

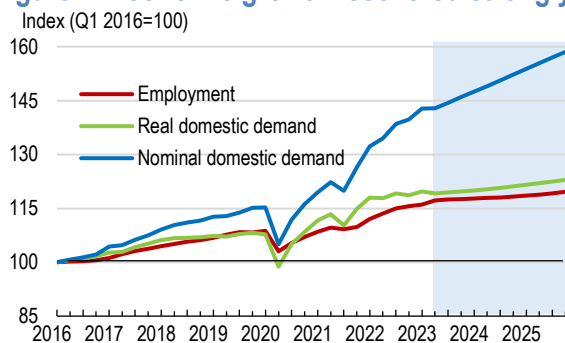
Executive summary

Growth is slowing as the economy rebalances


The economy is slowing amid tightening financial conditions, following a rapid post-pandemic recovery. To bring inflation down, monetary policy will need to remain restrictive and further windfall government revenues from elevated commodity prices saved.

The economic recovery from the pandemic was faster than in other major economies. Accommodative macroeconomic policies and higher commodity export prices helped real domestic demand rebound to its pre-pandemic trend by mid-2022 (Figure 1). However, coupled with supply constraints, the rapid demand recovery has contributed to macroeconomic imbalances, with labour shortages in key sectors. While inflation has peaked, price pressures have broadened from manufactured goods, food and energy to services.

Figure 1. Economic growth recovered strongly



Source: OECD Economic Outlook Database.

StatLink  <https://stat.link/9vmk5z>

Monetary policy has tightened significantly in response to higher inflation. The official policy rate has increased by 4 percentage points since May 2022 and unconventional monetary policy support measures are unwinding. The banking sector is well-capitalised and appears adequately prepared for any further rise in defaults. With underlying inflation still significantly above the target band, a restrictive stance of monetary policy remains appropriate. Further tightening may be needed if inflation proves more persistent than anticipated.

The fiscal balance has improved due to a period of high commodity prices, the strong labour market and inflation. However, fiscal deficits at the federal government level are projected to re-emerge in the coming years. This partly reflects

spending on the National Disability Insurance Scheme, which is expected to be a significant source of cost pressure. Some further narrowing of the fiscal deficit is warranted, which can be partly enabled through saving further windfall government revenues. Introducing tangible measures to slow growth in the costs of the National Disability Insurance Scheme would support deficit reduction.

OECD projections envisage subdued economic growth in the coming years (Table 1). High interest rates and cost of living pressures will dampen spending by households. Strong population growth and higher exports will partly offset these headwinds. The unemployment rate is projected to rise to 4.4 per cent in 2025 and inflation is expected to further moderate. A sharper than expected slowdown in China is a downside risk to economic growth.

Table 1. Macroeconomic projections

Annual average growth	2022	2023	2024	2025
Gross domestic product (GDP)	3.7	1.8	1.3	1.8
Unemployment rate	3.7	3.7	4.2	4.4
Core inflation index	5.9	5.9	3.3	2.8
Gen. gov. gross debt (% GDP)	56.8	57.8	59.3	60.6

Source: OECD.

Fiscal buffers need to be rebuilt

Public debt has increased over recent decades. Tax and spending reforms are needed, along with measures that ensure a robust fiscal framework, given substantial fiscal pressures ahead.

The public debt to GDP ratio has increased by over 30 percentage points since 2010, partly owing to weak commodity prices in the mid-2010s and the costs of the pandemic. There has been a substantial rise in the debt ratio of both the federal government and several state governments over the period. Looking forward, annual fiscal costs from health and long-term care are estimated to increase by 0.8% of GDP between 2023 and 2040. Some of these costs will fall on the states given their responsibility for funding hospitals and ambulance services. Spending pressures not yet built into budgets will also arise from the climate transition and adapting to the physical effects of climate change. Against this backdrop, there is a need to ensure the robustness of state and territory fiscal frameworks and improve mechanisms for fiscal dialogue between levels of government.

