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What is the outlook for 2010-11? A SmartCompany Q&A

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Happy new financial year! As the calendar ticks over to July 1, entrepreneurs and investors all over Australia are starting the day with a renewed sense of energy and optimism. This is the year where the deals will flow, investments will rise and we'll finally put the GFC behind us...

...Well, that's the hope, anyway. The reality is that the Australian economy will still largely be in recovery mode throughout much of 2010-11, and the outlook for the global economy is fragile at best.

But things are definitely improving, and most smart entrepreneurs already have their sights firmly set on growth.

With this in mind, let's look at the outlook for Australia's key economic indicators, the sharemarket, the property market and even the political environment.

Time for a SmartCompany Q&A.

Let's start with the big picture. What is the economy likely do over the next 12 months?

Most economists forecast over calendar years, so we can actually look out a bit further than that. Economic growth for the 2010 year is expected to come in somewhere between 2.6% and 3%, a solid improvement from the 1.3% growth posted in 2009.

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In 2011, things will start to accelerate, with growth tipped to come in between 3.5% and 3.9%. If you want to take a very long-term view, ANZ is tipping growth of 4.1% in 2012.

Take me through some of the major economic forecasts. Let's start with interest rates.

Westpac is tipping the official cash rate will be a 5.25% at July 1, 2011, which is 75 basis points higher than the current rate and implies we are in for at least three rate rises over the next 12 months.

That will take the average variable mortgage rate to around 7.6%.

The two big things to watch here are inflation, which appears to be creeping upwards and could actually force more rate rises, and the global economic environment. If the global economy deteriorates, rates could stay on hold for longer periods than expected.

Hmm, no one likes rising rate. How about unemployment?

Reading in one direction – down. The unemployment rate is expected to fall 5.3% to about 5.1% over the next 12 months.

In other words, watch out for the war for talent.

What about the Aussie dollar?

Very hard to predict, as we've seen when the dollar has bounced from US81c to as high as US94c, back down to US81c and to the current level of US83c.

Most economists expect the dollar will strengthen over the next 12 months as the global economy recovers and demand for commodities increases. ANZ has the dollar at US94c this time next year, while Westpac expects the currency to be at US90c.

Not great for exporters. Will consumer spending start to pick up?

Not really. ANZ expects household consumption over 2010 will increase 2.4% in 2010, up from 1.8% growth in 2009. However, growth is expected to fall to 1.8% in 2011, which suggests that households will remain cautious and frugal for some months to come.

Not such good news. Will businesses start to invest again?

They will. ANZ says business investment will increase just 1.7% in 2010, but will accelerate to 13.9% in 2011 and to 14.9% in 2012.

However, it is worth noting that much of the investment will be driven by the mining sector, so businesses focused on the B2B sector shouldn't automatically expect that all their customers will be ready to spend.

What's the outlook for the sharemarket?

Very mixed, so it's worth putting a bit of context around this. The Australian sharemarket's benchmark S&P 200 index increased 8.76% during the 2009-10 year, which sounds okay but masks what has really been an ugly end to the year.

Since the market hit a 12-month peak of 5001.9 points on April 15 – above that psychological 5000-point level – it has been all downhill, with the market dropping 14% to end the year at 4301.5 points.

The European debt crisis, fears of a Chinese slowdown and the continuing economic malaise in the US have all made Australian markets very nervous.

So where to from here?

Given recent volatility that's very hard to say. The range of predictions from brokers is quite amazing – some have the market recovering to 6250 by July 2011, some have the market recovering to just 4500 and most are predicting a level somewhere around 5300 and 5500. The average from a 10 broker forecasts published in the *Australian Financial Review* was 5302, which suggests the market will rise 23.5% next year.

That would be a brilliant year. How does the outlook for the property market compare?

The housing market has enjoyed a pretty good year, although it has also seen some volatility. After house prices jumped by as much as 20% in 2009, cooling prices in the first half of the 2010 mean the growth rate during 2009-10 is likely to be around 12%.

Looking further ahead, the best predictions for the rest of 2010 suggest growth rates of between 5% and 8%.

So shares look like outperforming property in the next 12 months?

It looks that way, but let's take a bit more historical context here as well, courtesy of Alan Kohler on ABC Television, who showed a chart showing the returns from the following asset classes over the past five financial years:

- All Ordinaries up 2.2%
- House prices up 42.4%
- Gold up 326%

Wow, why should we bother about the sharemarket at all? Housing and property are the places to be.

Well, most financial planners would suggest that diversification is an important strategy for any investor, so I wouldn't be dumping the sharemarket entirely.

It's also worth pointing out that many pundits believe the jumps in both house prices and gold have been overdone, and both asset classes have a bubble feel to them. So don't just jump in blindly on the strength of these numbers – careful research and good advice are always essential.

I guess the other big factor in the next 12 months is the election. What's the outlook there?

Now that is a really hard question. With Julia Gillard riding a wave of goodwill, all the betting suggests Labor will retain power. Given the ALP does have a good advantage over the Coalition, that outcome seems likely – but it will be close and sentiment could change when we are in full campaign mode.

It will be very interesting to see how the business community leans come election time. While business has been unhappy with many aspects of the Labor Government – particularly around industrial relations, the mining tax and the emissions trading scheme – a Coalition win would actually probably mean more uncertainty, given there are likely to be big changes in a number of these areas.

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