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Special Article

The Australian Economy in 2023–24: Navigating a Narrow Path

Viet Nguyen*, Tim Robinson and Sarantis Tsiaplias

… [T]he narrow path the Reserve Bank Board is seeking to navigate … is one where inflation returns to target within a reasonable timeframe, while the economy continues to grow and we hold on to as many of the gains in the labour market as we can. It is still possible to navigate this path … But it is a narrow path and likely to be a bumpy one, with risks on both sides.

(Reserve Bank Governor, Philip Lowe 7 June 2023)

Abstract

The economy grew at a moderate pace in 2022–23 as Australians adjusted to rising costs of living. The aggressive tightening of monetary policy has eased inflationary pressure, but inflation remains high. Strong labour market performance has been the brightest note in the current Australian macroeconomic landscape, although labour productivity growth was disappointing. The ongoing geopolitical conflict in Europe with its ensuing geoeconomic fragmentation, and the recent conflict in the Middle East increased global uncertainty and volatility in food and energy prices. This, together with the slowdown in China, added further downside risks to the outlook for the economy in 2023–24.

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1. Introduction

The Australian economy grew in 2022–23, although at a more moderate pace as tightening monetary policy filtered through to domestic demand to rein in inflation. Headline inflation peaked at 7.8 per cent in December 2022 but eased to 5.4 per cent in September 2023. Underlying inflation (trimmed mean measure) decreased from its peak of 6.8 per cent in December 2022 to 5.2 per cent in September 2023, but remained well above the Reserve Bank of Australia's (RBA) 2 to 3 per cent target band.

The RBA continued to tighten monetary policy with five more intereset rate rises in 2023, along with six rate pauses between April and December 2023. The cash rate rose by a total 125 basis points in 2023, to 4.35 per cent in December 2023. High inflation and high interest rates have translated into rising costs of living and the RBA continues to assess risks to keep the economy on a narrow path of reducing inflation, maintaining economic growth, and keeping as much of the employment gains as possible—the ‘soft-landing’ scenario.

The economy grew by 3.1 per cent in the 2022–23 financial year, down from 4.3 per cent in 2021–22. Over the calendar year, the economy is projected to grow by 1.8 per cent in 2023 and 1.3 per cent in 2024 (Table 1).

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Table 1 Indicators of Australian Activity (%)

		2024[a]		
	2023[b]	MI[c]	Low[d]	High[d]
GDP	1.8	1.3	0.8	2.1
Consumption	1.7	1.2	0.4	2.5
Domestic final demand	2.0	1.5	–	–
Unemployment rate	3.8	4.2	4.1	4.5
Employment growth	2.8	1.4	–	–
Wage Cost Index	3.8	3.8	3.6	4.1
Headline inflation	5.7	3.6	3.0	4.0
Underlying inflation	4.1	3.2	–	–
90-day bill rate[e]	4.4	4.1	3.5	4.4

[a] Forecasts.
[b] Estimates.
[c] MI denotes Melbourne Institute.
[d] Based on forecasts published in Consensus Forecasts, December 2023.
[e] As at end of year.
Source: Melbourne Institute and Consensus Economics.

Growth in domestic final demand slowed to 3.5 per cent in 2022–23 from 5.5 per cent in 2021–22. In calendar year terms, domestic final demand is projected to grow by 2.0 per cent in 2023 and 1.5 per cent in 2024, reflecting the slowdown in private demand with rising interest rates.

Labour market conditions were tight throughout 2023. The unemployment rate averaged around 3.6 per cent while the participation rate averaged around 66.8 per cent. Tight labour market conditions have translated into stronger nominal wage growth. However, in real terms, wage growth remained negative along with a fall in labour productivity, implying a decline in living standards for Australians.

The growth prospects for the Australian economy in 2024 are moderate with the balance of risks tilted to the downside. On the domestic front, inflation is likely to moderate further over the coming year. However, according to the RBA's projection (Bullock 2023a), inflation is unlikely to return within the RBA's 2 to 3 per cent target band before the end of 2025. This implies that the probability of further rate rises is not negligible.

Australian households have been experiencing a considerable squeeze on finances due to high inflation and high interest rates. As such, Australians have been deeply pessimistic, reporting sustained weakness in their finances. This, together with low real wage growth, will likely translate into ongoing weakness in consumption in the coming year, posing a considerable risk to prospects for growth.

On the international front, geoeconomic fragmentation and geopolitical tension have increased volatility in food and energy prices. This has added further to the RBA's challenge of bringing inflation back to the target band. Importantly, China is facing headwinds from its struggling property sector and low consumer confidence. If China's property sector crisis deepens, this will have adverse impacts on its economy and those of commodity exporters, including Australia.

As inflationary pressures have moderated across major developed economies, their tightening cycles are probably close to their peaks. The International Monetary Fund (IMF) projected global economic growth to slow a little further in 2024, to 2.9 per cent from 3.0 per cent in 2023 and 3.5 per cent in 2022 (IMF 2023). This, in part, is due to lags in the impacts of the global tightening cycle of monetary policy.

As in previous Reviews, Section 2 reviews major developments in the global economy, particularly uneven growth across the global economy in 2023 and the possibility that policy interest rates in advanced economies may stay higher for longer as headline and core inflation are not expected to return to targets until 2025.

Section 3 summarises developments in the domestic economy, with a particular focus on the state of the household sector, which is more vulnerable to downside risks than it was a year ago. Section 3 also discusses current wage growth and its longer-term prospects.

Section 4 provides some concluding remarks with a focus on the downside risks to Australian growth in 2024. We highlight the important coordination of monetary and fiscal policies to keep the Australian economy on the narrow path ahead amid rising global

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economic uncertainty stemming from ongoing geopolitical tensions.

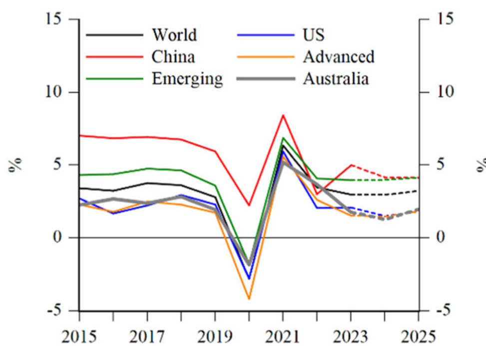
2. International Influences

Global economic growth is slowing but remains solid (Figure 1). The IMF in its recent World Economic Outlook (IMF 2023) anticipates that the global economy will grow by 3 per cent in 2023, down from 3.5 per cent in 2022. It is then expected to slow only moderately further in 2024 (2.9 per cent).

