

PART II: ECONOMIC OUTLOOK

GDP growth is expected to average around 3¼ per cent in 1998-99. This means growth will moderate from very high levels in the first quarter as growth in domestic demand slows and export growth remains below trend in response to continuing slow world economic growth. Nevertheless, growth of around 3¼ per cent compares very favourably with other developed economies and with most countries in the region. This strong economic performance is a reflection of the progress made in microeconomic reform, and sound fiscal and monetary policy.

The forecast easing in domestic demand during 1998-99 reflects a moderation in private consumption growth, slower growth in residential construction and an easing in business investment. Despite significant export diversion away from the troubled Asian economies toward faster growing economies elsewhere in the world, growth in export volumes is expected to remain below trend, particularly for elaborately transformed manufactures and some services. However, a significant slowing in import volume growth is also expected as domestic demand slows and local industries take advantage of the more competitive exchange rate.

GDP growth in 1999-2000 is expected to be around 2¾ per cent in year-average terms. Through the year to the June quarter 2000, growth is expected to strengthen to around 3½ per cent. These forecasts reflect slower growth in public investment, an easing in private non-residential construction and slower growth in housing investment. This is offset by a modest pick-up in export growth and plant and equipment investment as the international outlook gradually improves.

The combination of sound fiscal policy, low interest rates and inflation and an expected moderate pick-up in world growth during 1999-2000 should continue to underpin Australia's favourable economic performance by international standards.

Underlying fragility in financial markets around the world highlights the considerable uncertainty surrounding the economic outlook. At this stage the risks seem to be evenly balanced. There is downside risk to the forecasts from any intensification of the global financial instability that originated in Asia in 1997. At present the enduring strength of the United States' economy is providing a foundation for continued world growth, supported by recent easings in monetary policy. However, there is a risk that US growth could be compromised by a decline in business and consumer confidence in the event of renewed financial market turmoil. On the other hand, low interest rates in many developed economies, including Australia, could provide a strong stimulus to growth, and a competitive exchange rate in Australia could lead to stronger than expected growth in export and import-competing industries.

International Economic Developments

International economic conditions have deteriorated significantly in 1998, with sharp contractions in output evident in Japan and a number of other major Asian economies. In the United States, growth has remained strong throughout 1998. Strengthening has occurred in Europe; however, more recently, sentiment has begun to weaken and some indications of slowing activity have begun to emerge. Increased infrastructure spending in China has resulted in stronger growth in the second half of the year, offsetting the effects of weaker external demand.

Table 2: GDP Growth for Selected Countries and Groupings^(a)

	1996	1997	1998 ^(e)	1999 ^(e)	2000 ^(e)
United States	3.4	3.9	3½	2¼	2½
Japan	5.2	1.4	-3	-¼	1
EMU 11 ^(b)	1.6	2.6	3	2½	2¾
OECD ^(c)	3.3	3.4	2¼	2	2½
World	4.3	4.1	2¼	2½	3¼
East Asian MTP ^(d)	6.9	6.1	-2¾	1	3¾
Total MTP ^(f)	5.2	4.0	-1½	1	2¾

(a) EMU 11, OECD and World GDP growth is calculated using GDP weights. Major Trading Partner (MTP) GDP growth is calculated using Australian merchandise export trade weights.

(b) EMU 11 economies are Germany, France, Italy, Belgium, the Netherlands, Luxembourg, Austria, Spain, Portugal, Finland and Ireland.

(c) OECD economies are the United States, Japan, Germany, France, Italy, the United Kingdom, Canada, Australia, Austria, Belgium, Czech Republic, Denmark, Finland, Greece, Hungary, Iceland, Ireland, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland and Turkey.

(d) Australia's East Asian MTP are Korea, Singapore, Taiwan, Hong Kong, China, Indonesia, Malaysia, Thailand and the Philippines.

(e) Forecasts are Treasury Forecasts.

(f) Australia's total MTP comprises East Asian MTP plus the United States, Japan, Germany, France, the United Kingdom, Italy, Canada and New Zealand.

World GDP growth in 1998 is forecast to be around 2¼ per cent, slightly in excess of the IMF's most recent forecast, primarily reflecting developments in the United States and China. Given the relative weakness of activity in the Asian region, output in Australia's major trading partners is expected to decline by 1½ per cent in 1998, well below the rise of 1¾ per cent assumed at budget time.

