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Intergenerational Report

Opportunities in greater productivity, but only if things change

Research and Insights

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The Intergenerational Report issued by Treasury outlines five major forces that are going to shape Australia in the coming decades: population growth; technology; climate change; the needs of an ageing population; and growing global uncertainty. Mark Knight, CEO of Ausbil, looks at what these trends mean, not just for the economy, but also for investors, but warns that things need to change to unleash the benefits.

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Key points

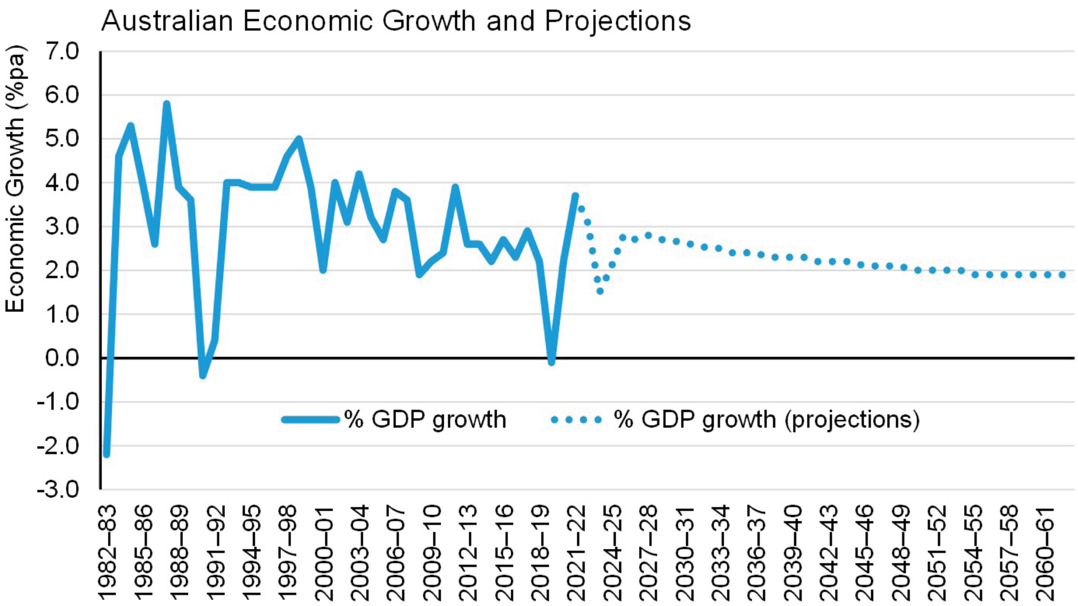
- In August 2023, The Australian Federal Government released the Australian Treasury's 2023 Intergenerational Report on the outlook for Australia over the coming 40-years. This coincides with the recent report from the Business Council of Australia, entitled 'Seize the moment: A plan to secure Australia's economic future'. The focus of both is improving productivity in Australia.
- Australian economic growth is set to slow over the coming decades, according to Treasury projections.
- Like other developed markets, the trend in the productivity of labour in Australia is falling and expected to weaken over the coming decades. There is an immediate need to address falling productivity with policy and tax reform.
- Australia's population growth is slowing, the population is ageing, and there is an increasing share of services over goods in the makeup of the economy.
- Regardless of the pace of policy reform, the outlook for Australia's economy is showing significant opportunity in the future facing commodities needed for decarbonisation; in energy and energy security; the services and support needed by an ageing population; and in growing demand for education, health services, pharmaceuticals and biotechnology, technology, infrastructure and many other sectors.

Q: In a nutshell, what does the Australian Government's 2023 Intergenerational Report say about the future?

MK: The Intergenerational Report looks at how Australia is expected to grow and change over the coming 40-years. In a nutshell, the report identifies five major trends driving how Australia will look in the future. The first is population. Australia's population growth is slowing, people are living longer, and getting older compared to earlier generations. In the next 40-years, the number of Australians aged over 65 years will more than double. The second trend is the rise of the digital economy and the rapid onset of technological change, and what we are seeing with the advent of artificial intelligence. The third change is the decarbonisation journey and how the world achieves its net zero targets. The fourth is the rising costs that come with an ageing population in the provision of services and care. The fifth is the changing world order, with globalisation falling away with increased fragmentation as countries rethink the benefits of an open world market with respect to the wellbeing and safety of their own populations.

