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Secretary to the Treasury

Post-Budget economic briefing*

Address to the Australian Business Economists

30 May 2024

Thank you Besa, it's a pleasure to be back with the ABE for my post-Budget address.

I begin today by acknowledging the Traditional Custodians of the land on which we are meeting, the Gadigal people of the Eora Nation, and I acknowledge their ongoing connection to Country.

I pay my respects to their Elders – past and present – and extend my respect to any First Nations people who are here with us today.

Today I will discuss the economic and fiscal outlook, before spending some time talking about structural spending pressures, competition policy and climate change policy.

Global outlook

In recent years, the global economy has been buffeted by shared shocks – a global pandemic, supply disruptions and war.

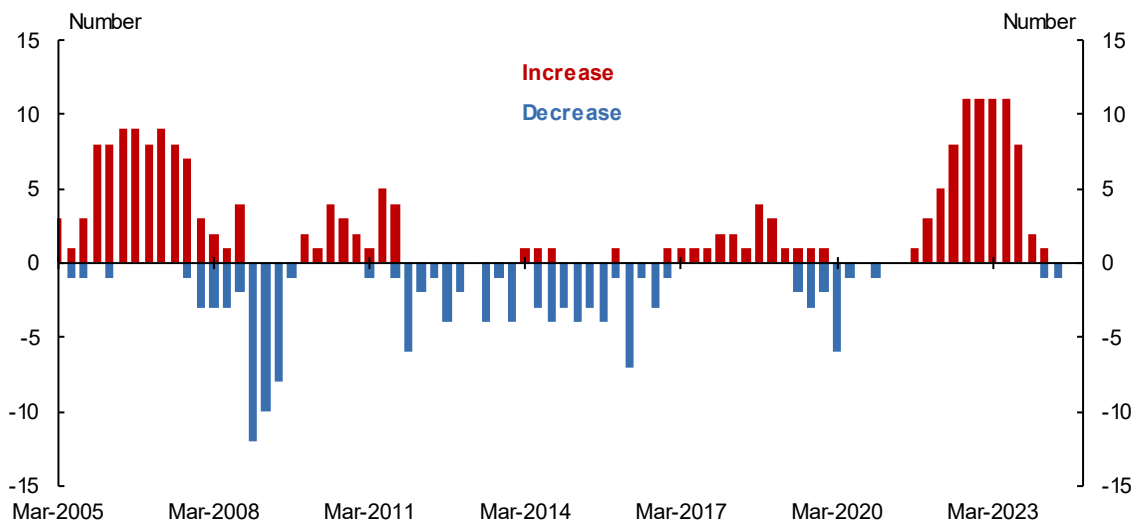
As a result, the immediate challenges facing economies were similar.

Initially these were characterised by sharp falls in economic activity during the pandemic, and then a surge of inflation as global supply-demand imbalances emerged.

In response, monetary and fiscal policy moved in a mostly synchronised fashion (Chart 1).

* I would like to express my appreciation to Shane Johnson and Nicola Neilsen for their assistance in preparing this address.

Chart 1: Number of advanced economy central banks adjusting their policy rate



Note: Sample comprises Australia, Canada, Japan, New Zealand, Norway, Sweden, Switzerland, United Kingdom and United States, as well as France, Germany and Italy under the jurisdiction of the European Central Bank. Latest data are for June quarter to date.

Source: Bloomberg and Treasury

It is too early to say if we are back in a more normal period, perhaps because no one is quite sure what normal is anymore.

And especially as unusual economic outcomes are persisting. For example, we are likely to experience the weakest period of global growth since the early 1990s.¹

But it is reasonable to say that the effects of recent shocks are abating, and we are beginning to see greater divergence in the global outlook, reflecting individual countries' circumstances.

The US economy has continued to display remarkable resilience. Growth in the past year has exceeded expectations. Household consumption and business investment have been strong, supported by robust employment growth, expansionary fiscal settings, and a post-pandemic rebound in productivity.

An element of the US fiscal expansion has been the automatic indexation of income tax brackets to inflation, which initially supported disposable wages when nominal wage growth was low, and later limited bracket creep when nominal wages accelerated. The automatic indexation of income tax brackets in the United States has been pro-cyclical with income tax payable as a share of household income declining by around 2 percentage points between June 2022 and December 2023, which compares with an increase of around 1 percentage point in Australia.

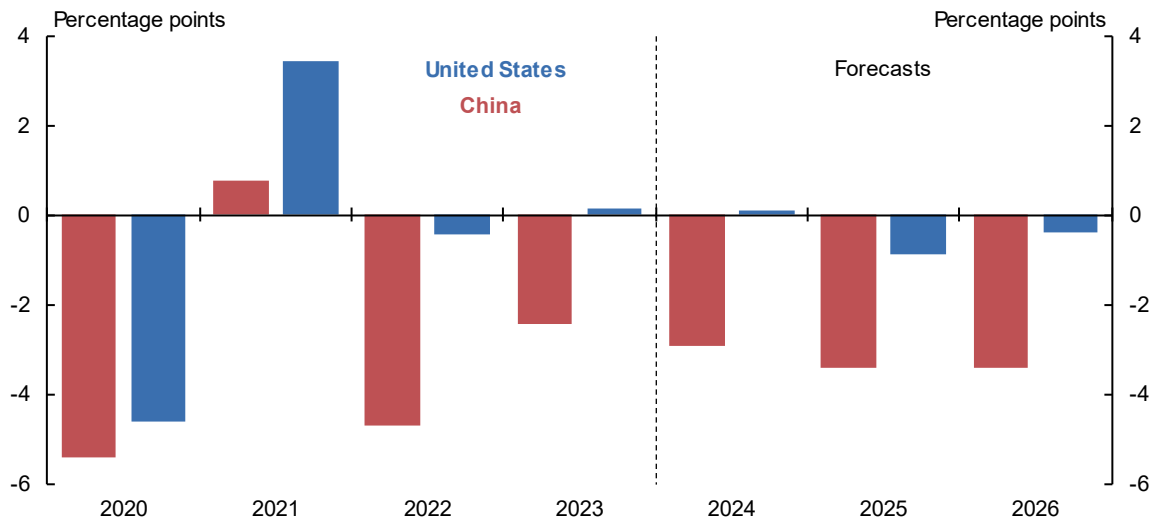
While growth exceeded expectations, US inflation moderated largely as expected in 2023. This created optimism that the US Fed may soon be able to ease monetary policy although this optimism has been tempered recently by mixed inflation data.

