Australia Business Forecast Report Q1 2015

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Abstracts

Core Views

We have revised up our real GDP growth forecast for 2014 to 2.8%, from 2.3% previously, given the stronger-than-expected growth rate seen in H114. However, we remain below consensus, and expect growth to slow to 2.3% in 2015 as the strong construction picture struggles to counteract the weakness in external demand.

We expect the Reserve Bank of Australia (RBA) to maintain its cash rate at 2.50% for the remainder of 2014 and 2015, as nominal GDP growth continues its downtrend. The weakening AUD is unlikely to trigger a rise in imported inflation given global disinflationary trends, while macro-prudential policies should help to curtail mortgage lending, which is the only significant driver of domestic inflation.

While a relief rally in the AUD looks likely in the near term, with key support at USD0.8650/AUD holding, we maintain that further weakness in likely over the medium term owing to a deteriorating terms of trade picture amid high external indebtedness. We forecast the currency to average USD0.9000/AUD this year and USD0.8500/ AUD in 2015.

The benign trends seen in Australia's fiscal accounts look set to reverse over the coming years, heightening the need for spending restraint. While we are seeing small signs of progress on this front, widespread parliamentary and public opposition to fiscal austerity will prevent significant measures being implemented. We forecast the FY2014/15 deficit to fall only marginally to 2.6% of GDP, significantly larger than the government's target of 1.6% of GDP.

Widespread voter opposition to the government's budget cuts is undermining the Liberal-National coalition's popularity, and reducing the chances of significant fiscal austerity measures being passed. Economic weakness is likely to feed through to rising opposition support and a further loss of appetite for spending restraint.

Major Forecast Changes

We have revised up our real GDP growth forecast for 2014 to 2.8%, given the stronger-than-expected growth rate seen in H114. However, the ongoing reversal in the country's terms of trade should continue to weigh on medium-term growth. We have revised down our forecast for the AUD slightly, and expect the currency to average USD0.8500/AUD in 2015 (from our previous forecast of USD0.8800/AUD) as lower real interest rates and a high current account deficit cause further currency losses

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Monetary Policy

Long Pause Ahead For The RBA

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Table: Monetary Policy

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AUD: Bounce Likely, But More Downside Thereafter

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TABLE: Exchange Rate

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The Australian Economy To 2023

Exports And Immigration Key For Long-term Growth

Australia's real GDP growth is expected to remain firm, averaging 2.7% in the 10-year period from 2014 to 2023. In particular, we believe commodity exports and a renewed interest in skilled immigration will be key drivers in helping the economy return to its trendline growth of around 3.0% from 2017 onwards, following a slowdown over 2013-2016.

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Operational Risk

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