

PART 2: ECONOMIC OUTLOOK

The Australian economy is forecast to grow by $3\frac{3}{4}$ per cent in 2003-04, an upward revision from the $3\frac{1}{4}$ per cent forecast at the 2003-04 Budget. The positive outlook is underpinned by expected robust growth in domestic demand and a stronger performance from the external sector. Non-farm GDP is expected to grow solidly, and farm production is expected to contribute around $\frac{3}{4}$ of a percentage point to GDP growth. Employment growth should remain moderate, with the unemployment rate remaining steady. Despite the upward revision to activity, the forecast for year-ended inflation in 2003-04 is unchanged from Budget at $2\frac{1}{4}$ per cent, reflecting the appreciation of the currency since that time, continued moderate wages growth and few signs of emerging tightness in the labour market.

The near-term outlook has brightened since Budget and, after a weak patch in the first half of 2003, economic growth is expected to gather pace through 2003-04. GDP increased by 2.6 per cent in the year to September 2003, but is expected to rise by over 4 per cent through 2003-04, with the recovery in farm production contributing nearly 1 percentage point. The pattern of growth is likely to be more balanced than over the past year and the near-term risks around the outlook also now appear to be more evenly balanced.

A key development since Budget has been a significant improvement in the global economic outlook. The tentative global recovery faltered in the first half of the year, with the war in Iraq and the effects of the Severe Acute Respiratory Syndrome (SARS) epidemic further delaying the expected global upswing. The pace of recovery has subsequently picked up, with the United States growing strongly. In line with the improved outlook, the forecasts for world and major trading partner growth have been revised up since Budget. World and major trading partner growth is forecast to be 4 per cent in 2004. While a solid global recovery is in prospect, the balance of risks around the medium-term outlook remains tilted to the downside.

Offsetting the improved global outlook is the sharp appreciation of the Australian dollar. The Budget forecasts were underpinned by an assumption that the exchange rate would remain around average levels at that time. Since then, the exchange rate has appreciated by over 10 per cent in trade-weighted terms. As a result, the forecast subtraction of net exports from economic growth is now substantially higher than at Budget, notwithstanding the expected recovery in rural exports.

Domestically, a major development since Budget has been the easing of drought conditions over much of the country. The Budget assumed a return to average seasonal conditions, so a substantial recovery was already factored into the forecasts. However, widespread rainfall through much of Australia's grain belt over winter, while not sufficient to fully break the drought, has provided more confidence that farm production will rebound strongly this year. On the basis of ABARE's latest forecasts, farm production is expected to rise by 27 per cent in 2003-04, contributing $\frac{3}{4}$ of a

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percentage point to overall economic growth. The rebound in farm production is expected to continue into 2004-05, possibly adding another $\frac{1}{4}$ - $\frac{1}{2}$ of a percentage point to economic growth, as the herd and flock rebuilding process continues, and assuming that water storage is sufficiently replenished to allow a rebound in irrigated crops.

The non-farm sector of the economy also looks set to grow solidly in 2003-04, notwithstanding the recent increases in interest rates. Consumer activity remains buoyant, with spending underpinned by solid income gains and increased wealth. The outlook for private business investment remains firm, with solid profitability, low interest rates and high levels of business confidence. Dwelling investment, which at Budget was expected to fall in 2003-04, looks set to hold up for longer than expected, underpinned by low, albeit rising, interest rates and, in some cases, unrealistic expectations of future capital gains from housing investment.

On the external front, net exports are forecast to subtract around $1\frac{1}{2}$ percentage points from GDP growth in 2003-04, a larger subtraction than the $\frac{1}{4}$ of a percentage point forecast at Budget, largely reflecting the ongoing strength in domestic demand and the effects of the exchange rate appreciation. The current account deficit (CAD) is forecast to average around $5\frac{3}{4}$ per cent of GDP over 2003-04, although it is expected to narrow sharply through the year from current high levels.

The labour market outlook is similar to that at Budget, with employment growing steadily, in line with solid growth in non-farm GDP, and the unemployment rate remaining around current levels. Recovery from the drought should boost employment in rural and regional areas. Employment growth is expected to be around $1\frac{1}{2}$ per cent in 2003-04 and the unemployment rate is forecast to average around, or possibly a little below, current levels of $5\frac{3}{4}$ per cent. It is anticipated that ongoing solid growth in activity, against a backdrop of low inflation, could see further reductions in the unemployment rate.

