

Unit 4 Topic 1: AUSTRALIAN MACROECONOMIC CONTEXT (2020-2024)

SNAPSHOT OF AUSTRALIA'S ECONOMY

Key Macroeconomic Indicators (Late 2024)

- **Real GDP Growth:** 1.1% (2023–24) – **Well below 2–3% trend**, indicating sluggish economic growth
 - **Unemployment Rate:** 4.1% – Near NAIRU (4.0–4.5%), labour market relatively tight
 - **Inflation Rate:** 3.0% – Moderating from 8.4% peak (June 2022), RBA target 2–3%
 - **RBA Cash Rate:** 4.35% – Held at peak after 425bp of tightening (May 2022–Nov 2023)
 - **Real Wages:** **DOWN 4.5%** (2020–2024 cumulative) – **Major political issue**
 - **Participation Rate:** 66.1% (up from 65.2%) – Immigration-driven labour force expansion
 - **Labour Force Underutilisation:** ~9.3% (unemployment 4.1% + underemployment 5.2%)
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THEMED EXAMPLES BY CONCEPT

1. PERCENTAGE POINTS & BASIS POINTS

Example 1: RBA Rate Path (May 2022–Nov 2023) - Started: 0.1% - Ended: 4.35% - **Total increase: 425 basis points = 4.25 percentage points** - Why basis points matter: Precision in financial markets; 25bp (0.25pp) moves are “micro” in central banking

Example 2: Unemployment Movement (2022–2024) - Peak post-COVID (July 2020): 7.2% - Low point (March 2022): 3.4% - Current (Oct 2024): 4.1% - Movement March 2022 → Oct 2024: **+0.7 percentage points** (NOT 0.7%)

2. NOMINAL vs. REAL GDP

Australia's Growth Story (2023–24) | Metric | Value | |——|——| | Nominal GDP | \$2.18 trillion | | Real GDP (2022–23 prices) | \$2.05 trillion | | Difference | \$130 billion (inflation gap) | | Nominal growth | 3.5% | | Real growth | 1.1% | | Inflation implied | ~2.4pp difference |

What this means: Australia's economy grew 3.5% nominally but only 1.1% in real terms. The other 2.4% was just inflation—people aren't actually better off.

3. NOMINAL vs. REAL WAGES

The Real Wage Crisis (2020–2024) - Nominal wage growth: +8% cumulative - CPI inflation: +13% cumulative - **Real wage change: –4.5%** ($1.08 \div 1.13 - 1$)

Impact: Workers earning \$60,000 in 2020 are equivalent to earning \$57,300 in real purchasing power by 2024 (after inflation). Major political issue driving: - Cost-of-living support (energy bills, rent assistance) - Stage 3 tax cuts (July 2024) - Childcare subsidies expansion - Fair Work Commission wage decision (2024)

4. REAL INTEREST RATES

The Negative Real Rates Period (Early 2023) - November 2023: RBA Cash Rate = 4.35%, CPI = 5.4% - **Real Rate = $4.35\% - 5.4\% = -1.05\%$** (extremely loose policy!) - Effect: Encouraged borrowing, discouraged saving - Mortgage held at ~\$500,000: Real cost was negative (you were actually paying back in cheaper dollars)

Current Situation (Late 2024) - RBA Cash Rate: 4.35%, Expected inflation: ~3% - **Real Rate: $4.35\% - 3\% = 1.35\%$** (tight policy) - Mortgages: Real cost risen significantly → harder to service

5. PRODUCTION POSSIBILITY CURVE – AUSTRALIA'S EXPANSION

Factors Shifting Australia's PPC Rightward (2022–2024) 1. **Skilled Migration:** 250,000+ arrivals (2023–24), fastest immigration in Australian history - Expanded labour force, supporting PPC expansion - Offsets aging population

2. **Technological Advancement**

- Renewable energy infrastructure (solar, wind farms expanding)
- Autonomous mining (ore handling, drones for surveying)
- Digital agriculture (smart irrigation, precision farming)

3. **Resource Discoveries**

- Rare earth deposits identified
- Continue dominance in iron ore (\$95–120/tonne range), coal (declining but significant)

Factors Shifting Australia's PPC Inward (Risks) 1. **Climate Events:** 2023 NSW/QLD floods damaged agricultural capital 2. **Skilled Emigration:** Concerns about Australians moving to Canada, UK 3. **Aged Capital:** Mining infrastructure aging without replacement investment

