



WHY IMMIGRATION IS KEY TO AUSSIE INTEREST RATES

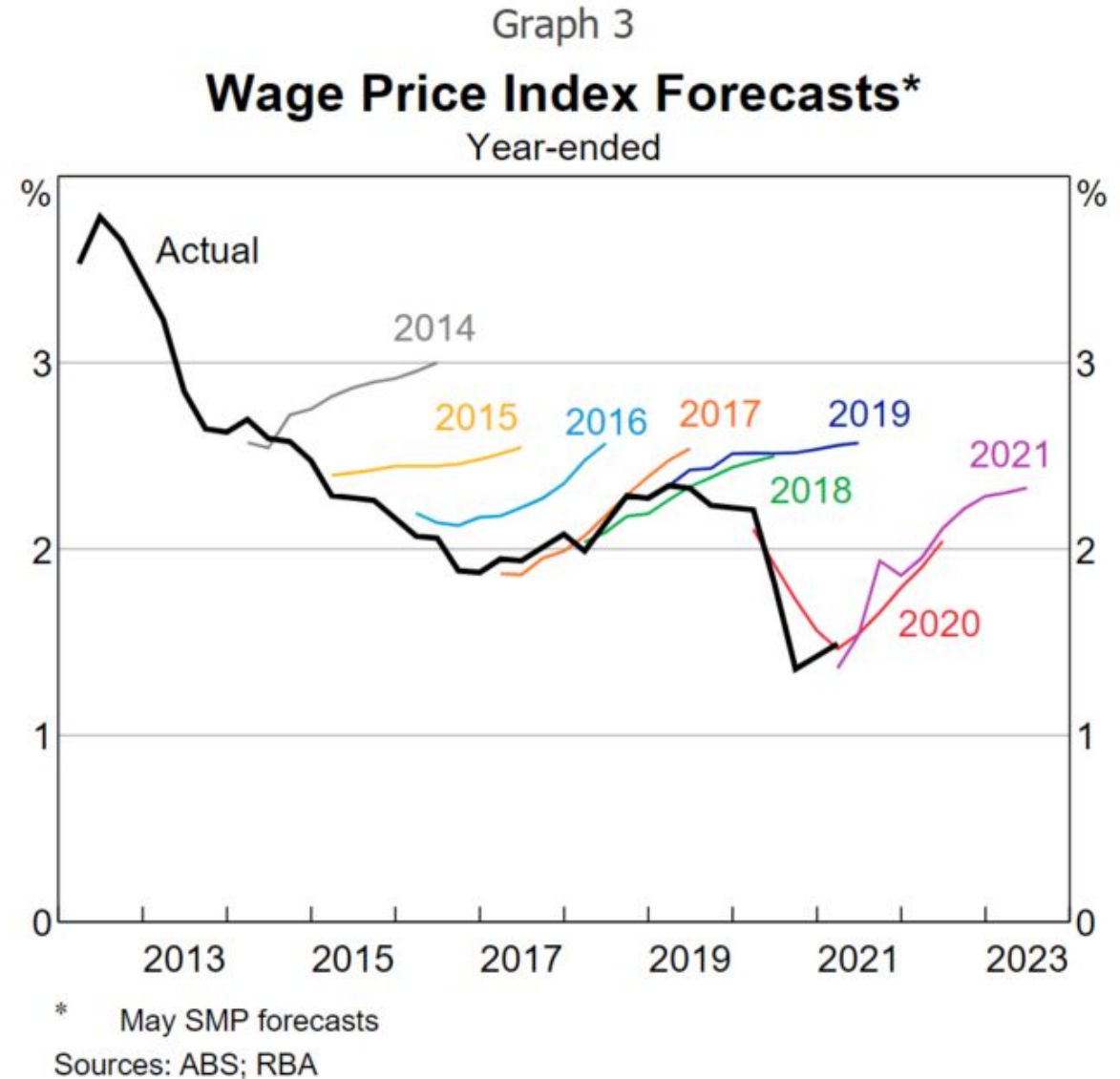


Agenda: Why immigration holds the key to Aussie interest rates

- After 11 long years of interest rate cuts, many commentators and markets are forecasting a rise in the official cash rate.
- Whether Australian inflation picks up largely depends on wage growth, which has undershot RBA forecasts for a decade.
- The planned reboot of pre-COVID levels of immigration will suppress wage growth and ergo inflation, meaning interest rates could remain lower for longer.

