Whose guess is as good as mine?

For 2000, the economists' crystal ball goes cloudy

Author and commentator EDNA CAREW, chair of a Securities Institute lunchtime seminar discussing "2000 And Beyond", summarises the findings and forecasts of a panel of economists who gathered late in 1999 to gaze into the future.

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Faced with a year to be characterised by key one-off events such as the introduction of a goods and services tax and the accompanying tax cuts and the hosting of the Olympic Games in Sydney, Australian economists exhibited an unwonted element of consensus – that 2000 is an extraordinarily hard year to predict with any accuracy.

A small proof of the slippery nature of predictive precision was the majority view of a panel gathered by the Securities Institute that Australia's official interest rate would rise by 0.25% early this year — and perhaps later by another hike of the same size. On 2 February the Reserve Bank announced a rise of 0.5%, demonstrating either its own perversity or the fickleness of forecasts.

The panellists in the Securities Institute seminar were: Dr Chris Caton, senior economic adviser, BT Financial Services Group; Craig James, chief economist, Colonial State Bank; Dr Shane Oliver, chief economist, AMP Asset Management Australia Ltd; Mark Rider, chief economist, Warburg Dillon Read; and Nigel Stapledon, chief economist, Westpac Banking Corporation.

The occasion gave rise to a new word: possimistic, signifying a degree of cautious wishfulness that is well short of pessimism but not exactly bullish. Overall, though, economic growth was expected to continue in a year dominated by events that make reading the economic tea-leaves more challenging than usual. Commenting on the US election, most agreed that the candidate likely to succeed is George W. Bush, largely because his chief rival, Al Gore, is handicapped by association with the Clinton administration.

CRAIG JAMES opened the session, commenting that the Australian economy is performing strongly with evidence of considerable confidence, especially in consumer spending. Business and investment is rather more circumspect and that is expected to continue ahead of the introduction of the GST.

James saw unemployment falling this year and inflation rising. Inflation, he said, is one of the major concerns for this year, together with the impact of the GST and effects of higher oil prices, rising tobacco prices and increases in health fund premiums. Factor these rises into decision-making and it is likely that this could translate into rises in wages and prices.

Thus he saw inflationary expectations as a major element during the course of this year; and he forecasts two moves in interest rates, each of a 0.25 per cent increase. That, he said, is what is expected of one of the proponents of the dismal science. And such a prediction should make people mindful about taking on debt, even against a background of increased household wealth and increased consumer confidence.

He nominated two areas to watch during this year: household debt and inflation, as well as developments in the euro. Generally, though, he remained optimistic that growth will continue.

SHANE OLIVER pointed out that less than 12 months previously, at the beginning of 1999, most economists were expecting a slowdown over the year, even leading to interest rate cuts, and were concerned about the possibility of a global depression. None of that occurred. Rather, growth rose and the US economy, which was expected to grow by around 2%, in fact turned in 4% growth. The story in Australia has been similar, with expectations of around 2% being overtaken by a reality of 4-5%.

A clutch of factors are stimulating growth, said Oliver, citing a “feel-good” sensation ahead of the Olympics, continuing low levels of interest rates, the stimulus of tax cuts ahead (even though some of that impact will be reduced by the Timor tax), and the proposed NRMA float.

He concurred with Craig James in identifying a rise in inflation as a concern, post-GST, but forecast that inflation will “continue to surprise on the downside” and would not be a major problem. He expected interest rates to “nudge up”, with two increases each of 0.25%.

Oliver predicted that European growth will start to improve and said he believed that, in Australia, we have seen the worst on the current account and that it will continue to improve as global growth increases and our exports to Asia rise.

As for the All-Ordinaries index, he contended that the main concern there is the US sharemarket but believed that it “will continue to surprise on the upside”.

