FAIR WORK COMMISSION

ANNUAL WAGE REVIEW 2022

NSW GOVERNMENT SUBMISSION

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Introduction and Overview

1. The NSW Government makes this submission to assist the Panel in the Annual Wage Review 2021-22.

2. The COVID-19 pandemic has dominated the global and domestic economic landscape over the past two years. While public health measures to reduce the spread of the virus saw significant short-term (and temporary) disruption to economic activity and the labour market, Australia has recorded more favourable health outcomes compared to other OECD countries. Similarly, the successful management of the pandemic, alongside significant and effective monetary and fiscal support, meant businesses have been able to re-open their doors and people return to work quickly following outbreaks of the virus.

3. The pandemic will continue to pose headwinds for the global and domestic recovery for some time to come, as demonstrated by the recent emergence of the Omicron variant. However, Australia's high vaccination rate and competent management of the health system, together with ongoing improvements in vaccines, are likely to assist in mitigating the downside risks to the economic outlook.

4. The NSW Government believes that the minimum wage is an important safety net for low-income households. It also plays a significant role in establishing a benchmark for many other awards and enterprise bargaining agreements in NSW and Australia. This is particularly important in NSW, where significant numbers of workers are reliant on awards.[1]

5. Any approach to setting minimum wages must be balanced and sensitive to prevailing economic and labour market conditions, to ensure minimum wage increases do not have a negative effect on employment. In this review, the presence of extra dimensions of uncertainty added by the current Omicron outbreak and potential future outbreaks make this task more difficult than usual.

6. This submission details the present and forecast future state of the NSW economy, with particular regard to the likely effects of the current Omicron outbreak and the potential impacts of future variants. Succeeding sections deal respectively with, award reliance, social inclusion and the promotion of collective bargaining.

Legislative Framework

7. In this Annual Wage Review, the Expert Panel is required to review the national minimum wage order and modern award minimum wages.[2] The Panel must then make a national minimum wage order and may make one or more determinations varying modern awards to set, vary or revoke modern award minimum wages.[3]

[1] ABS, Employee Earnings and Hours, May 2021, Cat.No.6306.0
[2] Fair Work Act 2009 s285(1)
[3] Fair Work Act 2009 s285(2)

8. In addition, the Panel must set special national minimum wages for all award/agreement free employees who are junior employees, employees to whom training arrangements apply, and employees with a disability, as well as setting the casual loading for award/agreement free employees.[4]

9. In arriving at its decision, the Panel must balance the economic, social and industrial considerations, relevantly provided for in the *Fair Work Act 2009* (Cth). These are:

- the performance and competitiveness of the national economy, including productivity,
- business competitiveness and viability, inflation and employment growth; and
- promoting social inclusion through increased workforce participation; and
- relative living standards and the needs of the low paid; and
- the principle of equal remuneration for work of equal or comparable value; and
- providing a comprehensive range of fair minimum wages to junior employees, employees to whom training arrangements apply and employees with a disability.[5]

10. In addition, the Panel is required to ensure that modern awards, together with the National Employment Standards, provide a fair and relevant minimum safety net of terms and conditions.[6]

Economic Outlook

11. The New South Wales economy rebounded strongly from the economic downturn caused by the COVID-19 pandemic in 2020. This reflected the successful management of the pandemic, which allowed the removal of most domestic social distancing measures alongside significant and effective monetary and fiscal support from all levels of government and the Reserve Bank of Australia (RBA).

12. The spread of the Delta variant of COVID-19 in 2021, however, temporarily halted this recovery. State final demand fell by 6.5 per cent in the September quarter 2021 as case numbers jumped sharply and restrictions were reinstated to manage health risks. Activity in the quarter was significantly supported by public spending, which grew by 3.1 per cent, helping to offset the large decline in private activity. Employment, meanwhile, fell by 234,000 over the three months to September 2021. Despite both a longer and, on average, harsher lockdown, both employment and level of activity saw a smaller impact compared to 2020.

13. The NSW economy again looked to be rebounding strongly from the Delta outbreak following the successful vaccination of most of the adult population and subsequent easing of restrictions. However, the emergence of the Omicron variant, which coincided with a sharp escalation in case numbers to levels not seen previously (both domestically and overseas), disrupted the recovery and significantly raised the level of uncertainty.

14. The sharp rise in COVID cases has created new challenges for the economy. Instead of restrictions to suppress the spread of COVID, the main impact now is via disruptions to

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[4] Fair Work Act 2009 s294

[5] Fair Work Act s284(1)

[6] Fair Work Act s134, also ss3(a), (b), (f) and (g)

the supply of labour, as sick workers, and their close contacts (and carers), are required to isolate. In addition, there also appears to have been an impact on confidence (and therefore spending). This appears to have been especially pronounced just prior to and after the Christmas and New Year period, an important period in particular for the hospitality, tourism and entertainment sectors.

15. While daily case numbers have fallen sharply from their mid-January peak, they remain well above the levels seen in prior outbreaks. It is uncertain where cases will settle moving forward. Meanwhile, it appears likely that we will experience future waves of COVID, potentially of new variants that current vaccines may or may not strongly protect against. In light of these factors, the risk to the economic outlook appears set to remain heightened.

