Australia Economic Outlook Q2 2023

KPMG Australia

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Contents

Executive summary

The economic outlook for the world economy is softening as the year progresses. Inflation has peaked but remains well above target levels, with core inflation in many economies being stubbornly persistent. Central banks are now applying strong-arm tactics to slow aggregate demand, with the increasing likelihood that some Western economies will get tipped into a shallow recession as a result.

The Australian economy entered 2023 relatively strongly, however the first quarter of year has seen output growth slow considerably as higher interest rates and inflation start to bite. Overall GDP growth of 0.2 percent for March Quarter 2023 was driven by domestic demand (+0.6 percent), with net exports (-0.2 percent) and inventories (flat).

With population growth running at 0.5 percent for the quarter, per capita GDP growth recorded a negative outcome at -0.2 percent – the first time this has occurred, excluding the period of the COVID pandemic, since 2018. More concerning is the continued decline in productivity, which has seen the annual change in real GDP per hour worked fall for the past four quarters – and at an increasing pace. Conversely real unit labour costs have swung around in the March quarter recording 1.1 percent annual growth.

This combination of falling productivity and rising wages is worrying. How much of this reflects a timing difference between businesses gearing up with new staff and new plant and equipment (which is running at a rolling four-quarter annual growth rate of 5.4 percent), and how much of this reflects a structural challenge in the economy is difficult to disentangle.

Nonetheless, the RBA will have recognised these facts as unhelpful in its mission to bring inflation back under control in a "reasonable timeframe". Even though the June Board meeting of the RBA was a few days in advance of the release of the 2023 March Quarter National Accounts by the Australian Bureau of Statistics, various partial indicators were pointing to wages now growing faster than output in many parts of the economy.

The RBA has signalled to the Australian community a preparedness to do whatever it takes to bring inflation back down to the 2-3 percent target band, which at this stage is not being forecast to be achieved until mid-2025. Interestingly the strong hawkish tone of the Statement by Governor Lowe on the Monetary Policy Decision released on 6 June is somewhat more muted in the Minutes of that same meeting which were released about two weeks later.

The markets are anticipating a near 100 percent chance of a further 25bp rise in the cash rate by August 2023 and again by November 2023, taking the cash rate to 4.60 percent by the end of the year and it being kept there until around August or September 2024.

This cash rate profile is materially higher than the market and many economists were expecting even as recently as a month or two ago. The consequence of considerably stronger cash rate profile is an even greater slowing in aggregate demand than was forecast in KPMG's March Quarter 2023 Quarterly Economic Outlook (QEO).

This slowdown is now anticipated to push Australia into a stagnation economic profile for the remainder of 2023 and into the first quarter of 2024. Despite consumption holding up somewhat – largely because of the strong return of net overseas migration – housing investment is now expected to weaken considerably, with business investment falling away towards the end of the year and into the next. Australia's labour market is also expected to weaken, with the unemployment rate pushing up from its current low level of 3.6 percent to high-4 percent range by the end of 2024.

	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25
GDP (Real)	3.7%	3.0%	1.2%	0.2%	-0.2%	0.4%	1.5%
Inflation*	7.8%	6.3%	4.2%	3.3%	2.9%	2.6%	2.5%
Unemployment*	3.5%	3.6%	4.0%	4.3%	4.8%	5.0%	4.9%
AUD/USD*	0.660	0.677	0.678	0.680	0.680	0.681	0.681

Global landscape

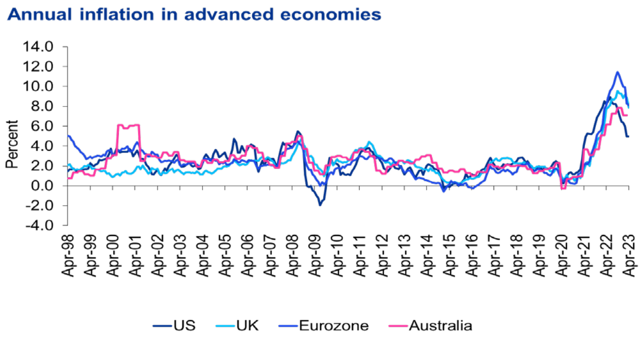
Inflation may have peaked, but upside risks could make the monetary policy tightening more challenging.

Inflation gradually falling from recent peaks

Inflation dynamics are being driven by a divergence between goods inflation and services inflation. Goods inflation has steadily declined, as supply chain problems that emerged during the pandemic have now evaporated and global shipping costs have normalised. Furthermore, demand – especially for durable goods – has ebbed as consumers tighten discretionary spending in response to higher costs of living. While headline inflation appears to be rapidly falling in some developed economies, core inflation remains problematically high, driven largely by a surge in the demand for services back to pre-pandemic levels.

Labour markets continue to remain tight, with the unemployment rates holding below the historical trend levels. Nonetheless, some signs of easing in labour demand is now showing. The number of vacancies is gradually starting to fall, while nominal wage growth is also seemingly decelerating in some economies.

Chart 1 – Annual inflation in advanced economies



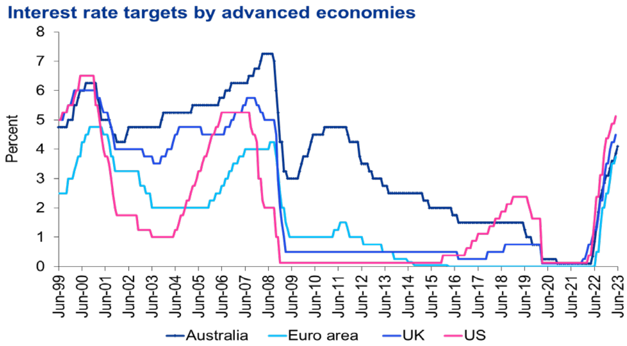
Source: ECB, ONS, ABS, BLS, Haver, KPMG

KPMG expects global headline inflation to continue to decline through the remainder of 2023, reflecting the easing of supply issues as well as the lagged impact of monetary policy tightening. That being said, inflation has tended to surprise on the upside recently, and there seems to be a considerable degree of persistence in core inflation. The risk is that consumers respond to the recent excessive surge in prices by adjusting their inflation expectations upwards. Inflation may also remain more elevated if contracts and agreements with an indexation component, start to be adjusted upwards at these last quarter/year (higher) values which would bake-in inflation for an extended period, requiring central banks to chase their tails and keep ratcheting up policy rates.

