Economic Intelligence – September 2022

Ai Group economic insights for Australian industry

In this month's edition:

- **Missing migrants and the labour market.** Our September deep dive looks at how Australia's border closure during COVID cut inwards migration and created crippling labour shortages.
- **Cresting the post-COVID wave.** Australian and global economic forecasts now predict slowing growth due to war, inflation, and China's COVID-zero policies.
- **Supply and demand.** Supply side constraints on Australian industry remain as tight as ever, whilst demand side indicators are beginning to show signs of weakness.

Deep dive – Australia's missing migrants?

Labour shortages are a top business challenge facing Australian industry today. Across all occupational classes – high and low skilled, professional and technical – employers simply cannot recruit and retain the staff they need.

According to ABS surveys, in June this year 31% of Australian businesses were unable to find suitable staff to fill jobs. Labour shortages were even worse in medium (62%) and large (66%) businesses. Despite the economic headwinds currently facing Australia, our labour markets have not been this tight for over a generation.

And there is a simple explanation – a missing batch of migrants that were unable to arrive during the pandemic.

Australia is a migration-driven economy. In the decade to 2019, Australia attracted an average of 215,000 net new migrants per year, of which two thirds entered employment. With a national labour force of around 13 million people, migration offers an approximate 1.0% infusion of new workers each year.

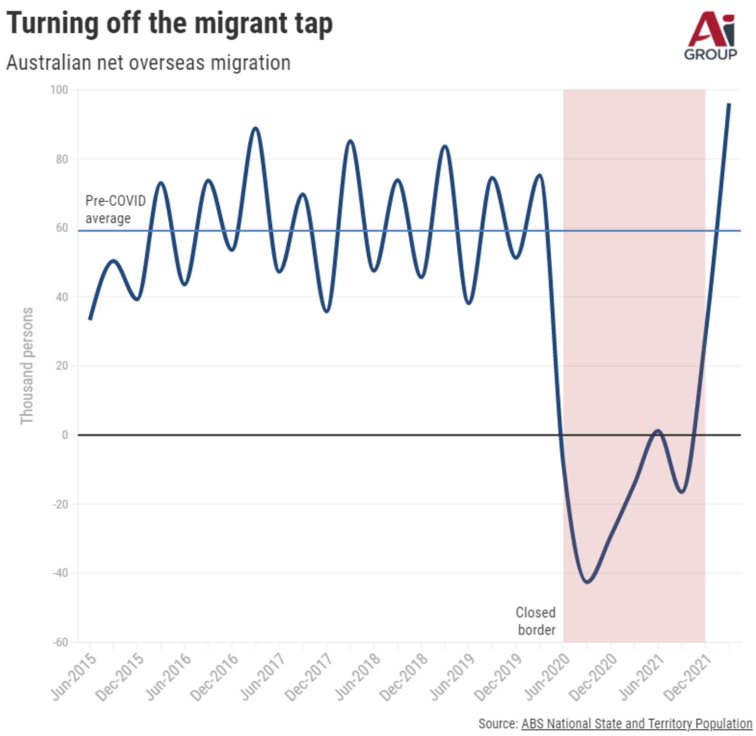
However, the pandemic temporarily cut this critical labour supply. To stop the intrusion of COVID, Australia closed its international border for 23 months between March 2020 and February 2022.

But very few new migrants were able to enter the country, while many temporary migrants already in Australia chose to return home.

As a result, Australia's net overseas migration (or NOM) turned negative in the second quarter of 2020 (see right).

This was historically unprecedented, as it was the first time Australia has experienced a net outflow of people since 1947. The NOM remained negative until early 2022 and is only now returning to normal levels.

