RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

November 2024

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Some graphs in this publication were generated using Mathematica.

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Contents

Overview

Key messages

Underlying inflation remains too high.

Headline inflation has fallen sharply in recent months as expected, due to declines in fuel and electricity prices. Headline inflation was 2.8 per cent over the year to the September quarter, down from 3.8 per cent over the year to the June quarter. This was as expected due to declines in fuel and electricity prices in the September quarter. But part of this decline reflects temporary cost-of-living relief. Underlying inflation, which is more indicative of inflation momentum, remains too high. Trimmed mean inflation was 3.5 per cent over the year to the September quarter and in quarterly terms the pace of decline has been gradual since mid-2023.

Our assessment is that demand in the economy still exceeds supply and that the labour market remains tight. Higher interest rates have been working to bring demand and supply closer towards balance, with weak growth in private domestic demand in recent quarters partly offset by strong growth in public demand. Labour market conditions in Australia have eased but are tighter than in peer economies. Wages growth is moderating; however, labour cost growth is still elevated alongside weak productivity growth.

The cash rate remains unchanged to support inflation returning to target.

Output growth is expected to recover and easing in the labour market is expected to be gradual. Household consumption is expected to pick up in the second half of 2024 as incomes rise. Over the coming year, output growth is expected to increase to around its potential growth rate. The unemployment rate is forecast to increase gradually before stabilising around full employment, and wages growth is expected to slow as labour market conditions ease.

Inflation is expected to return sustainably to the midpoint of the target in late 2026. Inflationary pressures are expected to moderate slowly, reflecting a gradual adjustment in the balance between the demand and supply of goods and services and the degree of tightness in the labour market. Trimmed mean inflation is expected to reach 2.5 per cent by late 2026. Headline inflation is expected to rebound to be above the 2–3 per cent target range in the second half of 2025 as the energy rebates unwind (as legislated) before returning sustainably to target in 2026.

At its November 2024 meeting, the Reserve Bank Board decided to leave the cash rate target unchanged. Sustainably returning inflation to target within a reasonable timeframe remains the Board's highest priority. The forecasts suggest that it will be some time yet before this is the case, which reinforces the need to remain vigilant to upside risks to inflation.

What's been going on in the economy?

In most advanced economies, continuing disinflation and softer labour market outcomes has resulted in central banks cutting their policy rates of late.

Underlying inflation has eased further across advanced economies, as expected, and more so than in Australia. Most advanced economy central banks have now eased their policy settings, reflecting greater confidence that inflation will settle at their targets. Labour market conditions have eased and unemployment rates have increased. In some economies, labour markets are assessed to be in balance; in others, there is spare capacity. Most advanced economy central banks still consider their policy rates to be restrictive.

Economic growth continues to recover in many of Australia's major trading partners. US growth has remained robust; in other advanced economies, growth has picked up a little more slowly than expected. Growth in China remains subdued. Chinese authorities have announced a sizable stimulus package, which is expected to support economic growth over the coming year.

Financial conditions in Australia are weighing on private domestic demand but are judged to be less restrictive than in most peer economies.

The current setting of the cash rate is assessed to be restrictive but less so than settings of policy rates in most peer economies. The market pricing underpinning the economic forecasts implied that the cash rate will stay at its current level until around mid-2025, broadly the same as assumed in the August *Statement*. Interest rates on deposits and loans remain elevated but housing credit growth has continued to pick up and business credit growth remains strong. Equity risk premia have narrowed further and wholesale market funding conditions remain favourable for issuers.

Restrictive financial conditions have weighed on private domestic demand, while public demand has contributed to growth in economic activity and demand for labour. GDP growth remained subdued in the June quarter and household consumption growth was weaker than expected. There is tentative evidence of an increase in household spending in the September quarter but by less than had been anticipated at the time of the August forecasts.

Productivity growth remains weak and the economy-wide level is currently around 2016 levels. Subdued domestic demand growth has closed much of the gap between demand and supply but weak productivity growth weighs on the economy's potential supply. Overall, our assessment is that demand for goods and services still exceeds the supply capacity of the Australian economy.

Conditions in the labour market remain tight relative to the assessment of full employment. Employment growth has been strong in recent months. The unemployment rate edged higher in the September quarter to 4.1 per cent, as growth in labour force participation outpaced employment growth. Demand for labour, particularly in the non-market sector, remains strong and vacancies are elevated. Labour cost growth has eased but remains higher than is consistent with inflation being sustainably at the midpoint of the target.

How do we see the economy developing?

The global outlook is for moderate economic growth and further easing of inflation.

Overall GDP growth for Australia's major trading partners is expected to be moderate. The outlook for economic growth of our major trading partners has been revised a little higher for 2025 following the announcement of the stimulus package in China. This package is expected to support growth in China and removes some of the downside risk to economic activity that had been building there. In advanced economies, labour markets are easing and inflation is expected to return to central bank targets as services inflation, rent inflation and wages growth moderate.

Growth in Australia is expected to slowly return to around its potential rate of growth.

The outlook for growth in 2025 and 2026 has been revised down slightly. Household consumption is expected to pick up alongside rising real household incomes and wealth, albeit a little later than anticipated at the time of the August forecasts. The outlook for services exports is materially weaker, reflecting tighter international student visa policies, but does not materially affect the inflation outlook because lower net overseas migration will also reduce the economy's supply capacity.

The labour market is expected to continue to ease gradually to be around full employment by late 2025. Wages growth and labour costs are expected to continue to moderate to levels consistent with inflation at target, although the outlook for productivity growth is uncertain.

Inflation is expected to return sustainably to the midpoint of the target range by the end of 2026.

The outlook for underlying inflation is little changed since the August *Statement*. Underlying inflation is expected to decline gradually as the gap between demand and supply in the economy closes. Services inflation is projected to decline as the labour market softens. Housing inflation is also projected to moderate as nominal income growth eases, population growth slows and earlier constraints on housing construction ease. Goods inflation is forecast to remain at its current modest pace.

Headline inflation will be below underlying inflation for a time due to temporary cost-of-living support to households. Following the end of these support measures (as legislated), headline inflation is expected to increase in the second half of 2025 to be outside the target range, before declining again to converge with measures of underlying inflation. Headline and underlying inflation are projected to reach 2.5 per cent by the end of 2026.

The outlook remains highly uncertain. A slower than expected pick-up in household consumption could result in continued subdued output growth, a sharper deterioration in the labour market and a swifter return of inflation to target. Ongoing tightness in the labour market and weak productivity growth present upside risks to inflation. More broadly, there are uncertainties regarding the lags in the effect of monetary policy and price- and wage-setting behaviour in the current economic environment. Heightened geopolitical risks and potential changes to trade and fiscal policies globally add further uncertainty to the outlook.

What did the Board decide?

At its November 2024 meeting, the Reserve Bank Board decided to leave the cash rate target unchanged. Sustainably returning inflation to target within a reasonable timeframe remains the Board's highest priority. This is consistent with the RBA's mandate for price stability and full employment. To date, longer term inflation expectations have been consistent with the inflation target and it is important that this remain the case. While headline inflation has declined substantially and will remain lower for a time, underlying inflation is more indicative of inflation momentum, and it remains too high. The current forecasts suggest that it will be some time yet before inflation is sustainably in the target range and approaching the midpoint. This reinforces the need to remain vigilant to upside risks to inflation and the Board is not ruling anything in or out. Policy will need to be sufficiently restrictive until the Board is confident that inflation is moving sustainably towards the target range.

Table: Output Growth, Unemployment and Inflation Forecasts[(a)]

Per cent

	Year-ended					
	June 2024	Dec 2024	June 2025	Dec 2025	June 2026	Dec 2026
GDP growth	1.0	1.5	2.3	2.3	2.3	2.2
(previous)	(0.9)	(1.7)	(2.6)	(2.5)	(2.5)	(2.4)
Unemployment rate[(b)]	4.1	4.3	4.4	4.5	4.5	4.5
(previous)	(4.0)	(4.3)	(4.4)	(4.4)	(4.4)	(4.4)
CPI inflation	3.8	2.6	2.5	3.7	3.1	2.5
(previous)	(3.8)	(3.0)	(2.8)	(3.7)	(3.2)	(2.6)
Trimmed mean inflation	4.0	3.4	3.0	2.8	2.7	2.5
(previous)	(3.9)	(3.5)	(3.1)	(2.9)	(2.7)	(2.6)
	Year-average					
	2023/24	2024	2024/25	2025	2025/26	2026
GDP growth	1.5	1.2	1.7	2.2	2.3	2.3
(previous)	(1.4)	(1.2)	(1.9)	(2.5)	(2.5)	(2.4)
	Assumptions[(c)]					
	2023/24	2024	2024/25	2025	2025/26	2026
Cash rate (%)	4.3	4.3	4.1	3.7	3.5	3.5
Trade-weighted index (index)	62.6	61.8	61.5	61.5	61.5	61.5

(a) Forecasts finalised on 30 October. Shading indicates historical data.

(b) Average rate in the quarter.

(c) The forecasts incorporate several technical assumptions. The cash rate is assumed to move in line with expectations derived from financial market pricing as per 30 October and the daily exchange rate (TWI) is assumed to be unchanged from its level at 30 October 2024 going forward. See notes to Table 3.1: Detailed Forecast Table in Chapter 3: Outlook for other forecast assumptions.

Sources: ABS; RBA.

Chapter 1
Financial Conditions

Summary

- **Australian financial conditions remain restrictive overall, though some indicators have eased a little since August.** The cash rate is estimated to be above the neutral rate but still by less than in peer economies, despite many having lowered their policy rates. Borrowing and lending rates are elevated – although some have declined a little lately – and household debt repayments remain high as a share of income. Housing and business credit growth have picked up over the past year and wholesale market funding conditions remain favourable, supporting strong issuance.
- **Market expectations for the path of the cash rate have moved a little higher since the August *Statement*.** Market participants expect a gradual easing in policy to begin around mid-2025 in Australia. Expectations for the future path of the cash rate continue to be influenced by offshore economic and policy developments, particularly in the United States.
- **Central banks in nearly all advanced economies have cut policy rates as inflationary pressures have eased, and signalled that further cuts are likely.** This has been at differing paces, however, as they assess shifts in the balance of inflation, economic activity and labour market risks. Market participants continue to expect further substantial easing in policy rates to around central bank estimates of neutral levels by the end of 2025. By contrast, longer term yields have risen across most advanced economies.
- **Conditions in financial markets in advanced economies have eased overall, including in Australia, as market participants appear more assured of a soft landing.** This has occurred on the back of improved labour market data and a continuation of solid growth in activity data in the United States, unwinding earlier concerns about downside risks there. However, the risks associated with the fiscal and trade policies that may follow the US election and broader geopolitical developments increase uncertainty about the inflation and growth outlook.
- **Chinese authorities have shifted to a more supportive policy stance with the announcement of a comprehensive stimulus package.** In response, financial asset prices in China increased sharply, although full details on the size and composition of the fiscal stimulus are yet to be announced. Even so, recent policy announcements indicate that authorities remain committed to deleveraging in some sectors, including property.
- **The Australian dollar trade-weighted index remains within its range of the last couple of years.** The modest appreciation since the recent low in August reflects a rise in yield differentials, but this has been offset by uncertainties surrounding the US presidential election and the prospect of significant tariffs on Chinese exports.

1.1 Interest rate markets

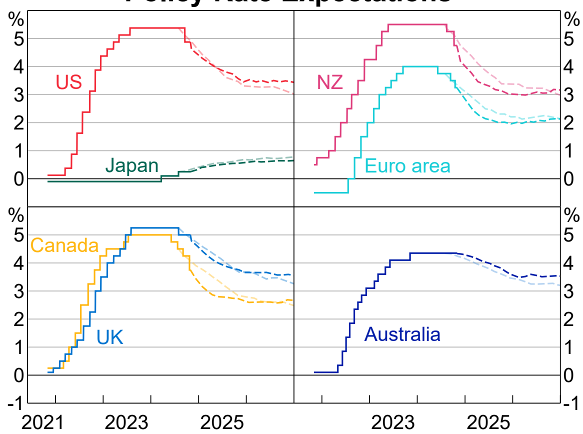
Advanced economy central banks are reducing their policy rates to less restrictive levels as the outlook for inflation improves and risks to labour markets and activity come to the fore.

Most central banks, including the US Federal Reserve (Fed) and European Central Bank (ECB), have decreased their policy rates by at least 50 basis points from their recent peak levels. These central banks have more confidence that inflation is sustainably returning to their targets – with some now concerned that inflation will fall below target – and have placed more weight on the outlook for labour markets and economic growth. Some central banks have adjusted their policy rates by less (Bank of England) or are yet to cut (Norges Bank), citing risks from persistent inflation and the need to sustainably return inflation to target in a timely manner. All central banks consider their policy rates to be restrictive, except for the Bank of Japan, which has said it expects to further increase its policy rate if the economy evolves as expected.

Central bank commentary on the pace of cuts has reflected the evolving assessment of local economic conditions. Fed policymakers have emphasised a more gradual approach to further cuts of late following the release of stronger-than-expected September employment data as they assess the balance of risks to achieving their dual mandate. Several other central banks have either increased the pace of easing or signalled a willingness to do so (ECB, Bank of Canada, Reserve Bank of New Zealand, Riksbank) in response to weakening outlooks for growth or strengthened confidence in timely disinflation. Differences in monetary policy strategies and remits across central banks (e.g. whether these include employment objectives) may also be contributing to variation in the pace of cuts in some cases. Some central banks are cutting faster as headline inflation approaches their targets; others have moved more slowly, emphasising more gradual declines in underlying inflationary pressures.

Market participants' policy rate expectations have declined in most economies since the August *Statement*. Policy rate expectations were sensitive to both upside and downside surprises in the US labour market data over this period. While influenced by these US developments, policy rate expectations in other economies have generally declined reflecting unexpected weakness in some inflation and economic data and associated shifts in central bank commentary; Australia a notable exception (Graph 1.1).

Graph 1.1
Policy Rate Expectations*



* Darker dashed lines show expectations implied by current overnight index swap rates; lighter dashed lines show the same expectations as of 31 July 2024.

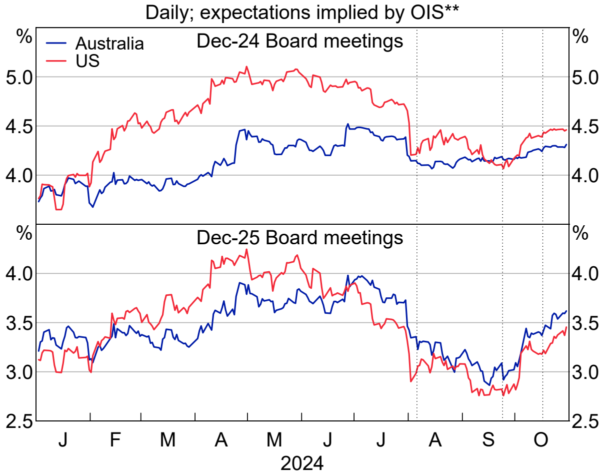
Sources: Bloomberg; RBA.

Market expectations for the path of the cash rate in Australia are a little higher since the August *Statement*.

Market participants see little chance of a near-term reduction in the Australian cash rate, following the release of the September labour force data and a recent increase in Fed policy rate expectations (Graph 1.2). This increase has more than offset a shift down in expectations following the Governor's September media conference, which revealed that the option of a further increase in the cash rate was not explicitly considered by the Board. The policy rate in Australia is now above those of several advanced economies.

A gradual reduction in the Australian cash rate is expected to begin around mid-2025. Market economists expect an earlier reduction in the cash rate than implied by market pricing, with easing beginning in the March quarter of next year.

Graph 1.2
Policy Rate Expectations*
Daily; expectations implied by OIS**

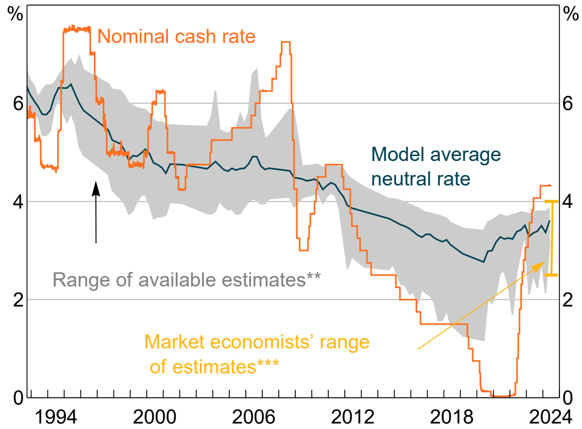


* Dashed lines show August RBA Board meeting, September RBA Board meeting and September Labour Force data release.
** Latest for December 2024 Board meeting, US 4.46%, Australia 4.31%. Latest for December 2025 Board meeting, US 3.45%, Australia 3.62%.
Source: Bloomberg, RBA, LSEG.

The cash rate is estimated to be above the RBA's range of estimates of the neutral rate, consistent with other indicators pointing to restrictive financial conditions.

The cash rate is also above market economists' estimates of the neutral rate (Graph 1.3). Even so, estimates of the nominal neutral rate are subject to considerable uncertainty and are sensitive to the models and assumptions used, including those about inflation expectations. Moreover, the perceived stance of policy goes beyond simple comparisons of the current policy rate with the neutral rate; it also involves expectations about how policy will react to evolving economic conditions. Those expectations in turn influence longer term interest rates and broader financial conditions, and the behaviour of households and companies.

Graph 1.3
Nominal Neutral Rate*



* Nominal neutral rates are defined using trend inflation expectations.
** Range of central estimates corresponding to available models; this range does not reflect considerable uncertainty around the central estimates.
*** The range of market economists' estimates has been adjusted by excluding the highest and lowest two observations.
Source: RBA.

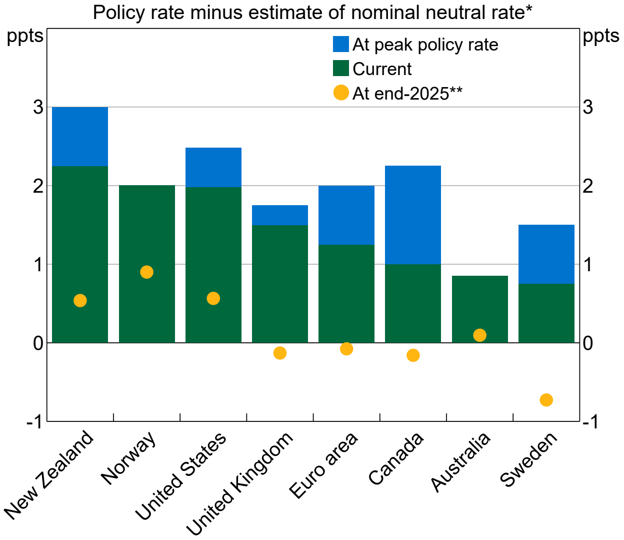
Estimates of the neutral rate have increased since the pandemic. This is a trend also seen in some other advanced economies and reflects a range of drivers affecting saving and investment trends, including growth, demographics and governments' fiscal positions. However, there is substantial variation in estimates across countries, so country-specific factors are also influential. Frictions in global capital markets could mean country-specific savings and investment trends will affect the neutral rate in that country, along with country-specific premia and spreads. Also, different inflation targets will translate into different estimates of nominal neutral rates.

The gap between policy rates and estimates of neutral (shown in green in the graph below) remains smaller in Australia than for central banks in most other advanced economies, despite many other central banks cutting rates multiple times (as indicated in blue). Market participants expect that to change over the next year, with pricing implying a more rapid easing for most other central banks. Markets expect policy rates in most advanced economies, including Australia, to converge to around central bank estimates of neutral levels by the end of 2025 (as shown by the orange dots) (Graph 1.4).

Graph 1.4

Estimates of Policy Restrictiveness

Policy rate minus estimate of nominal neutral rate*



* Estimate of nominal neutral interest rate from central banks for all jurisdictions except United Kingdom, which uses estimate from the Bank of England's survey of market participants.

** Using market participants' policy rate expectations.

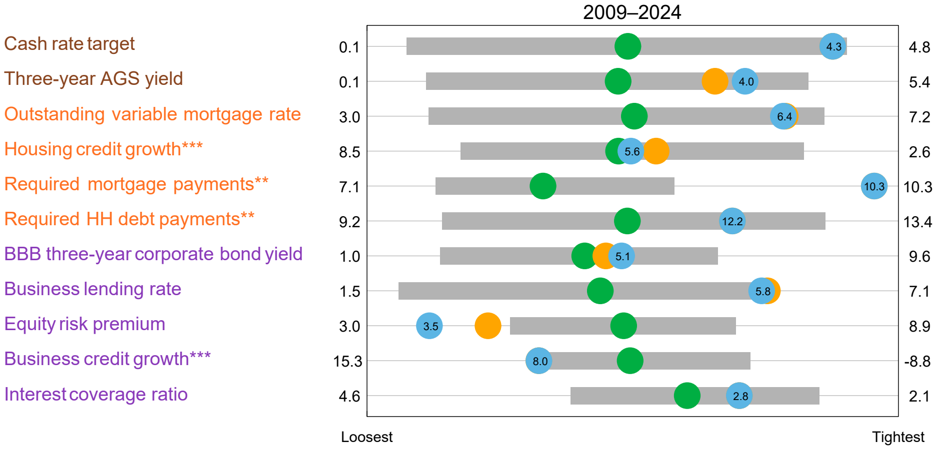
Sources: Bloomberg; central banks; RBA.

A comparison of key financial indicators in Australia against historical averages shows that conditions faced by the household sector (shown in orange text) are tighter than those faced by businesses (shown in purple text) (Graph 1.5). The financial indicators are discussed in more detail below. The Board reviews a broad set of economic data and the outlook for that data to determine whether financial conditions are restrictive enough to return inflation to target in a timely manner.

Graph 1.5

Financial Conditions*

2009–2024



* Blue dots show current measures, orange dots show values as at August 2024 Board meeting, green dots show the average over the sample and the grey bars show the middle 80 per cent of observations. Brown labels indicate reference rates, orange labels are conditions faced by households and purple labels are conditions faced by businesses.

** Calculated as a share of household income.

*** Six-month annualised.

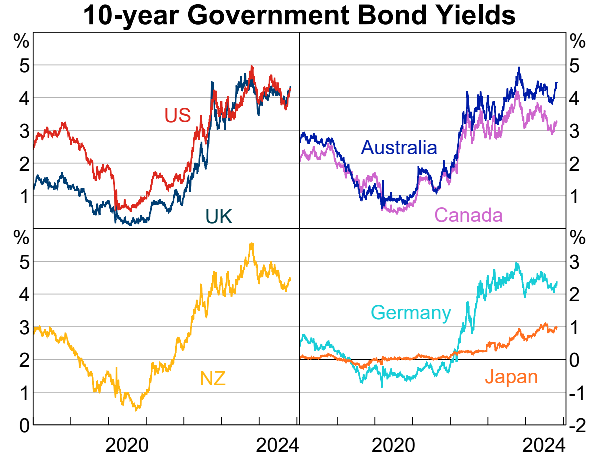
Sources: ABS; APRA; ASX; Bloomberg; major banks' websites; RBA.

In contrast to near-term policy rate expectations, longer term government bond yields in most advanced economies have increased since the August *Statement*.

The rise in longer term yields may have been driven in part by perceptions among market participants that a soft-landing scenario is increasingly likely. The rise has also been driven by upward pressure on term premia and long-term market-based inflation compensation associated with geopolitical tensions and uncertainty about future US trade and fiscal policies following the US election (Graph 1.6; Graph 1.7). This uncertainty may persist, as it could take some time beyond the election to understand which policies will be implemented and what their ultimate impact on markets and the global economy will be.

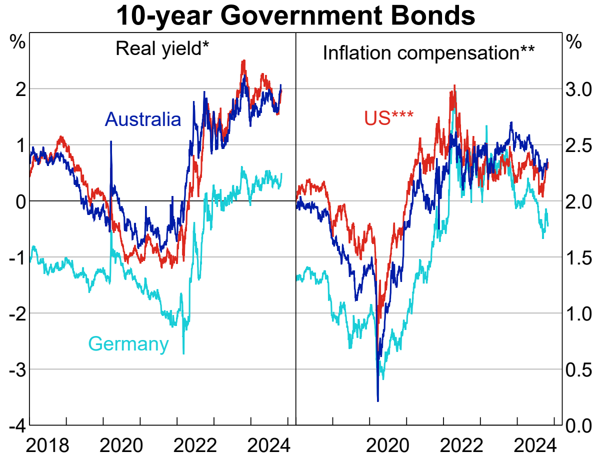
Yields on Australian Government bonds have also risen in recent months. Indeed, spreads between Australian and most overseas government bond yields are near their highs for the year.

