

Labour market snapshot #80 July (8) 2021

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Employment growth prospects for the next 6 months: Full steam ahead or looming roadblocks?

Key points

- The pace of labour market recovery in Australia has been astounding – Employment has never grown as quickly in any 12 months period as in the year to May 2021.
- Continuing stimulus from the underlying drivers of employment growth - fiscal policy and closed borders – appear to provide the preconditions for further employment growth in the next 6 months.
- I evaluate a range of potential roadblocks to that growth – and conclude that the main factors that could stall employment increases in the next 6 months – in addition to if there was a major outbreak of COVID-19 – are negative effects on business and household confidence from the slow pace of vaccine roll-out; and in the case of exceptionally strong employment growth, also labour shortages.
- Should employment growth continue, I argue that we should be aiming for a target rate of unemployment in the low 4 per cent range (based, for example, on the growth of under-employment).

The recovery

Australia's labour market recovery continues to astound. Employment increased by an average of 120,000 per month from May to October 2020; and then by 55,000 per month to May 2021. That is a growth rate in employment over the past 12 months of 8.1 per cent, never before seen.²

Employment is now above where it was in March 2020 by 130,000 persons. The job vacancy rate is at an all-time high of 2.7 per cent.³ The rate of labour under-utilisation (hours adjusted) in May 2021 was 0.5 ppt lower than in February 2020 (6.8 per cent compared to 7.3 per cent).⁴ And between April and May 2021, the rate of long-term unemployment fell from 1.8 to 1.6 per cent, reversing about one-half of the increase that had occurred in recent months.⁵

The underlying drivers of recovery

No doubt, there are already macro models churning away to explain why the recovery has been so strong. Intuitively, it seems two main factors must be responsible: first, having avoided major outbreaks of COVID-19; and second, the stimulus from fiscal policy and closed borders.

¹ Prepared for the Melbourne Economic Forum, 8 July 2021.

² ABS, Labour Force Australia, May 2021, Table 1 (sa).

³ ABS, Job Vacancies Australia, May 2021, Table 1 (sa).

⁴ ABS, Labour Force Australia – Detailed, May 2021, Table 23a.

⁵ ABS, Labour Force Australia – Detailed, May 2021, Table 14b (sa).

We are used to the idea of stimulus from government partly offsetting the negative effect of recessions on income, and thereby limiting the size of decrease in aggregate demand. But the COVID-19 stimulus is a whole new ball game. Business profits are a good illustration. Table 1 presents information on sales and profits for a selection of industries: comparing 2020 to the average of 2017-19. Take the example of accommodation and food services. As expected, its sales were down in 2020 compared to the previous years, by about 16 per cent. So the data should show profits fell as well? Actually, not. Gross operating profits were up by 67 per cent and the profit/sales ratio doubled in 2020 compared to 2017-19.⁶

Table 1: Sales and business gross operating profits, Selected industries, 2020 compared to average of 2017-19

	Business gross operating profits	Sales	Profit / Sales ratio
Construction	+36.6	-4.6	+43.2
Retail trade	+30.4	+4.1	+25.3
Accommodation and food services	+66.7	-16.4	+99.3

⁶ Regression analysis confirms a strong association between the change in profit/sales ratio by industry and government support payments in 2020. Over 70 per cent of the change in industry-level profit/sales ratio from 2017-19 to 2020 is explained by industry-level variation in JobKeeper payments and Boosting Cash Flows to Employers payments – see Appendix Table A1 in ‘An assessment of the economic effects of

Transport, postal and warehousing	+1.8	-10.2	+13.3
Information, media and telecomms	+1.9	-8.6	+11.5
Professional, scientific and technical services	+52.2	+7.7	+41.3
Arts and recreation services	+67.0	-16.8	+100.1
Other services	+174.7	-2.6	+182.1

Will the underlying drivers bring more employment growth in the next 6 months?

A sudden worsening of the COVID-19 situation in Australia, necessitating another prolonged lockdown, would of course send the labour market backwards. But if a major COVID-19 outbreak can be avoided, having grown so strongly in recent times, it would be unusual if employment now simply stopped increasing.⁷

Stimulus from fiscal policy is one reason. There is more stimulus to come; and there is the impact yet to be realised from stimulus already provided – such

COVID-19 – Version 3’, [Fair Work Commission Research Report 3/2021](#).

