



**Australian Government**

**The Treasury**

# JOINT ECONOMIC FORECASTING GROUP

ECONOMIC OUTLOOK FOR 2012-13 AND 2013-14

SEPTEMBER 2012

**This report incorporates Domestic and International data  
released up to 14 September 2012.**

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## OVERVIEW

The outlook for the global economy has weakened since the June update and Budget. The combined effect of deteriorating growth prospects in Europe, a weak recovery in the US economy, and a slowdown in the emerging market economies of Asia is being transmitted to the Australian economy through a number of channels. Weaker external demand and lower global non-rural commodity prices have reduced export revenues, while the risks to global economic and financial stability are weighing on consumer and business confidence.

Against this weak international outlook, Australia's real GDP growth is expected to be around trend over the forecast period. Real GDP is forecast to grow 3 per cent in both 2012-13 and 2013-14, a downgrade of  $\frac{1}{4}$  of a percentage point in 2012-13 compared with Budget. The downgrade to growth in 2012-13 mainly reflects a bring-forward of resource-related investment activity into 2011-12, along with the announced deferral or cancellation of resource projects.

The downgrade to forecast nominal GDP growth since Budget is more significant, primarily due to larger-than-anticipated falls in global prices for some of Australia's key non-rural commodity exports. Global energy and steel demand has eased as world GDP growth has moderated, reducing demand for raw materials such as coal and iron ore. The decline in iron ore and coal prices to mid-September, while consistent with lower demand, appeared to exceed market fundamentals. Iron ore prices have since increased and it is anticipated they will regain further ground over the coming months.

Still, consistent with a weaker international growth outlook, global prices for these commodities are expected to remain below the levels forecast at the June update and Budget. Consequently, the decline in Australia's terms of trade over the forecast period is expected to be greater, driving a downward revision to forecast nominal GDP growth to 4 per cent in 2012-13 from 5 per cent at Budget.

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

	2011-12	2012-13		2013-14			
	Outcome	Budget	June	Sep	Budget	June	Sep
Real GDP	3.4	3 1/4	3 1/4	3	3	3	3
Nominal GDP	5.0	5	4 3/4	4	5 1/4	5	5 1/2
Unemployment rate	5.1	5 1/2	5 1/2	5 1/2	5 1/2	5 1/2	5 3/4
Employment	0.7	1 1/4	1 1/4	1	1 1/2	1 1/4	1 1/4
CPI	1.2	3 1/4	3	3	2 1/2	2 1/2	2 1/4
Underlying inflation	2.0	2 3/4	2 1/2	2 1/2	2 1/2	2 1/2	2 1/4
WPI	3.7	3 3/4	3 1/2	3 1/2	3 3/4	3 3/4	3 1/2
Terms of trade	1.8	-5 3/4	-5 1/2	-8 1/4	-3 1/4	-3 3/4	-2 3/4

(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.

The solid outlook for the real economy reflects the continued strong outlook for business investment, underpinned by a record pipeline of already-committed resources projects. Economic growth is also expected to be supported by strong growth in non-rural commodity exports, as the resources boom transitions from the investment to the production phase, and solid growth in household consumption.

Investment in the resources sector is expected to continue to drive growth in the domestic economy in 2012-13. Recent falls in global commodity prices have led to some scaling back of investment plans, largely in the coal sector where mining companies have slowed the pace of their existing expansions and have closed some of their high-cost mines earlier than anticipated. However, the resource investment pipeline is dominated by large LNG projects where investment decisions are taken over long-time horizons and are underpinned by projections of the energy needs of the Asian region over a period of decades. In value terms, over two-thirds of the large resources projects included in the economic forecasts have received final investment approval, with the majority already under construction. Following 75 per cent growth in 2011-12, the latest capital expenditure survey suggests a

further 45 per cent increase in mining investment in 2012-13, taking new business investment as a share of the Australian economy to record levels.

The domestic growth outlook is also expected to be supported by growing non-rural commodity export volumes. The surge in investment in the resources sector will continue to see expansions in supply capacity, which will support a ramp-up in export volumes as major resources projects increasingly move from the investment phase to the production phase. Australia's non-rural commodity exports are expected to grow around 15 per cent over the next two years, notwithstanding a modest downgrade to forecast growth in coal exports since the June update and Budget, in line with announced production cuts.

Solid growth in household consumption is also expected to underpin economic growth across the forecast period. Over the past year, the combination of solid growth in disposable income and weak consumer price inflation enabled households to enjoy above-trend growth in real consumption, while maintaining high rates of saving. Looking ahead, the pace of household consumption growth is expected to moderate, consistent with the outlook for below-trend employment and wages growth, and subdued expectations for asset price growth. Reflecting this, the household saving ratio is expected to remain elevated across the forecast period.