6. MULTIPLIER EFFECT – AUSTRALIA'S COVID STIMULUS

COVID-19 Fiscal Stimulus (2020–2021): ~\$320 billion - JobKeeper: \$87 billion (wage subsidies) - Cash payments: \$130 billion (economic support payments) - Business support: \$90+ billion

Estimated Multiplier: 1.5–2.0 - Total demand support: ~\$480–640 billion (stimulus × multiplier) - Prevented deeper recession (without stimulus, unemployment would have peaked >10%) - Why multiplier lower than textbook 5.0? - High import share (22% of

spending leaks abroad) - Tax system (47% marginal rate) - Precautionary saving (offset accounts, insurance)

Lesson: Australia's multiplier ~1.7 (vs. textbook 4–5), so government needs larger injections

7. ECONOMIC CYCLE – AUSTRALIA'S 2020–2024 JOURNEY

Phase 1: Expansion (2020–2021) – Post-COVID Recovery

- Real GDP growth: 8.6% (fastest on record)
- Unemployment: 7.2% (July 2020) → 4.2% (December 2021)
- Inflation: Low (1.0% in 2021)
- Business confidence: Rebounding
- Government spending: Maintained via JobKeeper, stimulus
- Tax revenue: Rising as employment recovered
- Budget: Still in deficit (cyclical), but narrowing

Phase 2: Peak/Boom (2021–2022) – Overheating

- Unemployment fell to 3.4% (below NAIRU)
- Inflation: 8.4% (June 2022) – highest in 32 years
- Wage growth: 2.2–2.3% (accelerating)
- Housing prices: Sydney median \$1.27 million (March 2022, all-time high)
- Business confidence: High
- Asset bubbles forming
- RBA warning of overheating → began tightening (May 2022)

Phase 3: Contraction (2022–2023) – Near-Recession

- Unemployment rose: 3.4% → 4.1%
- Growth stalled: Q1 2023 = 0.2% YoY (near recession)
- RBA tightened: 425bp over 18 months (0.1% → 4.35%)
- House prices fell: 10–15% nationally
- Consumer confidence index: 105 → 93 (collapsed)
- Inflation: Fell from 8.4% to 4% (December 2023)
- Government deficit widened: Tax revenue fell, welfare rose
- Real wages stagnated/fell

Phase 4: Trough/Early Recovery (2023–2024) – Stabilising

- Growth bottoming: 1.1% (slow but positive)
- Unemployment: Stable at 4.1%
- Inflation: 3% (within RBA target 2–3%)
- RBA: Held rates, market expected cuts mid-2024, delayed to 2024–25
- House prices: Flat (no further falls, no recovery)
- Government stimulus: Stage 3 tax cuts, energy support, childcare subsidies

- Real wages: Still negative but stopping
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8. UNEMPLOYMENT IN AUSTRALIA

Types Active in 2024 - **Cyclical**: Minimal (economy near full employment) - **Structural**: Rising (manufacturing decline, coal transition) - Example: Latrobe Valley, Victoria (coal region) ~6% unemployment post-coal - Car manufacturing ended 2017 → permanent job losses - Skills mismatch: tech jobs vs. older workers - **Frictional**: Normal level (~1.5–2%) - **Seasonal**: Agriculture, tourism, retail (10–15% of total) - **Long-term** (>12 months): ~18% of unemployed (persistent issue) - **Hidden**: ~1–2% (discouraged workers not counted)

Total Labour Force Underutilisation: 9.3% (2024) - Unemployment: 4.1% - Underemployment: 5.2% (part-time wanting full-time) - Hidden unemployment: ~0.5–1% - **Broader than just 4.1% headline unemployment**

Effects of Unemployment in Australia - Career scarring: 35% lower future earnings for >12 month unemployed - Mental health: Depression/anxiety doubles in unemployed populations - Regional impacts: Rural unemployment >5% in some areas → poverty traps - Economic cost: Each 1pp increase in unemployment = \$12–15bn lost GDP + welfare/health spending

9. INFLATION IN AUSTRALIA

Australia's 2022 Inflation Breakdown

Type	Rate	Driver
Headline (all items)	8.4% (June 2022)	Energy prices, wages, supply
Underlying (ex-volatile)	6.1%	Persistent demand/cost pressures
Demand-pull component	~1.5%	Tight labour market, excess demand post-COVID
Cost-push component	~3–4%	Energy doubled, wage pressures, supply disruption
Imported inflation	~1.5–2%	AUD weakened (0.75→0.65 USD), import prices up
Inflation expectations	Rising	Wage demands increased; spiral risk