¹ Treasury forecasts longest period of below average growth since early 1990s. Similarly, World Bank forecasts lowest 5-year growth in 30 years.

The economic outlook is cloudier in China.

In 2023, growth in the Chinese economy was more than 2 percentage points lower than the average in the decade prior to the pandemic (Chart 2).

Chart 2: GDP growth, deviation from 2010-2019 average



Source: International Monetary Fund and Treasury

The Chinese economy continues to face structural challenges from slowing urbanisation, population ageing and lower productivity growth.

A persistent downturn in the property sector is weighing on growth. Declining dwelling prices are affecting consumer confidence and dwelling investment. This is a source of risk for Australian commodity exports.

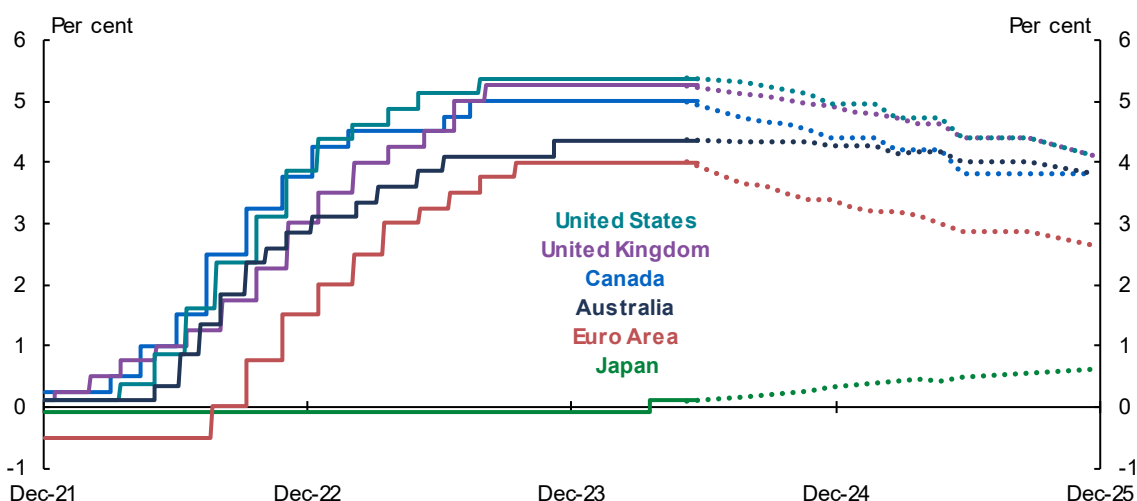
Recent increased investment in infrastructure and manufacturing, supported by additional fiscal policy may provide some offset this year.

Elsewhere in Asia, many other East Asian economies are expected to benefit from stronger demand in advanced economies, particularly the US.

As growth eases and inflation continues to moderate, most advanced economies are expected to ease monetary policy (Chart 3).

An exception is the Bank of Japan, which has only begun to withdraw longstanding monetary policy stimulus.

Chart 3: Monetary policy rates



Note: United States based on the midpoint of the target range for the Fed funds rate. Dotted lines reflect policy rate expectations implied by overnight indexed swaps (23 May 2024).

Source: Bloomberg.

However, there remains uncertainty around the paths of monetary policy globally.

As goods prices have normalised, services inflation has become the largest contributor to headline inflation.

Inflation rates are also being supported by the continued pass-through of earlier increases in other input costs and strong growth in insurance prices.

Central banks have emphasised they will not ease policy until they see inflation moving sustainably to their targets.

As inflation becomes increasingly driven by domestic factors, we can expect to see a greater divergence in policy settings across countries.

Domestic outlook

Domestic growth

Over the past year, the Australian economy has slowed, and inflation has moderated as expected.

In response to inflation and higher interest rates, households have pulled back on discretionary spending (Chart 4). Household consumption was broadly flat over the past year, and in per capita terms, it fell (Chart 5).

The contribution of household consumption to growth was the weakest in the past decade outside of the pandemic.

And weak retail trade data suggest this outcome is likely to continue into the first half of this calendar year.

The outlook for the March quarter GDP growth is subdued, reflecting the weakness in consumption.

Chart 4: Contribution to household consumption growth

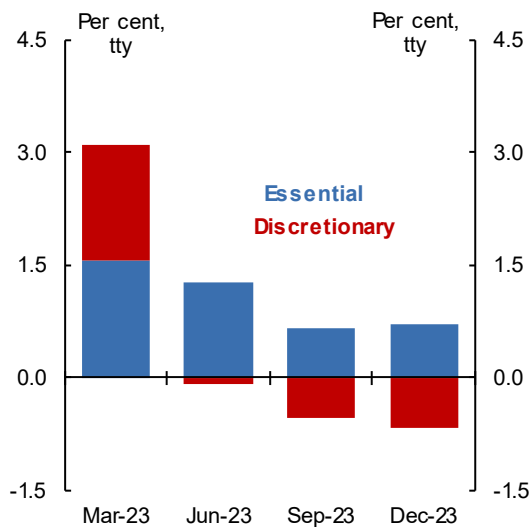
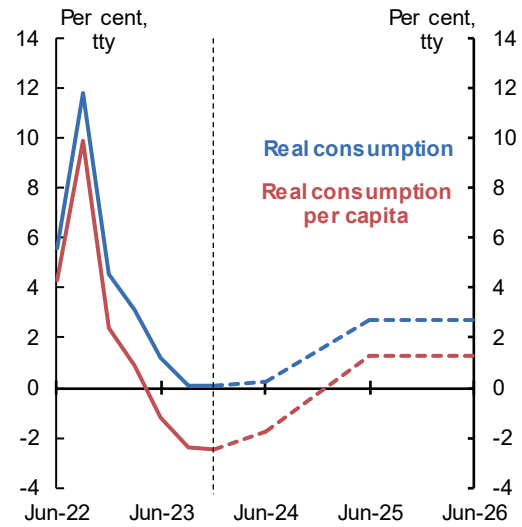


Chart 5: Household consumption



Source: ABS National Accounts: National Income, Expenditure and Product and Treasury.

