ECONOSIGHTS

with Diana Mousina

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What is the impact of Australia's high population growth?

Key points

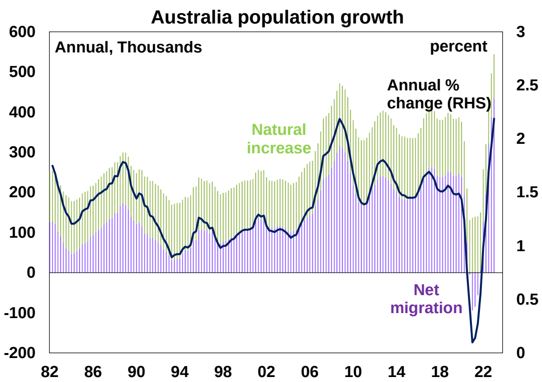
- Australia's population will increase by 2.5% over 2023, its highest rate since 1952 thanks to a record increase in immigration
- The bulk of the lift in immigration are for those on temporary student and work visas. Temporary visas are not included in the government's annual permanent migration level of 190,000 but add to demand for housing and consumer goods and services
- Running high immigration levels is an offset to an aging population as immigrants tend to be younger, which is positive for inflation in the long-run
- High population growth can mask underlying weakness in GDP growth per capita, which is a measure of living standards. Australia's per capita GDP growth has been negative since the start of 2023
- High population growth can also add to inflation at a time when the economy is running close to or above its potential, like it has been post-COVID
- Impacts to the society from high immigration include a more culturally diverse population but can also lead to congestion in infrastructure and schools

Introduction

There has been a lot of focus on the record high level of Australia's population growth in 2023 from the boom in immigration. We look at the impact of high population growth on the economy in this *Econosights.*

The backdrop

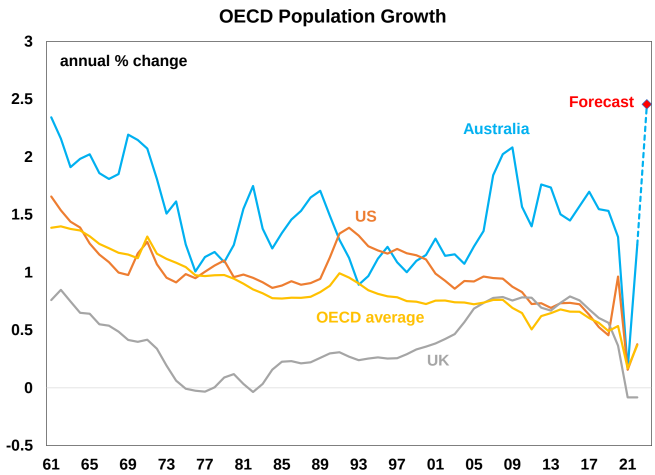
Australia started to run a high migration intake from 2005 which helped to reduce skills shortages as the mining boom got underway. Since that time, Australia's population growth has averaged around 1.6% per annum (excluding the pandemic - see the chart below).



Source: ABS, AMP

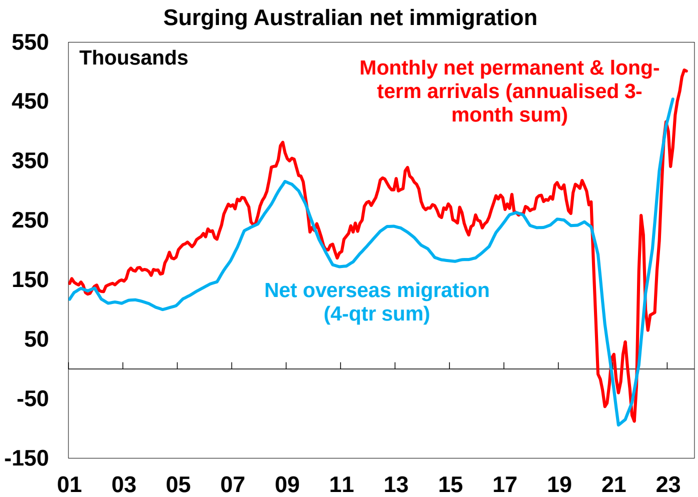
Prior to 2005, population growth was averaging at 1.2% per year.

This rate of population growth is well above the OECD average (see the chart below) and is forecast to be around 2.5% over 2023 – the highest level since the 1952.



Source: OECD, RBA, AMP

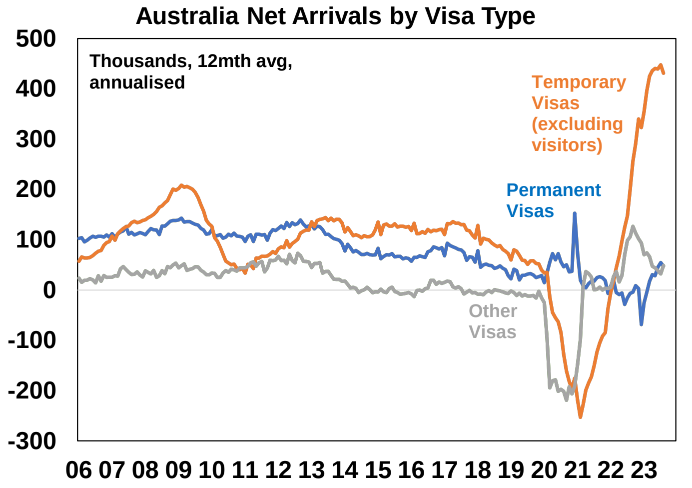
After net migration plunged during the pandemic, it has been playing catchup in 2023 with annual immigration (those arriving on permanent or long-term visas which are defined as those who stay for over 12 months) currently tracking at close to over 500K per year (see the chart below) which is a record high for Australia and well above the estimates in the May Federal budget of a 400,000 lift in overseas migration over 2022-23 and a 315,000 rise in 2023-24.



