



FACULTY OF  
BUSINESS &  
ECONOMICS

# Melbourne Institute Monthly Bulletin of Economic Trends

May 2011



MELBOURNE INSTITUTE®  
of Applied Economic and Social Research



## Outlook for Australia<sup>1</sup>

	Actual				Forecasts				Actual	Forecast
	2010	2010	2010	2010	2011	2011	2011	2011	Calendar Year 2010	2011
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec		
<b>Economic Activity</b>										
GDP	2.4	3.2	2.7	2.7	2.6	2.3	2.9	2.8	2.7	2.7
	(0.6)	(1.2)	(0.1)	(0.7)	(0.5)	(0.9)	(0.7)	(0.7)		
Household Consumption	2.3	2.6	3.3	2.8	3.2	2.6	2.5	2.8	2.7	2.8
	(0.3)	(1.3)	(0.8)	(0.4)	(0.7)	(0.7)	(0.7)	(0.7)		
Private Dwellings	1.5	11.3	4.6	2.2	4.0	0.5	2.0	3.6	4.8	2.5
	(-1.3)	(4.3)	(-0.4)	(-0.4)	(0.5)	(0.8)	(1.1)	(1.2)		
Business Investment	-3.9	-1.6	3.5	-1.3	2.1	3.8	2.5	3.0	-0.9	2.8
	(-3.0)	(-0.5)	(2.1)	(0.3)	(0.3)	(1.1)	(0.8)	(0.8)		
Imports of Goods & Services	13.6	17.7	13.7	8.4	9.6	9.4	11.4	9.7	13.2	10.0
	(1.4)	(3.8)	(0.0)	(3.0)	(2.5)	(3.6)	(1.8)	(1.5)		
Exports of Goods & Services	3.3	8.5	4.2	5.1	7.0	2.5	5.8	3.8	5.3	4.7
	(-1.2)	(5.7)	(-2.3)	(3.0)	(0.6)	(1.2)	(1.0)	(1.0)		
<b>Inflation &amp; Financial Market</b>										
Underlying inflation <sup>2</sup>	3.0	2.7	2.5	2.2	2.3	2.5	2.6	3.0	2.6	2.6
	(0.8)	(0.5)	(0.6)	(0.3)	(0.9)	(0.7)	(0.7)	(0.7)		
Headline Inflation	2.9	3.1	2.8	2.7	3.3	3.5	3.6	4.0	2.8	3.6
	(0.9)	(0.6)	(0.7)	(0.4)	(1.6)	(0.8)	(0.8)	(0.8)		
90-day Bill Rate <sup>3</sup>	4.3	4.9	4.8	5.0	4.9	5.3	5.5	5.8		
Trade Weighted Index <sup>4</sup>	70.3	69.5	69.7	74.0	74.8	77.7	75.0	74.0	62.9	69.7
\$A/\$US rate (100) <sup>4</sup>	0.90	0.88	0.90	0.99	1.00	1.06	1.04	1.00		
<b>Labour Market</b>										
Unemployment Rate <sup>4</sup>	5.3	5.2	5.2	5.2	5.0	4.9	4.9	4.9	5.2	4.9
Employment Growth Rate <sup>5</sup>	1.8	2.4	3.1	3.4	2.9	2.4	2.1	1.6	2.7	2.3
	(0.9)	(0.7)	(0.8)	(1.0)	(0.3)	(0.3)	(0.5)	(0.5)		
Participation Rate <sup>4</sup>	65.3	65.4	65.5	65.9	65.8	65.9	66.0	66.0	65.5	65.9
Wage Price Index	3.0	3.0	3.5	3.9	3.8	4.0	4.0	4.2	3.3	4.0
	(1.0)	(0.8)	(1.1)	(1.0)	(0.8)	(1.0)	(1.1)	(1.2)		

1: Actual in black and forecasts in blue; values in parentheses are quarterly growth rates.

2: As measured by the Reserve Bank's trimmed mean measure of inflation.

3: Average over last month in quarter.

4: Average of 3-months in the quarter.

