ECONOMIC UPDATE

PETER MUNCKTON – CHIEF ECONOMIST

WEEK ENDING 26TH MARCH 2021

Summary:

- The unemployment rate has fallen faster than even the most optimistic forecasters' expectations;
- A stronger economy has been one factor;
- Very low population growth has been another;
- A further significant improvement in the labour market is still required.

Recently we found out that the unemployment rate in February was 5.8%. The RBA (like most forecasters) didn't expect the unemployment rate to reach that level until the first half of next year. One of the key reasons for the sharp decline in the unemployment rate has been that the economy is doing better than virtually anyone had forecasted. But another is that jobs growth has been strong at a time when growth in the labour force has been weak.

With JobKeeper coming to an end some turbulence is likely to hit the economy. But the economy did keep powering ahead when JobKeeper was turned down a notch at the end of last September. One reason for that confidence is that the leading indicators (such as job ads) are saying more jobs are on the way.

So the economy is doing much better than we had hoped if we use the unemployment rate as the benchmark. But being ahead of where we thought is not the same as saying we have reached our destination.

The RBA has set an ambitious unemployment rate target. It believes that the unemployment rate might need to drop to at least 4.5% and wages growth will go above 3% (its benchmark for a strongly performing economy). We have done well. But we are still some distance from that mark.

And it is not even clear that the unemployment rate is the best measure of how the labour market is travelling. Movements in the underutilisation rate appear to have a stronger influence on wages growth. And that measure is still above its long-term average. It is also worth keeping an eye on movements in the participation rate as another sign of how the jobs market is performing. That rate is back at its pre-pandemic highs.

Are we there yet?

Over the past year the economy has had lots of surprises. And many of them not good. There was the worst bushfires in decades. The most devastating global pandemic since the Spanish Flu in 1918. And then to prove that bad things really do come in threes we have just had massive flooding down big parts of the East Coast.

But despite these nasty surprises the economy is doing well. Surprisingly well. Recently we found out that the unemployment rate in February was 5.8%. The RBA (like most forecasters) didn't expect the unemployment rate to reach that level until the first half of next year. By global standards the Australian economy is in decent nick.

One of the key reasons for the sharp decline in the unemployment rate has been that the economy is doing better than virtually anyone had forecast. But another is that jobs growth has been strong at a time when growth in the labour force has been weak. Very low population growth means that any new jobs must be filled by those already in the labour force, and not from immigration.

With JobKeeper coming to an end some turbulence is likely to hit the economy. Given the number of people that are still on JobKeeper it would be a surprise if its withdrawal did not leave some mark on the jobs market. But the economy did keep powering ahead when JobKeeper was turned down a notch at the end of last September.

One reason for confidence is that there are more jobs on the way. The number of jobs ads is on the rise. Business employment intentions is comfortably above its long-term average level.

So the economy is doing much better than we had hoped if we use the unemployment rate as the benchmark. But being ahead of where we thought is not the as saying we have reached our destination.

The Government had nominated 5.5% as the unemployment rate that they would consider unwinding fiscal support. But 5.5% is still above the level that the economy entered COVID. And that at time it would be hard to describe the labour market as going 'gangbusters'.

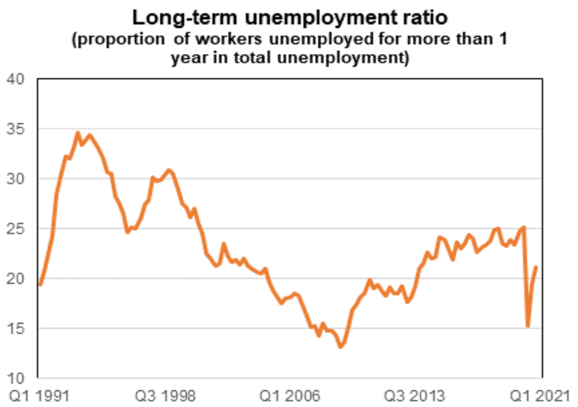
In any event, 5.5% is the average unemployment rate across Australia. Some areas (such as standalone house construction) have got plenty of work on. Others (such as tourism) still are likely to need Government help.

The RBA has set an even more ambitious target. It believes that the evidence pre-COVID was that the unemployment rate might need to drop to at least 4.5% before the economy can be called performing strongly. By this they mean the unemployment rate has got down so low it has driven wages growth above 3%. We have done well. But we are still some distance from that mark.

