

Labour market snapshot #86 January (27) 2022

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Using the December rate of unemployment to look ahead

Key points

- The rate of unemployment of 4.2 per cent in December 2021 is good news. And beyond what is likely to be a backward step due to omicron, there seems enough momentum for the rate to go even lower in 2022.
- But we need to exercise some caution in thinking that what has happened in 2021 (and will happen in 2022) is a guide to where the Australian labour market will land in the longer-term, post-COVID-19.
- Above-trend growth in employment since the onset of COVID-19, which seems mainly attributable to government policy, explains one-third to two-thirds of the decrease in rate of unemployment. This suggests that the extent to which policy continues to provide stimulus to economic activity will be critical for keeping the rate of unemployment low.
- Slower growth in the labour force participation rate during COVID-19 also explains some of the lower rate of unemployment. Should that growth return to its level prior to COVID-19, it will be a headwind to keeping the rate of unemployment low.
- Closed international borders may also be artificially lowering the measured rate of unemployment.

Introduction

The gyrations of the Australian labour market due to COVID-19 are much like a scene from an old black-and-white western movie. A steam train is getting to full pace when suddenly the driver sees ahead that a 'goodie' has been strapped to the tracks by one of the 'baddies'. The brake is thrown on, and in an instant the train comes to a shuddering and screeching halt. That's how it was in the Australian labour market in mid-2021 as the fastest recovery in employment on record was sent backwards by the Delta strain. And while the Labour Force Survey (LFS) numbers for December 2021 show that the train was getting back to full pace by year's end, it will be amazing if we don't find that the brakes have gone on again with the emergence of the omicron variant.

Yet even knowing that they are about to be undone, the LFS numbers for December are worth spending time on. Because they may be telling us where the labour market will land if COVID-19 is more completely brought under control.

The rate of unemployment: Then and now

In the decade prior to the onset of COVID-19 the rate of unemployment in Australia hardly moved. In March 2010 the rate was 5.4 per cent. Ten years later in March 2020 it was 5.3 per cent. In between it had initially increased by a small amount, reaching over 6 per cent in 2014-15, before slowly falling back to where it started. In the whole decade the rate only fell below 5 per cent for

two months, and then just to 4.9 per cent (both times in 2011).

That all changed in 2021. The rate of unemployment was below 5 per cent in six months out of twelve. By December it was down to 4.2 per cent.

There also seems plenty of momentum for the rate of unemployment to fall further in 2022, once the slow-down from omicron is behind us.

When you have had growth in employment of 365,000 in one month, and 65,000 in the next, as happened at the end of 2021, usually there is more to come.

In this case, a major reason for thinking there is more to come is the current high level of job vacancies. Suppose that the vacancy rate at the end of 2021 had been the same as prior to COVID-19 (that is, 1.75 per cent instead of 2.9 per cent).¹ This would have meant an extra 158,000 jobs filled; and hence an even lower rate of unemployment. For example, if one-half of the extra jobs were filled by unemployed persons moving into work, the rate of unemployment in December would have been only 3.6 per cent.

So the December 2021 LFS rate of unemployment is certainly some guide to the future. A continued low rate of unemployment seems likely in 2022 (especially once the impact of omicron diminishes). But what about the longer

term? Is a rate of unemployment of about 4 per cent here to stay for years ahead?

Is the December rate of unemployment our future?

Do the following thought experiment: Suppose that we could erase all the COVID-19 related impacts on the Australian economy since March 2020 – the impact of the pandemic and all the extra government spending alike. What would labour market outcomes look like today? I can't see that they would look too much different than 22 months ago. Because it's not like in that 22 months some big new economic opportunity has come along to boost GDP. Therefore, the main reason for thinking that we may be entering a phase with a permanently lower rate of unemployment has to be because policy is taking us there. Whether policy does take us there depends on: (i) How much stimulus will continue to come from COVID-19 related spending and programs already undertaken or committed to; and (ii) the future stances of fiscal and monetary policy.

It's possible to make this point – the importance of policy for what has happened to employment - a little more concrete by forecasting where the rate of unemployment would have been without COVID-19. To do this I make simple forecasts of the employment/population rate and labour force participation rate following

¹ Using numbers from the ABS Job Vacancy series for November 2021.

the onset of COVID-19 using linear trends of those series from prior to COVID-19. I use three time periods to make forecasts: 3 years, 4 years and 5 years prior to March 2020.

To give a feel for what the forecasts look like, in Charts 1a and 1b I show (respectively) the employment/population rate and the labour force participation rate: both the actual and the forecast from April 2020 onwards (using the 4-year forecast period).

