AiGROUP

Australia's economic and labour market outlook

An employer's guide to 2024-25

AUGUST 2024

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation, and in 2023 we celebrated our 150th year supporting Australian businesses.

Our vision is for *thriving industries and a prosperous community*. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders, we have the resources and the expertise to meet the changing needs of our membership. We provide the practical information, advice and assistance members need to run their businesses. Our deep experience of industrial relations and workplace law, positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

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Key insights

A slowing economy meets high inflation and a tight labour market, posing tough conditions for employers in 2024-25

The Australian economy has markedly slowed and will stay sluggish. Growth has fallen over the last year due to weak household consumption, while business and housing investment is expected to weaken over the next year. The growth outlook implies that we are currently in the middle of the longest sustained period of economic weakness since the 1990s recession.

Inflationary pressures are weighing heavily on the Australian economy. Inflation is proving stubbornly persistent and is now driven by homegrown factors. Inflation has reduced real incomes, crimped household spending, and will result in interest rates staying higher for longer than anticipated.

Business performance is deteriorating, albeit at different rates. Recent growth in industry output has been the weakest since the GFC, and is likely to be subdued over the coming year. Some industries are facing recession-like conditions, particularly industrials (manufacturing, wholesale trade and construction) and discretionary consumer industries (retail and accommodation & food).

However, the labour market has yet to weaken with deteriorating business conditions. Record-low unemployment levels has shown very little easing over the last 18 months, and remain well-below normal. This concurrence of a slowing economy with high inflation and a tight labour market will prove challenging for employers to manage over the coming year.

A pandemic-era demographic shock contributed to the tight labour market. An artificial reduction in the working age population due to Australia's closed border collided with a sudden growth in labour demand as the pandemic lifted. This created a large imbalance between labour supply and demand, which has persisted into 2024.

An overhang of job vacancies is preventing labour market rebalancing. Around 200,000 above-normal job vacancies accumulated during 2022, only half of which have cleared by mid-2024. These excess vacancies need to clear before the labour market rebalances to match the broader economy.

Skills shortages and hiring difficulties remain pervasive. Recruitment difficulties soared following the pandemic, but have since eased for lower skilled roles. However, higher skill occupations – particularly professional and trades roles – continue to display highly-elevated skills shortages.

Wages growth has accelerated to its fastest rate in two decades. Generalised labour and skills shortages have decoupled wages from industry performance, with high wages growth in many weaker performing industries. A contributor was recent large increases to award and minimum wages. The outlook is for wages growth to remain elevated for the next two years.

Australia has had four lost years for productivity growth. Despite the uptake of new technologies during the pandemic, national labour productivity is currently at the same level as 2019. While much of the private delivered productivity gains during this period, national performance was held back by weak results in government-aligned and the construction and utilities industries.

Economic outlook: Slow times ahead as growth stalls

There has been a marked deterioration in the Australian economy over the last year, and the outlook suggests weak conditions are likely to continue for the medium-term.

Australia enjoyed an economic boom following the pandemic. Aggressive fiscal stimulus stoked demand, and when the final public health restrictions were lifted in early 2022, growth rates surged to record levels.

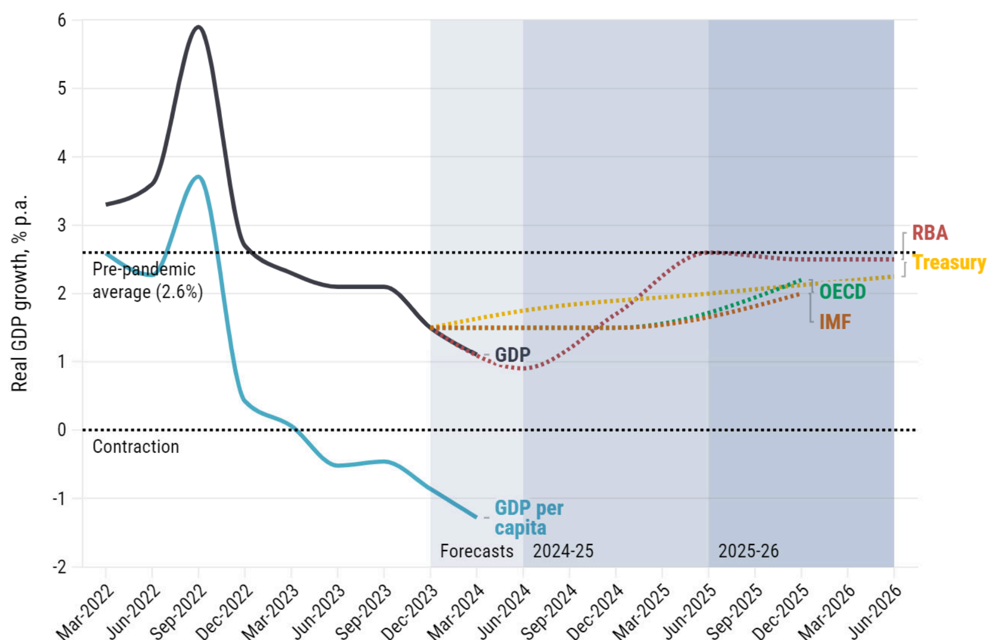
But the middle of 2023 proved the high-water mark, and since then the Australian economy has been in a progressive stall. GDP growth has been steadily declining, and fell to a lowly 1.1% p.a. in the first quarter of 2024. While we have fortunately avoided recession, GDP per capita has been in contraction for the last 12 months, revealing a dependence on migration to prop up the economy.