Inflation is forecast to decline to around $2\frac{3}{4}$ per cent through 2003-04, with the appreciation of the Australian dollar exerting downward pressure on import prices in the near term. Business costs are expected to remain moderate, notwithstanding relatively high levels of capacity utilisation. Wage pressures should remain well contained, with moderate wages growth and solid increases in productivity, further boosting prospects for sustained falls in the unemployment rate.

The initial forecast for 2004-05 is for economic growth of around $3\frac{1}{2}$ per cent. The outlook is underpinned by solid, although moderating, consumption and business investment and a pick-up in exports in line with the ongoing recovery in world demand and farm production. Consumption growth is likely to ease a little in line with a more subdued pace of wealth accumulation and higher debt servicing requirements, following the build-up in debt in recent years. Business investment growth should also ease, as engineering construction falls from the very high levels of activity reached in 2003-04, following a period of exceptional growth. Dwelling investment is expected to moderate as medium-density construction declines in response to over supply

conditions, constraining growth in the housing sector as a whole. The unemployment rate is forecast to remain at around, or a little below, 5¾ per cent over the course of the year and inflation is expected to stay at around, or below, the bottom of the medium-term inflation target band.

RISKS TO THE OUTLOOK

The risks around the near-term outlook for the domestic economy have diminished since Budget, and are now more evenly balanced. Some of the major downside risks that were clouding the outlook for the world economy have dissipated, domestic spending looks set to hold up better than expected, and drought conditions have eased across much of the country.

Expansionary macroeconomic policy settings in many countries should support a strengthening of the global recovery in the near term. However, the global recovery remains over reliant on US growth. Unbalanced world growth has led to the emergence of large global imbalances, which present a risk to the medium-term outlook. Moreover, this unbalanced growth leaves the global recovery more vulnerable to shocks such as major terrorist attacks, increased geopolitical tensions and sudden rises in energy prices.

On the domestic front, a significant issue is how the current housing cycle plays out, and associated developments with household balance sheets. Positive developments in economic fundamentals – in particular, low inflation, low interest rates and solid income growth – have contributed to house prices rising sharply over the past couple of years, boosting household wealth and spending. Consumer spending has run ahead of income for some time, as people borrow against accumulating wealth.

While household debt levels are not excessive by international standards, and debt servicing levels are presently manageable, households would be affected by significant adverse shocks. Higher interest rates, a deterioration in employment conditions, or a decline in consumer and investor confidence, could see falls in house prices, and cause some over-exposed consumers and investors to pull back on consumption and investment spending. The risk of a sharp decline in dwelling construction, leading to a broader economic slowdown, could also affect an otherwise positive outlook. There is also the risk that above-trend growth in household spending will continue for some time, boosting economic growth by more than expected in the short-term, and lead to a larger correction at a later time.

On the external front, conditions have improved substantially, although important risks remain. If the global recovery falters, the exchange rate appreciates further, or major security concerns re-emerge, the external sector will continue to be a major drag on growth. In addition, the drought has not fully broken, despite substantial rain, and there is still a risk, albeit diminishing, that a widespread recovery in rural production will be delayed for another year. On the upside, a vigorous and sustained global

upturn could see Australia's economy grow much faster than forecast over the next year or two.

INTERNATIONAL ECONOMIC OUTLOOK

World growth prospects have improved since Budget with the easing of a number of risks to the outlook. The tentative global recovery moderated over the first half of 2003 due to geopolitical tensions, uncertainties surrounding the war in Iraq and the effects of the SARS epidemic. As these influences have waned, the pace of recovery has picked up, with the United States growing strongly. While a solid global recovery is in prospect, the balance of risks around the medium-term outlook remains tilted to the downside.

Reflecting the improved outlook, the forecast for world growth for 2003 has been revised up by $\frac{1}{2}$ of a percentage point from the Budget forecasts and the major trading partner (MTP) growth forecast by $\frac{3}{4}$ of a percentage point (Table 2). For 2004, the world GDP growth forecast has been increased by $\frac{1}{2}$ of a percentage point and the MTP growth forecast by one percentage point.

