ECONOMIC UPDATE

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WEEK ENDING 2ND JULY 2021

BOQ GROUP

Summary

- Population growth has been a key driver of Australia's economy for the past few years;
- But it has slowed dramatically over the past year, mainly because of lower immigration;
- The slowing in population growth has been particularly marked in Victoria;
- One trend has been the fall in the number of people leaving regional areas to go to capital cities;
- Australia's population is projected to be lower than previously anticipated;
- But history suggests that there is big uncertainty about long-run population forecasts.

In recent years Australia has enjoyed very strong population growth. It has been an important economic driver. The majority of that population growth has been immigration. On average immigrants have a lower age than the average Australian (37). This has meant that an aging population has been a less pressing issue over the past decade.

Unsurprisingly given the national story, population growth was low in all states and territories. Overall, growth was strongest in Queensland and WA, and very weak in Victoria. WA and Queensland benefitted last year from inter-state migration. NSW typically suffers from an outflow to the other states. But this was not the case last year.

The very strong population growth in Victoria over recent years led to Melbourne becoming the most populous city in Australia by mid-2020. But given what happened last year, Sydney is likely to reclaim the crown as being Australia's most populous city next year.

The general narrative is that over the past year there has been a trend of people leaving cities to go to regional areas. The actual story is more complicated. For example, Sydney experienced a big fall in the number of people arriving from interstate but there was an even bigger decline in the number of people leaving Sydney to go to other states. There was also an increase in the number of people leaving Sydney to go to other parts of NSW. But the even bigger shift was that there was less people from regional NSW moving to Sydney.

A resumption of immigration growth back to pre-COVID rates will be necessary to achieve a stronger economy. More important will be a return to higher productivity growth. Here there are good signs, not the least the current massive increase in capex spending by firms.

Population growth will be at its slowest in over 100 years

Over time, population and productivity growth are the two main drivers of getting higher national income. Stronger population growth both boosts the demand in the economy (more houses, cars, shoes) and increases supply (more workers). By becoming bigger an economy with scale that can better absorb the buffeting that can happen in a turbulent global economy. But there are downsides (more traffic).

The population news over the past few months has been disappointing. First, we got the news that population growth last year was at its slowest pace in the history of quarterly data (about forty years). With international borders still (largely) shut that means that population growth will remain slow this year. And that would mean population growth this financial year will beat its slowest pace since World War I.

And then we find in the recent Federal Budget an 'assumption' that international borders are unlikely to open until mid-2022, with Pre-COVID numbers only returning by mid-2024. I have no problem with the Federal Treasury assumption. On current pace we are unlikely to reach required vaccination rates until early next year (although there are moves to try and speed up the process). Most opinion polls suggest that governments' will not feel much political heat to open up on a quicker timetable. But it does mean that population growth will be very low for the next 2-3 years.

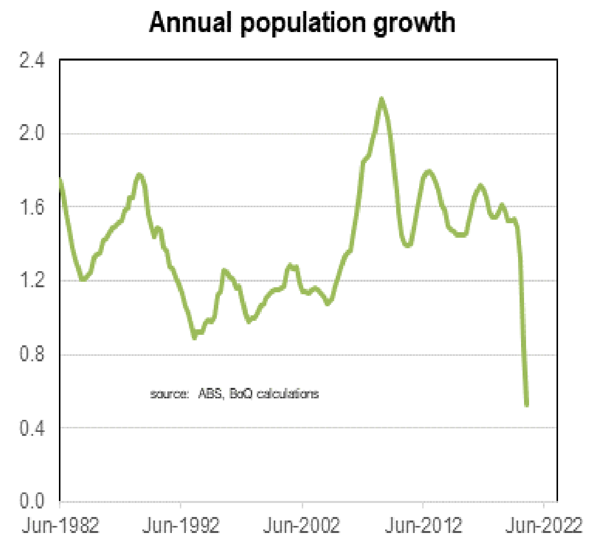
There has also been the news in the recent Intergenerational Report that Australia's population will be a bit under 40m by 2060. That is clearly a bigger population that we have today (a bit over 25m). But it is lower than Treasury had been forecasting. Six years ago Treasury thought we might have 40m people by the mid 2050's.

