

Chapter 3: Economic and labour market environment

Introduction

- 3.1 This chapter presents information on the Australian economy and labour market.
- 3.2 In terms of the labour market, the submission focuses on the recent labour market experience of disadvantaged groups.
- 3.3 The Commission can find more detailed information on the economic outlook in the *Mid-Year Economic and Fiscal Outlook (MYEFO) 2006-07, Part 2: Economic Outlook*.
- 3.4 As mentioned in the overview of this submission, the Government would welcome the opportunity to provide the Commission with up-to-date economic information from the 2007-08 Federal Budget. The Treasurer will deliver the Budget on 8 May 2007.

Economic environment

- 3.5 Gross Domestic Product (GDP) growth is forecast to accelerate in 2007-08, assuming a return to average seasonal conditions. Ongoing strong world economic growth and the continued high level of Australian business investment are expected to support a gradual shift in the composition of economic growth towards exports. Following recent strength, employment growth is expected to moderate in 2006-07 and 2007-08. Wage growth is expected to remain moderate, and underlying inflationary pressures are expected to ease.
- 3.6 The Australian economy is forecast to grow by 2½ per cent in 2006-07, down from 2.9 per cent in 2005-06, reflecting the severe drought being experienced across large parts of Australia. Real GDP growth is forecast to accelerate to 3¾ per cent in 2007-08, with non-farm GDP expected to grow by 3 per cent in 2006-07 and 3¾ per cent in 2007-08. The farm sector is expected to recover in 2007-08 with an assumed return to average seasonal conditions.

- 3.7 Household consumption growth is expected to remain moderate, reflecting ongoing consolidation in household balance sheets. Consumption is forecast to grow by 3 per cent in 2006-07 and 3¼ per cent in 2007-08. Following a period of rapidly increasing household debt, consumers have taken the opportunity in recent years to begin to rebuild their savings. This consolidation has been supported by strong household income growth, personal income tax cuts and increased support for families. Past interest rate increases are expected to constrain consumption growth over the forecast horizon.
- 3.8 The labour market continues to perform strongly. Employment is expected to increase by 2¼ per cent in 2006-07, before moderating to 1¼ per cent in 2007-08, in line with around trend non-farm GDP growth and a modest increase in real unit labour costs. The unemployment rate is expected to be around 5 per cent in 2006-07 before rising slightly in 2007-08 – in line with an expected increase in the participation rate, as the people entering the labour market as part of the Government's Welfare to Work reforms take time to gain employment.
- 3.9 Wage growth is expected to remain moderate, with the ABS Wage Price Index (WPI) forecast to grow by 4 per cent in 2006-07 and 2007-08. While wage growth has been strong in some sectors, particularly Mining and Construction and to a lesser extent the public sector, these sector-specific pressures are not expected to spill over to more rapid aggregate wage increases.
- 3.10 Inflation was 3.2 per cent in 2005-06, largely reflecting the jump in petrol prices in mid-2006 and the one-off impact of Tropical Cyclone Larry on fruit prices, although underlying inflationary pressures have also been present. Higher fuel prices and solid unit labour cost growth have contributed to these recent inflationary pressures. Inflation is expected to fall temporarily below 2 per cent when the 2006 impact of fruit and fuel prices unwind in 2007. Underlying inflationary pressures are expected to ease, resulting in inflation returning to around the middle of the Reserve Bank's medium-term target band by 2008.
- 3.11 There are risks around the domestic economy, particularly if dry conditions persist and seasonal conditions do not return to average in 2007-08 as assumed.
- 3.12 Severe drought conditions affected large areas of Australia during 2006. As a result, farm production is forecast to fall by around 20 per cent in

2006-07. The drought is expected to subtract $\frac{3}{4}$ of a percentage point from GDP growth in 2006-07, reflecting its impact on the farm sector and related industries, such as Transport and storage.

- 3.13 Rising house prices in the early part of this decade contributed to rising household debt and increased the sensitivity of households to adverse labour market outcomes and interest rates. Moreover, while housing market conditions have improved in recent months, there remains considerable uncertainty around the pace and extent of household balance sheet consolidation. It is possible that consumption and dwelling investment growth will slow more than expected in response to recent higher interest rates and the expected easing in employment growth.
- 3.14 Australia continues to benefit from strong demand for our commodity exports. This surge in demand requires a large adjustment within the economy, with significant increases in the demand for labour and capital in the mining and related sectors. This adjustment will take time and so far has progressed smoothly. Wages and other input prices have increased to attract the required resources. To date, these sector-specific input cost increases have not spilled over into other sectors. However, there is a risk that if labour and capital do not move to the fast-growing sectors of the economy, output growth could be constrained and there may be more significant upwards pressure on prices.