Tax reforms can allow rising fiscal costs to be accommodated. Revenue should be raised through reducing exemptions in the goods and services tax base and consideration should be given to raising the rate. To offset any regressive effects, compensation to low-income households should be provided. In addition, further reducing tax concessions on private pensions would more closely align their tax treatment with that of other forms of saving and raise revenues.

There are also potential savings on the spending side. Encouraging more patient care in primary care settings and preventive health policies can reduce public spending growth as the population ages. Designing more effective policies related to Indigenous Australians is also a priority. An important element will be implementing the changes to government under the Closing the Gap Agreement, requiring Indigenous Australians to be incorporated in decision-making processes for policies related to them.

Ongoing structural changes require an adaptable economy

As the population ages and the economy is shaped by global forces including the climate transition and digitalisation, policies must promote an adaptable labour force and business sector.

Immigration will continue to play a key role in the labour market. However, the composition of the skilled migrant intake needs to be more responsive to changes in the skill needs of industry, including through better use of timely and granular data, analysis and the views of employers.

Education policies can also ensure that the workforce has strong foundational skills that can easily adapt to structural changes. Standardised test scores for Australian students have stagnated or declined. Teaching hours are high compared to other OECD countries and administrative tasks consume a large amount of teachers' time. A straightforward improvement would be providing all teachers with access to high-quality and evidence-based curriculum resources.

Land use policies will need to be less prescriptive about the activities that can occur in each location. Greater flexibility in zoning systems would improve the ability of new businesses to enter and grow in desirable

locations. They could also benefit residential housing supply through enabling an increase in the density of housing.

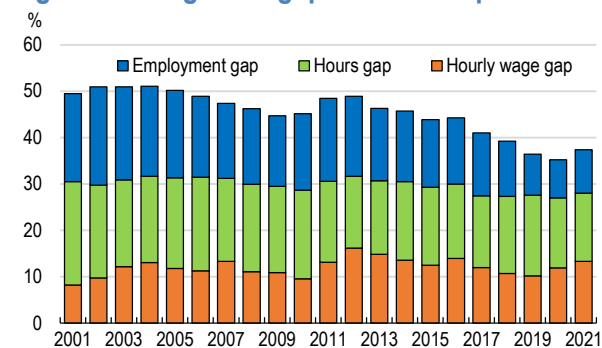
Competition policies can also support the ability of businesses to maximise the opportunities ahead. There are signs of increased market concentration in some sectors and a broad competition policy review is underway. One area to consider is more closely aligning the merger regime with other OECD countries.

Gender inequality can be further reduced

Gender inequalities have been steadily reduced. However, the talents of women can be better utilised, including through reducing barriers to their engagement in the labour market and encouraging more equal sharing of unpaid work responsibilities between genders.

There is still a significant gender gap in hours worked, owing to a high share of women in part-time work (Figure 2). One factor is high marginal effective tax rates when increasing work hours for low earners, due to benefit withdrawal as earned income rises. This is especially the case for single parents. Reducing the speed of benefit withdrawal could be financed by removing Family Tax Benefit B for couple families, which currently disincentivises second earners from working. While further increases in the JobSeeker benefit rate are warranted and would benefit many women given they comprise an increasing share of recipients, reforms that encourage those on the payment to increase working hours should also be considered.

Figure 2. The gender gaps in income persist



Source: HILDA, OECD calculations.

StatLink  <https://stat.link/e7jr0h>

The high cost of childcare also impedes some women from working. Out-of-pocket childcare costs are elevated by OECD standards and are

especially high as a share of income for lower income households. Initiatives that further encourage supply through the private childcare sector should be coupled with those that increase the provision of non-standard hours of care.

Additional improvements to the parental leave system would support mothers staying in work and labour market re-entry after childbirth.

Parental leave duration and the rate at which it is paid is low by OECD standards. The authorities are planning to extend the length of parental leave. This is welcome, but further reforms should also focus on increasing the rate at which it is paid and the share of leave reserved specifically for fathers.