16. News of the Omicron variant also has increased volatility in the global economy and will prolong the economic disruptions associated with the pandemic. Recent months have seen a significant increase in inflation across most developed economies, reflecting the combination of supply chain disruptions, policy support for demand, high energy prices, and localised wage pressures. This has prompted many central banks to either commence raising interest rates, or signal the intention to do so over coming months. Continued disruptions to global supply chains, alongside energy price volatility mean uncertainty around inflation and policy paths will remain high.

17. As central banks lift policy rates, risks to financial stability and emerging market and developing economies' capital flows, currencies, and fiscal positions—especially with debt levels that have increased significantly in the past two years—may emerge. Global risks may crystallise as geopolitical tensions remain high.

18. Inflation picked up strongly in Australia over the second half of 2021. Nationally, headline CPI rose by 1.3 per cent in the December quarter 2021 to be 3.5 per cent higher in through the year terms. This was largely driven by potentially transitory price rises in new dwelling costs, fuel and domestic holiday travel & accommodation. Underlying (trimmed mean) inflation also picked up to 2.6 per cent in through the year terms, slightly above the middle of the RBAs target range. This has prompted the Reserve Bank of Australia to end its bond buying policy. While the RBA has stopped short of foreshadowing a rate rise in 2022 as financial markets expect, officials nonetheless have opened the door to an increase in interest rates should the economy and wages growth signal that inflation will remain sustainably within their target band.

19. Outside deteriorating housing affordability, there is little evidence of a material worsening in living standards due to a rising cost of living over the past decade. Wages, pensions and government allowances all have increased in line with or faster than living costs. That said, while inflation has risen, this may not necessarily reflect the increase in the cost of living that all households experience. For example, lower-income households spend a larger proportion of their income on food and utilities and are likely to have been disproportionately impacted by the recent rise in petrol prices to record highs.

20. While there is considerable uncertainty due to the evolving nature of the pandemic, it is expected that economic activity will recover as the Omicron wave subsides, as pent-up demand in consumer spending is released and businesses re-employ and increase hours for workers. While much of the impact of the Omicron wave should therefore be transitory, COVID-19 is transitioning to being endemic in the community. There is the risk

that ongoing moderate levels of infection in the community, alongside future outbreaks or waves of infections, may continue to impinge on labour supply and confidence and, with it, the economy, for some time.

21. More detailed analysis and forecasting of NSW economic performance appears at **Attachment A.**

Award Reliant Employees

22. As noted in paras 9 and 11 above, the Panel is required to review the national minimum wage order and modern award minimum wages, as well as considering relative living standards and the needs of the low paid.

23. In terms of identifying low paid workers, in the 2020 Decision the majority said that '[a] threshold of two-thirds of median adult full-time ordinary earnings is the benchmark we use to identify who is 'low paid' within the meaning of ss 134(1)(a) and 284(1)(c).'[7] This view was reaffirmed in the 2021 decision[8]. According to the most recent ABS Working Arrangements survey[9], the full time median weekly wage as at August 2021 is $1,499 leading to a low paid benchmark figure of $999. The corresponding figures for NSW are $1,500 and $1,000 with the NMW at $772.60 per week as of 1 July 2021.

24. In its submission to the 2020 Review, the Australian Government estimated that 1.7 per cent (or around 180,200 employees) were paid the adult rate of the NMW in 2018, using ABS EEH 2018 data[10]. It was further submitted that '[i]n 2018, up to 21.0 per cent of Australian employees (or 2.2 million) had their pay set by an award[11].

25. In relation to award reliant employees, the most recently available ABS data[12] (2021) indicated that there are 11,578,600 employees in Australia, of which 10,771,200 are non-managerial. Of non-managerial employees, 24.7 per cent – 2,657,900 persons – are award reliant. This proportion of award reliant employees has increased from the 2018 figure of 22.5 per cent[13].

26. Recent data shows that there were 3,800,900 employees in NSW in 2021. Of these, it is estimated there were 431,350 NSW public sector employees and 54,900 local government employees[14]. This indicates that in 2021 approximately 3.37 million (88.7%) NSW employees were situated in the national industrial relations system. Also, 27.6 per cent of NSW employees are award reliant[15].

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[7] [2020] FWCFB 3500 at [359], also FWCFB 3500, [2017] FWCFB 1001, [2013] FWCFB 4000

[8] [2021] FWCFB 3500 at [137]-[138]

[9] ABS Working Arrangements 6336.0 December 2021

[10] Australian Government Submission AWR 2019-20 para 14

[11] Ibid, para 17

[12] ABS Employee Earnings and Hours 6306.0, May 2021

[13] ABS Employee Earnings and Hours 6306.0, May 2021

[14] NSW Public Service Commission *Workforce Profile Report 2021*; ABS Employment and Earnings, Public Sector, Australia, 2020-21, 6248.0.55.002, released 11 November 2021

[15] ABS Employee Earnings and Hours May 2021; NSW Public Service Commission *Workforce Profile Report 2021*

27. NSW has the highest numbers of award reliant employees (1,048,000) and the third highest proportion of award-reliant employees compared to other states and territories (27.6%)[16].

