THE ECONOMIC CHALLENGE

Thomas Greenwell

The Labor government came to power facing an economy rife with challenges. Both the domestic and international economy have been experiencing the adverse economic effects of the disruptions to global supply chains resulting from the COVID crisis and Russia's invasion of Ukraine. Global commodity markets have been beset by volatility, flowing through to rapid inflation. At home, Australia's workers are facing decline in their living standards as the cumulative impact of 10 years of stagnant wages growth and recent high inflation weigh heavily on their incomes. Unemployment rates are low but whether this can be maintained remains uncertain because of the restrictive monetary policies that the Reserve Bank of Australia has implemented.

This article discusses the economic challenges, both global and domestic, that the Labor government faces. It details the cost-of-living and real wage crises now facing Australian workers; and it examines the key economic trends shaping the inflationary process and the labour market conditions. Importantly, it emphasises that economic challenges are *opportunities* too, particularly for the Albanese government. The government has the opportunity, as well as the need, for creative thinking about policies to reduce inflation, to hold on to full employment, and to drag workers out of the cost-of-living crisis. It has an opportunity to reset the macroeconomic policy framework in an enduring way for the longer term. If it can so successfully, it would become a world leader in innovative policy implementation to addresses the current economic challenges. Conversely, failure to do so could have major consequences, both economic and political.

Greenwell, T. (2024)
'The Economic Challenge'
Journal of Australian Political Economy
No. 92, pp. 9-34.

The international economy

The difficulties of the international economic environment are widely recognised. The Reserve Bank of Australia (RBA) has drawn recurrent attention to the persistent inflationary pressures; ongoing supply disruptions; and the rapid increases in the price of energy, food, and other commodities due to the Russian invasion of Ukraine (RBA 2022). A few months after the ALP government was elected in May 2022, the Treasury Secretary told Parliament that it was increasingly likely that recessions would occur in major developed economies (Kennedy 2022).

The ongoing consequences of the COVID-19 era have been pervasive. The RBA reported in May 2022 that strength in real GDP growth in advanced economies was underpinned by fiscal and monetary stimulus implemented to combat the economic effects of the pandemic. The rebound that followed the removal of mobility restrictions also drove growth as pent-up consumer demand was released (RBA 2022). The recovery in demand resulted in falls in the unemployment rate in most advanced economies alongside increases in job vacancies. Wages growth picked up as the labour market tightened and workers tried to make up for lost real incomes.

Responding to inflation well above their respective inflation targets, the central banks of advanced economies had begun a rapid withdrawal of the monetary policy stimulus provided to support economic activity during the pandemic. They also announced intentions to reduce asset holding, unwinding the quantitative easing that had been in place since the Global Financial Crisis (RBA 2022). Inflation had risen faster than expected, partly because of global supply chains restraining production, arising from the health measures that had been implemented to halt the spread of the COVID-19 virus. Driving inflation still higher, global commodity prices had risen rapidly in response to Russia's invasion of Ukraine, as official sanctions and private sector decisions led to disruptions in trade and financing. The sharp increase in commodity prices was most acute in oil, thermal coal, and natural gas. Global wheat prices also increased sharply because of the prominence of both Ukraine and Russian as major suppliers of agricultural products (RBA 2022).

The net result of the clouded economic outlook was a downgrade of the Treasury forecasts for global growth in 2022 and 2023 compared with the forecasts presented in the *Pre-Election Fiscal and Economic Outlook* in April 2022, explained to Parliament by the new Treasurer a mere three months after their publication (Chalmers 2022b). The Labor government was facing a difficult global economic backdrop to the already challenging situation being experienced at home.

Over the course of the first year of Labor's term, the international economy did not show any sign of improvement. In its August 2023 *Statement on Monetary Policy* (SMP), the RBA reported that global economic growth had slowed due to higher interest rates and cost-of-living pressures (RBA 2023a). By August 2023, the RBA expected global growth to remain below average over the coming two years and had revised expected growth in Australia's major trading partners from around 4% in 2023 in the May 2022 SMP, published just prior to the ALP taking office, to around 3.25% in 2023 in its August 2023 SMP (RBA 2022, 2023a).

Monetary policy, having been rapidly tightened over the course of 2022 and 2023, may only have reached the peak of the cycle near the end of 2023. The minutes of the September 2023 RBA Board meeting noted that market expectations for central bank interest rates implied that most advanced economies were at or near the peak of their respective tightening cycles. The minutes also reported that, while headline inflation had eased in year-on-year terms in most economies because of declines in commodity prices, core inflation remained sticky. Wage growth in response to cost-of-living pressures during a tight labour market meant that core services inflation was still high in most advanced economies (RBA 2023b). Even after around twelve months of monetary policy tightening, labour markets had only eased slightly; and even that easing was very gradual. In most advanced economies, unemployment rates were still close to historic lows and vacancy-to-unemployment ratios were above pre-pandemic levels, while labour productivity remained subdued (RBA 2023a).

The RBA's August 2023 SMP highlighted that the combination of these factors meant that wages growth was above levels that were consistent with most central banks' inflation targets (RBA 2023a). These pressures remain unresolved, and the global economy continues to face the prospect of higher interest rates for longer, as central bankers continue using the orthodox tool kit of raising interest rates to try to return inflation to target levels and weigh down on workers trying to recover their standard of living. Indeed, Christine Lagarde, the head of the European Central Bank, commented as late as September 2023 that interest rates would stay high enough to restrict business activity for 'as long as necessary' (Weber and Randow 2023).

The new government could not expect an easy run from a buoyant global economy, unlike previous governments. Moreover, the outlook for global growth deteriorated further while Labor settled into office. Even though wages growth was picking up and advanced economies were close to full employment, orthodox policy thinking meant that these gains would likely be crushed by the conventional central bank policies for combatting inflation. These developments in the global economy were reflected, in many important respects, in domestic economic difficulties.

The Australian economy

The opening sentence of Treasury's outlook for the domestic economy in the new government's first Budget read: 'The Australian economy is facing serious challenges – a sharp global economic slowdown, high inflation, rising interest rates and falling real wages' (Treasury 2022). The state of the economy was defined by COVID-19, inflation, and the policy stance of the Reserve Bank of Australia. The Consumer Price Index (CPI) showed quarterly growth of 2.1% in March 2022, the highest quarterly print since the GST was introduced in September 2000 (ABS 2023c). The year-on-year figure of 5.1% was the highest since September 2008, presaging what would become an accelerating cost-of-living crisis in Australia. The rise in inflation had prompted the Reserve Bank Board to increase the cash rate by 25 basis points on 3 May 2022, part-way through the election and a prelude to the tightening cycle that Labor was to face as it took the Treasury benches (Lowe 2022).

