

Economic outlook: upbeat for Australia

Growth to accelerate to 4% through 2010.

The Australian economy has performed remarkably well in 2009, given the unfavourable international environment, and the outlook is upbeat. We are forecasting the economy to expand by almost 4% through calendar 2010. Although, expect conditions to be uneven, as is typical in the early stages of a recovery. A housing construction boom, a burst of public investment and exports, supported by a resurgent China, will be the key growth engines.

Beginning with the global backdrop, the world economic recovery has arrived. An unprecedented global monetary and fiscal stimulus has triggered an upturn in activity, supported by the inventory adjustment process. The public resources globally devoted to economic stimulus and financial rescue have been staggering – approaching 5% of world GDP. Interest rates are at or close to zero in the major industrialised economies of the US, Europe and Japan. While markets fret about the possible headwinds from winding back policy stimulus, Finance Ministers from G20 nations have made it clear that they will err on the side of leaving the stimulus in place for too long.

Strength in emerging economies a plus for Australia.

Australia, as a major commodity producer, is well placed to benefit from what will be an uneven global recovery. Ongoing balance sheet adjustment is likely to be a headwind in some major countries during 2010. The US is forecast to expand by a modest 1.5%, while Europe is expected to record little to no growth – which is still an improvement upon a 4% contraction in 2009. By contrast, prospects are more upbeat for developing economies – particularly Australia. The net result is that overall growth in Australia's major trading partners is likely to approach trend in 2010. This underlines the positive medium-term outlook for the Australian economy.

Turning to the domestic front, the Australian economy exceeded all expectations, expanding by 1.0% over the first half of 2009. That more than reversed the 0.7% contraction in the December quarter. Aggressive interest rate cuts, aggressive borrowing by Government, a healthy banking system and the boost from a resurgent China all contributed to this resilience.

Business and consumers upbeat.

Business and consumer confidence is at healthy levels, buoyed by the domestic expansion and improved global conditions. Businesses have begun to upgrade investment plans, pointing to an emerging upswing in business investment from the second half of 2010. Although, in the near-term, weakness in non-residential construction points to a moderation in business investment. We're forecasting a 3% rise in business investment over the second half of 2010, boosted by strength in the resource sector, particularly energy.

The resilience of the labour market is a key reason for the turnaround in consumer confidence. Firms opted to hoard labour, while at the same time reducing hours worked by employees, mindful that in the last upswing finding skilled labour became increasingly difficult. The peak unemployment rate is now forecast to be about 6.5% around mid-2010. That would be a far better outcome than the Government's forecast of an 8.5% peak around mid-2011.

Housing, exports and public investment growth engines in 2010.

The expected recovery in the interest rate sensitive housing sector is clearly in view. Pent-up demand for housing stock, after years of high interest rates and strong population growth, is driving a surge in housing finance. Lending to owner-occupiers for the construction of new dwellings jumped 70% over the year to August. That points to housing construction activity, which has been a major drag on activity over the first of 2009, adding to growth from late this year and through 2010.

Australia's export performance has been remarkably resilient. Export volumes have increased by 3% over the first half of 2009. That is in stark contrast to the 6% contraction in import volumes over this period as companies ran down inventories to cut costs and in response to patchy sales late in 2008. The resilience of exports can be attributed to the resurgence of China and a jump in rural exports, driven by the rebound in farm output from drought.

RBA responds with gradual lessening of stimulus.

The Reserve Bank has responded to the upbeat outlook by beginning to gradually lessen the degree of monetary stimulus that was put in place when the outlook appeared to be much weaker. The cash rate, up 0.5% over October and November to 3.5%, is likely to move higher in the months ahead. Westpac Economics expects the RBA cash rate to be around 4.5% by mid-2010, followed by a pause over the second half of 2010. The successful, timely management of normalising interest rates will work to increase the sustainability of the economic expansion over the medium term.

Economic outlook: upbeat for Australia

Chart 1.