28. The latest ABS Employee Earnings and Hours publication shows that the majority of award reliant employees are women – 59 per cent nationally. Significantly, there is no industry or occupation where women earn more than men[17].

29. Award reliance was particularly prevalent in the accommodation and food services (60.4%), administrative and support services (42.4%), health care and social services (33.3%) and retail (29%) industries[18].

30. Over 45 per cent of award reliant employees were casuals[19].

Promoting Social Inclusion

31. The Panel is required to take account, in giving effect to the minimum wage objective, 'promoting social inclusion through increased workforce participation[20.]

32. In the 2020-21 decision, the Panel reviewed recent research about the employment effects of increases in minimum wages and concluded that:

> '[132] We …. remain of the view that moderate and regular increases in minimum wages do not result in significant disemployment effects.
>
> [133] As discussed in last year's Review, what constitutes a moderate increase, such that it does not have significant disemployment effects must be assessed in the present context. The increase we propose to make to the NMW and modern award minimum wages in the present economic circumstances do not pose a significant risk of disemployment or a significant risk of adversely affecting the employment outcomes of low-skilled and young workers.'[21]

33. It is further noted that the Australian Government in its submission to the 2020-21 Review said that:

> '[i]ncremental and modest increases to the minimum wage have minimal employment impacts, as noted in the literature, however downturns may exacerbate the impact increasing the magnitude of the effect. During an economic downturn, employers that are already under financial stress have reduced capacity to respond to minimum wage increases with higher prices to consumers or a fall in profits to cover the increased costs of wages.'[22]

34. While higher minimum wages can provide incentives to workers not in the labour market to seek paid work, that needs to be balanced against potential negative impacts on the supply of jobs for low paid workers, particularly against the background of continuing

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[16] ABS Employee Earnings and Hours, 6306.0, May 2021
[17] Ibid
[18] Ibid
[19] Ibid
[20] FW Act s284(1)(b)
[21] [2021] FWCFB 3500 [132]-[133], footnotes omitted
[22] Australian Government submission, 26 March 2021 at para. 274

COVID-related uncertainty. As noted above[23], while recovery from the Delta and Omicron outbreaks has been relatively swift and pronounced, uncertainty as to future outbreaks remains quite elevated.

35. Further sources of risk and uncertainty include the possible emergence of new COVID variants, global geopolitical tensions, global supply chain constraints impacting global inflation, the potential for weaker growth in key trading partners, and domestic labour shortages[24].

36. Since the 2021 Budget, the NSW Government has committed economic and social support packages totalling $13.7 billion. These include JobSaver payments to keep workers connected to employers and facilitate a rapid rebound in jobs, as well as other COVID-19 grants to support businesses and not-for-profit organisations. The NSW Government has also announced a comprehensive $2.8 billion Economic Recovery Strategy. The $5 billion WestInvest initiative will also rejuvenate Western Sydney through improved parks, more open spaces and other community projects.

37. The NSW Government is investing $110.4 billion on vital infrastructure across NSW over the next four years, supporting the construction of productivity-enhancing assets to boost economic growth. Current infrastructure commitments include public transport and roads including Sydney Metro West and the Coffs Harbour Bypass, hospitals and health facilities, and schools, TAFE and skills infrastructure.

38. A stable wage environment is critical to the success of these projects, particularly in the COVID-uncertain environment now confronting us.

39. The NSW Government submits the maintenance of a safety net of fair minimum wages must reflect general economic conditions, including the degree of uncertainty around those conditions, the needs of business and employment stability.

40. Minimum wage jobs provide employment for low skilled workers, function as an important stepping-stone for new entrants into the labour market, particularly young people, and provide opportunities to develop employability skills that facilitate progression to higher paying jobs.

41. As noted by the Australian Government in its submission to the 2020-21 Review:

> ‘Low-paid employment is often temporary and can act as a stepping stone…. [A]lmost two-thirds of workers who enter low-paid employment leave within one year, while 84.0 per cent who enter low-paid employment leave within two years. Most of these workers move into higher-paid work, and this is more likely the longer the worker has been in low-paid work…. The median increase in hourly wages for those moving from low-paid to higher paid jobs was 58 per cent.’

42. The NSW Government submits that the best way of promoting increased workforce participation is to ensure that the level at which minimum wages are set is appropriately balanced with the continuing provision of employment opportunities.

43. In this context, it is also noted that the tax-transfer system plays a role in relation to the maintenance of an effective safety net for the low paid. The NSW government endorses

[23] See paras 13-16 above
[24] See also paras 17-19 above

the view expressed by the majority in the 2020 decision and reaffirmed in the 2021 decision:

> ‘Consistent with previous Reviews, we have taken account of the interaction between wages and the tax-transfer system in our consideration of ‘the needs of the low paid’, … and have had regard to various assistance packages introduced by the Australian Government in response to the COVID-19 pandemic. We affirm the position taken by the Panel in previous Review decisions, that it is not appropriate to apply a direct, quantifiable discount to the increase we would have awarded in the absence of such changes; but these changes are a moderating factor in our assessment of the appropriate level of the NMW and modern award minimum wages arising from this Review.’[25]

44. Minimum wages must not act as an impediment to affected workers securing and maintaining employment or regaining employment once out of the workforce. Nor should a minimum floor be set such that it raises costs to a level that hinders an enterprise’s competitiveness.

