FOI 3492
Document 1

Australian Government
The Treasury

Ministerial Submission

MS23-001301

FOR INFORMATION – Recent movements in s 22 [redacted] **inflation**

TO: Treasurer - The Hon Jim Chalmers MP
CC:

KEY POINTS

s 22 [redacted]

2 pages have been removed from this document as irrelevant material under section 22 of the FOI Act

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- In the long run, there is a close relationship between nominal unit labour costs and inflation (Chart 9). However, there is heightened uncertainty around the pass through from measured nominal unit labour costs to inflation in the current environment.
  - Ordinarily, we would expect that forward-looking firms may be reluctant to fully pass through increasing costs where they recognise those increases are temporary or cyclical.
  - Additionally, measurement issues, particularly outside of the market sector, may mean that measured nominal unit labours costs do not accurately reflect costs facing firms.
  - Offsetting these factors, in the current high inflationary environment, some firms may be more willing and able to quickly pass through cost increases to prices.
  - The business cycle is also a relevant consideration. On the downswing of the cycle, firms may find it more difficult to pass through cost increases as demand conditions soften, leading to reduced margins and a lower profit share of income.

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[1] Based on OECD data. Note that the OECD measure of nominal unit labour costs is slightly different to that derived from the National Accounts.

- In late 2022, around half of inflation was driven by external factors and supply disruptions. As these pressures subside and inflation dynamics normalise, domestic costs are increasingly expected to drive inflation.
- If productivity were to grow more slowly than expected and firms pass this cost increase on to consumers, this could delay the return to the RBA's target band.
  - If sustained, slower productivity growth would mean that the level of wage growth consistent with stable inflation is lower.
  - Ultimately, productivity growth drives long-run growth in real wages and per capita living standards.

s 22

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s 22

CONSULTATION

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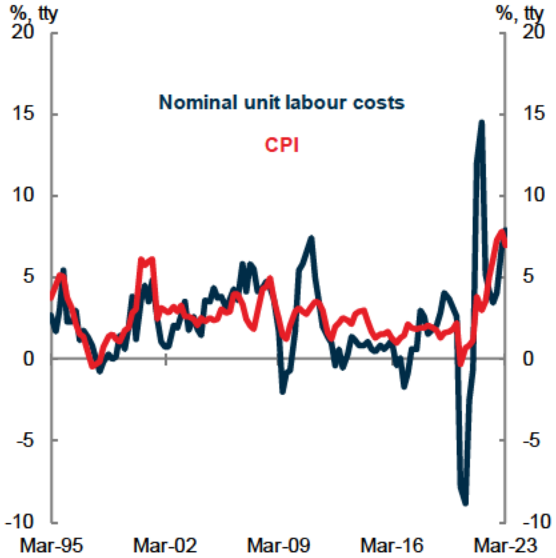
ATTACHMENTS

A: Charts

Chart 9: Consumer price inflation and nominal unit labour cost growth over time



Source: ABS National Acccounts, Treasury.

Australian Government
The Treasury

Ministerial Submission

MS23-001300

FOR INFORMATION - Impacts of global supply-chain and inflation pressures

TO: Treasurer - The Hon Jim Chalmers MP
CC:

KEY POINTS

- The Budget forecasts for headline inflation to ease are predicated on the resolution of recent global supply constraints, particularly for manufactured goods and energy.
  - We estimate that higher import prices and domestic supply constraints accounted for between a third and a half of the 7.8 per cent peak in annual inflation in the December quarter 2022.
  - The forecasts assume an unwinding of this contribution (i.e. disinflation) but do not assume any significant deflationary effects.
- Key indicators suggest that this is occurring largely as expected. Supply bottlenecks for global manufactured goods have now resolved, while energy and commodity markets have adjusted to the reduction in Russian supply.
  - Global shipping costs, after surging by over 700 percent, have returned to pre-pandemic levels and the New York Federal Reserve's global supply chain pressure index has fallen to below pre-pandemic levels.
  - The global semi-conductor shortage has eased, allowing auto manufacturers to resume a normal pace of production, consistent with a record high volume of new vehicle imports in the March quarter in Australia.
  - Commodity prices, including for energy, have retreated from extreme levels reached in 2022 following the onset of Russia's invasion of Ukraine.
  - Chinese producer and export prices are also declining, due to lower commodity prices and softening Chinese and global demand.
- The decline in upstream global goods and energy prices is flowing through to moderating consumer prices in most advanced economies.
  - In the US, annual headline inflation has fallen from a peak of 9.1 per cent in June 2022 to 3.0 per cent in June 2023. In the Euro area, it has fallen from a peak of 10.6 per cent in October 2022 to 5.5 per cent in June 2023.
- In Australia, there are also clear signs that easing global supply constraints are bringing down the rate of headline inflation, with disinflation evident in several components of the CPI that

contributed to the inflation spike in 2022. Recent domestic supply disruptions related to flooding have also passed and cost pressures are easing in the housing construction sector.

- Overall import prices fell by around 4 per cent in the March quarter 2023, after quarterly growth peaked above 6 per cent during the pandemic in late 2021.
- Annual price growth for automotive fuel, new dwellings, fruit and vegetables, and broader tradable goods is easing sharply.

- The June quarter CPI provided further evidence of the handover in the drivers of inflation from supply-side disruptions to broader pressures in the services sector. Annual services inflation rose at its fastest pace since 2001 and exceeded goods inflation for the first time since September 2021.
- This easing in global and domestic supply constraints is welcome and consistent with the Budget forecasts, but there remain risks to the outlook.
  - Further risks to global energy and food prices remain if Russia's ongoing war in Ukraine or more extreme weather events see further disruptions to energy and agricultural commodities, or additional energy demand.
    - Renewed global energy price pressures could exacerbate the ongoing passthrough of higher wholesale energy costs to consumer prices in Australia, which is still occurring with a lag due to the prevalence of forward contracting in Australian energy markets.
  - Slower-than-expected easing in groceries and new dwellings price growth in the June quarter 2023 could see greater persistence in goods inflation than anticipated.
  - Outside of supply-side factors, rental price pressure may be greater than forecast, buoyed by ongoing strength in advertised rents and population data.
- More broadly, as supply constraints moderate, the key factors that will determine the outlook for inflation will be movements in wages and productivity *(for further information see MS23-001312)*.

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s 22

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ATTACHMENTS

A: Additional Information

ATTACHMENT A – ADDITIONAL INFORMATION

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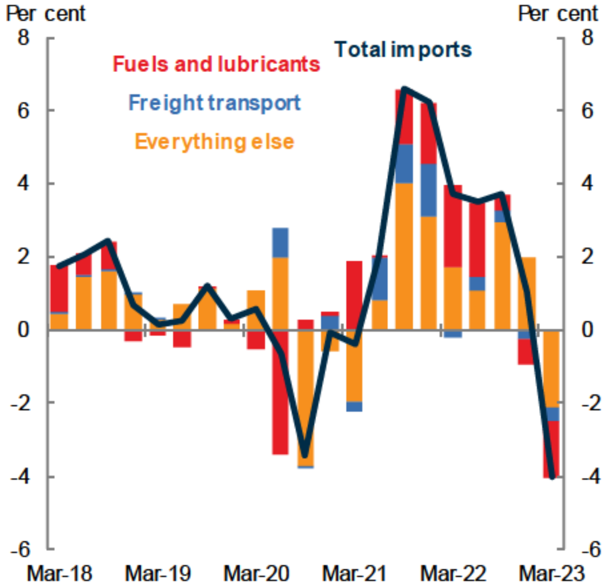
Australian inflation has eased from its late 2022 peak, as global factors have seen fuel and imported goods prices decline. Improved domestic supply conditions have aided disinflation

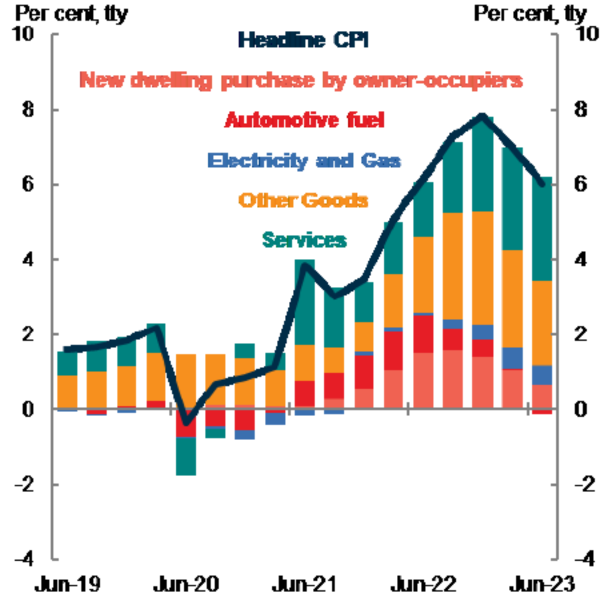
- Import prices have fallen in line with easing supply conditions globally and domestic headline inflation moderated further to 6.0 per cent through the year to the June quarter 2023, with disinflation evident in a range of components, reflecting improved supply (Charts 5 and 6).