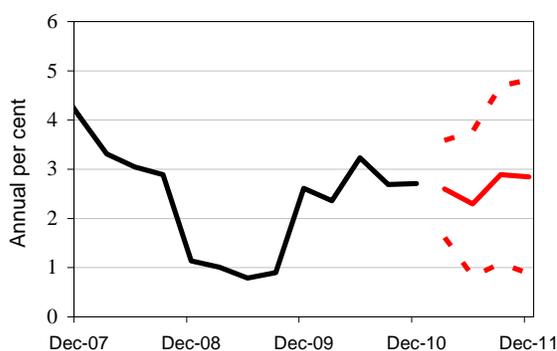
5: Calculated from quarterly employment numbers that are averaged over the 3 months in the quarter.

Prepared by G.Lim, M.Chua, E.Claus & V.Nguyen, Macroeconomics Research, Melbourne Institute

## Economic Activity

- We expect modest real GDP growth in 2011 and forecast quarterly growth of 0.5 per cent for the March quarter, 0.9 per cent for June and 0.7 per cent for the September and December quarters. This translates into 2.6, 2.3, 2.9 and 2.8 per cent year-on-year growth. (see Figure 1)
- We also expect moderate growth for 2012 in contrast to Treasury’s very strong 4 per cent growth for 2011-12 (see 2011-12 Budget, Statement 2 Table 1). To achieve the growth rate expected by Treasury, we need either a quarterly growth of about 1.1 per cent over the financial year or a strong rebound of around 1.4 per cent in September and December 2011 with more moderate growth of around 0.7 per cent for the remainder of the financial year. But where will the growth come from?
- Consider the four components of GDP: household consumption, government consumption, public and private investment and net exports (exports less imports). Household consumption is not likely to grow strongly over the forecast horizon. Despite low unemployment, consumers remain hesitant about purchasing consumer goods and services which suggest a fundamental change in consumer attitude away from accumulating debt toward paying off debt. In light of the desire for fiscal consolidation, government expenditures are also not likely to grow strongly while new signs of weakness in the global economy coupled with a very strong dollar render large positive contributions from net exports rather unlikely. This leaves only investment as the driver of growth.
- To be a driver of strong growth, business investment must record large rises given its relatively smaller share of GDP (about 15 per cent compared to about 55 per cent for consumption). Treasury forecasts business investment to grow 16 per cent in 2011-12. This is close to historical highs. (Figure 2) Business investment grew at an average of about 10 per cent per year between 2000 and 2008 and at about 13 per cent between 2006 and 2008. We are expecting an improvement in business investment, but at a more modest average rate of growth.

**Figure 1: Growth in real GDP (per cent)  
(actual and forecast)**



The dashed lines are the 90% confidence bands.