As part of the Intergenerational Report, Treasury has provided a long view of Australia's expected economic growth out to 2060/61, as illustrated in Chart 1.

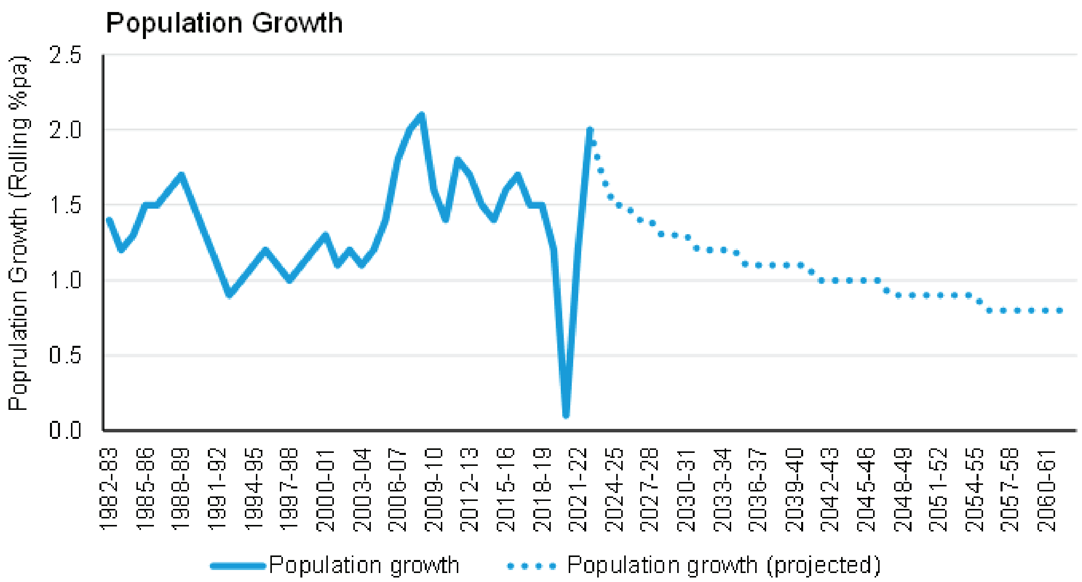
Chart 1: Australia's growth profile is maturing and slowing



Source: Intergenerational Report 2023. ABS Australian National Accounts: National Income, Expenditure and Product, and Treasury.

Not only is Australia's long-term economic growth slowing, so is its population growth, as illustrated in Chart 2. By 2040, Australia's population growth will have slowed from the post-COVID 2% level in 2022 to under 1% per annum from 2040 onwards.