NIGEL STAPLEDON summarised 1999 as a year distinguished by several underestimations, particularly an underestimation of the strength of the US, European and Australian economies. Two years ago, he said, we were very confident about the outlook for those economies as they, and particularly the US, were demonstrating how, against the right macro environment – low inflation, low interest rates – an economy can grow to its full potential. Then the Asian crisis threw everyone off-course.

But again, said Stapledon, economists underestimated the capacity of the Asian economies to bounce back from adversity. “We focused a great deal on their structural weaknesses, especially in Japan,” he said. “But an economy can have structural weaknesses and still be able to bounce back. These Asian economies proved themselves very responsive, they do not have a big social security system to fall back on, they have to bounce back and move on.”

Stapledon asserted that we also underestimated movements in the price of oil, which fell sharply with the Asian crisis but bounced back quickly, another good indicator, he said, of the resilience of economies.

“In Australia we underestimated the economy’s underlying strength, and we overestimated our links with Asia,” Stapledon said. “Australia in fact has stronger links with the US and looking ahead, that’s where the risks are.”

Turning to the Reserve Bank, Stapledon said that the central bank showed its approach to monetary policy management was more subtle than market economists had expected. The central bank is not simply targeting inflation but is also aiming to maximise the potential of the Australian economy, to get unemployment down as far as possible and avoid the boom/bust pattern of the past. “Managing the business cycle reflects a subtle change in thinking on the part of the Reserve Bank,” Stapledon said.

He said he expected that Europe and Asia will “surprise on the upside” and emphasised that, for Australia, the US is a critical variable. He predicted higher interest rates and a slowing in the economy in the second half of this year and stressed that US unemployment is an indicator to watch. “US unemployment is close to the low level seen in the late 1960s and in the late 1960s inflation in the US gradually climbed,” he warned.

Summarising Australia as a “very hard economy to pick because of a lot of noise”, Stapledon forecast that inflation will lift and be higher post-GST for a year and that interest rates will also rise.

MARK RIDER commented on the uncommon level of agreement among the economists present, given that economists are habitually incapable of consensus, and added his voice to those who had conceded that 2000 is a year in which it is very difficult to identify an underlying trend in the economy.

A look at the conventional data suggests that the Australian economy is strong and could accelerate through this year, he said; it grew strongly even though exports have been weak so a rise in exports should be a source of fresh growth.

Rider was not predicting a boom of 6-7% growth as exports feed additional strength into the economy but more modest growth of about 5%. Adding to the growth scenario are expectations of further growth in the US and Japan and further recovery in Asia generally.

Against this background, Rider forecast interests rates in Australia of about 6% in the middle of this year, and expected a “fair value” for the $A of about 65, maybe 70, US cents. He forecast strong global growth with very little inflation and was bullish about the euro.

CHRIS CATON opened his address by remarking on how far we had moved in a year. “Had this seminar been held in late 1998 we would have heard talk of a good chance of a recession in 1999 and that suggestion has gone completely,” he said. Asia is on a recovery path and Latin-America never deteriorated as much as expected. Such is the turnaround that there is now talk of a world economic boom in 2000 and that, said Caton, is not far-fetched when the three economic epicentres of the US, Europe and Japan are growing well.

An example of how some Asian economies have defied expectations is South Korea, which was forecast at the start of 1999 to grow at 2% and in fact has grown by 9%. Caton awarded a “gold star” to Asia for improved economic performance. The changed mood, he said, has led to remarkable recoveries in financial markets, with the Dow Jones, the $A and the All-Ordinaries all far higher than their late-1998 levels.

Turning to 2000, Caton predicted that the US economy will slow, if not of its own accord then because the Federal Reserve will tighten policy to bring about a slowdown. For Australia, the improved outlook for

Asia means that the "Asian effect" on our exports is diminishing.

Caton also introduced a new word for monetary policy – de-loosening – which he claimed is a more accurate description of the Reserve Bank's move on interest rates than "tightening". The RBA, he said, is aiming to make monetary policy "less expansionary", not tighter. He expected a further rise in the first half of this year for three reasons: the threat from Asia has disappeared; growth is not slowing; and we have tax reform ahead. Tax reform, Caton emphasised, is an issue in monetary policy. We will have to wait until after tax reform has been introduced before determining whether further increases in interest rates are likely.