Several factors have played a role in the slowdown. Principal amongst these is household consumption, which has grown very weakly due to inflation reducing real income and spending power. This has been offset to some extent by growing government expenditure, underpinned by surging tax revenues.

The outlook for the next two years is particularly poor. Official forecasts expect growth to bottom out in the middle of 2024, before recovering to just under 2% in 2024-25 then just over 2% in 2025-26. The contributing factors are expectations for a decline in business investment, housing investment and export growth.

This outlook implies we are now in the middle of the longest sustained period of low growth in Australia since the recession of the early 1990s. Businesses should expect only a modest improvement in overall economic conditions as they plan for the next two years.

Australia's economic growth outlook to 2025-26



Source: ABS National Accounts, various official forecasts

Homegrown pressures mean higher inflation for longer

One of the principal factors dragging on the Australian economy is inflation. Despite some recent improvements, it is proving stubbornly difficult to bring under control.

After peaking at 7.8% p.a. in late 2022, inflation for consumer goods (measured by the consumer price index) began to ease. The slowing economy, and thirteen interest rate rises by the Reserve Bank, contributed to the fall. However, in 2024 CPI has been going sideways rather than down. It remains well over the target range of 2-3% considered sustainable in the long-term.

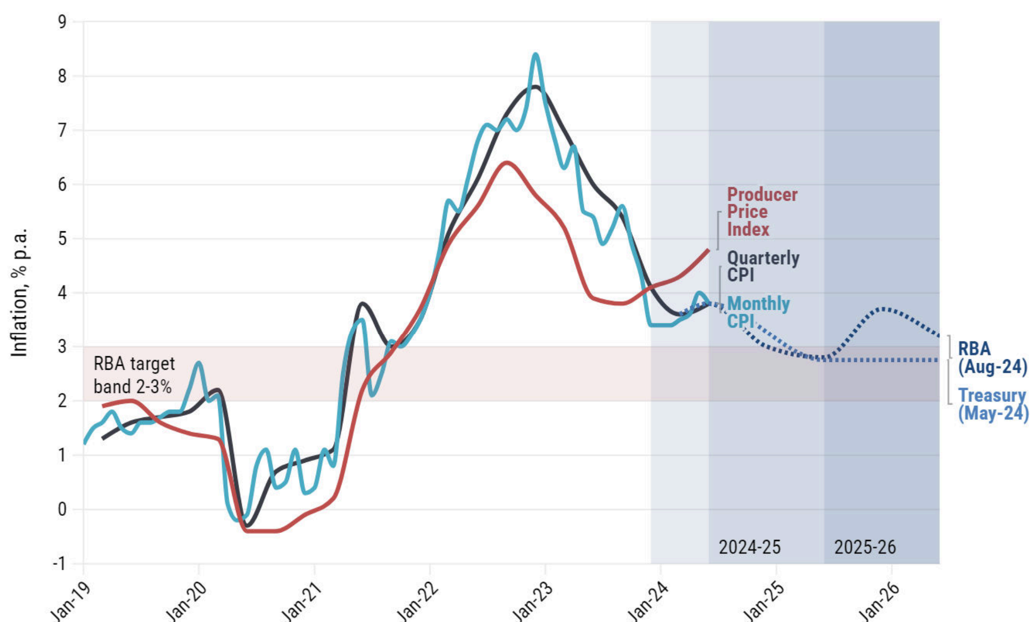
For industry, the Producer Price Index (a measure of prices charged and paid by businesses) is equally if not more important. After a short period of decline the PPI began accelerating again in late 2023, and now sits at a concerning 4.8% p.a.

Inflationary pressures now have a very different source. In 2022 they were largely imported and due to global problems, particularly supply chain disruptions and a boom in energy prices. In 2024, the problem is now squarely homegrown. Inflation for non-tradables sits at 5.0% p.a., compared to only 1.5% p.a. for internationally traded goods. Wage pressures are contributing, with services prices (which are more sensitive to wage costs) outrunning those for goods.

There is not much cheer in the inflation outlook. Treasury forecasts inflation will not sustainably return to its target range for another year, the Reserve Bank expects another two years. This means that any reductions in interest rates is going to take longer than expected, extending the period of borrowing cost pressures on businesses and cost of living impacts on households.

Business should expect to face conditions of higher-than-usual inflation and interest rates, alongside lower-than-usual growth, for at least the next financial year.

Australia's inflation outlook to 2025-26



Source: ABS CPI, ABS Monthly CPI, ABS PPI

Rates and inflation crimp household spending growth

Slowing growth alongside persistent inflation has led to mark weakness in the consumer economy. Household spending has been crimped by a perfect storm of factors:

- Record-level inflation has greatly eroded the purchasing power of households.
- Interest rate rises, required to reduce inflation, have increased financial stress on mortgagees.
- Rents, which grew at 7.3% over the last financial year, have done the same for renters.
- Savings buffers accumulated during the pandemic are finally being exhausted.