Table 2: International GDP growth forecasts^{(a)(b)}

| | 2002 Actual | 2003 Forecasts | 2004 Forecasts |
|------------------------|----------------|-------------------|-------------------|
| World | 3.0 | 3 1/2 | 4 |
| Total OECD | 1.8 | 2 1/4 | 3 |
| United States | 2.4 | 3 | 4 1/4 |
| Japan | 0.2 | 2 1/2 | 1 3/4 |
| Euro area | 0.9 | 1/2 | 1 3/4 |
| Major Trading Partners | 3.0 | 3 1/4 | 4 |
| Non-Japan East Asia(c) | 4.8 | 4 | 5 1/2 |

(a) Growth rates for the World and Euro area are calculated using GDP weights based on purchasing power parity, while growth rates for Major Trading Partners and non-Japan East Asia are calculated using export trade weights.

(b) Percent change from previous year.

(c) Non-Japan East Asia comprises Korea, Singapore, Taiwan, Hong Kong, China, Indonesia, Malaysia, Thailand, and the Philippines.

Source: National statistical publications, IMF and Treasury.

In the near term, expansionary macroeconomic policy settings in many countries should support a strengthening of the global recovery. Low inflation is expected to allow monetary policy settings to remain accommodative in 2004. However, the global recovery continues to be overly reliant on US growth. Unbalanced world growth has led to the emergence of large global imbalances, which are unlikely to dissipate in the near term and which present a serious risk to the outlook. Moreover, this unbalanced growth leaves the global recovery vulnerable to shocks such as major terrorist attacks, increased geopolitical tensions and sudden rises in energy prices.

The near-term outlook for the **United States** economy has improved markedly since Budget, in part reflecting the easing of uncertainties associated with the war in Iraq. The US recovery has been underpinned by robust consumption growth, which in turn has been supported by tax cuts and record levels of mortgage refinancing. Strong growth in business investment and a rebound in employment are necessary to sustain the recovery. The low cost of capital and apparent recovery in corporate profits should support growth in business investment over 2003-04.

Recently, employment has begun to recover and there are signs that growth will strengthen. However, the recovery in employment has been weak to date, with total employment around 2 million people lower than in early 2001. If employment growth were to continue to languish, there may be a reversal of consumer sentiment which, in turn, might prompt a weakening of consumer spending.

Fiscal expansion and weak economic growth has led to the US federal budget deteriorating by around 6 percentage points of GDP since FY2000. Recent official estimates place the US budget deficit at 3.5 per cent of GDP in FY2003, and forecast no return to surplus, given current policies, before 2012. The US CAD in the June quarter 2003 was only marginally below its historic high of 5.2 per cent of GDP in the previous quarter. In these circumstances, the US CAD will continue to fuel concerns over its sustainability and the possible ramifications of a subsequent correction.

The prospects for growth in the **Euro area** have deteriorated since Budget, with Germany and Italy in recession in the first half of 2003 and France recording negative growth in the June quarter. Domestic demand in the Euro area is expected to remain subdued, with high unemployment and uncertainty over the economic and geopolitical outlook restraining consumption. The appreciation of the euro (around 14 per cent against the US dollar in the year to early December 2003) has dampened export growth, and will continue to weigh on prospects for an increased contribution to growth from the export sector.

The likelihood of a robust recovery in the Euro area is low, with few signs of strong growth over the forecast horizon. However, there are some positive signs with manufacturing surveys suggesting that the worst of the downturn in industrial production may be over and with most Euro economies showing modest growth in September. In addition, the recently announced tax cuts in Germany and France, to take effect from 2004, should provide some support to growth. More generally, structural reform is occurring, albeit slowly, in Germany, Europe's largest economy. Combined with developments elsewhere, this provides some hope that the extensive product and labour market rigidities holding back European growth may ease over the medium term. The outlook for the United Kingdom remains better than for the Euro area, with domestic demand expected to be the major driver of growth.

Growth in **Japan** has surprised on the upside in 2003, underpinned by a rebound in business investment, and solid consumption and export growth. However, the

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strength of activity may be somewhat overstated, with concerns over the reliability of data, ongoing weak employment conditions and continuing deflation. Japanese growth is forecast to ease next year with an upside risk emanating from possible stronger external demand from the US and East Asia.

The outlook for **non-Japan East Asia** has improved since Budget. The region was heavily affected by the SARS epidemic and uncertainties related to the war in Iraq. The dissipation of these risks and the apparent strengthening in the US suggest improved prospects for the region. Exports and domestic demand are expected to grow solidly over next year, supported by expansionary policy settings.

China's exports, which held up well through the first half of 2003, are expected to continue to grow strongly, while continued rapid investment should support domestic activity. Exports are expected to be a major driver of growth in East Asia's newly industrialised economies, supported by a recovery in consumption. In Southeast Asia, consumption and investment are expected to contribute strongly to growth in 2004.