Greater uncertainty about monetary policy paths

With inflation, albeit receding from peaks, at levels beyond central bank target ranges, central banks in major advanced economies continue to rally efforts to bring inflation down.

Chart 2 – Policy rates in advanced economies



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

Banking stress concerns have alleviated and financial conditions continue to remain tight on account of monetary policy tightening, and do not seem to have been aggravated by the recent banking turmoils. The US dollar has depreciated on average against a basket of other currencies, due to narrowing interest rate differentials. There seems to be wider consensus that the US policy rate may indeed be close to its peak, especially following the debt ceiling discussions and the emergency advance of a bill in that respect.

Markets seem to be pricing in expectations that policy rates are near their peaks. Central bankers, however, have continued to signal to the market they are prepared to have a 'whatever it takes' approach to fight inflation.

Divergent growth trajectories

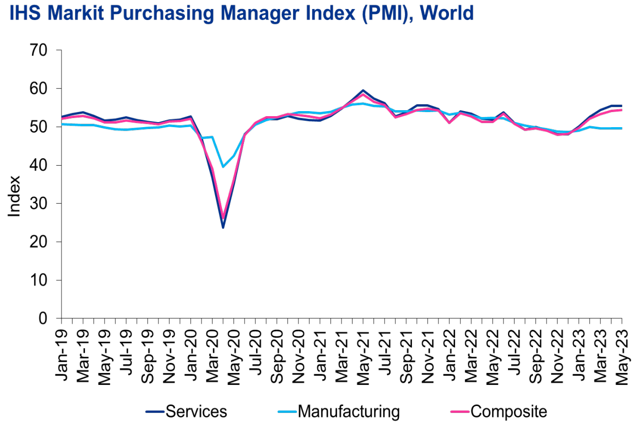
The World Bank's June 2023 Global Economic Prospects warns of a fragile world economy throughout 2023 and 2024, with a higher risk of a deeper downturn if financial market instability persists and more aggressive contractionary monetary policy are required to address inflation.

Global growth is now expected to fall to around low-to-mid 2 percent range in 2023, gradually picking up to mid-to-high 2 percent range in 2024 and around 3 percent in 2025.

Financial conditions have 'tightened' across most countries following rapid increases in policy rates. Added to this is the continuing conflict between Russia and Ukraine which is still predominantly impacting markets across Europe.

Despite these collective headwinds, the global economy started 2023 remarkably well, and to some degree this positivity ebbed into the second quarter as well. The upturn in growth at the beginning of the second quarter is led by the services sector. The JP Morgan/S&P Global Services PMI rose steadily to an 18-month high in May 2023. Meanwhile, the manufacturing PMI continued to remain in the contraction zone, and business confidence amongst firms in the sector dampened. New orders failed to pick up, reflecting subdued demand.

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



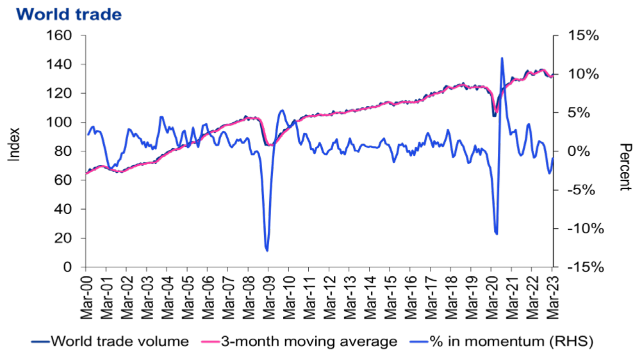
Source: JP Morgan, S&P Global, Haver, KPMG

The economic outlook for the second half of 2023 is expected to be more positive compared to the first half. This is due to the anticipated strengthening of the Chinese economy, supported by government stimulus measures and a rebound in the property sector, as well as increased spending in the services sector following the easing of lockdown restrictions.

World trade to improve in 2023

Trade volumes remain tepid following a decline in the final quarter of 2022, although they picked up slightly in the first quarter of this year as supply issues in the semiconductor industry resolved themselves and external demand from China picked up following the reversal of its zero-COVID policy. Nonetheless, anaemic trends in shipping volumes and transport prices, combined with weak demand in the manufacturing sector, suggesting trade volumes will be soft in the immediate outlook.

Chart 4 – World trade



Source: CPB, Haver, KPMG

Outlook for global economic growth

Trade volumes have been declining, since the first quarter of 2022. However, there was a slight improvement in the first quarter of this year as semiconductor supply issues were resolved and external demand from China rebounded after the reversal of its zero-COVID policy. Nevertheless, shipping volumes and transport prices remain low, and weak demand in the manufacturing sector indicates that trade volumes will likely remain soft in the near term.

With high inflation causing concerns about the cost of living worldwide, there is limited room for expansionary fiscal policy. Implementing such policies is likely to prolong the inflationary challenges addressed by monetary policy. Additionally, many economies have exhausted their fiscal resources due to the various government support programs implemented during the COVID-19 pandemic.

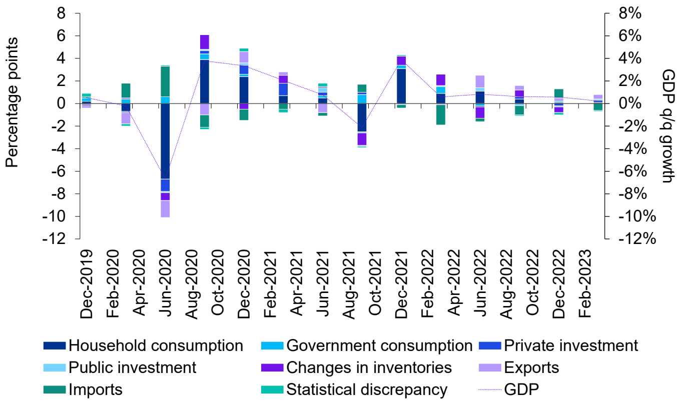
Australia overview

Stagnation now appears the most likely short-term outcome for the Australian economy as monetary policy bites.