The slowdown in 2023 has not been even across nations. It has been most pronounced in the advanced economies—particularly the Euro Area, United Kingdom and Canada, whereas in emerging markets and developing countries overall it has been marginal. China persisted with a zero COVID policy beyond other nations, and its subsequent recovery, while continuing, has been sluggish. Also, while growth slowed in India, there is an anticipated increase in activity in Russia.

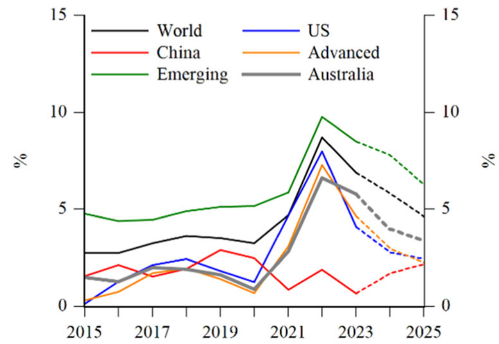
The sharp tightening in monetary policy that commenced in 2022 in many nations is an important contributing factor to the slowing global growth. It has also contributed to falling headline inflation (Figure 2), which was elevated in 2022 due to increases in energy prices stemming from the war in Ukraine as well as tight labour markets in some advanced economies, such as the United States.

Figure 1 Global Economic Growth (Annual, %). *Notes:* Dash lines for forecasts.



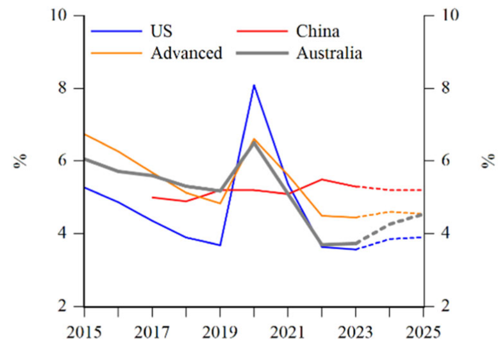
Source: IMF.

Figure 2 Headline Consumer Inflation (%). *Notes:* Dash lines for forecasts.



Source: IMF.

Figure 3 Unemployment Rate (%). *Notes:* Dash lines for forecasts.



Source: IMF.

Global core inflation was little changed in 2022. The IMF anticipates a sizable decline in 2023 for the advanced economies, although labour markets in several developed nations—such as the United States—while softening, have displayed considerable resilience (Figure 3). Expectations of a need for policy rates to be 'higher for longer' to lower inflation have arisen. However, for the United States, in the economic projections accompanying the Federal Reserve's December 2023 meeting, several cuts in 2024 were anticipated.

Yields on long government bonds have increased sharply in the United States since July, which has had spillover effects to other

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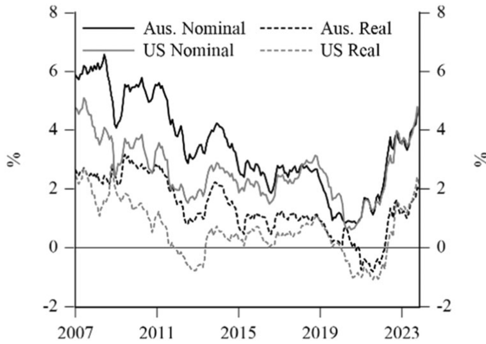
Figure 4 Nominal and Real 10-Year Government Yield (%). ***Notes:*** **Australian indexed bond yields are for bonds possessing the longest time to maturity. US yields are constant maturity.**



Source: RBA and Federal Reserve Board of Governors.

countries, including Australia (Figure 4). These higher yields represent a tightening in financial conditions. The increase in the United States, rather than being mainly driven by near-term inflation prospects, has been attributed by US Federal Reserve Board Governor Powell to factors that possibly include greater concerns over fiscal deficits and an increase in the term premium (Cranston 2023).

Indeed, yields on indexed bonds have moved considerably higher. The IMF has highlighted a need for fiscal policy to be more aligned with monetary policy, particularly in the United States, and that '… fiscal policy everywhere should focus on rebuilding fiscal buffers that have been severely eroded by the pandemic and the energy crisis …' (Gourinchas 2023).

Core inflation—in year-average terms—in emerging and developing countries is expected by the IMF to be little changed in 2023. Experiences amongst these countries varies greatly. At one extreme, Turkey continues to have extremely high inflation, although since mid-2023 its central bank has sharply increased its policy rate. Meanwhile, core inflation in China, due to the sluggish recovery, has been very weak.

The Chinese property sector remains an important risk for global growth. As discussed in Tsiaplias and Wang (2023), with the property market in 2020 running very hot, regulation was subsequently introduced to decrease speculation and to cause developers to moderate leverage, thereby lessening financial risks. The direct impacts of financial distress in the property sector on growth may be relatively large in China compared to other nations as construction plays a substantial role in underpinning economic activity. Spillover effects to the shadow banking sector are possible, and uncertainty about the property market may well be dampening household consumption growth.

Chinese policymakers have responded by introducing measures to support the property market, such as relaxing credit policies for households. The People's Bank of China also provided guidance to banks to lower interest rates on existing first-home owner mortgages, presumably to support consumption growth, and has eased monetary policy (see RBA 2023).

Additionally, the Chinese economy faces a significant youth unemployment problem. The overall unemployment rate has declined from around 5.5 per cent at the beginning of 2023 to be approximately 5 per cent, whereas the youth unemployment rate reached 21.3 per cent in June (see Feng et al. 2023). This increase reflects both demand and supply factors and is contributing to the considerable uncertainty in the outlook for household consumption growth in China.

Looking ahead, both the IMF and the OECD highlight that potential growth in many nations is slowing and there exists a need for further supply-side policy responses to address this (IMF 2023; OECD 2023).

