



**Australian Government**

**The Treasury**

# JOINT ECONOMIC FORECASTING GROUP

ECONOMIC OUTLOOK FOR 2012-13, 2013-14 AND 2014-15

DECEMBER 2012

This report incorporates Domestic and International data released up to 18 December 2012.

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## OVERVIEW

The outlook for the domestic economy has weakened since the September update and MYEFO. Following strong growth in real GDP in the first half of 2012, real GDP grew at a below-trend rate in the September quarter and total hours worked in the economy declined. It is clearer that resources investment will peak over the next year or so and then detract from growth. At the same time, with no material signs yet emerging of a recovery in non-mining investment, the outlook is for a period of slightly-below-trend real GDP growth in 2013-14 and 2014-15. Still, with the resources investment peak coinciding with the start of the production and export phase of many projects, and growth in household consumption expected to remain firm, real GDP growth is expected to remain solid at 2¾ per cent in 2013-14 and 2014-15. Consistent with slightly-below-trend growth, the unemployment rate is forecast to rise to 6 per cent by the June quarter of 2015.

The international outlook has also weakened marginally since the September update, notwithstanding signs of a modest recovery in China. The euro area is now clearly in recession and the threat of an escalation in the euro area sovereign debt crisis lingers. However, the most significant near-term risk to global growth is the imminent fiscal cliff and threat of consequent recession in the United States. The risks to global economic and financial stability continue to weigh on consumer and business confidence.

**Table 1: Key Domestic Forecasts<sup>(a)</sup>**

	2011-12	2012-13		2013-14		2014-15
	Outcome	Sep	Dec	Sep	Dec	Dec
Real GDP	3.5	3	3	3	2 3/4	2 3/4
Nominal GDP	5.1	4	3 1/4	5 1/2	5 1/4	4 1/4
Unemployment rate	5.1	5 1/2	5 1/2	5 3/4	5 3/4	6
Employment	1.1	1	1	1 1/4	1 1/4	1 1/4
CPI	1.2	3	3 1/4	2 1/4	2 1/4	2 1/4
Underlying inflation	2.1	2 1/2	2 1/2	2 1/4	2 1/4	2 1/4
WPI	3.7	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
Terms of trade	0.4	-8 1/4	-8 3/4	-2 3/4	-1/2	-3

(a) Real GDP, nominal GDP and the terms of trade are year-average growth. Employment, CPI, underlying inflation and the WPI are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter.

In Australia, economic growth in 2012-13 will continue to be supported by rising investment in the mining sector along with solid growth in household consumption. As mining investment passes its peak in 2013-14, economic growth is expected to be supported by accelerating growth in non-rural commodity exports, continued solid growth in household consumption and a modest recovery in investment growth outside the mining sector. Public final demand is expected to detract from growth over 2012-13 and 2013-14 as previously forecast, consistent with announced expenditure plans at state budgets and on the basis of Commonwealth commitments presented in MYEFO. While the outlook is for solid growth in the real economy, lower-than-anticipated domestic and international price growth is weighing on the nominal economy. Nominal GDP growth in 2012-13 has been revised down substantially, driven largely by a weaker-than-anticipated September quarter National Accounts outcome, partly due to lower commodity prices, but largely reflecting softer-than-anticipated investment prices.

Mining investment in 2012-13 is forecast to grow more strongly than expected in September, reflecting faster-than-expected progress on some major projects and some additional planned investment on standing LNG projects. Forecasts of growth in mining investment in 2013-14 have been downgraded slightly. In addition to the bring-forward of some expenditure into 2012-13, weaker-than-expected coal prices have led to isolated closures of some high-cost coal mines and the paring back of some coal-related investments. From 2014-15, the decrease in mining investment is forecast to detract substantially from growth as existing projects move from construction to production.

Investment intentions outside the mining sector appear to have weakened since September. Risks to the global economic outlook, shifting household expenditure patterns and the high exchange rate all continue to weigh on the confidence of businesses. The September quarter 2012 ABS CAPEX survey presented few signs of a recovery of investment outside the mining sector, consistent with other business survey measures. Nevertheless, non-mining investment is still expected to pick up toward the end of the forecast period as low interest rates support a recovery in non-mining construction, and as firms move from maintaining current capital stocks to acquiring new machinery and equipment to support the expansion of activity.

Dwelling investment is expected to stage a recovery over the forecast period, with low interest rates, strong population growth, rising rental yields and low vacancy rates all driving an improvement in residential construction activity. However, while these fundamentals support a pick-up in the demand for housing, continued household caution around debt accumulation, coupled with concerns about housing affordability, job security and ongoing global volatility pose risks to this recovery.