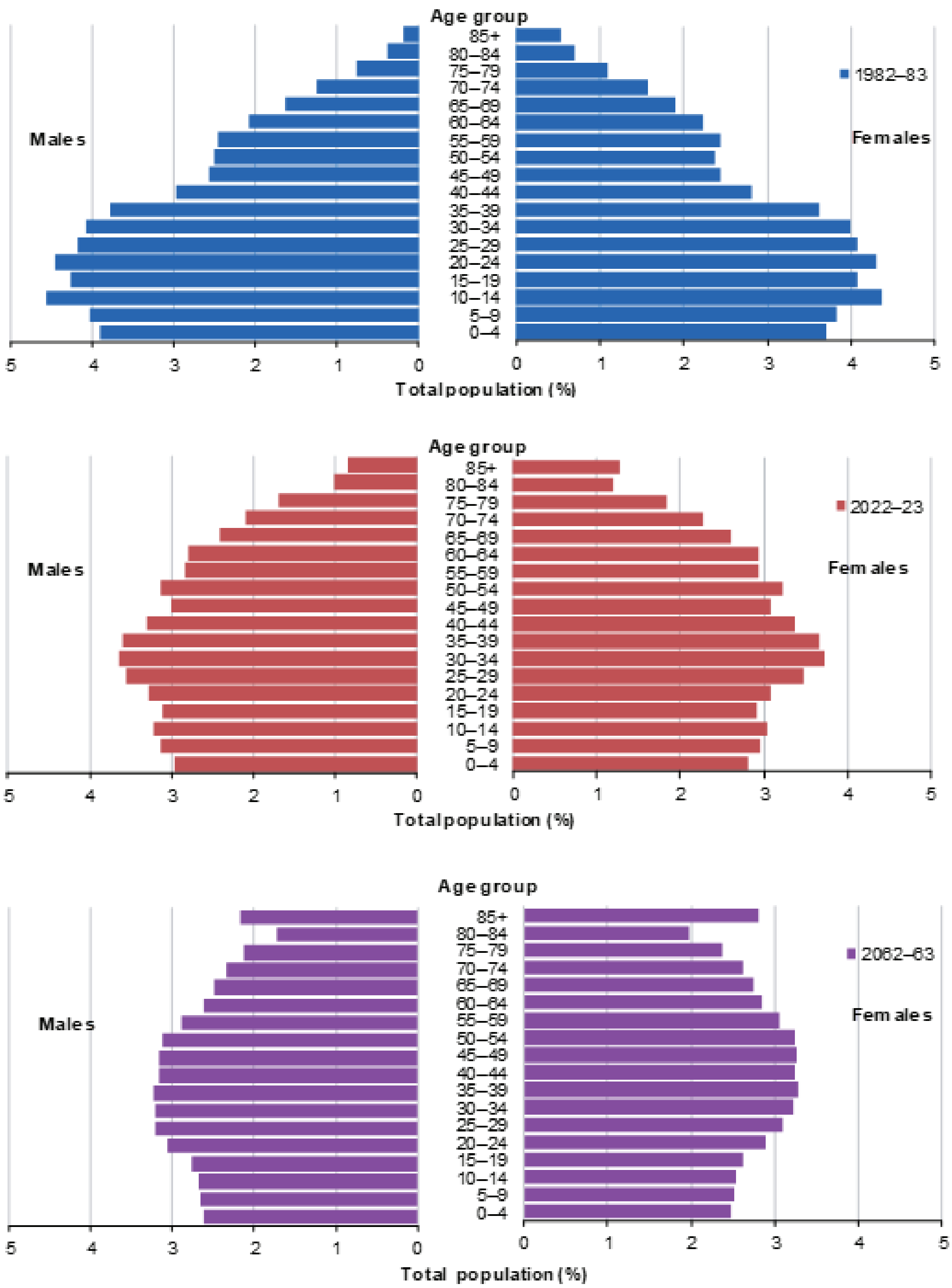
Chart 2: Australia's population growth is slowing



Source: Intergenerational Report 2023. Australian Bureau of Statistics (ABS), National, state and territory population, September 2022, 2023; and Treasury.

Fertility rates have been falling for decades, with families expected to stay at around 1.6 children each on average into the future. Moreover, with lower migration levels, the Australian population has been steadily getting older (Chart 3), with a falling share in the productive younger labour market years, and a population swelling in the post-retirement years which is helping to drive an increasingly services orientated economy.

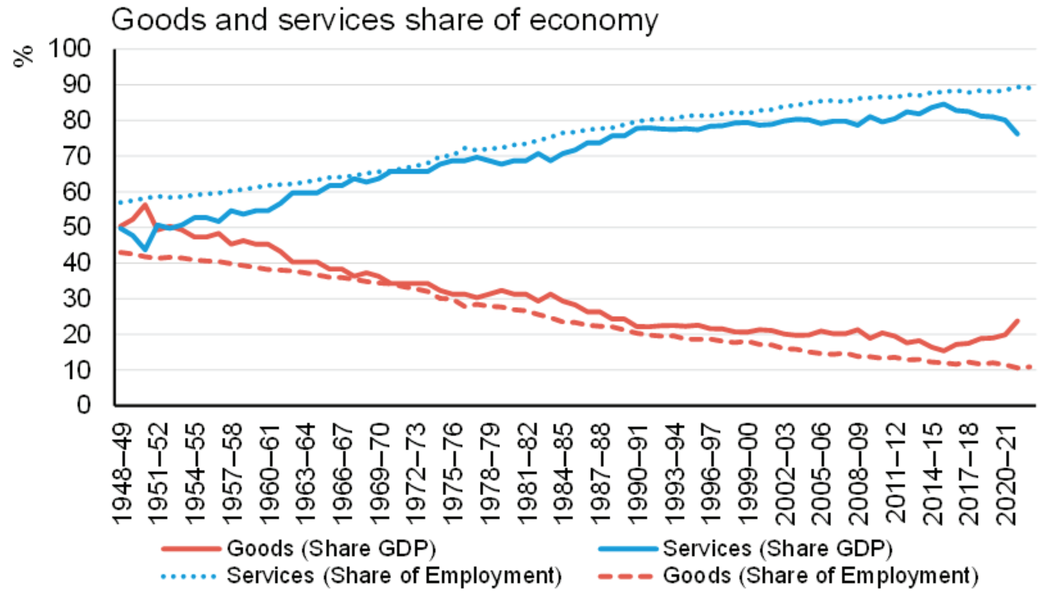
Chart 3: Australia's population is also getting older



Source: Intergenerational Report 2023. ABS, National, state and territory population, September 2022, 2023; Treasury.