A number of the downside **risks** that were overshadowing the near-term world outlook have abated since Budget. Along with the end of military conflict in Iraq and the associated moderating of oil prices, tensions on the Korean peninsula have eased and the recovery in the US is building momentum. Furthermore, the risk of generalised deflation has eased.

While there has been a marked improvement in the overall balance of risks, a number of risks continue to weigh on prospects for stronger and more broadly-based world growth. These include the still high price of oil, concerns of further major terrorist attacks, the investment overhang in a number of major economies, structural rigidities in Europe and structural weakness in Japan. In addition, large increases in household debt in a number of developed economies have made households more vulnerable to adverse shocks.

A key uncertainty facing the medium-term world economic outlook is the path of adjustment of global current account and fiscal imbalances. The US has been the major driver of world growth in recent years. This unbalanced world growth is reflected in large current account imbalances, with the US CAD at record levels. The steady depreciation of the US dollar since early 2002, if maintained, should assist in the adjustment of these imbalances. However, a reduction in the US CAD may be associated with a period of lower US growth and a large depreciation of the US dollar. A disorderly adjustment involving a sudden withdrawal of funds from the US and a sharp depreciation of the US dollar would have significant negative consequences for the world economy.

DOMESTIC FORECASTS

The forecasts for the domestic economy are underpinned by several key technical assumptions. The exchange rate is assumed to remain around the average level of recent months (a trade weighted index of around 62 and a \$US exchange rate of around 72c). Interest rates are assumed to remain around current levels. World oil prices (West Texas Intermediate) are assumed to fall gradually to around \$US25 per barrel by June 2005, broadly in line with market expectations. The farm sector forecasts are based on an assumption of a return to average seasonal conditions in 2003-04.

Domestic economy — 2003-04

The Australian economy is expected to grow by 3¾ per cent in 2003-04, stronger than at Budget. Non-farm GDP is expected to increase by 3 per cent in 2003-04, and at a substantially quicker pace through the year. However, farm production is set to rebound strongly as drought conditions ease, and is forecast to grow by 27 per cent in 2003-04.

The key domestic macroeconomic forecasts for 2003-04 are summarised in Table 3.

Table 3: Domestic economy forecasts^(a)

| | Outcomes(b) | 2003-04 Budget | 2003-04 MYEFO |
|---|-------------------------|---------------------------|---------------------------|
| | 2002-03 Year average | Forecasts Year average | Forecasts Year average |
| Panel A - Demand and output(c) | | | |
| Household consumption | 4.1 | 3 1/4 | 4 1/2 |
| Private investment | | | |
| Dwellings | 16.0 | -5 | 3 |
| Total business investment(d) | 16.9 | 7 | 7 |
| Other buildings and structures(d) | 31.9 | 14 | 11 |
| Machinery and equipment(d) | 16.4 | 4 | 5 |
| Intangible fixed assets | 5.7 | 9 | 4 |
| Private final demand(d) | 6.8 | 3 | 5 |
| Public final demand(d) | 4.2 | 3 1/4 | 2 3/4 |
| Total final demand | 6.3 | 3 | 4 1/2 |
| Change in inventories(e) | | | |
| Private non-farm | 0.1 | 0 | - 1/4 |
| Farm and public authorities(f) | -0.2 | 1/2 | 1/2 |
| Gross national expenditure | 6.2 | 3 1/2 | 4 3/4 |
| Exports of goods and services | -0.6 | 6 | 3 |
| Imports of goods and services | 13.5 | 6 | 9 |
| Net exports(e) | -3.0 | - 1/4 | -1 1/2 |
| Gross domestic product | 2.8 | 3 1/4 | 3 3/4 |
| Non-farm product | 4.0 | 2 3/4 | 3 |
| Farm product | -28.7 | 25 | 27 |
| Panel B - Other selected economic measures | | | |
| External accounts | | | |
| Terms of trade | 2.2 | 1 3/4 | 3 1/4 |
| Current account balance | | | |
| \$billion | -41.1 | -42 3/4 | -46 |
| Percentage of GDP | -5.5 | -5 1/4 | -5 3/4 |
| Labour market | | | |
| Employment (labour force survey basis) | 2.5 | 1 3/4 | 1 1/2 |
| Unemployment rate (per cent) | 6.1 | 6 | 5 3/4 |
| Participation rate (per cent) | 63.9 | 64 | 63 3/4 |
| Prices and wages | | | |
| Consumer Price Index | 3.1 | 2 3/4 | 2 1/4 |
| Gross non-farm product deflator | 2.7 | 2 1/4 | 2 3/4 |
| Average earnings(g) | 3.1 | 4 | 3 3/4 |

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

(b) Calculated using original data.

