Unemployment escalates as economy slows

Labour market data for the month of April showed a record decline in the number of workers employed as the Coronavirus related business shutdowns sharply slowed economic activity. Employment declined by a record 594,000, or 4.6% during April. The decline in employment was accompanied by a jump in the unemployment rate from 5.2% to 6.2%.

The rise in unemployment would have been more significant if it were not for a sharp fall in the Workforce Participation Rate. The Workforce Participation Rate refers to the percentage of the adult population that is in the workforce (i.e. either employed or seeking employment). During April, the Participation Rate fell from 66.0% to 63.5%. This is the lowest rate of participation since mid-2004. The fall in participation suggests a large number of workers who lost their jobs in April left the workforce (at least temporarily), rather than actively seek alternative employment.

Also impacting on the pattern of labour market data last month was the “Job Keeper” scheme. This scheme, funded by the Commonwealth Government, provides a wage subsidy to employers to flow through to employees of businesses that experience a 30% reduction in revenue during the Coronavirus shutdown impact period (a 50% reduction hurdle applies for businesses with turnover above $1bn). The payment is $1,500 per fortnight (pre-tax) per employee. An objective of the scheme is to encourage employers to retain employees and therefore reduce the number of workers becoming unemployed. In late May, the Federal Treasury estimated that approximately 3.5 million workers would be covered by Job Keeper.

Given the sharp movements in the participation rate and the presence of the Job Keeper Scheme, data on the number of hours worked may provide a more accurate assessment of the impact of the shutdowns than the employment or unemployment aggregates. During April, the number of hours worked across the economy declined by 9%. Hence, this decline was approximately double the decline in the number of workers employed and highlights an underlying rise in the number of workers “Underemployed”. An underemployed worker refers those who are unemployed, as well as part-time workers that would like to work more hours. In addition, a worker who normally works full-time, but was only able to work part-time due to economic reasons (e.g. insufficient work available) is also considered underemployed. The rate of underemployment jumped 4.9% to 13.7% during April.

The Reserve Bank anticipates that the labour force data will worsen before it improves. In late April, the Governor of the Reserve Bank, Mr. Lowe, suggested that hours worked could fall by 20% in the first half of 2020, with unemployment peaking at 10%.

Q1: Define the term “underemployed”.

Q2: Explain why the decline in hours worked during April was significantly more than the decline in the number of workers employed.
Soft wages growth continues

With the demand for labour declining due to the business shutdowns, the outlook for wages growth remains subdued. Wages growth has been at modest levels for an extended period and has been a key contributor to the maintenance of low inflation – both locally and overseas. Further evidence of a continuation in this trend in Australia was contained in wages data for the March quarter. The seasonally adjusted Wage Price Index rose by just 0.5% over the 3-month period, resulting in the annual rate of growth declining from 2.2% to 2.1%. The Wage Price Index series commenced in the September quarter of 1998. Over this time, the average rate of growth has been 3.2%. As such, current growth is well below average; but still above the record low of 1.9% recorded in 2016/17.

![Price and Wage Movements (%pa)](chart)

Source: Australian Bureau of Statistics 6345, 6401

As indicated on the chart above, movements in inflation and wages growth tend to be closely correlated. As wages are a major component of production costs, wage increases are often passed through by producers as higher prices. Therefore, the absence of significant wages growth reduces this potential source of inflation. The chart also highlights that for much of the past 5 years there has been minimal difference between underlying inflation and wages growth. This implies there has been little “real” growth in average wages, which removes scope for any significant improvement in living standards. Wages growth in the year to March 2020 was just 0.3% above underlying inflation.

Even prior to the Coronavirus related shutdowns, Australia appeared to have surplus capacity in the labour market, with the demand for labour below the supply of labour. This imbalance is likely to be a factor in keeping wages growth low.

However, even after accounting for some surplus in the supply of labour, it would appear there has been a structural decline in wages growth over the past decade. Even in industries where labour is generally considered to be in short supply, wage growth has been relatively muted. For example, boom conditions have characterised the construction industry over much of the past 5-years. However, the average rate of wages growth in the private sector construction industry has been just 1.1% per annum over the past 5-years.

The role of inflationary expectations could be important in explaining the decline in the rate of wages growth over the past decade. As workers’ expectation of future inflation may now be lower than it has been in past periods, they may be demanding lower rates of wage increase to compensate for future inflation. Also impacting the willingness of workers to demand higher wages could be the increasing globalisation of the production process. With firms more able to shift production to locations with lower wage costs, the bargaining power of workers has been eroded.

