Flashnote

HSBC Global Research

Macro
Australian Economics

Downunder Digest

Australia's aging population and its challenges

- **As the 'baby boomers' are starting to retire, Australia faces similar demographic challenges to other countries**
- **An aging population is expected to lower the potential growth rate and put extra pressure on government finances**
- **Australia's openness to migrants could help with demographic challenges, given it has a history of attracting large numbers of skilled migrants, particularly from Asia**

Migration could help deal with the challenge of aging

An ageing population presents a policy challenge for Australia in coming years. Because the 'baby boomers' are now starting to retire, growth in the working age population is already starting to slow. This is expected to act as a drag on Australia's potential growth rate, adding to the problem of Australia's recent weak productivity performance.

To some degree, Australia's compulsory superannuation system has helped to deal with this issue, leaving it better placed than many developed nations. The introduction of this scheme in the late 1980's, means Australia now has a pool of superannuation funds to rival the size of the world's largest sovereign wealth funds. Australia has the world's 4th largest pool of superannuation funds.

Nonetheless, an older population still presents a challenge, particularly for government budgets, as it means greater spending on healthcare and less revenue from the income tax system. With the government's budget currently in deficit (-3.0% of GDP in 2013/14), the ageing population adds to the case for a credible medium-term plan to return to a budget surplus. Cuts to government-funded healthcare are a policy option available to the government. Another option is a shift in the tax base to consumption or wealth-oriented taxes, rather than the current system, which relies heavily on income taxes.

Still another policy option is stronger inward migration flows. Migrants are typically younger than the extant population. They also bring with them much needed skills and have strong ties to their former home countries, which can strengthen financial and trade ties. Australia's already has a targeted immigration scheme, which allows the government to control the types of skills of individual migrants.

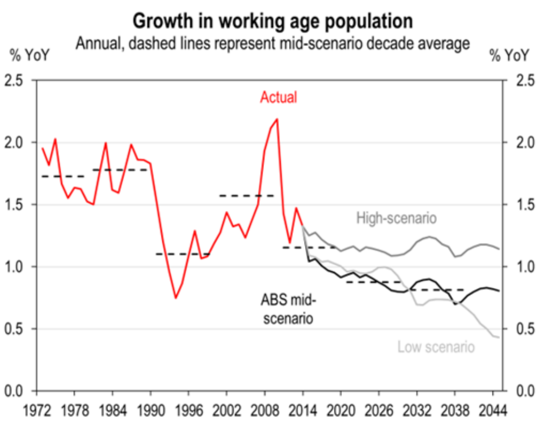
Strong migration flows, particularly from fast-growing Asian nations, could help Australia deal with its demographic challenges and also strengthen its links with the fastest growing economies.

8 April 2014

Paul Bloxham
Chief Economist, Australia and New Zealand
HSBC Bank Australia Limited
+61 2 9255 2635
paulbloxham@hsbc.com.au

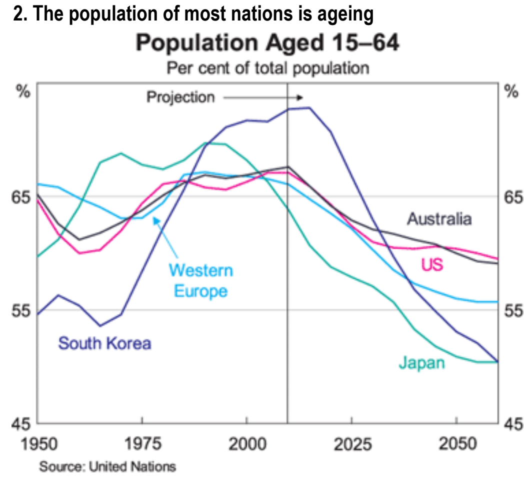
Adam Richardson
Economist, Australia and New Zealand
HSBC Bank Australia Limited
+61 2 9006 5848
adamrichardson@hsbc.com.au