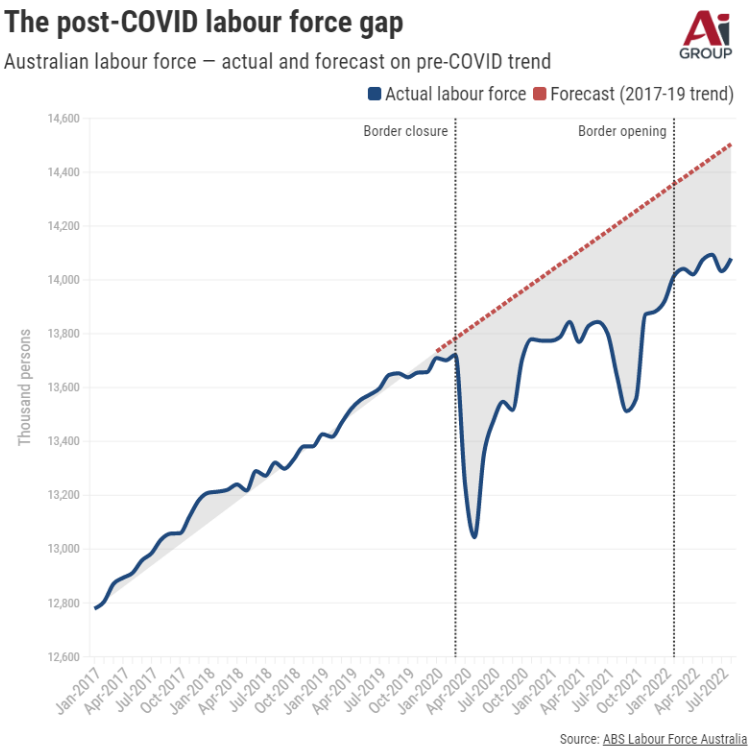
Australia lost two years' worth of new migrants – around 400,000 people – due to border closures.



These missing migrants are now wreaking havoc with Australia's labour markets. Migrants play a critical role in supplementing the national labour supply, because:

- 68% of new migrants immediately enter employment. With a median age of 26, they also stay in the workforce for several decades.
- 69% of migrants hold a tertiary qualification at their time of arrival, and another 35% obtain a tertiary qualification after arriving. For migrants arriving on a skilled visa, the tertiary qualification rate is an impressive 86%.
- A higher proportion of recent migrants (70%) are in the workforce than people born in Australia (65%). Recent migrants are also more likely to be employed full-time (76% vs 68%).

New Ai Group economic analysis (right) shows the impact of the closed border on Australia's labour force.



As the COVID recession hit in early 2020, the size of the workforce shrank with layoffs and lockdowns. As the economy recovered in late 2021, these jobs were recreated, and unemployment levels returned to normal. But with several hundred thousand missing migrants, the labour force couldn't fully recover.

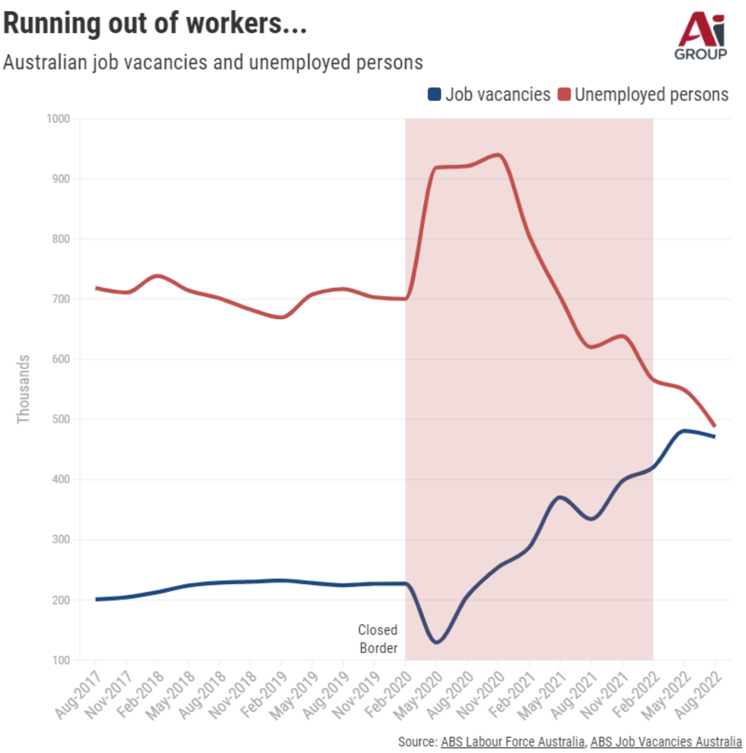
A 'labour force gap' – the difference between the actual Australian workforce, and that which would be expected based on past trends – opened up.