⁷ The ABS Payroll data for the week ending June 5 do suggest that the lockdown in Melbourne brought some pause to growth; and the current lockdowns will also have a negative effect. But the experience of previous short-term lockdowns has been that the employment losses and more are added back once lockdown finishes.

as will happen if the savings rate moves further back towards its pre-COVID-19 level.

Thinking that there is stimulus 'still to come' appears to be supported by the opening statement to the Economics Legislation Committee (March 24) by the Treasury Secretary Steven Kennedy: As the economy continues to recover, the remaining direct fiscal support will taper further. Although it is worth noting that of the \$251 billion in direct measures, around \$100 billion is yet to be provided or have its full effect.

Of course, the exact size of impact depends on how much effect there is yet to come from the stimulus; and on behaviour of households and business.

A further important consideration is Saul Eslake's analysis which suggests a large net positive impact of international border closures, amounting to about 1.25 per cent of GDP in 2020 compared to the average of 2016-19.⁸ Since continued border closures are now appear locked in for the next six months, that will continue to promote employment growth.

What rate of unemployment might we be heading for in the next 6 months?

What happens to the rate of unemployment in the next six months will depend on two key determinants: (i) The amount of employment growth; and (ii) The extent to which that employment growth reduces

unemployment (rather than coming from persons who are out of the labour force).

Table 2 presents forecasts of the rate of unemployment in six months, based on alternative assumptions about these determinants.

For employment, I assume that growth per month will be between 20,000 and 30,000. That compares to 55,000 per month over the past six months. As well, it's worth noting that if the only thing that happened in the next six months was for job vacancies to return to their February 2020 level, that by itself would add about 20,000 extra employed persons per month.

For the extent to which employment growth will reduce unemployment, I assume from one-third to two-thirds of the employment growth will show up as a decrease in unemployment. The actual proportion over the past six months has been two-thirds.

The overall message is that with employment growth of 20 to 30 thousand per month, and sufficient impact of employment growth on unemployment, the rate of unemployment will be in the mid-4 range in the next six months.

⁸ Saul Eslake (2021), 'A new form of 'protectionism' – Australia's prolonged

border closure', Webinar presentation, 24 June.

Table 2: Forecast rate of ue in 6 months

	Proportion of Emp growth from UE		
Emp growth ('000s)	One-third	One-half	Two-thirds
20	4.8	4.6	4.5
25	4.7	4.5	4.3
30	4.6	4.4	4.2

Are there roadblocks ahead?

Are there reasons (in addition to a major outbreak of COVID-19) why employment growth for the next six months might be far more limited than the underlying drivers would suggest?

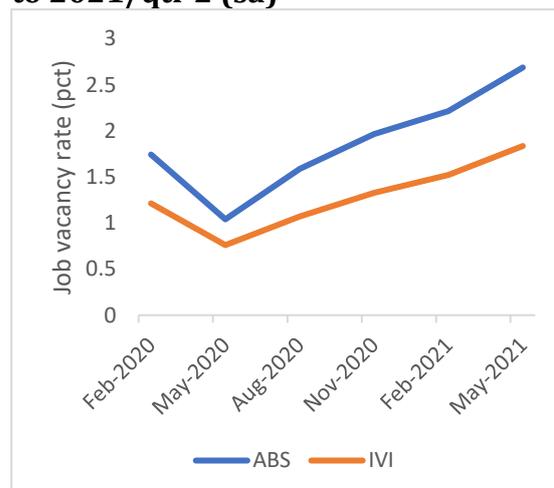
A **first potential roadblock** is labour shortage – which would mean that available jobs can't be filled. Recent movements in the job vacancy rate in Australia might be interpreted as a warning signal that this roadblock already exists.

Chart 1 shows the job vacancy rate for Australia using two alternative measures – the ABS job vacancy series and the Labour Market Information Portal Internet Vacancy Index (IVI).

Both series are at record levels, about 50 per cent higher in May 2021 than in February 2020.