**Figure 2: Growth in Real Business Investment  
Financial Year (per cent)**

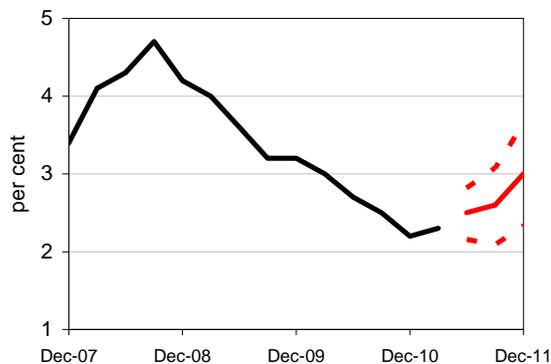


Source: ABS

### Inflation and Interest Rates

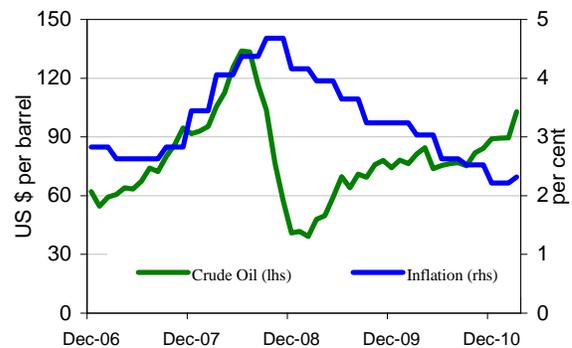
- The latest ABS report on the consumer price index showed that headline inflation rose 1.6 per cent in the March quarter 2011, following a rise of 0.4 per cent in the December quarter 2010. The year-end equivalents are 3.3 per cent and 2.7 per cent respectively. Underlying inflation, as measured by the trimmed mean fell to 2.3 per cent in the March quarter.
- In April, the TD-MI Inflation Gauge rose by 0.3 per cent, following a rise of 0.6 per cent in March. In the twelve months to April, the Inflation Gauge increased by 3.6 per cent. Contributing most to the overall change in April were price increases in health services, overseas holiday travel and accommodation as well as automotive fuel. These were mostly offset by falls in the prices of fruits and vegetables.
- Monthly consumer inflationary expectations for May fell further to 3.3 per cent from 3.5 per cent in April. The proportion of consumers expecting inflation to fall to within the RBA’s target band rose to 16.1 per cent in May from 12.9 per cent in April. This downward trend in inflationary expectations is likely to be associated with the downward movement in the prices of fruits and vegetables.
- Notwithstanding the falls in some components of the Consumer Price Index, the rise in the price of crude oil is likely to be passed through in the form of increases in transport and energy costs. This would put upward pressure on underlying inflation (see Figure 4).
- The Melbourne Institute expects underlying inflation to reach the upper end of the RBA target band by the end of 2011(Figure 3). The persistence rise in oil prices has led us to revise our forecasts upward.
- The Reserve Bank left the cash rate unchanged at 4.75 per cent for the sixth consecutive month in May. Reading between the lines of the minutes of the RBA monetary policy meeting, many market economists now expect the RBA to increase the cash rate in the June meeting. We view a June policy change as possibly a pre-emptive strike to keep a lid on domestic inflation. While we continue to forecast at least two rate rises, we are mindful of the fact that consumer confidence remains weak, and global financial conditions are still problematic.

**Figure 3: Trimmed mean CPI (actual and forecast)**



The dashed lines are the 90% confidence bands.

**Figure 4: Crude Oil and Underlying inflation**

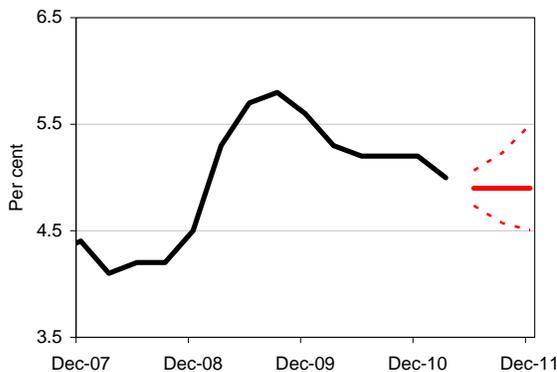


Sources: RBA and Federal Reserve Bank of St Louis

## Labour Market

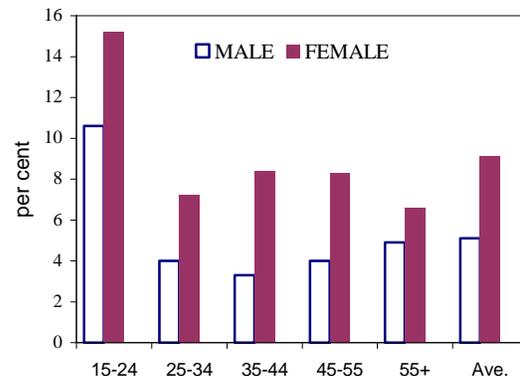
- In April, the ABS labour force statistics showed the unemployment rate to be steady at 4.9 per cent. The number of unemployed persons fell slightly by 1.7 per cent. However, further analysis did not offer encouraging news about movements between the states: employed, unemployed and out-of-the-labour-force.
- In net terms, the number of employed persons decreased by 22100 in April (the largest drop in two years) and there was a significant exodus of 31900 persons from the labour force (the largest number since 2006). This was what kept the unemployment rate on hold. Importantly, despite a large increase in part-time employment of 27000 persons (mainly females), there were even larger decreases in both males and females in full-time employment (ABS reported a total of 49100 persons, the largest number since 2009).
- What was more worrying was the deteriorating employment picture for the youngest group in the labour force, those aged 15-24. In particular, the number of employed persons in this group dropped for the fourth consecutive month (14000 persons, mainly in full-time jobs) and 14600 persons left the labour force following the March exits of 25000.
- Figure 6 displays the latest male and female UNDERemployment rates by age-groups. It clearly shows the underemployment of the 15-24 group to be almost double that of the other age-groups. Furthermore, the latest ABS underemployment statistics highlights the gaps between male and female underemployment rates. Are more females willing to be underemployed than to be unemployed?
- The current employment situation may be one of the driving forces behind the ‘*Building Australia’s Future Workforce*’ initiative in the latest government budget aimed at improving vocational education and training services.
- The Melbourne Institute forecast the national unemployment rate to remain at 4.9 per cent for the rest of the year (Figure 5). The ANZ job advertisement series continue to indicate growth in jobs, but the Westpac – Melbourne Institute Unemployment Expectations Index had been reporting concerns by households about employment prospect for two months, although it decreased by 3.0 per cent in May, reversing the increasing trend in March and April. On balance, there may be improvements in the employment outlook but perhaps, not for a while.