Conditions in many parts of the economy remain difficult, reflecting the continued high exchange rate, shifting patterns of household demand and the more restrained approach of households and businesses towards taking on new debt. These factors have placed downward pressure on domestic prices, meaning that some industries experienced profit declines over 2011-12 despite recording growth in sales volumes. Still, household consumption remains robust in aggregate and there are tentative signs that residential building activity may be starting to improve as resources investment passes its peak, the forecast are for low interest rates to support modest growth in dwelling construction and non-mining investment in 2013-14.

Reflecting the pressures on businesses in some employment-intensive parts of the economy, such as retail and construction, the pace of employment growth has slowed in recent months and average hours worked have declined significantly. While employment growth is expected to pick-up over the forecast period, it is forecast to remain below trend, as the uncertain operating environment continues to weigh on hiring decisions. Through-the-year employment growth is forecast to edge up to 1 per cent to the June quarter 2013 and to 1¼ per cent to the June quarter 2014, weaker than anticipated at Budget. This softer employment growth outlook results in forecasts of a rising unemployment rate from 5.1 per cent currently to 5¾ per cent in the June quarter of 2014.

Consistent with the slightly weaker outlook for the labour market, forecast wages growth and inflation have been revised down. The Wage Price Index is forecast to increase 3½ per cent through the year to the June quarter of both 2013 and 2014. Headline inflation is forecast to rise to 3 per cent through the year to the June quarter of 2013 (incorporating an estimated one-off ¾ of a percentage point increase from the introduction of the carbon price), before easing to 2¼ per cent through the year to the June quarter of 2014.

The main risks to the forecasts are external and remain firmly on the downside. The outlook for the euro area is particularly uncertain, with a risk that the sovereign debt crisis could escalate into a major monetary and financial crisis, with severe implications for global growth. The threat of a 'fiscal cliff' in the United States also remains a severe downside risk to the global economic outlook, with the possibility of a recession in the United States economy if no resolution is reached. A further escalation of the European crisis or a downturn in the United States economy would detract from global trade and leave a number of emerging market economies vulnerable to sudden capital outflows and a breakdown in trade finance. These uncertainties are complicating macroeconomic management in China, where there is a risk that the combination of weaker-than-anticipated external demand and the authorities' efforts to place their economy on a more sustainable growth path could result in a sharper slowdown in economic activity than desired. As seen in recent months, a sharper-than-anticipated slowdown in China can have significant implications for global commodities markets.

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In this context, there is a substantial risk that Australia's terms of trade could decline further or more rapidly than currently forecast, which would further reduce forecasts for nominal GDP and weaken the currently solid outlook for real economic growth.

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

	Outcomes (b)	Forecasts	
	2011-12	2012-13	2013-14
<b>Panel A - Demand and output(c)</b>			
Household consumption	3.7	3	3
Private investment			
Dwellings	-3.3	0	4
Total business investment(d)	21.3	11	6 1/2
Non-dwelling construction(d)	39.0	14	5 1/2
Machinery and equipment(d)	10.6	9	7 1/2
Private final demand(d)	6.7	4 3/4	4
Public final demand(d)	1.1	- 1/2	- 1/4
Total final demand	5.3	3 1/2	3
Change in inventories(e)	0.2	0	0
Gross national expenditure	5.5	3 3/4	3 1/4
Exports of goods and services	3.7	4 1/2	4
Imports of goods and services	11.8	7	5
Net exports(e)	-1.8	- 3/4	- 1/4
<b>Real gross domestic product</b>	3.4	3	3
Non-farm product	3.3	3 1/4	3
Farm product	7.5	-3	6
Nominal gross domestic product	5.0	4	5 1/2
<b>Panel B - Other selected economic measures</b>			
External accounts			
Terms of trade	1.8	-8 1/4	-2 3/4
Current account balance			
\$billion	-40.5	-78 1/2	-94 3/4
Percentage of GDP	-2.8	-5 1/4	-6
Labour market			
Employment (labour force survey basis)(f)	0.7	1	1 1/4
Unemployment rate (per cent)(g)	5.1	5 1/2	5 3/4
Participation rate (per cent)(g)	65.3	65	65
Prices and wages			
Consumer Price Index (h)			
- headline	1.2	3	2 1/4
- underlying	2.0	2 1/2	2 1/4
Gross non-farm product deflator	1.7	3/4	2 1/2
Wage Price Index(f)	3.7	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 103 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\$118 per barrel. The farm sector forecasts are based on an assumption of average seasonal conditions.

