

5. Economic Outlook

Global growth is forecast to slow and remain well below its historical average in the year ahead. This reflects the ongoing effects of tighter monetary policy on demand in advanced economies, as well as a soft outlook for the Chinese economy (see Chapter 1: The International Environment).

Growth in the Australian economy is expected to remain below trend over 2023 and 2024 as cost-of-living pressures and higher interest rates continue to weigh on demand. But the economy has proved to be more resilient in recent quarters than previously expected – which is supporting demand conditions for Australian businesses. Hence, the outlook for growth has been revised up in the near term compared with the August *Statement*. The very tight labour market conditions of last year have begun to ease and labour underutilisation rates are expected to rise gradually over the forecast period given below-trend economic growth. The easing in labour market conditions is forecast to be more gradual than previously expected because of the stronger outlook for aggregate demand. Much of the labour market adjustment to below-trend growth in economic activity is expected to occur through a decline in average hours worked; employment is expected to increase over the forecast period. Over coming years, a more sustainable balance between supply and demand across the economy, including in labour and product markets, is expected to support the return to low and stable inflation as growth in domestic activity returns to trend.

Inflation is forecast to decline to 3½ per cent by the end of 2024 and to reach a little below 3 per cent at the end of 2025 (Table 5.1). The forecast decline in inflation is more gradual than anticipated three months ago because domestic inflationary pressures are dissipating more slowly than previously thought (Graph 5.1). Goods prices have accounted for almost all of the decline in inflation so far; goods inflation is expected to continue falling in the near term as the resolution of supply disruptions flows through to prices paid by consumers. By contrast, services inflation remains high. Services inflation is expected to ease but to remain above its inflation-targeting average throughout the forecast period in an environment of elevated domestic cost pressures and still-robust levels of demand. The key domestic uncertainties that shape the risks around these forecasts are: (i) inflation could be higher for longer; and (ii) growth could be weaker than expected, resulting in lower inflation than anticipated. These risks are discussed at the end of this chapter.

The forecasts incorporate several technical assumptions:

- The cash rate is assumed to peak at around 4½ per cent before declining to around 3½ per cent by the end of 2025. This assumes a higher cash rate path than used for the August *Statement*. The path for the cash rate reflects expectations derived from surveys of professional economists and financial market pricing.

Table 5.1: Output Growth and Inflation Forecasts^(a)

Per cent

	Year-ended					
	Jun 2023	Dec 2023	Jun 2024	Dec 2024	Jun 2025	Dec 2025
GDP growth	2.1	1½	1¾	2	2¼	2¼
(previous)	(1½)	(1)	(1¼)	(1¾)	(2)	(2¼)
Unemployment rate ^(b)	3.6	3¾	4	4¼	4¼	4¼
(previous)		(4)	(4¼)	(4½)	(4½)	(4½)
CPI inflation	6.0	4½	4	3½	3¼	3
(previous)		(4¼)	(3½)	(3¼)	(3)	(2¾)
Trimmed mean inflation	5.9	4½	4	3¼	3	3
(previous)		(4)	(3¼)	(3)	(3)	(2¾)
Year-average						
	2022/23	2023	2023/24	2024	2024/25	2025
GDP growth	3.3	2	1¾	1¾	2	2¼
(previous)	3	1½	1	1¼	1¾	2

(a) Forecasts finalised 7 November. The forecasts are conditioned on a path for the cash rate broadly in line with expectations derived from surveys of professional economists and financial market pricing; the cash rate is assumed to peak at around 4½ per cent before gradually declining to 3½ per cent by end-2025. Other forecast assumptions (assumptions as of August *Statement* in parenthesis): TWI at 61 (61); A\$ at US\$0.64 (US\$0.66); Brent crude oil price at US\$84/bbl (US\$80/bbl). The rate of population growth has been revised higher in the near term but is expected to gradually decline to around its pre-pandemic average. Forecasts are rounded to the nearest quarter point. Shading indicates historical data, shown to the first decimal point.