45. In the latter connection, the NSW Government submits that governments should continue to focus on economic reforms and improvements to productive capacity. For NSW’s part, the NSW Productivity Commissioner has identified a number of areas as the focus of future productivity improvements[26], including:

- Supporting a skilled and high performing workforce;
- Enabling new technologies;
- Improving housing choice and affordability; and
- Smarter use of infrastructure and natural resources.

Encouraging Collective Bargaining

46. Nationally, agreement reliant employees significantly outnumber their award reliant counterparts. In 2021, the proportion of employees whose pay was set by awards rose (from 22.5% in 2018 to 24.7% in 2021), while that whose wages were set by collective agreements fell (from 40% in 2018 to 37.2% in 2021)[27].

47. However, in NSW, the ABS data indicates that a greater proportion of employees now have their pay set by an award than by a collective agreement. The proportion of employees whose pay was set by awards increased (from 28.5% in 2018 to approximately 30.2% in 2021) while the proportion of employees whose pay was set by collective agreements decreased significantly (from 30.9% in 2018 to 27.4% in 2021)[28].

48. The most recent available data from the federal Attorney General’s Department[29] indicates that the number of agreements approved in the September 2021 quarter has increased to 1,272 from 1,065 in the previous quarter. The number of employees in the

[25] [2021] FWCFB 3500 at [67], footnotes omitted
[26] NSW Productivity Commission White Paper *Rebooting the Economy* May 2021
[27] ABS Employee Earnings and Hours 2021, 6306.0, May 2018, May 2021
[28] ABS Employee Earnings and Hours 2021, 6306.0, May 2018, May 2021
[29] Trends In Enterprise Bargaining September Quarter 2021 Report, published 18 December 2020

September 2021 quarter covered has increased to 180,500, from 100,100 in the June quarter.

49. Data from different sectors displays a mixed picture: construction agreements increased significantly (from 404 to 684 March – September), as did manufacturing (from 135 to 180), accommodation and food services (4 to 13). Transport postal and warehousing and wholesale agreements remained steady (96 in both March and September quarters and from 10 to 30 for wholesale agreements). Retail, education and training, and healthcare and assistance were the only sectors to see a decrease in the last two quarters.

50. Further, private sector agreements approved in the September quarter provided an average 2.7 per cent pay rise over 2.3 years, a slight increase from 2.6 per cent in the March and June 2021 quarters[30].

51. In the 2021 Review, the Panel concluded that:

> [160] Consistent with the views expressed by the majority in the 2019–20 Review decision, we accept that there has been a decline in current enterprise agreements, but a range of factors impact on the propensity to engage in collective bargaining, many of which are unrelated to increases in the NMW and modern award minimum wages. Given the complexity of factors which may contribute to decision making about whether or not to bargain, we are unable to predict the precise impact of our decision on bargaining.
>
> [161] The increases we have determined in this Review may impact on bargaining in different sectors in different ways and we cannot be satisfied that the increase we have determined will encourage collective bargaining. We have taken this into account along with the other statutory considerations in determining the outcome in this Review[31].

52. The NSW Government submits that it is critical that a sustainable safety net of minimum wages is one that supports enterprise bargaining at NSW workplaces. In particular, the Panel should continue to set minimum wages at a level that continues to maintain incentives for enterprise bargaining that rewards flexible and productive work practices.

Conclusion/Submission

53. The NSW Government believes that the minimum wage is an important safety net for low income households. It also plays a significant role in establishing a benchmark for many other awards and enterprise bargaining agreements in NSW and Australia more broadly. This is particularly important in NSW where significant numbers of workers are reliant on awards.[32]

54. Any approach to setting minimum wages must be balanced and sensitive to prevailing economic and labour market conditions to ensure minimum wage increases do not have a negative effect on employment.

[30] Ibid
[31] [2021] FWCFB3500 [160]-[161]
[32] ABS, Employee Earnings and Hours, May 2021, Cat.No.6306.0

55. In the near term, the impact of the Omicron outbreak is expected to result in little by way of job losses, given Health orders allow most businesses and sectors to still open as per normal. Instead, it is expected that the majority of the impact on the labour market in the very near term to be felt in a reduction in hours worked.

56. The ongoing pandemic means that risks to the economic outlook from COVID-19 remain elevated. In particular, new variants (beyond Omicron) of the virus may emerge that have more severe health impacts and could render vaccines less effective. This could adversely impact confidence, disrupt the workforce, and necessitate tighter health restrictions, which could impact economic activity.