There is a lack of women working in STEM and ICT jobs, two growth areas as the digital transformation further evolves. Similarly, men are underrepresented in caring roles, such as nursing and childcare. Programmes that focus on promoting work experience and mentoring arrangements for underrepresented genders in these fields should be reviewed.

Achieving the climate transition will require significant reforms

The authorities are committed to achieving net zero emissions by 2050. Australia is well-placed to become a major producer of renewable power, having plentiful wind and solar resources and a large wealth of minerals critical to the climate transition. However, further reforms are required to meet emission reduction goals, support the reallocation of workers and adapt to climate change.

Australia's renewable electricity target of 82% by 2030 is central to the net zero transition. To ensure this target is met, Australia should stand ready to provide further policy support and consider scaling up and refocusing public funding towards the development and demonstration of clean energy and energy-efficiency technologies.

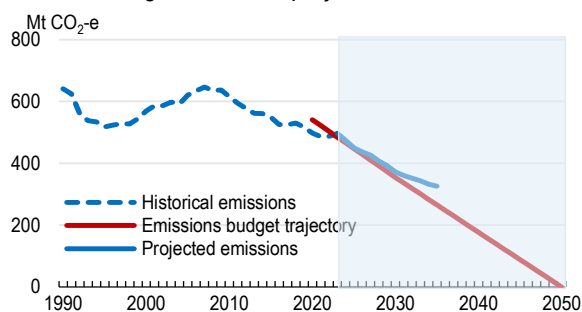
Recent reforms of the Safeguard Mechanism, which sets limits on the emissions of individual industrial facilities, have brought welcome changes to its functioning. However, further reforms may be needed after the 2026-27 review to guarantee a significant reduction in industrial emissions, including switching from baselines

based on emissions intensity to limits on total emissions.


Transport is projected to become the largest source of emissions in Australia by 2035. States have introduced various policies to promote purchases of electric vehicles, which come at a high fiscal cost. These programmes should be aligned and stringent federal fuel economy standards introduced and progressively tightened to zero emissions by 2035. Fuel taxes should also be raised and existing fuel tax credits reconsidered.

Ensuring that new buildings are as energy efficient as possible will be critical to limit emissions. A priority is regularly updating the energy efficiency requirements in the National Construction Code to keep in line with international standards.

Figure 3. Large emission reductions are needed
Greenhouse gas emission projections



Source: DCCEEW (2022).

StatLink  <https://stat.link/eid654>

As the economy decarbonises, workers will need to reallocate from high carbon to low carbon industries. Many occupations integral to the renewable energy transition face national shortages, requiring training programs focused on reallocating displaced workers and developing the skills for renewable energy jobs.

Australia is highly exposed to climate-related hazards such as wildfires, extreme heat and heavy rainfall. Adapting to climate change will require substantial investment and careful planning. Mandatory disclosure of climate-related risks in certain cases such as the sale of property will help raise awareness of these hazards and encourage more effective adaptation. In addition, incorporating climate hazard considerations in land-use planning will help reduce risks.

