Australia Economic Outlook Q1 2023

KPMG Australia

April 2023

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Executive summary

There are positive signs emerging in 2023 that the inflation surge which has been plaguing most countries around the world is starting to ease, with commodity prices retreating and supply chains returning to pre-pandemic operations. Nonetheless, central banks have been maintaining the fight against inflation with policy rates continuing to be ratcheted upwards, although there are now signs that some countries may be near, or even at, the top of their tightening cycle.

The Australian economy finished 2022 on a positive note, albeit slightly lower than most economists were predicting. Domestic demand was marginally negative in the December quarter 2022, and once the run-down of inventories was considered, Gross National Expenditure (GNE) fell 0.5 percent during the final three months of the year. The $6 billion swing in net exports during the quarter ($1.3 billion from higher exports and $4.7 billion from lower imports) helped save GDP growth from recording a negative result.

From a production perspective, Australia's growth engines during 2022 were in professional, scientific and technical services (+$12.3 billion higher real Gross Value Added over 2021), transport, postal and warehousing (+$10.7 billion), healthcare and social assistance (+$7.2 billion) and accommodation and food services (+$6.7 billion) – sectors that largely had been materially negatively impacted by the COVID-19 pandemic in their abilities to deliver face-to-face services to clients and customers.

This upswing in production has brought with it a strong demand for additional workers, and combined with global labour mobility challenges, including the timely access to visas, affordable international airline seat capacity and increased competition from other countries for skilled migrants, Australia has mainly had to rely on its own labour supply for sourcing personnel. The consequence of this has been a decade-low unemployment rate and equally a decade-high participation rate, which has resulted in levels of wages growth not seen since 2012.

While this uptick in wages growth has been seen positively by policymakers in both fiscal and monetary quarters, the commentary has now moved into one concerned about the emergence of a 'wage-price' spiral, further adding to the inflationary woes of Australia. This concern has been evidenced in the dialogue now coming from the RBA which, for the first time KPMG can remember, is splitting the discussion around inflation into 'goods inflation' and 'services inflation', recognising that wages play a much more significant role in the cost base of services production than goods production.

The difficult line that the RBA is walking in terms of tightening monetary policy just enough to return inflation back to its 2 percent to 3 percent target band, but not too tight that it chokes off economic activity causing a recession in the process, has been highlighted in the April 2023 Board meeting. That is, the RBA decided to leave the cash rate unchanged at 3.6 percent on the basis it is wanting more time to understand the impacts of the previous 10 consecutive increases in the cash rate since May 2022.

This decision by the RBA in April would have been more surprising, given that much of the data released over the previous month – added to public comments by Governor Lowe – seemed to indicate that another rise was likely. But the pressure on the RBA to end the rate increases has been unprecedented.

Also, the pause at the April Board meeting may reflect information at the Bank's disposal, not yet reflected in published data, that inflationary pressures have unambiguously eased. This information may better reflect the coalface realities of what is happening to businesses and households right now. Notably the April 2023 Statement on the Monetary Policy Decision concludes with virtually the same wording as March's statement, with the exception of one very important phrase that has been revised from, 'further tightening of monetary policy will be needed' to 'further tightening of monetary policy may well be needed'.

The adoption of these two simple words provides the RBA with a 'get out of jail' card if inflation risk is now materially different. If inflation pressures ease on the back of falling aggregate demand, the RBA can call the top of the contractionary cycle at the current cash rate. However, if inflation remains elevated the RBA is flagging that it will hit the economic brake and raise interest rates again.

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While this 'pause and see' approach seems like a low risk strategy, it is only so if the information used to arrive at the decision made on 5 April 2023 is clearer than the published data. The dice will be loaded for the next couple of RBA meetings and any upside surprises on activity and inflation may make the market question whether the opportunity for the RBA to engineer a soft landing has been lost.

Our cash rate profile remains consistent with a 'Goldilocks' scenario where wage growth remains contained and the economy slows without entering recession territory. To the extent a wages breakout occurs beyond what we have forecast, or inflation becomes more entrenched due to global factors beyond the control of Australian policymakers, then the RBA may find itself in the position of needing to push the cash rate higher in order to pull back aggregate demand more aggressively.

At this stage, KPMG's central macro-economic forecast is for Australia to experience a slowdown in economic activity later in 2023, but we are not expecting the economy to enter a recession over the forecast period. The risks of higher interest rates and recession have increased in recent months.

	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25
GDP (Real)	3.7%	3.1%	1.4%	1.2%	1.1%	1.8%	2.3%
Inflation*	7.8%	6.5%	4.4%	3.5%	3.0%	3.0%	2.9%
Unemployment*	3.5%	3.6%	4.0%	4.6%	4.8%	4.8%	4.8%
AUD/USD*	0.66	0.70	0.70	0.70	0.71	0.71	0.71

* = Value at end of the year

Source: KPMG

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Global landscape

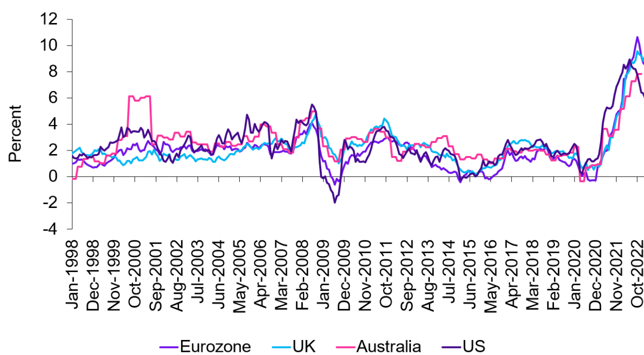
Inflationary and supply chain pressures started to ease, with the end of the monetary tightening cycle in sight.

Global inflationary pressures easing

The first quarter of the year has witnessed some easing of the global supply chain issues, with the global energy prices coming down to the levels seen before the war in Ukraine. Prices of other commodities and global food prices have also declined. Headline inflation has therefore come off its peaks.

However, inflation has seen a handover from global to domestically generated factors in most economies. Services inflation has remained elevated due to the tightness in labour markets and a continuation of solid demand for services. Rents inflation in most advanced economies has been high, but appears to begin softening in the US.