By End 2024: Headline 3%, Underlying 3.2% – Near RBA target range

Who Was Harmed by 2022 Inflation? 1. Retirees: Pensions (~\$20k/yr) not fully indexed, lost 5% real value 2. Savers: Cash interest 3%, inflation 6% = –3% real return 3. Fixed-wage earners: Government wage freeze 2020–22 eroded real value 4. Exporters: Tourism & education less competitive globally 5. Taxpayers: Bracket creep pushed workers into higher tax brackets

Who Benefited? 1. Mortgage holders: Real debt fell as inflation eroded debt value 2. Asset owners: Real estate, shares nominally increased 3. Borrowers: Real interest rates negative (especially 2022–early 2023)

10. FISCAL POLICY IN AUSTRALIA

RBA Rate Decisions & Effects

Period	Rate Path	Effect on AD
May 2022	0.1% → 0.35%	Start tightening; mortgage rates 2.8%
Nov 2023	0.35% → 4.35%	Peak tightening; mortgage rates ~7.5%
2024–25	4.35% (hold, then cuts)	Expected cuts; mortgage relief coming

Government Budget Decisions (2024–25) 1. **Stage 3 Tax Cuts** (~\$9bn/year): Lower taxes for earners >\$180k - Lower MPC (high earners save more) → smaller multiplier effect - Targets high income but misses cost-of-living squeeze for low income

2. **Energy Bill Support:** \$100–150/household
 - Direct cost-of-living relief
 - Higher MPC (lower income recipients spend more) → larger multiplier
3. **Childcare Subsidies:** 30 hours free/week
 - Encourages labour force participation (especially women)
 - Supports working families
4. **Infrastructure Spending:** \$120bn over 10 years
 - Roads, rail, ports (long-term multiplier)
 - Slow implementation → lags effects

Automatic Stabilisers in Action (2022–24) - **Expansion (2021):** Tax revenue rose (from employment), welfare fell → surplus emerges - **Contraction (2022–23):** Tax revenue fell (job losses), welfare rose → deficit emerges - **Without stabilisers:** Deficit would have been \$50bn+ (vs. actual \$37bn) - **Effect:** Reduced cyclical shock without government decision

Fiscal Multiplier in Australia: ~1.7 - During COVID downturn (spare capacity): ~1.9–2.0 (stimulus very effective) - Currently (2024, near capacity): ~1.5 (less room to expand) - Long-term average: ~1.7

11. AGGREGATE DEMAND IN AUSTRALIA (2023–24)

$$AD = C + I + G + (X - M)$$

Component	% of GDP	2023–24 Trend	Drivers
C (Consumption)	63%	Declining	Real wages down 4.5%, interest rates high
I (Investment)	20%	Weak	High mortgage rates, uncertainty
G (Government)	18%	Stable	Welfare

Component	% of GDP	2023–24 Trend	Drivers
X (Exports)	20%	Flat	supports, infrastructure Iron ore prices soft, coal under pressure
M (Imports)	22%	Falling	Weak domestic demand, AUD soft
Net (X–M)	–2%	Deficit	Current account deficit ~3% of GDP

Why AD Growth is Weak (1.1% real) - C collapsing: Real wage falls, savings up (household deleveraging) - **I weak:** High rates kill business capex - **X pressured:** China slowdown, commodity prices falling - **M falling:** But not enough to offset—demand shortage

Factors That Would Boost AD - RBA rate cuts (2024–25) → lower mortgage rates → C and I rise - Wage growth accelerating → C rises - Global recovery → X rises - Government stimulus → G rises - Consumer confidence recovering

12. STRUCTURAL vs. CYCLICAL FACTORS

Cyclical (Reversible) Factors in 2022–24 - Business cycle downturn → temporary unemployment rise → reverses with recovery - Confidence collapse → temporary spending fall → reverses - Temporary supply shocks (2023 floods) → output disruption → repairs restore capacity

Structural (Long-Term) Challenges for Australia 1. **Manufacturing Decline** (car production ended 2017) - Permanent job losses (40,000+ workers) - Low-skill workers most affected - LRAS shrinks slightly

2. Coal-to-Renewables Transition

- Latrobe Valley power generation declining
- Coal mining jobs under pressure
- Structural unemployment in coal regions
- Long-term LRAS adjustment needed

3. Aging Population

- Median age: 38 (rising)
- Participation rate falling naturally (retirement)
- But offset by immigration (currently 66.1%, up from 65.2%)
- Long-term potential growth rate may slow

4. Inequality & Uneven Recovery

- High-income earners (Stage 3 tax cuts) vs. low-income (welfare dependent)

