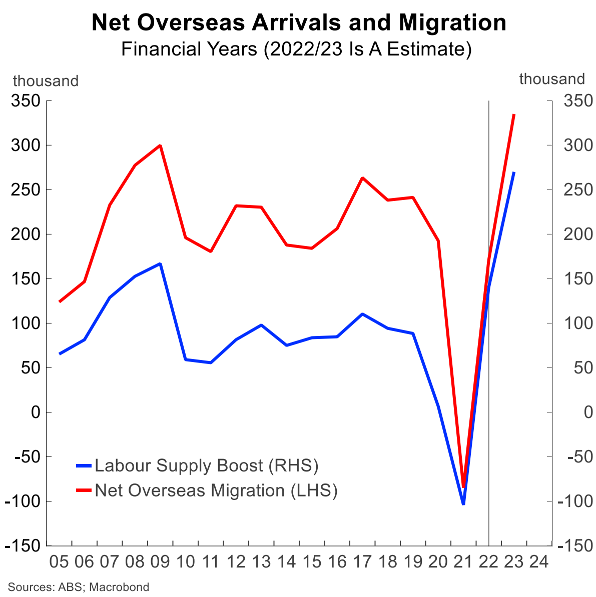
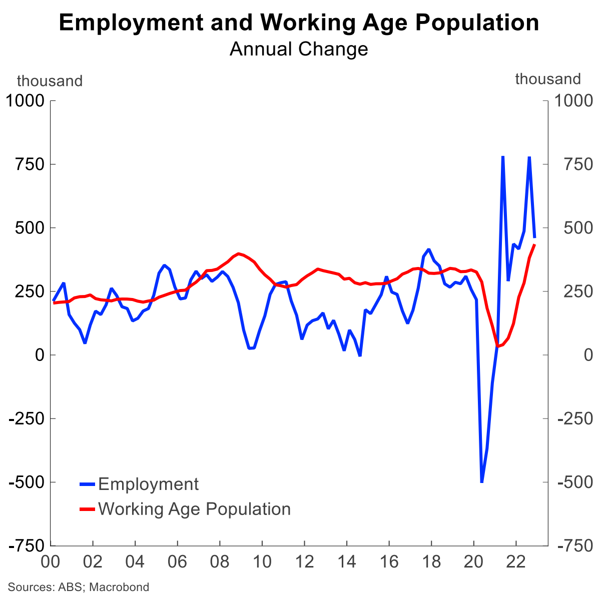
Friday, 3 February 2023

Population Insights

Arrivals Helping Release The Pressure Valve

- **Net overseas arrivals in the visa categories that add to Australia's labour supply are increasing at a record pace. The labour supply boost from these categories is likely to be 270k in 2022-23, 100k more than the previous peak of 167k recorded in 2008-09.**
- **The mix of arrivals is just as important as the levels. The boost comes from net arrivals on work visas, skilled visas, and student visas. This includes sponsored individuals who are filling skills shortages, often in regional areas, and students, who are adding supply to industries with acute shortages, such as hospitality and admin services.**
- **The boost to labour supply will act as a pressure relief valve for a labour market that is extremely tight. Measures of labour market tightness such as the employment-to-population ratio and the unemployment rate could ease by up to 0.5 percentage points. Further, up to 0.2 percentage points could be sliced from services inflation. More importantly, it will reduce the risk of unsustainable wages growth and the possibility of an economic hard landing.**
- **The softening in economic conditions will not necessarily result from people losing jobs, rather labour demand not keeping pace with the boost to labour supply. In the second half of 2022, labour supply accelerated while demand started to wane, a dynamic which is likely to continue.**
- **Arrivals will not only expand labour supply. They also add to demand for goods and services. This makes the net impact on services inflation complicated. But we expect supply-side impacts to dominate given labour demand is already slowing, the arrival mix directly increases labour supply and arrivals tend to spend less and save more than residents.**
- **The labour supply boost will also translate to higher net overseas migration. In our view, net overseas migration will be at least 100k higher than the current Federal Budget forecast of 235k.**





