ECONOMIC OUTLOOK 2024: SETTING AUSTRALIA UP FOR LONG-TERM SUCCESS

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Cassandra Winzar is the Chief Economist at CEDA. Prior to joining CEDA she was Principal Economist at the WA Department of Communities (Housing Authority) where she focused on WA economic conditions and housing related research, including running the state government's Housing Industry Forecasting Group. Cassandra has also held roles as the WA-based Economist for the Reserve Bank of Australia and in Transfer Pricing at EY.

2023 saw the Federal Government undertake consultation, discussion and inquiries on a broad range of policy issues, including the employment white paper, the migration strategy and the aged-care taskforce amongst many others.

This year, after more than a year of discussion and design, the focus must be on getting things done. Some areas of policy reform look promising, such as the migration strategy released late last year and the stronger agenda on disability and care-economy reform.

Others are underwhelming – little has yet to come from the employment white paper, and the Housing Accord has had no noticeable impact as housing affordability worsens. We are also still on the look-out for key strategic policy pieces such as the clean-energy industry policy and a full response to the US Inflation Reduction Act in this year's Federal Budget.

This year, both business and the community are looking for action from the Government. Consultation is crucial for good policy development, but the speed and breadth of the process so far has left much to be desired, with quantity seemingly prioritised over quality.

Future consultation needs to be of higher quality, on a more targeted range of issues, with clear line of sight to impact and implementation. The burden on business from policy and regulatory changes, and the impact this has on productivity and innovation, must be considered as part of any reform.

Meanwhile, the global economic outlook remains uncertain, and there will be plenty to keep economists and policymakers busy in 2024.

Domestically, the immediate challenges include inflation and cost-of-living concerns and relatively high interest rates. We will feel the impact of ongoing conflicts in Ukraine and the Middle East. But when responding to these, we must also put the building blocks in place for the longer-term headwinds coming our way.

We can't predict the next big economic shock, nor when it will come. We need to aim for a resilient, innovative and productive economy that can weather what is thrown at it. We can manage these challenges if we are decisive, proactive and prepared to respond when shocks appear.

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Short-term challenges

Slow growth ahead

Despite concerns about the risk of a hard landing, the Australian economy made it through 2023 in fairly good shape, helped by a resilient labour market, buoyant business conditions and strong commodity prices. Risks of a recession this year are low, but that doesn't mean things will be easy.

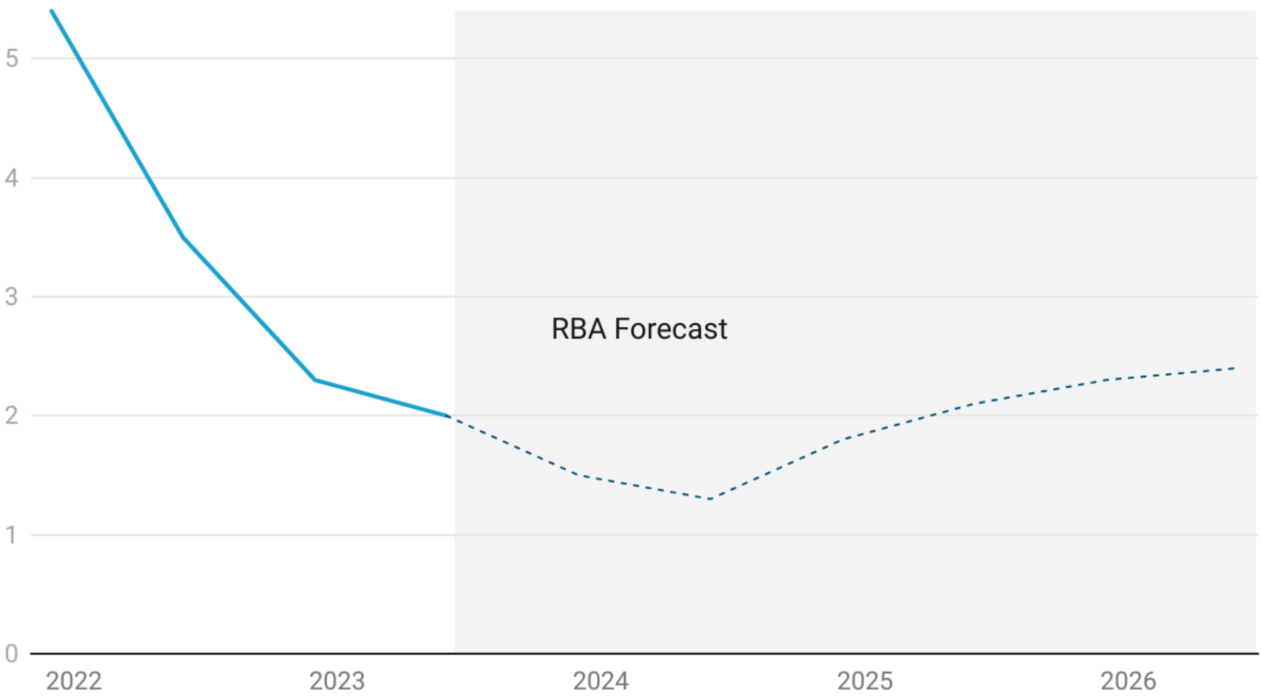
The cumulative impacts of interest-rate rises are starting to bite, with softening consumer spending and more gloomy consumer confidence. Firms are still adapting to higher interest rates, which is likely to mean increased volatility and uncertainty in business conditions and lower business sentiment.

