

Part 2: Economic Outlook

Overview

The Australian economy has slowed more than expected over the past year due to the impact of higher interest rates, cost-of-living pressures and weaker global economic conditions. Despite these challenges, the Australian economy has outperformed many advanced economies and is on track for a soft landing. The economy has continued to grow, and inflation has moderated substantially. The labour market has also remained resilient, with more than a million jobs created since the middle of 2022, the labour force participation rate is near record highs, real wages and household incomes are growing again, and the gender pay gap is the narrowest it has ever been. Furthermore, business investment is at its highest level since the early 2010s.

Uncertainty and volatility around the world continue to weigh on the global economy. Almost three quarters of OECD nations have recorded a negative quarter of growth over the past 18 months. Global growth is expected to be 3¼ per cent this year and for the next two years, which is the longest stretch of below average growth since the 1990s. Global activity has been affected by challenges in the Chinese economy and the effect of conflicts in Ukraine and the Middle East, while tighter financial conditions have weighed on activity and labour markets in many countries. An escalation of trade tensions is a key risk to the global outlook, although details of significant aspects of the incoming United States administration's policy agenda are yet to be settled.

Against this challenging global backdrop, economic growth in Australia is expected to improve over the forecast period. Growth in Gross Domestic Product (GDP) is expected to increase from 1.4 per cent in 2023–24 to 1¾ per cent in 2024–25, and then to 2¼ per cent in 2025–26. The pick-up in growth is expected to be supported by a gradual recovery in household consumption.

The Government's cost-of-living tax cuts, together with the anticipated easing in inflation and continuing employment and wage growth are expected to drive growth in real household disposable income in 2024–25. Growth in real household disposable income in 2024–25 would be around 1 percentage point lower without the Government's cost-of-living tax cuts. The tax cuts are delivering a tax cut to all 13.6 million Australian taxpayers from 1 July 2024, with the average income earner receiving a tax cut of \$1,604.

Inflation has moderated substantially in the Australian economy across both headline and underlying measures. Headline inflation has declined from its peak of 7.8 per cent in the December quarter 2022 to 2.8 per cent in the September quarter 2024, returning to the Reserve Bank of Australia's (RBA) target band for the first time since 2021. This was supported by cost-of-living relief policies and lower fuel prices. The Government's cost-of-living relief measures announced in the 2024–25 Budget are expected to directly reduce annual inflation by ½ of a percentage point in 2024–25.

Underlying inflation fell by 0.5 percentage points in the September quarter to be 3.5 per cent, and was 3.3 per cent on a six-month annualised basis, which is its lowest level in almost three years. The easing of underlying inflation has largely been driven by the normalisation of goods price inflation. Services inflation has also moderated from its peak. Inflation is expected to sustainably return to the RBA's target band around the end of 2025.

Over a million jobs have been created in the Australian economy since the beginning of the monetary policy tightening phase (Box 2.1). Most of these gains are expected to be preserved, with employment growth expected to remain positive but moderate over time. The unemployment rate is low by historical standards and is expected to remain comparatively low over the forecast period, rising modestly to 4½ per cent by June 2025. The participation rate is forecast to remain near its peak. Many Australians who were previously outside the labour force have sought and secured work, including people that have traditionally faced barriers to employment such as women and younger Australians.

Nominal wage growth has eased but remains solid at 3.5 per cent and is expected to remain above its 10-year pre-pandemic average of 2.7 per cent. Real wages are expected to grow with moderating inflation and solid growth in nominal wages.

Investment should continue to support activity in the Australian economy, with business investment forecast to remain at around decade highs and dwelling investment expected to pick up over the forecast period, which will expand the supply of new housing.

While growth in public demand remains below its five-year pre-pandemic average, government consumption and investment have played an important role in ensuring the Australian economy remains on track for a soft landing. Without the contribution of public demand in the September quarter, growth in the economy would have been much weaker. State and local government spending was the major driver of public demand, while the Commonwealth's share was primarily driven by investment in defence equipment. Public final demand is expected to continue to support growth, with around two-thirds of the upgrade in growth over the two years to 2025–26 attributed to increases in state and local government spending.

There are a number of global factors that are posing risks to the economic outlook. Global uncertainty will continue to weigh on global economic conditions, and Australia will not be immune. There is political uncertainty in a number of advanced economies. Protectionism and strategic competition between the United States and China present challenges to global trade, and geopolitical tensions increase the potential for a sharp commodity price shock (including for oil). This will contribute to uncertainty about the path of global inflation. In many advanced economies, the decline in inflation has not been smooth.

Developments in China continue to present downside risk to Australia's export sector. Recent policy announcements by authorities are expected to support China's growth in the near term. However, these announcements are unlikely to offer significant or ongoing support for bulk commodity prices (which have fallen since the beginning of 2024), or quickly restore Chinese demand for Australian education and tourism services.