57. In our submission, the correct approach to addressing these issues is for the Panel to take a cautious approach to this Review, on the basis that governments should seek to drive wages growth by means of a vigorous productivity agenda, including measures such as lowering the tax burden, reducing red tape, and implementing forward looking regulation to support competition and innovation.

Attachment A - The NSW Economy

Performance of the NSW Economy

58. The New South Wales economy has rebounded strongly since the depths of the economic downturn caused by the COVID-19 pandemic in 2020. This reflected the successful management of the pandemic, which allowed the removal of most domestic social distancing measures alongside significant and effective monetary and fiscal support from all levels of government and the Reserve Bank of Australia (RBA).

59. The spread of the Delta variant of COVID-19 in 2021, however, temporarily halted this recovery. State final demand fell by 6.5 per cent in the September quarter 2021 as case numbers jumped sharply and restrictions were reinstated to manage health risks. Activity in the quarter was significantly supported by public spending, which grew by 3.1 per cent, helping to offset the large decline in private activity. Employment, meanwhile, fell by 234,000 over the three months to September 2021. Despite both a longer and, on average, harsher lockdown, both employment and the level of activity saw a smaller impact compared to 2020.

60. The 2021-22 Half Yearly Review forecast a strong recovery from the impact of the Delta outbreak, underpinned by Australia's high vaccination rate and effective policy support (see table 1). While these forecasts were finalised before the arrival of the Omicron variant, the recovery had been expected to be stronger than following the initial lockdown in 2020.

Table 1: NSW Economic performance and outlook – as at 2021-22 Half Yearly Review[a]

	2020-21 Outcomes	2021-22 Revised Forecast	2022-23 Revised Forecast	2023-24 Revised Forecast	2024-25 Revised Forecast
Real state final demand	2.9	2¾ (3½)	5 (1¼)	1 (2½)	2½ (3)
Real gross state product	1.4	2½ (3¼)	3¼ (1)	1½ (3¼)	2¼ (3¼)
Employment	0.4	½ (1¼)	2¼ (½)	1 (1¼)	1¼ (1¾)
Unemployment rate [b]	5.2	5¼	4½ (5)	4½ (4¾)	4¼ (4½)
Sydney consumer price index	1.5	2½ (1¾)	2¼ (1¾)	2½ (2¼)	2½ (2¼)
Wage price index	1.5	2¼ (2)	2¼	2½ (2¼)	2¾ (2½)
Nominal gross state product	3.0	8 (5½)	4¼ (2½)	2¼ (4)	3¾ (4½)
Population [c]	0.1	0.4 (-0.1)	0.7	1.1	1.2

(a) Per cent change, annual average, unless otherwise indicated. Budget forecasts in parenthesis where different.
(b) June quarter, per cent.
(c) Per cent change through the year to 30 June. Forecasts rounded to nearest 0.1 percentage point.

Source: ABS 3101.0, 5206.0, 5220.0, 6202.0, 6401.0, 6345.0 and NSW Treasury

61. However, the emergence of the Omicron variant which coincided with a sharp escalation in case numbers to levels not seen previously (both domestically and overseas) disrupted the recovery and significantly raised the level of uncertainty around these forecasts and the outlook generally.

62. The sharp rise in COVID cases has created new challenges for the economy. Instead of restrictions to suppress the spread of COVID, the main impact now is via disruptions to the supply of labour, as sick workers, and their close contacts (and carers), are required to isolate until they recover. In addition, there also appears to have been an impact on confidence (and therefore spending). This appears to have been especially pronounced just prior to and after the Christmas and New Year period, an important period in particular for the hospitality, tourism and entertainment sectors.

63. While daily case numbers have fallen sharply from their mid-January peak, they remain well above the levels seen in prior outbreaks. It is uncertain where cases will settle moving forward. Meanwhile, it appears likely that we will experience future waves of COVID (potentially of new variants that current vaccines may or may not strongly protect against. In light of these factors, the risk to the economic outlook appears set to remain heightened.

64. News of the Omicron variant has also increased volatility in the global economy and will prolong the economic disruptions associated with the pandemic. Recent months have seen a significant increase in inflation across most developed economies, reflecting the combination of supply chain disruptions, policy support for demand, high energy prices, and localised wage pressures. This has prompted many central banks to either commence raising interest rates, or signal the intention to do so over coming months. Continued disruptions to global supply chains, alongside energy price volatility mean uncertainty around inflation and policy paths will remain high.

65. As central banks lift policy rates, risks to financial stability and emerging market and developing economies' capital flows, currencies, and fiscal positions—especially with debt levels that have increased significantly in the past two years—may emerge. Global risks may crystallise as geopolitical tensions remain high.

66. While there is considerable uncertainty due to the evolving nature of the pandemic, it is expected that economic activity will recover as the Omicron wave subsides, as pent-up demand in consumer spending is released and businesses re-employ and increase hours for workers. While much of the impact of the Omicron wave should therefore be transitory, COVID-19 is transitioning to being endemic in the community. There is the risk that ongoing moderate levels of infection in the community alongside future outbreaks or waves of infections, may continue to impinge on labour supply and confidence and with it the economy for some time.