Aussie wage growth undershoots RBA's target

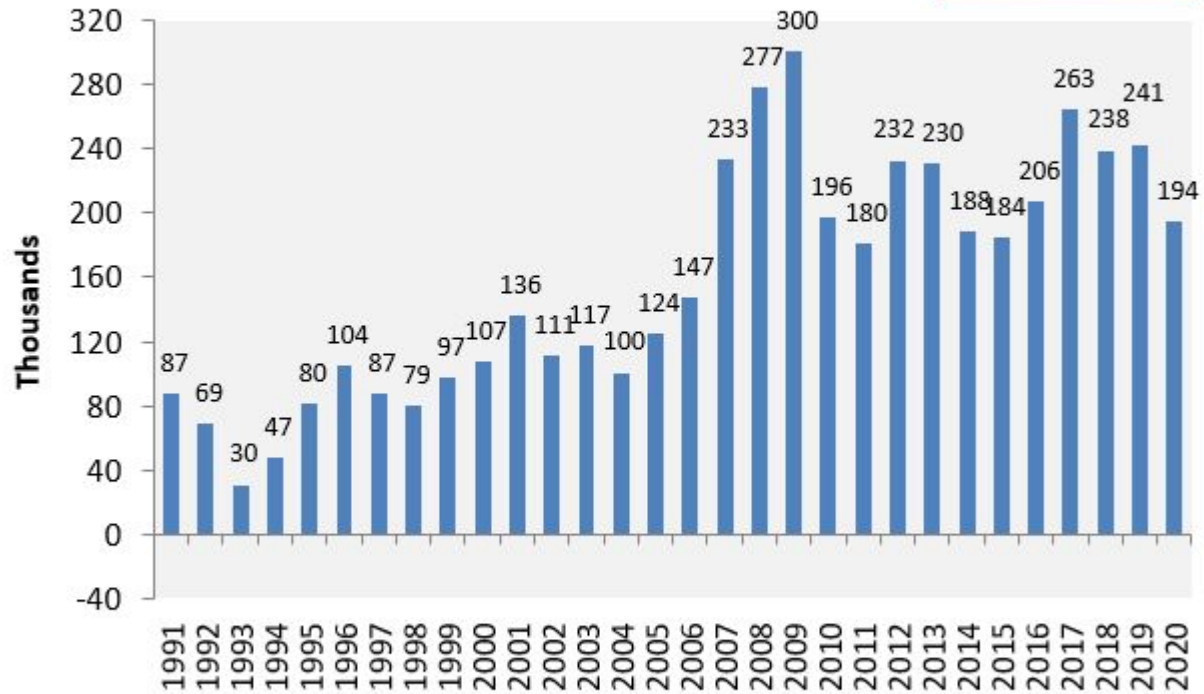
- The primary driver of the falling cash rate is the collapse in wage and household income growth, which has continually undershot the RBA's targets, in turn suppressing inflation.