Domestically, there is uncertainty about how quickly household consumption will respond to growth in real household disposable income. While consumers are initially expected to replenish saving buffers, the speed at which they do so will have implications for the outlook. Although Australia’s labour market has performed strongly, it could adjust more than is currently forecast, resulting in a higher unemployment rate.

The Australian economy is expected to remain resilient in the face of challenging economic conditions and is on track for a soft landing. Growth is forecast to pick up, inflation is expected to sustainably return to the target band, the unemployment rate is expected to remain low by historical standards and real wages are forecast to grow.

International economic outlook

The global economy is forecast to grow at 3¼ per cent across the forecast period. Around three quarters of OECD nations have experienced at least one negative quarter of growth in the past 18 months. The Chinese economy is continuing to slow as cyclical and structural factors drag on growth. Growth in the United States economy has been stronger than expected and an outlier compared with other advanced economies. Growth rates in other advanced economies have been lower and are picking up only gradually.

Global disinflation has enabled central banks in many advanced economies to begin easing monetary policy to counter weaker growth in employment and economic activity. For several countries, this follows more aggressive monetary policy tightening than in Australia since late 2021. Despite having already commenced easing, policy rates in the United States and the United Kingdom remain higher than in Australia. Yet, inflation in services prices has remained persistent in many economies and housing-related components of inflation remain elevated in some economies.

Risks to the international outlook remain tilted to the downside. Rising global protectionism and strategic competition between the United States and China loom over global trade flows and have the potential to significantly disrupt and re-shape supply chains. Significant trade disruptions and a more adversarial trade environment would lead to a reduction in global trade, higher input costs and lower productivity.

Ongoing tensions in the Middle East and Ukraine increase the risk of a sharp commodity or oil price shock, with potential implications for Australian import prices and inflation. Although oil prices have trended lower in 2024, in line with slowing global demand, significant supply disruptions that cause prices to surge could add materially to the costs of production, freight and transport, as well as put pressure on domestic energy costs.

The **United States** has continued to outperform other advanced economies. Inflation has moderated without substantially affecting employment outcomes, with the unemployment rate at 4.1 per cent in November. Growth in the United States is expected to be 2¾ per cent in 2024, and then 2 per cent in 2025 and 2026. The growth outlook has improved in line with robust consumption and investment. There is some uncertainty around the outlook for the United States with the incoming administration's policy platform of tariffs, tax cuts and deregulation yet to be settled.

China's economic growth continues to moderate in line with the ongoing property sector downturn and mounting structural challenges. Growth is expected to continue to moderate over the forecast period from 4¾ per cent in 2024 to 4½ per cent in 2025, and then to 4¼ per cent in 2026. If realised, this would be the weakest consecutive three-year period of growth since China opened up to the global economy in the 1970s. Since September, Chinese authorities have announced a range of measures that are expected to provide some support to near term activity, including easing of monetary policy, efforts to restructure local government debts, and to ease the adjustment in the property sector.

The multi-year downturn in the property sector continues to weigh on China's growth. Despite targeted support, authorities remain committed to deleveraging the sector and real estate investment continues to decline. Falling house prices have weighed on household wealth and spending. Longer-term, China continues to face significant structural headwinds that will weigh on growth, including an ageing and shrinking population, and slowing urbanisation rates.

The **euro area** is projected to experience modest improvements in growth over the forecast period. GDP is forecast to grow by $\frac{3}{4}$ per cent in 2024, $\frac{1}{4}$ per cent in 2025 and $1\frac{1}{2}$ per cent in 2026. Rising real wages may provide some support to consumption, while the anticipated easing of monetary policy could aid business investment. However, persistent structural challenges in German industry, political and trade uncertainties, and delays to fiscal consolidation in some countries pose significant risks to the outlook.

The **United Kingdom** is expected to post subdued growth through 2026, supported by higher public sector spending announced in the new government's October budget, and a further expected easing in monetary policy. GDP is forecast to grow by 1 per cent in 2024, $1\frac{1}{4}$ per cent in 2025 and $1\frac{1}{2}$ per cent in 2026.

In **Japan**, growth in 2024 has been adversely affected by recent and lingering supply disruptions in the auto sector and the dissipation of one-off factors that supported growth in 2023, including the post-pandemic surge in tourism.

Unlike many other advanced economies, the Bank of Japan has begun gradually tightening monetary policy, signalling confidence that prices will grow sustainably, following decades of weak inflation and deflation. Despite this, financial conditions remain accommodative and the pace of monetary policy tightening has been gradual. As a result, growth is expected to be moderate. The Japanese economy is forecast to record zero growth in 2024, with growth rebounding to $1\frac{1}{2}$ per cent in 2025, and then moderating to 1 per cent in 2026. Trade exposure presents a key risk to near-term growth, particularly if trade tensions escalate or Chinese growth weakens.