Such a world growth outcome for 1998 will be slightly stronger than the troughs experienced during previous international economic cycles. However, it appears that any upturn might be more muted than was the case in previous recoveries. In particular, it seems likely that growth in 1999 (at 2½ per cent) will be only marginally stronger than in 1998, though there are likely to be significant changes in the regional composition of growth. Moreover, world economic growth in 2000 (at 3¼ per cent) will also remain below long-term average rates of growth, reflecting ongoing constraining influences of corporate and financial sector restructuring in Japan and the rest of Asia. Over the same period, output in Australia's major trading partners is forecast to rise by 1 per cent and 2¾ per cent, respectively.

A slowing in growth is expected in the United States and Europe, particularly in the former where recent growth rates may have been unsustainably high. Considerable uncertainty about the outlook for the United States arose from financial market developments through September and early October, in particular from increases in interest rate spreads and difficulties in accessing credit, as evidenced in a sharp decline in corporate bond issuances. However, a series of three reductions in official US interest rates — in conjunction with easings in monetary conditions in a number of other developed economies, as well as positive announcements on Brazil and in G7 statements — appears to have calmed financial markets somewhat, resulting in some fall

in interest rate spreads and a resumption of higher levels of debt issuance. Nevertheless, a substantial slowing in the United States, to more sustainable rates of growth, remains in prospect. The weak external environment will continue to detract from growth, and domestic demand growth is likely to slow; weaker profits growth and lower levels of capacity utilisation are expected to dampen business investment growth, and reduced wealth effects should result in lower rates of growth in consumer spending. With core inflation remaining low, the monetary authorities still have flexibility for policy action should circumstances warrant it.

In continental Europe, there have been some recent signs of reduced business confidence and some indications of weakening demand and production growth. Continuing weakness in the external environment, and exchange rate appreciation from levels prevailing in the first half of 1998, will also act as dampening influences on growth. However, some reduction in average interest rates has occurred through convergence toward core rates for monetary union and through the recent coordinated easing by the Euro-11 central banks. Continued low inflation in the core economies provides the scope for some reduction in overall rates during 1999 if economic growth threatens to slow more rapidly than expected. However, the existence of relatively higher rates of inflation in some of the other economies, and the desirability for the new central bank to establish its anti-inflation credentials, will be constraining influences on such policy flexibility.

There is evidence of a pronounced slowing in activity in the United Kingdom. Domestic demand growth is slowing and the external sector remains weak. However, interest rate reductions and some easing in fiscal policy settings should enable a renewed strengthening in growth over the latter stages of 1999.

In addition to the United States and Europe, China has provided an important foundation for world growth in 1998. There were signs of slowing output growth in China in the first half of the year as external demand waned. However, increased infrastructure spending was responsible for a renewed increase in growth in the September quarter 1998, despite the adverse impacts of flooding. This policy stimulus is likely to have been more evident late in the year, and can be expected to underpin activity throughout 1999, maintaining outcomes near to target levels in the short term. However, significant structural issues need to be addressed, and could be a constraining influence on longer-term activity. Some cyclical slowing of growth has been evident in Taiwan, related to developments elsewhere in the region. As in China, stimulatory measures are also being introduced, with a likely impact on activity late in 1998 and throughout 1999.

Japan remains in deep recession, though recent industrial production data indicate some signs of stability appearing. There are also early indications from a recent sharp lift in construction permits that increased public works expenditure is beginning to impact, and can be expected to have a mounting effect over coming months. Nevertheless, uncertainty remains about the overall effectiveness of announced packages, as well as about intentions for future levels of expenditure. In addition, there appears to be few signs that the income tax rebates paid are influencing expenditure patterns, particularly given continuing weak confidence and severe constraints on credit availability. While there have been some more favourable recent developments in relation to financial sector problems, there remain uncertainties about the operational detail of the scheme and the likely speed of implementation. The recent appreciation of the yen, if sustained, could also represent a further significant drag on growth over the coming year. In aggregate,

there could be a further small contraction in output in 1999, following a sharp fall this year, and ongoing structural problems are likely to continue to constrain growth in 2000.

There have been some more positive developments over recent months in the other troubled Asian economies. The earlier sharp contractions in output experienced through late 1997, and during the first half of 1998, appear to be coming to an end in some economies. In addition, increased stability in financial markets has enabled general reductions in interest rates, in most cases to levels at or below pre-crisis outcomes. In many cases, real effective exchange rate movements indicate a sustained boost to external competitiveness. A number of countries in the region have also announced plans to increase public spending, designed to arrest the decline in domestic demand and to alleviate some of the social costs associated with the recession and restructuring process.

