Australia Economic Outlook Q4 2024

KPMG Australia

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Contents

Executive summary

The Australian economy is growing at its slowest pace in 33 years. The design of the cost-of-living packages has complicated the CPI calculation, which is creating problems for policymakers in disentangling underlying price pressures in the economy.

Global economic developments in the aftermath of the pandemic have highlighted a contrast in the implementation of monetary and fiscal policy. While monetary policy has maintained a tight stance, fiscal policy has remained relatively loose. This divergence has complicated the task of central banks in their efforts to control inflation. However, this policy mix is beginning to change as inflation moderates towards central banks' targets. Policy rate reductions have been implemented in most advanced economies, reflecting a shift towards a more coordinated approach to managing economic stability.

The latest National Accounts (third quarter, 2024) reveal a moribund domestic economy being propped up by government spending and recording the weakest annual growth in a quarter since December 1991.

This growth in public spending can also be seen in employment data, with the public sector generating nearly 40% of new employment during the 12 months to the end of 2024Q3. However, this reliance on government jobs will, at some point, have to be reduced.

With the current weakness in the private sector and strong population growth, we expect the labour market to soften, leading to higher unemployment. This perspective is also present in the December Statement by the Reserve Bank Board which provides a more dovish outlook towards monetary policy compared to earlier statements.

Clearly the weaker-than-expected economic outcome has also influenced the financial market. At the time of preparing this report (early January 2025) the futures market is pricing in three 25 bp cuts to the cash rate through 2025, with a roughly 69% chance of a rate cut at the RBA's first meeting of the year, in February, a marked improvement in sentiment compared to a month ago.

Underlying inflation remains high. However, our inflation analysis – the KPMG Pressure Gauge – indicates that demand-driven factors are now contributing less to inflation than at any time in the post-Covid period and are in fact back in line with 'normal settings'. This suggests that the holding of the cash rate at 4.35% since November 2023 has had the intended effect in curbing domestic demand.

A key challenge at the moment in using inflation data as a bellwether for interest rate policy setting is the impact government-initiated cost-of-living relief support is having on the calculation of CPI.

For example, the ABS has acknowledged that:

- The 2024–25 Commonwealth Energy Bill Relief Fund rebates in all states and territories and state government electricity rebates in Queensland, Western Australia and Tasmania led to a 17.3% fall in electricity prices in the September quarter. Without the rebates, electricity prices would have increased 0.7% during the three months to the end of September 2025; and
- The maximum rate for Commonwealth Rent Assistance (CRA) increased by 10% in September 2024 on top of the usual CPI indexation on 20 March and 20 September, partly offsetting the annual rise in rents which came in at 6.7% in the 12 months to October 2025 instead of an 8.1% rise for the same period.

The mathematical consequence of these measures has been a rapid fall in headline CPI calculated over 2024H2, albeit the underlying inflation pressures as measured by the trimmed mean show price pressures being much stickier and declining more slowly. This is highlighted by the widening difference between headline and core inflation, which has blown out to around 1.0% over the three months to November 2024; a differential not seen since 2020Q2 when aggregate demand fell dramatically at the start of the Covid pandemic.

The key question then becomes what will happen with the CPI calculation when the cost-of-living relief packages end, noting that the production cost of electricity and rental accommodation has not changed – it is just the payment sources for their costs to some households and small business that has.

KPMG's central view remains that the RBA will not reduce the cash rate until near midway through 2025, although we do not entirely rule out an earlier rate cut. Our view is highly dependent on how inflation will react to the potential geopolitical risks associated with a new Trump administration in the US and the threat of an increased global tariff environment, which will only add to pricing pressure in imported goods.

Key Economic Forecasts

	2023 (a)	2024 (f)	2025 (f)	2026 (f)
Real GDP (average annual)	2.1%	1.1%	2.2%	2.5%
Real GDP (year-ended)	1.5%	1.4%	2.4%	2.3%
Unemployment rate	3.9%	4.1%	4.2%	3.9%
Headline CPI	4.1%	2.3%	3.3%	3.3%
Core CPI	4.2%	2.8%	3.0%	3.3%
RBA cash rate	4.35%	4.35%	3.60%	3.60%
AUD/USD	0.68	0.62	0.64	0.68

Global landscape

Stable global growth is expected but threatened by rising trade tensions and protectionism.

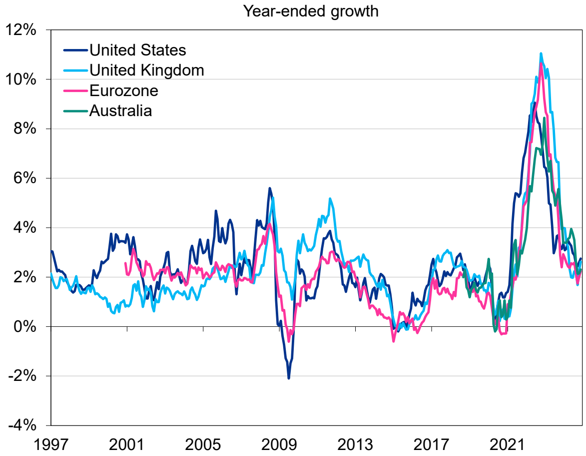
Steady disinflation and policy mix shifting away from tight monetary and loose fiscal

Economic developments in the aftermath of the pandemic have seen a contrast in the implementation of monetary and fiscal policy. Despite the tight stance in monetary policy, fiscal policy has remained relatively loose. This has complicated the task of central banks in their fight against inflation.

This policy mix is changing. As inflation moderates towards central banks' targets, policy rate reductions have been happening in most advanced economies. KPMG expects that inflation in most countries will be back in the target bands by the end of 2025, with interest rates expected to be at neutral to ensure that growth stabilises around its long-term trend and inflation remains sustainably within the targets.

Chart 1: Inflation in Selected Advanced Economies

Year-ended growth



Source: National sources, Haver, KPMG

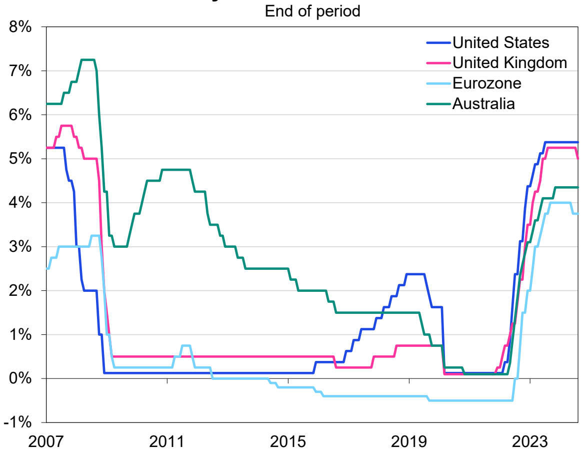
In addition, with public-debt-servicing costs on an upward trend in most economies, necessary fiscal consolidation is underway to ensure debt sustainability and rebuild the required buffers to react to future economic shocks. While lower policy rates in some advanced economies provide some relief by lowering funding costs, the level of interest rates remains much higher than the pre-pandemic levels, which means that stronger efforts to contain and reallocate spending are needed to ensure that debt burdens stabilise.

Recovery of world economy threatened by higher tariffs and uncertainty surrounding future trade policies

The global economy is projected to remain resilient despite significant challenges. KPMG expects global growth to come in at a 3.1% pace in 2024, slightly lower than 2023, and below the pre-pandemic norm of 3.6% from 2000 to 2019. In 2025, we expect growth to drop slightly to 3.0%.

Chart 2: Policy Rates in Advanced Economies

End of period

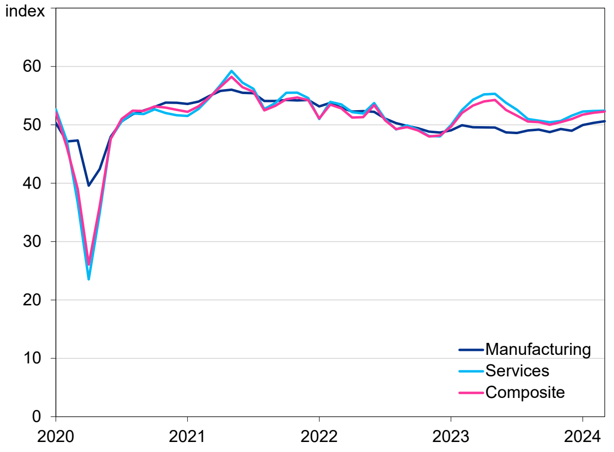


Source: BoE, ECB, FRB, RBA, Haver, KPMG

The recovery is nevertheless threatened by significant challenges. The ongoing conflicts in the Middle East could further disrupt energy markets. Rising trade tensions and the uncertainty about future changes in trade policies also pose significant risks as they might disrupt supply chains, raise price levels and slow down economic recovery.