Growth in **other East Asian** economies is expected to remain steady through 2026, with combined GDP forecast to grow by $4\frac{1}{4}$ per cent in 2024, 4 per cent in 2025 and 4 per cent in 2026. The region may experience uneven effects from rising trade tensions. While Vietnam and other emerging economies may benefit from trade shifts, growth in Taiwan and South Korea is expected to slow as China's weaker economic outlook weighs on regional growth prospects.

India is projected to remain the world's fastest-growing major economy through 2025. It is forecast to grow by 7 per cent in 2024, $6\frac{3}{4}$ per cent in 2025 and $6\frac{1}{2}$ per cent in 2026. While growth in the first half of 2024 was subdued amid broader geopolitical and economic uncertainty, easing inflation and a pick-up in state spending is expected to support activity. Growth prospects have improved due to stronger domestic demand and state investment.

Table 2.1: International GDP growth forecasts^(a)

	Outcome	Forecasts (Calendar Years)			
	2023	2024	2025	2026	
Australia	2.0	1	2 1/4	2 1/4	
China	5.2	4 3/4	4 1/2	4 1/4	
India	8.2	7	6 3/4	6 1/2	
Japan	1.7	0	1 1/2	1	
United States	2.5	2 3/4	2	2	
Euro area	0.4	3/4	1 1/4	1 1/2	
United Kingdom	0.3	1	1 1/4	1 1/2	
Other East Asia ^(b)	3.3	4 1/4	4	4	
Major trading partners	3.6	3 1/4	3 1/2	3 1/4	
World	3.3	3 1/4	3 1/4	3 1/4	

a) World and Other East Asia growth rates are calculated using GDP weights based on purchasing power parity (PPP). Growth rates for major trading partners are calculated using Australian goods and services export trade weights.

b) Other East Asia comprises Indonesia, Malaysia, the Philippines, Thailand, Vietnam and Singapore, along with Hong Kong, South Korea and Taiwan.

Source: National statistical agencies, IMF, Refinitiv and Treasury.

Domestic economic outlook

The combination of higher interest rates, cost-of-living pressures and weaker global economic conditions has caused the Australian economy to grow more slowly over the past year than initially expected. Despite this, Australia has still outperformed many advanced economies during this difficult economic period and is on track for a soft landing. The economy has continued to expand and inflation has moderated substantially from its peak. More than a million jobs have been created since the middle of 2022, the labour force participation rate is near record highs, real wages and household incomes are growing again, and the gender pay gap is the narrowest it has ever been.

While global and domestic economic pressures have weighed on growth over the past year, the Australian economy is expected to regain some momentum over the course of 2025. Growth in Australia is expected to increase from 1.4 per cent in 2023–24 to 1¾ per cent in 2024–25, and then 2¼ per cent in 2025–26.

Over the last year, consumption growth was the weakest in around three decades, outside of the COVID-19 pandemic and Global Financial Crisis. In aggregate, households have cut back discretionary spending after an initial post-pandemic adjustment and also curtailed savings to manage cost-of-living pressures.

Consumption growth is expected to pick up gradually over 2024–25. This is expected to be driven by a recovery in real household disposable incomes supported by moderating inflation, continuing employment and wage growth, and the Government's cost-of-living tax cuts. It is assumed monetary policy will begin to ease in the first half of 2025, with the official cash rate assumed to decline to 3.6 per cent by the middle of 2026.

The Government's cost-of-living tax cuts came into effect on 1 July 2024, providing an income tax cut to all Australian taxpayers and supporting growth in real household disposable income. This was reflected in the fall in income tax payable in the September quarter 2024.

Inflation has moderated substantially from its peak in 2022. Headline inflation was 2.8 per cent in the September quarter 2024, which is the first time it has been inside the RBA's target band since 2021. The Government's cost-of-living relief measures announced in the 2024–25 Budget are expected to directly reduce annual inflation by ½ of a percentage point in 2024–25. Trimmed-mean inflation moderated to its lowest level in three years in the September quarter 2024. The easing of rental market pressures, new dwellings prices and services inflation are expected to contribute to the sustainable return of inflation to the RBA's target band around the end of 2025.

The labour market has remained resilient, with Australia experiencing faster jobs growth than any major advanced economy since the middle of 2022. Employment is forecast to continue growing, but at a more moderate pace. The unemployment rate has remained historically low and is forecast to rise only modestly to 4½ per cent by the middle of 2025, which is below the pre-pandemic average and slightly above Treasury's assumption for the Non-Accelerating Inflation Rate of Unemployment (NAIRU). Participation has been

at record highs as new workers have entered the labour force, including cohorts that have traditionally faced barriers to employment such as women and younger Australians.

