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SE Money

HD **Familiar pattern to the year ahead**

BY David Potts

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Forecast home price rise Median house price increase

Sydney	5-7%
Melbourne	3-5%
Brisbane	5-7%
Perth	5-7%
Adelaide	0-3%
Canberra	0-3%
Hobart	3-5%
Darwin	5-7%

2014 is looking a lot like 2013, says David Potts.

TD

Take a deep breath, let it out slowly and before you know it the economy will be on its way again.

Sometime in the next few months unemployment should have peaked and by year's end interest rates will be on the way up again as growth lifts.

In between will be a nasty Budget in May.

Hmm, this year seems awfully familiar.

"Think of it as a V shape. The yearly average is the same going up as it is going down, but the trajectory is better," says Chris Caton, chief economist, BT Financial Group.

I think he means we'll be going in the right direction.

Growth

We left 2013 growing at about 2.3 per cent. Treasury says that will inch up to 2.5 per cent but the Reserve Bank and leading economists see 3 per cent as a possibility that would still be below the norm and wouldn't happen until much later this year.

Yet this will make more difference than you might think. That's because growth won't be coming from mining investment, but home building and household spending spurred on by record low interest rates and what you could call the feel-good factor of rising property and share values.

"Not many really experienced the mining boom. In fact, the two-speed economy seemed a disaster. But with a pick-up in retail sales, housing construction and tourism, more Australians will see it," says Shane Oliver, head of investment strategy and chief economist at AMP Capital.

The massive mining investment boom will bear fruit later this year. Instead of investing we'll be producing more, perfectly timed as the three biggest trading economies - the US, China and Japan - are improving.

The US is hitting its straps after five years of sub-par growth, thanks to a collapse in the housing market, and China's engineered slowdown from supersonic to just high-speed growth has made much less of a dent on commodity prices than was feared. Even Japan is finally dragging itself out of three decades of deflation, though there's a difference between getting inflation and growth.

Perhaps you've noticed the European debt crisis has gone strangely quiet, too.

So with the rest of the world moving in our favour, how come economists aren't more upbeat about 2014?

Because of the rundown of mining investment, which was the be-all and end-all of growth last year. And the year before.

Prices

You can say one thing for sub-par growth: it'll keep inflation at 2.5 per cent, though that disguises the fact that locally provided goods and services are running at a higher 3 to 4 per cent.

So will wages keep up?

Only just, I'm afraid. Real incomes won't be growing.

And the budget hole diggers will be growing faster than inflation.

School fees will rise at least 5 per cent. Why? Because schools can get away with it.

Health insurance - set in April - and costs will also soar, thanks to the ageing population.

It's a pity those 20 cents-a-litre discount supermarket shopper dockets you collected expire soon because the Australian Competition and Consumer Commission banned them from January 1. Petrol prices will rise as the dollar drops and stronger global growth pushes up crude oil prices.

You're not going to believe this but power will be the odd one out. The Australian Energy Market Commission is even predicting power prices will fall. The abolition of the carbon tax about July 1 when the new Senate sits will help.

Jobs

Since it takes at least 3 per cent growth all year to generate jobs, unemployment will rise.

Private-sector economists say the worst of the job losses will be concentrated in the next few months, peak at about 6 per cent and that by the end of the year the labour market will be on the mend.

But the Government says the worst hit will come later in the year when it will rise to 6.25 per cent and stay there for years to come.

"There would be more unemployment but for more people retiring," Oliver says.

Even so, an unsung feature of the workforce statistics is that the number who couldn't get a fulltime job peaked in June and has been falling ever since.

Other signs of unemployment defying the headlines about mass redundancies at Holden and Qantas are that more people have part-time jobs than they did a year ago, plus the number of hours worked has increased.

Then there's the recent Dun & Bradstreet survey of businesses that showed 10 per cent of them expect to hire this quarter while 5 per cent intend to shed staff. Last quarter it was the other way around.

"Not only are firms optimistic about expected sales, profits and selling prices but there is a clear uptrend now evident in expected capital expenditure and employment," Stephen Koukoulas, economic adviser to Dun & Bradstreet says.

And the best job generator of all, home building, is on the rebound.

'The pick-up in housing prices is flowing to new construction. And this will feed through to household spending," says HSBC Australia chief economist Paul Bloxham.

The dollar

There can't be an economist in the country who says the dollar will rise - proof that it can't be ruled out.

Still, logic suggests it will drop especially if it's being nudged down by the Reserve Bank.

Governor Glenn Stevens says US85 cents is "closer to the mark" of where the dollar should be.

And you don't want to mess with the Reserve.