Employment

One of the achievements of recent years has been sustained low rates of unemployment. The unemployment rate has averaged 3.7 per cent over the past 2 years, compared with 5.5 per cent over the 5 years prior to the pandemic.

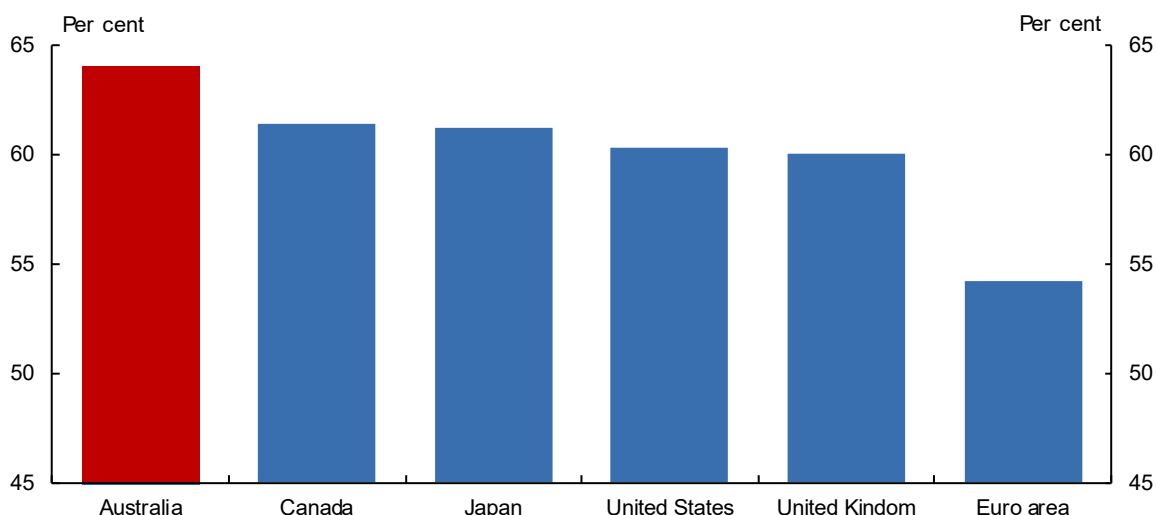
Employment growth in Australia has been stronger than any major advanced economy over the past 2 years. Employment has grown even after accounting for population growth (Chart 6).

For example, Canada also experienced strong population growth similar to Australia, but has not had as strong labour market outcomes. The employment-to-population ratio in Canada is lower than it was in early 2020, whereas in Australia it is 1.8 percentage points higher.

If the Australian employment-to-population ratio was at the same level as Canada, around 600,000 fewer people would be employed.

This suggests that population increases have added more equally to labour supply and labour demand in Australia than in Canada.

Chart 6: Employment-to-population ratio



Source: National statistical agencies, Refinitiv.

We have seen significant improvements in labour market outcomes for those who typically find it harder to find a job - youth unemployment is 2.6 percentage points lower than it was immediately prior to the pandemic.

Despite the recent strength, broader indicators of labour demand suggest that conditions are beginning to soften. This is expected to continue over the next year.

But we are not expecting a return to the 5-plus per cent rates of unemployment seen prior to the pandemic, with the unemployment rate expected to reach 4½ per cent by June 2025 and remain at around that level over the forward estimates.

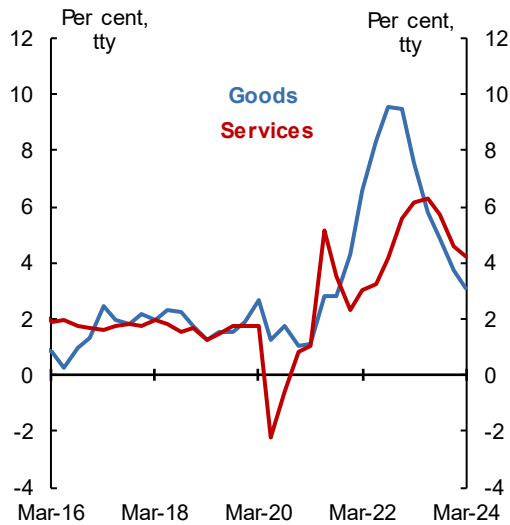
It is important to lock in as many of the labour market gains as we can from recent years. This involves macroeconomic policy aiming to keep employment near its maximum sustainable level consistent with low and stable inflation.

Inflation

Inflation is still above target in Australia, but is now less than half its peak in 2022.

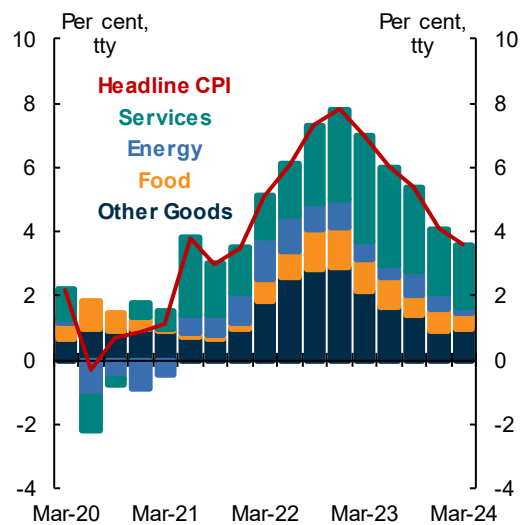
The rise in inflation was initially driven by goods and energy prices, reflecting strong global demand for goods, supply shocks in food and energy markets, and constrained global supply chains (Charts 7 and 8).