1. An ageing population will be a challenge for Australia



Source: ABS

2. The population of most nations is ageing



Source: RBA, United Nations

Past the peak in the demographic dividend

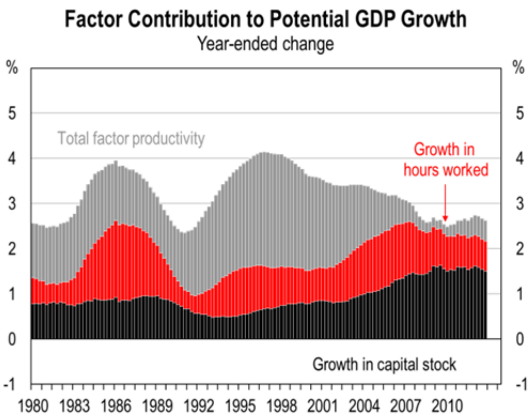
Australia's demographic dividend is likely to be past its peak. The country has experienced high rates of working age population growth over the past few decades; however, with the 'baby boomer' generation beginning to retire, the pace of growth in the working age population is likely to slow. The Australian Bureau of Statistics (ABS) projects that population growth will average +1.2% a year in the 2010's and +0.9% in the 2020's, down from +1.6% in the 2000's (Chart 1). The ABS also presents a low and high scenario, with the variation between the outlooks largely explained by differing assumptions about migration.

An ageing population is an issue faced by most developed nations around the world. The post-war 'baby boom' and subsequent declining birth rate is one part of the story. Rising incomes and advances in medical technology also mean greater life expectancy, further skewing the average age to the upside. In the US, estimates from the United Nations suggest that 20% of the population will be above 65 by 2030, up from 14% currently. Australia's population is expected to age in a similar way, with over 65s projected to account for 19% of the population by 2030, from 14% currently (Chart 2).

By itself, the ageing of the population will present challenges for Australia's economy. One challenge is that more people will retire, as the 'baby boomer' cohort ages. This will see labour force participation begin to decline. Despite older generations choosing to work longer, partly due to better health, the sheer number of retirees is likely to offset even the most optimistic assumptions about older worker labour force participation (see Bloxham, P. and Richardson A. (2014), *Downunder Digest: Australia's labour market in focus*, 10 February).

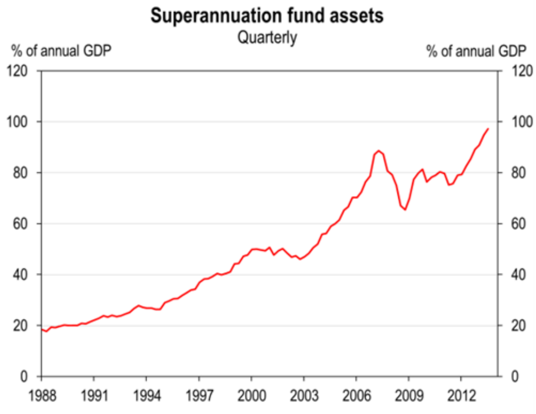
The amount of workers and their skills is also a key determinant of potential growth. As a result, the projected decline in participation will act as a drag on Australia's potential growth – the rate at which the economy can sustainably grow in the medium term and the key determinant of the country's living standards. A trend weakening in labour market participation has already hampered potential growth and this will remain an issue in the future, compounding the problem of Australia's recent weak productivity performance (Chart 3). See Bloxham, P. and Richardson A. (2014), *Downunder Digest: Australia's lowered potential*, 22 January.

3. Slower growth in the workforce has hampered potential



Source: ABS, HSBC estimates

4. Compulsory superannuation has helped raise savings



Source: ABS, RBA

Aging presents a budget challenge

Another challenge presented by an aging population is the pressure this will place on government finances, both in terms of reduced revenue and increased expenditure, particularly on healthcare. The Australian Productivity Commission estimates that the aging of the population could see government expenditure rise by +5.9 percentage points of GDP by 2060. On these estimates and current policy settings, Australia would deliver consistent budget deficits over the period, without some policy adjustments. A key challenge for the healthcare budget policy is the forecasted increase in the cost of provision due to ever-improving technology. Adjusting the quantum of public provision of health is a policy option for the government.