**Figure 5: Unemployment Rate (actual and forecast)**



The dashed lines are the 90% confidence bands.

**Figure 6: Underemployment Rates (by age group and by gender)**

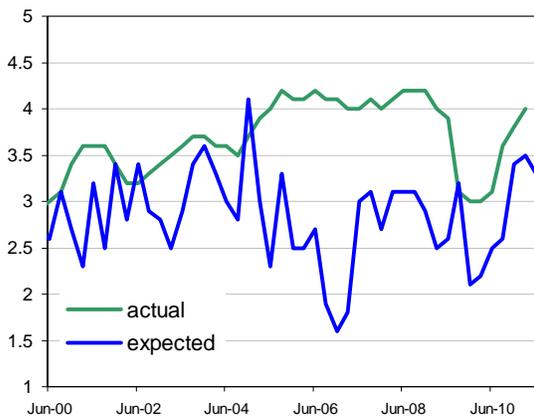


Source: ABS

**Will there be a wage break-out?**

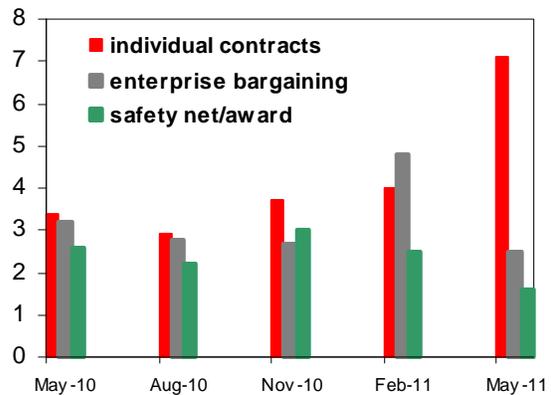
- In the next few months, more attention will be paid to the growth in wages, as there is growing concern about the negative effects of increases in the cost of labour. The ABS reports that, over the period March quarter 2010 to March quarter 2011, hourly rates of pay excluding bonuses grew by 4 per cent, compared to the 3 per cent over the previous March 2009 to March 2010 quarters.
- More up to date information from the May issue of the Melbourne Institute Wages Report indicated that total pay growth over the 12 months to May 2011 was 5.1 per cent while basic hourly wages rose by virtually the same amount, 5.0 per cent. While these rates of change are not directly comparable with the ABS estimates, they confirm one important point – wage growth is on the rise. More importantly, the similarity between the total pay indicator and the basic wage indicates that these increases are more a reflection of general inflationary pressures than a reflection of tightness in specific labour markets.
- Attention has also been drawn recently to the spread in wage growth among the industry groups. Workers in professional, scientific & technical services and in mining experienced a change in their hourly rate of pay (excluding bonuses) in excess of 4.5 per cent while workers in the service industries - rental, hiring, real estate, arts and recreation - experienced wage growth of only about 3.0 per cent.
- The worry is that these higher wages will become entrenched and insensitive to changes in the economic environment. At this stage, there is no evidence of unrealistic wage expectations. As reported in the Melbourne Institute’s Wages Report, the expected change in wages jumped from around 2.5 per cent in August 2010 to about 3.5 per cent in November 2010 and they have been around 3.5 per cent for the last 3 quarters. (Figure 7),
- However, we note one important development in wage expectations. The Wages Report also show the expected change in total pay disaggregated by individual contracts, enterprise bargaining and safety-net/award system. The latest information show that those on contracts expect to re-negotiate their wages and they have the highest expectation of a change to their wages. (Figure 8)

