Part II: Economic Outlook

Following three years of economic growth in excess of 4 per cent, growth is expected to remain robust in 2000-01 at around 4 per cent, slightly above the Budget forecast of 3¾ per cent. Employment growth is expected to be strong at around 3 per cent (up significantly from the Budget forecast of 2¼ per cent), with the unemployment rate continuing its downward trend.

The slight upward revision to the growth forecast since the Budget reflects a further upgrade to the world growth outlook and the lower Australian dollar, which together are expected to provide an additional boost to net exports.

The outlook for world economic growth has strengthened since the Budget, with growth now expected to be around ½ of a percentage point higher than forecast in the Budget. Contributing to the improved world outlook are the sustained growth in the United States, a solid European recovery and steady improvements in Japan so far in 2000. World oil prices are expected to ease over the forecast period but the oil price outlook remains uncertain, with prices likely to remain volatile.

In 2000-01, net exports are expected to make a significant positive contribution to economic growth in Australia for the first time since the Asian downturn of 1997 and 1998. At the same time, overall domestic demand is expected to grow at a moderate rate of around 3 per cent, following several years of very strong growth. This more moderate growth in domestic demand reflects some unwinding of a bring-forward in spending, particularly residential construction and household consumption, ahead of the introduction of *The New Tax System* on 1 July 2000, and the effect of monetary tightening since late 1999 which has lifted short-term interest rates from historical lows. The strong turn-around in net exports is expected to contribute to a significant decline in the current account deficit in 2000-01 to around 4¼ per cent of GDP from 5¼ per cent of GDP in 1999-2000.

The Consumer Price Index (CPI) is forecast to increase by 6 per cent in year-average terms in 2000-01 and by 5½ per cent through the year — ¼ of a percentage point higher than forecast at Budget. The forecast for the headline CPI includes the impact on consumer prices of *The New Tax System*. Leaving aside these effects, 'ongoing' inflation in 2000-01 is forecast to be around 3¼ per cent in year-average terms and 3 per cent through the year. The year-average forecast for 'ongoing' inflation in 2000-01 has been revised up from 2¾ per cent in the Budget, largely reflecting higher world oil prices and a lower exchange rate relative to the levels assumed in the Budget, rather than any significant step up in wage or general inflationary pressures.

The initial forecast for 2001-02 is for economic growth of around 3¾ per cent, in line with Australia's medium term potential growth rate, reflecting solid growth in employment of around 2 per cent and an increase in labour productivity of around 1¾ per cent. The unemployment rate is expected to continue its downward trend, to a little below 6 per cent by the June quarter 2002. The headline CPI is expected to increase by around 2¼ per cent in year-average terms and by 2 per cent through the year. Elements of *The New Tax System* are expected to put downward pressure on consumer prices in 2001-02, while the CPI forecast also includes an allowance for falling world oil prices, and hence petrol prices, during the year. The rate of increase in wages is expected to be higher than in recent years but to remain moderate, at rates consistent with ongoing inflation trends in line with the target band.

International economic outlook

The outlook for world economic growth has strengthened since the Budget, with growth now expected to be around ½ of a percentage point higher than previously forecast. Contributing to the improved world outlook are the sustained growth in the United States, a solid European recovery and steady improvements in Japan so far in 2000.