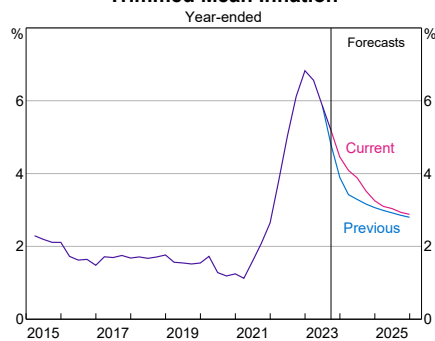
(b) Average rate in the quarter.

Sources: ABS; RBA.

- The exchange rate is assumed to be unchanged at its current level, which is 1 per cent lower than the August forecasts on a trade-weighted basis.
- Crude oil and fuel prices are assumed to be broadly unchanged around their current levels for the rest of the forecast period, which is around 5–8 per cent higher than at the August *Statement*. (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.)
- The level of the population has been revised higher again, reflecting stronger-than-expected net overseas migration; year-ended population growth is assumed to have peaked in the September quarter at around 2½ per cent, after which it is expected to decline back to its pre-pandemic average of around 1½ per cent.

Graph 5.1

Trimmed Mean Inflation



Sources: ABS; RBA.

(The population assumption is underpinned by a range of sources, including projections from the Australian Government’s Centre for Population, partial indicators from the Australian Bureau of Statistics and liaison with the education sector.)

Inflation in Australia is easing, but more gradually than previously expected

Consumer price inflation is forecast to continue to decline across the forecast period (Graph 5.2). However, the expected decline will be more gradual than anticipated at the time of the August forecasts because domestic inflationary pressures are dissipating more slowly than previously thought. Underlying inflation was stronger than expected in the September quarter, pointing to demand being stronger than anticipated as cost pressures have remained elevated; this builds on underlying inflation being higher than expected over the past year (see Box B: Has the Economic Outlook Evolved as Forecast a Year Ago?). The forecasts for both headline and underlying inflation over the year ahead have been revised higher to account for the typical persistence of the components of inflation that were stronger than expected (Graph 5.3).

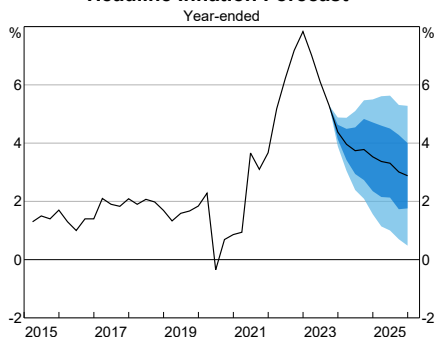
The inflation forecasts out to 2025 have also been revised higher. The domestic economy has proved more resilient than previously expected, and the labour market is expected to ease more gradually as a result. In addition, the prospect of higher inflation over the year ahead increases the risk of embedding higher inflation expectations in price-setting decisions.

Services inflation remains high and was the primary driver of stronger-than-expected underlying inflation in the September quarter. This reflects the still-strong level of demand for services as well as recent strong growth in domestic costs, including for labour (partly because of poor productivity outcomes) and non-labour business inputs such as energy, rent and insurance. A moderation in services inflation is still expected over the forecast period as growth eases in labour and non-labour costs, and as the demand for services moderates. But services inflation is expected to moderate more gradually than earlier anticipated.

Goods price inflation is forecast to moderate further in the period ahead as the easing in global upstream costs continues to be passed through to final prices. A further moderation in goods price inflation would be consistent with the experience in other advanced economies. Firms in the Bank’s liaison program have

Graph 5.2

Headline Inflation Forecast*

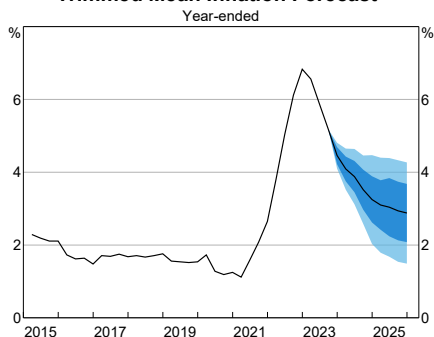


* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Graph 5.3

Trimmed Mean Inflation Forecast*



* 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.

reported supply chain improvements and an easing in imported goods inflation. Domestic cost pressures remain a source of upward pressure in firms' pricing decisions, though these cost pressures are expected to ease over time.