In any case "the huge capital inflow that has been financing **mining** investment will dry up, which will weaken the dollar", Michael Blythe, chief economist at the Commonwealth Bank says.

Still, let's not kid ourselves: the dollar isn't about us, it's about everybody else.

Such as the US pulling back its money-printing stimulus which caused an unprecedented tide of liquidity, lifting all boats including commodity prices and everybody else's currencies.

The taper will boost the US dollar because fewer greenbacks will be printed, which will pull down the value of anything denominated in it, such as commodity prices.

So it's not a bad guess the dollar will be weak. George Boubouras, chief investment officer of **Equity** Trustees, says it's more likely to be closer to US80 cents. But then he's one of the few to tip another rate cut.

Rates

If growth isn't going to be all that much better this year, why are economists predicting higher interest rates? Oliver even expects two rapid-fire rate hikes around September.

The answer is they expect growth to pick up and the Reserve Bank will be keeping an eagle eye out for any stirring in inflation.

Don't forget that the dollar hovering around the 70s or 80s will lift import prices.

Bond yields have been rising, the market's way of saying it expects rates to rise.

Shares

By any stretch the sharemarket ran ahead of itself considering this year's likely economic growth.

Unless, that is, it's already looking towards next year, in which case it's probably fairly valued.

The trouble is the market will be vulnerable as the Fed's tapering, which began this month, proceeds.

Hang on, what's the Fed's tapering got to do with our market?

Almost everything. After all, the market didn't climb last year because it was expecting a surge in profits this year.

It sure won't be getting that. It climbed because of rising liquidity in the US which has spilled into other markets and assets offering better returns.

The Fed's stimulus is why global share prices have been pushed up, lifting our market's price/earnings (p/e) ratio to a smidgin over its long-term average, suggesting it's a bit expensive.

Still, households will be spending more, which will be good for sales, and the subdued labour market will keep wage costs in check.

"Better-quality growth will **lead** to profits rising and that will be good for the sharemarket. Rather than the price/earnings ratio rising we'll get better-quality gains," Oliver says.

Since the Fed is the biggest single buyer of US government-issue **bonds**, which pushes more money into the global financial system, reducing the purchases must depress bond prices.

As the price drops the yield rises because you get more bang from your interest buck.

Alas, rising bond yields are the biggest enemy of sharemarkets.

Despite the US Federal Reserve vowing to keep official interest rates near zero for as far as you can see, bond yields had begun creeping up as the taper came closer.

While the Fed's taper casts a shadow, it'll be ultimately good for sharemarkets by showing US economic growth has its own momentum.

Still, no matter how you look at it, the sharemarket will be tougher going.

"We've had the best part of the run," Caton warns.

We've probably seen the last of rate cuts and maybe even the best part of the dollar's drop.

"I'm normally ebullient but the low-hanging fruit has been picked. We've had a few good years since the GFC," says Elio D'Amato, chief executive of research house and fund manager Lincoln.

He tips the market will rise 10 per cent this year.

"Anything that disappoints - like QBE did last year - will get a violent reaction," he says.

Resource stocks were last year's duds, and with the drop in the dollar would appear to be bargain-priced. Or are they?

'They need the commodity cycle to ramp up and I can't see that happening in 2014. Global supply is increasing," D'Amato says.

Sectors likely to do best are gaming, telcos and retailers and insurance.

Home values

Without more borrowing by first-home buyers and upgraders the mini boom in property prices last year, especially in Sydney, will fizzle out.

A borrowing binge isn't going to happen when first unemployment is rising, and then interest rates.

Property was already slowing down towards the end of last year.

Australian Property Monitors forecasts an average 5 to 7 per cent rise in prices in Sydney, Brisbane and Perth, and 3 to 5 per cent in Melbourne.

With the general reluctance to get deeper into debt, the higher prices left over from last year will increasingly stretch the budgets of potential buyers to breaking point.

"Higher prices are causing more realism. There'll be a lot more supply over the year from units around the city," says Craig James, chief economist at CommSec.

Paul Bloxham

GDP Cash rate

2.8%

Up year end

Dollar US85c Shares 6100 Housing 8-10%

Michael Blythe

GDP Cash rate

2.75% Stable Dollar US89c Shares 5600 Housing 8%

George Boubouras

GDP Cash rate

3.1%

Drop 0.25% Dollar US80-85c Shares 6000 Housing 8%

Chris Caton

GDP Cash rate

2.5%+

Up 0.5% Dollar US84c Shares 5550 Housing 5-6%

Craig James

GDP Cash rate

3%+

Up year end Dollar US89c Shares 5600 Housing 3-5%

Shane Oliver

GDP Cash rate

3%

Up 0.5% Dollar US86c Shares 5800 Housing 6%

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