**Figure 7: Growth in Wages**



Source: RBA

**Figure 8: Expected pay change (in the next 12 months)**



Source: ABS

**Outlook for States**

	Actual				Forecasts				Actual	Forecast
	2010	2010	2010	2010	2011	2011	2011	2011	Calendar Year	
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	2010	2011
<b><i>New South Wales</i></b>										
Final Demand	4.0 (-0.1)	4.7 (0.9)	4.8 (1.3)	2.2 (0.0)	2.6 (0.4)	2.4 (0.7)	1.7 (0.6)	2.2 (0.6)	3.9	2.2
Consumption	2.0 (-0.5)	2.6 (1.3)	3.1 (0.9)	2.2 (0.5)	3.3 (0.5)	2.6 (0.7)	2.4 (0.6)	2.5 (0.6)	2.5	2.7
Unemployment Rate	5.5	5.4	5.2	5.0	4.9	4.9	4.8	4.9	5.3	4.9
Employment	1.5 (0.6)	-0.9 (0.5)	0.3 (1.2)	0.5 (1.5)	1.4 (0.6)	1.7 (0.4)	1.6 (0.3)	1.8 (0.3)	2.3	2.9
<b><i>Victoria</i></b>										
Final Demand	5.1 (0.9)	5.2 (1.7)	5.2 (0.2)	2.9 (0.2)	2.5 (0.5)	1.6 (0.8)	1.9 (0.5)	2.1 (0.4)	4.6	2.0
Consumption	2.5 (0.6)	2.7 (2.1)	4.1 (1.3)	4.1 (0.1)	4.1 (0.6)	2.7 (0.7)	2.0 (0.6)	2.3 (0.5)	3.3	2.8
Unemployment Rate	5.3	5.4	5.4	5.3	4.8	4.7	4.8	4.9	5.4	4.8
Employment	3.6 (0.7)	3.9 (0.6)	4.1 (1.1)	3.4 (1.0)	3.4 (0.8)	3.2 (0.3)	2.6 (0.5)	2.1 (0.4)	3.8	2.8
<b><i>Queensland</i></b>										
Final Demand	0.2 (-0.7)	1.5 (1.4)	1.7 (0.1)	1.5 (0.8)	2.7 (0.4)	2.3 (1.0)	3.0 (0.8)	3.0 (0.8)	1.2	2.7
Consumption	1.5 (0.6)	1.2 (0.2)	2.1 (0.4)	1.9 (0.7)	2.0 (0.7)	2.7 (0.9)	3.1 (0.7)	3.2 (0.8)	1.6	2.7
Unemployment Rate	5.5	5.5	5.4	5.7	5.5	5.2	5.2	5.2	5.5	5.3
Employment	0.7 (1.1)	2.7 (1.4)	2.6 (-0.1)	3.6 (1.2)	1.9 (-0.6)	1.4 (0.8)	2.2 (0.8)	1.9 (0.8)	2.4	1.9
<b><i>Western Australia</i></b>										
Final Demand	5.0 (1.6)	4.8 (2.1)	5.9 (-0.1)	3.1 (-0.4)	2.1 (0.6)	1.1 (1.0)	2.0 (0.8)	3.3 (0.8)	4.7	2.1
Consumption	4.4 (1.4)	5.2 (1.8)	4.8 (0.4)	4.3 (0.6)	3.7 (0.8)	2.9 (1.0)	3.3 (0.8)	3.4 (0.8)	4.7	3.3
Unemployment Rate	5.0	4.3	4.5	4.5	4.3	4.1	4.2	4.3	4.6	4.2
Employment	1.1 (1.1)	2.2 (1.1)	4.7 (1.2)	3.5 (0.0)	2.3 (-0.1)	1.9 (0.8)	1.6 (0.8)	2.1 (0.6)	2.9	2.0
<b><i>South Australia</i></b>										
Final Demand	3.2 (0.4)	4.4 (1.1)	2.7 (-0.6)	2.9 (1.9)	2.9 (0.4)	2.7 (0.9)	3.8 (0.6)	2.3 (0.5)	3.3	2.9
Consumption	2.3 (1.2)	2.4 (1.3)	3.4 (0.1)	2.7 (0.1)	2.1 (0.7)	1.5 (0.7)	2.0 (0.6)	2.5 (0.5)	2.7	2.0
Unemployment Rate	4.9	5.5	5.4	5.6	5.5	5.4	5.5	5.5	5.3	5.5
Employment	2.3 (1.4)	0.7 (-0.8)	2.2 (1.0)	1.9 (0.3)	0.7 (0.3)	2.2 (0.7)	1.5 (0.2)	1.5 (0.3)	1.8	1.5
<b><i>Tasmania</i></b>										
Final Demand	0.8 (-0.1)	0.3 (0.6)	2.7 (1.1)	3.4 (1.6)	3.8 (0.4)	4.0 (0.8)	3.4 (0.6)	2.2 (0.5)	1.8	3.3
Consumption	1.1 (-0.7)	-0.3 (0.4)	0.7 (0.3)	0.5 (0.5)	1.8 (0.6)	2.1 (0.7)	2.5 (0.7)	2.6 (0.6)	0.5	2.3
Unemployment Rate	5.8	6.2	5.8	5.3	5.9	5.5	5.4	5.3	5.8	5.5
Employment	-1.9 (1.3)	1.4 (0.8)	1.4 (0.1)	2.5 (0.3)	1.6 (0.4)	1.0 (0.1)	1.4 (0.5)	1.7 (0.7)	0.8	1.4