⁹ IVI data are from the [Labour Market Information Portal](#). Employment data are from ABS, Labour Force Australia – Detailed, LM4. The decrease in employment of 50,000 may over-estimate the impact of less temporary visa holders since employment could also have decreased due

Chart 1: Job vacancy rate, 2020/qtr 1 to 2021/qtr 2 (sa)



A first possible explanation for the high vacancy rate is the decrease in immigration in 2020, especially of temporary visa holders. If that is the cause of the high vacancy rate, and with little prospect of substantial reopening of borders in the next six months, it follows that extra jobs may not flow into higher employment in the way we would normally expect.

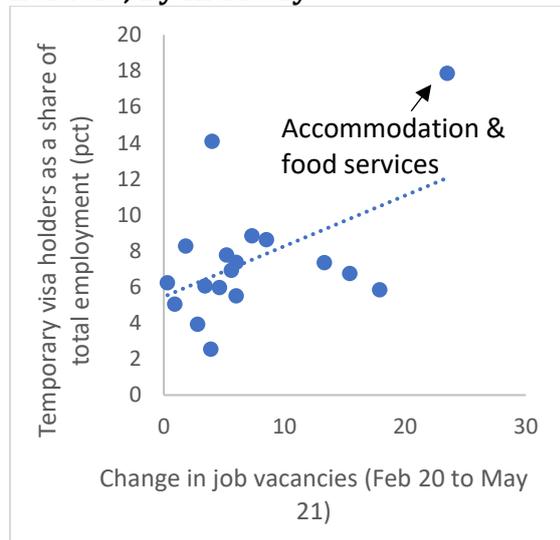
ABS job vacancy data suggests that vacancies were up by about 130,000 in May 2021 compared to February 2020. At the same time, ABS LFS data shows that employment of immigrants in Australia for less than 5 years was down by about 50,000 compared to 2019 (see Appendix Chart 1).⁹ The aggregate numbers might therefore be taken to suggest that the reduced inflow of temporary visa holders can explain

to them losing employment due to the impact of COVID-19 and not being eligible for JobKeeper. However, the LFS is also likely to under-estimate the decrease in employment of temporary vis holders – due, for example, to not including immigrants in Australia for less than 12 months.

some, but by no means all, of the rise in vacancies.

Looking at industry-level data weakens further the case for immigration as the main reason the vacancy rate has increased. Chart 2 shows industry-level data on the change in vacancies from February 2020 to May 2021 plotted against the share of employment by industry accounted for by temporary visa holders (2016). On average, industries more reliant on temporary visa holders have had a larger increase in vacancies over 2020-21. But that positive relation is entirely driven by accommodation and food services, where it does seem that a shortage of temporary visa holders has mattered for the growth in job vacancies.

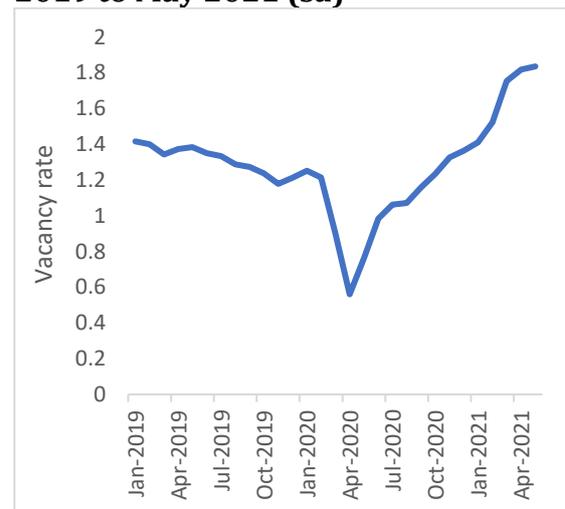
Chart 2: Change in job vacancies 2020-21 and share of employment accounted for by temporary visa holders, By industry



¹⁰ The recent pattern of movement in the Beveridge curve in Australia is what is predicted during the initial phase of economic recovery by standard labour market models. The hiring process - matching jobseekers to jobs - takes time.