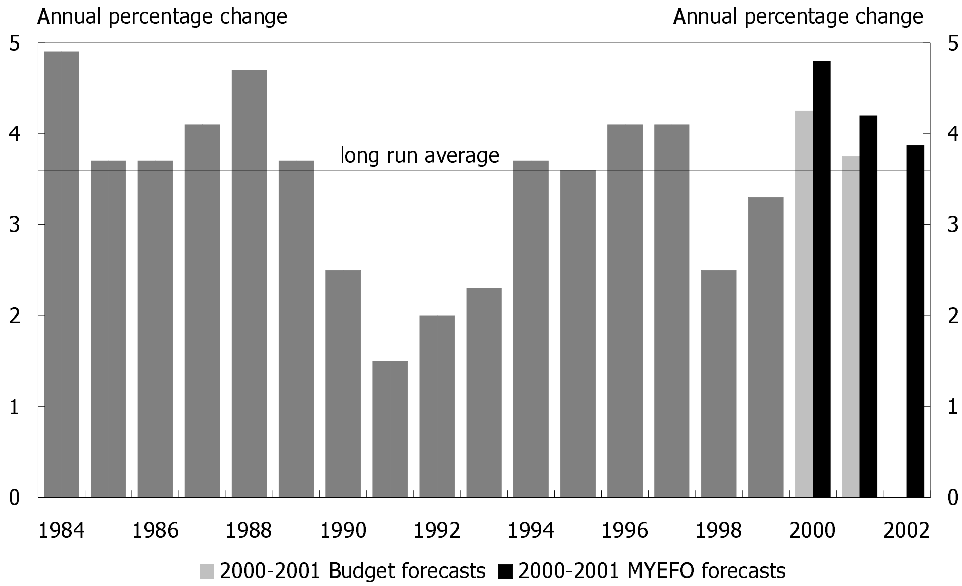
World oil prices are assumed to ease over the forecast period from a world trade-weighted[1] average of $US 27½ per barrel in 2000 to $US 24¼ per barrel in 2001 and $US 22 per barrel in 2002. While this represents a significant upward revision from the oil price assumptions made at Budget ($US 25 per barrel in 2000, $US 19½ per barrel in 2001, and $US 19¼ per barrel in 2002), oil prices are still expected to decline over the forecast period, as world oil production increases in response to higher prices and the rate of growth of world industrial activity moderates somewhat.

Nevertheless, the outlook for world oil prices is uncertain and prices are likely to remain volatile. Sustained high oil prices, above those assumed, would lead to slightly weaker world growth, other factors unchanged. Countries which are highly dependent on imported oil, such as Japan, would be most affected, although increased revenue to oil producing countries would mute the overall effect on world growth. However, the impact of sustained higher oil prices on world activity would be much less than that felt during the oil price shocks of the 1970s, as oil dependency ratios across many developed countries have fallen sharply. Notably, in the Organisation for Economic Co-operation and Development (OECD) region, oil imports per unit of output have been halved since the early 1970s, and oil use per unit of output has fallen by about 40 per cent.

World growth is now forecast to rise to 4¾ per cent in 2000 before moderating to 4¼ per cent in 2001: in each case, this is about ½ of a percentage point higher than the Budget estimates. The moderation in world growth in 2001 reflects an expected easing in growth in the United States to rates closer to estimated potential growth, while the expansions in Europe and Japan are anticipated to continue at a solid pace. In 2002, world growth is expected to ease further to 4 per cent, although remaining slightly higher than the long-term average.

1 The world trade weighted oil price is the average of the contract price of different types of oil, weighted by their share of the world oil trade (that is, between countries).

Chart 1: World GDP growth(a)



(a) World GDP growth rates are calculated using GDP weights based on purchasing power parity.
Source: Various national statistical publications, International Monetary Fund (IMF) and Treasury.

Table 2: International GDP growth forecasts(a)

	1997	1998	1999	2000(b)	2001(b)	2002(b)
	Actual	Actual	Actual	Forecast	Forecast	Projection
World	4.1	2.5	3.3	4 3/4	4 1/4	4
Total OECD(c)	3.5	2.4	3.0	4	3 1/4	3
United States	4.4	4.4	4.2	5 1/4	3 1/4	3
Japan	1.6	-2.5	0.3	1 3/4	2	2
European Union	2.6	2.7	2.3	3 1/4	3	2 3/4
Non-Japan East Asia(d)	6.7	1.0	6.3	7 1/4	6 1/2	6 1/4

(a) Growth rates for World, total OECD, European Union, and non-Japan East Asia are calculated using GDP weights based on purchasing power parity.
(b) Treasury estimates for World, total OECD, and European Union growth rates.
(c) Total OECD comprises the United States, Japan, Germany, France, Italy, the United Kingdom, Canada, Australia, Austria, Belgium, the Czech Republic, Denmark, Finland, Greece, Hungary, Iceland, Ireland, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland and Turkey.
(d) Non-Japan East Asia consists of Korea, Singapore, Taiwan, Hong Kong, China, Indonesia, Malaysia, Thailand, and the Philippines.