(c) Chain volume measure.

(d) Excluding transfers of second-hand asset sales between the public and private sectors.

(e) Percentage point contribution to growth in GDP.

(f) For presentational purposes, forecast changes in inventories held by privatised marketing authorities are included with the inventories of the farm sector and public marketing authorities.

(g) Average earnings (national accounts basis).

Household consumption is forecast to increase by 4½ per cent in 2003-04, an upward revision from the 3¼ per cent forecast in the 2003-04 Budget. Underpinning the upward revision are stronger-than-expected gains in household wealth, largely due to higher house prices, and increased household borrowing. The buoyant outlook for consumer activity should also be supported by robust growth in household income, low interest rates, the 2003-04 Budget income tax cuts, high levels of consumer confidence, and a sharp rebound in rural incomes.

The near-term outlook for **dwelling investment** has also improved since Budget, with activity now forecast to increase by 3 per cent in 2003-04. Continued solid growth in both detached housing and renovation work is expected to be offset by a decline in medium-density housing in the first half of 2004.

In contrast to conditions in the detached housing segment of the market, the level of medium-density activity appears to be unsustainable, with high and rising vacancy rates and low and falling rental yields pointing to significant over supply of apartments. However, there is considerable uncertainty regarding the extent and timing of the expected downturn in medium-density dwelling investment. The expectation of a continuation of capital gains has seen activity remain at high levels in the face of declining fundamentals for some time. However, the expected sharp increase in the number of completed apartments over the next six months will exacerbate the existing over supply in the near term, placing further pressure on vacancy rates and rental yields, and highlighting still further the lack of realism in expectations of ongoing capital gains. The recent increases in interest rates and tentative signs of a plateauing in prices may also help to slow activity in this part of the market.

Business investment is expected to grow by 7 per cent in 2003-04, consistent with Budget, underpinned by supportive financial conditions, strong growth in corporate profits over the last year, low interest rates and generally sound corporate balance sheets. Business surveys point to high levels of confidence and capacity utilisation remains relatively high.

In line with these positive fundamentals, plant and equipment investment is expected to grow by 5 per cent in 2003-04, a little stronger than forecast at Budget, although slower than the growth rate in 2002-03, as the aviation industry's fleet upgrade is phased down. Investment in buildings and structures is expected to grow by 11 per cent in 2003-04, driven by the tail-end of the boom in engineering construction, and continuing non-residential building activity.

Investment in private non-farm **inventories** (excluding private marketing authorities) is expected to broadly keep pace with solid sales growth in 2003-04.

Public final demand is expected to increase by 2¾ per cent in 2003-04, a slower rate than in 2002-03. Defence and national security spending are expected to remain key contributors to overall growth in Australian Government final demand, although

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expenditure on these items is expected to grow at a slower rate than in 2002-03. At the state and local government level, the expected increase in final demand relates mainly to expenditure on health and law and order. In addition, a number of state and local government funded infrastructure projects are expected to commence.

Exports are forecast to rise by 3 per cent in 2003-04 as a whole, and 11 per cent through the year, underpinned by improving global demand, a sharp rise in rural exports following an easing of drought conditions, and modest increases in tourist arrivals as health and security concerns abate. **Imports** are forecast to increase by 9 per cent in 2003-04, in line with the slower pace of domestic demand growth and the phasing down of the aviation industry's fleet upgrade. However, the appreciation of the currency will increase import growth by encouraging some switching of demand from domestic to foreign production.

Taken together, the trade forecasts imply that the external sector is likely to subtract around 1½ percentage points from overall economic growth in 2003-04, significantly greater than the ¼ of a percentage point subtraction forecast at Budget, with the downwards revision largely reflecting the sharp appreciation of the currency since that time.

Despite weak export prices, the **terms of trade** is likely to continue to rise this year, with the trend fall in the prices of imported manufactured goods expected to persist, driven by excess capacity in world goods markets, competitive pressures and ongoing falls in the prices of information and communication technology goods.

The current account deficit is forecast to average 5¾ per cent of GDP in 2003-04, narrowing significantly from 6.4 per cent of GDP in the June quarter 2003 to around 5¾ per cent by the June quarter 2004.

