

Speech

Economic Conditions in Post-Pandemic Australia with a Regional Lens

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Governor

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Thank you to Rotary Club of Armidale for hosting me today. And a worthy cause raising funds for the University of New England SMART Region Incubator. It is particularly good to be standing here in Armidale where I grew up and went to university. I see many familiar faces in the crowd, including school and university friends, and parents of friends. My school maths teacher. And last but not least my parents who have come back to Armidale to hear me speak today. I am really thrilled by the turnout here.

I will do two things in my speech today. First, I will briefly set out the Reserve Bank Board's framework for setting monetary policy and then give some context for the [Board's decision on Tuesday](#) to hold the cash rate steady. I will then talk about economic conditions in regional Australia since the pandemic and offer some reflections on challenges and opportunities facing these parts of the country.

How the RBA sets monetary policy

The mandate of the Reserve Bank Board is to contribute to the economic prosperity and welfare of the Australian people by delivering price stability and full employment. In practice, this means setting monetary policy to keep inflation between 2 and 3 per cent and employment at the maximum level that is consistent with maintaining low and stable inflation. We achieve this by setting the interest rate on overnight loans between banks ('the cash rate'). The cash rate influences other interest rates

in the economy, affecting the behaviour of borrowers and lenders, economic activity and ultimately the rate of inflation.

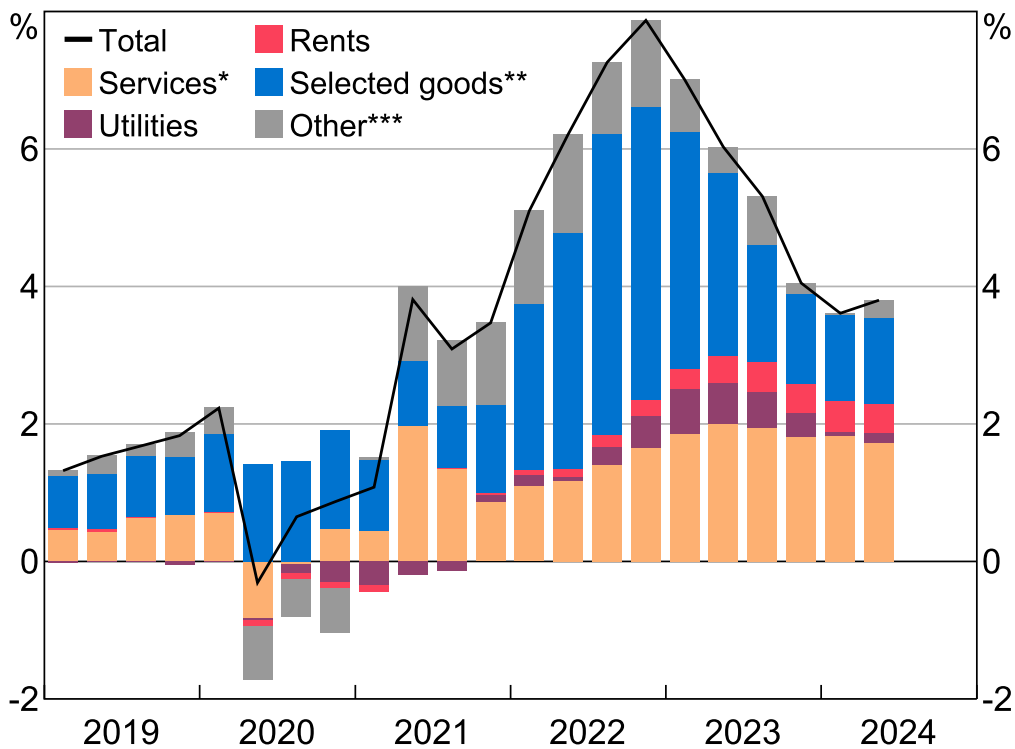
That sounds straightforward. But it is quite complex. It involves the Board assessing current economic conditions, forecasting how the economy is likely to evolve over the coming year or so, considering the risks and trade-offs and then deciding what level of interest rates is required to deliver an inflation rate of between 2 and 3 per cent, while at the same time keeping the unemployment rate as low as possible. The experience since the pandemic has demonstrated just how complex this can be.

Since the pandemic, there has been a worldwide surge in inflation (Graph 1). Initially it was driven by disruptions to supply chains. Resurgent demand coincided with difficulties getting goods produced and distributed around the world, which led to large price rises. Then, when Russia invaded Ukraine, there was a second shock as energy prices rose dramatically. As with other countries, Australia felt the impacts of these shocks. We saw inflation rise sharply, peaking at 7.8 per cent at the end of 2022. We hadn't seen inflation this high in more than 30 years.