Another option is to seek to increase tax revenues to meet future spending commitments, including on healthcare. Unless adjustments are made to the tax system, revenues are expected to be reduced by the aging population. A key drag on projected tax revenues is the fact that much of the revenue in the current tax system (at least 45%) comes from personal income taxes, which will be less effective as the population ages. An option is to shift the tax base more towards consumption and wealth-oriented taxes.

Australia's has a head start on pension funding

Past policy choices have helped mitigate the effects of an aging population on the government's finances, in terms of its pension liabilities. Australia adopted a compulsory superannuation scheme in the late 1980's, which now sees employer contributions set at 9.25% of annual salaries, with this rate set to rise to 12% by 2019. The steady rise in the contribution rate, expanded coverage of the system, as well as investment returns have seen superannuation assets reach close to 100% of GDP (Chart 4). The value of Australia's superannuation assets is 1.6 times greater than the value of Norway's sovereign wealth fund.

Research suggests the implementation of compulsory superannuation has had a positive impact on Australia's wealth, on net, despite the reduced incentive it provided for saving out of income. Research from the RBA suggests the offset from reduced private savings is in the region of only 10-30%. Given this, compulsory superannuation has likely helped to lessen the need for Australia's government to provide for people in retirement.

High migration flows are a policy option

Even with the boost from rising retirement savings, health and superannuation costs will put pressure on the budget and hamper Australia's potential growth. Increased migration is a further policy option. Indeed, Australia has historically had strong rates of inward migration, supporting population growth.

Since 2000, Australia's population growth has averaged +1.4% y-o-y, compared to an average of +0.7% y-o-y amongst OECD countries. These flows have already helped Australia to somewhat mitigate the impact of an aging population.

Typically, migrants are younger than the Australian population as a whole and therefore provide a boost to the Australia's workforce and its productive potential. In 2012/13, 74% of migrants were aged between 15 and 65, compared to 67% in the Australian population as a whole (Chart 5). Migrants can also bring needed skills to the Australian workforce. Data from 2010 revealed 45% of recent migrants had a bachelor degree or greater, compared to 25% across the entire country in 2013. Encouraging continued strong migration remains a policy option to mitigate the impacts of an ageing population.

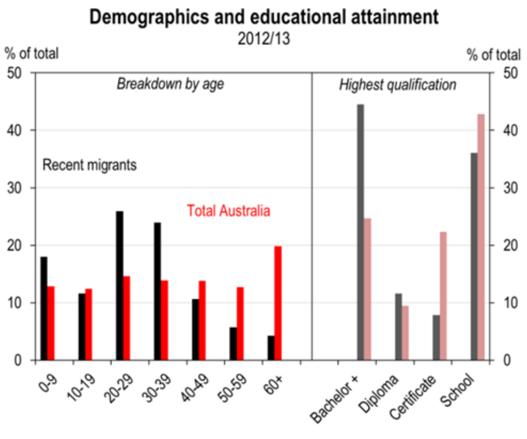
More recently, this strong rate of inward migration has been driven by strong links to Asia (Chart 6). In 2012/13, India was the second largest source of migrants, followed closely by China, with these countries only beaten by New Zealand (reflecting there are essentially no restrictions on migration between Australia and New Zealand). All up, Asia accounted for 48% of total migrants in 2012/13.

In this regard, it is important to keep in mind that migrants also bring further benefits to Australia that are harder to quantify, including skills, knowledge and ties related to their home countries. Australia's already strong trade ties to the fastest growing economies in the world, in Asia, can be complemented by strengthening ties in terms of population flows, which may also facilitate greater business and financial connections to the region.