Today, the national labour force is 425,000 workers smaller than it would have been on pre-COVID trends. So, when the Australian economy roared back to life following the COVID recession, we quickly felt the impact of the missing migrants.

A lack of workers saw unemployment steadily fall – from just over 5% before the pandemic to only 3.5% today. The under-employment rate – people employed but looking for additional work – has also cratered, from 9% pre-pandemic to around 6% now.

There is also evidence that the economy has hit the limits of the available labour supply in mid-2022:

The number of unemployed persons has fallen from 700,000 pre-pandemic to 470,000 lowering the supply of available workers by 31%.



As the economy had rebounded, the number of job vacancies has more than doubled – from around 200,000 pre-pandemic to 480,000 today.

There are now about as many unemployed people as advertised jobs in Australia (see left).

It will require the return of normal migration to restore balance in the Australian labour market. Fortunately, there are some positive signs this will occur soon.

The Federal Government has temporarily raised the permanent migration cap from 160,000 to 195,000 in 2022-23, specifically to address workforce gaps.

NOM bounced back very strongly in the first quarter of 2022, indicating pent-up demand for migration to Australia.

But it will take many more years to claw back the migrant lost due to the pandemic border closures. In the meantime, Australia's tight labour markets are here to stay.

Australian economic forecasts – conditions deteriorating, but labour markets to remain tight

The RBA offers the most recent forecast for the Australian economy in its August *Statement on Monetary Policy*. Over the next two years it expects:

- **GDP growth to dramatically slow**, falling from 3.5% to 2.3% by the middle of 2023, and then to 1.7% by 2024.
- The **unemployment rate will fall further** from 3.8% to 3.4% p.a. by the middle of 2023, before rising back to 4% during 2024. This remains well below the RBA's estimate of 'full employment' of between 4-5%.
- **Wages growth** will accelerate, from 2.6% now to 3.4% in mid-2023, and then to 3.9% by the end of 2024.
- **Household consumption** and **dwelling investment** will both decline dramatically over the next two years, but **business investment** will remain strong and become the strongest component of GDP growth.
- **Annual headline inflation** will peak at 7.8% at the end of 2022, before gradually declining to 3.0% by the end of 2024. However, inflation remains well above the RBA's target band of 2-3% across the forward outlook.

Australian economy: latest annual growth rates and RBA forecasts (as of August 2022)

% change over the year	Dec 2021	Jun 2022	Dec 2022	Jun 2023	Dec 2023	Jun 2024	Dec 2024
Gross domestic product (GDP)	**4.2**	3.5	3.2	2.3	1.8	1.8	1.7
Household consumption	3.5	4.6	4.9	2.8	2.4	2.3	2.2
Dwelling investment	5.3	−1.7	1.7	2.5	−0.1	−2.6	−4.8
Business investment	6.4	1.6	4.9	5.9	6.6	5.7	4.6
Public demand	5.1	6.3	3.6	−0.5	−0.7	0.8	1.8
Gross national expenditure	5.0	4.1	3.7	1.5	1.5	1.8	1.9
Imports	1.0	5.0	11.4	6.2	4.0	3.0	2.9
Exports	−2.6	2.3	8.6	9.8	5.1	2.8	2.2
Terms of trade	10.3	6.8	2.6	−14.6	−8.9	−4.4	−1.6
Real household disposable income	3.7	3.9	−0.9	−3.1	−0.9	0.9	1.5
Unemployment rate (qtr. average, %)	**4.2**	3.8	3.4	3.4	3.5	3.7	4.0
Employment	2.1	3.2	4.4	2.2	1.4	1.1	0.9
Average wage rates (WPI)	**2.3**	2.6	3.0	3.4	3.6	3.8	3.9
Trimmed mean inflation (CPI)	**2.6**	4.9	6.0	5.0	3.8	3.3	3.0
Headline inflation (CPI)	3.5	6.1	7.8	6.2	4.3	3.5	3.0

= actual. = forecast. Sources: ABS, various data; RBA 'baseline scenario' in *Statement on Monetary Policy*, May 2022.