The latest Global Purchasing Managers' Index (PMI) indicated that the pace of global economic activity has been steady, with the index recording a value of 52.6 in December 2024, up from 51.9 recorded three months ago. The service sector's business activity continues to outperform manufacturing. Among the major developed economies, the US registered the strongest rate of expansion; while India and China led growth among the emerging economies.

Chart 3: IHS Markit Purchasing Managers' Index™, World



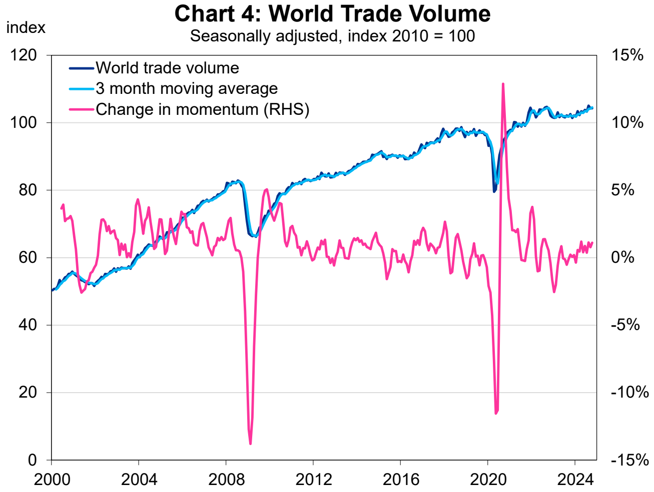
Source: JP Morgan, S&P Global, Haver, KPMG

Global trade set to reach new high despite geopolitical tensions

In December 2024, world trade volume showed strong annual growth of about 2.3% despite persistent geopolitical challenges, significantly higher than the 1.1% average growth in the first half of 2024. The year-to-date growth rate is now approximately 1.5%, a notable improvement from the -1.3% decline in 2023.

Chart 4: World Trade Volume

Seasonally adjusted, index 2010 = 100



Source: CPB, Haver, KPMG

The increase in global trade is primarily driven by a large increase in services trade, while goods trade recorded a smaller increase.

In the third quarter of 2024, developed countries outpaced developing nations in trade growth, with Japan and the United States seeing significant increases. However, China and India faced declines in goods trade. ICT and apparel sectors led growth, while automotive, energy, metals, and textiles sectors saw declines.

The 2025 outlook is uncertain due to potential US policy shifts, trade wars, and geopolitical challenges, which could all impact global value chains and economic growth. Countries and regions which have a significant trade surplus with the US, such as China, India, the European Union and Vietnam are particularly exposed to changes in US trade policy. Other countries with a smaller trade surplus, such as Canada, Japan or Mexico, may also face some risks, despite having established trade agreements.

Economic developments vary significantly across regions

From a regional perspective:

– North American growth is expected to slow from 2.8% in 2023 to 2.4% in 2024 and 1.6% and 1.5% in 2025 and 2026 respectively. The US economy has been holding up, growing at 2.8% in 2024Q3 on the back of strong consumer demand, although the expectation is that consumption growth will decelerate to a pace consistent with the long-run estimates of sustainable income. The Canadian economy is clearly inhibited by restrictive monetary policy that has successfully returned inflation to the 1–3% target range. However, a rebound is expected as the Bank of Canada has slashed rates from 5.0% to 3.25%, with more to possibly follow.

– Growth in Asia and the Pacific remained robust in 2024. In advanced Asia excluding Japan, activity was heavily reliant on exports and manufacturing, with strong demand from the United States and emerging markets; whereas in emerging Asia, both domestic and external demand contributed to growth. Japan is recovering from a sharp downturn in the first quarter of 2024. Japan recorded a second consecutive quarter of positive growth in the third quarter of 2024, due to a rebound in consumption and wages growth even though the economy navigates to a new regime of higher inflation and positive interest rates. In China, the correction of the property market has continued to weigh on private demand, but was partially offset by strong export growth, with rising demand from emerging markets substituting for weaker demand from advanced economies. In South Korea, President Yoon declared martial law in December 2024, but it was quickly lifted by the parliament; thereby having limited effect on South Korea's economy and financial market.

- After a prolonged period of stagnation, the EU economy including the Eurozone and Eastern Europe is slowly recovering, forecast to achieve economic growth of 1.5% in 2024, 1.74% in 2025 and 1.2% in 2026. Growth strengthened this year, driven by a moderate pick-up in private consumption due to real income growth and high levels of employment. The service sector maintained its robust recovery, but industrial production has been stagnant, reflecting weakening external demand from China. As a result, economic outcomes varied across countries, with some benefitting from strong services demand (Spain, France and the United Kingdom) while manufacturing-intensive countries such as Germany and Austria were weighed down by weak goods demand. The disinflation process continues, with headline inflation in about 60% of advanced European countries declining to within 1 percentage points or less of central bank targets by the second quarter of 2024.
- Headline inflation has continued to ease in most of Latin America and the Caribbean through 2024, led by further falls in food, energy and goods price inflation. However, growth has been affected in response to higher rates to tackle inflation. Growth in South America is forecast to jump from 1.4% in 2023 to 1.9% in 2024 and 2.3% in 2025, dropping then to 2.0% in 2026. Growth in Argentina is expected to contract this year but will recover next year as the government attempts to curb inflation using both fiscal consolidation and tight monetary policy, with annual inflation rates dipping below 200% for the first time in close to a year in November 2024. By contrast, Brazil's economy has performed much better than expected, driven by strong consumer spending and business investment despite a sharp contraction in the agricultural sector. In December 2024, the Banco Central do Brasil raised rates by 1 percentage points to 12.25%, a third consecutive rate hike, with inflation remaining volatile due to the recent surge in the USD and heightened trade policy uncertainty.
- Growth continues to be subdued in the Middle East and North Africa (MENA) as a result of the conflict in the region and geopolitical uncertainties. As a result of that, uncertainty about economic growth in the region is currently twice the average of other emerging markets and developing economies, according to the World Bank.

Australia overview

Economic activity was subdued throughout the year, recording its weakest annual growth rate in 33 years, outside of the recent pandemic.

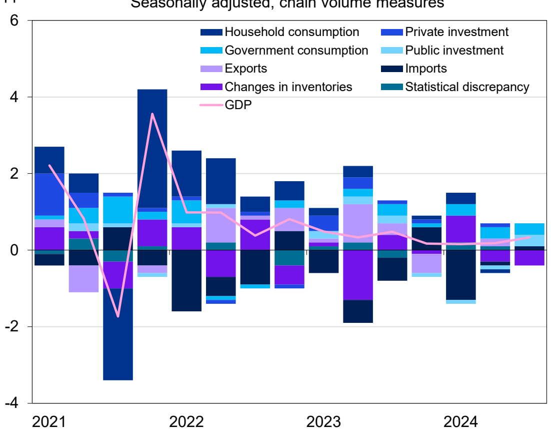
Economic activity has remained weak throughout the year, with the September quarter 2024 National Accounts revealing that annual GDP growth slowed to 0.8%, a level not seen since December 1991, excluding the recent COVID-19 pandemic period. GDP per capita continues its downward slump, declining by 0.3% in the September quarter, marking seven continuous quarters where this indicator of living standards has gone backwards.

These headline figures mask the full extent of the challenges that households and businesses are facing. Growth in the Australian economy was almost entirely driven by the public sector, with government expenditure and public investment both contributing 0.3 percentage points each to quarterly GDP growth in September 2024. Outside of the public sector, only net trade made a small positive contribution of 0.1 percentage points to GDP growth.

While public sector demand has supported economic growth, it has also kept the labour market tight and added to inflationary pressures. This slow progress in returning inflation to sustainable levels has prolonged the easing of monetary policy settings by the RBA. Without the prospect of imminent rate cuts, and facing higher costs, private demand paints a completely different picture of the economy.

During the September quarter 2024, private demand through household consumption and business investment made zero contribution to GDP growth. Meanwhile, a run-down in inventories subtracted 0.4 percentage points from GDP growth as retail businesses respond to subdued household demand by opting not to replenish stock, while mining businesses produced a lesser quantity than their exports.