\*

## Around the world<sup>†</sup>

- Inflation pressures remain elevated in major economies. Some central banks have so far avoided substantial tightening in monetary policy further while others maintained their accommodative stances. This was mainly out of concern for stimulating the momentum in the economic recovery process.
- In the US, CPI inflation increased to 3.2 per cent year-on-year, the highest rate since October 2008. Rising gasoline prices were the main driver and, to a lesser extent, rising food price. However, the core inflation rate remained low at 1.3 per cent. This, coupled with an unemployment rate of 9 per cent may warrant monetary policy to remain accommodative for an extended period.
- In Europe, most of the Eurozone members, except for Portugal, posted higher economic growth in the first quarter of 2011 compared to the last quarter of 2010. While the core countries grew at a faster pace (1.5 and 1 per cent growth in GDP for Germany and France), the periphery's growth was considerably lower. The diverging performances of the core and the periphery in addition to rising inflation are points of concern. In the UK, the Bank of England has revised inflation forecasts upwards and growth forecasts downwards for 2011 and 2012.
- In Japan, the economy contracted 0.9 per cent in the first quarter of 2011. The monthly industrial production dropped 15.3 per cent in March (five times higher than the drop following the 1995 Kobe earthquake). The supply-chain disruptions and power supply constrains may also be the main reasons behind the year-on-year falls in exports (2.2 per cent) in March. Corporate and consumer confidence sled further in April. The repercussions of the disrupted supply chains in Japan are also starting to be felt in other major economies.
- In China, despite recent successive tightening measures the inflation rate only moderated slightly and remained relatively high at 5.3 per cent. The yuan broke past the 6.5 yuan per-dollar mark in April for the first time since 1993. This shows that the pressure to contain domestic inflationary pressures may have led policy makers in China to allow a strengthening in the yuan at a faster pace, in particular to curb price rises of imports such as fuel and food.

## International indicators

	Leading indexes: per cent growth rates				Coincident indexes: per cent growth rates			
	One month ago	Latest month		Annual rates (per cent)	One month ago	Latest month		Annual rates (per cent)
United States	3.8	3.1	Mar	Average	3.5	3.6	Mar	Average
Canada	-2.8	-1.2	Feb	Average	3.6	3.4	Feb	Slow/Average
Mexico	1.3	1.5	Feb	Average	3.3	3.0	Feb	Average
Germany	3.2	2.0	Feb	Average	6.8	7.0	Feb	Average
France	3.3	4.1	Feb	Slow/Average	3.3	4.6	Jan	Average
United Kingdom	-0.6	-1.0	Feb	Slow	1.6	0.4	Feb	Slow
Italy	-13.1	-9.9	Feb	Slow	1.2	1.1	Dec	Slow
Spain	-3.5	1.0	Feb	Recessionary/Slow	-3.0	-2.8	Feb	Recessionary/Slow
Switzerland	1.0	0.6	Feb	Slow	2.3	0.4	Dec	Slow
Sweden	-0.2	2.3	Feb	Average	12.0	11.4	Feb	Average
Japan	0.5	2.0	Feb	Recessionary	2.1	4.4	Feb	Recessionary
China	3.4	5.1	Feb	Average	8.7	8.2	Feb	Average
India	2.9	4.3	Feb	Average	1.1	-2.2	Dec	Average
South Korea	10.2	5.8	Feb	Average	5.8	3.5	Feb	Slow/Average
Taiwan	20.4	18.3	Feb	Average	16.2	9.6	Feb	Average
New Zealand	-5.6	-4.9	Feb	Recessionary	-1.4	-1.1	Dec	Recessionary

