Opening statement to the Economics Legislation Committee
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Thank you for the opportunity to make an opening statement.

Today I will provide an update on Treasury's near-term economic and fiscal outlook. I will also briefly discuss the recently published Measuring What Matters Statement, Intergenerational Report and the Employment White Paper.

Economic outlook

The Australian economy has been resilient over recent quarters, growing by 3.4 per cent in 2022–23. Labour market outcomes have continued to outperform expectations. However, inflation remains high, and momentum in household demand has slowed considerably.

In the global economy, there have been several key developments.

The most severe bout of global inflation in decades peaked in mid-to-late 2022 and is now slowing.

Global goods price inflation has fallen as pandemic supply constraints fade and the post-pandemic boost to household demand eases.

Elevated energy prices due to Russia's invasion of Ukraine have also eased, although the recent rebound in oil prices has partially reversed this trend.

Recent developments in Israel are contributing to uncertainty in oil markets. With oil prices already at high levels, the potential for higher inflation and lower global and domestic growth could quickly emerge should oil prices spike and remain at high levels.

Easing inflation in global goods and energy prices has brought headline inflation in advanced economies closer to central bank targets. There has also been some moderation in 'core' inflation.

But there is still some way to go to bring global core inflation back to target. As supply-side shocks subside, global inflation will increasingly reflect services prices, which can be 'stickier' than good prices.

And there is a risk that global interest rates will need to remain elevated for some time to contain inflation. The Federal Reserve and a number of other central banks have recently signalled their intention to keep interest rates higher for longer.

Overall, advanced economies have been more resilient to high inflation and tight monetary policy than expected. The path for a so-called 'soft landing' appears to have widened in many, but not all, countries.

While there have been positive developments in advanced economies, a new risk has emerged to the global outlook from a softening Chinese economy.

A deeper and more protracted than expected decline in the Chinese property sector is dampening household and investor confidence, and hurting local government finances. While recent economic indicators have improved somewhat, weaker consumer and business sentiment is still expected to weigh on overall economic activity.

These cyclical factors are intersecting with existing structural challenges for the Chinese economy, including an ageing population and the ongoing transition to domestic consumption-led growth.

The IMF continues to expect global growth to slow in 2023 and 2024 to rates, 'well below the historical average'. In its October World Economic Outlook, the IMF expects the global economy to expand by 3 per cent this year and 2.9 per cent in 2024. This will be the weakest two-year period over the last two decades outside of the GFC and the pandemic.

The Australian economy is experiencing similar challenges to other advanced economies.

It is now clear that growth in household spending has softened considerably as a result of high inflation and rising interest rates.

In the June quarter National Accounts, real household consumption grew by 0.1 per cent. This is the lowest growth since the pandemic lockdowns of 2021.

Retail trade in current prices was just 1.5 per cent higher than a year ago in August, taking into account inflation, this suggests that the volume of goods sold is continuing to decline from its peak in the September quarter 2022.

Soft household demand is expected to continue to weigh on GDP growth over 2023–24.

There are several factors that are offsetting the softening in consumer spending.

Australia has been experiencing a large increase in net overseas migration as the world emerges out of the COVID-19 pandemic. Much of this migration comprises the return of international students along with working holiday makers and skilled workers.

ABS preliminary estimates of net overseas migration in the first three quarters of the 2022-23 fiscal year totalled around 379,000 persons.

Additionally, the ABS has revised up the 2021–22 outcome by 19,000 persons.

The stronger than expected return of students is leading to a boost in services exports and is offsetting the downturn in domestic household demand, providing support to aggregate GDP.

The rapid recovery in migration is adding to pressures in the housing market.

Growth in national advertised rents peaked at 9.6 per cent through the year to September 2022. Growth has since eased to be 8.4 per cent through the year to September 2023, but the rental market remains tight, with vacancy rates remaining near record lows.

A large backlog of residential construction activity, along with a forecast pick-up in medium-density activity, will gradually lift supply over the coming years, but this will not alleviate near-term rental pressure. Indeed, capacity constraints including labour shortages are still limiting the sector's ability to work through its pipeline, with new residential construction activity holding broadly steady over the past year.

Given the pressure on supply, the recent announcements as part of the Government's housing reform agenda are a welcome development, in particular those that will encourage supply-side development and reforms such as planning and zoning changes.

Over the first half of 2023, private investment activity has exceeded expectations and together with the boost in services exports has offset the marked slowing in household demand.

High inflation remains the primary challenge for households in the current environment.

In the near-term, there will be volatility in headline inflation. We have observed this in other countries, particularly with increases in headline inflation driven by petrol, and we are likely to see similar instances in Australia. However, we still expect inflation to steadily fall toward the target band although its descent toward the target band may be slower than initially expected due to higher petrol prices.

