

Statement 2: Economic Outlook

Global growth is set to slow considerably in 2023. High inflation, sharply rising interest rates, and a tightening in financial conditions associated with recent banking sector strains are all weighing on activity. These factors are expected to more than offset the boost from the earlier-than-anticipated reopening of China's economy, following the lifting of pandemic restrictions from December 2022 onwards.

Global growth is expected to slow from 3.4 per cent in 2022 to 2¾ per cent in 2023, before a modest pick-up to 3 per cent in 2024 as inflation eases and financial conditions improve. Growth over the next 2 years is expected to be the weakest in over 2 decades, excluding the Global Financial Crisis and the pandemic. The global outlook remains highly uncertain with the balance of risks firmly tilted to the downside. Recent banking sector stress has added to the elevated risk of recession in some advanced economies.

The Australian economy is not immune from these global economic challenges, but it is well placed to navigate them. The unemployment rate is holding near 50-year lows of 3.5 per cent, wages growth has picked up, and national income is being supported by elevated commodity prices, which are flowing through to higher export revenues. These factors have helped to deliver solid growth in 2022–23.

While the Australian economy is expected to outperform all major advanced economies, global and domestic headwinds will be a drag on activity in 2023–24. High inflation and the rise in interest rates are squeezing households and weighing on dwelling investment. A rebound in services exports is helping to offset the slightly faster downturn in domestic demand than anticipated at the October Budget, with real GDP growth unchanged at 1½ per cent in 2023–24. Employment growth is expected to moderate as the economy slows, but to a lesser extent than expected at the October Budget. The unemployment rate is projected to remain low by historical standards, rising modestly to 4¾ per cent by the June quarter of 2024 and 4½ per cent by the June quarter of 2025.

Economic growth is expected to strengthen in 2024–25 as inflation returns to target and positive real wage growth continues. The economy is forecast to expand by 2¾ per cent in 2024–25 and 2¾ per cent in 2025–26. The continued recovery in population growth and an associated increase in investment in new housing will reinforce the expected rebound.

Inflation has peaked and begun to moderate. While still uncomfortably high, inflation outcomes have been less severe than in Europe, the UK and US. Domestic inflation peaked at 7.8 per cent in the December quarter of 2022, fell to 7.0 per cent in the most recent quarter, and is expected to return to the inflation target in 2024–25. The global price shocks and supply constraints that contributed to the surge in inflation over the past year are easing, although oil prices remain above pre-COVID levels and market rents are expected to remain elevated.

The Government's measures to deliver cost-of-living relief directly reduce the CPI in 2023-24, and are not expected to add to broader inflationary pressures in the economy. These measures are expected to reduce inflation by $\frac{3}{4}$ of a percentage point in 2023-24.

Nominal wage growth has picked up and is expected to build to 4 per cent in 2023-24, its fastest pace since 2009. The pace is then projected to ease to $3\frac{3}{4}$ per cent in 2024-25 as the labour market softens and administered wage outcomes normalise. There is no evidence of a wage-price cycle developing and inflation expectations remain well-anchored. The lift in wages growth has been supported by the Fair Work Commission determinations on the minimum wage and will be assisted further by the Aged Care Work Value Case.

With inflation moderating and wages picking up, positive real wage growth is expected to return in early 2024. This is slightly earlier than anticipated in October, largely due to the reduction in inflation from the Government's Energy Price Relief Plan. Responsible and targeted cost of living relief, indexation of government allowances and pensions and the potential impact of the Annual Wage Review decision will also support many low-income households.

There are significant risks to the economic outlook. Further tightening in global monetary policy in response to more persistent global inflation or a deterioration in financial conditions could trigger a more pronounced slowing in the world economy. This would spill over to commodity prices, consumer and business confidence and real activity. Uncertainty also remains about the ongoing impacts of Russia's invasion of Ukraine. Domestic inflation could be more persistent, which would dampen household spending through further reductions in real incomes and higher-for-longer interest rates. Consumer spending could also soften more than anticipated if households become more cautious in the face of the current cost-of-living pressures.

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Statement 2: Economic Outlook

Outlook for the international economy

Outlook for global growth

Elevated core inflation, sharp rises in interest rates and tighter financial conditions are all expected to constrain growth in advanced economies in 2023 to well below the pre-pandemic average. These pressures will more than offset the boost from the earlier-than-anticipated reopening of China's economy and unexpected resilience to date in advanced economies, most notably in the United States and euro area.

Global growth is expected to slow from 3.4 per cent in 2022 to 2¾ per cent in 2023. A modest pick up to 3 per cent is then expected in 2024, as inflation and financial conditions begin to ease. Overall, growth over 2023 and 2024 is projected to be the weakest 2 years in over 2 decades, excluding the Global Financial Crisis and the pandemic. The earlier-than-anticipated reopening of China's economy has led to an upgrade in Major Trading Partner growth by ¼ of a percentage point to 3¾ per cent in 2023. Australia's growth is expected to exceed all major advanced economies in 2023 (Chart 2.1).

The full effect of the rapid tightening in monetary policy has yet to flow through the global economy. Growth in some advanced economies has been surprisingly resilient, including the United States, but there are clear signs that higher interest rates are weighing on demand, particularly in the housing sector. Financial market participants anticipate policy rates have now peaked in the United States and are expected to fall over the course of the year (Chart 2.2). However, central banks are yet to signal that an easing in monetary policy is appropriate in 2023.

Recent bank collapses in the United States have added additional uncertainty to the outlook. There is potential for further disruption as the economy and financial sector continue to adjust to higher interest rates. Swift and coordinated regulatory responses have helped to avert a broader systemic financial shock, allowing financial markets to stabilise. Nevertheless, stresses have exposed vulnerabilities in parts of the global banking system, heightened investor risk aversion and generated tighter financial conditions for households and firms. This will weigh on growth, particularly in the United States and Europe.

The outlook for growth in advanced economies remains highly uncertain with risks firmly weighted to the downside. Financial conditions could deteriorate once again if markets become concerned about the health of financial institutions. The rapid rise in interest rates could also lead to a sharper slowdown in investment and consumer spending (and therefore growth) than currently anticipated. This outcome would be further compounded if inflation in advanced economies proves more persistent, requiring a more sustained tightening in monetary policy than currently expected.

Offsetting these developments in advanced economies has been the improved outlook for growth in China following its rapid transition from zero-COVID policy settings over December 2022 and January 2023. The removal of activity restrictions led to a strong

rebound in activity in the March quarter, driven by greater household consumption of services. This recovery has led to an upgrade to China’s forecast growth to 5¾ per cent in 2023, comfortably above the Chinese authorities’ 5 per cent target. This has also led to an upgrade in Major Trading Partner growth by ¼ of a percentage point to 3¼ per cent in 2023.

The reopening of China’s economy has been accompanied by supportive policy settings. Fiscal support introduced last year is still flowing into infrastructure investment. There are also tentative signs China’s property market may now be improving following the introduction of policy support for developers in late 2022. Households in China have responded positively to the reopening of the economy, although weak consumer confidence remains a key downside risk for the outlook.

Growth in Other East Asia and India will slow in 2023 due to tighter monetary policy and high inflation. Additionally, the slowing of advanced economies will crimp growth in export-driven economies of Other East Asia. However, China’s reopening will support activity across the region, with Asia expected to outperform the global average over the forward estimates.

Table 2.1: International GDP growth forecasts^(a)

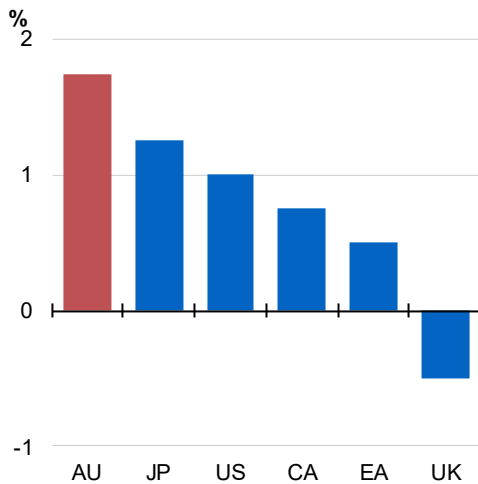
	Outcome	Forecasts (Calendar Years)		
	2022	2023	2024	2025
Australia	3.6	1 ¾	1 ½	2 ¾
China	3.0	5 ¾	4 ½	4 ½
India	6.7	5 ½	6 ¼	6 ¾
Japan	1.0	1 ¼	¾	1
United States	2.1	1	¾	2 ¼
Euro area	3.5	½	1	1 ¾
United Kingdom	4.1	-½	½	2 ¼
Other East Asia (b)	4.4	3 ¼	4	4 ¼
Major trading partners	3.0	3 ¼	3 ¼	3 ½
World	3.4	2 ¾	3	3 ½

a) World and Other East Asia growth rates are calculated using GDP weights based on purchasing power parity (PPP). Growth rates for major trading partners are calculated using Australian goods and services export trade weights.

b) Other East Asia comprises Indonesia, Malaysia, the Philippines, Thailand, Vietnam and Singapore, along with Hong Kong, South Korea and Taiwan.

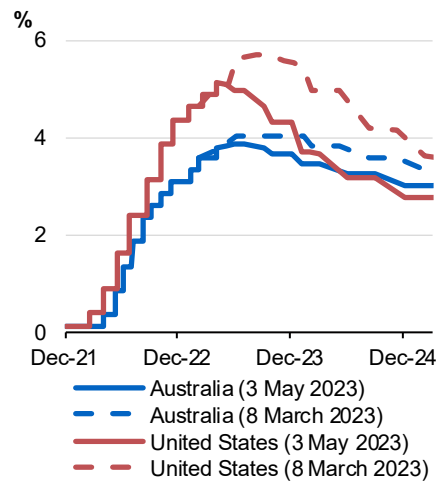
Source: National statistical agencies, IMF, Refinitiv and Treasury.

Chart 2.1: 2023 growth forecasts



Source: Treasury.
 Note: AU is Australia. JP is Japan. US is United States. CA is Canada. EA is euro area. UK is United Kingdom.