Graph 1

CPI Inflation

Year-ended with contributions



* Includes market services and administered items; excludes utilities, rents and holiday travel & accommodation.

** Includes groceries, alcohol & tobacco, consumer durables and new dwellings.

*** Primarily holiday travel & accommodation and fuel.

Sources: ABS; RBA.

But higher inflation wasn't all due to supply shocks. There was also a surge in demand as countries came out of the pandemic and people were keen to spend on goods and activities that were restricted during lockdowns. So central banks around the world increased interest rates sharply – first to remove the stimulus from very low interest rates and then to move them into restrictive territory where they would start to restrain demand.

Australia too has seen a sharp rise in interest rates. The cash rate has risen from 0.1 per cent in April 2022 to 4.35 per cent today. The most obvious area where this has had an impact is on the interest rates paid by households with mortgages. It has increased their payments, which in turn has reduced the amount of spare cash they have to spend on other goods and services. In this way, it has lowered demand. But it has also led to an increase in interest rates on deposits, which has been beneficial for those who have savings. These cash flow effects, though, are just one way in which monetary policy works through the economy. Higher interest rates also reduce incentives to borrow, lower the demand by firms to invest, support the exchange rate, and by themselves weigh on asset

prices and hence wealth. All these effects lead to lower growth of demand in the economy, thereby helping to bring it back into better balance with supply.

Which brings me to Tuesday's Board decision. The most recent inflation reading shows that while inflation is lower than it was a year ago, it is still too high. Inflation in many goods prices has declined but inflation in services prices is high and proving very sticky. And the reason for this is that demand for goods and services in the economy is still higher than the ability of the economy to supply those goods and services. A key point to make here is that demand recovered very strongly after the pandemic, to quite a high level. So even though demand growth has been fairly weak recently, this slowing has not been enough to restore balance in the economy. The Board has been trying to bring inflation down by slowing the growth of demand to bring it back into line with supply. And it has been trying to do this while preserving as many of the gains in the labour market as possible. We've described this as the 'narrow path'.

At its meeting on Tuesday, the Board noted two things. First, that although growth in the economy has been weak, estimates suggest that the gap between aggregate demand and aggregate supply in the economy is larger than previously thought and this is resulting in persistent inflation. It also noted that the growth of demand looks like it will pick up over the next year, although there is considerable uncertainty around the outlook. The effect of this is that the Board's expectations for when inflation will come back to target have been pushed out. We don't expect to be back in the 2–3 per cent target range until the end of 2025 – over a year away. This is why the Board explicitly considered whether another interest rate rise was required to ensure inflation continues to decline in a reasonable timeframe. On balance, the Board decided to keep interest rates on hold, judging that such an outcome would still meet the Board's mandate to balance its inflation and employment objectives. But the Board remains vigilant with respect to upside risks on inflation and will not hesitate to raise rates if it needs to. I know this is not what people want to hear. But the alternative of persistently high inflation is worse. It hurts everyone.

Let me now move on to the second part of my remarks – the regional lens.

