

Electricity Transmission Revised Proposal

2008/09 – 2013/14

Appendix Q

Private Sector Inflation Forecasts



Mr Alastair Watson
Treasurer
SP Ausnet
Level 31, 2 Southbank Boulevard
Southbank Vic 3000

Re: CPI Forecasts

Alastair,

Further to our recent telephone conversation, ANZ Banking Group Limited provide you with the following information.

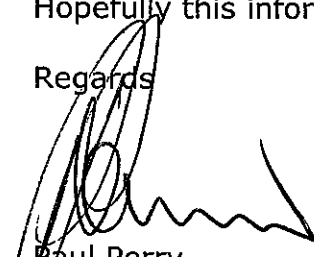
Our short term headline inflation forecasts are as follows:

Quarter	Headline	Quarterly % change	Year-end % change
Sep-07	158.9	0.9	2.1
Dec-07	160.2	0.8	3.0
Mar-08	161.3	0.7	3.7
Jun-08	162.2	0.6	3.0
Sep-08	163.4	0.7	2.8
Dec-08	164.5	0.7	2.7
Mar-09	165.6	0.7	2.7
Jun-09	167.1	0.9	3.0
Sep-09	168.5	0.9	3.1
Dec-09	169.6	0.7	3.1

We do not have a longer term forecast/projection to 2017 but we believe the middle of the RBA's target range is a reasonable basis for forming long-term inflation forecasts. The Treasurer and the Governor of the Reserve Bank of Australia reached an agreement in 1996 which was restated in July 2003 to keep consumer price inflation between 2 and 3 per cent, on average, over the cycle. This broad objective has also been adopted as ALP policy.

Hopefully this information assists.

Regards



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Economic Issues

CBA's CPI forecasts

CBA's forecasts for CPI inflation are 2.5% and 2.6% in 2007/08 and 2008/09 respectively.

Beyond 2008/09, we assume that CPI inflation will be 2.5%, ie in the middle of the RBA's 2-3% target band. The RBA's record is that in the period since 1993 when the RBA started inflation targeting the CPI, inflation has averaged 2.6%pa.

There is precedence for selecting a long term CPI inflation forecast that is close to 2.5%.

- Federal Treasury's medium term projections of CPI inflation, as outlined every year in the Budget, is 2.5%pa.
- A survey of Australia's leading economists by Consensus Economics show long run forecasts of CPI inflation is 2.6%pa for 2011-2017.

Given that the government has tasked the RBA to keep CPI inflation at 2-3% over the course of the economic cycle, it does not make much sense to have a long term forecast of inflation which is outside of the target. If the RBA believes that inflation will stay outside of the target band their record shows they will adjust interest rates to bring inflation back to target.

Joseph Capurso – Economist – 9312 0429 – joseph.capurso@cba.com.au

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18 September 2007

BY COURIER
SP AusNet
Level 31, 2 Southbank Boulevard
Southbank VIC 3006

Attention: Mr Alastair Watson

Dear Alastair

Please see our response below to your questions 1 – 4.

(1) A short term forecast of inflation.

Consumer price inflation over the four quarters to June was 2.1%. We expect it to reach 2.7% in the four quarters to December, and 2.9% over the four quarters of 2008.

(2) A longer term forecast/projection of inflation going out to the end of calendar year 2017. If you do not have a longer term forecast/projection can you (ie. the bank's economic area) please provide your opinion on whether you believe that the middle of the RBA's target range (keeping inflation between 2% and 3% on average over the economic cycle) is a reasonable basis for forming long-term inflation forecasts (say from 2012 to 2017)?

The only important variable that is explicitly targeted in the Australian system of economic management is consumer price inflation, which the central bank is required to maintain between 2% and 3%. In our view a long term consumer price inflation forecast of 2.5% is an eminently reasonable one. To have a markedly higher or lower forecast suggests an assumption that something will go radically wrong with economic management and the Australian economy. That assumption would need to be explained.