2.1 Australian Terms of Trade and Trade B

Australia's terms of trade—the ratio of export to import prices—is heavily influenced by developments in commodity prices. The disruptions to energy markets in 2022 stemming from the war in Ukraine boosted Liquefied Natural Gas (LNG) and thermal coal prices, which are major exports for Australia. Australia's terms of trade rose strongly and reached a historical high in Q2

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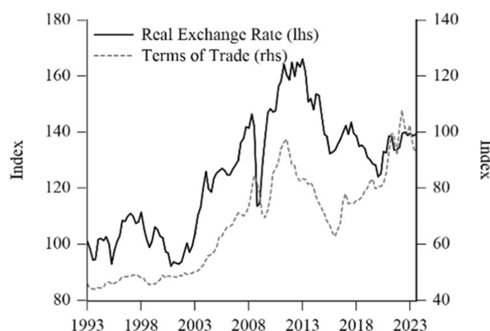
Figure 5 Real Exchange Rate (lhs, Index) and Terms of Trade (rhs, Index). ***Notes:*** **Terms of Trade are 2020–2021 = 100; real-trade weighted exchange rate is March 1995 = 100.**



Source: ABS and RBA.

2022 (Figure 5). The unwinding of global energy prices in 2023 has weighed on Australia's terms of trade and in the September quarter they were 9.0 per cent lower than a year ago.

The Australian dollar is typically thought of as a commodity currency and co-moves strongly with the terms-of-trade, thereby moderating their real impacts. The real depreciation, which has occurred in this instance, however, has been negligible (Figure 5).

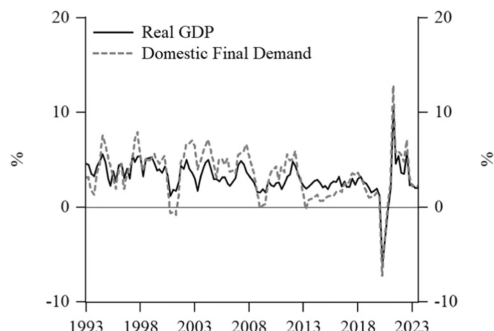
Australia's exports of goods and services rebounded relatively strongly in 2022–23. Exports grew by 6.7 per cent, up from a fall of 0.5 per cent in 2021–22 while imports grew by 9.2 per cent, up from 6.9 per cent in 2021–22. Exports grew solidly in the June quarter of 2023; of particular note was very strong growth in service exports, with travel exports, including personal travel and education, an important contributing factor. This continued in the September quarter of 2023, although total exports declined due to lower goods exports as growth in global demand weakened.

3. Australia

3.1 Overall Economic Growth

Australian economic growth weakened markedly in the 2022–23 financial year, following

Figure 6 Real GDP and Domestic Final Demand Growth (Year-Ended, %).



Source: Australian Bureau of Statistics (ABS).

a strong rebound in 2021–22 (4.3 per cent). Nevertheless, an annual growth rate of 3.1 per cent in 2022–23 is still considerably higher than the average annual growth rate of 2.6 per cent post-GFC and pre-COVID. The year-ended growth rate has slowed to 2.1 per cent in September 2023 from a recent peak of 5.8 per cent in September 2022 (Figure 6).

Weaker economic growth in 2022–23 resulted from a strong decline in dwelling investment and weaker household consumption growth in the last two quarters of the 2022–23 financial year. This reflected Australian consumers' adjustments to considerably higher inflation and interest rates.

Growth in private investment slowed considerably to 0.8 per cent in 2022–23 from 7.5 per cent in 2021–22 due to a sharp decrease in dwelling investment (see Section 3.3). Private business investment remained strong in 2022–23, growing by 6.7 per cent, driven mainly by non-mining investment (up by 10.9 per cent). Mining investment grew by 1.6 per cent. Strong business investment growth offset the sharp fall in dwelling investment, keeping overall investment growth positive at 1.9 per cent in 2022–23, down from 7.1 per cent in 2021–22. Business investment in 2024 is likely to be weaker with an expected growth rate of 1.6 per cent; see the latest forecasts in Consensus Economics (2023).

Domestic final demand growth slowed to 3.5 per cent in 2022–23, down from a strong post-COVID rebound of 5.0 per cent in

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2021–22. This reflected the downward pressure on household consumption and dwelling investment from higher interest rates and higher inflation. Nevertheless, 3.5 per cent is still its second strongest read since 2011–12 (5.4 per cent), and above the average of 2.4 per cent between 2010–11 and 2018–19 (post-GFC and pre-COVID).

In per-capita terms, annual GDP growth slowed to 1.0 per cent during the 2022–23 financial year, following an increase of 3.7 per cent in 2021–22. This decline, in part, is attributable to a strong increase in the population (625,000 people in the 2022–23 financial year with 83.0 per cent of this increase coming from net overseas migration). The migration intake is well above the average annual population increase of 370,000 pre-COVID and a total of 328,000 in 2021–2022.

Annual growth in GDP per capita in 2022–23 was around its post-GFC average of 1.1 per cent, which is much lower than the pre-GFC average of 2.3 per cent (Figure 7). This decline is due to both lower economic growth and stronger population increase in post-GFC. Average annual economic growth slowed from 3.6 per cent pre-GFC to 2.5 per cent post-GFC while Australia added an average of 342,000 people per year post-GFC, up from 242,000 people pre-GFC. This indicates a decline in the average rate of improvement of living standards. Indeed, Australia currently is in a per capita recession (MI 2023).

In 2024, the IMF forecasts Australian output growth to fall to 1.2 per cent in 2024, followed by a moderate rise of 2.0 per cent in 2025. These estimates take into account growing uncertainties from geopolitical tension, geoeconomic fragmentation and China's loss of momentum (IMF 2023).

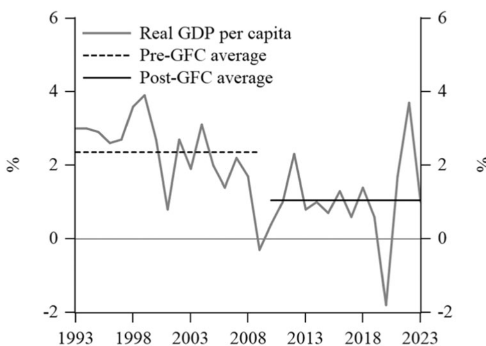
3.2 Household Consumption and Savings

Household consumption grew strongly by 5.1 per cent in 2022–23, up from 4.3 per cent in the previous financial year. This strong household consumption growth amid aggressive monetary policy tightening was due to a combination of several factors.