The United States economy continues to be resilient, with low inflation and strong productivity growth, while unemployment remains at historically low levels. The current account deficit is at record levels as a share of GDP, reflecting the very high levels of domestic spending and the strength of the US dollar. Nevertheless, growth in the United States is showing signs of slowing and is expected to ease further in the latter part of 2000 and into 2001 as private demand growth moderates in response to earlier monetary policy tightening and slower growth in household wealth. The very strong US dollar is also likely to adversely affect activity levels in many exporting industries in the United States, as well as firms and industries competing against imports.

Growth in Europe strengthened considerably in the first half of 2000, and this pace is expected to ease only slightly in 2001. Strong private consumption and net exports (which are being helped by the competitive euro-currency and strong world growth) are supporting the improvement in European growth.

The recovery in the Japanese economy seems to have consolidated in 2000 and is expected to firm in 2001, as private sector spending makes a stronger contribution to growth and fiscal policy continues to be supportive. For non-Japan East Asia, private domestic demand is expected to play an increasing role in the recovery, although the region's activity is still heavily reliant on strong export demand.

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, thus abstracting from some of the most recent volatility in foreign exchange markets. These exchange rate assumptions are around 6 per cent below those used at Budget, and contribute to the stronger outlook for net exports and overall economic activity, and the larger increase in the CPI in 2000-01 than forecast at Budget. The farm sector forecasts are based on an assumption of average seasonal conditions for the remainder of 2000-01 and in 2001-02.

The forecasts for activity and inflation in both 2000-01 and 2001-02 take into account the changes to the indirect taxes, and the general reductions in income tax rates and increases in social welfare payments flowing from the introduction of *The New Tax System* on 1 July 2000. These tax changes appear to have caused a bring-forward of some consumption spending into the latter part of 1999-2000, which is likely to have reduced these components of demand in the early part of 2000-01. A similar pattern has occurred with residential construction. On the other hand, plant and equipment investment in 2000-01 should be supported by the beneficial impact of *The New Tax System* on business costs.

Interest rates are also assumed to remain around current levels, with the forecasts taking into account the 150 basis points increase in the cash rate between November 1999 and August 2000, and the increase in longer term interest rates since the historical lows reached in 1998.

Domestic economy — 2000-01

The forecasts for 2000-01 are summarised in Table 3. Economic growth is expected to be around 4 per cent, revised up slightly from the budget forecast of 3¾ per cent. The slight increase largely reflects the upward revision to expected world economic growth and the lower exchange rate since the Budget, which together provide an added boost to net exports and overall economic activity.

Table 3: Domestic economy forecasts[(a)]