The change also highlights the problem with any long-range forecast. In the first Intergenerational Report released in 2002 Treasury assumed that the population would hit 25m in the late 2030's. That report was full of doom and gloom about the problems of an aging population for the economy and government budgets. By the time of the 2015 Report, we had not only almost hit 25m but we were in the midst of the biggest population boom since the post Second World War.

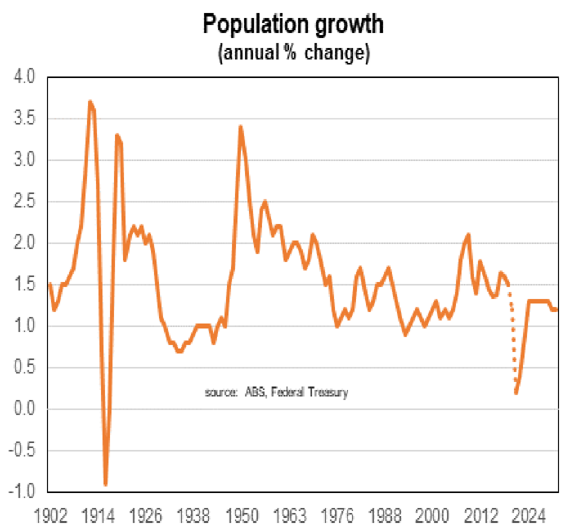
The lesson then is that even something as relatively slow moving as population growth is difficult to forecast too many years into the future. The low forecast made in 2002 followed a decade (for Australia) of modest population growth. Just as the forecast made in the 2015 Report came in the midst of a population boom.

Population growth will almost certainly be low over the next couple of years. A bigger economy will require the existing population to buy more, or to become more productive. Given the amount of fiscal and monetary stimulus in the system that should not be a problem. Thereafter, Australia's population growth will be stronger. But there is a good chance that population growth will not return back to the pace seen 2005-20.

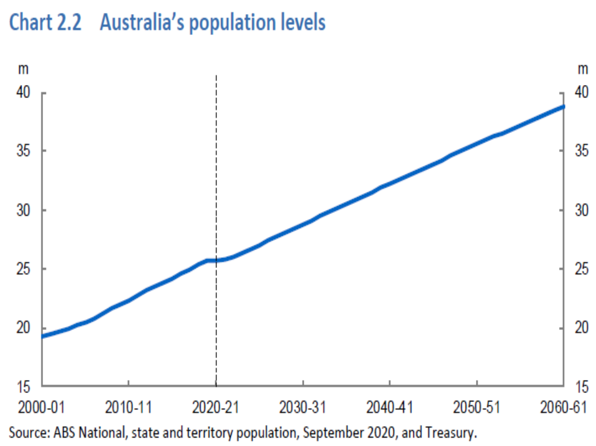
The population growth rate has plunged.



It is projected to rise again, albeit unlikely to hit the pace seen in the years' pre-COVID.

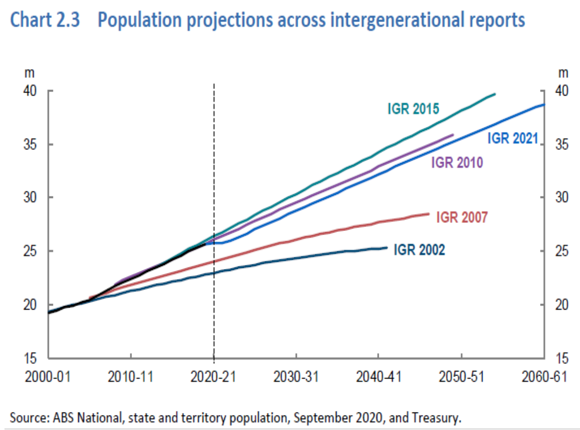


A slower population growth rate still means a higher population.