Graph 1.6



Source: Bloomberg.

Graph 1.7



* The yield on inflation-linked bonds.

** Spread between yields on nominal and inflation-linked bonds.

*** Over the longer term, the price index referenced in US inflation-linked bonds has averaged 0.5 percentage points more than the PCE deflator targeted by the US Federal Reserve.

Sources: Bloomberg; RBA.

1.2 Other measures of financial conditions

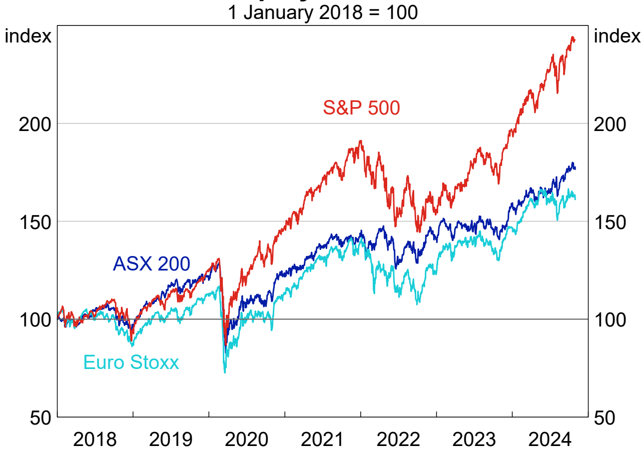
Prices of riskier assets have generally increased in advanced economies since early August.

Equity prices in most advanced economies have increased since early August (Graph 1.8). The rise in equity prices over this period has been driven by an increase in expectations of future earnings in the United States and a decline in equity risk premia in Australia and most other advanced economies. Consistent with developments in interest rate markets, this suggests market participants see a soft landing as more likely than they did previously and, following some robust US labour market data released in October, attach a lower probability to a severe downside economic scenario. Australian mining companies' equity prices increased following the announcement of the Chinese policy stimulus package, though this has since partly unwound.

Graph 1.8

Equity Prices*

1 January 2018 = 100



* Total return basis.

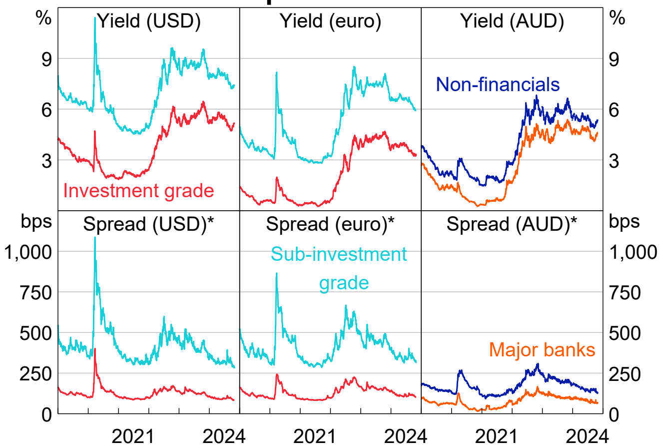
Sources: Bloomberg; LSEG.

In early August, a bout of heightened volatility followed the release of weaker-than-expected US economic data and was amplified by the unwinding of leveraged trades and seasonally low market liquidity, with Japanese equities experiencing their largest ever three-day fall. The subsequent rebound in equity prices has encouraged leveraged investors to partly rebuild positions, which could again exacerbate volatility in response to further economic shocks. While this episode highlighted that markets can recover quickly in the absence of further adverse shocks, expected equity price volatility in the United States, Europe and Japan remains above the low levels of earlier this year, but below the long-term average. By contrast, expected Australian equity price volatility has declined back to around the low levels seen earlier in the year.

Corporate bond yields in the United States and Europe have generally declined since the August *Statement* (Graph 1.9). Spreads on corporate bonds have narrowed over the same period, reaching their lowest level in the United States in more than 15 years. Spreads on sub-investment grade debt have narrowed notably, consistent with strong investor demand and increasing confidence among market participants of a benign credit outlook. In Australia, spreads on non-financial corporate bonds have been little changed and are near their lowest level since early 2022.

Corporate bond issuance in the United States and euro area has increased of late to around or above average historical levels, with some market reports suggesting US companies have brought forward issuance to avoid potential market volatility around the upcoming US election. Issuance by Australian non-financial corporations has been strong since early this year, with liaison contacts citing continued strength in investor demand as a driver.

Graph 1.9
Corporate Bonds



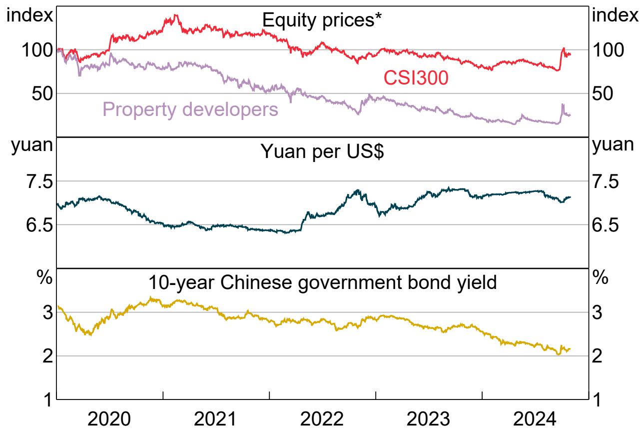
* Spread to equivalent maturity government bond yield.
Sources: Bloomberg; ICE Data used with permission; RBA.

In China, financial markets have reacted positively to the announcements of further macroeconomic policy support, though long-run challenges remain.

Authorities have shifted their policy stance notably with a comprehensive package to support economic growth and address some vulnerabilities (see Box B: Economic Policy Developments in China). Equity prices increased by more than 30 per cent following recent policy announcements, as investor risk sentiment improved (Graph 1.10). However, equity prices remain well below levels of earlier years, and have been volatile of late as markets await further details of the fiscal stimulus package. Property developers' asset prices have risen sharply from very low levels but continue to reflect severe financial stress in the sector. It is unclear if the announced measures will stabilise property sector conditions, with weakness in the sector continuing to weigh on broader economic activity and credit demand despite further monetary easing by the People's Bank of China.

Chinese Government bond yields have risen a little from recent lows, supported by an improved economic outlook and expectations for additional bond issuance to fund fiscal stimulus. Some of the additional bond issuance will be used to address local government debt problems that have been exacerbated by property sector weakness and weighed on bank profitability. The Chinese renminbi has appreciated modestly but remains close to its recent lows.

Graph 1.10
China – Financial Markets



* Jan 2020 = 100.
Sources: Bloomberg; CEIC Data; RBA.

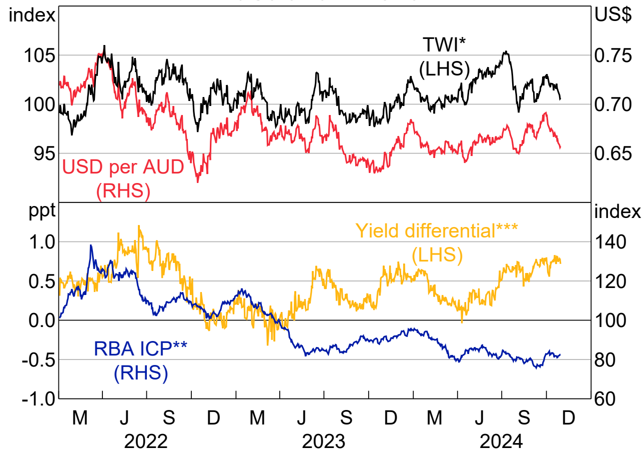
The Australian dollar trade-weighted index (TWI) remains within the range observed since early 2022, as the effect of a rise in yield differentials has been offset by uncertainty around the US presidential election.

The Australian dollar TWI is around the middle of the range observed since early 2022 after nearing its year-to-date low in early August amid the liquidation of positions related to Japanese yen carry trades and a deterioration of risk sentiment. The small appreciation since then reflects higher yield differentials between Australia and other major advanced economies, as market participants continue to expect policy easing by the RBA to be later and more gradual than in other major advanced economies. An improvement in the outlook for the global economy also provided support, as concerns about a US recession abated and Chinese authorities announced stimulus measures. However, the risk of the United States placing significant tariffs on Chinese exports following the US presidential election has weighed on the yuan and tempered the appreciation of the Australian dollar; China is Australia's largest trading partner with a 30 per cent weight in the Australian dollar TWI (Graph 1.11).

In real terms, the Australian dollar TWI has appreciated marginally over the December quarter to date and remains close to the model estimate implied by the long-run historical relationship with the forecast terms of trade and real yield differentials (Graph 1.12).

Graph 1.11

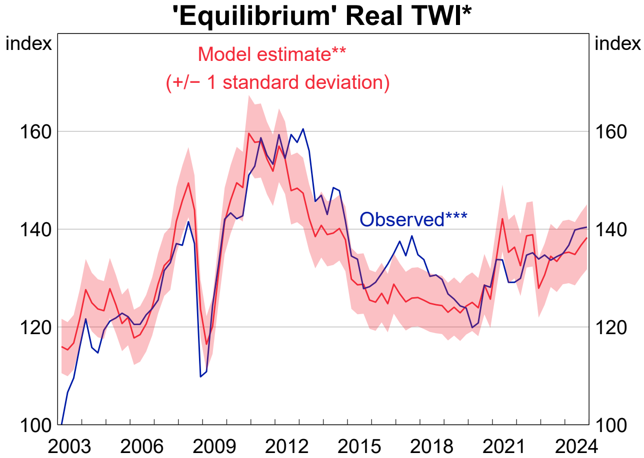
Australian Dollar



* Trade-weighted index; 31 December 2021 = 100.
** Index of Commodity Prices (USD terms); 31 December 2021 = 100.
*** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.
Sources: Bloomberg; RBA.

Graph 1.12

'Equilibrium' Real TWI*



* Data up to and including 30 October 2024.
** Using terms of trade forecast and real Australian Government bond yield curve factors relative to the G3, see Chapman, Jääskelä and Smith (2018); standard deviation based on model errors.
*** Quarterly average real TWI; March 2003 = 100.
Source: Bloomberg; RBA.

1.3 Australian banking and credit markets

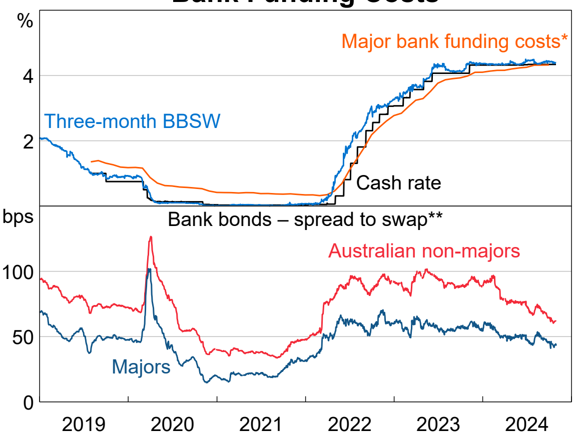
Banks' funding costs have been little changed and wholesale funding market conditions remain favourable for financial institutions.

Banks' estimated funding costs are little changed recently, with small changes reflecting movements in bank bill swap rates (BBSW). Since the start of the tightening phase in May 2022, funding costs have increased by around 385 basis points alongside the 425 basis points increase in the cash rate.

Bank bond spreads relative to the swap rate – a reference rate for the pricing of securities – have continued to narrow following market volatility in early August and are now around their tightest level since early 2022 in the domestic market (Graph 1.13). Conditions in the Australian asset-backed securities (ABS) market – a key source of funding for non-bank lenders – continue to be very favourable for issuers. Year-to-date issuance is at a post-GFC high and spreads remain quite tight across ABS markets.

Graph 1.13

Bank Funding Costs



* RBA estimates of overall outstanding hedged debt and deposit costs for the major banks.

** Domestic secondary market; three-year target tenor.

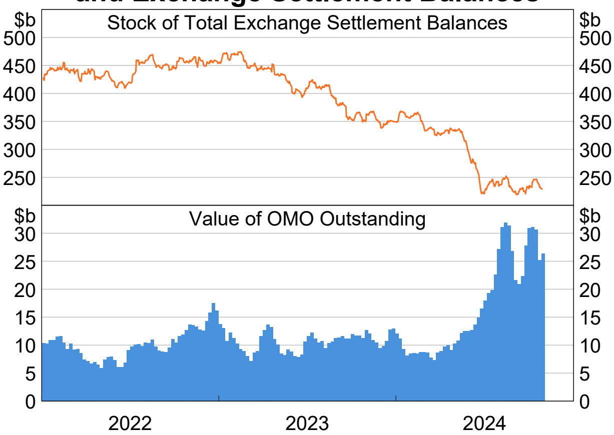
Sources: APRA; ASX; Bloomberg; LSEG; major bank liaison; Private Placement Monitor; RBA.

Borrowing at the RBA's open market operations (OMO) has again helped alleviate quarter-end tightness in short-term funding markets.

Yields in short-term funding markets increased slightly towards the end of the September quarter. Banks responded to this by increasing the amount of Exchange Settlement (ES) balances borrowed at OMO, as they did during the June quarter as the Term Funding Facility ended. The borrowing from OMO has been recycled into short-term markets, helping reduce borrowing pressures. ES balances have remained little changed since the middle of the year (Graph 1.14).

Graph 1.14

OMO Funding and Exchange Settlement Balances



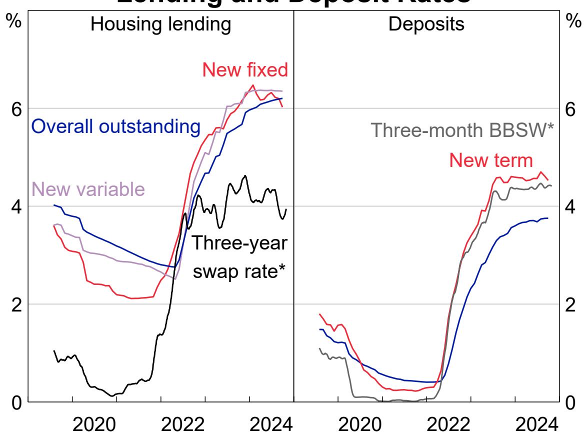
Source: RBA.

Average rates on outstanding mortgages and deposits have been little changed in recent months, despite decreases in some advertised rates.

Average outstanding and new variable mortgage rates have been little changed over recent months (Graph 1.15). Rates paid on most outstanding deposits have also been little changed. Since August, several banks have reduced their advertised rates for fixed-rate mortgages and some term deposit products in response to lower benchmark (swap) rates; these changes have not had a material effect on overall household financial conditions as they affect only a small share of total lending and saving. The fixed-rate share of new lending increased in September but remained low at 3 per cent, while new term deposits comprise just 5 per cent of total deposits.

Graph 1.15

Lending and Deposit Rates



* 30-day moving average.
Sources: APRA; ASX; Bloomberg; Major banks' websites; RBA.

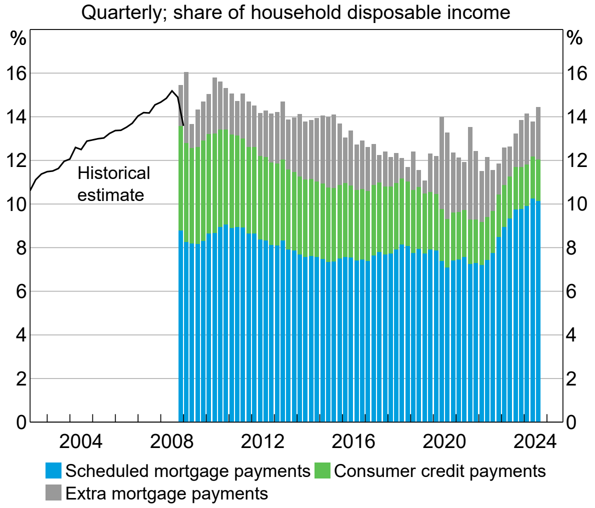
Financial conditions remain restrictive overall for households, but household credit growth has increased further.

Scheduled mortgage and consumer credit payments remain high as a share of household disposable income but have stabilised in recent months (Graph 1.16). The rise in interest payments over the past couple of years has contributed to weaker consumption growth (see Chapter 2: Economic Conditions). More recently, the share of household disposable income spent on scheduled mortgage payments fell a little in the September quarter, as the effects of fixed-rate expiries were offset by growth in disposable income associated with Stage 3 tax cuts. While debt payments are high, nearly all borrowers are expected to be able to service their debts even if inflation and interest rates remain high for an extended period.[1] Payments into mortgage offset and redraw accounts picked up in the September quarter and have been around the longer term average over the past year.

Graph 1.16

Selected Claims on Household Income

Quarterly; share of household disposable income



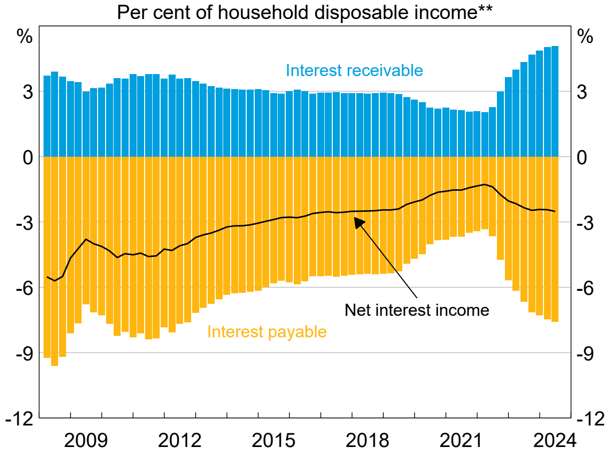
Sources: ABS; APRA; RBA.

While net savers benefit from higher interest rates on savings, higher interest rates on debt have caused household net interest income to fall over the tightening phase. This is because households hold more interest-sensitive debt than assets overall, despite a steady increase in interest-bearing deposits over recent years. Net household interest income remained steady in the June quarter at around –2.5 per cent as a percentage of household disposable income, a little lower than immediately prior to the pandemic (Graph 1.17).[2]

Graph 1.17

Net Interest Income for Households*

Per cent of household disposable income**



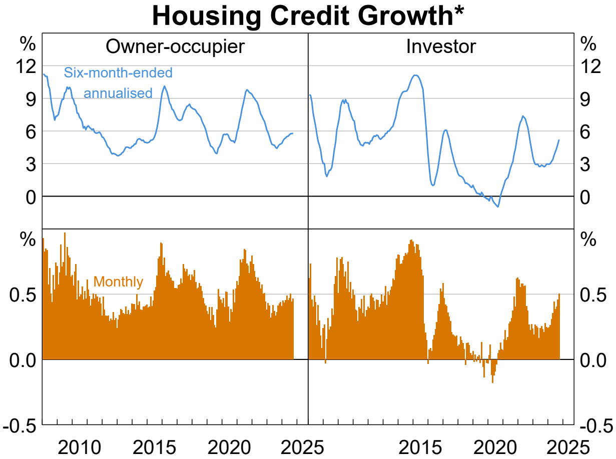
* Nominal, quarterly. Excluding unincorporated enterprises.
** Disposable income is after tax and before deduction for interest payments.
Source: ABS.

Housing credit growth has been picking up since mid-2023 to around its post-GFC average, despite higher interest rates. The pick-up in housing credit growth has been accompanied by strong growth in housing prices and supported by the ability of households to service new debt given growth in nominal household incomes (see Box A: The Pick-up in Housing and Business Credit Growth). In liaison, banks have commented that they have been surprised by the resilience of demand in the mortgage market over the tightening phase.

Investor credit growth has increased notably this year, although the level of credit growth remains below that of owner-occupiers (Graph 1.18). Investor credit growth appears to have been supported by expectations of future capital gains; survey measures of housing price growth expectations have remained high this year. Historically, investor loan commitments have grown more strongly than owner-occupier commitments at times of rising housing prices. On average, investors also have higher incomes than owner-occupiers. Along with low rental vacancy rates and strong growth of rents, this may be supporting investors' willingness and ability to borrow in the current environment of high interest rates and other pressures on disposable incomes.

Graph 1.18

Housing Credit Growth*



* Seasonally adjusted and break-adjusted.
Sources: APRA; RBA.

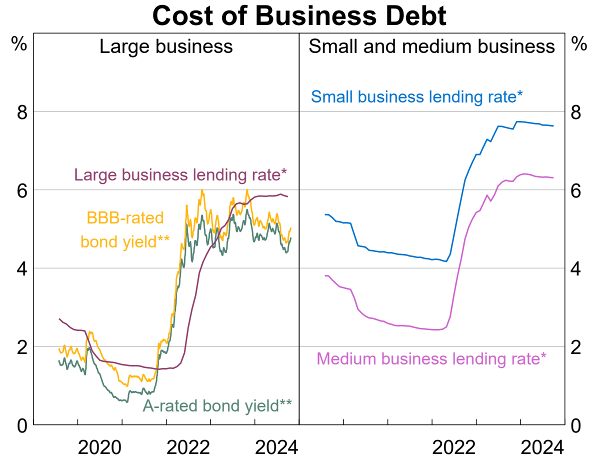
Growth in new mortgage lending is increasingly divergent across states. This is consistent with trends in price and activity data, and partly reflects differing economic fundamentals and affordability across states (see Chapter 2: Economic Conditions).

Growth in business debt remains above its post-GFC average.

The cost for businesses to take out loans or issue corporate bonds has increased substantially since the start of the policy tightening phase in 2022 (Graph 1.19). Even so, corporate bond yields have risen by less than risk-free rates over the tightening phase as strong investor demand for wholesale debt has contributed to a narrowing in credit spreads. The higher level of interest rates has contributed to a decline in the median interest coverage ratio of listed companies over the tightening phase, but only to slightly below its post-GFC average. This partly reflects the relatively low leverage of many listed companies. The use of fixed-rate debt and interest rate hedges has also slowed the pass-through of cash rate increases to larger businesses' effective interest rates.[3]

Graph 1.19

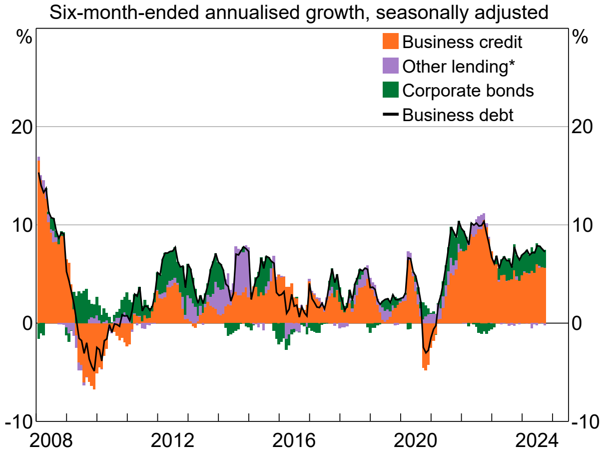
Cost of Business Debt



* Average variable rates on credit outstanding.
** Secondary market, three-year target tenor, includes domestic and offshore issuance by Australian NFCs.
Sources: APRA; Bloomberg; RBA.

Business debt growth remains above its post-GFC average and internal funding remains resilient (Graph 1.20). While the growth of business debt remains elevated, the level of business debt has been relatively stable as a share of nominal GDP. The growth of business debt is only weakly related to business investment. In part, this reflects the fact that internal funding (which flows directly from companies' operating cash flows) makes up the bulk of funding for businesses. While internal funding for listed companies moderated in 2023/24, mostly driven by the resources sector, it remains high in nominal terms and has been broadly stable as a share of nominal GDP. For further discussion, see Box A: The Pick-up in Housing and Business Credit Growth.

Graph 1.20
Business Debt
Six-month-ended annualised growth, seasonally adjusted



* Lending to large businesses by institutions that do not report to APRA.
Sources: APRA; Bloomberg; LSEG; RBA.

Endnotes

1 See RBA (2024), 'Chapter 2: Resilience of Australian Households and Businesses', *Financial Stability Review*, September.

2 While the change in net interest payments over the tightening phase has been modest, higher interest rates also work in other ways to constrain spending by a wide range of households. See Kent C (2023), 'Channels of Transmission', Address to Bloomberg, Sydney, 11 October.

3 See RBA, n 1.

Box A: The Pick-up in Housing and Business Credit Growth

Despite borrowing rates remaining at a high level, housing credit growth has picked up since mid-2023, and business credit growth is above its post-GFC average. This Box compares these trends with previous periods of monetary policy tightening and discusses factors that have supported credit growth recently. While some recent trends in credit growth have been unusual for an interest rate tightening phase, we continue to view overall financial conditions as restrictive.