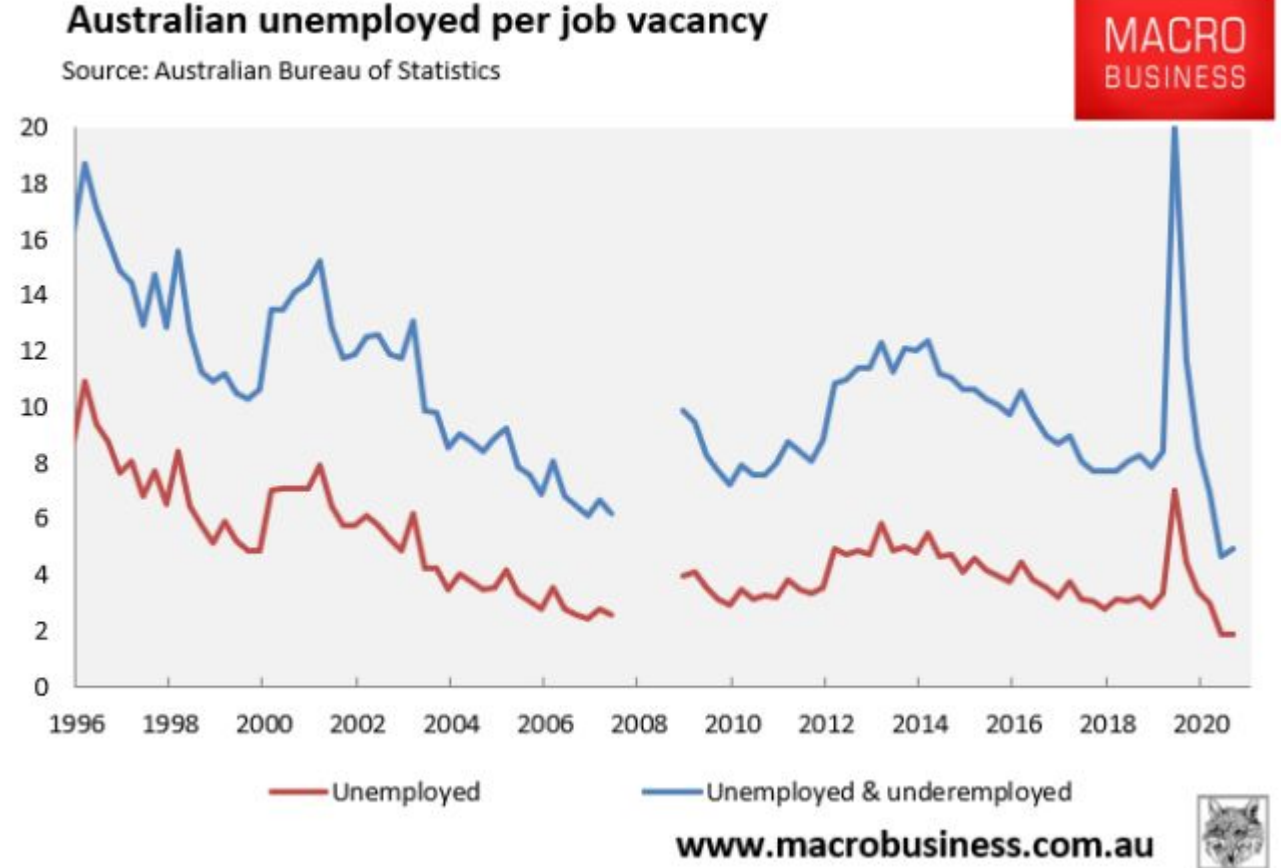
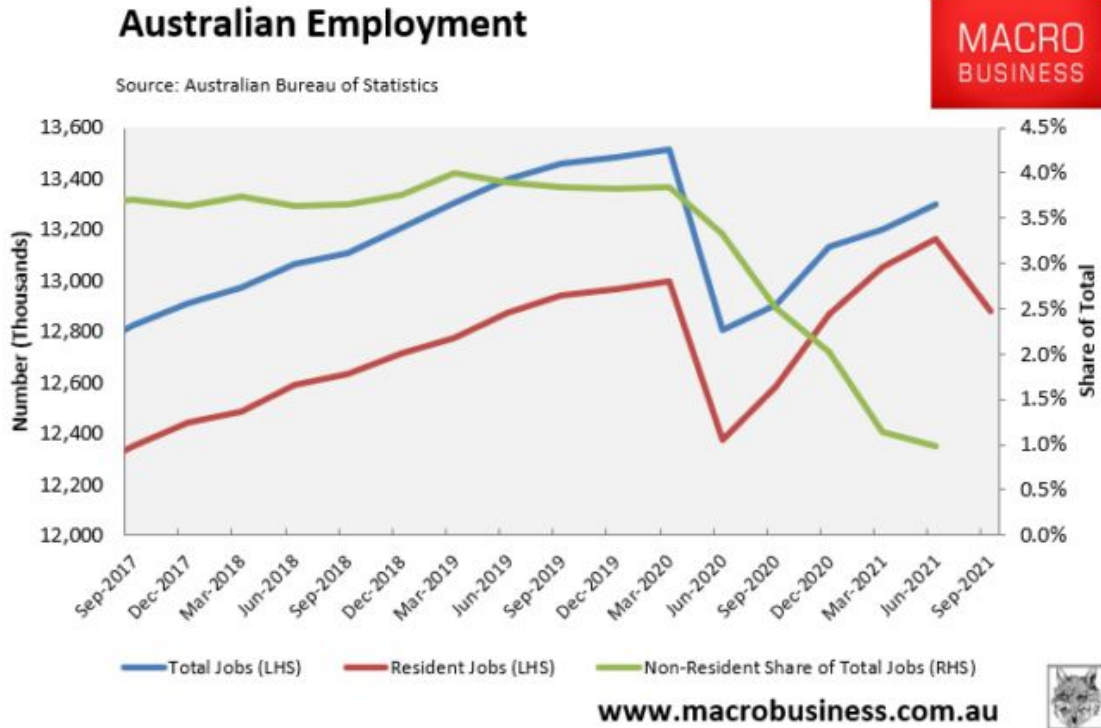
Inflation holds key to wage growth