Chart 5: Quarterly growth in import prices



Source: ABS Balance of Payments and International Investment Position, Australia

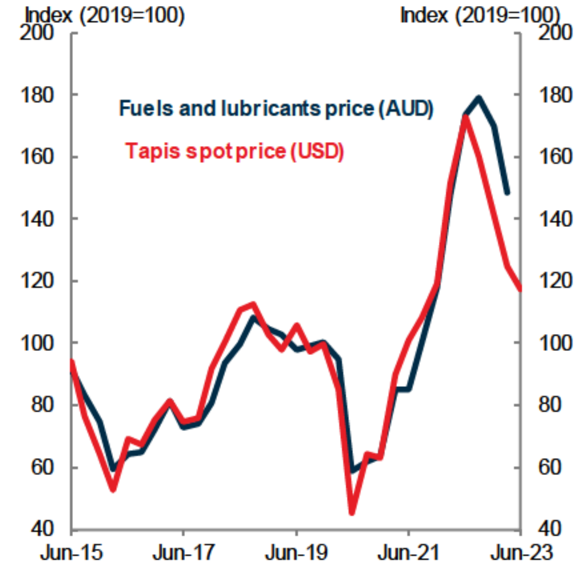
Chart 6: Contributions to CPI growth



Source: ABS Consumer Price Index, Treasury
Note: Contributions are back-cast using 2022 CPI expenditure weights.

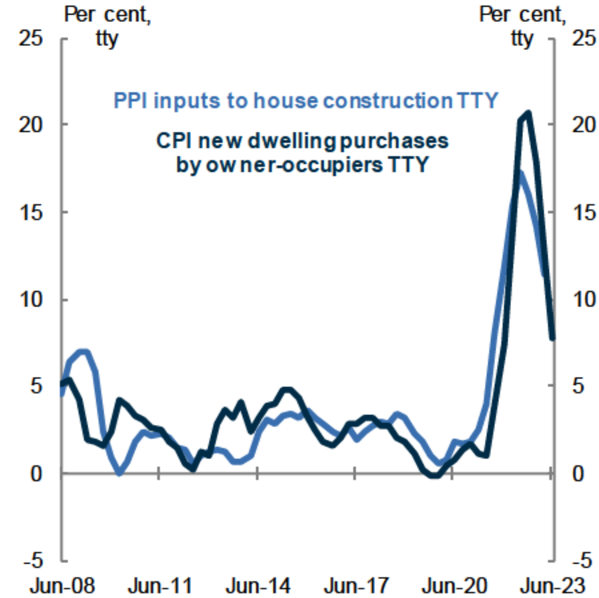
- Australian petrol prices have fallen as oil prices have retreated significantly from their recent peak in early 2022 (Chart 7). In the June quarter 2023, fuel prices experienced an annual fall of 3.6 per cent, the first annual decline since early 2021.
- The impact of severe flooding over 2022 on agricultural and logistic supply chains has started to abate, with annual fruit and vegetables price growth moderating in recent quarters.
- Broader goods inflation declined from its peak of 9.6 per cent through the year to the September quarter 2022, to 5.8 per cent to the June quarter 2023.
- The strong growth in residential construction costs has started to moderate, although remains elevated, as easing global supply chain disruptions and softening demand growth have curtailed further price increases in the sector (Chart 8).
  - Annual new dwellings price growth eased from 20.7 per cent in the September quarter 2022 to 7.8 per cent in the June quarter 2023.
- A fall in the price of motor vehicles in the June quarter 2023 is consistent with moderating vehicle supply backlogs, following the record high volume of new vehicle imports in the March quarter 2023. This is the first quarterly decline in the price of motor vehicles since March 2020.

Chart 7: Oil and Australian fuel import prices



Source ABS Balance of Payments and Bloomberg.

Chart 8: Housing construction costs



Source: ABS Producer Price Indexes, ABS Consumer Price Index
Note: PPI only available to March 2023

The near-term outlook is for improved supply conditions but risks to inflation remain in energy, food and housing

- Further disruptions to global energy and food prices remain a risk given Russia's ongoing war in Ukraine. Energy and commodity markets are also vulnerable to adverse weather events.
  - The expiration of the Black Sea Grain Initiative on 17 July is likely to see wheat price spikes in the short-term. However, the global wheat market is better placed to absorb this shock than before the invasion and prices are not expected to reach 2022 peaks.
  - Ongoing weather-related disruptions to agricultural supply could see renewed upwards pressure on global food prices. Additional energy demand from more extreme weather such as the recent heatwaves in the US and Europe may also see renewed upward pressure on energy prices.
- Domestically, higher energy costs for households are expected to see further contributions to headline consumer price inflation over the forecast period. This reflects the lagged pass through of wholesale energy costs to regulated annual increases in consumer tariffs.
  - At Budget, the Government's Energy Price Relief Plan, through wholesale price caps and household bill rebates, was expected to reduce inflation by ¾ of a percentage point in 2023-24 and add around ¼ of a percentage point to inflation in 2024-25.
    - The Queensland Government's recent announcement of further electricity subsidies presents some downside risks to 2023-24. Early assessment suggests these could result in a lower average electricity price rise of between 5-10 per cent through-the-year to June 2024, before adding to measured CPI in 2024-25.
- Rental price growth was marginally stronger than expected in the June quarter 2023 and continues to present an upside risk to the outlook, given stronger-than-expected population growth and stronger advertised rents.

FOI 3492
Document 3

Australian Government
The Treasury

Ministerial Submission

MS23-001312

FOR INFORMATION – Implications of net overseas migration on the economy

TO: Treasurer - The Hon Jim Chalmers MP
CC:

KEY POINTS

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- At the margin, higher NOM is placing upward pressure on inflation, which among other factors is materially affecting rental price growth and adding up to 0.1 percentage points to annual headline inflation.
  - CPI rents increased 6.7 per cent through the year to June 2023, and is expected to peak above 10 per cent in September 2024, as low vacancy rates and continued growth in advertised rents flow through to rental agreements (Figures 3 and 4).
  - Since 2015, the rental component of the CPI has grown slower than headline inflation. In the June quarter, this trend reversed, with rental price growth expected to exceed headline inflation over the forecast period (Figure 5). Advertised rents for combined capital city dwellings are now 26.7 per cent higher than pre-pandemic (Figure 6).
  - Australia is not alone in experiencing strong rental price growth. Current annual CPI rental price growth is well above the pre-pandemic average across comparable countries, the US, UK, NZ, Canada and the Euro area (Figure 7).
  - Compared to international counterparts, Australia saw a stronger decline in CPI rents in 2020 and 2021, and is now seeing a later pickup. Australia's rental price cycle

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appears to be lagging New Zealand where prices are starting to moderate, partly in response to increased supply (Figures 8 and 9).

s 22

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ATTACHMENTS

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B: Charts

ATTACHMENT B – CHARTS

s 22

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Figure 3: Near record tightness in vacancy rates is driving the strong increase in advertised rents.

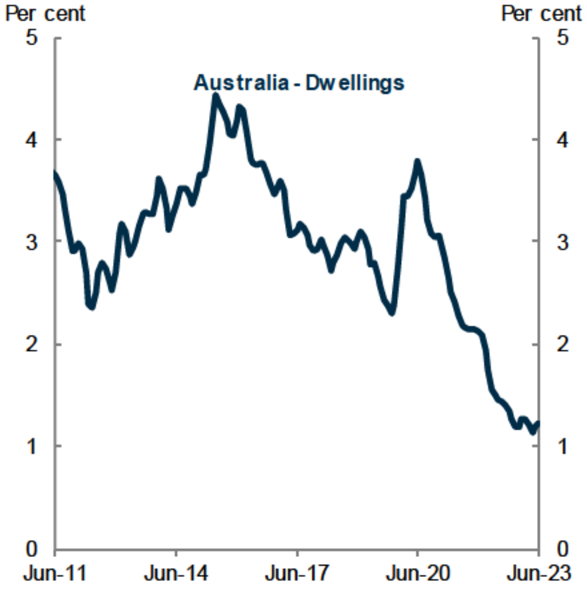


Figure 4: Recent outcomes for advertised rents point to further increases in CPI rents.