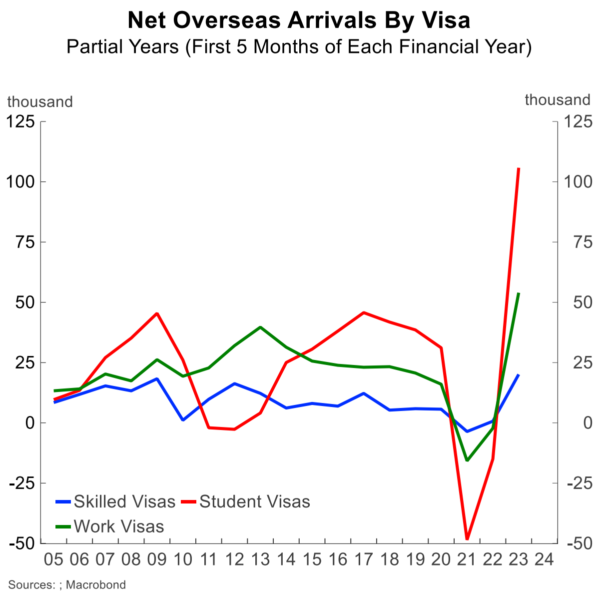
Net overseas arrivals

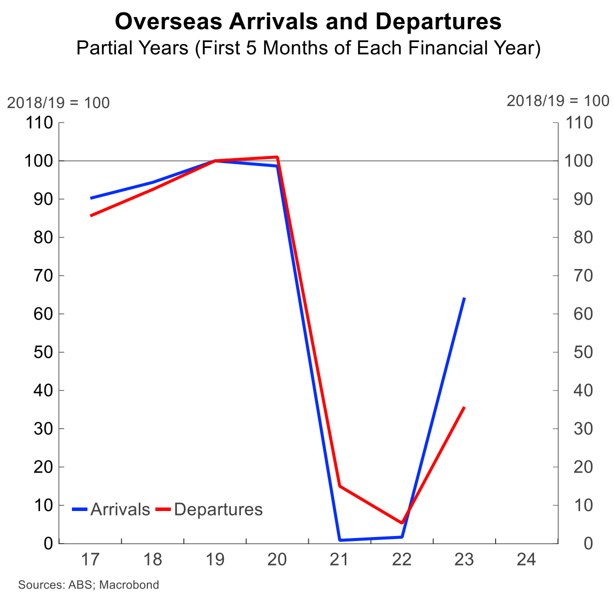
Net overseas arrivals in the visa categories that add to Australia's labour supply, including temporary skilled visas, temporary work visas and temporary student visas, are all increasing at a record pace. Over the first five months of the 2022-23 financial year there was a labour supply boost from the total of these visa categories of 180k – the highest on record.

Forward indicators of arrivals point to continued strength. The number of rent searches from overseas property seekers increased by 65% in 2022 and were 20% higher than the pre-pandemic level in 2019. The number of buy searches increased by 10% in 2022 and were 11% higher than 2019. There is also likely to be an influx of Chinese students who were studying in Australia remotely. The Chinese Government recently announced that they will no longer recognise certificates/degrees earned through distance education.

Based on current trends and forward indicators, the boost to labour supply could amount to 270k in 2022-23. That is 100k more than the previous peak of 167k recorded in 2008-09.

Arrivals data shows that most of these temporary workers are going to the states on the east coast. While arrival numbers have staged an impressive come back, a slower pickup in departure numbers is also contributing to the net increase in labour supply. The significant economic headwinds hitting the UK, Europe and US may be putting some Australians off relocating.





Net overseas migration

The Federal Treasurer on 16 January flagged there was "significant upside risk" to net overseas migration (NOM) estimates. NOM is the net addition to the domestic population from people and families relocating across international borders. To be included in NOM, individuals must have arrived and lived in Australia for at least 12 of the previous 16 consecutive months (i.e. the "12/16 rule").