When Labor took office, the average real wages of Australian workers had been declining for six of the seven previous quarters, on top of the real wage stagnation suffered during the length of the Coalition government (ABS 2023e, 2023c). The new government's election commitment of 'getting wages moving again' would prove to be a far more difficult promise to deliver on than could have been anticipated (Chalmers 2022a). Year-on-year inflation peaked in December 2022 at 7.8% and remained well above the Reserve Bank's 2-3% target range throughout 2023. The Wage Price Index (WPI) in September 2023 showed that real wages were as low as they had been in June 2009. The official cash rate set by the RBA had increased by 425 basis points, up to 4.35% by November 2023. The effect has been probably the worst cost-of-living crises in a generation, resulting in declining living standards for many households, and a major challenge for the new government.

This is a situation needing careful political economic analysis, including deeper understanding of the nature of the recovery from COVID-19; the drivers of inflation; and the characteristics of the labour market.

The recovery from COVID-19

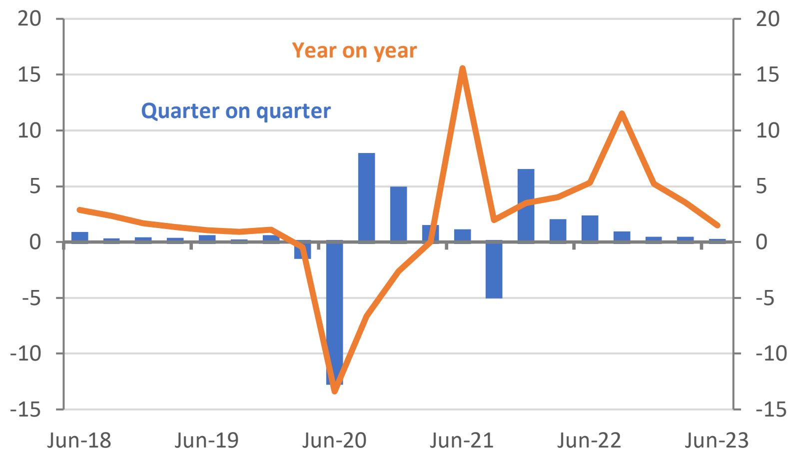
The after-effects of the health crisis and lockdowns were still unwinding as Labor took office. The last of the mobility restrictions were removed in mid-2022 and workers were releasing pent-up demand accumulated during two years of lockdowns and substantial macroeconomic stimulus. Growth in 2022 was driven by consumer spending, as workers returned to buying services that had been restricted by lockdowns (Kennedy 2023b).

During the first part of the new government's time in office, household final consumption grew 11.5% in September and 5.2% in December 2022 (see Figure 1). Household spending was mainly driven by discretionary spending, which grew 26.7% year-on-year in real terms in September and 9.9% in December 2022 (see Figure 2).

The household savings ratio, having peaked at 23.6% in June 2020, declined to 7.2% in September 2022 and 4.4% in December 2022 (see Figure 3). Tourism also saw a robust recovery, growing by over 1000% in both June and September 2022 and well over 600% in December 2022 in year-on-year terms (see Figure 4). With movement restrictions lifted and the supply of services now freely available, workers were saving less of their current income and were instead spending as if to make up for lost time.

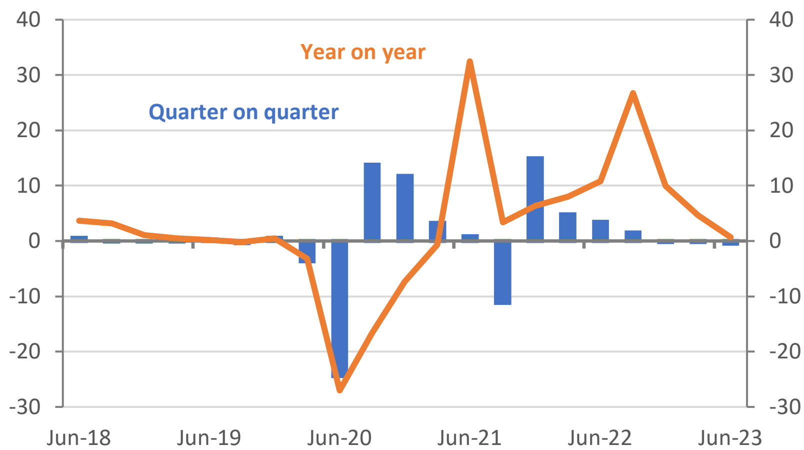
The robust rebound in household consumption drove GDP growth, giving the impression of a buoyant recovery. Yet, even in Labor's first Budget, Treasury was forecasting that the strength in the household-driven rebound was expected to fade once the recovery in discretionary services eased and mounting pressures on households began to take hold (Treasury 2022). Chief among these pressures was the effect of elevated inflation on real household incomes, which no amount of pent-up demand could paper over forever.

Figure 1: Real household consumption growth (%)



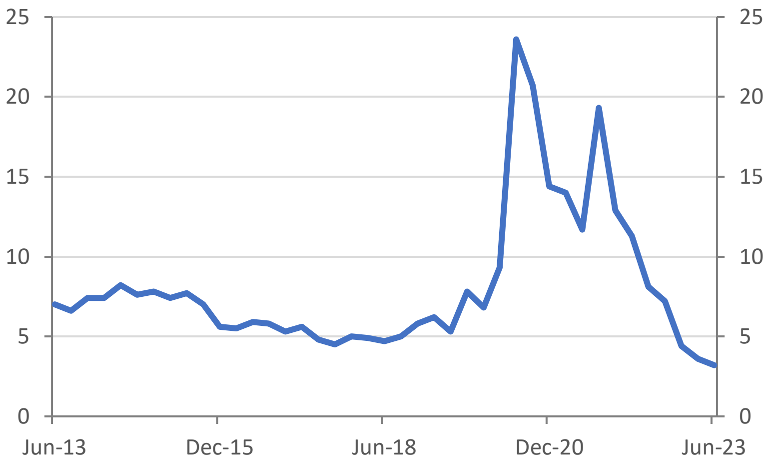
Source: ABS (2023a), author's calculations.

Figure 2: Real discretionary consumption growth (%)



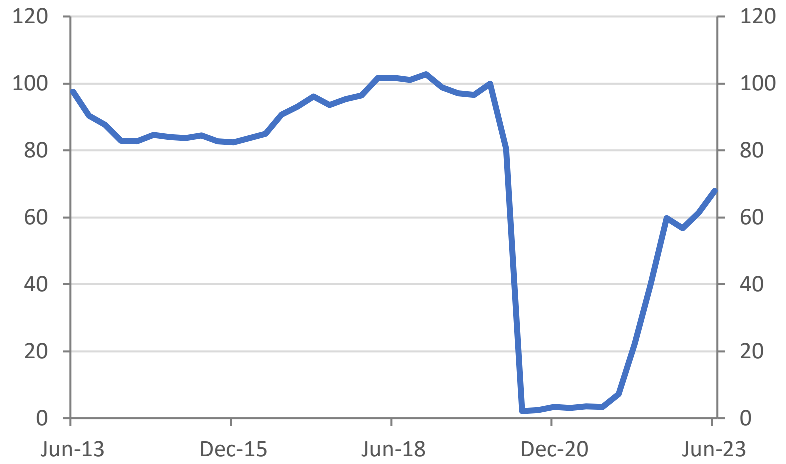
Source: ABS (2023a), author's calculations.