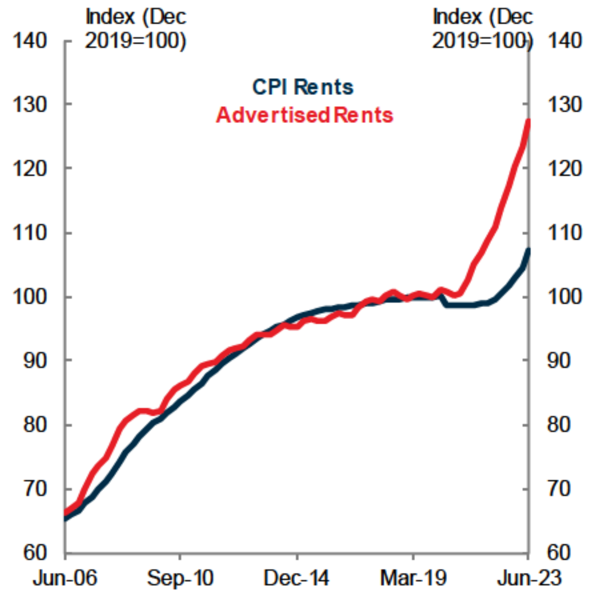


Figure 5: Rental prices have fallen relative to headline CPI since mid-2015. This trend only started to reverse in the June quarter.

s 47(1)(b)

Figure 7: Compared to international counterparts, Australia saw a stronger decline in ***CPI rents*** *in 2020 and 2021, and is seeing a later pickup*

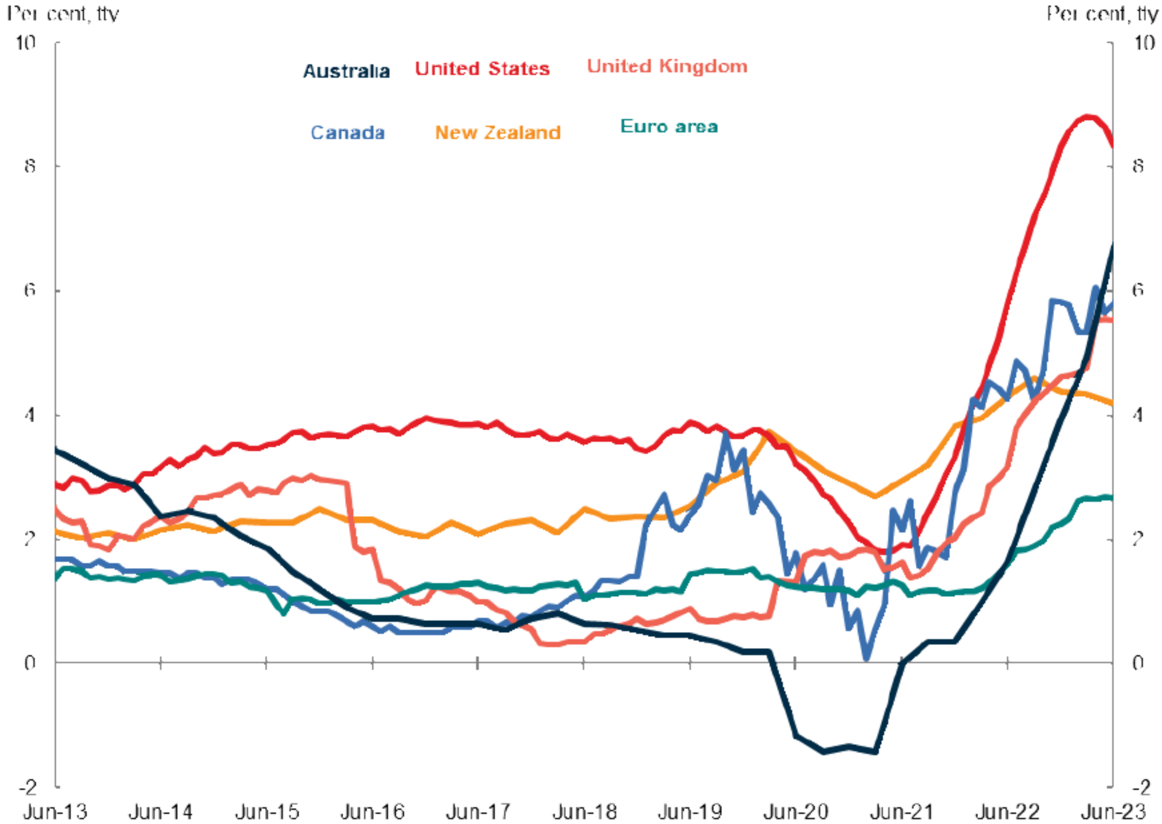


*Figure 8: A reduction in annual **new dwelling price** growth has contributed to the moderation in New Zealand's CPI.*

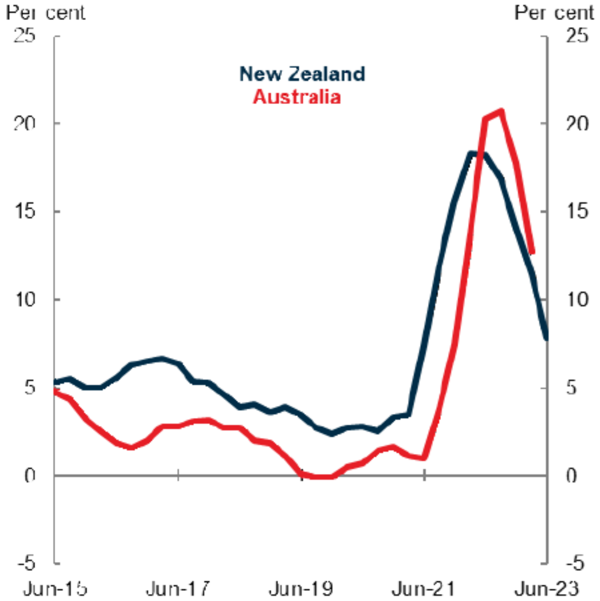
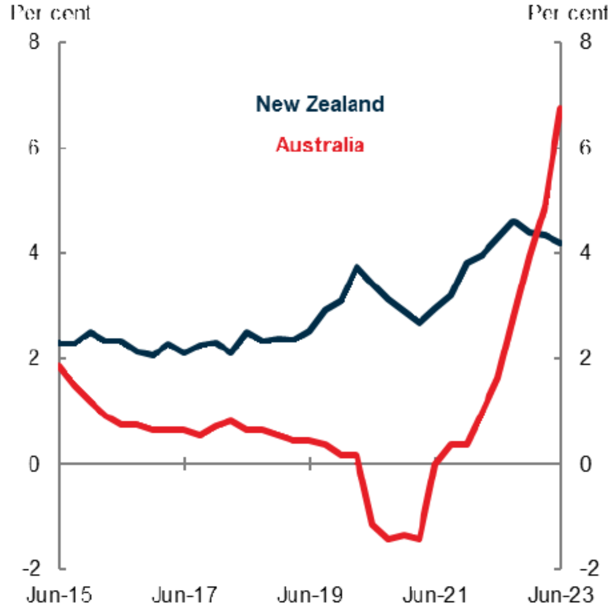


Figure 9: Annual CPI rents growth in New Zealand has started to slow, partly in response to increased supply.



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FOI 3492
Document 4

Australian Government
The Treasury

Ministerial Submission

MS23-001750

FOR INFORMATION - Australian and international inflation outlook

TO: Treasurer - The Hon Jim Chalmers MP
CC:

KEY POINTS

- The most severe bout of global inflation in decades peaked in mid-to-late 2022 and is now slowing materially, including in Australia.
- Australia experienced a lower and later peak in inflation than most other comparable economies, however, disinflation in Australia is expected to lag those economies over the next year (**Chart 1**)
  - Australia's June quarter inflation rate of 6.0 per cent is higher than that of all G20 advanced economies except for the United Kingdom and Germany. Australia's monthly CPI indicator for July of 4.9 per cent is somewhat lower, but remains close to two percentage points higher than the rate in the United States (3.2 per cent).
  - Australian consumer prices are expected to increase by around 3¼ per cent over the next year, higher than forecasts for all advanced G20 economies.
    - In the longer term, Australia's higher inflation forecast reflects the midpoint of the RBA's higher inflation target relative to most other central banks (2 ½ per cent rather than 2 per cent elsewhere).
- Despite a higher forecast rate of inflation for the next 12 months, the cumulative increase in Australian consumer prices over the course of this high inflation episode is expected to remain towards the lower end of outcomes for large advanced economies (**Chart 2**).
  - The cumulative increase in consumer prices in Australia from December 2019 to June 2023 was around 15 per cent, more than in Japan and South Korea and around the same as in Canada, but less than the United States, United Kingdom, euro area and New Zealand (**Table 1**).
  - By June 2024, the cumulative increase in prices is expected to be 19 per cent for Australia, compared with an average of around 21 per cent in the major advanced economies excluding low-inflation Japan.