Chart 2.2: Market-implied policy rate expectations

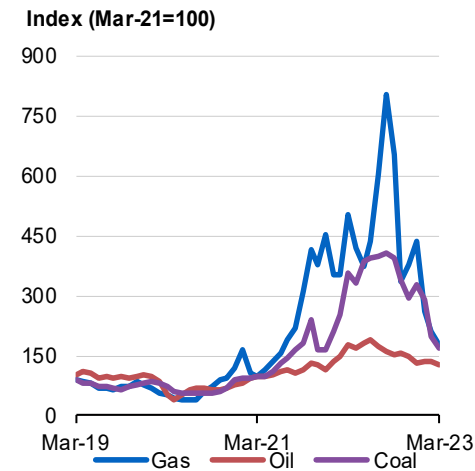


Source: Bloomberg.
 Note: Derived from OIS market pricing

Outlook for global inflation

Inflation in advanced economies is expected to gradually decline over 2023 and 2024. Food and energy inflation is expected to subside as commodity markets continue to adjust to Russia’s invasion of Ukraine (Chart 2.3). Broader pandemic-induced supply and demand dynamics are also rebalancing, which is reflected in the easing of supply chain bottlenecks for goods and falling global shipping prices (Chart 2.4). Nevertheless, in some countries, including the US, inflation is proving relatively sticky and is not expected to return to target until 2025.

Chart 2.3: Global energy spot prices



Source: IMF and Refinitiv.

Note: Oil prices include Brent, WTI and Dubai Fateh. Gas prices include European, Japanese and American prices. Coal prices include Australian and South African prices.

Chart 2.4: Supply chain pressures



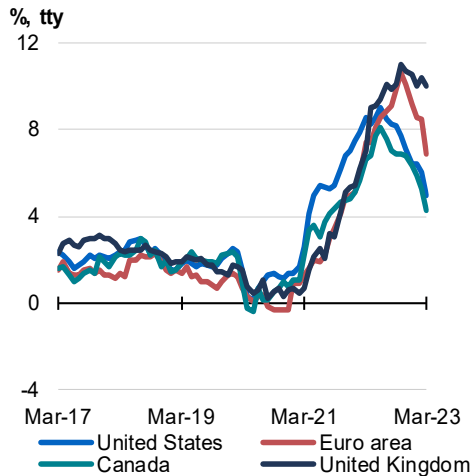
Source: Federal Reserve Bank of New York, Harper Petersen & Co and Refinitiv.

Note: Global shipping price index is the HARPEX container shipping index, which is in nominal terms. The long-term average index value for supply chain pressures is zero.

Core inflation remains more persistent than headline inflation (Chart 2.5 and 2.6). There are signs core inflation has moderated in the United States and Canada, but in the euro area and United Kingdom the pass through of sharper energy price inflation has limited any moderation. Strong services inflation is being led by inflation in travel services, as the industry struggles to meet the sharp recovery in demand. Services categories exposed to earlier goods price inflation, such as motor vehicle insurance and repair and food-related services, are also contributing.

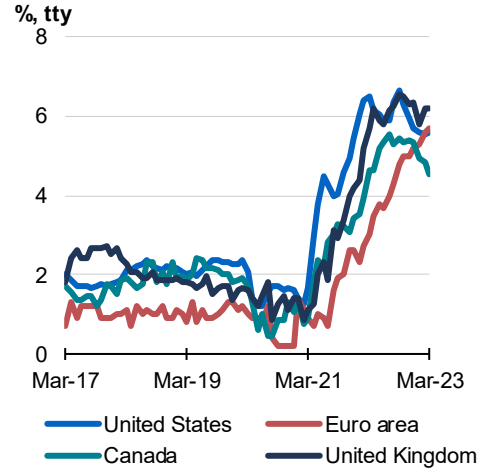
Labour markets have remained tight in many countries, with unemployment rates at or below pre-pandemic levels. This has driven elevated wages growth, which is contributing to stronger services inflation. However, the risk of a wage-price spiral in advanced economies is receding, as the pace of wage growth has moderated in some countries, including the US and Canada.

Chart 2.5 Headline inflation



Source: Refinitiv, US Bureau of Labor Statistics, Statistics Canada, Eurostat and Office of National Statistics United Kingdom.

Chart 2.6 Core inflation



Source: Refinitiv, US Bureau of Labor Statistics, Statistics Canada, Eurostat and Office of National Statistics United Kingdom.

Oil prices are well below the levels seen over 2022, despite the recent announcement of quota cuts by OPEC+. Limited inflows of Russian piped natural gas and the need to build LNG trade infrastructure in the US and Europe means the global gas market will remain structurally tight until around 2026. In the meantime, natural gas will remain vulnerable to weather-related price spikes, particularly during the northern hemisphere winter. Gas and thermal coal prices are likely to move together in response to these demand side shocks, as electricity generators switch fuel sources to minimise costs.

China is the most notable exception to the current period of elevated global inflation. There are few signs of a broad-based pick-up in consumer prices, with inflation remaining below the government’s target of around 3 per cent. Chinese export prices moderated in early 2023, consistent with easing supply chain pressures.

Global policy and financial conditions

Policymakers globally continue to use a range of tools to bring down inflation while balancing growth, cost-of-living pressures, and financial stability considerations. Monetary policy has been the main tool deployed to slow demand and bring down inflation. Many countries have used targeted fiscal policies to offset the impact of elevated cost-of-living pressures on their most vulnerable households. More recently financial regulators have acted swiftly to address bank failures, backstopped by central banks’ liquidity actions, to stem the risk to the broader financial system.

After a period of synchronised rapid interest rate hikes, many central banks have now slowed the pace of tightening. Some, including the Bank of Canada and Bank of Korea, have paused rate hikes to assess the economic impact of their cumulative increase. The

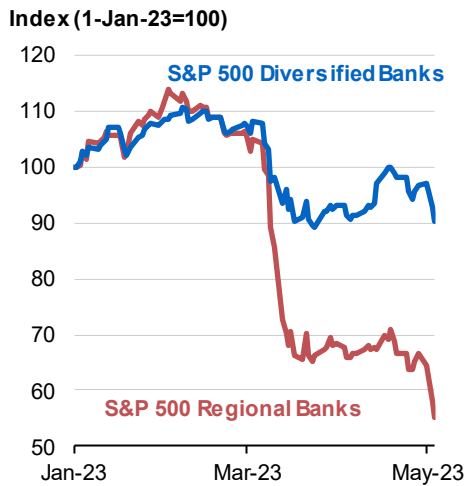
most significant exceptions to the tightening of macroeconomic policy globally are China and Japan, where monetary policy remains accommodative.

Market volatility and measures of financial market stress have increased since March triggered by the collapse of two US regional banks and concerns about the long-term viability of Credit Suisse which was ultimately resolved through a government-facilitated takeover by UBS. In early May the US government also facilitated the sale of another US regional bank, First Republic. Global policy makers' swift and coordinated response to these events, which included protection of depositors and the provision of liquidity by central banks, mitigated broader systemic impacts.

While most large US and European banks' share prices have stabilised, prices for many mid-sized and smaller banks remain well below earlier levels (Chart 2.7). Sentiment among investors and deposit holders also remains fragile and commercial real estate exposure is seen as another potential source of vulnerability, especially among small banks who hold the majority of outstanding commercial real estate loans in the US (Chart 2.8).

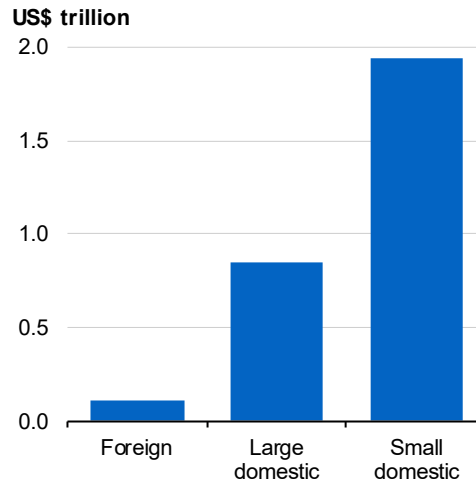
In emerging market and developing countries, the combination of higher borrowing costs and the slowing in growth is generating debt distress. In April, the IMF highlighted that over 50 per cent of low-income developing countries are either in or at high risk of government debt distress, and about 25 per cent of emerging market economies are at high risk. Limited fiscal space could curtail policy options for these countries and contribute to further instability in the global economy.

Chart 2.7: S&P 500 US bank indexes



Source: Bloomberg.

Chart 2.8: Commercial real estate loans in the US by type of lender



Source: United States Federal Reserve and Refinitiv.

Note: Large domestic banks are the top 25 US-chartered banks ranked by US assets. Small domestic banks hold around 29 per cent of all US bank assets. Data covers the week ending 19 April 2023.

Key risks to the international outlook

The international outlook remains highly uncertain, with the balance of risks firmly tilted to the downside. There remains an elevated risk of recession across major advanced economies. An immediate and potentially significant downside risk to the global economy is an escalation of the recent banking sector stress (Box 2.1).

These events have complicated the task of central banks in setting monetary policy. Most central banks have acknowledged the tightening in financial conditions due to the recent bank failures may limit the extent of further increases in policy rates. However, the extent and impact of this tightening in financial conditions is highly uncertain and difficult to quantify, increasing the risk that central banks over- or under-estimate the amount of additional monetary policy tightening required to bring inflation sustainably back to target.

While headline inflation is expected to continue to fall, core inflation may remain more persistent than expected. Additionally, energy and food markets remain vulnerable to extreme weather events, which have become more common, and to an escalation of Russia's invasion of Ukraine. Either event could require tighter monetary policy and a larger increase in unemployment if the associated higher prices flow through to core inflation or increase inflation expectations.

There are also upside risks to growth. If the banking sector stress remains contained and the flow of credit is not materially impacted, this could see stronger outcomes for investment, consumer spending and labour markets. Additionally, in some countries, such as the US, wage growth is moderating whilst employment growth remains robust. If this trend continues, inflation may be able to return to target without the economy slowing as much as currently expected.

Outlook for major trading partners

China's economy is forecast to grow by 5¾ per cent in 2023 and 4½ per cent in 2024 and 2025. The sudden removal of strict COVID-19 containment measures led to a strong rebound in the services sector in the March quarter of 2023 (Chart 2.9), as consumption of services picked up. There are also early signs of an improvement in China's property sector following the policy support introduced in late 2022, which will flow through to dwelling construction. With Chinese consumer confidence still fragile, the rebound in consumption over the rest of the year is expected to moderate.

Near-term risks to the Chinese economy are broadly balanced. A faster-than-expected slowing of global demand may lead to further falls in exports and weaker growth. Alternatively, a quicker-than-expected recovery in domestic consumption or property investment could strengthen and accelerate the rebound.

