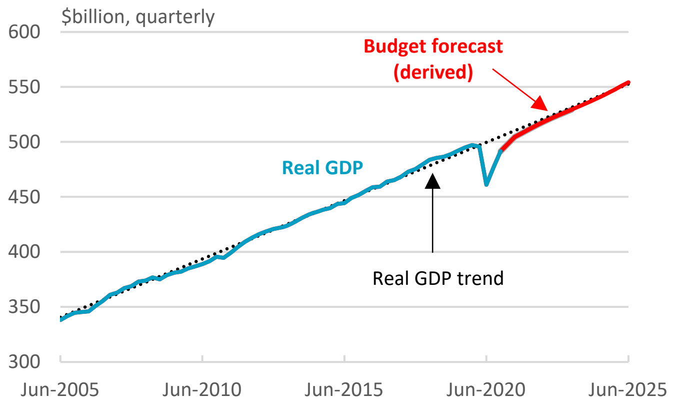
ASFA Economic Snapshot: Federal Budget 2021-22

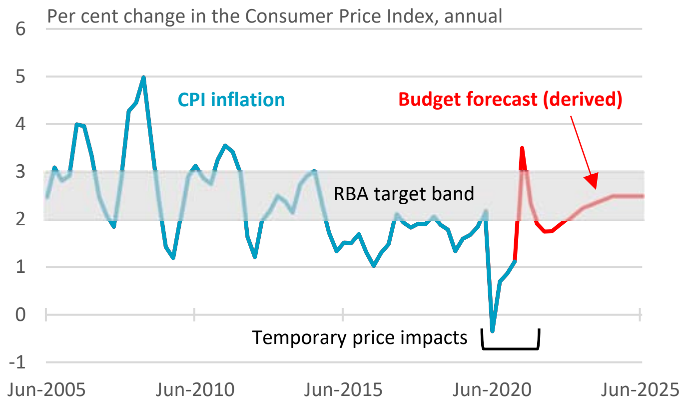
This is a weekly update on the impact of the COVID-19 pandemic on financial and economic conditions, in Australia and globally, and government policy measures to support economic activity and employment.

An economy in recovery



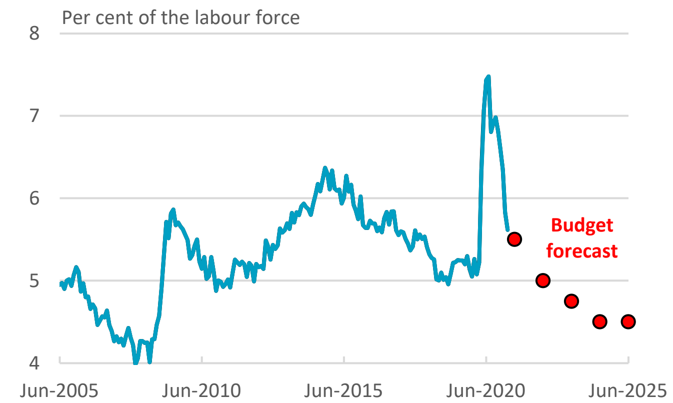
In broad terms, the Budget forecasts imply that by 2024 GDP will be around the level it would have been in the absence of the crisis (assuming trend growth rates). The contribution to GDP growth from government spending (all levels combined) is expected to diminish over the forecast period, while the contribution from the private sector – particularly non-mining investment – is expected to increase.

Inflation will rise, but remain moderate



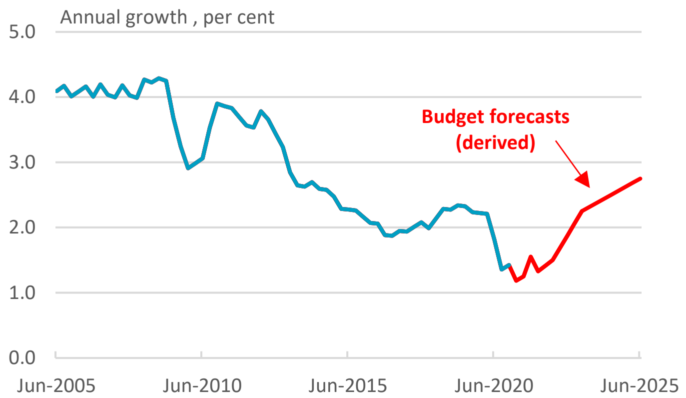
As spare capacity in the economy diminishes, inflation will rise. Inflation is forecast to reach the middle of the RBA's target band by mid-2024. The RBA won't raise its policy interest rate until inflation is sustainably within the band – by these forecasts, the end of 2023 at the earliest. Note, temporary price impacts reflect the introduction and removal of free childcare, and the recovery in oil global prices.^