Chart 7: Australian goods and services inflation



Note: The introduction and expiry of COVID-19 related childcare policies generated significant volatility in services inflation in 2020 and 2021.
Source: Australian Bureau of Statistics, Treasury.

Chart 8: Contribution to Australian CPI growth



Note: Contributions are approximations prior to December 2023.
Source: Australian Bureau of Statistics, Treasury.

Compared with goods inflation, services inflation took longer to build momentum and is now the larger contributor to headline inflation. These lags reflect a prolonged recovery in the demand for services as COVID-related restrictions eased, and wage and other input cost increases took longer to flow through services supply chains.

The recovery in services demand was supported by strong population growth and healthy household balance sheets.

Inflation is expected to continue to moderate, with Treasury's inflation forecasts being broadly in line with the RBA's forecasts in the *May Statement on Monetary Policy*.

The ½ percentage point difference in June 2025 is mostly due to the Budget's 2 largest cost-of-living relief measures – that is the extension of the Energy Bill Relief Fund (EBRF) and further increase in Commonwealth Rent Assistance (CRA) payments.

The Budget outlined the risks to the inflation outlook.

A further escalation in current geopolitical tensions presents risks to energy and shipping prices. And housing inflation could continue to surprise on the upside.

Another key risk is productivity growth.

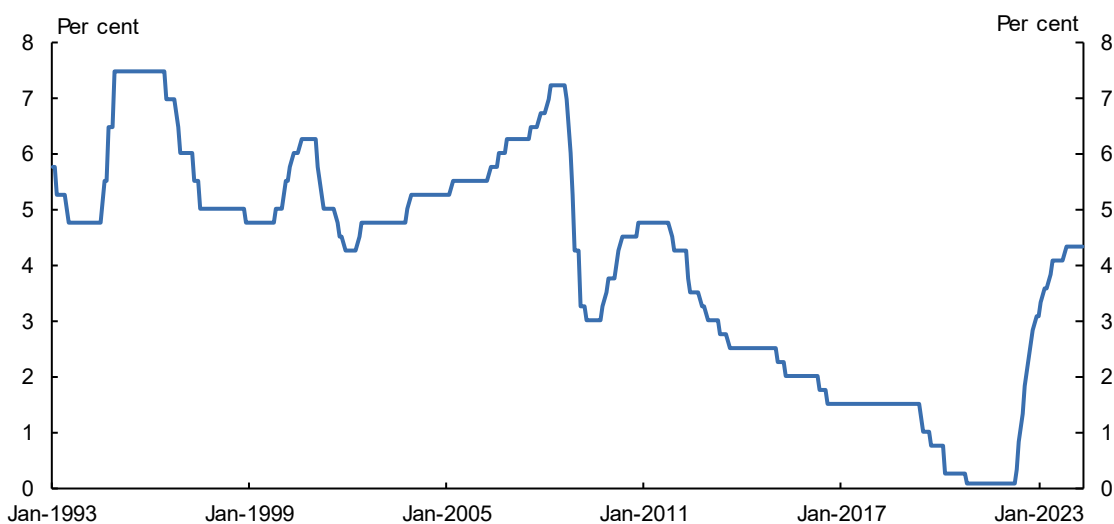
Globally recent productivity performance has been obscured by COVID-related factors. The extent to which productivity growth will recover remains uncertain, reflecting the uncertainty around medium-term productivity trends.

Monetary and fiscal policy

Since May 2022, the Reserve Bank of Australia Board has executed the sharpest tightening phase of monetary policy since inflation targeting was introduced in the early 1990s, raising the cash rate target by 425 basis points between May 2022 and November 2023.

The cash rate target is now around the levels that prevailed prior to the GFC (Chart 9). But it is much higher than the low-interest rates that we became accustomed to in the years immediately prior to the pandemic.

Chart 9: Cash rate target



Source: Reserve Bank of Australia.

Recent analysis by the IMF (2024) found that household cash flows and wealth tend to be relatively more affected by monetary policy in economies where fixed rate mortgages are less common, household debt and loan-to-value ratios are higher, and housing supply is restricted – all features of the Australian economy.²

Fiscal policy in Australia tightened at a record pace as inflation rose.

Measures of Australia's budget balance to GDP have improved by around 7 percentage points at the Commonwealth level, and by 7½ percentage points including the states and territories, since the pandemic trough.

The fiscal tightening in Australia has continued at a faster pace than in most other advanced economies. Since 2021, Australia's budget balance to GDP ratio has improved by over 5 percentage points (Chart 10). The advanced economy budget balance improved by only around 1½ percentage points over the same period.

² International Monetary Fund (2024) 'Feeling the Pinch? Tracing the Effects of Monetary Policy through Housing Markets', *World Economic Outlook, April*, accessed 23 May 2024.

Chart 10: Change in fiscal balance to GDP (2021 to 2023)



Note: International Monetary Fund fiscal data are produced on a consistent basis across countries. They are produced for calendar years and on a general government basis. They are not directly comparable with fiscal aggregates reported elsewhere in the Budget.

Source: International Monetary Fund, Treasury.

The tightening partly reflects allowing temporary fiscal support from the pandemic to expire – and restraint in not extending them or replacing them with new spending.