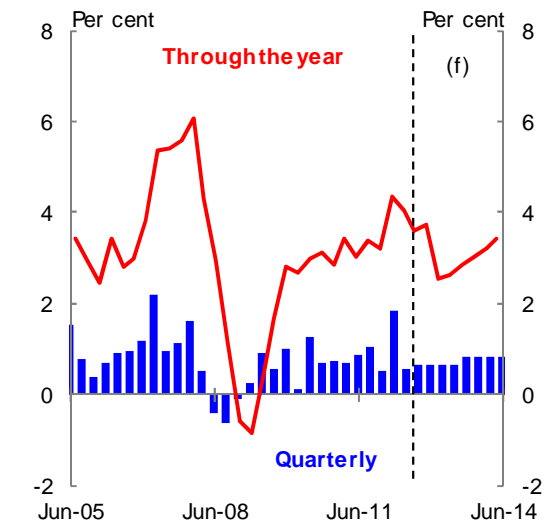
Source: ABS cat. no. 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

OUTLOOK FOR THE DOMESTIC ECONOMY

Household consumption

Household consumption is forecast to grow 3 per cent in both 2012-13 and 2013-14. While solid, growth in household consumption is expected to be below-trend, consistent with the outlook for employment and wages growth, continued subdued growth in household wealth and the impact of continued global volatility on consumer confidence. Consistent with this, 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.

Chart 1: Household consumption

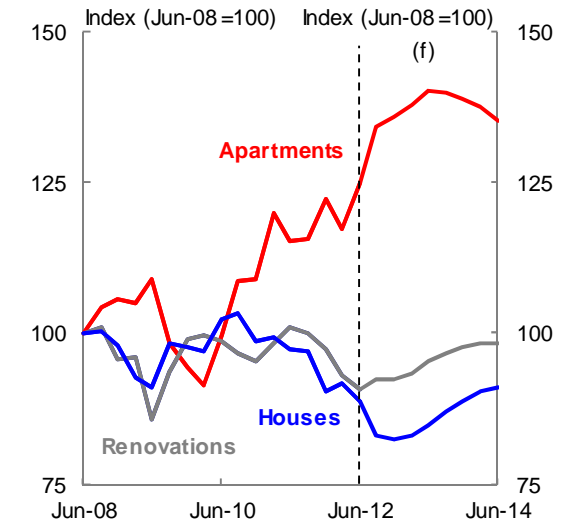


Source: ABS cat. no. 5206.0 and Treasury.

Dwelling investment

Dwelling investment is forecast to be flat in 2012-13, before growing 4 per cent in 2013-14. Dwelling investment declined 3.3 per cent in 2011-12 – the largest annual decline since 2000-01 – on the back of continued weakness in the detached housing market. Conditions across the sector are expected to gradually improve over the remainder of 2012, consistent with the solid growth in dwelling approvals and commencements seen in the June quarter 2012. The recovery is expected to gather momentum into 2013-14, driven by a pickup in homebuyer demand in line with the assumption that interest rates will remain below average across the forecast period.

Chart 2: Dwelling investment

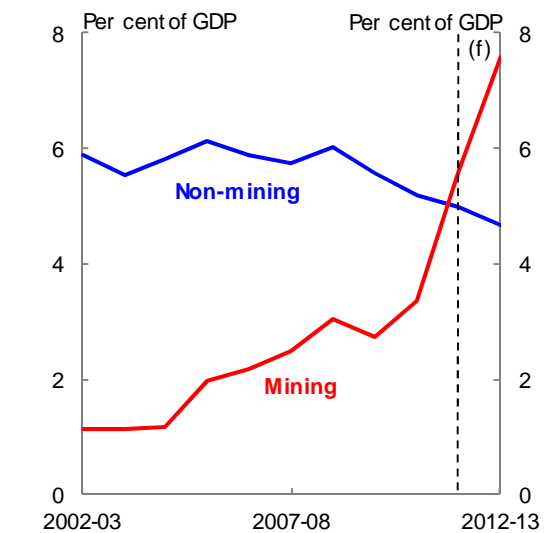


Source: ABS cat. no. 5206.0 and Treasury.

Business investment

New business investment is expected to grow 11 per cent in 2012-13 and 6½ per cent in 2013-14, reflecting strong forecast growth in resources investment but a weak outlook for investment in other sectors of the economy.

Chart 3: Mining and non-mining CAPEX



Source: ABS cat. no. 5625.0, 5206.0 and Treasury.