The strength of the labour market has supported a pick up in wage growth, with the wage price index (WPI) growing by 3.5 per cent through the year to the September quarter 2024. As conditions in the labour market ease, wages growth should continue to moderate, but remain above its 10-year pre-pandemic average. Upcoming administered wage decisions are likely to support overall wages growth. After going backwards in 2022, annual real wages began growing again in 2023 and further growth is expected over the forecast period.

Business investment has remained resilient, assisted by strong business balance sheets, elevated capacity utilisation and resilient sentiment. While growth is forecast to moderate over the period ahead, the level of investment activity is expected to remain at levels not experienced since the early 2010s.

Dwelling investment contracted in 2023–24 due to elevated construction and financing costs and constraints in the availability of labour in the residential construction sector. However, new home construction should support a pick-up in dwelling investment over the forecast period as the combination of strong demand, easing inflation in construction costs and support from the Government’s housing agenda underpin an expansion in activity.

While growth in public demand has been below the five-year pre-pandemic average, it has played an important role in Australia’s progress towards a soft landing. More recently, state and local government spending has driven the majority of the growth in public final demand.

Net overseas migration peaked in 2022–23, and is forecast to decline over the forward estimates. While the number of new arrivals is declining in line with expectations at Budget, departures were lower than expected in 2023–24. Departures are expected to pick up over 2024–25, albeit at a slower rate than anticipated at Budget.

Table 2.2: Domestic economy – detailed forecasts^(a)

	Outcomes ^(b)		Forecasts		
	2023–24	2024–25		2025–26	
		Budget	MYEFO	Budget	MYEFO
Real gross domestic product	1.4	2	1 3/4	2 1/4	2 1/4
Household consumption	1.1	2	1	2 3/4	2
Dwelling investment	-1.4	0	1	6 1/2	5
Total business investment ^(c)	6.0	1	1 1/2	2	2
<i>By industry</i>					
Mining investment	7.8	-3 1/2	-3	2	2 1/2
Non-mining investment	5.5	2 1/2	2 1/2	2	2
Private final demand ^(c)	1.8	1 3/4	1	3	2 1/4
Public final demand ^(c)	4.1	1 1/2	3 3/4	1 1/2	2 1/4
Change in inventories ^(d)	-0.5	1/4	0	0	0
Gross national expenditure	1.9	1 3/4	1 3/4	2 1/2	2 1/4
Exports of goods and services	3.7	5	1	2 1/2	3
Imports of goods and services	6.5	4	2 1/2	4 1/2	3 1/2
Net exports ^(d)	-0.4	1/2	- 1/4	- 1/4	0
Nominal gross domestic product	4.1	2 3/4	3 1/4	4	3 1/2
Prices and wages					
Consumer price index ^(e)	3.8	2 3/4	2 3/4	2 3/4	2 3/4
Wage price index ^(f)	4.1	3 1/4	3	3 1/4	3
GDP deflator	2.7	1/2	1 1/2	1 3/4	1 1/4
Labour market					
Participation rate (per cent) ^(g)	66.8	66 1/2	66 3/4	66 1/4	66 1/2
Employment ^(f)	2.2	3/4	1 3/4	1 1/4	1
Unemployment rate (per cent) ^(g)	4.1	4 1/2	4 1/2	4 1/2	4 1/2
Balance of payments					
Terms of trade ^(h)	-6.3	-7 3/4	-5 1/4	-4	-5 1/4
Current account balance (per cent of GDP)	-1.3	- 3/4	-2	-2	-3 1/4
Net overseas migration ⁽ⁱ⁾	446,000	260,000	340,000	255,000	255,000

a) Percentage change on preceding year unless otherwise indicated.

b) Calculated using original data unless otherwise indicated.

c) Excluding second-hand asset sales between the public and private sector.

d) Percentage point contribution to growth in GDP.

e) Through-the-year growth rate to the June quarter.

f) Seasonally adjusted, through-the-year growth rate to the June quarter.

g) Seasonally adjusted rate for the June quarter.

h) Key commodity prices are assumed to decline from elevated levels over four quarters to the end of the September quarter of 2025: the iron ore spot price is assumed to decline to US\$60/tonne; the metallurgical coal spot price declines to US\$140/tonne; the thermal coal spot price declines to US\$70/tonne; and the LNG spot price converges to US\$10/mmBtu. All bulk prices are in free on board (FOB) terms.

i) Net overseas migration is forecast to be 225,000 in 2026–27 and 225,000 in 2027–28. Forecasts for net overseas migration were finalised prior to the release of the ABS National, State and Territory Population data, June 2024, on 12 December 2024.