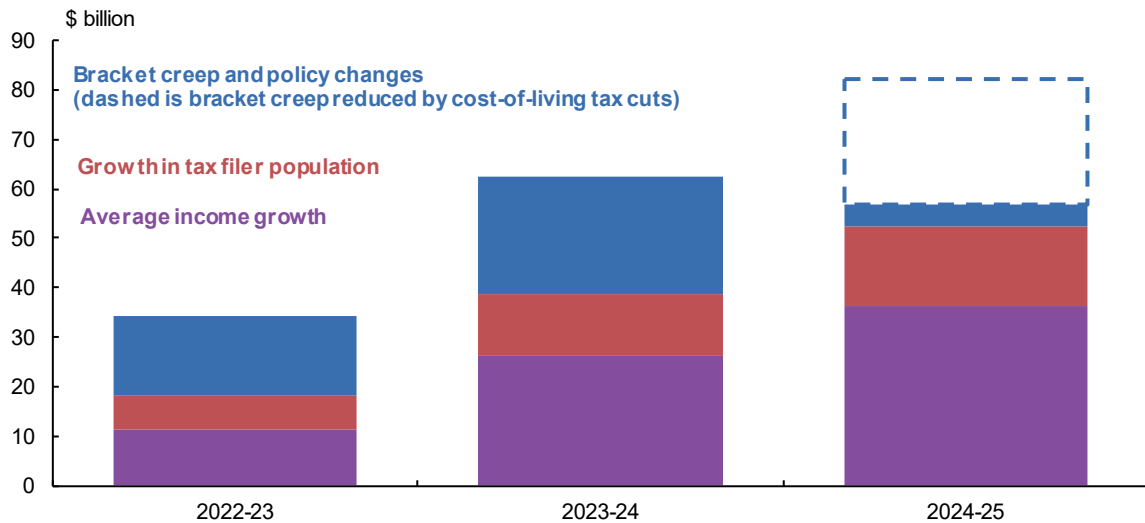
It also reflects fiscal automatic stabilisers. A strong economic recovery, tight labour market and high commodity prices meant higher activity and employment, and higher incomes for both individuals and businesses – drove up personal income and company tax collections.

Additional tax filers and growth in incomes are the main contributors to the increase in personal income tax since 2021–22. Bracket creep also contributed to additional income tax. However, in 2024–25, it is expected to account for less than 10 per cent of the forecast increase, reflecting the Government’s income tax cuts. Without the income tax cuts, bracket creep would have contributed a third of the personal income tax increase in 2024–25 relative to 2021–22 (Chart 11).

Bracket creep has been a helpful stabilising force over the past 3 years, contributing significantly to the automatic stabilising influence of the tax system. This stands in stark contrast to the US for example, where noted earlier, the indexation of income tax brackets has worked against monetary policy and been pro-cyclical.

Not indexing income tax brackets, within a medium-term fiscal framework, allows fiscal authorities to both assist in the management of business cycles and ensure fiscal sustainability.

**Chart 11: Drivers of growth in personal income tax compared to 2021–22
(income year basis)**



Note: Growth in the number of tax filers reflects a combination of population growth, labour force participation and other economic factors that affect the number of individuals earning income. Growth in average incomes includes the effect of growth in nominal wages and non-employment incomes, including capital gains, business income and dividend income. Bracket creep reflects the increase in the average tax rate due to income growth, as individuals pay a decreasing share of their income at lower marginal tax rates, and includes the effect of policy changes.

The chart is prepared on an income year basis, which differs from tax receipts due to differences in when tax is incurred compared to when paid.

Source: Treasury.

The speed of the recovery meant significant upgrades to revenue.

Banking the majority of revenue gains allowed these improvements in receipts to improve the fiscal position and moderate demand in the economy.

In addition to tightening to reduce demand pressures, fiscal policy has been used to provide cost-of-living support to limit the impact of rapid price rises on those with the least capacity to adjust.

Beyond allowing automatic stabilisers to take full effect, fiscal policy can play an important stabilising role when large swings are running through the economy. However, active fiscal policy is not well suited to fine tuning growth.

Decision and implementation lags make it difficult to alter the course of policy in a sufficiently timely way.

Fiscal policy is usually more suited to pursuing longer-term objectives that contribute to stability, sustainability and improving living standards.

As inflation moderates and we emerge from the recent crises, it is appropriate for fiscal policy to shift in emphasis towards these objectives.

Debt-cycles

The rapid fiscal consolidation since the pandemic has had a welcome flow-on effect on debt burden reduction.

Despite projections of a larger and more persistent increase early in the pandemic, gross debt-to-GDP was stabilised and has since been reduced by about 4.7 percentage points over the 2 years to 2023–24.

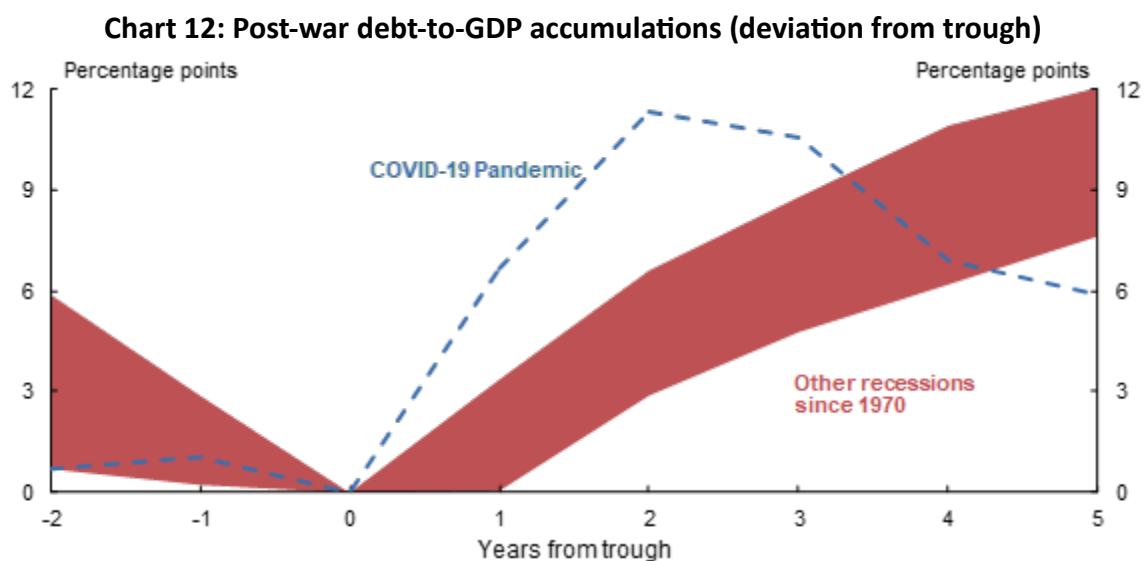
To keep debt-to-GDP on a stable path requires that it be reduced sufficiently in expansions to offset intermittent increases sparked by events such as sharp economic recessions and disruptive global events.