Since the release of the 2023 Q1 edition of the KPMG QEO we have revised down our short-term economic forecasts for Australia. The downside scenario we have been monitoring is now looking more likely leading us to adopt a slightly more pessimistic outlook than previously forecast, suggesting a short-term growth profile that was marginally positive for the remainder of 2023 and into 2024, will now be a mix of flat and marginally negative growth over the same period.

This outlook reflects the definition of economic stagnation, with virtually zero growth and rising unemployment, with the economy predominantly negatively affected by a drawn out downturn in housing investment, followed by a subsequent slowdown in business investment towards the end of 2023 and into 2024.

Chart 5 – Contribution to quarterly GDP growth



Source: ABS, Haver, KPMG

The RBA, like other central banks in developed economies which are experiencing high, sticky inflation, appears now to be ratcheting up policy rates further despite many economists and market commentators believing interest rates were very near their peak at the end of 2023 Q1. The dialling-up of a more 'hawkish' position by the RBA appears to be driven by several factors, including:

- The monthly CPI rose to 6.8 percent y/y in April from 6.3 percent y/y in March, and core inflation (as measured by the 'trimmed mean' series also increased from 6.5 percent to 6.7 percent.
- The return to escalating property prices across most markets following the RBA's pause in rate rises in April.
- A continued expansion in the labour market with nearly 220,000 additional workers employed during the five months from the end of 2022 to May 2023, with the maintenance of a near 40-year low unemployment rate at 3.6 percent.
- Lacklustre productivity growth occurring concurrently when wages have been growing at their fastest pace for more than a decade, leading to rising unit labour cost – which has proved to be correlated with inflation. This wages growth is now driving services sector inflation, which means it is likely to be more persistent than previous forecasts considered.

In terms of fighting inflation it seems the RBA is doing most of the heavy lifting, with fiscal policy settings at best neutral, or arguably, unhelpful in reducing aggregate demand.

Arguably, fiscal policy needs to do more to help bring inflation back to the target band. Recent research completed by ANU found higher government spending during the pandemic was responsible for around 60 percent of the annual consumer price inflation recorded at the end of the December quarter 2022 (as compared to the counterfactual 'no-COVID scenario'). In 2019–2020, government spending as a proportion of GDP equalled 25.0 percent, while over the coming four years government spending is forecast to average 26.7 percent of GDP.

KPMG views fiscal policy as an important tool in the fight to control inflation. Government's have the tricky challenge of framing fiscal policy to work in tandem with monetary policy at a time when cost of living pressures are impacting the most vulnerable in society and make good on recent election promises. The RBA's job of getting inflation under control will be made easier if fiscal policy becomes less expansionary.

Separately, the Commonwealth Government budget forecast a $4 billion budget surplus for the 2022–23 financial year, the first time a surplus has been achieved in 15 years – with recent comments by the Treasurer also suggesting the final budget outcome will be around $19 billion.

This strong budget outcome has essentially been achieved because of windfall gains in personal income tax (driven by an extra 500,000 people employed, combined with higher wages and bracket creep which collectively resulted in around an extra $40 billion in personal income tax receipts over 2021–22) and company income tax (around $15 billion increase from 2021–22) due to commodity prices holding up higher for longer than previous Budget forecasts.

Production

The March quarter of 2023 continued to see activity growth pull back to a soft footing across most industries, with eight out of 19 industries experiencing a contraction in real GVA.

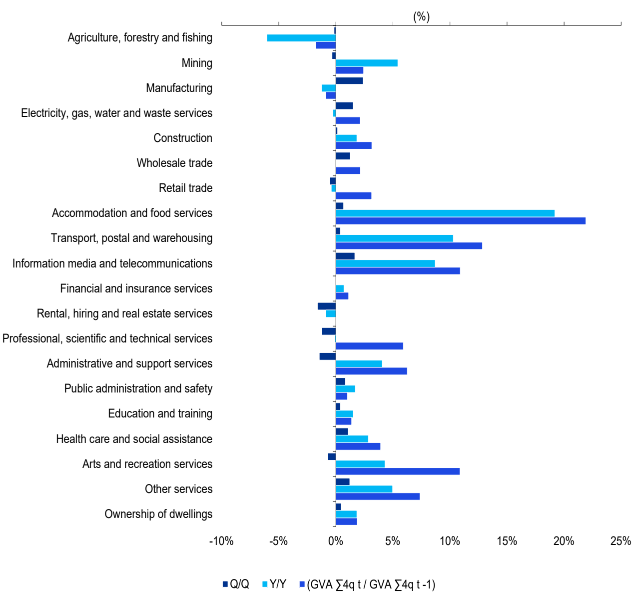
The top three with the largest q/q reduction included:

– *Rental, Hiring & Real Estate Services* (-1.6 percent) due to reduced residential real estate sales volumes, which was partly offset by an increase in equipment hire
– *Administrative & Support Services* (-1.5 percent) owing to a reduction in demand for recruitment and labour hire services
– *Professional, Scientific & Technical Services* (-1.2 percent) driven by lower demand for engineering and consulting services, as well as computer system design and related services.

In contrast, those recording the largest q/q growth were:

– *Manufacturing* (+2.4 percent) in which the largest rise was observed in food, beverage and tobacco products manufacturing driven by increased meat and sugar production
– *Information Media & Telecommunications* (+1.7 percent) due to increased demand for internet and mobile services, which was potentially driven by immigration growth
– *Electricity, Gas, Water & Waste Services* (+1.5 percent) as electricity consumption rose in line with hotter weather.

Chart 6 – Industry Gross Value Added, 2024 Q1



Source: ABS, KPMG

Real GVA in *Agriculture, Forestry & Fishing* inched down by 0.15 percent driven by a fall in agriculture support services and cotton plantings due to flooding in southern New South Wales. Agricultural production is expected to fall in 2023–24 as a result of drier climate conditions that will reduce crop yields. As global prices for most commodities moderate, domestic prices received by producers are also forecast to decline.

