4
Private investment			
Dwellings	7.4	3	5
Total business investment	0.4	-1	0
Other buildings and structures	-0.9	-10	-11
Machinery and equipment	-2.7	1	0
Private final demand	3.9	2 3/4	3 1/2
Public final demand	5.0	3 1/4	4 1/2
Total final demand	4.2	3	3 3/4
Change in inventories(d)			
Private non-farm	0.7	0	0
Farm and public authorities	0.0	- 1/4	- 1/4
Gross national expenditure	4.8	2 3/4	3 1/2
Exports of goods and services	1.7	5	5
Imports of goods and services	5.0	4	5
Net exports(d)	-0.7	1/4	0
Gross domestic product	4.5	3	3 1/2
Non-farm product	4.3	3	3 1/2
Farm product(e)	8.2	1	0
Panel B - Expenditure Excluding Transfers and One-off Transactions(c)(f)			
Total business investment	2.6	0	2
Other buildings and structures	7.8	-9	-9
Machinery and equipment	-3.6	3	3
Public final demand	3.5	2 1/2	3 1/4
Change in inventories(d)	0.6	0	- 1/4
Gross national expenditure	4.7	2 3/4	3 1/2
Exports of goods and services	2.3	5	5
Panel C - Other Selected Economic Measures			
Prices and wages			
Consumer Price Index	1.2	2	2 1/4
Gross non-farm product deflator	0.6	1 3/4	1 1/4
Average earnings(g)	3.9	3 3/4	3 1/2
Labour market			
Employment (Labour Force Survey basis)	2.2	1 3/4	2 1/4
Unemployment rate (per cent)	7.6	7 1/2	7
Participation rate (per cent)	63.2	63 1/4	63 1/4
External accounts			
Terms of trade	-5.1	1/2	1
Current account balance			
$billion	-32.4	-32	-33 1/2
Percentage of GDP	-5.5	-5 1/4	-5 1/2

(a) Percentage change on preceding year unless otherwise indicated.
(b) Calculated using original data.
(c) Chain volume measure.
(d) Percentage point contribution to growth in GDP.
(e) 1998-99 outcome calculated at basic prices.
(f) Transfers are net second hand asset sales from the public sector to the private sector. One-off transactions are gold sales by the Reserve Bank, 'lumpy' imports of civilian aircraft, ships and satellites, and the export of ANZAC frigates.
(g) Average non-farm compensation of employees (National Accounts basis).

Demand and output

Growth in **private consumption** is expected to moderate slightly but remain strong in 1999-2000, following the very strong increases of around 5 per cent in 1997-98 and 4½ per cent in 1998-99. The introduction of the GST on 1 July 2000 is expected to result in some transitional effects on normal consumption patterns, as consumers bring forward consumption of some items that will rise in price and defer consumption of others that will fall in price. While the net impact of these timing changes is uncertain, the forecasts incorporate a relatively small net bring-forward of household consumption from 2000-2001 into the latter part of 1999-2000. Allowing for this bring-forward, growth in private consumption is forecast to be around 4¼ per cent in 1999-2000.

This outlook for a slight decline in the pace of private consumption growth is consistent with an assumed slowing in growth in real private sector wealth to around its longer-term trend rate, following several years of very strong growth, slower growth in real wages and a fading in the boost to consumption from the AMP demutualisation. However, consumption growth should continue to be supported by ongoing solid employment growth and a supportive interest rate environment by historical standards. The results of recent consumer confidence surveys also suggest consumer optimism remains at very high levels.

Following very strong rises in **dwelling investment** of around 15½ per cent in 1997-98 and around 7½ per cent in 1998-99, more moderate growth of around 5 per cent is expected in 1999-2000. This forecast includes a GST-induced bring-forward of construction activity into 1999-2000, at the expense of activity in 2000-2001. Abstracting from the GST bring-forward, dwelling investment is expected to increase modestly in 1999-2000, underpinned by the long-term structural trend towards larger and more expensive housing and ongoing moderate growth in alterations and additions to the existing housing stock. The number of new houses being built appears broadly to match the underlying demand for new houses based on demographic factors, and so is not expected to contribute significantly to growth in dwelling investment.

Business investment (abstracting from asset sales) is forecast to grow by around 2 per cent in 1999-2000, broadly in line with the growth rate recorded in 1998-99, following six years of strong growth. This forecast reflects the expected gradual world recovery, the mature stage of the investment cycle in some sectors and a provision for the deferral of some investment spending in the lead-up to the introduction of Government's tax package, *The New Tax System*.