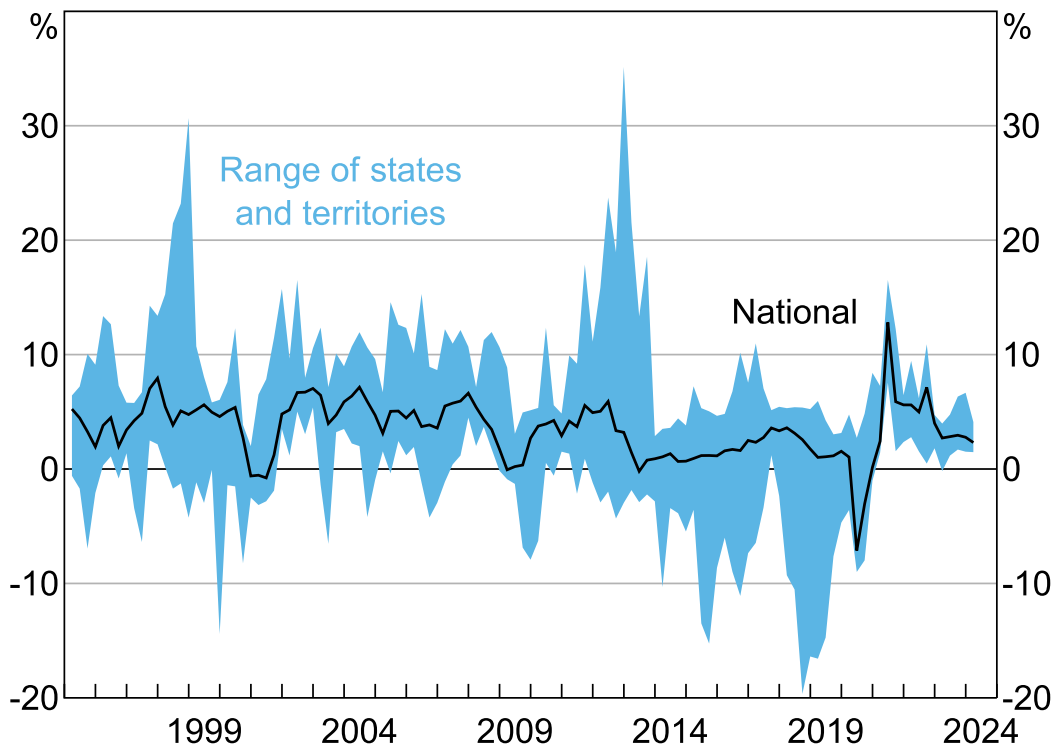
The importance of our regions

The RBA sets monetary policy for the Australian economy as a whole. Through the pandemic, economic conditions were relatively similar around Australia. However, the rate of growth in domestic activity often varies noticeably from one state and territory to another (Graph 2).

Graph 2

State and National Domestic Demand Growth*

Year-ended



* National line shows domestic final demand growth; range shows minimum and maximum state final demand growth of states and territories.

Sources: ABS; RBA.

While the RBA needs to set monetary policy based on aggregate conditions, we are aware that the aggregate is just the sum of its parts. So, to fully understand the overall picture, we need to understand what is going on around the country. We are also conscious that the effect of monetary policy decisions is not felt evenly across all groups.

The RBA has long had a dedicated team of people to gather and analyse information on economic conditions in different regions and industries. [\[1\]](#) The team has staff permanently located in five Australian states, who meet regularly with businesses, industry organisations, government agencies and community groups. In the past financial year, the team hosted around 950 meetings. We systematically factor this information into our forecasts and it feeds into the Board's decisions on monetary policy.

The team regularly speaks with contacts in regional areas and travels to different parts of the country to do this in person; in fact, some of my colleagues have been visiting Armidale and Tamworth this week. We do this because we understand the important role of regional areas in the Australian economy. Regional Australia is estimated to account for around one-third of the population and one-

third of all economic output. ^[2] Moreover, the contribution of regional areas to certain types of economic activity is substantial. For example, regional areas play a crucial role in Australia's mining and agricultural production and exports, with 50 per cent of mining workers and 80 per cent of agricultural workers living in the regions.

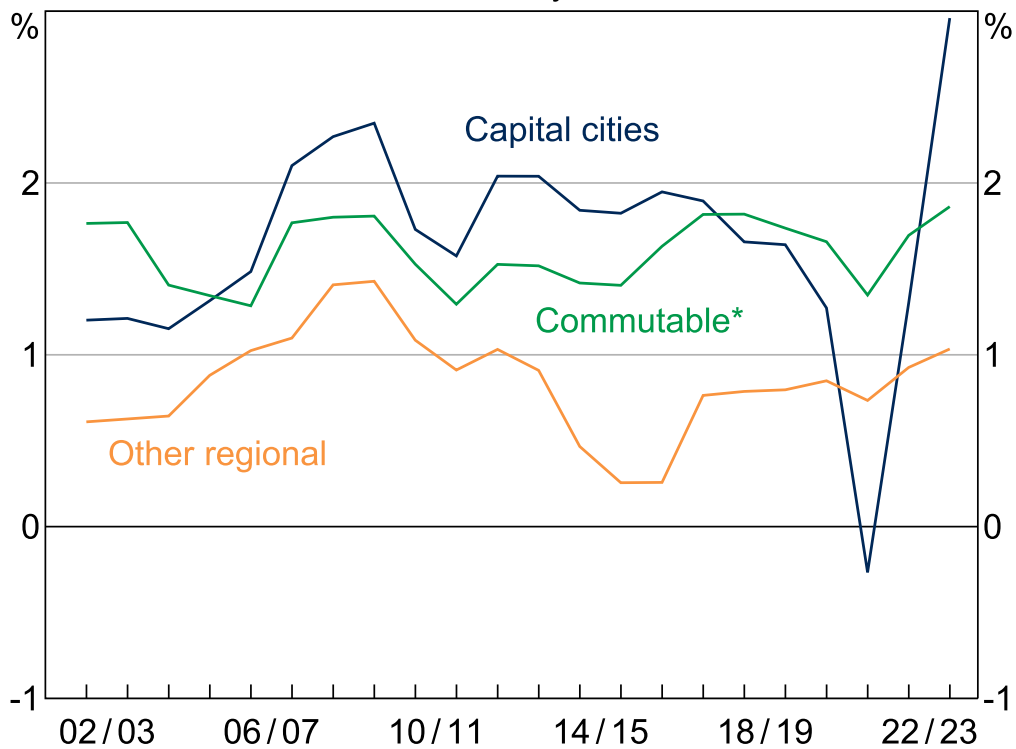
Economic conditions in regional areas coming out of the pandemic