- Regional disparity (Sydney/Melbourne vs. regional Australia)
- Structural labour market changes (tech vs. traditional sectors)

13. PHILLIPS CURVE IN AUSTRALIA

Australia's NAIRU: 4.0–4.5%

Scenario	U rate	vs NAIRU	Inflation Pressure	Recent Example
Slack	>5%	Above	Downward (deflation risk)	July 2020 (U=7.2%)
Moderate slack	4.5–5%	Above	Modest downward	Early 2021 (U~6%)
Equilibrium	4.0–4.5%	At	Stable	Late 2024 (U=4.1%)
Tight	3.5–4%	Below	Upward (wage-price risk)	March 2022 (U=3.4%)
Very tight	<3.5%	Well below	Strong upward (spiral risk)	Not recent

Australia's 2022 Example - March 2022: U = 3.4% (well below NAIRU 4.5%) - Inflation: 8.4% (June 2022) – highest in 32 years - Wage growth: 2.2–2.3% (accelerating) - RBA response: Tighten rates from 0.1% to 4.35% - Effect: Unemployment rose, inflation fell (policy worked)

Late 2024 Situation - U = 4.1% (within NAIRU range) - Inflation: 3% (within RBA target 2–3%) - Phillips Curve in equilibrium – no need for extreme policy

SUMMARY TABLE: AUSTRALIAN MACROECONOMIC TIMELINE

Period	Real GDP	Unemployment	Inflation	RBA Rate	Real Wages	Budget
2019 (Pre-COVID)	2.2%	5.2%	1.8%	1.0%	+0.5%	Surplus
2020 (COVID)	–3.2%	6.7%	0.9%	0.1%	–2%	Large deficit
2021 (Recovery)	8.6%	4.2%	1.0%	0.1%	–1%	Deficit narrows
2022 (Boom/Peak)	3.5%	3.7%	6.7%	0.1%→2.85%	–3%	Deficit
2023 (Contraction)	0.2%	3.7%	4.0%	2.85%→4.35%	–2%	Deficit widens
2024 (Trough/Recovery)	1.1%	4.1%	3.0%	4.35% (hold)	Stabilising	Deficit contracts

HOW TO USE THIS CONTEXT IN ANSWERS

Example 1: Multiplier Question

Q: "Explain why Australia's fiscal multiplier is smaller than the simple Keynesian model suggests."

A: Australia's multiplier ≈ 1.7 (vs. textbook 4–5) because: - High marginal tax rate (47% + Medicare levy) = large leakage each round - High import share (22%) = spending leaks abroad - High precautionary saving (offset accounts) = lower MPC - Example: 2024 tax cuts cost \$9bn but generate only ~\$15bn total demand (multiplier ~ 1.7)

Example 2: Real vs. Nominal

Q: "Explain the significance of real GDP vs. nominal GDP for 2023–24."

A: Nominal GDP grew 3.5%, but real GDP grew only 1.1% because: - Nominal: \$2.18 trillion - Real: \$2.05 trillion
- Difference: 6.3% cumulative inflation 2022–24 - Significance: Australians aren't actually better off despite nominal growth - Policy implication: Real wage stagnation (–4.5% 2020–24) is the real problem

Example 3: Economic Cycle

Q: "At which phase of the economic cycle is Australia currently, and what policy should the RBA adopt?"

A: Australia is in early recovery (trough/early expansion) because: - Growth weak (1.1% real) = below 2–3% trend - Unemployment near NAIRU (4.1% vs. 4.0–4.5%) = labour market equilibrium - Inflation stable at 3% = target range - Policy: RBA should cut rates (expected 2024–25) to support AD growth - Danger: If cuts too aggressive, could reignite inflation; if too slow, growth stalls

KEY TAKEAWAYS FOR STUDENTS

1. **Basis Points Matter:** RBA hiked 425bp (0.1% $\rightarrow$ 4.35%), NOT "4.25%"
2. **Real Wages Are Falling:** +8% nominal but +13% inflation = –4.5% real
3. **Multiplier Is Small:** Australia's ~ 1.7 , not textbook 5, due to taxes & imports
4. **NAIRU Concept Matters:** At 4.1%, Australia is in equilibrium—policy neutral
5. **Cyclical vs. Structural:** Unemployment partly cyclical (recoverable), partly structural (coal transition)
6. **Fiscal Stabilisers Work:** Without them, deficit would be \$50bn+ vs. actual \$37bn
7. **Current Challenge:** Weak growth (1.1%) vs. inflation controlled (3%)—hard policy mix