Australia continues to mature as a developed economy that is less focused on manufacturing and more on services output. While Australia has benefited from extensive natural resources over the last 200-years, over the last 40 years the country has evolved towards a higher share of services to goods output, as shown in Chart 4. Given the level of wages and the cost of land and services, Australia has long lost any competitive advantage it may have had in the production of goods and, apart from natural resources production and export, continues to pivot more towards a services economy.

Chart 4: Australia is pivoting towards services at the expense of goods



Source: Intergenerational Report 2023. Treasury, Australian National Accounts: National Income, Expenditure and Product Accounts (ABS) 2011 to 2022, Butlin et al, ABS Labour Force and Connolly and Lewis (2010).

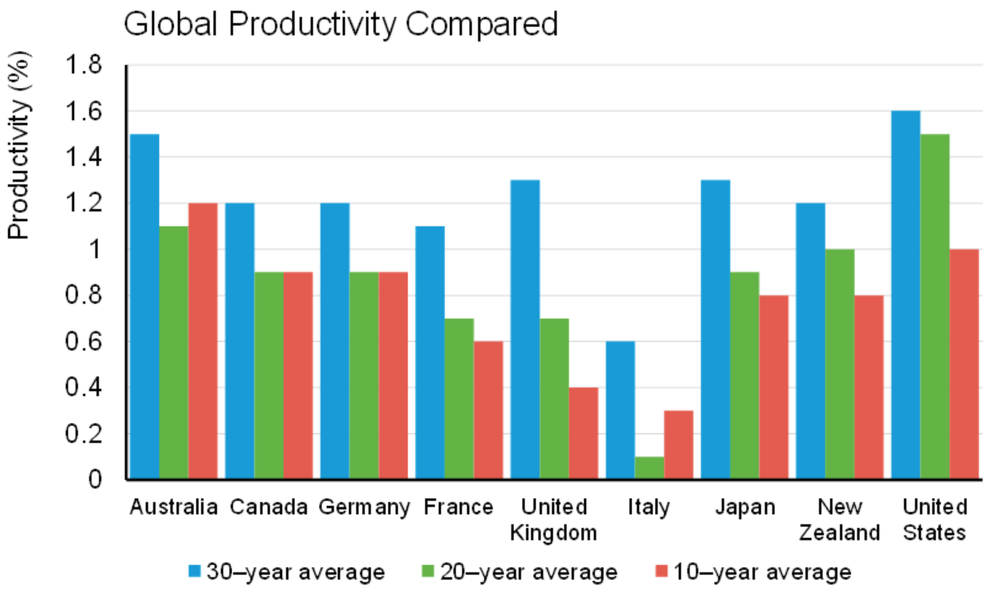
Over the past four decades, Australia's labour productivity has fallen as the economy matures, becomes wealthier and moves towards the demand and production of services at the expense of goods, as illustrated in Chart 5.

Chart 5: Australia's labour productivity is falling

Source: Intergenerational Report 2023. Treasury analysis of ABS 2022 Australian System of National Accounts. Note: Productivity cycles determined by the ABS. 2018–2022 is not a complete productivity cycle. The dashed lines represent 20 year and 30 year productivity growth averages to 2021–22.

Though Australia's labour productivity is falling, by international standards, Australia's recent (10-year) labour productivity is the highest compared to other developed markets, as shown in Chart 6. However, much older and more mature economies than Australia such as Germany, France, the UK, Italy and Japan are stark warnings that developed market productivity can fall even lower as value-adding production shifts to labour markets in emerging and developing countries at the expense of older and wealthier populations in developed markets.

Chart 6: Australia's relative productivity is slipping



Source: Intergenerational Report 2023. Treasury analysis of OECD data. Note: Averages calculated to 2021.