Note: The forecasts for the domestic economy are based on several technical assumptions. The exchange rate is assumed to remain around its recent average level – a trade-weighted index of around 62 and a US\$ exchange rate of around 66 US cents. Interest rates are informed by the Bloomberg survey of market economists. World oil prices (Malaysian Tapis) are assumed to remain around US\$77 per barrel.

Source: ABS Australian National Accounts: National Income, Expenditure and Product; Balance of Payments and International Investment Position, Australia; National state and territory population; Labour Force Survey, Australia; Wage Price Index, Australia; Consumer Price Index, Australia; unpublished ABS data and Treasury.

Household consumption

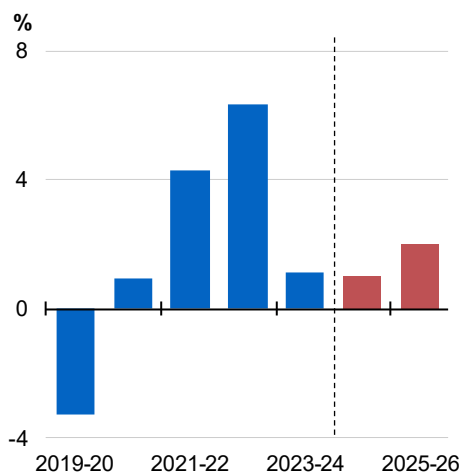
Higher interest rates and cost-of-living pressures weighed on households in 2023–24, resulting in weak household consumption and lower savings. Household consumption rose by 1.1 per cent in 2023–24 and the net saving ratio was the lowest since the Global Financial Crisis as households have used more of their income to support consumption.

Household consumption is expected to remain subdued in 2024. However, it is forecast to grow by 1 per cent in 2024–25, and 2 per cent in 2025–26, with a gradual rise in real household disposable income supporting consumption growth (Chart 2.1).

Real household disposable income is forecast to grow by 2¾ per cent in 2024–25, supported by moderating inflation, labour income growth and the Government’s cost-of-living tax cuts. Growth in labour income is estimated to contribute 4¾ percentage points to real household disposable income growth over 2024–25. Without the Government’s cost-of-living tax cuts, growth in real household disposable income would have been around 1 percentage point lower.

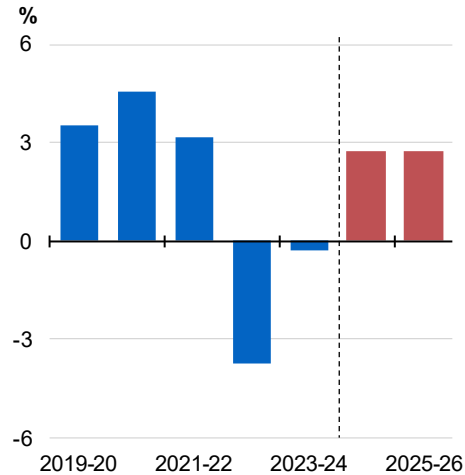
There remains significant uncertainty about the responsiveness of household consumption to evolving economic conditions. Although inflation is expected to moderate and real household disposable incomes are forecast to grow (Chart 2.2), households will still face financial pressures and may prioritise the replenishment of saving buffers in the near term.

Chart 2.1: Household consumption



Source: ABS Australian National Accounts: National Income, Expenditure and Product and Treasury.

Chart 2.2: Real gross disposable income



Source: ABS Australian National Accounts: National Income, Expenditure and Product and Treasury.

Dwelling investment

After a period of weakness, dwelling investment has started to grow again and this is expected to continue over the forecast period.

Dwelling investment contracted in 2023–24, with construction and financing costs and labour constraints weighing on the sector's capacity to progress new builds. Elevated labour, raw materials and financing costs are adversely affecting developer margins and constraining activity, particularly in high-density dwellings.

Dwelling investment is forecast to grow 1 per cent in 2024–25 and at 5 per cent in 2025–26. Robust demand for housing, together with an expected easing of both monetary policy and construction costs, is likely to support an expansion in the sector. Growth in dwelling investment will expand the supply of new homes, which will be assisted by the Government's \$32 billion housing plan.

Business investment

Business investment grew strongly in 2023–24, driven by spending on new machinery and equipment, non-mining projects (including data centres and warehouses) and in the mining sector. Investment in software has also been strong.

Resilient business balance sheets, elevated capacity utilisation and a solid pipeline of non-dwelling construction work are expected to support a higher level of business investment over the next two years. While growth in investment is forecast to moderate to 1½ per cent in 2024–25, and 2 per cent in 2025–26, it is forecast to remain at highs not recorded since the 2010s.