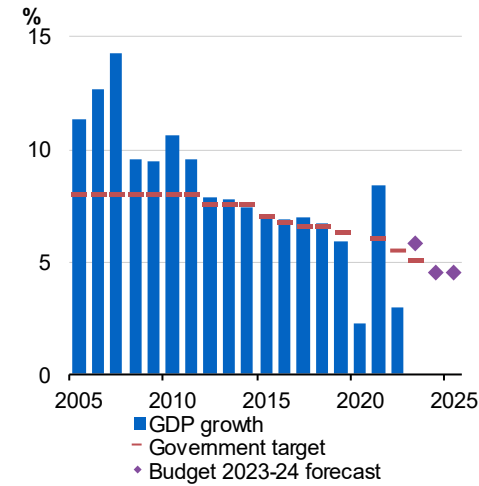
The 2023 growth target of "around 5 per cent" announced at the National People's Congress in March is the lowest in China's recent history (Chart 2.10). The target is likely to be easily exceeded this year as the economy benefits from the rebound out of pandemic restrictions. However, growth above 5 per cent will be more difficult to achieve in future years due to structural pressures, including demographic trends and slowing productivity growth.

Chart 2.9: China Services Purchasing Managers' Index



Source: Bloomberg and National Bureau of Statistics, China.

Chart 2.10: Chinese GDP growth forecasts



Source: Refinitiv, Treasury and National sources.

The **United States** economy is forecast to grow by 1 per cent in 2023, $\frac{3}{4}$ per cent in 2024 and $2\frac{1}{4}$ per cent in 2025. The cumulative effects of monetary policy tightening and tighter credit conditions due to banking sector stresses are expected to see US growth slow sharply over the remainder of 2023, with a recession remaining a risk. This follows unexpectedly solid growth in late 2022 and early 2023, underpinned by still firm employment growth and the inflation-indexed increase in income tax brackets. Weakness in interest rate-sensitive components of domestic demand, including housing and commercial property investment, will lead the slowdown and in turn flow through to slower employment, income and consumption growth.

The US Congress will need to raise the Federal government debt ceiling later this year to avoid disruption to day-to-day government activities. In January 2023 the US Treasury enacted extraordinary measures to avoid a technical default after reaching its debt ceiling. If action by Congress to raise or suspend the debt ceiling is delayed this could generate volatility in financial markets, which could weigh on credit flows and broader economic activity.

The **euro area** economy is forecast to grow by $\frac{1}{2}$ per cent in 2023, 1 per cent in 2024 and $1\frac{3}{4}$ per cent in 2025. Activity was flat in the December quarter of 2022 and growth was weak in the March quarter of 2023 as uncertainty and high inflation weighed on household consumption. Despite growth stalling, this outcome was stronger than the expected economic contraction, with milder than expected winter temperatures and significant fiscal packages buffering the impact of the earlier energy price shock.

High inflation continues to weigh heavily on the outlook, with core inflation higher than the beginning of 2023. The European Central Bank has responded by continuing to raise interest rates at its recent policy meetings.

Vulnerabilities in the European financial system were exposed in March when Credit Suisse customers and investors became concerned about its long-term viability, forcing a government-facilitated takeover by UBS. Uncertainty continues to be high as other European banks face increased scrutiny over their exposures. This financial sector stress will likely weigh on growth by impairing the flow of credit and undermining confidence. As such, growth is expected to remain weak in 2023. Beyond 2023, a pick-up is expected as moderating inflation generates an improvement in real household incomes and allows some mild easing in policy interest rates.

Growth in **Japan** is expected to be $1\frac{1}{4}$ per cent in 2023, $\frac{3}{4}$ per cent in 2024 and 1 per cent in 2025. Growth in 2023 will be supported by record levels of fiscal support and a recovery in services consumption following the pandemic, as consumer confidence, although depressed, continues to improve. The resolution of global supply chain constraints is expected to support Japanese manufacturing, particularly in the auto industry.

Monetary policy will likely remain accommodative and support growth, with inflationary pressures limited compared to other economies. Annual wage negotiations for 2023 delivered the largest pay increase in multiple decades, but they only cover a small portion of Japan's workforce.

Growth is expected to slow in 2024 as base effects dissipate and fiscal policy becomes less expansionary. Japan remains vulnerable to recessionary risks in the United States and euro area, which would reduce Japan's export volumes and dampen business investment.

The **United Kingdom** economy is forecast to contract by $\frac{1}{2}$ per cent in 2023, before growing by $\frac{1}{2}$ per cent in 2024 and $2\frac{1}{4}$ per cent in 2025. Growth slowed substantially over 2022, with the economy only narrowly escaping a technical recession in the second half of the year as high energy prices held back consumption. Economic activity is expected to contract across 2023 as the impacts of monetary tightening continue to build, household purchasing power remains weak and increases in personal and company taxes take effect. As inflation moderates, improvements in real household incomes and some easing of financial conditions are expected to lead to a pick-up in growth over 2024 and 2025.

Risks are tilted to the downside and the United Kingdom economy is vulnerable to being adversely affected by financial sector stress. Domestic inflationary pressures and wage growth have continued to be strong, and markets expect further interest rate hikes from the Bank of England. Nevertheless, inflation is expected to return to target as energy inflation subsides and a period of weak growth sees supply and demand rebalance.

The economies of **Other East Asia** are forecast to grow by $3\frac{1}{4}$ per cent in 2023, 4 per cent in 2024 and $4\frac{1}{4}$ per cent in 2025. Growth will slow in 2023 due to tighter monetary policy and high inflation. Partially offsetting this will be the benefits from China's reopening, including increased international tourism. In contrast, the slowing of advanced economies in 2023 will weigh on export demand. Risks remain tilted to the downside with the region vulnerable to the uncertain global outlook, elevated inflation and high interest rates.

India's economy is forecast to grow by $5\frac{1}{2}$ per cent in 2023, followed by $6\frac{1}{4}$ per cent in 2024 and $6\frac{3}{4}$ per cent in 2025. While growth is expected to slow in 2023, India will remain one of

the fastest growing major economies. Growth has been resilient in recent quarters but momentum has slowed as the pandemic rebound has faded. Elevated inflation and higher interest rates are likely to weigh on domestic demand in the near term, while strong government investment is expected to be a key source of growth.



Box 2.1: Global financial stress scenario

The Budget economic outlook incorporates a moderate tightening in global financial conditions arising from recent instability in the global banking system. To assess the uncertainty around the forecasts, Treasury has also modelled the impact of an escalation of global financial sector stress on the global and Australian economies.

The scenario assumes there are further failures of small financial institutions internationally. Financial authorities contain the fallout and quarantine the affected institutions, limiting contagion and preserving the sound functioning of the global financial system. Nonetheless, further instability leads to a significant deterioration in investor sentiment, additional tightening in global credit conditions and negative impact on global consumer and business confidence.

While not immune to the effects of global financial instability, the Australian banking system is well-placed to absorb shocks emanating from overseas. Australia's unquestionably strong prudential requirements, introduced in January 2023, exceed international standards in several areas. As a result, Australian banks have strong capital positions and liquidity coverage.

Nonetheless, in the scenario additional global investor uncertainty is expected to impact the Australian economy. Financial and other asset prices fall, and heightened investor risk aversion contributes to a material tightening in domestic financial conditions. Reduced household and business confidence would slow consumption and investment and contribute to weaker employment growth. Weaker global activity would also weigh on demand for Australian exports.

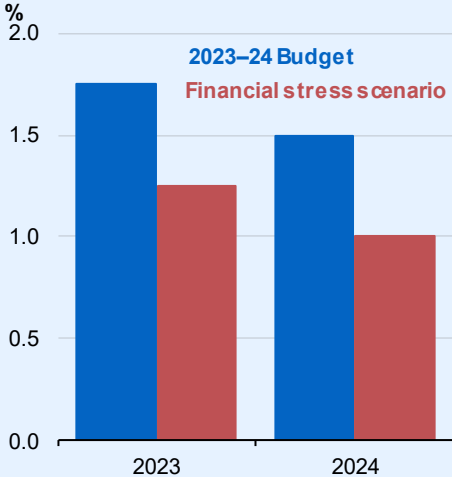
In the scenario, global growth in both 2023 and 2024 slows to 2 per cent rather than $2\frac{3}{4}$ per cent and 3 per cent, respectively, in the forecasts. Australian growth would slow to $1\frac{1}{4}$ per cent in 2023 and 1 per cent in 2024, around $\frac{1}{2}$ of a percentage point lower than in the forecasts (Chart 1). The Australian unemployment rate rises somewhat more quickly and to a higher level than in the forecasts, reaching a rate of $5\frac{1}{4}$ per cent in June 2025 rather than $4\frac{1}{2}$ per cent (Chart 2).

Growth in Australia would likely prove more resilient compared with other advanced economies that are more directly exposed to the banking sector failures. A more severe shock that effects the core of the global financial sector, similar to developments during the Global Financial Crisis, would have a more severe impact on the world economy and Australia.

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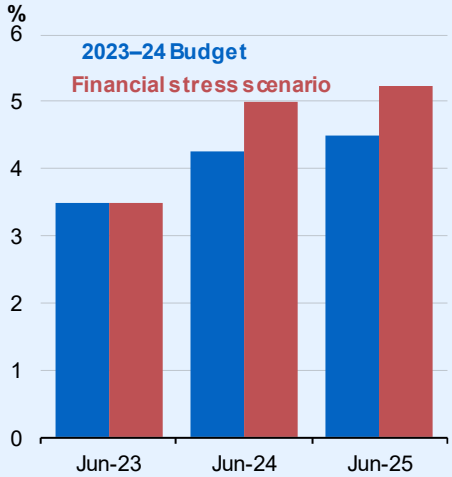
Box 2.1: Global financial stress scenario (continued)

Chart 1: Annual GDP growth, Australia



Source: Treasury.

Chart 2: Unemployment rate, Australia



Source: Treasury.

Outlook for the domestic economy

The Australian economy has shown resilience to global headwinds, supported by a post-pandemic rebound in household spending, strong employment growth and a pick-up in wages. National income is also being supported by elevated commodity prices. Real GDP growth is expected to be 3¼ per cent in 2022–23.

But the economy is not immune to the global slowdown and there are clear signs that domestic demand is responding to higher interest rates and other cost-of-living pressures. This slowing was expected in the October Budget, but has materialised slightly earlier than anticipated, with consumers and the housing sector most exposed. This is being offset by a stronger than expected rebound in service exports following the reopening of international borders. Overall, the near-term outlook for real GDP growth is unchanged from the October Budget, slowing to 1½ per cent in 2023–24, and then strengthening to 2¼ per cent in 2024–25 (Chart 2.11).

Inflation peaked at the end of 2022 and is now moderating. Supply constraints and the impact of Russia's invasion of Ukraine have begun to subside and the Government's Energy Price Relief Plan is expected to further reduce inflation in 2023–24. This should see inflation return to the RBA's target band in 2024–25, although cost-of-living pressures will remain a near term weight on households.