A second possible explanation for the growth in job vacancies is the pace of employment growth. With such rapid growth, hiring may not have been able to keep up – and hence the vacancy rate has increased. But as the rate of growth in employment slows, hiring will catch up, and we should expect the vacancy rate to decrease. While certainly not conclusive, evidence in support of this explanation is that the rise in the job vacancy rate appeared to slow from April to May 2021. This is shown in Chart 3, using vacancy data from the IVI.¹⁰

Chart 3: Job vacancy rate, January 2019 to May 2021 (sa)



A third possible explanation is that the scale and speed of employment growth means that the limits of available labour

Hence, in the initial phase of a recovery, increases in vacancies can run ahead of the capacity to fill them, so there is a relatively large increase in the vacancy rate and smaller relative decrease in the rate of unemployment.

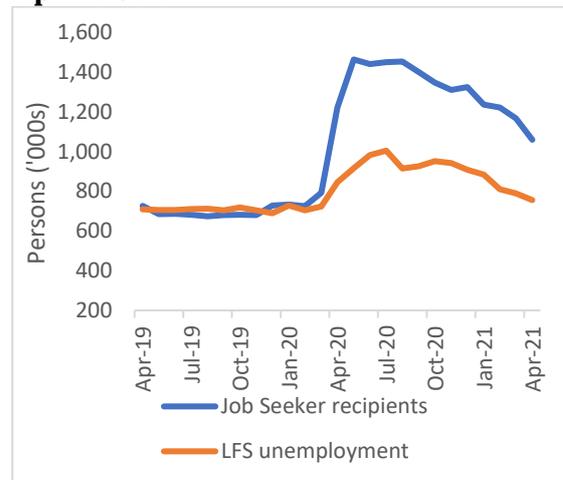
supply are being reached.¹¹ With a labour under-utilisation rate that is still almost 7 per cent, it is difficult to envisage that the limits of labour supply have been reached in a way that would prevent employment growth of 20,000 to 30,000 per month for the next six months – more so if the strength of employment also brings extra growth in labour supply. But with a faster rate of employment growth in the next six months, or continued strong growth beyond that time, labour shortage would be likely to become an increasing barrier – especially in some industries.

A **second potential roadblock** is the large number of JobSeeker recipients relative to the pre-COVID-19 level. Chart 4 shows how the number of recipients increased at the onset of COVID-19 compared to the LFS count of unemployed persons. With recovery there has been a gradual narrowing between the series, but the gap has not disappeared; and in April was about 300,000 persons.

An increased number of JobSeeker recipients could be a roadblock if it implies a slower rate of flow to employment from unemployment or out of the labour force. That is, if for the extra job seekers who have come onto JobSeeker as a result of COVID-19, the payment raises the reservation wage at which they are willing to work, then it will be more difficult to increase employment.

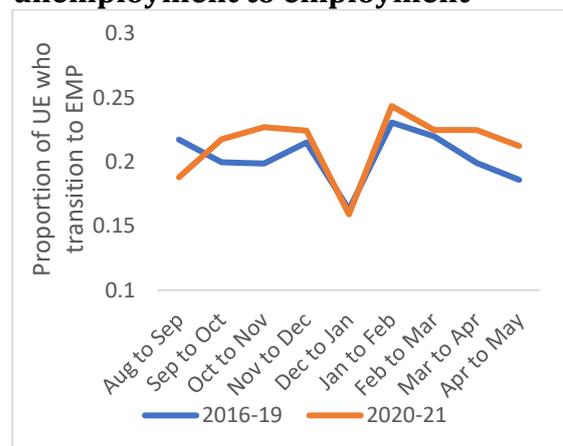
¹¹ This is a different explanation to attributing the high vacancy rate to decreased migration. It is saying that, even

Chart 4: JobSeeker recipients and LFS unemployment, April 2019 to April 2021



But the evidence from ABS gross flows data does not suggest this is happening. Chart 5 shows the monthly rates of flow from unemployment to employment – comparing the period from August 2020 to May 2021 with the average for the corresponding period from 2016-19. There is nothing to suggest a slower rate of outflow. Appendix Chart 2 shows a similar finding for flows from out of the labour force to employment.

Chart 5: Monthly rates of flow from unemployment to employment



if migration was at previous levels, the rate of employment growth would still be causing a labour shortage in Australia.