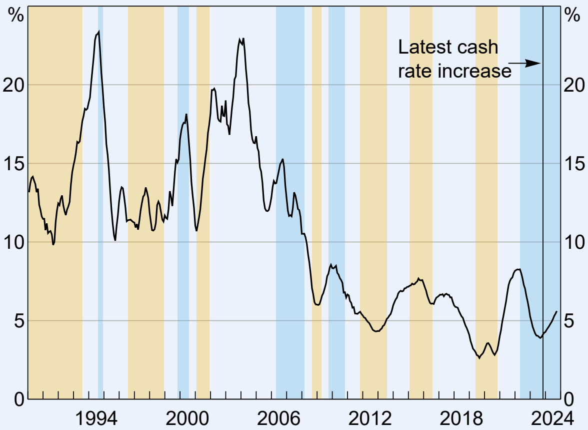
Overall household financial conditions remain restrictive.

There is evidence that tighter monetary policy is weighing on housing credit growth. Serviceability and affordability constraints have weighed on growth in the stock of outstanding mortgages, particularly for lower income borrowers. Loan discharges – whereby a loan is fully repaid, usually on the sale of a property – remain high relative to new lending. This is consistent with incentives to reduce debt in a higher interest rate environment. Other indicators such as the level of mortgage rates and scheduled household debt repayments, as well as developments in the real economy, also point to household financial conditions being restrictive (see Chapter 1: Financial Conditions; Chapter 2: Economic Conditions).

Unusually for a rate tightening period, housing credit growth has picked up over the past year …

Nominal housing credit growth has been gradually increasing since August 2023, over which time the RBA has assessed financial conditions as being restrictive. In previous tightening phases, housing credit growth generally decreased after a period of tighter monetary policy (and then continued to decline even as policy was eased). Although housing credit growth did initially decline materially during the current tightening phase, the recent pick-up is unusual compared with previous periods of restrictive monetary policy (Graph A.1).

Graph A.1
Housing Credit Growth*
Six-month-ended annualised



* Seasonally adjusted and break-adjusted; including securitisation. Blue shading represents tightening and yellow represents easing phases. The current tightening phase is shown as ongoing, while earlier phases are defined by the peak and trough cash rate for each period.

Sources: ABS; APRA; RBA.

… but the rate of growth remains subdued, particularly in light of growth in nominal incomes, population and housing prices.

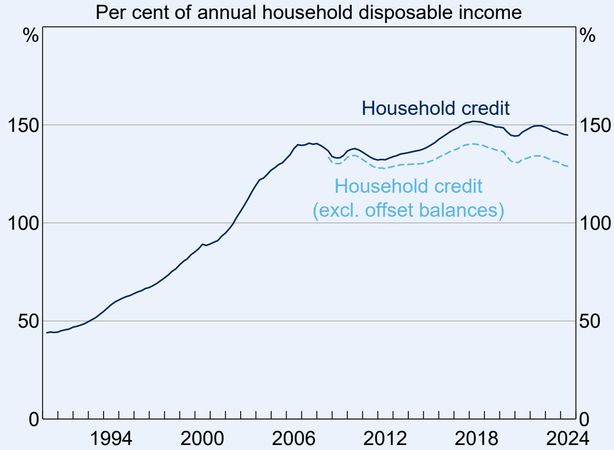
While housing credit growth has increased, the current rate of growth is not that strong – particularly after accounting for growth in nominal incomes. Housing credit growth has increased from a relatively low rate and is around its post-GFC average. The ability of households in aggregate to service new debt has also been supported by strong growth in nominal incomes. Reflecting this, household credit has declined steadily as a share of household disposable income since late 2022 (Graph A.2).

Housing prices and housing credit growth have been supported by strong population growth and constrained housing supply. Population growth over the tightening phase has contributed to increased demand for housing, which (combined with a lack of new supply) has led to strong growth in housing prices (see Chapter 2: Economic Conditions). Housing price growth and a modest pick-up in housing turnover have supported demand for housing credit, despite higher interest rates.

Graph A.2

Household Credit*

Per cent of annual household disposable income



* Seasonally adjusted and break-adjusted; including securitisation. Includes housing and personal credit. Data to June quarter 2024.

Sources: ABS; APRA; RBA.

Business credit growth has been strong, though its historical relationship with monetary policy is weaker than for housing credit growth.

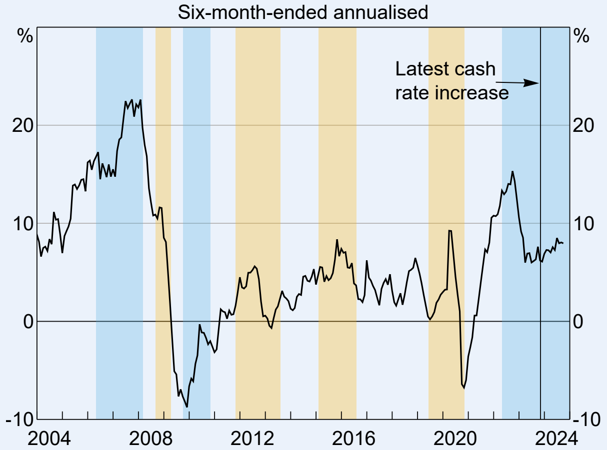
Business credit growth has declined over the most recent tightening phase but remains well above its post-GFC average.[1] Businesses' ability to continue to borrow has been supported by relatively low levels of leverage and above-average cash balances. This has meant that the increase in interest rates has had a weaker effect on business credit growth than in some previous tightening phases, which has contributed to financial conditions being less restrictive for businesses than for households. Profit margins for most large and small businesses remain around pre-pandemic levels, supporting their ability to service debt despite higher interest rates.[2] Lenders have also noted that competition for business loans has increased, suggesting that the availability of business credit has not tightened alongside the slowing economy.

The link between business credit growth and official interest rates is weaker than for housing credit. Business credit growth has both increased and declined in previous easing and tightening phases (Graph A.3). While businesses' demand for credit is influenced by the level of interest rates (including because of their effect on current and expected future economic conditions), other factors are also at play. For example, borrowing to fund mergers and acquisitions contributed to strong growth in business credit in the 2006–2008 tightening phase. More recently, favourable farming conditions and higher land values have contributed to strong growth in lending to the agriculture industry. Business credit growth is also affected by the supply of credit: lenders may be less willing to provide loans during easing phases as they coincide with economic slowdowns (and vice versa).

Graph A.3

Business Credit Growth*

Six-month-ended annualised



* Seasonally adjusted and break-adjusted; including securitisation. Blue shading represents tightening and yellow represents easing. The current tightening phase is shown as ongoing, while earlier phases are defined by the peak and trough cash rate for each period.

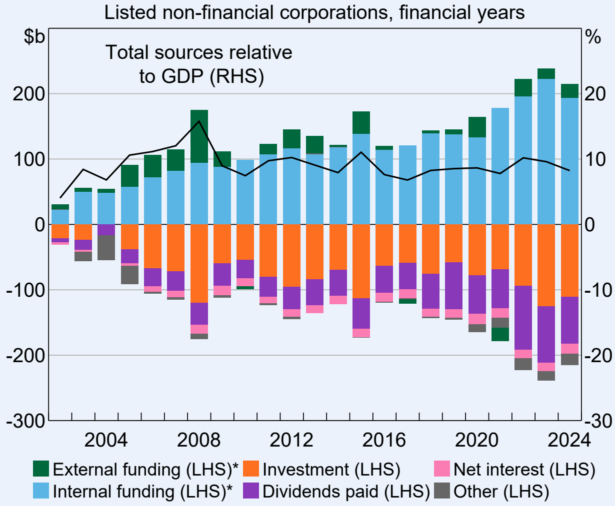
Sources: ABS; APRA; RBA.

While firms' business investment decisions are affected by monetary policy, business credit growth has a relatively weak relationship with aggregate business investment. This is partly because internal funding (i.e. retained profits) makes up the bulk of businesses' total funding, including for investment spending (Graph A.4). Additionally, businesses can substitute between different funding sources such as bond issuance and trade credit. Businesses also use their funding for a broader range of purposes than investment. Notwithstanding this weak aggregate relationship, the availability and cost of finance are important factors influencing individual firms' decision-making, growth and profitability. Research using firm-level data has found that the investment decisions of firms that are more financially constrained or reliant on external funding are more sensitive to monetary policy.[3] This is consistent with the fact that while internal funds are the largest source of business funding, the level of interest rates affects businesses' marginal cost of obtaining additional funding for investment.

Graph A.4

Total Sources and Uses of Funding

Listed non-financial corporations, financial years



* Internal funding includes operating cash flows and changes in cash balances. External funding includes net debt and equity.

Sources: ABS; Morningstar; RBA.

Endnotes

1 Business credit refers to the stock of outstanding loans made by financial intermediaries to businesses.

2 See RBA (2024), 'Chapter 2: Resilience of Australian Households and Businesses', *Financial Stability Review*, September.

3 See Nolan G, J Hambur and P Vermeulen (2023), 'Does Monetary Policy Affect Non-mining Business Investment in Australia? Evidence from BLADE', RBA Research Discussion Paper No 2023-09.

Box B: Economic Policy Developments in China

In late September, Chinese authorities announced a comprehensive package of economic stimulus measures. This was a notable change from the incremental and targeted measures implemented in recent years. This Box discusses the measures and possible implications for China and Australia.

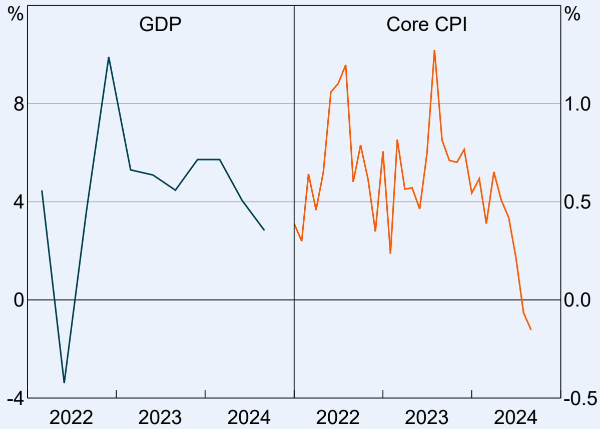
Weaker-than-expected economic activity prompted Chinese authorities to act.

Chinese economic activity and core inflation have weakened significantly in recent quarters, in contrast to the modest improvement expected by authorities earlier in the year (Graph B.1). Domestic demand growth has weakened, local government revenues have declined and expenditure growth has slowed. Furthermore, the property market continues to contract, credit demand is declining, and household income growth and consumer sentiment remain weak. Recent announcements suggest that authorities are not willing to accept a sharp decline in economic activity, especially as this would hinder their ability to meet other objectives such as deleveraging in the local government sector.

Graph B.1

China – Activity Indicators

Six-month annualised growth



Sources: CEIC Data; RBA.

The package includes fiscal, monetary and property market measures.

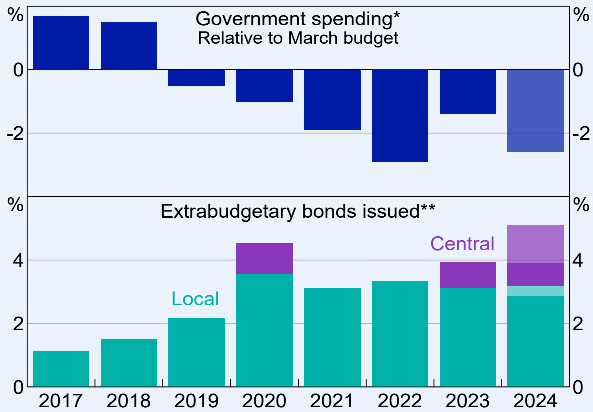
Fiscal policies

Authorities announced an increase in fiscal expenditure in response to weaker-than-expected economic activity, which has been driven partly by pressure on local government finances. Local governments will be allowed to issue an extra CNY400 billion in local government debt this year (using unused bond quotas from previous years) and authorities have indicated that additional fiscal stimulus will be forthcoming. Authorities are reportedly considering issuing an additional CNY2 trillion of central government special-purpose bonds, with around half expected to be used to support consumption and business investment and the rest to address local government fiscal pressures. While this is a material increase in fiscal expenditure, government expenditure as a proportion of GDP is still projected to be 2.6 per cent lower than budgeted this year (Graph B.2).

Graph B.2

China – Fiscal Policy

Per cent of GDP



* Includes general and government fund expenditure; bar with transparency uses full-year GDP estimate from the 2024 budget and full-year expenditure estimated from data to September.

** 2024 is from quota; bars with transparency show expected additional local and central government bond issuance for 2024.

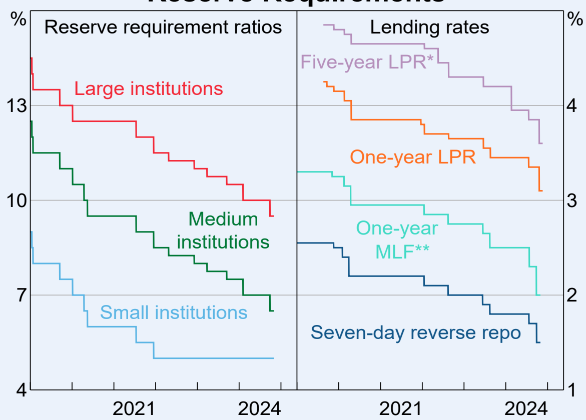
Sources: CEIC Data; MoF; RBA.

Monetary policies

Since late September, the People's Bank of China (PBC) has reduced its key policy rates by up to 30 basis points and lowered the reserve requirement ratio by 50 basis points (Graph B.3).[1] These rate reductions and the forward guidance that further policy rate reductions may be required, contrasts with the earlier more gradual approach of the PBC. Although nominal interest rates have declined to historical lows, real interest rates remain well above their historical averages due to low inflation, which is one factor that has contributed to ongoing weakness in credit demand.

Graph B.3

Chinese Lending Rates and Reserve Requirements



* The average interest rate on loans that commercial banks provide to their most creditworthy customers.

** The rate on medium-term loans that the PBC provides to qualified commercial and policy banks via its medium-term lending facility.

Sources: CEIC Data; RBA.

The PBC has also announced further liquidity support for the stock market – in the form of a CNY500 billion swap facility and a CNY300 billion relending facility, which appear to be aimed at supporting market sentiment. Authorities are also reportedly planning to inject capital into the largest state banks to support their capacity to increase lending to households and businesses in the face of an impending increase in non-performing loans and declining profitability. Funding for the capital injection is likely to come from the issuance of special sovereign bonds.

Property sector and mortgage support

Also in September, authorities committed to 'stop the decline' in property sector activity and have announced plans to expand and increase the effectiveness of existing property support, such as directing banks to lend to 'whitelisted' projects. The PBC's measures to support the property sector include expanding measures that support lending to state-owned enterprises to purchase housing from developers and directing banks to lower existing mortgage rates. It is estimated that the latter will save households CNY150 billion (0.3 per cent of household consumption in 2023) annually, thereby supporting household consumption. It is unclear how effective the new measures will be in supporting sales and investment because they largely extend existing support measures, which have not yet stabilised the property market.

Markets have responded positively to these announcements and the economic outlook has improved.

The policy package should boost sentiment and be more effective in supporting Chinese domestic growth than previous, incremental monetary policy and property sector measures – particularly if the fiscal support is substantial. Indeed, the initial financial market reaction to the announcements was positive and significant, and iron ore prices rebounded sharply from recent lows (see Chapter 1: Financial Conditions; Chapter 2: Economic Conditions). However, the measures have so far had only a modest impact on housing sales.

Overall, these measures are expected to boost growth from next year and have led us to upgrade our forecast for China in 2025 and 2026 modestly (see Chapter 3: Outlook). While CNY2 trillion of additional spending is large (at around 1.6 per cent of GDP), the revision to our forecast for Chinese growth in 2025 relative to the August *Statement* is much smaller. This is because some expectations for further stimulus had already been factored in, and the stimulus is partly offset by the weakening activity and local government positions to which the authorities are responding.

Stimulus in China will affect Australia primarily through commodities.

China is Australia's largest trading partner and developments there have a direct effect on demand for our exports. However, developments in China also affect demand for our exports indirectly, through their effect on growth in Australia's other major trading partners, such as Japan and South Korea. Resource exports comprise more than 60 per cent of Australia's exports, and changes in the growth outlook for our trading partners would support export revenues – most importantly, boosting prices of iron ore and coal, which are two key inputs in steel production.

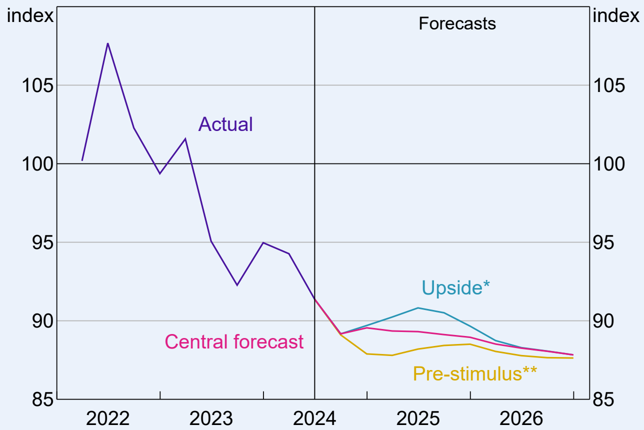
The overall impact of the fiscal stimulus package on Australia will be affected by both its size and its composition. If the authorities' stimulus is more focused on consumption than investment, then the impact on steel demand in China – and demand for Australia's commodity exports – would be smaller than in the previous episodes of fiscal support.

The impact of changes in demand for key resource exports is expected to be mostly through export prices and Australia's terms of trade rather than large changes in export volumes. Mining investment and output in Australia has become much less price sensitive since the previous investment boom, with mining firms focusing on long-run price fundamentals and maintaining export volumes. Australian export volumes are resilient to price declines because Australian production costs are among the lowest in the world.

A higher terms of trade boosts national income, with the most direct effects on mining sector and government revenues. The current forecast for the terms of trade is higher than it would have been absent stimulus announcements in China, and there remains some upside risk if the stimulus is ultimately larger or more resource intensive than forecast (Graph B.4). The Australian dollar exchange rate continues to act as a shock absorber for the Australian economy in response to movements in the terms of trade and developments in China (see Chapter 1: Financial Conditions).

Overall, the positive effects of stimulus could be amplified by an improvement in sentiment in China, Australia and globally, with flow-on effects to consumption and activity.

Graph B.4
Terms of Trade
2021/22 = 100



* Assumes iron ore and coking coal export prices increase in early 2025 in response to a potentially larger-than-expected increase in Chinese fiscal spending.
** Uses the expected path of iron ore and coking coal export prices before the announcement of the stimulus in September.
Sources: ABS; RBA.

Endnotes

1 For an explanation of policy instruments used by the PBC, including the reserve requirement ratio, see Maher W (2024), 'China's Monetary Policy Framework and Financial Market Transmission', RBA *Bulletin*, April.

Chapter 2
Economic Conditions

Summary

- **Economic conditions and inflation have evolved broadly in line with our expectations in the August *Statement*.**
- **Our overall assessment is that the demand for goods and services still exceeds the supply capacity of the Australian economy, though the gap has continued to narrow.**
- **Underlying inflation remains elevated, despite easing in the September quarter.** Trimmed mean inflation softened to 0.8 per cent in the quarter and declined to 3.5 per cent over the year.
- **Headline inflation fell sharply in the September quarter owing to electricity rebates and declining fuel prices**. Year-ended headline inflation is expected to increase in the September quarter of 2025 to be above the target band as the rebates unwind (as currently legislated). Growth in advertised rents has slowed more than expected in recent months; this will flow through to lower CPI rent inflation over time.
- **Labour market conditions remain tight relative to full employment. Conditions have continued to ease gradually as expected, although the easing in some key indicators has recently stalled or modestly reversed.** The unemployment rate edged higher in the September quarter, but the monthly outcomes have been close to 4.1 per cent for some time now. Demand for labour remains strong, particularly in the non-market sector, and the employment-to-population ratio increased in the September quarter. Survey measures indicate that labour availability has improved since late 2022 but remains constrained and has not eased recently. The easing in average hours worked and job ads has also stalled recently while the underemployment rate has declined a little. Nevertheless, labour cost growth has eased further.
- **GDP growth remained subdued in the June quarter but looks to have picked up in recent months.** Household consumption (excluding the effect of energy rebates) appears to have increased solidly in the September quarter, albeit by a little less than anticipated in the August *Statement*. That follows a surprisingly weak June quarter outcome. Over recent quarters, private demand growth has been weak while public demand has grown strongly. Productivity has declined, consistent with subdued GDP growth and ongoing capacity and inflationary pressures.
- **US GDP growth has been surprisingly robust and market participants appear more assured of a soft landing, while in other advanced economies growth has been a little weaker than expected.** Labour markets in advanced economies have eased broadly as expected and most are now estimated to be in balance or have spare capacity. While only modest further increases in unemployment are expected, central banks have become more attentive to downside risks to labour markets and economic growth.

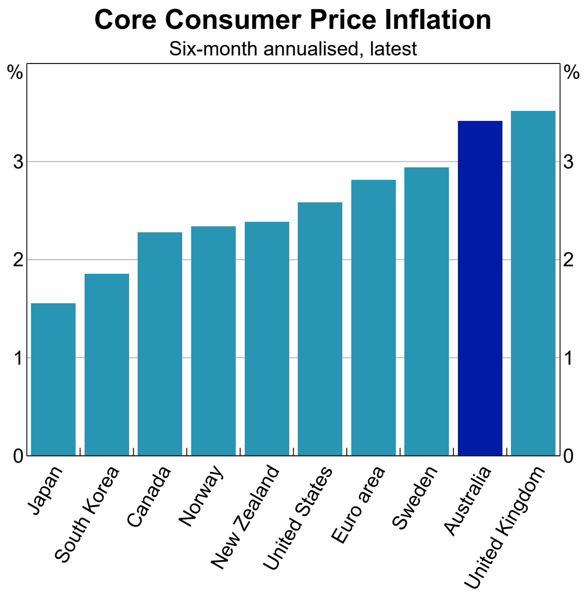
- **Inflation in advanced economies has eased, giving central banks greater confidence that it will return sustainably to target.** While core inflation remains above central banks' targets, and services inflation and wages growth are still elevated amid weak productivity growth (outside of the United States), disinflation is progressing broadly as expected. Reduced capacity pressures are expected to contribute to further moderation in wages growth and services inflation. Central banks in most advanced economies have eased monetary policy as risks to the inflation outlook are now assessed to be more balanced.
- **Iron ore prices responded sharply to a package of economic support measures announced in China in late September.** Growth in Chinese domestic demand has remained sluggish this year as local governments' spending has declined, and the property market downturn has continued unabated. Central authorities have responded with a significant economic stimulus package, though many details are still to be confirmed.

2.1 Global economic conditions

Inflation in advanced economies has continued to ease broadly as expected, or in some cases a little quicker, giving central banks confidence that it is returning sustainably to their targets.

Core inflation in advanced economies has continued to ease broadly as expected. While it remains above rates consistent with central banks' targets in most peer economies – with Australia sitting at the upper end of the range – many central banks have communicated greater confidence that inflation is returning sustainably to their targets (Graph 2.1). That confidence reflects further progress on disinflation, a slackening in labour markets and in some cases weaker-than-expected recent activity – all of which is consistent with the restrictive stance of monetary policy in most advanced economies. With upside inflation risks seen to be receding, some central banks have become more attentive to downside risks to activity, labour markets and, in some cases, inflation (see Chapter 1: Financial Conditions).

Graph 2.1



Sources: ABS; LSEG; RBA.

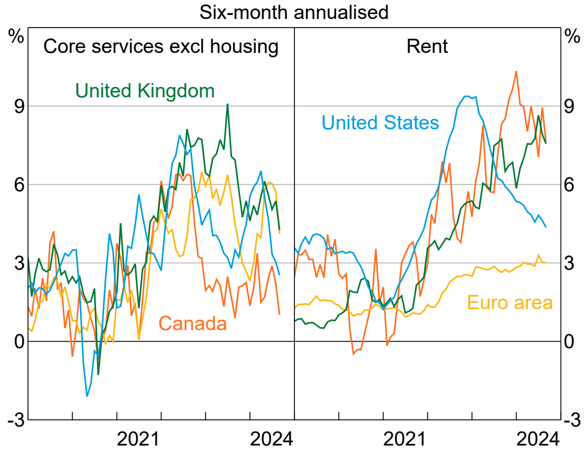
Headline inflation has eased more quickly than expected in Canada and the United States since the August *Statement*. In the United Kingdom and the euro area, headline inflation is temporarily close to target, owing partly to government policies having reduced energy prices for a time. Energy inflation is expected to increase across advanced economies in coming months as price falls last year drop out of the year-ended inflation calculation, supporting a slight pick-up in headline inflation in several advanced economies.