It is important to note that there is significant misunderstanding on what productivity is and how it is measured, according to the Gordon, Zhao and Gretton (Productivity Commission, 2015). Productivity is described as the efficiency by which an economy converts inputs (labour, capital, and raw materials) to output. The Business Council of Australia (BCA, 2023) describes productivity as "getting more output from every dollar invested or hour worked." A negative productivity figure would mean a nation's production depletes the value of its inputs, while a positive value indicates the positive value conversion that come with engaging inputs to generate output. The movement in productivity contributes to a countries GDP growth. Moreover, improving productivity can be contagious, with more productive firms often helping advance the general productivity of their industries in a 'spillover' effect, and further assisting growth in the economy (Gordon, Zhao and Gretton, 2015).

Q: How do we address the problem of falling productivity?

MK: At the granular level, industry policy, taxation rules, labour policy, the adoption of new technology, and many other aspects of how companies are able to transform inputs into outputs, directly impacts the contribution of productivity to economic growth. The Business Council of Australia (BCA) recently launched their research paper, Seize the moment: A plan to secure Australia's economic future, focused on how Australia can unlock higher levels of productivity, and how government can help facilitate change.

The BCA has outlined ways policymakers can help increase productivity for business which by definition contributes to economic growth, including: investing in new facilities and equipment; enhancing existing technology and investing in new technology; initiatives that develop workforce skills; more innovation and faster adoption of new ideas; and removing friction and red tape in the approvals process.

Specifically, the BCA has highlighted a range of what it calls 'big ideas' aimed at improving on productivity issues that have been highlighted in the Intergenerational Report. The initiatives include a review and update of Australia's industry policy that helps identify and drive comparative advantages, and significant improvement and support for Australian businesses' access to global supply chains. The BCA exhorts policymakers to develop and expand on Australia's Asian locality with more trade regionally, and expanded relationships with India. There is a call for a five-year plan to simplify business.

On climate change and the potential to spark productivity in actively embracing net zero targets, the BCA proposes that the Australian Government and state and territory governments commit to a detailed 10-year national Net Zero Roadmap based on a whole-of-system approach to decarbonising the economy to 2050.

The BCA has also called for a significant reform of the taxation system to help remove drag on productivity and the disincentives for investing through a range of initiatives, including: the implementation of broad-based taxation initiatives rather than direct taxes; broaden and increase the goods and services tax (GST) but with a low-income household compensation consideration; streamline direct taxes like income tax and company tax (reducing it to 25% in line with the OECD average); and implementing the Personal Income Tax Plan stage 3 tax cuts. The BCA suggest addressing the capital gains and tax on savings; and to address state-based taxes such as harmonising payroll tax; abolishing stamp duty in favour of a broad-based land tax; and abolishing insurance taxes.

With respect to population growth and workforce participation, the BCA is calling for more targeted migration that supports productivity with skills, policies that increase the participation of women in the workforce, more creative working engagements the expand the workforce, and improvements in work-relevant education and access to lifelong education.

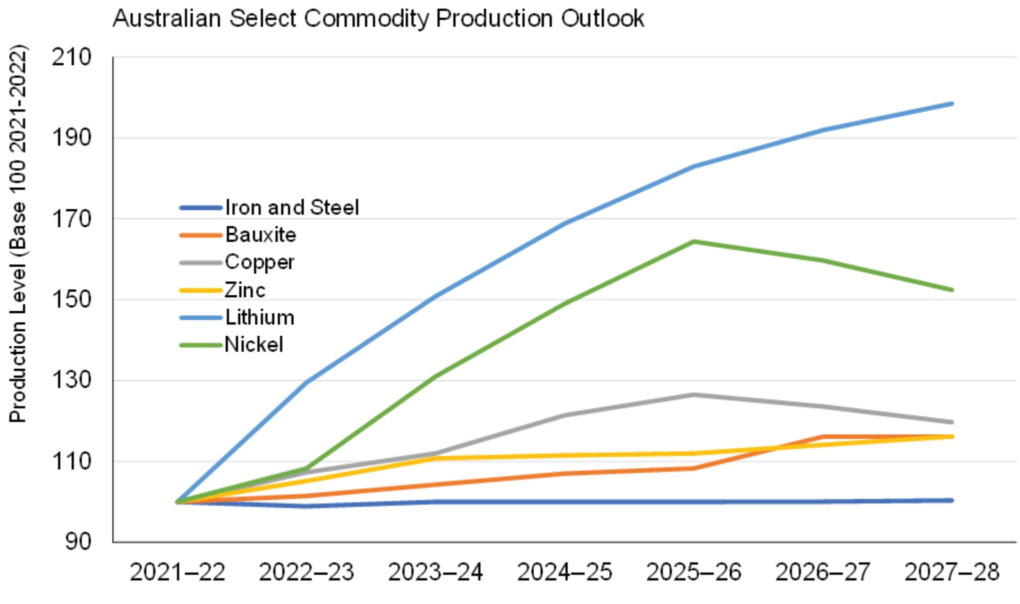
Of course, in Australia, there is a spectrum of views on each of these reform issues and how to address the declining productivity of Australia's economy. What is undebatable is the pressing need for governments and other policymakers and regulators to look at a coordinated approach to helping address the productivity problem that is outlined in the Intergenerational Report, and by the BCA and the Productivity Commission in their work to promote greater productivity for Australia. For investors, there are myriad opportunities that can come from a focus on improving Australia's ability to grow its economy.