Wage growth is still expected to accelerate through 2023, and peak at around 4 per cent in 2024.

This outcome would be below that of other advanced economies. For example, growth in the United States' Employment Cost Index peaked higher, at 5.1 per cent through the year to the June quarter of 2022.

A key feature of Australia's labour market over the recent cycle has been the responsiveness of labour supply to an increase in demand. This has played an important role in opening up job opportunities, supporting the recovery and has helped to avoid unsustainable wage growth.

The slower response of wages is also partly due to the nature of wage setting in Australia. The prevalence of collective agreements, and the system of industry awards, mean tight labour-market conditions take some time to pass through to higher wage growth.

A slow pass-through of labour market conditions to wage growth means that as inflation eases and wage growth persists, Australia is likely to return to a period of moderate real wage growth.

While wage growth is going through a cyclical upturn, there are no signs of a wage-price spiral. Wage growth is led by prevailing conditions in the labour market. As the labour market loosens in response to weaker demand, wage growth will ease, and inflation along with it.

A November 2022 IMF working paper found that across advanced economies, in periods where wages and prices accelerate together, there very rarely follows a sustained period of acceleration in both wages and prices.

Instead, it is much more common for periods of concurrent wage and price acceleration to be followed by a period of declining inflation and elevated nominal wage growth, after which both inflation and wage growth stabilise around long run average levels. This is consistent with recent macroeconomic outcomes in Australia and with Treasury's expectations.

As expected at Budget, the labour market has remained tight. At 3.6 per cent in the September month, the unemployment rate remains near historic lows.

Over 2023 so far, many new workers have found job opportunities and have been drawn into the labour force. Australia's participation rate is still near record highs at 66.7 per cent in September as a result. This increase in the labour supply and employment is a welcome development.

Tightness in the labour market is not expected to persist. The labour market is expected to loosen significantly over 2024 and 2025 as the economy cools.

Easing in the labour market is already evident in key leading indicators. The ABS measure of job vacancies peaked in the quarter to May 2022, and has fallen by 18 per cent. The rate of underemployment has also eased up to 6.4 per cent in September, from its trough of 5.8 per cent in February 2023.

Treasury will update its economic forecasts at the 2023–24 MYEFO.

Near-term fiscal outlook

The Final Budget Outcome for 2022–23 shows that fiscal policy has tightened rapidly from the emergency levels reached during the pandemic.

The Australian Government recorded a surplus of $22.1 billion in the 2022–23 fiscal year, or around 0.9 per cent of GDP. This is $17.9 billion higher than expected at the 2023–24 Budget. This is the first surplus since 2007–08.

The underlying cash balance outcome for 2022–23 is an improvement of more than 2 percentage points on 2021–22. This follows a 5 percentage point improvement in the prior year. These are the largest two fiscal contractions on record.

Furthermore, the improvement in our fiscal position has been more pronounced than elsewhere, with few other developed economies moving back into surplus. For example, the latest IMF Fiscal Monitor projects that the US general government budget deficit will increase from 3.7 per cent of GDP in 2022 to 8.2 per cent this year. In an Australian context, a widening of this magnitude is equivalent to an increase in the deficit of around $100 billion.

With inflation substantially above the RBA's 2-3 per cent target, a contractionary fiscal stance has been appropriate and in concert with the monetary policy settings.

The tightening in the fiscal position partly reflects additional fiscal revenues and lower payments due to strong activity, low unemployment, and elevated commodity prices. These factors are sometimes termed automatic stabilisers, and they play an important role in managing business cycles.

The Government's decisions have resulted in 95 per cent of tax upgrades since the Pre-Election Economic and Fiscal Outlook in 2022–23 being returned to the Budget. By banking revenue when inflation was at its peak, fiscal policy has been aligned with monetary settings and consistent with the commitments made in the fiscal strategy.

Turning now to the details of the fiscal outcome for 2022–23, government receipts were $13.9 billion higher than expected at Budget.

The increase in receipts was primarily driven by revenue from companies in the resources sector, which was bolstered by sustained elevated commodity prices.

Government payments were $4.0 billion lower in 2022–23 than expected at Budget. This is largely a result of softer demand for some Government programs, including social support payments due to a strong labour market, and lower-than-estimated demand for COVID-19 public health services.

As at 30 June 2023, gross debt was $889.8 billion, or 35.2 per cent of GDP, more than 4 percentage points below the peak in 2020–21. Net debt to GDP has been reduced by more than 9 percentage points, to be below 20 per cent.

While recent fiscal outcomes are encouraging, the debt-to-GDP ratio remains high. The Budget projected deficits in the underlying cash balance will re-emerge in 2023–24 and continue over the next decade.

Measuring What Matters

The Australian Government's inaugural edition of the national wellbeing framework, *Measuring What Matters*, was published in July 2023.