Although these measures are likely to contribute to some strengthening in demand over the forecast period, there remain factors that are likely to constrain their effectiveness. Ongoing structural problems in financial sectors, particularly high and rising levels of non-performing loans, are likely to continue to constrain the availability of credit. In some countries, there has been difficulty in meeting increased government expenditure targets, due to inadequate social security administration and some continued reticence to accept the need and desirability for a fiscal stimulus in these circumstances. Finally, continuing weak external demand, constraints on the availability of trade credit financing, and dislocations to production are offsetting the benefits to exports of increased competitiveness. As a result, while an increase in output is expected to occur over the course of 1999, the recovery is likely to be very subdued, implying a further contraction in year-average terms in 1999 and relatively slow growth in 2000. As a result, the level of production in the latter year — in the most affected economies in particular — is unlikely to have returned to pre-crisis levels.

There are, of course, considerable uncertainties continuing to surround the international outlook. One of the more important of these relates to possible developments in world financial markets. Not only has activity been affected by the financial market instability which occurred throughout Asia, but renewed instability in recent months — in response to developments in Russia and Latin America — has resulted in increased risk aversion which has had consequences both for emerging markets and financial sectors in the major industrialised economies. While concerns over these developments have currently receded somewhat, financial market sentiment remains fragile and vulnerable to any signs of inappropriate policies in emerging markets or of systemic problems in major financial sectors. The consequential effects of renewed instability upon capital flows, interest rate premia and overall liquidity could have a significant impact on real sector activity around the world. The possibility of a correction to equity prices continues to be a major risk to prospects for the United States. Another major uncertainty influencing the outlook is the threat that there could be an increase in protectionist sentiment arising from the likely rising imbalance in current account outcomes between major economies.

While uncertainties such as the above are very real, it is also important to recognise that some areas of fundamental strength remain. Outcomes in the United States, for example, continue to surprise on the upside and it is possible that recent structural improvements have resulted in a rise in productivity growth which will enable a continued growth performance in excess of expectations. Some recent positive indications in Japan and some other Asian economies might also suggest that ongoing constraining structural

problems might be less binding than generally assessed, allowing a slightly earlier and stronger rebound than forecast.

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 levels reached in recent months. The farm sector forecasts for 1998-99 take into account generally wetter than normal seasonal conditions to date, while forecasts for 1999-2000 are based on an assumption of average seasonal conditions in that year.

The Australian Bureau of Statistics has recently revised its procedures for compiling Australia's national accounts, in line with the new international statistical standards contained in the *System of National Accounts 1993*. As a result, the current forecasts for various income and expenditure categories may not be directly comparable with earlier published forecasts. In particular, plant and equipment investment and imports have been substantially affected, although the impacts on GDP are largely offsetting.

Domestic Economy — 1998-99

Demand and Output

The forecasts for 1998-99 are summarised in Table 3. GDP is expected to grow at 3¼ per cent in 1998-99, above the Budget forecast of 3 per cent and the forecast of 2¾ per cent in the *Pre-Election Economic and Fiscal Outlook*. The upward revision partly reflects the stronger than expected growth recorded in the September quarter 1998 and base effects associated with data revisions to 1997-98. As noted above, changes in the composition of growth largely reflect the recent implementation of revised international statistical standards by the Australian Bureau of Statistics.

The impact of overseas developments on the domestic economy was examined at length in the *1997-98 Mid-Year Economic and Fiscal Outlook*, the *1998-99 Budget Paper No.1* (Statement 2) and the review of the economy in 1997-98 published in the Spring 1998 Treasury *Economic Roundup*.

In summary, the Australian economy has, to date, shown considerable flexibility and strength in the face of sharp downturns in many important export markets. Australian exporters have boosted sales in non-Asian markets, aided by a substantial decline in the exchange rate, with this export diversion being most marked in the commodities sector. Microeconomic and regulatory reforms, and a sound macroeconomic policy framework, have produced a more responsive export sector. Furthermore, Australia's sophisticated, competitive and transparent financial sector has helped insulate the economy from much of the extreme financial market volatility that damaged many regional economies and later spread to emerging markets.