Bottom line

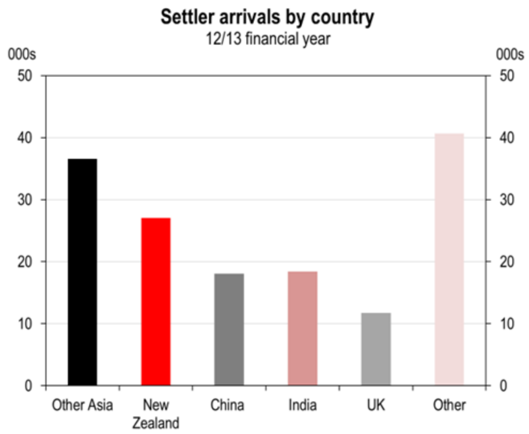
Australia's demographic dividend has likely peaked, with 'baby boomers' beginning to retire and life expectancy continuing to rise.

5. Migrants are generally younger and better educated



Source: Department of Immigration and Border Protection, ABS

6. Asia is Australia's key source of migrants



Source: Department of Immigration and Border Protection

This will present challenges for the Australian economy, including that it may: weigh on Australia's potential growth rate; reduce tax revenues; and, increase government spending, particularly on healthcare.

Next month's budget should look at these long-term issues, with adjustments to the tax system and spending commitments.

Migration policy can also help to meet the demographic challenge and may provide additional benefits of increasing Australia's linkages to the fastest growing economies in the world.

HSBC

Table 1. HSBC's forecasts for Australia and New Zealand

	Year-average			Year-ended						
	2013	2014	2015	Q413	Q114e	Q214e	Q314e	Q414e	Q115e	Q215e
%*										
AUSTRALIA										
GDP	2.4	2.8	3.2	2.8	2.9	2.7	2.8	2.7	2.9	3.2
Consumption	2.0	3.0	2.8	2.6	2.9	3.0	3.1	3.0	2.9	2.8
Public consumption	1.1	2.4	1.8	2.7	2.3	2.7	2.2	2.3	2.0	1.8
Investment	-1.7	-2.0	1.0	-3.2	-1.0	-2.7	-2.9	-1.6	-0.5	0.8
- Dwelling	2.0	7.5	5.9	1.4	5.1	6.6	9.2	9.2	7.5	6.4
- Business	-2.3	-6.4	-2.0	-7.2	-3.8	-6.4	-8.8	-6.4	-4.5	-2.4
- Public	-3.3	5.1	6.3	10.3	3.9	2.4	8.8	5.6	6.1	6.7
Final domestic demand	0.9	1.7	2.3	1.2	1.9	1.5	1.4	1.8	2.0	2.2
Domestic demand	0.4	1.5	2.3	0.9	1.8	1.1	1.5	1.6	2.0	2.2
Exports	6.8	7.2	9.1	6.5	6.1	6.3	8.3	7.9	8.6	8.7
Imports	-2.8	0.2	5.5	-4.6	-0.9	-3.1	1.6	3.4	5.0	5.2
GDP (% quarter)	--	--	--	0.8	0.6	0.7	0.7	0.7	0.8	0.9
CPI**	2.4	2.8	2.8	2.7	2.9	3.1	2.6	2.5	2.7	2.8
Trimmed mean**	2.4	2.8	2.8	2.7	2.8	2.8	2.8	2.5	2.7	2.8
Unemployment rate	5.7	5.9	5.6	5.8	6.0	6.0	5.8	5.7	5.6	5.6
Labour price index	2.9	2.9	3.6	2.6	2.6	2.7	3.0	3.2	3.4	3.5
Current A/C (%GDP)	-2.9	-1.9	-1.5	-2.6	-1.9	-2.0	-2.0	-1.8	-1.8	-1.7
Terms of trade	-4.2	-4.6	-1.8	-1.2	-4.5	-5.8	-3.8	-4.2	-3.2	-2.2
Budget balance (%GDP)	-1.3	-3.0	-2.0	--	--	--	--	--	--	--
Capital city house prices	6.4	10.2	7.5	9.3	10.7	10.1	10.3	9.8	9.3	8.8
Private sector credit	3.4	6.0	6.2	3.9	5.0	5.8	6.4	6.8	6.5	6.1
USD/AUD (end period)	0.93	0.86	0.86	0.93	0.89	0.88	0.87	0.86	0.86	0.86
90-day bank bill rate	2.60	3.10	3.60	2.60	2.60	2.70	2.90	3.10	3.10	3.20
Cash rate (end period)	2.50	2.75	3.50	2.50	2.50	2.50	2.50	2.75	3.00	3.00
%*										
NEW ZEALAND										
GDP	2.7	3.5	3.0	3.1	3.5	3.8	3.5	3.3	3.2	3.1
Consumption	3.4	3.5	2.5	3.7	3.6	3.4	3.8	3.2	3.0	2.6
Government consumption	0.9	1.5	0.8	1.3	2.4	2.2	0.3	1.0	0.9	0.8
Investment	9.4	9.8	6.8	10.7	11.2	9.1	8.7	10.3	8.7	7.1
Final domestic demand	4.3	4.7	3.3	4.9	5.1	4.6	4.4	4.6	4.1	3.4
Domestic demand	4.3	4.0	3.3	4.3	4.7	3.9	3.0	4.6	4.1	3.4
Exports	0.9	4.0	3.5	1.0	0.3	5.1	6.5	4.4	3.9	3.6
Imports	6.2	8.0	4.2	8.7	9.0	9.0	6.4	7.6	5.9	4.4
GDP (% quarter sa)	NA	NA	NA	0.9	0.9	0.8	0.8	0.8	0.9	0.6
CPI	1.1	2.3	2.5	1.6	1.8	2.3	2.2	2.6	2.5	2.5
Unemployment rate	6.2	5.4	5.0	6.0	5.7	5.5	5.3	5.2	5.1	5.0
Labour price index	1.7	2.3	2.0	1.6	1.9	2.2	2.4	2.7	2.5	2.2
Current A/C (%GDP)	-3.3	-2.9	-3.8	-1.5	-1.9	-2.6	-3.2	-3.7	-3.7	-3.8
Cash rate (end period)	2.50	3.50	4.50	2.50	2.75	3.25	3.25	3.50	3.75	4.00