Services inflation has continued to decline in advanced economies (Graph 2.2). Housing services inflation has remained particularly sticky (including in Australia) but is expected to ease gradually. In the United States, rent inflation has slowed substantially but remains above its pre-pandemic average; other economies have seen a moderation in market rents, which suggests that CPI rent inflation will ease gradually from its recent peaks.

Non-housing services inflation remains elevated in some advanced economies, though it is around its historical average in the United States and Canada. Labour costs are an important contributor to non-housing services inflation. Wages growth has continued to moderate in most advanced economies but remains high, in part reflecting some catch-up to prior price increases. In turn, growth in unit labour costs remains high and has moderated only gradually – except in the United States where it has declined rapidly because of strong productivity growth. Some central banks have noted that weak demand and rising labour market slack will weigh on wages growth and on firms' ability to pass on input cost increases to consumers, resulting in a moderation of non-housing services inflation.

Graph 2.2

Services Inflation

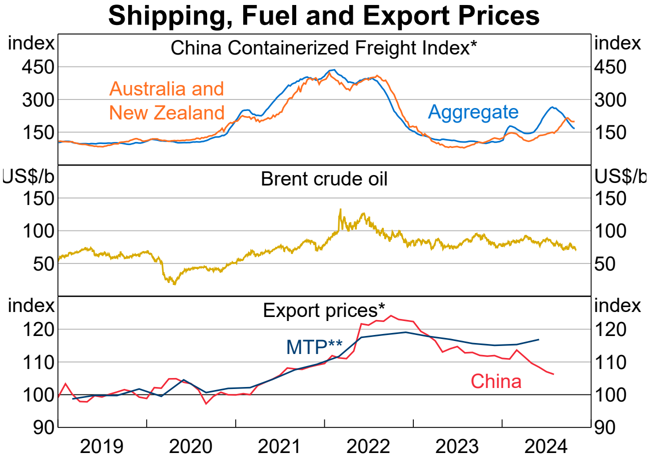


Sources: BLS; Eurostat; LSEG; ONS; RBA; Statistics Canada.

Goods inflation remains low in advanced economies and a continuation of recent falls in Chinese export prices is a downside risk. However, geopolitical tensions and high shipping costs continue to present upside risks to the outlook. Oil prices increased over October due to the escalation in the conflict in the Middle East; that said, prices remain below recent peaks. While global shipping costs have fallen from their July peak, shipping costs for routes from China to Australia and New Zealand have not yet eased much (Graph 2.3).

Graph 2.3

Shipping, Fuel and Export Prices



* 2019 average = 100.

** Weighted by the import share of Australia's major trading partners (MTP).

Sources: Bloomberg; LSEG; Oxford Economics; RBA; Shanghai Shipping Exchange.

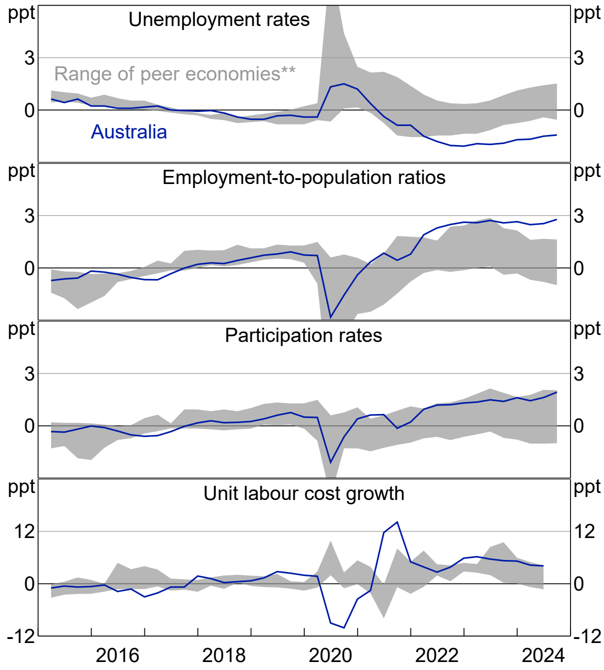
Labour markets in advanced economies have continued to ease broadly as expected, though Australian labour market conditions are tighter than in peer economies.

Unemployment rates have continued to increase – in most cases broadly as expected by central banks – consistent with restrictive monetary policy and, in many cases, below-trend growth. In some advanced economies, the easing in labour market conditions has continued to be supported by high population growth or rising participation rates (or both). However, labour demand has also continued to soften. To date, in most economies this softening has largely come through lower levels of new job creation, with firms cutting back on hiring rather than engaging in widespread layoffs. New Zealand, where layoffs have increased significantly, is a notable exception. Vacancy rates have also continued to decline such that they are now back to pre-pandemic levels in most peer economies. In the United States the unemployment rate fell in August and September, unwinding a larger-than-expected increase in July, consistent with there being only a gradual easing in labour market conditions there. In most advanced economies labour markets are now either close to balanced or have spare capacity.

Employment growth remains low in most advanced economies. Employment growth has been weaker than expected in some economies that have also experienced weaker-than-expected GDP growth (e.g. Canada and New Zealand). Most central banks expect only modest further easing in labour markets but have increasingly emphasised downside risks to labour markets in their communications.

Australian labour market conditions are tighter than in most peer economies (Graph 2.4). Labour market conditions in Australia have continued to ease this year (see section 2.3 Labour market and wages). However, relative to pre-pandemic averages, the unemployment rate is lower and employment, participation, unit labour cost growth and job vacancies are all higher than in peer economies. That suggests domestic labour market conditions remain tighter than in those economies, consistent with monetary policy settings having been less restrictive in Australia (see Chapter 1: Financial Conditions).

Graph 2.4
International Labour Markets*
Change from 2015–2019 average



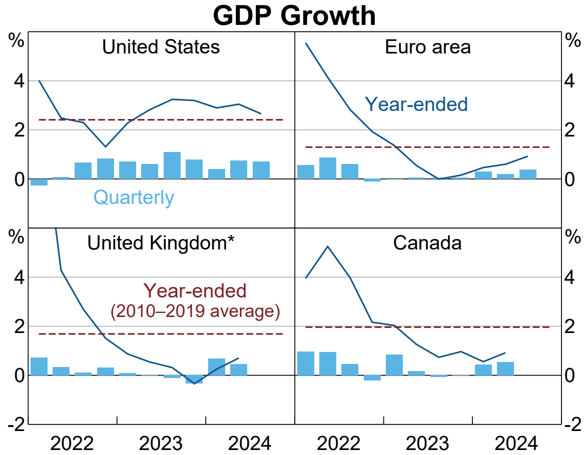
* Data unavailable for the most recent quarter are extrapolated from a simple trend; outliers during the COVID-19 pandemic have been truncated.
** Peer economies include the United States, the United Kingdom, Canada, Germany, New Zealand and Sweden.
Sources: Eurostat; LSEG; RBA; Statistics Canada.

US GDP growth has been surprisingly resilient but growth in some other advanced economies appears to have been a little weaker than previously expected.

US GDP growth remains robust and surprised to the upside relative to Consensus forecasts at the time of the August *Statement*, supported by favourable supply-side developments, including strong productivity growth. Quarter-on-quarter growth slowed slightly in the September quarter, although by less than previously expected. Household consumption growth remained resilient and increased in the September quarter. Upward revisions to US real household income growth and the savings rate for the June quarter suggest less downside risk to the US consumption outlook than previously thought.

Growth in other advanced economies has recovered somewhat from the very weak pace of 2023 but remains below estimates of potential growth rates, consistent with weak productivity growth in these economies (Graph 2.5). Activity in the September quarter now looks to have been a touch weaker than expected at the time of the August *Statement*. Euro area GDP picked up in the September quarter, in line with expectations in August, but September nowcasts for Canada and New Zealand have been revised lower. Consumption growth has remained soft relative to growth in real household disposable incomes in these economies, with households choosing to save more. In contrast to downward revisions elsewhere, the Consensus nowcast for UK September quarter GDP growth has been revised up, though it remains below trend growth. Several central banks have noted that continued weakness in productivity growth remains a key downside risk to the expected recovery in output growth, and an upside risk to inflation, especially if wages growth were to remain elevated.

Graph 2.5
GDP Growth

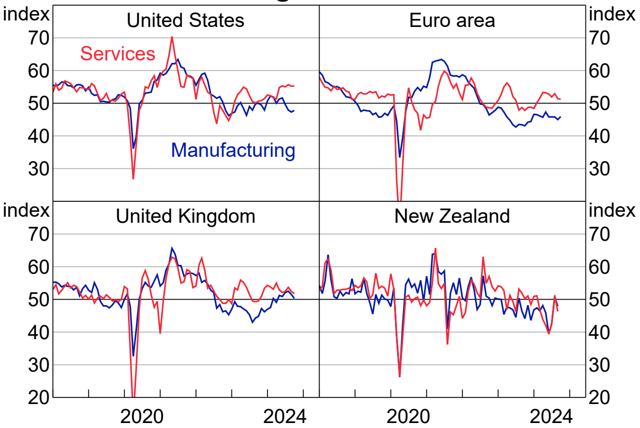


* Year-ended GDP growth for the March quarter of 2022 was 11.5 per cent.
Sources: LSEG; RBA.

Timely activity indicators suggest the recovery in advanced economy growth has slowed in the December quarter, but US conditions remain robust. Business conditions in the services sector remained expansionary in October: while conditions eased a little in the euro area and the United Kingdom, US conditions surprised to the upside. Manufacturing sector conditions remained contractionary in the United States and euro area, with conditions in Germany particularly weak. Conditions in New Zealand remain contractionary, despite some improvement since the middle of the year (Graph 2.6).

Graph 2.6

Manufacturing and Services PMI*



* Purchasing Managers' Index; outliers during the COVID-19 pandemic have been truncated.

Sources: LSEG; RBA; S&P Global.

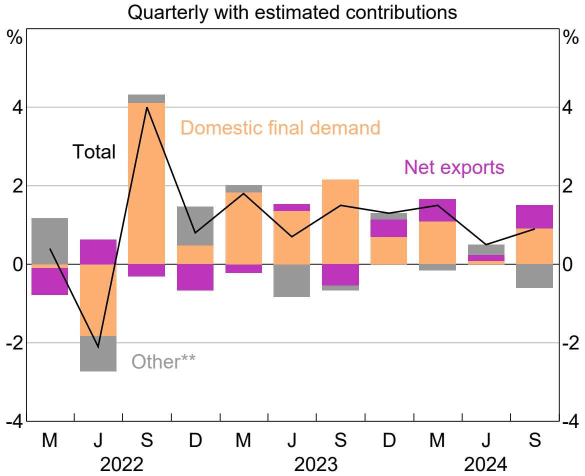
In China, recent economic growth outcomes have been weak and authorities have announced a large suite of stimulus measures to support growth.

Chinese GDP growth remained subdued in the September quarter, despite ticking up as domestic final demand rebounded after extreme weather in the June quarter. Net exports also made a significant contribution to growth (Graph 2.7). However, consumer sentiment remains weak, the real estate sector has continued to drag on growth and local government fiscal positions have worsened.

Graph 2.7

China – GDP Growth*

Quarterly with estimated contributions



* Components seasonally adjusted by the RBA and their contributions calculated by the RBA.

** Reflects the change in inventories and the difference between RBA and NBS seasonal adjustment.

Sources: CEIC Data; RBA.

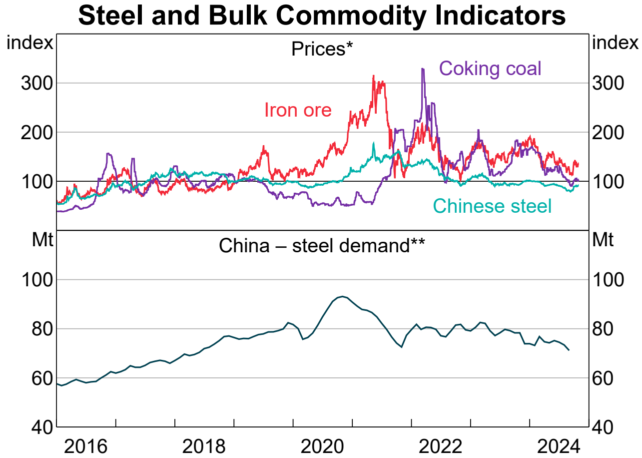
The Politburo took the unusual step of using its late-September meeting to discuss the outlook for the economy, and signalled a material step up in policy support (see Box B: Economic Policy Developments in China). This includes a package of monetary and fiscal measures, though the exact size and composition of the fiscal stimulus has yet to be announced. These announcements are expected to support growth over the next year and had an immediate impact on market sentiment, causing Chinese equity prices to increase sharply (see Chapter 1: Financial Conditions; Chapter 3: Outlook).

Iron ore, coking coal, steel and base metals prices have also increased following the announced Chinese stimulus package.

Iron ore prices have increased significantly since late September, driven by optimism around the outlook for steel demand in China following stimulus announcements. Iron ore prices have almost fully retraced declines in prior months. That recovery largely reflects improved market sentiment – underlying steel demand in China has declined recently, and global iron ore supply and portside inventories in China remain high. The stimulus announcements in China have also supported coking coal and base metals prices (Graph 2.8).

Graph 2.8

Steel and Bulk Commodity Indicators



* January 2019 average = 100.

** Estimated from steel production less net exports and less the change in inventories.

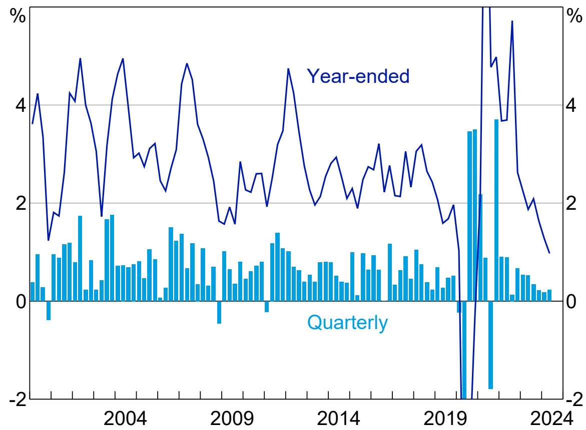
Sources: Bloomberg; CEIC Data; McCloskey by OPIS; RBA.

2.2 Domestic economic activity

Australian GDP growth remained subdued in the June quarter, as expected.

GDP growth was 0.2 per cent in the June quarter and 1.0 per cent over the year, in line with our expectations at the August *Statement* (Graph 2.9). However, the component-level results suggest there was a little less momentum in aggregate demand; household consumption was much weaker than expected, while the stronger-than-expected outcomes were in components that tend to be more volatile from quarter to quarter, including trade. We continue to assess that aggregate demand exceeded potential supply in the June quarter. Subdued GDP growth is helping to bring the economy back into balance, despite weak productivity outturns dragging on the estimated growth rate of supply (see section 2.4 Assessment of spare capacity).

Graph 2.9
GDP Growth*



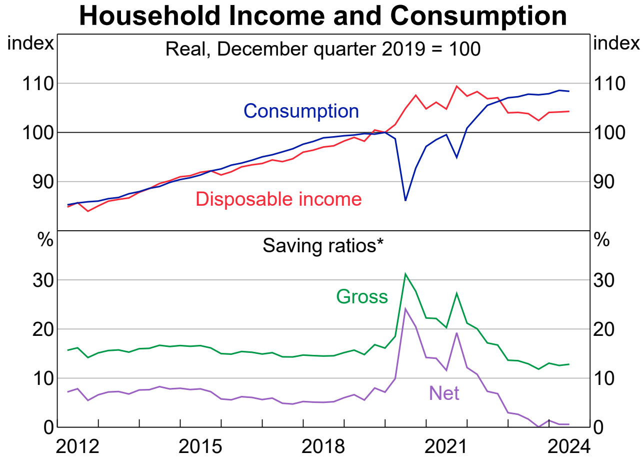
* Outliers during the COVID-19 pandemic have been truncated.
Source: ABS.

Growth in private demand was weak over the year to June, while public demand continued to grow strongly. Private domestic demand increased by just 0.7 per cent over the year to the June quarter. Earlier large declines in real disposable incomes and restrictive financial conditions continued to weigh on household consumption. Dwelling investment remained weak amid subdued inflows of new construction projects and as capacity constraints in finishing trades continued to limit progress on the backlog of work. After strong growth in 2023, business investment declined over the first half of the year and growth in spending by tourists and international students slowed. The contrasting strength in public demand largely reflects the provision of government services to households, led by higher disability and aged care benefits, which has supported demand for labour in non-market sectors.

Household consumption growth was unexpectedly weak over the first half of the year; timely indicators suggest it has since picked up but by less than expected.

Real household disposable incomes have stabilised (following earlier falls) as inflation has declined and the pace of increase in interest and tax payments has slowed (Graph 2.10). Real incomes grew by 0.1 per cent in the June quarter, below our expectations in the August *Statement*. The implementation of the Stage 3 tax cuts is expected to have boosted real incomes by 1.3 percentage points in the September quarter, with bank account data already recording a lift in take-home pay.

Graph 2.10
Household Income and Consumption



* The net saving ratio accounts for the depreciation of household fixed assets (mainly dwellings), whereas the gross saving ratio does not.
Sources: ABS; RBA.

Household net wealth has continued to increase steadily, which may be providing some support for consumption. Real household net wealth grew by 4.5 per cent over the year to the June quarter, and was 22 per cent higher than prior to the pandemic. This increase in household wealth has been largely driven by strong housing price growth. Households' holdings of liquid assets, such as deposits, have also grown much more quickly than incomes over recent years. Increases in housing prices and share prices since the June quarter will have added further to wealth (see Chapter 1: Financial Conditions).

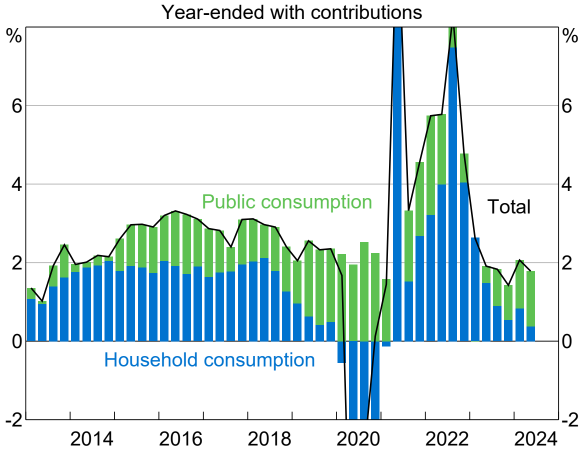
Household consumption growth was weaker than expected over the first half of the year. Household consumption declined by 0.2 per cent in the June quarter to be just 0.5 per cent higher over the year, driven by weakness in discretionary consumption – a noticeable slowing from the upwardly revised 0.6 per cent growth in the March quarter. This partly reflects the continuing effect of the weakness in real household incomes over recent years and, to a lesser extent, the unwinding of strength related to a number of large recreational and cultural events in the March quarter. Bank transaction data suggest that the weakness in household spending has been broadly based, including for households that own their home without a mortgage and those that rent. Strong growth in government consumption – which includes the provision of services to households – means that overall consumption growth has been more resilient; overall consumption growth nonetheless remains below its pre-pandemic average (Graph 2.11).

The growth rates of household consumption in prior years were revised higher in the recent Annual National Accounts release, primarily reflecting improvements in the measurement of digital services in the Australian economy. While the revision to growth in the most recent financial year was small, the level of consumption is now nearly 1 per cent higher than previously reported and is somewhat closer to its pre-pandemic trend.[1]

Graph 2.11

Total Consumption Growth*

Year-ended with contributions



* Outliers during the COVID-19 pandemic have been truncated.

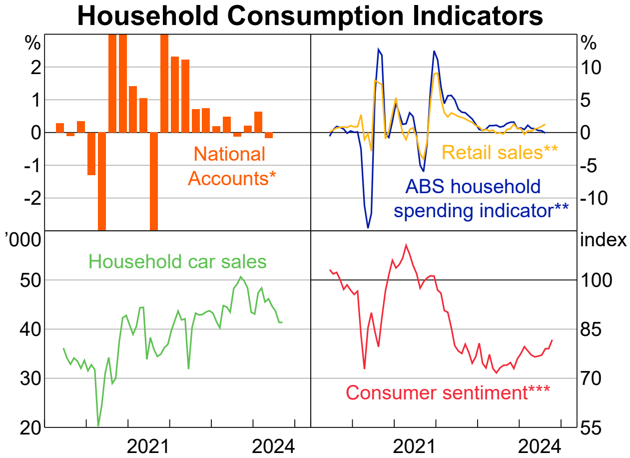
Sources: ABS; RBA.

Timely indicators suggest underlying household consumption growth has recovered in the September quarter but by a little less than previously expected. A range of indicators – including retail sales, bank transaction data and liaison – suggest that underlying consumption increased in the September quarter, though consumption per capita is expected to decline a little further (Graph 2.12). This is consistent with the small recent pick-up in consumer sentiment from very low levels. Business liaison contacts continue to report soft underlying trading conditions, although some household goods retailers have noted that an improvement during end-of-financial-year trading has been sustained.

Taking into account cost-of-living subsidies, measured household consumption is expected to be flat in the quarter (see Chapter 3: Outlook).

Graph 2.12

Household Consumption Indicators



* Quarterly growth; the y-axis cuts off outlier consumption growth rates during 2020 and 2021.

** Retail sales and ABS household spending indicator are three-month on three-month growth rates as these series are monthly; data is up to August 2024.

*** Mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys.

Sources: ABS; ANZ–Roy Morgan; FCAI; RBA; Westpac–Melbourne Institute.

The household saving ratio has been relatively stable over recent quarters and has been below its pre-pandemic level on both a gross and net (of depreciation) basis over the past year. The extent to which households are willing to continue to save at this lower rate, particularly once real income growth starts to recover, is a key uncertainty in the outlook for household consumption (see Chapter 3: Outlook).

Growth in export volumes in the June quarter was stronger than expected.

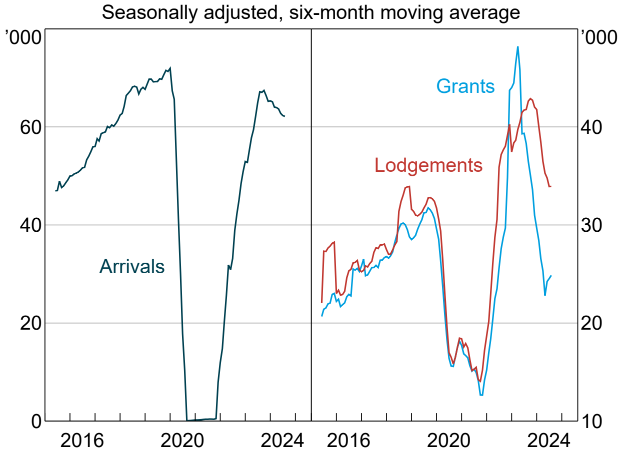
Iron ore and education exports drove the stronger-than-expected quarterly outcome. Iron ore exports grew solidly as China continued to restock portside iron ore inventories. The stronger-than-expected increase in education exports reflected a rise in the average spend of international students onshore, which nonetheless remains below expectations from late 2023 (see Box D: Annual Review of the Forecasts). The number of international students onshore was little changed in the quarter. Partial data suggest that growth in resource and services exports has remained robust in the September quarter to date.

However, the tightening in student visa policy is beginning to weigh on international student arrivals. International student arrivals have begun to slow, as tighter visa processing standards have led to a decline in the proportion of student visa applications being granted. There are also signs that demand for student visas has decreased, likely in response to more stringent requirements for applicants (such as proof-of-savings and higher minimum English language requirements), although lodgements are still higher than pre-pandemic levels (Graph 2.13).

Graph 2.13

International Student Visas*

Seasonally adjusted, six-month moving average



* Series are seasonally adjusted by the RBA.

Sources: ABS; Department of Home Affairs; RBA.