Global economic forecasts – inflation, war and China's COVID-zero dim the outlook

In July the IMF **downgraded its forecasts** to 3.2% growth in global GDP in 2022, and 2.9% in 2023. The July forecast for 2022 is 0.4% lower than that forecast in May, and 1.2% lower than the forecast of January. It is also half the growth rate which occurred in the COVID recovery year of 2021.

The forecast downgrades the outlook for **almost all major economies**, including Australia. The ASEAN-5 (Singapore, Malaysia, Indonesia, Philippines and Thailand) is the only group expected to do better in 2022 and 2023 than during the pandemic.

Chinese growth is expected to dramatically fall to 3.3% this year, posing significant downsides for Australia's China-exposed commodity exports. **Iron ore prices** have already fallen back to the pre-pandemic normal.

These latest downgrades to the IMF's global outlook are due to:

- **Economic problems related to Russia's invasion of Ukraine.** The conflict has caused a rapid spike in food, energy and commodity prices, and further interrupted already strained global value chains.

- **Stronger inflation impacting central banks' monetary policies**. The IMF notes that disinflationary monetary policy (higher interest rates) from central banks will drag heavily on growth in 2023 in all countries.

- **China's COVID-zero policies** are demanding further lockdowns, and its property sector has fallen into crisis. Dramatically falling Chinese growth will carry major negative spill-overs for almost all economies.

IMF growth forecasts, selected countries (as of July 2022)

Real GDP growth, % y/y	2021 actual	2022 April forecast	2022 July forecast	2023 April forecast	2023 July forecast
Advanced economies	**5.2**	**3.3**	**2.5**	**2.4**	**1.4**
USA	5.7	3.7	2.3	2.3	1.0
Euro area	5.3	2.8	2.6	2.3	1.2
UK	7.4	3.7	3.2	1.2	0.5
Japan	1.6	2.4	1.7	2.3	1.7
Australia	**4.2**	**4.2**	**3.8**	**2.5**	**2.2**
Emerging and developing economies	**6.8**	**3.8**	**3.6**	**4.4**	**3.9**
China	8.1	4.4	3.3	5.1	4.6
India	8.9	8.2	7.4	6.9	6.1
ASEAN-5	3.4	5.3	5.3	5.9	5.1
World output	**6.1**	**3.6**	**3.2**	**3.6**	**2.9**

a = actual. f = forecast. Sources: IMF, *Australia: Staff Concluding Statement of the 2022 Article IV Discussions*, Dec 2021; IMF, *World Economic Outlook,* April 2022

Key Australian industrial indicators

Inflationary pressures build

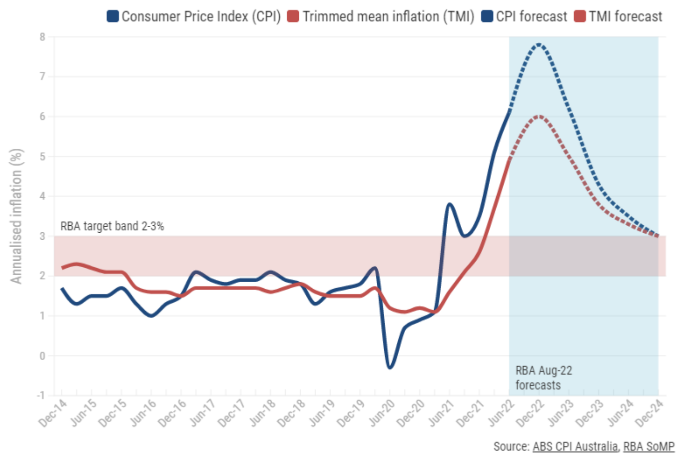
Headline CPI sits at 6.1% in June, well in excess the RBA's 2-3% target band. It is forecast to peak at 7.8% before the end of the year.