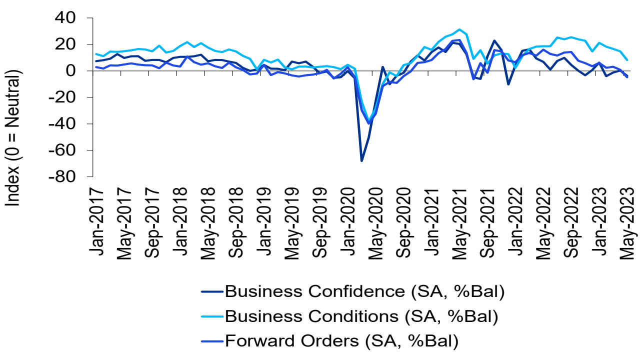
NAB surveys show business confidence fell into pessimism in May with a sharp decline in forward orders. If forward orders continue to stay at these low levels, then business conditions could deteriorate materially, weighing on economic growth. Cost pressures remained in May as growth in labour costs and input prices saw an uptick and stayed at a high level. There was mixed evidence regarding output prices as final product prices growth rose to 1.3 percent, while retail price growth eased.

The production outlook appears weak across most industries through 2023. Industries more dependent on household discretionary spending such as *Retail Trade, Accommodation & Food Services, Arts & Recreational Services,* are expected to experience subdued growth as households tighten their belts.

Construction activity is anticipated to remain soft over the coming months due to challenges related to input and financing costs. Weaker business conditions and high input costs, although supply chain easing is expected to resume, are likely to weigh on growth in *Wholesale Trade* and *Manufacturing* in 2023; however, strong capex plans leading to more demand for machinery and equipment can be a positive factor for these industries.

Forecasts for exports in *Mining* were revised up by the Department of Industry, Science and Resources in March quarter 2023 with a better outlook for iron ore and metallurgical coal earnings, coupled with a depreciation in the Australian dollar compared to the US dollar.

Chart 7 – Business sentiment indicators



Source: NAB, Haver, KPMG

Consumption

High inflation and the rapid tightening cycle have taken a toll on household spending. Real consumption growth decelerated to 0.2 percent in Q1 2023 from 0.3 percent in Q4 2022, marking the weakest quarterly growth since Q3 2021 – notably a COVID lockdown period.

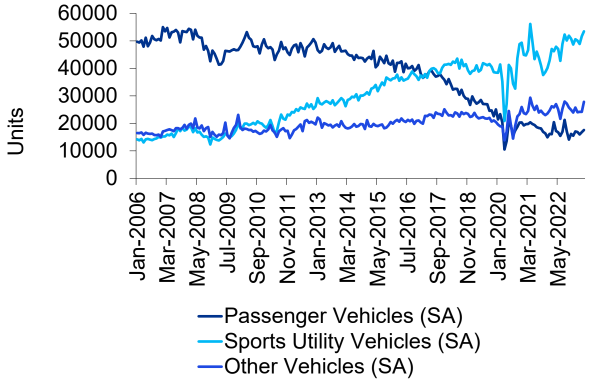
Quarterly growth was led by essential spending, while discretionary spending declined as the pandemic-driven pent-up demand had waned and households had drawn down their saving buffers. The only discretionary spending categories printing a rise were *Transport Services* (+4 percent), *Hotels, Cafes and Restaurants* (+0.2 percent), and *Clothing and Footwear* (+0.2 percent); however, their pace of growth was relatively weak. Overall, growth contracted across most categories compared to previous quarters.

Electricity, Gas and Other Fuel increased by 5.2 percent from Q4 2022 owing to the conclusion of Queensland's cost of living rebate and the warmer end of summer. The largest percentage decline in this quarter was seen in *Purchase of Vehicles* (-2.9 percent), which also witnessed the largest drop in absolute terms. Going into Q2, *Purchase of Vehicles* is likely to improve as seasonally adjusted motor vehicle sales in April and May expanded from the monthly figures recorded in Q1, signalling some easing in supply that was previously hindered by shipping and logistics issues.

Household saving ratio declined from 4.4 percent in Q4 2022 to 3.7 percent in Q1 2023, the lowest since 2008 – just a year ago it still stood at 11.3 percent. This reflects the increase in household consumption due to higher cost of living eclipsed a milder rise in gross disposable income.

Higher frequency data suggests that the morosity surrounding consumption spending will continue through Q2 2023. The calendar-adjusted monthly household spending index has been on a downward trend since February 2023, with annual growth appearing to have peaked in January 2023. As monthly nominal household spending was up by only 6 percent y/y in April, volume may have contracted given the current level of inflation.

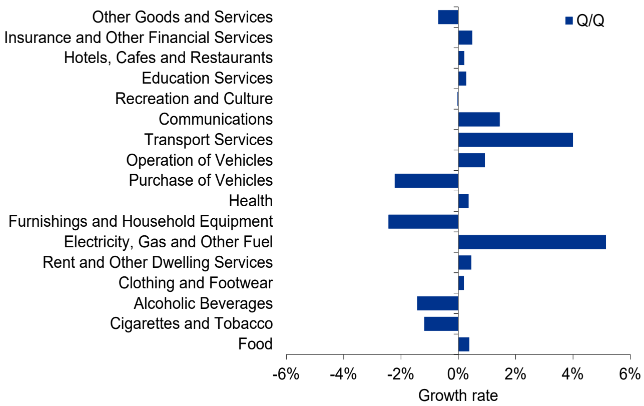
Chart 8 – Passenger vehicles and SUV sales



Source: Federal Chamber of Automotive Industries, Haver, KPMG

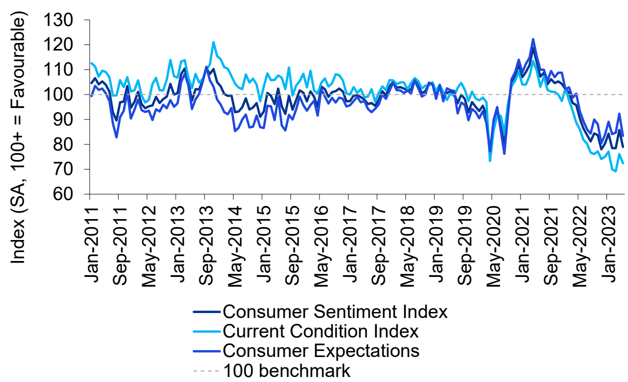
Consumer sentiment has been at sustained pessimistic levels comparable to the deep recession of the late 1980s, with confidence dropping after the surprise rate rise to 4.1 percent in June. Household optimism around jobs observed in the past year seems to be fading quickly over recent months as households expect more monetary tightening to come.

