Opening statement to the Economics Legislation Committee

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3 June 2024

Thank you for the opportunity to make an opening statement.

International outlook

Most advanced economies recorded subdued growth in 2023, with around one third of OECD economies experiencing a technical recession. This follows the fastest synchronised tightening of monetary policy in decades.

Global inflation has fallen but remains elevated. There are concerns that inflation is not falling as quickly as had been expected earlier this year, with many central banks noting the persistence in services price inflation in their economies and most central bank targets are not expected to be achieved until next year. Consequently, markets have pushed out the expected timing of policy rate cuts in many advanced economies.

Notable exceptions are in Europe, where the Swedish Riksbank and the Swiss National Bank have commenced policy easing and the European Central Bank is moving closer to easing monetary policy, and Canada, where markets have fully priced in a rate cut for the Bank of Canada's meeting in July. This reflects recent weak economic growth outcomes and confidence that inflation targets can be sustainably achieved.

With monetary policy still restrictive in most advanced economies, we expect global growth to remain subdued over the next three years at around 3¼ per cent.

China is facing structural headwinds such as lower productivity growth, a shrinking working age population and a slowing urbanisation rate. The property sector has been a concern for a couple of years now and how those issues are resolved is a key source of risk for the global economic outlook, and particularly the outlook for our own economy.

Heightened geopolitical tensions in a number of regions continue to create uncertainty for the global economy, particularly for trade and commodity prices.

Domestic outlook

Growth

The Australian economy grew by 2.0 per cent in 2023 and it is clear that growth in household spending has softened considerably as a result of high inflation and elevated interest rates.

The contribution of household consumption to economic growth was the weakest it has been in the past decade outside of the pandemic. The run of recent weak retail trade data suggests consumption is expected to remain subdued into the first half of this calendar year as households continue to prioritise essential spending.

More broadly, we expect activity to be very weak in the March quarter GDP to be published on Wednesday this week.

That said, the expected moderation in inflation, higher nominal wage growth, and tax cuts are expected to bolster real household disposable incomes, which we expect will support a recovery in household spending from the second half of 2024.

In contrast to household spending, private business investment has been growing strongly. Last year, business investment grew by 8.3 per cent, and was underpinned by stronger business balance sheets and high capacity utilisation. This upswing in business investment is expected to continue through to 2025-26. If realised, it would be the longest sustained period of annual increases in investment since the mining boom that occurred between 2002 and 2012.

The investment in coming years is expected to be driven primarily by the non-mining sector, particularly in non-residential construction, including investment in renewable energy and data centre projects. And businesses are investing in software to automate more of their processes and to secure their systems from cyber threats.

Public investment is expected to grow, supported by a large pipeline of infrastructure projects at both the state and federal level.

Overall, we expect real GDP to grow by 2 per cent in 2024-25. This is more subdued growth than we expected at MYEFO.

Population

The size of the population is an important input into economic growth, with one driver being net overseas migration, or NOM, a concept based on a person's place of usual residence.

A person counts as an arrival for NOM purposes if they are in Australia for 12 months out of a continuous 16-month period. Likewise, they count as a departure if they are out of the country for 12 out of 16 months. The recent highs in NOM have been driven by both higher arrivals and fewer departures post pandemic.

In the decade prior to COVID-19, temporary migration accounted for more than half of NOM arrivals. The remainder consisted of permanent visa holders and travellers with essentially free movement across the border, namely Australian and New Zealand citizens.

Forecasting net overseas migration during and since the pandemic has proved challenging. The 2023-24 Budget forecast for the year 2022-23 was 24 per cent lower than the latest ABS estimate. Other countries have faced similar challenges, including New Zealand where the equivalent forecast was 42 per cent lower than the latest estimate, and the United Kingdom, where the forecast was 58 per cent lower.

Following the relaxation of COVID-19 border restrictions, we saw a large catch up in arrivals as many people who wanted to come to Australia to work or study during the pandemic arrived in a compressed time frame. While there has been a catch up in arrivals, we are yet to see a pickup in departures, predominantly because many of the international students who have arrived over the past couple of years are still studying and are yet to depart.

This has driven an increase in the stock of temporary visa holders in Australia. Looking at comparable periods, there were 1.9 million temporary visa holders in Australia at the end of the March 2019 quarter, 1.7 million at the end of the March 2022 quarter, and 2.4 million at the end of the March 2024 quarter, of which roughly 670,000 were student visa holders and 185,000 were working holiday makers. We expect arrivals to ease and departures to pick up over the next few years, with the number of temporary visa holders in Australia to be consistent with pre-pandemic trends.

Treasury expects NOM to have peaked in 2022-23. In the Budget, we forecast NOM to approximately halve to 260,000 in 2024-25, before falling to 235,000 in 2026-27, in part due to actions outlined in the Migration Strategy.