Wages developments

- 3.15 The WPI is the ABS' and Reserve Bank of Australia's preferred measure of wage movements. The WPI measures wages growth for performing the same work at the same level, unlike earnings measures that are affected by compositional shifts in the workforce.
- 3.16 Over the year to the December quarter 2006, the WPI rose by 4.0 per cent, up from the 3.8 per cent growth over the year to the September quarter 2006, but slightly lower than the growth of 4.2 per cent recorded over the year to the December quarter 2005.⁵

⁵ As a result of the change in timing of the Commission's 2006 Minimum Wage Review decision compared with the previous system, the seasonal effects of the wages data from the September quarter 2006 will be more pronounced than previous September quarters. The ABS also noted that it will take some time before it can determine the seasonality of the new wage setting mechanisms.

- 3.17 The annual increase in the WPI for the public sector over the year to the December quarter 2006 was 4.5 per cent, while for the private sector the annual WPI rose by 3.8 per cent.
- 3.18 The industries experiencing the highest wages growth continue to be those with strong labour demand, such as Mining (up by 6.5 per cent over the year), Electricity, gas and water supply (up by 6.0 per cent) and Construction (up by 5.1 per cent). As shown in Chapter 2 (Table 2.1), these sectors all have low award-reliance.

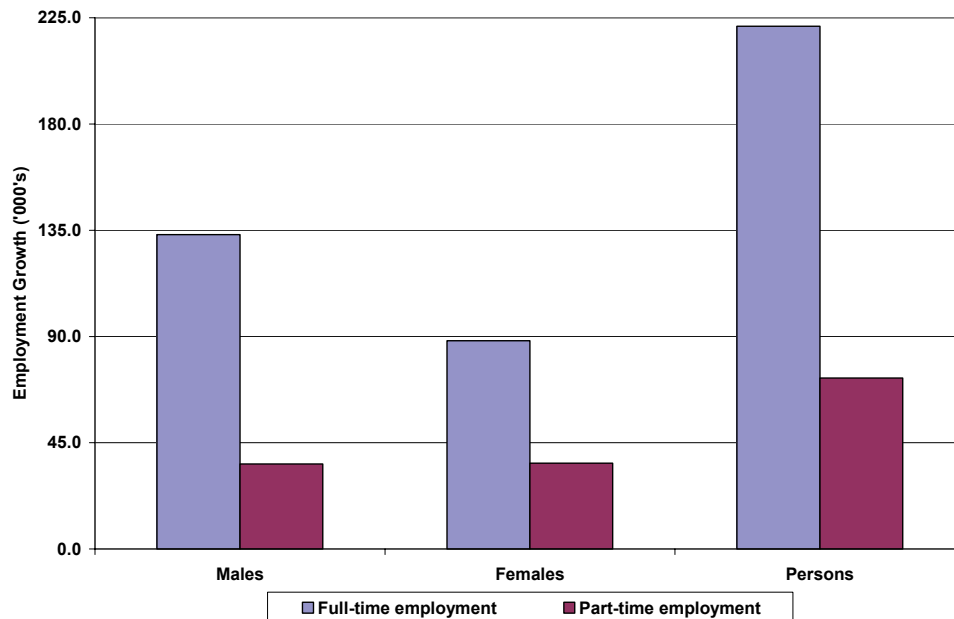
Labour market overview

- 3.19 Reflecting almost a decade and a half of uninterrupted economic growth, Australia has experienced historically strong labour market conditions, with employment growth averaging 2.0 per cent per annum over the past 15 years. Employment has continued to grow strongly in recent months, presenting an upside risk to the MYEFO forecast of 2¼ per cent employment growth in 2006-07. Against this backdrop, the participation rate increased by 0.4 percentage points over the year to February 2007 to stand at 64.9 per cent, a near record high.
- 3.20 There are, however, a number of specific groups, including teenagers, the long-term unemployed and lone parents, who continue to experience significant labour market disadvantage, while certain regions (despite the strengthening in labour market conditions) continue to record persistently high unemployment rates.

Employment

- 3.21 Over the year to February 2007, both full-time employment (up by 221,400 or 3.1 per cent, to a record high of 7,407,700) and part-time employment (up by 72,400 or 2.5 per cent) have grown strongly. Full-time employment accounted for over three-quarters (75.4 per cent) of total employment growth over this period.
- 3.22 Employment growth has been particularly strong for males (up by 169,200 or 3.0 per cent, to a record high of 5,717,100). This reflects, in part, continued strong conditions in the male dominated industries of Construction and Mining, underpinned by the resources and building booms. Nevertheless, female employment also increased strongly (by 124,600 or 2.8 per cent to 4,640,800) over the year to February 2007.