New engineering construction is expected to grow 19 per cent in 2012-13 and 7 per cent in 2013-14, underpinned by liquefied natural gas and iron ore projects. The resources sector is also expected to drive higher levels of investment in new machinery and equipment, with growth forecast to be 9 per cent in 2012-13 and 7½ per cent in 2013-14. Weakness in the retail sector and the expectation of below-trend employment growth and therefore subdued

demand for new office space is expected to be reflected in weak growth in new non-residential building activity, with growth forecast of just 1 per cent in 2012-13 and 1½ per cent in 2013-14.

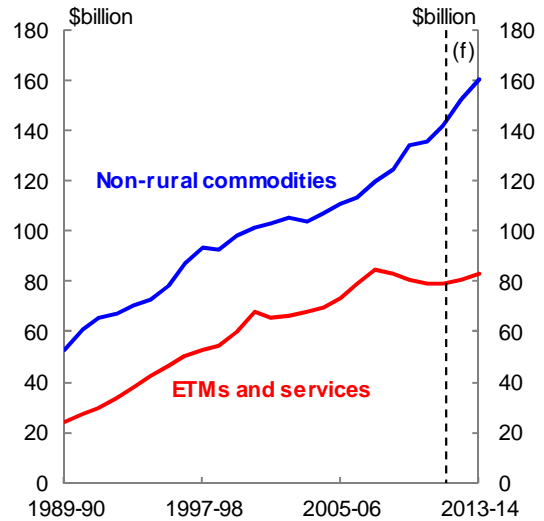
### Public final demand

Public final demand is forecast to fall ½ of a per cent in 2012-13 and ¼ of a per cent in 2013-14, consistent with the planned fiscal consolidations of the Commonwealth and State governments. Compared with Budget, the forecast decline in public final demand has increased, reflecting reductions in spending by the Commonwealth and State Governments.

### Exports, imports and the current account deficit

Export growth forecasts are slightly weaker than the June update and Budget, with growth of 4½ per cent expected in 2012-13 and 4 per cent in 2013-14. While the growth outlook remains strong, weaker-than-expected outcomes in 2011-12, coupled with recent coal mine closures and announcements to not proceed with planned expansions, mean that the volume of non-rural commodities exports is lower over the forecast period than previously anticipated. Services exports are expected to remain flat and manufactured exports are forecast to rise only modestly over the next two years, reflecting the high Australian dollar and forecasts for continued weak external demand. Farm production and rural exports surged to record levels in 2011-12, reflecting favourable weather conditions. In 2012-13, rural output and exports are expected to decline moderately, in line with an assumed return to average weather conditions.

Chart 4: Export volumes

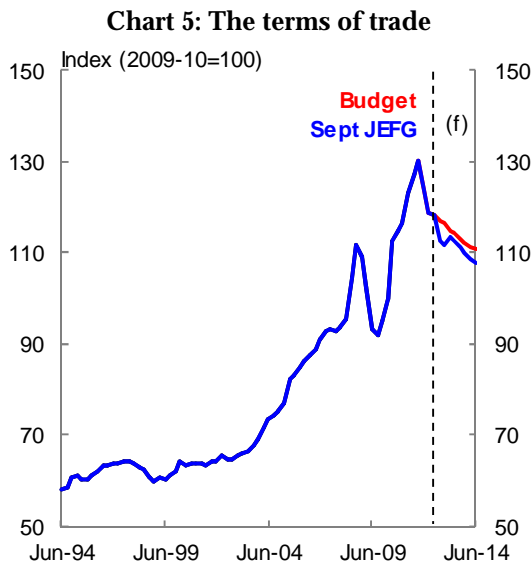


Source: ABS cat. no. 5302.0 and Treasury.

Import growth forecasts have been downgraded slightly over the forecast period, consistent with lower forecast growth in business investment. Import volumes are forecast to grow 7 per cent in 2012-13 and 5 per cent in 2013-14. Net exports are expected to detract ¾ of a percentage point from real GDP growth in 2012-13 and ¼ of a percentage point in 2013-14.