Non-mining investment is expected to drive new business investment activity. This is forecast to increase by 2½ per cent in 2024–25, and by a further 2 per cent in 2025–26. The elevated pipeline of non-dwelling construction projects will support growth.

Growth in mining investment is expected to fall by 3 per cent in 2024–25 as major LNG projects reach completion, and then to grow by 2½ per cent in 2025–26. The outlook primarily reflects expenditure to maintain existing resource production capacity, including through the replacement of outdated mining machinery, along with a modest number of new metal ore and LNG projects.

Public final demand

While growth in public demand has been below the five-year pre-pandemic average, it has played an important role in supporting economic activity and helped Australia withstand difficult global and domestic economic circumstances.

Without the contribution from public demand in the most recent period, growth in the economy would have been much weaker. In the most recent September quarter, state and local government spending contributed around 60 per cent to quarterly public final

demand growth. Of the Commonwealth's remaining share, two-thirds of the growth reflected investment in defence.

Public final demand is forecast to grow by $3\frac{3}{4}$ per cent in 2024–25, and $2\frac{1}{4}$ per cent in 2025–26. This is stronger than expected at Budget with the majority of the revision attributable to spending by states and territories.

Government consumption is expected to grow, in part due to growth in spending on demand-driven programs in the care sector across all levels of government and measures to address cost-of-living pressures.

Growth in new public investment is expected to moderate over the forecast period. The large pipeline of public infrastructure projects at the state and federal level will continue to support new public investment, however, capacity constraints are limiting progress and slowing completions.

Net exports

Net exports are expected to subtract $\frac{1}{4}$ of a percentage point from real GDP growth in 2024–25 and make no contribution to growth in 2025–26. This reflects subdued growth in non-rural commodity exports and the moderation of growth in services exports, while imports growth remains relatively strong.

Growth in exports is expected to moderate to 1 per cent in 2024–25, before picking up to 3 per cent in 2025–26. Non-rural commodity exports are expected to remain weak, despite recently announced policy support in China. While services exports are expected to support growth across the forecast period, the profile is weaker than expected at Budget. In part, this is due to a softer than expected recovery in Chinese tourists and students, both of which remain below pre-pandemic levels.

Growth in import volumes is expected to moderate to $2\frac{1}{2}$ per cent in 2024–25. This reflects ongoing stabilisation following the post-pandemic recovery, particularly around outbound tourism, and an easing in domestic demand for imported goods. However, growth is expected to pick up to $3\frac{1}{2}$ per cent in 2025–26 reflecting the gradual recovery in domestic final demand.

The labour market

Australia's labour market has remained resilient despite the slowdown in economic activity and is well-positioned to preserve much of the recent gains in employment as inflation continues to moderate (Box 2.1). Over a million jobs have been created in the economy since the middle of 2022. Employment is expected to continue to grow, albeit at a more moderate pace. Employment growth has eased in industries most exposed to the household sector but there has been continued demand for labour in health and aged care services.

Australia has recorded faster jobs growth than all major advanced economies (Box 2.1) and the labour force participation rate is near record highs. These conditions have lifted

prospects for cohorts who traditionally face barriers to employment. Female participation remained near its record high in November 2024 and the youth unemployment rate remains well below the five-year pre-pandemic average of 12.4 per cent (Chart 2.3).

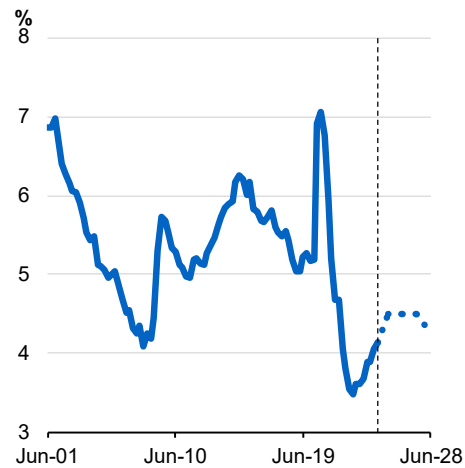
There are signs that labour market conditions are gradually easing, particularly in the retail and hospitality sectors that are more exposed to soft household demand. The unemployment rate has recently stabilised around 4 per cent, which is historically low and consistent with Treasury’s assumption for the NAIRU. The participation rate is expected to remain elevated in the near term and the unemployment rate is forecast to gradually rise to peak at 4½ per cent by the June quarter of 2025, which is low by historical standards.

Chart 2.3: Youth unemployment rate



Source: ABS Labour Force, Australia.

Chart 2.4: Unemployment rate



Source: ABS Labour Force, Australia.

Resilient labour market conditions continue to support nominal wage growth. In line with the expected moderation in the labour market and continued easing of inflation, wage growth is expected to ease to 3 per cent in both 2024–25 and 2025–26 but remain above its pre-pandemic average.