Source: Intergenerational Report 2021

Long-term population forecasts still need to be taken with a grain of salt.



Source: Intergenerational Report 2021

Immigration is the main factor driving the slowing in population growth

The main reason for the dramatic slowing of population growth has been the closure of the international border. Net migration comprised over 60% of population growth over the past decade. But in 2020 the total number of immigrants had almost halved from the previous year. Less international students is part of the reason although a good portion of those would have already been in Australia by the time the borders shut in March.

Clients often ask me about the impact of citizens returning to Australia, and particularly what this meant for house prices. Bankers and lawyers returning from overseas jobs are counted as immigrants. As noted, the total amount of immigrants fell sharply last year. Certainly it is possible that the composition of immigration has changed and this has had some impact on the housing market. Returning bankers and lawyers are more likely to influence high-end house prices in the suburbs and coastal regions (such as Byron Bay). By contrast, international holidaymakers are more likely to want to stay in an inner-city apartment. The closure of international borders did see less emigration (people wanting to leave Australia).

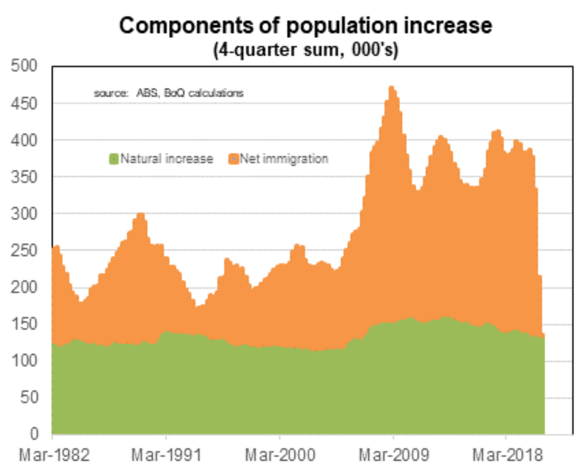
The dramatic fall of immigration as a result of the impact of the pandemic was also a factor behind the downwardly revised population forecast. But an even more important factor was the lower projected annual immigration intake over the forecast period. After rising following the end of the pandemic, Treasury assumed that the annual number of immigrants does not change. The result is that the percentage increase in population falls (eg, 200,000 is a bigger percentage for a 20m population than 40m). Maybe that will turn out to be right. A lot of factors drive immigration flows (government policy, relative economic performance, geopolitical tensions). But a decreasing percentage increase of immigration over a number of decades has been inconsistent with Australia's economic history over the past 120 years.

But so was the slowing in the 'natural' rate of population growth

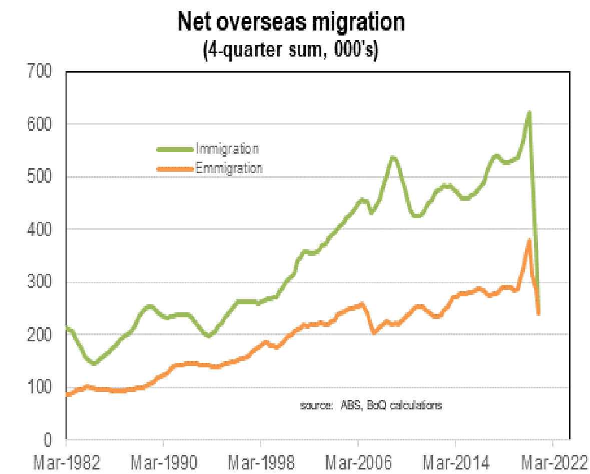
A decline in the 'natural rise' (births minus deaths) was another factor behind the dramatic slowing in population growth last year. The good news is that even though we are in the worst pandemic in a century there was no notable increase in the death rate. But there has been a clear slowing in the birth rate. Some have suggested that reflected the economic uncertainty associated with the pandemic. But it is too early to know what impact COVID might have on birth rates. The most recent data is from December quarter and the impact of the pandemic only become clear in March.