Given the importance of regional Australia, today I want to touch on how economic conditions in the regions have evolved since the pandemic compared with those in the capital cities. I also want to cover some medium-term challenges and opportunities for our regions.

First, however, a couple of disclaimers. In this speech, I draw a distinction between regional areas that are located relatively close to capital cities and those further out. This is because conditions in 'commutable' regions are quite different from more remote ones. I also want to acknowledge up front that while I have grouped regions into very broad categories, we know there is significant variation within these groups.

A standout difference in the experience of regions since the pandemic has been population growth (Graph 3). Migration from overseas all but stopped for a time during the pandemic, which led to a sharp decline in population growth in capital cities, followed by an even sharper pick-up as restrictions eased. By contrast, the regional population continued to grow at roughly the same rate as it had before the pandemic, with consistently stronger growth in 'commutable' regions than those located further from capital cities. As many of you would know, net migration to regional areas has been high since the pandemic as remote and hybrid working has become more common and many workers have opted for a lifestyle change.

Graph 3
Population Growth
 Financial year



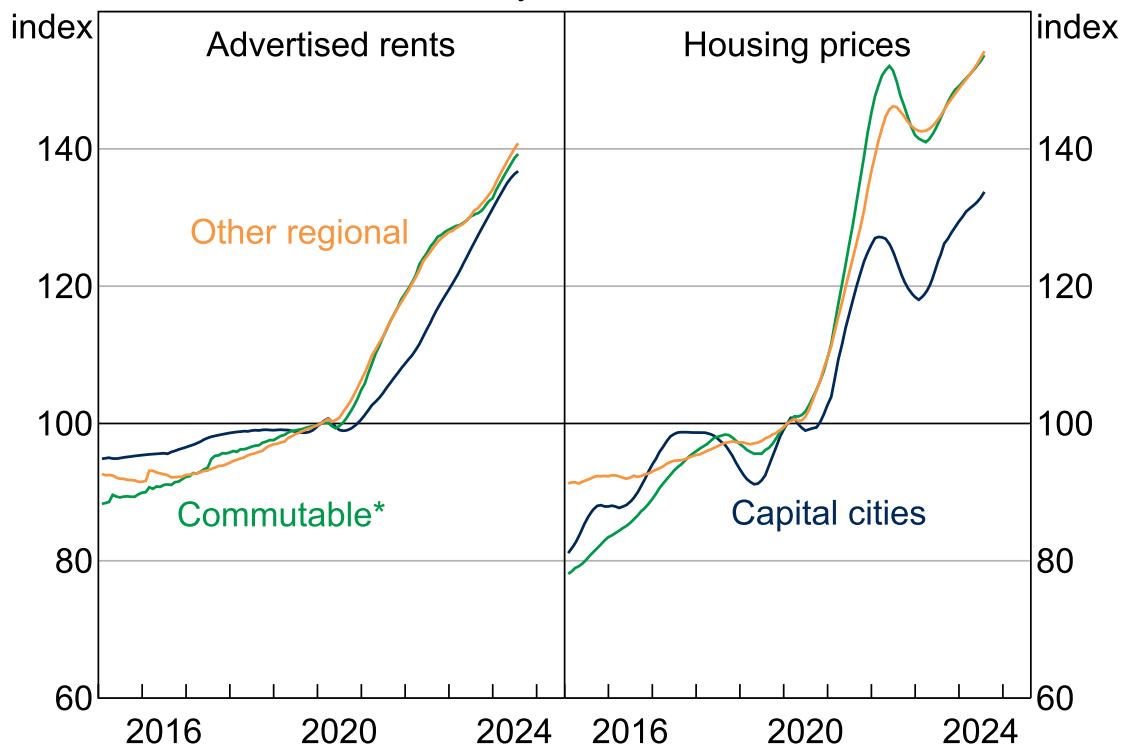
* Commutable defined as regional areas less than 150 km from capital city GPO.