Wage growth forecasts take account of administered wage decisions, including the Fair Work Commission’s (FWC) Annual Wage Review and Aged Care Work Value Case. These decisions will likely add to overall wage growth. Where the FWC is yet to make a determination, Treasury has assumed that these decisions will be consistent with the Government’s submissions. In particular, there is an expectation that any large wage increases would be gradually phased in to support an orderly adjustment for labour markets and service supply.

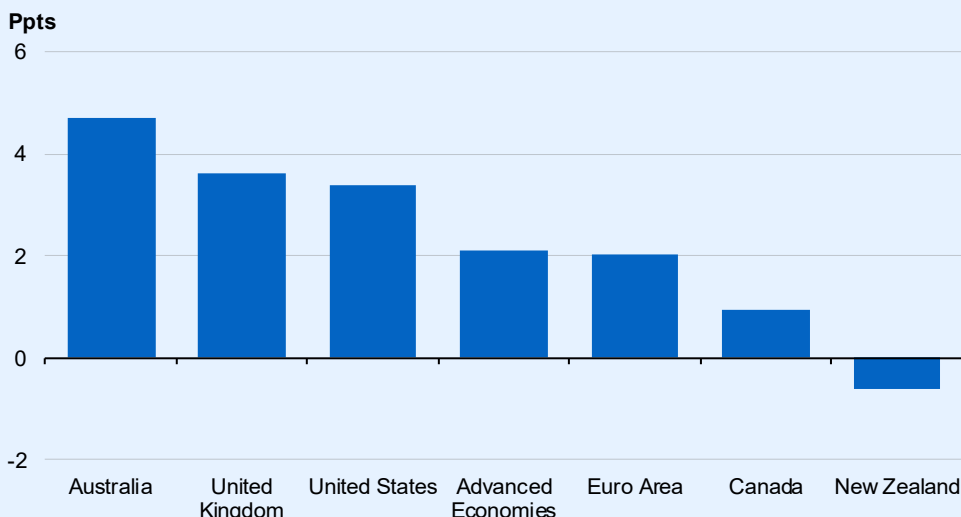
Real wages started to grow again in the December quarter 2023 and are expected to be supported by a cyclical upswing in labour productivity. This upswing is expected to be driven by capital deepening driven by elevated levels of business investment and easing employment growth.

Box 2.1: Navigating the narrow path

Following the pandemic, there was a worldwide surge in inflation that necessitated a strong policy response. Tighter macroeconomic policies around the world have been successful in reducing inflation from the peaks seen in 2022, but have also put pressure on households and have contributed to a slowdown in economic activity and employment.

In Australia, the Government and Reserve Bank of Australia have calibrated policy settings to navigate a narrow path to balance the need to reduce inflation while preserving the strong labour market gains of recent years. The improvement in the budget balance has been well above the advanced economy average, particularly in recent years (Chart 2.5), helping to reduce inflation from its peak.

Chart 2.5: Improvement in fiscal balance to GDP (2021 to 2024)



Source: International Monetary Fund.

Note: International Monetary Fund fiscal data are produced on a consistent basis across countries. They are produced for calendar years and on a general government basis. They are not directly comparable with fiscal aggregates reported elsewhere in MYEFO.

While the overall trajectory of interest rate tightening in Australia has been similar to many advanced economies, the increase in Australian interest rates was lower than in many of these countries. Economies that experienced a larger tightening of monetary policy have typically experienced lower employment growth (Chart 2.6).

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Box 2.1: Navigating the narrow path (continued)

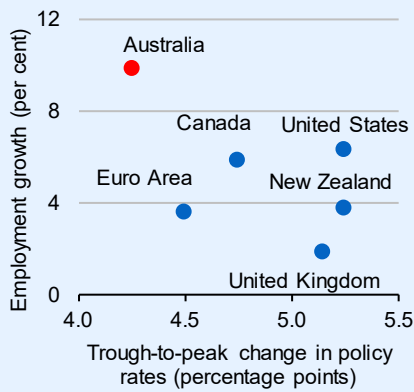
Australia’s inflation and labour market outcomes compare favourably against many other advanced economies. Australia’s inflation peaked lower and later than most comparable economies.

Australia has also experienced a smaller cumulative increase in consumer prices than many countries (Chart 2.7), but stronger employment growth and a smaller rise in unemployment.

In New Zealand, policy rates were increased by more than 5 percentage points, with employment growth slowing and the unemployment rate rising more than 1½ percentage points in response. Nevertheless, the cumulative increase in prices since December 2019 has been higher than in Australia.