These events have tended to occur around every 15 years, on average.

Australian Government debt-to-GDP is in its eighth cycle of the last 110 years, and fifth since the 1970s.

Cycles sparked by recessions have seen debt-to-GDP rise by an average of around 13 percentage points from its trough, stabilising typically after around 5 years (Chart 12).

To keep debt-to-GDP on a stable trajectory – and not trending upwards – it has been necessary to reduce it by 1 to 1½ percentage points per year on average in the remaining years, to offset the earlier accumulations.



Source: Australian Office of Financial Management, Parliamentary Budget Office, Treasury.

Though gross debt-to-GDP has begun to be reduced, it remains 6 percentage points above pre-COVID levels, and well above the levels that persisted before the GFC. Current projections are for debt-to-GDP to drift upwards over the immediate period ahead before declining again from 2027–28 – taking over a decade to return to its pre-COVID levels.

Global debt-to-GDP levels remain well above pre-pandemic levels, which in turn are well above pre-GFC levels. This ratcheting up of global debt burdens adds to fiscal pressures from higher debt servicing costs, and poses risks to financial stability.

While unexpected inflation helped with a brief reduction in 2021 and 2022, the global macroeconomic and fiscal environment has become less favourable.

Across the developed world, spending pressures are growing, medium-term growth rates continue declining on the back of weak productivity growth, and borrowing costs are expected to remain higher than the historically low levels of the past decade.

As Arslanalp and Eichengreen argued at the Jackson Hole Symposium last year, these unfavourable dynamics mean debt-to-GDP is likely to stay elevated across most countries and the risk of debt crises will similarly remain elevated.

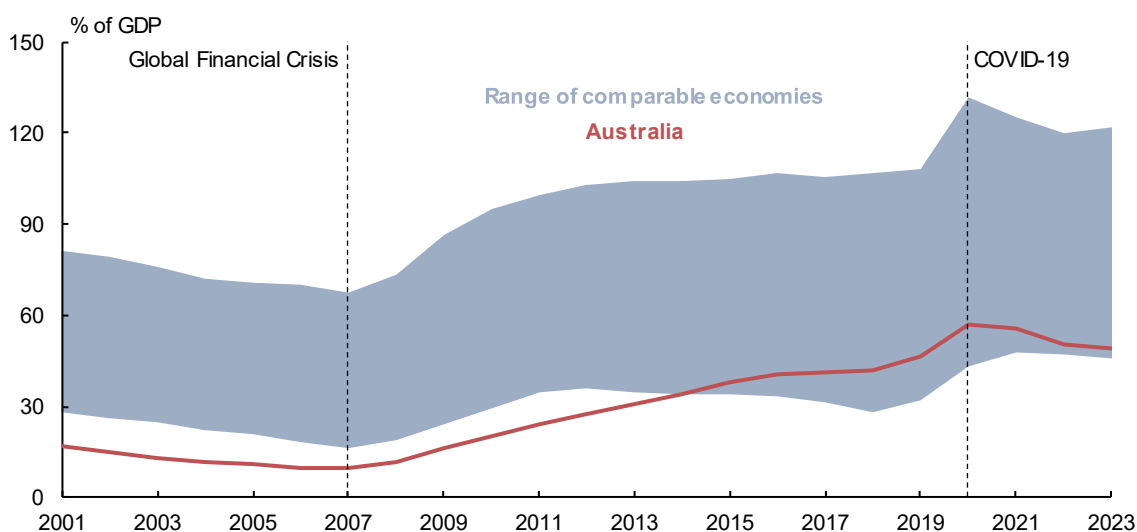
By way of example, current IMF projections see the US government debt-to-GDP ratio climb to 134 per cent by 2029, and US Congressional Budget Office projections under current policies are for it to exceed 160 per cent by 2054. As the Congressional Budget Office points out, among other effects, such large stocks of debt would drive up interest payments to foreign debt holders, heighten the risk of a fiscal crisis, and slow economic growth.

Fortunately, Australia's debt level remains low compared to international peers (Chart 13).

And while Australia is well placed, it is important to maintain this international advantage.

This will also help to ensure that governments are able to respond effectively to future crises.

Chart 13: General government gross debt



Note: International Monetary Fund fiscal data are produced on a consistent basis across countries. They are produced for calendar years and on a general government basis. They are not directly comparable with fiscal aggregates reported elsewhere in the Budget. The range has been calculated using a subset of comparable advanced economies: Canada, the Euro Area, New Zealand, United Kingdom and United States.
Source: International Monetary Fund, Treasury.

Challenges and opportunities

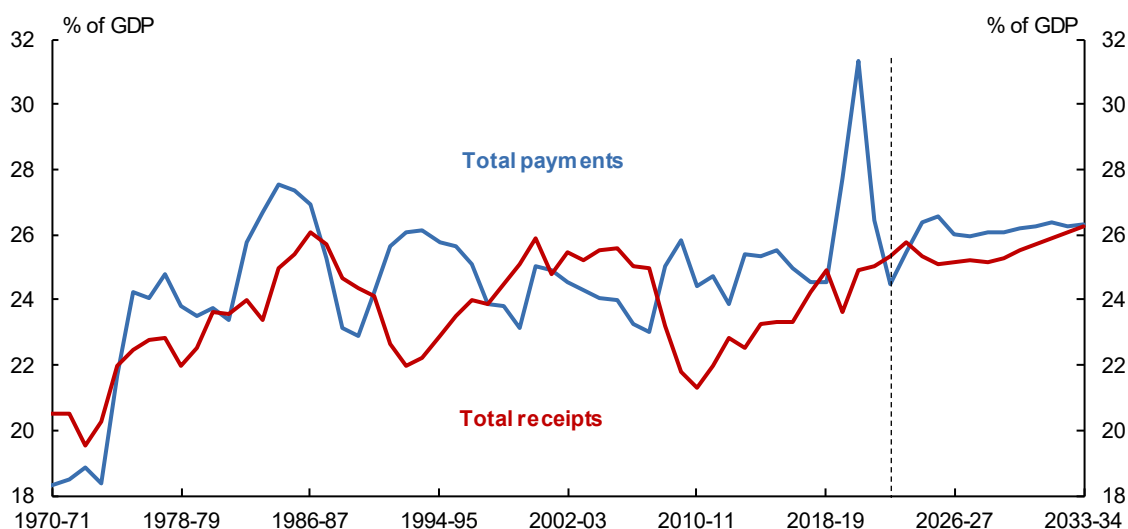
Following a \$22.1 billion surplus in 2022–23, a second successive surplus of \$9.3 billion (0.3 per cent of GDP) is now forecast in 2023–24. These would be the first back-to-back surpluses in 16 years.