Rents have increased at an annualised rate of around 10 per cent over the past six months and rent inflation is expected to remain broadly around this rate for the year ahead, before easing gradually. Housing supply has not kept pace with the increased demand for housing from the decrease in average household size since the beginning of the pandemic, robust nominal income growth and strong population growth, contributing to very low vacancy rates and high rent inflation.

There remains a high degree of uncertainty around the speed and extent of the disinflation in the period ahead (see the section on 'Key domestic uncertainties' below).

Economic activity is forecast to be more resilient than was expected a few months ago, although growth will remain below trend and this will help to achieve a better balance between supply and demand in the economy

Growth in the Australian economy is expected to remain below trend over the year ahead as cost-of-living pressures and higher interest rates continue to weigh on demand; GDP per capita is expected to decline over 2023 (Graph 5.4). The outlook for growth in the near-term has been revised up compared with three months ago; stronger-than-expected growth in private and public investment and further upgrades to services exports have more than offset a weaker outlook for household consumption. These developments are supporting demand conditions for Australian businesses and has implications for firms' price-setting.

The relatively soft outlook for GDP growth in the near term reflects subdued growth in consump-

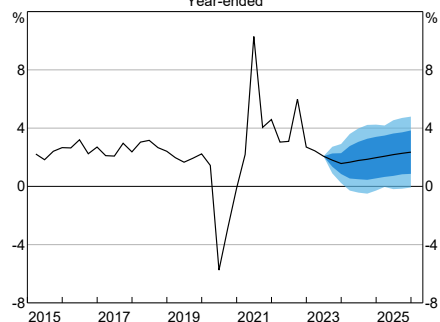
tion by Australian residents as higher interest rates, cost-of-living pressures and higher tax payable weigh on real disposable income growth. Weak demand for new housing, high construction costs and ongoing capacity constraints – reflecting shortages for some skilled trades – are also expected to continue to weigh on new building approvals and dwelling investment in the period ahead. While new dwelling cost inflation has slowed significantly since mid-2022, it remains above its pre-pandemic pace.

Conversely, the near-term outlook for non-mining business investment and public investment remains strong following recent broad-based growth and because of a large pipeline of construction and public infrastructure work. The ongoing rebound in international student and tourist numbers is also expected to support growth in the near term and provide some offset to weak spending by Australian residents. Robust total spending in Australia is expected to continue supporting demand conditions for businesses and impact firms' ability to pass on cost pressures to customers (Graph 5.5).

GDP growth is forecast to increase gradually from early next year, largely reflecting stronger growth in household consumption and public

Graph 5.4

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. Household consumption growth is forecast to pick up to around its pre-pandemic average by late 2024, supported by a recovery in real income growth as current headwinds fade and higher household wealth (Graph 5.6). The household saving ratio is expected to decline further over the coming year before increasing gradually as real income growth turns positive from around the middle of next year. The extent to which households draw down on their savings to smooth consumption remains a key uncertainty for the consumption outlook, particularly given the additional incentive for all households to save more as interest rates increase.

Dwelling investment is also expected to increase over coming years from current subdued levels.

This increase reflects ongoing progress through the pipeline of work to be done as capacity constraints continue to ease, as well as stronger demand for new housing supported by strong population growth, higher prices for established housing and an improvement in build times. While stronger demand will support an increase in dwelling investment, higher density housing supply typically responds with a significant lag due to long planning and construction lead times.