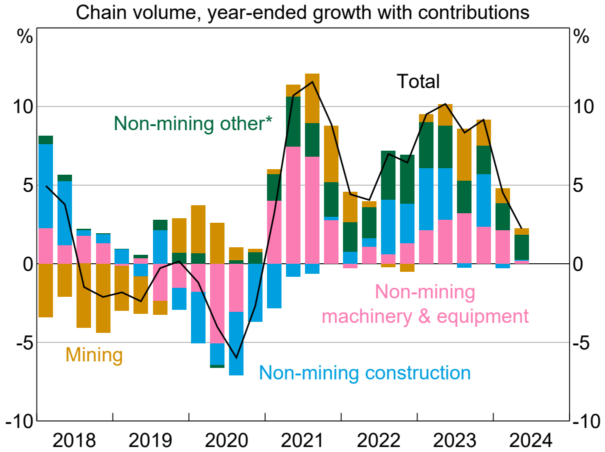
Business investment continued to grow but at a slower pace than in recent years, partly due to persistent construction cost pressures.

Growth in business investment slowed over the first half of the year following a period of rapid growth since late 2020 (Graph 2.14). Non-mining construction investment increased in the June quarter, driven by ongoing investment in renewable energy infrastructure projects and warehouses for data centres. Growth in non-mining machinery and equipment investment has slowed in year-ended terms. Firms in the RBA's liaison program report that investment has been supported by demand for some types of light commercial vehicles and data centre fit-outs. Non-mining software investment has grown strongly, which liaison contacts attribute to firms investing in software platforms and a range of other digital services relating to data migration, cloud storage and cybersecurity.

Graph 2.14

Business Investment

Chain volume, year-ended growth with contributions



* Includes biological resources, artistic originals, non-mining software and non-mining research & development.

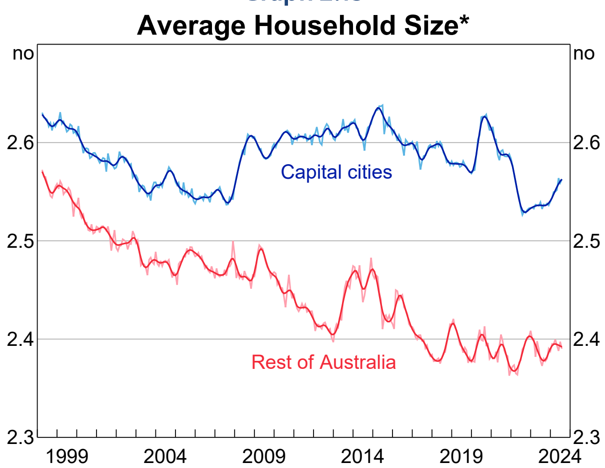
Sources: ABS; RBA.

Firms have moderated their nominal investment intentions for 2024/25 and investment is now expected to remain around similar levels to last year. That largely reflected a downward revision in firms' expectations for construction investment, which is now anticipated to be flat in nominal terms over the next financial year rather than increasing. Expectations for non-mining machinery and equipment investment are little changed, with an easing in growth still expected, while mining investment is still projected to be relatively flat. Firms in liaison have cited postponements in major renewable energy projects and higher input costs (particularly for the construction sector) as drivers of the moderation in investment intentions, alongside the subdued outlook for private demand and broader macroeconomic uncertainty.

Advertised rents growth has slowed considerably and by more than expected, while housing price growth has been steady in recent months.

Growth in underlying demand for housing has slowed. Average household size has picked up this year, while population growth appears to have passed its peak and is weaker than was expected in the August *Statement* (Graph 2.15). The combination of these factors has contributed to the larger-than-expected slowing in advertised rents growth (see section 2.5 Inflation).

Graph 2.15



* Smoothed lines are 13-period Henderson trends.
Sources: ABS; RBA.

Dwelling investment was little changed in the June quarter and our assessment remains that dwelling supply is unlikely to pick up significantly in the near term. Labour shortages continue to constrain progress in working through the elevated backlog of residential construction work, although the subdued inflow of new work is helping to reduce the pipeline of projects. Detached approvals have trended up since mid-2023 but remain below average; liaison contacts report that uncertainty around whether interest rates have peaked continues to weigh on demand to build new housing. For higher density construction, high building costs continue to limit the viability of many projects.

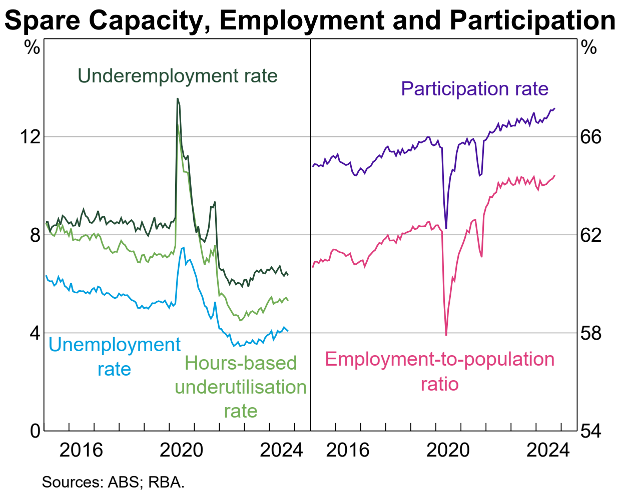
Housing price growth was robust in the September quarter, with housing credit growth also picking up (see Chapter 1: Financial Conditions). There continues to be significant variation across states. Housing price growth remains particularly strong in Perth, Brisbane and Adelaide, while price rises have been more moderate in Sydney and regional areas and prices have declined in Melbourne. Growth remained stronger for lower value segments of the market.

2.3 Labour market and wages

Labour market conditions remain tight relative to full employment. While conditions have continued to move gradually towards better balance this year, the easing in some indicators has stalled recently and others have shown some signs of a tightening.

The labour market has continued to ease this year through a gradual increase in the unemployment rate, as strong growth in employment has only partially absorbed higher labour force participation. The unemployment rate was 4.1 per cent in the September quarter, in line with the August *Statement* forecast and 0.7 percentage points above its late-2022 trough. The participation rate and employment-to-population ratio were stronger than expected, increasing to record highs. With labour force participation increasing by a little more than employment, the gradual drift up in the unemployment rate reflects increasing labour supply outpacing still-solid growth in labour demand. The pace of increase in the unemployment rate has slowed recently; four of the past six-monthly outcomes have been at 4.1 per cent. The hours-based underutilisation rate has stabilised recently and is 0.8 percentage points above its late-2022 trough (Graph 2.16).

Graph 2.16

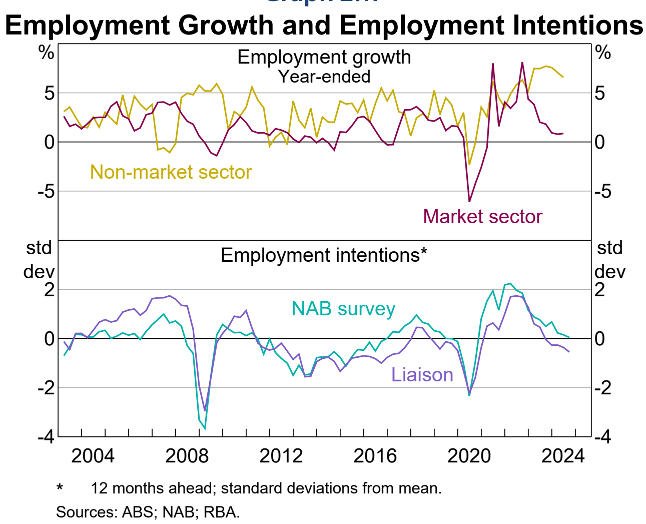


Participation rate outcomes have been strong. The increase since the start of the year has been observed across most demographic groups. The increased level of labour force participation may reflect some combination of cost-of-living pressures causing individuals to seek work and the continued availability of jobs (as measured by still-elevated vacancies), alongside longer run trends of greater female and older worker participation.

Employment growth has been stronger than expected at the time of the August Statement, consistent with labour demand remaining robust. The employment-to-population ratio increased further in the September quarter, having increased by more than in peer economies since the pandemic (see section 2.1 Global economic conditions). Given the subdued pace of economic activity, the recent strength in employment growth is consistent with ongoing weakness in measured productivity growth.

Growth in employment has been driven by the non-market sector – industries that are typically less sensitive to the business cycle, including health care and education. Information from liaison suggests labour demand remains strong in some sectors, such as health care, in which demand for services routinely exceeds supply. Survey and liaison measures of employment intentions, which tend to focus more on market sector industries, have eased in recent months and suggest that market sector employment growth will remain subdued in the near term (Graph 2.17).

Graph 2.17

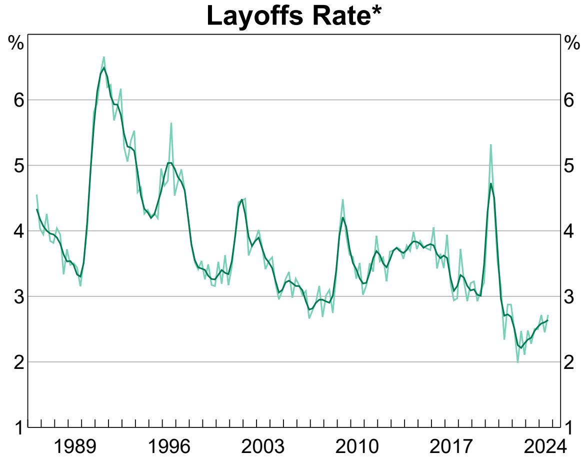


Employment growth has remained strong alongside a decline in vacancies, supported by firms finding it somewhat easier to fill vacancies as the labour market has eased. Some firms in the liaison program have reported that they had been able to hire staff into longstanding vacancies that they were unable to fill when the labour market was tighter. The filling of pre-existing vacancies has likely contributed to the overall decline in the vacancy rate since mid-2022, though the vacancy rate remains above pre-pandemic levels. Our assessment is that further falls in vacancies can still occur alongside a relatively modest increase in the unemployment rate.

The rate of layoffs has increased modestly since 2022, alongside the gradual easing in labour market conditions, although it remains low by historical standards (Graph 2.18). Liaison information indicates that some firms have decided not to fill roles that had become vacant through natural attrition and turnover. In limited cases, some firms may have been discouraged from laying off workers due to expectations that economic conditions would improve in the period ahead and concerns around recruitment and training costs. However, this motivation is unlikely to be widespread as survey measures of capacity utilisation continue to be above average, an above-average share of firms still report that the availability of labour remains a constraint, and the vacancy rate and average hours look to be around or above their longer run trends.

Graph 2.18

Layoffs Rate*



* Layoffs as a share of total filled jobs; darker line is a seven-term Henderson trend.

Sources: ABS; RBA.

The earlier easing in some labour market indicators has stalled recently, though other indicators continue to point to further gradual easing in labour market conditions. Average hours worked were a key margin of adjustment over 2023 but, looking through volatility, have not eased materially since late 2023. Similarly, the underemployment rate, which had been increasing since early 2023, was broadly unchanged in the year to mid-2024, and has declined recently. The youth unemployment rate, a more cyclical measure of unemployment, declined in the September quarter. Some leading indicators of labour demand, such as job advertisements, have also picked up in recent months.

Taken together, the various indicators suggest that the labour market remains tight relative to full employment, in contrast to most other advanced economies, but has continued to ease gradually (see section 2.4 Assessment of spare capacity).

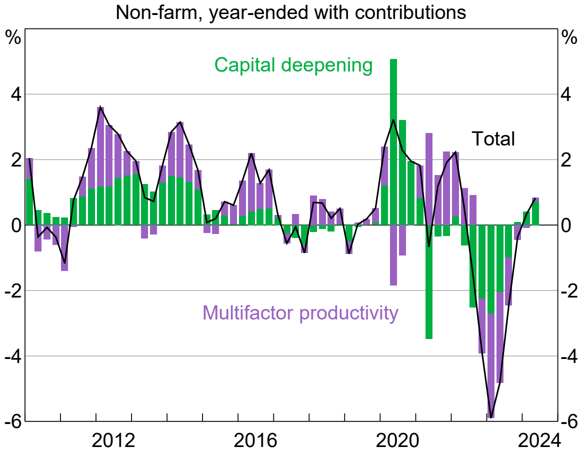
Productivity growth remains weak, weighing on the growth of the economy's supply capacity.

Non-farm labour productivity increased by 0.8 per cent over the year to the June quarter. Looking through pandemic-related volatility, labour productivity is now around the same level as in 2016. Over the past year, productivity growth has been supported by modest capital deepening, as the capital-to-labour ratio has been reverting towards pre-pandemic levels. Multifactor productivity, which is the part of labour productivity growth not due to changes in the capital-to-labour ratio, remains weak (Graph 2.19). Productivity outcomes have been weak in both market and non-market industries over the past year, albeit a little softer in non-market industries. Subdued productivity in the mining industry has notably weighed on market sector productivity growth over the past year.

Graph 2.19

Labour Productivity Growth

Non-farm, year-ended with contributions



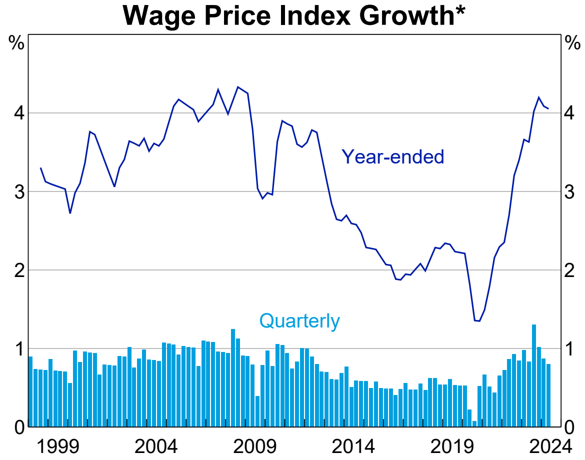
Sources: ABS; RBA.

Wages growth has continued to ease towards a more sustainable rate but remains high relative to recent productivity growth outcomes.

Growth in the Wage Price Index (WPI) eased further in the June quarter, to be 4.1 per cent over the year (Graph 2.20). The easing in wages growth since its 2023 peak has been broadly based, though the slowing in growth in the June quarter was more pronounced in the private sector.

Graph 2.20

Wage Price Index Growth*



* Seasonally adjusted; total hourly rates of pay excluding bonuses and commissions.

Source: ABS.

At current rates of productivity growth, WPI growth remains somewhat above rates that can be sustained in the long term without putting upward pressure on inflation. All else equal, when productivity growth is positive, WPI growth is able to outpace inflation while still being consistent with inflation at the midpoint of the target range. As trend growth in labour productivity is likely below its rate in previous decades, the sustainable WPI growth rate is probably lower than in the past and below the current rate of growth. That suggests it would be difficult to sustain wages growth at its current pace in the longer term without a higher pace of trend productivity growth.

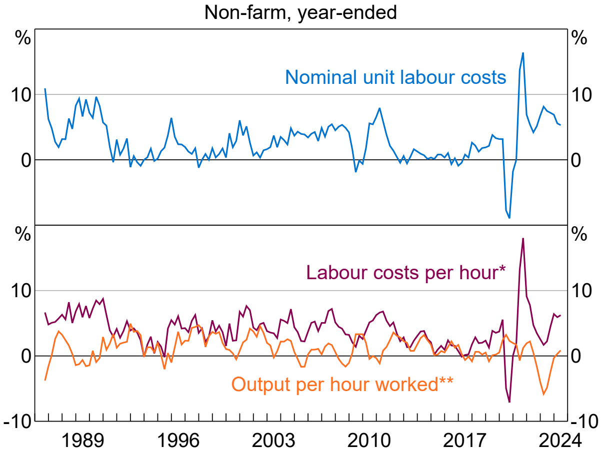
Unit labour cost growth continued to ease in the June quarter but remains higher than is consistent with inflation being sustainably at the midpoint of the target range.

Year-ended unit labour cost growth remains high but eased further in the June quarter (Graph 2.21). Unit labour costs, which are labour costs adjusted for labour productivity, grew by 5¼ per cent over the year to June, well above their historical average pace and faster than is consistent with inflation being sustainably at the midpoint of the target range. In year-ended terms, unit labour cost growth has slowed since its peak in 2023, as productivity growth has increased while labour cost growth remains elevated. The six-month annualised growth rate was 3½ per cent in the June quarter, down from 7 per cent in the December quarter of 2023. A further easing in the growth rate of labour costs, or an increase in productivity growth, will be needed to bring unit labour costs growth to around its sustainable level.

Graph 2.21

Nominal Unit Labour Cost Growth

Non-farm, year-ended



* Compensation of employees plus payroll taxes less employment subsidies, divided by employee hours worked.

** Includes self-employed.

Sources: ABS; RBA.

2.4 Assessment of spare capacity

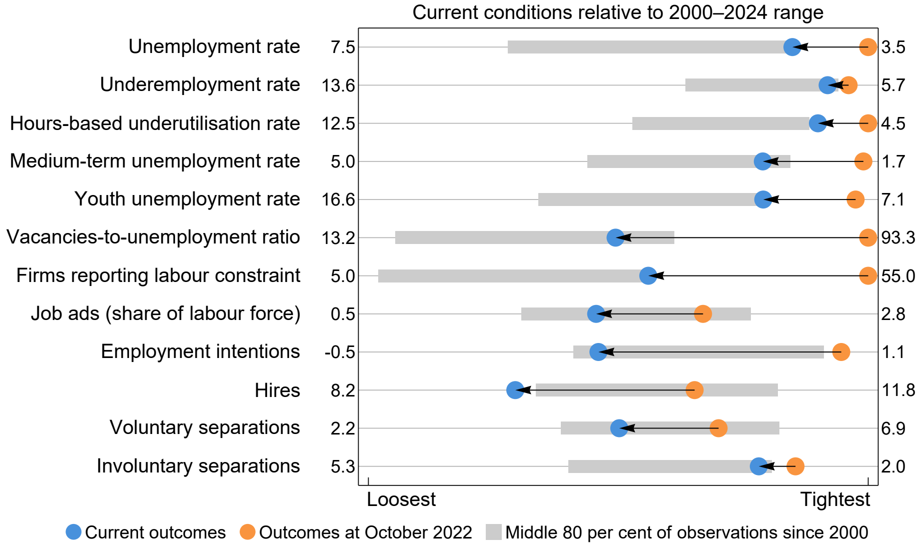
Our overall assessment is that there continues to be excess demand in the economy, but that it has moved closer to balance.

A range of information – including underlying inflationary pressures – continues to suggest the labour market is tight and aggregate demand remains above the economy's capacity to sustainably supply goods and services. However, taken together, developments since the August *Statement* suggest the economy has continued to move gradually towards balance. Subdued output growth has resulted in a narrowing of the gap between actual output and estimates of potential output. Labour market conditions have continued to ease gradually, though the earlier easing in some indicators has stalled recently. The evolution of the output gap and labour market spare capacity is broadly consistent with expectations at the time of the August *Statement*.

Labour market and capacity utilisation indicators suggest economic conditions remain tight.

Although labour market conditions have eased since late 2022, a range of indicators suggest the labour market remains tight. These include the hours-based underutilisation rate, the vacancies-to-unemployment ratio, and the share of firms reporting the availability of labour as a significant constraint. Some leading indicators such as employment intentions have continued to ease, which has flowed through to subdued employment growth in the market sector. However, the effect of this weakness on the level of labour underutilisation has been mitigated by strong employment growth in the non-market sector, so that overall labour market conditions have eased only gradually (Graph 2.22).

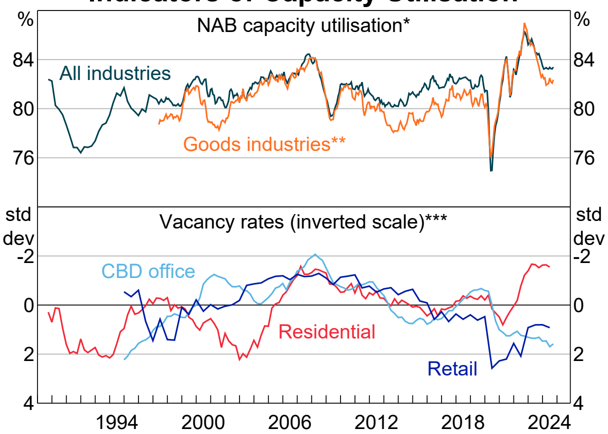
Graph 2.22
Full Employment Indicators
Current conditions relative to 2000–2024 range



Sources: ABS; JSA; NAB; RBA.

Indicators of capacity utilisation suggest some resources continue to be used intensively. The NAB survey measure of capacity utilisation remains elevated and is broadly unchanged from the August *Statement*, having stabilised above its historical average. This suggests businesses are still using their labour and capital resources at higher-than-normal rates to meet demand. However, liaison indicates that conditions vary across sectors. Rental vacancies data show the housing stock continues to be utilised intensively, consistent with subdued growth in housing supply over recent years, contributing to high CPI rent inflation (Graph 2.23).

Graph 2.23
Indicators of Capacity Utilisation

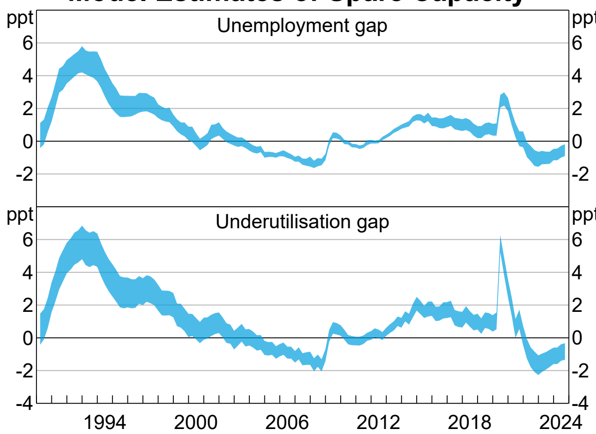


* Quarterly data prior to May 1997, three-month moving average thereafter; excludes mining.
** Goods industries include manufacturing, construction, wholesale and retail.
*** Series are standardised to measure the number of standard deviations each series is from its mean value; retail refers to regional retail centres.
Sources: ABS; JLL Research; NAB; RBA; REIA.

Estimates of the gaps between demand and supply in the economy are somewhat closer to balance than in August.

Model-based estimates suggest that the labour market remains tighter than full employment, consistent with elevated wages growth and inflation. Both the unemployment rate and the broader hours-based underutilisation rate remain lower than their estimated full-employment levels, resulting in negative unemployment and underutilisation gaps (Graph 2.24). These gaps have narrowed over the past year, suggesting the labour market is gradually moving towards full employment. Estimates of the gaps for the June quarter are broadly consistent with the assessment in the August *Statement*. There is substantial uncertainty surrounding estimates of full employment, although each of the model estimates in the suite that we consider implies that the labour market is tighter than full employment.

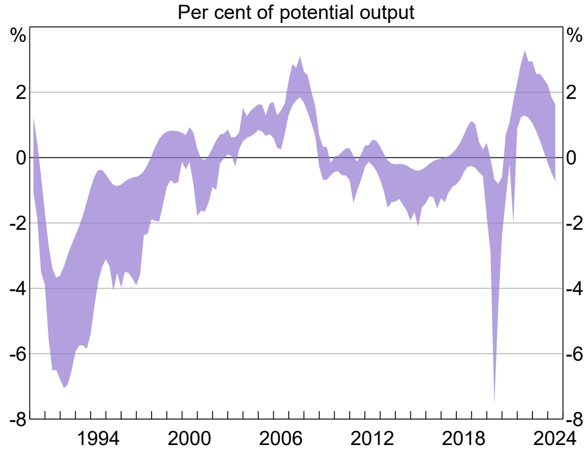
Graph 2.24
Model Estimates of Spare Capacity*



* Blue-shaded region shows illustrative range of central gap estimates from a selection of models; September quarter 2024 values are partial estimates; estimates are subject to substantial uncertainty, as well as revision due to data and model refinements.
Sources: ABS; RBA; Ruberl et al (2021).

A range of model-based estimates suggest the output gap is positive but continues to narrow (Graph 2.25). Recent outcomes for actual output remain higher than estimates of potential output, suggesting aggregate demand continues to exceed the capacity of the economy to sustainably produce goods and services. However, estimates indicate the output gap continued to narrow in the June quarter, reflecting subdued growth in output relative to potential. This narrowing was broadly as expected in the August *Statement*. The range of model estimates for the output gap remains wide, reflecting differences in how individual models interpret the data. Over and above this, each individual model estimate comes with its own range of statistical uncertainty. Therefore, the range of plausible estimates of the output gap is wider than that indicated by the range of model estimates shown in Graph 2.25.