- Australia's experience of a slower pick-up in inflation and relatively lagged disinflation reflects its unique exposure to global energy price shock and pandemic-related fiscal policy responses, the timing of domestic lockdowns and reopening of borders, and a different labour market response (**Charts 4** s 22
  - In addition to a global shift in consumption patterns from services to goods given the pandemic and associated restrictions, the large US fiscal response to the pandemic drove an earlier increase in goods prices in the United States that later spilled over to other advanced economies including Australia. The subsequent disinflation in goods prices is now occurring earlier in the US.
  - Europe's greater exposure to Russian energy supply drove very large rises in household energy prices following Russia's invasion of Ukraine, while Australia has seen a smaller increase. Household energy prices are now falling from very high peaks in Europe and contributing to disinflation, while in Australia energy prices are continuing to increase from relatively low levels as annual contracts reset.
  - The continued increase in Australian rents has lagged developments in the US, where rent price growth has now peaked.
    - The initial negative population shock at the start of the pandemic and later reopening of Australia's international borders delayed the post-pandemic increase in rents seen in a number of countries.
  - Wages grew later and less strongly in Australia due in part to a strong labour supply response and more rigid wage-setting mechanisms.
- Despite strong inflation, real disposable income per capita has increased by 3 per cent in the US and ¾ per cent in Australia since prior to the pandemic. In contrast, nominal income growth has failed to keep pace with inflation in Germany and the UK.

Chart 1: CPI inflation rate

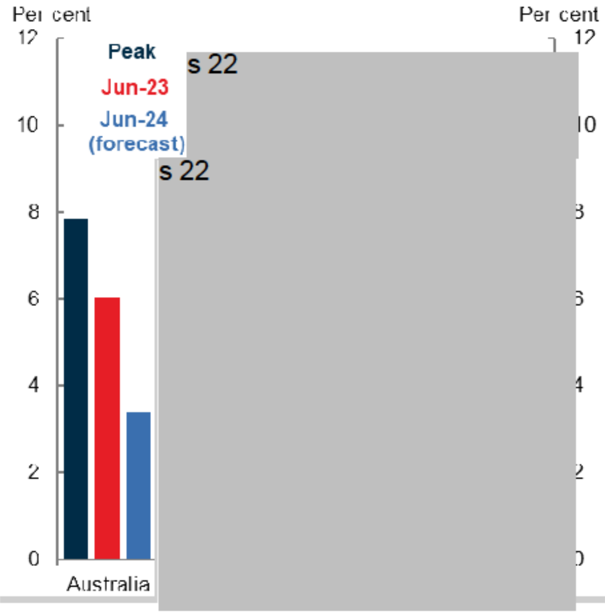

Chart 2: Cumulative change in CPI, Dec-19 to Jun-24

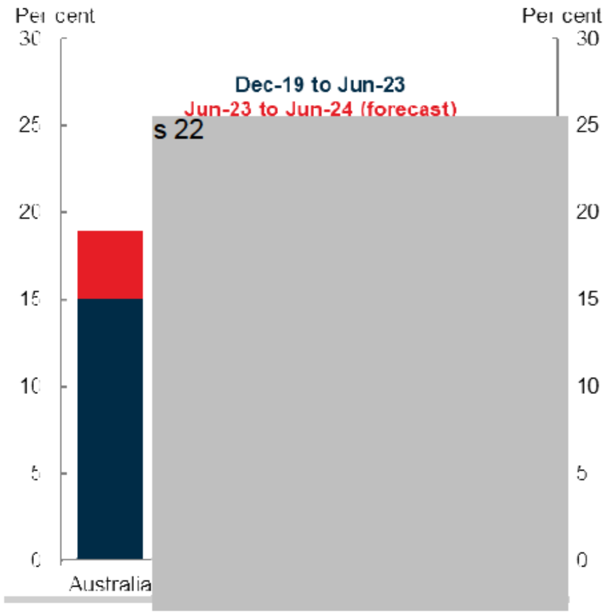

Table 1: CPI inflation outcomes and forecasts

Country	Peak	Date of peak	Latest	Date	Jun-24 forecast	Cumulative inflation to Jun-23	Cumulative inflation to Jun-24 (forecast)
Australia	7.8	Dec-22	6.0	Jun-23	3¼	15.1	19.0

s 22 [redacted]

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CONSULTATION

Nil

ATTACHMENTS

A: Additional Information
B: Charts and tables

ATTACHMENT A – ADDITIONAL INFORMATION

Strongest global inflation in decades is now moderating

- In recent years, advanced economies have experienced the most severe inflation in decades, but globally inflation has peaked and is now rapidly moderating (**Charts 1 and 3**).

s 22

  – Inflation in Australia peaked somewhat lower and later than many other countries, at 7.8 per cent in December 2022, though this represented the highest rate of inflation since 1990.

- Inflation globally has begun to rapidly fall, although is not currently expected to return to central bank targets until 2025 in most countries.
  – Treasury expects Australian inflation to fall into the RBA's target band in mid-2025.

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Australia is expected to see a higher rate of inflation than many other economies in the near term, but the episode will be more mild overall

- Although Australia experienced a lower and later peak in inflation than many comparable countries, inflation is now moderating more quickly elsewhere.
- Australia is expected to see a higher rate of inflation than many other countries in the near term.
  – Australia's current annual inflation rate of 6.0 per cent for the June quarter is higher than that in the United States, Canada, and the euro area; equal to that in New Zealand; but lower than in the United Kingdom.
  – Australia's monthly CPI indicator for July is somewhat lower at 4.9 per cent, though is still much higher than the rate in the United States and Canada.
  – While the inflation rate in the United Kingdom is expected to remain high for some time, it too is expected to fall below that of Australia in mid-2024.
- Australia's higher inflation forecast in the longer term reflects the RBA's higher inflation target of 2-3 per cent, in contrast to the US Federal Reserve, European Central Bank, and Bank of England's target of 2 per cent.

The cumulative increase in consumer prices in Australia over the course of the episode is expected to be less than in many comparable economies

- While the rate of inflation in Australia is likely to be higher than in many other countries over the next 12 months, Australia has experienced a smaller increase in prices to date since the beginning of the pandemic; and is likely to experience a smaller cumulative increase in prices over the course of this inflationary episode (**Chart 2**).
  - Consumer prices in Australia were around 15 per cent higher in June 2023 than they were prior to the start of the pandemic in December 2019, compared with around 18 per cent in the United States, 20 per cent in the United Kingdom, and 18 per cent in New Zealand.
  - Australian consumer prices are expected to increase by a further 3¼ per cent by the middle of 2024, but the cumulative increase in prices since the start of the pandemic is expected to remain lower than in the US, euro area, UK and New Zealand.

The United States' US$4½ trillion pandemic fiscal support contributed significantly to the increase in global goods inflation

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- As the increase in the price level for goods was earlier and sharper elsewhere, the rate of goods inflation has slowed in many other countries earlier than in Australia, contributing to Australia's stronger inflation outlook (**Chart 12**).

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  [redacted]

  – In Australia, goods price inflation peaked at 6 per cent in late 2022, and has since fallen to around 4 per cent.

Russia's invasion of Ukraine drove energy price rises globally but Australian domestic energy markets have been relatively insulated

- Already elevated global energy prices due to a rapidly rebounding global economy rose significantly in early 2022 in response to the Russian invasion of Ukraine (**Chart 13**).
  – Energy prices experienced by consumers rose swiftly in response to the spike in energy commodity prices, particularly in Europe due to its reliance on Russian energy supplies. However, the increase was much less significant in Australia.
  – As global energy commodity prices have normalised, consumer energy prices have also fallen and in many countries are now deflationary in through-the-year terms (**Chart 14**).
- Prices for motor vehicle fuels rose in Australia and other advanced economies in response to the increase in global oil prices, though the increase (and subsequent decline) was less significant in Australia due in part to the temporary fuel excise cut in 2022.

- The impact of energy commodity price increases on household electricity and gas prices has been much less severe in Australia than other economies (**Charts 15 and 16**).
- In Australia, contract prices for household electricity and gas supply are generally set annually with regulated default offers, introducing a lag between increases in energy commodity prices and the impact on consumers. Electricity generators also generally have long-term forward contracts in place for coal and gas supply, limiting the pass through from increases in spot prices.

  s 22 [redacted]

  – Although electricity prices in Australia increased by 13 per cent over the year to June 2023, they remain only around 5 per cent above their pre-pandemic levels.
  – Gas prices in Australia increased 26 per cent in the year to June 2023, but were only around 30 per cent higher than before the pandemic, compared with around 60 per cent higher in the euro area and around 150 per cent higher in the UK.
- As price levels for electricity and gas did not increase to the same extent in Australia as in many other countries, Australia is not experiencing the same downwards pressure on CPI from energy prices.