The principal drivers are rising prices for food and energy, resulting from a global price spike caused by the Russian invasion of Ukraine.

Supply chain interruptions also continue to elevate prices for consumer goods and industrial inputs.

The RBA has responded by raising the cash rate from 0.1% to 1.8% since May.

Australian inflation and forecasts



A global inflationary context

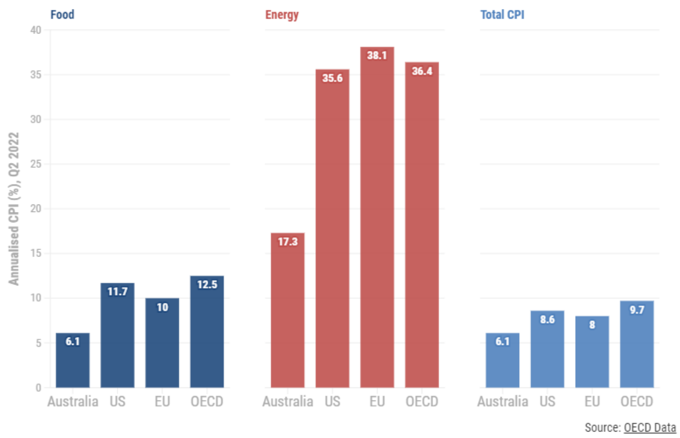
Australian inflation remains lower than our developed-economy peers.

OECD economies experienced 9.7% CPI inflation in the year to Q2 2022, much higher than Australia's 6.1%.

Food and energy are the primary culprits, with the EU suffering 38.1% growth in energy price inflation.

As a net exporter of both energy and food, Australia is cushioned against the full effects of these global inflationary drivers.

CPI inflation in the OECD, Q2 2022



Labour markets drum tight

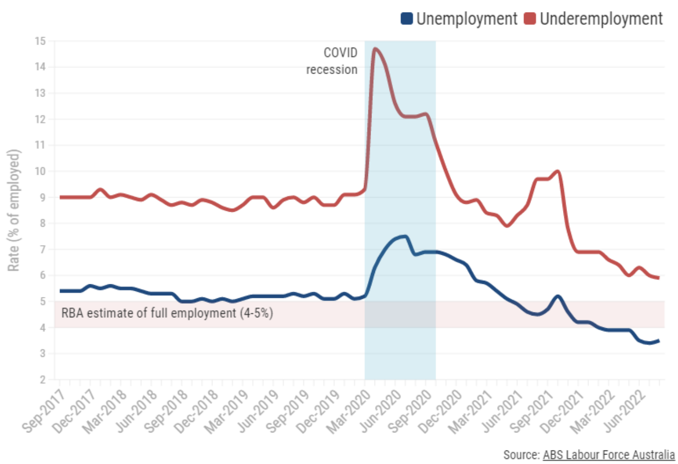
The unemployment rate has fallen to record low levels with very tight labour markets.

July figures of 3.5% unemployment are lowest in a generation, well below 'full employment' of 4-5%.

Australia's closed borders– which stopped net inward migration for two years – combined with high growth since mid-2021 are the drivers.

The RBA expects unemployment to remain below 4% through to the end of 2024.