Household consumption

67. Household consumption has been the biggest driver of swings in economic activity since the beginning of the COVID-19 pandemic. This sector was most affected by public health orders aimed at reducing mobility to limit the spread of COVID-19. In the initial lockdown of 2020, consumer spending collapsed by 13.4 per cent. As restrictions eased through the latter part of 2020, and then the first half of 2021, there was a strong rebound in household spending. By the June quarter 2021, household spending was almost back to its pre-COVID level having grown by 17.1 per cent compared to the year earlier.

68. This recovery was disrupted by the Delta outbreak. Household spending dropped by 10.8 per cent in the September quarter 2021. Once again, service components of consumption and discretionary goods, such as recreation, hospitality, transport services and clothing and footwear, were most affected. While significant, the decline in spending was smaller than the June quarter of 2020, despite the longer duration of the Delta outbreak. This indicates consumers and businesses adapted better to the Delta shutdown as seen through stronger levels of consumer and business sentiment throughout the shutdown period.

69. While consumption was on a strong path to recovery on the back of easing restrictions in the December quarter 2021, the emergence of the Omicron variant has already started to cause headwinds. Despite the absence of lockdown restrictions, reports from major banks have shown spending was below normal seasonal levels, particularly in the early part of January.

70. Over the medium term, our base case is that spending should remain supported by the tightening labour market and higher household wealth. Furthermore, consumers have built up a large pool of savings throughout the shutdown that will support additional spending.

Dwelling investment

71. Government incentives, such as the HomeBuilder program, alongside low-interest rates and rising housing prices, have supported a large pipeline of work in the sector. Restrictions, which have crimped spending on services and holidays and seen people spend more time in their own homes, meanwhile have provided additional support, especially to the renovation sector.

72. Nonetheless, much of this represents a pull-forward of demand which means that dwelling investment may fall back from current elevated levels to more normal levels further ahead. However, near-term capacity constraints are expected to present some headwinds, as building material and labour shortages extend completion times and raise costs.

73. There has been a modest tightening in borrowing conditions for households, reflecting rising interest rates for some home loan products along with recent macroprudential policy measures. Despite this, the value of new loan commitments remains at a high level, with a pick-up in investor activity while owner-occupier loan commitments remain elevated despite moderating in recent months.

74. Dwelling Investment in New South Wales held up well during the Delta outbreak. In the September quarter 2021, the level of activity fell 5.0 per cent, driven by a two-week ban on construction to reduce the spread of COVID. While this may seem like a sharp decline, it is significantly smaller than what is implied by the two-week construction shutdown (which represents approximately 15 per cent of the quarter). In addition, there were restrictions in place for construction workers within the LGAs of concern during the quarter. The contraction being less significant than expected given the extent of restrictions during the quarter highlights the continued underlying momentum in the residential dwelling sector.

Public final demand

75. The public sector has been a key contributor to economic growth throughout the pandemic and is expected to continue to contribute strongly over the forecast period. Public consumption in New South Wales rose by 5.0 per cent in the September quarter 2021 to be 8.5 per cent higher in through the year terms, in part owing to spending related to the Delta outbreak and the vaccine rollout.

76. Aside from other income support measures (such as the acceleration of personal income tax cuts), the state governments infrastructure program will make a meaningful contribution to economic growth. State and local public investment contributed 0.4 percentage points to state final demand over the past year, more than twice its long run average, as the state government took action to accelerate projects and build on the existing pipeline of infrastructure projects. The NSW Government's commitment to a record $110.4 billion in infrastructure spending over four years underpins a lift in state and local public investment, which is expected to contribute ½ a percentage point to economic growth in 2021-22.

Business investment

77. Private business investment fell sharply in the September quarter 2021 amidst the height of the Delta outbreak. The hit to activity during this outbreak appears to have been temporary, with firms looking through the short-term volatility and remaining optimistic of a strong rebound in the longer term. Business investment in aggregate is expected to contribute to growth in the economy over the remainder of 2021-22 and the forecast horizon.

78. New machinery and equipment investment is expected to be a key driver of this strength, with the latest ABS Capital Expenditure Survey showing firms across the country have upgraded their capital plans, with strong growth expected for 2021-22. This upgrade was stronger across the non-mining sectors compared with mining – this is a positive sign for New South Wales, as the non-mining sector makes up a greater proportion of capital expenditure.

79. Across the other major private investment categories, demand for new commercial buildings (which includes office and retail buildings) is likely to soften due to the movement towards more flexible working arrangements, along with a post-COVID shift towards greater online spending. This will weigh on non-residential construction activity. While higher demand for industrial buildings is expected to provide some offset, non-residential construction is still expected to be a drag on growth in the near term.

80. Business investment growth is expected to slow when Commonwealth Government tax incentives expire in the middle of 2023. However, investment is expected to remain positive reflecting the improvement in underlying economic conditions. In addition to its direct contribution to economic growth, business investment also will provide a key ingredient for driving future productivity growth as businesses adapt and implement new technologies.