Table 3: Economic Outlook for 1998-99^(a)

	1997-98 Outcomes	1998-99 Budget Forecasts (b)	Revised 1998-99 Forecasts (c)
	Year Average	Year Average	Year Average
Panel A - Demand and Output			
Private consumption	4.5	4	3 1/2
Private investment			
Dwellings	14.6	10	4
Total business investment	9.3	6	-2
Other buildings and structures	15.4	9	-8
Machinery and equipment	6.8	5	0
Private final demand	6.0	5	2 3/4
Public final demand	2.6	2 1/4	6 3/4
Total final demand	5.3	4 1/4	3 1/2
Change in inventories(d)			
Private non-farm	0.1	1/4	0
Farm and public authorities	0.6	0	0
Gross national expenditure	5.9	4 3/4	3 1/2
Exports of goods and services	3.8	2 1/2	1 1/2
Imports of goods and services	9.4	9	3
Net exports(d)	-1.1	-1 3/4	- 1/4
Gross domestic product	4.6	3	3 1/4
Non-farm product	4.8	3 1/4	3 1/2
Farm product	-2.9	-1	3
Panel B - Expenditure excluding Transfers and One-Off Transactions(e)			
Total business investment	9.4	8	1
Public final demand	3.5	1	4 1/4
Change in inventories	0.3	1/2	0
Gross national expenditure	5.7	4 3/4	3 1/2
Exports of goods and services	5.5	2 1/2	2 1/4
Panel C - Other Selected Economic Measures			
Prices and wages			
Consumer Price Index(f)	0.0	2 1/2	2
Gross non-farm product deflator	1.4	3	1 1/4
Average earnings(g)	3.7	4 1/4	4
Labour market			
Employment (Labour Force Survey basis)	1.3	1 3/4	2
Unemployment rate (per cent)	8.3	8	8
Participation rate (per cent)	63.2	63 1/4	63 1/2
External accounts			
Terms of trade(h)	0.0	-1 1/4	-5 1/4
Current account balance			
\$billion	-23.3	-31	-32
Percentage of GDP	-4.1	-5 1/4	-5 1/2

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

(b) Calculated using seasonally adjusted constant price data.

(c) Calculated using seasonally adjusted chain volume data.

(d) Percentage point contribution to GDP growth.

(e) Transfers are net second hand asset sales from the public sector to the private sector. One-off transactions are gold sales by the Reserve Bank, 'lumpy' imports of aircraft, ships and satellites, and the export of an ANZAC frigate.

(f) Budget forecast was on 12th series basis and revised forecast refers to the 13th series.

(g) Average earnings (national accounts basis).

(h) The Budget forecast was adjusted to exclude computer import prices. The revised forecast is calculated on a chain volume basis and hence is less distorted by computer prices.

Net exports are expected to detract from growth in 1998-99, but less so than in 1997-98. Export volumes are expected to grow at a slower rate in 1998-99 than in 1997-98 and well below the longer-term trend rate. However, the slowdown in export volume growth is expected to continue to be cushioned to some extent by the diversion of exports away from the troubled Asian economies. At the same time, a substantial slowing is also expected in import growth, in line with moderating domestic demand and the increased competitiveness of domestic import-competing industries following the decline in the exchange rate over the past year or so.

A weakening in commodity prices (in US dollar terms) has contributed to the decline in the Australian dollar over the past year or so. While the depreciation in the exchange rate has broadly offset the fall in US dollar commodity prices, import prices across the docks have also increased somewhat, with a consequent deterioration in the terms of trade. Nevertheless, the decline in Australia's terms of trade over the past year has been quite small compared with previous international downturns. This is because the relatively slow growth in the world economy, and particularly in the Asian region, has placed downward pressure on world currency prices of some of Australia's key imports, such as motor vehicles. Australia's terms of trade are expected to be around 5 per cent lower in 1998-99 than in 1997-98.

Private consumption growth is expected to remain strong in 1998-99, although the pace of growth will not be as rapid as in 1997-98. Private consumption rose 4.5 per cent in 1997-98, following particularly weak growth the previous year. In particular, spending on motor vehicles was very strong in 1997-98 as consumers responded to the very attractive prices on offer.

The positive outlook for private consumption in 1998-99 is consistent with the strong growth in the September quarter and will be underpinned by ongoing solid employment and real wage growth, low interest rates, consumption expenditure associated with the continued strength in the housing sector and a transitory boost from gains to consumers as a result of the AMP Society demutualisation. The results of recent consumer confidence surveys are also favourable, especially with regard to consumers' expectations about their personal financial situation and their apparent willingness to purchase major household items. While consumer sentiment showed some weakness in early 1998 under the influence of media coverage of the Asian economic crisis, it has since rebounded to be a little above its historical average.