Source: Economic Cycle Research Institute, *International Cyclical Outlook*, April 2011

<sup>†</sup> This is an extract from the *Westpac – Melbourne Institute Indexes of Economic Activity*, May 2011

Monthly Bulletin of Economic Trends – May 2011

	Precision of Forecasts				Calendar Year 2011
	2011	2011	2011	2011	
	Mar	Jun	Sep	Dec	
<b>Australia</b>					
<i><b>Economic Activity</b></i>					
GDP	0.6	0.9	1.1	1.2	0.7
Consumption	0.5	0.8	1.0	1.1	0.7
Dwelling	2.3	2.4	2.5	2.8	1.9
Business Investment	5.2	6.0	6.7	7.5	4.6
Import	2.5	4.2	5.8	6.6	3.7
Export	2.6	3.4	4.0	4.4	2.9
<i><b>Inflation &amp; Financial Market</b></i>					
Underlying Inflation		0.2	0.3	0.4	0.3
Headline Inflation		0.5	0.7	0.9	0.6
90 day bill		0.5	0.7	0.9	0.6
Trade Weighted Index		3.7	3.9	4.5	2.3
<i><b>Labour Market</b></i>					
Unemployment Rate		0.1	0.2	0.3	0.3
Employment		0.2	0.4	0.6	0.5
Participation Rate		0.1	0.2	0.3	0.3
Wage Price Index		0.3	0.4	0.4	0.4
<b>States</b>					
<i><b>New South Wales</b></i>					
Final Demand	1.0	1.5	1.9	2.3	1.0
Consumption	0.7	1.1	1.4	1.6	0.5
Unemployment Rate		0.2	0.3	0.5	0.1
Employment		0.5	0.8	1.1	0.3
<i><b>Victoria</b></i>					
Final Demand	1.2	1.7	2.3	2.7	1.1
Consumption	0.7	1.0	1.4	1.7	0.6
Unemployment Rate		0.3	0.5	0.6	0.2
Employment		0.5	0.8	1.1	0.4
<i><b>Queensland</b></i>					
Final Demand	1.4	2.0	2.5	3.0	1.4
Consumption	0.8	1.2	1.6	2.1	0.8
Unemployment Rate		0.3	0.5	0.7	0.2
Employment		0.8	1.0	1.4	0.4
<i><b>Western Australia</b></i>					
Final Demand	2.1	2.9	3.9	4.6	2.2
Consumption	0.9	1.3	1.6	1.9	0.9
Unemployment Rate		0.3	0.5	0.7	0.2
Employment		0.8	1.0	1.4	0.5
<i><b>South Australia</b></i>					
Final Demand	1.4	1.9	2.3	2.7	1.5
Consumption	0.9	1.3	1.6	1.9	1.1
Unemployment Rate		0.1	0.3	0.5	0.2
Employment		0.5	0.7	1.0	0.5
<i><b>Tasmania</b></i>					
Final Demand	2.5	2.9	3.3	3.7	2.2
Consumption	1.0	1.5	1.7	2.0	1.2
Unemployment Rate		0.3	0.5	0.6	0.3
Employment		0.9	1.1	1.5	0.7

**Melbourne Institute  
Monthly Bulletin of Economic Trends**

The *Melbourne Institute Monthly Bulletin of Economic Trends* provides forecasts of the state of the Australian economy. Variables forecasted include: the growth in GDP, consumption and the unemployment rate as well as the outlook for inflation, the 90-day bill rate and the exchange rate. The forecasts are generated using econometric techniques which combine both historical information and forward information contained in, for example, consumer expectations, leading indexes of economic activity, and financial futures. The monthly updates of forecasts four quarters ahead provides timely on-going information in advance of official quarterly data.

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For information on the data contained in the report contact the Melbourne Institute, The University of Melbourne, on (03) 8344 2196.

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