(3) Whether your forecasts are 'most likely' or are 'mean' forecasts. If your forecasts are of the 'most likely' outcome then whether you believe that the 'mean' forecast is above or below your forecast?

The short term forecasts are "most likely". In the context of a longer term forecasts, this distinction is meaningless

(4) Your opinion as to the impact of the RBA inflation target on the probability distribution for medium to long term inflation outcomes. Specifically, is it your opinion that the operation of RBA monetary policy means that the probability distribution of possible inflation outcomes has a relatively 'shorter tail' outside the RBA's target range than inside the RBA's target range?

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If it is the case, as it has become in Australia, that the central bank's target is a credible one, the departures from it become smaller and it is less expensive in terms of output volatility and quicker to bring inflation back within the target range. Furthermore, the RBA procedure is not to seek an average outcome of 2.5% but so far as possible to keep inflation within the 2% to 3% band (and preferably at the midpoint). It ought therefore be the case that over time inflation is more often within the band than without.

John Edwards

**HSBC Chief Economist Australia and New Zealand
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Long-term CPI Forecast

At the NAB, we do not generally forecast economic and financial data beyond a 2-3 year horizon.

For the CPI, our short term forecasts are as follows:

Australia - Growth	2005	2006	2007	2008	2007				2008			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
CPI headline - quarter%					0.1	1.2	0.4	0.2	0.6	0.6	0.6	0.6
CPI headline - annual %	0.8	1.0	2.0	2.2	2.4	2.1	1.6	2.0	2.5	1.8	2.0	2.4
CPI underlying - qtr%					0.5	0.9	0.7	0.6	0.7	0.6	0.6	0.7
CPI underlying - ann%	2.5	2.9	2.7	2.6	2.7	2.7	2.6	2.7	2.8	2.5	2.5	2.6

Beyond 2008, we assume that variables such as the CPI will approach their long-term average. Also, the RBA has a target for the underlying inflation rate of 2-3% over the medium term.

Hence we assume that the central bank is successful in achieving this goal and that the inflation rate averages around 2.5% over the longer term (ie the middle of the 2-3% target band).

Consensus Economics polls around 15-20 economic forecasters, and in their latest Long-term forecasts edition (April 2007), the forecast for inflation was an average of 2.6% from 2011 – 2017.

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18 Sept 2007

CPI Forecast and Comment

Alastair

Please see below, Westpac's response to your queries in regards CPI.

Short and Long term Forecasts

The following forecasts have been copied directly from Westpac's regular Economic publication, detailing GDP, Unemployment and CPI.

13 August 2007



Australian economic forecasts

	GDP % chg	Unemp %	CPI % chg
Quarterly actual			
Jun 2006	2.4	4.9	4.0
Sep 2006	2.4	4.7	3.9
Dec 2006	2.9	4.6	3.3
Mar 2007	3.8	4.5	2.4
Jun 2007	3.9 (f)	4.3	2.1

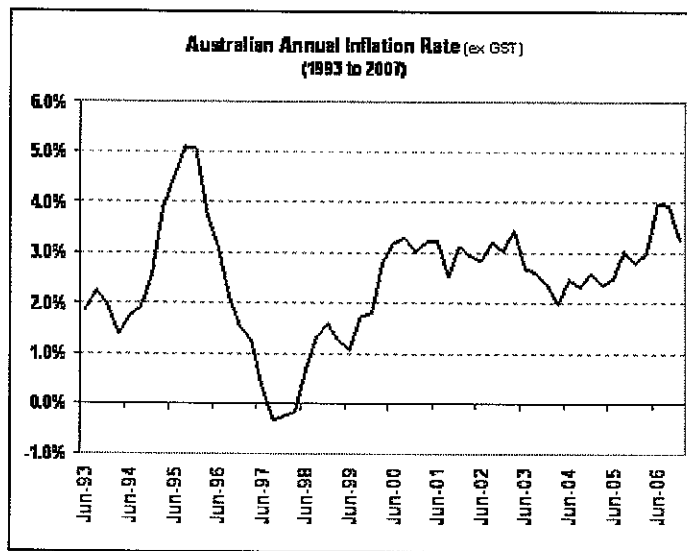
Quarterly forecasts			
Sep 2007	4.4	4.1	2.1
Dec 2007	4.6	4.2	2.7
Mar 2008	4.1	4.2	2.9
Jun 2008	4.5	4.2	2.6
Sep 2008	4.8	4.0	2.9

