

ECONOMIC INSIGHTS

Dangerous dichotomy facing Australia

The RBA's decision this week following the recent resurgence of inflation highlights the dangerous dichotomy of Australia's economy: **households and businesses vs government**.

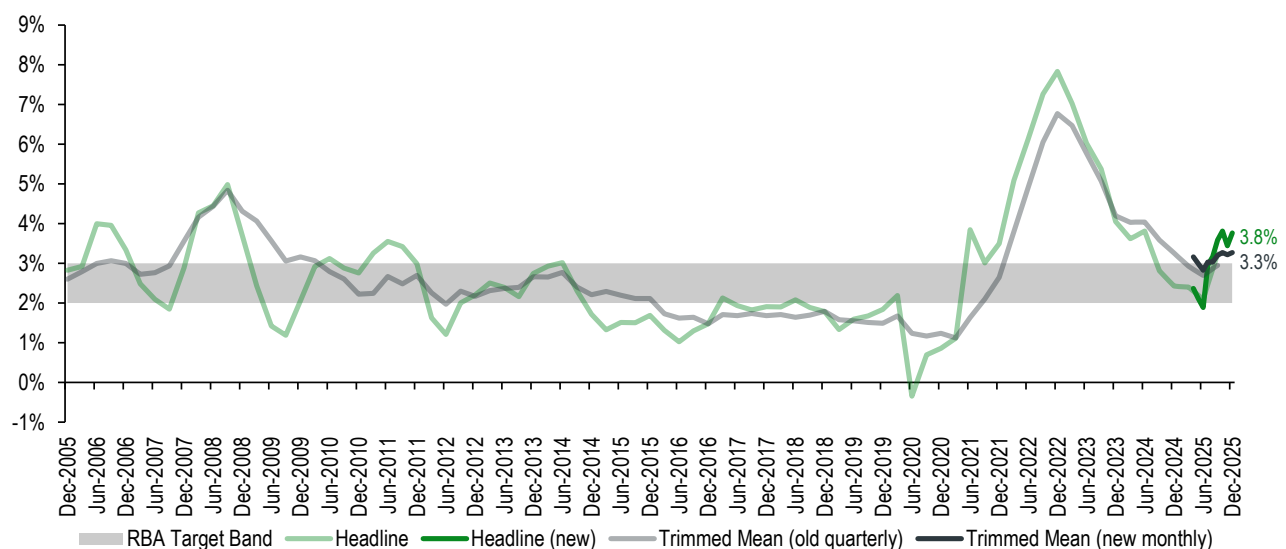
Why inflation and interest rates:	
Should be low:	Are actually high:
Households struggling with cost-of-living pressures	Record government spending and job creation
Private sector businesses with few productive investment opportunities	Elevated population growth
Housing unaffordability and energy cost pressures exacerbating both of these sides	

Many of the factors on the left are similar to – if not worse than – the conditions that prevailed before the pandemic, resulting in much lower inflation and interest rates than today. Remember in late 2019, before anyone had heard about COVID-19, the RBA's cash rate was at just 0.75 per cent and inflation wasn't even able to sustain 2 per cent.

And yet, inflation and interest rates are persisting at so much more elevated levels than before, because the factors on the left are being completely over-powered by the factors on the right.

Inflation, Headline and Trimmed Mean, Annual

Source: ABS



And unfortunately, higher interest rates are unlikely to dramatically affect the right-side factors of government spending and job creation, the rate of population growth, or energy prices. They may also actively worsen household affordability by impeding new supply.

What all this means is that despite households and businesses being arguably even more constrained than ever, government policies are burdening them with inflation and interest rates that are higher than last decade and higher than market conditions would normally dictate.

It is true that a number of factors are pulling Australia forward in aggregate but the pie isn't growing fast enough to give every Australian a much larger piece. And with the cost of living higher than ever, many are seeing their piece get smaller.

The solutions are already before government:

- **Affordable housing** – this means:
 - *Reduced taxes on homeowners and renters* in favour of sourcing revenue from a broader and potentially expanded tax base, such as the GST or land taxes
 - *Planning reforms* to fast-track greenfield land to market and facilitate higher densities in existing suburbs where jobs and transport already exist
 - *More skilled trades*, including through streamlined migration and domestic workforce development, supporting apprentices and promoting careers in construction
- **Abundant energy** to bring down electricity prices for households and existing (and potentially new) businesses and industries that need to be internationally competitive
- **Investment in other basic infrastructure**, including transport and utilities, rectifying decades of inadequate investment and weak productivity growth. This will facilitate home building and business development through the fast and efficient transport of people to and from work, and goods between markets
- **Encouraging foreign investment**, rather than demonising it, so we can access not just foreign finance but their skills, knowledge, expertise and technology too
- **Stable population settings** that governments and industry can predict and plan for, and **targeted migration programs** that source in-demand workers that help expand Australia's productive capacity, not just its demands for goods and services
- **Sustainable fiscal positions** where the government doesn't perpetually outpace, outweigh and crowd out the private sector.

With these policies and reforms, we can help catalyse a private sector 'renaissance'.

Without, we just burden already-constrained households and private businesses with higher inflation and interest rates, without the economic momentum to push through it.