Figure 3: Household saving ratio (%)



Source: ABS (2023a), author's calculations.

Figure 4: Australian tourism consumption (index)

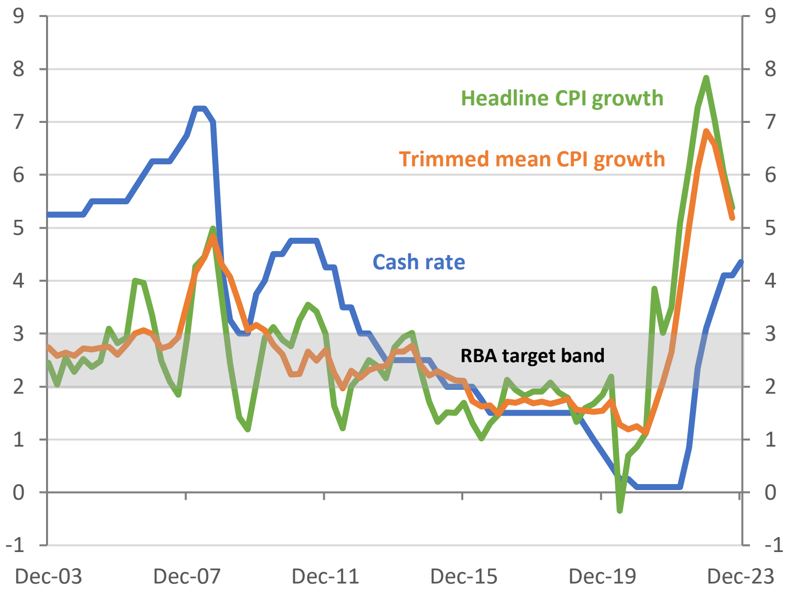


Source: ABS (2023b), author's calculations.

Drivers of inflation

In his post-Budget economic briefing, given just under a year after Labor took office, the Treasury Secretary noted that: 'The return of high inflation, to the fastest rate in thirty years, is one of the defining features of the current economic landscape' (Kennedy 2023a). By the time of the May 2022 election, headline CPI had been above the Reserve Bank's inflation target range for around a year, showing 3.8% year-on-year growth in June 2021 (see Figure 5).

Figure 5: RBA cash rate and inflation growth (%)



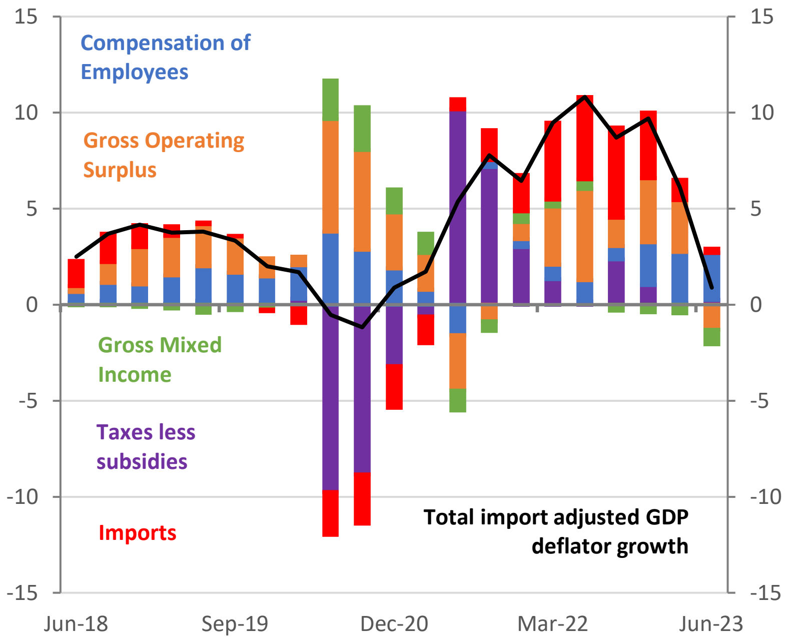
Source: ABS (2023c) and RBA (2023d), author's calculations.

The drivers of Australia's inflation proved to be a controversial subject. Stanford (2023), using a decomposition of the GDP deflator by income components, ascribed the main driver of inflation to unit profit costs arising from elevated corporate profits. Stanford's results were in line with analysis by the OECD, which also ascribed much of the upward price pressure in the GDP deflator to elevated unit profit costs (OECD 2023).[1] The claim of profits driving inflation was disputed by the Treasury, however, which released advice to government (under freedom of information) that argued that elevated inflation could be explained for the most part by the impacts of cost increases and sectoral shocks resulting from the pandemic's impact on supply chains, Russia's invasion of Ukraine and severe weather events disrupting supply chains in Australia (Treasury 2023a). Treasury disputed the validity of decomposing inflation via the GDP deflator, on grounds that imports detract from GDP and would therefore not be counted in the decomposition of price drivers. The Treasury advice also suggested that, once mining was removed, profit margins had only increased slightly compared to just prior to the pandemic, suggesting corporate profiteering was not relevant to inflation in Australia.

Reference to an earlier iteration of the GDP deflator decomposition used by the OECD, which adjusts for imports, sheds some light on the relative contributions to price pressures in Australia (OECD 1985). Between March 2022 and March 2023, imports contributed on average 38% of total growth in the GDP deflator, peaking at 53.9% in September 2022 when imports contributed 4.7 percentage points of total growth of 8.7%. Gross operating surplus, the national accounting measure of aggregate profits, contributed an average of 34% of total growth over the same period, peaking in June 2022 when profits contributed 4.7 percentage points of total growth of 10.8% (see Figure 6). The picture is complicated slightly by the heavy weight of mining in overall profits in Australia, and the OECD rightly cautions that mining may account for a large share of the rise in unit profits since COVID-19 in commodity exporting countries like Australia (OECD 2023). Nevertheless, the disaggregation by factor incomes does show that the combination of profits and imports have driven price pressures. Further, the disaggregation exercise rules out any notion that workers' wages did any of the heavy lifting in contributing to upward price pressures before the most recent quarters, giving the lie to any notion of a 1970s-type wage-price spiral.

[1] Unit profit costs are a measure of profits per unit of output, calculated by dividing Gross Operating Surplus by real Gross Domestic Product.