Within the forecast for overall business investment there are, however, significant differences between the outlook for plant and equipment investment and for non-residential construction. Plant and equipment investment (abstracting from asset sales) is forecast to grow by around 3 per cent in 1999-2000, supported by rising capacity utilisation and some strengthening in export demand flowing from the expected gradual pick-up in world growth. This is consistent with surveyed business investment intentions which point to modest growth in plant and equipment investment in 1999-2000.

On the other hand, the outlook for investment in non-residential construction (abstracting from asset sales) is less favourable, with a fall of around 9 per cent expected in 1999-2000. After five years of strong growth in non-residential construction, which have taken it to a relatively high level as a share of GDP, there is now more limited scope for further spending in many areas such as offices, hotels, shops, casinos and sporting arenas. The deferral of many mining investment projects in response to the weakness in commodity prices will also weigh on the outlook for non-residential construction. This outlook is broadly consistent with surveyed business investment intentions, which also point to a large fall in non-residential construction, and other forward indicators, such as the value of building approvals and the amount of work still in the pipeline, which are well down on their mid-1998 peaks.

Private non-farm inventories are not expected to contribute to growth in 1999-2000. Over the past few quarters, the non-farm stocks-to-sales ratio has increased sharply. Some of this stock building would appear to be aimed at returning stocks to desired levels, following the steep decline in the non-farm stocks-to-sales ratio experienced from late 1996 through 1997. However, the further sharp increase in the non-farm stocks-to-sales ratio in the June quarter 1999 may reflect some mild unanticipated stock building, in response to the temporary pause in sales, which is likely to be unwound in 1999-2000. The anticipated moderation in sales growth in 1999-2000 will also weigh on the outlook for investment in inventories. However, these effects will be largely offset by the privatisation of Wool International, the Wheat Board and the Barley Board in the September quarter 1999 (which will lead to both an increase in non-farm stocks and a corresponding decrease in public authority stocks).

The Australian Bureau of Statistics (ABS) will build some further Olympic-related expenditure into public authority inventories over the course of 1999-2000, partially offsetting the impact of the privatisation of the three public marketing authorities. (In the September quarter of 2000, this Olympic-related stock building of the last four years will be unwound.)

More generally, the quarterly pattern of activity in 1999-2000 could be affected to some extent by Y2K-related precautionary stock building in the latter part of 1999, consistent with recent business surveys. These stocks are likely to be unwound in the first half of 2000. Such stock building would provide a temporary boost to GDP growth ahead of the New Year, with an offsetting detraction in the first half of 2000.

Following a strong increase of 5.0 per cent in 1998-99, growth in **public final demand** is expected to moderate slightly but remain very solid in 1999-2000, rising by around 4½ per cent. In part this forecast growth reflects an anticipated reduction in second hand asset sales (which detract from investment) from their high 1998-99 level.

After adjusting for second hand asset sales, public final demand is forecast to grow by 3¼ per cent, down slightly on the 3½ per cent growth recorded for 1998-99. Relatively subdued growth is forecast at the State / local level, both for consumption and investment, while the forecast for Commonwealth consumption includes an allowance for increased defence expenditure flowing from Australia’s commitments in relation to East Timor.

The level of **gross agricultural product** is forecast to remain unchanged in 1999-2000, compared with the Budget forecast of a 1 per cent increase from its level in 1998-99. Forecast production of cereals and grains, dairy and cotton have been revised down marginally since Budget, while beef and veal production is also expected to fall slightly, reflecting a rebuilding phase in the cattle herd.

Net exports are expected to make no contribution to GDP growth in 1999-2000, after detracting from growth in 1998-99. Export volume growth is forecast to be around 5 per cent, compared with around 2 per cent in 1998-99, as world growth strengthens. Import volumes in 1999-2000 are also expected to increase by around 5 per cent, slightly more than was anticipated at Budget, with the upward revision reflecting both the increase in forecast domestic demand since Budget and a downward revision to expected import prices.

Following a significant decline of around 5 per cent in 1998-99, the terms of trade is expected to recover slightly in 1999-2000. This reflects a mixed commodity price response to strengthening world growth. While price negotiations have resulted in substantial price falls for bulk commodity exports such as coal and iron ore for 1999-2000, the combination of a stronger world economy and supply restrictions is expected to result in significant increases in mineral fuels and base metals prices (in both US and Australian dollar terms) in this year. More generally, although growth in world GDP is expected to move closer to its long-run trend, the *level* of world GDP is expected to remain below its trend path in 1999-2000, following the below-trend growth of recent years. As a result, overall prices of export commodities are expected to remain below trend over the forecast period.