Financial markets and market economists now expect the cash rate to remain at 3.85 per cent until early 2024, before gradual cuts back to 3 per cent by June 2025. This is slightly above expectations at the October Budget, which will put a further drag on consumption and dwelling investment activity once the backlog of work is completed in the near term. Both have been downgraded since the October Budget.

Business investment is expected to support activity, underpinned by the strong pipeline of work and a need to add capacity to meet the level of demand. Adding to the recovery in services exports, mining and rural export volumes are forecast to recover after weather-related disruptions. Spending on goods imports and overseas travel by Australians is expected to moderate, in line with more subdued domestic demand.

The tight labour market has persisted but is expected to gradually soften in response to slowing demand. Employment growth will be supported by stronger migration, with a projected increase of 1 per cent in 2023–24. This is ¼ of a percentage point stronger than the October Budget. The unemployment rate is expected to increase modestly from a near 50-year low of 3.5 per cent to 4¼ per cent by the June quarter of 2024, and 4½ per cent in the June quarter of 2025. Even with this modest rise, the unemployment rate is expected to remain low by historical standards. The labour force participation rate is expected to fall slightly to 66¼ per cent in the June quarter of 2025, but remain at high levels.

The strength of recent labour market outcomes is flowing through to wages, with growth projected to reach 4 per cent in 2023–24, its fastest pace since 2009. The Fair Work Commission's forthcoming Minimum Wage Determination and the Aged Care Work Value Case are also assumed to contribute strongly to wages growth in the near term. Wage

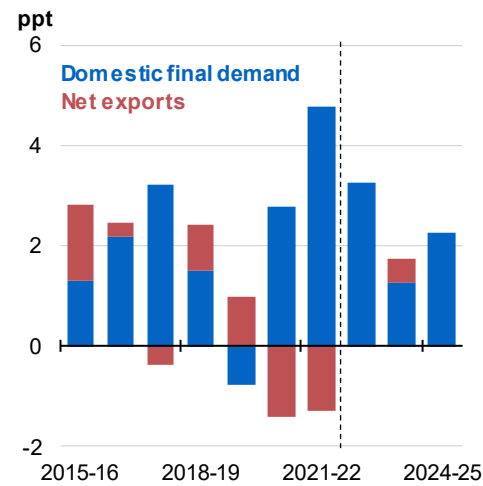
growth is expected to remain robust at 3¼ per cent in 2024–25, materially faster than the outcomes achieved in the decade prior to the pandemic. This pick-up in wages growth remains consistent with inflation returning to the target band in 2024–25.

The combination of stronger nominal wages growth and easing inflation is supporting an earlier and stronger return to real wage growth. Annual real wage growth is now expected to resume in early 2024, for the first time since early 2021 and slightly ahead of the October Budget forecasts. By the June quarter of 2024, real wages are expected to grow by ¾ per cent, helping to drive the recovery in domestic activity through 2024–25 (Chart 2.12).

There are downside risks to the economic outlook. A key risk is a potential worsening of global financial conditions, which could impact confidence and global growth. Were this to materialise, lending conditions in Australia would tighten, households could become more cautious and businesses could delay investment decisions.

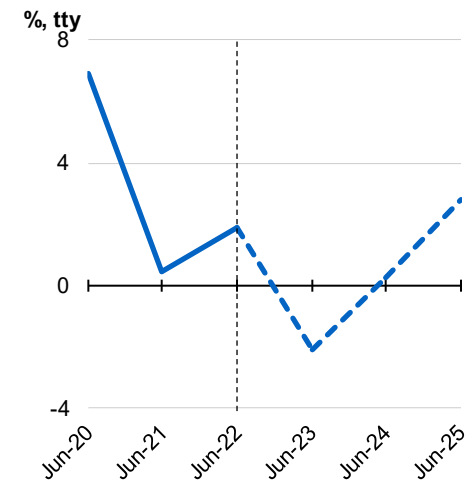
More persistent global inflation than currently anticipated could result in tighter global monetary policy, which would further slow global growth, and dampen confidence and export earnings. Domestically, the ongoing cost-of-living pressures may see households reduce their spending more than is anticipated. Any additional persistence in inflation that keeps interest rates higher for longer would further heighten this risk.

Chart 2.11: Domestic and net export contribution to growth



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

Chart 2.12: Real disposable income growth



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

Table 2.2: Domestic economy – detailed forecasts^(a)

	Outcomes	Forecasts		
	2021-22	2022-23	2023-24	2024-25
Real gross domestic product	3.7	3 1/4	1 1/2	2 1/4
Household consumption	3.7	5 3/4	1 1/2	2 1/2
Dwelling investment	2.9	-2 1/2	-3 1/2	-1 1/2
Total business investment ^(b)	6.1	3	2 1/2	2
<i>By industry</i>				
Mining investment	8.4	0	2	1 1/2
Non-mining investment	5.4	4	2 1/2	2
Private final demand ^(b)	4.3	4	1	2 1/4
Public final demand ^(b)	6.5	1 3/4	1 1/2	2
Change in inventories ^(c)	0.1	0	0	0
Gross national expenditure	5.1	3 1/4	1	2 1/4
Exports of goods and services	-0.3	8	6	3 1/2
Imports of goods and services	7.0	9	4	3 1/2
Net exports ^(c)	-1.3	0	1/2	0
Nominal gross domestic product	11.0	10 1/4	1 1/4	2 1/2
Prices and wages				
Consumer price index ^(d)	6.1	6	3 1/4	2 3/4
Wage price index ^(d)	2.6	3 3/4	4	3 1/4
GDP deflator	7.0	7	- 1/4	1/4
Labour market				
Participation rate (per cent) ^(e)	66.6	66 1/2	66 1/4	66 1/4
Employment ^(d)	3.6	2 1/2	1	1
Unemployment rate (per cent) ^(e)	3.8	3 1/2	4 1/4	4 1/2
Balance of payments				
Terms of trade ^(f)	11.9	1 1/2	-13 1/4	-8 3/4
Current account balance (per cent of GDP)	2.0	3/4	-2 1/2	-3 1/2
Net overseas migration ^(g)	184,000	400,000	315,000	260,000

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.

g) Net overseas migration is forecast to continue at 260,000 in 2025–26 and 2026–27.

Note: The forecasts for the domestic economy are based on several technical assumptions. The exchange rate is assumed to remain around its recent average level – a trade-weighted index of around 60 and a \$US exchange rate of around 67 US cents. Interest rates are informed by the Bloomberg survey of market economists. World oil prices (Malaysian Tapis) are assumed to remain around US\$87/barrel. Population growth is forecast to be 2.0 per cent in 2022–23, 1.7 per cent in 2023–24 and 1.5 per cent in 2024–25.

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.

Box 2.2: Population

The pandemic resulted in the first net outflow of overseas migration from Australia since World War II. The rebound in temporary migration following the reopening of Australia's international borders was initially slow but has recently started to recover at a faster rate. This has resulted in an upgrade in the forecast level of population, even though the total number of temporary migrants arriving in Australia is not expected to make up for the loss in migration during the pandemic for some time.

Population growth is now expected to be 2.0 per cent in 2022–23 and 1.7 per cent in 2023–24, upgraded from 1.4 per cent in those years in the October Budget. Net overseas migration is forecast to be 400,000 in 2022–23 and 315,000 in 2023–24, reflecting the one-off catch up from the pandemic. This strength in migration and population growth is expected to be temporary, with migration forecast to largely return to normal patterns from 2024–25.

Even with this stronger near-term outlook, total net overseas migration is not expected to catch up to the level forecast prior to the pandemic until 2029–30. By the time border restrictions were relaxed at the end of 2021, net overseas migration was cumulatively almost 500,000 lower than expected prior to the pandemic. On current forecasts, net overseas migration will still be cumulatively 315,000 lower than pre-pandemic forecasts by June 2023 and 215,000 lower by June 2024.

Notwithstanding the recovery in net overseas migration, the total population is still expected to be 750,000 people (2.5 per cent) smaller in June 2031 compared with pre-pandemic forecasts. This is attributable to a lower fertility assumption, which was updated in early 2020 to better reflect long-running trends.

The reopening of international borders has seen a rapid recovery in the stock of international students, skilled temporary visa holders and working holiday makers in 2022–23. Second and third-year students who were studying online during the pandemic have been returning, in addition to those arriving in Australia to begin their studies. At the same time, very low temporary migrant arrivals during the pandemic now means fewer departures – those who did not arrive cannot now leave. Strong labour market conditions and increased eligibility for temporary visas with work rights are also supporting higher levels of temporary migration.

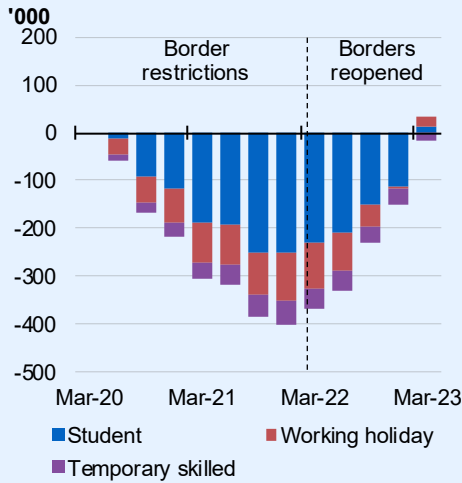
From 2023–24, arrivals of temporary migrants are expected to return to normal levels. It will take more time for departures to return to normal because of the low arrivals during the pandemic. As such, the elevated forecast for net overseas migration in 2023–24 is largely driven by fewer temporary migrants departing Australia than usual, rather than a greater number of people arriving.

Once the temporary catch-up effect from the pandemic subsides, net overseas migration is expected to return to more normal levels, falling back towards historical trends of 235,000 per year, which is the assumed level into the medium term.

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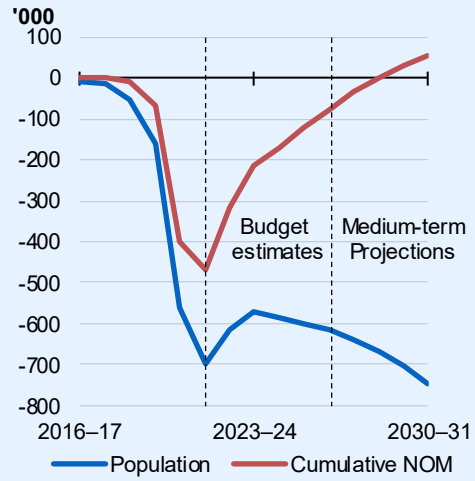
Box 2.2: Population (continued)

Chart 1: Selected temporary visas, changes since 31 March 2020



Source: Department of Home Affairs, Temporary entrants visa holders.
 Note: Selected visas are a subset of those that contribute to net overseas migration.

