

Labour Force Scenarios around the GFC

January 2009

Key Points:

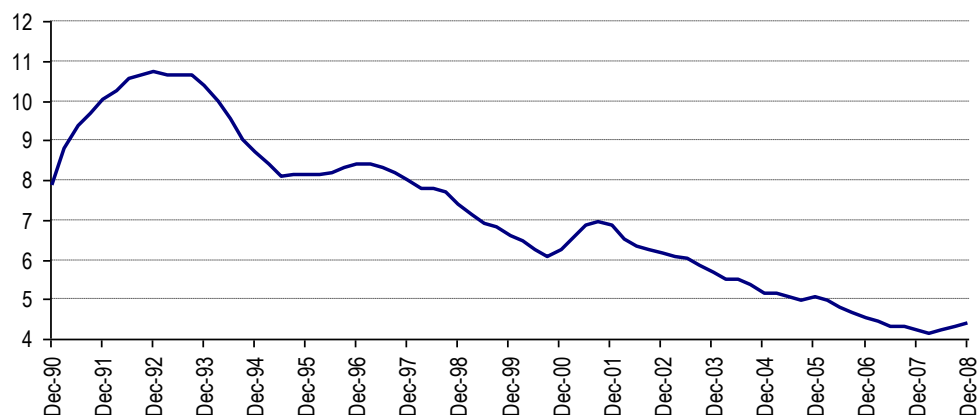
- This research considers the likely impact on jobs and unemployment from a number of potential economic growth scenarios over the next two years.
- A 'middle ground' case has the unemployment rate rising to 6.3 per cent by June 2010, swelling the unemployed pool to 718,000 persons.
- A worst-case scenario would be a repeat of the labour market performance of the last Australian recession in the early 1990's - increasing the unemployment rate to 7.8 per cent by June 2010 and peaking at a million people unemployed, or a rate of nearly 9 per cent, by the end of 2010.

Since the last Australian recession in the early 1990's the Australian Labour market has experienced a golden age. Figure 1 shows that unemployment peaked at 10.7 per cent in 1992 and then dropped to a cyclical low of 4 per cent early in 2008. During this period, employment growth averaged 2.2 per cent per annum and Gross Domestic Product (GDP) growth averaged 3.5 per cent per annum. The number of Australian's who were unemployed halved from 920,000 to 460,000.

By early 2008, Australia was effectively operating at full employment, the first time this situation had occurred in over a generation. This full employment starting point was always going to magnify the bad news associated with deterioration in the unemployment rate whenever that inevitably began to occur, which is now.

Australian Unemployment Rate (%), Trend,

Source: ABS 6202



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With the downturn in the economy, unemployment has begun to creep back up and there is little doubt that unemployment will increase significantly over the next couple of years. Economic growth has slowed to an annualised rate of around 1 per cent.

Unemployment lags other economic indicators so the slowing Australian economy is yet to translate into a major up-tick in the unemployment rate. That up-tick is expected to occur over the next two years and the extent of the rise in unemployment will reflect the depth of the economic slowdown.

This research considers the likely impact on jobs and unemployment from a number of potential economic growth scenarios over the next two years.

The first scenario is an optimistic view that the economy remains slow but avoids a recession and picks up pace in 2010. The second scenario is the 'middle ground' case where the economy fails to grow in 2009 and remains slow through 2010. A third scenario is a pessimistic one where the economy follows a similar trajectory to the recession of the 1990s which means that economic activity contracts to a -2 per cent annualised rate and does not return to positive growth until mid-2010.

Optimistic Jobs Scenario:

Under this scenario the economy's current annualised growth rate of 1 per cent remains intact over 2009 and then increases to 2 per cent by mid-2010. This 'optimistic' scenario would rely on only a moderate slowing in the Chinese economy and on monetary and fiscal policy here at home having a positive and permanent impact on both confidence and real levels of spending.

Using historical relationships between economic growth and jobs growth and likely population and participation rate changes, Table 1 provides projections of likely employment and unemployment scenarios.