	Outcomes(b)	2000-01 Budget	Revised 2000-01
	1999-2000 Year average	Forecasts Year average	Forecasts Year average
Panel A - Demand and output(c)			
Household consumption	4.5	3 3/4	3 3/4
Private investment			
Dwellings	12.2	-3	-8
Total business investment(d)	3.2	6	4
Other buildings and structures(d)	-12.1	-6	-7
Machinery and equipment(d)	8.1	9	8
Private final demand(d)	5.0	3 1/2	2 3/4
Public final demand(d)	7.0	2	3 1/2
Total final demand	5.4	3 1/4	3
Change in inventories(e)			
Private non-farm	-0.5	0	0
Farm and public authorities	0.0	- 1/4	0
Gross national expenditure	4.9	3	3
Exports of goods and services	9.4	7	9
Imports of goods and services	12.8	4	3
Net exports(e)	-0.9	3/4	1
Gross domestic product	4.4	3 3/4	4
Non-farm product	4.4	3 3/4	4 1/4
Farm product(f)	5.5	1	-1
Panel B - Expenditure excluding one-off transactions(c)(g)			
Change in inventories(e)	-0.5	0	0
Gross national expenditure	5.0	3	3
Net exports(e)	-1.0	1/2	3/4
Gross domestic product	4.4	3 1/2	3 3/4
Panel C - Other selected economic measures			
Prices and wages			
Consumer Price Index - Headline	2.4	5 3/4	6
Consumer Price Index - 'Ongoing'(h)	2.4	2 3/4	3 1/4
Gross non-farm product deflator	1.8	2 3/4	3
Average earnings(i)	2.8	4 1/4	4 1/4
Labour market			
Employment (Labour Force Survey basis)	2.7	2 1/4	3
Unemployment rate (per cent)	6.9	6 1/2	6 1/4
Unemployment rate (per cent)(j)	6.7	6 1/4	6 1/4
Participation rate (per cent)	63.4	63 1/2	64
External accounts			
Terms of trade	4.0	1/4	1 1/2
Current account balance			
$billion	-33.7	-31 1/2	-28 1/2
Percentage of GDP	-5.3	-4 3/4	-4 1/4

(a) Percentage change on preceding year unless otherwise indicated.
(b) Calculated using original data.
(c) Chain volume measure.
(d) Excluding transfers of net second-hand asset sales from the public sector to the private sector.
(e) Percentage point contribution to growth in GDP.
(f) Calculated at basic prices.
(g) One-off transactions are Olympic ticket sales, the international sale of Olympic broadcasting rights, other direct Olympic-related travel service exports, the change in inventories resulting from transactions by the Sydney Organising Committee for the Olympic Games (SOCOG), imported and re-exported gold, imports and exports of goods for processing and the export of an ANZAC frigate.
(h) The 'ongoing' CPI is the headline measure abstracting from the impact of the introduction of *The New Tax System*.
(i) Average non-farm compensation of employees (national accounts basis).
(j) The level in the June quarter of each year.

Demand and output

Growth in **private consumption** is expected to moderate slightly to 3¾ per cent in 2000-01, following the very strong increases of around 5 per cent in 1998-99 and 4½ per cent in 1999-2000. The expected moderation in private consumption growth is consistent with an assumed slowing in the rate of growth of real wealth, in part reflecting recent increases in interest rates. Higher interest rates and higher debt levels have also contributed to an increase in the household debt-servicing ratio, although it remains well below its peak reached in 1989. The sharp increase in petrol prices over the past year is also likely to weigh on overall household spending.

Nevertheless, continuing above-trend consumption growth will be supported by strong growth in after-tax labour income, underpinned by strong growth in employment and the income tax cuts and increases in social security payments associated with *The New Tax System*.

The introduction of the GST on 1 July 2000 seems to have resulted in some change to normal consumption habits, as consumers brought forward consumption of items that rose in price, and deferred consumption of items that fell in price. Overall, the net impact is likely to have been a small bring-forward into the latter part of 1999-2000, at the expense of 2000-01.

Following very strong growth over the last three years, **dwelling investment** is expected to decline by around 8 per cent in 2000-01. This decline largely reflects the unwinding of the bring-forward of building activity ahead of *The New Tax System*, which saw dwelling investment rise well ahead of underlying demand. Also expected to contribute to the decline is lower housing affordability, reflecting the combination of rising house prices and higher mortgage interest rates. While housing affordability has declined, it remains well above the levels experienced in the late 1980s and early 1990s.

The impact of lower housing affordability and particularly *The New Tax System* has seen sharply lower forward indicators of dwelling investment (such as building approvals and housing finance) in the latter part of 1999-2000 and in the early part of 2000-01. Partially offsetting these negative factors are the beneficial impact of the First Home Owners Scheme and moderating, but solid, growth in spending on alterations and additions to existing dwellings.