Chart 1 – Annual inflation in advanced economies



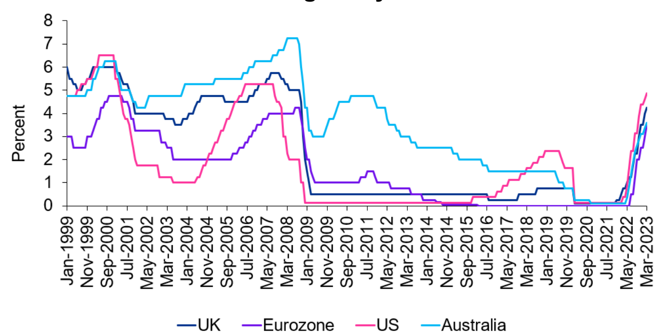
Source: ECB, ONS, ABS, BLS, Haver, KPMG

KPMG expects the headline inflation across most advanced economies to continue decreasing in 2023 and potentially reach central banks' targets by 2024. Central banks remain cautious that inflation could remain persistent, with stubborn core inflation (excluding volatile items such as food and energy) and broad-based price increases across the economy still occurring as a result of a tight economic environment in a number of countries. The monthly data remained elevated in the US in March at 5.6 percent, and rose slightly to 5.7 percent in the Eurozone economies.

Banking instability complications

Recent turmoil in the global banking system is adding further complexity to central banks' deliberations. Expectations of further interest rate hikes were pared back in the light of this banking turbulence.

Chart 2 – Interest rate targets by advanced economies



Source: BoE, ECB, FRB, RBA, Haver, KPMG

Central banks seem to have not been swayed from their determination to combat inflation and have tools to handle liquidity shortages. Three major central banks – the European Central Bank, Fed and Bank of England took turns to lift their policy rates after the banking events, though further increases were not clearly signalled. The Fed Chairman made an interesting remark that the tightening in financial conditions would work in the same direction as monetary tightening and be equivalent to a rate hike or perhaps more.

KPMG anticipates with the latest developments in the banking sector and bond markets, the rates peak could be in sight sooner and at lower levels.

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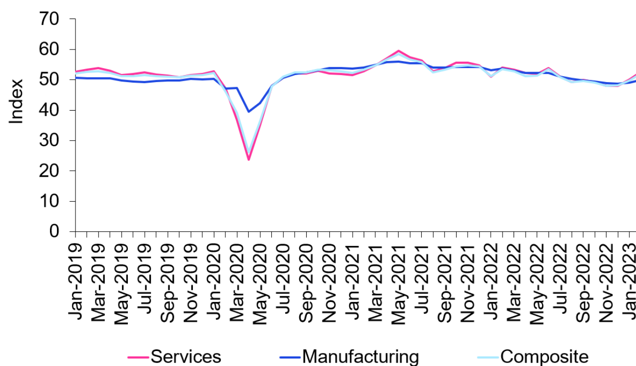
Recent pick-up in growth momentum

This year started off with some signs of strength in the indicators of services consumption and from business surveys in several advanced economies, and a surge in the US consumption in January.

Consumer confidence has shown signs of picking up in the UK and Eurozone, albeit staying at low levels. We expect consumer demand to improve this year as consumers potentially look to spend their excess savings that are still rather high in China and Europe. Resilient labour markets will provide another crucial support for household income and consumption. Downside risks to consumer confidence include rising interest rates and tighter credit conditions.

Leading indicators from the global Purchasing Managers' Index™ survey reveal world economic activity and new orders in February returned to expansion, led by the services sector and further strengthened by the first reversal to growth in manufacturing production since July 2022. Growth in economic output was positive across most countries, except for Brazil and Kazakhstan, but varied widely, with strong upturns observed in India and Spain, and only marginal growth in the US. China and Japan continued to see positive output growth for the second consecutive month.

Chart 3 – IHS Markit Purchasing Managers' Index™ (PMI™), World



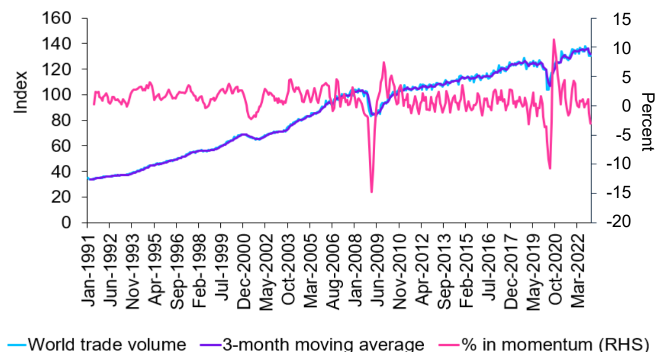
Source: JP Morgan, S&P Global, Haver, KPMG

Positive business sentiment from both manufacturers and service providers in the global PMI™ survey increased to its highest level over a year. The growth in employment resumed and accelerated, with the rate of expansion reaching a six-month high. The February survey also saw a moderate reduction in input price inflation in both manufacturing and services sectors.

World trade to improve in 2023

The World Trade Monitor shows world trade momentum continued to drop in January 2023. Yet, we expect global trade to improve this year as a result of the normalisation after the Chinese economy's reopening and a recovery in global growth – though geopolitical tensions are likely to continue adding some pressure to trade flows in the medium term.

Chart 4 – World trade



Source: CPB, Haver, KPMG

Outlook for global economic growth

KPMG expects to see positive growth momentum in 2023 following the reopening of the Chinese economy and a relatively strong growth in some emerging markets. The easing in global supply chain issues and shipping costs should ameliorate the inflationary pressures and improve supply capacity for firms.

Nonetheless, global growth is anticipated to be moderate over the next two years and remain below its long-term average, with lesser contribution from the Eurozone and US. Risks remain tilted towards the downside amid volatile financial markets, while the consequences of the historically large public debt and the rapidly tightening monetary policy may not have fully surfaced.

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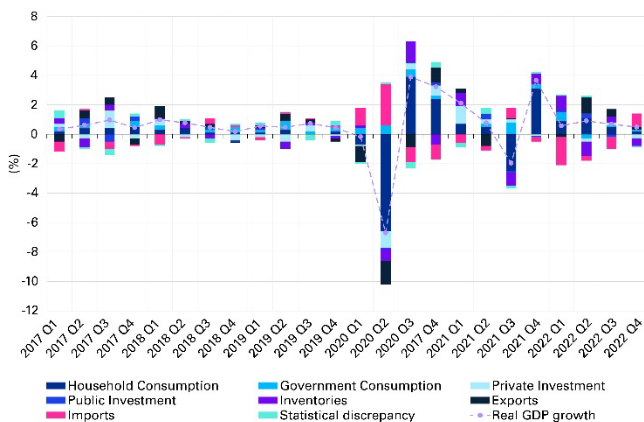
Australia overview

Australia's economic outlook will weaken as the year progresses.

The Australian economy prospered during 2022 on the back of post-Covid consumer spending, strong investment activity across public and private sectors, and a healthy labour market that has resulted in more Australians working either absolutely or proportionally than has ever been the case before.