Globally, growth is expected to be soft. Of particular concern is weakening economic activity in China. Ongoing geopolitical risks in Ukraine, the Middle East and China are adding to the uncertainty, compounded by the looming US election.

Extreme weather events, both at home and abroad, are already in the headlines in 2024 and are a constant reminder that climate resilience and the energy transition remain policy priorities and are likely to have an impact on economic growth for some time.

FIGURE 1

GDP growth expected to be soft



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Inflation and cost-of-living continue to bite

Inflation is moving in the right direction but is still too high. It is likely to remain the focus of economic policy and public debate throughout 2024. Globally, inflation is clearly receding. This will assist the Australian outlook. However, domestic inflation is increasingly homegrown and driven by demand for services, rather than imported through goods. This may prove more difficult to contain, and will make it harder to reset the inflation expectations of both consumers and businesses.

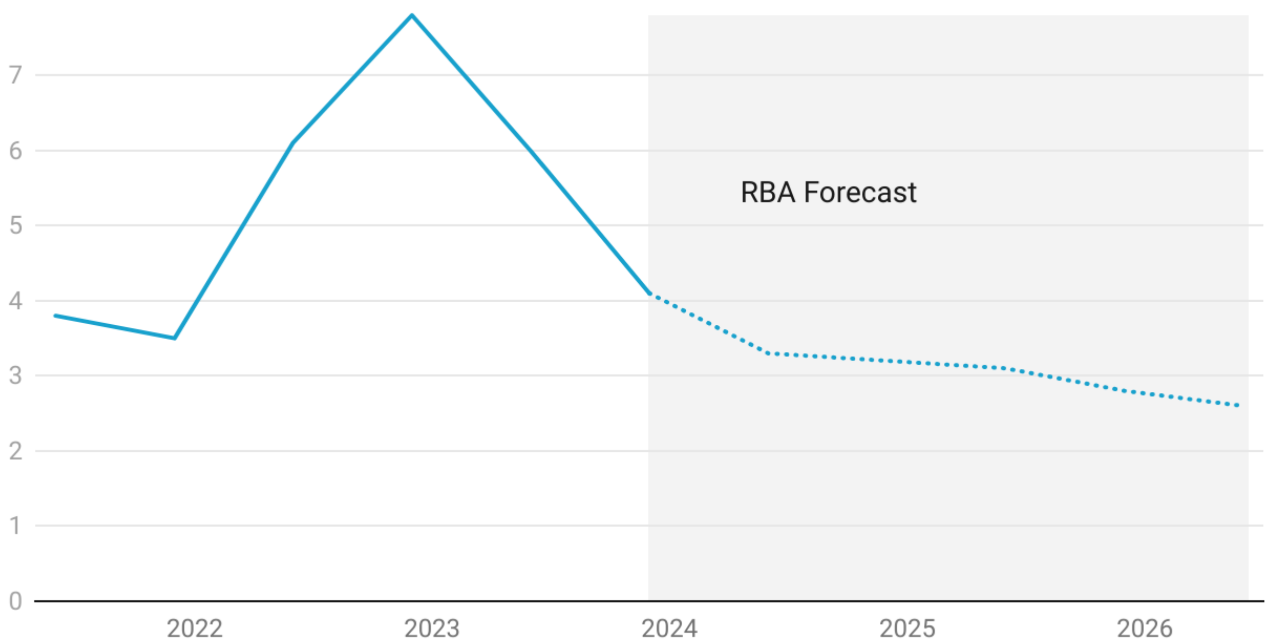
Cost-of-living pressures worsened over 2023 as rising prices and interest rates hit households hard. Strong labour markets have softened the blow somewhat, but many households have had a material decline in their living standards. These pressures are not likely to abate anytime soon, and are already shaping the policy landscape this year. The debate is only likely to heat up as we head towards the Federal Budget.