Australian unemployment rates



Wage growth accelerates

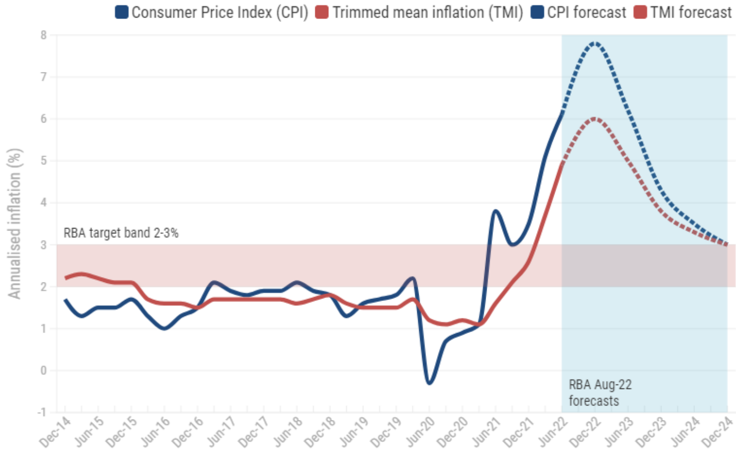
With labour markets tight and growth robust, wages have turned rapidly upwards.

Private sectors wages started growing in Q3 2020, and are presently growing at 2.7% p.a.

Public sector wages – typically regulated by EBAs – show the same pattern with a 6-month lag.

The RBA expects annual wage growth to climb to 3.0% by the end of 2022, and then rise to 3.9% by the end of 2024.

Australian public and private sector wages



Source: ABS CPI Australia, RBA SoM

Staff shortages get worse

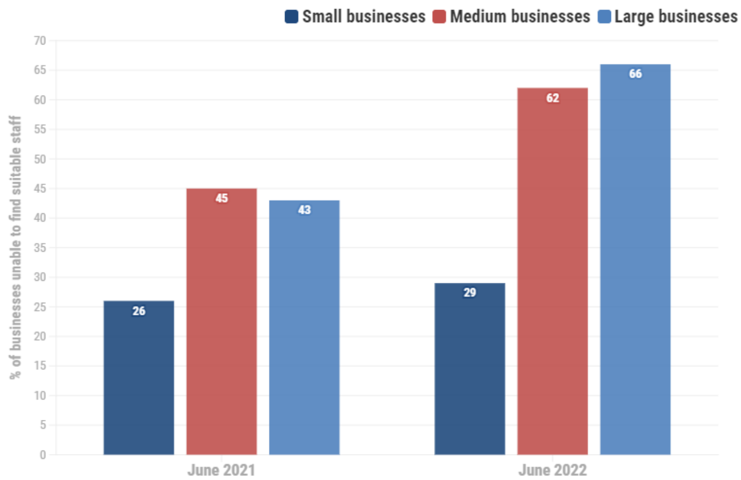
31% of businesses experienced difficulty finding suitable staff in June 2022.

Medium and large businesses report higher rates of staff shortage than small businesses.

Staff shortage problems have grown over the last year, with the number of affected medium and large businesses increasing around 20%.

Where staffing issues were previously due to COVID interruptions in 2021, they are now a result of labour shortages across the economy.

Australian businesses facing staffing difficulties



Source: ABS Business Conditions and Sentimen

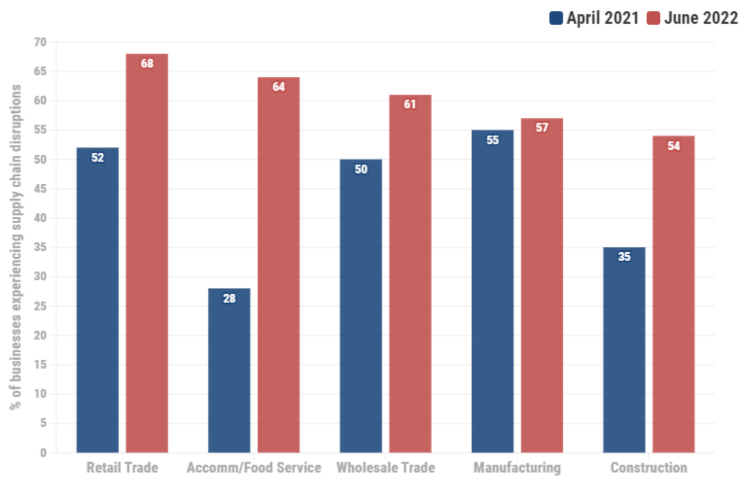
Supply chains still disrupted

41% of businesses experienced supply disruptions in June 2022. Rates were much higher for retail, food service, construction and manufacturing.