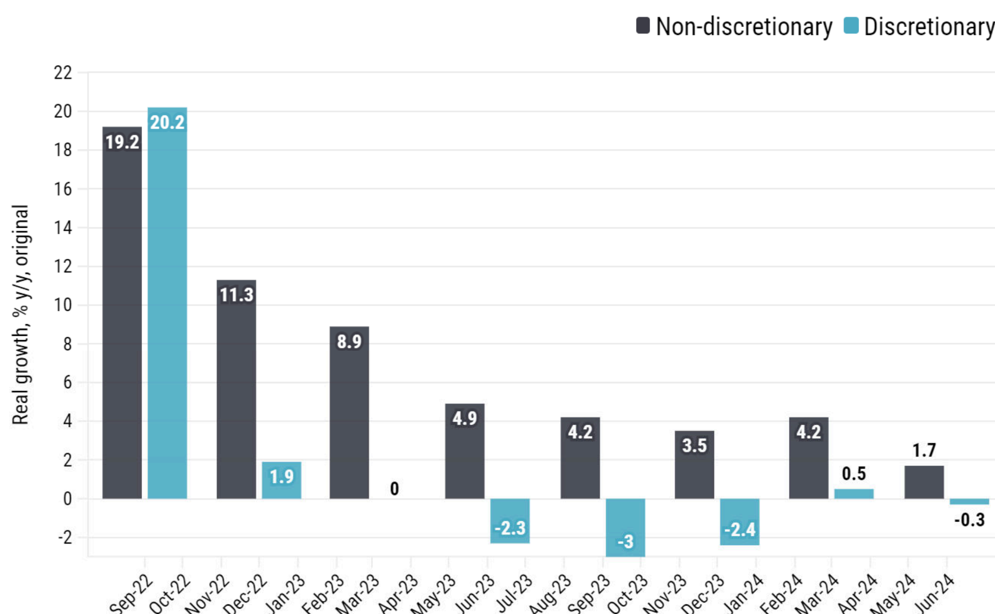
Data on household spending paints a sobering picture. In real (inflation-adjusted) terms, total household spending grew by only 1.4% over the year to June 2024, down from 21% growth two years earlier during the height of the post-pandemic rebound.

However, the total obscures even greater losses in discretionary spending. Household discretionary spending stalled in early 2023 and has been in contracting for the last six quarters. Non-discretionary spending – comprising food, health and transport – remains positive, but is also slowing rapidly.

The fall in household spending has implications for businesses exposed either directly or indirectly to the consumer economy. Outside the groceries category, the Australian retail industry has been in recession for the last financial year. Personal services and accommodation & food are also under particular pressure as consumers cut back on discretionary spending.

The outlook is for only a modest improvement for households, with growth of around 2% forecast for the nest financial year. However, these forecasts are premised on inflation continuing to fall. The risk is to the downside is inflation continues to prove stubborn, delaying the cut to interest rates and improvement in real incomes needed to stimulate spending again.

Growth in Australian household spending by category



Source: ABS MHSI • Ai Group Research & Economics
Non-discretionary spending comprises food, health and transport. Discretionary spending comprises all other categories.

A multi-speed slowdown hits industrials and consumers

The slowdown is passing through the Australian economy in complex ways, leading to multi-speed conditions facing different industries. Industrial and discretionary consumer sectors are currently facing the weakest conditions, non-discretionary and government sectors are performing better.

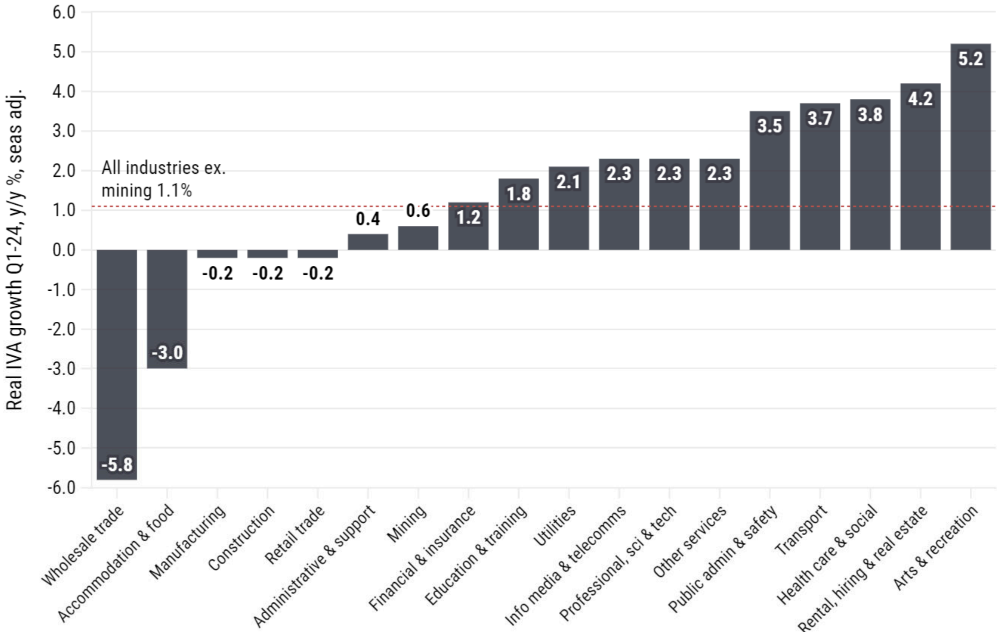
In the first quarter of 2024, industry output in Australia grew only 1.1% on the year prior (ex-mining). Outside of the pandemic-era lockdowns, this was the weakest quarter of output growth since the global financial crisis, and well below Australia's long-run average of 2.4% p.a.