Chart 2: Difference in population between 2019–20 MYEFO and 2023–24 Budget



Source: Treasury.
 Note: Population is expected to be lower than in the 2019–20 MYEFO because of a lower fertility assumption.

Household consumption

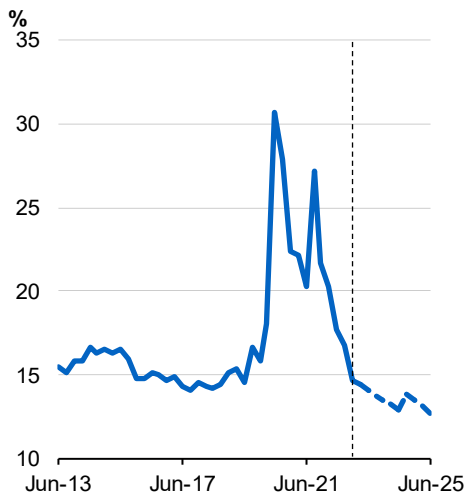
Household consumption growth is expected to slow from 5¾ per cent in 2022–23 to 1½ per cent in 2023–24. A strong post-pandemic rebound in services spending, including pent-up demand for international tourism supported consumption over 2022.

The cumulative impact of cost-of-living pressures and higher interest rates is now constraining household budgets. Recent data indicates household spending has slowed over the March quarter of 2023, and high interest rates (including the roll off of fixed-rate mortgages) will increasingly weigh on household budgets and spending over the year ahead. To maintain consumption in the face of these pressures, many households will be required to save less of their income. This is expected to see the savings ratio fall below its pre-pandemic level (Chart 2.13).

Household consumption growth is expected to rebound in 2024–25, growing by 2½ per cent (Chart 2.14). The pick-up will be driven by continued growth in household disposable income as wages lift and inflation subsides. Mirroring current spending patterns, the recovery is expected to be driven by the more cyclical components of household spending.

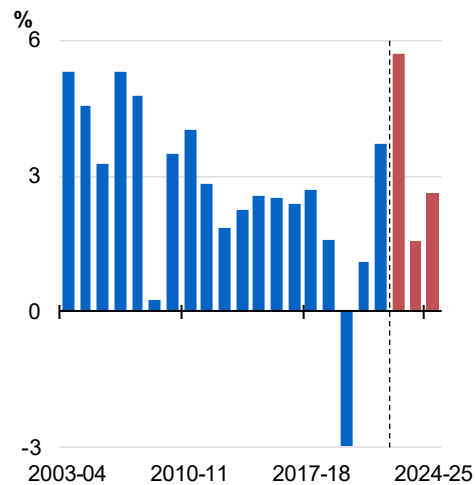
There remains significant uncertainty around how sensitive aggregate household consumption will be to current conditions. Households that built up significant buffers through the pandemic may choose to support their spending in the near term through a lower savings rate. However, a significant number of households are facing more acute budget pressures. Those with minimal savings, high debt or high rent are more vulnerable and may have to reduce discretionary spending.

Chart 2.13: Gross savings ratio



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

Chart 2.14: Consumption growth



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

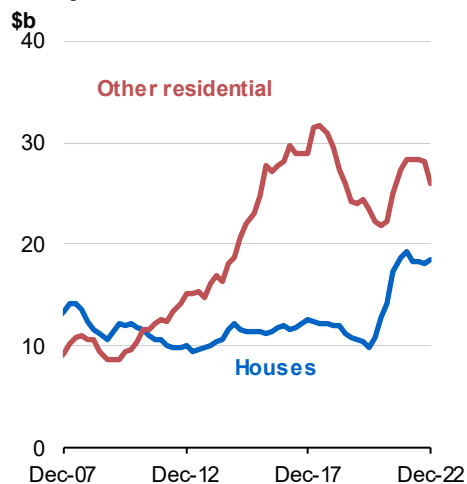
Dwelling investment

A significant pipeline of projects currently underway is supporting dwelling investment, with the sector working through the tail end of recent strong demand, supply chain delays and disruption due to floods in 2022 (Chart 2.15). As work is completed and the impact of earlier interest rate hikes and house price declines flow through the system, activity is expected to contract by 3½ per cent in 2023–24.

The downturn in activity is expected to extend into 2024–25, with a further 1½ per cent decline anticipated, before recovering strongly over 2025 and onwards. The ongoing rebound in net overseas migration, strong rental yields, expected lower interest rates and a reduction in building input costs are expected to drive the recovery, particularly in medium and high-density housing. Government initiatives to boost supply will also assist in supporting investment in new dwellings.

There is some downside risk to the near-term outlook associated with the weak financial position of a number of builders, due to elevated construction and financing costs. However, as capacity constraints ease, these pressures are expected to moderate (Chart 2.16).

Chart 2.15: Real value of residential work yet to be done



Source: ABS Building Activity, unpublished ABS data and Treasury.

Note: Nominal pipeline of residential work is deflated by dwelling prices.

Chart 2.16: House building input price growth



Source: ABS Producer Price Indexes.

Business investment

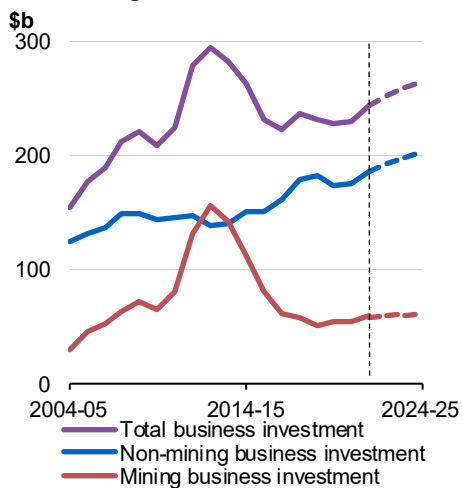
The outlook for business investment remains relatively positive, despite weakening domestic demand and the tightening in financial conditions (Chart 2.17 and 2.18). A large pipeline of construction projects will underpin the near term, and strong business balance sheets and high levels of capacity utilisation will support investment over 2023-24 and 2024-25.

Investment is expected to grow by 3 per cent in 2022–23. As overall demand in the domestic and global economy softens, momentum is expected to ease in 2023–24 and 2024–25, growing by 2½ per cent and 2 per cent, respectively. The possibility that firms may delay or cancel projects in response to elevated input costs and ongoing domestic and global headwinds remains a downside risk.

Non-mining investment is expected to be the main driver of growth in business investment over the coming years, increasing by 4 per cent in 2022–23, 2½ per cent in 2023–24 and 2 per cent in 2024–25. Ongoing upgrades to machinery and equipment and continued expenditure on construction projects is driving growth throughout these years.

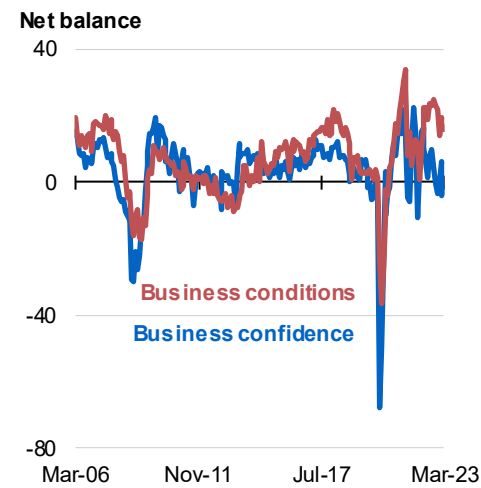
Despite high commodity prices, mining investment is forecast to be flat in 2022–23 before growing modestly over the rest of the forecast period, by 2 per cent in 2023–24 and 1½ per cent in 2024–25. The outlook primarily reflects expenditure to maintain existing resource production capacity along with a modest number of new LNG and metal ore projects.

Chart 2.17: Total, mining and non-mining business investment



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

Chart 2.18: Business confidence and conditions



Source: NAB Monthly Business Survey.

Public final demand

Following elevated health and related spending during the pandemic, growth in new public final demand is forecast to moderate over the forecast period. Increases in government spending are not expected to be a significant driver of GDP growth, with expenditure forecast to increase by 1¾ per cent in 2022–23 and 1½ per cent in 2023–24.

Public investment activity will remain solid as state and federal governments work through a large pipeline of public infrastructure projects. However, progress and projected delivery is anticipated to be at a slower pace than previously expected in the October Budget due to sustained capacity constraints in the sector.

Net exports

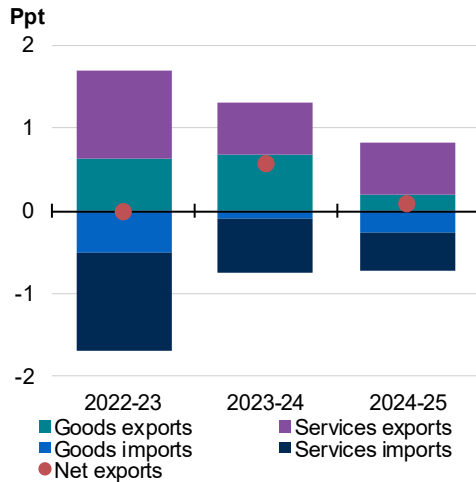
Net exports are expected to make a flat contribution to GDP growth in 2022–23, an upgrade from the October Budget. Net exports are then expected to add ½ of a percentage point to growth in 2023–24 before moderating in 2024–25 (Chart 2.19). The moderation over the period reflects slowing growth in exports, particularly for goods, alongside steady growth in imports.

Exports are forecast to grow by 8 per cent in 2022–23 and 6 per cent in 2023–24. This would be the fastest period of export growth since the early 2000s (Chart 2.20). Exports will be supported by the recovery in tourism and international education, following the prolonged period of international border closures during the pandemic. A recovery in mining exports following weather disruptions and favourable seasonal conditions which are supporting rural exports will also contribute. Export growth is expected to slow to 3½ per cent by 2024–25, as growth in mining and services exports moderates.

International education exports are now expected to reach pre-pandemic levels in 2024, a year earlier than the October Budget. An earlier-than-assumed reopening of China's borders and stronger student arrival projections from key source countries have been reflected in an upgrade to international education exports.

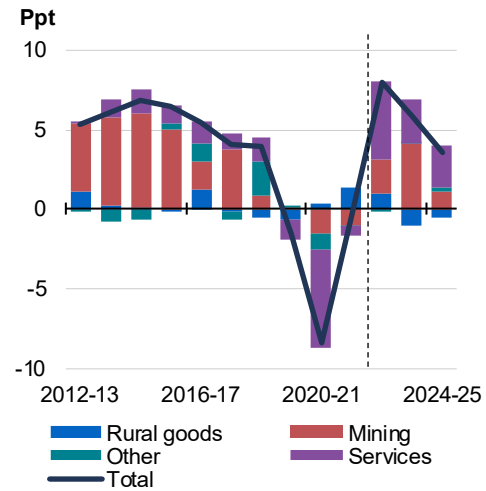
Imports are forecast to increase by 9 per cent in 2022–23, led by the ongoing recovery of services imports as Australians travel overseas in higher numbers. Growth in capital goods imports will be underpinned by continued strength in business investment. In 2023–24, goods imports growth is expected to soften in line with weaker domestic demand, before an acceleration in 2024–25 as domestic spending recovers.