MAIN FINDINGS	KEY RECOMMENDATIONS
Achieving sustained economic growth	
Inflation has begun to fall but remains above target.	Maintain a restrictive stance of monetary policy until inflation is clearly on track to meet the central bank target, while maintaining a data-dependent and flexible approach.
Higher global commodity prices have boosted government receipts. The federal structural budget is in deficit and there are significant cost pressures on the horizon.	Continue to narrow the budget deficit in the years ahead and use windfall government revenues to reduce public debt. Improve mechanisms for fiscal dialogue between federal and state/territory governments.
The National Disability Insurance Scheme is exerting cost pressures on federal government finances.	Slow the growth in National Disability Insurance Scheme costs, potentially through better clarity on the eligibility and scope of support packages, as well as improved scheme administration.
The health system is already a major government expense that will increase as the populations ages.	Further encourage patient care in primary care settings and increase the focus on preventive care.
Wellbeing and economic indicators for the indigenous population suggest significantly lower living standards than for the non-indigenous population.	Make further progress on raising the living standards of indigenous Australians by implementing the Closing the Gap Agreement across all levels of government.
There is relatively little revenue raised from consumption taxes. Tax treatment across different savings vehicles differs markedly, with relatively low tax rates on private pension savings.	Broaden the base of the goods and services tax through reducing exemptions and consider increasing the rate. Further reduce tax concessions on private pensions.
A recent review of the migration system found outdated data systems and infrequently-updated occupation lists determining the composition of skilled migrants.	Make the composition of the skilled migrant intake more responsive to changes in the skill needs of industry, including through better use of timely and granular data, analysis and the views of employers.
Standardised test scores for Australian students have stagnated or declined.	Provide all teachers with access to high-quality and evidence-based curriculum resources that are regularly updated.
Land zoning systems are overly prescriptive about the types of activity that can be undertaken. Low density housing is more common than in other OECD countries.	Review planning and zoning regulations to enable an increase in the density of housing.
Some indicators of competitive intensity in product markets have weakened. Unlike in most OECD countries, pre-merger notification is not required. A competition policy review has commenced.	Consider requiring companies to give pre-merger notification to the competition authority for transactions above a defined threshold and introducing divestiture as a legislated remedy.
Improving gender equality	
The design of the tax system narrows gender income inequalities and results in low participation tax rates. However, steep benefit tapers are a barrier to some women moving from part-time to full-time work.	Introduce a more gradual tapering of benefits as household earnings rise, potentially funded through removing Family Tax Benefit Part B for couple families.
An increasing share of JobSeeker unemployment benefit recipients are now women, but the replacement rates are low.	Further increase the rate for JobSeeker benefits and consider further options to reduce disincentives for recipients to increase working hours.
Net childcare costs are high and create a significant barrier to employment for women.	Improve access and affordability of high-quality childcare by encouraging the development of the private childcare sector and improving provision for non-standard hours of care.
The payment rate of parental leave is relatively low, with low take-up by fathers. The authorities are planning to expand parental leave duration to 26 weeks in 2026.	Along with extending public parental leave duration, prioritise raising the rate at which it is paid and increasing the share of parental leave reserved specifically for fathers.
Women are underrepresented in information technology and science, technology, engineering and mathematics careers. Men are also underrepresented in caring roles, such as nursing and childcare.	Implement effective programmes that focus on promoting early work experience, apprenticeships and mentoring arrangements for females studying STEM and ICT and men studying caring professions.
Responding to climate change	
Australia's public spending on energy research, development and demonstration is significantly below the IEA average. It is also unclear whether current policies will achieve the necessary increase in renewable energy generation, storage and transmission.	Consider scaling up and refocusing public funding towards the development and demonstration of clean energy and energy-efficiency technologies. Stand ready to provide further policy support and accelerate the planning and implementation of renewable energy projects to ensure that renewable energy targets are met.
Emissions baselines (or limits) under the Safeguard Mechanism have been tightened and will decline by 4.9% per year until 2030. Facilities that reduce emissions below their baseline will earn credits.	Switch to limits on total emissions if the current Safeguard Mechanism baselines based on emissions intensity fail to deliver the desired emissions reductions and consider broadening the coverage of the mechanism.
States have introduced various policies to promote purchases of electric vehicles, including rebates and stamp duty exemptions, which come at a high fiscal cost.	Align the various state subsidy programmes for electric vehicles and introduce stringent federal fuel economy standards.
Overall public support to agriculture is low (0.2% of GDP) and extension services and agricultural education receive small amounts of funding.	Further increase support for agricultural research and development as well as extension services and agricultural education, with a particular focus on emissions reduction technologies and practices.
Further electrification and strong improvements in energy efficiency are required to significantly reduce emissions from buildings.	Regularly update energy efficiency requirements in the National Construction Code.
Australia is particularly exposed to climate-related hazards.	Consider improving the disclosure of climate and hazard-related risks in certain cases such as the sale of residential or commercial properties. Require all states and territories to consider climate and hazard risk when making land-use planning decisions for new developments.



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