  – At Budget, gas and electricity prices in Australia were forecast to increase by around another 5 and 10 per cent respectively over the year to June 2024, though the overall price increases are expected to remain considerably lower than those experienced overseas.

Wages in Australia have been less responsive to labour market tightness

s 22 [redacted]

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  - An increase in nominal wage growth is likely to place moderate upwards pressure on consumer prices in Australia, while the slowing in wage growth overseas is likely to place some downwards pressure on inflation in those countries.

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Inflation in rents and other services have lagged in Australia

- Services inflation continues to increase in most countries, including Australia, though is now beginning to moderate in the United States and Canada.
- Although the share of labour inputs is generally higher for services than for goods, services inflation also reflects a range of other factors beyond labour costs.
- A major contributor to services inflation in many countries including Australia has been rents. CPI rents have risen significantly in most advanced economies since mid-2021 (**Charts 19 and 20**).
  - In the year to June 2023, CPI rents rose 6.7 per cent in Australia, around the same as in Canada, but lower than in the United States (8.3 per cent).
  - Given a relatively more responsive housing market and increasing vacancy rates, CPI rent price growth in the United States has recently begun to slow, and the San Francisco Federal Reserve projects CPI rent to be flat or even negative by mid-2024, which will weigh heavily on headline CPI inflation.
  - In part due to legislated rent freezes and in part to a large negative shock to the population of temporary visa holders (the majority of whom are renters), Australia uniquely experienced a fall in rent prices during the pandemic. The cumulative increase in rents over the course of the pandemic has so far been smaller than in most other economies.

- However, Treasury expects CPI rent price growth in Australia to continue to increase in the near term and remain a significant upwards contributor to domestic inflation.
- Strong population growth and a relatively unresponsive housing market suggests rents, all else equal, poses upside risk to the 2023-24 Budget inflation forecast.

- A range of other categories are contributing to services inflation as pandemic-related volatility continues to works its way through the economy, notably travel and accommodation.
  - Demand for air transport and tourist accommodation following the pandemic has been extremely strong given pent-up demand, while rising oil prices also contributed to high air transport prices. In some countries, this is now beginning to unwind, though this is not yet the case in Australia.
    - In the United States, airline fares peaked in mid-2022 at around 25 per cent above their pre-pandemic levels, but are now back below their pre-pandemic levels, contributing to a decline in services inflation.
    - In Australia, in part due to a later reopening of travel restrictions, prices for international holiday travel and accommodation remained 33 per cent above pre-pandemic levels in June, with domestic holiday travel and accommodation 23 per cent higher.

An alternative inflation gauge confirms that inflation in Australia has lagged and increased less in cumulative terms

- Differences between countries in the apparent severity and timing of inflation during this inflationary episode in part reflect differences in how the Consumer Price Index is compiled, particularly in the treatment of owner-occupied housing, used cars, and energy price subsidies.
- A more comparable measure of inflation across countries than the CPI is a measure derived from the National Accounts, the Consumption Deflator.
  - As well as ensuring consistent treatment of items like housing and used cars, it abstracts from the effect of subsidies. However, unlike CPI, for most countries it is generally only available quarterly and with a significant lag.
- The Consumption Deflator is generally lower than the Consumer Price Index, particularly during periods of high inflation, as it captures changes in composition as consumers substitute away from more expensive items in favour of cheaper ones, while the CPI assumes a fixed basket (**Chart 21**).
  - While the CPI shows that US inflation peaked at 9.1 per cent and Australian inflation peaked at 7.8 per cent, using the Consumption Deflator rather than CPI shows that inflation in Australia actually peaked at around the same level as in the United States (**Chart 22**).
    - However, as with CPI, the Consumption Deflator also shows that the cumulative increase in inflation since the start of the pandemic has been greater in the US.

ATTACHMENT B – CHARTS AND TABLES

Chart 1: CPI inflation rate

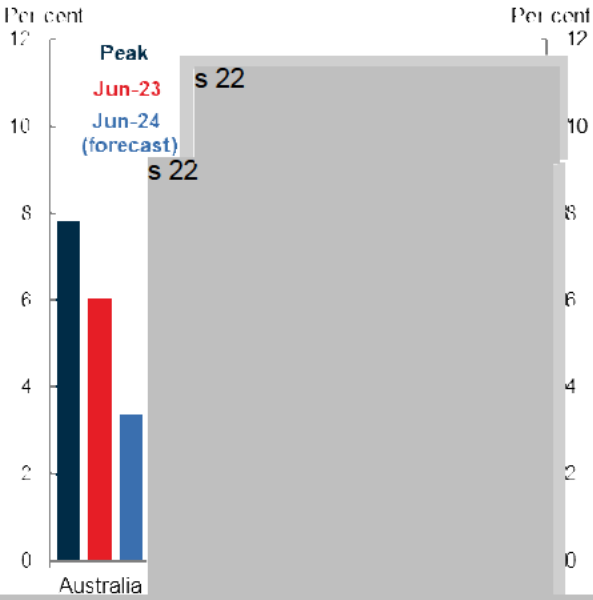

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Chart 2: Cumulative change in CPI, Dec-19 to Jun-24

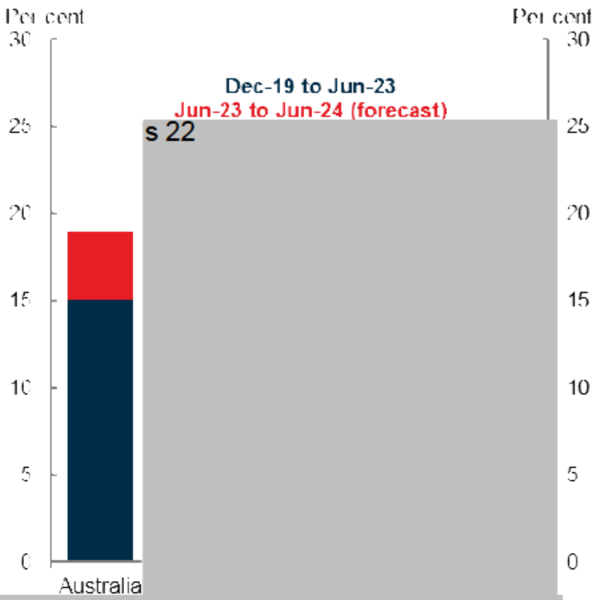

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Chart 3: Change in CPI since peak

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Chart 4: Cumulative change in CPI, Dec-19 to Jun-23, by component

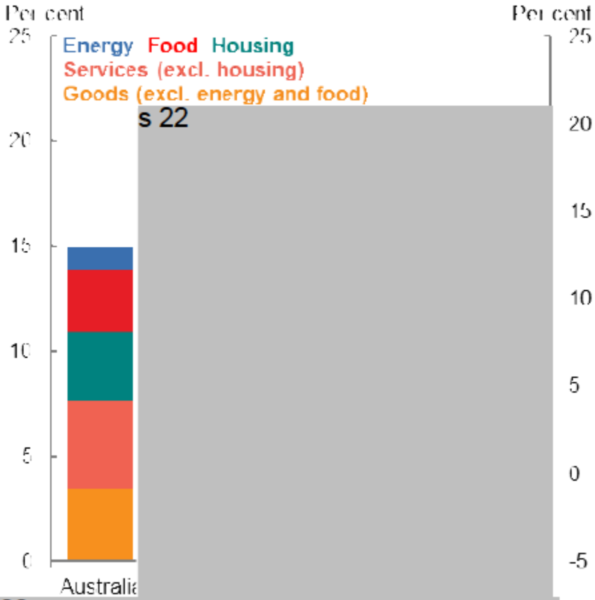

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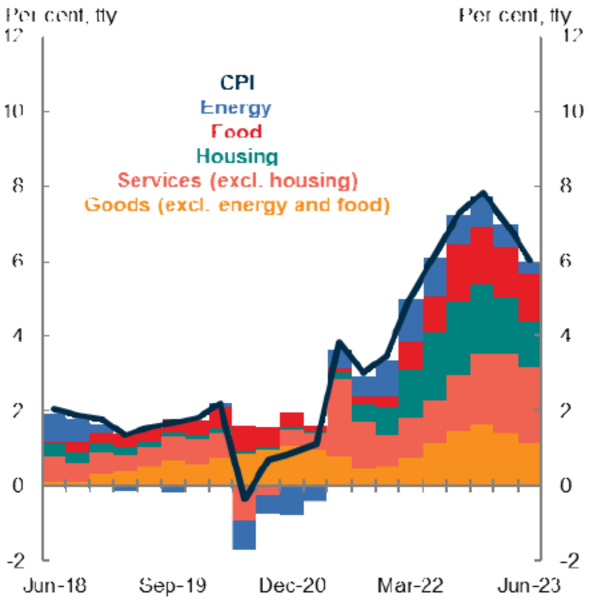
Chart 5: Contributions to CPI growth, Australia