Q: Where are the investment opportunities in the 40-year outlook for Australia painted by the Intergenerational Report?

MK: There are opportunities for investors in the long secular themes outlined by the Intergenerational Report, and we believe these would be magnified with improved conditions for productivity like a review of the tax system, and more pro-productivity policies that are harmonised between federal and state governments.

We see a number of major investment opportunities in the long view of Australia's economy. Firstly, perhaps, is the outlook for commodities and natural resources. Australia is resource rich, and there have been many different cycles in which different commodities have been beneficial to Australia's economic growth. Firstly, soft commodities like wool and grain were significant exports for Australia in the nineteenth and early twentieth centuries. Bulk commodities, iron ore and coal, have long been dominant contributors to Australia's export trade, especially with the rapid urbanisation of China over the last three decades. With the onset of a global climate emergency driving the need to decarbonise, Australia's commodity complex is looking at decades of major demand for key decarbonisation commodities as countries seek to achieve their net zero targets by 2050. The commodity outlook is shifting towards the commodities that support decarbonisation, as illustrated in Chart 7, especially in a context where there has been major underinvestment in supply over the last decade.

Chart 7: Key commodity production outlook is shifting



Source: Intergenerational Report 2023. Forecasts and projections from 2022–23. Department of Industry, Science and Resources – Resources and Energy Quarterly, March 2023.

Decarbonisation remains a key driver of Australia's markets, with positive ramifications for the metals and mining, and energy sectors. We remain focused on the key thematics that are driving long-term earnings growth, particularly where imbalances see demand exceeding supply on a fundamental basis for some time. We like critical metals and commodities for the long rotation from fossil fuels to renewables in the great decarbonisation, and the electrification-of-things, with the steady switch from combustion and fossil fuel power to renewable electricity generation. This is a long game which requires a significant amount of investment. Service companies associated with the cap-ex investment needed for this energy transition are also attractive.

There is a multiplicity of other investment themes driven by the long trends identified in the Intergenerational Report. There are significant investment opportunities from Australia's ageing population, including health, wellbeing and housing support, and medical and pharmaceutical developments associated with greater support. Education remains a major export for Australia, and a relative advantage in the Asian region, which will see significant growth in school, tertiary and professional education services. Waste management and conversion, and the recycling industry is another area of growth set to benefit from a rising population and a growing services economy. The building of sustainable infrastructure (energy, communications, transport, utilities and technology), and building sustainable communities in real estate also offer interesting investment options. Artificial intelligence, cybersecurity, privacy, access to technology, data, electronic storage and the internet-of-things is also offering options that are significantly leveraged to Australia's productivity path. Finally, energy and energy security in an increasingly uncertain world, particularly since the energy shock that came with Russia's invasion of Ukraine, has become a major long-term opportunity for Australia in helping supplement energy supplies, and assisting in the acceleration of renewables globally.

Q: What do you conclude about Australia's future as outlined in the Intergenerational Report?

MK: The Intergenerational Report highlights some long trends that call for a critical response from policymakers to address the core problem of falling productivity in Australia. The BCA has proposed a range of constructive opportunities for change, and governments are also reviewing the report for future changes that support productivity. While we wait for policymakers to respond, the trends like decarbonisation, support for an ageing population, increased participation and an expanded workforce for more productive output, a growing services sector, the adoption and leverage of new technologies, and any actions that can be made to make it easier for business to invest, and for consumers to participate more in the productivity equation, all offers compelling opportunities for investors with a long-term focus. While the Intergenerational Report is a great start, the time is now for policymakers to act in order to accelerate the potential for Australia to engage more productively with the world.

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