Sources: ABS; RBA.

Changes in population dynamics can have an important impact on housing markets. Population growth is a key determinant of housing demand. But it can also influence housing supply over the medium term (e.g. if it changes the size of the construction workforce). Increases in housing prices and rents were much larger in regional areas than in the cities during the pandemic, though this has slowed somewhat over the past couple of years (Graph 4). Overall, the cumulative increase in housing prices since the beginning of the pandemic has been higher *on average* in our regions than in our cities, while the cumulative increases in advertised rents have *on average* been broadly similar. In Armidale, average housing prices have risen by almost 40 per cent since the beginning of the pandemic, while average advertised rents are up by almost 25 per cent.

Graph 4 Housing Costs

January 2020 = 100



* Commutable defined as regional areas less than 150 km from capital city GPO.

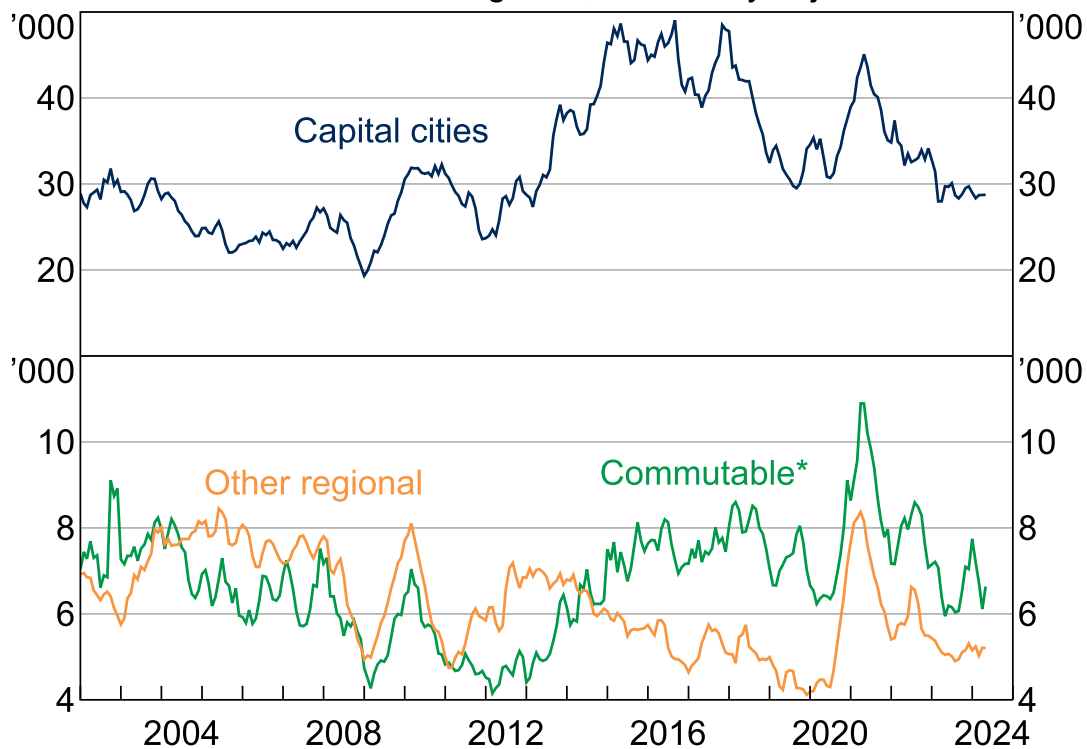
Sources: CoreLogic; RBA.

In a recent speech, my colleague Sarah Hunter discussed how housing supply has not yet responded materially to strong housing prices and rents growth. [\[3\]](#) Approvals for new housing are below their average levels from the five years or so prior to the pandemic in many regions (Graph 5). This is quite a common story, although there are some areas where approvals are close to, or above pre-pandemic levels, including here in Armidale. More generally, though, we know that the strain on household finances from high housing costs is being felt acutely in our regional areas as well as our cities and could continue for some time if construction activity remains low.