Traditional economic and budget indicators have long been the focus of public debate and remain a vital part of measuring progress. Productivity improvements in particular are key to lifting incomes and living standards.

But these metrics are not holistic, and they fail to capture the many ways through which society and living standards progress over time.

In short, traditional economic indicators do not capture everything that matters to national wellbeing and progress.

The Measuring What Matters Wellbeing Framework enables the Government to measure a broad range of indicators that together encapsulate the lived experience of Australians over time.

The Framework identifies five broad themes that are important to Australians' individual and collective wellbeing: healthy, secure, sustainable, cohesive and prosperous.

Progress across the five themes and 50 indicators over recent decades has been mixed. For example, we perform relatively well when it comes to life expectancy. A baby born between 2019–21 can expect to live to 83.4 years, the fourth-highest life expectancy in the OECD. This metric has improved steadily over time, by just over three years since 2003.

But there is clearly work to be done in other areas.

The performance of Year 3 students in the NAPLAN reading and numeracy tests has not improved since 2015, and the gap between children from low SES and high SES backgrounds (based on parental occupation) is equivalent to almost two years of learning for reading and one year for numeracy.

Mental health problems also place a significant burden on many people, particularly First Nations Australians.

The Framework's usefulness does not have to be limited to government analysis and decision making. It has been designed so that it can be drawn upon by business, academia and the community to support their efforts to create better lives for Australians.

Intergenerational Report

The Government's recent *2023 Intergenerational Report* (IGR) explored five powerful forces that will shape our economy while exploring the structural budget challenges that will have to be faced in the coming decades.

As projected in previous intergenerational reports, the economy is expected to grow and living standards to rise. But this will occur more slowly than in the recent past.

Under the IGR's economic framework, economic growth over the long run is driven by the 3Ps: population, participation and productivity.

Growth in Australia's 3Ps has been stronger than most other major advanced economies over recent decades.

Our population growth has been higher than all the major advanced economies, supported by high net overseas migration.

Reflecting in part strong population growth, Australia's participation rate has risen more than most major advanced economies in the last decade.

Increased participation by women and older Australians, and strong labour market conditions have also helped push participation rates to record highs and above previous IGR projections.

Australia's average productivity growth has been higher than most of the major advanced economies over the past two decades.

Nevertheless, there has been a consistent slowing in global and domestic productivity.

I recently explored this issue in a briefing to CEDA. I noted the longer-term implications of slower global productivity growth for Australia and the risks for future generations in the light of the climate and energy transition, and global fragmentation.

The IGR projections show that deficits are projected to decrease over the medium term before rising from the 2040s to reach 2.6 per cent of GDP by 2062–63.

The main driver of long-term underlying cash deficits will be increasing pressures on Government spending. Government spending is projected to grow by 3.8 percentage points of GDP from 24.8 per cent in 2022–23 to 28.6 per cent in 2062–63.

The main contributors will be health, aged care, NDIS, defence and interest payments. These factors are projected to grow from one third of spending to around half of all payments by 2062–63.

As previous IGR reports have highlighted, long-term trends in government spending will be strongly influenced by Australia's ageing demographics. Demographic ageing is estimated to account for around 40 per cent of the increase in spending between 2022–23 and 2062–63.

Pressure on the Government's budget will be further compounded by the slowing pace of economic growth and as a result revenue. Tax receipts are projected to rise to 24.4 per cent of GDP over the medium term and are then assumed to remain constant as a share of GDP from 2033–34.

As a result of these trends in spending and receipts, the IGR projects gross debt to decrease from 36.5 per cent of GDP in 2025–26 to 22.5 per cent in 2048–49, before rising to reach 32.1 per cent by 2062–63.

Employment White Paper

Working Future: The Australian Government's White Paper on Jobs and Opportunities is the culmination of over 12 months of work following the September 2022 Jobs and Skills Summit, led by the Employment Taskforce in Treasury.

It is the third such White Paper to be published by an Australian Government, following on from the *Full Employment in Australia* White Paper in 1945 and the *Working Nation* White Paper in 1994.

This White Paper outlines a vision for a dynamic and inclusive labour market.

It covers a wide range of issues facing the Australian labour market. Today I will focus on the objective of delivering sustained and inclusive full employment, and its role in government decision-making.

The White Paper defines achievement of a full employment objective when everyone who wants a job is able to find one without having to search for too long.

Explicitly targeting full employment is not a new policy commitment in Australia's economic history. This goal was explicitly adopted by multiple governments for a long period after World War II, and the previous government announced a commitment to move towards full employment in the 2021–22 Budget.

The full employment objective and approach is fully consistent with the key frameworks Treasury has long used to understand the macroeconomy and labour markets.

However, what the White Paper brings forward is more explicit and ambitious framing around 'sustained and inclusive' full employment. One that not only incorporates a macroeconomic framing of full employment but also a role for policy ambition and action to reduce structural underutilisation over time.