Chart 5: Contribution to Quarterly GDP Growth



Source: ABS, Haver, KPMG

Other key insights from the National Accounts data for the September 2024 quarter include:

- Household consumption recorded zero growth. In part, this reflects the introduction of government energy subsidies, which has shifted some household consumption to government expenditure. As a result, spending on *Electricity, gas and other fuel* fell by 16.7%. This was offset by increases elsewhere, including in *Clothing and footwear* (+2.2%), *Rent and dwelling services* (+0.4%), *Health* (+0.8%) and *Education* (+1.0%).
- The household saving ratio was 3.2%, rising from 2.4% in the June quarter. Gross disposable income rose by 1.5%, exceeding the rise in nominal household spending which was 0.6%. Adding to disposable incomes was a rise in compensation of employees (+1.4%), higher interest received (+3.6%) due to greater savings balances, and a decrease in income tax paid by households (-3.8%) following the introduction of the Stage 3 tax cuts.
- Divergence in public and private sector wages has continued. Public sector compensation of employees (COE) rose by 2.0%. At a Commonwealth level, this was due to increased headcount, while wage rises and backpay were primarily responsible at the state and local government level. By comparison, private sector COE rose by 1.2%.
- Labour productivity continued to fall, with GDP per hour worked falling by 0.5%, alongside a 0.9% decrease in the June quarter. On an annual basis, productivity has dropped by 0.8%. Nevertheless, this has translated into slower growth in real unit labour costs, currently at 0.5% compared to 1.5% in the previous quarter.
- Public investment rose strongly (+6.3%), but this is in the context of three consecutive declines in the preceding quarters. Imports of defence equipment, alongside investment in road and hospital projects, drove general government investment. Meanwhile, private investment only recorded a modest increase of 0.1%, mainly due to increased work on dwelling construction as labour and materials shortages ease.
- Business profitability has weakened, with gross operating surplus (GOS) falling by 1.5%, led by private non-financial corporations (-3.9%). In particular, the mining sector has faced lower commodity prices due to softer global demand, particularly from China, resulting in a third consecutive quarter where GOS has declined (-9.1%).

Production

The September quarter 2024 saw a mixed performance between industries, with 8 out of 19 sectors recording a contraction in Gross Value Added (GVA) over the quarter.

The industries which recorded the largest quarterly reduction in GVA were:

- *Administrative and support services* (-1.0%), with a fall in recruitment activity leading to a slowdown in Administrative services.
- *Professional, scientific and technical services* faced similar headwinds (-1.0%), as reduced demand for engineering design, research, and consulting services led to a 1.1% fall in Other professional, scientific and technical services. There was also a 0.7% reduction in Computer system design and related services.
- *Other services* also experienced a fall (-1.0%), primarily due to a fall in Personal and other services.

On the other hand, the sectors which recorded the largest quarterly increases in GVA were:

- *Agriculture, forestry and fishing* (+6.6%), comprising a 7.2% rise in Agriculture due to grains and livestock, and a 2.0% rise in Forestry and fishing.
- *Arts and recreation services* also performed strongly (+2.4%), although this was in the context of a 0.8% decline in the previous quarter. Major sporting events were the main driver of this gain.

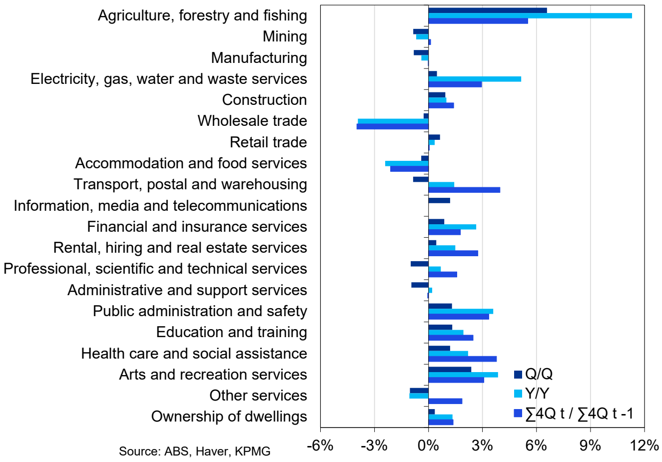
When factoring in the size of each industry, *Agriculture, forestry and fishing* made the largest contribution to economic growth (+0.2 ppt), while both *Mining* and *Professional, scientific and technical services* detracted the most (-0.1 ppt each).

While price pressures remain in the economy, the September quarter 2024 release of the Producer Price Index (PPI) suggests they are beginning to ease. Final demand increased by 1.0% in the September quarter, compared to 1.8% in the corresponding period of 2023. One crucial factor was the Fair Work Minimum Wage and Award decision, which increased modern award rates by 3.75% at the beginning of the September quarter. This was substantially less than the 5.75% decision last year and represents the lowest increase since the 2020/21 financial year, contributing to the easing of labour cost growth.

The largest contributors to movements in the PPI were:

- *Property operators* (+1.9%), driven by fees linked to increased rents as demand for rental dwellings continues to outstrip supply.
- *Residential building construction* (+0.9%) due to labour cost increases and shortages of skilled tradespeople.
- Offsetting this was *Petroleum refining and petroleum fuel manufacturing* (-9.4%), due to reduced demand for oils and refined fuels.

Chart 6: Industry Gross Value Added, Sep 24

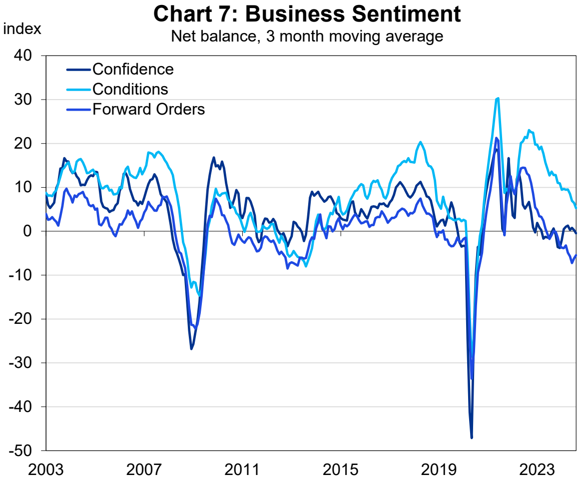


Source: ABS, Haver, KPMG

Recent NAB monthly business surveys continue to reflect a relatively weak outlook, with positive signs observed in both September and October reversing in the latest data. Business confidence fell sharply in November and is again below average at -3 index points. Business conditions have continued to soften, with goods production and distribution sectors experiencing stronger declines, while services industries have been more resilient. Overall, capacity utilisation remains at elevated levels, suggesting that price pressures have yet to fully normalise.

Chart 7: Business Sentiment

Net balance, 3 month moving average



Source: NAB, Haver, KPMG

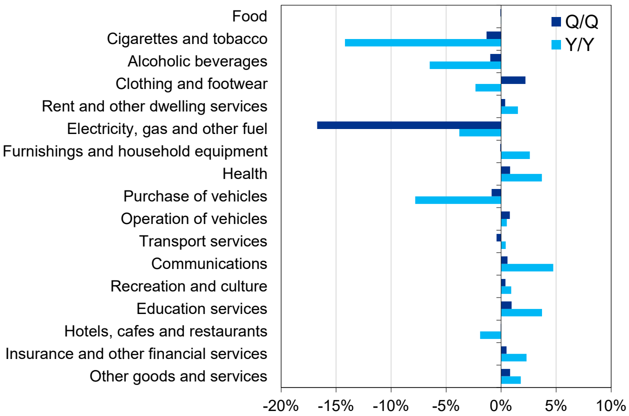
Looking ahead, the Australian Bureau of Agricultural and Resource Economics and Sciences expects the gross value of agricultural production to rise by 7.0% to $88.4 billion in 2024–25 in their December quarter 2024 forecasts. This is the second highest result on record, due to a recovery of livestock prices and increased production volumes. The Department of Industry, Science and Resources has revised down their outlook for resources and energy exports, with the value of exports now anticipated to decrease to $372 billion in 2024–25 according to their September 2024 forecasts.

Household consumption

Household final consumption expenditure was unchanged over the September quarter 2024, following a 0.3% fall in the June quarter. However, this was in the context of a 16.7% decline in *Electricity, gas and other fuel* due to energy bill relief rebates, which meant that some consumption was recorded as government expenditure instead. Overall, a decrease in spending was recorded in 7 out of the 17 expenditure categories, including *Purchase of vehicles* (-0.9%), *Alcoholic beverages* (-1.0%), and *Cigarettes and tobacco* (-1.3%).

Meanwhile, a rise in household spending was recorded in *Clothing and footwear* (+2.2%) in response to unseasonably warm weather, alongside moderate growth in other essential categories such as *Rent and other dwelling services* (+0.4%), *Health* (+0.8%) and *Education services* (+1.0%).

Chart 8: Household Final Consumption Expenditure, Sep 2024



Source: ABS, Haver, KPMG

The fall in spending by households on goods has continued for a second consecutive quarter, decreasing by 0.7% in September 2024, whereas spending on services increased by 0.3% following a fall in 0.2% in June. This growth in expenditure on services partly reflects increased spending by Australian travellers overseas.