Firstly, monetary policy usually operates with long and variable lags (for international and Australian evidence, see for example, Havranek and Rusnak 2013; Gruen, Romalis and Chandra 1997).

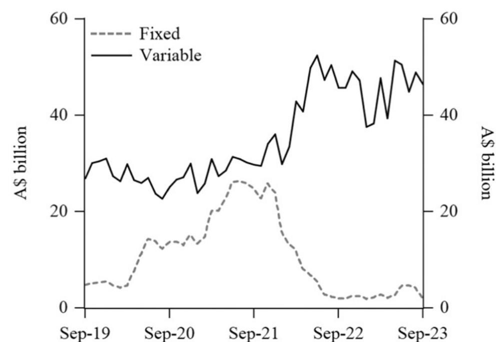
Secondly, around 40 per cent of Australia's home loans were on low fixed rates in 2022, and this delayed the effect of the higher interest rates on borrowers' cash flows (Lovicu et al. 2023). Figure 8 shows that the amount of new home loans (including refinancing) on fixed mortgage rates rose strongly in 2020 as the cash rate hit its record low of 0.1 per cent and subsequently dropped as the cash rate rose sharply in 2022.

Figure 7 Growth in Real GDP Per Capita (Annual, %).



Source: ABS.

Figure 8 New Home Loan Commitment (Monthly, Including Refinancing, A$ Billion).



Source: ABS.

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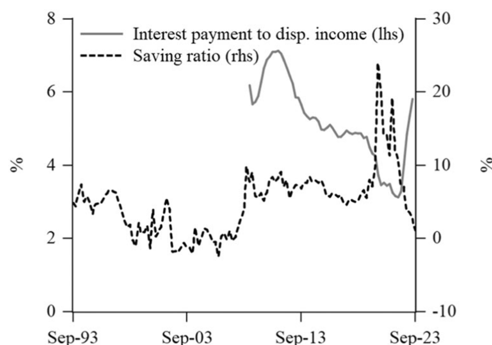
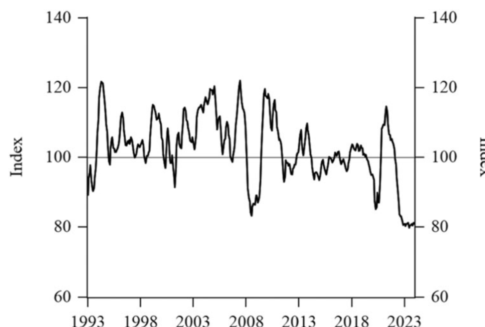
Figure 9 Interest Payment as Share of Disposable Income (lhs, %) and Saving Ratio (rhs, %).



Source: ABS.

Figure 10 Consumer Sentiment Index (3-Month Centred Moving Average, Index). ***Note:*** **A reading above (below) 100 indicates optimism (pessimism) with 100 being the neutral mark.**



Source: Melbourne Institute.

Thirdly, the ratio of household liquid assets to household income in Australia has increased substantially over recent decades (Wang 2022). Particularly, Australians built up a sizable savings buffer during the COVID pandemic (Figure 9). This allowed households to smooth their spending and maintained their debt payment obligations in the event of adverse shocks to their cash flows, such as the steep increase in interest rates since May 2022.

Tight labour market conditions with improving wage growth was another factor supporting household consumption in 2022–23. However, household consumption growth is showing signs of weakening as consumers adjust to higher cost of living and interest rates. Year-ended growth in household consumption decreased from a high of 11.8 per cent in September 2022 to 0.4 per cent in September 2023. Consumers have cut spending on durables (furnishings and household equipment) and recreation and culture. Year-ended growth rates in these spending categories were −4.6 and −5.4 per cent in September 2023.

Consumer sentiment rebounded strongly in 2021 as the economy opened up post-COVID but has declined into pessimistic territory (below the 100 neutral mark) since March 2022 (Figure 10). Consumers are even more pessimistic now than they were during the GFC and COVID pandemic. This, together with a dwindling household savings buffer (the saving ratio was 1.1 per cent in September 2023), suggests that growth in household consumption is likely to weaken further in 2023–24.

3.3 Dwelling Investment and Housing

In 2020–21 and 2021–22, dwelling investment rebounded strongly, growing by 3.8 and 2.6 per cent, respectively, following a strong decline of 7.3 per cent in 2019–20. The strong rebound in dwelling investment in 2020–21 and 2021–22 is consistent with existing evidence that housing markets respond strongly to lower interest rates (Lim and Tsiaplias 2018). As interest rates increased in mid-2022, dwelling investment fell significantly, by 4.0 per cent in 2022–23.

Together with interest rates, population growth is another important factor influencing dwelling investment. Figure 11 shows that the volatility in dwelling investment growth reduced significantly from around 2004. This is likely to be partially attributable to stronger population growth, particularly overseas migration. Stronger population growth translated into stronger and sustained housing demand, reducing volatility in dwelling investment. Average year-ended population growth since 2005 is 1.5 per cent, up from 1.1 per cent in the preceding decades, while net overseas

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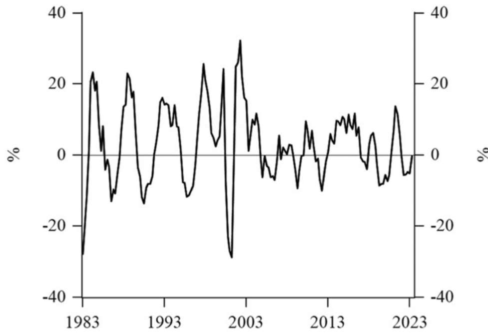
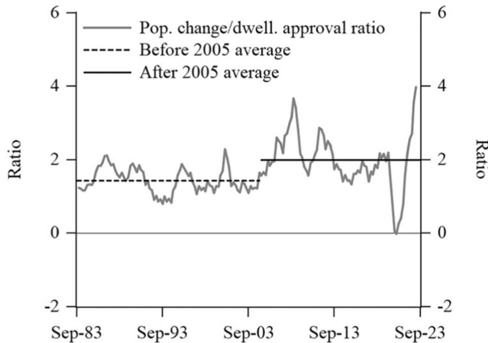
Figure 11 Dwelling Investment Growth (Year-Ended, %).



Source: ABS.

Figure 12 Population Change to Dwelling Approvals Ratio (3-Quarter Centred Moving Average).