Business investment (abstracting from the purchase of second-hand assets by the private sector) is forecast to grow by around 4 per cent in 2000-01, slightly higher than the growth of 3.2 per cent in 1999-2000. The outlook for solid investment growth reflects favourable fundamentals: healthy corporate profitability and balance sheets; relatively high levels of capacity utilisation; strong world growth; and a boost to Australia's international competitiveness flowing from the decline in the exchange rate.

While growth in overall business investment in 2000-01 is expected to be solid, significant differences are expected between the components of business investment. New plant and equipment investment is expected to grow by a strong 8 per cent in

2000-01, reflecting the above-mentioned factors and lower plant and equipment prices following the introduction of *The New Tax System*.

On the other hand, new investment in buildings and structures is expected to decline by 7 per cent in 2000-01, following a decline of around 12 per cent in 1999-2000. Continued falls in non-residential building approvals, engineering construction commencements and in the stock of work-yet-to-be-done, all point to a decline in non-residential construction investment in 2000-01. However, even with these declines, non-residential construction activity is expected to remain close to its historical average as a share of GDP in 2000-01. Further, both building activity and engineering construction are likely to improve over the course of the year, with potential for further growth in power generation and telecommunications facilities, factories and other business premises.

Conditions in the mining sector are also conducive to increased investment spending, with very high profitability supported by higher world commodity prices and the lower exchange rate. Together with the large amount of potential resource projects on the drawing board, a nascent recovery in mining investment is likely to develop over the next year.

Investment in private non-farm **inventories** is expected to be relatively steady in 2000-01 and therefore will not contribute significantly to overall economic growth. This follows a modest run-down of inventories over 1999-2000 and is consistent with a continued gradual decline in the inventories-to-sales ratio as firms continue to manage down stock levels to increase profitability.

After adjusting for second-hand asset sales, real **public final demand** is expected to grow by 3½ per cent in 2000-01, down from growth of 7 per cent in 1999-2000. (Expenditure in 1999-2000 was boosted by defence related expenditure on East Timor and strong Public Trading Enterprise (PTE) investment, especially by Telstra.) Growth in public final demand in 2000-01 is expected to be underpinned by continued strong Commonwealth expenditure on administrative costs associated with defence, immigration and telecommunications. At the State / local level, growth in consumption is expected to moderate to around 2 per cent in 2000-01.

Net exports are forecast to make a substantial 1 percentage point contribution to GDP growth in 2000-01 (up from ¾ of a percentage point forecast at Budget), the first positive contribution since the Asian downturn. This reflects stronger activity in the world economy, some moderation in domestic demand growth, a temporary boost from the Olympics and the lower exchange rate.

In 2000-01, export volume growth is expected to be around 9 per cent, similar to 1999-2000 and around the longer-term trend, but well above the very low growth rate recorded in 1998-99. This export volume growth is expected to be underpinned by strong growth in exports of services and elaborately transformed manufactures (ETMs). Services exports were given a significant boost from the Olympics, particularly in the September quarter, with further strength coming from increased tourist arrivals from East Asia. The volume of ETM export growth in 2000-01 (abstracting from the export of an ANZAC frigate in 1999-2000) is expected to be above the pre-Asian crisis trend rate.

More moderate increases are expected in commodity export volumes. Below average seasonal conditions experienced in some areas over recent months (particularly in sugar growing regions), point to a fall in rural commodity export volumes, following strong growth in 1999-2000. On the other hand, resource exports are expected to grow solidly in 2000-01, above the growth rate in 1999-2000. The continued pick-up in the volume of resource exports primarily reflects additional supply capacity coming on stream, coupled with stronger growth in traditional export markets in East Asia and higher commodity prices, particularly in Australian dollar terms.

Import volume growth in 2000-01 is expected to decline significantly to around 3 per cent, from almost 13 per cent in 1999-2000, in response to more moderate growth in domestic demand than in recent years and a fall in one-off imports (with significant falls in non-monetary gold and civil aircraft more than offsetting a rise in imports of defence-related equipment). Import volume growth in 2000-01 will also be affected by higher import prices, reflecting an increase in world producer prices and the lower exchange rate. However, experience over the past decade or so indicates that the relationship between world producer prices, the exchange rate and domestic retail prices of imported items is imprecise and difficult to predict. Competitive pressures, both at home and abroad, can have a strong influence on the outcome.