Compounding the impact of subdued wages growth on household disposable income is the progressive nature of Australia’s income tax system. This results in average income tax rates rising as wages increase - unless tax rates and scales are changed. With an absence of material change to tax scales over recent years, rising average tax rates have further constrained the income available (disposable income) for households to spend.

With wages growth remaining relatively modest, the scope for households to expand consumption expenditure is somewhat restricted. This scope will be further reduced by the recent reduction in employment discussed above. As household consumption is the largest component of aggregate demand in the Australian economy, a continued lack of real wages growth could be a factor in constraining overall demand and economic growth.

Q3: Outline two potential explanations for the current low rate of wages growth.

Q4: Describe the potential impact of constrained growth in disposable income on the overall level of demand in the Australian economy.
Prime Minister seeks consensus approach to industrial relations

Policies relating wage setting and other workplace arrangements will be subject to review over coming months. During May, the Prime Minister, Mr. Morrison, foreshadowed a new industrial relations “compact” that would be achieved by bringing together employer groups and trade unions to develop policy. The approach was announced as a part of the Government’s “JobMaker” strategy aimed at restoring employment following the Coronavirus crisis. In making the announcement, the Prime Minister highlighted the following problems with the current industrial relations system:

“Our industrial relations system has settled into a complacency of unions seeking marginal benefits and employers closing down risks, often by simply not employing anyone. The system has lost sight of its purpose - to get the workplace settings right, so the enterprise, the business can succeed, so everybody can fairly benefit from their efforts and their contributions. It is a system that has to date retreated to tribalism, conflict and ideological posturing. No side of that debate has been immune from those maladies. This will need to change or more Australians will unnecessarily lose their jobs and more Australians will be kept out of jobs.”

Between now and September, five working groups, consisting of representatives from government, employer groups, trade unions and other selected individuals, will examine reform opportunities in the following areas of the industrial relations system:

- Award simplification
- Enterprise agreement making
- Casuals and fixed term employees
- Compliance and enforcement
- Greenfields agreements for new enterprises (where the new investment will go)

RBA calls for extended fiscal stimulus

With major fiscal policy support programs, such as the Job Keeper scheme, due to expire in September, the Governor of the Reserve Bank has suggested there will be a need for ongoing fiscal stimulus to support economic growth. When addressing the “Senate Select Committee on COVID-19” the Governor, Mr. Lowe, suggested the following:

“The economy is going to need support from both monetary and fiscal policy. There are certain risks if we withdraw that support too early. I know, from the Reserve Bank’s perspective, we’re going to keep the monetary support going for a long period of time, and I’m hopeful that the fiscal support will be there for a long period of time. If the economy picks up more quickly, that can be withdrawn safely, but, if the recovery is very drawn out, then it’s going to be very important that we keep the fiscal support going.

Going forward, fiscal policy will have to play a more significant role in managing the economic cycle than it has in the past. For the last 20 years monetary policy has been the mainstream instrument; we’ve moved interest rates up and down to manage the business cycle and keep inflation under control. In the next little while there’s not going to be very much scope at all to use monetary policy in that way. So I think fiscal policy will have to be used, and that’s going to require a change in mindset.”

As suggested by the Reserve Bank Governor, there is now limited scope for monetary policy to become more stimulatory. With the overnight cash interest rate at 0.25%, material further declines in interest rates would only be possible if interest rates were to move to negative levels, which the Governor has suggested is “extraordinarily unlikely.” Therefore, should economic growth remain low and unemployment remain high, there will be a larger role required from fiscal policy.

Q5: Evaluate the case for further extending fiscal stimulus programs and describe the implications of increased net government spending on government debt levels.

External accounts remain strong

Despite the sharp slowdown evident in the domestic economy, Australia’s trade accounts have remained relatively healthy. Over recent years, Australia’s export income has benefited from increased prices for key commodity exports. Additionally, notwithstanding some recent softening, export volumes have experienced strong growth over majority of the past 7 years. This combination of higher export prices and strong export volumes has resulted in substantial improvement in Australia’s Current Account position. In fact, Australia’s Current Account moved from a deficit to surplus in 2019 - for the first time since 1975.
The **Current Account** (which measures the difference between what Australians pay and receive for the exchange of goods, services and income with overseas entities) has remained in surplus in the March 2020 quarter. The latest surplus of $8.4 billion compares with $1.7 billion in the September quarter and a deficit of $2.8 billion recorded in the same quarter of 2019. The chart below shows the improvement in the Current Account position over recent quarters.