The underlying cash balance returns to deficit in 2024–25 and is projected to remain in a structural deficit over the medium term to 2034–35.

Structural spending pressures

Payments as a share of GDP are rising to around 26.5 per cent over the next 2 years before returning to 26 per cent at the end of the forward estimates. Revenue-to-GDP remains persistently lower (Chart 14). For example, tax receipts as a proportion of GDP are not expected to reach earlier peaks of around 24 per cent until 2030–31.

Chart 14: Payments and receipts



Source: Treasury.

Over the next 10 years, payments as a share of GDP are on average expected to be around 2.1 percentage points higher than the 10-year average projected pre-COVID.

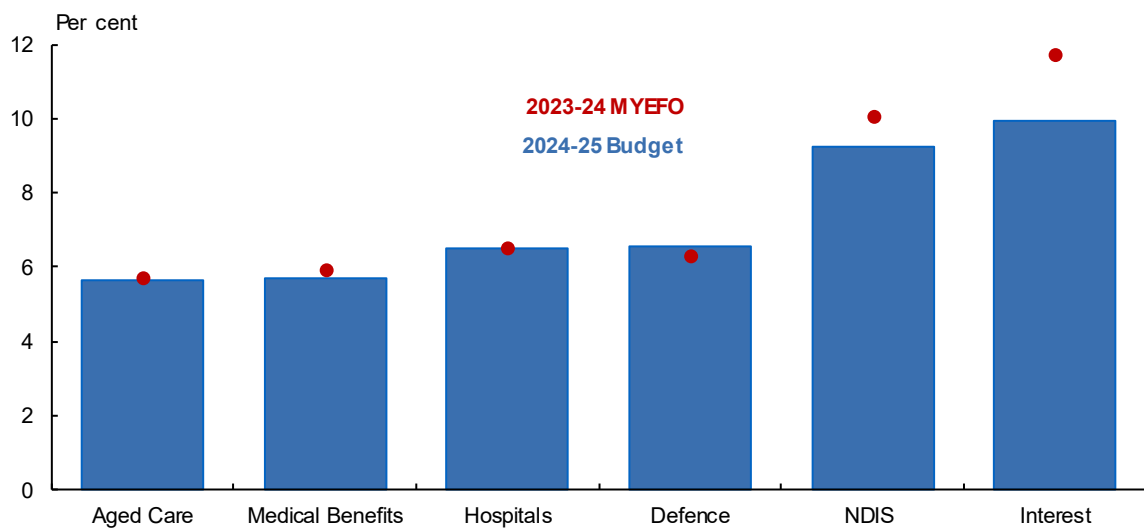
The majority of this difference has been from 3 payments. These are NDIS payments which are 0.9 percentage points of GDP higher compared to pre-COVID estimates, as well as public debt interest (0.6 percentage points of GDP higher) and aged care costs (0.3 percentage points of GDP higher).

When the NDIS reached full national roll-out in 2020, it became apparent it was not on a sustainable fiscal trajectory, reflecting upward revisions to the size and cost of support packages and growth in participants.

Aged care costs as a percentage of GDP have been steadily rising for over 20 years from 0.6 per cent of GDP in 2004–05 to 1.4 per cent in 2024–25, reflecting an increase in services delivered through home care.

These areas, together with Defence and health care, are projected to continue to be significant drivers of payment growth over the next 10 years (Chart 15).

Chart 15: Average annual growth in major payments 2024–25 to 2034–35



Note: Shows major payments that are growing faster than nominal GDP over the projection period. Interest refers to interest payments on Australian Government Securities. NDIS refers to the Australian Government's contribution to payments for NDIS participant supports. Growth rate for the 2023–24 MYEFO is from 2023–24 to 2033–34. Growth rate for the 2024–25 Budget is from 2024–25 to 2034–35. Growth rates are consistent with parameters in current intergovernmental agreements.

Source: Treasury.

The Government is taking on difficult but much needed reform in the NDIS and aged care.

The NDIS reforms, which respond to the recommendations of the NDIS Review, will reduce the cost of the scheme improving fiscal sustainability, while importantly delivering a better experience for individuals and more appropriate services.

The reforms help clarify information required for plan reassessments and the types of supports provided under the NDIS. They also set out a new model for determining a reasonable and necessary budget for each individual that focuses on their support needs as a whole rather than on individual items.

The reforms increase support for participants to spend within their budget in accordance with their plans, which should help address intra-plan inflation – a key driver of increasing Scheme costs.

Currently, there is a genuine opportunity for a bipartisan approach to reforming the NDIS and putting it on a sustainable footing while better delivering on its important aims.

There is a similar opportunity in reforming aged care, where the Minister for Aged Care continues to work on high-quality reforms in response to the Aged Care Taskforce.

Competition policy

The Budget contained a series of competition reforms designed to improve productivity.

Competitive pressures spur individual businesses to innovate and invest.

More competitive markets result in a better allocation of resources across the economy. This process of reallocation has been identified as a key factor behind multifactor productivity growth across advanced economies, including Australia.³

Competition can have important distributional effects.

Competitive markets help ensure that productivity gains – when they do occur – are passed on to workers as higher wages and to consumers through lower prices and better quality and service.

This means the gains from economic growth are shared more widely – and more quickly – across the community.