The terms of trade have declined more sharply than was previously anticipated. Following growth of 90 per cent over the past decade, the terms of trade are now expected to decrease 8¼ per cent in 2012-13 and 2¾ per cent in 2013-14. The near-term downgrade reflects the declines in global prices for Australia's key non-rural commodity exports since June. For iron ore and metallurgical coal, which are key inputs to the steel-making process, recent declines in price reflect weaker global steel demand, a destocking of raw materials at Chinese steel mills, and ongoing growth in the global supply of these materials. Falls in the price of thermal coal have been influenced by subdued global demand for thermally generated electricity, weighed down by a continuation of ongoing weakness in Europe, electricity demand in China and lower natural gas prices in the US, which has promoted exports from the Americas into the Asian market. While modest increases in non-rural commodity prices are anticipated in the near-term – particularly for iron ore – prices are expected to remain lower than previously

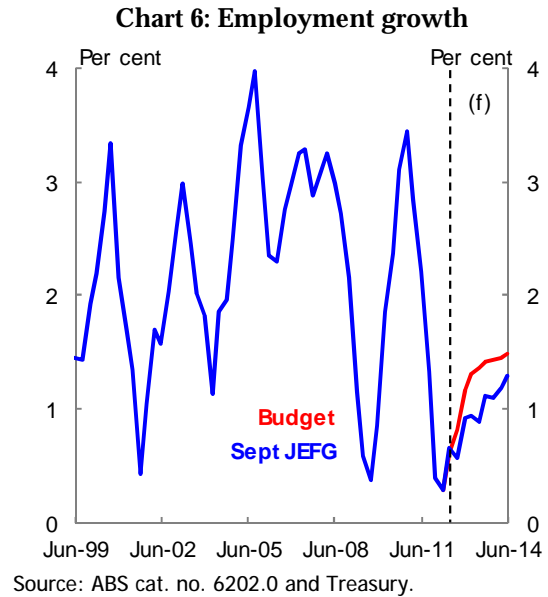
expected, in line with lower forecast growth in global GDP.



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 expected deterioration in the terms of trade. The current account deficit is expected to be 5¼ per cent of GDP in 2012-13 and 6 per cent of GDP in 2013-14. Considered from a net lending perspective, the key driver of the rising current account deficit 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

Following strong growth in the first half of 2012, employment growth has moderated in recent months, with the high Australian dollar, uneven patterns of demand and continued deleveraging by 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 quarter 2014. The unemployment rate is forecast to increase to 5½ per cent by the June quarter 2013 and to 5¾ per cent by the June quarter 2014.

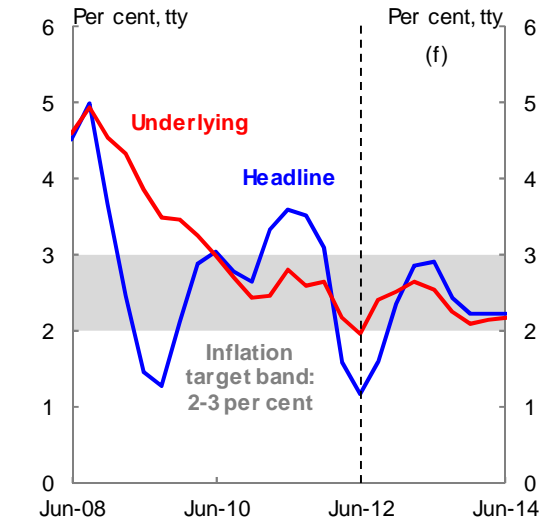


Wages growth is expected to slow, consistent with the forecast softening in labour market conditions. Aggregate wages have grown solidly over the past year, with the low unemployment rate supporting slightly above-trend growth in private sector wages. This has been balanced by weakness in public sector wages growth, which has eased in line with ongoing fiscal consolidation at the state and federal levels of government. Looking ahead, the Wage Price Index is forecast to grow 3½ per cent through the year to the June quarters of both 2013 and 2014, slightly weaker than previously expected.

Inflation is expected to pick up slightly in 2012-13 due to the one-off effect of introducing the carbon price, but remain within the target band. While the high exchange rate is expected to exert less downward pressure on domestic prices over the forecast period, it is expected that solid productivity growth and subdued wages growth will dampen domestic price pressures. Headline inflation (including the carbon price impact) is expected to be 3 per cent through the year to the June quarter of 2013 and 2¼ per cent through the year to the June quarter of 2014. Underlying inflation (including the carbon price impact) is expected to be 2½ per cent through the year to the June quarter of 2013, and 2¼ per cent through the year to the June quarter of 2014.



Chart 7: Inflation



Source: ABS cat. no. 6401.0 and Treasury.