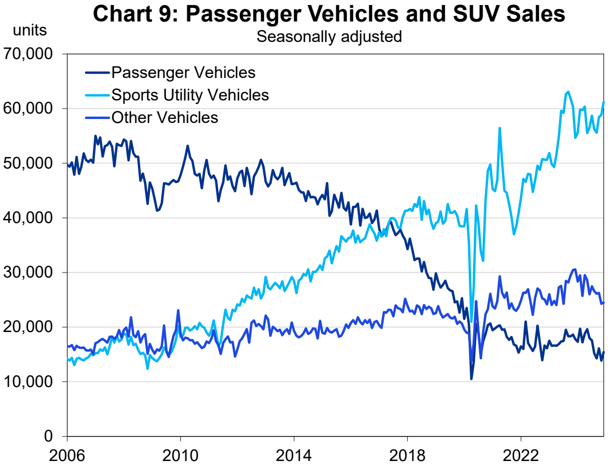
The introduction of the Stage 3 tax cuts did not appear to have a substantial impact on household consumption. Gross disposable income grew by 1.5% in the September quarter, in part due to this fall in income tax paid by households (-3.8%), alongside growth in compensation of employees (+1.3%) and interest received (+3.6%). The rise in interest received reflects larger balances in saving and offset accounts, with the household saving ratio now at 3.2% compared to 2.4% in the previous quarter, suggesting that households are choosing to respond to difficult economic conditions through increased saving.

Furthermore, some earnings were absorbed by higher interest paid on dwellings, which increased by 3.4% in the September quarter. The latest ANZ CoreLogic Housing Affordability Report found that as of September 2024, 50.6% of the median household income was required to service a new home loan, well above the 20-year average of 36.6%.

New vehicles sales volumes grew slightly in the December quarter 2024, with seasonally adjusted sales rising to 299,000 units compared to 296,500 units in the previous quarter. However, this remains less than the same period last year, where 322,500 units were sold. Households have been a major contributor to this fall, with the Federal Chamber of Automotive Industries reporting that the private buyer segment experienced an annual decline of 16.6% in November 2024.

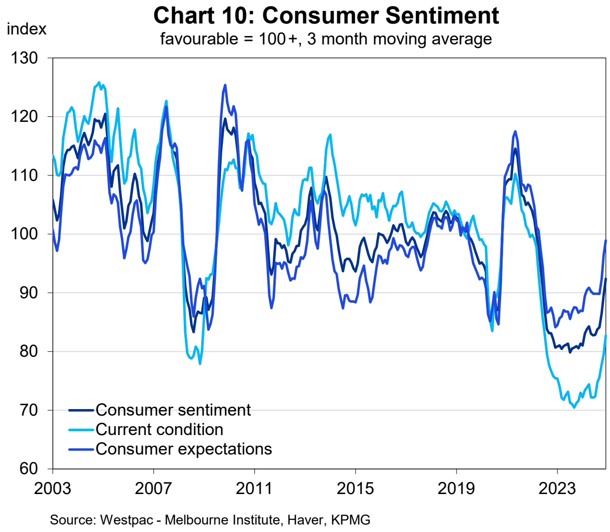
Chart 9: Passenger Vehicles and SUV Sales

Seasonally adjusted



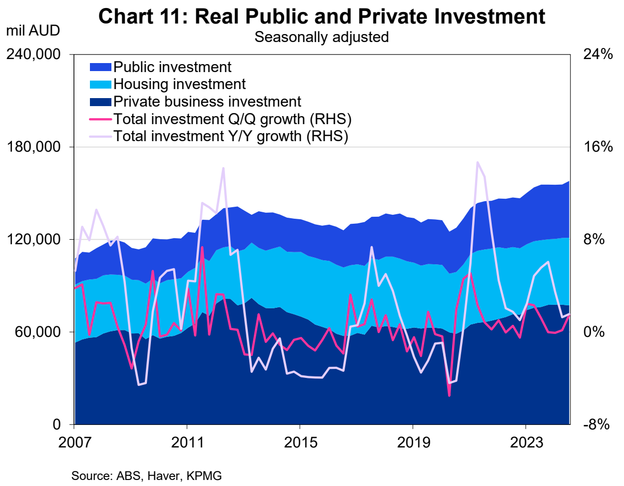
Source: Federal Chamber of Automotive Industries, Haver, KPMG

Despite the weakness in household consumption and vehicle sales, consumer sentiment has picked up substantially compared to the first half of the year. Although it remains in unfavourable territory, consumer sentiment lifted by 3% in December 2024 compared to the previous month and is now up 13.6% compared to the corresponding period last year. While economic conditions are still tough, confidence is recovering as inflationary pressures subside and households look forward to the prospect of rate cuts in mid 2025. This is also reflected in the latest KPMG Retail Health Index, which has increased by 0.72 index points in the November quarter 2024, although the retail sector is not expected to return to healthy conditions until mid 2025.



Investment

Real investment activity, as measured by gross fixed capital formation, increased by 1.5% in the September quarter 2024. This was almost entirely driven by increased public investment (+6.3%), whereas private investment remained weak (+0.1%).



The September quarter 2024 reflected the lowest quarterly growth in private investment since December 2022. Positive movements were observed in:

– *Dwellings* (+1.2%), driven by an improvement in new home commencements. Preliminary data indicates that the real value of residential construction work done increased by 1.8% in the September quarter 2024. This follows a period of bottlenecks due to labour and materials shortages.
– *Ownership transfer costs* (+1.6%), due to continued turnover in the property market.
– *Intellectual property* products (+1.5%) and Machinery and equipment (+1.0%) also recorded growth.

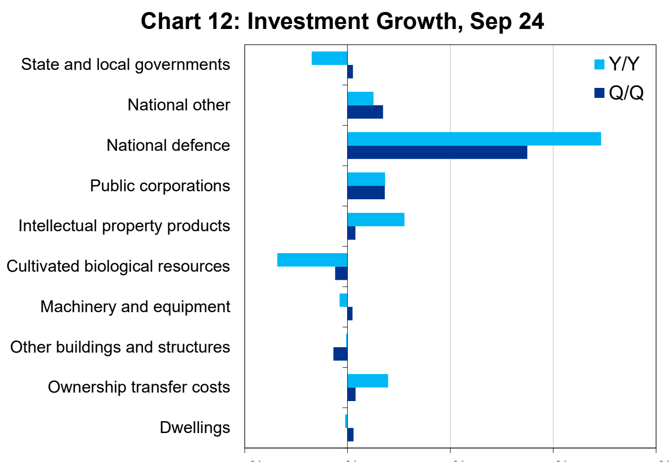
However, these gains were mostly offset by:

– *Non-dwelling construction* (-2.7%), with the preliminary estimate of the real value of non-residential construction work done showing a decrease of 1.0% in the September quarter 2024. However, it continues to be at elevated levels due to recent investment in warehouses and data *centres.*
– *Cultivated biological resources* also decreased (-2.4%).

When considering the relative significance of each component, *Dwellings* contributed 0.1 percentage points to quarterly GDP growth. Meanwhile, the slowdown in *Non-dwelling construction* subtracted 0.1 percentage points from overall economic growth.

After three consecutive quarters of falls, public sector real gross capital formation bounced back strongly. This was the largest quarterly increase since June 2017 and translates into an annual growth rate of 1.5%. Major contributors to this quarterly movement included:

– *National defence* (+35.0%), due to imports of defence equipment.
– *National non-defence* (+6.9%), driven by hospital and road projects.
– *Public corporations* (+7.2%), predominantly led by an 8.8% rise by State and local governments due to increased activity across states on major road and renewable projects.

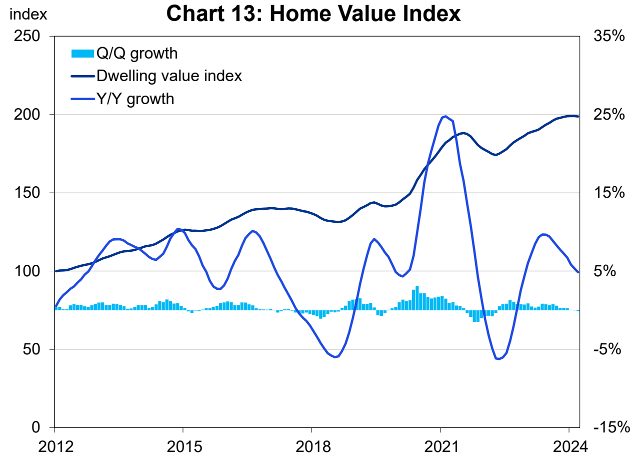


Private new capital expenditure (capex) rose by 1.1% in the September quarter 2024, and this was 1.0% more than the same period of 2023. For non-mining industries, this measure of business investment rose 2.3% over the quarter. However, a 1.9% fall in mining capex offset part of these gains. Considering the trends in each asset type:

– *Buildings and structures rose* (+1.1%) due to spending on large scale upgrades in *Manufacturing,* and data centre projects in the *Information, media and telecommunications industry.*
– *Equipment and machinery* also increased (+1.1%), driven by the *Finance and insurance, Health care and social assistance,* and *Manufacturing industries.*

Businesses have also revised upwards their expected capex spend for 2024–25 by 5.1% compared to the previous release, with *Equipment and machinery* estimated to be 8.7% higher. From an industry perspective, the sectors which contributed most to this revision were *Construction* (+33.3%), followed by *Electricity, gas, water and waste services* (+10.9%) and *Transport, postal and warehousing* (+8.3%).