Chart 1a: Employment/Population rate, Actual and Forecast (using 2016-20), March 2016 to December 2021

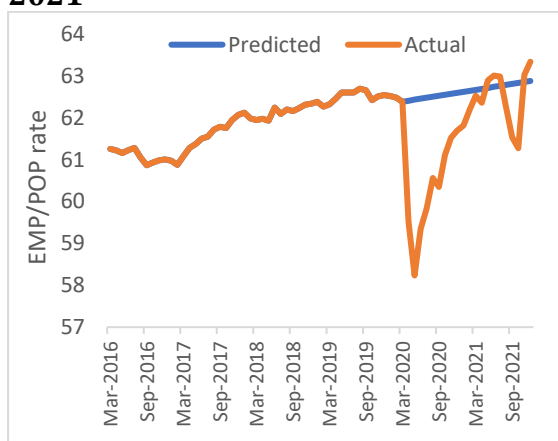
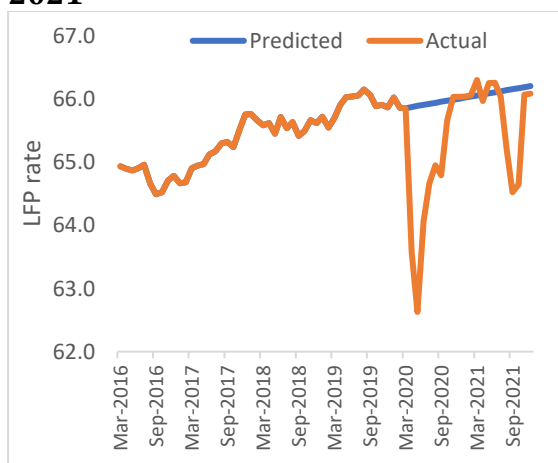
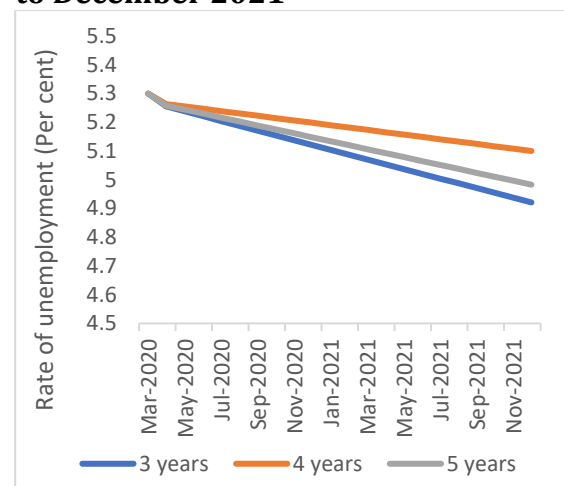


Chart 1b: Employment/Population rate, Actual and Forecast (using 2016-20), March 2016 to December 2021



Using the forecasts of the employment/population and labour force participation rates it is possible to also forecast the rate of unemployment in the absence of COVID-19 and policy responses. These forecasts are presented in Chart 2. If pre-existing trends in the employment/population and labour force participation rates had continued, then rate of unemployment would have decreased to 4.9 to 5.1 per cent by December 2021 (that is, by between 0.2 and 0.4 ppts compared to March 2020).

Chart 2: Forecast rate of unemployment, Australia, April 2020 to December 2021



Note: Rate of unemployment = (LFP rate – EMP/POP rate)/LFP rate.

Of course, the actual rate of unemployment in December 2021 was 4.2 per cent. Hence, pre-existing trends can explain some, but nowhere near all, of the observed decrease in the rate of unemployment. Instead, the majority of the decrease in the rate of unemployment must be explained by some combination of faster growth than forecast in the employment/population

rate or slower growth than forecast in labour force participation.

Table 1 presents the results from a decomposition of the change in the rate of unemployment from 5.3 per cent in March 2020 to 4.2 per cent in December 2021 between the effects of:

- (i) the pre-existing trend in the employment/population and labour force participation rates;
- (ii) growth in the employment/population rate being faster than forecast; and
- (iii) growth in labour force participation being slower than forecast.

Table 1: Decomposition of change in rate of unemployment from March 2020 to December 2021

	Forecast using:		
	3 Years	4 years	5 years
Trend	-0.4	-0.2	-0.3
Above-trend employment/population growth	-0.3	-0.7	-0.65
Below-trend LFP growth	-0.4	-0.2	-0.15
Total change	-1.1	-1.1	-1.1

Note: Forecast using x years is a forecast from April 2020 onwards using the linear trend in EMP/POP rate and LFP rate from x years prior to March 2020.

In all the forecasts, above-trend growth in the employment/population rate is a

major explanation for the lower rate of unemployment, accounting for one-third to two-thirds of the decrease.²

I interpret the above-trend growth in the employment/population rate as being primarily due to policy.