In the question-and-discussion session following the addresses, topics raised included the ongoing concerns about Y2K, especially on key dates such as 30 June and 31 December this year and technology worries related to the introduction of GST. Apprehension was expressed about the weakness of the German economy, given its major role as accounting for almost one-third of the euro zone and the fact that the genesis of much of its problems is not short-term cyclical factors but structural difficulties.

Concern was also voiced about the US sharemarket's continuing giddy rise and the potential effects of a fall on household wealth, given the widespread share ownership and rising exposure to telecommunications and technology stocks. A comment from the audience was that a significant correction in the US sharemarket could have a correspondingly significant impact on wealth, as so many individuals have run down their savings to buy shares, a trend that is mirrored in Australia.

Offsetting that concern, however, is that the net asset position of Australian households is healthier than that of the US and while equities are important in overall wealth, a considerable amount is also generated in housing.

A dismal comparison was made between the heady rise in share prices, but not profits, of the new breed of "dot.com" companies and the fortunes of radio companies, which in the 1920s numbered 100, of which a mere two survived. As was the case with radio companies, the benefits brought by the dot.com companies will be enjoyed by consumers but there are likely to be some unhappy investors.

TABLE 1 **2000 GDP growth prospects (%)**

Month of forecast	M	A	M	J	J	A	S	O	N
Australia	3.2	3.2	3.2	3.1	3.2	3.2	3.3	3.5	3.6
US	2.2	2.3	2.4	2.5	2.7	2.7	2.7	2.9	3.1
Japan	0.2	0.1	0.2	-0.1	-0.2	-0.1	0.4	0.4	0.6
Germany	2.6	2.6	2.6	2.5	2.5	2.5	2.6	2.6	2.7
World	**2.2**	**2.2**	**2.3**	**2.3**	**2.3**	**2.4**	**2.6**	**2.6**	**2.8**

Source: BT Funds Management

TABLE 2 **2000 inflation outlook (%)**

Month of forecast	M A	M	J	J	A	S	O	N	
Australia	2.8	3.0	3.0	3.2	3.2	3.3	3.5	3.6	3.8
US	2.4	2.4	2.5	2.5	2.4	2.5	2.5	2.5	2.6
Japan	-0.2	-0.2	-0.2	-0.1	-0.1	-0.2	0.0	0.0	0.0
Germany	1.5	1.6	1.5	1.5	1.4	1.4	1.4	1.4	1.4
World	**1.7**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.7**	**1.7**	**1.7**

Source: BT Funds Management

TABLE 3 **Asian growth forecasts (%)**

	1998	1999	2000
South-East Asia			
Indonesia	-13.2	0.1	4.1
Malaysia	-7.5	4.5	5.5
Philippines	-0.4	2.9	3.7
Singapore	0.3	5.4	5.8
Thailand	-10.0	4.1	4.5
North-East Asia			
China	7.8	7.3	7.4
Hong Kong	-5.1	0.9	2.9
Japan	-2.8	1.0	0.6
South Korea	-5.8	8.6	6.2
Taiwan	4.7	5.4	6.1

Source: BT Funds Management

FINAL THOUGHTS

Central banks are focused on inflation and if inflation in the US remains benign, then that is all to the good. Alan Greenspan, chairman of the Federal Reserve, has warned against "irrational exuberance".

In Australia, we need a trigger factor to send the sharemarket down and, in the absence of that, money will continue to pour into shares. Is there a surprise lurking somewhere? Perhaps the possibility that inflation might not remain low – with unemployment in the US at a 30-year low, how tenable is low inflation? We need to consider the implications of that for the bond and equity markets. Ending on an upbeat note, the growth cycle of the 1990s underlines the resilience of economies. J