Source: Refinitiv, National statistical agencies, Treasury estimates

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Chart 12: Core goods price inflation

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Chart 14: CPI Energy price inflation, tty

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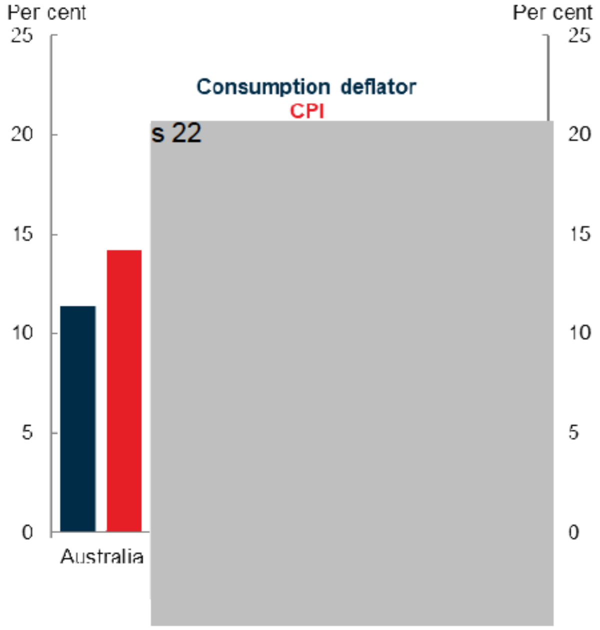
s 47(1)(b)

[redacted]

s 47(1)(b)

[redacted]

Chart 21: Consumption deflator and CPI, cumulative change Dec-19 to Mar-23



s 22 [redacted]

Chart 22: CPI (solid) and consumption deflator (dash), US and Australia

s 47(1)(b) [redacted]

Table 2: Percentage point contributions to cumulative inflation (Dec-19 to Jun-23)

Country	Food	Energy	Goods (excl. energy and food)	Housing	Services (excl. housing)	Total
Australia	2.9	1.2	3.5	3.3	4.1	**15.1**

s 22 [redacted]

Supplementary Budget Estimates 2023 - 2024

TOPIC: IMPACT OF CORPORATE PROFITS ON INFLATION

Key Points

- Sectoral shocks and rising input costs, not corporate profits, have driven domestic inflation to date.

KEY FACTS AND FIGURES
• Treasury does not consider that increased profit margins have been a key driver of the recent rise in consumer price inflation.
• The non-mining labour share of income has remained relatively stable over time.
• RBA analysis supports Treasury's conclusion.

Talking Points

- **Treasury does not agree with the conclusion that an increase in corporate profit margins have been a key driver of consumer price inflation.** The Australia Institute claim that excess profits are responsible for 69 per cent of inflation above the RBA's target, noting that the RBA target the Consumer Price Index. Treasury analysis does not support the strength of the conclusions for a number of reasons.
- The Australian Institute **use the GDP deflator**, not the Consumer Price Index (CPI) to attribute drivers of inflation.
  - Whereas the CPI reflects changes in prices of goods and services consumed by households, the GDP deflator reflects the composition of GDP, not household consumption. For example, mining is weighted as 14 per cent of the GDP deflator, and agriculture at only 2 per cent.
- Given this, the Australian Institute **overstate the role of mining prices** and profits driving domestic inflation (implying consumer price inflation).
  - Commodity prices are a driver of energy prices, which Treasury estimates contributed only ½ a percentage point directly to the 7.8 per cent December quarter 2022 peak in annual inflation.
  - Australian fossil fuels are largely exported, and do not affect household consumption. 92 to 95 per cent of coal, and 65 to 70 per cent of oil and gas production were exported from 2018-19 to 2020-21.

- The Australian Institute assert that profits have caused inflation, **without assessing why profits have changed**. Profits and inflation are generally driven by demand and supply imbalances.
  - Where firms raise prices due to excess demand, competition should ensure high profits growth is temporary, and monetary policy should constrain excess aggregate demand.
  - Profits do not themselves cause changes in consumer prices, particularly if products are exported, or profits are driven by changes in volumes.
- The Australian Institute **use gross operating profit**, an inaccurate measure of firm profits which does not account for taxes, interest, or depreciation.
- RBA analysis presented in the May 2023 Statement on Monetary policy supports Treasury's position. The RBA considers:
  - There is little evidence that there has been a broad-based increase in domestic non-mining profit margins, suggesting profit margins have not been a significant systemic cause of the increase in aggregate inflation.
  - It is not appropriate to include mining sector profits when assessing the impact of corporate profits, as the outputs of this sector are exported in much larger volumes than are used as inputs to domestic production.
- Treasury's position is also supported by research presented at the RBA's Annual Conference 2023 by officials from the RBA, Treasury and the University of Melbourne:
  - They do not consider that firm markups (a proxy for corporate profits) have been a plausible source of inflation amplification in Australia recently.
- Work by organisations including the IMF, ECB and OECD has not changed Treasury's view.
  - The methodologies have generally been inappropriate for measuring consumer price inflation in Australia. As in the Australia Institute report, they typically focus on measures of output price inflation, such as the GDP deflator.
  - The authors of this analysis typically note that for commodity producers and exporters, the GDP deflator is a less appropriate measure of the price inflation faced by consumers.
  - Outsized contributions of exports, particularly commodities, are less of an issue in the European context, where mining is a smaller share of GDP.

Excluding mining, the profit share of income has remained relatively stable.

- The profit share of factor income (including mining) increased from December 2019 to June 2023 (see Table 1). However, this result was driven by mining profits on the back of persistently high commodity prices.
  - Once mining sector activity is excluded, the profit and wage shares of factor income have remained relatively stable.
  - While not a precise guide to firm profits, this measure provides an indication of the distribution of income between factors of production and is inconsistent with margins increasing significantly outside of the mining sector.

Table 1: Shares of factor income

%	Dec-19	Jun-23	Ppt change
Profits share of total factor income	28.5	29.5	1.0
Profit share of factor income excluding mining	20.9	21.2	0.3
Wages share of total factor income	52.0	52.4	0.4

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Supplementary Budget Estimates 2023 - 2024

TOPIC: AGED CARE AND MODELLING MINIMUM WAGE ANALYSIS, IMPACT ON AGGREGATE WAGES, INFLATION

KEY FACTS AND FIGURES

s 22

[redacted]

- At the 2023-24 Budget, Treasury assumed Fair Work Commission (FWC) determinations would add around ½ of a percentage point to wages growth in 2023–24, above the 10-year average contribution of the Annual Wage Review (AWR) decision of around a ¼ percentage point. This includes the AWR and Aged Care Work Value Case.
  - The FWC AWR decision was assumed to add around ¼ of a percentage point to inflation by June-2025
- On 2 June 2023, the FWC announced that modern award wages would increase by 5.75 per cent and the National Minimum Wage would increase by an aggregate 8.6 per cent, effective from 1 July 2023.
  - The AWR outcome was slightly larger than the technical assumption used in Budget, but does not materially increase the forecasts for wages and inflation in the 2023-24 Budget.
  - Treasury will update its forecasts, considering the full range of new data, at MYEFO.
- The Government supported a pay rise for aged care workers and has provided $11.3 billion to support the FWC's decision to provide an interim increase of 15 per cent to minimum wages for many aged care workers.
  - This includes $2.6 billion in 2023-24, which is not expected to have a material impact on inflation.
  - The annual dollar amount rises to a maximum of $3.1 billion in 2026-27.