The weight of evidence suggests competitive pressures have declined in the Australian economy since the mid-2000s, coinciding – as it turns out – with the end of the last major round of competition reforms.

While economists may dispute exactly how much competition has contributed to Australia's declining productivity growth, few would dispute that increased competition can contribute to Australia's productivity performance.

Illustrative modelling undertaken jointly by the RBA and Treasury highlights the potential value of competition, suggesting that Australia's GDP could be 1-3 per cent higher if we returned to the level of competition that prevailed in the early 2000s. In today's dollars, that is approximately \$30 to \$80 billion each and every year.

Realising these benefits requires modern and fit-for-purpose competition policy settings.

The Government is undertaking the biggest reform to Australia's merger controls system in nearly 50 years. The current ad hoc, voluntary approach to merger control has been inadequate for stopping anti-competitive mergers and acquisitions – those that consolidate market power and raise prices for consumers.

The current mergers system takes too long, is too opaque and has high costs even for benign mergers, potentially harming Australia's ability to attract investment in areas going through significant structural adjustment.

The Government will introduce a mandatory and suspensory administrative merger system built around a single risk-based pathway making use of the latest economic and data analysis. This more targeted, stronger, and more transparent system will bring Australia into line with 6 of the G7 economies and around three quarters of OECD members.

The Treasury Competition Review is also assessing the impact of non-compete and other restraint clauses that restrict workers from moving to better-paying jobs. Around 1 in 5 Australian businesses used non-compete clauses for at least some of their employees in

³ Ziegelschmidt H, Koutsogeorgopoulou V, Bjrnerud S and Wise M (2005), 'Product Market Competition and Economic Performance in Australia', *OECD Economics Department Working Papers*, No. 451, OECD Publishing, Paris, <https://doi.org/10.1787/018570574720>.

2023.⁴ It is likely that the overuse of non-compete clauses is restraining competition, reducing the efficiency of the labour market and suppressing wages.

Following the 1993 Hilmer Competition Review, co-ordinated reform on National Competition Policy fundamentally changed and modernised Australia's economy. In 2005 the Productivity Commission credited National Competition Policy and related reforms with contributing to a surge in productivity and boosting Australia's GDP. The Commission's modelling indicated a boost of 2.5 per cent to GDP.

The Commonwealth, states and territories are working together to revitalise National Competition Policy. As part of this process, the Treasurer recently provided a terms of reference to the Productivity Commission to estimate the likely economy-wide and fiscal effects of a broad agenda of policy reforms. The Commission is due to report in November 2024.

Climate change

The positive effects of competition have been delivered through democratic capitalism, and the result has been wealth and prosperity for billions of people.

However, as Martin Wolf argued in his recent book, *The Crisis of Democratic Capitalism*, to safeguard democratic capitalism we need to make it work better to ensure that the prosperity generated by a dynamic, growing economy is shared, which includes providing an appropriate welfare net. To quote Wolf, "It needs to protect people through the most extreme vicissitudes of life."⁵ In Australia's case, reinforcing the need for a well targeted highly effective NDIS.

And, Wolf argues, we must do this while meeting the global challenge of climate change.

Nobel prize winning economist William Nordhaus noted in his 2018 Nobel Prize winning lecture that:

*"Global warming is the most significant of all environmental externalities. It menaces our planet and looms over our future like a Colossus. It is particularly pernicious because it involves so many activities of daily life, affects the entire planet, does so for decades and even centuries, and, most of all, because none of us acting individually can do anything to slow the changes."*⁶

Climate change requires a coordinated response across governments.

⁴ Australian Bureau of Statistics, 2024, *Restraint Clauses, Australia, 2023*. ABS. <https://www.abs.gov.au/articles/restraint-clauses-australia-2023>.

⁵ McKinsey & Company, 2023, *Author Talks: Martin Wolf issues a wake-up call on the state of democratic capitalism*. <https://www.mckinsey.com/featured-insights/mckinsey-on-books/author-talks-martin-wolf-issues-a-wakeup-call-on-the-state-of-democratic-capitalism>.

⁶ Nordhaus, William, 2019, 'Climate change: The ultimate challenge for economics'. *American Economic Review* 109 (6): 1991-2014.

Around the world, a vast array of climate change policies are being put in place. However, given that the negative externalities from carbon emissions are still not appropriately priced into global markets, there is underinvestment in the transition here and abroad.

Meeting the bipartisan commitment to net zero by 2050 will be one of the most significant economic transitions in Australia's history.

The strong fundamentals that have underpinned past economic success will continue to be fundamental to a successful transition to net zero.

The Government announced in Budget how the Future Made in Australia agenda would help to drive the net zero transition. This would be through policies that foster and encourage private sector investment to decarbonise the domestic economy and play our part in our trading partners' decarbonisation.

To support decision making, Treasury released as part of the Budget, the Future Made in Australia National Interest Framework supporting paper.

The Framework aims to provide rigour to decision making in relation to both the net zero transformation and policies that enhance economic resilience and national security.

The net zero dimension of the framework will be used to help identify priority sectors that are expected to have a sustained comparative advantage in a net zero global economy, and where public investment is required to address market failures and incentivise and attract private sector investment.

The Framework has a clear focus on prioritising market-based solutions, and ensuring public investment is only used where it can be demonstrated that it provides significant public benefit and where market-based solutions are not effective or available.

Treasury will be responsible for developing legislation for, and the application of, the Framework.

Closing

Australia's future prosperity will continue to be underpinned by the strong foundations that have supported the strength and resilience of the economy over the past 40 years.

Macroeconomic policy, including an ongoing focus on fiscal sustainability and reform to government services, combined with a series of microeconomic reforms, have helped drive strong sustainable growth with low inflation.

It is probably the case that we did not achieve the lowest sustainable unemployment rate possible over the past decade, however, that opportunity may be presenting itself now.

Since the reforms of the 1980s, these foundations supported a dynamic, competitive economy and ensured we had access to leading ideas and technologies and ideas that drive productivity and real wage growth.

Australia's future path will depend in large part on building on these strong foundations while adapting to the major challenges of the decade such as climate change.