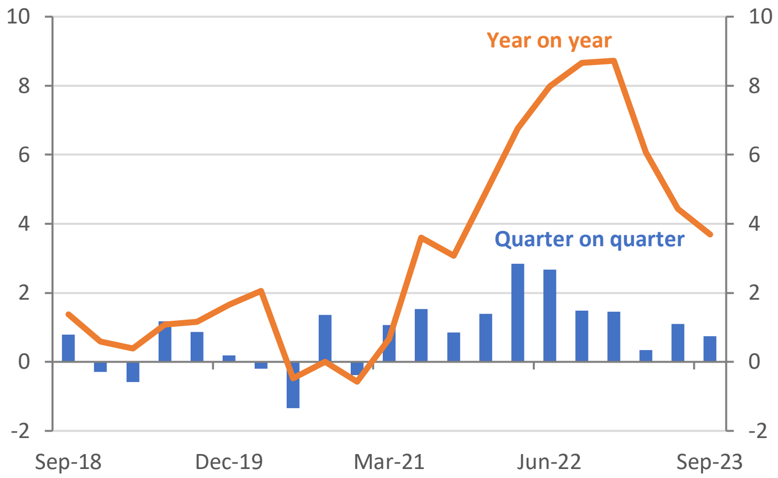
Figure 6: Factor income contributions to year-on-year GDP deflator growth (%)



Source: ABS (2023a) and ABS (2023b), author's calculations.

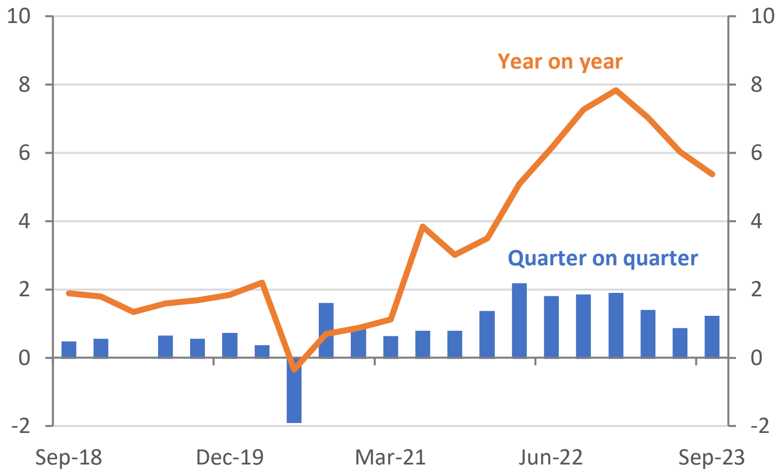
The outsized contribution of import prices to inflation growth in Australia is also reflected in the tradeable inflation series published as part of the CPI release. Tradeable inflation rose rapidly from June 2021, the first quarter headline CPI left the RBA's target band. Tradeable inflation peaked at 8.7% year-on-year in December 2022, then fell to 3.7% in September 2023 (see Figure 7). This easing has been coincident with the easing in headline inflation, which also declined from the peak of 7.8% year-on-year in December 2022 to 5.4% in September 2023 (see Figure 8).

Figure 7: Tradeable inflation (%)



Source: ABS (2023c), author's calculations.

Figure 8: Headline inflation growth (%)



Source: ABS (2023c), author's calculations.

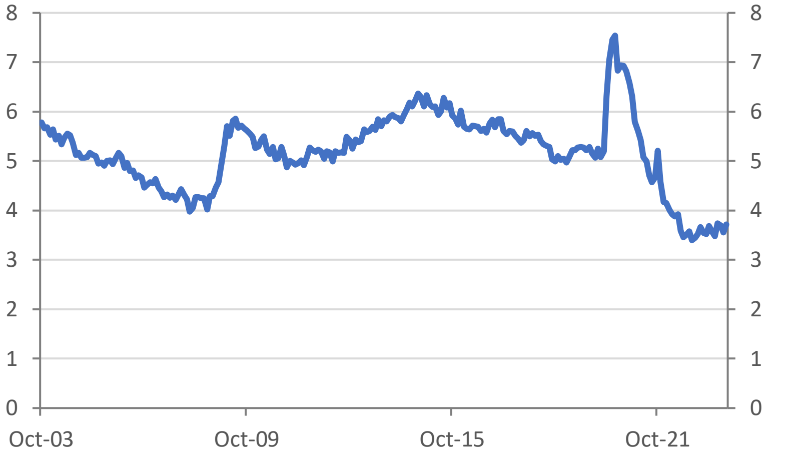
The ALP government can take little comfort from this modest easing in the contribution of imported inflation to Australia's overall inflation problem. The Treasury Secretary acknowledged this in his opening statement to the Senate Economics Committee in May 2023, noting that inflation was moving into a new period, one where elevated import prices are flowing through to final domestic prices, leading to 'a pick-up in services inflation and mark[ing] the beginning of a return to more usual inflation dynamics, where domestic costs are the main driver' (Kennedy 2023b). The difficulty for Labor is the evident determination of the RBA to use the interest rate tool to quash inflation, *whatever its causes*. The effect of this currently dominant policy will be to unwind the modest gains that workers have achieved in the labour market since COVID-19.

Labour market

By May 2022, the month of the Federal election, the unemployment rate had fallen to 3.9%, down from a peak of 7.5% in June 2020, when Australia was in the depths of the COVID-19 related lockdowns (ABS 2023d). The subsequent rebound in employment and severe decline in the unemployment rate meant the labour market was performing better than before COVID-19, when unemployment had averaged 5.6% in the five years prior to January 2020, just before the virus reached Australia (see Figure 9).

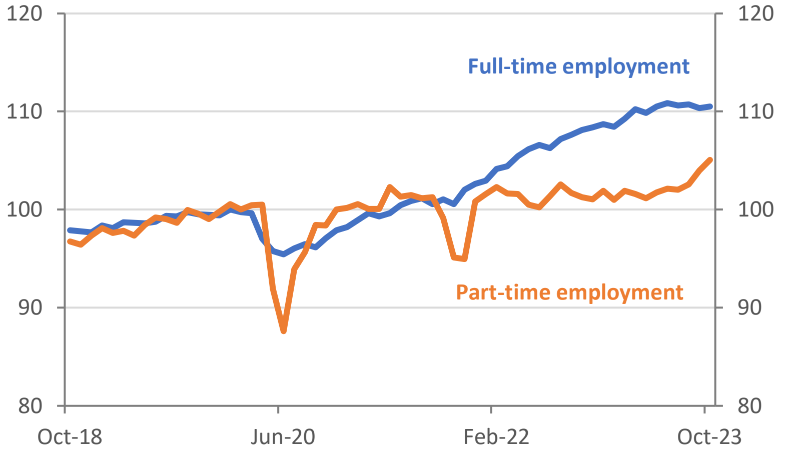
In the government's October 2022 Budget, Treasury observed that the 'labour market [had] continued to tighten, with strong employment growth driving the unemployment rate to almost a 50-year low' (Treasury 2022). This trend continued throughout the first year of the government's time in office, with the unemployment rate rising no higher than 3.7% during the 17 months to October 2023. The labour market improvements were mainly in full-time employment, growing by 7.7% between December 2021 and October 2023. By contrast, part-time employment grew 4.3% over the same period (see Figure 10). The shift to full-time employment was most pronounced for female employees, with growth in full-time employment of 11.3% between December 2021 and the peak in October 2023. In the same period, part-time female employment increased by only 2.8% (ABS 2023d).