However, there is a significant spread in performance across industries. We can identify four groups:

1. **Industrial sectors** – mining, manufacturing, construction, wholesale trade and administrative services – are either in contraction or close to it. These are facing surging materials and/or wages cost which often cannot be fully passed on to consumers.
2. **Discretionary consumer sectors** – retail and accommodation & food – are also in contraction. These have been adversely impacted by contracting discretionary consumption.
3. **Non-discretionary consumer sectors** – education, media & telecoms, transport and real estate – have also slowed, but are performing better than their discretionary counterparts.
4. **Government-connected sectors** – healthcare & social, public administration, utilities – are performing well above the national average. These have been protected from the slowdown by increasing expenditure from federal and state governments.

This multi-speed slowdown reveals asymmetric impacts of inflation on the Australian economy. The industries most exposed to inflationary pressures are performing considerably worse than those which are insulated from it by either government spending or non-discretionary status. This pattern of industry performance should be expected to continue until inflationary pressures are tamed.

Growth in Australian value-add by industry



Source: ABS Australian National Accounts • Ai Group Research & Economics

Labour market stays hot while rest of economy cools

Despite the marked deterioration in the Australian economy, the labour market has proven surprisingly resilient. Overall, employment conditions are yet to adjust in response to the decline in business conditions seen over the last eighteen months.

After a spike during the early phase of the pandemic, Australia's unemployment rate steadily declined over the next two years. By the middle of 2022, it had fallen to 3.5%, driven down by surging demand for labour as industries reopened. Under-employment, female unemployment and youth unemployment were all major beneficiaries of the tight labour market conditions.

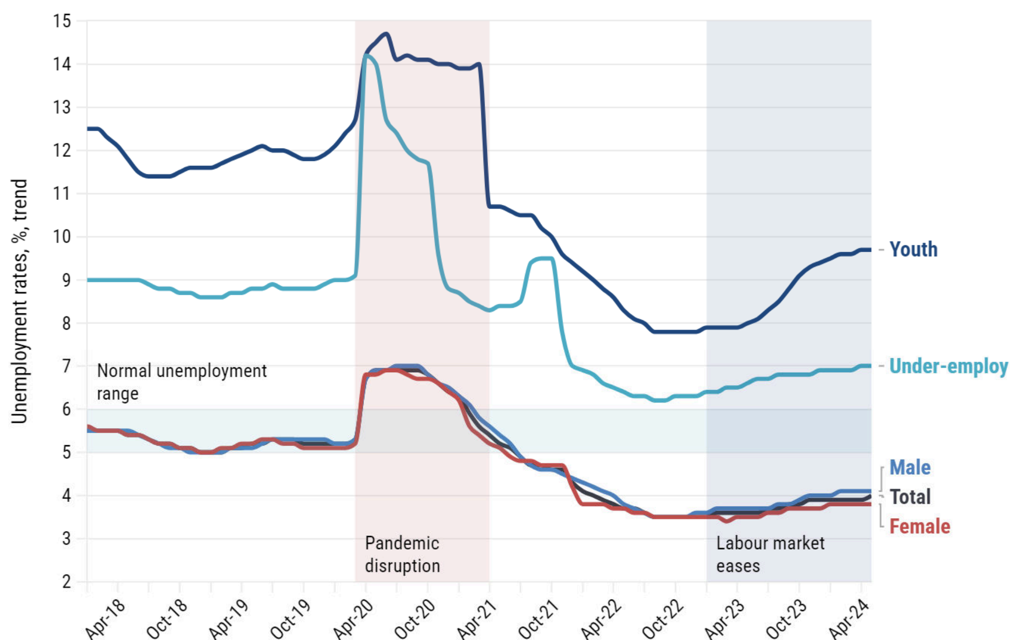
This unemployment rate is unprecedented in Australia. It is the lowest sustained level on record since contemporary statistics began in 1978. It is well below Australia's normal range (5.0 and 6.0%), and at the bottom of the range considered 'full employment' (usually estimated at between 4.0 and 4.5%).

Nor has much easing occurred as the economy has slowed. While the unemployment rate crept up marginally to 4.0% in mid-2024, this remains well below normal levels. Female unemployment and underemployment – two indicators which lead upwards first in a downturn – also remain resilient.

The only indicator showing weakness is for youth unemployment, which has risen back to near 10%. This is due to weak conditions in the retail and accommodation & food industries, which employ large numbers of youth workers. Even then, youth unemployment remains well below its normal levels.

This labour market resilience is a paradox. During similar periods of sluggish growth, the unemployment rate has risen above its normal range as demand for labour falls. This rebalancing has not happened over the last 18 months, with labour demand continuing to outstrip supply. The explanation lies in changes in the Australian labour market occurring during and after the pandemic.

Australian unemployment indicators



Source: ABS LFS, Ai Group Research & Economics • Normal unemployment rate defined as range over decade to 2019.

Demographic deficit meets labour market boom

Demographics is one of the main factors behind Australia's surprising labour market resilience. To put it directly, since the pandemic there has simply not been enough workers to go around.

Australia was one of very few countries which closed their borders during the pandemic. This policy cut off the supply of new migrants for two years, which Australia relies upon to drive population growth. This resulted in a sudden fall in the working age population – which by mid-2021 was 390,000 people (or 2%) smaller than its normal growth path would have delivered.