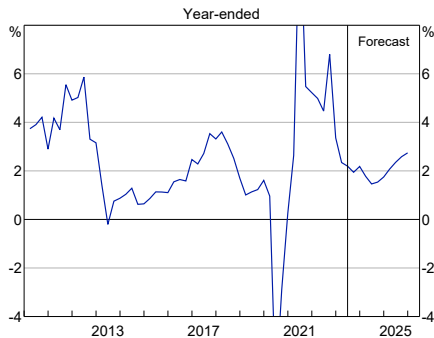
Employment is expected to increase further, though labour underutilisation is forecast to gradually rise as growth in economic activity remains below trend

The near-term outlook for employment growth has been revised higher because of the stronger outlook for domestic activity and an assumption of stronger growth in the working-age population over the year ahead; growth in the working-age population supports growth in labour supply while also adding to aggregate demand in the economy. Employment is expected to increase further over the next couple of years and much of the labour market adjustment to below-trend growth in economic activity is expected to occur through a decline in average hours worked (Graph 5.7). The labour market is less tight than in late 2022, though labour market spare capacity is still around multi-decade lows, and measures of labour underutilisation (i.e. people working fewer hours than they want) are expected to continue to increase gradually over the next two years.

Employment growth is expected to remain positive throughout the forecast period, but it is expected to be below growth in the working-age population for a time, resulting in a gradual increase in the unemployment rate. Because of the more resilient outlook for economic activity, the unemployment rate is now forecast to rise more gradually than at the *August Statement*, to be around 4¼ per cent from late 2024 to 2025

Graph 5.5

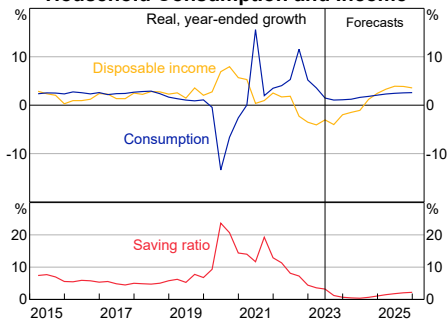
Domestic Final Demand Growth*



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

Graph 5.6

Household Consumption and Income



Sources: ABS; RBA.

(Graph 5.8). An unemployment rate around 4¼ per cent is well below the typical rate experienced over the past five decades.

In coming years, a more sustainable balance between supply and demand in the labour market and the economy more broadly is expected to support the return to low and stable inflation as growth in domestic activity returns to trend.

Participation in the labour force is expected to be sustained close to historically high levels over the forecast period. The effect of the cyclical slowing in the labour market is expected to be partly offset by trends that have been driving the participation rate higher over a longer

period, including higher participation by female and older workers.

Wages growth is forecast to be close to its peak and to decline gradually as the labour market eases

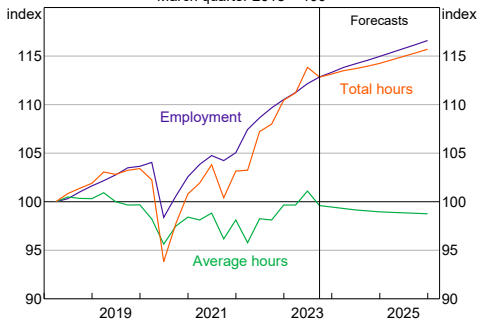
Nominal wages growth is expected to remain robust in the near term, underpinned by the ongoing tightness of the labour market and high inflation outcomes. Growth in the Wage Price Index (WPI) – which seeks to measure changes in base wage rates for a given quantity and quality of labour – is forecast to rise a little further over the second half of 2023 to stabilise at around 4 per cent before declining gradually as the labour market eases (Graph 5.9). Inertia in the wage-setting process and some lagged catch-up in real wages mean that the decline in wages growth is forecast to be slower than the decline in inflation.

Timely indicators suggest that wages growth increased in the September quarter, but tightness appears to have eased in some segments of the labour market by more than expected, even as aggregate labour underutilisation rates have increased only gradually. The Fair Work Commission decision to increase minimum and award wages has flowed through as expected in the September quarter,

Graph 5.7

Employment and Hours Worked

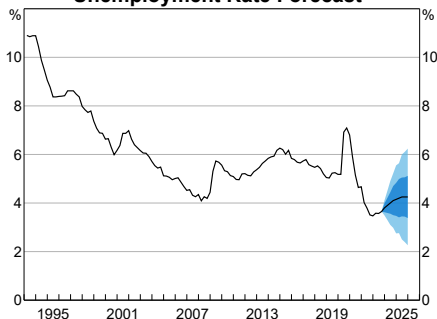
March quarter 2018 = 100



Sources: ABS; RBA.