Chart 13: Home Value Index



Source: CoreLogic, KPMG

The residential property market has recorded its first monthly decline since January 2023. In the month of December 2024, the CoreLogic House Price Index fell by 0.1%, after peaking in October and holding steady in November.

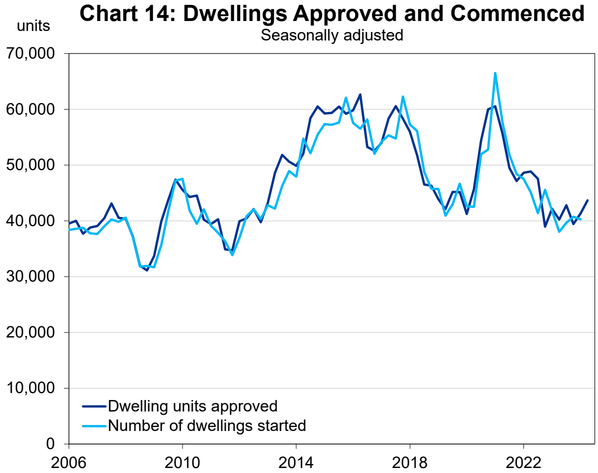
Compared to the relatively strong performances of the mid-sized capitals, both Melbourne and Sydney have faced greater headwinds. Melbourne recorded a monthly fall of 0.7% in December, while the Sydney market has also weakened, with values falling by 0.6%. The Perth market continued to be the strongest (+0.7%), followed closely by Adelaide (+0.6%). Brisbane (+0.5%) and Darwin (+0.4%) were the only other capital cities to record a monthly gain.

Affordable dwellings experienced stronger price gains over the year, with housing values in the lower quartile across the combined capital cities rising 9.8% in 2024. This compares to just 1.5% for upper quartile housing values, reflecting ongoing affordability challenges.

Entering the new year, the December 2024 edition of the KPMG Residential Property Market Outlook forecasts that price growth in 2025 will remain modest as elevated interest rates and housing affordability continue to weigh on buyers. However, anticipated rate cuts in the middle of the year should serve as a morale boost, allowing the pace of growth to pick up in 2026.

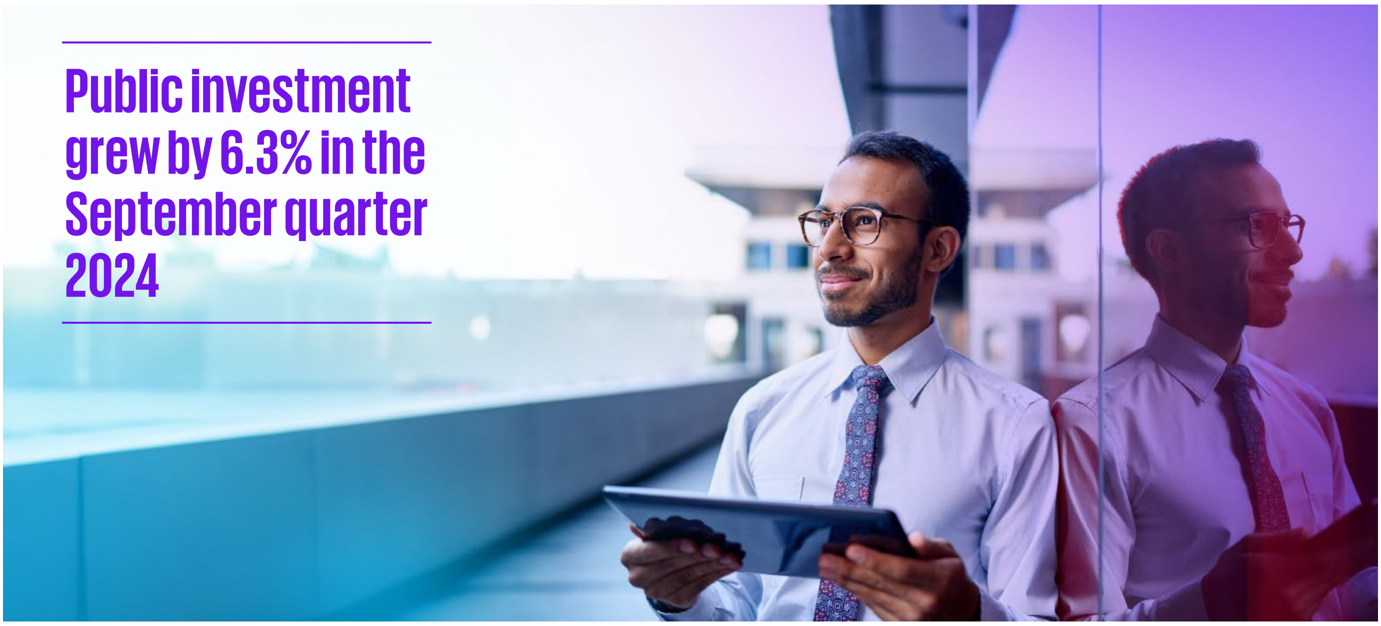
Chart 14: Dwellings Approved and Commenced

Seasonally adjusted



Source: ABS, KPMG

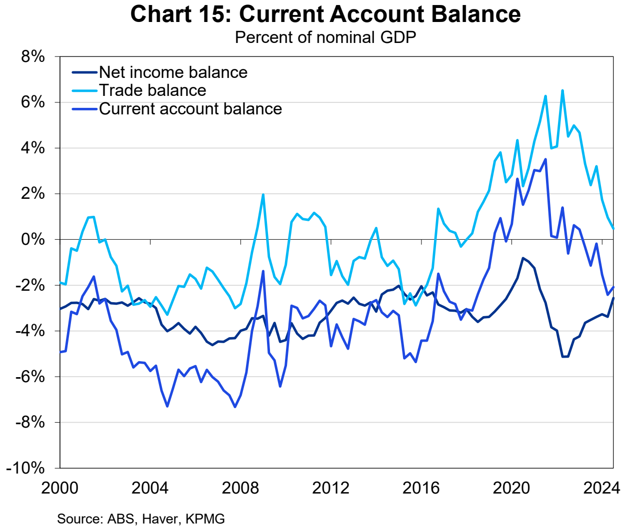
In another positive sign, housing investment is beginning to trend upwards again, with approvals rising by 5.7% in the September quarter 2024. This is 8.6% higher than the same period one year ago, though this will take time to translate into building activity. While the latest data for commencements show a decrease of 1.0% in the June quarter 2024, preliminary estimates of the value of construction work done show growth in the residential sector. This provides an indication that the number of commencements in the September quarter 2024 is likely to have lifted as well, mirroring the trend in approvals.



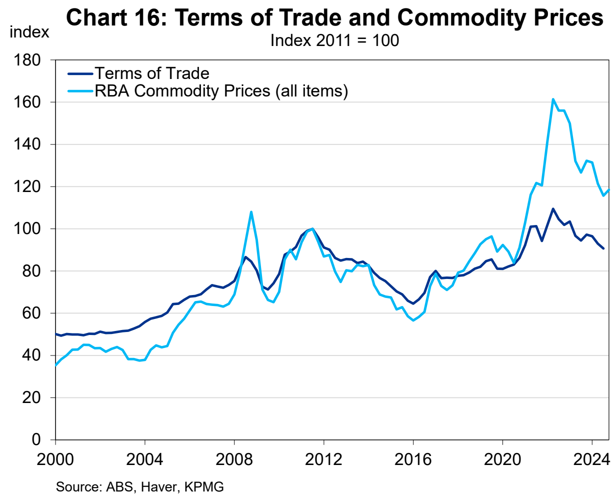
Net exports

Net trade contributed 0.1 percentage points to GDP growth as imports (-0.3%) fell and exports (+0.2%) grew modestly.

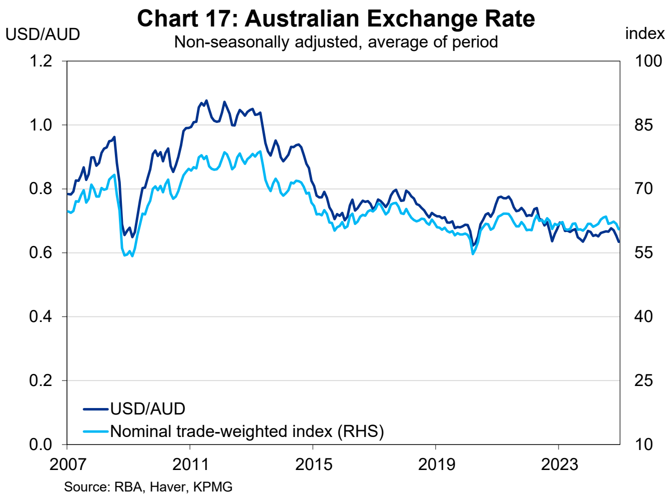
- Exports of goods fell by 2.3%, driven by declines in other mineral fuels and metal ores and minerals, with LNG exports being impacted by production disruptions and iron ore exports being affected by global price drops. Exports of services decreased by 3%, primarily due to fewer international students arriving for Semester 2, and a decline in other personal travel services.
- Imports of goods fell 2.2% due to reduced domestic demand for fuels and lubricants. Imports of services offset the fall in goods imports, rising 4.6% from the June quarter, led by an 11.7% rise in travel services.