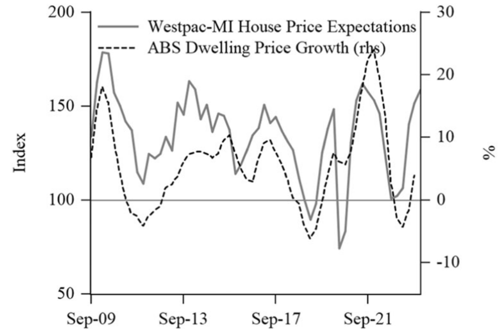


Source: ABS and authors' calculations.

migration doubled to an average of 50,000 people per quarter from 2005 onwards, up from an average of 24,000 before 2005.

Strong population growth and declining dwelling investment have raised concerns about worsening housing affordability in Australia. Figure 12 plots the ratio of population change to dwelling approvals, a measure that approximates excess housing demand relative to housing supply. Despite the strong decline in the ratio during COVID, (due to the decline in population growth), its average increased from 1.5 in the pre-2005 period, to 2.0 from 2005 onwards. This long-term indication of excess housing demand is likely the key driver of elevated house prices and worsening housing affordability.

Figure 13 House Price Expectations (lhs, Index) and Growth in Dwelling Prices (rhs, Year-Ended, %). ***Note:*** **the ABS Dwelling Price growth is constructed from the discontinued ABS Residential Property Price Indexes and the current ABS Dwelling Prices.**



Source: ABS, Melbourne Institute.

On 16 August 2023, Prime Minister Albanese announced a plan by the National Cabinet to build an extra 1.2 million houses over the next five years (Albanese 2023). The plan contains various measures aiming at boosting housing supply and improving housing affordability for low and middle-income families and renters. This is an ambitious plan and industry insiders and experts have already raised concerns about whether Australia has the capacity, regulatory processes and cooperation across government levels to achieve this target (Bleby 2023; Vaz-Serra 2023).

With strong housing demand stemming from strong population growth amid a shortage of housing supply, house prices are likely to increase in 2024. Figure 13 plots the Westpac-MI House Price Expectations Index (HPI), a leading indicator of housing market activity and the ABS house price growth. The HPI indicates that the majority of consumers are expecting house prices to rise in 2024 despite high mortgage rates but the majority of consumers are also reporting weak buying intentions for dwelling.

3.4 Inflation and the Cost of Living

In 2022, annual domestic headline inflation surged to a high of 7.8 per cent in the

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December quarter, surpassing the annual rate of inflation observed in 2000–01 and nearly reaching inflation rates not seen since the late 1980s and early 1990s, during which the overnight cash rate reached 18 per cent. The recent bout of inflation, which appears to have peaked in the final months of 2022, has reflected both global and domestic factors. These include elevated oil and gas prices, and housing-related price rises, both for rents and construction.

Table 2 shows the contributions of each expenditure group in September 2022, in June and September 2023. Housing-related price changes have contributed materially to inflation in each quarter, with an average contribution equal to about 30 per cent of quarterly inflation between September 2022 and September 2023. In the presence of unabated price rises for housing rents, in September 2023, the contribution of housing to quarterly inflation was more than double its contribution in June 2023.

Construction-related price rises have, however, eased, likely reflecting both the effects of tighter monetary policy and gradual easing of COVID-related supply side constraints. Moreover, housing-related inflation was constrained by the provision of significant consumer energy-rebates, which partially offset the consumer price effects of higher wholesale energy prices. Reflecting higher energy related costs, the contribution of food-related prices to inflation has also remained high, surpassing the contribution of housing in the June 2023 quarter.

The impact of inflation on different types of households is reflected in their respective cost of living measures. Figure 14 shows year-end changes in the monthly cost of living of aged pensioners, employees, government beneficiaries, self-funded retirees, and pensioners and beneficiaries.

Given sharply tighter monetary policy over the course of 2022 and 2023, the annual change in the cost of living of employees increased disproportionately. Between August 2022 and August 2023, the annual change in the cost of living of employees surpassed that of pensioners and beneficiaries, with an average gap of 1.0 percentage point. In recent months, the gap has receded and, in September 2023, the annual change in the cost of living of pensioners and beneficiaries exceeded that of employees by 0.1 percentage points.

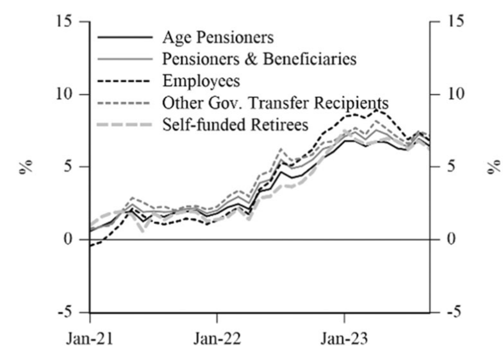
Figure 15 plots the Melbourne Institute's Index of Consumer Inflationary Expectations with that of the bond market, which reflects the expectations of financial market participants. Over the course of 2023, consumer inflation expectations declined, falling to 4.9 per cent by the September quarter (relative to

Table 2 Contribution to Quarterly Inflation (%)

Categories	*Sep-22*	*Jun-23*	*Sep-23*
Food[a]	0.54	0.27	0.10
Alcohol and tobacco	0.11	0.08	0.11
Clothing and footwear	–0.01	0.02	0.01
Housing	0.74	0.18	0.49
Furnishings*	0.26	0.18	–0.07
Health	0.02	–0.01	0.05
Transport	-0.04	–0.01	0.35
Communication	0.03	–0.01	0.05
Recreation and culture	0.11	–0.02	0.02
Education	0.00	–0.01	–0.02
Financial services*	0.08	0.16	0.08
Total	**1.8**	**0.8**	**1.2**

Note: Headline inflation.
(a) Full category description: Food for 'Food & non-alcoholic beverages', Furnishings for 'Furnishings, household equipment & services', Financial services for 'Insurance & financial services.'
Source: ABS.

Figure 14 Monthly Percentage Changes in the Cost of Living (Year-Ended, %).



Source: Melbourne Institute.