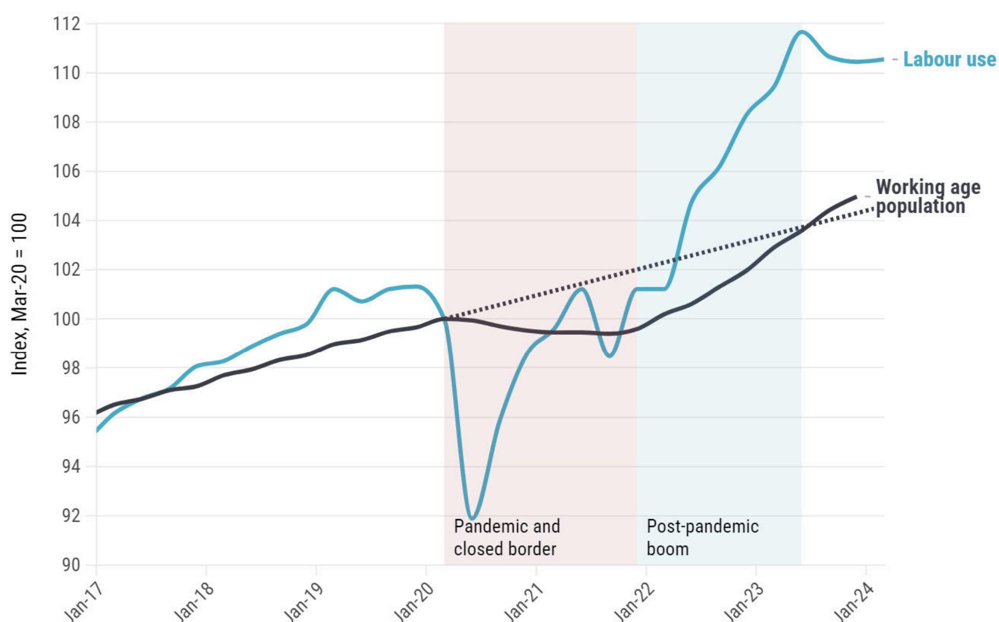
Once Australia opened its borders, this demographic deficit collided with an equally sudden labour market boom. As the economy rebounded in 2022 demand for labour exploded, growing by a staggering 10% in just 18 months. This growth rate was twice as fast that seen during previous economic booms.

With the pandemic removing 2% of the working population, then the post-pandemic boom adding 10% to labour utilisation, a sudden and dramatic imbalance in the labour market was inevitable.

The return of migrant inflows since 2022 has been insufficient to close the gap. The working age population had recovered by late 2023, and is now slightly above normal trend. But these migration flows have largely just restored the deficit created by the closed border. And while labour utilisation has flatlined over the last year it has not fallen back either, leaving a continuing imbalance.

This means that Australia's surprisingly resilient labour market is ultimately due to labour shortages. With supply constrained while demand surges, we have had to utilise our existing workforce far more intensively. This has not only driven unemployment to record-low levels, but contributed to further challenges for employers including vacancies, recruitment difficulties, and wages pressures.

Australia's working age population and labour use



Source: ABS NSTP, ABS National Accounts • Ai Group Research & Economics
Working age population is 15-64 year old residents. Dashed line is pre-pandemic trend. Labour use is aggregate hours worked.

Vacancies overhang delays labour market rebalancing

One of the main consequences of the imbalanced labour market was a rapid increase in vacant jobs. Indeed, a persistent overhang of vacancies explains why rebalancing has yet to occur.

The imbalance in the of supply and demand for labour since the pandemic saw the number of vacant jobs explode. The vacancy rate nearly doubled from 1.6% to 3.1%, leaving some 487,000 jobs unfilled by the middle of 2022. This was approximately 200,000 more vacancies than would be considered normal in the Australian labour market at the time.

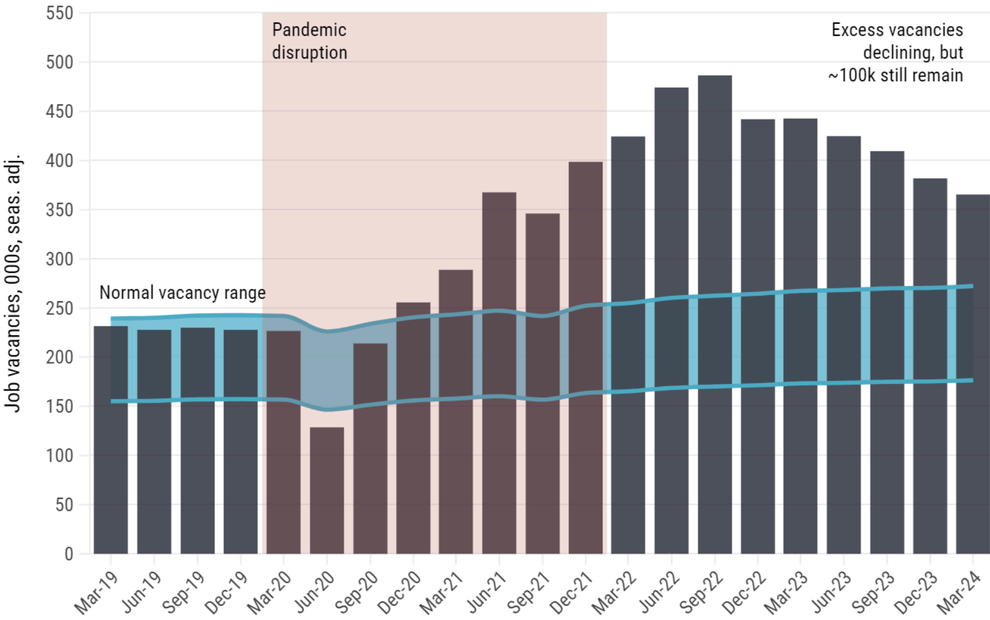
The vacancy crisis was especially elevated in the industries which enjoyed a post-pandemic rebound. Mining, accommodation & food, professional services and healthcare all faced vacancy rates well above the national average as they restarted when public health restrictions were lifted.