During the COVID-19 pandemic, NOM declined by 85k in 2020-21. This was the first annual decline since WWII. NOM recovered in 2021-22, growing by an estimated 170k. Based on this recovery, the Government upgraded its expectation for NOM in 2022-23 to 235k from 185k – an increase of 50k. This is equivalent to the average annual NOM before the onset of the COVID-19 pandemic.

Individuals arriving with visa categories that add to Australia's labour supply contribute the most to NOM. Working visa classes are often sponsored and have jobs waiting in Australia when they arrive. University students usually stay for extended periods of time to finish degrees, train, and gain experience. Currently, students have no restrictions on the number of hours they can work, a COVID-19 measures which has been extended to the end of June 2023.

Before this financial year, 2008-09 marked the largest increase in visa categories. In that year, net temporary arrivals amounted to around 160k over the full financial year and NOM increased by almost 300k, a historic high.

If net arrivals continue at their current pace, based on previous trends, NOM could be 100k higher than the official Budget estimate of 235k in 2022-23.

What does all this mean?

With a current unemployment rate near a 50-year low of 3.5%, the labour market is extremely tight. This has meant that skill shortages remain public enemy number one for businesses of all sizes.

The lack of arrivals when international borders were shut during the COVID-19 pandemic has meant that Australia's population is lower today than would otherwise be the case. Border restrictions meant that international students who work part time in hospitality, backpackers who typically work in regional areas, and young families and professionals wanting to call Australia home were unable to relocate.

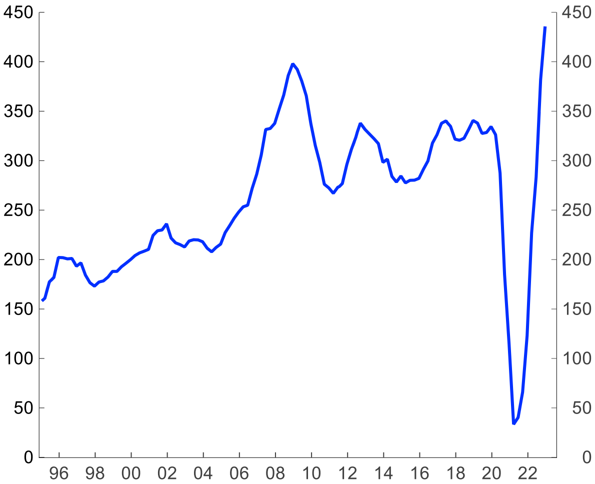
Along with strength in demand across the economy and the unprecedented level of support provided by governments and the Reserve Bank, border restrictions contributed to the tightness of the labour market and the skills shortages we are currently experiencing.

The boost to labour supply from the surge in arrivals will act as a pressure relief valve for the labour market, helping fill the huge backlog of vacant positions in the economy.

Temporary workers and migrants are usually of working age when they come to Australia. They also tend to be skilled, which is often a requirement to migrate under certain visa categories. Therefore, as the flow of these migrants return to Australia, they will help address skills shortages and reduce the risk of unsustainable wages growth.

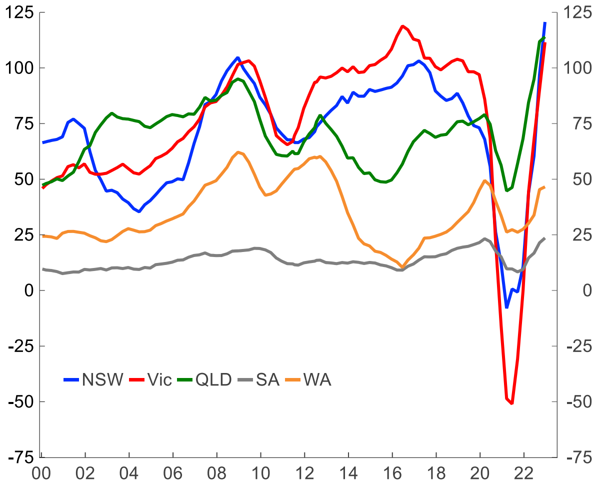
We have already seen the increase net overseas arrivals flow through to the working age population. In 2022, Australia's working age population increased by a record 435k. Growth accelerated throughout the year, with the working age population increasing by around 230k in the second half of the calendar year, compared with around 200k in the first half. Record increases were recorded in NSW, Victoria, Queensland, and South Australia. Changes in net internal migration patterns also contributed to these shifts.