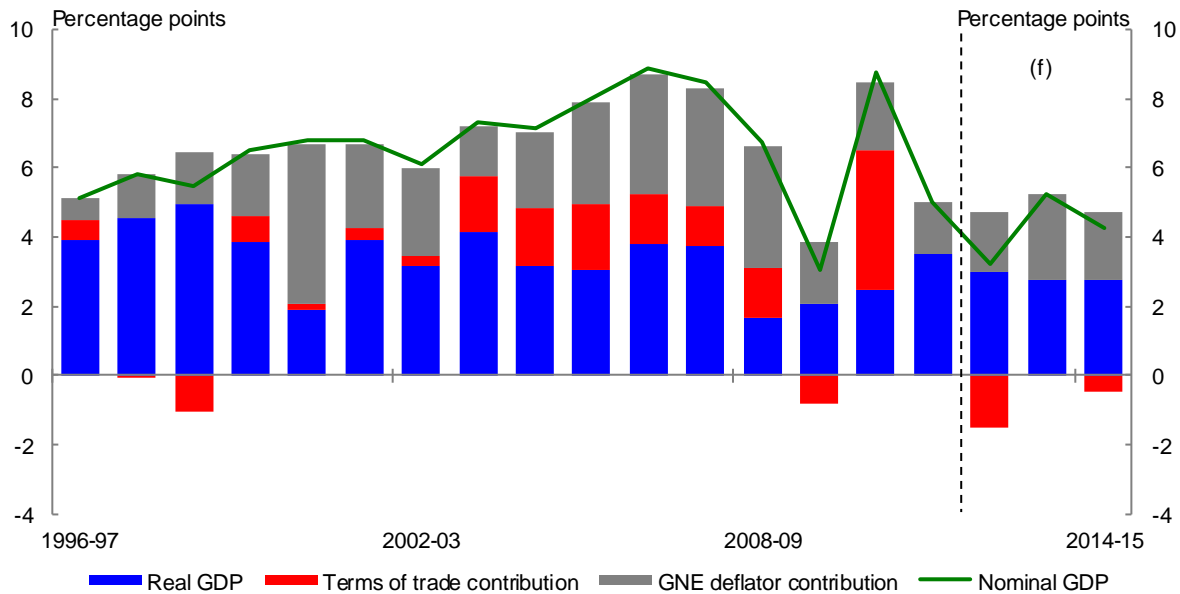
Growth in household consumption will continue to support economic growth across the forecast period, underpinned by moderate growth in both employment and wages. However, household consumption growth has been slightly downgraded in 2012-13 following a weaker-than-expected September quarter outcome. The household saving ratio is expected to remain elevated over the forecast period, as households continue to rely on saving rather than capital gains to strengthen their balance sheets.

Export growth forecasts have been upgraded across the forecast period, driven largely by an improved outlook for non-rural commodity volumes. Growth in export volumes is expected to strengthen further in 2014-15 as the shift from resources sector construction to production gathers pace. The level of imports is forecast to remain high in 2012-13 and 2013-14, reflecting continued import-intensive LNG investment over those years. Growth in imports is then expected to slow sharply in 2014-15 as some large mining construction projects reach completion.

After falling sharply in July and August, non-rural commodity prices have since recovered some of the lost ground. Iron ore spot prices recovered following the stabilisation of China's steel sector and mill restocking, however coal prices are yet to recover as expected. Given the weaker-than-anticipated recovery in non-rural commodity export prices, the terms of trade have been downgraded slightly in 2012-13.

Nominal GDP growth for 2012-13 has been downgraded by  $\frac{3}{4}$  of a percentage point to  $3\frac{3}{4}$  per cent, consistent with the weaker-than-expected investment deflators in the September quarter and the slightly weaker terms of trade. Nominal GDP growth for 2013-14 has been revised down to  $5\frac{1}{4}$  per cent, largely reflecting the downward revision to real GDP growth in that year. In 2014-15, nominal GDP growth is expected to moderate to  $4\frac{1}{4}$  per cent, reflecting below-trend real GDP growth, a steadily falling terms of trade, and continued weakness in domestic price growth. Nominal GDP growth is forecast to remain well below its 30-year average annual growth rate of around  $7\frac{1}{4}$  per cent.

**Chart 1: Decomposition of nominal GDP growth**



Source: ABS Catalogue Number 5206.0 and Treasury.

Forecast employment growth remains unchanged. The unemployment rate is forecast to rise from 5.2 per cent in November 2012 to 5½ per cent in the June quarter of 2013. With employment growth expected to remain below-trend through 2013-14 and 2014-15, the unemployment rate is expected to drift higher to 5¾ per cent by the June quarter of 2014, and then to 6 per cent by the June quarter of 2015. The participation rate is assumed to remain unchanged over the forecast period at 65¼ per cent, notwithstanding continued downward pressure from the ageing of the population.