## INTERNATIONAL ECONOMIC OUTLOOK

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

	2011		2012		2013		2014	
	Actual	Budget	Sept JIEFG	Budget	Sept JIEFG	Budget	Sept JIEFG	
United States	1.8	2	2	2 1/4	2 1/4	2 1/2	2 1/2	
Euro area	1.5	- 3/4	- 1/2	3/4	1/4	1 1/4	1 1/4	
Japan	-0.8	2 1/4	2 1/2	1 3/4	1 3/4	1 1/4	1 1/4	
China <sup>(b)</sup>	9.3	8 1/4	7 1/2	8 1/2	7 3/4	8 1/4	7 3/4	
India <sup>(b)</sup>	7.1	6 1/4	5 1/2	7 3/4	7	7 1/2	7 1/2	
Other East Asia <sup>(c)</sup>	4.3	3 3/4	3 3/4	5	4 1/2	5	4 3/4	
Major Trading Partners	4.3	4 1/4	4 1/4	5	4 3/4	5	4 3/4	
World	3.9	3 1/2	3 1/4	4	3 3/4	4 1/4	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.

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

## World outlook and risks

Prospects for global growth have softened further since Budget. Recent growth outcomes in a number of East Asian economies, most notably China and India, have been weaker than anticipated. The European crisis also continues to weigh on global confidence. While the European Central Bank's (ECB) announcement that it will intervene in the bond markets of troubled euro area sovereigns as long as they commit to undertake fiscal and structural reforms, coupled with Germany's recent ratification of the region's bailout fund eased concerns somewhat, the issues underlying the crisis remain unresolved. In addition, the recent slowing in growth in a number of major emerging market economies has added to concerns about the durability of the global recovery.

Conditions in the major advanced economies have weakened further. The euro area is in recession as financial stress, ongoing fiscal consolidation, and bank deleveraging drag on growth. Growth in the United States has eased as weak labour market outcomes and rising

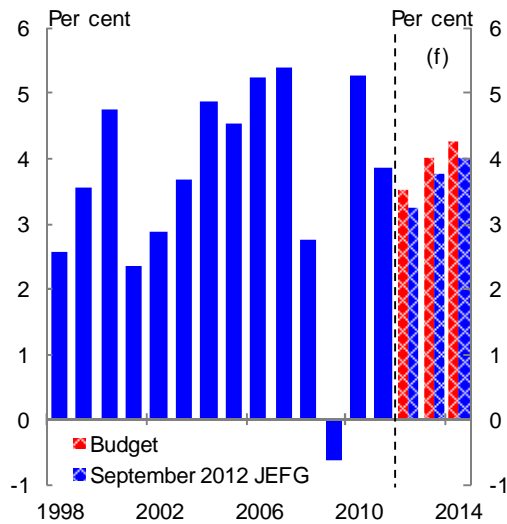
concern over the so-called 'fiscal cliff' (the sudden fiscal tightening that will occur at the end of 2012 unless new legislation is passed) have impacted on activity, while the boost to Japanese growth from earthquake reconstruction likely peaked in the first half of 2012 with growth expected to moderate going forward.

Since the end of the global recession, growth across the emerging market economies, particularly in Asia, has been relatively robust on the back of strong domestic demand, and these economies have been the driving force of the global recovery to date. However, more recently a number of major emerging economies have seen a slowing in their growth rate, including China. This reflects a reduction in export demand as growth in advanced economies has weakened and the dampening effect of previous policy tightening in some economies, particularly in China.

The further weakening in the global economic outlook means that world GDP is now

expected to grow 3¼ per cent in 2012 and 3¾ per cent in 2013, compared with Budget forecasts of 3½ per cent and 4 per cent. The global recovery remains vulnerable to shocks, most notably stemming from Europe, but also the threat of a sharp fiscal tightening occurring in the US at the end of 2012. Growth in emerging market economies, while slowing, has the potential to be boosted by policy action, although policy support in China has been less forthcoming than expected. However, a sharper-than-expected deterioration in the situation in Europe or the US would inevitably have spill-over effects on the growth performance of emerging market economies, including through the risks of sharp outflows of capital, a deterioration of trade finance, and lower confidence.

Chart 8: World GDP growth



Source: IMF and Treasury.

Although growth in Australia’s major trading partners (MTPs) is forecast to be lower than at Budget, it is nonetheless expected to remain solid. After MTP growth of 4.3 per cent in 2011, growth is expected to be 4¼ per cent in 2012. Growth is then forecast to be 4¾ per cent in both 2013 and 2014, as conditions in Europe and the US continue to improve, with the anticipated increase in external demand flowing through to China’s growth, and to the global economy more broadly. The more robust growth prospects for Australia’s MTPs compared with the global economy overall reflects the composition of our MTPs, which is increasingly weighted towards the fast-growing emerging Asian economies.