Chart 2.19: Contribution to GDP growth



Source: ABS Balance of Payments and International Investment Position, ABS Australian National Accounts: National Income, Expenditure and Product and Treasury.

Chart 2.20: Contribution to exports growth



Source: ABS Balance of Payments and International Investment Position and Treasury.

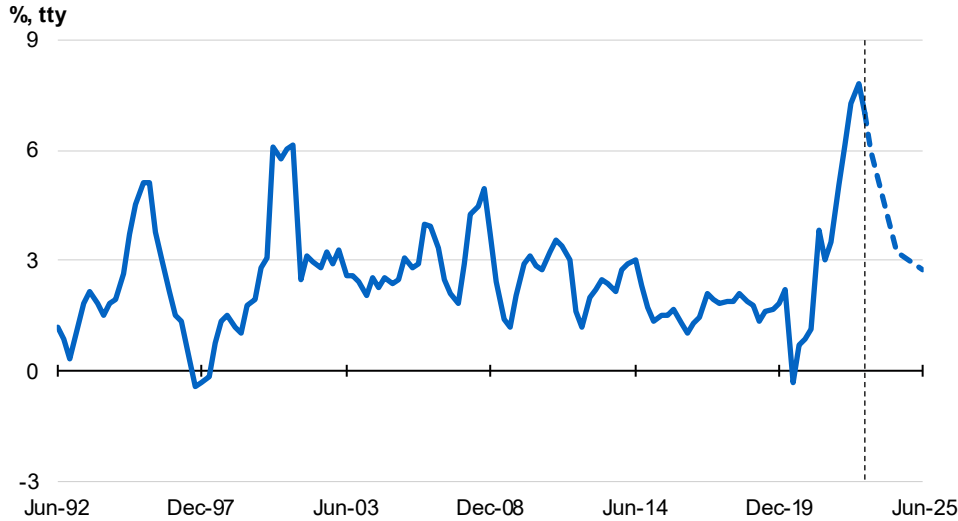
Note: 'Other' includes exports of non-commodity goods and additive differences due to rebasing of volume change measures.

Inflation

As expected, inflation in Australia peaked in late 2022 and has begun to moderate. Annual inflation fell from 7.8 per cent through the year to the December quarter of 2022 to 7 per cent in the March quarter of 2023. Inflation is expected to return to the RBA target band in 2024–25 (Chart 2.21). The global price shocks and supply constraints that contributed to the large increase in inflation over the past year are easing. The Government’s Energy Price Relief Plan is expected to significantly lower inflation in 2023-24 by around $\frac{3}{4}$ of a percentage point. High goods inflation is giving way to a pick-up in services inflation in some areas, including rents. Over the medium term, the impact of temporary price shocks is expected to ease, keeping inflation in the RBA’s target band.

Global and one-off supply factors played a significant role in the recent inflation spike, and these are expected to dissipate. Supply disruptions associated with the pandemic and Russia’s invasion of Ukraine saw the cost of imported goods rise steeply over 2022, reversing the trend of weak or declining import prices prior to the pandemic. Some of these supply factors are starting to wane, with recent data suggesting import prices have eased considerably, causing a decline in some goods prices (Chart 2.22).

Chart 2.21: Headline CPI growth



Source: ABS Consumer Price Index and Treasury.

Spillovers from Russia’s invasion of Ukraine resulted in very high wholesale energy prices, which have compounded temporary domestic electricity market disruptions associated with sustained under-investment in the energy transformation over the last decade. Energy price rises directly contributed around ½ of a percentage point to annual inflation in December 2022. Broader domestic supply disruptions have also contributed to high inflation. This includes the impact of 2022’s flood events, which damaged fresh produce and added to existing delays and cost pressures in residential construction (Chart 2.23).

While severe, the high inflation episode in Australia is proving to be less pronounced than in Europe, the UK and US. This may partly reflect important structural differences between the economies. Growth in the supply of labour due to a strong increase in the participation rate helped Australia avoid the widespread labour shortages and unsustainable wage growth seen in some other countries over the past 2 years. In December 2022, the Government also took action to limit further impacts of global energy prices caused by Russia’s invasion of Ukraine on domestic energy prices.

In the near term, annual inflation is expected fall to 6 per cent over the year to the June quarter of 2023. This slight upgrade since the October Budget reflects broad-based price pressures in recent CPI outcomes. Inflation is then projected to moderate to 3¼ per cent to the June quarter of 2024, which is lower than the October Budget, and to 2¾ per cent to the June quarter of 2025.

The downgrade in 2023-24 is linked to government policy interventions to directly ease cost-of-living pressures, and these measures are not expected to add to broader inflationary pressures in the economy. The Government’s Energy Price Relief Plan is expected to reduce headline inflation by ¾ of a percentage point by the June quarter of 2024. Further relief includes increased rental assistance payments and lowering the cost of some medicines.

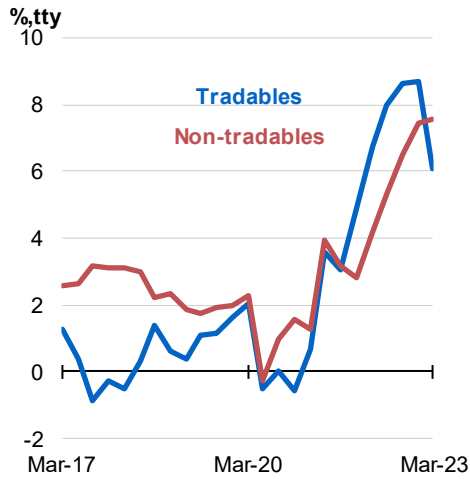
Average rental costs are expected to pick up in the next few years as increases in advertised rents flow through to existing lease agreements when they are renewed. The rental market is currently very tight, with national vacancy rates at near record lows of around 1 per cent and advertised rents growing at over 10 per cent as of April 2023. Demand has increased sharply, driven by a fall in average household size through the pandemic (some of which may reverse) and the reopening of international borders. Conversely, material and labour constraints affecting the residential construction sector have limited the capacity for housing supply to keep up with growing demand. The Government's decision to increase Commonwealth Rent Assistance will help support the most vulnerable households with these pressures, and along with other measures to boost the supply of housing will help reduce pressures on rents and inflation.

The Government's Energy Price Relief Plan is expected to reduce inflation by $\frac{3}{4}$ of a percentage point in 2023–24, including the expected impact of electricity rebates (Box 2.3). Average national retail electricity prices are now forecast to rise by around 10 per cent in 2023–24, which is much lower than the earlier estimate of 36 per cent without the Government's intervention. Households eligible for electricity bill relief will generally face smaller price increases. Retail gas prices are now forecast to increase by 4 per cent in 2023–24 compared to the October Budget forecast of 20 per cent.

Energy prices in 2024–25 are highly uncertain. Based on the limited information currently available, Treasury has assumed that energy prices will not contribute materially to inflation in 2024–25. Wholesale electricity futures trading to date imply a small decline in retail electricity prices assuming other factors remain constant. The unwinding of rebates will increase retail prices, and further upward pressure could materialise if global energy markets remain structurally short and as new regulated network determinations take effect. Given the current uncertainty, it is assumed that electricity prices grow in line with CPI inflation in 2024–25.

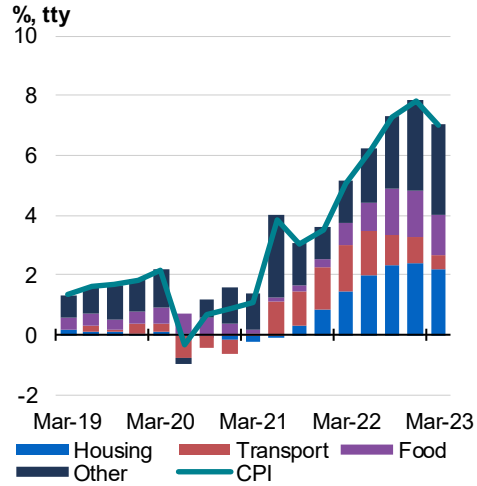
There is significant uncertainty surrounding the outlook for inflation. Recent global supply shocks are unwinding as expected, but further shocks cannot be ruled out. The extent to which households adjust consumption patterns in response to cost-of-living pressures also presents a risk to the inflation outlook.

Chart 2.22: Tradables and non-tradables inflation



Source: ABS Consumer Price Index and Treasury.

Chart 2.23: Inflation components



Source: ABS Consumer Price Index and Treasury.

Note: Contributions prior to September 2022 are back-cast using 2022 CPI expenditure weights.

Box 2.3: Impact on inflation of interventions in domestic energy markets

In December 2022, the Government introduced the Energy Price Relief Plan to shield Australians from the worst impacts of the extraordinary energy price increases that were projected for 2022–23 and 2023–24. The intervention temporarily caps wholesale gas and coal prices and provides targeted energy bill relief for households and small businesses. It also announced a mandatory Code of Conduct for wholesale gas sales to ensure Australian households and businesses have access to gas at reasonable prices, and to establish a more level playing field for negotiations between gas producers and customers.

The intervention was in response to extreme increases in international wholesale energy prices in 2022, associated with Russia’s invasion of Ukraine. At their peak, energy prices were more than double their level in March 2021, with global gas and coal prices rising 8 and 4-fold, respectively. Despite being a net exporter of gas and coal, these international prices further disrupted local price dynamics, driving significant increases in the costs of wholesale electricity generation.

From the end of January 2022 to the release of the October Budget, wholesale electricity futures contract prices for states in the National Electricity Market (NEM) increased by between 172 per cent and 226 per cent. Following the Government announcement of energy market intervention, futures contract prices declined. Since the release of the October Budget and the end of April 2023, these prices fell by between 36 per cent and 43 per cent across states in the NEM (Chart 1).

East coast wholesale gas spot prices reached unprecedented levels, peaking at \$50 per gigajoule or 5 times pre-invasion levels of around \$10 per gigajoule. Wholesale gas prices have declined significantly since the intervention and have now settled at levels close to those traded prior to the invasion in early 2022.

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Box 2.3: Impact on inflation of interventions in domestic energy markets (continued)

Chart 1: ASX Energy 2023–24 financial year base load futures contract



Source: ASX Energy.