The announcement by European central banks that they would limit sales and leasing of their monetary gold over the next five years, along with the decision by the IMF not to sell part of its gold reserves, have removed a significant source of negative sentiment from the gold market, and led to a significant pick-up in the price of gold. Nevertheless, there is a greater than usual degree of uncertainty surrounding the outlook for the gold price, with both upside and downside risks.

Consistent with the expected stability in net export volumes and the slight increase in the terms of trade, Australia's **current account deficit** (CAD) is expected to remain around 5½ per cent of GDP in 1999-2000, with a declining trend through the year. The risks around the CAD appear evenly balanced. On the one hand there is the possibility of stronger than expected flow-through of more robust world growth to commodity prices and export volumes, leading to a faster turnaround in the terms of trade and net export volumes than forecast. Against this is uncertainty surrounding the rate of recovery in the world economy and the possibility that continuing robust domestic demand could lead to stronger than expected import volume growth. More generally, quarterly outcomes are likely to remain quite volatile, and therefore subject to the usual uncertainties.

Downward revisions by the ABS to estimates of the level of the net income deficit have reduced the forecast for this component of the CAD for 1999-2000 compared with Budget. These downward revisions, combined with an assumption of world interest rates at around current levels, are expected to largely offset the anticipated increase in Australia's net external liabilities and result in only subdued growth in the net income deficit over the forecast period.

Labour market

Employment is forecast to grow by 2¼ per cent in 1999-2000 in year-average terms, up from 1¾ per cent at Budget and broadly unchanged from 1998-99. The upward revision to forecast growth in employment in 1999-2000 reflects the stronger outlook for overall economic activity than was factored in at Budget, and is consistent with a range of supportive partial indicators such as job vacancy series and business surveys of employment intentions. A modest cyclical slowing in productivity growth is expected compared with 1998-99 in line with the forecast slowing in economic growth.

Having fallen over the course of 1998-99, the participation rate is expected to increase slightly from its level at the start of 1999-2000, as continued solid employment growth encourages some workers to enter or re-enter the labour market. In year-average terms the participation rate is forecast to remain flat in 1999-2000 at around 63¼ per cent, similar to the Budget forecast.

In keeping with these forecasts for employment growth and for the participation rate, the unemployment rate is expected to continue its recent downward trend, averaging around 7 per cent over 1999-2000 as a whole. This forecast is below that at Budget, reflecting the improvement in the outlook for activity and the recent strength of the labour market. Volatility in the participation rate, however, represents a key uncertainty around the outlook for the unemployment rate.

Wages

Wages growth is expected to moderate slightly in 1999-2000 as output growth slows, although firm labour market conditions will limit the extent of the moderation. On a national accounts basis, average earnings growth in 1999-2000 is now forecast to be 3½ per cent, compared with the Budget forecast of 3¾ per cent. However, despite this expected moderation, nominal unit labour costs are expected to increase marginally more quickly in 1999-2000 than in recent years, reflecting the anticipated cyclical slowdown in productivity growth.

A number of uncertainties surround the forecast for wages growth in 1999-2000. In addition to the general possibility that the expected further fall in unemployment over the year may lead to stronger wage pressures than anticipated, some business surveys have indicated emerging skills shortages. However, there is little evidence that these shortages are currently having a widespread impact on wages growth across the economy.

Prices

In year-average terms, the Consumer Price Index (CPI) increased by only 1.2 per cent in 1998-99. This outcome was reduced by around ¼ percentage point by the Government's 30 per cent rebate for private health insurance, which commenced on 1 January 1999. In 1999-2000, inflation is expected to rise a little from this level, averaging 2¼ per cent. This modest increase in inflation reflects expected slightly faster growth in nominal unit labour costs in Australia as well as some reversal of the international deflationary forces which were evident during the economic downturn in Asia in 1997 and 1998.

World oil prices have increased sharply since early 1999 and the associated increase in petrol prices had a direct impact on the CPI in the June and September quarters, with some further minor impact expected in the December quarter. Higher oil prices and rising world commodity prices are also expected to put some moderate upward pressure on production costs more generally, both in Australia and overseas.

Changes associated with the Government's tax package, *The New Tax System*, are expected to increase the CPI slightly in 1999-2000. The move to per-stick taxation of cigarettes will add to prices in the December and March quarters of 1999-2000, partly offset by the 29 July reduction of Wholesale Sales Tax (WST) rates from 32 per cent to 22 per cent on a range of items.