Conditions in the euro area have continued to deteriorate, with output declining in the June quarter, credit markets remaining impaired, business and consumer confidence continuing to weaken, and the unemployment rate rising to new euro-era highs. Leading indicators suggest this weakness is likely to continue, with the euro area expected to contract in 2012. The euro area is assumed to make incremental progress towards resolving the crisis and gradually recover over the forecast horizon. However, growth over this period is expected to be anaemic, with remaining fiscal consolidation requirements and bank deleveraging expected to drag on growth.

Throughout the year, the focus of the sovereign debt crisis has increasingly turned to Spain. Spain has come under increasing pressure as a result of the troubles arising from its banking sector and more recently from the fiscal difficulties of both its central and regional governments. However, fears are that markets would then focus on Italy, the third-largest economy in the euro area, given its significantly larger sovereign debt and poor growth prospects.

The recent ECB announcement that it is prepared to purchase short-term sovereign debt of troubled euro area economies through Outright Monetary Transactions as long as they commit to fiscal and structural reforms has, at least for now, stabilised financial markets and appears to have bought the region much needed time. However, the ECB can only relieve the immediate funding pressures facing the troubled euro area sovereigns. A lasting resolution to the European sovereign debt crisis will only be achieved through a firm political commitment to achieving a closer political, fiscal and banking union in the euro area. It will also require the euro area’s troubled economies to continue to implement structural reforms in order to boost their competitiveness and growth potential.

Unlike Europe, the US economy continues to grow, albeit at a subdued rate by historical standards, with persistent underlying weaknesses in its labour and housing markets constraining growth. The US continues to be dependent on very accommodative monetary

policy, and is still yet to achieve a self-sustaining recovery. Consequently, it remains vulnerable to any further negative shocks.

While the US is assumed to avoid the so called 'fiscal cliff', it remains a key risk to the outlook. A variety of tax provisions, including the 'Bush' tax cuts, expire at the end of 2012, while discretionary spending cuts are currently legislated to commence at the end of 2012. If Congress is unable to come to an agreement to avoid the fiscal cliff, this would have a severely detrimental impact on the US economy in 2013. The US' independent non-partisan Congressional Budget Office has estimated that, under current legislation, the US economy would experience a mild recession in 2013. Even if the fiscal cliff is avoided, the longer it takes for Congress to come to any agreement, the more likely businesses and households will defer investment and consumption decisions. A complicating factor is that even if the fiscal cliff is avoided, it remains crucial that the US craft a credible medium-term fiscal consolidation plan.

Growth in economic activity in China has eased in recent months due to a weakening external sector and the effects of previous policy tightening measures. The larger-than-expected moderation in growth has seen a cautious shift in Government policy towards supporting growth. Chinese authorities have eased monetary policy, accelerated the approval of infrastructure projects, provided consumption incentives to households, and lowered taxes for small and medium-sized enterprises.

The magnitude of any policy stimulus is likely to be smaller than that undertaken in 2008-09, with Chinese officials mindful of avoiding the asset quality issues and substantial inflationary pressures that resulted from the previous round of stimulus. The more supportive policy settings being implemented this year are expected to see growth pick up later in the year and in early 2013. Over the forecast horizon, China's growth is expected to remain relatively solid, albeit lower compared with Budget. While the projected growth rates are more moderate compared with those recorded

over the past 30 years, this more moderate outlook is more consistent with a maturing economy on a sustainable and balanced growth path and with the growth target under the 12<sup>th</sup> Five-Year Plan. A further deterioration in economic conditions in Europe or a more significant slowing in US growth poses the main risk to China's growth outlook.

Elsewhere in the region, the outlook is becoming increasingly linked to developments in external demand from the world's major economies. The boost to Japan's growth from earthquake reconstruction activity peaked in the first half of 2012, with Japan's growth in the medium-term likely to return to very subdued rates and a reliance on exports to drive growth.

The weakening in external demand has impacted on the highly trade-exposed Newly Industrialised Economies, particularly Taiwan and Hong Kong. In contrast, the economies in the ASEAN-5 such as Indonesia, Thailand and the Philippines have generally continued to record more robust growth rates due to healthy domestic demand. However, a key risk across a number of east Asian economies is their vulnerability to the threat of a sharp outflow of capital if global conditions deteriorate.

In India, economic growth is forecast to be lower overall than expected at Budget, particularly for 2012, reflecting a slowing in investment, a delay in monsoon conditions, and the uncertainty in Europe impacting export growth. Over the remainder of the forecast horizon, India's growth is expected to improve, reflecting a gradual recovery in private investment and a return to normal seasonal conditions.