The Budget did contain moderate upgrades compared to MYEFO. The biggest driver of these upgrades was working holiday makers staying longer in Australia. We also forecast slightly higher net migration by those on temporary skill visas.

Although student migration had previously been the biggest driver of forecast upgrades, the Budget slightly downgraded the forecast for student NOM, with fewer arrivals expected in part due to the Government's actions to improve the integrity of international education.

Within Treasury, we are making changes to improve our NOM forecasts, including working with the Department of Home Affairs to delve further into administrative data sets to seek indicators that can help us forecast migration better; introducing a formalised peer review process with experts across government; and investing additional resources to forecast NOM.

Labour market

Despite the recent slowdown in economic activity, the labour market has remained resilient, and the unemployment rate only recently increased to 4.1 per cent in April. This is around a full percentage point below pre-pandemic levels and has occurred while we have had record participation in the labour market.

In response to weaker growth, firms have mostly chosen to reduce hours worked rather than their headcount, which has delayed the expected increase in the unemployment rate.

The tighter labour market and recent administrative wage decisions have resulted in nominal wages growing near their fastest rate in nearly 15 years. This has happened while medium-term inflation expectations have remained well anchored.

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.

Despite the recent strength, broader indicators of labour demand suggest that labour market conditions are softening. For example, while most indicators of job advertisements and vacancies are still quite elevated, they have been declining. Similarly, underemployment and underutilisation rates have risen slightly.

We are expecting that labour market conditions will continue easing over the year ahead and for the unemployment rate to rise to 4½ per cent by June 2025. This rate of unemployment is still well below pre-pandemic levels.

Inflation

Like other advanced economies, inflation is still above target, but good progress has been made in inflation returning to the Reserve Bank's target band. Inflation is now less than half of its peak in 2022.

Australia has benefited from the disinflation in goods prices, but services price inflation remains high. Services inflation has likely peaked and is expected to steadily decline and become consistent with inflation being sustainably in the target band.

The Government announced in the Budget a couple of measures to directly ease cost of living pressures for households. Energy bill relief will continue for another year and be extended to all households, and maximum Commonwealth Rent Assistance will be increased by 10 per cent. We estimate that these measures will directly take about ½ percentage point off headline inflation. This could result in inflation returning to the target band by the end of this year.

Productivity

Productivity outcomes in Australia have been similar to those in comparable advanced economies like Canada and New Zealand but below those recorded in the United States.

It has been difficult over the past few years to get a good read on productivity because of COVID-related factors. GDP per hour worked has only recently returned to pre-COVID levels. However, GDP per worker has been declining since December 2021, and this trend is yet to be reversed.

The extent to which productivity growth recovers in a cyclical and trend sense remains uncertain and has implications for the risks to the outlook for both growth and inflation.

Fiscal Outlook

Overview

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. Australia's debt level remains low compared to international peers.

The forward estimates

Following a $22.1 billion surplus in 2022-23, the Government is expecting a second surplus of $9.3 billion (0.3 per cent of GDP) in 2023-24. The Budget is then expected to return to deficit in 2024-25, growing to 1.5 per cent of GDP in 2025-26 before beginning to improve.

Primarily as a result of the improved outlook for 2023-24, gross debt relative to the size of the economy is lower than anticipated at MYEFO.

Tax receipt upgrades in this Budget are much smaller than in previous budget updates

This Budget sees tax receipt upgrades (excluding GST and policy decisions) of $27 billion over the 5 years to 2027–28.

The mining sector continues to be a significant contributor to company tax and is estimated to contribute two-fifths of company tax payable in 2022–23. In the past year, many companies in the oil and gas sector that hadn't previously paid company tax have moved into a tax paying position after exhausting past losses. These losses reflected significant depreciation and other deductions associated with large capital investments. This is expected to lead to an increase in the company tax base for the foreseeable future.

Fiscal policy

The fiscal tightening since the pandemic is the fastest and largest on record in Australia – and more than double what was seen after previous downturns.

The rapid fiscal tightening has seen fiscal policy work with monetary policy to reduce inflationary pressures.

Cost-of-living support has been designed so as not to undermine policy efforts to reduce demand pressures and lower inflation.

The Budget's fiscal policy settings are consistent with Treasury's expectation for inflation to return to the target band. The Budget strikes an appropriate balance in addressing inflation and supporting sustainable growth.

As inflation eases, it is appropriate that the focus of fiscal policy transition towards its longer-term objectives, rather than short-term macroeconomic management, for which it is less well suited outside of large shocks or crises. Fiscal policy has an important role to play in delivering long-term prosperity by helping to deliver strong productivity growth and a sustainable budget position over the medium to longer term.