However, the growth trajectory started to ameliorate as the year progressed with the successive increases in the cash rate by the RBA aimed at returning inflation to its target band (of 2 percent to 3 percent) starting to bite at aggregate demand. This can be seen in the December quarter national accounts where positive economic growth was only achieved through the realisation of a trade surplus, whole domestic demand provided no net contribution to growth during the quarter.

Chart 5 – Contribution to quarterly GDP growth



Source: ABS, Haver, KPMG

The RBA continues to press hard on driving the inflation genie back into its bottle. There was much conjecture prior to the April 2023 Board meeting whether the RBA would pause with rate hikes or continue on. Factors influencing the case for a rate pause include:

– The monthly CPI fell from 7.4 percent y/y in January to 6.8 percent y/y in February, and core inflation also declined from 7.5 percent to 6.9 percent. The headline inflation was noticeably softer than the market expectation of 7.2 percent, which could provide comfort to the RBA.

– The recent turbulence in the global banking system has raised concerns over the impact of rapidly tightening monetary policy on financial stability. But this has a lesser impact on Australia, given our banks are well-capitalised and do not have liquidity issues due to strict macroprudential regulations.

– Many have expressed worries about a mortgage cliff caused by the monetary tightening, in which those still on fixed rates will be hit hard at the end of their fixed terms. There is currently a 250bp gap between new variable and existing three-year fixed mortgages, meaning nearly $45 billion in higher annual interest payments in FY23.

Ultimately, the April 2023 RBA Board meeting saw the Monetary Policy Decision leave the cash rate at 3.6 percent, albeit noting that they 'expect some further tightening of monetary policy may well be needed to ensure inflation returns to target'.

Interestingly all of the public statements coming from Governor Lowe since the March meeting and all of the data that has been available over the past month has pointed to the RBA continuing to hike rates this month. Notably, at the Financial Review Business Summit, Governor Lowe elaborated on the really important pieces of data that they assess in determining whether to adjust rates upwards or keep as is, being employment, monthly inflation, retail spending and business surveys.

All of these indicators showed a continuing strength in the economy, and combined with statements like, 'Inflation is too high, we need to keep raising rates, and we will', suggests the pause in the cash rate has been driven by the non-bank Board members who arguably are more in tune with the coalface realities of businesses and households (and politics).

The Statement on the Monetary Policy Decision for April 2023 concludes with virtually the same wording as last month, with the exception of one very important phrase that has been revised from 'further tightening of monetary policy will be needed' to 'further tightening of monetary policy may well be needed'.

The adoption of these two simple words provides the RBA with a 'get out of jail' card if inflation risk is now materially different. Simply, if inflation starts to drop more rapidly than anticipated on the back of falling aggregate demand, and most likely an accompanying recession, then the RBA now has the capacity to call the top of the contractionary cycle at the current cash rate. If, however, inflation remains elevated then this statement also gives it the opportunity to stomp its foot back on the economic brake and raise interest rates again.

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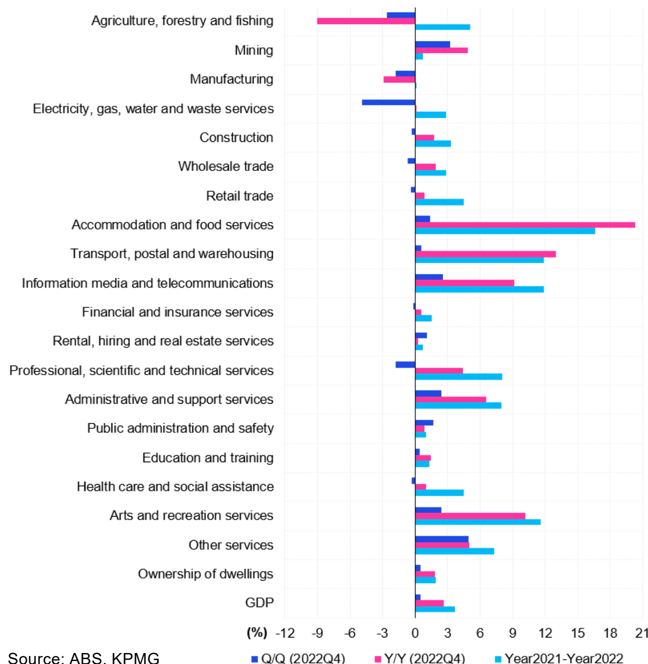
Production

The last quarter of 2022 saw industrial activity growth pull back to a very soft footing. Real industry GVA (IGVA) expanded moderately by 0.3 percent in 2022Q4, decelerating from 0.9 percent and 1.1 percent in the previous two quarters. Real industry GVA growth has gradually dropped below December 2021's peak of 3.5 percent, and the December 2022 reading was the weakest since mid-2018.

Through the first three quarters of the year, spending linked to post-Covid demand had propelled real GVA growth upwards, as can be observed through strong growth outcomes in the accommodation and food services; transport, postal and warehousing; and arts and recreation services sectors. However, by the end of the year, these contributors have petered out, leading to slower quarterly growth in travel and hospitality linked industries in the December quarter. The effects of slow consumer demand also manifested through a contraction of 0.4 percent in the retail sector.

The mining sector remained the bright spot, leading IGVA growth in the December 2022 quarter. Activity in the mining sector continued to surge, as production was boosted due to operations in new mines and as foreign demand picked up. However, capacity in the sector was constrained, as production in mining sites in New South Wales was impacted by adverse weather conditions. This led to mining firms having to run down inventories to meet increased foreign demand and to make up for the shortfall in production.

Chart 6 – Industry Gross Value Added

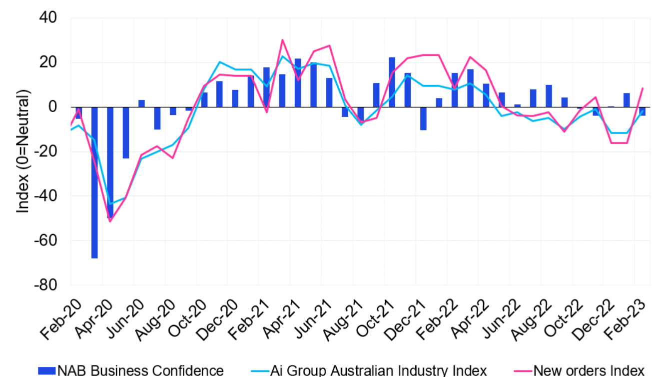


Source: ABS, KPMG

Looking forward, the production outlook appears mixed. It is true that unfavourable weather has been a recurrent theme, driving down output in agricultural, manufacturing and electricity sectors, and potentially signifying that the 2022Q4 real GVA growth slowdown is temporary. This is further substantiated by the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) March 2023 Outlook, which highlights record production in 2022/3, and agricultural production to fall thereafter with the return of drier conditions.