Supply chain disruptions have grown for all industries in the last year, despite domestic COVID challenges abating in Australia.

International drivers of supply chain disruptions now dominate. China's ongoing COVID-zero policies, rising global protectionism and Russia's invasion of Ukraine are key factors.

Australian businesses facing supply chain disruptions



Source: ABS Business Conditions and Sentimen

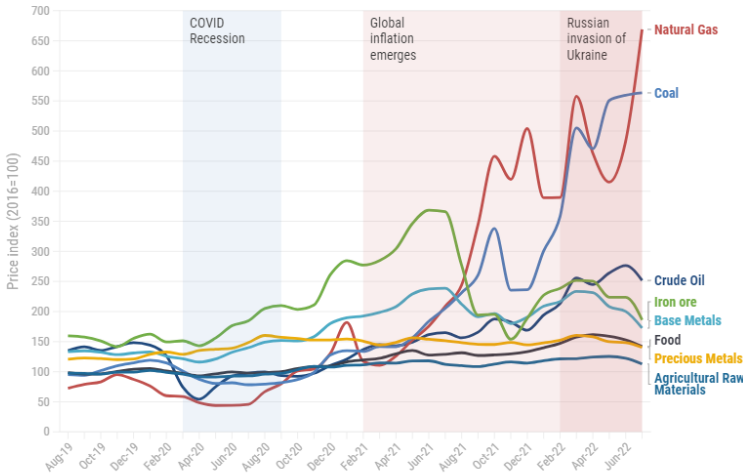
Commodity prices sky high

Supply chain interruptions and Russia's invasion of Ukraine have driven global commodity prices to all-time records.

Commodity prices are the principal driver of the global inflationary breakout in early 2022. Since mid-2022, Australia's commodity export prices exploded.

These commodity prices benefit the Australian economy through higher taxation receipts, but also increase financial strain on industry and households.

Global commodity prices



Source: IMF Commodity Price

Manufacturing recovery stalls

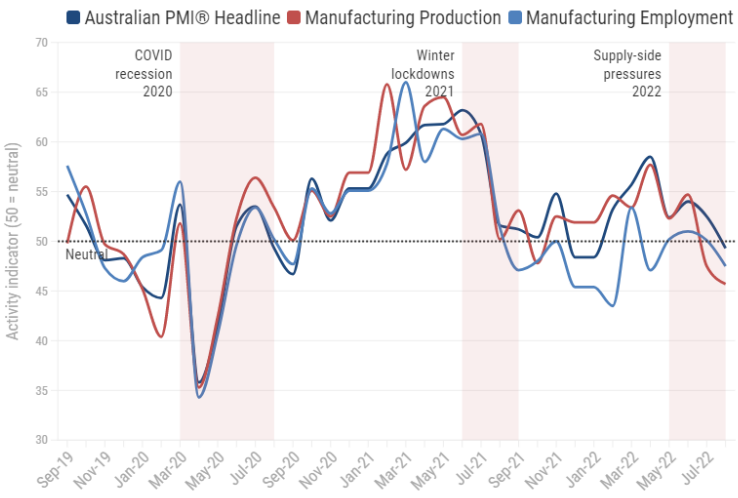
The post-COVID recovery in manufacturing is slowing in Q2 2022.

The sector experienced two cycles of collapse and recovery over the pandemic. The Australian PMI® shows the most recent upswing has stopped in May.

Supply-side issues – labour and supply chain – remain the major constraints on manufacturing. Input prices and wages are at all-time highs.

Strong capex forecasts for the remainder of 2022 will partially shield manufacturing from interest rate rises. But it is likely to decline further in coming months.

Ai Group Australian PMI® manufacturing indicators



Source: Ai Group Australian PMI® • 50 = neutral. Higher scores denote expansion, lower denote contraction

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