Figure 9: Unemployment rate (%)



Source: ABS (2023d), author's calculations.

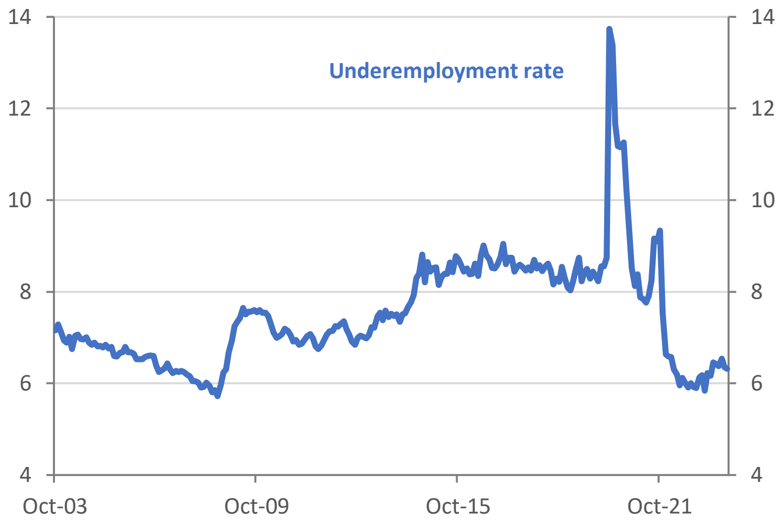
Figure 10: Growth in full-time and part-time employment (index)



Source: ABS (2023d), author's calculations.

Strong demand for labour also saw a substantial decline in the *under*employment rate, which averaged 6.2% during the first 17 months of the Labor government, compared to an average of 8.5% in the five years prior to the COVID-19 outbreak (see Figure 11). This decline in underemployment was a substantial reversal of the situation in the pre-pandemic decade when underemployment was widespread. Many people were finally able to get the hours they wanted to work.

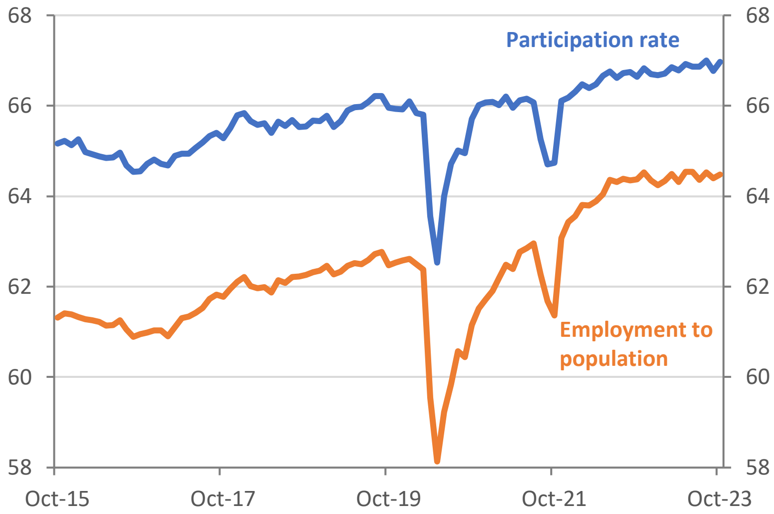
Figure 11: Underemployment rate (%)



Source: ABS (2023d), author's calculations.

In response to the improved labour market conditions, workers grabbed these employment opportunities. As the RBA observed in the May SMP, in Australia, labour supply was robust in response to the strong labour demand (RBA 2022). The workforce participation rate rose from 66.2% in December 2021 to average 66.8% during the government's first 17 months in office, reaching a record high of 67% in August 2023. The ratio of employment to population also reached record heights, rising from 63.4% in December 2021 to an average of 64.4% during the first 17 months of the new government's term (see Figure 12).

Figure 12: Measures of labour supply (%)



Source: ABS (2023d), author's calculations.

The challenge for the new government was not the luck of facing the best labour market in decades, but instead what such a low unemployment rate implied. In a speech in June 2023, the RBA's Deputy Governor Michele Bullock (subsequently appointed as Governor) gave the RBA's assessment that 'for the first time in decades, firms' demand for labour exceeds the amount of labour that people are willing and able to supply.' Putting her view of this situation in no uncertain terms, Bullock followed this up by saying that: '*employment is above what we* [the RBA] *would consider to be consistent with our inflation target*' (Bullock 2023, emphasis added). The inference was that, in the RBA's view, the unemployment rate would need to rise from three-point-something, as it was at the time of that speech, to the RBA's assessed 'sustainable balance' point of around 4.5%. This meant the government was facing a determination by the central bank to put potentially thousands of workers out of work in pursuit of its goal of dampening an inflation process that originated mainly from overseas.

Over the first year of the Labor government, the RBA vigorously pursued this policy of returning inflation to within it target range. In the statement following the RBA Board's meeting in September 2023 – the last of out-going Governor Philip Lowe – the labour market was assessed as still tight, although conditions had 'eased a little' (Lowe 2023). The Labour force release showed that full-time employment had levelled off at around 9.8 million persons in May 2023, staying there for the next five months (ABS 2023d). Part-time employment increased by around 158,000 persons between May and October 2023. This compositional shift has been evident since mid-2023 and may be a warning sign that the gains made after COVID are on shaky ground in the face of the RBA's determination to return employment to its so-called sustainable balance point. Youth unemployment has risen too, up from 7.6% in May to 9.2% in October (ABS 2023d). In other words, groups that usually face a deterioration in their employment prospects when the economy begins to turn down were seeing the consequences of the slowdown that had been emerging in the economy since the March quarter of 2023.

Seeking to clarify how it was responding to this situation, the government published its *Employment White Paper* in September 2023, only three months after Bullock's speech outlining the need for a higher unemployment rate. In it, Labor committed to an 'ambition for a dynamic and inclusive labour market in which Australians have the opportunity for secure, well-paid jobs in a country where workers, employers and communities can thrive and adapt' (Treasury 2023b). The ALP is faced with the challenge of holding on to the record low unemployment and buoyant labour market conditions, even as the central bank pursues a policy of raising interest rates, which restrains economic activity and tends to increase unemployment. This is an economic situation that would be hard enough for any new government, but the Albanese government is also facing one of the most severe cost-of-living crises in Australian history.

