Opening Statement to the Economics Legislation Committee
6 November 2024
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Secretary to the Treasury

Thank you for the opportunity to make an opening statement.

International economic conditions

The global economy has evolved broadly in line with expectations, but there is considerable variation in growth across economies.

Economic conditions in our largest trading partner, China, have remained weak. Household spending has been subdued and the major adjustment under way in the real estate sector continues to be a drag on growth. This is reflected in the decline in steel and iron ore prices since the beginning of the year. In September and October, the Chinese authorities announced a range of monetary and fiscal measures. However, China faces significant cyclical and structural headwinds, and the effects of these measures are uncertain.

Growth in the United States has been stronger than expected and it has been a clear outlier among advanced economies. The US has seen inflation moderate without a significant slowing in demand. In most other advanced economies, growth has been subdued, including the UK and Europe.

With labour market conditions easing and increased confidence that inflation will sustainably return to target, central banks have begun reducing interest rates. Central banks in the US, the UK, New Zealand, Canada and the euro area have joined Sweden and Switzerland in cutting interest rates this year. Despite these reductions, in a number of these countries, interest rates remain above the level in Australia.

While markets anticipate a further easing in monetary policy, the level of long-term government bond yields across advanced economies suggests that interest rates are not expected to return to the low levels that prevailed before the onset of the COVID pandemic, including here in Australia.

As has been the case for some time, a significant ongoing source of uncertainty is the potential escalation of geopolitical tensions, particularly in the Middle East.

Domestic economic conditions

The Australian economy recorded subdued growth of 1.4 per cent in 2023-24, which was weaker than forecast in the 2024-25 Budget.

Household consumption grew by 1.1 per cent in 2023-24, which is the weakest growth in around three decades outside of the pandemic and the GFC. While the Government's tax cuts are supporting real disposable incomes, recent indicators suggest that consumption remains subdued, and households are using the income boost to rebuild savings buffers.

Dwelling investment fell by 1.5 per cent in 2023-24 as elevated construction costs weighed on activity. In a welcome development, the growth in the prices of new dwelling purchases by owner occupiers has fallen from an annual rate of over 20 per cent to now be around 5 per cent, with the notable exception of Western Australia. The fall in prices of new dwelling purchases mirrors the easing in housing construction material costs.

Business investment grew by 6.6 per cent in 2023-24. Solid growth in investment reflects the need for businesses to grow the capital stock in line with strong growth in labour input. Machinery and equipment investment and non-dwelling construction activity remain the dominant drivers of investment. Although smaller in size, business investment in computer software has been growing rapidly over the past three years.

Public demand has been a strong contributor to economic growth over the past year. This reflects strength in both public consumption and investment. The strength in public consumption reflects increases in spending on health and education, including Medicare, the National Disability Insurance Scheme (NDIS), and the Pharmaceutical Benefits Scheme. Further, since May's Budget, state and territory governments have released their budgets and, in total, around $20 billion in new spending was announced for 2024-25.

Inflation over the year to the September quarter fell to 2.8 per cent. Underlying inflation also continues to fall with the trimmed mean measure declining in the September quarter to 3.5 per cent.

It is worth briefly revisiting the purpose and use of the CPI, sometimes referred to as headline inflation, and underlying measures of inflation such as the trimmed mean, in light of the differences in these measures at this time.

The reduction we have observed in (headline) inflation represents a material reduction in cost-of-living pressures for households. The CPI captures changes in the price of a representative basket of goods and services that Australian households actually purchase. Therefore, the CPI remains our best overall measure of the price pressures faced by households.

The RBA target range is expressed in (headline) CPI terms because this is the measure most relevant to households and price stability. Underlying measures of inflation, such as the trimmed mean, can be a guide to future movements in (headline) inflation and provide useful information in the setting of monetary policy. Underlying inflation is expected to continue to fall in the period ahead.

As is often the case, changes in government policies have affected the prices of goods and services that households face and hence headline inflation. For example, we estimate that energy bill relief reduced inflation by 0.3 percentage points over the year to the September quarter.

Australia has had a somewhat similar inflation experience to the rest of the world. Inflation in Australia peaked at 7.8 per cent in the December quarter 2022. However, this was lower and later than most other OECD countries. The IMF recently published its World Economic Outlook, and it is worth putting their inflation forecasts in perspective. Based on these forecasts, the IMF expects that the cumulative increase in prices between 2019 and 2025 in Australia to be similar to that of the US and lower than that of the UK and New Zealand.

While we have made significant progress on inflation, just as importantly, we have managed to maintain the gains in the labour market. Employment grew by 3.1 per cent over the year to September and the unemployment rate remained at 4.1 per cent.

Policymakers have a difficult trade-off to make. They can be more aggressive in bringing inflation down, but this would not be achieved at no cost. By way of example, in the RBA's November update and in our forecasts at Budget, unemployment is expected to peak at 4½ per cent. If, instead, the unemployment rate was to reach the peak expected in New Zealand of 5.4 per cent, we would add an extra 130,000 people to the ranks of our unemployed.

We remain optimistic in being able to preserve the gains that have been made in employment in a sustainable way. Recent data has shown a deceleration in nominal wage growth at the current level of unemployment alongside continued easing in inflation. While estimates of the NAIRU, which is the level of unemployment below which inflation would be expected to rise, are uncertain, Treasury estimates that the NAIRU is around 4¼ per cent, close to the current rate of unemployment.