The shutting of state borders for big parts of last year also led to a dramatic slowing of inter-state migration. By some measures the population is not as mobile between states as it was back in the 1980s and 1990s. Mostly that can be explained by the very high rate of immigration (new arrivals are less likely to be moving interstate). The number of people moving interstate has been broadly unchanged (at around 350,000-400,000 per year).

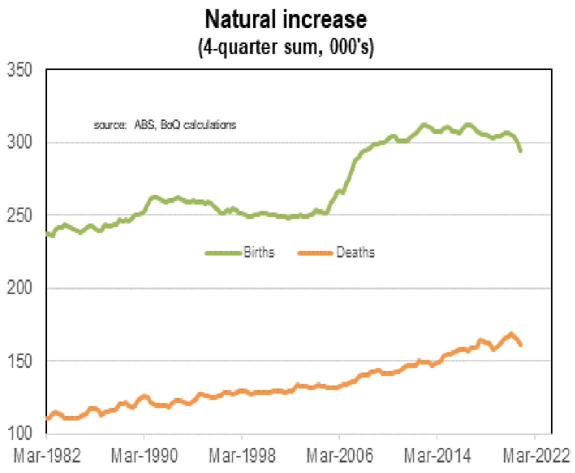
The slowing of immigration was the biggest driver in slowing population growth.



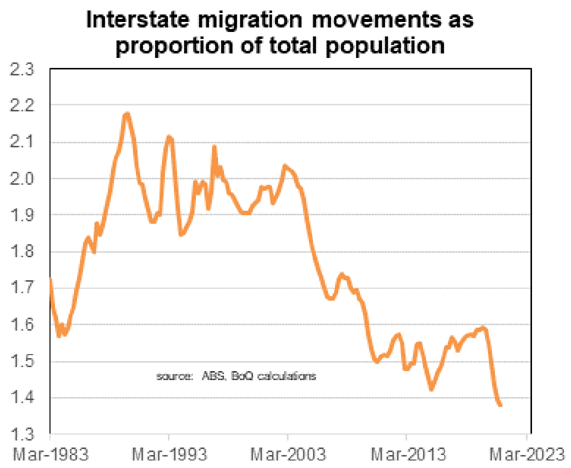
The number of emigrants fell, but the number of immigrants fell even more.



There was also a drop in the birth rate last year.



As well as migration between states.

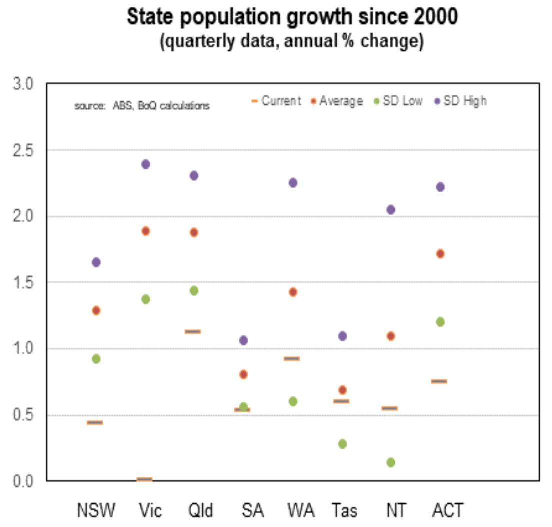


Unsurprisingly given the national story population growth was low in all states and territories. For the three eastern States and the ACT population growth last year was the lowest for at least forty years.