However, the probability of activity picking up sustainably over the medium term remains uncertain. The Ai Group Australian Industry Index® has continued to remain in contraction zone since the start of RBA's monetary policy tightening cycle. Business confidence is pessimistic, as indicated by NAB's business confidence sitting at -4 in February 2023. Mounting pressures in the form of a skilled labour shortage, high wage costs, high costs of financing, and elevated input costs are clouding producers' sales and profitability expectations. Nonetheless, business conditions has remained strong relative to history. New orders have picked up in February 2023, and global supply issues are easing. If these positive trends are sustained, industry production may even out over the year.

Chart 7 – Business conditions indicators



Source: Haver, KPMG

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Consumption

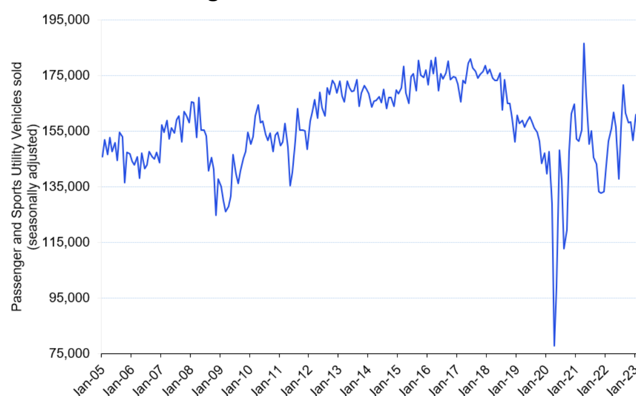
Household consumption, which makes up more than half of the economy's GDP, has been under stress lately. Household consumption growth moderated to 0.3 percent in the December 2022 quarter, decelerating from 1.0 percent in the previous quarter. This marked the lowest growth rate throughout the year, with the sluggishness in consumption growth driven by households tightening their belts because of more difficult financial conditions and post-Covid catch-up spending now dwindling.

High interest rates played a major role in discouraging consumption, as a higher share of household budgets were being allocated to mortgage payments. Furthermore, households are now being impacted by substantial cost of living increases with inflation reaching record highs by the end of 2022.

Although, some relief came in the form of higher wages growth because of the labour market being extremely competitive, bracket creep coupled with high interest payments resulted in declining disposable income. Australian households are now back to achieving 'normal' saving buffers with the household saving ratio back down to 4.5 percent, leaving less room for households to bolster consumption through savings.

Higher frequency data suggests that the morosity surrounding consumption spending will perpetuate through 2023Q1. There was a broad-based decline in household spending in January 2023. The seasonally adjusted household spending index was down nearly 15 percent m/m in January. Consumers were cautious in their spending decisions, as can be observed with discretionary spending falling by 22 percent, far exceeding the drop in non-discretionary spending of around 7 percent. This is further seen through the level of new motor vehicle sales verging to below pre-pandemic levels.

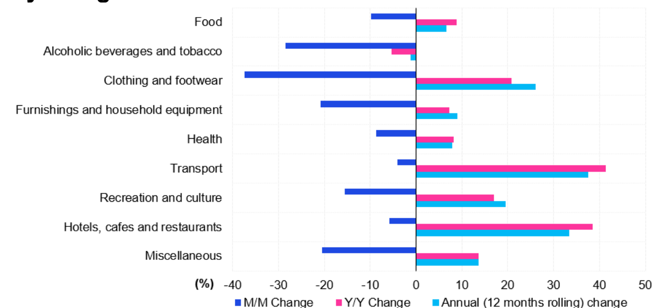
Chart 8 – Passenger vehicles and SUV sales



Source: Haver, KPMG

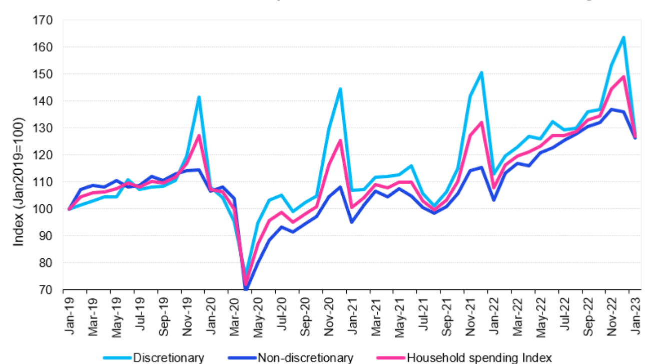
Household consumption is expected to dampen further as the year progresses. As consumption constitutes the majority share of domestic demand, the outlook for domestic growth looks poor. Consumer sentiment has consistently remained unfavourable since March last year, with the prevalent consumer sentiment level comparable to crisis periods such as the pandemic or the 2007/8 Global Financial Crisis.

Chart 9 – Calendar adjusted household spending by categories



Source: ABS, KPMG

Chart 10 – Calendar adjusted household spending



Source: ABS, KPMG

The outlook for household is not expected to improve through to the medium term either albeit it is being underpinned by resilient labour markets and some remaining excess savings. Inflation remains outside the RBA's target range, and although the RBA is now slowing down the pace of rate hikes, it will still need to maintain a tight monetary policy stance to bring inflation within the target range of 2-3 percent. The financial burden across the household sector will also worsen through the year as the roll-off of fixed term mortgages accelerates through FY24. Add to this real purchasing power falls due to lower nominal wage growth than headline inflation and continuing cost of living pressures that are already locked in for this year (such as the 20 percent to 24 percent increase in the default electricity market offer which is due to commence on 1 July 2023) then household consumption is likely to remain under pressure for some time.

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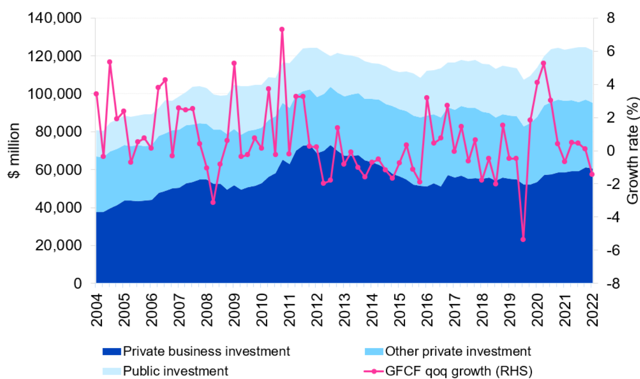
Investment

Investment activity fell marginally by 1.4 percent in 2022Q4, with both private and public investment dropping during the quarter. The largest decline was led by a fall in private investment, which constitutes more than three-quarters of total investment in the economy. Investment is a powerful growth engine, and the stagnation of private investment is a cause of concern for Australia's future economic prosperity.