With below-trend employment growth, domestic wage pressures are expected to be limited. Forecasts of the Wage Price Index are unchanged from September at 3½ per cent through the year to the June quarters of 2013, 2014 and 2015. The forecast for headline inflation has been upgraded to 3¼ per cent through the year to the June quarter 2013, largely reflecting higher-than-expected administered prices growth in the September quarter 2012. Consistent with the subdued labour market outlook, both headline and underlying inflation are forecast to remain in the bottom half of the Reserve Bank's target band at 2¼ per cent through the year to the June quarters of 2014 and 2015.

The main risks to the outlook stem from the external environment. The impending fiscal cliff in the United States is a significant and imminent downside risk to the global economic outlook, and growth prospects for the euro area remain very weak. In this context, business confidence is likely to remain fragile, adding to a domestic risk that the transition from mining to non-mining investment will be less seamless than forecast, with attendant risks to real GDP growth and employment growth over the forecast period. The risk of a sharper-than-anticipated fall in global commodity prices, perhaps in response to weaker-than-anticipated growth in emerging Asia, also remains a key risk to the outlook for nominal GDP growth.

**Table 2 – Domestic economy forecasts<sup>(a)</sup>**

	Outcomes (b)	Forecasts		
	2011-12	2012-13	2013-14	2014-15
<b>Panel A - Demand and output(c)</b>				
Household consumption	3.3	2 3/4	3	3
Private investment				
Dwellings	-3.7	- 1/2	5	5
Total business investment(d)	20.8	12 1/2	5 1/2	-2
Non-dwelling construction(d)	37.5	20	5	-9 1/2
Machinery and equipment(d)	10.3	4 1/2	5 1/2	6 1/2
Private final demand(d)	6.2	4 3/4	3 3/4	1 3/4
Public final demand(d)	2.3	- 1/2	- 1/4	1/4
Total final demand	5.3	3 1/2	2 3/4	1 1/2
Change in inventories(e)	0.0	0	0	0
Gross national expenditure	5.2	3 1/2	3	1 1/2
Exports of goods and services	4.6	5 1/2	5 1/2	7
Imports of goods and services	11.4	7 1/2	6	2
Net exports(e)	-1.3	- 1/2	- 1/4	1 1/4
<b>Real gross domestic product</b>	3.5	3	2 3/4	2 3/4
Non-farm product	3.4	3 1/4	2 3/4	2 3/4
Farm product	8.3	-9	3	-2
Nominal gross domestic product	5.1	3 1/4	5 1/4	4 1/4
<b>Panel B - Other selected economic measures</b>				
External accounts				
Terms of trade	0.4	-8 3/4	- 1/2	-3
Current account balance				
Percentage of GDP	-2.9	-5	-5 1/2	-5
Labour market				
Employment (labour force survey basis)(f)	1.1	1	1 1/4	1 1/4
Unemployment rate (per cent)(g)	5.1	5 1/2	5 3/4	6
Participation rate (per cent)(g)	65.3	65 1/4	65 1/4	65 1/4
Prices and wages				
Consumer Price Index (h)				
- headline	1.2	3 1/4	2 1/4	2 1/4
- underlying	2.1	2 1/2	2 1/4	2 1/4
Gross non-farm product deflator	1.7	0	2 1/2	1 1/2
Wage Price Index(f)	3.7	3 1/2	3 1/2	3 1/2

(a) Percentage change on preceding year unless otherwise indicated.

(b) Calculated using original data unless otherwise indicated.

(c) Chain volume measures except for nominal gross domestic product which is in current prices.

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

(e) Percentage point contribution to growth in GDP.

(f) Seasonally adjusted, through-the-year growth rate to the June quarter.

(g) Seasonally adjusted rate for the June quarter.

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

Note: The forecasts for the domestic economy are based on several technical assumptions. The exchange rate is assumed to remain around its recent average level — a trade-weighted index of around 77 and a \$US exchange rate of around 104 US cents. Interest rates are assumed to move broadly in line with market expectations. World oil prices (Malaysian Tapis) are assumed to remain around US\$115 per barrel. The farm sector forecasts are based on an assumption of average seasonal conditions.