Working Age Population
Annual Change



Sources: ABS; Macrobond

Working Age Population
Annual Change By State



Sources: ABS; Macrobond

Implications for the labour market and wages growth

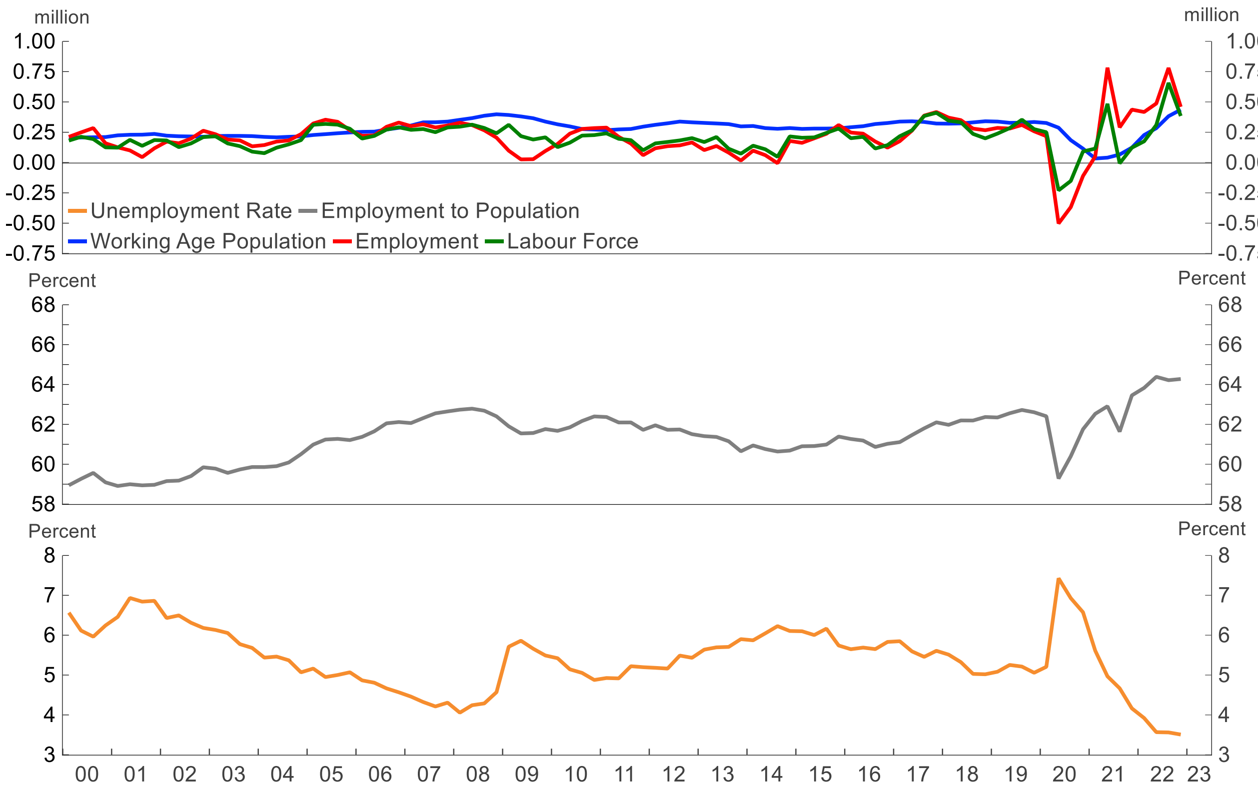
Looking at the chart below, when the working age population (blue line) increases faster than employment (red line), the employment-to-population ratio (grey line) declines. This ratio measures the share of working age people who are employed.