Graph 5

Residential Building Approvals

Three-month moving sum, seasonally adjusted



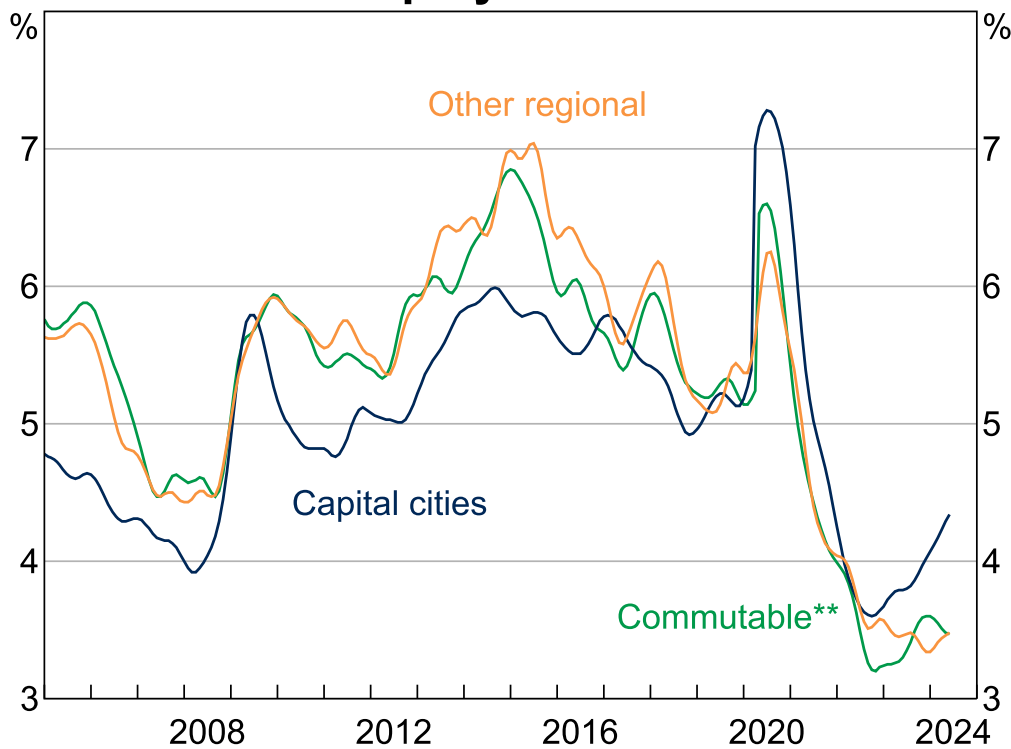
* Commutable defined as regional areas less than 150 km from capital city GPO.

Sources: ABS; RBA.

Looking at labour markets, unemployment rates did not rise as much in regional areas as in capital cities during the pandemic, consistent with their shorter lockdowns and lower shares of workers employed in the services sector. After the pandemic, unemployment rates dropped significantly to very low levels across the country; this was particularly true in 'commutable' regional areas, possibly due to an increase in remote and hybrid workers around that time. Since then, regional labour markets have been tighter than those in capital cities. The New England North West region is no exception, with an unemployment rate that has averaged just 2½ per cent since the beginning of 2023, compared with an average of around 6 per cent over the past 20 years. While still at low levels, there has been a more noticeable increase in the average capital city unemployment rate compared with average regional unemployment rates to date (Graph 6).

Graph 6

Unemployment Rate*



* 13-term Henderson trend; seasonally adjusted.

** Commutable defined as regional areas less than 150 km from capital city GPO.

Sources: ABS; RBA.

Some challenges and opportunities for our regions

In addition to the shorter term forces that have been at play as the effects of the pandemic have worn off, there are also some important longer term structural factors that affect industries in different ways and in turn the regions in which they operate. The energy transition is one of these factors that presents both challenges and opportunities for our regions. I will return to this later.