Sustained full employment is about minimising volatility in economic cycles and keeping employment as close as possible to the current maximum level consistent with low and stable inflation.

As a part of preparing Budget forecasts and policy advice we need to have a view on what this current maximum level is.

As the White Paper observes, it is important to take into account a suite of measures in making this assessment.

Metrics such as underemployment, which captures people who would like more hours of work, and those not in the labour force but looking for work, are important measures of labour market conditions in addition to unemployment. The White Paper also recognises the significant uncertainty surrounding estimates of full employment and other measures such as NAIRU.

Inclusive full employment is about broadening opportunities, lowering barriers to work including discrimination, and reducing structural underutilisation over time to increase the maximum level of employment that can be sustained in our economy.

Policies that reduce these barriers will increase the level of sustainable full employment (all other things equal).

Importantly, such policies will result in higher labour force participation rates and/or higher average hours worked for the individual cohorts that currently face barriers to participation.

The Government's sustained and inclusive full employment objective is broader, and complementary to, the RBA's cyclical full employment objective which requires them to pursue an inflation target and the maximum level of employment consistent with that.

Other key findings from the White Paper include the role of dynamism in the labour market, which manifests as job switching and labour mobility. Job switching promotes higher wages growth, and mobility plays a vital role in enabling our economy to adjust to structural change such as the climate and energy transition.

The White Paper also identified the importance of productivity growth in driving improvements in living standards, the benefits of reducing barriers to work and building inclusive workplaces, and the role the education system plays in providing training to people throughout their working lives. Enabling workers to gain new skills will create a resilient labour force that can adapt and thrive as the economy evolves over time.

Ongoing activities

In addition to producing Measuring What Matters, the IGR and the Employment White Paper, Treasury has been working on a number of consultations and legislative processes.

We in the process of implementing the recommendations of the Review of the Reserve Bank of Australia. The Treasurer released the Review's report on 20 April 2023 and the Government agreed in-principle with the Review's 51 recommendations.

We are working towards introducing the necessary legislation before the end of the year, and the Government will agree a new Statement on the Conduct of Monetary Policy with the Bank in the coming months.

Through the course of this year, Treasury has overseen passage of 14 Bills delivering on key Government priorities. This includes measures as part of the Government's housing agenda, remaining recommendations from the Financial Services Royal Commission, extending concessional tax treatment for Primary Producers that generate Australian Carbon Credit Unit income, tax changes that support small and medium businesses through the Skills and Training Boost and Technology Investment Boost and a number of measures streamlining and clarifying tax law, including clarifying the taxation treatment of Bitcoin and other crypto assets.

Treasury has also supported the introduction of three Bills that are currently before Parliament, including a bill that will encourage investment by increasing the instant asset write-off threshold for small businesses.

Other bills include ensuring multinationals are paying their fair share, in addressing risks to revenue in the Australian tax system, enhancing tax transparency, improving the integrity of the tax system and encouraging philanthropic giving.

Ongoing and recent consultations include draft legislation for a series of reforms to the payments regulatory framework, superannuation concessions, and secrecy provisions for the Australian Charities and Not-for-profits Commission.

We expect to release a number of consultation papers in the coming months. These include draft legislation to regulate Buy Now Pay Later services, the introduction of financial market infrastructure crisis resolution and supervisory powers, a Sustainable Finance Strategy and the first tranche of reforms in response to the Quality of Advice Review. It also includes consultation papers on sanctions for misconduct and investigative powers of tax practitioners by the Tax Practitioners Board.

Further consultations include paying superannuation on pay day and further recommendations following the Quality of Advice Review; the regulation of digital and crypto assets; payment systems reform; screen scraping and unfair trading practices.

We have also commenced a review of competition including the ACCC proposals for merger reforms, and we are progressing work on scams and competition issues arising from digital platforms.

Before I conclude, I would like to make a special mention of Professor Max Corden – who sadly passed away this week – and to recognise his significant contribution to trade and welfare economics, both in Australia and around the world.

For over six decades, Professor Corden was an intellectual giant in international trade theory and Australian economic policy. As one of Australia's most influential economists, he was a key thought leader behind the drive to modernise the Australian economy through cutting tariff protection in the 1970s and 80s.

Professor Corden had a deep interest in practical questions, combining 'big picture' analysis with a clear understanding of institutional and practical realities. Some of his pioneering work included research on the theory of effective protection, exchange rate policies, the international monetary system, and 'Dutch Disease'.

Professor Corden was a member of a distinguished group: refugees from Nazi-occupied Europe who made major contributions to their new found home in Australia.

Professor Corden received many honours and awards, including the Companion of the Order of Australia. He will be sadly missed by the economic fraternity.

Thank you for the opportunity to provide you with an update.