- This low wage growth, in turn, was driven by persistent 'slack' in the Australian labour market caused primarily by the strong immigration program.
- This immigration program added 180,000-plus workers to the Australian economy each and every year in the decade leading up to COVID, keeping unemployment and underemployment elevated.

Australia's Net Overseas Migration



Immigration collapse has driven labour market tightness



- Australia has lost around 400,000 non-resident temporary migrant workers since the pandemic began, which has reduced temporary migrants' share of jobs from around 4% to 1% currently.
- Australia's labour market is around the tightest on record, as illustrated clearly by the sharp decline in the ratio of unemployed and underutilised workers per job vacancy, which are both tracking near all-time lows.

Wage pressures building

Australian Unemployment Rate

Source: Australian Bureau of Statistics

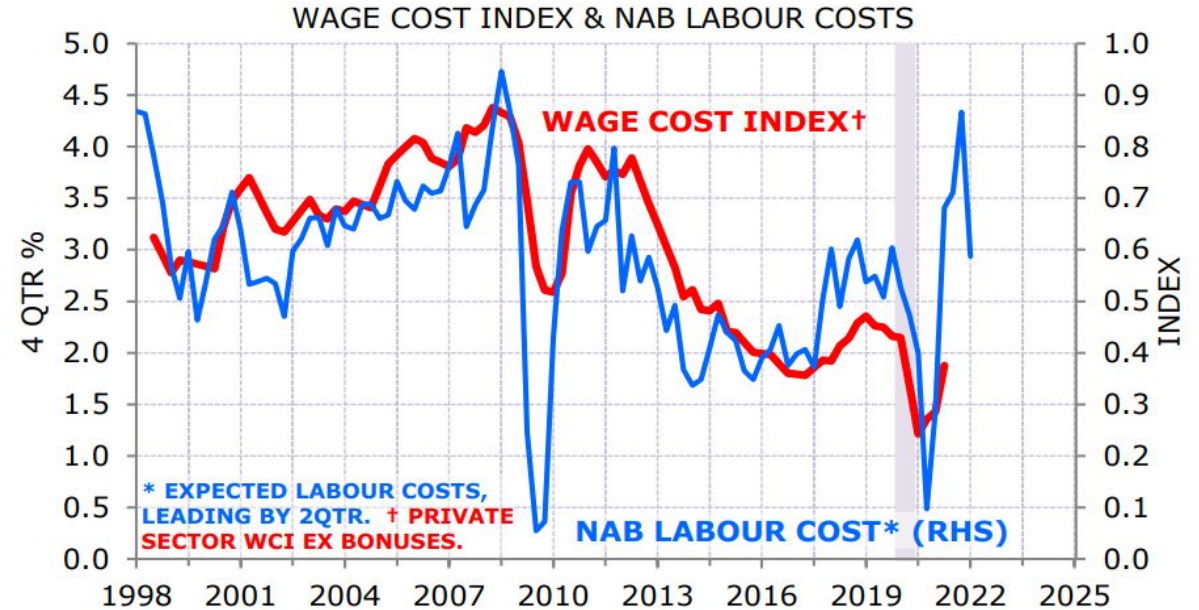
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Signs of wage growth ahead