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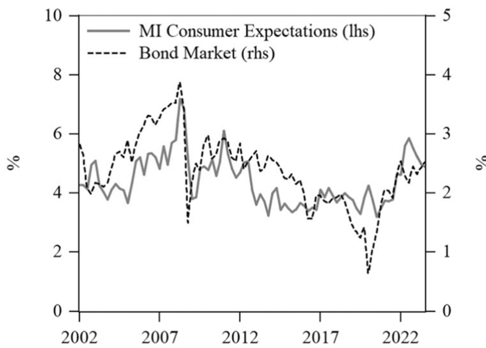
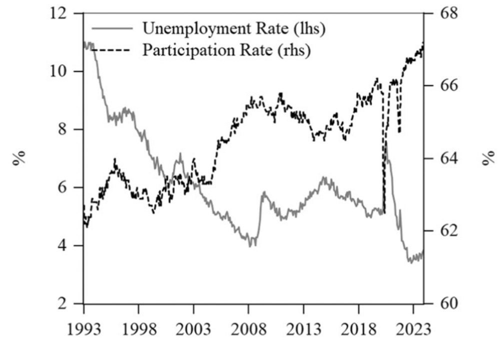
Figure 15 Inflation Expectations (Year-Ended, %). ***Note*: Melbourne Institute measure is a 30 per cent trimmed mean.**



Sources: Melbourne Institute, RBA.

Figure 16 Unemployment Rate (lhs, %) and Participation Rate (rhs, %).



Source: ABS.

5.9 per cent in September 2022). The relatively smooth decline in expectations suggests that consumers are responding, albeit somewhat slowly, to the general presence of higher interest rates.

Looking ahead, consumers anticipate continued moderation in inflation and hence a moderation in their monthly cost of living. The inflation rate implied by long-term bond market yields, however, has risen in recent months, suggesting that financial markets are concerned about the rate at which inflation is likely to moderate.

In this respect, stubbornly high food, rental and fuel related prices are likely to constrain the rate at which inflation declines to within the RBA's target band, together with inflation remaining elevated internationally. Given the stickiness in food, rental and fuel related inflation, we anticipate that inflation will remain above the 2–3 per cent target band in 2024, and likely in 2025. The RBA holds a similar view, forecasting that inflation will only fall to within the target band in late 2025.

3.5 Labour

The Australian labour market continued to be tight in 2022–23. Although the unemployment rate has increased from its historic low of 3.4 per cent in October 2022 to 3.9 per cent in November 2023, it has remained relatively low by historical standards (Figure 16). The participation rate stayed at a high level throughout 2022–23, reaching a historic high of 67.2 per cent in November 2023 while averaging at 66.8 per cent since May 2022. These rates reflect the resilience of the Australian labour market amid the aggressive tightening of monetary policy since May 2022.

Job creation has slowed a little in 2022–23 as the tightening of monetary conditions gained traction on the economy. In 2022–23, the economy added a net of 435,000 jobs, down from 522,000 jobs in 2021–2022 and 785,000 jobs in 2020–2021.

The sustained low unemployment rate has been accompanied by strong, but not unprecedented, wage inflation. In principle, an unemployment rate below the Non-Accelerating Inflation Rate of Unemployment (NAIRU) usually translates into wage inflation pressure. However, the true NAIRU is unobservable and empirical estimates of the NAIRU vary considerably. In Australia, examples include as low as 3.3 per cent in Lye and McDonald (2021) and around 4.5 per cent in Ellis (2019). Estimates of the NAIRU also change over time as the structure of the economy and labour market evolves (Bullock 2023b).

Nevertheless, the number of jobs added in 2022–23 is still considerably higher than the 290,000 average jobs added in the three financial years prior to COVID. The employment population ratio has been steady at 64.4

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Table 3 Employment by Industries ('000): Full-Time (FT) and Part-Time (PT)

	Change between Aug 2021 and Aug 2022			*Change between Aug 2022 and Aug 2023*			*% of part-time (%)*		
	FT	*PT*	*Total*	*FT*	*PT*	*Total*	*Aug 2021*	*Aug 2022*	*Aug 2023*
Agriculture, forestry, fishing	−11	−12	−23	8	−1	7	30	28	28
Mining	7	−3	5	15	8	24	5	4	6
Manufacturing	−67	−41	−109	71	8	79	18	15	15
Electricity, gas, water, waste services	8	6	15	5	−1	4	8	11	10
Construction	132	9	141	38	10	48	15	14	14
Wholesale trade	38	−12	26	13	18	31	19	14	17
Retail trade	37	78	115	38	−23	14	49	51	49
Accommodation, food services	70	43	112	1	−8	−7	64	61	60
Transport, postal, warehousing	60	1	61	23	13	36	23	21	22
Information media, telecommunications	16	−1	15	−10	−2	−11	21	19	19
Financial, insurance services	15	3	18	23	−12	11	17	17	14
Rental, hiring, real estate services	6	1	7	−13	−1	−14	23	22	24
Professional, scientific, technical ser.	106	−12	94	20	−4	16	23	20	19
Administrative, support serv.	10	22	32	−15	−10	−25	39	41	41
Public administration, safety	−24	−16	−40	58	17	75	16	14	15
Education, training	28	−10	18	−14	27	12	40	39	41
Health care, social assistance	127	48	175	54	47	100	45	44	44
Arts, recreation services	10	18	28	6	16	22	45	47	49
Other services	11	−13	−3	−9	−8	−17	33	31	30
Total (Industries)	**578**	**108**	**686**	**312**	**95**	**406**	**32**	**31**	**31**

Source: ABS, Labour Force, Australia, Detailed, Quarterly, August 2023, Table EQ. 05.

per cent since mid-2022, up from 62.5 per cent pre-COVID.

Looking at changes in labour market conditions across industries, Table 2 shows that Health Care & Social Assistance (+100,000), Manufacturing (+79,000) and Public Administration & Safety (+75,000) recorded the largest job gains between August 2022 and August 2023 (Table 3). Job creation in Retail Trade and Accommodation and Food Service weakened considerably as consumers gradually reduced spending. Job gain in Construction also declined as dwelling investment waned.

Across the major states, the bulk of the jobs added in Manufacturing were concentrated in NSW (+32,000) and VIC (+40,000), while the bulk of the job loss in Retail Trade was in QLD (−52,000) (Table 4).

Looking forward, the Westpac-MI Consumer Unemployment Expectations Index, a leading indicator of labour market conditions, has increased to its long-run average (Figure 17, an increase in the Index indicates that more consumers expect rising unemployment and 100 is the neutral mark). This suggests that labour market conditions are likely to loosen over the course of 2024 and 2025.