Australia recorded its sixth consecutive current account deficit in the September quarter 2024, reaching $14.1 billion (seasonally adjusted, current prices). The deficit exceeded forecasts of $10.3 billion and followed a downwardly revised $16.4 billion deficit in the June quarter 2024. The shortfall was driven by weaker resources prices, shrinking the trade surplus to its lowest level since June 2018, and resulted in lower-than-expected net export contribution to economic growth.



Australia's terms of trade has fallen for three quarters in a row, decreasing by 2.5% in the September quarter 2024. A fall in bulk commodities' export prices amidst weaker global demand was largely responsible for this drop. This is reflected in the Reserve Bank of Australia's Index of Commodity Prices, which was 7.4% lower in the month of December 2024 compared to the same period in 2023. This is 24.8% lower than the peak recorded in the month of June 2022, predominantly due to lower iron ore and coking coal prices. The World Bank expects commodity prices to fall further by 5% in 2025 and 2% in 2026.



The Australian dollar (AUD) has depreciated substantially against the US dollar (USD), falling to 0.634 USD in December 2024 compared to 0.654 USD the month prior. This translates into a 5.1% decline compared to the corresponding period of 2023 and is 18.2% less than the most recent peak in May 2021. The prospect of escalating tariffs and trade tensions has increased demand for the US dollar, while threatening to plunge the Australian dollar due to its reliance on commodity exports and trade with China, which face reduced demand and economic uncertainty, particularly if China responds to higher tariffs by allowing its own currency to weaken. This can be seen in the AUD on a Trade Weighted Index basis, which has depreciated by 2.1% in the year to December 2024, though it remains within the range observed since early 2022. The AUD is forecast to remain weak in the near term, with added pressures from weaker commodity prices and subdued demand from China.

External Demand Assumptions

	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25
Exchange rate (AUD/USD)	0.62	0.63	0.63	0.63	0.63
Thermal coal price (USD/tonne)	140	115	119	123	127
Semi soft coking coal price (USD/tonne)	200	193	203	211	217
Gold price (USD/oz)	2,708	2,695	2,730	2,765	2,790
Dalian Iron Ore 62% Futures	105	100	99	98	97
Brent Spot Average (USD/barrel)	75	80	78	75	74
West Texas Intermediate Spot Average (USD/barrel)	71	77	74	72	70

Labour market

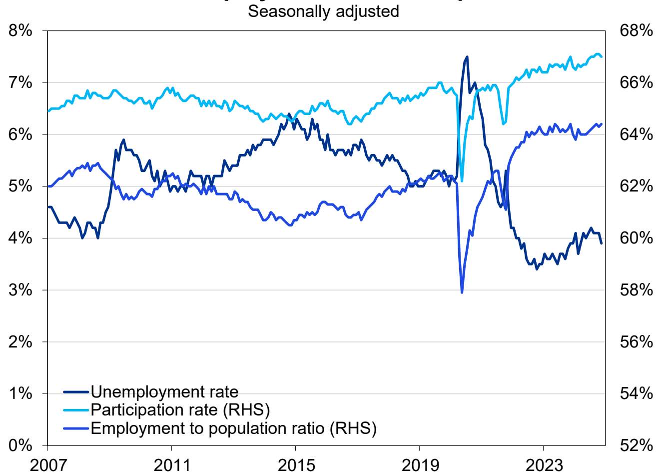
Australia's labour market continues to demonstrate strength, with the seasonally adjusted unemployment rate falling slightly to 3.9% in November 2024, after holding steady at 4.1% in the three prior months. This is 0.4 percentage points higher than the low of 3.5% recorded in June 2023, however, it remains substantially less than the pre-pandemic level of 5.2% which was recorded in March 2020.

Employment grew by 36,000 in November, resulting in an employment-to-population ratio of 64.4%, holding on to historically high levels. The participation rate also held on to record highs, falling slightly to 67.0% in November from a record 67.1% recorded in the two prior months.

Seasonally adjusted monthly hours worked fell marginally in November, marking the first time in six months where growth in hours worked did not match employment growth. However, the annual growth rate of 2.1% recorded in November is still consistent with employment and population growth.

Chart 18: Unemployment and Participation Rates

Seasonally adjusted



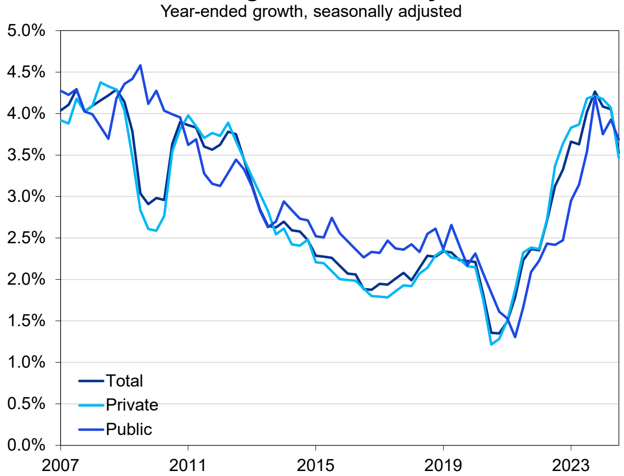
Source: ABS, Haver, KPMG

After having peaked in the December quarter 2023, nominal wage growth has gradually declined in line with KPMG's projections as labour market conditions continue to ease. In the September quarter 2024, annual wage growth slowed to 3.5%, marking its first drop below 4% since June 2023. This moderation in wage growth can be partially explained by the smallest increase in minimum wage in three years. Minimum wage increased 3.75% from July 2024 and was significantly lower than the 5.75% increase in 2023 and 5.2% in 2022.

Public sector wages increased faster than private sector wages for the first time in four years, growing by 3.7% compared to 3.5%. Public sector pay has proven resilient to the recent economic slowdown, supported by a surge in generous State and Federal Government pay deals. The 3.5% wage growth in the private sector also marked the lowest annual growth since the September quarter 2022.

Chart 19: Wage Price Index by Sector

Year-ended growth, seasonally adjusted



Source: ABS, Haver, KPMG

Despite slowing wage growth, 65% of jobs saw annualised increases above 3% in the past year, up from 59% in September 2023. The last time the share of jobs with an annualised increase at this level of above 3% was the June quarter of 2009 (68%).

Through the year, wages growth in Electricity, gas, water and waste services recorded the highest growth (5%) while Arts and recreation services industry recorded the lowest growth (2.9%). By state and territory, Tasmania led annual growth at 4%, while Victoria, South Australia, and the Northern Territory trailed with increases around 3.0–3.2%.

Australia's unemployment rate remains historically low, largely due to a surge in public sector employment, which has grown at more than double the pace of private sector employment. However, this expansion in jobs in the public sector is likely to slow down. Combined with the current weakness in the private sector, KPMG expects unemployment to rise gradually towards the natural levels.

We are also seeing other evidence of a slowdown in the labour market. While layoffs remain below pre-pandemic levels, new entrants, including migrants and graduates, are experiencing longer job search periods. Indicators such as underutilisation, hours worked, and youth unemployment suggest reduced labour demand. SEEK's job ad index in October 2024 revealed that ads fell 10.7% over the year, while applications per ad declined for the first time in two years (-0.9% m/m).

Government

Public demand was a key driver of growth in the September quarter 2024, contributing 0.6 percentage points to quarterly GDP growth, with government consumption and government investment accounting for 0.3 percentage points each.

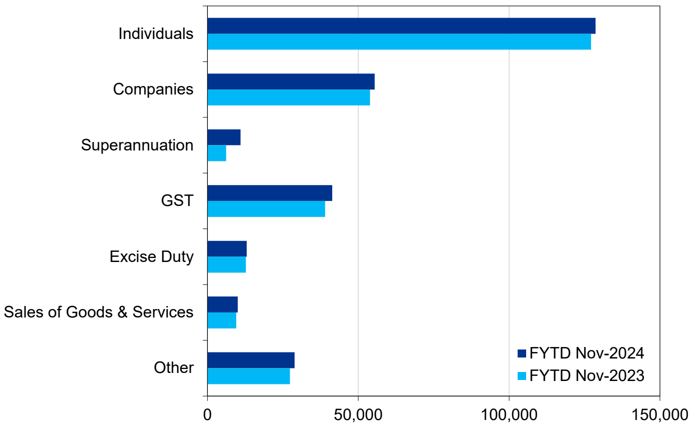
Government spending rose 1.4% primarily due to energy bill relief rebates. However, growth in Commonwealth social benefits, including NDIS and aged care, slowed compared to recent quarters. Public investment rose 6.3% to reach record levels, following three consecutive quarterly falls, driven by defence equipment imports and investment in hospital and roads.