Australia & US growth compared

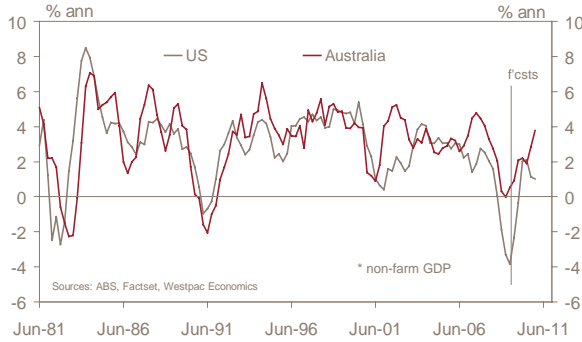


Chart 2.

Australia: confidence climbs

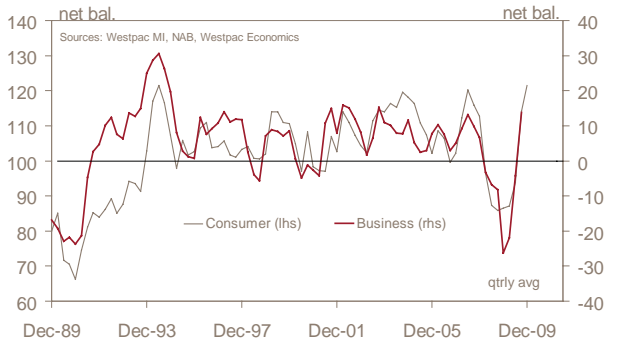


Chart 3.

RBA: begins gradual tightening

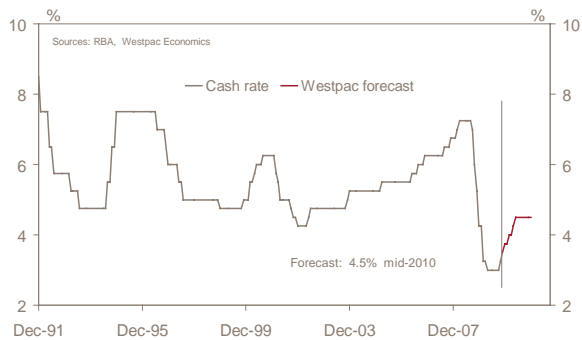


Chart 4.

Australian dollar: actual versus fitted

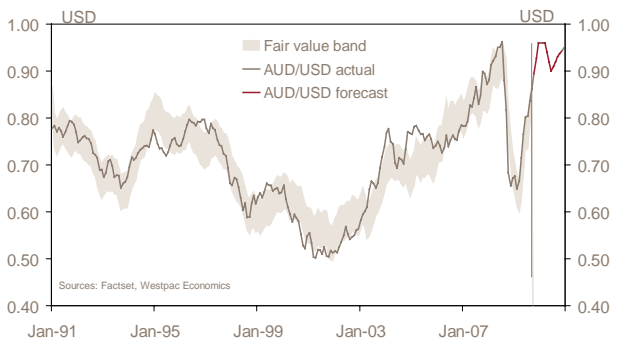


Chart 5.

Finance for new construction surges 69%

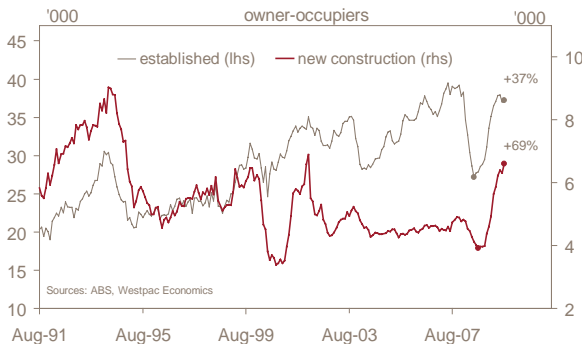
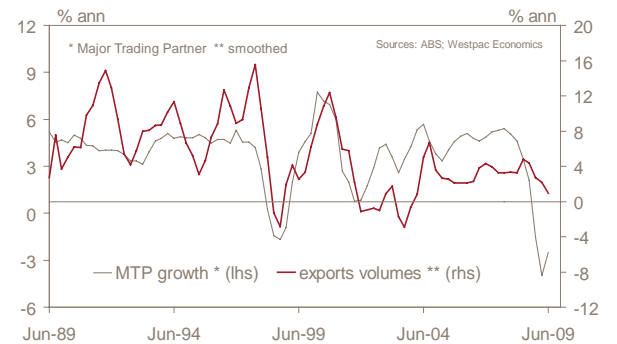


Chart 6.

Export volumes defy gravity



Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.