Labour productivity across the economy was flat in 2023-24. This reflects, in part, a cyclical weakness in productivity because of the strength in our labour market.

There are a couple of reasons why this is the case. Australia has absorbed a large number of new workers in a relatively short amount of time. Initially, this cohort of new workers, on average, is less productive than the existing workforce. Over time, however, these workers will become more productive as they build skills and find jobs that are a better match to their skills. This will contribute to better labour productivity outcomes.

The other channel is through capital shallowing, or a lower capital-to-labour ratio. The capital stock cannot adjust as quickly to the rapid increase in employment because it takes time to make investment decisions and then build and install the capital. Over time, as the capital stock adjusts and employment growth eases, the capital-to-labour ratio will rise, and this will provide a welcome boost to labour productivity growth.

Population

Annual net overseas migration fell to 510,000 in the March quarter 2024 after reaching an annual peak of 560,000 in the September quarter 2023. This was largely driven by a fall in migrant arrivals. Going against this downward trend are New Zealand citizen arrivals which have continued to rise with Australia's comparatively stronger economic conditions being a key factor.

Lower-than-expected migrant departures mean that net overseas migration is likely to be higher in 2023-24 and 2024-25 than forecast at Budget. Rather than depart, many migrants have extended their stay by applying for new visas, including permanent visas.

Since the lifting of international travel restrictions, other countries have also experienced rapid increases in net overseas migration. For example, New Zealand and Canada have recorded population growth rates that peaked around 3 per cent or higher, Australia's peak was 2.6 per cent over the year to September 2023.

Fiscal update

Final Budget Outcome

In September, the Government released the 2023-24 Final Budget Outcome. The Commonwealth recorded a surplus of $15.8 billion in the 2023-24 fiscal year, or 0.6 per cent of GDP. This was $6.4 billion higher than estimated in the 2024-25 Budget and was due to lower payments being partially offset by lower receipts.

Payments were $10.2 billion lower than estimated in the Budget reflecting lower-than-expected payments across a range of programs, including around $4.2 billion in lower payments across several National Partnership agreements.

Tax receipts at the Final Budget Outcome were $5.3 billion lower than estimated at Budget, mostly due to weaker-than-expected personal income and company tax receipts. Receipts from total individuals and other withholding taxes were $3.1 billion below the Budget estimate.

The fiscal outlook and long-term cost pressures

The 2024-25 Budget shows a return to deficit in 2024-25, peaking in 2025-26 before narrowing. The Government will update the fiscal outlook later this year as part of the Mid-Year Economic and Fiscal Outlook.

In terms of longer-term fiscal pressures, the Budget and the 2023 Intergenerational Report identified several major payments that are growing more quickly than the national income over the long-term, including the NDIS and aged care. Bipartisan support to enable reforms to these programs will help manage the long-term costs and is a very welcome development. It gives participants in these programs more certainty about the future and ultimately better care.

The recent passage of the NDIS legislation provides the framework to give effect to the measures announced at Budget. These measures are expected to reduce scheme costs by around $60 billion over the next ten years. By 2034-35, we expect the cost of the NDIS will be reduced by roughly one-quarter of a percentage point of GDP compared to our estimates at the 2024-25 Budget.

The Government's reforms to the aged care sector are welcome and will lead to a more sustainable program while delivering better services. The changes include expanding access to home care and introducing co-contributions for non-clinical care. Compared to projections in the Budget, the reforms are expected to slow the rate of payment growth from 5.7 per cent per year over the decade to 2034-35 to 5.2 per cent. This represents total savings over the coming decade of around $12.6 billion relative to our expectations at Budget.

I sincerely hope parties can continue to work constructively in reforming government services as further reforms will be required and will improve the welfare of all Australians.

Merger reform

Since the last Estimates, the Government has introduced legislation for merger reform. This is a policy process led by Treasury with support from the ACCC. We very much appreciate the support from the ACCC, including the secondment of staff to the Treasury taskforce. Mergers and acquisitions remain an important feature of dynamic economies. They can support cost and price reduction through generating greater scale and help spread the adoption of new technologies. Although most mergers are unlikely to harm competition, it is important that we have a credible regime that will stop mergers that are likely to reduce competition.

The Mergers and Acquisitions Reform Bill that Parliament is currently considering will establish a new system for mergers and acquisitions in Australia. Under the new system, mergers that meet risk-based monetary thresholds must notify and receive approval from the ACCC, who will have the mandate and the resources to review and stop anti-competitive mergers.

The new regime will also be transparent, with greater certainty for businesses around the merger process. The ACCC will maintain a public register containing details of notified mergers, review timelines and the reasons for its decisions. This will increase the transparency, understanding and, ultimately, confidence in the new merger control regime. Businesses will also have certainty about whether they are obliged to notify the ACCC of a proposed merger, and how long the ACCC's assessment will take. This will help businesses structure mergers and acquisitions in a way that promotes competition.

Before I conclude, I would like to acknowledge the announcement made by the Presiding Officers last week that Sam Reinhardt has been appointed as the Parliamentary Budget Officer. I congratulate Sam on this appointment and would like to publicly acknowledge her work in Treasury over more than 20 years, most recently as the Deputy Secretary, Fiscal Group.

Once again, thank you for the opportunity to provide this opening statement.