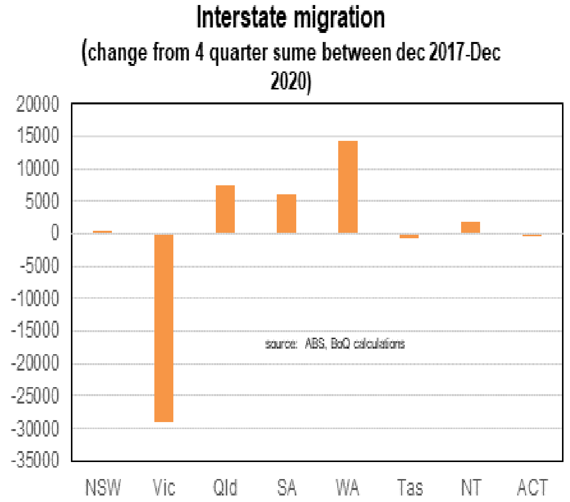
Overall, growth was strongest in Queensland and WA, and very weak in Victoria. WA and Queensland benefitted last year from inter-state migration. NSW typically suffers from an outflow to the other states. But this was not the case last year likely reflecting the closed state borders. But that didn't help Victoria that suffered a significant loss of population to other states (Tasmania and the ACT also had a net loss).

Net immigration rates were down significantly for all state and territories. The biggest inflow was to NSW, with small rises also recorded in WA and SA. Again Victoria suffered the biggest outflow. The rise in natural population was broadly unchanged in NSW last year, although it fell in most other states and territories.

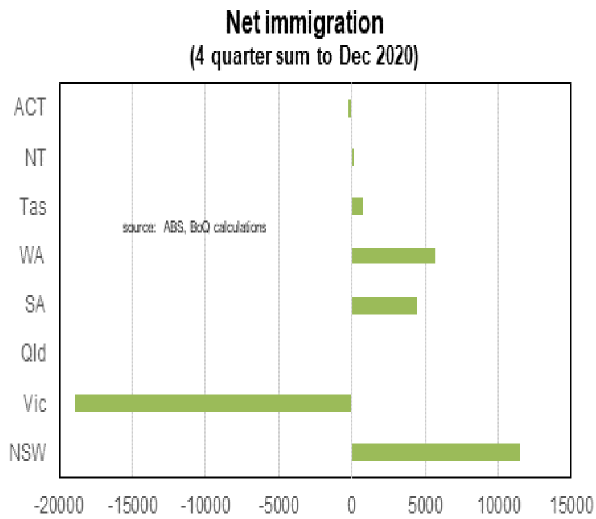
Population growth last year was low in all states and territories, particularly the mainland eastern ones.



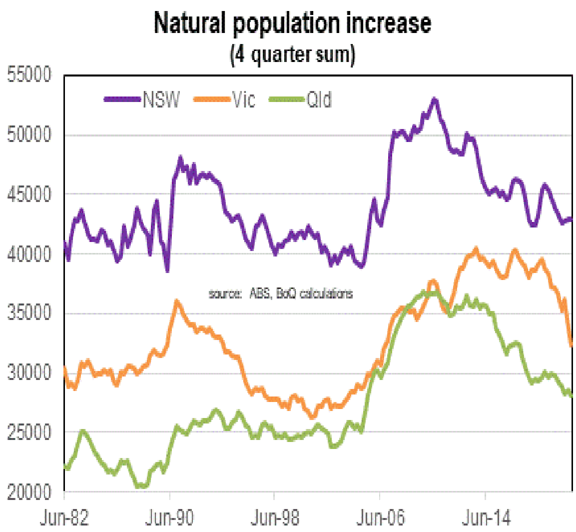
There was a significant outflow of people from Victoria, while WA, Qld and SA all received inflows.



Lower immigration had the most significant impact in Victoria.



The natural increase was broadly unchanged in NSW, but fell in the other large eastern states.



The very strong population growth in Victoria over recent years led to Melbourne becoming the most populous city in Australia by mid-2020. But given what happened last year Sydney is likely to reclaim the crown as being Australia's most populous city next year.