Graph 2.25
Model Estimates of Output Gap*
Per cent of potential output



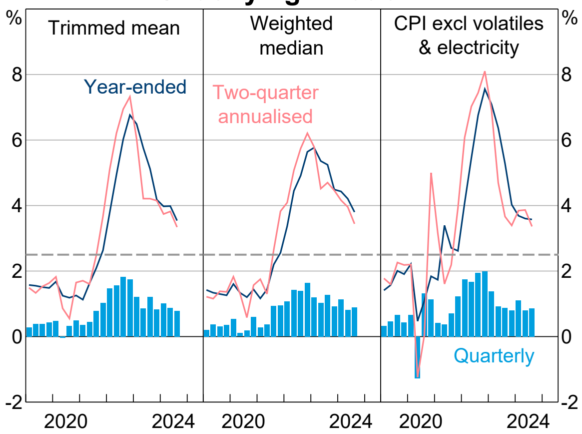
* Violet-shaded region shows illustrative range of central gap estimates from a selection of models encompassing different measures and definitions of the output gap; estimates are subject to substantial uncertainty, as well as revision due to data and model refinements.
Sources: ABS; OECD; RBA.

2.5 Inflation

Underlying inflation remains above the target range but is slowing as expected.

Underlying inflation eased in the September quarter in year-ended terms, though in quarterly terms the pace of decline has been gradual since mid-2023. Trimmed mean inflation eased to 0.8 per cent in the September quarter and was 3.5 per cent in year-ended terms, down from 4.0 per cent in the June quarter (Graph 2.26). These outcomes were broadly as expected in recent *Statements*. The recent slow pace of quarterly disinflation is consistent with the assessment that the labour market remains tight and that aggregate demand exceeds supply, though these gaps have been closing.

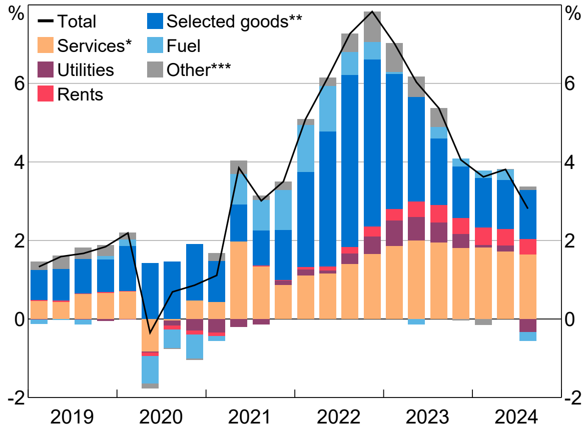
Graph 2.26
Underlying Inflation*



* Dashed line indicates the midpoint of the inflation target.
Sources: ABS; RBA.

Headline inflation has fallen sharply due to federal and state government electricity rebates and declining fuel prices. Headline CPI increased by just 0.1 per cent (seasonally adjusted) in the September quarter, its smallest increase since June 2020 (Graph 2.27). The introduction of new state and federal government electricity rebates and a decline in fuel prices were the main drivers of the low growth rate, subtracting 0.7 percentage points from quarterly inflation in September. In year-ended terms, headline inflation eased to 2.8 per cent in September, down from 3.8 per cent in June. Nonetheless, year-ended headline inflation is expected to increase in the September quarter of 2025 to above the target band as the rebates unwind (as currently legislated).

Graph 2.27
CPI Inflation
Year-ended with contributions

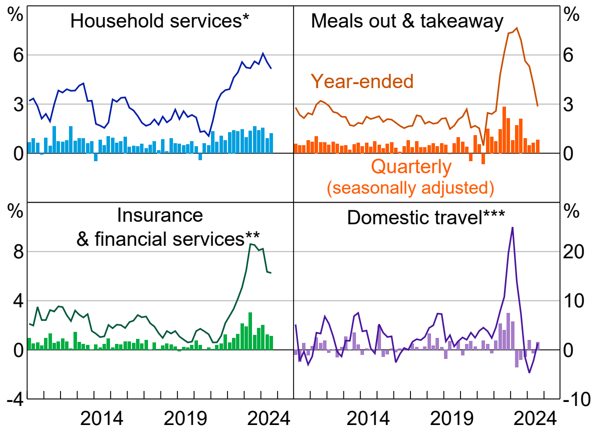


* Includes market services and administered items; excludes utilities, rents and holiday travel & accommodation.
** Includes groceries, alcohol & tobacco, consumer durables and new dwellings.
*** Primarily holiday travel & accommodation.
Sources: ABS; RBA.

Year-ended services inflation eased further, though from a high level.

Market services inflation eased over the year to the September quarter (Graph 2.28). Market services inflation was 1.0 per cent in the September quarter and 4.6 per cent over the year, down from 5.3 per cent (excluding domestic travel and telecommunications). The easing in year-ended inflation was broadly based across most market services. Market services inflation, which remains above its historical average, picked up in quarterly terms, driven by increases in inflation for household services, and meals out and takeaway. These outcomes are consistent with the still-significant pace of growth in domestic non-labour costs and in unit labour costs. Survey measures, including in the RBA's liaison program, suggest that services firms are continuing to pass at least some of this cost growth through to prices, and expect prices growth to ease only modestly over the year ahead.

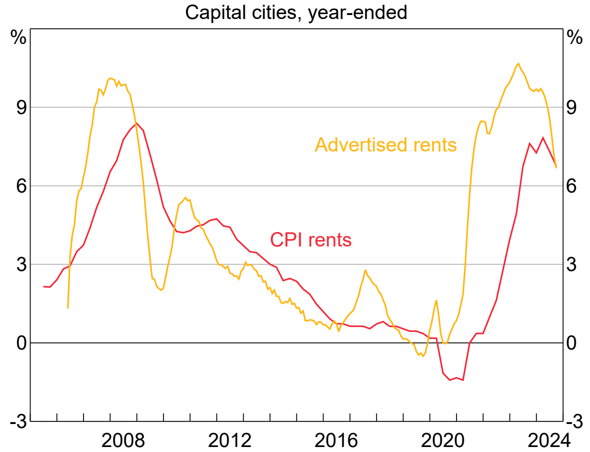
Graph 2.28
Market Services Inflation



* Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.
** Excludes deposit & loans to June quarter of 2011.
*** Imputed using headline CPI in the June and September quarters of 2020 and September quarter of 2021.
Sources: ABS; RBA.

CPI rent inflation remains high but has eased a little, reflecting the gradual pass-through of the slowing in advertised rents. Rent inflation – for the stock of rental accommodation captured in the CPI, which excludes regional areas – was 1.6 per cent in the September quarter and 6.7 per cent over the year, down from 7.3 per cent. The easing in CPI rent inflation has followed a faster-than-expected slowing in advertised rents growth. This reflects slowing growth in demand for housing through an increase in average household size, possibly due to affordability constraints, and slowing population growth. The federal government's 10 per cent increase to Commonwealth Rent Assistance in September has weighed on CPI rent inflation slightly and will also contribute to an easing in the December quarter. CPI rents are expected to ease further over the coming year as the recent slowing in advertised rents growth flows gradually through to CPI rents as leases are updated (Graph 2.29).

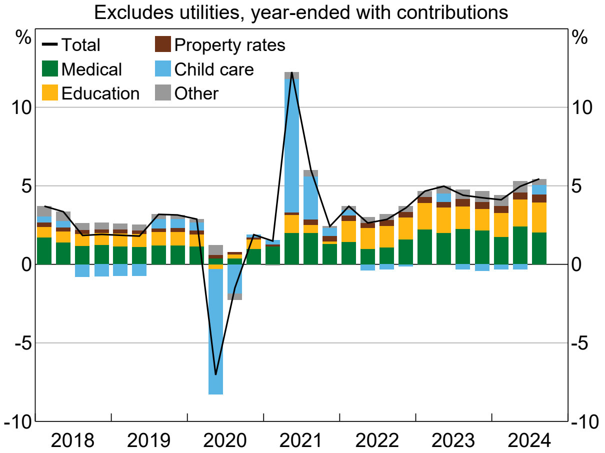
Graph 2.29
Housing Rent Inflation
Capital cities, year-ended



Sources: ABS; CoreLogic; RBA.

Inflation for goods and services with administered prices (excluding utilities) increased over the year to the September quarter. Administered prices are those that are (at least partly) regulated or relate to items for which the public sector is a significant provider. The recent increase in year-ended inflation largely reflected the 2023 changes to the Child Care Subsidy no longer having an effect (Graph 2.30). The earlier strong pace of headline inflation continues to place some upward pressure on year-ended administered price inflation, as some administered prices are indexed to lagged CPI.

Graph 2.30
Administered Price Inflation
Excludes utilities, year-ended with contributions

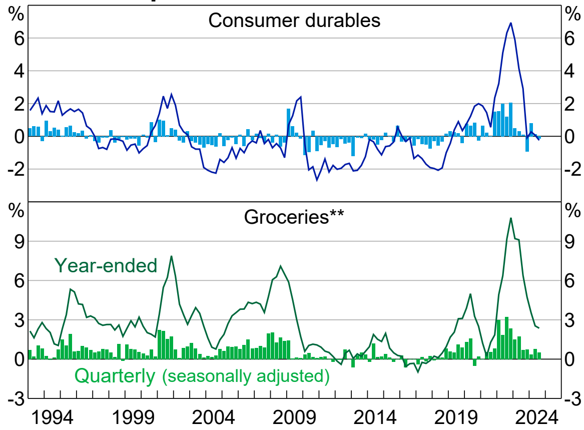


Sources: ABS; RBA.

Goods inflation has eased further.

The pace of retail goods inflation eased a little further in the September quarter. Prices of many household goods have continued to decline in year-ended terms, consistent with some retail firms in liaison reporting they are less able to pass on cost increases to prices given current demand conditions. Consumer durables inflation was stable at around zero in the year to the September quarter, with the earlier easing in price inflation of imported consumption goods having largely flowed through to domestic prices. Groceries inflation (excluding fruit and vegetables) declined a little further and remains around the average level seen over the past decade (Graph 2.31). Global container shipping costs have eased since their July peak, though the cost of shipping a container from China to Australia remains elevated. Shipping costs continue to pose some upside risk to the outlook for domestic retail inflation.

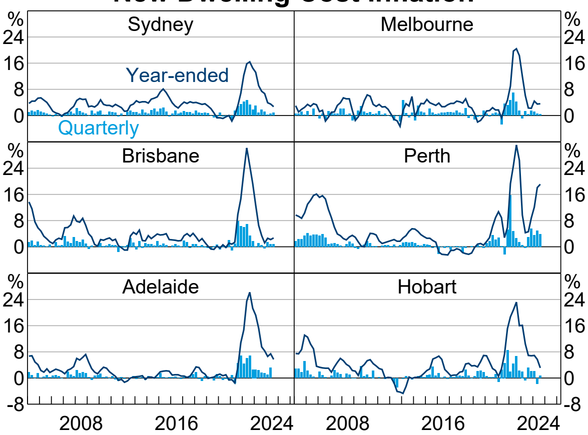
Graph 2.31
Components of Retail Inflation*



* Adjusted for the tax changes of 1999–2000.
** Excludes fruit & vegetables.
Sources: ABS; RBA.

New dwelling cost growth has stabilised at above its pre-pandemic rate. Labour costs continue to contribute to ongoing cost growth, partly driven by the large pipeline of construction work and ongoing labour shortages for certain trades. Outcomes have varied across capital cities. Year-ended new dwelling cost inflation has returned to around its pre-pandemic average in Sydney, Brisbane and Hobart. By contrast, new dwelling cost inflation in Perth has increased further in year-ended terms, consistent with high demand for new homes and increases in labour costs (Graph 2.32).

Graph 2.32
New Dwelling Cost Inflation

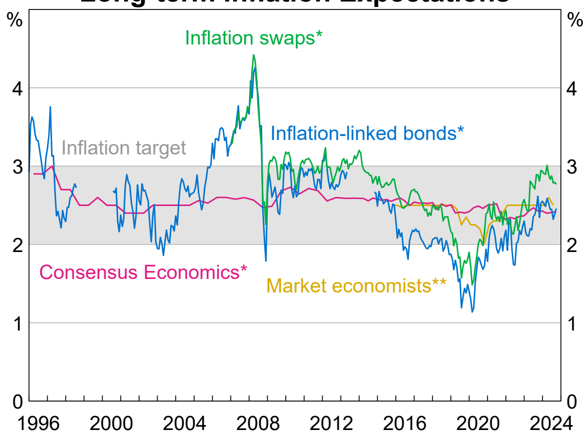


Source: ABS.

Inflation expectations remain consistent with achieving the inflation target over time.

Survey and financial market measures of short-term inflation expectations have declined from their mid-2022 peaks, consistent with declines in actual inflation. Financial market measures of inflation compensation have declined to be close to survey measures of medium- and long-term expectations. Our assessment is that long-term inflation expectations remain anchored at the target (Graph 2.33).

Graph 2.33
Long-term Inflation Expectations



* Average over the five years starting from five years ahead.
** Average over the next 5–10 years.
Sources: Bloomberg; Consensus Economics; RBA.

Endnotes

1 The 2023/24 Annual National Accounts contain the most recent data on GDP. The earlier June quarter 2024 National Accounts contain the most recent data on quarterly movements in GDP.

Box C: Insights from Liaison

This Box highlights key messages collected by teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 260 businesses, industry bodies, government agencies and community organisations over the period from the beginning of August 2024 to the end of October 2024.

Recent liaison discussions suggest that demand from households remains subdued. Investment intentions for the year ahead remain above average but have been wound back in recent months. Contacts report that it has become easier to fill vacancies and voluntary staff turnover rates have declined over the past year, but it is still harder to find and retain suitable labour than before the pandemic. While growth in employment has picked up a little in recent months, hiring intentions for the year ahead have continued to ease. Wages growth and selling price inflation continue to ease gradually, and contacts expect a further modest decline over the year ahead.

Household spending remains subdued.

Households remain budget conscious, reducing non-essential spending, trading down to cheaper items, shopping around more to compare prices and waiting for items to go on sale. Retailers continue to report that trading conditions remain subdued, though a few have reported a marginal improvement in conditions since September. Budget-conscious consumers are generally expected to respond well to promotional events in coming months, such as the Black Friday and Boxing Day sales. Contacts also report subdued demand in hospitality, entertainment and tourism. Households are spending less on experiences and eating out and choosing more affordable options for their holidays.

Community service organisations continue to report that demand for their services remains much higher than usual, due to cost-of-living pressures and a shortage of affordable housing. Contacts expect this heightened demand to continue in the period ahead.

Conditions in the higher education sector have softened over the past year. While domestic university student enrolments have picked up a little recently, international student commencements have declined at some institutions as fewer visas have been approved. The cap on international student commencements is expected to further reduce new enrolments in 2025. In response to this weaker outlook, some providers are reconsidering investment plans and/or staffing requirements.

Detached home building activity is expected to stabilise or pick up over the year ahead, while apartment construction is likely to remain weak.

Builders of new detached homes have generally seen their workload slow in 2024, but many contacts are cautiously optimistic about the outlook for the year ahead. Contacts suggest that demand is likely to pick up when buyers have more certainty around the outlook for interest rates, and most contacts expect new home sales to either stabilise or pick up over the next 12 months. There is, however, considerable variation in conditions across states because of factors such as population flows, relative affordability and policy changes. Builders in Western Australia, South Australia and Queensland report relatively stronger conditions and are more confident about the outlook for sales, whereas builders in New South Wales and Victoria are experiencing relatively weaker demand and express more uncertainty around the outlook.

Apartment construction activity remains low and is expected to continue to be subdued in the year ahead. Many potential developments are currently on hold as they are not considered financially feasible because construction costs are too high relative to selling prices. Contacts attribute high construction costs to both labour and materials, a decline in productivity, prolonged build times and the cost of finance. While inflation in materials costs has slowed, the cost and availability of labour remains a challenge in some areas.

Investment intentions have continued to soften but remain above average.

A growing proportion of firms report that they plan to reduce investment in the year ahead, though overall investment intentions remain above average. Firms reducing their investment attribute this to cost pressures, a weak demand outlook and broader macroeconomic uncertainty. Contacts that report stronger investment plans for the year ahead tend to be investing in new industrial buildings, renewable energy infrastructure, automation and software.

Some firms expect engineering construction to moderate over the year ahead. This is because a few large public transport infrastructure projects have been completed, descoped or deferred, and fewer new projects have been announced. Renewables investment has also been slower to ramp up than many contacts had expected. There continues to be a significant pipeline of infrastructure work to keep many larger engineering firms busy, but some smaller firms are having to compete more intensively than in recent years.

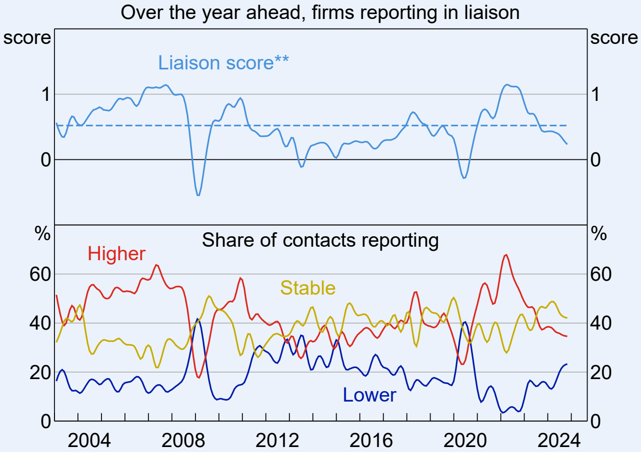
Hiring intentions for the year ahead have continued to ease.

While employment growth among liaison contacts has picked up a little over the past quarter, employment intentions for the year ahead have drifted lower and are below their long-run average. Contacts attribute the easing in hiring intentions to a greater focus on cost containment and their efforts to improve productivity, or to weaker demand. While most contacts expect headcount to remain stable or increase a little, a growing number of contacts expect headcount to decline over the year ahead (Graph C.1). Many of these organisations are not planning layoffs but where possible would like to avoid replacing staff who leave voluntarily.

Graph C.1

Employment Intentions*

Over the year ahead, firms reporting in liaison



* Smoothed with a 13-month Henderson trend.

** Dashed line shows average since 2003; a score of 0 indicates no change.

Source: RBA.

Contacts report that labour availability has improved further over recent months and voluntary staff turnover rates have continued to decline. An increasing number of contacts report that it has been easier to fill positions compared with the same time last year, with improvements noted in both the quantity and quality of candidates. However, contacts indicate the labour market remains tight relative to the period prior to the pandemic and finding suitable labour remains a challenge for many organisations, particularly in the smaller states and in regional areas.

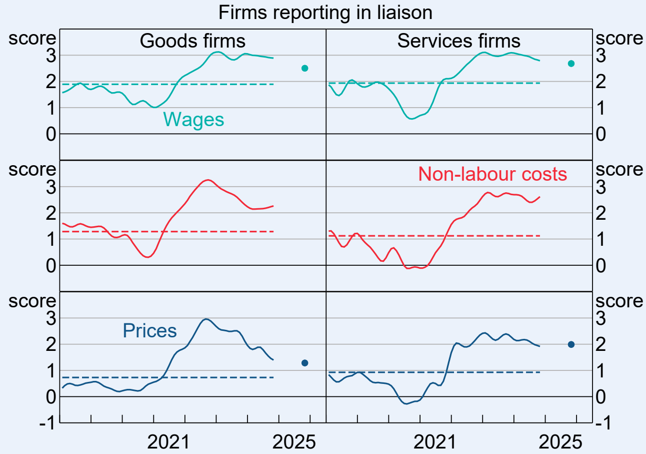
Growth in wages and selling prices continues to ease gradually.

Liaison suggests that wages growth has slowed a little over recent quarters (Graph C.2). Most contacts expect wages growth to continue to moderate gradually over the year ahead, as inflation continues to ease and labour market conditions soften further.

Graph C.2

Costs and Prices*

Firms reporting in liaison



* Solid lines are outcomes over the 12 months before each observation, with the series averages since 2003 shown as dashed lines; dots are expectations over the next 12 months from October 2024; smoothed with a 13-month Henderson trend; a score of 0 indicates a firm has reported no change; excludes mining.

Source: RBA.

The pace of growth in non-labour costs is similar to a year ago, for both goods and services firms. A number of contacts have reported increasing costs related to managing compliance and regulatory obligations. Services firms generally expect growth in their non-wage costs to remain above average over the year ahead; this largely reflects an expectation of continued strong growth in fees from labour-intensive suppliers, such as contractors, consultants and software providers. Goods firms expect growth in their non-labour costs to slow over the year ahead, as the general easing in inflation and the more subdued demand environment lessens upward price pressures from their suppliers.

Inflation in selling prices has eased for both goods and services firms over the past year. Contacts generally expect selling price inflation to decline modestly over the year ahead, though the extent of easing is expected to be more gradual than was the case at the time of the August *Statement*.

Chapter 3
Outlook

Summary

- **The outlook for inflation and the unemployment rate in Australia is broadly unchanged from the August *Statement*.** The economy is still assessed to be operating above capacity; however, as the economy and labour market move towards a better balance between overall supply and demand, there is more uncertainty around this assessment.
- **Underlying inflation is expected to return to the target range of 2–3 per cent in mid to late 2025 and to the midpoint of the target in late 2026.** Inflationary pressures are expected to ease as demand and supply in the economy return to balance, although the pace of disinflation is expected to be gradual.
- **Headline inflation is expected to temporarily be within the target band over the coming year, owing primarily to cost-of-living support measures provided to households.** However, year-ended headline inflation is then expected to increase in the second half of 2025 to be above the target band when energy rebates are scheduled to end, before moving in line with underlying inflation once these temporary effects have passed.
- **Labour market conditions remain tight but are expected to return to balance by late 2025.** The unemployment rate is forecast to increase gradually over the coming year, consistent with subdued economic growth. While this assessment is little changed from the August *Statement*, the earlier easing in some labour market indicators has stalled recently and this presents some risk that labour market conditions ease by less than expected. Wages growth is expected to continue slowing gradually alongside an easing in labour market conditions.
- **GDP growth is expected to return to around its potential growth rate by late 2025.** The recovery in domestic activity over the coming year is expected to be less pronounced than forecast in the August *Statement*. While consumption growth is still expected to pick up alongside rising real household incomes, recent data suggest that this is likely to occur slightly later than previously envisaged.
- **The tightening in student visa policy is expected to result in growth in net overseas migration slowing materially from its current strong pace.** This slowing in population growth is expected to weigh on GDP growth from mid-2025. However, it will also reduce the economy's supply capacity, such that there will not be a material effect on the degree of spare capacity in the economy and therefore inflation.
- **Forecast growth in major trading partners has been revised slightly higher for 2025 compared with three months ago, largely due to the announcement by Chinese authorities of a sizeable stimulus package.** Otherwise, the outlook for trading partner growth is little changed. Growth in most G7 economies in 2025 is expected to continue to recover gradually as household consumption picks up, while growth in the United States is expected to ease from its current strong rate. Inflation is forecast to continue to ease in advanced economies, with many central banks now more confident that inflation will return sustainably to target.

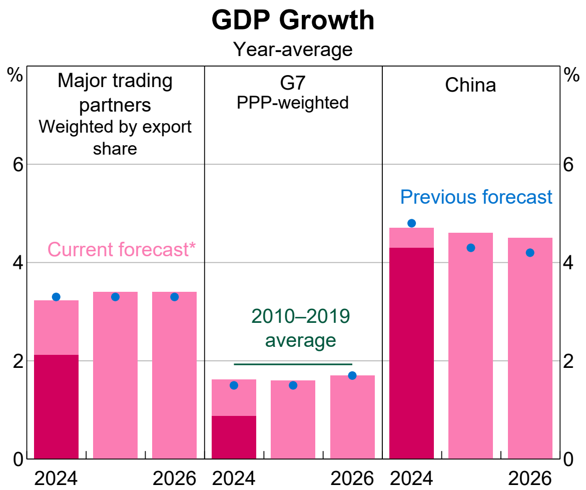
- **There are risks on both sides of the global and domestic outlook.** The outlook internationally remains highly uncertain given heightened geopolitical risks and potential changes to trade and fiscal policies; notwithstanding these, the risks to the global outlook are less tilted to the downside relative to three months ago. Domestically, if low productivity growth persists over the next couple of years, inflation could take longer to return to target and GDP growth could also be lower. The timing and pace of the recovery in private demand could also be later than projected, which would flow through to labour market and inflation outcomes.

3.1 The global outlook

Growth in Australia's major trading partners has been revised up slightly following the announcement of stimulus measures by Chinese authorities.

Overall GDP growth for Australia's major trading partners is expected to be moderate, at close to 3½ per cent in 2025 and 2026 (Graph 3.1). The outlook has been revised slightly higher relative to three months ago, as upward revisions to growth in China have been only partially offset by downward revisions to growth in New Zealand and India (for 2026).

Graph 3.1



* Darker bar indicates the contribution to 2024 year-average growth from realised quarterly outcomes; 2024:Q2 latest data for all economies except China, where 2024:Q3 data is included.