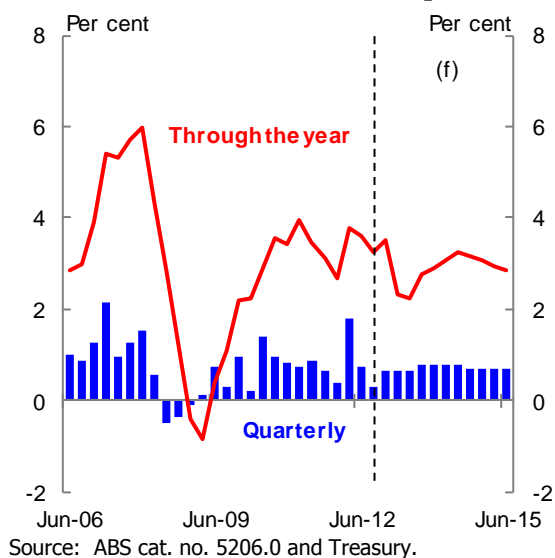
Source: ABS cat. no. 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

## OUTLOOK FOR THE DOMESTIC ECONOMY

### Household consumption

The forecast for **household consumption** growth in 2012-13 has been downgraded from 3 per cent to 2¾ per cent compared with September JIEG. The lower forecast is in large part due to weaker-than-expected consumption and wages growth in the September quarter National Accounts. Over the remainder of the forecast horizon, consumption growth is expected to remain solid, albeit below trend at 3 per cent. This outlook reflects softness in the labour market and below-trend wages growth, subdued growth in household wealth, and fragile consumer confidence. Consistent with this outlook, the household saving ratio is expected to remain elevated over the forecast period, as households remain prudent and continue to rely on saving rather than capital gains to strengthen their balance sheets.

Chart 2: Household consumption



### Dwelling investment

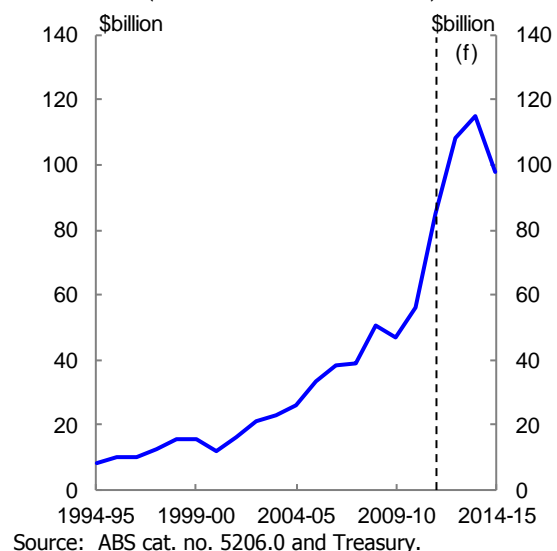
**Dwelling investment** is forecast to contract ½ a per cent in 2012-13, before growing 5 per cent in both 2013-14 and 2014-15. While dwelling investment declined 3.7 per cent in 2011-12, conditions across the sector are expected to continue gradually improving over the remainder of 2012-13, consistent with the solid September quarter National Accounts outcome and the continued growth in new dwelling finance supported by the substantive easing of monetary policy over the past year. The recovery is expected to gain momentum

into 2013-14 and 2014-15, driven by a pick-up in home buyer demand in line with lower interest rates and continued tight rental market conditions. Fragile household confidence and a reluctance to take out new debt are key risks to the forecast.

### Business investment

**New business investment** growth has been upgraded 1½ percentage points to 12½ per cent in 2012-13, reflecting recent strong outcomes, faster-than-expected progress on some major mining investment projects, and an increase in the announced volume of expenditure on the Gorgon LNG project. Business investment is expected to remain strong in 2013-14, growing 5½ per cent, before falling 2 per cent in 2014-15 as the mining investment peak passes.

Chart 3: New engineering construction (chain-volume measure)



Consistent with the pipeline of committed major projects, **new engineering construction** is expected to remain strong in 2012-13 and 2013-14, growing 28 per cent and 6½ per cent respectively, before falling 15 per cent in 2014-15 as major resources projects move towards their production phase.

**New machinery and equipment** is expected to grow 4½ per cent in 2012-13, with the latest CAPEX survey confirming that recent commodity price weakness is flowing through to mining sector investment intentions, while investment intentions outside of the mining sector remain subdued. Investment in new

machinery and equipment is expected to remain solid in 2013-14, growing 5½ per cent, before picking up in 2014-15 with higher non-mining investment, growing 6½ per cent. Investment in **new non-residential building** is expected to remain flat in 2012-13 and 2013-14, before low vacancy rates and continued low interest rates support a modest recovery in 2014-15.