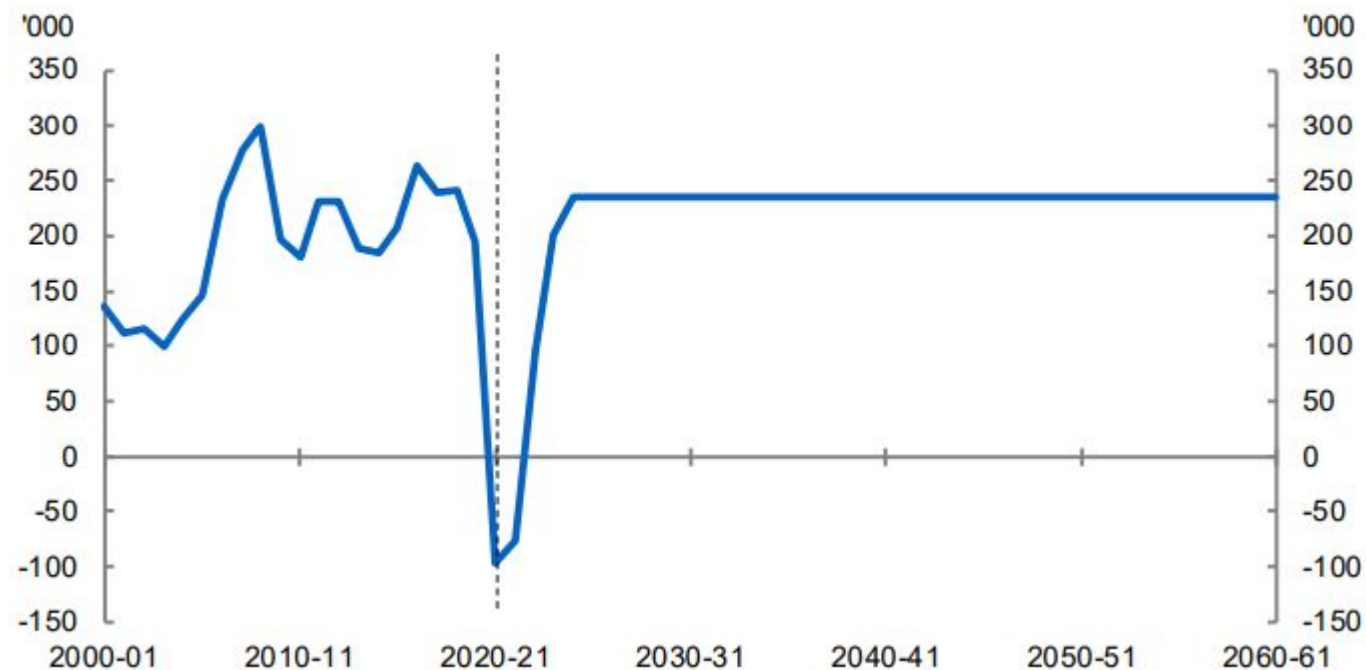
Source: ABS, NAB; Minack Advisors

- RBA has stated explicitly that it won't lift interest rates until underlying inflation is sustainably within its 2-3% target range.
- RBA has also suggested the unemployment rate needs to fall to 4% or below to generate wage growth with a '3' in front of it.
- History suggests that wage growth of 3-3¾% has been consistent with inflation in the RBA's target range.
- Reducing the supply of labour seems to already be putting upward pressure on its price.

Big Australia rebooted

- The Morrison Government has just opened the international border to overseas students, skilled visa holders and working holiday makers, with at least 200,000 migrant workers expected to arrive in Australia by July 2022.
- This decision effectively brought forward the Intergenerational Report's (IGR) projection of 235,000 annual net overseas migrants from 2025-26 onwards.

Chart 2.4 Net overseas migration



Source: ABS National, state and territory population, September 2020, and Treasury.

Kiss goodbye to decent wage growth and interest rate rises

- Wage growth is likely to be a function of immigration levels and labour supply.
- If the federal government achieves its goal of quickly rebooting immigration to pre-COVID levels (or above), then slack will return to Australia's labour market, reducing wage growth and inflation, and allowing the RBA to keep the cash rate 'lower for longer'.
- Wage growth and inflation will again undershoot expectations, leading to the RBA delaying interest rate rises into the 'never never'.

Viewer question of the week:

Should Australia return to pre-pandemic levels of immigration?

Drop your answers in the comments

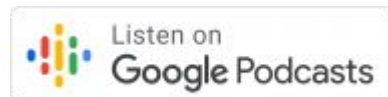
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