Labour market

81. The emergence of the Delta variant of COVID in NSW saw a second lockdown imposed from the end of June to mid-October 2021. As was the case in 2020, restrictions that forced businesses across a broad range of sectors to temporarily close had an immediate and marked impact on employment and hours worked. However, businesses were more measured in their response than in 2020. Despite both a longer and, on average, harsher lockdown, including the brief closure of the construction sector, more of the labour market impact was worn via a reduction in hours worked than employment losses. Hours worked

dropped 10.8 per cent over in the three months to September 2021 (or by 13.1 per cent at its peak), a larger decline than in 2020. By contrast, employment dropped by a slightly smaller 234,000 (5.6 per cent).

82. As was the case with the first lockdown, the Government stepped in with support for businesses, with the JobSaver program and other support measures. These supports helped hibernate businesses for the duration of the lockdown, while maintaining the relationship between employers and employees. This was critical to the recovery after the initial lockdown. Subsequently, in December 2021, less than three months after the lockdown ended, more than 95 per cent of the jobs lost during the Delta lockdown had been recovered. This was significantly faster than the recovery from the first lockdown where it was 9 months before 95 per cent of the jobs lost during the lockdown had been recovered.

83. In the near term, the impact of the Omicron outbreak is expected to result in relatively little by way of job losses compared to previous outbreaks, given Health orders allow most businesses and sectors to still open as per normal. Instead, it is expected that the majority of the impact on the labour market in the very near term to be felt in a reduction in hours worked.

84. The extent to which there are job losses, these will most likely occur in those sectors that have continued to be most adversely affected by COVID since the onset of the pandemic, including CBD-based businesses, hospitality, tourism and entertainment sectors. Instead, it is expected that the majority of the impact on the labour market in the very near term to be felt in a reduction in hours worked.

85. The elevated level of job vacancies, especially in those sectors most impacted by international border closures, is expected to work to limit job losses in the very near term as firms will be reluctant to shed staff given the difficulty many firms were having finding suitable labour throughout the course of 2021. The opening of international borders will see a gradual return of migrant workers and, with it, some easing in labour supply problems is expected. But these improvements are expected to be modest in the very near term.

Population

86. Despite edging slightly higher, NSW's annual rate of population growth remained weak in the June quarter 2021. This was driven by continuing weakness in net overseas migration as a result of the closure of Australia's international border since 20 March 2020.

87. Looking ahead, the reopening of the international border for fully vaccinated Australian citizens and permanent residents from 1 November 2021, followed by eligible visa holders such as international students and temporary workers from 15 December 2021 should support a gradual recovery in net overseas migration and population growth.

Inflation

88. Inflation in Australia has picked up. The Sydney Consumer Price Index rose 1.2 per cent in the December quarter 2021 to be 3.1 per cent higher in through the year terms. This was largely driven by price rises in new dwelling costs, fuel and domestic holiday travel & accommodation. Underlying inflation (trimmed mean) rose to be 2.6 per cent higher through the year in the December quarter 2021 – slightly above the middle of the RBAs target range and the highest annual growth since 2014.

89. A sizeable portion of the latest inflation outcome has been driven by temporary factors (such as the HomeBuilder grant) and stronger petrol prices which are not expected to be persistent and are likely to be excluded from the core inflation measure.

90. While the RBAs preferred measure of inflation has already risen to be around the middle of the RBAs target range, they continue to reiterate that it is too early to conclude that it is sustainably in the target range. The Board will likely want to see actual wages growth much stronger and to have clarity on the persistence of supply chain disruptions on prices before they increase the cash rate.

91. The RBA Governor has stated it was "plausible" for the cash rate to rise in 2022, but this was not his central case. This was a notable departure from RBAs dovish tone throughout 2021 that judged 2024 to be the likely timing for the first increase. While this does not materially change the overall message, it emphasises that it is conditions in the economy, and not the calendar year, that will determine when rates increase.

Wages

92. The medium-term outlook for wages growth remains positive. Initially, wages are expected to remain sluggish while existing enterprise agreements remain in place and businesses use measures other than raising base wages to retain and attract staff. The increase in the superannuation guarantee will act as a drag on wages growth. However, a strong labour market outlook and reduced spare capacity, are expected to drive wages growth over time.

Productivity

93. Productivity growth is essential for real income growth and improved living standards over the long run, through a combination of higher sustainable wage increases for workers, lower prices for consumers, and higher profits for business. Real wages growth and productivity growth tend to move together, however, there are often short-run deviations which reflect labour market and economic conditions.

94. The RBA Governor has stated that productivity growth is a key driver of wages growth and that lifting productivity is the key to building on our current prosperity and ensuring sustained growth in wages and incomes.

95. However, recent productivity growth has been subdued and remains below the peak of the 1990s. Alongside below average productivity growth, Australia has experienced relatively subdued wages growth in recent years, in part due to changes to Australia's terms of trade.

96. This fall in productivity growth is not a NSW phenomenon but a global one. It has been seen not just across all Australian states and territories, but across many advanced economies, including the United States, Germany, and Japan.

Cost of living

97. Outside deteriorating housing affordability, there is little evidence of a material deterioration in living standards due to a rising cost of living over the past decade. Wages, pensions and government allowances have all increased in line with or faster than living costs.