Chart 9 – Household final consumption expenditure, Q1 2023



Source: ABS, KPMG

Chart 10 – Consumer sentiment index



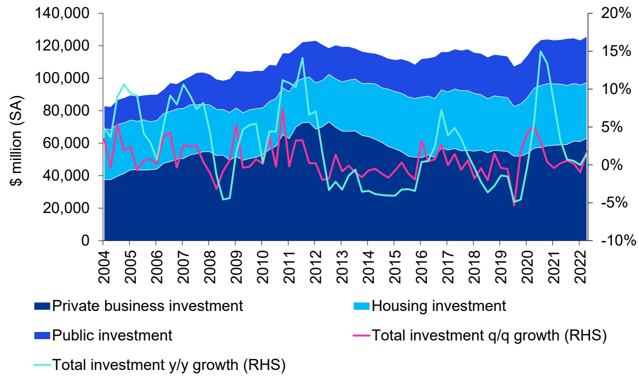
Source: Westpac, Haver, KPMG

Looking ahead, household consumption is expected to dampen further through the remainder of 2023 since the saving ratio has returned to its pre-COVID level, and the risks of high inflation and more interest rate rises remain elevated, with heightened chances of a hard landing. Upside risks to consumption outlook include a strong increase in population and low unemployment rate relative to history, although unemployment is expected to rise through the year.

Investment

Real investment increased by 2.2 percent q/q in 2022 Q4, driven by private business (+3.4 percent) and government investment (+3 percent). Business investment saw a 6 percent uplift from the previous quarter in purchases of machinery and equipment after recent declines, with the main contributors being the manufacturing, transport, and mining industries. Non-dwelling construction rose 2.4 percent q/q on the back of improvements in materials supply.

Chart 11 – Real public and private investment

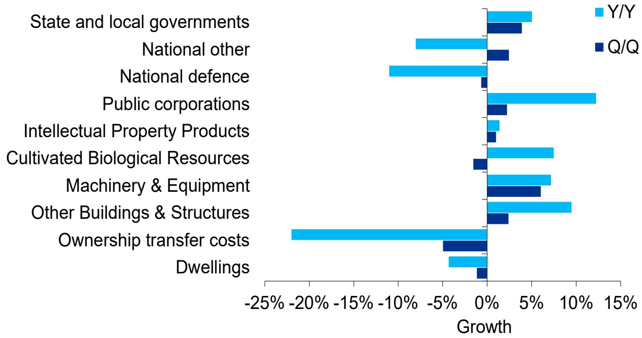


Source: ABS, KPMG

Total housing investment continued to contract, down by 2 percent q/q. This was driven by another sharp decrease of 22 percent in ownership transfer costs due to the monetary tightening impacts on property market activity, and a 4.4 percent decline in dwelling investment due to reduced demand for renovation work and ongoing labour challenges causing project delays and protracted completion times.

The property market is showing signs of an early rebound, driven by a significant influx of returning migrants and population growth. This has directly contributed to a tight rental market and increased activity in the housing sector and increased demand in the housing market. Homebuyers' anticipation of a peak in the rate hikes also contributed to this recovery.

Chart 12 – Investment growth, Q1 2023



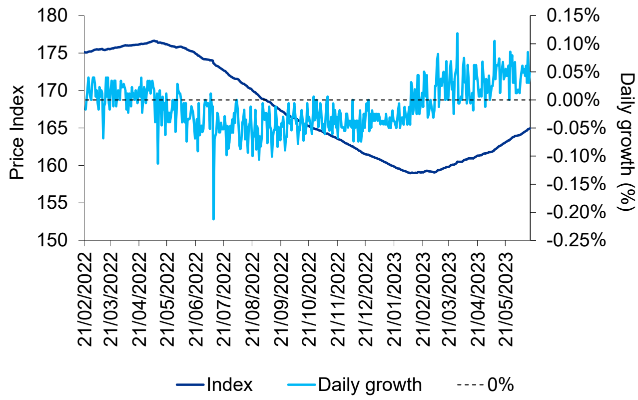
Source: ABS, KPMG

These factors have offset the effects of high interest rates and a weaker economic outlook. The CoreLogic price index for combined dwellings in five capital cities aggregate averaged over May 2023 was 2.3 percent higher than its trough in February 2023.

Looking forward, housing investment is expected to remain subdued in 2023 and potentially 2024 as signalled through the number of dwelling units approvals that has trended down to be 50 percent below its peak in March 2021 and due to capacity constraints with builders experiencing high construction and financing costs.

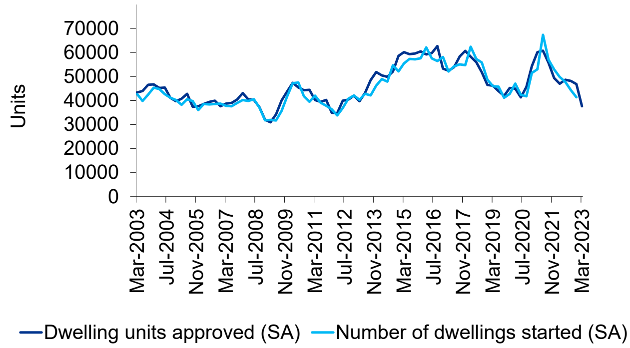
Into 2025, strong population growth, anticipated lower interest rates, along with government initiatives to boost supply and the easing in construction input costs, are expected to drive a rebound in dwelling investment.

Chart 13 – Daily home value index



Source: CoreLogic, KPMG

Chart 14 – Dwelling units approved and started



Source: ABS, KPMG

Public sector projects contributed to the growth in public investment in Q1 2023. The increase in public demand came from investment by national general government in non-defence categories (+2.5 percent q/q), state and local general governments (+3.9 percent), and state and local non-financial public corporations in transport infrastructure and health (+4.1 percent).

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 Q4 2024 and then staying elevated at between $18 billion and $20 billion per quarter until the end of 2025.