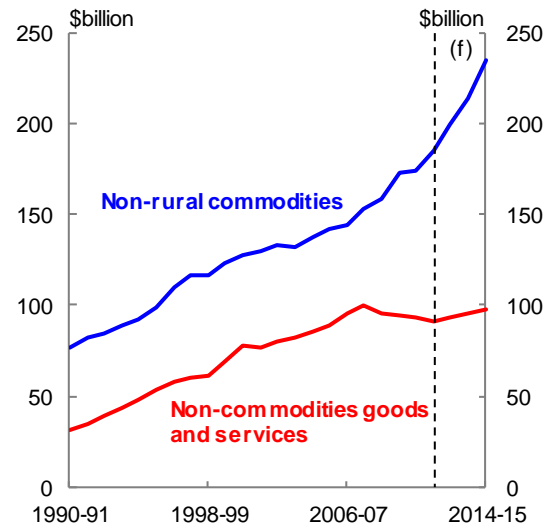
### Public final demand

**Public final demand** is forecast to fall ½ of a per cent in 2012-13 and ¼ of a per cent in 2013-14, unchanged from September JIEFG, before growing by a modest ¼ of a per cent in 2014-15. The forecasts are consistent with announced expenditure plans at state Budgets and the Commonwealth commitments presented in MYEFO.

### Exports, imports and the current account deficit

**Export** growth forecasts have been slightly upgraded over the forecast period, with growth of 5½ per cent expected in both 2012-13 and 2013-14, and 7 per cent in 2014-15. The outlook for non-rural commodity volumes has been upgraded, consistent with higher expected exports of non-bulk commodities. Services exports are forecast to grow 1¼ per cent in 2012-13, 1½ per cent in 2013-14 and 2¼ per cent in 2014-15, reflecting a continuation of the recent pick-up in business travel and an expected return to growth in the international student sector based on recent enrolments data. In 2012-13, farm production and rural exports are expected to decline from the record levels that occurred in 2011-12, due to less favourable weather conditions. In 2013-14, rural output and exports are expected to increase moderately, in line with an assumed return to average weather conditions.

**Chart 4: Export volumes**

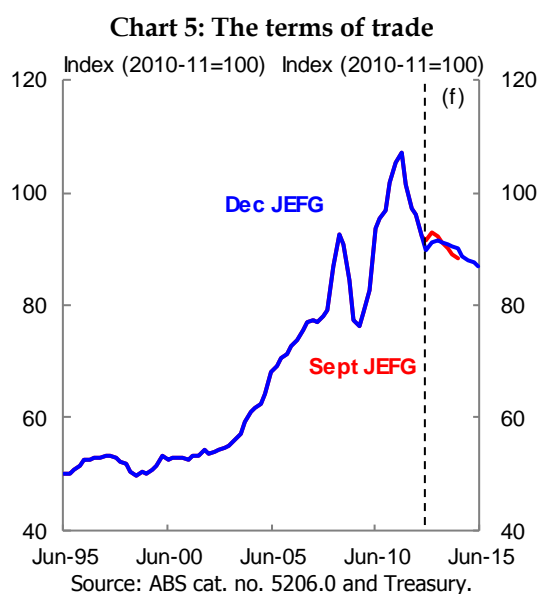


Source: ABS cat. no. 5302.0 and Treasury.

**Import** growth forecasts have been upgraded slightly over the forecast period, largely driven by the upgrade to forecast growth in LNG investment. Import volumes are forecast to grow 7½ per cent in 2012-13 and 6 per cent in 2013-14. With the passing of the peak of mining investment, imports growth is expected to slow considerably to 2 per cent in 2014-15. Net exports are expected to detract ½ of a percentage point from real GDP growth in 2012-13 and ¼ of a percentage point in 2013-14, before adding 1¼ percentage points in 2014-15.

The **terms of trade** have been downgraded slightly in the near term and are expected to decrease 8¾ per cent in 2012-13, ½ of a percentage point in 2013-14 and 3 per cent in 2014-15. The near-term downgrade reflects a weaker-than-expected recovery in global coal prices. Iron ore prices have recovered since the September JIEFG, driven by stabilization of China's steel sector and mill restocking. Iron ore prices are expected to gradually drift lower as greater low-cost global supply comes online. Metallurgical coal prices have also recovered since September, coinciding with global production cuts and mine closures, but this recovery was not as strong as anticipated in September, resulting in a lower price forecast.