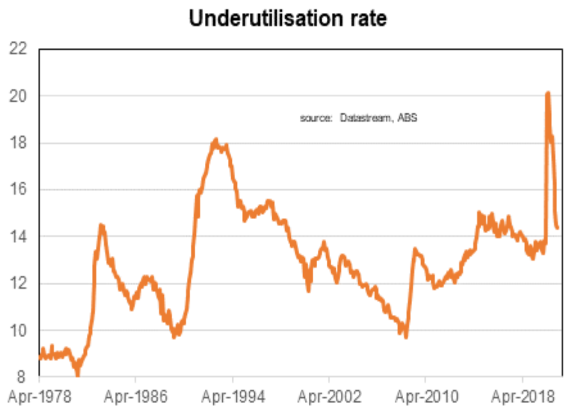
There has been a sharp drop in the unemployment rate. But it remains above its pre-COVID level.

But the proportion of people in the labour force is back at its record highs.

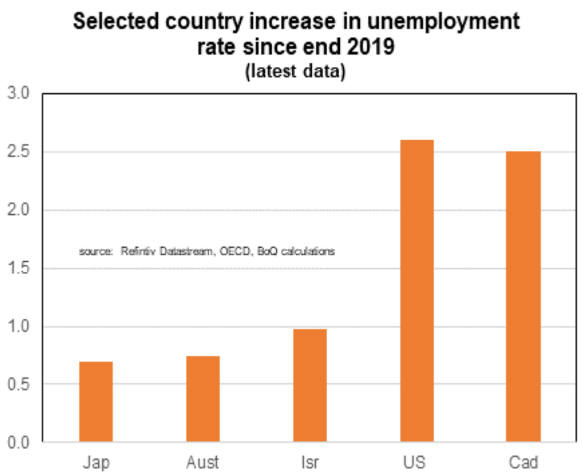
There has been a rise in long-term unemployment. But it remains below its recent pre-COVID peaks.



The underutilisation rate is above its long-term average.



Australia has done well by global standards.



The unemployment rate is too high across states, particularly in South Australia.

The current unemployment rate masks differences between regions and sectors. NSW and Victoria and their unemployment rate is in the 'mid 5's'. But the unemployment rate is above 6% in Queensland and Tasmania. And it is over 6.5% in South Australia.

And it is not even clear that the unemployment rate is the best measure of how the labour market is travelling. Movements in the underutilisation rate (the unemployment rate plus those working part-time that would like a full-time job) appear to have a stronger influence on wages growth. That measure is still north of 14%, comfortably above its pre-COVID mark. It is also above its long-term average. And above the level consistent with 3% wages growth.

It is also worth keeping an eye on movements in the participation rate. The participation rate is another sign of how the jobs market is performing. It is also an important driver of long-term economic growth. There were worries in the early days of the pandemic that a lot of people could leave the labour force leaving a lasting mark on the economy's ability to grow.

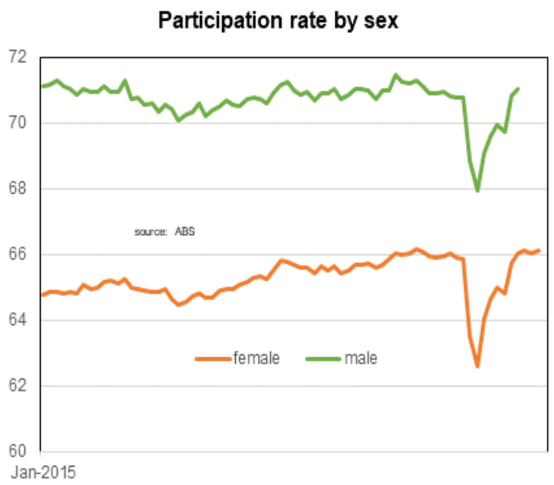
But Australia's participation rate has reached its pre-pandemic highs. Participation by females in particular is near record highs. Male participation is lagging a little. But it is not significantly lower.

The growth of the labour force has been very low.

There are more job being created.

And firms say they are happy to expand the size of their workforce.

Female participation rate is back at record highs. The male rate is still a bit below its highs.



The unemployment rate has fallen a lot quicker than what anyone had thought. Some economic turbulence is likely in coming months. But with the increasing likelihood that the economy will stay in good shape over the next couple of years a further fall in the unemployment rate is highly probable. The longer that the population growth remains very low, the sharper the decline in the unemployment rate could be.

The economy has travelled a surprising distance in a relatively short period of time. There is some distance on the journey still to go.

We live in interesting times.

Regards,

Peter Munckton
Chief Economist
Bank of Queensland