While we may not see more interest rate rises in 2024, rate cuts are not yet on the agenda – unless inflation falls quicker than expected. Anything that entrenches inflation for longer will lead to worse outcomes for the economy and the broader community. The Government must ensure its policies and spending decisions work with monetary policy, not against it, to avoid stoking inflation.

FIGURE 2

Inflation will remain elevated through 2024

Consumer Price Index (%)



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Unemployment is likely to rise

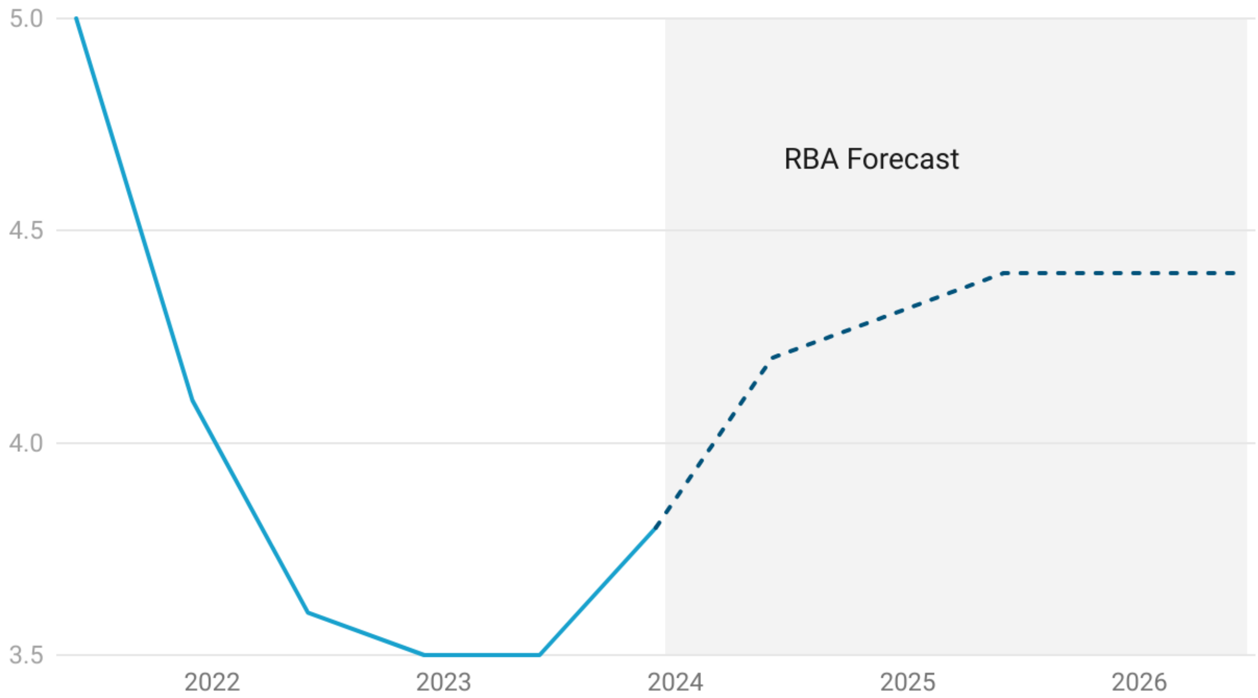
One of the positive outcomes of 2023 was the resilience of our labour markets – with low unemployment rates, shrinking underemployment and increases in participation. The unemployment rate stayed near historic lows for longer than expected, remaining under four per cent throughout the year.

We are unlikely to be able to get inflation sustainably under control without higher unemployment, a trade-off the RBA has been increasingly clear about. Unemployment has started to creep up and advertised job vacancies have started to fall, although they remain at historically high levels. This suggests further increases in unemployment are likely, particularly as higher interest rates continue to weaken demand.