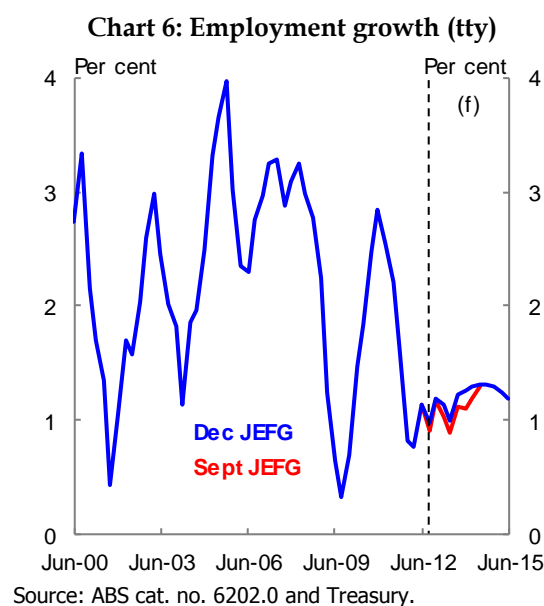




The **current account deficit** is forecast to widen over the next two years. This reflects an expected turnaround in the trade balance from a surplus to a deficit, driven by the deterioration in the terms of trade. The current account deficit is expected to be 5 per cent of GDP in 2012-13, 5½ per cent of GDP in 2013-14 and 5 per cent of GDP in 2014-15. The reduction in the current account deficit in 2014-15 reflects a decrease in imports related to reduced LNG investment and higher export volumes. Considered from a net lending perspective, the key driver of the widening current account deficit over the first half of the forecast period is the inflow of capital needed to finance the mining investment boom, with the household sector expected to be a net saver over the forecast period.

### Employment, wages and inflation

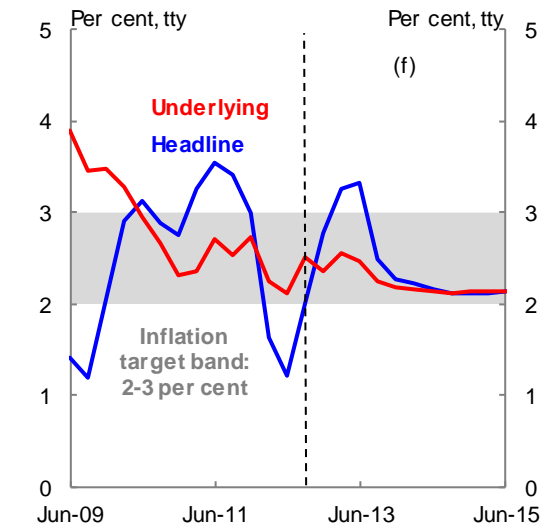
The outlook for **employment** growth continues to be subdued, with the high Australian dollar, uneven patterns of demand and continued balance sheet consolidation in the household and corporate sectors weighing on employment conditions in many industries. Employment is expected to increase 1 per cent through the year to the June quarter 2013 and 1¼ per cent through the year to the June quarters of 2014 and 2015. The **unemployment rate** is forecast to increase to 5½ per cent by the June quarter 2013 and 5¾ per cent by the June quarter 2014, before reaching 6 per cent by the June quarter 2015 in line with below-trend growth in GDP.



**Wages** growth is forecast to slow, consistent with the expected subdued conditions in the labour market. Private sector wages growth has slowed to around trend, while ongoing fiscal consolidation across all levels of government has driven weak public sector wages growth. Going forward, the Wage Price Index is forecast to grow 3½ per cent through the year to the June quarters of 2013, 2014 and 2015.

**Inflation** is expected to pick up slightly in 2012-13 following strong growth in administered prices in the September quarter, part of which reflects the introduction of the carbon price. Despite this, inflation is expected to remain towards the bottom half of the target band thereafter, with solid productivity growth, the rising unemployment rate and the subdued wages outlook dampening price pressures. Headline inflation (including the carbon price impact) is expected to be 3¼ per cent through the year to the June quarter 2013 and 2¼ per cent through the year to the June quarters of 2014 and 2015. Underlying inflation (including the carbon price impact) is expected to be 2½ per cent through the year to the June quarter 2013, and 2¼ per cent through the year to the June quarters of 2014 and 2015.

**Chart 7: Inflation**



Source: ABS cat. no. 6401.0 and Treasury.