As the economy has slowed in 2023, the vacancies problem has started to unwind. Total vacancies have fallen back to 366,000, as employers responded to weaker conditions by scrubbing off around 100,000 unfilled jobs. However, this removed only half of the accumulated overhang, with another 100,000 above-normal vacancies still to be cleared.

This vacancies overhang is a major factor behind the resilience of the labour market. As conditions slow, employers have been able to adjust by shedding vacant jobs rather than deploying redundancies or natural attrition. New entrants to the labour market, and those who lose jobs, have also been able to more easily find new jobs while the vacancy pool remains so deep, thus avoiding unemployment.

Until the remainder of the post-pandemic vacancies overhang clears, the labour market is likely to weaken only slightly. On current trajectory, these are likely to persist through the next financial year.

Australian job vacancies since the pandemic



Source: ABS Labour Account • Ai Group Research & Economics
"Normal vacancy range" is calculated from decade to 2019 (1.1% to 1.7%), projected to future observations

Recruitment difficulties persist for higher skill roles

Australia's record-level vacancy rate has exacerbated a further challenge for employers – difficulties completing recruitment processes, particularly for skilled roles.

Since mid-2020, Jobs and Skills Australia has surveyed employers on whether they are facing recruitment difficulties, and for which jobs. Starting from a base of 45% during winter 2020, the share reporting such difficulties surged to 72% at the peak of the labour market in mid-2022.

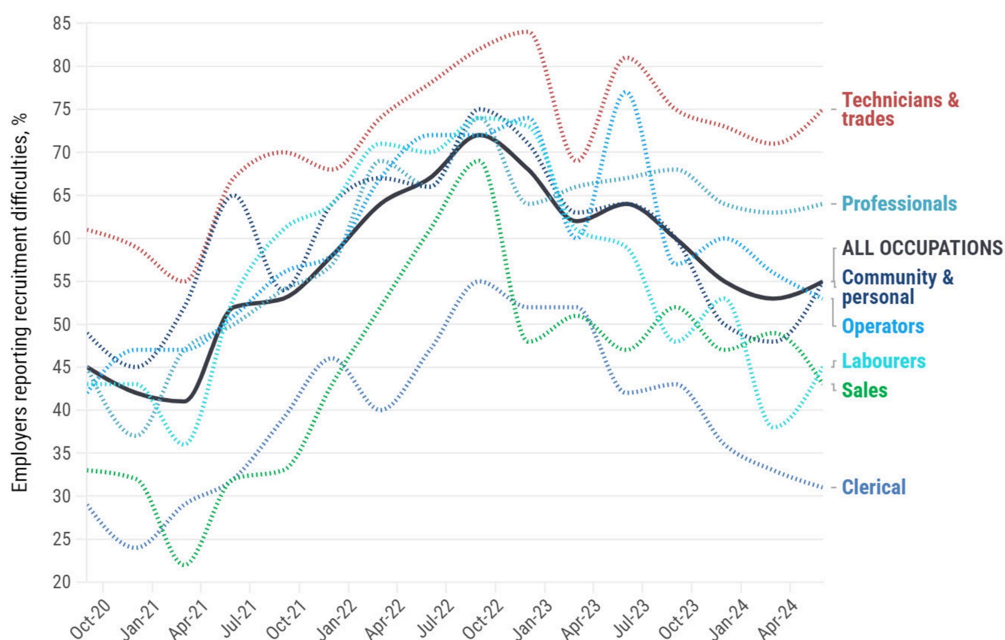
There are marked occupational differences in recruitment difficulty. Higher skill roles – such as professionals, trades and community & personal workers – are consistently harder to recruit across the cycle. This reflects both job-fit considerations (for professionals), and training/licensing requirements that means labour supply has lagged demand (for trades and technical roles).

As the vacancies overhang began to ease in 2023, so too did challenges for successful recruitment. By mid-2024, only 55% of employers reported suffering recruitment difficulties. Significant falls are reported for lower-skilled roles, in particular sales and clerical staff.

However, there has been little movement for higher-skilled roles. Three quarters of employers recruiting for trades, and two-thirds recruiting for professionals, continue to report difficulties. While marginally down on the peak rates, higher-skilled roles have not seen the same degree of relief. Though overall labour shortages are slowly easing, skills shortages remain acute.

This data points to an emerging bifurcation in the Australian labour market: between a materially easing market for lower-skill jobs, alongside tight conditions persisting at the higher end. Employers who rely on higher-skilled workforces should expect their recruitment difficulties will persist even as the overall labour market eases.

Recruitment difficulties by occupational group



Source: JSA RE&O Survey • Ai Group Research & Economics

Fast wages growth expected to moderate only slightly

The tight Australian labour market has unsurprisingly seen wages growth increase. And despite a very moderate easing in early 2024, wages growth is expected to remain high for several more years.