Source: ABS, AMP

If we break down the arrivals data further by visa type, we can see that a big increase in temporary visa arrivals has accounted for the bulk of the increase in net migration (see the chart below). We included temporary skilled, student, work and other visas as these groups tend to demand housing and add to consumer spending but excluded visitors who are usually tourists and only within the country for a short-time (less than 12 months).

This also explains why the government continues to run its annual permanent migration target level at around 190,000 persons per year – as those on temporary visas are not included in this cap.



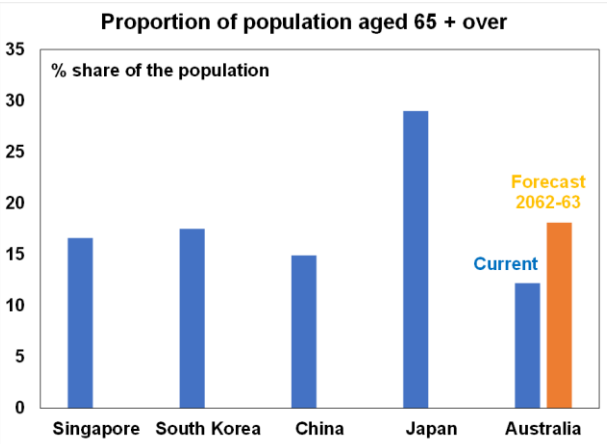
Source: Macrobond, AMP

The pace of net migration is unlikely to continue at its current rate because the increase in temporary arrivals reflects a catch-up after the pandemic. Treasury is forecasting net overseas migration to slow to around half of its recent pace, at 260,000 in 2024-25, 2025-26 and 2026-27 which is closer to its pre-COVID levels.

Given the recent strength in population growth, there is a risk that actual migration ends up higher than these estimates. There are impacts of high population growth on the economy both in the medium and the long-term.

High population growth is an offset to an aging population

Like many advanced economies, Australia's population is aging. Australia's "old age dependency ratio" (the number of people aged over 65 for every 100 people of working age between 15-64 years) will increase from its current level of 26.6% to 38.2% by 2063. Prior to the 1960's, it was under 15%. As a share of the population, those aged over 65 will increase from 12.2% of the population to 18.1% of the population by 2062-63 which is closer to the demographic profile of some of our neighbouring Asian economies that have older populations (see the chart below).

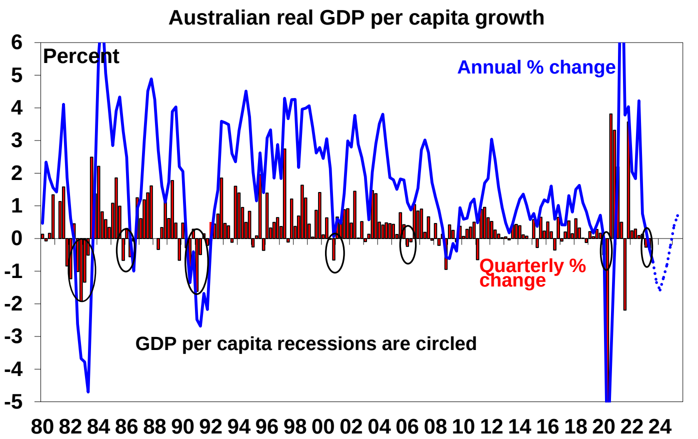


Source: Treasury, AMP

A higher ratio of older people, relative to the working age population puts downward pressure on national savings and tends to put upward pressure on inflation as spending increases but savings (from those working) grows at a slower pace. So there is a case to bring in younger workers, especially with needed skills to alleviate the pressure from an aging population.

The impact on living standards and inflation

High population growth adds to economic growth because as the population grows there is additional demand for consumer spending and housing. Currently, Australia's population growth is running above GDP growth which means that GDP growth per capita is declining, has been negative for at least two quarters (which technically indicates a "per capita recession") and on our forecasts will bottom at -1.6% year on year in early 2024 (see the chart below) before improving as population growth slows and GDP growth stabilises. This means that high population growth can mask the changes in real living standards via per capita GDP growth. The decline in Australian per capita GDP means that living standards are going backwards which also reflects cost of living pressures and high interest rates.



Source: ABS, AMP

Population growth adds to demand in the economy and supply (through the labour market). However, high population growth can boost inflation if it leads to an imbalance between demand and supply, especially in sectors where there is already tightness, like in housing, as is the case in Australia.

The impact on housing

We have previously written about the impact of high immigration on the housing market here. Demand for housing is running well above supply. Housing demand is tracking at around 220,000 per year but dwelling completions (which are indicative of housing supply) will be around 175,000 in 2023. Current building approvals which are a sign of future completions are running close to an annualised figure of 160,000 which means the outlook for housing supply remains very challenging, despite the government targets to lift housing supply. This housing shortfall will continue to add pressure to the already tight rental market which is clear in ultra-low vacancy rates and high rental growth.

Implications for investors

The lift in Australia's population growth in 2023 has surprised economic commentators and the government. High population growth has added to inflation in 2023 and the stronger-than-expected economic growth and the rebound in home prices. While the same pace of population growth is unlikely to be repeated in the next few years, the challenging inflation environment and the decline in Australian living standards from negative per capita GDP growth means there is a case for the government to assess its temporary visa intake.

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