Unemployment will continue to decline



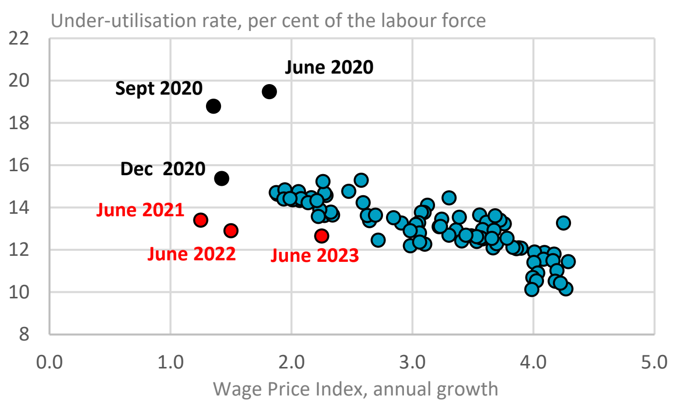
As the economy recovers, the labour market will continue to improve and employment will continue to rise. The unemployment rate, which is currently 5.6%, is expected to fall to 4.5% by June 2024. With labour shortages becoming increasingly prevalent across industries and locations, firms will need to bid up wages in order to attract workers.

Wage growth will rise slowly



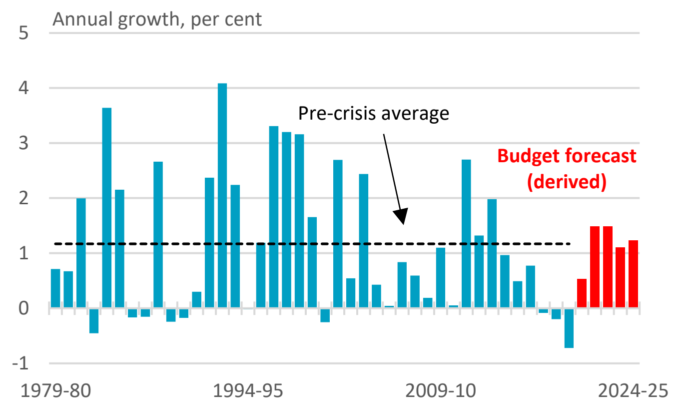
The Wage Price Index (WPI) includes the wages of about 18,000 jobs. Annual growth is expected to rise over the forecast period, to be 2.5% by June 2024. Even so, growth will be well below the historical average (3.6% prior to the GFC), and given that inflation is forecast to be around 2.5% at the same time the WPI forecast implies flat real wages.

The 'Philips Curve'



Using two decades of data, this version of the 'Philips Curve' shows that higher rates of under-utilisation of labour (that is, unemployed people *plus* workers on reduced hours) is related to lower wage growth. Black dots denote the crisis period, while red dots denote derived Budget forecasts.* In the forecast period, a still relatively high under-utilisation rate is associated with relatively low wage growth.

Productivity growth to return



The Budget forecasts imply a rebound in growth in labour productivity (real GDP *per* worker), to near its average growth rate for the past four decades. Over the long-term, real wages tend to move in line with labour productivity. That wages are forecast to grow generally in line with inflation (Panels 2 and 4) suggests that, in broad terms, the productivity dividend will accrue to profits rather than to wages.

Sources for each panel: (For all panels) The Commonwealth of Australia, *Budget 2021-22* and ASFA calculations; (1) ABS, *National Accounts*, December 2020; (2) ABS, *Consumer Price Index*, March 2021; (3) ABS, *Labour Force*, March 2021; (4) ABS, *Wage Price Index*, December 2020; (5) ABS, *Labour Force*, March 2021; (6) ABS, *National Accounts*, December 2020. ^See Snapshot of *30 April 2020*. *The under-employment rate (workers on reduced hours) is currently 7.9%, which is around pre-crisis levels. The same rate is assumed for the forecast period.