Labour market conditions are expected to be solid, although a little weaker in 2003-04 than over the previous year, with employment forecast to grow by around 1¾ per cent to the June quarter 2004, in line with the easing growth rate of non-farm GDP. Contributing to overall employment growth in 2003-04, rural and regional employment is forecast to pick-up sharply, in line with the expected rebound in farm production. The unemployment rate is expected to remain at around, or a little below, 5¾ per cent over the forecast horizon.

Inflation is forecast to fall to around 2¼ per cent in year-ended terms in 2003-04, with the possibility that it could even be a little lower if the current exchange rate appreciation is sustained. Wages growth is expected to remain steady which, together with solid productivity growth, should see labour costs remain well contained. Import prices are expected to continue to hold down inflation, reflecting excess capacity in world goods markets and the appreciation of the currency over the last year. Oil prices should fall further in the period ahead. With the non-farm economy expected to grow a little below trend, significant capacity constraints are unlikely to emerge over the

coming year despite high levels of capacity utilisation. Moreover, with domestic competition robust, there appears to be little scope for generalised margin building.

Domestic economy — 2004-05

The initial forecast for 2004-05 is for economic growth of around 3½ per cent. Domestic demand growth is expected to be solid, although a little weaker than in 2003-04, reflecting more moderate growth in household consumption and declines in medium-density dwelling investment and engineering construction. The external sector is forecast to make a zero contribution to growth, a much better outcome than the large subtractions in recent years, with exports forecast to pick up in line with the ongoing recovery in world demand and a further recovery in farm production.

Household consumption is expected to grow solidly in 2004-05, broadly in line with household income growth, although the pace of growth is expected to ease from the above-trend rates of recent years. The pace of wealth accumulation is expected to slow, in line with an assumed slowdown in the rate of increase of house prices, and household income growth should moderate a little.

Dwelling investment is forecast to ease in 2004-05, with continued growth in both detached housing and renovation work expected to be offset by a long-anticipated decline in medium-density housing activity.

Business investment growth is forecast to be solid in 2004-05, with continued growth in plant and equipment investment and non-residential construction. However, engineering construction activity is likely to ease from the high levels reached in 2003-04, as work on projects currently underway is gradually completed.

Exports are expected to pick-up further in 2004-05, supported by the ongoing recovery in both global demand and farm production and strong growth in non-rural commodity exports, as new production capacity in the mining sector starts to come on line, following the recent boom in engineering construction. **Import** growth is expected to moderate in line with the slowing pace of domestic demand growth.

The trade forecasts imply that the external sector will not contribute to GDP growth in 2004-05, an improvement from the 3 percentage point subtraction in 2002-03 and the expected 1½ percentage point subtraction forecast for 2003-04. The terms of trade should increase moderately and the current account deficit is expected to narrow.

Employment growth is forecast to be 1¼ percent in 2004-05, in line with firmer growth in non-farm GDP. The unemployment rate is forecast to remain at around, or a little below, 5¼ per cent in 2004-05. **Wages** growth should remain firm, but slow a little in 2004-05, in line with solid, albeit easing, employment growth over the forecast horizon and a broadly stable unemployment rate.

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Inflation is forecast to fall to 2 per cent through the year to June 2005, consistent with the expected slight easing in wages growth, further anticipated falls in import prices and moderating domestic demand pressures. The scheduled reduction in motor vehicle and textile, clothing and footwear tariffs from 1 January 2005 should also put downward pressure on inflation in 2004-05. If the recent exchange rate appreciation is sustained, and in the absence of any positive shocks, it is likely that inflation will fall below 2 per cent, possibly as low as 1¾ per cent, in the year to June 2005.

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 2003-04 and 2004-05, 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 in employment and productivity, while the projections for inflation are consistent with the Government's medium-term inflation target band.

Table 4: Major economic parameters^(a)

| | Forecasts | | Projections | |
|---------------|-----------|---------|-------------|---------|
| | 2003-04 | 2004-05 | 2005-06 | 2006-07 |
| Real GDP | 3 3/4 | 3 1/2 | 3 1/2 | 3 1/2 |
| Employment(b) | 1 1/2 | 1 3/4 | 1 1/2 | 1 1/2 |
| Wages(c) | 3 3/4 | 3 1/2 | 3 3/4 | 3 3/4 |
| CPI | 2 1/4 | 2 | 2 1/2 | 2 1/2 |

(a) Percentage change from previous year.

(b) Labour force survey basis.

(c) Average earnings (national accounts basis).