Australia's employment-to-population ratio is currently at a historic high, meaning more Australians than usual are currently in jobs. Another way to look at this is that Australia currently has the lowest capacity on record to fill skills shortages with our existing population.

A truly remarkable feature of the Australian economy is that strong economic conditions have induced a powerful labour market response – thousands of people who were previously unemployed have the opportunity to find suitable and rewarding work. In other advanced economies like the US and the UK, the employment-to-population ratio is yet to recover even to pre pandemic levels.

The pick up in net overseas arrivals and working age population (blue line) also translates into a bigger labour force (green line). When the labour force increases faster than employment (red line), the unemployment rate increases (orange line). This does not necessarily mean people lose their jobs, rather demand cannot accommodate for the increase in labour supply. Recently, employment has been growing faster than the labour force and, as a result, we have seen the unemployment rate fall to a near 50-year low.

Population and Labour Market Indicators
Annual Change and Percent

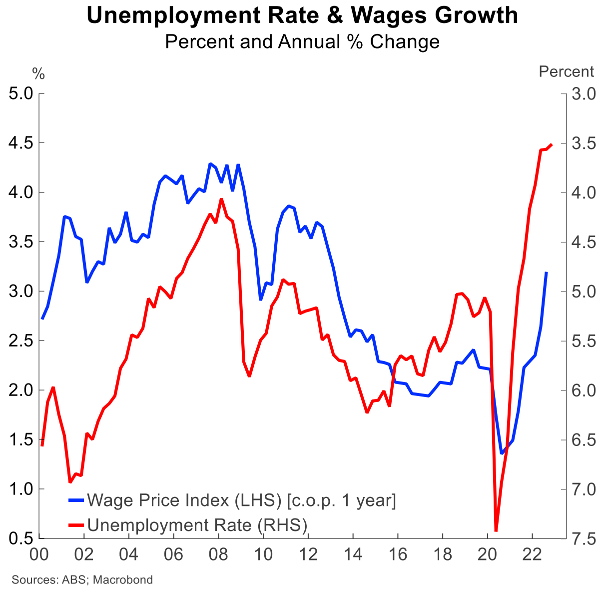


Sources: ABS; Macrobond

An increase in net overseas arrivals will, therefore, lead to an increase in the "potential" labour supply businesses can draw on to meet skills shortages. In certain instances, for example, following the GFC, strong migration inflows also pushed unemployment higher. This was because, in net terms, jobs growth was not strong enough to fully accommodate the rise in the labour force.

An increase in labour supply from greater migration will also help reduce the risk of unsustainable wages growth. Where there's enough supply to meet demand, there is less need for employers to offer unsustainably high wages.

The chart below shows there is a strong link between both the employment to population, unemployment rate and wages growth as measured by the wage price index (WPI).



Policy implications - Perhaps the economy doesn't need to slow as much to get inflation down.

Goods inflation is retreating globally. While energy prices and certain commodities remain elevated, they are no longer accelerating. Supply-chain disruptions are improving. Freight costs are coming down. Delivery times are being slashed. In the US, goods inflation has fallen in five of the last six months.

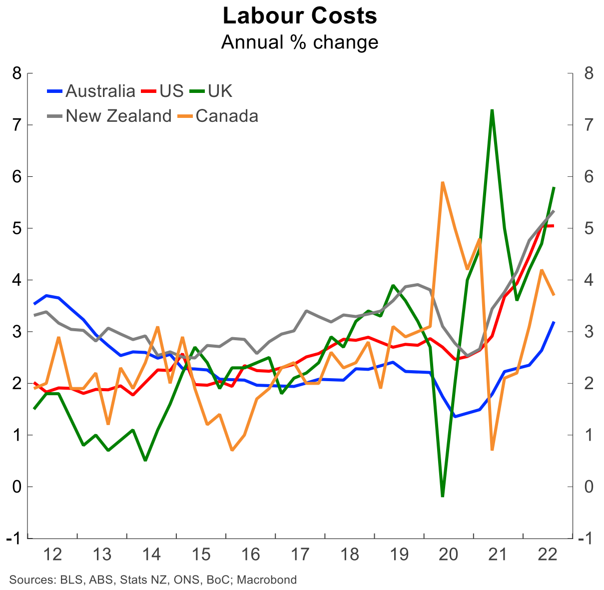
Central banks around the world and our Reserve Bank (RBA) are now focused on the much "stickier" services inflation. Services (for example, haircuts, music lessons, education) are labour intensive and are, therefore, sensitive to wages outcomes. Tight labour markets coupled with still robust demand mean there's a risk wages grow at unsustainable rates, or at rates that are inconsistent with the inflation target. If this occurs, the only way to get inflation out of the system is by engineering a harder landing – that is, reducing demand in a significant manner to cause unemployment to rise.