Table 1: Summary of AWR budget judgements and outcomes
This table was published as part of FOI 3402

	Budget Assumption	Outcome
Minimum wage increase	6.9% ($56 p/w for full time worker)	8.6% ($70.20 p/w for full time workers)
Award wages (and award linked)	4% or $56 p/w, whichever is larger	5.75%
Estimated average pay increase (total)	5.2%	5.8%
Workers who received minimum wage increase	184,000 receive 6.9%	79,200 receive 8.6% (Non-award workers with IAs on the NMW) 104,800 receive 5.75% (Award and Award-linked EBA workers on the NMW)
Employees on award wages (May 2021)	2,659,400 employees (23.0% of all employees)	
Employees on award-linked EBA's or Individual arrangements	Around 5% of employees (Based on RBA estimate)	
Impact on WPI above 10-year average impact (rounded) WPI spillover assumption	Direct: 1/4 **Total: 1/4** 50% over 6 quarters	Direct: 1/4 **Total: 1/2**
Impact on AENA (rounded) above 10-year average impact AENA spillover assumption	Direct: 1/4 **Total: 1/2** 50% over 6 quarters	Direct: 1/2 **Total: 1/2**
Assumed pass-through to CPI	50% of AENA impact	
Impact on CPI	¼ percentage point	¼ percentage point

***Indicates data not publicly available**

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FOI 3492
Document 7

SB23-000242

ECONOMIC OUTLOOK

Headline Statement

- Since Budget, global financial risks have moderated and there has been greater-than-expected resilience in advanced economies, particularly the US. However, the outlook for China has deteriorated and global growth is still expected to be the weakest two-year period in over two decades, outside of the GFC and pandemic.
- Economic growth in Australia is expected to moderate in 2023-24 as high inflation and interest rates weigh on household spending. The outlook for domestic demand has softened since Budget, although this is expected to be offset by the strong return of international students, which will contribute to net exports.
- CPI inflation eased to 6.0 per cent in the June quarter 2023 and is expected to return to the RBA's target band in 2024-25.

s 22 [redacted]

Key Points

- At Budget, elevated inflation and tighter financial conditions were expected to slow **global growth** from 3.4 per cent in 2022 to 2¾ per cent in 2023.
- Since Budget, both the IMF and OECD have revised up growth for 2023 and slightly revised down growth in 2024.
  - Both outlooks still represent the weakest two-year period in over two decades, outside of the GFC and pandemic.
- Global headline inflation has fallen sharply since peaking in the second half of 2022, while core inflation is declining more gradually.
  - The IMF expects inflation will not return to target in most countries until 2025 or later, with recent increases in oil prices presenting upside risks.

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- Inflation has fallen and is expected to return to the RBA target band in June 2025. The weaker domestic demand outlook will relieve underlying price pressures, but temporary factors such as higher oil prices will add to near-term headline inflation in 2023-24.

Domestic forecast comparisons

- Treasury's 2023-24 Budget forecasts for real GDP are slightly higher than more recent forecasts of the RBA and Deloitte Access Economics. Budget forecasts for the unemployment rate, headline inflation and wage growth sit within the range of other forecasts.

s 22

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Table 1: Domestic outlook

	Outcome		Forecasts				
	2021-22	2022-23	2022-23	2023-24	2024-25	2025-26	2026-27
Real GDP	3.7	3.4	3 1/4	1 1/2	2 1/4	2 3/4	2 3/4
Employment	3.7	3.2	2 1/2	1	1	1 3/4	1 3/4
Unemployment rate	3.8	3.6	3 1/2	4 1/4	4 1/2	4 1/2	4 1/4
Consumer price index	6.1	6.0	6	3 1/4	2 3/4	2 1/2	2 1/2
Wage price index	2.6	3.6	3 3/4	4	3 1/4	3 1/4	3 1/2
Nominal GDP	10.9	9.7	10 1/4	1 1/4	2 1/2	5 1/4	5 1/4

a) Real GDP and Nominal GDP are percentage change on preceding year. The consumer price index, employment, and the wage price index are through the year growth to the June quarter. The unemployment rate is the rate for the June quarter.

Source: ABS Australian National Accounts: National Income, Expenditure and Product; Labour Force Survey, Australia; Wage Price Index, Australia; Consumer Price Index, Australia; and Treasury

Table 2: Detailed forecasts[(a)]

	Outcomes		Forecasts		
	2021-22	2022-23	2022-23	2023-24	2024-25
Real gross domestic product	3.7	3.4	**3 1/4**	**1 1/2**	**2 1/4**
Household consumption	3.7	5.3	5 3/4	1 1/2	2 1/2
Dwelling investment	2.9	-3.5	-2 1/2	-3 1/2	-1 1/2
Total business investment[(b)]	6.1	5.9	3	2 1/2	2
By industry					
Mining investment	8.4	3.0	0	2	1 1/2
Non-mining investment	5.4	6.9	4	2 1/2	2
Private final demand[(b)]	4.3	4.2	4	1	2 1/4
Public final demand[(b)]	6.5	2.3	1 3/4	1 1/2	2
Change in inventories[(c)]	0.0	0.0	0	0	0
Gross national expenditure	5.0	3.6	3 1/4	1	2 1/4
Exports of goods and services	-0.3	8.8	8	6	3 1/2
Imports of goods and services	7.0	10.2	9	4	3 1/2
Net exports[(c)]	-1.3	0.0	0	1/2	0
Nominal gross domestic product	10.9	9.7	10 1/4	1 1/4	2 1/2
Prices and wages					
Consumer price index[(d)]	6.1	6.0	6	3 1/4	2 3/4
Wage price index[(d)]	2.6	3.6	3 3/4	4	3 1/4
GDP deflator	7.0	6.1	7	- 1/4	1/4
Labour market					
Participation rate (per cent)[(e)]	66.6	66.9	66 1/2	66 1/4	66 1/4
Employment[(d)]	3.7	3.2	2 1/2	1	1
Unemployment rate (per cent)[(e)]	3.8	3.6	3 1/2	4 1/4	4 1/2
Balance of payments					
Terms of trade[(f)]	11.9	-1.8	1 1/2	-13 1/4	-8 3/4
Current account balance (per cent of GDP)	1.9	1.1	3/4	-2 1/2	-3 1/2

a) Percentage change on preceding year unless otherwise indicated.
b) Excluding second-hand asset sales between the public and private sector.
c) Percentage point contribution to growth in GDP.
d) Through-the-year growth rate to the June quarter.
e) Seasonally adjusted rate for the June quarter.
f) Key commodities are assumed to decline from elevated levels over four quarters to the end of the March quarter of 2024: the iron ore spot price is assumed to decline from a March quarter 2023 average of US$117 to US$60/tonne; the metallurgical coal spot price declines from US$342 to US$140/tonne; the thermal coal spot price declines from US$260 to US$70/tonne; and the LNG spot price declines from US$16 to US$10/mmBtu. All bulk prices are in free-on-board (FOB) terms.

Source: ABS Australian National Accounts: National Income, Expenditure and Product; Balance of Payments and International Investment Position, Australia; National state and territory population; Labour Force Survey, Australia; Wage Price Index, Australia; Consumer Price Index, Australia; unpublished ABS data and Treasury.

Table 3: Domestic forecast comparisons

	Real GDP (a)			Nominal GDP (a)		
	2022-23	2023-24 (f)	2024-25 (f)	2022-23	2023-24 (f)	2024-25 (f)
Treasury - 2023-24 Budget	3.4	1 1/2	2 1/4	9.7	1 1/4	2 1/2
RBA		1	1 3/4		na	na
s 47(1)(b)						

	Unemployment rate (b)			Consumer Price Index (c)			Wage Price Index (c)		
	2022-23	2023-24 (f)	2024-25 (f)	2022-23	2023-24 (f)	2024-25 (f)	2022-23	2023-24 (f)	2024-25 (f)
Treasury - 2023-24 Budget	3.6	4 1/4	4 1/2	6.0	3 1/4	2 3/4	3.6	4	3 1/4
RBA		4.2	4.5		3.6	3.1		4.0	3.7
s 47(1)(b)									

a) Percentage change on the preceding year.
b) Unemployment rate is for the June quarter.
c) CPI and WPI seasonally adjusted through the year to the June quarter.
Note: 2022-23 numbers are actuals.
Source: Treasury 2023-24 Budget forecasts; National Income, Expenditure and Product, September 2023; RBA Statement on Monetary Policy August 2023; s 47(1)(b)

Table 4: International GDP growth forecast comparison[(a)]

Forecast (Calendar Years)

	2023			2024			2025
	2023-24 Budget	IMF October	OECD September	2023-24 Budget	IMF October	OECD September	2023-24 Budget
Australia	1 ¾	1.8	1.8	1 ½	1.2	1.3	2 ¾

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FOI 3492
Document 8

SB23-000244

HOUSING MARKET

s 22 [redacted]

- Rental market conditions remain tight, with national vacancy rates remaining at near-record lows of around 1 per cent and advertised rents continuing to grow strongly in September 2023 (Table 4).
  - CPI rents (which measures average rents across all rentals in capital cities), rose by 6.7 per cent through the year to the June quarter 2023, contributing 0.4 percentage points to annual inflation.