Domestic economy — 2000-2001

Growth in 2000-2001 is expected to be a strong 3¾ per cent in year-average terms, with employment growth remaining firm at around 2 per cent, raising the prospect of further declines in unemployment. Domestic demand growth is expected to ease, with the impact on activity more than offset by stronger growth in net exports.

The gradual strengthening in world economic growth is expected to result in faster growth in Australia's export volumes and some further gradual recovery in world commodity prices and in Australia's terms of trade. Nevertheless, world commodity prices and the terms of trade are likely to remain below their levels of mid-1997, prior to the onset of the downturn in Asia, consistent with the expectation that the level of world GDP will remain below trend. Services exports will also be boosted by the Olympics, with the main impact likely to be felt in the September quarter 2000. Some moderation in import volume growth is expected, reflecting the outlook for domestic demand and some increase in import prices.

Growth in household consumption is expected to ease further in 2000-2001, but to remain above its longer-term trend growth rate. Real wages are expected to grow at more moderate rates than in recent years. Asset prices and hence household wealth are also assumed to stabilise to some extent, following several years in which asset prices increased significantly in an environment of falling interest rates. Nevertheless, the future course of asset prices, and the impact of changes in wealth on household consumption, remain a source of uncertainty around the forecasts.

The Government's tax package, *The New Tax System*, will provide substantial income tax cuts and increases in welfare benefits in 2000-2001. The impact on real household disposable income and hence household consumption will be partly offset by overall increases in indirect taxes and the temporary Defence — East Timor levy on incomes above $50,000 which will apply in that year. Further, the expected net bring-forward of consumption into the latter part of 1999-2000 will result in some weakness in consumption in the early part of 2000-2001.

Following a subdued period in 1999-2000, growth in business investment in plant and equipment is expected to respond positively to the improving world economy in 2000-2001, reinforced by the beneficial impact of the Government's tax package, *The New Tax System*, on business costs. In contrast, non-residential construction investment is expected to decline further in 2000-2001, following an expected sharp decline in 1999-2000. Residential construction is also expected to decline a little in 2000-2001 as the bring-forward of activity into 1999-2000, ahead of the changes to indirect tax arrangements, is unwound.

Leaving aside the direct effects of the Government's tax package on consumer prices, inflation is estimated to be around 2½ per cent in year-average and through-the-year terms in 2000-2001, up marginally from around 2¼ per cent in year-average terms in 1999-2000. The gradual increase in inflation reflects expected slightly faster growth in nominal unit labour costs compared with recent years and a continuing reversal of the international deflationary forces which accompanied the sharp downturn in Asia in 1997 and 1998.

The changes to indirect tax arrangements are estimated to increase the CPI by around 2¾ per cent through the year to the June quarter 2001. With ongoing inflation of around 2½ per cent, the CPI is expected to increase by around 5¼ per cent through the year to the June quarter 2001. In year-average terms, the CPI is expected to increase by around 5½ per cent.

The effect of the revised indirect tax arrangements on prices will not be felt evenly through 2000-2001. The main effects will occur in the September quarter of 2000, with the impact of the GST on retail prices only partially offset by the direct impact of the removal of wholesale sales tax. In subsequent quarters, increases in the CPI will be smaller than would otherwise have been the case, as the removal of wholesale sales tax and lower diesel excise reduce embedded production and transportation costs and hence put downward pressure on retail prices.

The longer-term impact of the Government's tax package on the CPI will be appreciably less than the impact in 2000-2001. Additional tax package measures will be introduced in 2001, 2002 and 2005 which will further reduce the overall CPI impact of the package to around 2¼ per cent over the longer run (or around 1¾ per cent excluding tobacco). These measures include the removal of Financial Institutions Duties (FID) and Bank Account Debit (BAD) taxes and the phasing-in of input tax credits for motor vehicles.

Medium-term projections

Table 3 below sets out the major economic parameters used in preparing the revised Budget estimates. The parameters comprise the forecasts for 1999-2000 and 2000-2001, and medium-term projections for the following two financial years. The projections for economic growth in the outyears are based on analysis of underlying trends, while the projections for inflation are consistent with the mid-point of the medium-term inflation target band.

Table 3: Major economic parameters (percentage change from previous year)

	1999-2000	2000-01	2001-02	2002-03
	Forecasts		Projections	
Real GDP	3 1/2	3 3/4	3 1/2	3 1/2
Employment(a)	2 1/4	2	2	2
Wages(b)	3 1/2	3 3/4	3 1/2	3 1/2
CPI	2 1/4	5 1/2	2 1/2	2 1/2

(a) Labour Force Survey basis.
(b) Average earnings (national accounts basis).