98. That said, while underlying (trimmed mean) inflation has risen to be in the middle of the RBAs target band, this may not necessarily reflect the increase in the cost of living for all household types.

99. The Consumer Price Index (CPI) is designed to measure price inflation for the household sector as a whole and is not the conceptually ideal measure for assessing the changes in the purchasing power of the disposable incomes for all types of households. This is because the CPI weights are based on average expenditure behaviours. Expenditure patterns do, however, differ significantly between different household types. For example, lower-income households spend a larger proportion of their income on food and utilities and a smaller proportion on consumer durables and recreational services.

100. Recent data shows that the prices of many essential items, such as petrol and food, have driven the recent increases to inflation. Meaning households who are likely to spend a greater share of their income on essential goods and services have 'experienced' a larger increase to their cost of living than headlines figures would otherwise suggest.

Australian Economic Outlook

101. Prior to the emergence of Omicron, the Australian economy was rebounding strongly from the impact of the Delta outbreak, underpinned by Australia's high vaccination rate and effective policy support.

102. The pandemic will continue to pose headwinds for the global and domestic recovery for some time to come, as demonstrated by the Omicron variant. However, Australia's high vaccination rate and increased investment in health system capacity, together with ongoing improvements in vaccines, diagnostics, and other therapeutics, are likely to assist in mitigating the downside risks to the economic outlook.

103. Beyond the Omicron variant, the Australian economy is expected to see solid growth over the coming years as the recovery continues, although there is considerable risk and uncertainty around the outlook. Support from emergency fiscal support measures, low-interest rates, and significant spending on infrastructure are helping to hasten the recovery.

World Economic Outlook

104. The global economy is emerging from the downturn caused by the coronavirus pandemic, but economic recovery is likely to be gradual.

105. The International Monetary Fund released an updated *World Economic Outlook (WEO)* in late January 2022 stating that the global economy entered 2022 in a weaker position than previously expected. It highlighted that as the new Omicron COVID-19 variant spreads, countries have reimposed some mobility restrictions.

106. Global growth is expected to moderate from 5.9 in 2021 to 4.4 per cent in 2022—this is half a percentage point lower for 2022 than expected in the October *WEO*. Global growth is then expected to slow further to 3.8 per cent in 2023. Although this is 0.2 percentage points higher than in the previous forecast, the upgrade largely reflects a mechanical pickup after current drags on growth dissipate in the second half of 2022. The forecast is conditional on adverse health outcomes declining to low levels in most countries by the end-2022, assuming vaccination rates improve worldwide and therapies become more effective.

107. Elevated inflation is expected to persist for longer than envisioned in the October *WEO*, with ongoing supply chain disruptions and high energy prices continuing in 2022. Assuming inflation expectations stay well-anchored, inflation should gradually decrease as supply-demand imbalances wane in 2022 and monetary policy in major economies responds.

108. The IMF noted that risks to the global baseline are tilted to the downside. The emergence of new COVID-19 variants are likely to prolong the pandemic and induce renewed economic disruptions. Moreover, supply chain disruptions, energy price volatility, and localised wage pressures mean uncertainty around inflation and the path of monetary policy is high.

Risks to the domestic outlook

109. The ongoing pandemic means that risks to the economic outlook from COVID-19 remain elevated. In particular, new variants (beyond Omicron) of the virus may emerge that have more severe health impacts either due to changed properties of the virus or because the new variant renders current vaccines less effective. This could adversely impact confidence, disrupt the workforce, and necessitate tighter health restrictions, all of which could adversely impact economic activity.

110. Aside from COVID-19, global risks include the possibility that China's economic growth could slow significantly, particularly due to weakness in the property sector. That would impact commodity prices and resource exports, as well as the State's international education and tourism exports. Geopolitical risks also remain heightened, with conflict around Eastern Europe rising. More generally, there also is uncertainty around the speed of recovery in international travel flows after nearly two years during which Australia's border has been shut and while the pandemic continues to evolve.

111. Global supply chains currently are stretched as a strong global demand for goods has occurring against a slower recovery in production capacity, resulting in supply shortages as well as a lift in global inflation. There is a risk that supply disruptions are more

prolonged than expected and that renewed global inflation pressures continue for longer than expected. Higher wages growth, if it were to eventuate, could lead to earlier than expected interest rate rises globally and higher inflation domestically.

112. Domestic risks include a continued worsening of labour supply shortages, which limits businesses ability to expand production as the economy picks up. This may also push up wages costs which may be problematic for businesses if the backdrop for demand meant they are unable to pass these higher costs on.

113. Other domestic risks relate to the housing market, which is sensitive to unexpected changes in interest rates and macroprudential policies, as well as adverse weather conditions (such as the current floods in NSW) which could affect the agriculture sector as well as the broader economy.

114. On the upside, there is potential for a faster recovery in household spending, which would lift the broader economy given that households represent by far the largest share of the state economy. The household saving rate has been at elevated levels during the pandemic and households may draw on their accumulated savings more quickly than forecast.