Housing supply

The market supply of housing continues to be too low to meet demand, particularly in recent years. This is despite a large number of medium-high density dwellings being built between 2014 and 2018, when low interest rates encouraged a significant pick up in investor activity.

A limited supply of dwellings creates affordability pressures for households and makes it difficult to find a property to buy or rent. We have seen declines in the number of homes being offered for sale since 2015. The number of homes for rent has also been falling since early 2020, while the national rental vacancy rate is well below the rate considered to reflect a balanced rental market.

This has implications for the affordability of, and access to, adequate housing for many people. Nominal dwelling prices and advertised rents have more than doubled since the mid-2000s, having increased sharply in the past five years. Households are taking longer to save for a deposit and more people are renting. These impacts are disproportionately felt by those on lower incomes.

The Government has addressed some of these distributional effects through changes to Commonwealth Rent Assistance. Both this Budget and the 2023–24 Budget included assistance for renters on low incomes by increasing the maximum rates of Commonwealth Rent Assistance. The further 10 per cent increase in this Budget is in addition to the 15 per cent increase provided in September 2023.

The current lack of new supply has been exacerbated by several factors flowing from COVID-19, including supply chain bottlenecks in inputs to construction and higher inflation, both of which have increased the costs of materials and financing needed to build homes. This is compounding structural barriers in the system itself.

The reasons that Australia's housing system is less responsive to evolving demands are complex and have built up over time. They involve all levels of government, as well as industry and community housing suppliers.

Industry's capacity to add new supply has also been hampered by a lack of essential infrastructure in greenfield development sites, while there have been critical shortages of skilled labour and low productivity in the sector in recent years. According to the National Housing Supply and Affordability Council the average time from approval to completion for a new house is around 12 months, up from 9 months in 2019–20. New townhouses currently take around 15 months from approval to completion and new apartments around 29 months.

At the same time, there has been a long-term under-investment in social housing by governments, leading to lengthening waitlists.

Because of the complexity of the system, and the responsibilities sitting with all levels of government, concerted action is needed to address these barriers and increase supply for the long term.

The Government's policies are sensibly focused on boosting the supply of housing. However, meaningful progress cannot occur unless the states use their policy levers to boost supply and, longer-term, allow the housing supply to adapt more flexibly to changes in housing demand.

Future Made in Australia

Over the coming decade, the strong fundamentals that have underpinned Australia's economic success will continue to be critical to our competitiveness. This includes a strong commitment to open trade and investment, sound macroeconomic management, and fostering competitive, flexible and dynamic markets.

However, heightened geostrategic competition and the net zero transition are transforming the global economy. As a medium-sized open economy, there are risks that Australia may become reliant on global supply chains that are highly concentrated and vulnerable to disruptions.

In addition, policies are needed to allow markets to internalise the negative externalities from emissions, drive efficient decarbonisation, and spur long-term investment in clean, low-emissions technologies and industries, in line with our significant long-term comparative advantages.

The Future Made in Australia package sets the Government's framework for enabling the substantial transformation ahead.

Treasury is responsible for developing legislation for, and the application of, a National Interest Framework. The National Interest Framework will help to identify priority sectors that may warrant government intervention to attract private investment at scale.

For the net zero transformation, the Framework will identify priority sectors where Australian industry can make a material contribution to reducing domestic and global emissions, will 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.

For economic resilience and security, it will identify those sectors of the economy where some level of domestic capability is a necessary or efficient way to protect our economic resilience and security, and the private sector will not deliver the necessary investment in the absence of government support.

In each of these areas, the role for government usually arises from a market failure, where incentives for business are not always aligned with the national interest.

Treasury will also be establishing a taskforce to consult on the design of a new front door to help streamline investors' engagement with Government and to make it simpler to invest in Australia.

Foreign Investment Framework

The Government announced policy in the Budget to deliver a stronger, more streamlined, and more transparent approach to foreign investment. This will help attract the significant investment needed to support priorities like Future Made in Australia.

To strike the right balance between economic and national security, the approach to foreign investment needs to evolve in response to global economic and political circumstances.

National security threats are increasing due to intensifying geopolitical competition. At the same time, there is strong competition for global capital.

The Government is dedicating greater resources and scrutiny to foreign investment proposals in critical and sensitive sectors of the economy in order to consider economic benefits, security risks and potential mitigations. Coupled with this, the Government is streamlining consultation and assessment processes to enable faster decisions on lower-risk investment proposals. Treasury is providing greater guidance to investors on those areas that are a priority for foreign investment and where investment is likely to face greater scrutiny.

These actions will ensure that Australia can attract the significant foreign investment needed to support its priorities, while protecting the national interest in an increasingly complex global environment.

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