Table 1 summarises the impact of the optimistic jobs scenario. Unemployment increases to 5 per cent by June 2009 and to 5.7 per cent by June 2010. Unemployment will be around 150,000 higher than current levels by June 2010. Growth in the labour force will be extremely slow at only 0.2 per cent per annum. Labour force participation will drop to 64.7, 0.4 percentage points below current levels.

Table 1 Optimistic Unemployment/Economic Growth Scenario

	Employment Annualised Growth	Unemployment (000s)	Unemployment (%)	GDP growth Annualised Growth
Jun-08	1.3%	474	4.2	1
Dec-08	0.2%	498	4.4	1
Jun-09	0.5%	561	5.0	2
Dec-09	0.5%	606	5.3	2.5
Jun-10	0.5%	650	5.7	3

Source: HIA Economics Group

Median Jobs Scenario:

Under this scenario the economy's current annualised growth rate of 1 per cent drops to no growth over 2009 and then increases slowly to 2 per cent by late 2010. This scenario would likely incorporate a continuation of credit availability problems, a much slower Chinese economy, and confidence levels remaining low throughout 2009. Table 2 provides projections of likely employment and unemployment scenarios.

Unemployment increases to 5.1 per cent by June 2009 and 6.3 per cent by June 2010. Unemployment will be around 220,000 higher than current levels by June 2010. The labour force will fail to grow over the coming two years. Labour force participation will drop to 64.4, 0.8 percentage points below current levels.

Table 2 Median Unemployment/Economic Growth Scenario

	Employment Annualised Growth	Unemployment (000s)	Unemployment (%)	GDP growth Annualised Growth
Jun-08	1.3%	474	4.2	1
Dec-08	0.2%	498	4.4	0
Jun-09	0.0%	574	5.1	0
Dec-09	0.0%	646	5.7	0
Jun-10	0.0%	718	6.3	1
Dec-10	1.0%	761	6.6	2

Source: HIA Economics Group

Pessimistic Jobs Scenario:

Under this scenario Australia moves into a recession of a similar magnitude to our last recession in the early 1990's. This scenario would suggest: a worsening of the global credit crisis, leading Australian banks to further tighten credit conditions and confidence to worsen; low interest rates to prove relatively ineffective; federal fiscal stimulus packages to only have short term impacts at best; and the Chinese economy to slow substantially.

Table 3 shows the likely impact on the jobs market. Unemployment increases to 5.5 per cent by June 2009 and to 7.8 per cent by June 2010. Employment contracts by 1 per cent per annum. Unemployment increases by nearly 400,000 on the latest figures. Labour force participation drops significantly to 64 per cent, 1.2 percentage points lower than current levels.

Table 3 Pessimistic Unemployment/Economic Growth Scenario

	Employment Annualised Growth	Unemployment (000s)	Unemployment (%)	GDP growth Annualised Growth
Jun-08	1.3%	474	4.2	1
Dec-08	0.2%	498	4.4	-1
Jun-09	-1.7%	626	5.5	-1.7
Dec-09	-1.7%	757	6.7	-0.2
Jun-10	-1.8%	887	7.8	2
Dec-10	-1.0%	995	8.7	4.2