A possible explanation for the increase in JobSeeker recipients is that a combination of policy-related factors associated with COVID-19 – easier access to JobSeeker, the increase in JobSeeker payment and the removal of Mutual Obligation requirements – caused a ‘new’ type of recipient to flow onto JobSeeker. Easier access included expanding eligibility to sole traders and self-employed, making the partner income test more generous and waiving asset tests and waiting periods.¹² The new JobSeeker recipients appear to be gradually flowing off payments (although this can’t be confirmed exactly from aggregate data) as job search requirements are reimposed and with continuing economic recovery.

A **third potential roadblock** is delayed impacts from the end of the JobKeeper program. Thus far it is estimated that the end of the program caused about 55,000 jobs to be lost in April.¹³ This is much less than forecasts (including mine). Most likely the discrepancy is due to the forecasts being wrong – with the final 1.1 million jobs covered by JobKeeper more resilient than anticipated. But it might also be that job destruction due to the end of JobKeeper will be spread out over time rather than occurring immediately. That would then act as a drag on future employment growth. However, it seems unlikely that any future job losses would be larger than the initial impact, and they will be

¹² Klapdor, Michael and Christopher Giuliano (2020), ‘The impact of COVID-19 on JobSeeker payment recipient numbers by electorate’, [Parliamentary Library Research Paper](#), 14 July.

spread out over time. Hence, it is hard to see this as a major reason why employment growth will not continue in the next six months.

A **fourth potential roadblock** is negative effects on confidence from the vaccine roll-out. Confidence effects are hard to quantify. But my impression is that the impact on confidence was an important reason why policies such as JobKeeper were effective in keeping employment higher than it would otherwise have been when COVID-19 hit: Businesses and households believed that the government had the resources available, and was willing to commit them, to maintain the economy intact. Equally, it is possible to believe that the slow roll out of vaccines in Australia – with daily media headlines about policy failure and the current lockdowns illustrating the costs of the approach taken – will have a negative effect on confidence about the chances of future disruption to economic activity. With diminished confidence, businesses then will begin to curb their rates of job creation.

What rate of unemployment should we be aiming for?

Suppose we get lucky – the underlying drivers of employment growth remain strong, and the potential roadblocks do not materialise. In that case, what rate of unemployment should we aim for?

¹³ Kennedy, Steven (2021), ‘[Opening statement to the Economics Legislation Committee](#)’, June 1.

I believe we should be aiming for a rate of unemployment in the low 4's – and then deciding whether to push further based on what happens to inflation.

In a [Snapshot](#) in March this year, I described how the rise of under-employment has shifted the target rate of unemployment we should be setting. Any given rate of unemployment today involves a higher overall rate of labour under-utilisation than in the past – due to the rise of under-employment. So to maintain the same rate of labour under-utilisation as in the past, we need to be targeting a lower rate of unemployment today. Based on this argument, I estimate that if the target rate of unemployment was 5 per cent in the mid-1990s, today it should be 4 per cent.

It has also been suggested that the target rate of unemployment can be lower because wage and price dynamics in Australia have changed - due to structural factors such as increased competition in goods markets; and regulation of labour markets.

A first objection to going for a rate of unemployment in the low 4's could be that estimates of the NAIRU are currently at 4.5 per cent (RBA) and 4.75 to 5 per cent (Treasury).

My own view is that we should be significantly reducing the weight we

place on the estimated NAIRU in setting macroeconomic policy; and using a more pragmatic approach.¹⁴

When you look at the relation between the actual rate of unemployment and the level of estimated NAIURUs used in policy making prior to 2021, it is hard to avoid the impression that the NAIRU has been regarded as a rate of unemployment below which we should never (or only accidentally) go.¹⁵

I see two main problems with this policy approach. First, it treats the estimated NAIRU too seriously. With such wide confidence intervals around the estimated rate, the appropriate approach should be to be willing to experiment around the NAIRU to establish the actual responsiveness of inflation to unemployment; and with a recognition that inflation is likely to change incrementally around the NAIRU, rather than sending the Australian economy into an inflationary abyss should we ever move below it. Second, emphasising the NAIRU means emphasising the inflation objective – and that means not putting enough weight on goals of maximising GDP and distributional objectives.