Wages growth – as measured by the WPI, an indicator of hourly wage rates – began accelerating as soon as the pandemic ended. It peaked at 4.2% p.a. in late 2023, before easing very slightly as the labour market started to cool. This is the fastest rate of wages growth recorded in Australia since the global financial crisis, and is considerably higher than our long-run average of 2.6% p.a.

Private sector wages growth has exceeded that in the public sector. This is due to the more prominent role of enterprises agreements in the public sector (whose longer duration means changes lag market arrangements), as well as constraining wages policy decisions by some governments.

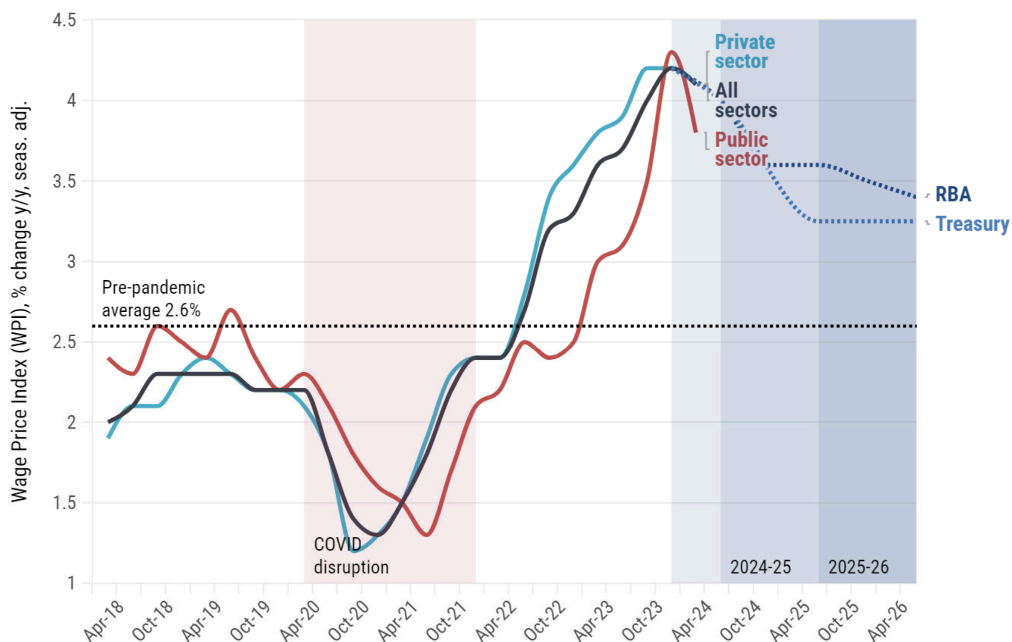
At the industry level, wages growth is tightly clustered. Except for healthcare and social (currently at 5.3%), nearly all industries have wages growth between 3.5% to 4.0%. This is due to the generalised nature of labour shortages, which are affecting all industries irrespective of their business conditions.

For example, the retail industry currently faces 4.4% p.a. wages growth – the second highest rate, despite it being one of the weakest performing industry in Australia today.

Official forecasts expect strong wages growth to persist for some time. It is forecast to fall to the mid-3s range over 2024-25, before settling in the lows 3s by 2026. This is consistent with expectations for both inflation and the labour market to moderate on approximately the same timeline.

However, employers in all industries should expect to contend with above-normal wage increases during a period when we will face below-normal economic growth and industry performance.

Australian wage trends and forecasts



Source: ABS WPI, RBA SoMP, Treasury BP1 • Ai Group Research & Economics

Awards and bargaining now lead wage increases

One of major contributors to recent wages growth has been the impact of policy decisions. Regulated and bargained wages are now growing much faster than those set in the market.

In its 2022 and 2023 decisions, the Fair Work Commission has awarded comparatively large increases to minimum and award wages in Australia – of 5.2% and 5.75% growth. Since 2022, this has seen wage increases for award employees surge ahead those for other employment types. Award wages grew by 5.6% p.a. in the first quarter of 2024, compared to 4.1% p.a. across the labour market.

While enterprise bargaining outcomes are not tied to FWC minimum wage decisions, they do provide the context for the bargaining process. It is therefore unsurprising that wages set by enterprise agreements have also accelerated at faster rate, currently growing at 4.3% p.a.

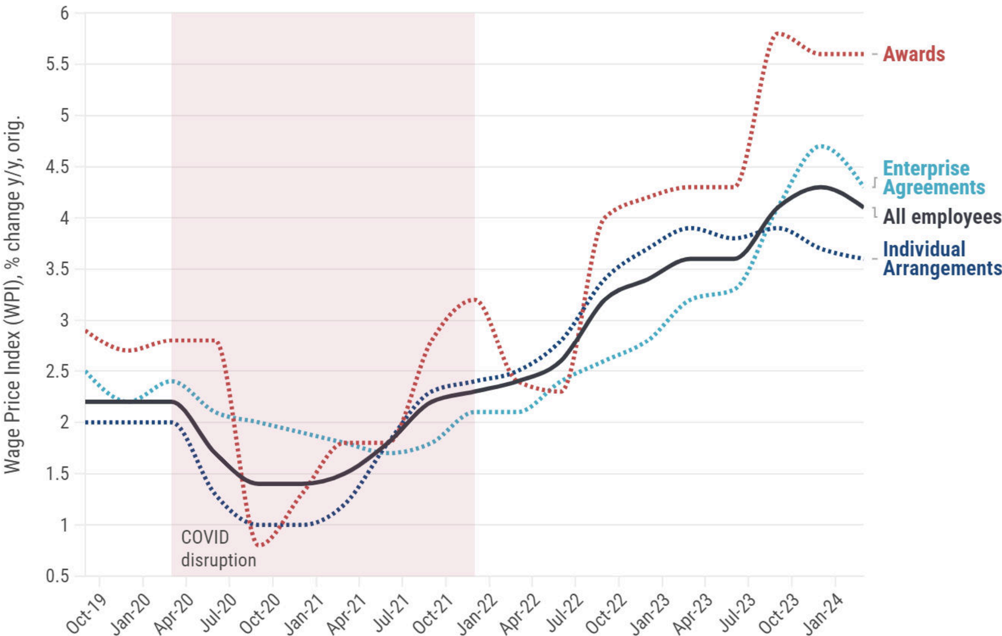
By contrast, wages set in the market display more modest increases. The growth of individual arrangement wages peaked much earlier and lower – in March 2023, at 3.9% p.a. – and have since fallen back to 3.6% p.a. Market-set wages are more responsive to changes in business conditions.