Sources: ABS; CEIC Data; Consensus Economics; LSEG; RBA.

GDP growth in China has been revised higher, mainly reflecting recently announced economic policy support. While full details on the size and composition of further fiscal support are yet to be announced, our China forecasts assume that around CNY2 trillion (or 1.6 per cent of GDP) of additional central and local government fiscal support could be provided, alongside measures announced by the central bank and Chinese regulators. We expect this support will boost consumption and manufacturing investment and offset a weakening outlook for infrastructure investment. Policy support is expected to materially impact growth from 2025. Risks to the outlook for growth in China have become more balanced since the announcement of the stimulus. However, structural headwinds to the economy, such as ongoing weakness in real estate and local government financial conditions, could still intensify.

Growth in most G7 economies is expected to pick up a little in 2025, except for the United States. GDP growth in G7 economies overall is expected to be supported by stronger real income growth and easing financial conditions but is forecast to remain below pre-pandemic decade averages. Following a period of strong growth, US GDP growth is forecast to slow a little further in coming quarters, before picking up as financial conditions continue to ease; Consensus forecasts for US growth in 2025 are a little weaker than the latest Federal Reserve forecasts.

Many advanced economy central banks are easing policy settings as they have become increasingly confident that inflation is returning sustainably to targets and with some noting emerging downside risks. While central banks generally expect only modest increases in unemployment rates from current levels, many have become more attentive to downside risks to the labour market and inflation; labour market conditions remain tighter in Australia than in other advanced economies. Inflation in New Zealand, Canada and Sweden is now assessed to be around target and is expected to remain there in the forecast period (for Sweden, this abstracts from a temporary drag from energy prices). Inflation is expected to approach the target next year in the euro area, in 2026 in the United States and United Kingdom, and in 2027 in Norway.

3.2 Key domestic judgements

The central forecasts incorporate many judgements, such as the choice of models used and whether to deviate from the models given the signal from recent data or qualitative information from liaison. These judgements are considered and debated extensively throughout the forecast process. The three most important judgements for the staff's current assessment of the economic outlook are discussed below.

Key judgement #1 – Household consumption growth will recover in line with growth in real incomes, but a bit later than forecast in the August *Statement*.

The weak consumption outcome in the June quarter and partial data for the September quarter suggest that momentum in consumption growth has been weaker than expected in the August *Statement*. The staff judge that this reflects a combination of underlying weakness and the unwinding of one-off spending in the March quarter (see Chapter 2: Economic Conditions). The underlying weakness may reflect a greater degree of precautionary saving by households than had been assumed, or that it may take more time than expected for household spending to pick up following the earlier stabilisation of real incomes and recent tax cuts. Weighing these considerations up, the staff have taken some signal from recent outcomes, with the level of consumption per capita in the near term revised down from three months ago and the saving rate revised up. Further out, we continue to judge that the pick-up in real income and wealth will boost consumption growth, such that by 2026, consumption per capita and the saving rate return towards the levels expected at the August *Statement*.

Key judgement #2 – The labour market will continue to ease at a gradual pace and then stabilise following the pick-up in GDP growth.

The unemployment rate is forecast to gradually increase over the coming year, consistent with subdued growth in economic activity and the signal from some leading indicators of labour demand, including vacancies and hiring intentions.

We judge that part of the adjustment to easing labour demand will continue to occur through lower vacancies (which are still elevated) and average hours worked. While the rate of layoffs has increased, it remains at a low level relative to history. It is judged that this will likely remain the case while vacancies remain high, and so the easing in labour demand can be partly absorbed by a decline in vacancies without a large increase in the unemployment rate. While unemployment could rise sharply if businesses have been hoarding labour and reach a tipping point, there is little evidence that this has been occurring on a large scale: survey measures of capacity utilisation remain above average and vacancies and average hours are at or above their long-run trends.

In recent months, some labour market indicators, such as the underemployment rate, suggest that the labour market could have stopped easing. If labour underutilisation does not increase by as much as anticipated, this could slow disinflation progress given the assessment that there is currently excess demand in the labour market. However, staff have judged that there is enough evidence across the full suite of indicators for further gradual easing in labour market conditions.

Key judgement #3 – The unemployment and output gaps will gradually close, bringing inflation back to target.

Estimates of how far the economy is from sustainable full employment or potential output are important considerations for the wages and inflation outlook, but are subject to considerable uncertainty. Moreover, as economic conditions have eased and the economy and labour market have moved towards a better balance, it becomes more difficult to conclude if the economy is operating at above or below capacity.

The current assessment is that there is excess demand in the labour market. However, the gradual increase in the unemployment rate over the forecast period is judged to see the labour market return to around the level consistent with full employment in late 2025. In the broader economy, a period of subdued economic growth has quickly reduced excess demand; however, it is assessed that parts of the economy remain tight. Further weakness in aggregate demand is expected to bring the economy closer to balance. These outcomes are based on an assumption that trend labour productivity growth picks up. Risks around this judgement are discussed in section 3.4 Key risks to the outlook.

3.3 The domestic outlook

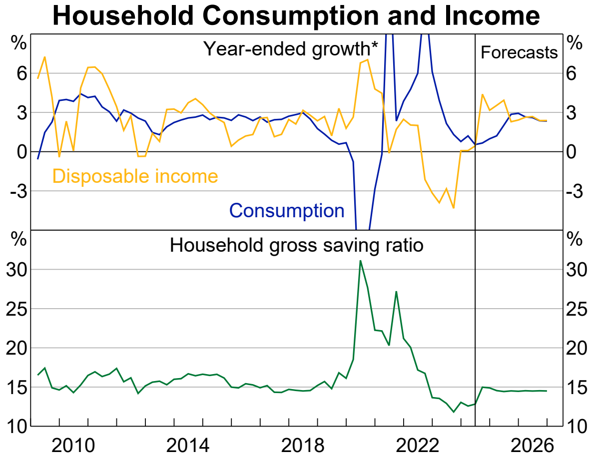
Growth in domestic demand is expected to pick up as growth in household consumption recovers and public demand continues to support activity.

The forecasts are conditioned on a cash rate path derived from financial market pricing; it is assumed that the cash rate has peaked, with market pricing implying little chance of a further increase. The cash rate is assumed to begin to decline around mid-2025, and to decline to around 3.5 per cent by the end of 2026. This is a little higher than the assumption underpinning the forecasts in August. The pick-up in private demand is driven by an increase in household consumption growth, which is expected to reach its pre-pandemic decade average in late 2025 (excluding the effect of cost-of-living subsidies, see below), driven by growth in real incomes as the Stage 3 tax cuts take effect and inflation eases.

The pick-up in private demand is expected to occur a little later than in the August *Statement*, driven by a slower recovery in household consumption. This slower recovery reflects a reassessment of household consumption and savings momentum following the unexpectedly weak consumption outcome in the June quarter and partial data for the September quarter. These data suggest that households will save slightly more of their income in the second half of 2024 than was previously assumed (Graph 3.2). A lower assumption for resident population growth is expected to weigh a little on aggregate household consumption growth in 2026.

Cost-of-living subsidies will lower measured household consumption growth in the September quarter of this year before boosting it in 2025. The official statistical treatment of the cost-of-living subsidies provided to households will have the effect of reallocating measured spending between household and public consumption. This is expected to reduce measured household consumption growth in the September quarter of 2024 by around 0.4 percentage points, before adding to household consumption growth in 2025 as the subsidies unwind (as currently legislated). The impact of this reallocation was factored into the August *Statement* forecasts.

Graph 3.2

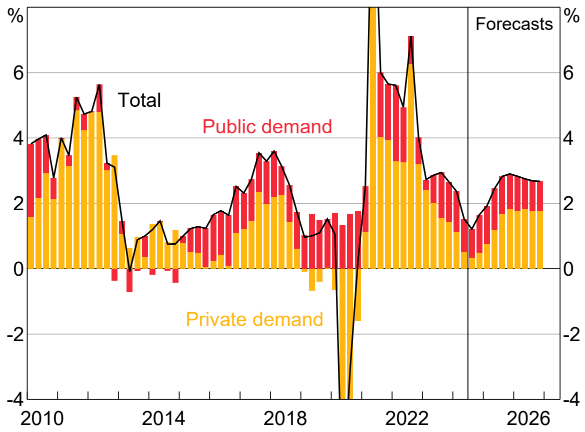


* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

The outlook for private investment is broadly similar to the August *Statement*. Business investment is expected to stabilise around current levels over the year ahead. Information from the RBA's liaison program and the ABS Capital Expenditure Survey suggests that firms have moderated their investment intentions for the year ahead in response to persistent construction cost pressures and delays to renewable energy projects. By contrast, the level of dwelling investment is expected to be higher than previously expected in the near term, consistent with the pick-up in building approvals over the past year. The effect of construction cost pressures on business investment has been slower to materialise than for dwelling investment, consistent with the shorter lead times for detached housing projects and the sustained period of headwinds to household incomes. Private investment is expected to pick up from late 2025, supported by the assumed decline in the cash rate, the large pipeline of infrastructure work, digitisation and the renewable energy transition.

Public spending is expected to continue supporting aggregate economic growth. Growth in public consumption is expected to remain robust over coming years, supported by the provision of government services to households, with the outlook similar to three months ago (Graph 3.3). The near-term outlook for growth in public investment is weaker, with investment expected to stabilise following the completion of some major projects; information from liaison suggests that some projects have been deferred. However, this weakness is expected to be temporary given investment spending announced in government budgets and the large pipeline of engineering work yet to be done.

Graph 3.3
Domestic Final Demand Growth*
Year-ended with contributions

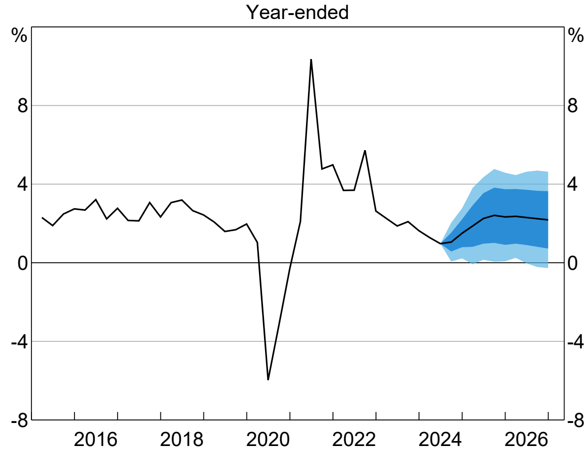


* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

The outlook for growth in net overseas migration has been revised down, which will reduce growth in both demand and supply in the economy from mid-2025.

In addition to the near-term downward revisions to GDP growth stemming from weaker private demand, GDP growth has been revised down from mid-2025 in line with slower expected growth in net overseas migration (Graph 3.4). The lower forecast for net overseas migration primarily reflects the impact of a range of international education policies, which includes a tightening in student visa policy; the effects of which has started to become apparent in timely data (see Chapter 2: Economic Conditions). This has driven a downwards revision to the outlook for international education exports from mid-2025. The outlook for other migration has also been revised down and this is expected to weigh a little on household consumption. Lower population growth also reduces the supply capacity of the economy given the propensity of migrants to work; this suggests that there will not be a material impact on the amount of spare capacity in the economy over the medium term.

Graph 3.4
GDP Growth Forecast*
Year-ended



* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.
Sources: ABS; RBA.

Demand and supply are expected to move closer to balance over the forecast period.

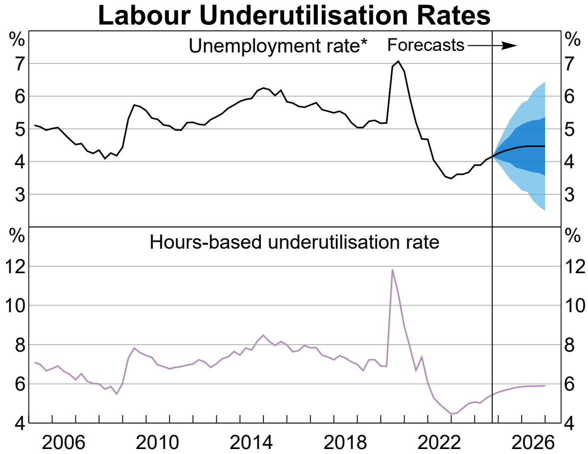
It is assessed that there is still excess demand in parts of the economy, but the economy will gradually approach balance. The output gap is expected to narrow further, particularly in the near term alongside subdued growth in aggregate demand, and close by the end of the forecast period, although there is considerable uncertainty around this projection. The staff's assumption for potential output growth reflects a decline in population growth from its current high rate being largely offset by an increase in trend productivity towards its pre-pandemic decade average. There are large risks around the outlook for supply capacity, which are explored in section 3.4 Key risks to the outlook.

The labour market is expected to continue to ease over the next year before stabilising at a level consistent with full employment estimates. This outlook is little changed from the August *Statement*.

Labour underutilisation rates are expected to increase gradually alongside subdued growth in economic activity. The unemployment rate is forecast to increase further over coming quarters, consistent with the recent easing in some leading indicators of labour demand, including job vacancies and employment intentions (Graph 3.5). Supported by the gradual pick-up in GDP growth, the unemployment rate is expected to stabilise at around 4½ per cent, which is consistent with the staff's estimates of full employment.

Graph 3.5

Labour Underutilisation Rates



* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Growth in employment and the labour force are both expected to ease in the medium term. Participation in the labour force, which has been higher than expected in recent months, is now judged to pick up a little more in the near term, reflecting solid employment opportunities as well as cost-of-living pressures faced by households. Further out, the participation rate is expected to continue to increase very gradually, as the continued trend of increased participation by females and older workers is partially offset by some discouraged workers leaving the labour force as demand conditions eases.

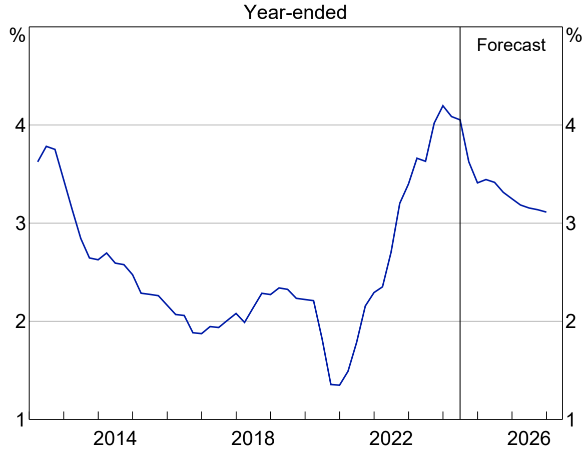
Growth in nominal wages is expected to moderate further as the labour market eases.

Wages growth has passed its peak and is expected to slow further as the labour market eases. The quarterly pace of wages growth eased a little more than expected in the June quarter, and points to slightly lower wages growth over the second half of 2024 than previously expected (Graph 3.6). The 3.75 per cent increase to modern award wages, effective from 1 July, is a step down in award-linked wages growth compared with the previous year. Further easing in the labour market is also expected to continue to put downward pressure on wages growth, consistent with information from liaison that employers expect a further slowing in wages growth in the coming year. The pace of nominal wages growth is expected to remain high relative to productivity growth outcomes in the near term, before gradually easing towards the end of the forecast period to a pace that is consistent with inflation remaining sustainably within the target range. However, the sustainable level of wages growth in the medium term depends on underlying trend productivity growth, as discussed in section 3.4 Key risks to the outlook.

Graph 3.6

Wage Price Index Growth*

Year-ended



* Seasonally adjusted.

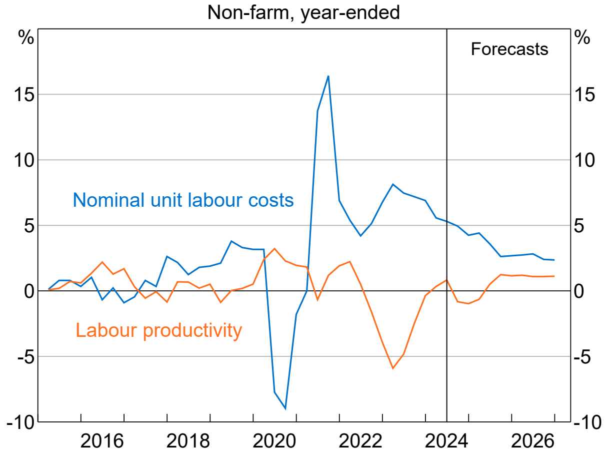
Sources: ABS; RBA.

Growth in unit labour costs is expected to moderate from its high rate over the coming years. Growth in nominal unit labour costs (ULCs) – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – is expected to ease as nominal wages growth gradually eases (Graph 3.7). Weak productivity outcomes are also expected to contribute to ULCs growth remaining elevated. Growth in ULCs is expected to remain a little above the rate consistent with achieving the inflation target until the latter half of 2026.

Graph 3.7

ULC and Productivity Growth*

Non-farm, year-ended



* Seasonally adjusted.

Sources: ABS; RBA.

Labour productivity growth in the second half of 2024 is assumed to be weaker than previously anticipated; there is significant uncertainty around the longer term outlook. The weaker near-term outlook reflects the lower forecast for GDP growth but continued solid employment growth. The strength in healthcare employment has had a small drag on measured aggregate productivity growth in recent years, and this effect is likely to continue. The productivity outlook further out is little changed. Productivity growth is assumed to pick up in the medium term to reach its long-term (excluding the pandemic) average rate (see section 3.2 Key domestic judgements). The forecasts assume multifactor productivity growth will rebound over the next couple of years, which would be consistent with increased rates of technology adoption, improved reallocation of labour between low- and high-productivity firms, improved labour quality and improved quality of job matching. However, there are risks to the outlook for productivity that will have implications for inflation outcomes (see section 3.4 Key risks to the outlook).

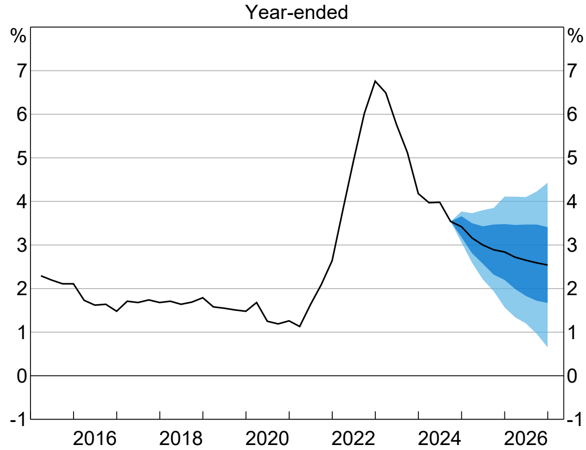
Underlying inflation has continued to moderate and is expected to ease further. The outlook for underlying inflation is little changed from the August *Statement*.

Underlying inflation – as measured by trimmed mean inflation – is expected to return to the target range in mid-to-late 2025 and to the midpoint of the target in late 2026 (Graph 3.8). The output and unemployment gaps are projected to narrow and close over the forecast period, and growth in unit labour costs is expected to ease, which would help bring the economy back towards a balanced position and inflation back to target. Inflation expectations are assumed to remain consistent with achieving the inflation target over this timeframe.

Graph 3.8

Trimmed Mean Inflation Forecast*

Year-ended

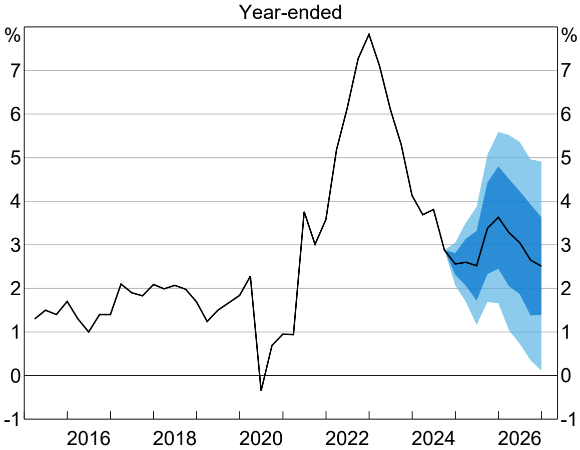


* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Year-ended headline inflation is expected to temporarily be within the target range, before rising again in the second half of next year. Governments' cost-of-living measures – electricity rebates and increases to rent assistance – reduced headline inflation in the September quarter and will also weigh on inflation in the December quarter (Graph 3.9). However, year-ended headline inflation is expected to increase when the electricity rebates are scheduled to unwind next year, which would see headline inflation increase sharply to be back above the target range in the second half of 2025, before converging towards underlying inflation once these temporary factors have passed. Because headline inflation can be affected by large swings in the prices of individual items, the RBA continues to pay close attention to underlying measures of inflation.[1]

Graph 3.9
Headline Inflation Forecast*
Year-ended



* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Services inflation remains high and is expected to decline only gradually over the coming year. Strong domestic cost pressures (both labour and non-labour inputs) have kept services inflation outcomes high in recent quarters. The more gradual decline in services inflation relative to the earlier decline in goods inflation is in line with trends in other advanced economies. However, cost pressures are expected to ease alongside a softening in labour market conditions, contributing to a gradual easing in market services inflation over the forecast period. Inflation of administered items (excluding utilities) is expected to ease a little in the coming year since the prices of some items are indexed to past headline inflation, which has declined.

Housing inflation is expected to moderate from a high level over the forecast period, and to ease a little more quickly than expected in the August *Statement*. Tightness in the rental market is now forecast to unwind a bit more quickly than expected in August, due to increases in average household size (possibly linked to affordability constraints) and slowing population growth. Despite the recent sharp slowing in advertised rent inflation, CPI rents inflation is expected to remain elevated for a time as rents on new leases gradually flow through to the stock of rents in the CPI. New dwelling cost inflation is expected to moderate as capacity constraints, such as shortages for skilled trades, gradually abate. However, in some capital cities, particularly Perth, these capacity constraints are expected to take longer to ease.

Goods inflation has eased and is expected to stabilise at a relatively modest pace during the forecast period. The earlier easing in imported inflation as global supply chains normalised last year has flowed through to domestic goods prices. Growth in domestic labour and non-labour costs is moderating, and information from liaison suggests that softer demand conditions have meant that retailers are less able to pass on increases in costs. While there has been little evidence from liaison that elevated shipping costs are flowing through to retail prices, there have been some reports of retailers' margins being affected by recent shipping cost rises over the past few months.

3.4 Key risks to the outlook

The risks to the domestic outlook for activity and inflation are broadly balanced.

While we view the risks to the outlook overall as balanced, there is always considerable uncertainty about key judgements and broader conditions. Staff have considered a range of plausible ways in which the economy could evolve differently to our base case or central forecast, and the likely effects this could have on our inflation and employment objectives.

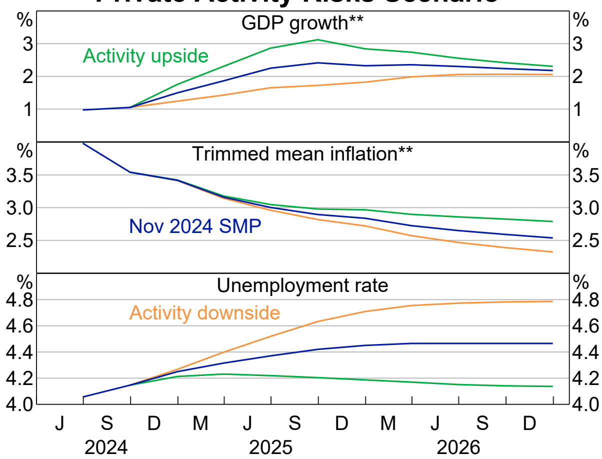
Key risk #1 – The period of subdued growth in private activity could be more persistent, or the recovery in private activity could be much stronger.

The central forecast is for a gradual recovery in private demand following a period of subdued growth.

However, the recent weak consumption data suggests it is possible that consumers are even more cautious and constrained than the central forecasts assume, and they may choose to save more of their growth in income. There is also a risk that large investment projects may be delayed even further than we have assumed if persistent construction cost pressures and weak consumer demand mean that construction projects do not become more economically feasible. This could prolong the period of below-trend GDP growth. The staff considered a scenario of weaker consumption and investment growth using the MARTIN model. GDP growth would be approximately 0.5 and 0.1 percentage points lower over 2025 and 2026, and the increase in the unemployment rate would be more pronounced. This would see a period of excess supply or spare capacity in the economy, which would imply inflation could reach the midpoint of the target by mid-2026 (without any change to the cash rate path that underpins the central forecast).