1 page has been removed from this document as irrelevant material under section 22 of the FOI Act

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- Growth in market rents is expected to remain elevated over 2023-24, as recent increases in advertised rents flow through to existing leases. Growth is expected to ease in 2024-25, aided by an expected pickup in dwelling completions.

- Rises in interest rates, dwelling prices and rental prices have contributed to worsening housing affordability.

  - The HIA Affordability Index, the ratio of income to mortgage repayments, fell by 8.7 per cent in the June quarter 2023 to its lowest level since 2008.

  - The deposit hurdle, as measured by the number of years needed to save for a deposit, rose to 9.9 years in the June quarter 2023 for dwellings nationally, above the 10-year average of 9.1 years.

  - Increasing rental prices are exacerbating rental affordability issues, with people renting for longer, and taking longer to save for a deposit.

Background tables

s 22

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s 47(1)(b)

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INFLATION

Headline Statement

- CPI inflation eased to 6.0 per cent in the June quarter 2023 after peaking at 7.8 per cent in the December quarter 2022.
- CPI inflation is expected to return to the RBA's target band in 2024-25.
- The Government's measures to deliver cost-of-living relief will directly reduce the CPI by ¾ of a percentage point in 2023-24.
- In aggregate, fiscal policy has been supporting monetary policy to reduce demand and inflationary pressures. Over the two years to 2022-23, the budget deficit as a share of GDP has reduced by 7.3 percentage points.

Key Points

Table 1: Published CPI forecasts

	2022-23	2023-24	2024-25
May Budget 2023-24	6	3¼	2¾
October 2022-23 Budget	5¾	3½	2½

- Inflation has fallen broadly as expected at Budget, led by an easing of price growth across goods, housing, transport, and travel. Easing supply pressures have slowed annual price growth in new dwellings and motor vehicles.
- However, some upside risks have emerged since Budget.
  - **Petrol prices** have risen significantly in recent months and remain a key upside risk to the outlook in the near-term. Metropolitan average petrol prices are back over two dollars a litre, similar to the early stages of Russia's invasion of Ukraine, reflecting renewed rises in oil prices.
  - **Rental conditions** have remained tighter than expected at Budget, posing an upside risk for rents.
  - While **food inflation** peaked in the December quarter 2022, in line with broader price pressures, the continued flow through of input costs and El Niño conditions present upside risks in the near-term.

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- Over July and August 2023, CPI electricity prices have risen by 4.7 per cent.[1] Without the Government's Energy Bill Relief Fund, prices would have risen by 19.7 per cent thus far in 2023-24.
- The handover from goods- to services-led inflation has also occurred as expected at Budget: the June quarter 2023 was the first time in this inflationary episode where annual services inflation (6.3 per cent) had been greater than goods inflation (5.8 per cent).
  - Prices for services such Insurance and Restaurant meals grew significantly in the August Monthly CPI Indicator, by 14.7 per cent and 6.1 per cent, through the year respectively. However, this level of growth is broadly in line with Treasury's expectations.
- Profits have not been the major driver of inflation in Australia.
  - In aggregate, the profit share of factor income excluding mining is 0.3 percentage points higher than in the December quarter of 2019.
  - Excluding the mining industry, the profit share has remained relatively stable.
  - The run up of inflation in Australia can largely be explained by the direct and indirect impact of known cost increases and sectoral shocks.

Table 2: Key component price growth (%, tty)

	March quarter 2023	June quarter 2023	Jul-23 (m)	Aug-23 (m)
Automotive fuel	1.1	-3.6	-7.6	13.9
Rents	4.9	6.7	7.6	7.8
Food	8.0	7.5	5.6	4.4

Fiscal policy stance

- In aggregate, fiscal policy has been supporting monetary policy to reduce demand and inflationary pressures. The Final Budget Outcome for 2022-23 shows that fiscal policy has tightened significantly.
  - Over the two years to 2022-23, the budget deficit as a share of GDP has reduced by 7.3 percentage points – larger than the 6½ per cent improvement estimated at the May Budget.

[1] Source: ABS Monthly Consumer Price Index Indicator.

Policy and CPI impacts - Table 3: CPI Impact of Various Policies

Policy	Impacts/Summary
Energy and Energy Price Relief Plan	• Directly reduce inflation by ¾ of a percentage point 2023–24), including price caps and energy rebates. • As at Budget, Retail electricity price increases in 2023–24 are expected to be around 10 per cent with subsidies. – Including the subsidies, this is around 25 percentage points smaller than was expected in Dec 2022. • Retail gas price increases in 2023–24 are expected to 4 per cent. – This is around 16 percentage points smaller than expected prior to the Government's intervention.
Annual Wage Review (AWR)	• Treasury has assumed Fair Work Commission (FWC) determinations will add around ¼ of a percentage point to inflation across 2023-24 and 2024-25. This includes the Annual Wage Review and Aged Care Work Value Case.
Commonwealth rent assistance (CRA)	• *Policy* – 15 per cent increase in the maximum rates of CRA, which will directly reduce rental prices as measured in the CPI. • It is not expected to have a material impact on broader market rents or inflation.
Tobacco excise increase	• *Policy* – The Tobacco excise increase of an extra 5 per cent to indexation for three years. • Is not expected to materially impact CPI inflation. • Changes will increase tobacco prices by an additional 3.5 percentage points annually in 2022-23, 2023-24 and 2024-25. • Tobacco currently represents 2.8 per cent of the CPI basket.
Road User Charge (RUC)	• *Policy* – 6 per cent increase annually to the RUC for the years from 2023-24 to 2025-26. • Expected to have a negligible impact on headline CPI inflation (less than 0.1 percentage points after three years). • Treasury estimates road transport costs constitute around 3 per cent of final demand (less exports). • RUCs constitute around 5 per cent of this share.

Table 4: Cost-of-living relief package – At Budget 2023-24

	2022-23	2023-24	2024-25	2025-26	2026-27	Total
Reducing the cost of health care						
Strengthening Medicare - Supporting Bulk Billing in General Practice	..	-619	-953	-946	-942	-3,460
Medicare Urgent Care Clinics	-24	-19	-11	-30	..	-85
Changes to maximum dispensing quantities (reinvested in full in community pharmacy)	-	-	-	-	-	-
Energy price relief						
Energy Bill Relief Fund	0	-1,110	-385	0	0	-1,495
Household Energy Upgrades Fund (co-funded support)	0	-9	-66	-102	-123	-300
Support for those who need it most						
Parenting Payment (Single) – improved support for single parents	-2	-365	-498	-517	-532	-1,915
Increase to Working Age Payments	-5	-982	-1,231	-1,213	-1,221	-4,651
More affordable housing						
Increased Support for Commonwealth Rent Assistance Recipients	-6	-538	-705	-725	-743	-2,717
Total	**-38**	**-3,641**	**-3,848**	**-3,534**	**-3,561**	**-14,622**

**Note, the UCB impact of Increase to Working Age Payments is $4.7b when $220m of related receipts are included. The $85m for Medicare Urgent Care Clinics is new funding in this Budget as there was already money in the Contingency Reserve.*

Table 5: International inflation comparison

	Headline peak (tty)		Core peak (tty)		Latest data (tty)			Core peak (QoQ)		Q2-23
	Peak	Date	Peak	Date	Core	Headline	Date	Peak[(g)]	Date	QoQ[(g)]
Australia	7.8	Dec-22	7.1	Dec-22	5.8[(a)]	6.0	Jun-23	1.9	Dec-22	0.9

s 22 [redacted]

a) Excluding food and energy. s 22 [redacted]

s 22 [redacted]

FOI 3492
Document 10

Australian Government
The Treasury

Ministerial Submission

MS23-002288

FOR INFORMATION - Israel-Hamas conflict: Economic impacts of oil price shocks

TO: Treasurer - The Hon Jim Chalmers MP
CC:

KEY POINTS

- The recent Israel–Hamas conflict poses upside risks to oil prices and headline inflation if tensions were to escalate and spill over into major oil exporting regions. This would disrupt supply in an already tight oil market.

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- Higher oil prices lead to a peak increase in domestic inflation of 0.4 percentage points in the moderate scenario and around 1 percentage point in the severe scenario.
  - Around half of the inflation impact occurs directly through higher automotive fuel prices. The remainder reflects the indirect pass through of higher inputs costs for businesses into other prices, which is assumed to occur over 4 quarters.
  - The peak inflation impact occurs in the December quarter of 2023. This impact moderates as the oil price increase unwinds.

3 pages have been removed from this document as irrelevant material under section 22 of the FOI Act

s 22 [redacted]

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ATTACHMENTS

A: Additional Information