Regulated and bargained wages have thus driven Australian wages growth higher than market outcomes, contributing to wage pressures on employers.

However, this split between methods of setting pay is likely to narrow soon. The FWC raised minimum and award wages by 3.75% for 2024-25. This will see growth in award wages fall back towards the forecast economy-wide average.

These differences mean that employers should pay close attention to how the composition of their workforce influences movements in overall wage costs, and adjust expectations accordingly.

Growth in Australian wage rates by method of setting pay



Source: ABS WPI Methodology Annex B • Ai Group Research & Economics

Productivity dragged by poorly performing industries

Improving productivity is essential if Australia is to emerge from the low growth, high inflation context in which we now find ourselves. Looking at our productivity performance since the pandemic gives much cause for concern, but also points the way to better outcomes.

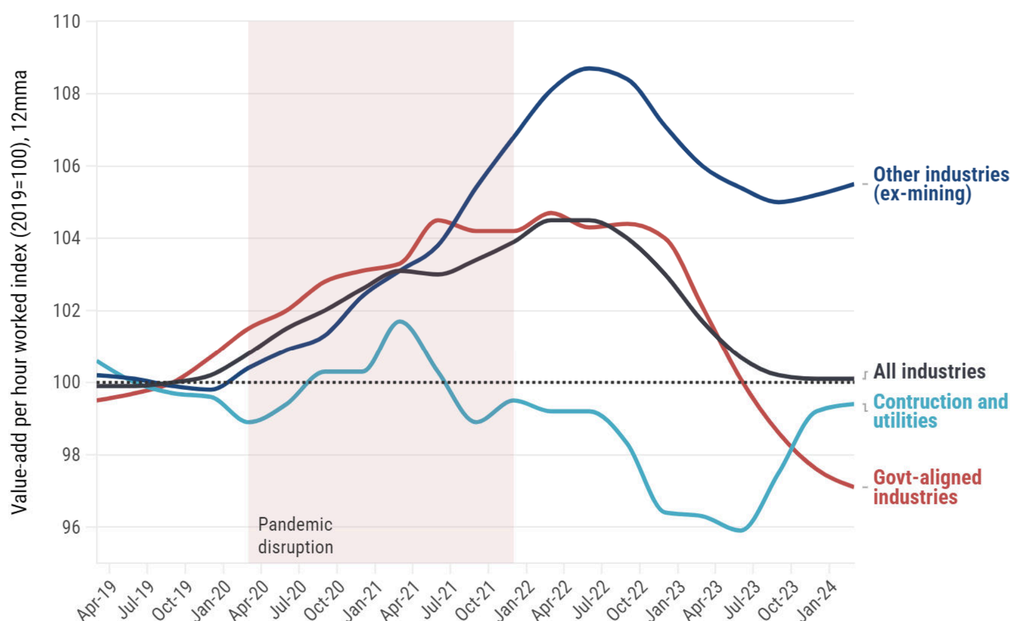
First, the concerning news: Australia has experienced zero productivity growth in the last four years. Labour productivity grew by 3.1% over the two years of the pandemic, due to a complex set of factors associated with the introduction and removal of public health measures. But from mid-2022 it crashed again, and the pandemic era gains were entirely erased.

Importantly, Australia's productivity problem is concentrated in a number of weak industries. One are government-aligned sectors – healthcare, education and public administration – where productivity declined by 2.9% over the last four years. Another are the heavy industries of construction and utilities, which saw productivity collapse by 4% in 2023 in the face of acute supply chain and labour shortages.

If we exclude these poor performers, Australia's productivity story looks much better. Other private sector industries achieved a 5.4% uplift, with a greater rise in 2022 and a lower fall in 2023. Information & media (20.3%), accommodation & food (17.2%) and professional services (14.6%) all delivered large increases, counteracting the drag from government-aligned and heavy industries.

The success of these industries tells us that Australia's productivity problem is far from intractable. But it requires creating the conditions that allow industry to succeed. There is a pressing task for government and industry in pushing for the reform that will broaden our productivity base, and help lift Australia from the economic doldrums in which we now find ourselves.

Australian labour productivity since the pandemic



Source: ABS National Accounts, ABS Labour Account • Ai Group Research & Economics
Government-aligned industries are public administration, healthcare & social and education & training.

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