Calendar year actual**			
2002	4.1	5.4	3.0
2003	3.1	5.9	2.6
2004	3.7	5.4	2.3
2005	2.8	5.1	2.7
2006	2.7	4.6	3.5

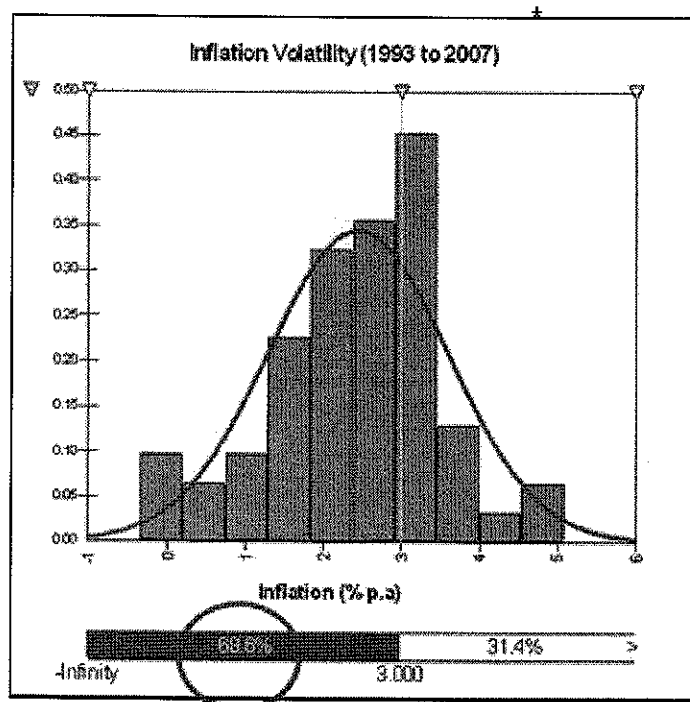
Calendar year forecasts - 5 years out**			
2007	4.2	4.5	2.3
2008	4.5	4.1	2.9
2009	3.5	4.3	2.5
2010	3.2	4.7	2.5
2011	3.2	5.0	2.5

As you can see, Westpac doesn't forecast beyond, 5 years, for CPI. However, in regards longer term expectations for CPI, Westpac would strongly expect that actual CPI outcomes, will 'mean revert' towards the historic mean of 2.45%, for periods beyond our forecast period.

In 1993, as you are aware, the Reserve Bank of Australia introduced a target range for the maintenance of inflation within a 2% to 3% band. As you can see from the chart and histogram, shown below, although Australia's inflation rate has been to higher levels than the top of the RBA's band, it has usually returned to levels more consistent with the middle of the RBA's target range over time.



* All CPI data has been normalised for the introduction of GST spike in 2000.

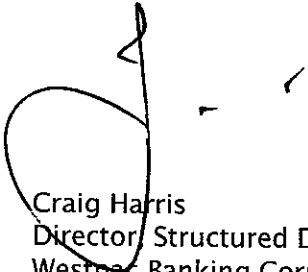


The Operation of the RBA's Monetary Policy, should ensure that the forecast probability distribution will be similar to the historic probability distribution that we've seen here in Australia for CPI.

Historic probability distribution as illustrated above, shows that only 31% of all outcomes since 1993, were above 3.00%.

If you have any further queries, please feel free to contact me.

Regards



Craig Harris
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