Chart 11 – Public and private investment

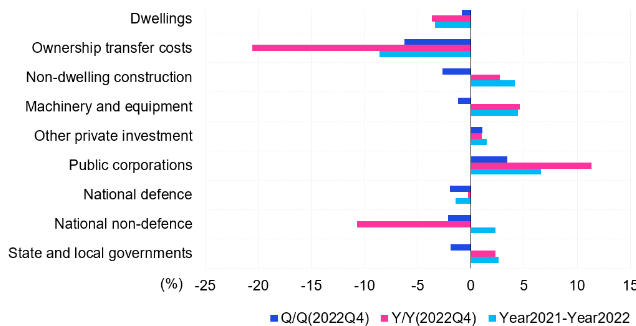


Source: ABS, KPMG

Overall, dwellings investment fell marginally, with renovation dwelling investment dropping throughout 2022, although this was cushioned by a rise in new and used dwellings investment. High interest rates continued to impact activity in the property sector, as reflected in the fifth consecutive drop in ownership transfer costs during the quarter.

House sales were subdued, as prospective house owners' funding capacity has been diminished by higher borrowing costs. Sentiment around the acquisition of new dwellings has also soured markedly, with Westpac-Melbourne Institute's 'Time to buy a dwelling' index now prevailing at levels not seen since September 1989.

Chart 12 – Investment growth rates

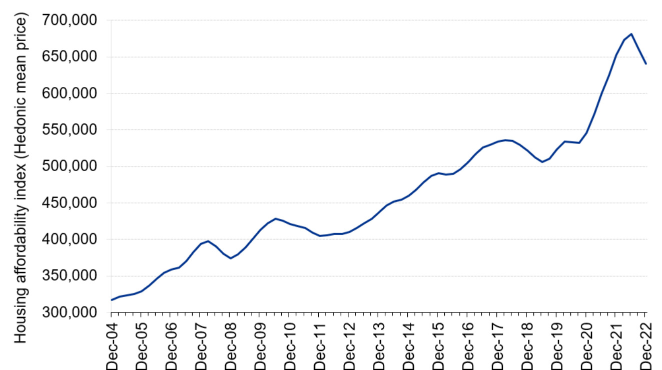


Source: ABS, KPMG

The property market has been losing strength since the middle of 2022, with average dwelling prices down around 6 percent from the 2022Q4 peak. This drop follows strong prices that had been prevailing up to mid-year 2022.

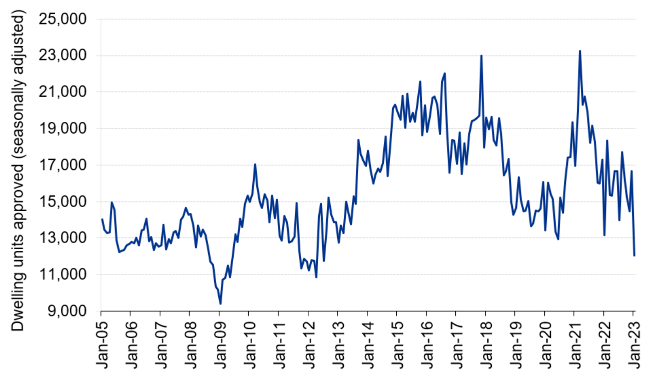
Looking forward, housing demand is expected to remain weak due to high mortgage rates, but this might be offset by demand from incoming migrants who are now returning to Australia in great numbers following the reopening of borders. This demand pressure is occurring just as housing supply limps forward as the number of dwelling units approvals has consistently fallen since March 2021, dropping sharply to 12,065 in January 2023.

Chart 13 – Housing prices



Source: Housing Industry Association, KPMG

Chart 14 – Dwelling units



Source: ABS, KPMG

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A drop in public investment accentuated the decline in total investment. While general government's defence and non-defence-related spending fell during the quarter, the decline was partially offset by an increase in capital spending by public corporations.

Large-scale investment projects not only boost the medium- and long-term productive capacity of the economy, but also act as employment hubs, creating a number of jobs over the life of the project. For example, the Australia Renewable Energy Hub, a $53.6 billion green hydrogen and ammonia production facility in Western Australia, is estimated to add 5,000 construction roles and a further 3,000 ongoing jobs. As per the Major Projects Facilitation Agency there are 25 projects currently holding Major Project Status in Australia, with 13 in Western Australia, five in the Northern Territory, three in New South Wales, two in Victoria and one each in South Australia and Queensland.

In the near term, significant public expenditure has already been earmarked for road and rail infrastructure upgrades in Victoria and New South Wales. These include projects such as the West Gate Tunnel, the Level Crossing Removal project and the Suburban Rail loop in Victoria, and the economy's largest public transport project, the Sydney Metro in New South Wales.

Infrastructure Partnerships Australia Pipeline Forecast by Expenditure analysis shows spending on major infrastructure projects rising through 2023 with peak quarterly expenditure expected at just under $20 billion in 2024Q4 and then staying elevated at between $18 billion and $20 billion per quarter until the end of 2025.

The December quarter survey of private new capital expenditure is showing strong forward momentum for both the remainder of FY23 and into FY24. Estimate 5 in current prices for FY23 ($79.9 billion in actual spend for FY23H1 and $78.7 billion in expected spend for FY23H2) is 12.6 percent higher than FY22 Estimate 5, and based on average realisation rates for FY21 and FY22 final private new capital expenditure for FY23 is likely to end up at around $162 billion. The latest survey also provides the first estimate of expected private new capital expenditure for FY24 at $129.7 billion, which is about 11 percent higher than Estimate 1 for FY23. Given non-residential building construction and heavy and civil engineering construction both experienced strong price growth over the past 12 months (8.7 percent and 9.6 percent respectively), this double-digit expected capex growth is unfortunately only likely to translate into marginal investment growth.