3.6 Wages and Labour Productivity

Nominal wage growth improved from 2.7 per cent over the year to June 2022 to 4.0 per cent over the year to September 2023. Historically, this is the highest growth rate since March 2009.

The upswing in wage growth occurred in both private and public sectors with the former recording a stronger year-ended growth rate of 4.2 per cent, compared to a

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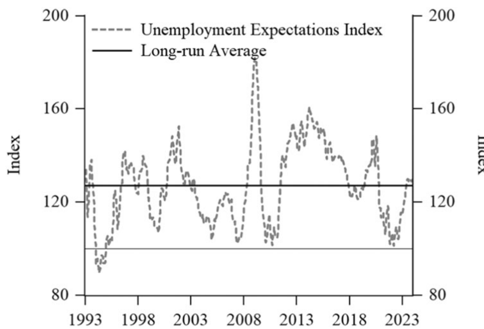
Table 4 Employment by Industries and States: Jobs Added (Jobs, '000) and Industry Share (Share, %)

	Change in employment between Aug 2022 and Aug 2023					*Employment share by Industry as of August 2023*				
	NSW	*VIC*	*QLD*	*SA*	*WA*	*NSW*	*VIC*	*QLD*	*SA*	*WA*
Agriculture, forestry, fishing	5	–1	7	2	–3	2	2	2	4	2
Mining	6	1	0	4	13	1	0	3	1	10
Manufacturing	32	40	–3	2	10	6	8	6	8	6
Electricity, gas, water, waste services	0	7	3	4	–9	1	1	1	1	1
Construction	19	–8	32	–10	16	9	9	10	8	10
Wholesale trade	–12	0	25	6	9	3	3	3	3	3
Retail trade	3	42	–52	9	18	10	10	9	10	9
Accommodation, food services	5	0	–2	0	–12	7	6	7	6	6
Transport, postal, warehousing	–6	–1	32	4	7	5	5	6	5	5
Information media, telecommunications	–26	6	8	1	–3	1	2	1	1	1
Financial, insurance services	15	–5	10	–4	–6	5	4	3	3	2
Rental, hiring, real estate services	5	–13	–5	1	–3	2	2	1	1	2
Professional, scientific, technical ser.	6	17	4	1	–9	10	10	8	7	8
Administrative, support serv.	0	–7	–9	–1	–7	3	3	3	3	3
Public administration, safety	53	5	8	9	–18	7	5	7	7	5
Education, training	8	–5	1	1	4	8	8	9	8	8
Health care, social assistance	26	44	–3	14	19	15	16	16	18	14
Arts, recreation services	–2	18	–7	5	7	2	2	1	2	2
Other services	–16	–8	3	–10	13	4	3	4	3	4
Total (Industries)	121	134	52	38	44	100	100	100	100	100

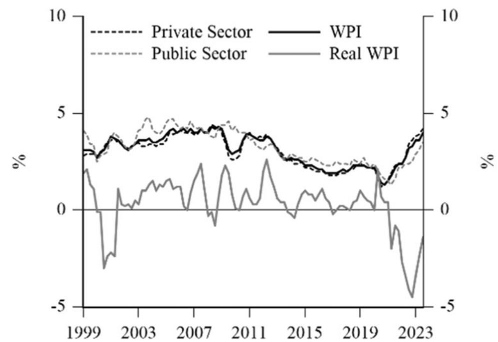
Source: ABS, Labour Force, Australia, Detailed, Quarterly, August 2023, Table EQ. 03

Figure 17 Unemployment Expectations (3-Month Moving Average, Index).



Source: Melbourne Institute.

Figure 18 Wage Price Index Growth (Year-Ended, %).



Source: ABS.

growth rate of 3.5 per cent in the latter in September 2023.

In real terms, wage growth remained negative (Figure 18), declining by 1.4 per cent over the year to September 2023. It was positive in the decade before COVID (with an average year-ended growth of 0.6 per cent). Since June 2021, it has been negative.

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In the pre-COVID period, low wage growth in the pre-COVID period was a common phenomenon across developed economies. Several contributing factors have been put forward including slack labour markets, low productivity growth, declining bargaining power of workers, low inflation and inflationary expectation (IMF 2017; Arsov and Evans 2018), as well as the decoupling of wages from productivity (OECD 2018).

In Australia, analyses at the RBA and the Treasury indicate that a slack labour market (high underemployment), low inflation and inflationary expectations, and slowing labour productivity growth all played a part in the sluggish wage growth pre-COVID (Gilfillan 2019).

The recent analysis by the Productivity Commission (2023) shows that, for the majority of the Australian labour force (95 per cent), productivity growth is still the main long-run driver of real wage growth. Wage decoupling—productivity growth exceeding wage growth over the long term—only occurred in Mining and Agriculture, which together only account for 5 per cent of the labour force.

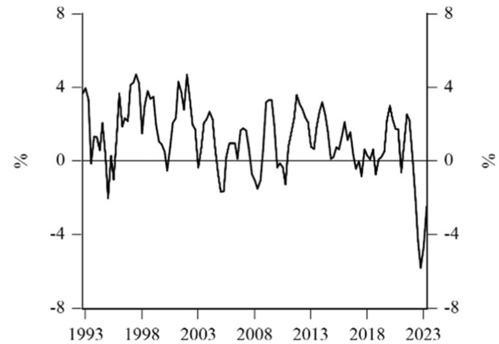
Labour productivity growth in Australia, measured by non-farm labour productivity per hour growth, was weak before COVID. This is also an observed phenomenon in many developed economies due to the slowdown in global trade, business dynamism, job mobility and structural reform (Bruno, Dunphy and Georgiakakis 2023).

After a temporary recovery in 2020, labour productivity growth in Australia turned negative in 2022–23 (Figure 19). This, together with its pre-COVID trend, suggests that there may have been a structural decline in productivity growth, with ramifications for future wage growth.