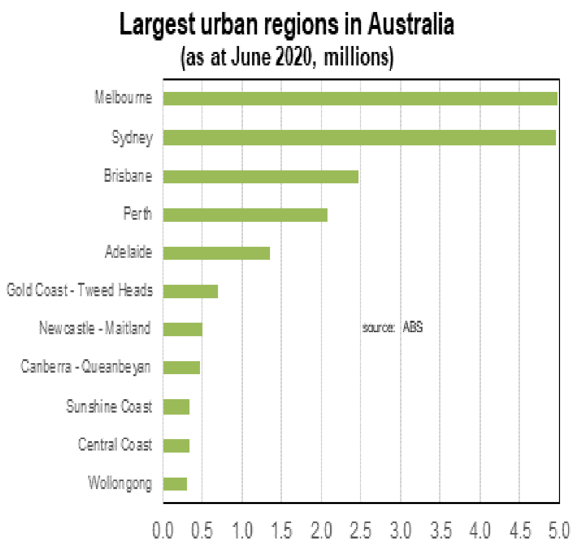
The fastest growing urban regions are rarely the largest cities (although the Gold Coast is often an exception). In recent years the fastest growing areas have been towns with good links to capital cities, have cheap housing and good amenities (such as Melton, Yanchep and Geelong). The strength of the iron ore industry last year is the reason behind the rapid growth of population in Karratha and Port Headland (as well as the need to be within the WA COVID bubble).

In most years there are always some towns that lose population, often because of a downturn in the local economy. Of the reasonable-sized urban centres in Australia, last year 18 experienced a population decline. With the exception of Darwin (that experienced a very weak economy post mining boom) most were regional centres.

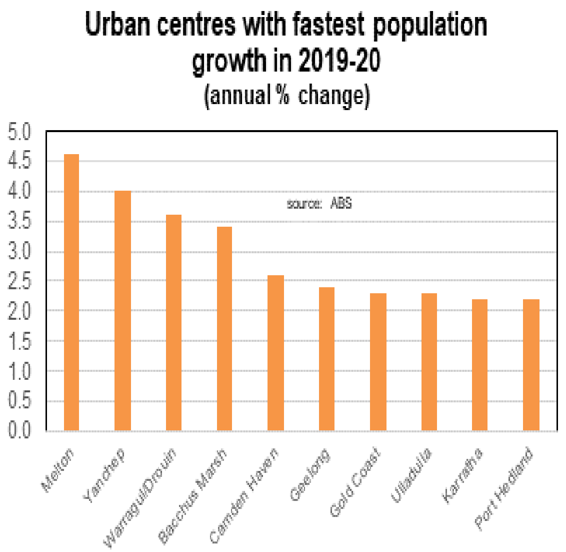
The general narrative is that over the past year there has been a trend of people leaving cities to go to regional areas. The actual story is more complicated. With state borders often closed, Sydney experienced a big fall in the number of people arriving from interstate but there was an even bigger decline in the number of people leaving Sydney to go to other states. Certainly there was an increase in the number of people leaving Sydney to go to other parts of NSW. But the even bigger shift was that there was less people from regional NSW moving to Sydney.

A similar pattern of population movement was also evident in Brisbane. The intrastate people movement between Melbourne and the rest of Victoria was broadly similar to what took place in NSW and Queensland. But there was a big drop in the number of people moving to Melbourne from interstate. And there was a notable rise in the number of people leaving Melbourne to move interstate.

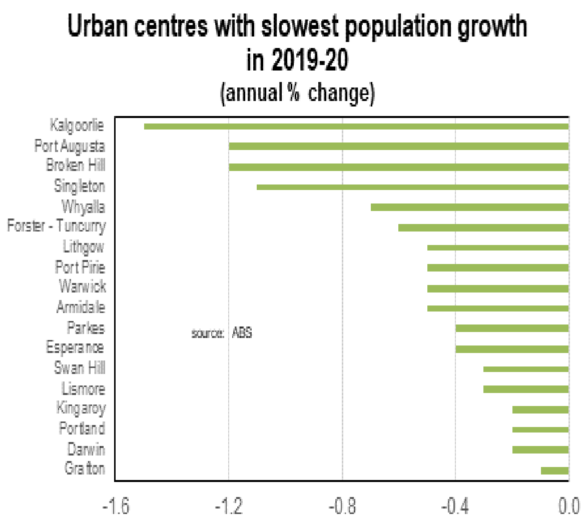
Last year Melbourne became the most populous city. But that is unlikely to be the case in 2021.