The three non-market industries all contributed to GDP with strong growth in the September quarter. Public Administration and Safety (+1.3%) rose driven by increased activity in the public sector. Health Care and Social Assistance (+1.2%) rose driven by a continued increase in GP attendance during an adverse flu season.

Across all levels of government, the general government operating balance fell to a deficit of $18.3 billion for the September 2024 quarter, $32.7 billion lower than in the previous quarter. Over this same period, taxation revenue fell by $39.2 billion to $187.7 billion.

Chart 20: Australian Government Tax Receipts by Type

Non-seasonally adjusted, mil AUD



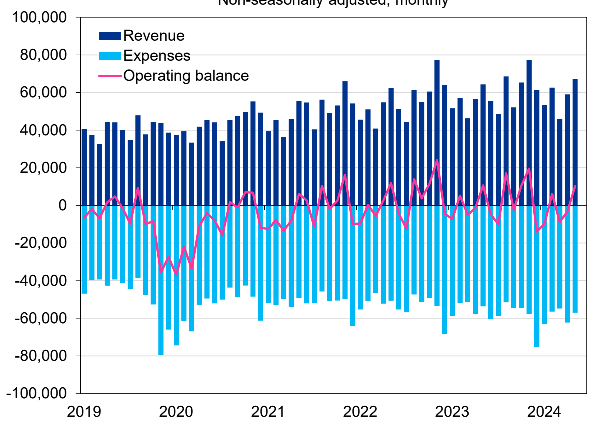
Source: AOFM, Haver, KPMG

Looking ahead, the 2024–25 National Fiscal Outlook anticipates most budget aggregates to improve as a share of GDP at a national level (Commonwealth and State combined) compared to the 2023–24 edition, except for public debt interest payments. The national net operating balance is forecast to return to a surplus of 0.3% of GDP ($9.6 billion) in 2027–28.

At the Commonwealth level, total revenue in the financial year-to-date (FYTD) until November 2024 was 4.5% higher than compared to November 2023. The largest contributor to this rise was tax receipts from superannuation, which sits at $10.9 billion compared to $6.1 billion one year prior.

Chart 21: Central Government Operating Balance

Non-seasonally adjusted, monthly



Source: AOFM, Haver, KPMG

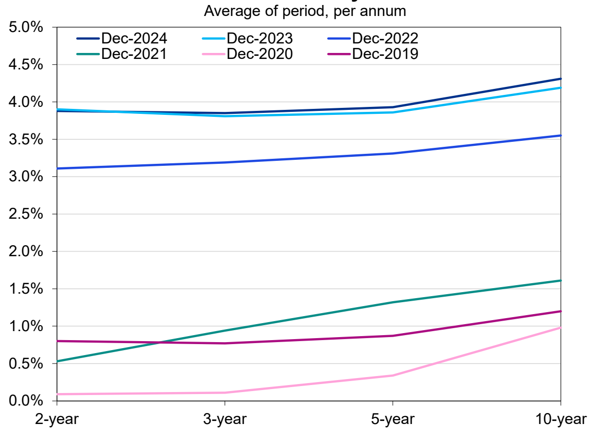
However, total expenses during this same period have increased by 7.4%, leading to a worsened operating balance overall. Net debt was $514.5 billion as at November 2024, an increase of $12.9 billion over the year.

While the Commonwealth mid-year economic update projects a modest reduction in the budget deficit to $26.9 billion for 2024–25, compared to $28.3 billion in the May budget, it reveals an overall deterioration in the fiscal outlook. Over the next four years, deficits are projected to be $21.8 billion larger, peaking at a deficit of $46.9 billion in 2025–26. In part, this downgrade was due to a weaker Chinese economy and reduced demand for commodities, with mining exports expected to be $100 billion lower over the next four years. This translates to an $8.5 billion reduction in company tax revenues over this period.

Australian Government bond yields have fallen across the curve in December 2024, after rising between August to November. The 10-year Commonwealth bond yield in the three months to December averaged 4.37%, representing a 44-basis point premium over 2-year tenor bonds. Compared to 12 months ago, the rise in longer term yields may have been driven by the increasing likelihood of a soft-landing scenario.

Chart 22: Australian Treasury Bond Yield Curve

Average of period, per annum



Source: ABS, Haver, KPMG

Financial conditions

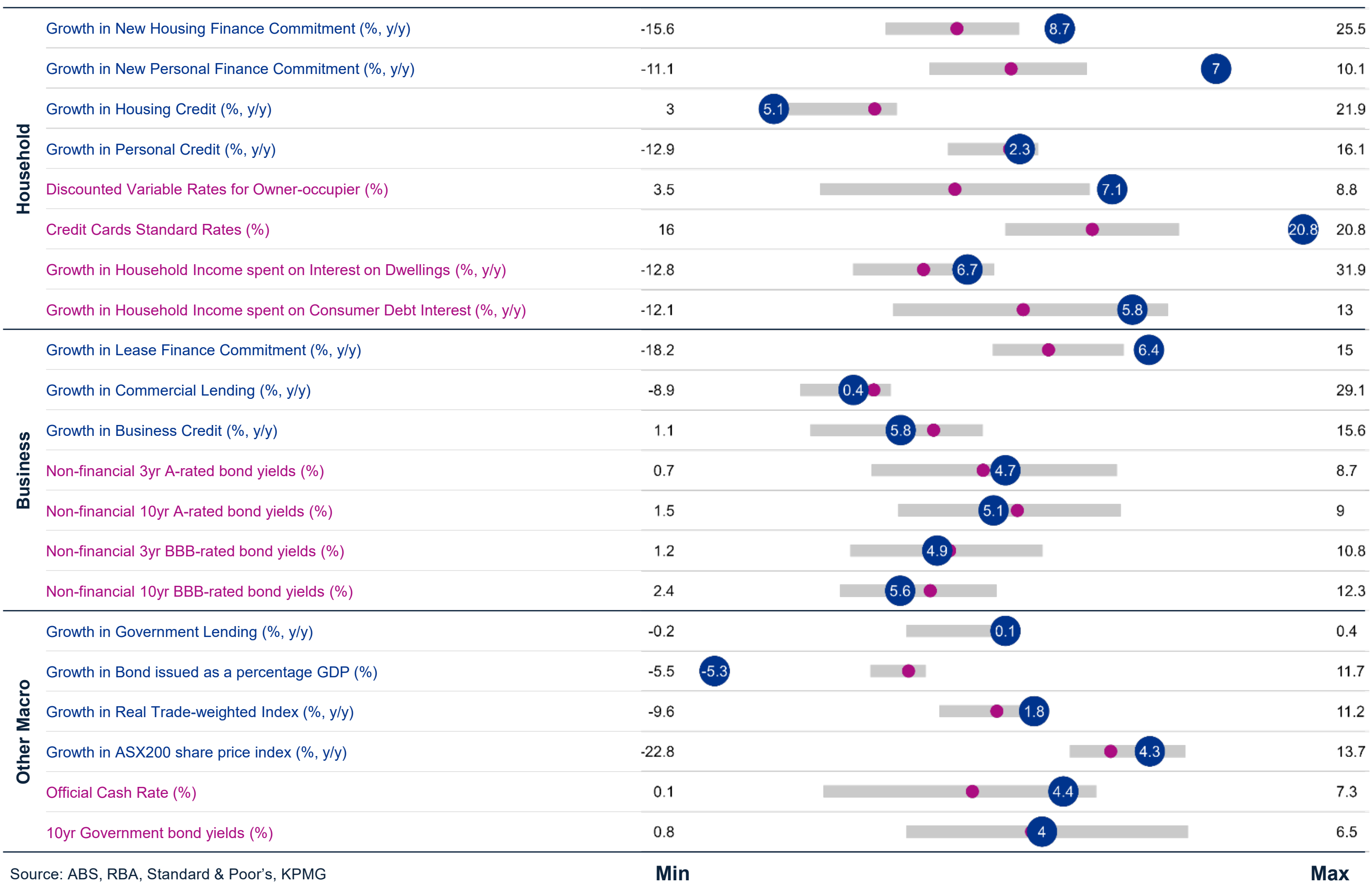
We need to access financial conditions by examining a broad set of indicators – beyond just the overall stance of monetary policy.

KPMG's Financial Conditions Index measures the state of financial conditions in Australia, not just for the overall economy but also for households and businesses. It is based on quarterly data from households, businesses, and macroeconomic sources.

We assess financial conditions by examining a broad set of complementary indicators, as detailed in the table below. A significant deviation of an indicator from the average of the sample means that the financial conditions are more restrictive/expansionary.