## OUTLOOK FOR THE INTERNATIONAL ECONOMY

**Table 3: International GDP growth forecasts<sup>(a)</sup>**

	2011		2012		2013		2014		2015	
	Actual	Sep JIEFG	Dec JIEFG	Sep JIEFG	Dec JIEFG	Sep JIEFG	Dec JIEFG	Sep JIEFG	Dec JIEFG	
United States	1.8	2	2 1/4	2 1/4	2	2 1/2	2 1/2	n.a.	2 1/2	
Euro area	1.5	- 1/2	- 1/2	1/4	0	1 1/4	1	n.a.	1 1/2	
Japan	-0.6	2 1/2	2	1 3/4	1	1 1/4	1	n.a.	1	
China <sup>(b)</sup>	9.3	7 1/2	7 3/4	7 3/4	8	7 3/4	7 3/4	n.a.	7 1/2	
India <sup>(b)</sup>	7.9	5 1/2	4	7	4 3/4	7 1/2	6 1/2	n.a.	6 1/2	
Other East Asia <sup>(c)</sup>	4.3	3 3/4	3 3/4	4 1/2	4 1/2	4 3/4	4 3/4	n.a.	5	
Major Trading Partners	4.5	4 1/4	4	4 3/4	4 1/4	4 3/4	4 1/2	n.a.	4 1/2	
World	3.8	3 1/4	3 1/4	3 3/4	3 1/2	4	4	n.a.	4	

(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) Production-based measure of GDP.

(c) Other East Asia comprises the newly industrialised economies (NIEs) of Hong Kong, South Korea, Singapore and Taiwan and the Association of Southeast Asian Nations group of five (ASEAN-5), which comprises Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

n.a. - Not available.

Source: National statistical publications, IMF *World Economic Outlook* October 2012, Thomson Reuters and Treasury.

### World outlook and risks

The global outlook remains highly uncertain, and has weakened slightly since September. Downside risks are still dominant, and the outlook for a number of major economies has softened. However, there have been increasing signs that economic growth in China has stabilised.

The largest near-term risk to global growth is the fiscal cliff in the United States. The prospects for Congress reaching an agreement to avert the cliff before the end of 2012 remain uncertain. If the US 'falls over' the fiscal cliff, a US recession is likely, with attendant consequences for global growth, confidence and financial market stability.

The European Central Bank's (ECB) September announcement of Outright Monetary Transactions (OMTs) has removed the tail risk of a sudden sovereign default in the euro area and a sharp intensification in financial stress in the region. However, the moderation in financial volatility contrasts with developments in the real economy. The euro area is in recession and the 'core' economies are increasingly being dragged down. Overall, the outlook for the region is slightly weaker than at September JIEFG and the threat of an escalation in the euro area sovereign debt crisis lingers. The troubles in Greece and Spain will likely remain a focus. There are also risks that European governments will be unable to meet

the challenge of implementing the structural reforms needed to address the underlying causes of the crisis.

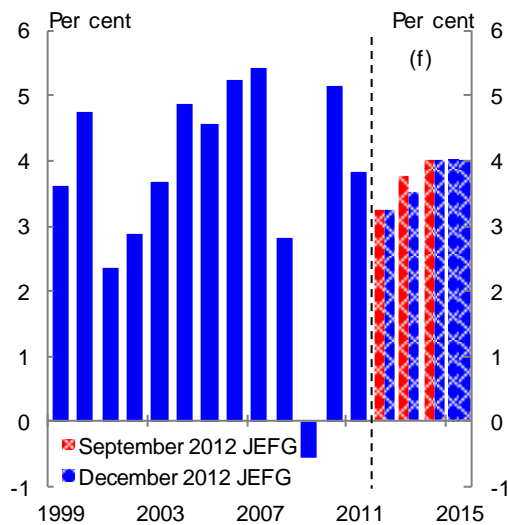
Japan and India's short-term economic outlooks have also weakened noticeably since September JIEFG, reflecting much weaker-than-expected growth in the September quarter and potential constraints on their medium-term growth outlooks.

Given ongoing political tension in the Middle East, the threat of an oil price spike persists, although this remains very much a secondary risk compared to the damage the US fiscal cliff or a full-blown crisis in the euro area would entail.

As with previous JIEFG rounds, the forecasts assume that the key risks outlined above are avoided. The world growth forecast for 2012 remains within the 3¼ per cent rounding barrier (Chart 8), with modest upward revisions to growth in China and the US partially offsetting larger downward revisions to Japan and India. The ¼ of a percentage point downward revision to the forecast for 2013 largely reflects weaker outlooks for the euro area, Japan and India, as well as a modest downward revision for the US. While the 2014 forecast is unchanged, the substantive downgrade to India and modest downward revisions to the euro area and Japan place it at a 'weak' 4 per cent. Even under a best-case scenario, world growth will

be below trend in 2012 and 2013, with any subsequent recovery likely to be relatively moderate.

**Chart 8: Global GDP growth**



Source: IMF and Treasury.

Aggregate growth for Australia's major trading partners (MTPs) has been revised down across the forecast horizon (down a ¼ of a percentage point in 2012, ½ of a percentage point in 2013 and a ¼ of a percentage point in 2014). As with the global growth forecasts, the downgrades largely reflect the weaker-than-expected outlooks for Japan, India, and the euro area. For 2012 and 2013, downgrades to the forecasts for Korean growth also contribute to lower MTP growth as a whole.