In Chapter 1, CEDA Economist Liam Dillon outlines the evolution that will need to take place in the labour market to meet the challenges and opportunities ahead for the Australian economy, focusing on skills shortages, artificial intelligence (AI) and education. The employment white paper, *Working Future*, has set clear objectives to address the changing nature of the economy and demographic shifts. But we have yet to see much clear policy reform or action emerge from the process.

FIGURE 3

Unemployment is drifting higher



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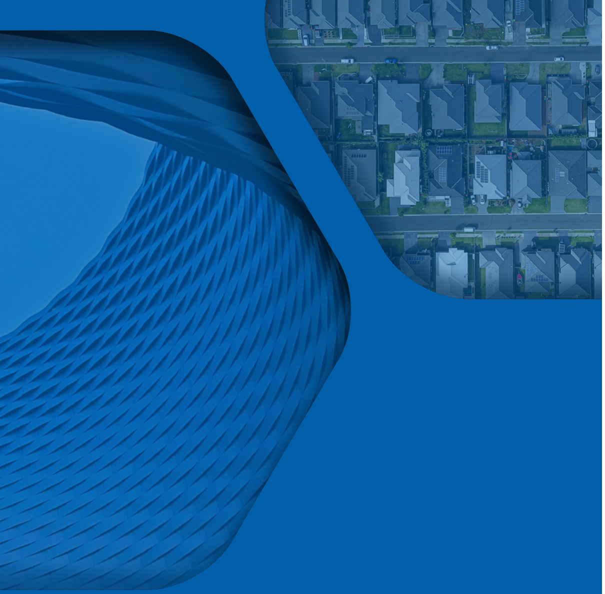

This year, we must take concerted action to address persistent workforce shortages in the care economy, develop the skills to meet our goals under the transition to net-zero, and improve the productivity of the workforce to meet our short-term needs and set us up for the longer term. Progressing the Federal Government's migration strategy, one of the stronger pieces of policy work to come out of 2023, will be a key lever to achieve these goals.

The Federal Government and RBA must be on the same page

2023 proved a challenging year for coordination on economic policy, with monetary and fiscal policy at times appearing to be heading in opposite directions, particularly on inflation and cost-of-living relief. The Federal Government has also renewed its commitment to full employment at the same time as the RBA has suggested that an increase in unemployment is needed to bring inflation sustainably under control. These tradeoffs need to be openly discussed and there should be a clear narrative and direction around goals and timing.

The Government needs to look at its role in managing inflation and not leave the heavy lifting solely to the RBA. Inflation and higher interest rates are increasingly hitting different parts of the community very differently. Younger, lower income households and newer entrants to the housing market are feeling the full impact, while older and more established homeowners continue to spend, benefiting from paid-off mortgages and increased interest rates on savings.

The RBA has a blunt lever in interest rates, but the Government has more options. Reviewing infrastructure spending, as it did in late 2023, is a good start, but the inflationary impacts of any decisions – including the planned changes to the stage three tax cuts – must be a key consideration of the Federal Budget. The Federal Government and the RBA must be on the same page to ensure a soft landing.

Housing shortages will continue and pressure governments to act

Governments must take tangible steps to fix the acute housing shortages throughout much of Australia in 2024. The problems in the housing market have been building for some time, and cannot be resolved overnight, but the pace of reform must be ramped up. We risk significant intergenerational inequality and further entrenching disadvantage in some parts of the community if we cannot provide affordable and adequate housing across the country.

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The announcement of the Housing Accord in late 2022 showed promise, but progress has been far too slow amid continued housing shortages, struggles in the construction sector and a dearth of progress on planning and zoning reforms.

Housing supply has not kept up with demand and housing construction activity is not at the level it needs to be. The current low rate of building approvals means activity will remain slow this year and will not materially change the housing shortages in the short term, although price growth may soften as the impact of interest rate rises reduces borrowing capacity.

We need to increase building activity over the longer term and address barriers to supply, most of which were well identified in the Housing Accord but have seen little action. In the short term, we can also look at how to better use existing housing stock, as small households are increasingly living in larger houses.

We must look more creatively at all immediate-term options to ease the crisis, such as encouraging people to share houses, rent out spare bedrooms or incentivising downsizing. Innovative approaches to building more homes faster, such as modular construction or repurposing buildings, must also be considered.

Setting Australia up for long-term success

Looking ahead, CEDA has been consulting with members and stakeholders on the biggest issues the nation must tackle to ensure a prosperous economy for all Australians. Three areas clearly require more attention: improving our productivity performance, particularly through innovation; ramping up the energy transition and decarbonisation agenda; and ensuring more Australians benefit from economic development. Crucial to success in these areas is a skilled, flexible and innovative workforce.