Growth in **dwelling investment** is expected to remain solid in 1998-99 in year-average terms, although slowing from that recorded in 1997-98. The apparent peaking in approvals will not be fully reflected in construction activity for some time and activity will also be supported by the higher average value of work per dwelling unit (reflecting an increase in the average size and quality of new dwellings) and solid alterations and additions activity. The overall downturn in the number of dwelling unit approvals is expected to be relatively mild due to the high level of affordability and continuing very low interest rates.

Business investment (exclusive of asset sales) is forecast to be relatively flat in 1998-99 after six years of strong growth. While the recent improvements in business confidence, coupled with low nominal and real interest rates and sound corporate profits, provide a supportive investment environment, continued international uncertainty is expected to result in the deferral of some investment plans until the outlook is clearer.

Non-residential construction is expected to be nearing its peak for this cycle, with underlying growth of around 3½ per cent in year-average terms. Work done should be maintained at a high level over 1998-99, supported by work on existing projects in private infrastructure, offices (particularly in the CBD of Sydney) and Olympic-related areas. The latest set of non-residential construction expectations for 1998-99 from the ABS Private New Capital Expenditure Survey implies a solid outlook, as do other partial indicators of activity. The level of work yet to be done remains high for both building and engineering activity with approvals, commencements and finance commitments remaining at supportive levels.

A small contraction is expected in plant and equipment investment (abstracting from asset sales) in 1998-99 after several years of above trend growth. Nevertheless, as a share of GDP, plant and equipment investment is forecast to remain at high levels.

No contribution to growth from **stocks** is expected in 1998-99. The stock-sales ratio fell sharply in 1997-98 as sales growth ran ahead of growth in stocks. The stock-sales ratio appears to have fallen below desired levels in 1997-98. While this suggests that a modest increase in the stock-sales ratio is likely during the course of 1998-99, it is expected to be brought about through slower growth in sales rather than stronger investment in stocks.

Abstracting from asset sales, **public final demand growth** is expected to pick up in 1998-99 as a result of increased investment spending (including Olympics-related construction). The very strong headline growth forecast for public investment in 1998-99 reflects both this underlying investment growth and the impact of major public asset sales in 1997-98 such as the Dampier-Bunbury pipeline in Western Australia and the sale of spectrum by the Commonwealth Government, which acted to depress the headline measure of public investment in that year. Commonwealth investment in 1998-99 is forecast to be well up on its very low 1997-98 level, although still well below its 1996-97 level.

Gross agricultural product is forecast to increase by around 3 per cent in 1998-99, compared with the Budget forecast of a small fall. The improved outlook reflects higher crop production, particularly of wheat. Partly offsetting this, wool production is forecast to be lower than expected at Budget as producers continue to respond to low prices.

Labour Market

Employment is expected to increase by around 2 per cent in year-average terms in 1998-99, stronger than expected at Budget, reflecting the upward revision to the economic growth forecast.

Given the growth forecast, the outlook for employment growth and the unemployment rate will hinge on the rate of productivity growth and the participation rate, both of which are subject to considerable uncertainty. A cyclical slowing in productivity is expected after the recent period of very strong growth, consistent with the slowing experienced during the period of slower economic growth around 1995-96. The participation rate is expected to increase slightly in response to the recent improvement in employment opportunities, with the unemployment rate remaining around 8 per cent.

Wages

On a national accounts basis, wages growth in 1998-99 is expected to be in line with the forecast in the *Pre-election Economic and Fiscal Outlook* and broadly similar to wages growth in 1997-98, despite a very strong September quarter 1998. Over the course of the year, wages growth is expected to moderate slightly, reflecting weaker labour market conditions.

The uncertain external environment presents risks to the wages outlook in both directions. Further external shocks that impact negatively on growth could be expected to moderate wage pressures. On the upside, the prospective modest pick-up in inflation could feed more strongly into wage determination than currently expected. Strong wage rises being paid in some sectors, particularly construction, are less likely to flow through to other sectors. This reflects the impact of the *Workplace Relations Act 1996* and increased flexibility in wage determination arrangements, which ensure that wage rises better reflect the circumstances of individual firms.

Prices

The inflation rate is expected to rise over the coming quarters, returning to the monetary policy target range and rising to around 2½ per cent through the year to the June quarter 1999.