Source: ABS, RBA, HSBC forecasts
*unless otherwise specified; **includes the effect of the carbon tax from Q312

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Paul Bloxham and Adam Richardson

Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments (including derivatives) of companies covered in HSBC Research on a principal or agency basis.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

Additional disclosures

1. This report is dated as at 08 April 2014.
2. All market data included in this report are dated as at close 07 April 2014, unless otherwise indicated in the report.
3. HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

** Legal entities as at 8 August 2012*
'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Bank Canada, Toronto; HSBC Bank, Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR

Issuer of report
HSBC Bank Australia Limited
Level 32
HSBC Centre
580 George Street
Sydney, NSW 2000, Australia
Telephone: +61 2 9006 5888
Fax: +61 2 9255 2205
Website: www.research.hsbc.com

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This material is distributed in the United Kingdom by HSBC Bank plc. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. Any recommendations contained in it are intended for the professional investors to whom it is distributed. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR. This material is distributed in Japan by HSBC Securities (Japan) Limited. This material may be distributed in the United States solely to "major US institutional investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. Note, however, that HSBC Securities (USA) Inc. is not distributing this report, has not contributed to or participated in its preparation, and does not take responsibility for its contents. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF).

This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. This document has been prepared without taking account of the objectives, financial situation or needs of any specific person who may receive this document. Any such person should, before acting on the information in this document, consider the appropriateness of the information, having regard to the personal objectives, financial situation and needs. In all cases, anyone proposing to rely on or use the information in this document should independently verify and check its accuracy, completeness, reliability and suitability and should obtain independent and specific advice from appropriate professionals or experts. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

In Canada, this document has been distributed by HSBC Bank Canada and/or its affiliates. Where this document contains market updates/overviews, or similar materials (collectively deemed "Commentary" in Canada although other affiliate jurisdictions may term "Commentary" as either "macro-research" or "research"), the Commentary is not an offer to sell, or a solicitation of an offer to sell or subscribe for, any financial product or instrument (including, without limitation, any currencies, securities, commodities or other financial instruments).