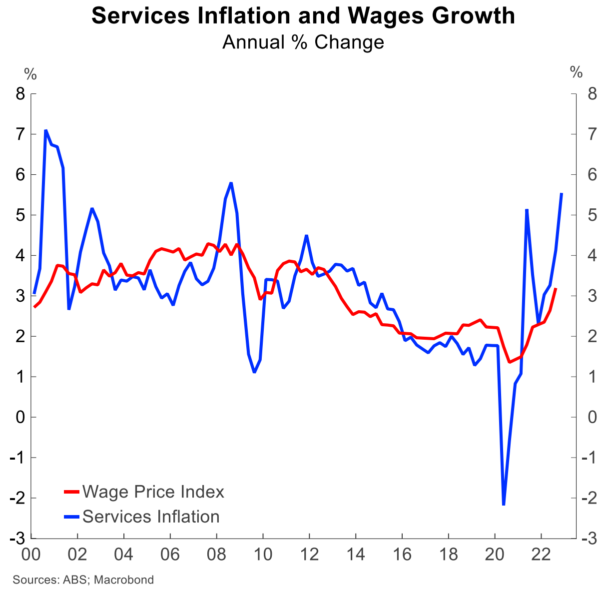
In Australia, services inflation accelerated in the December quarter 2022 to reach 5.5% in annual terms, the highest since 2008. A lot of this was driven by hospitality, including air travel and accommodation. More generally, Australia has avoided wages growth of 5% or 6% that are entrenched in other comparable countries. This could be due to several reasons. First, higher participation in the labour force supported labour supply while borders where closed. Second, there's inertia in our wage fixing system. And third, higher net overseas arrivals are now boosting labour supply.

Higher arrivals and population growth may very well be the pressure relief valve for Australia's labour market. It may mean that we can keep wages growth in check without having to engineer a hard landing. While we have managed to avoid unsustainable wage growth to date, it remains an open question whether this can continue.

Our forecasts have wages growing by 4.5% this calendar year before drifting down to the RBA's "steady state" growth rate of 3.5%.

The boost to labour supply will unload some pressure from a labour market that is extremely tight. In our view, measures of labour market tightness such as the employment-to-population ratio and the unemployment rate could ease by up to 0.5 percentage points from the boost in arrivals. Further, around 0.2 percentage points could be sliced from services inflation. More importantly, it will reduce the risk of unsustainable wages growth and the need for a hard landing.





What about the demand side?

Arrivals will not only expand the supply side of the economy, they also add to demand for goods and services. A larger working age population needs to be accommodated. This means more infrastructure will be required and higher expenditure on public services – such as health and education. The housing stock will also need to grow to accommodate the larger population. Advertised rents have been growing strongly and may continue to grow without an increase in housing supply.

However, the balance of all of these factors is important.

We expect the supply-side impacts of higher arrivals to dominate in the short run given:

- Labour demand is already showing signs of slowing.
- The arrival mix is skewed to those that directly increase labour supply –including people on work and skilled visas, and students who tend to work part time. This could differ if the arrival mix was more skewed to families and children who are likely to add to demand without adding to supply.
- Net overseas arrivals tend to spend less and save more than residents as they are more likely to pay remittances and, at least initially, do not have income support payments to fall back on if their circumstances change.

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