Clearly, many of these issues are on members' minds. This is in part because they received little attention from previous governments, whose reform agendas were tepid at best. But without decisive action, we will not be able to maintain our long run of economic success. The scale and scope of the challenges Australia is facing require focused effort to manage threats, take advantage of opportunities and sustain the living standards Australians have rightfully come to expect. Too much public policy remains focused on short-term issues and reacting to the day-to-day. We need to keep the focus on long-term outcomes to provide strong and sustainable growth to all Australians.

> Productivity cannot be solved through a single policy change. It must be considered across all areas, including: increasing the up-take of innovation and technology; addressing tax reform, improving management capa-bility; and revising migration settings, amongst others.

More action needed on productivity

One of the big stories of 2023 was the declining rate of productivity in Australia. This is unlikely to turn around quickly this year, but we must start making progress on reforms that will shift the trajectory.

With an ageing population and a shrinking working-age cohort, looking at ways to increase the productivity of our labour force will be key to our capacity to deliver the services Australians expect. We must make the most of the workers that we do have and look at ways to further build productive capacity across our economy.

In Chapter 2, CEDA Senior Economist Melissa Wilson and Economist James Brooks explore one piece of the workforce productivity puzzle – the role of working from home. Remote work in some form is clearly here to stay, but there will be ongoing debate about how to find the right balance between the wants of employers and employees. Crucial to getting the most out of the workforce will be good management and ongoing trial and testing of approaches. Unlocking participation and productivity gains from groups with previously limited access to the workforce could be a key benefit of working from home. Finding the right mix could bring increased productivity and workforce participation as well as greater diversity.

Productivity cannot be solved through a single policy change. It must be considered across all areas, including: increasing the uptake of innovation and technology; addressing tax reform, improving management capability; and revising migration settings, amongst others.

This year, every single policy decision should be reviewed in the context of the likely impact on, or risk to, productivity and this should be a core feature of the next Federal Budget. We won't see an immediate payoff, but not acting now means accepting a sustained lower rate of productivity growth and with it, lower growth in living standards. This is not an acceptable outcome for business or the community.

The energy transition needs to ramp up

To get anywhere near close to meeting our net-zero targets, energy-transition policy must accelerate at all levels of government. In Chapter 3, CEDA Senior Economist Andrew Barker warns we must remove barriers to the transition and the development of clean-energy exports. We need long-term, sustainable policy signals to underpin investor certainty in an area that has for too long been denied them.

This is a global challenge. Many countries are making the same transition. That means competition for materials, skilled workers and expertise will get tougher. The Federal Government delayed its response to the US Inflation Reduction Act due to concerns about a lack of skilled workers and slow environmental approvals – this will be a key piece of policy to look out for in 2024. But while supportive policy will be necessary to get Australia on track to meet its decarbonisation goals, there are potentially big costs from doing this the wrong way. Regardless of the measures chosen, governments will need to take a more active role in guiding the transition in the absence of a broad-based emissions price.

The transition will be bumpy even under the best possible scenarios, and it will not impact all Australians equally. Proper consultation with affected communities and environmental experts is critical, and must occur early enough to enable plans to change where substantive issues are uncovered.

Increasing social and economic participation

For any economic reform to be successful the community must be on board. It must feel confident that the benefits of economic growth will be widely shared for governments to be able to enact reform and encourage a dynamic and competitive business sector.

More Australians need to feel they are benefiting from economic growth, whether through improved quality of and access to human services, increased participation in employment and social and economic activity, or access to opportunities for themselves, their families and communities.

As highlighted earlier, urgently tackling housing shortages will be crucial to address growing concerns about intergenerational inequality and wealth distribution and allow more Australians to feel part of our economic future.

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Where to from here?

This will be the year to put many of the Government's strategies into action and take the consultation of 2023 through to implementation. We must properly address the major short-term challenges facing us – in particular, getting inflation under control, addressing housing shortages and accelerating the energy transition. Failing to do so will leave us worse off over time, and risks entrenching intergenerational disadvantage, poor business conditions and lower living standards.

We must also use this year to ensure Australia remains a productive, dynamic and resilient nation over the long term. To this end, CEDA will continue to encourage action on the most pressing issues facing the economy in 2024 and beyond.