A second objection is that with the labour market recovery occurring much faster than expected, we are already seeing (or on the verge of) an increased rate of wage inflation.

¹⁴ This is not a criticism of the many excellent empirical studies that have estimated the NAIRU for Australia. It is a criticism of how the NAIRU is being applied in policy-making.

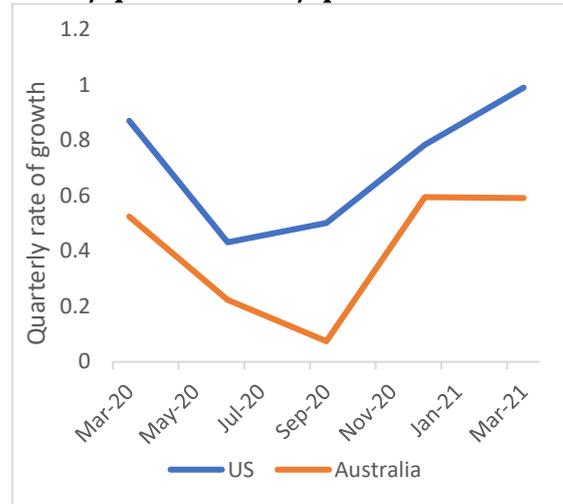
¹⁵ See for example chart 3 in Heather Ruberl, Meika Ball, Larissa Lucas and Nathan Williamson (2021), 'Estimating the NAIRU in Australia, Treasury Working Paper 2021-1.

It's important to note that this did not seem to have happened in the period of recovery up until the March quarter 2021 - when the WPI grew by 0.6 pct, similar the December quarter, and much the same rate as prior to COVID-19.

However, with labour market tightness increasing, it's to be expected that aggregate wage inflation will begin to increase at some point. There may also be a short-term rise in wage inflation due to the speed of employment growth during recovery – and especially in industries where the most rapid growth has happened (such as professional, scientific and technical services, where employment was about 90,000 higher in May 2021 than February 2020). The June quarter WPI will therefore be critical for evaluating the inflationary impact of employment growth that has occurred thus far – But at this stage it would be premature to use inflation as a reason for not pursuing further employment growth.

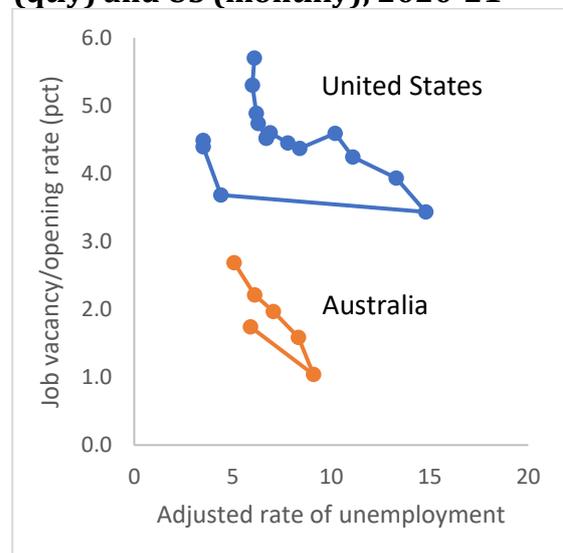
In the United States there has been more immediate evidence of increasing wage inflation. This can be seen from Chart 6 which shows the quarterly rate of growth in employment cost from March quarter 2020 onwards.