![Current Account Balance Chart](source: Australian Bureau of Statistics S302)

Changes in the size of the Current Account balance are often heavily influenced by movements in **"The Balance on Merchandise Trade"** (i.e. the difference between receipts and payments for the export and import of physical goods). The Balance on Merchandise Trade has been in surplus (i.e. receipts from physical exports have been above payments for imports) for the past 3 years. In the March quarter, the Merchandise Trade surplus was $19.3 billion, which compares with $14.7 billion one year earlier. Receipts from exports rose by 1.9% over the 3 months to March, whereas lower levels of spending resulted in imports falling by 5.1%.

In addition to receipts and payments for physical goods, the Current Account position is also impacted by the Services and Income accounts. The net **Services Account** has had payments and receipts at similar levels over recent quarters. In the March 2020 quarter, there was a small deficit on the Services account of $0.1 billion, reversing a similar sized surplus from the December quarter. Lower services receipts from overseas tourists and students are expected in coming quarters, although this will be offset to some extent by lower levels of spending by Australians travelling abroad.

A deficit on the **Net Incomes Account** continues to be the largest negative contributor to the Current Account position. In the March 2020 quarter, the Net Income Account was in deficit by $10.8 billion, which is below the $16.8 billion recorded one year earlier. This is largely made up of the interest bill on Australia’s foreign borrowings and dividend payments to foreign investors in Australian companies. After improving between 2011 and 2014 (possibly due to falling interest rates), the deficit on the income account widened between 2014 and 2019, before falling again over the past few quarters.

**Q6: Define the term “Current Account”.

Q7: Identify the factors contributing to an improved Current Account position over recent years.**

### Chinese trade tensions

A potential threat to the maintenance of Australia’s healthy trade accounts has emerged over recent weeks, with escalating trade tensions between Australia and China. During May, China imposed an 80% tariff on Australian barley exports and also suspended beef imports from four Australian abattoirs. There are concerns these actions are a precursor to a wider program of trade restrictions, potentially involving iron ore and coal, which make up a dominant share of Australia’s total exports.

The tariff imposed on barley was in response to Chinese allegations that Australian producers “dumped” barley on global markets between 2014 and 2016. “Dumping” refers to the situation where a company exports its products at a price below what it would normally charge in its home markets. It can be used as an anti-competitive action as it may force other companies out of production. Under World Trade Organisation guidelines, Governments are able to take action against dumping practices. However, some commentators have linked the barley tariffs with Australia’s public support for an independent global COVID-19 inquiry.

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<tr>
<th>Stats on Australia</th>
<th>Latest</th>
<th>Previous Year</th>
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<tr>
<td>Economic Growth</td>
<td>2.2% (Year to Dec)</td>
<td>2.2%</td>
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<tr>
<td>Inflation</td>
<td>2.2% (Year to Mar)</td>
<td>1.3%</td>
</tr>
<tr>
<td>Unemployment</td>
<td>6.2% (Apr)</td>
<td>5.2%</td>
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<tr>
<td>Employment Growth</td>
<td>-3.1% (Year to Apr)</td>
<td>2.5%</td>
</tr>
<tr>
<td>Wage Price Index</td>
<td>2.1% (Year to Mar)</td>
<td>2.3%</td>
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<tr>
<td>Exchange Rate (TWI)</td>
<td>58.8 (28th May)</td>
<td>60.1</td>
</tr>
<tr>
<td>Cash Interest Rate</td>
<td>0.25% (May)</td>
<td>1.50%</td>
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<tr>
<td>Current Account Surplus</td>
<td>$22.2 bn (Yr to Mar)</td>
<td>-$31.0 bn</td>
</tr>
<tr>
<td>Current Acct (% GDP)</td>
<td>0.5% (Year to Dec)</td>
<td>-2.1%</td>
</tr>
<tr>
<td>Foreign Debt (% GDP)</td>
<td>57.3% (End Dec)</td>
<td>58.8%</td>
</tr>
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Source: Australian Bureau of Statistics & Reserve Bank

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**Stats on Australia**

Latest: Data as of 28th May 2020

Previous Year: Data as of 31st March 2019

Economic Growth: In Percent (Year to)

Inflation: In Percent (Year to)

Unemployment: In Percent (Month to)

Employment Growth: In Percent (Year to)

Wage Price Index: In Percent (Year to)

Exchange Rate (TWI): In Points (Date of)

Cash Interest Rate: In Percent (Month to)

Current Account Surplus: In Billion (Year to)

Current Account (% GDP): In Percent (Year to)

Foreign Debt (% GDP): In Percent (End of Year)

Source: Australian Bureau of Statistics & Reserve Bank