The Australian Government has announced its plan to review and streamline its $120 billion public sector infrastructure project pipeline. However, the progress and delivery of projects are expected to be affected by labour shortages, supply chain issues, and the financial challenges faced by several builders. These factors are likely to hinder the growth of public investment in 2023.

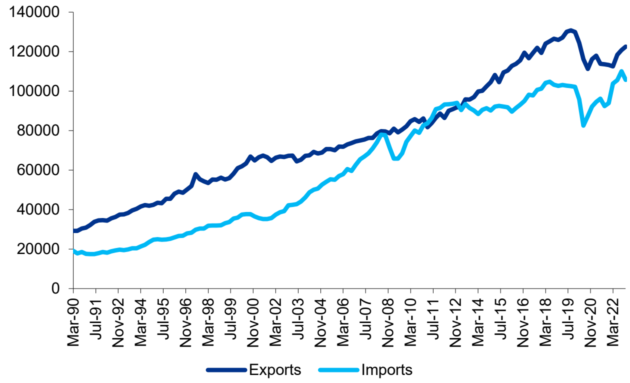
The March 2023 quarter survey of private new capital expenditure is showing strong forward momentum for both the remainder of FY23 and into FY24. Estimate 6 in current prices for FY23 ($116.6 billion in actual spend for the first nine months of FY23 and $46 billion in expected spend for the last three months of FY23) is 13.5 percent higher than FY22 Estimate 6, and based on average realisation rates for FY21 and FY22 final private new capital expenditure for FY23 is likely to end up at around $163.5 billion. The latest survey also provides the first estimate of expected private new capital expenditure for FY24 at $137.6 billion, which is about 5 percent higher than Estimate 2 for FY23 and approximately 6.4 percent higher than Estimate 1 for FY24.

However, the balance of risks to business investment remains tilted to the downside given non-residential building construction and heavy and civil engineering construction both experienced strong price growth over the past 12 months (8 percent and 7.5 percent respectively), as well as the possibility of further interest rate rises placing pressure on financing costs.

Net exports

Net trade detracted 0.2 percentage points from GDP in Q1 2023, with a 3.2 percent increase in imports outweighing a smaller 1.8 percent increase in exports.

Chart 15 – Imports and exports of goods and services (SA, $ million)

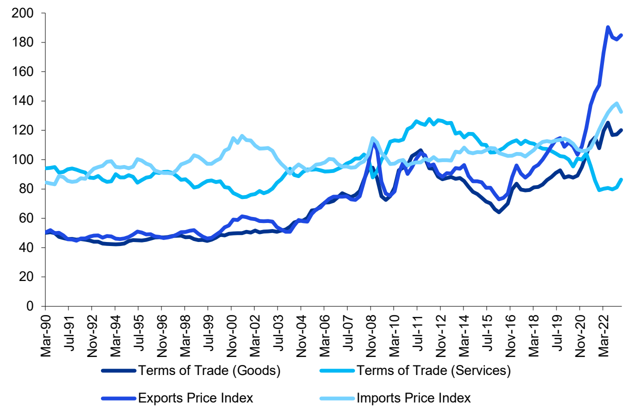


Source: ABS, Haver, KPMG

The growth in exports was driven by services (+7.7 percent), reflecting the continued recovery in travel activities and the education sector, as more international students return to Australia.

Goods and services both contributed to the increase in imports. Imports of goods rose by 3.3 percent, primarily due to the higher demand for telecommunications equipment, motor vehicles and machinery and equipment. Imports of services rose by 3.1 percent as Australians continued to travel to neighbouring countries.

Chart 16 – Terms of trade (index)

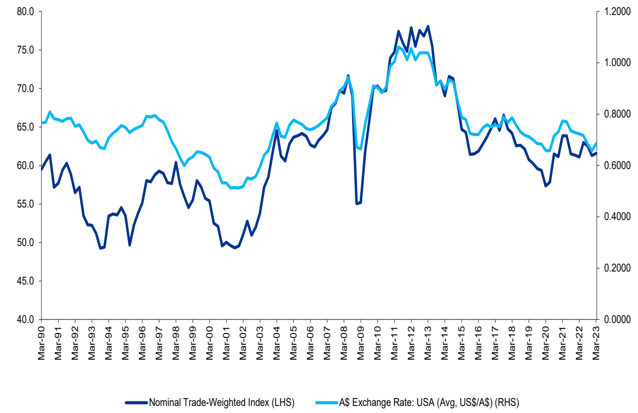


Source: ABS, Haver, KPMG

Export prices have somewhat eased in recent quarters as the global supply chains improved after being elevated throughout 2022 due to the Russia-Ukraine war. Import prices, however, the easing in supply chain pressures should place a downward pressure on import prices too, contributing to further inflationary pressures in the economy.

Foreign exchange markets have shown relative stability in recent months, with the Trade-Weighted Index remaining largely unchanged since the last QEO. The US dollars experienced a slight depreciation, influenced by weaker-than-expected US economic data. Moreover, the resumption of the RBA tightening cycle has also supported the strength of the Australian dollars.

Chart 17 – Australian dollar exchange rates



Source: ABS, KPMG, Haver

Coal and iron ore experienced significant price falls during the first quarter of 2023 largely on the back of concerns regarding the oversupply and subdued global sales, including from China where expectations were for higher demand associated with a post-lockdown bounce.

Commodity market analysts noted that a number of Chinese steelmakers took the opportunity of lower prices to increase their production levels, while a number of Chinese coal-fired power plants accumulated record-high stockpiles by the end of May.

Other factors influencing global prices in the first quarter of 2023 included excessive inventories and lower winter demand in Europe led to a near cessation of coal imports during that period.