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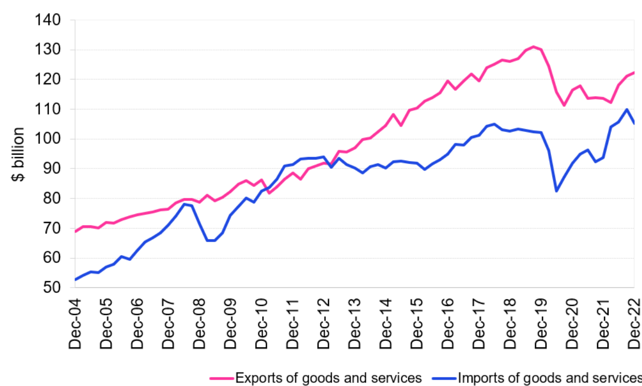
Net exports

Net exports were the main growth driver in 2022Q4. Whilst domestic demand was lacklustre, with private demand subtracting 0.1 percentage point from real GDP growth, offset by 0.1 percentage point contribution from public demand, net exports of goods and services contributed 1.1 percentage point to the quarter's growth. The external demand component remained positive, as exports rose, primarily on the back of a rising demand for services, supported by a rather sharp decline (-4.3 percent) in goods and services imports.

Chart 15 – Imports and exports of goods and services



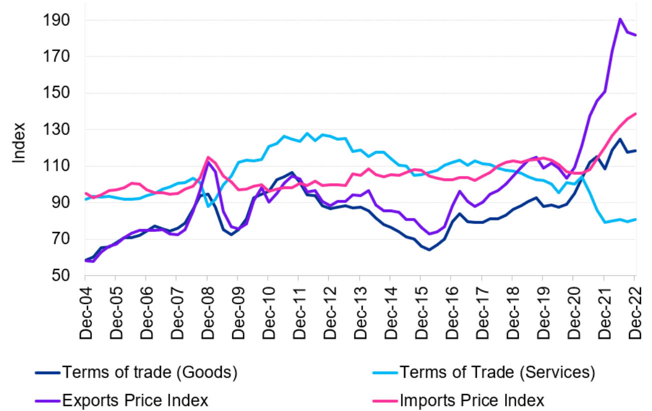
Source: ABS, KPMG

The price of Australian exports has remained elevated throughout 2022. The ongoing war between Russia and Ukraine disrupted world energy markets which led to a surge in the price of 'Coal, coke and briquettes' – Australia's second largest export.

Export prices have somewhat eased through the last two quarters of 2022, as the global supply issues improved and global demand ameliorated due to several factors, including tighter monetary policy settings across most advanced economies and the restrictions put in place to manage the spread of Covid in China.

Import prices have remained elevated, contributing to inflationary pressures in the economy. Import prices were influenced by the continued strength in the US dollar, which has been appreciating due to its safe-haven appeal in the context of global uncertainty as well as the increase in the Fed Funds rate. However, this was partly countered by a fall in petroleum import prices as global oil prices continued to stabilise.

Chart 16 – Terms of trade

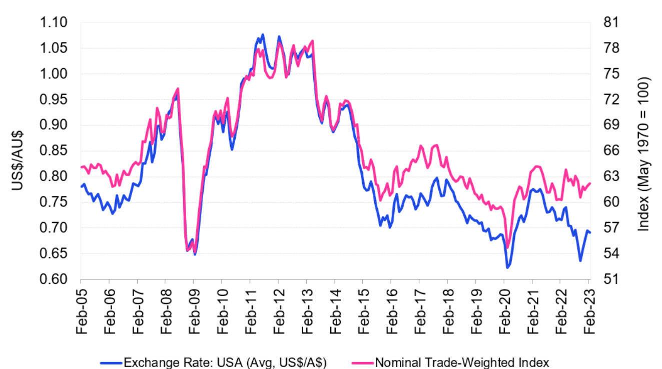


Source: ABS, Haver, KPMG

Forex markets have been mixed, owing to global markets uncertainty. Whilst initially the greenback appeared to be shedding some of its strength, built up since the beginning of 2023 amidst recession fears and a less hawkish stance adopted by the US Federal Reserve, banking sector turmoils have led to increased risk aversion.

Markets are broadly expecting the RBA to have reached the terminal cash rate in this tightening cycle, leaving a strong interest rate differential between policy rates in Australia and the US.

Chart 17 – Australian dollar exchange rates



Source: ABS, KPMG

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Net exports will likely remain in positive territory through 2023. As per the March 2023 release of the US Energy Information Administration (EIA) Short Term Economic Outlook Report, brent crude oil prices are expected to drop from an average of US$101/barrel to US$83/barrel in 2023, although OPEC+ has just announced a further cut to the cartel's oil production targets by more than 1 million barrels per day. Other upside risks around oil prices are likely to come from an increase in demand in China as it lifts its post-Covid economic activities and the fallout associated with the imposition of sanctions on Russia's seaborne petroleum product exports.

The main driver of external demand for Australian goods and services is still likely to come from our single largest trading partner, China, especially so given strong growth prospects for the economy as it abandons its strict Covid policies and starts lifting off official and unofficial trade sanctions on Australian commodities.

The scarcity in global commodities, driven in part by the Russia/Ukraine war, has enabled Australian exporters to diversify their traditional buyer cohorts, albeit some coal exporters already had to draw down inventories to meet demand last quarter.

Although volume-wise the value of exports is expected to be sustained due to strong demand, international prices of iron ore and coal, which constitute approximately half of Australia's total exports are expected to dip throughout 2023, as prices stabilise due to improvements in global supply.

External demand assumptions

	2023Q1	2023Q2	2023Q3	2023Q4
Exchange rate: Australian dollar/US dollar	0.69	0.70	0.71	0.72
Thermal coal price (US$/tonne)	327	247	235	246
Semi soft coking coal price (US$/tonne)	240	238	223	220
Gold price (US$/oz)	1,823	1,825	1,841	1,866
Dalian Iron Ore 62% Futures	912	851	799	769
Brent Spot Average (US$/barrel)	83	84	83	81
West Texas Intermediate Spot Average (US$/barrel)	78	78	77	75

Source: Refinitiv Eikon, except for energy prices which are taken from the US Energy Information's Administration Short Term Energy Outlook March 2023, KPMG

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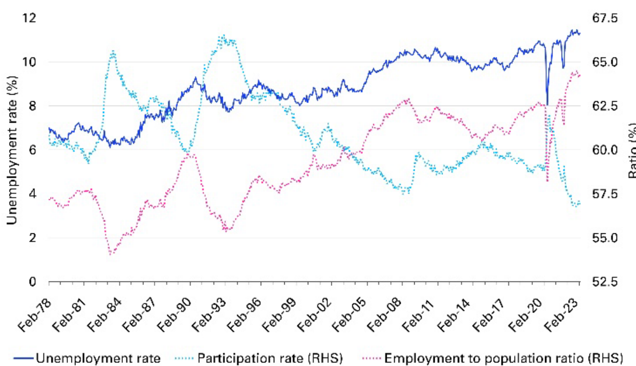
Labour market

The labour market in Australia has continued to experience tight conditions into 2023. After a small rise in the unemployment rate in January (as a result of higher than normal levels of workers changing jobs and taking extended holidays – which technically meant those individuals were unemployed for the purposes of the ABS Labour Force Survey), February's labour data reaffirmed the underlying strength in Australia's labour market with the unemployment rate falling back to 3.5 percent. This level of unemployment remains at one of the lowest readings since the availability of ABS records from 1978, with the participation rate similarly at near record highs at 66.6 percent.