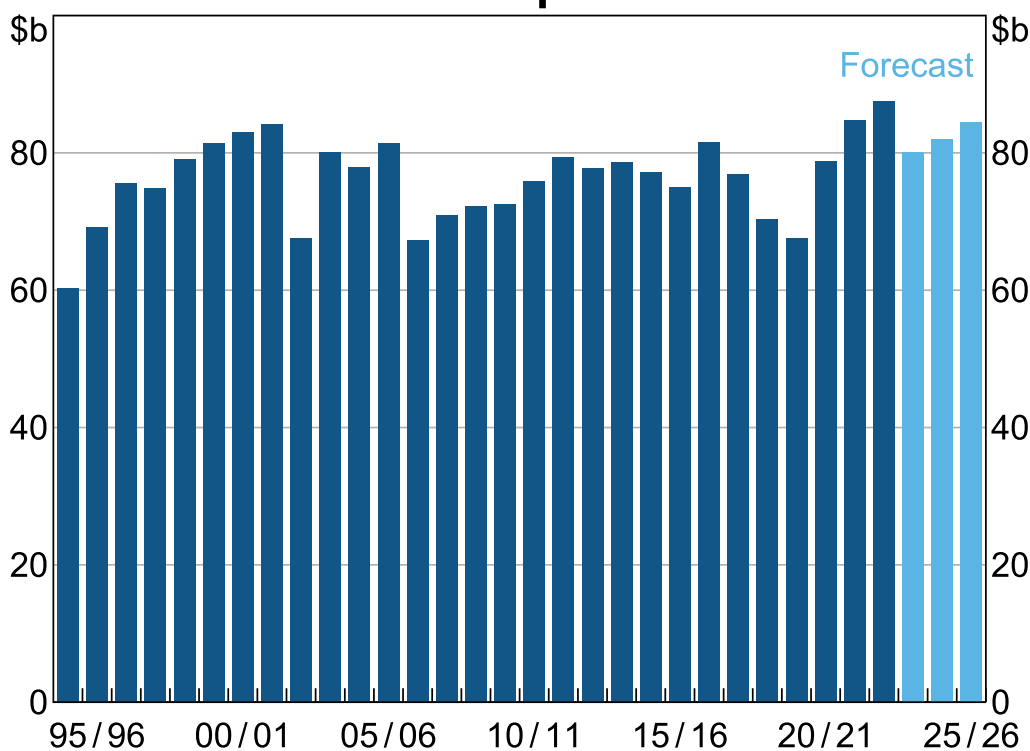
First, though, I want to discuss the changes taking place in the agricultural sector, given its importance to regional areas and the wellbeing of all Australians.

As I'm sure you are aware, this sector has been undergoing structural change in recent decades. Innovation in agriculture has boosted productivity significantly, but it has also led to a decline in jobs in this sector. The people and businesses in regional areas have had to adapt to this change, which is always challenging. Investment in agricultural innovation is continuing, including in digital technologies, though technology also has its challenges in regional areas due to difficulties with access.

On top of this structural change, conditions in the agricultural sector also tend to be more volatile than other industries, largely due to its dependence on weather. The past few years have been relatively favourable for agriculture in many regions – particularly in crop-producing areas – with high global prices and record high production volumes following above-average rainfall (Graph 7). Over the past year, prices have come down a little and production is forecast to have declined somewhat, but both prices and production are expected to remain at high levels in coming years, which would be good news if it eventuates. But of course, the future is uncertain. Increasing volatility in our weather patterns and rising temperatures over time pose challenges for farmers and will be disruptive for all communities.