3.7 Monetary and Fiscal Policies

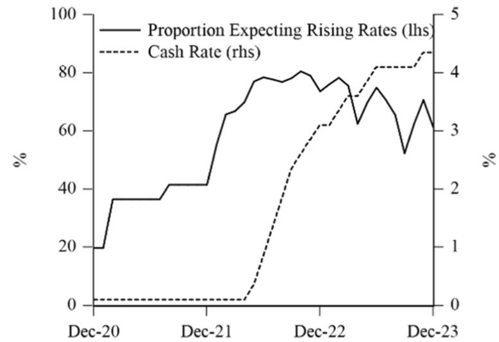
In 2023, the RBA tightened monetary policy further to bring inflation back within the 2 to 3 per cent target band. As inflationary pressures gradually eased, the pace and intensity of the tightening has moderated, with five rate rises in 2023 (totalling 125 basis points) compared to eight consecutive rate rises between May and December 2022 (totalling 300 basis points).

Figure 19 Non-Farm Labour Productivity Growth (Year-Ended, %).



Source: ABS.

Figure 20 Consumer Interest Rate Expectations (lhs, %) and Target Cash Rate (rhs, %).



Source: RBA, Melbourne Institute.

With 13 rate rises since May 2022, the vast bulk of the tightening in this cycle is likely to have occurred. Figure 20 charts the proportion of consumers expecting rising interest rates in the coming 12 months. It shows that this proportion declined from its peak in late 2022, with sharp declines when the RBA held the cash rate unchanged in 2023. But it has edged up again with the November 2023 rate rise, suggesting that most consumers acknowledge a material probability of further rate rises in the coming twelve months as core inflation remains high.

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In its November 2023 policy statement, the RBA indicated that 'whether further tightening of monetary policy is required … will depend upon the data and the evolving assessment of risks' (Bullock 2023a). Given the long and variable lags of monetary policy, such a wait-and-see strategy is appropriate, to keep the economy on the narrow path ahead.

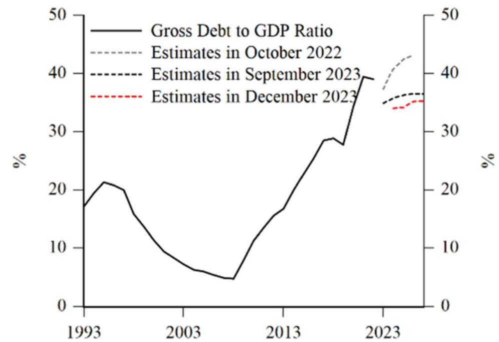
In July 2022, Treasurer Chalmers announced the first wide-ranging review of the RBA 'to ensure that our monetary policy framework is the best it can be' (Chalmers 2022). The review was concluded in March 2023 with 51 recommendations to improve the RBA's effectiveness, operation and governance. (Commonwealth of Australia 2023). Following these recommendations, the monetary policy board will meet eight times a year from February 2024—instead of 11 times a year—to allow for more time to make better monetary policy decisions. The length of the board meeting will change, and board members will attend a prior 'policy issues meeting', the purpose of which is to '… engage Board members with policy issues earlier' (Bullock 2023c).

Importantly, the Governor will hold a media conference at 3.30pm after the announcement of the meeting decision at 2.30pm, to explain the Board's views. In addition to the released policy statement, this media presence is to improve the communication of policy decisions. Empirical evidence shows that central bank communication and news on monetary policy can facilitate consumers' understanding of key economic concepts, and hence improve the efficacy of monetary policy (Dräger, Lamla and Pfajfar 2016).

In 2023, fiscal policy continued to provide targeted supports for Australian households amid higher interest rates, inflation and cost of living pressures while avoiding adding to inflationary pressure. The May budget provided a $14.6 billion assistance package which included a range of payments for low- and middle-income families, including energy bill savings, cheaper medicines, and modest increases to JobSeeker and rent assistance, to ease cost of living pressures (Treasury 2023a).

In September, the final budget outcome revealed a budget surplus of $22.1 billion in

Figure 21 Gross Debt to GDP Ratio (%).



Source: Commonwealth Treasury.

2022–23, the first in 15 years (Treasury 2023b)—a reversal from a projected deficit of $36.9 billion in the October 2022 budget (Treasury 2022). This improvement was due to stronger commodity prices, higher-than-expected income and company tax revenue, and saving and spending reprioritisation measures in the past 12 months.

In the Mid-Year Economic and Fiscal Outlook 2023–24 (Treasury 2023c) released in December 2023, the government projected a smaller deficit of $1.1 billion in the 2023–24 financial year, down from a projected deficit of $13.9 billion in the Federal Budget 2023–24. The smaller projected deficit in 2023–24 is mainly due to stronger tax receipts.

The forward estimates of gross debt as a percentage of GDP have also been progressively revised downward since the October 2022 Federal Budget (Figure 21). The debt to GDP ratio is now projected to stabilise around 35.3 per cent over the next four years, as compared to a projected 43.1 per cent for 2026–27 in the October 2022 budget. While the Australian debt to GDP ratio is low by international standards, the consolidation of our fiscal buffer is important and necessary, in the event of future adverse shocks.

4. Concluding Remarks

Growth in the economy is expected to slow to 1.3 per cent in 2024, from an estimated 1.8 per cent in 2023, driven by soft household

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consumption. There are three primary downside risks to this growth forecast.

The first significant downside risk relates to inflationary pressures in 2024. Private demand growth already is weak. If more monetary tightening is required to bring the inflation rate down to within the target band in a timely way, household finances will be squeezed further. This scenario heightens the risk of a recession stemming from depressed household consumption. Household finances have weakened considerably, and households are more vulnerable to adverse shocks now than a year ago.

The second downside risk is the expected weakening in labour market conditions in 2024. It has been resilient so far to the tightening in monetary policy, providing a solid foundation for household consumption. However, should labour market conditions weaken more than anticipated, household consumption and economic growth will be negatively affected. Thus, how much of the current labour market strength is maintained also depends on how quickly inflationary pressures can be brought under control.

The third downside risk stems from global economic prospects. Core inflation in many developed economies remains high and is not expected to decline quickly. Thus, monetary policies in these economies might remain tighter for longer than anticipated. This, together with sluggish growth in China, poses a notable downside risk to global demand. In addition, further climate and geopolitical shocks could cause further food and energy price spikes adding to inflationary pressures.

Given that the balance of risks appears tilted to the downside, it is critical that monetary and fiscal policies in Australia continue to coordinate in 2024, to ensure that the economy remains on the narrow 'growth' path.

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Data Availability Statement

Data sources are included in the article.

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