Cost of living crisis

The significant decline in living standards being suffered by Australian workers, while exacerbated by the surge of inflation, has deeper roots in ten years of Coalition government. The Abbott-Turnbull-Morrison governments deliberately suppressed wages through a combination of public sector wage caps, relying on the Fair Work Commission to cut penalty rates, and targeted measures against trade union activity (Quiggin 2019). In a notably open statement in early 2019, then Finance Minister

Matthias Cormann described downwards wage flexibility as a 'deliberate design feature of our economic architecture' (Clench 2019). Cormann's statement crystalised the LNP Coalition's strategy toward the working class, one that was substantially successful in suppressing workers' wages.

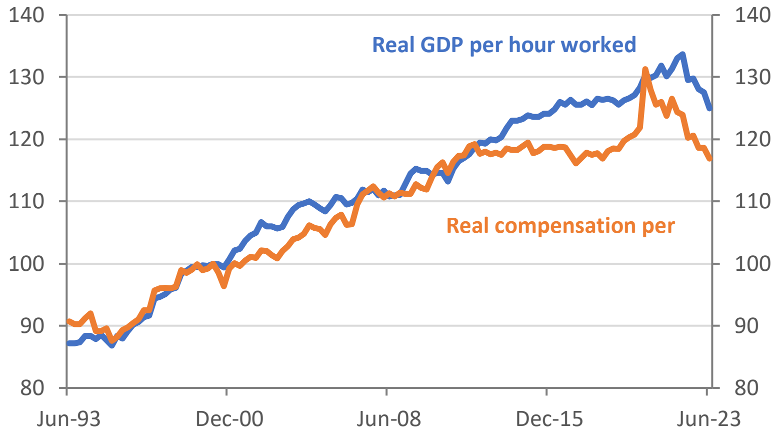
Real wages, measured by the Wage Price Index (ABS 2023e, 2023c), increased only 0.5% between September 2013, around the time of election of the Abbott government, and March 2022, the last full quarter of the Morrison government. Real compensation of employees per hour worked – which is a broader measure of wages including superannuation and other wage and salary income – increased only 5.5% across the same period (see Figure 13).

By contrast, real GDP per hour worked, a proxy measure for labour productivity, rose 11.1% between September 2013 and March 2022, a little more than twice the rate of increase of real compensation. Gross value added per hour worked in the 'market' sector – *i.e.* excluding the public sector of the economy – rose 13.4% over the same period, well above the increase in real compensation per hour worked and 27 times as fast as real wages measured by the WPI (ABS 2023a, 2023e).

Over this period, the profit share of the national income rose 3.5 percentage points to 31.0%, while the wage share of national income fell 3.2 percentage points to 49.9%, reaching its lowest ever level in June 2022 as the ALP took office (ABS 2023a).

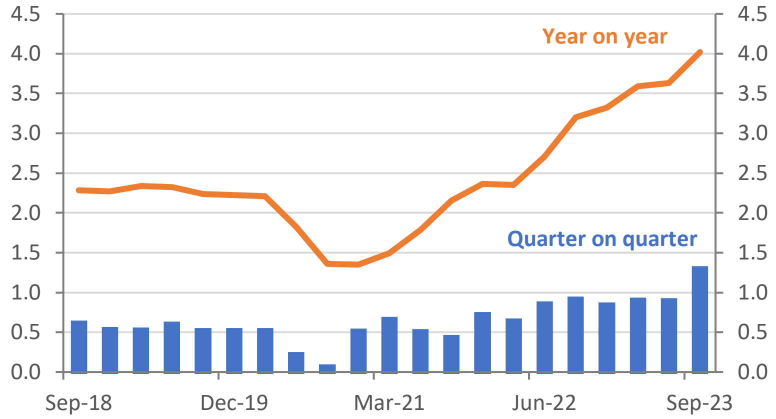
With real wage growth not even close to productivity growth in the previous ten years, the cost-of-living crisis could only worsen during the first year of Labor's time in power. This was despite the tight labour market and strong employment growth offering some counterweight through a pick-up in nominal wages growth. After seven months of an official unemployment rate with a three in front of it, and firms in the RBA's liaison program reporting difficulties finding suitable labour (RBA 2023a), wages growth picked up in the September quarter 2022. The WPI rose 3.2% in year-on-year terms in that quarter, the fastest wages growth recorded since March 2013 (ABS 2023e). Robust wages growth continued for the next four quarters to September 2023, the first such period of sustained wages growth for workers since the Coalition took office in September 2013 (see Figure 14).

Figure 13: Real GDP and real compensation per hour worked (index)



Source: ABS (2023a), author's calculations.

Figure 14: Nominal wage growth (%)

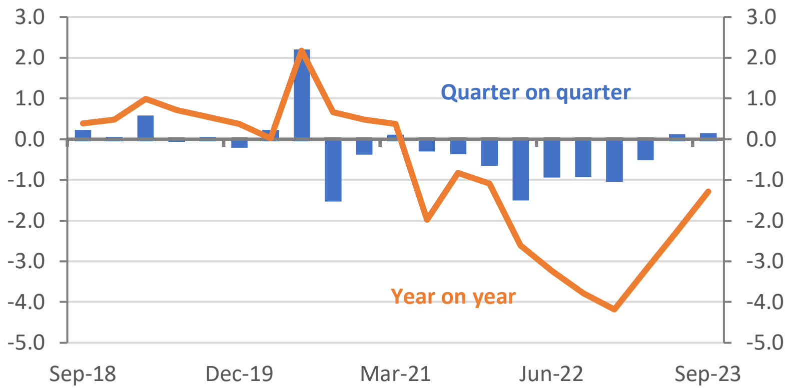


Source: ABS (2023e), author's calculations.

The pick-up in wages growth and strong employment growth partially explain the resilience of the Australian economy during the first year of the ALP government. As the Treasury Secretary noted in May 2023, '[h]ousehold spending has been supported by the record low unemployment rate, strong labour force participation, and rising nominal wages growth' (Kennedy 2023b). However, the combination of high inflation and the RBA's pursuit of the reduction of inflation to target using orthodox policy tools meant that the uptick in wages growth was not enough to offset the losses from inflation and interest rates, with the fall in real income described by the Treasury Secretary as 'squeezing household incomes and weighing on consumer spending.'

Indeed, the modest gains in nominal wages were swallowed completely by rapid inflation growth. Over the first year of the new government, from June 2022 to June 2023, real wages fell by a cumulative 2.3%, having declined in year-on-year terms in each of those four quarters; and continuing to do so in the September quarter 2023 (see Figure 15).

Figure 15: Real wage growth (%)



Source: ABS (2023e) and (2023c), author's calculations.

Because inflation outweighed growth in nominal wages, coming on top of a cumulative impact of 10 years of Coalition government, as of September 2023, real wages were brought back to the same level as they were in June 2009 (see Figure 16).