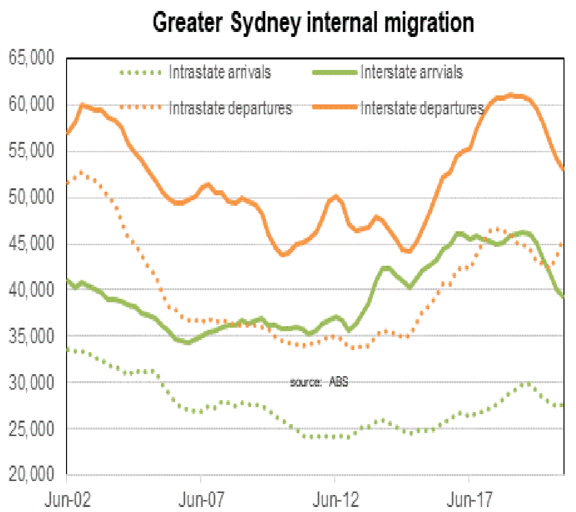
A number of regional towns close to capital cities saw the biggest population increase.



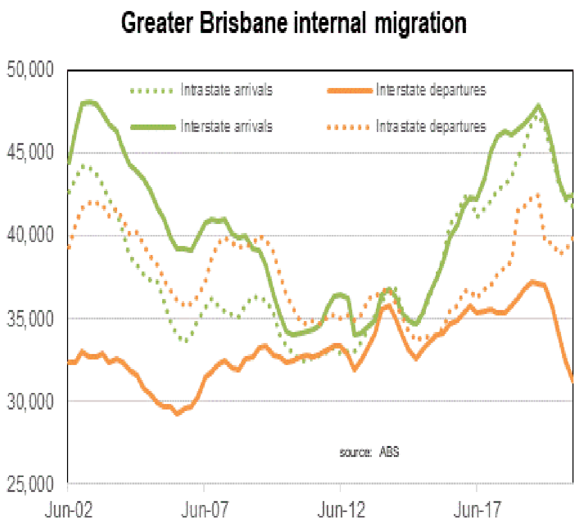
But a number of regional centres also experienced a population fall.



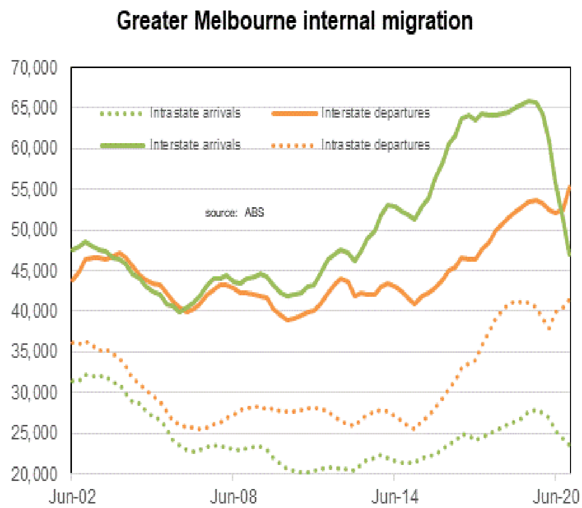
Less people moved to Sydney from the regions last year.



And that was also the case in Brisbane.



Melbourne not only saw less interstate arrivals they also experienced more interstate departures.



Implications

In recent years Australia has enjoyed very strong population growth. It has been an important economic driver (housing construction, infrastructure). The majority of that population growth has been immigration. On average immigrants have a lower age than the average Australian (37). This has meant that an aging population has been a less pressing issue over the past decade. But COVID will result in a 3-5 year 'hole' in the growth of population. The Intergenerational Report highlighted that Australia may have a lower, older population in the future. How much lower though is a matter for debate.

A resumption of immigration growth back to pre-COVID rates will be necessary to achieve a stronger economy. More important will be a return to higher productivity growth. Here there are some good signs, not the least the current massive increase in capex spending by firms.

We live in interesting times.

Regards,

Peter Munckton
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