Alternatively, growth in private aggregate demand could rebound more quickly than forecast. Households may respond more strongly than expected to the near-term pick-up in household incomes if a greater share of households have become liquidity constrained in recent years than thought, or because households are willing to save less out of their current income following the significant increases in wealth (including a large stock of savings) since the onset of the pandemic. Business investment may pick up more quickly than expected, in part due to improved business sentiment spurred by improving consumer demand. In the 'higher private activity' scenario, the unemployment rate would remain below estimates of full employment over the forecast period. As such, progress in reducing inflation would be slower, with the scenario showing trimmed mean inflation in the top half of the target range at the end of 2026 (Graph 3.10).

Graph 3.10
Private Activity Risks Scenario*

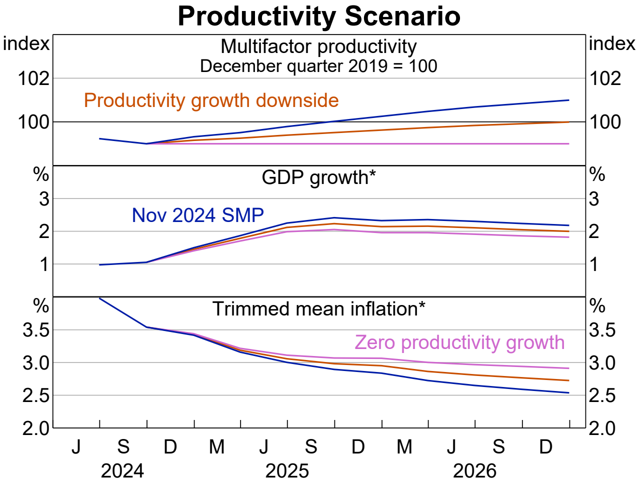


* Scenario assumes upside and downside risks to business investment and consumption; scenario assumes exchange rate and policy path are fixed to November SMP assumptions.
** Year-ended.
Sources: ABS; RBA.

Key risk #2 – Weak productivity growth could slow progress on disinflation.

It is possible that we are overestimating the degree of supply capacity in the economy over the next few years because productivity growth may not return to its long-run average growth rate as currently assumed. The staff's assumption for potential output growth assumes that a decline in population growth from its current high rate will be largely offset by an increase in trend productivity. However, productivity growth has been weaker than expected in recent years (see Box D: Annual Review of the Forecasts). Staff considered two scenarios of weaker multifactor productivity growth: 'moderate' multifactor productivity growth assumes the average growth over the five years before the pandemic, while 'zero' multifactor productivity growth is a continuation of recent outcomes (Graph 3.11).

Graph 3.11



* Year-ended.
Sources: ABS; RBA.

Lower productivity growth would be inflationary because it is expected to cause a greater reduction in the supply capacity of the economy than in GDP growth. This is because it would take households, businesses and governments some time to adjust their saving, spending and investment decisions to the weaker productivity outlook. In both downside scenarios, GDP growth is moderately weaker by the end of the forecast period (Graph 3.11). Under the zero productivity assumption, the progress of disinflation would be expected to slow sharply, and inflation would be at the upper bound of the band by end 2026.

Key risk #3 – Global uncertainty creates two-sided risks to the domestic outlook.

The global outlook remains highly uncertain given heightened geopolitical risks and potentially large changes to the global trade and fiscal policy outlook during the forecast period. If such shocks materialise, they could have significant effects on the outlook for activity and inflation in Australia.

An intensification of regional conflicts could disrupt trade and lead to sustained increases in shipping costs or commodity prices, while also lowering global growth. This would result in higher inflationary pressure domestically by further constraining the supply capacity of the economy (e.g. given the supply chain issues that are already affecting construction activity).

There is also uncertainty around the degree of fiscal stimulus in the global economy over the next couple of years. If the Chinese fiscal stimulus is considerably larger than currently assumed in our central forecast, this will boost domestic growth (and inflation) through trade and commodity linkages (see Box B: Economic Policy Developments in China). In such a scenario, domestic activity would be boosted by higher exports and export prices, although there would be little upside to the volume of resource exports unless mining capacity was expanded. Ultimately, the size of the boost to the domestic economy from a large Chinese stimulus package would depend on both the response of the exchange rate (which would typically appreciate) as well as how governments respond to any unexpected commodity price revenue.

3.5 Detailed forecast information

Table 3.1 provides additional detail on forecasts of key macroeconomic variables. The forecast table from current and previous *Statements* can be viewed, and data from these tables downloaded, via the Statement on Monetary Policy – Forecast Archive.

Table 3.1: Detailed Forecast Table[(a)]

Percentage change through the four quarters to quarter shown, unless otherwise specified[(b)]

	Jun 2024	Dec 2024	Jun 2025	Dec 2025	Jun 2026	Dec 2026
Activity						
Gross domestic product	1.0	1.5	2.3	2.3	2.3	2.2
Household consumption	0.5	1.0	2.0	2.9	2.6	2.3
Dwelling investment	−3.0	−0.7	−0.9	0.5	1.3	2.0
Business investment	2.2	0.0	0.8	1.7	2.6	3.1
Public demand	3.6	4.0	4.4	3.7	3.1	3.0
Gross national expenditure	2.2	2.0	2.5	3.0	2.7	2.6
Major trading partner (export-weighted) GDP	3.1	3.2	3.5	3.5	3.4	3.3
Trade						
Imports	5.2	7.2	3.9	5.1	4.0	2.9
Exports	0.1	3.2	2.7	2.3	2.4	1.2
Terms of trade	−3.9	−5.7	−2.2	−0.7	−1.2	−1.1
Labour market						
Employment	2.4	2.6	2.2	1.4	1.3	1.3
Unemployment rate (quarterly, %)	4.1	4.3	4.4	4.5	4.5	4.5
Hours-based underutilisation rate (quarterly, %)	5.3	5.6	5.7	5.9	5.9	5.9
Income						
Wage Price Index	4.1	3.4	3.4	3.2	3.2	3.1
Nominal average earnings per hour (non-farm)	5.9	3.1	4.2	3.9	4.0	3.5
Real household disposable income	0.4	3.2	3.9	2.4	2.7	2.4
Inflation						
Consumer Price Index	3.8	2.6	2.5	3.7	3.1	2.5
Trimmed mean inflation	4.0	3.4	3.0	2.8	2.7	2.5
Assumptions						
Cash rate (%)[(c)]	4.3	4.3	4.1	3.7	3.5	3.5
Trade-weighted index (index)[(d)]	62.6	61.8	61.5	61.5	61.5	61.5
Brent crude oil price (US$/bbl)[(e)]	85.0	72.4	71.6	71.6	71.6	71.6
Estimated resident population[(f)]	2.2	1.9	1.6	1.2	1.1	1.3
Memo items						
Labour productivity[(g)]	0.8	−1.0	0.5	1.1	1.1	1.1
Household savings rate (%)[(h)]	0.6	3.2	2.7	2.7	2.7	2.7
Real Wage Price Index[(i)]	0.2	0.8	0.9	−0.4	0.1	0.6
Real average earnings per hour (non-farm)[(i)]	2.0	0.6	1.6	0.2	0.9	1.0

(a) Forecasts finalised on 30 October.

(b) Forecasts are rounded to the first decimal point. Shading indicates historical data.

(c) The cash rate is assumed to move in line with expectations derived from financial market pricing. Prior to the May *Statement*, the cash rate assumption also reflected information derived from surveys of professional economists. For more information, see A Change to the Cash Rate Assumption Method for the Forecasts.

(d) The daily exchange rate (TWI) is assumed to be unchanged at its current level going forward.
(e) Oil prices are assumed to remain constant at the current price over the current quarter. For the rest of the forecast period oil prices are expected to remain around the price implied by the six-month-forward rate.
(f) The population assumption draws on a range of sources, including partial indicators from the Australian Bureau of Statistics, migration policies, and estimates made by the Australian Government.
(g) GDP per hour worked (non-farm).
(h) Household savings ratio refers to the ratio of household saving (disposable income minus consumption) to household disposable income, net of depreciation.
(i) Real Wage Price Index and non-farm average earnings per hour worked are both deflated by Consumer Price Index.
Sources: ABS; Bloomberg; CEIC Data; Consensus Economics; LSEG; RBA.

Endnotes

1 See RBA (2024), 'Box C: Headline and Underlying Inflation', *Statement on Monetary Policy*, August.

Box D: Annual Review of the Forecasts

Each year, a review of the RBA staff economic forecasts is undertaken to assess what we have learned about the economy and the forecasting approach, with a view to continuous improvement.

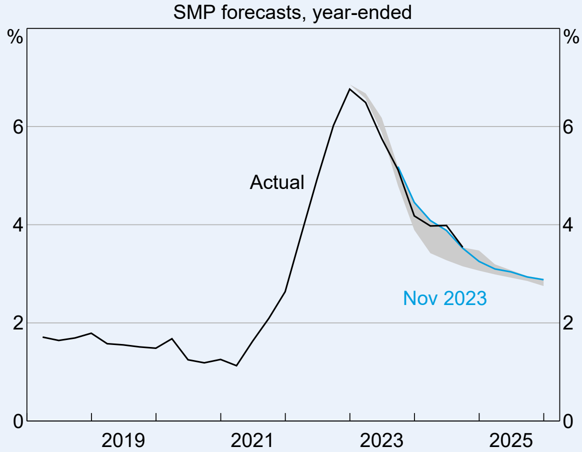
Compared with forecasts in the November 2023 *Statement*, underlying inflation and the unemployment rate in Australia have evolved broadly in line with expectations.[1] However, inflation outcomes more broadly over the past two years have been higher than expected, and quarterly outcomes for underlying inflation since late last year point to relatively slow progress in disinflation. Against this backdrop, we revised down our assessment of full employment, which is the level of employment that can be sustained without generating inflationary pressures, relative to a year ago.

GDP growth has proven significantly weaker than forecast a year ago, driven by weaker-than-anticipated growth in private demand. Taken together, the weaker GDP outcomes, persistence in underlying inflation and the rate of unemployment coming in broadly as forecast suggests that the economy's supply capacity has been less than projected a year ago. Specifically, measured labour productivity has proven weaker than expected.

Underlying inflation and the unemployment rate have evolved as expected.

Underlying inflation was broadly as expected by staff a year ago, though a bit higher than expected by market economists at the time (Graph D.1). The November forecasts were for gradual disinflation over the following year; however, the December 2023 outcome for underlying inflation was weaker than expected and there has been slow progress in disinflation since then.

Graph D.1
Trimmed Mean Inflation*
SMP forecasts, year-ended



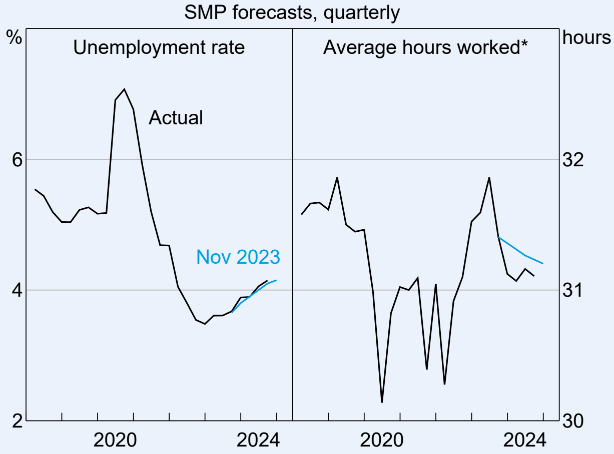
* Shaded area represents range of forecasts between February 2023 and August 2024.
Sources: ABS; RBA.

Further, underlying inflation over the past year has tended to come in a bit higher than suggested by our suite of inflation models, which use variables such as estimates of the unemployment or output gap to explain inflation. Staff had imposed upward judgement to the forecasts using the near-term projections for some of the inflation components. This judgement also allowed for a bit more persistence in inflation than the models suggested. Inflation outcomes being a bit stronger than can be explained by the aggregate models contributed to the reassessment in recent months that the level of full employment was lower than previously thought (see the section on full employment below).

By contrast, headline inflation declined more rapidly than forecast in the November 2023 *Statement*. This was largely due to the expansion of the electricity rebates by federal and state governments announced around May 2024; the forecasts had assumed that the electricity rebates introduced in 2023 would be unwound in 2024, as was legislated at the time. An increase in rent assistance was also introduced. Together, these policies accounted for a large share of the forecast miss over the year. Weaker-than-expected fuel prices also subtracted a little more from headline inflation over the year.

The unemployment rate increased in line with expectations over the year to the September quarter (Graph D.2). The labour market also adjusted to subdued growth in economic activity via a further decline in vacancies and average hours worked. However, growth in employment and labour force participation were both stronger than expected (see the section on employment below).

Graph D.2
Unemployment Rate and Average Hours
SMP forecasts, quarterly

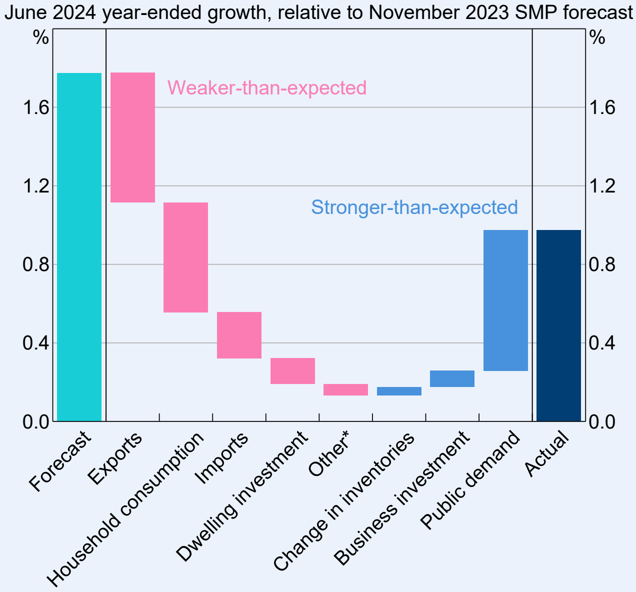


* Weekly average actual hours worked; non-farm.
Sources: ABS; RBA.

Domestic GDP growth was considerably weaker than forecast.

GDP grew by 1.0 per cent over the year, compared with expectations of 1.8 per cent at the November *Statement*. The outcome was also weaker than Treasury forecasts and more in line with market economists' expectations. In per capita terms, the forecast miss was even larger, given population growth was stronger than had been assumed. The momentum in GDP growth has also been materially different to expectations; GDP growth is yet to show signs of a recovery and has remained around 0.2 per cent in quarterly terms since December 2023. At the expenditure component level of GDP, weaker growth in household consumption and exports, which was only partially offset by stronger-than-anticipated growth in public spending, contributed to the forecast miss (Graph D.3).

Graph D.3
Contributions to GDP Forecast Miss
June 2024 year-ended growth, relative to November 2023 SMP forecast

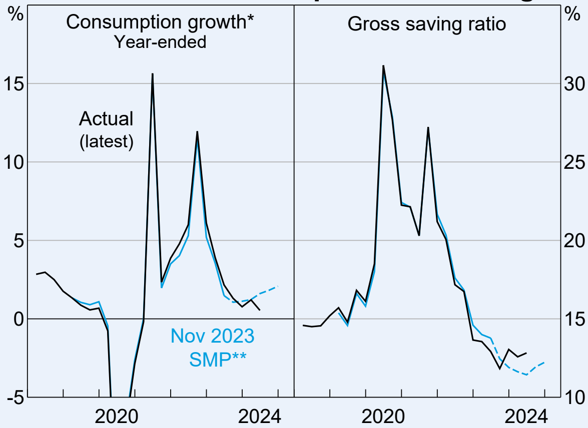


* Includes asset transfers, ownership transfer costs and the statistical discrepancy.
Sources: ABS; RBA.

Growth in household consumption was notably weaker than expected over the year to June 2024, with much of the forecast miss related to the weak June quarter outcome (Graph D.4). The level of consumption by Australian households since the pandemic was revised up significantly in the March quarter GDP release and in the annual National Accounts, with Australians spending more on domestic and overseas travel and imported digital services than previously thought.[2] Since late 2023, the response of consumption growth to the stabilisation of real incomes has been weaker than expected and the expected timing of the pick-up in consumption has been pushed out.

Graph D.4

Household Consumption and Saving



* Outliers during the COVID-19 pandemic have been truncated.
** Dashed lines represent SMP forecasts.
Sources: ABS; RBA.

Exports growth has also been much weaker than expected over the past year, primarily driven by services exports. Tourism exports remain around 25 per cent below 2019 levels, which was weaker than staff forecasts and expectations from many domestic tourism operations in liaison. Education exports were also notably weaker than expected. This reflects an unanticipated tightening in student visa requirements by the Australian Government over the year and an unexpected decline in the average expenditure of international students.

By contrast, growth in government spending has been stronger than expected, driven by public consumption. The staff forecast of public consumption has been revised higher several times over the past year in response to announcements of additional spending (the staff forecast does not typically incorporate expenditure that has not been budgeted). A large share of the announced additional spending has been for existing services as well as cost-of-living support packages.

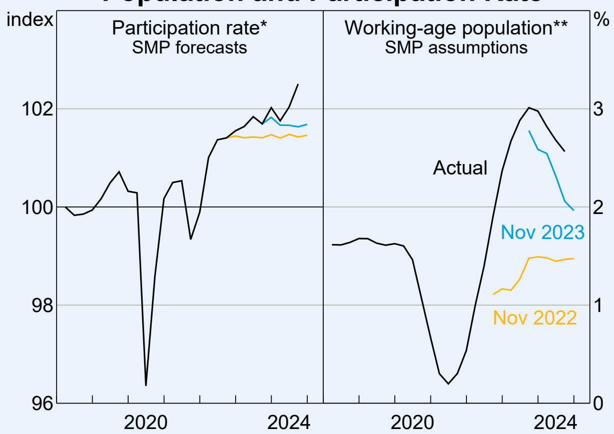
Despite weaker GDP, employment growth has surprised to the upside.

Although the level of GDP is lower than previously anticipated, employment growth has surprised to the upside. Labour supply has also increased by notably more than forecast, such that unemployment rate outcomes have been largely as expected.

The unanticipated strength in labour supply reflected stronger-than-expected increases in both the working-age population and labour force participation (Graph D.5). Population growth was materially higher than assumed a year ago, mostly due to fewer-than-expected departures (i.e. many temporary migrants stayed in Australia longer than expected). The participation rate also continued to increase, against expectations last November that it would ease a little over the year. In part, this may have reflected the ongoing structural increase in labour force participation for women and older workers. However, given that the participation rate continued to increase across most demographic groups, it may also have been facilitated by continued labour demand and driven by cost-of-living pressures.

Graph D.5

Population and Participation Rate



* March quarter 2018 = 100; quarterly.
** Resident population aged 15 years and over; year-ended growth; quarterly
Sources: ABS; RBA.

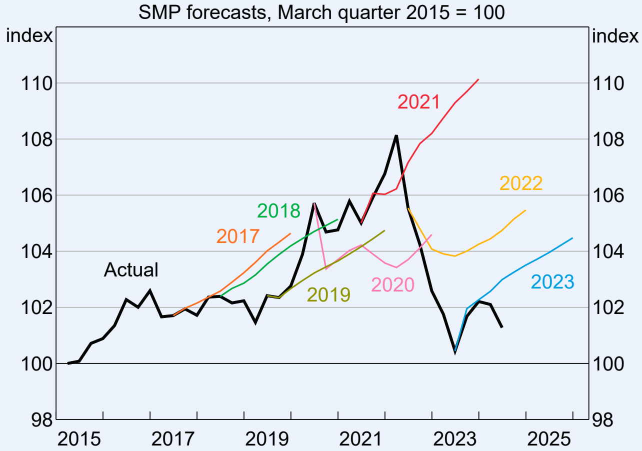
Lower-than-expected labour productivity implies the economy's supply capacity is lower than previously thought.

The rebound in labour productivity growth over the past year was much less pronounced than assumed in November 2023 (Graph D.6). This is consistent with underlying inflation having held up largely as expected, despite weak growth in economic activity.

Graph D.6

Productivity*

SMP forecasts, March quarter 2015 = 100



* Non-farm GDP per hour worked; November SMP forecasts.

Sources: ABS; RBA.

Explaining trends in productivity outcomes has been an area of focus. Part of the explanation comes from a reallocation of employment growth to lower productivity industries. Around three-quarters of employment growth over the past year was in the non-market parts of the economy such as health and social care, where labour demand tends to be less cyclical and often more aligned with government spending. As measured productivity growth in these areas is lower than other parts of the economy, this was a small drag on overall productivity growth. However, productivity growth was weaker than its historical average across a wide range of market and non-market industries, suggesting other factors have contributed (see Chapter 2: Economic Conditions).

The persistent forecast misses on productivity have generated internal discussions about future trend labour productivity growth, which feeds into estimates of potential output over the forecast period. The current assumption is that annual productivity growth will return to around one per cent in the medium term, noting that strong investment, particularly associated with the rapid adoption of technology across many industries, could lead to higher productivity outcomes. However, this remains a key judgement and the staff will continue to assess its validity. Similarly, many peer economies are experiencing low productivity growth, except the United States, and central banks in those economies have recently lowered their trend productivity growth estimates.

Estimates of full employment are also lower.

The staff's assessment of how far the economy was from potential output or sustainable full employment gradually evolved over the past year. While the unemployment rate was easing largely as expected, there was a gradual accumulation of evidence that suggested that the level of full employment may be lower than previously thought, such that labour market conditions were tighter than assumed.

This re-assessment, which was outlined in the August *Statement*, was based on a number of factors:

- Inflation outcomes had been a bit higher (i.e. there was less disinflation) than could be explained by previous estimates of the degree of excess capacity in labour markets.
- Wages growth remained high relative to productivity outcomes.
- Information from business and household surveys and liaison points to significant capacity pressures in the labour market, despite the unemployment rate increasing a little.

While the level of full employment cannot be observed directly or summarised by a single statistic, the current (central) estimate of the unemployment rate consistent with full employment (used in the staff's forecasting models) is around 4½ per cent.

Staff have uplifted the modelling of spare capacity and provided greater transparency around key judgements and further use of scenarios.

The RBA forecasts draw on a range of models and data, augmented by information from the liaison program and staff judgement. Differences between the forecasts and outcomes (forecast errors or misses) may reflect events that were difficult to anticipate, dynamics in the economy that were not captured adequately by the models, unrecognised structural change, revisions to data or incorrect judgements. Differences can also be quite sensitive to the period over which the forecasts are assessed.

In this respect, regularly reviewing forecasts can contribute to a better understanding of current economic conditions and how the economy is evolving over time. Some of the more persistent or sizeable forecast errors detailed in this review have prompted changes to the staff's models and a reassessment of some of the judgements and assumptions in the latest set of forecasts. Other forecast errors have highlighted a need for further analytical work and revisions to forecasting models; this work is underway and will inform staff forecasts and analysis in the future.

Specific developments since November 2023 include:

- The staff have uplifted modelling and analysis of spare capacity in the economy, as recommended by the RBA Review. Compared with a year ago, there is a greater focus on how spare capacity affects the forecasts, the models and key judgements.
- MARTIN – the staff's main macroeconometric model – has been further incorporated into the forecasting process. Over the past year, infrastructure has been developed that allows MARTIN's forecast updates (given new assumptions and data) to be compared with the 'bottom-up' GDP growth and inflation forecasts. This provides an additional cross-check on the forecasts, alongside the usual comparisons to forecasts from market economists and other institutions.
- The staff have also made several improvements to their modelling of variables over the past year, building from considerable evaluation of forecasting models for key variables. These include improvements in the modelling of education exports and key components of inflation, and greater use of the near-term leading indicators of the labour market.

Further, the current forecast review has provided impetus for analysis on a number of dynamics in the economy:

- The impact of population growth on both demand and supply in the economy. There is work planned on how population growth changes are accounted for in the staff's current modelling framework for economic activity.[3] This also includes improving the understanding of the effect of population flows on potential output estimates and the impact of large changes in population growth on housing and labour markets.
- An assessment of the outlook for trend productivity growth based on a better understanding of the historical drivers of productivity outcomes.

Looking ahead, a larger and more comprehensive forecast evaluation project is underway to assess the accuracy of staff forecasts over a longer time period and relative to other forecasters. This broader review – to be completed in 2025 – will also include a more fulsome review of the various key models, with the project to be supported by an upgrade to the staff's forecast infrastructure.

Endnotes

1 The analysis is based on the latest data: GDP, productivity and wages data for the year to June 2024, and the labour market and CPI data for the year to September 2024.

2 This resulted in an upward revision to both consumption and imports, and therefore had no effect on overall GDP.

3 For example, the MARTIN model does not revise variables such as consumption, employment or income for changes to population. There is merit in considering alternative forecasting of some variables in per capita terms.