Spending by government on COVID-19 related programs - or policies such as the superannuation release that have allowed increased spending - have added considerably to GDP, hence increasing employment.

What follows is that whether the rate of unemployment remains low will depend on policy makers being willing to continue to provide stimulus to economic activity.

It's also worth noting that another aspect of policy, closed international borders, may have artificially boosted GDP, and hence employment. Last year Saul Eslake estimated that the effect of Australians redirecting spending they would have made on international travel to domestic consumption had raised GDP in Australia by 1.25 ppt between March 2019 and March 2020.³ Reopening of international borders would therefore imply slower employment growth, providing another reason to think that continued stimulus will be needed to keep the rate of unemployment low.

² Note that if we were also to add in the extra job vacancies that exist at present, the proportion of the lower rate of unemployment due to above-trend employment growth would be even higher.

³ Saul Eslake (2020), 'A new form of 'protectionism' – Australia's prolonged border closure', Presentation to webinar.

The extent to which the lower rate of unemployment can be attributed to above-trend growth in the employment/population rate does depend somewhat on the period used to make the forecast of future growth. Growth in the employment/population rate was on average faster in the three years before COVID-19 than the four or five years before. Therefore, using the three years forecast period attributes a slightly larger proportion of the lower rate of unemployment to the pre-existing trend and a lower proportion to above-average growth in the employment/population rate during COVID-19.

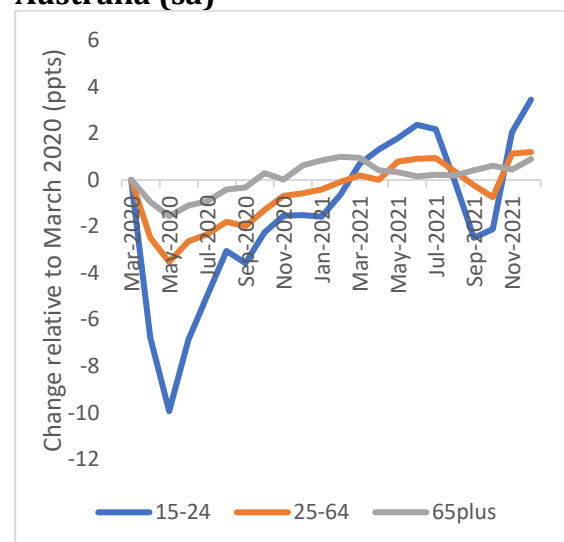
A slower rate of growth in the labour force participation rate has also been responsible for the lower rate of unemployment. That slow-down explains from 0.15 to 0.4 ppt in the decrease in the rate of unemployment. It is easy to imagine many ways in which growth in the labour force participation rate may have been stalled due to COVID-19 (such as withdrawal to care for children). If growth in the labour force participation rate does return to its previous path as COVID-19 recedes, this will be another headwind to keeping the rate of unemployment low.

Has young people's employment really grown so much?

It's interesting that the strongest employment growth from March 2020 to December 2021 was for the young, aged 15 to 24 years. Yes, even though the young have been hardest hit during downturn phases associated with

COVID-19, by December 2021 the proportion of the young in employment was 3.5 ppts higher than in March 2020 – compared to 1.2 ppt for those aged 25-64 years and 0.9 ppt for those aged 65 years and above. Chart 2 shows how the employment/population rates for these age groups have evolved.

Chart 2: Change in employment/population rates by age, Relative to March 2020, Australia (sa)



The strength of employment growth for the young - given all we know about the increasing difficulties they faced in the labour market in the 2010s – does seem surprising.

Maybe it is reflecting that the recovery had by the end of 2021 pushed total employment well above its level from March 2020; and that we always expect the young to benefit most from strong employment growth.

But it may also partly reflect a compositional change in employment of the young. If young Australian

permanent residents are taking over jobs previously held by international students and working holiday-makers, and are more likely to be captured in the LFS, then even if total employment of the young hasn't changed, it will seem to be increasing because of who is doing the work.⁴ Of course, I can't say for sure how much of a factor this is, but it does seem worth keeping in mind.

Data

- Charts 1a and 1b, Table 1: ABS, Labour Force Survey, Table 1.
- Chart 2: ABS, Labour Force Survey, Tables 1, 12 and 16.

⁴ There are two reasons for thinking that international students and working holiday-makers are less likely to be picked up by the LFS than permanent Australian residents. First, international students and working holiday makers are only counted in the LFS if they are in Australia for more than 12

months. Second, international students and working holiday makers are likely to be harder to find to survey – because of the types of dwellings in which they live and being itinerant.