Graph 5.8

Unemployment Rate Forecast*



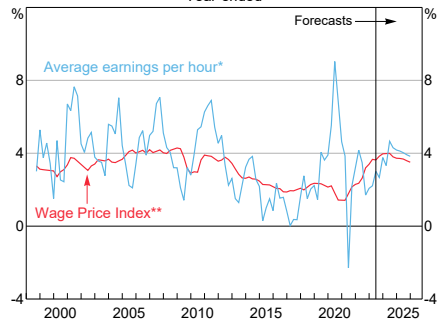
* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Graph 5.9

Wages and Earnings Growth

Year-ended



* Non-farm; includes social contributions.

** Excluding bonuses and commissions.

Sources: ABS; RBA.

providing a boost to aggregate wages growth, but there is little sign that it has had larger spillovers than usual on the wages of other workers. In response to these developments, the wages growth forecast has been revised down a little in the near term and is little changed further out as the stronger forecast for the labour market provides an offset. The forecast is consistent with the message from firms in the Bank’s liaison program, with a larger share of firms reporting they expect that wages growth in a years’ time will be below its current rate.

Broad measures of labour income are expected to grow at a faster rate than the WPI. This reflects additional earnings growth associated with improvements in skills over time, and the use of bonuses, allowances and other non-base wage payments to retain or attract staff. These broader measures imply less of a decline in real wages than suggested by the WPI measure (Graph 5.10)

Overlaying all of this, growth of labour costs remains very high. Recent labour productivity outcomes have been weak. Together with solid growth in average earnings over the past year, this has seen recent growth in unit labour costs – which is the measure of labour costs that matters most for inflation – reach 7 per cent, its highest rate since 1990 (excluding pandemic-

impacted outcomes in 2020). The forecasts for nominal wages growth remain consistent with the inflation target, provided productivity growth returns to its pre-pandemic trend (this risk is discussed further below).

Key domestic uncertainties

The risks to the domestic outlook are assessed to be broadly balanced – assuming that inflation expectations remain well anchored.

Inflation could take longer to return to target than anticipated

Inflation could be higher for longer, which could lead to an upward drift in inflation expectations. This would be very costly (in terms of both employment and inflation) to unwind and could take a number of years. There are a number of channels through which inflation could be higher for longer than forecast:

- *Demand could be stronger than expected.* Household consumption could turn out to be stronger than forecast, which would result in an easing by less than expected of firms’ ability to pass cost pressures on to prices, labour market conditions and domestic inflationary pressures. The stronger outlook for wealth could lead to a faster or larger turnaround in household consumption growth, including via increased housing turnover and increased ability to obtain credit (although credit growth and turnover remain low so far). Households may also be more willing to spend from their sizeable savings buffers than currently expected. The tight labour market conditions could, if sustained, contribute to stronger-than-expected outcomes for household incomes and consumption.
- *Services inflation could be higher for longer than expected.* Services inflation is expected to remain elevated over the forecast period, taking signal from recent inflation outcomes

Graph 5.10

Real Wages*
December 2019 = 100



* Deflated using the headline Consumer Price Index.
** Non-farm; includes social contributions.
*** Excluding bonuses and commissions.
Sources: ABS; RBA.

and the typical gradual moderation that has been experienced historically in Australia and some other countries. But there is a risk that it remains stubbornly higher than forecast. In a high inflation environment, it is easier for firms to increase prices; people also tend to pay closer attention to changes in costs and prices than when inflation is low, and so may come to expect further large price increases. There are also uncertainties regarding the lags in the effect of monetary policy and how firms' pricing decisions and wages respond to slower growth in the economy at a time when the labour market remains tight. While profit margins outside of the mining sector have been broadly stable in recent years, firms may expand their margins as cost pressures ease if demand remains sufficiently strong.