Chart 18 – Historical labour market data

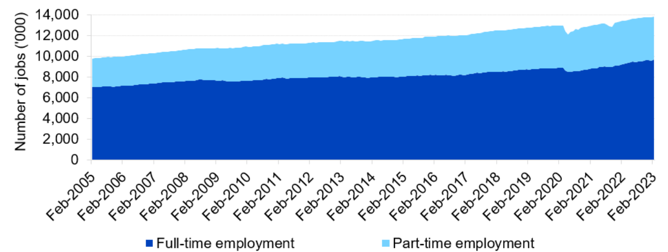


Source: ABS, KPMG

As at February 2023, more than 13.8 million people were employed, meaning 64.3 percent of Australia's population had a job. Employment has generally been on an upward trend since April 2022, and is noticeably rising at a steeper rate compared to the pre-pandemic level. The increase in the number of full-time jobs far outpaced the increase in the number of part-time jobs, reflecting the fact that employers are keen to lock in their workforce.

With unemployment holding near historical lows, the labour market strength storyline is substantiated by the fact that more than 925,000 people were employed in multiple jobs. In terms of hours worked, the February data reflected the return to normalcy, as data was no longer influenced by sick leaves or holiday leaves, compared to prior years. The hours worked index increased by 5 percent y/y in February 2023.

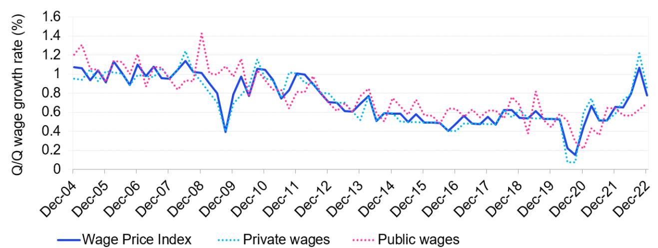
Chart 19 – Full-time and part-time employment



Source: ABS, KPMG

In comparison to the ongoing labour market strength, wage pressures remain relatively contained. The q/q wage price in comparison to the ongoing labour market strength, wage pressures remain relatively contained. The q/q wage price index growth decelerated from 1.1 percent in 2022Q3 to 0.8 percent in the December quarter. On an annual basis, the seasonally adjusted wage price index was higher by 3.3 percent. The largest increase to the wage price index came from the accommodation and food services industry, coinciding with an increase in award prescribed by the Fair Work Commission Annual Wage Review. Notwithstanding that, wage growth would have been even weaker. Private sector wage growth continued to outpace public sector wage growth, primarily because of the ongoing public sector wage cap. However, whether this trend would perpetuate through 2023 is doubtful, especially with the new NSW Labor Government's election promise to uplift public sector wages.

Chart 20 – Wages growth



Source: ABS, KPMG

Labour market strength is expected to ebb gradually until the end of the year. Leading labour market indicators, namely SEEK's jobs ad index, shows that labour demand pressures may have already started to fall. The jobs ad index in February 2023, albeit higher than pre-Covid levels, was sitting at a level nearly 20 percent below the May 2022 peak. Furthermore, the reopening of orders and an expected increase in the number of migrants will help alleviate problems linked to the acute labour shortages that businesses had been dealing with. As such, we are expecting the unemployment rate to gradually rise from near historical lows to levels closer to full employment by mid-2024.

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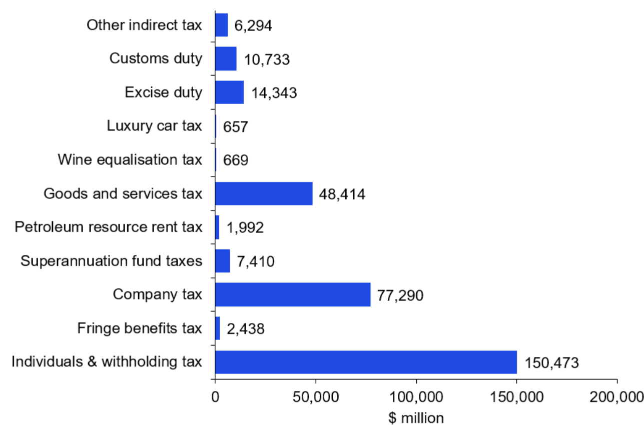
Government

Public demand contributed 0.1 ppt to quarterly change in GDP in the December quarter. It was driven by an increase in public consumption, which remained elevated compared with the pre-Covid level.

Chart 21 – Taxation revenue sources



Source: DoF, KPMG

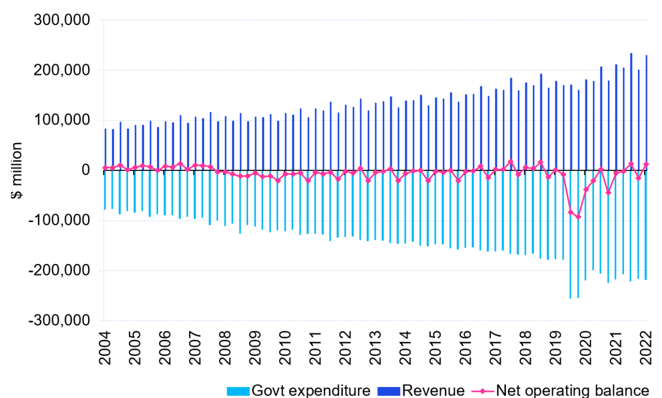
The October 2022-23 Budget had forecast an underlying cash balance deficit of nearly $37 billion, or 1.5 percent of GDP, in 2022/3, which itself was a material downwards shift from the March 2022 budget estimates of a deficit equal to around 3.4 percent of GDP.