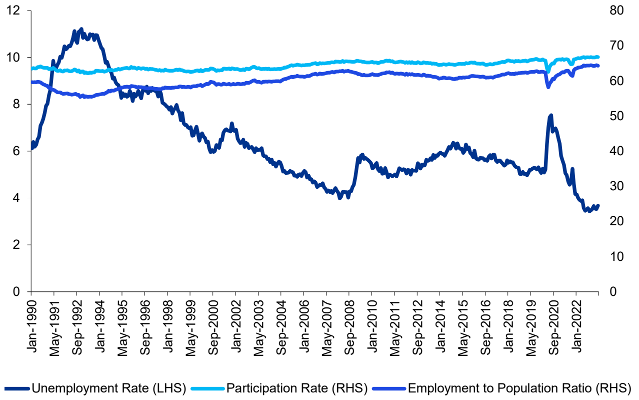
External demand assumptions

	2023Q1	2023Q2	2023Q3	2023Q4	2024Q1
Exchange rate: Australian dollar/US dollar	0.68	0.68	0.68	0.68	0.68
Thermal coal price (US$/tonne)	240	168	146	153	157
Semi soft coking coal price (US$/tonne)	249	229	230	243	255
Gold price (US$/oz)	1,889	1,976	1,917	1,963	2,119
Dalian Iron Ore 62% Futures	109	105	110	108	103
Brent Spot Average (US$/barrel)	81	79	79	80	83
West Texas Intermediate Spot Average (US$/barrel)	76	74	73	75	77

Labour market

Recent labour market data reflected some signs of easing, with the unemployment rate going up to 3.6 percent in May 2023 from 3.5 percent in March 2023. The balance between labour demand and supply has improved as more immigrants arrived in Australia. However, the labour market remains robust, as monthly employment increased by approximately 40,000 on average over the past three months.

Chart 18 – Labour market condition



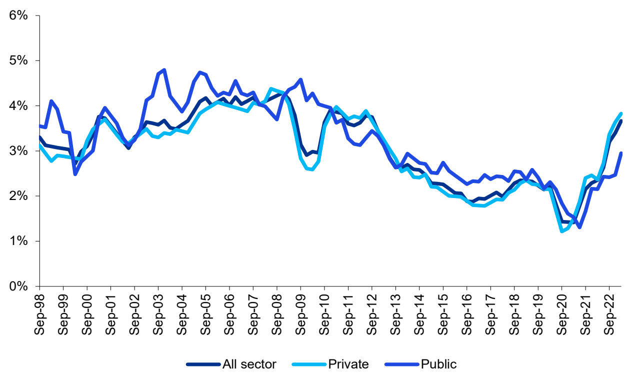
Source: ABS, Haver, KPMG

The strong employment figures were accompanied by a record-high level of the employment to population ratio, of approximately 64.5 percent. However, labour supply slightly edged lower with participation dropping by 0.1 percentage points to 66.7 percent.

As the labour market remained tight, the seasonally adjusted Wage Price Index (WPI) continued to grow 0.8 percent in the March quarter 2023, and 3.7 percent annually. The annual wages growth recorded in March 2023 is the highest level recorded since September 2012, and was driven by both the private and public sectors. Private sector wage growth accelerated from 3.6 percent to 3.8 percent over the quarter while public sector wage growth also accelerated from 2.5 percent to 3.0 percent, partly due to the higher public sector wage caps.

We anticipate that the tightness in the labour market and existing inflationary pressures will lead to further wage growth in the near term. The decisions on the minimum wage and award wages, along with a 15 percent pay rise for many aged care workers announced in this year's Budget, are expected to contribute significantly to wage growth, especially for lower-paid workers.

Chart 20 – Wages growth (y/y)



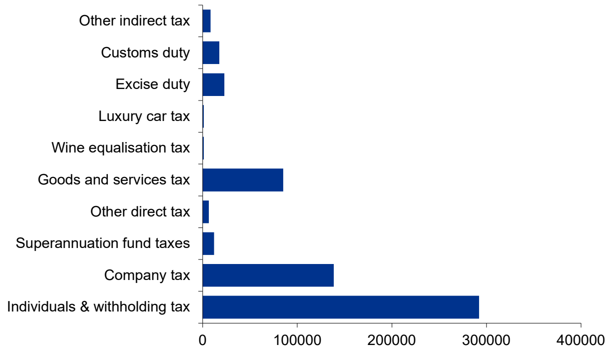
Source: ABS, KPMG

The strength of the labour market is expected to gradually weaken until the end of the year. Leading labour market indicators, such as SEEK's jobs ad index, indicate a decrease in labour demand pressure, with a 22 percent decline in year-on-year terms as of May 2023. Furthermore, the increase in migration would continue to help to address some of the tightness in the labour market. As a result, we expect the unemployment rate to gradually rise from its current low levels to reach full employment by mid-2024.

Government

Public demand contributed 0.1 ppt to the quarterly change in GDP in the March quarter. The contribution was primarily driven by a 3 percent increase in public investment. However, government consumption expenditure remained subdued, rising only by 0.1 percent.

Chart 21 – Taxation revenue sources (NSA, $ million)



Source: DoF, Haver, KPMG

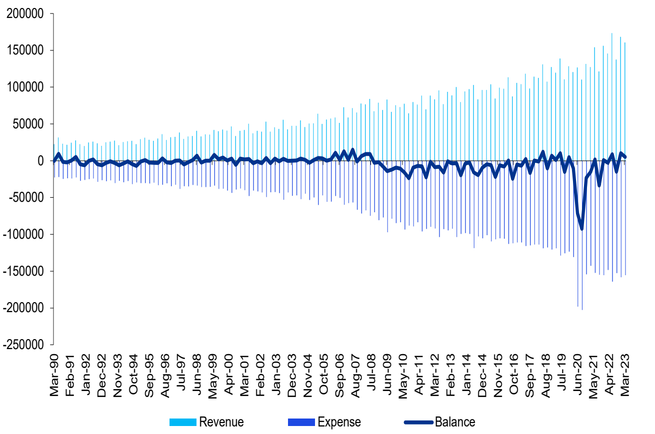
The May 2023–24 Budget announced a small surplus of $4 billion, marking a first budget surplus in 15 years. The anticipated budget outcome is a significant turnaround from the forecast made in the October 2022–23 Budget, which projected a budget deficit of $37 billion. The favourable budget position is due to higher than anticipated receipts, particularly from personal income tax (PIT) and company tax.

In the October budget, personal income tax (PIT) was projected to generate $287 billion, reflecting an 8 percent increase from the previous year. However, the government now anticipates that PIT receipts will reach $304 billion, representing a substantial $60 billion increase compared to the previous year. This significant rise in PIT receipts can be attributed to several factors. Firstly, there has been an increase in the number of workers, with employment growing by 400,000 since the beginning of the financial year. Additionally, there has been substantial wage growth of approximately 3.5 percent.