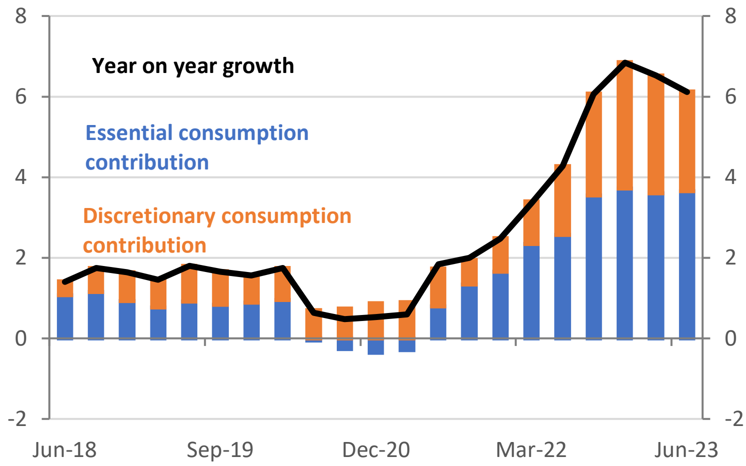
Figure 16: Real wage level (index)

Source: ABS (2023e) and (2023c), author's calculations.

Turning to how the current cost of living crisis impacts on Australian households, it is worth noting that some of the sharpest price rises have been concentrated in forms of consumption that workers and their families cannot avoid. Disaggregating the household consumption deflator into its essential and discretionary components, as defined by the ABS, indicates that since March 2022, essential consumption has contributed on average 59% of the inflation faced by households between June 2021 and June 2023 (see Figure 17).

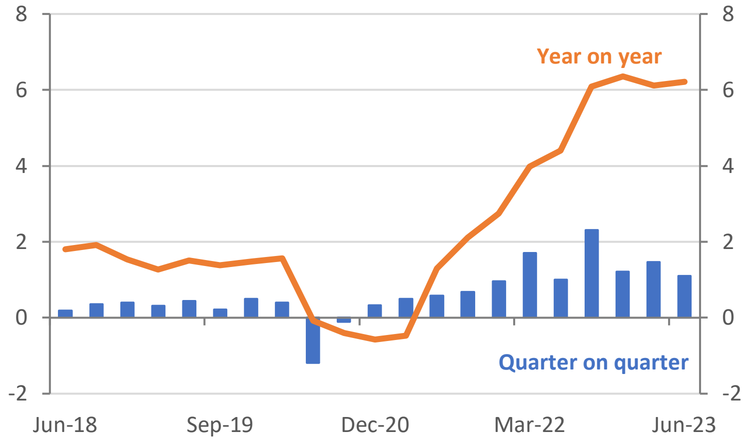
Key among these price pressures have been rents, which, as measured by the national accounts, rose by 6.8% in the June quarter of 2023, the highest since March 2009. Rents have risen by a cumulative 7.6% since March 2022, weighing particularly heavily on young workers. The price of electricity, gas, and other fuels also rose 19.3% in the June quarter 2023 and has risen by a cumulative 21.9% since March 2022. The price of food rose 7.2% in the June quarter, having increased by a cumulative 9.3% since March 2022. The price increases in food over this period were the highest since late 2006. The combined effect of these price rises in essential consumption have plateaued at the equivalent of 6% year-on-year from September 2022 to June 2023 (see Figure 18).

Figure 17: Consumption price growth by category (%)



Source: ABS (2023a), author's calculations.

Figure 18: Essential consumption price growth (%)



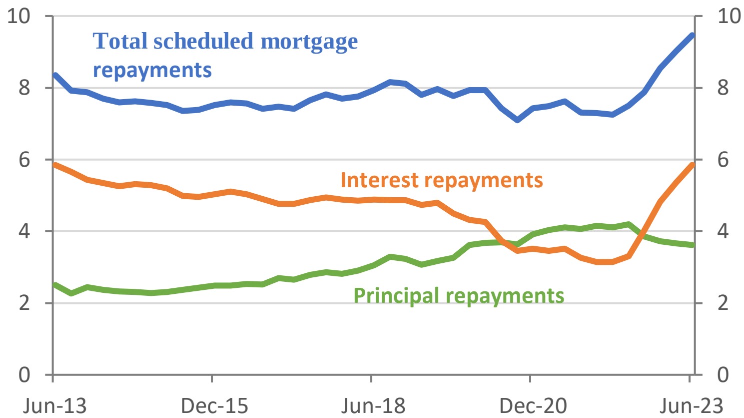
Source: ABS (2023a), author's calculations.

Weighing further on households has been the increase in the *debt servicing ratio*, which is a measure of the share of income given over to interest payments. The debt servicing ratio rose from a low of 3.6% in March 2022, just prior to the first increase in the cash rate, to 7.5% of household income in June 2023 (see Figure 19). The RBA's cumulative increase in the cash rate has pushed the ratio to its highest level since June 2013. Total scheduled mortgage repayments have also risen to 9.5% of household income as of June 2023, the highest share of income in the series available (see Figure 20). On top of the increasing prices for essentials like food, rent and electricity, indebted workers are also having to scale back on spending to service debts and make ends meet. A consequence of this cost-of-living crisis is a slowdown in household spending and economic activity, which is the intended effect of the RBA's interest rate rises. The outcome is that Australia's workers are being crushed between inflation that to date has been driven by overseas wars and supply disruptions – which the interest rate increases can do very little to deal with – and rising debt servicing costs resulting from the use of the orthodox economic policy instruments.

Figure 19: Household debt servicing ratio (%)

Source: ABS (2023a), author's calculations.

Figure 20: Household mortgage repayments as a share of income (%)



Source: RBA (2023c), author's calculations.

The pressure on workers' income from the cost-of-living crisis is not expected to abate soon. In their August 2023 SMP, the RBA forecast household consumption growth to remain below average until late 2024. The RBA stated that this 'reflects weak growth in real disposable incomes as the strong growth in labour incomes is being more than offset by high consumer price inflation, the earlier tightening in monetary policy and higher tax payable' (RBA 2023a).

The cumulative impact of ten years of stagnant real wage growth and real income losses during the post-COVID inflation surge is weighing heavily on households and represents the most significant challenge in the economy inherited by the Labor government. It is no surprise then that Australia's workers consider this to be the top priority needing to be addressed by Labor. Polling undertaken by Redbridge Group in September 2023 indicated that, by a significant margin, those polled viewed the cost-of-living crisis as the number one issue the Albanese government should be focusing on (Redbridge Group 2023). The depth of the crisis in cost-of-living and the breadth of those feeling it will make any well-meaning reform difficult for the government until such time as the decline in real incomes begins to reverse. For these reasons, addressing the cost-of-living crisis needs to be at the heart of all policy initiatives undertaken.