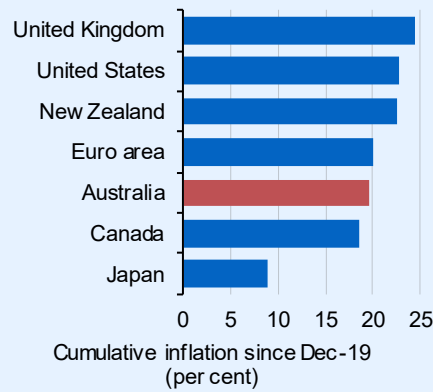
In Canada, while inflation has fallen faster than in Australia, unemployment has risen by 2.0 percentage points since its post-pandemic low in mid-2022. Over the same period, Australia has seen unemployment rise by only 0.4 percentage points. Australia has also experienced cumulative employment growth of around 10 per cent since late-2021.

Chart 2.6: Cumulative employment growth since late 2021 compared with policy rate increase



Sources: ABS, Refinitiv.

Chart 2.7: Cumulative changes in consumer prices in advanced economies to September 2024



Sources: Refinitiv, national statistical agencies.

Inflation

Inflation has moderated substantially across both headline and underlying measures. Headline inflation has moderated from its peak of 7.8 per cent in 2022 to return to the RBA's target band of 2 to 3 per cent in the September quarter 2024. At 2.8 per cent, this was the first time inflation was in the target band since 2021. Cost-of-living relief measures have helped to directly reduce headline inflation. Electricity rebates and the increase in Commonwealth Rent Assistance are estimated to have directly reduced annual inflation in the September quarter 2024 by $\frac{1}{2}$ of a percentage point. Lower fuel prices have also contributed to the lower inflation outcome.

Underlying inflation moderated by 0.5 percentage points in the September quarter to be 3.5 per cent, its lowest level in almost three years. In six-month annualised terms, underlying inflation was 3.3 per cent through the year to the September quarter 2024.

Goods inflation has rapidly normalised across most categories in 2023 and 2024 on the back of easing demand and supply chain pressures. Services inflation, which has recently stabilised well below its peak, is expected to normalise more gradually. The outlook for services inflation remains uncertain, especially around the expected improvement in labour productivity and the pace at which rental and insurance pressures will ease.

Key drivers of housing inflation remain elevated. Strong housing demand in Perth and labour supply constraints have sustained new dwellings inflation in aggregate, although this has moderated to be around one-quarter of its peak in 2022. New dwelling inflation is expected to normalise in the near term as labour supply constraints ease, supported by the Government's housing agenda.

Rental inflation has similarly passed its peak as most rental contracts have now responded to tight market conditions and passed through higher interest costs. Lower growth in housing demand and a slower rate of household formation are likely to support a continued easing in the near term. However, this easing may be stronger than expected if household formation is more responsive to affordability constraints or supply constraints resolve more quickly to drive stronger dwelling investment and housing supply.

Outlook for the terms of trade, nominal GDP and medium term

Australia's terms of trade, or the ratio of export to import prices, are forecast to decline by $5\frac{1}{4}$ per cent in 2024–25. Iron ore prices have fallen since the beginning of 2024 and remain under pressure from slowing growth in China. Key commodity prices are assumed to return to their long-run fundamental levels over four-quarters by the end of the September quarter 2025.

Nominal GDP is expected to grow at $3\frac{1}{4}$ per cent in 2024–25 and $3\frac{1}{2}$ per cent in 2025–26. The moderation from recent years largely reflects lower export prices.

Treasury uses a macroeconomic model of the Australian economy to inform its forecasts and projections. The model informs how the economy returns to its trend level of output, known as potential GDP, following short-term fluctuations of the business cycle.

Potential GDP is estimated based on an analysis of trends for population, productivity, and labour force participation. While these underlying trends have shifted, the level of potential GDP over the projections is largely consistent with 2024–25 Budget.

Since 2024–25 Budget, the level of population (aged over 15) has been revised up by $\frac{1}{2}$ per cent on average over the medium term. The trend participation rate has been revised up. A reduction in trend average hours partly offsets the upward revision to trend participation.

The upgrade in the size of the workforce has been offset through a lower level of trend productivity, reflecting continued weak underlying productivity growth. In the long run, annual productivity growth is assumed to be 1.2 per cent – unchanged from the assumption at 2024–25 Budget.

The unemployment rate settles at the NAIRU assumption of $4\frac{1}{4}$ per cent by the June quarter 2028 and remains at that rate over the projections.

Domestic inflation converges over time to the midpoint of the RBA's target band of 2.5 per cent. The terms of trade are projected to remain around their 2025–26 level over the medium term, with key commodity prices returning to levels consistent with their long-term fundamentals. Nominal wage growth converges to $3\frac{3}{4}$ per cent, reflecting the outlook for labour productivity growth and inflation. The level of nominal GDP over the projections is broadly consistent with 2024–25 Budget.