

ECONOMICS: AUSTRALIAN PERSPECTIVES—JANUARY 22, 2010

Unemployment Peaks Early, but There Are Still Reasons for Caution

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At first sight, Australia’s labor market appears to have been going from strength to strength. But is it all plain sailing? We think there are two reasons for caution—at least at the margin—in the interpretation of the numbers.

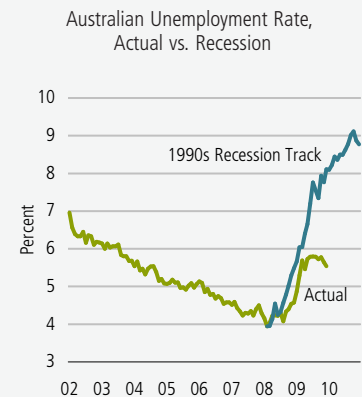
At first sight, Australia’s labor market appears to have been going from strength to strength. In the six months to December, the economy gained 25,000 jobs a month. This has been fast enough to absorb the rapid increase in new entrants to the labor force: as a result of record immigration, the working age population is now growing at 2% a year, the fastest since the late 1980s. Accordingly, the unemployment rate appears to have peaked and is now falling, reaching 5.5% in December (**Display 1**). Considering that many analysts at the start of 2009 thought unemployment was heading to 8.5% or 9%, the fact that we are seeing it peak at less than 6% is extraordinary.

Most labor-market leading indicators point to a continuing jobs recovery. The employment index of National Australia Bank’s business survey, for example, is consistent with employment growth running at around 2.5%. Our leading-indicator employment model, which uses a range of factors to predict jobs growth, suggests jobs will grow by 23,000 to 27,000 a month in the first half of 2010.

But is it all plain sailing? We think there are two reasons for caution—at least at the margin—in the interpretation of these numbers. First, one of the features of the employment correction in late 2008 – early 2009 was that average hours were cut quite aggressively, so that the fall in total hours worked was much larger than the fall in headcount (**Display 2**). So far in this recovery, average hours are little changed—that is, while hours have recovered alongside jobs, there is still a gap between the two. In other words, there is more spare capacity in the economy than a 5.5% unemployment rate would suggest.

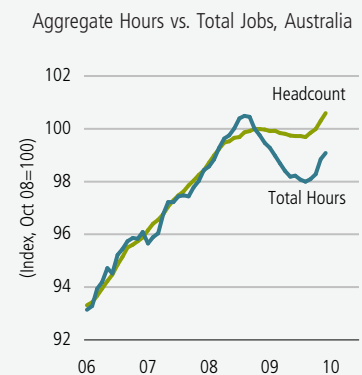
Second, the occupational composition of employment is interesting. Unfortunately, the data are only available quarterly, so the best we can do is look at the November figures. But even these are illustrative. In the early part of the downturn, the manager/professional group was hardest hit. That cohort has bounced back very sharply (**Display 3**). By contrast, the laborer/clerical group held up well initially, but has been falling recently. This is an

Display 1
Unemployment Peaks Early



Source: Australian Bureau of Statistics

Display 2
Hours Worked Lag Headcount



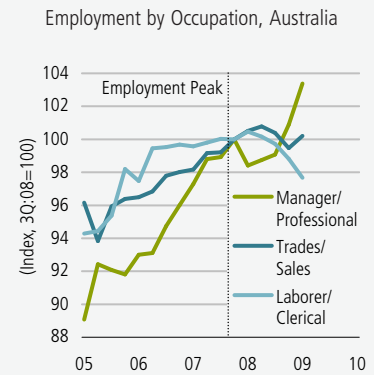
Source: Australian Bureau of Statistics

area to watch, given that this group is more likely to be affected by housing stress as interest rates rise.

These notes of caution notwithstanding, the Australian economy has clearly entered 2010 with spare capacity much tighter than the Reserve Bank of Australia (RBA) had anticipated. Consequently, inflation looms larger in the policy debate and the tug-of-war between the disinflationary impact of the stronger Australian dollar and potential domestic inflationary

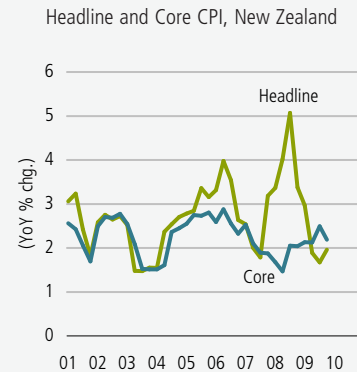
pressures may prove crucial. Next week's CPI figure (January 27) will be important. In that context, it's worth noting that New Zealand's fourth-quarter CPI yielded some positive surprises. The headline number turned out to be lower than expected (down 0.2%), and the array of core measures was also surprisingly subdued. Some of the angst the Reserve Bank of New Zealand expressed about inflation in its December Monetary Policy Statement will surely have eased. ■

Display 3
What's Driving Jobs Growth?



Source: Australian Bureau of Statistics

Display 4
NZ Inflation—a Positive Surprise



Source: Reserve Bank of New Zealand and Stats NZ

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