The terms of trade increased by around 4 per cent in 1999-2000 and are expected to increase by a further 1½ per cent in 2000-01, returning to around the level experienced prior to the Asian downturn.

In Special Drawing Rights (SDR) terms, commodity prices — as measured by the Reserve Bank of Australia Commodity Price Index — increased during 1999-2000, driven by stronger world demand. Although the outlook for the world economy remains positive, growth in world demand for commodities is expected to be partly offset by increased world supply of several of Australia's key commodities. As a result, commodity prices expressed in SDR terms are expected to remain below their pre-Asian crisis levels over the forecast horizon. On the other hand, in Australian dollar terms, aggregate commodity prices are well above pre-Asian crisis levels, reflecting the lower Australian dollar.

Labour market

In 2000-01, employment is expected to grow by around 3 per cent in year-average terms, around ¼ of a percentage point above actual employment growth in 1999-2000 and ¾ of a percentage point higher than forecast at Budget. Upward revisions to forecast employment growth in 2000-01 largely reflect stronger than expected employment growth in the September quarter. It is possible that some of the strong increase in employment growth over recent quarters reflected temporary effects associated with the introduction of *The New Tax System* and the Olympics. Employment growth is expected to moderate over the remainder of 2000-01, consistent with the recent slowing growth in job vacancies.

In 2000-01, the unemployment rate is expected to continue the general downward trend experienced over recent years, falling to around 6¼ per cent by the June quarter 2001. This outlook is largely unchanged from the Budget, with stronger growth in employment matched by a higher labour force participation rate.

Wages

Wages have continued to increase at a moderate pace, with average earnings on a national accounts basis (AENA) increasing by just 2.8 per cent in 1999-2000, a little lower than estimated at Budget. Wages growth is expected to increase in the period immediately ahead, growing by 4¼ per cent in 2000-01, reflecting the continued strength in the labour market and the downward trend in the unemployment rate. Abstracting from the increase in the superannuation guarantee charge on 1 July 2000, wages are expected to increase by 3¾ per cent.

It is assumed that the one-off increase in the CPI resulting from the introduction of *The New Tax System* does not feed into wages growth, given that households have been generously compensated for these price increases with income tax cuts and higher welfare payments.