Graph 7

Total Farm Output Volumes*



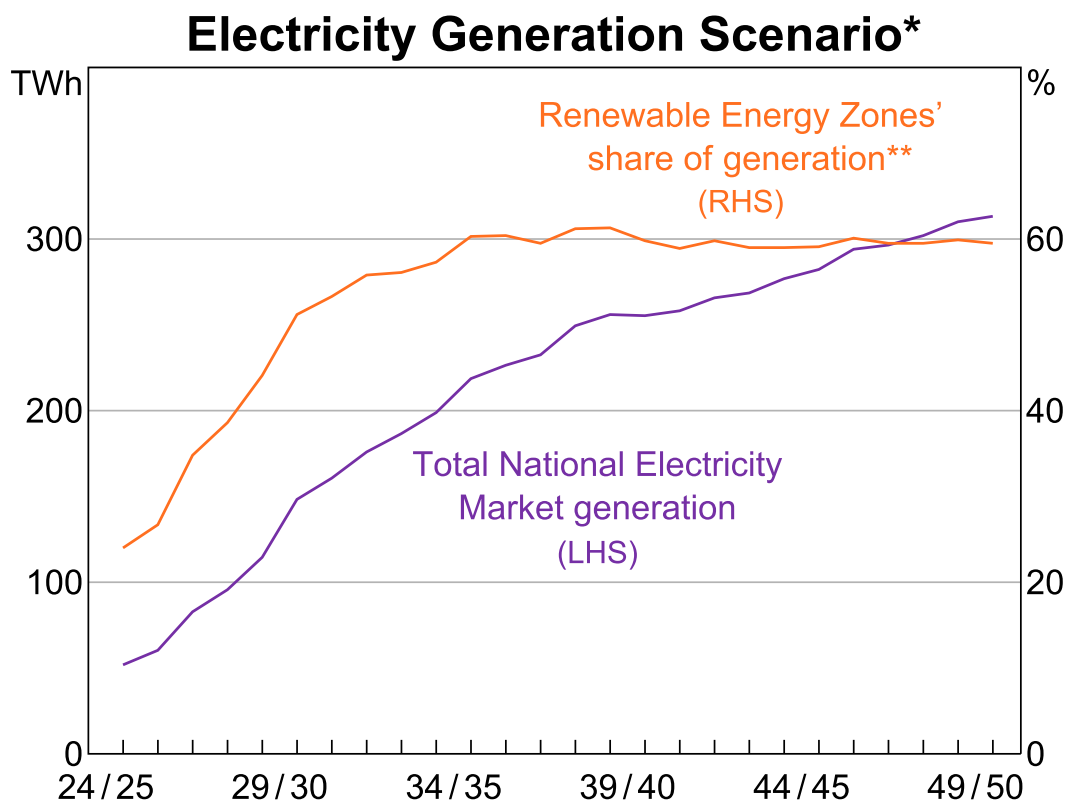
* Farm production volumes referenced to 2023/24 gross value of production.

Sources: ABARES; RBA.

Looking ahead, the changes that are made to mitigate the risks posed by climate change will lead to even more structural changes in our economy, including in our regions. The shift towards renewable energy sources and commitments to reduce carbon emissions mean the share of coal-driven electricity could halve over the next 10 or so years. [\[4\]](#) At the same time, demand for electricity is expected to grow significantly over coming decades alongside economic growth and the electrification of transport and industrial activities. Taken together, this suggests the need for greater investment in new energy generation capacity, storage and transmission.

Regional Australia will play a critical role in this transition, with the majority of utility-scale solar and wind capacity for electricity generation over coming years expected to be installed in 'Renewable Energy Zones' (REZs). These zones may be responsible for around half of National Energy Market generation over coming decades (Graph 8). It is likely that Renewable Energy Zones will be primarily located in regional areas.

Graph 8



* Graph shows the 2024 Integrated System Plan, Step Change scenario – optimal development path – CDP14, National Electricity Market, as-generated generation; a range of other outcomes are possible.

** Projected Renewable Energy Zones' collective share of total terawatt hours (TWh).

Sources: AEMO; RBA.

This will present many challenges, but installing this capacity, and the infrastructure to support it, will ultimately increase investment in regional communities. This investment should bring with it significant economic benefits, including jobs and new income streams for landholders hosting this infrastructure. Of course, these types of changes affect communities in a range of ways and different communities will follow different paths. But there are certainly opportunities here, and some good reasons for optimism about the future of many of our regions.

Conclusion

The RBA sets monetary policy for the Australian economy as a whole and we have only one tool – the interest rate – to achieve our objectives. We are aware, however, that conditions vary across the country. Regional Australia contributes greatly to the Australian economy and so understanding the economic challenges and trends in the regions is essential to the work we do at the RBA. I hope today I have provided some insight into how we are considering the regions in our analysis of the economy.

Thank you for your attention and I am happy to take your questions.

Endnotes

- [*] Thank you to Michelle Wright, Fiona Price and Kate McLoughlin for excellent assistance with this speech.
- [1] For more information of the Regional and Industry Analysis team, see Dwyer J, K McLoughlin and A Walker (2022), [‘The Reserve Bank’s Liaison Program Turns 21’](#), *RBA Bulletin*, September 2022.
- [2] Regional Australia is defined as ‘Rest of State’ spatial regions under the Australian Statistical Geography Standard (ASGS). For information on economic output estimates by region, see Department of Infrastructure, Transport, Regional Development, Communications and the Arts (2024), [‘Experimental Gross Regional Product Estimates’](#), Australian Government.
- [3] Hunter S (2024), [‘Housing Market Cycles and Fundamentals’](#), Speech at the REIA Centennial Congress, Hobart, 16 May.
- [4] Australian Energy Market Operator (2024), [‘2024 Integrated System Plan’](#).

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