Source: HIA Economics Group

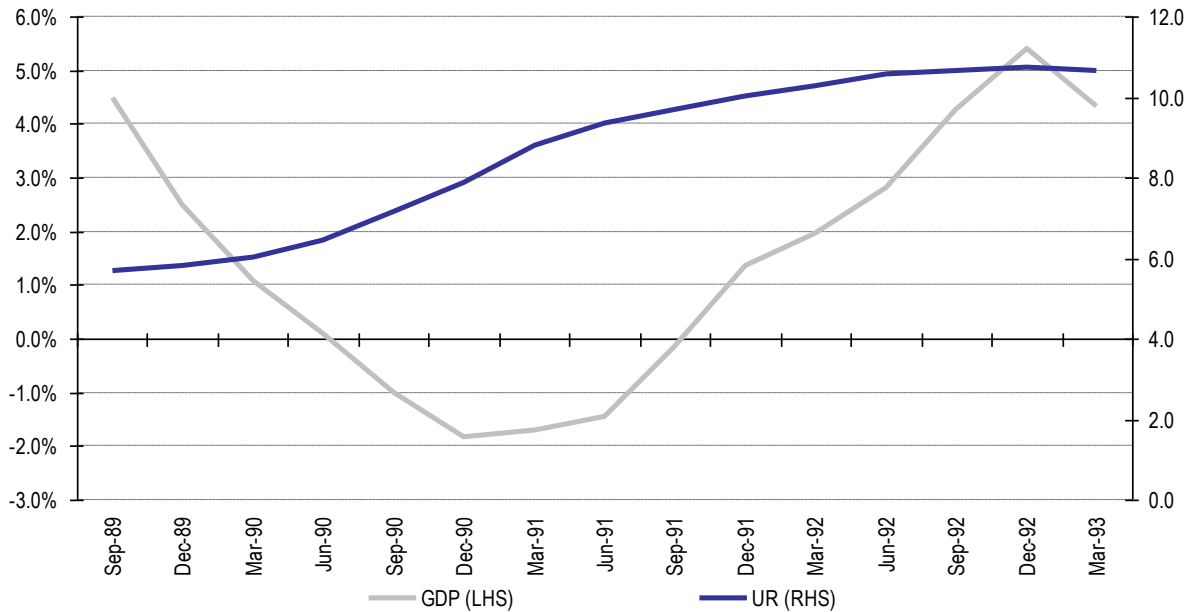
That was then this is now:

Australia's last recession was grim. Unemployment rose to 10.8 per cent (up from 6 per cent) and GDP went backwards by nearly 2 per cent during the 1990/91 financial year. Interest rates were running at 17 per cent and the federal government was unable to use the fiscal levers as government was already running a hefty deficit. Policy makers face a different set of circumstances in 2009 with bank mortgage rates as low as around 6 per cent (and set to fall much further) and the Federal Budget is moving into deficit from a position of surplus.

During the recession of the early 1990s unemployment was still increasing well after the economy had returned to strong economic growth. Figure 2 shows the relationship between economic growth and the unemployment rate during the last recession. Where the rate of change in GDP bottomed in December 1990, unemployment didn't peak until 2 years later. Unfortunately, unemployment is even slower to fall than it is to rise. It was not until 2003 that unemployment returned to pre-recession levels.

Australian Unemployment and GDP – 1990s recession

Source: ABS 6202, 5206



Comparing the current economic slowdown to the last Australian recession and considering the unemployment impact is a difficult task. The Australian labour market is now more flexible meaning that the impact of the economic slowdown on the labour market may be felt differently. Recent labour market statistics are suggesting that hours worked are being reduced and new jobs tend to be part-time rather than full-time. This may mean that the unemployment rate may not increase at the same rate as in past recessions.

Conclusion:

HIA has considered various demographic and economic scenarios to investigate the labour force over the coming two years. A repeat of the recession in the early 1990s is considered a 'worst case' scenario, while a best case scenario is that offered by a continuation of the most recent economic data. A more likely scenario would be economic growth running at zero or near zero and employment growth being no greater than zero. Under this scenario, and the likelihood of a lower participation rate and continued strong immigration, unemployment will likely reach 6.3 per cent by June 2010 (and 6.6 per cent by December 2010). This will condemn a further 260,000 people to the unemployment queue. There is a far higher risk of this 'middle ground' scenario being too optimistic than too pessimistic.

Current economic conditions have little precedents, making the job of forecasting a difficult one. The fallout from the global credit crisis is yet to fully play out, the China effect remains unclear, and the impact of monetary policy (lower interest rates from the Reserve Bank of Australia) and fiscal policy (government spending and taxation measures) is also unclear. On the positive side Australia now has a more flexible labour force and still has room to move on these major macroeconomic levers of monetary and fiscal policy. However these factors play out over the coming years it would seem assured that the era of full employment and continuous strong economic growth is being replaced with a world that has lost its confidence. This will inevitably lead to large job losses and limited economic growth at best over the next couple of years.