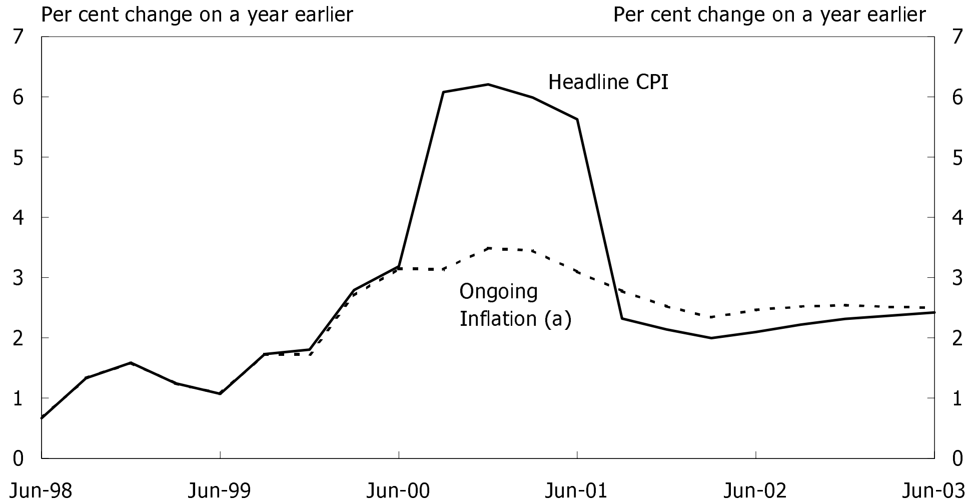
Prices

In year-average terms, the CPI increased by 2.4 per cent in 1999-2000, in line with the Budget forecast of 2½ per cent. In the year to the June quarter 2000, the CPI increased by 3.2 per cent partly reflecting a range of temporary and one-off factors. For example, world oil prices rose by over 60 per cent in the year to the June quarter, which, combined with the decline in the Australian dollar over that period, increased petrol prices by around 22 per cent. Some aspects of *The New Tax System* also affected the price of several items in the CPI basket over the year to the June quarter, ahead of the major tax changes. For example, insurance charges, tobacco prices and the prices of some electrical and electronic equipment were affected directly by some early elements of the tax changes. Project home prices are also likely to have been boosted by the strength of activity in the residential construction sector ahead of the tax changes. On the other hand, car prices are likely to have been reduced by discounting ahead of the tax changes.

These special factors make it difficult to readily assess the inflation 'pulse'. Abstracting from petrol prices and those items which seem to have been significantly affected by and ahead of *The New Tax System*, price increases among the remaining 80 per cent of items in the CPI basket averaged a little under 2 per cent in the year to the June quarter 2000.

The headline CPI is forecast to increase by 6 per cent in 2000-01 in year-average terms and by 5½ per cent through the year to the June quarter 2001 (see Chart 2). Leaving aside the direct effects of *The New Tax System* on consumer prices, 'ongoing' inflation is expected to be around 3¼ per cent in year-average terms in 2000-01 and around 3 per cent in the year to the June quarter 2001. The forecast for 'ongoing' inflation in 2000-01 has been revised up from 2¾ per cent in year-average terms in the Budget, reflecting higher world oil prices and the decline in the exchange rate from the levels assumed in the Budget.

Chart 2: CPI forecasts and projections — the impact of *The New Tax System*



(a) Excludes the impact of *The New Tax System* on prices.
Source: ABS Cat. No. 6401.0 and Treasury.

In the September quarter 2000, the CPI rose by 3.7 per cent, significantly lower than the 4½ per cent expected at Budget. With recent quarterly increases in the CPI (excluding petrol) averaging around ½ per cent and with petrol contributing 0.4 of a percentage point to the increase in the CPI in the September quarter, it seems likely that the remaining increase of a little less than 3 per cent in the quarter largely reflected the impact of *The New Tax System*. This compares with the budget estimate of an increase in prices flowing from *The New Tax System* of around 3¾ per cent in the September quarter. At Budget, some of the embedded cost reductions flowing from the tax changes were expected to be reflected in consumer prices in later quarters, bringing the impact of *The New Tax System* back to 2¾ per cent through the year to the June quarter 2001.

In the event, intense competition in the Australian economy and effective monitoring by the Australian Competition and Consumer Commission appear to have resulted in some of the tax increases being absorbed by sellers in the September quarter and cost savings flowing from the tax changes may have been passed into final retail prices more quickly than anticipated. As a result, the lower than expected September quarter CPI outcome may be slightly offset by outcomes over the next few quarters.

The move to the 14th series CPI in the September quarter 2000 also had the effect of slightly reducing the estimated impact of *The New Tax System* on the CPI in the first year by around ¼ of a percentage point. Some items which declined in price as a result of the tax changes, such as motor vehicles, receive a higher weight in the 14th series, while others, such as cigarettes and clothing, receive a lower weight. These weighting changes in the 14th series more accurately reflect current household spending patterns. *The New Tax System* is now expected to increase the CPI by 2½ per cent through the year to the June quarter 2001 compared with 2¾ per cent as expected at Budget.

There are several key uncertainties around the inflation outlook in 2000-01. The increase in the CPI could be affected if world oil prices stabilise at a substantially higher level than assumed, or the exchange rate settles significantly below the assumed rate incorporated into the current forecasts. The CPI forecasts also assume that there will be no flow on into wages from price increases arising from *The New Tax System*.