The forecast rise in inflation during 1998-99 primarily reflects the lagged pass-through into retail prices of the higher import prices over the past year or so, associated with the decline in the Australian dollar against the currencies of the major industrial countries. The year-average forecast for inflation in 1998-99 is lower than in the 1998-99 Budget, despite a lower exchange rate since then, reflecting a number of influences. Slower than expected world growth has depressed the world price of many goods which Australia imports, such as motor vehicles, while widespread domestic competitive pressures have dampened the pass-through of import prices into retail prices.

The Current Account

The current account deficit is expected to be slightly higher than previously forecast at around \$32 billion, an average of around 5½ per cent of GDP, in 1998-99. This forecast is below previous peaks and is underpinned by a stable domestic economy with a strong fiscal position, low interest rates and low inflation — a contrast to previous episodes of increases in the current account deficit when some or all of these factors led to problems that spilled over into the external sector. In 1998-99, a widening in the trade deficit flowing from weaker net exports and a deterioration in the terms of trade is expected. In addition, the net income deficit is expected to rise modestly in 1998-99 in response to an

increase in Australia's net external liabilities, which is expected to more than offset any positive impact from lower world interest rates.

Domestic Economy — 1999-2000

Growth in 1999-2000 in year-average terms is expected to be around 2¾ per cent, although strengthening gradually through the year, with growth through the year to the June quarter 2000 of around 3½ per cent. The expected gradual recovery in economic conditions in Asia, combined with the effects of continuing low interest rates and a competitive exchange rate, is expected to result in a slight strengthening in exports and plant and equipment investment. This is expected to be partly offset by slower growth in public investment and a fall in private non-residential construction due in part to the winding down of Olympic-related construction, and slower growth in dwelling investment.

Private consumption growth is expected to be similar in 1999-2000 to the previous year but below the very strong growth rate recorded in 1997-98. This reflects a range of factors including: weaker employment growth; the more moderate growth in housing investment, leading to slower sales of housing related consumer items such as furniture and white goods; weaker car sales; and a fading in the boost to consumption from the AMP demutualisation. Working in the opposite direction, the introduction of the Goods and Services Tax on 1 July 2000 is expected to result in some bring forward of consumption expenditure into the latter part of 1999-2000.

Inflation is expected to be around 2½ per cent in year-average terms in 1999-2000, although it could be a little higher in through the year terms in the latter quarters of 1999 as higher import prices eventually feed into retail prices.

The forecasts for 1999-2000 require assumptions about the timing and degree of a turnaround in world economic growth and the resulting confidence effects on Australian investors and consumers. The current episode is complicated by the wide global spread of financial instability, and the severity of the structural problems in a number of countries. Just as for 1998-99, there remains the possibility that stronger world growth, particularly in the US, together with sustained low domestic interest rates and a relatively low exchange rate may provide a greater than anticipated stimulus to growth.

As noted in the Government's paper on taxation reform, circulated in August 1998, the overall effects of the taxation reform package on economic activity during the transition phase surrounding the planned introduction of the GST on 1 July 2000 are likely to be small and dominated by the fiscal stimulus inherent in the package. While some components of activity are likely to be affected to some extent in 1999-2000, the overall impact on activity is expected to be positive but small, with the effects on individual components tending to work in offsetting directions. For example, consumption of currently relatively lightly taxed goods may be brought forward. On the other hand, there could be some deferral of business investment into 2000-01 when wholesale sales tax will be removed from business inputs reducing the cost of investment.

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 1998-99 and 1999-2000, and medium-term projections for the following two financial years. The projections for economic growth in the out-years 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	
	1998-99	1999-00	2000-01	2001-02
Real GDP	3 1/4	2 3/4	3 1/2	3 1/2
Employment(a)	2	1 1/4	2 1/4	2 1/4
Wages(b)	4	3 3/4	3 1/2	3 1/2
CPI	2	2 1/2	2 1/2	2 1/2

(a) Labour Force Survey basis.

(b) Average earnings (national accounts basis).

The medium-term projections do not at this stage reflect the price and activity impact of the taxation reform package. International experience indicates that, over the medium term, the GST is unlikely to lead to an increase in inflationary expectations and on-going inflation. In relation to activity, the implementation of the taxation reform package will increase GDP growth over a run of years, compared with what would otherwise be the case. Higher GDP growth has been reflected in the revenue projections in the taxation reform package, but not in other components of the budget at this stage.