The Government’s measures are expected to directly reduce inflation by $\frac{3}{4}$ of a percentage point in 2023–24. This comprises the impact of both gas and coal price caps and the up to \$3 billion in electricity bill relief, jointly funded by the Commonwealth and state and territory governments. Retail electricity price increases in 2023–24 are expected to be around 25 percentage points lower than was expected at the time of the Government’s announcement. Retail gas price increases in 2023–24 are expected to be around 16 percentage points smaller than expected prior to the Government’s intervention.

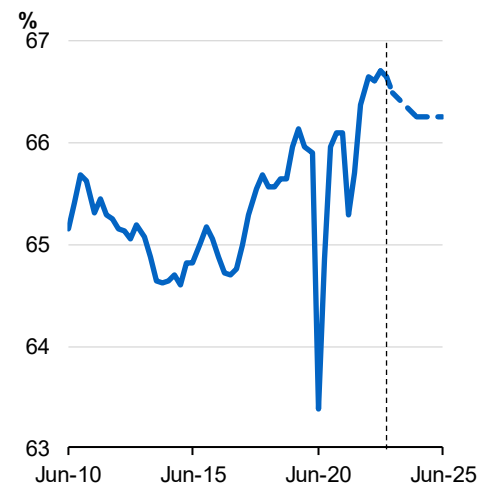
The labour market

The demand for labour is proving to be resilient to the recent softening of household consumption. Strong employment growth has kept the unemployment rate close to its near-50 year low and has encouraged many more (often marginalised) workers to join the labour force. The employment-to-population ratio and the participation rate are near record highs. These conditions have lifted prospects for cohorts who traditionally face barriers to employment. The youth unemployment rate has fallen below 8 per cent and women’s participation is at a record high.

Skills and labour shortages remain present in some sectors and regions, but an increase in labour supply from higher migration will help businesses find workers and alleviate specific shortages in the near term. Employment growth has been upgraded to 2½ per cent in 2022–23, before moderating to 1 per cent growth in both 2023–24 and 2024–25 as the economy slows. The participation rate is expected to fall slightly from its recent record highs to be 66¼ per cent in the June quarter of 2025, but remain above its pre-Covid level, reflecting the structural trend of higher women’s and older worker participation (Chart 2.24).

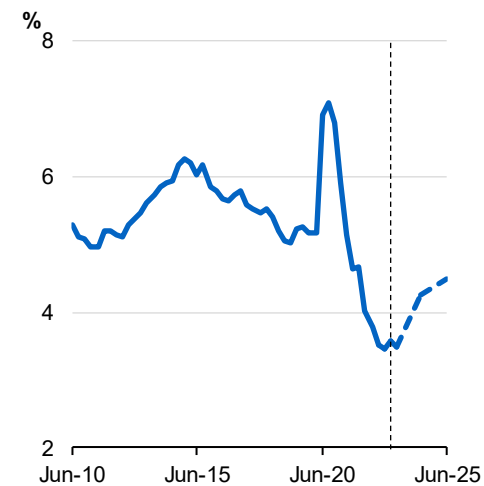
The unemployment rate is expected to remain at 3½ per cent in the June quarter of 2023. As economic growth moderates, the unemployment rate is forecast to rise modestly to 4¼ per cent by the June quarter of 2024 and 4½ per cent by the June quarter of 2025, but to still remain lower than pre-pandemic levels and by historical standards (Chart 2.25). The resilience of labour demand means the rise in the unemployment rate is expected to be more gradual, and to peak slightly later, than expected in the October Budget.

Chart 2.24: Participation rate



Source: ABS Labour Force Survey and Treasury.

Chart 2.25: Unemployment rate



Source: ABS Labour Force Survey and Treasury.

Nominal wage growth has picked up over the recent quarters and is expected to build further. There are no signs of a wage-price spiral developing and medium-term inflation

expectations remain well anchored. Growth in the Wage Price Index (WPI) is expected to reach 3¼ per cent through the year to the June quarter of 2023 and 4 per cent through the year to the June quarter of 2024 (Chart 2.26). This would be the fastest nominal wage growth since 2009 and remains consistent with inflation returning to target in 2024–25. As the labour market moderates and inflation eases, growth in nominal wages is forecast to settle at 3¼ per cent through the year to the June quarter of 2025.

The lift in wages growth is being supported by the Fair Work Commission determinations on the minimum wage and Aged Care Work Value Case, which will increase the relative wages of low-paid workers. These decisions are expected to add around an additional ½ of a percentage point to wage growth in 2023–24, and provide support for Australia’s low paid workers who are disproportionately impacted by price increases for essential goods and services. As a technical assumption, Treasury has assumed that the forthcoming FWC determination adopts a similar approach to last year.

The acceleration in wage growth also reflects the lagged effect of the current tight labour market. Market sensitive individual agreements have been the biggest contributor to the pick-up in aggregate wages to date, but momentum is expected to wane as the labour market eases (Chart 2.27). A lift in public sector wages growth and the re-negotiation of multi-year enterprise bargaining agreements will partially offset this. Broader measures of wages that include bonuses, which tend to be more responsive to labour market conditions, are expected to see a more pronounced cycle.

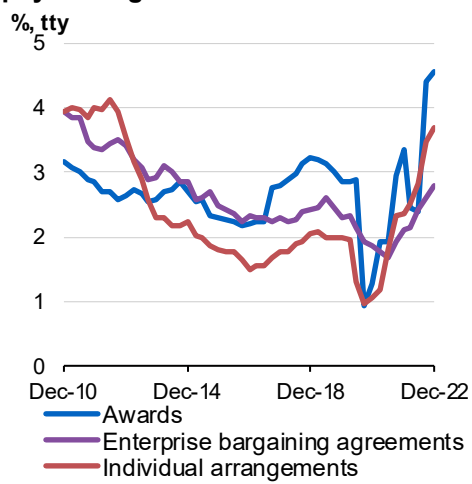
With inflation moderating and wages picking up, positive annual real wage growth is expected to return by early 2024, increasing to ¾ per cent the June quarter of 2024. This is slightly earlier than anticipated, and an upgrade from the October Budget.

Chart 2.26: WPI growth



Source: ABS Wage Price Index and Treasury.

Chart 2.27: WPI growth by method of pay-setting



Source: ABS Wage Price Index.

Aggregate wage growth would be expected to be stronger if labour market outcomes were more robust than forecast, the large administered wage increases assumed for 2023–24 continue into future years or enterprise bargaining wage increases are larger than anticipated.

Outlook for the terms of trade

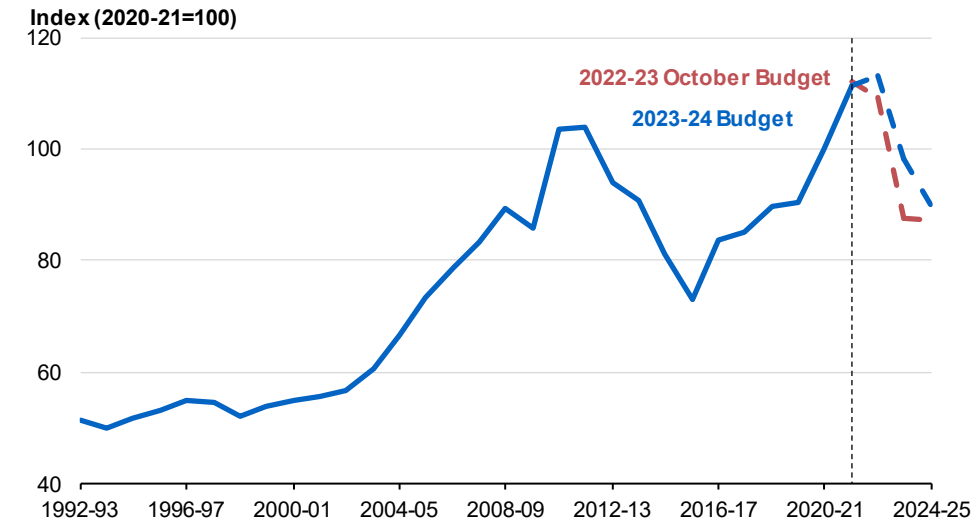
Australia's terms of trade, the ratio of export to import prices, are expected to increase by 1½ per cent in 2022–23, after rising by 11.7 per cent the year before, to reach its highest level on record. The terms of trade have been supported by strong global demand and tight global supply for Australia's key mining and rural commodity exports.

The terms of trade are forecast to decline sharply in 2023–24, driven by an assumption that bulk commodity prices return to their long-run anchors over 4 quarters (Chart 2.28). At the October Budget, commodity prices were assumed to reach their long-term levels over 2 quarters. This has now been extended to 4 quarters to better balance the risks around the near-term outlook for commodity prices.

The long-term price levels for iron ore, metallurgical coal, thermal coal and LNG spot prices have also been increased modestly to take account of recent developments in commodity markets, inflation in the mining industry and updated assessments of long-run supply and demand fundamentals. The commodity price assumptions remain conservative and at the lower range of market forecasts (Box 2.4).

The adjustment to long-term price assumptions contributes to a higher long-run level for the terms of trade relative to the October Budget, although the impact of the longer-term US-dollar price has been partially offset by an appreciation in the Australian dollar against the US dollar. Overall, the terms of trade are 2¼ per cent higher at the end of the detailed forecast period compared with the October Budget.

Chart 2.28: Terms of trade



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

Box 2.4: Commodity prices

Treasury forecasts reflect a technical assumption that commodity prices return to their long-term fundamental level within the detailed forecast period. The glide path and long-term anchors are reviewed ahead of each budget update. The individual glide paths have been adjusted 12 times since 2016–17. Long-term price assumptions, specifically for metallurgical coal, were last adjusted in the 2021–22 MYEFO.

A series of significant and interrelated shocks have affected global commodity markets in recent years.

In early 2022, Russia’s invasion of Ukraine precipitated a shift in global commodity supply, including a significant reduction in global gas supply and forced restructuring of global oil trade flows.

Major weather disruptions in key producing regions, including for coal production in Australia and iron ore production in Brazil, reduced both the level and reliability of non-Russian supplies to global commodity markets.

The global economy has also experienced a sustained period of cost inflation that has increased production costs across the global mining sector. Input prices for the Australian coal sector, for example, have increased by around 15 per cent since 2021. Strong cost inflation has built in a materially higher cost base across the industry that is expected to result in structurally higher prices over the medium term.

Treasury has undertaken analysis and consulted widely with market and industry participants to understand the implications of these shocks for commodity prices in both the short- and long-term. There is broad consensus that the supply shocks associated with Russia’s invasion of Ukraine and Brazilian iron ore production issues will take some time to fully resolve. Energy prices in particular are expected to remain both elevated and volatile until additional LNG capacity comes online in the mid-2020s.