Domestic economy — 2001-02

Economic growth in 2001-02 is expected to be around 3¾ per cent in year-average terms, in line with Australia's medium term potential growth rate, reflecting solid growth in employment of around 2 per cent and growth in productivity of around 1¾ per cent. The unemployment rate is expected to decline further, to below 6 per cent by the June quarter 2002.

The outlook for world economic growth in 2001 remains relatively strong and is about ½ of a percentage point higher than the Budget estimates, but is expected to moderate from 4¾ per cent in 2000 to 4¼ per cent in 2001 and to 4 per cent in 2002. The moderation in world growth reflects an expected easing in growth in the United States to rates closer to estimated potential growth, while the expansions in Europe and Japan are anticipated to continue at a solid pace.

In Australia, private consumption growth in 2001-02 is forecast to remain above trend, supported by the lagged effects of the income tax cuts and increased welfare payments in the previous year. Continued solid employment growth and further reductions of the unemployment rate will also support continued consumption growth. A further but more modest decline in dwelling investment is expected in 2001-02 as the excess supply of new houses is unwound.

New plant and equipment investment is expected to continue to grow strongly in 2001-02, reflecting ongoing positive business conditions. In addition, the decline in non-residential construction investment is expected to abate in 2001-02, establishing a base for stronger investment growth in the following year. Overall investment spending in 2001-02 should be assisted by more conducive conditions in the mining sector.

Growth in public final demand is expected to ease further in 2001-02 as both Commonwealth consumption and investment expenditure moderates. Net exports are expected to make a small contribution to growth in 2001-02, contributing to a further small decline in the current account deficit.

Wage increases in 2001-02 are expected to be slightly higher than forecast in 2000-01 (abstracting from the rise in the superannuation guarantee charge), but to remain modest at around 4 per cent, consistent with ongoing inflation trends remaining within the target band.

'Ongoing' inflation is expected to ease to 2½ per cent in both year-average terms and through-the-year terms (see Chart 2). The lower 'ongoing' inflation relative to 2000-01 largely reflects the effect of an assumed fall in international crude oil prices and subdued price pressures in the residential construction sector.

The New Tax System will act to reduce the headline CPI slightly, by a little over ¼ of a percentage point in year-average and through-the-year terms in 2001-02, reflecting the phased introduction of input tax credits for motor vehicles and the removal of Financial Institutions Duty and stamp duty on marketable securities. The downward pressure on the CPI from *The New Tax System* in 2001-02 is slightly more than expected at Budget, reflecting the move to the 14th series weights.

Taking together the estimates for 'ongoing' inflation and the impact of *The New Tax System* on prices in 2001-02, the headline CPI is expected to increase by around 2¼ per cent in year-average terms and 2 per cent in the year to the June quarter 2002.

The longer-term impact of *The New Tax System* on the CPI will also be a little less than previously published due to the move to the 14th series CPI. *The New Tax System* is now expected to add between 1¾ per cent and 2 per cent to the CPI in the long run. Excluding tobacco, *The New Tax System* will add a little over 1½ per cent to the CPI. The lower estimate of the impact of *The New Tax System* in the long run relative to the impact in 2000-01 and 2001-02 reflects the phased introduction of input tax credits for motor vehicles and the phased abolition of various State taxes.

The significant uncertainties around the inflation outlook in 2000-01 also apply to 2001-02. These uncertainties relate primarily to world oil prices and the exchange rate being substantially different from the assumed levels used to prepare the forecasts.

Medium-term projections

Table 4 below sets out the major economic parameters used in preparing the revised budget estimates. The parameters comprise the forecasts for 2000-01 and 2001-02, 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 4: Major economic parameters (percentage change from previous year)

	Forecasts		Projections	
	2000-01	2001-02	2002-03	2003-04
Real GDP	4	3 3/4	3 1/2	3 1/2
Employment(a)	3	2	2	2
Wages(b)	4 1/4	4	3 1/2	3 1/2
CPI	6	2 1/4	2 1/2	2 1/2

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