The sustained high prices in commodities have played a significant role in boosting company income tax. Prices of commodities such as iron ore, metallurgical coal, and thermal coal have all surpassed the initial forecasts. For instance, iron ore, which was expected to decrease from US$91 per ton to US$55 per ton by March, actually averaged around US$110 dollars per ton over the course of the year.

The net operating balance also benefitted from higher goods and services tax (GST) collections. GST collection in the March 2023 quarter has fallen by 8 percent from the December 2022 quarter, roughly in line with previous patterns observed after the holiday season.

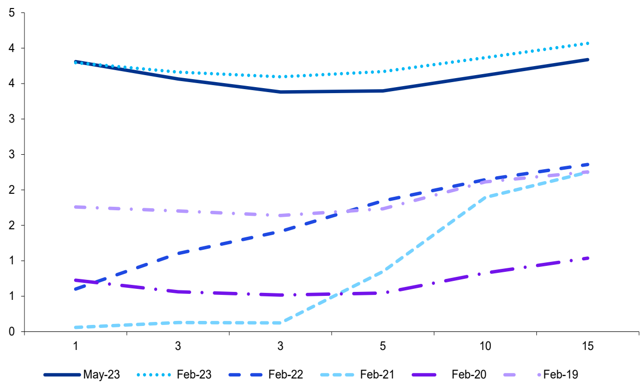
Chart 22 – Government balances (NSA, $ million)



Source: ABS, Haver, KPMG

Going forward, the Budget forecasted that the budget will return to deficit in 2024, and the deficit will continue to increase over the remaining forecast period. In the near term, revenue 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. Towards the medium term, there will also be uncertainty about personal income tax collections as unemployment starts to rise. The Budget projected that government expenses as a percentage of nominal GDP will increase from 25.3 percent this year to 26.4 percent and 27.1 percent respectively over the next two years.

Chart 23 – Yields on Commonwealth Government bonds (Bid yield, %)



Source: Tullett Prebon, Haver, KPMG

Recent developments in the banking sector and weaker economic outlook further lower the yields observed in the March quarter 2022. The yield curve is still inverted at the short end.

Forecast

GLOBAL	Annual GDP Growth[1]			Unemployment Rate[2]			Average Annual Inflation[3]		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	2.7	2.9	3.0				10.7	9.2	3.4
Euro Area	0.9	1.5	1.8	7.0	6.9	6.8	5.9	2.6	2.0
UK	0.3	0.6	1.2	4.2	4.6	4.6	7.4	3.9	2.2
US	1.4	0.9	1.9	3.8	4.5	4.0	4.2	2.6	2.1
Brazil	1.7	1.2	2.2	9.4	8.7	8.4	5.6	4.7	4.1
China	5.4	5.1	5.2	6.0	6.0	6.1	1.8	2.7	2.3
India	6.1	7.0	6.2				6.6	5.8	4.1
Indonesia	4.7	5.1	5.0	5.6	5.7	5.7	4.3	3.7	2.7
Japan	1.3	1.1	1.2	2.2	2.0	1.9	2.8	1.3	1.2
Singapore	2.2	2.9	2.5	2.0	2.2	2.2	4.8	2.7	1.9
South Korea	1.5	2.1	1.7	2.9	2.9	2.8	3.4	2.6	2.5
Taiwan	1.9	2.5	2.5	3.7	3.9	4.0	2.4	2.3	1.5
Vietnam	5.6	6.7	5.5	3.0	3.3	2.9	4.2	4.0	3.0
Australia	1.0	-0.3	2.4	4.1	4.9	4.8	5.2	3.3	3.2
New Zealand	1.0	1.2	1.4	3.4	3.4	3.4	6.7	4.7	3.0

[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	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24	Jun-25	Dec-25	Jun-26
Consumption	6.5%	5.3%	1.5%	0.3%	0.0%	0.7%	1.8%	4.2%
Business Investment	3.9%	5.7%	4.9%	0.4%	-1.5%	0.2%	2.0%	4.5%
Housing investment	-4.6%	-7.6%	-5.6%	-2.6%	-0.8%	2.0%	5.1%	7.8%
Government	4.8%	1.7%	1.4%	2.0%	1.9%	1.9%	1.8%	1.7%
Exports	3.4%	7.8%	5.7%	1.2%	-0.8%	0.0%	2.3%	4.3%
Imports	12.7%	9.8%	3.5%	1.7%	1.4%	3.2%	5.3%	7.0%
GDP	3.7%	3.0%	1.2%	0.2%	-0.2%	0.4%	1.5%	3.3%
Headline CPI	7.8%	6.3%	4.2%	3.3%	2.9%	2.6%	2.5%	2.5%
WPI	3.4%	4.2%	4.9%	4.5%	3.4%	3.2%	3.2%	3.3%
Real WPI	-4.1%	-2.0%	0.7%	1.1%	0.4%	0.5%	0.7%	0.8%
Current account balance*	2.2%	1.1%	0.3%	-0.7%	-1.8%	-2.7%	-3.2%	-3.6%
Government budget*	-2.2%	-0.5%	-1.4%	-2.1%	-2.2%	-2.1%	-1.8%	-0.8%
RBA Cash Rate*	3.1%	3.9%	4.6%	4.5%	4.3%	3.9%	3.5%	3.5%
10-government bond*	3.7%	3.2%	3.2%	3.3%	3.3%	3.2%	3.2%	3.2%
AUD/USD*	0.660	0.677	0.678	0.680	0.681	0.681	0.681	0.680
Terms of trade	6.9%	-13.0%	-10.0%	-6.1%	-5.9%	-5.3%	-4.1%	-3.1%
Employment	5.1%	1.6%	-0.2%	-0.1%	0.2%	0.6%	1.0%	2.2%
Unemployment rate*	3.5%	3.6%	4.0%	4.3%	4.8%	5.0%	4.9%	4.6%
Dwelling price	-1.9%	-1.1%	1.1%	2.9%	3.5%	3.6%	3.8%	3.9%

*=values at end of period

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