Consistent with the findings of this work, Treasury has updated the technical assumptions for the 2023–24 Budget to ensure they remain appropriate, fiscally prudent and reflect prevailing conditions (Table 1).

The period over which iron ore, metallurgical coal, thermal coal and LNG spot prices are assumed to return to long-term levels has been extended from 2-quarters to 4-quarters.

The long-term prices at which iron ore, metallurgical coal, thermal coal and LNG are expected to settle over the forecast period have been increased modestly.

Treasury has extended the period over which prices return to their long-term anchors to better reflect ongoing price pressures associated with current market disruptions. But this adjustment period remains highly conservative relative to market views, to account for the downside risk of sharp price corrections, such as the 50 per cent fall in thermal coal prices over the first 2 months of 2023.

continued on next page

Box 2.4: Commodity prices (continued)

Table 1: Commodity price assumptions

	2023-24 Budget		2022-23 October Budget		Market range
	<u>Long-run price*</u>	Adjustment period	<u>Long-run price*</u>	Adjustment period	Real long-run price estimates [^]
Iron ore	US\$60	4-quarters	US\$55	2-quarters	60-92
Metallurgical coal	US\$140	4-quarters	US\$130	2-quarters	140-200
Thermal coal	US\$70	4-quarters	US\$60	2-quarters	70-175
LNG	US\$10	4-quarters	US\$9	2-quarters	10-16

* All assumptions refer to spot prices. Iron ore – 62% Fe, free-on-board; Metallurgical coal – premium-hard low-vol, free-on-board; Thermal coal – Newcastle 6000kcal, free-on-board; LNG – Argus North East Asia.

[^] 2028–2030 price horizon. Prices in real 2022–23 dollars (base year varies across contacts).

Treasury has revised higher the long-term price assumptions to reflect the higher cost environment and an updated assessment of long-run supply and demand fundamentals (Chart 1, 2, 3 and 4). There is a wide range of forecasts for long-run prices, which reflects the high degree of uncertainty around how demand and supply will evolve. Demand for resources and energy is uncertain and depends on many factors including China’s maturing economy, the pace of industrialisation in India and South-East Asia, as well as the effect of climate policy. Long-run supply is also difficult to predict given uncertainty around project execution and investment plans.

Treasury’s revised assumptions are at the bottom-end of the market range, and therefore remain conservative relative to broader market views. The changes are expected to reduce the likelihood and magnitude of nominal GDP and revenue upgrades in future Budget updates.

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Box 2.4: Commodity prices (continued)

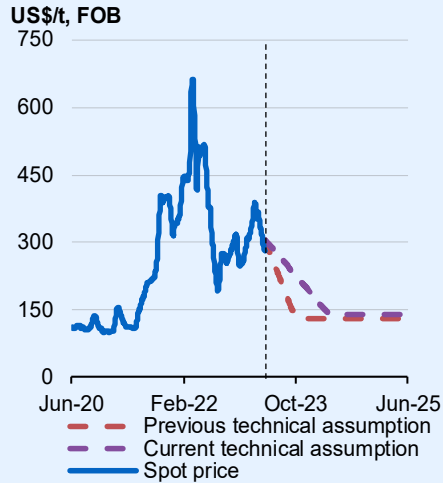
Commodity price assumptions

Chart 1: Iron ore



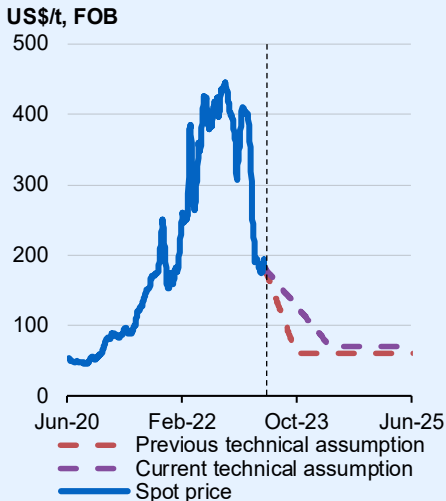
Source: Argus Media and Treasury.

Chart 2: Metallurgical coal



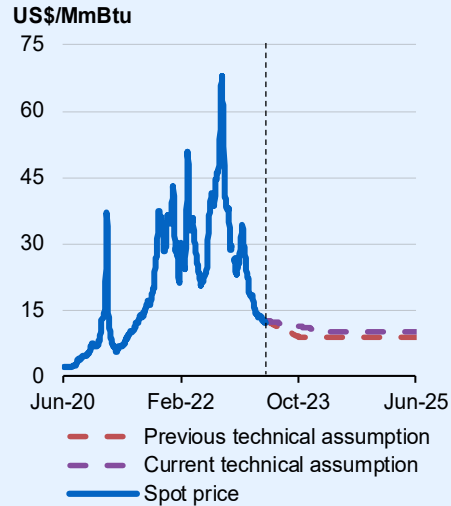
Source: Argus Media and Treasury.

Chart 3: Thermal coal



Source: Argus Media and Treasury.

Chart 4: LNG



Source: Argus Media and Treasury.

Note: Spot price data are presented as a 5-day moving average and are expressed in Free-on-Board (FOB) terms, which exclude the cost of freight. Calculations made by Treasury are based on confidential proprietary data from Argus Media under licence. Argus Media shall not be liable for any loss or damage arising from any party's reliance on, or use of, the data provided or the Treasury's calculations.

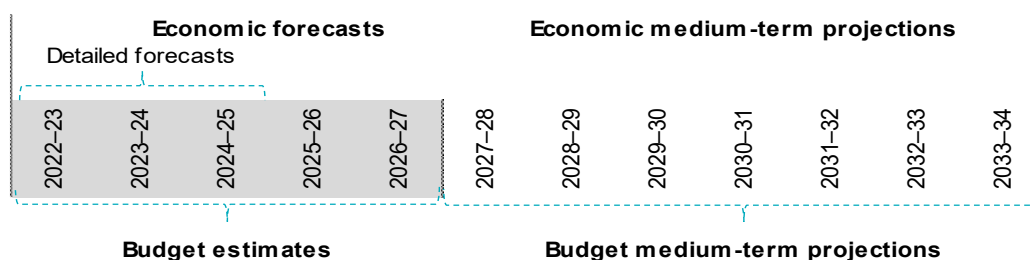
Outlook for nominal GDP growth

Nominal GDP is forecast to grow strongly by 10¼ per cent in 2022–23. The strength of the labour market, pick up in nominal wages growth, an elevated terms of trade from higher commodity prices and stronger growth in domestic prices are all contributing to this strong growth. Nominal GDP growth is then expected to slow to 1¼ per cent in 2023–24 due to the assumed decline in commodity prices, which is offset by ongoing strength in domestic prices and growth in output. Solid output growth is expected to underpin nominal GDP growth of 2½ per cent in 2024–25.

Medium-term projections

The fiscal aggregates in the Budget are underpinned by forecasts of economic activity over the Budget estimates period and projections over the medium term (Chart 2.29).

Chart 2.29: Medium-term projection period



Source: Treasury.

Treasury uses a macroeconomic model of the Australian economy for its forecasts and projections beyond the detailed forecast horizon of 2024–25. The model informs how the economy returns to its trend level of long-run output, known as potential GDP, following short-term fluctuations of the business cycle.

Potential GDP is estimated based on an analysis of trends for population, productivity, and participation. Overall changes in these trends have resulted in the level of potential GDP over the projection period being upgraded compared with the October Budget. Potential GDP growth is projected to average 2½ per cent per annum over the 2027–28 to 2033–34 projection period, unchanged from the October Budget.

Since the October Budget, both population and participation estimates have been upgraded. The population (aged over 15) has been revised up by 1½ per cent and the trend participation rate has been revised up by 1¼ per cent by 2032–33. This is in addition to an upward revision in the trend participation rate of ½ of a per cent in the October Budget.

Population growth is expected to be stronger in the near term than in the October Budget, reflecting stronger net overseas migration due to the one-off catch up from the pandemic following prolonged border closures (Box 2.2). This strength in migration and population growth is expected to be temporary, with migration forecast to largely return to normal

patterns from 2024–25. Higher growth in the near term increases the size of the population across the medium term, compared to the October Budget. However, even with this upgrade, the level of population is still expected to remain below pre-pandemic forecasts over the medium term.

The upgraded trend participation rate reflects the younger age structure of the additional migrant population, as well as increases in predicted participation rates. Full-time participation rates have been increased for men aged 35–54 years and women aged 30–44 years to better capture trends in recent years. These trends will reflect a variety of factors, including migrants lifting participation rates within age-sex cohorts, and an array of societal trends and enabling policies, including increased educational attainment and increased access to child care and paid parental leave arrangements that strengthen workforce attachment.

More recent data has also flowed through to upward revisions to part-time participation rates for those aged 25–29 years. This may again reflect influences such as trends in migration and educational attainment.

By 2032–33, these forecast revisions increase the size of the labour force by 2.7 per cent compared to the October Budget. Of this, approximately 1.5 percentage points of the upgrade can be attributed to the increase in total population and 0.5 percentage points of the upgrade can be attributed to a change in age demographics. Migrants are younger than the resident population on average and have a higher participation rate. The upward revisions to participation rates for prime working age men and women increases the labour force by 0.7 per cent.

The changes to population and participation imply that there is a larger workforce available to produce goods and services over the medium term, increasing potential GDP. The unemployment rate settles at Treasury's Non-Accelerating Inflation Rate of Unemployment (NAIRU) assumption of 4¼ per cent by the June quarter 2027 and remains at that rate over the medium-term projection period.

The upgrade in the size of the workforce has been partially offset by a lower estimated level of trend productivity in the near term. Relatively weak productivity growth was evident prior to the pandemic and this has likely been exacerbated by COVID-19 related adjustments. In the long run, underlying productivity is assumed to grow at 1.2 per cent per annum, which is around the average growth rate in labour productivity over the last 20 years.

Domestic price growth converges over time to the midpoint of the RBA's inflation target band of 2.5 per cent. The terms of trade are projected to remain around their 2024–25 level over the medium term, with key commodity prices being at levels consistent with their long-term fundamentals. Nominal wage growth converges to around 3¾ per cent, reflecting the outlook for labour productivity growth and inflation.

The level of nominal GDP over the projections is higher than the October Budget, reflecting the combination of a higher domestic price level, stronger commodity export

price assumptions and a higher level of potential GDP (Chart 2.30). The revision to commodity price anchors is responsible for a small share of the total upgrade.

Chart 2.30: Projected nominal GDP