The latest Department of Finance Monthly Financial Statement shows the YTD (to February 2023) deficit is now $12.9 billion compared to budget projections of $33.4 billion. This favourable budget position is due to both higher than anticipated receipts (+$13 billion) and lower than expected payments (-$7.5 billion). Personal income tax and company income tax are achieving significant positive variances to budget expectations ($5 billion and $6 billion respectively), while some expenses are well behind the average monthly run-rate, including expenses associated with government functions related to housing and community amenities; agriculture, forestry and fishing; and transport and communications.

Consistent with the Department of Finance summaries, government revenue increased significantly in the December 2024 quarter by approximately 15 percent. Individuals and withholding tax collections as a percentage of total tax revenue increased despite the tax cuts because of the strong labour market. The net operating balance also benefited from higher corporate taxes driven by high commodity prices. In addition, revenues from Goods and services tax (GST) collections increased because of seasonal holiday spending.

Government expenditure was little changed from the September quarter. The government continued providing assistance to those who were affected by the floods in New South Wales and Queensland, as well as the National Disability Insurance Scheme.

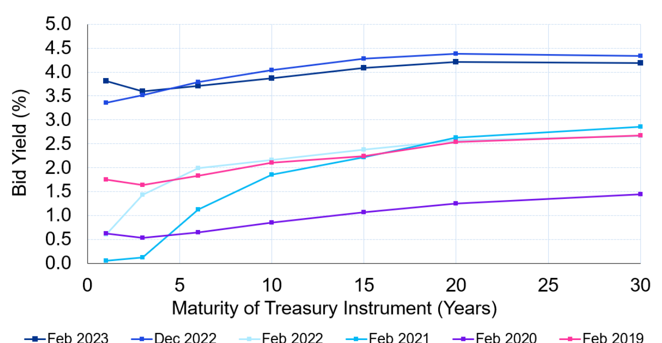
Chart 22 – Government balances



Source: ABS, Haver, KPMG

Going forward, KPMG expects the fiscal stance to remain neutral. Government expenditure has remained elevated since the pandemic but is expected to revert in light of the expiry of the COVID-19 support packages. Revenues will be supported by strong labour and wage growth. However, there is more uncertainty around revenues from Corporate Tax, as commodity prices are projected to fall in 2023. Overall, Australia has ample fiscal space, with net debt projected to be around 23 percent of GDP in 2022/3, the country's net debt position is the lowest amongst G7 peers.

Chart 23 – Yields on Commonwealth Government Bonds



Source: Refinitiv, KPMG

Recent developments in the banking sector reversed the increase in government yields observed in the December quarter 2022 and inverted the yield curve at the short end. The consensus view going forward is that inflation is on track to be back to target and the end of the tightening cycle appears to be close.

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Forecast

GLOBAL	Annual GDP Growth[1]			Unemployment Rate[2]			Average Annual Inflation[3]		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	3.1	2.1	2.6	5.2	5.2	5.4	7.4	5.3	3.2
Euro Area	3.5	0.6	1.4	6.7	6.8	7.1	8.4	6.4	2.0
UK	4.0	-0.3	0.6	3.7	4.1	4.6	9.1	6.3	1.8
US	2.1	0.9	1.3	3.6	3.6	4.3	8.0	4.3	2.4
Brazil	3.0	0.8	2.2	9.4	9.0	8.8	9.3	6.4	4.9
China	3.0	5.7	5.2	5.6	5.3	5.2	2.0	2.4	2.2
India	7.0	6.4	6.9	7.5	6.0	5.4	6.5	5.3	4.4
Indonesia	5.3	4.6	5.0	5.5	5.3	5.2	4.2	4.0	3.1
Japan	1.0	1.1	1.2	2.6	2.4	2.4	2.5	2.9	1.0
Singapore	3.6	1.7	2.5	2.1	2.1	2.1	6.1	4.7	2.6
South Korea	2.6	1.1	2.2	3.1	3.4	3.5	5.1	3.2	1.9
Taiwan	2.5	2.0	2.6	2.9	2.0	2.0	3.7	3.8	3.8
Vietnam	8.0	5.9	6.5	3.2	3.7	3.2	3.8	3.3	3.3
Australia	3.7	1.4	1.0	7.8	3.3	3.9	3.5	4.0	4.8
New Zealand	2.7	1.1	1.0	7.2	5.6	2.9	3.3	4.1	4.8

[1] GDP growth calculated as (GDP q1-q4 t / GDP q1-q4 t -1) [2] Estimated unemployment rate at end of year. [3] Estimated average inflation though the year.

AUSTRALIA	Jun-22	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25
Consumption	3.7%	6.5%	5.5%	1.8%	0.6%	0.0%	1.6%	2.3%
Business Investment	7.0%	3.7%	3.2%	0.2%	-0.6%	0.8%	2.6%	3.2%
Housing investment	5.9%	-4.7%	-7.2%	-4.2%	-0.5%	2.3%	4.9%	5.7%
Government	6.4%	4.8%	1.4%	0.6%	1.2%	1.2%	0.7%	0.5%
Exports	-0.3%	3.3%	7.3%	5.7%	3.5%	3.3%	3.6%	4.2%
Imports	6.9%	12.6%	8.6%	2.5%	3.4%	3.8%	3.2%	3.5%
GDP	3.7%	3.7%	3.1%	1.4%	1.2%	1.1%	1.8%	2.3%
Headline CPI	6.1%	7.8%	6.5%	4.4%	3.5%	3.0%	3.0%	2.9%
WPI	2.6%	3.4%	5.6%	5.6%	3.9%	3.2%	3.2%	3.2%
Real WPI	-3.3%	-4.1%	1.2%	2.3%	-0.7%	-0.6%	-0.5%	-0.5%
Current account balance*	2.4%	2.4%	1.0%	0.5%	-0.4%	-1.0%	-1.3%	-1.5%
Government budget*	-2.8%	-1.7%	0.1%	-0.4%	-0.9%	-0.6%	-0.5%	-0.4%
RBA Cash Rate*	0.9%	3.1%	3.9%	3.6%	3.5%	3.1%	3.1%	3.1%
10-government bond*	3.4%	3.7%	3.7%	3.5%	3.4%	3.4%	3.3%	3.3%
AUD/USD*	0.71	0.66	0.70	0.70	0.70	0.71	0.71	0.71
Terms of trade	7.8%	7.2%	-13.1%	-10.8%	-6.6%	-6.7%	-5.1%	-3.4%
Employment	3.6%	5.0%	1.3%	0.1%	0.6%	1.1%	1.5%	1.6%
Unemployment rate*	4.0%	3.5%	3.6%	4.0%	4.6%	4.8%	4.8%	4.8%
Dwelling price	9.4%	-2.0%	-1.2%	-0.2%	1.2%	2.7%	3.3%	3.5%

*=values at end of period

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