Chart 3.1: Change in full-time and part-time employment growth ('000s) over the year to February 2007

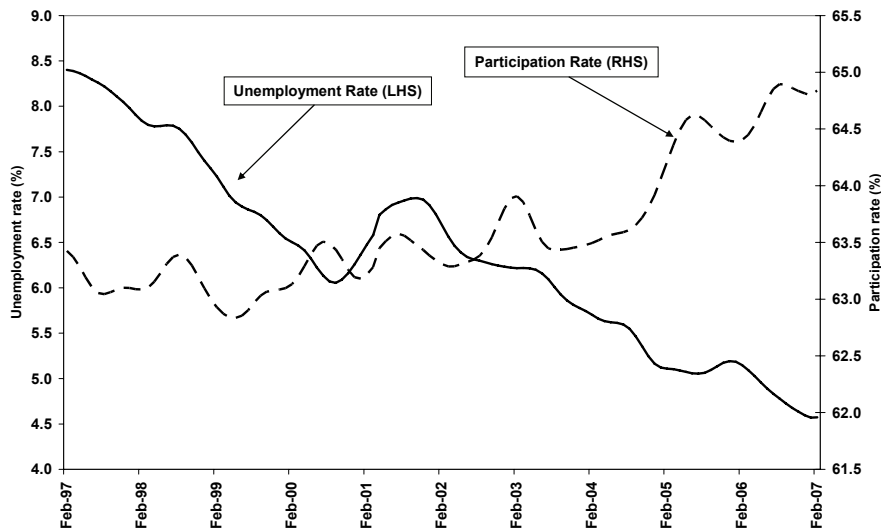


Source: ABS Labour Force, Australia, February 2007 (Cat No: 6291.0.55.001).

Unemployment

3.23 Against the backdrop of strong employment growth, the level of unemployment fell by 51,600 (or 9.3 per cent) to 502,000 over the year to February 2007. Not surprisingly, the unemployment rate also fell, from 5.2 per cent in February 2006 to 4.6 per cent in February 2007, close to a 30 year low (see Chart 3.2).

Chart 3.2: Unemployment Rate and Participation Rate, February 1997 to February 2007



Source: ABS Labour Force, Australia, Spreadsheets, February 2007 (Cat No: 6202.0.55.001), Trend data.

Participation rate

3.24 Reflecting the strengthening in labour market conditions, the participation rate also rose over the year, from 64.5 per cent in February 2006 to 64.9 per cent in February 2007 - a near record high. Over this period, the female participation rate increased by 0.6 percentage points, to 57.6 per cent, while the male participation rate rose by 0.2 percentage points to 72.4 per cent.

3.25 While the participation rate is close to its record high, the continuing ageing of the population is likely to impact on participation rates.

Disadvantaged groups in the labour market

3.26 While labour market conditions have strengthened for most cohorts over recent years, a number of groups, including teenagers, the long-term unemployed and lone parents, continue to face significant labour market disadvantage.

3.27 Accordingly, it is, critical that increases in minimum wages do not price these vulnerable groups out of the labour market. In this context, the Government outlines below the labour market performance for each of these disadvantaged groups.

Teenagers

- 3.28 Teenagers have also benefited from the strengthening in labour market conditions over the past year. However, employment for 15-19 year olds increased by a relatively modest 3,600 (or 0.5 per cent) to stand at 709,900 in February 2007. The increase in teenage employment was due, entirely, to an increase in teenage part-time employment, up by 5,700 (or 1.2 per cent) over the year to February 2007.
- 3.29 At the same time, the teenage full-time unemployment rate fell to 19.8 per cent in February 2007, from 20.8 per cent in February 2006. While the teenage full-time unemployment rate is often used to gauge teenage labour market performance, it is not necessarily the best indicator of overall teenage labour market disadvantage, as it excludes the vast majority of teenagers.⁶ A much better indicator of teenage labour market disadvantage is the teenage full-time unemployment to population ratio, which stood at just 4.1 per cent in February 2007, down from 4.4 per cent in February 2006 and around the lowest rate on record.

Long-term unemployed

- 3.30 The level of long-term unemployment fell by 14,600 (or 14.9 per cent) over the year to stand at 83,300 in February 2007. Male long-term unemployment declined by 15,800 (or 25.7 per cent), while female long-term unemployment actually increased, by 1,300 (or 3.4 per cent).
- 3.31 Similarly, very long-term unemployment (persons unemployed for two years or longer) fell by 12,100 (or 22.9 per cent) to stand at 40,900 in February 2007.
- 3.32 Despite the considerable inroads that have been made into long-term unemployment and very long-term unemployment, around one in five job seekers has been unemployed for 12 months or more. Moreover, despite the recent strength in labour market conditions, around one in two long-term unemployed people remains classified as very long-term unemployed.

Lone parents

- 3.33 In June 2006 (latest available data), there were 2,261,800 families with dependent children aged under 15 in Australia. A total of 319,600 (or

⁶ Around two-thirds of teenagers attend an educational institution full-time.

