

Economic research note

15th January 2009

Australia's labour market will deteriorate over 2009

- In December 2008 annual employment growth was 1.3%. However, between November and December the number of employed persons actually fell by 2,000.
- The unemployment rate rose to 4.5% from 3.9% in February 2008.
- The unemployment rate is set to rise towards 6.0% over 2009 given the expected falls in employment across financial services, property and business services and mining.
- Recovery in the labour market will occur in 2010 and be contingent on a rebound in investment.

Unemployment, and the general health of the labour market, will be a key determinant in the scale of the current downturn and the shape of the recovery to follow. As the domestic economy's expansion slows, and in certain sectors contracts, the labour deployed within an economy must also shrink. The greater the adverse impact on the labour market, the longer will be the downturn and more shallow the eventual recovery.

The current state of the labour market

Australia's labour market has been relatively stable since 1998. Annual employment growth over this period averaged 2.1% and the unemployment rate has fallen from 8.0% to a low of 3.9%. However, in 2008 the labour market has deteriorated due to a weaker global outlook. Annual employment growth has slowed from 3.0% in February 2008 to 1.3% in December 2008 and unemployment has risen to 4.4%. This is observed in Figure 1.

Figure 1

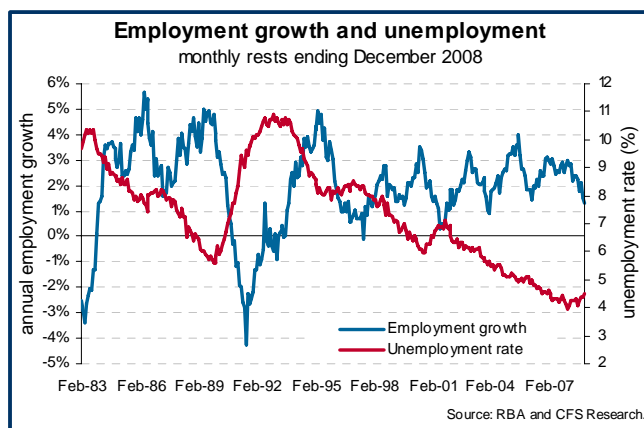
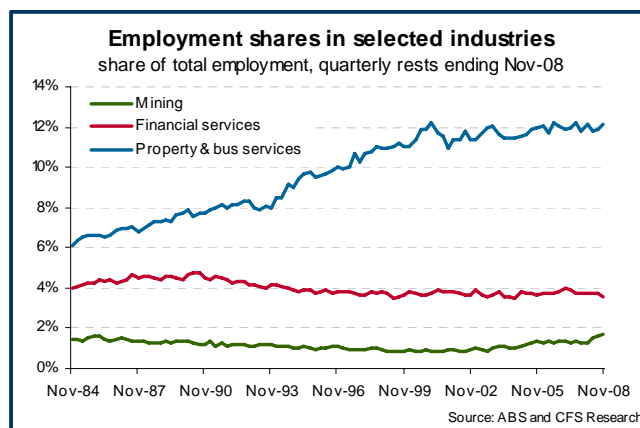


Figure 2



The labour market is expected to remain weak throughout 2009. Those industries directly impacted by the global credit crisis are likely to see a contraction in employment while higher unemployment in these industries will slow domestic demand and indirectly weaken the labour market in other sectors of the domestic economy such as retail and wholesale trade and construction. The impact of the weaker global economy will also soften employment prospects in the external sector, despite the depreciating currency.

The labour market outlook

The industries most impacted by the credit crisis and global slowdown will be financial services, property and business services and mining. Despite mining and financial services having a small share of total employment (refer to Figure 2), the indirect spill-over effect to the wider economy will be substantial. Property and business services have a significantly larger share and so, a fall in employment here will have a more substantial direct impact.

The decline in employment in certain industries provides a useful starting point for forecasting the unemployment rate. Our forecast model attempts to identify the likely size of the contraction in employment in those industries most impacted by the current global credit crisis based on three scenarios for economic growth over 2009. From these initial forecasts of direct job losses the model measures the likely spill-over effect to other areas of the labour market.

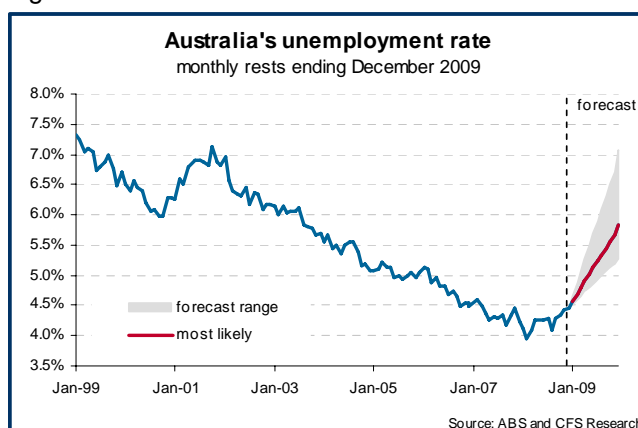
Worst case scenario: assumes a recession similar to the 1990s with a substantial contraction across the most impacted sectors. This implies further declines in asset prices, a higher probability of deflation and very weak external demand, even from emerging markets.

Best case scenario: assumes a recovery in asset prices and an improvement in emerging market demand. This scenario is under-pinned by a rapid positive response to the low interest rate environment. This scenario, however, still implies a relatively large contraction in employment in financial services. Australia would avoid a recession and annual economic growth would recover to just below trend growth of around 3% in 2009.

Base case scenario: this implies stable asset prices in 1H09 rather than a recovery, and a better outlook for emerging market demand in 2H09. Again financial services would bear the brunt of job losses. Australia would avoid a recession and experience annual economic growth of 1-2% over 2009.

Model forecasts for the unemployment rate for the three scenarios are shown in Figure 3. Forecasts range between 5% and 7% with a most likely estimate of 6%. The largest job losses are likely to occur in 1H09 with a recovery likely to occur in 2010. These forecasts are broadly in line with consensus forecasts for the unemployment rate which range between 5.1% and 8.0% with a mean forecast of 5.7%.

Figure 3



Implications

The forecast deterioration in the labour market over 2009 will adversely impact the consumer segment of the economy. This will see consumers continue to curb discretionary spending and add further to downward pressure on economic activity.

The decline in financial services and property and business services employment will have the most pronounced adverse effect on national office markets as space market fundamentals weaken.

The wider investment implications of the unemployment rate rising towards 6-7% have been factored into investment markets. Indeed, if the rise in the unemployment rate remains limited to the lower end of market forecasts this would reflect a more positive demand outlook and be a trigger for a stronger recovery in asset prices over 2009.

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