Chart 6: Rate of growth in employment cost, Quarterly, 2020/qtr 1 to 2021/qtr2



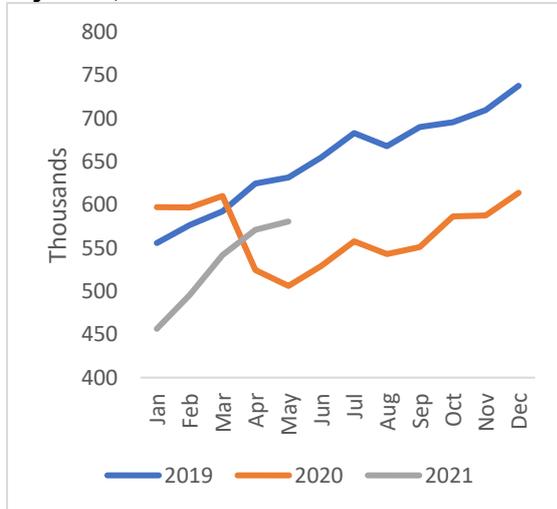
It may be that the comparative wage inflation outcomes show that the Australian labour market has had less problems adjusting to rapid employment growth than the US. Chart 7 shows that, while a higher vacancy rate in Australia has been associated with a lower rate of unemployment, the US has in recent months appeared to be 'stuck' – with an increasing vacancy rate not associated with a lower rate of unemployment.

Chart 7: Beveridge curve, Australia (qtlly) and US (monthly), 2020-21

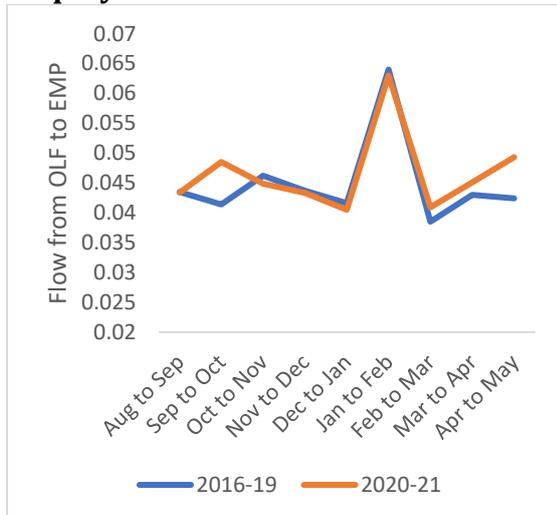


Appendix

Appendix Chart 1: Employment of immigrants in Australia for less than 5 years, 2019-21



Appendix Chart 2: Monthly rates of flow from out of the labour force to employment



Data

- Table 1: ABS, Business Indicators, Tables 6 and 15.
- Chart 1: Job vacancy rate = Job vacancies/(Job vacancies + Employment). i] Vacancy data: ABS series – ABS, Job vacancies Australia, Table 1; IVI series: Labour Market Information Portal, Internet Vacancy Index, May 2021; ii] Employment – ABS, Labour Force Australia, Table 1.

- Chart 2: Job vacancies – ABS, Job Vacancies Australia, Table 4; Temporary visa holders as a share of employment – ABS Census 2016, Tablebuilder.
- Chart 3: Job Vacancies - Labour Market Information Portal, Internet Vacancy Index, May 2021; Employment – ABS, Labour Force Australia, Table 1.
- Chart 4: Unemployed persons – LFS: ABS, Labour Force Australia, Table 1; JobSeeker recipients – Department of Social Services, Jobseeker Payments and Youth Allowance Recipients, Monthly Profile, April 2021.
- Chart 5: ABS, Labour Force Australia, GM1.
- Chart 6: Australia – Wage Price Index: ABS, Wage Price Index, Table 1 (Total hourly rates of pay excluding bonuses; sa); US – Bureau of Labor Statistics, Employment Cost Index for Wages and Salaries (sa); <https://www.bls.gov/news.release/pdf/eci.pdf>
- Chart 7: Australia – February 2020 to May 2021: i] Adjusted rate of unemployment = Rate of unemployment adjusted to include the increase in zero hours workers in the category ‘no work, not enough work, stood down’ relative to March 2020. ABS, Labour Force Australia, Table 1; ABS, Labour Force Australia – Detailed, EM2a; ii] Vacancy rate: ABS, Job Vacancies Australia, Table 1. US – January 2020 to April 2021: i] Rate of unemployment: Civilian unemployment rate (sa); <https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>; ii] Vacancy rate – From Jason Furman and Wilson Powell III (2021), ‘The US labor market is running hot...or not?’, [Data for Figure 4](#)
- Appendix Chart 1: ABS, Labour Force Australia – Detailed, LM4.
- Appendix Chart 2: ABS, Labour Force Australia, GM1.