Concluding remarks

The economy inherited by the Labor government elected in May 2022 has few bright spots. Because the international economic environment is beset by many similar pressure points, there is little prospect of external demand smoothing over the difficulties in the domestic economy. Even the positive features of a labour market in which full-time employment has been growing strongly is showing signs of stalling in response to the orthodox use of raised interest rates to try to reduce inflation.

The fiscal policy response by the Labor government thus far has been modest and guarded. Its 2023-24 Budget delivered around $15 billion in targeted cost-of-living relief, including price caps on coal and gas, a $40 per fortnight increase in JobSeeker, and a modest increase in Commonwealth Rent Assistance. But these are comparatively small measures and offer little prospect of a sustained restoration of workers living standards, real wages, and livelihoods. Alongside this, Labor has committed in the *Employment White Paper* to creating an economy where 'everyone who wants a job is able to find one without having to search for too long' (Treasury 2023a). However, the commitment to full employment may mean very little if the RBA's use of monetary policy brings unemployment back up to its modelled 'stable balance point' through using the orthodox tool kit to slow demand and dampen price pressures.

The Labor government therefore faces a difficult economic situation, requiring creative policies to reduce inflation, retain full employment, and relieve workers from the cost-of-living crisis. Raising interest rates and running budget surpluses – the orthodox macroeconomic tools of the last few decades – cannot suffice. The government has both the need and opportunity to reset the macroeconomic policy framework. Conversely, failure to adequately address the cost-of-living crisis and restore workers living standards may derail other well-meaning policy goals of the government and could see Labor returned to the opposition benches before it has had time to reverse the damage resulting from a decade of Coalition government.

Thomas Greenwell is Senior Economist at the Australian Council of Trade Unions. All views expressed are those of the author and do not necessarily reflect the views of the ACTU.

tgreenwell@actu.org.au

Acknowledgements: I wish to thank Jim Stanford for the encouragement to write this article. I also thank the anonymous reviewers and Frank Stilwell for the constructive feedback in developing this manuscript.

References

ABS (2023a) '5206.0 – Australian national accounts: National Income, expenditure and product', Australia, June.

ABS (2023b) '5302.0 – Balance of payments and international investment position', Australia, June.

ABS (2023c) '6401.0 – Consumer price index', Australia, September.

ABS (2023d) '6202.0 – Labour force', Australia, October.

ABS (2023e) '6345.0 – Wage price index', Australia, September.

Bullock, M. (2023) 'Achieving full employment', speech at Ai Group, 20 June, Newcastle, available: *https://www.rba.gov.au/speeches/2023/sp-dg-2023-06-20.html*.

Chalmers, J. (2022) 'Canberra press conference', 27 April, Canberra, available: *https://jimchalmers.org/latest-news/transcripts/canberra-press-conference-27-04-22/*.

Chalmers, J. (2022a) 'Ministerial statement on the economy', 28 July, Canberra, available: *https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/speeches/ministerial-statement-economy*.

Chalmers, J. (2023) 'Budget speech 2023-24', 9 May, Canberra, available: *https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/speeches/budget-speech-2023-24*.

Clench, S. (2019) 'Sixteen-second backflip turns interview into trainwreck', *News.com.au*, 11 March, available: *https://www.news.com.au/finance/economy/australian-economy/sixteensecond-backflip-turns-interview-into-trainwreck/news-story/fe62507c8e961d6381f510133cd68563*.

Kennedy, S. (2022) 'Opening statement to the Economics Legislation Committee', 8 November, Canberra, available: *https://treasury.gov.au/speech/opening-statement-economics-legislation-committee-4*.

Kennedy, S. (2023a) 'Address to the Australian Business Economists: Post-Budget economic briefing', 13 May, Canberra, available: *https://treasury.gov.au/speech/address-australian-business-economists-1*.

Kennedy, S. (2023b) 'Opening statement to the Economics Legislation Committee', 30 May, Canberra, available: *https://treasury.gov.au/speech/opening-statement-economics-legislation-committee-may-2023*.

Lowe, P. (2022) 'Statement by Philip Lowe, Governor: Monetary policy decision', 3 May, Sydney, available: *https://www.rba.gov.au/media-releases/2022/mr-22-12.html*.

Lowe, P. (2023) 'Statement by Philip Lowe, Governor: Monetary policy decision', 5 September, Sydney, available: *https://www.rba.gov.au/media-releases/2023/mr-23-23.html*.

OECD (1985) 'OECD Economic Surveys: Australia 1985', January, available: *https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-australia-1985_eco_surveys-aus-1985-en.*

OECD (2023) *World Economic Outlook*, available: *https://www.oecd.org/economic-outlook/june-2023/.*

Quiggin, J. (2019) 'Ultra low wage growth isn't accidental. It is the intended outcome of government policies', *The Conversation*, 18 March, available: *https://theconversation.com/ultra-low-wage-growth-isnt-accidental-it-is-the-intended-outcome-of-government-policies-113357.*

RBA (2022) 'Statement on monetary policy: May 2022', available: *https://www.rba.gov.au/publications/smp/2022/may.*

RBA (2023a) 'Statement on monetary policy: August 2023', available: *https://www.rba.gov.au/publications/smp/2023/aug/.*

RBA (2023b) 'Minutes of the Monetary Policy Meeting of the Reserve Bank Board', 5 September, available: *https://www.rba.gov.au/monetary-policy/rba-board-minutes/2023/2023-09-05.html.*

RBA (2023c) 'Housing loan payments – E13', August, available: *https://www.rba.gov.au/statistics/tables/.*

RBA (2023d) 'Cash Rate Target,' November, available: *https://www.rba.gov.au/statistics/cash-rate/*

Redbridge Group (2023) 'Voice Referendum Poll – 13', 21 September, *https://redbridgegroup.com.au/voice-referendum-poll-13-21-september-2023/.*

Stanford, J. (2023) *Profit-Price Spiral: The Truth Behind Australia's Inflation*, Centre for Future Work, Canberra, available: *https://futurework.org.au/report/profit-price-spiral-the-truth-behind-australias-inflation/.*

Treasury (2022) *Budget Strategy and Outlook: Budget Paper No. 1*, 25 October, Canberra, available: *https://archive.budget.gov.au/2022-23-october/.*

Treasury (2023a) *Australia Institute Profits and Inflation Report*, 7 July, Canberra, available: *https://treasury.gov.au/the-department/accountability-reporting/foi/3376.*

Treasury (2023b) *Working Future: The Australian Government's White Paper on Jobs and Opportunities*, 25 September, Canberra, available: *https://treasury.gov.au/employment-whitepaper/final-report.*

Weber, A. and J. Randow (2023) 'Lagarde says ECB rates to stay restrictive as long as needed', *Australian Financial Review*, 26 September, available: *https://www.afr.com/policy/economy/lagarde-says-ecb-rates-to-stay-restrictive-as-long-as-needed-20230926-p5e7jm.*