Inflation could also moderate more slowly than anticipated if productivity growth does not pick up. This would increase labour costs by more than expected given the current outlook for nominal wages and so add to inflationary pressures. The forecasts include an expectation that labour productivity growth increases to the rate recorded in the decades preceding the pandemic. Recent productivity growth outcomes have been weaker than this, although the effects of the pandemic on the economy has made it difficult to discern underlying trends.

- *Inflation could be pushed up by supply shocks or a further rise in rent inflation.* The Hamas–Israel conflict could lead to further increases in oil prices, which would both directly increase fuel prices and indirectly affect consumer prices by raising firms' costs. However, in this scenario some of the initial upward pressure on inflation could be unwound if the oil price shock were also to weigh on economic growth and so demand for goods and services. The El Niño weather pattern and/or ongoing climate change

effects could cause disruptions to agricultural production that increase food prices by more than expected. Rent inflation could be higher for longer than expected. Strong population growth is occurring at a time when the rental market is already very tight and it will take time for supply to respond. Households pay relatively close attention to fuel, food and housing costs and so further price increases in these consumption categories in an environment of already-high inflation could raise households' expectations of future inflation.

Inflation could fall faster than expected if domestic or international demand is softer than anticipated

- *The recent weakness in household consumption could persist for longer than expected.* This could occur if weak real disposable income growth has a larger-than-expected effect, particularly on low-income households that typically have lower savings buffers. While many households are well placed to absorb higher interest rates, there is a risk that households, especially those with low savings buffers and high debt relative to incomes, will adjust spending by more than expected. Higher interest rates could also encourage all households to save more than expected, resulting in lower consumption growth. If household consumption is weaker than expected, there may be an easing by more than expected of firms' ability to pass cost pressures on to prices, labour market conditions and domestic inflationary pressures.
- *If international demand for Australian goods and services is weaker than expected, domestic inflationary pressures may ease by more than anticipated.* The outlook for the global economy remains uncertain, with risks tilted to the downside. China's weaker growth outlook continues to create uncertainty

around the outlook for demand for bulk commodities and, in turn, the prices of Australia's key exports and terms of trade. Despite overall fixed-asset investment and steel production remaining robust through most of 2023, real estate investment has been a drag on investment since 2021, and policy support in the property sector has been restrained.

Notwithstanding the continued recovery in household consumption in China, consumer confidence in that trading partner remains subdued, and if consumption growth settles at a lower trend path after the post-pandemic recovery, this could pose additional downside risks to Australia's education and tourism exports. A prolonged cyclical downturn in China could further weigh on Australia's exports through its effect on the rate of economic growth in Australia's major trading partners in the east Asian region.

Outside of China, broader risks to global economic growth pose additional risks to Australia's exports outlook. In particular, if downside risks to growth in advanced economies are realised in a material way – for example, due to a sizeable further tightening in financial conditions that is not accompanied by stronger growth – this would likely weigh further on growth in China and east Asia more broadly. Tighter global financial conditions could also weigh on domestic demand if this were to lead to tighter domestic financial conditions and/or were associated with a broader loss of confidence.

- *Goods prices could decline significantly if domestic demand or international demand eases by more than anticipated.* The inflation forecasts assume that goods prices stabilise at a high level rather than decline over coming years. Supply chain conditions are back around pre-pandemic norms and goods inflation has eased in most advanced economies. Large or widespread declines in goods prices would moderate inflation outcomes by more than currently expected. One way this could occur is if the simultaneous tightening of monetary policy across many economies, as well as independent tightening in financial conditions in some economies, affects demand by more than the sum of individual-economy effects would imply, leading to lower import prices for Australia. Depreciation of the Australian dollar exchange rate may provide some offset in a scenario where the global economy is weaker than expected. The pass-through to domestic goods prices also depends on domestic demand conditions and non-import business costs; so far, the downward pressure on goods prices from easing import costs has been partly offset by elevated domestic cost pressures.

To give a sense of the magnitude of this risk, if prices for consumer durables reversed one-third of the price increases recorded since the onset of the pandemic, year-ended headline inflation would be around ½ percentage point lower than the current forecast. This would mean that headline inflation would be around the upper end of the inflation target range in late 2024. ✎