An expansionary financial condition indicator (blue text) indicates that the greater that variable from its average, the more expansionary the financial conditions are. Conversely, a restrictive financial condition indicator (pink text) indicates that a larger deviation from the average corresponds to more restrictive conditions. Blue dots show the latest readings, pink dots show the average over the sample and the grey bars show the middle 50% of observations (the interquartile range).

Indicators of Financial Conditions (2003–2024)

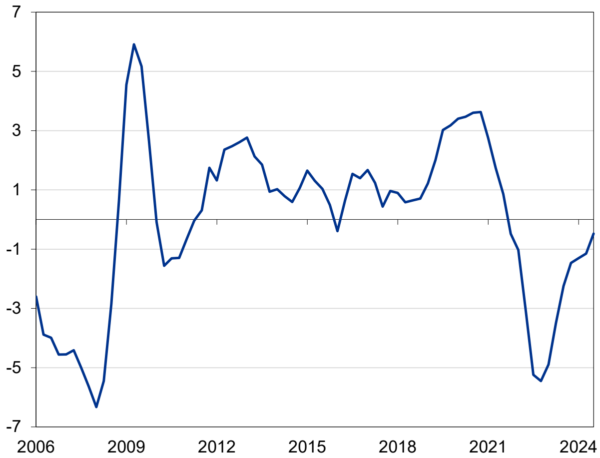


Source: ABS, RBA, Standard & Poor's, KPMG

Financial conditions are particularly restrictive for households, but less so for businesses

Charts 23 and 24 illustrate KPMG's Financial Condition Index (FCI) for the time period from the March quarter 2006 to the September quarter 2024. A positive index value indicates generally expansionary financial conditions, while a negative index value indicates restrictive financial conditions.

Chart 23: KPMG's Financial Condition Index



Source: KPMG

The FCI shows that financial conditions tightened significantly during the GFC. Despite the onset of the pandemic, financial conditions did not deteriorate as expected, due to historically low cash rates, rising asset prices and substantial fiscal stimulus.

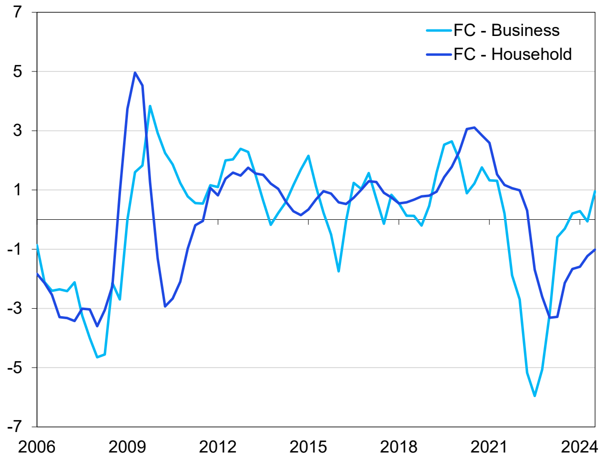
The tightening in monetary policy across the advanced economies over the past two years has led to more restrictive financial conditions in Australia since the December quarter 2021, contributing to slower economic growth as a consequence.

In the past four quarters, KPMG's Financial Condition Index has shown some signs of easing, coinciding with the Reserve Bank of Australia's (RBA) pause on rate hikes. The 10-year government bond yield growth of 4% aligns with long-term averages but remains above pre-tightening levels. Additionally, the ASX share price index has risen significantly over the past year, increasing from 7,234 to 8,419.

Financial conditions for households have become more expansionary over the past 12 months but remain in the restrictive zone. Despite elevated interest rates, housing credit growth has picked up over the past year due to steady growth in housing prices and households' preference to purchase their own homes in the tight rental market. Nevertheless, the rate of housing credit growth remains subdued at 5.1% over the year, significantly lower than the long-term average of 8.3%.

Chart 24: KPMG's Financial Condition Index

Household vs Business



Source: KPMG

The discounted variable rate remains high at 7.1% in the September quarter 2024 but has slightly decreased from the peak of 7.3% observed between December 2023 and March 2024. Household spending on interest surged, with dwelling-related interest up 6.7%, well above the 3.4% average, highlighting high levels of mortgage stress. Despite these elevated mortgage rates, new housing loan commitments increased 8.7% y/y in the September quarter and have been growing for four consecutive quarters.

Financial conditions for businesses are back to the expansionary zone

Business financial conditions are now back in the expansionary territory, driven by robust credit growth and expanding commercial activity.

Business credit growth remains strong at 5.8%, exceeding post-GFC averages, supported by low leverage, resilient internal funding, and solid investor demand for wholesale debt.

Lease finance commitments grew 6.4%, significantly above the long-term average of 0.8%, reflecting confidence in capital expenditure.

Following a steady upward trajectory and peaking at pre-pandemic levels by late 2022, corporate bond yields have exhibited a gradual decline since early 2023, reflecting strong investor demand and increasing confidence in the economic outlook. This decline has been more pronounced for longer maturities. In the third quarter of 2024, the 10-year A-rated bond yields experienced a significant year-to-year reduction of 75 basis points, a sharper drop compared to the gradual 4–40 basis point decreases observed over the past two years. Similarly, 10-year B-rated bond yields saw an even steeper year-to-year reduction of 107 basis points, contrasting with the 30–50 basis point decreases over the previous two years.

Forecasts

GLOBAL[1]	Annual GDP Growth[2]			Unemployment Rate[3]			Average Annual Inflation[4]		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
World	3.2	3.1	3.0	5.4	5.3	5.2	6.1	4.5	3.6
Euro Area	0.5	0.8	1.3	6.5	6.3	6.3	4.2	2.2	2.2
UK	0.3	0.9	1.3	3.8	4.2	4.0	6.8	2.4	1.8
US	2.9	2.8	2.2	3.8	4.1	4.0	3.8	2.5	2.0
Brazil	2.9	3.1	2.4	7.5	6.5	6.7	4.6	4.3	3.7
China	5.2	4.8	4.5	5.0	5.3	5.6	0.2	0.5	1.4
India	7.7	7.2	6.9	9.0	6.8	7.5	5.7	4.3	4.3
Indonesia	5.0	5.0	5.1	5.2	6.4	6.2	3.7	2.3	2.3
Japan	1.7	-0.1	1.2	2.5	2.5	2.5	3.0	2.4	2.1
Singapore	1.1	2.8	2.4	2.0	2.5	2.3	4.9	2.4	1.8
South Korea	1.4	2.5	2.2	2.8	2.8	3.1	3.6	2.4	2.2
Taiwan	1.3	4.5	2.4	3.4	3.5	3.6	2.1	2.1	2.0
Vietnam	5.0	7.1	6.5	2.4	2.4	2.9	3.2	3.5	3.2
Australia	2.1	1.1	2.2	3.9	4.1	4.3	5.9	3.8	2.5
New Zealand	0.9	0.8	1.8	4.0	3.8	3.1	5.6	2.6	2.3

[1] Source: NIESR [2] GDP growth calculated as (GDP q1-q4 t / GDP q1-q4 t-1) [3] Estimated unemployment rate at end of year [4] Estimated average inflation though the year

AUSTRALIA	Q/Q Growth			Y/Y Growth			
	Q3-24 (a)	Q4-24 (f)	Q1-25 (f)	2023 (a)	2024 (f)	2025 (f)	2026 (f)
GDP and Components							
Consumption	0.0%	0.4%	0.5%	1.1%	0.7%	2.3%	2.2%
Business investment	-0.6%	0.4%	0.7%	8.9%	0.0%	4.2%	4.8%
Housing investment	1.3%	1.2%	0.9%	-1.1%	4.2%	4.9%	4.5%
Government	2.4%	0.8%	0.7%	4.1%	5.0%	2.8%	2.4%
Exports	0.2%	0.3%	0.7%	3.7%	1.2%	3.1%	2.7%
Imports	-0.3%	0.7%	1.5%	5.7%	6.3%	5.0%	4.3%
GDP	0.3%	0.7%	0.5%	1.5%	1.4%	2.4%	2.3%
Inflation and Rates							
Headline CPI*	2.9%	2.3%	2.1%	4.1%	2.3%	3.3%	3.3%
RBA Cash Rate*	4.35%	4.35%	4.35%	4.35%	4.35%	3.60%	3.60%
10-year government bond*	4.08%	4.11%	3.94%	4.48%	4.11%	3.60%	3.38%
AUD/USD*	0.693	0.622	0.630	0.684	0.622	0.635	0.678
Terms of trade	-2.5%	5.0%	0.3%	-4.5%	-2.1%	-3.0%	-3.1%
Labour Market							
Employment	1.0%	-0.8%	1.0%	3.0%	1.3%	1.4%	1.0%
Unemployment rate*	4.2%	4.1%	4.1%	3.9%	4.1%	4.2%	3.9%
WPI	0.8%	0.6%	0.2%	4.3%	3.0%	2.6%	4.1%

* Values at end of period

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