The forecasts for **China's** growth for 2012 and 2013 have been revised up slightly from September JIEFG by a ¼ of a percentage point in each year. This reflects stronger-than-expected GDP growth in the September quarter and is consistent with the continued modest pick-up in partial data in recent months. Data released in the December quarter are also pointing to a further broad-based improvement in economic activity. Investment and credit continue to grow strongly, while growth in industrial production and consumption continue to accelerate.

The momentum generated during the second half of 2012 is expected to drive economic growth in China to 8 per cent in 2013. This

outlook reflects solid growth prospects for domestic demand in China, with export demand expected to make only a modest contribution to growth in line with the continued weak outlook for advanced economies in 2013. Growth is expected to ease in 2014 to 7¾ per cent, in part reflecting the fading effect of stimulus measures implemented by the Chinese authorities during 2012.

The near-term risks to China's outlook stem mainly from the external environment, with the possibility that adverse developments in Europe or the US could weigh on China's growth through weaker demand for Chinese exports. Beyond the near term, there are a range of economic policy challenges facing the new Chinese leadership, including growing debts in the financial system. However, with consumer price inflation muted and remaining well below the Government's annual target of 4 per cent, Chinese policymakers have scope for further policy easing if conditions were to deteriorate unexpectedly.

The recovery in the **United States** remains relatively subdued, in line with expectations, though better-than-expected growth in the September quarter has contributed to an upward revision to the 2012 forecast of a ¼ of a percentage point. The forecast for 2013 has been eased down a ¼ of a percentage point, reflecting some effect of current uncertainty over the resolution to the fiscal cliff. It is still assumed that an agreement to avoid the majority of the fiscal cliff eventuating will be achieved before the end of 2012.

Even if the fiscal cliff and the debt ceiling are resolved in a timely manner, the US outlook is likely to remain subdued, with longer-term fiscal pressures persisting. Unemployment is still relatively high and jobs growth is still moderate. While the housing sector is showing increasing signs of recovery, it is not expected to significantly contribute to GDP growth in the near term.

September quarter data confirm the **euro area** has returned to recession. While Germany and France recorded better-than-expected growth in the quarter, forward indicators suggest these economies are increasingly being

dragged down, with production and new orders in Germany and France falling at rates not seen since the global financial crisis. Consequently, the 2013 and 2014 forecasts for the euro area have each been revised down a  $\frac{1}{4}$  of a percentage point to zero growth and 1 per cent respectively.

Any recovery in the euro area is likely to be a very subdued and protracted one, with unemployment at euro-era highs and structural reforms and closer financial and economic union likely to take some time to implement.

While the ECB's OMT program has removed tail risks to the euro area's outlook, there are still a number of risks heading into 2013. There is scepticism in markets about whether Greece will be able to meet its fiscal targets without further debt restructuring. The enormity of Greece's fiscal challenges, as well as the unstable nature of its coalition government, mean that Greece will remain a risk for the euro area for the foreseeable future. Spain faces a high financing requirement in 2013, and a combination of market and political pressure could force Spain into requesting the European Stability Mechanism program it has so far resisted. It is also unclear whether the €39.5 billion of aid being disbursed by the EU to recapitalise Spain's banks will be sufficient. In addition, the recent bout of political uncertainty in Italy has raised concerns over backsliding on reforms.

The weaker-than-anticipated 0.9 per cent contraction in **Japan's** GDP in the September quarter was largely due to a sharp decline in exports, with the dispute over the Diaoyu/Senkaku islands restricting exports to China, now Japan's largest export market. Japan is at considerable risk of returning to recession in the second half of 2012. With earthquake reconstruction abating, softer global demand and a persistently high yen, Japan's economy is likely to return to its history of slow growth. The forecast for Japanese growth for 2012 has been revised down  $\frac{1}{2}$  a percentage point to 2 per cent, while the forecasts for 2013 and 2014 have been revised down  $\frac{3}{4}$  of a percentage point and a  $\frac{1}{4}$  of a percentage point respectively to 1 per cent for both years.

The forecasts for **India** have been revised down across 2012 to 2014 by between 1 and  $2\frac{1}{4}$  percentage points. The Indian economy has weakened much more than anticipated, contracting on a seasonally-adjusted market price basis in the June and September quarters. Growth is being constrained by persistently high inflation, widening fiscal and current account deficits, a slowdown in investment, and an uncertain external environment. India's growth outlook is dependent on implementing further structural reforms, the prospects for which are uncertain in the current political environment. The impacts of any reforms that are eventually passed could also take some time to flow through to growth.