14.1 per cent) of these families with children had no parent employed. Significantly, lone parent families accounted for more than two-thirds (69.9 per cent) of these families.

- 3.34 While the number of dependent children in jobless families fell by 12,100 (or 2.0 per cent) over the year to June 2006, there remain 585,200 children who live in a family where no parent is employed.
- 3.35 As discussed further in Chapter 5, children who grow up in jobless families are at a significantly greater risk of being unemployed later in life and are more likely to experience poverty as a consequence. Accordingly, it is essential that parents in these families are given the opportunity to find employment, thereby reducing the risk of intergenerational unemployment.
- 3.36 Given that the vast majority of jobless families are headed by a lone parent, the labour market experience of this group is of particular importance. Over the last year, the number of employed lone parents with dependent children rose by 10,200 (or 4.3 per cent) to stand at 245,100 in June 2006. In comparison, employment for parents in a couple family with dependent children increased by 54,000 (or 2.0 per cent) over the year to stand at 2,772,000.
- 3.37 While the unemployment rate of lone parents with dependent children fell significantly over the year to June 2006 (by 1.2 percentage points to 15.2 per cent) it remains almost five times higher than the 3.2 per cent unemployment rate for parents in couple families with dependent children. As discussed in detail in Chapter 5, a key element of the Government's Welfare to Work reforms is the requirement for some lone parents to actively seek work of 15 or more hours per week.

Regional disparities

- 3.38 The strong labour market conditions prevailing at the national level are mirrored in most state and regional labour markets across Australia. Developments at the national level, however, can often mask the disparities in labour market performance between states and territories, metropolitan and non-metropolitan areas and smaller disaggregated regions. Indeed, job seekers in certain pockets of Australia still face considerable labour market disadvantage.

States

- 3.39 Consistent with the strengthening in labour market conditions at the national level over the year to February 2007, conditions also improved in all states and territories. Employment grew strongly (in percentage terms) in Queensland (up by 117,200 or 5.9 per cent), the Northern Territory (up by 4,400 or 4.5 per cent), Western Australia (up by 34,600 or 3.3 per cent) and the Australian Capital Territory (up by 6,000 or 3.3 per cent).
- 3.40 Not surprisingly, given the widespread improvement in labour market conditions, the unemployment rate decreased in most states and territories over the 12 months to February 2007. The largest falls were in the Northern Territory (down by 3.9 percentage points to 2.5 per cent), followed by Queensland (down by 1.3 percentage points to 4.0 per cent) and Western Australia (down by 1.1 percentage point to 3.0 per cent). New South Wales and South Australia were the only areas not to record a fall in their unemployment rate (where it was unchanged at 5.2 per cent and 5.3 per cent respectively).

Metropolitan and non-metropolitan areas and regional disadvantage

- 3.41 Employment rose strongly in both metropolitan and non-metropolitan areas over the year to February 2007. Employment has increased by 156,100 (or 2.5 per cent) in metropolitan areas and by 138,600 (or 3.8 per cent) in non-metropolitan areas. Over the same period, the unemployment rate in metropolitan Australia fell by 0.4 percentage points to stand at 4.9 per cent in February 2007, while in non-metropolitan Australia, the unemployment rate declined by 1.1 percentage points to 5.1 per cent.
- 3.42 The vast majority of the 76 ABS labour force regions recorded a fall in their unemployment rate over the year to February 2007. In total, 75.8 per cent of non-metropolitan regions recorded a decline compared with 65.9 per cent of metropolitan regions. Importantly, not one region recorded a double-digit unemployment rate in February 2007.
- Regions recording strong labour market performances include Inner Brisbane (where employment increased by 12.3 per cent over the year to February 2007 and the unemployment rate fell by 2.1 percentage points to 2.8 per cent) and South West Perth (where employment increased by 10.2 per cent over the year to

February 2007 and the unemployment rate fell by 0.9 percentage points to 3.1 per cent). Similarly, employment in Murray-Murrumbidgee in New South Wales increased by 6.2 per cent, while the unemployment rate fell to 4.1 per cent.

- On the other hand, employment in Northern Adelaide fell by 5,900 (or 3.5 per cent) over the year to February 2007, while the unemployment rate increased by 1.9 percentage points to 8.2 per cent. Similarly, Northern, Far West-North Western and Central West NSW experienced a 11,400 (or 4.6 per cent) decline in employment and the region's unemployment rate increased by 0.4 percentage points to 5.8 per cent.

Conclusion

3.43 Economic growth is forecast to be at a more moderate pace in 2006-07 reflecting the severe drought, before picking up in 2007-08.

3.44 A number of particular groups experience poorer labour market outcomes than the remainder of the labour market. It is the Government's submission that the Commission needs to balance any increase in the minimum wages of the low paid against the need for disadvantaged groups and regions to remain competitive in the labour market.