A lingering additional risk to the global outlook is the potential for a spike in global oil prices as political tensions in the Middle East remain unresolved. While global oil prices fell in the three months to June, they have since risen noticeably despite the softening in global economic conditions, suggesting that market concerns over geopolitical risks are a major factor. While the possibility of an oil price spike persists, if conditions in the euro area were to deteriorate and global growth was to

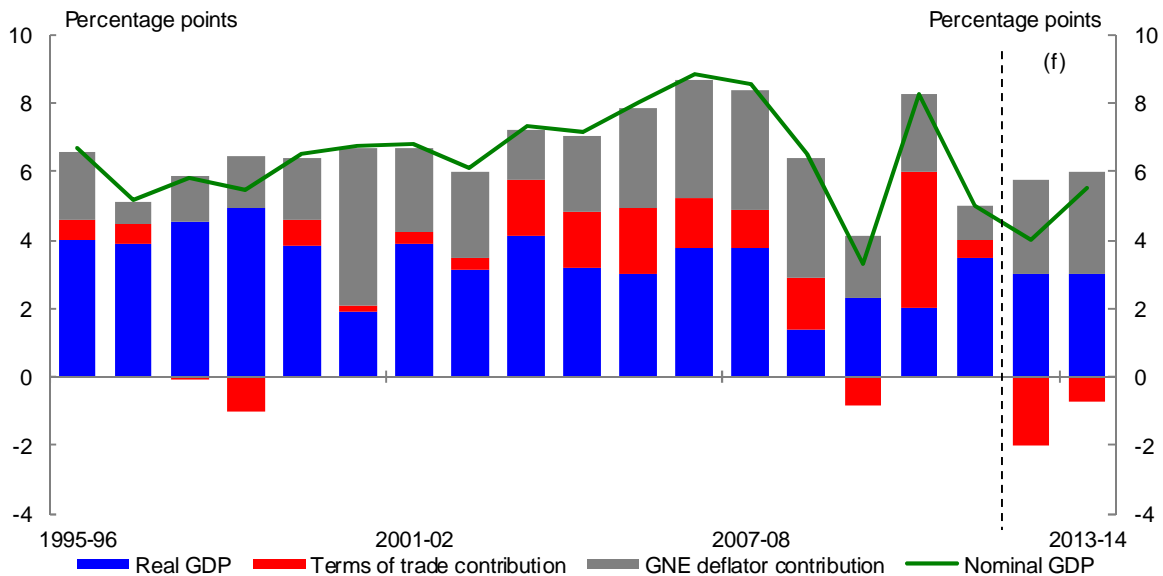
slow sharply, then conversely oil prices could decline substantially.

While a sharp rise in oil prices remains the key risk in commodity markets at present, prices for agricultural commodities are also historically high, albeit below their most recent peaks, recorded during the Arab Spring of early 2011. Were agricultural prices to rise sharply this would contribute to inflationary pressures in a number of emerging markets, complicating policy responses to any deterioration in global economic conditions.

## Attachment A: Forecast growth in nominal GDP

Nominal GDP is forecast to grow 4 per cent in 2012-13 and 5½ per cent in 2013-14. The lower forecast for 2012-13 reflects the ¼ of a percentage point downward revision to real GDP growth, softer-than-expected growth in domestic prices and a sharper forecast decline in the terms of trade. Forecast growth in 2013-14 is ¼ of a percentage point higher than at Budget.

Chart 9: Decomposition of nominal GDP growth



Source: ABS Catalogue Number 5206.0 and Treasury.

Total corporate gross operating surplus (GOS) is expected to grow 1 per cent in 2012-13 and 7 per cent in 2013-14. Forecast growth in total GOS for 2012-13 has been revised down since Budget, largely reflecting weaker forecast growth in mining sector profits due to lower non-rural commodity prices. Forecast GOS growth in 2012-13 is 2¼ percentage points weaker than Budget forecasts while growth in 2013-14 has been revised upwards by 1¼ percentage points. However, in levels terms, GOS remains around \$21 billion lower than expected at Budget in 2013-14.

Compensation of employees (COE) is forecast to grow 5¼ per cent in 2012-13 and 5 per cent in 2013-14. This growth is ¼ of a percentage point higher than at Budget in 2012-13, reflecting the solid June quarter National Accounts outcome. Forecast growth in 2013-14 has been revised down ½ of a percentage point reflecting expectations of softer wage growth combined with slower employment growth compared with Budget.

Gross mixed income (GMI), which includes the wages and profits of farm and other unincorporated enterprises, is forecast to increase 3½ per cent in 2012-13 before growing 4 per cent in 2013-14.