Box C

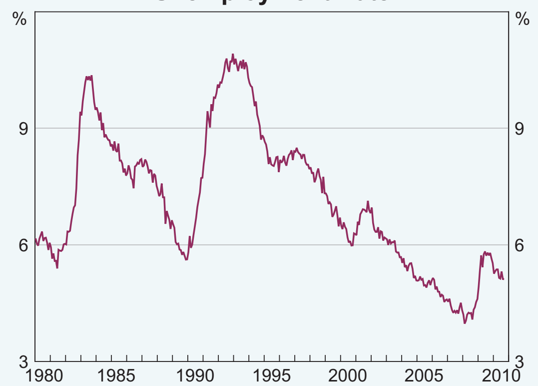
Spare Capacity in the Labour Market

The amount of spare capacity in the labour market is an important determinant of domestic wage and inflationary pressures. When suitable labour is scarce, there is a greater tendency for wages to be bid up and for firms to be faced with increasing cost pressures. This was the case prior to the 2008–2009 downturn in the labour market, when the unemployment rate fell to 4 per cent and widespread skills shortages emerged.

After easing during the downturn, conditions in the labour market have tightened over the past year. The unemployment rate has declined from its mid-2009 peak of 5.8 per cent to its current level of 5.1 per cent (Graph C1). While this is above the lows recorded in 2008, it is around the levels of late 2004 and early 2005 when growth in the wage price index picked up to around 4 per cent. The unemployment rate, however, is only one of a range of indicators of spare capacity in the labour market.

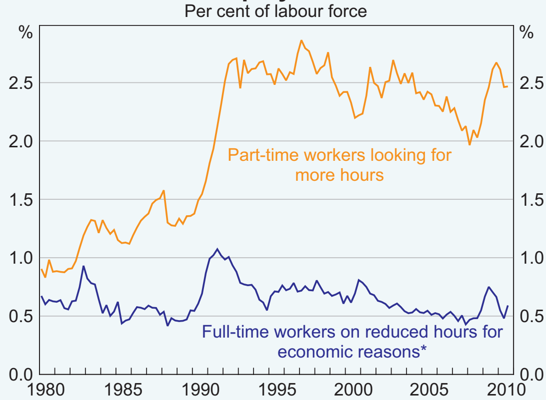
The labour market downturn was also associated with an increase in the proportion of *underemployed* workers in the labour force – those who would like to work more hours – of about 1 percentage point (Graph C2). As labour market conditions have improved over the past year or so, the share of underemployed workers has declined by around ¼ percentage point, which suggests that there is a little more spare capacity in the labour market than implied by the unemployment rate.

Graph C1
Unemployment Rate



Source: ABS

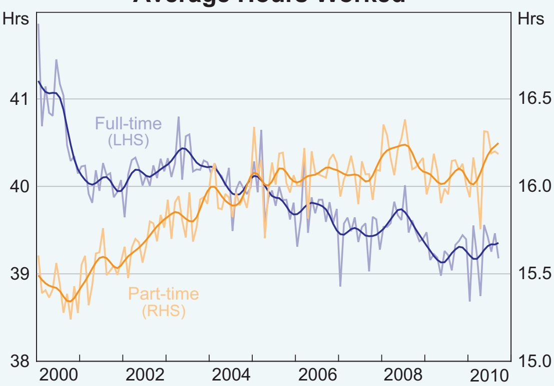
Graph C2
Underemployed Workers
Per cent of labour force



* Economic reasons include insufficient work being available
Sources: ABS; RBA

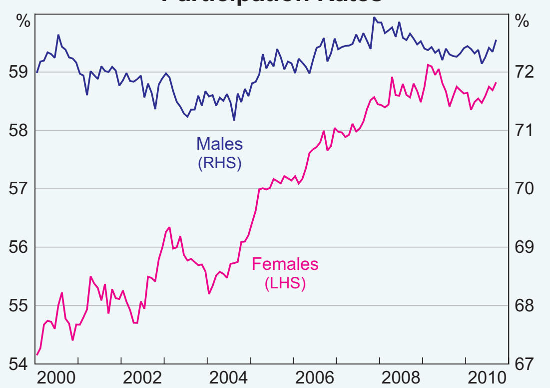
More generally, a significant amount of the reduction in labour input during the 2008–2009 labour market downturn occurred via decreasing the working hours of employees, rather than as a result of a fall in the number employed.[1] Average hours worked are estimated to have declined by more than 2 per cent in trend terms, while the number of people in employment was broadly flat. This decline was due to a fall in average hours worked by both full-time and part-time workers and an increase in the proportion of part-time workers (Graph C3).

Graph C3
Average Hours Worked*



* Smoothed lines are 13-period Henderson trends
Sources: ABS; RBA

Graph C4
Participation Rates



Source: ABS

Average hours of full-time workers have since retraced less than half of the fall, which might suggest significant scope for further increases in average hours worked. However, there has been a longer-run decline in full-time average hours worked, and the increase in the level of average hours worked throughout early 2008 coincided with a tight labour market, so it is possible that some employees were then working longer hours than they desired.

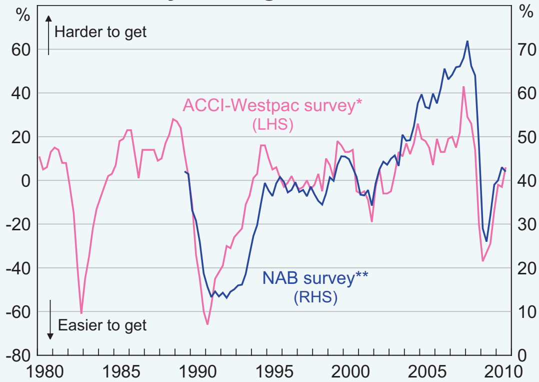
The amount of spare capacity in the labour market also depends upon the likelihood of people currently not in the labour force moving into the labour force. The participation rate has exhibited an upward trend since the 1980s, with the participation rates of females and older persons increasing over time (Graph C4). The trend increase in female participation has been associated with a range of factors, including increased educational attainment, lower fertility rates (until recently), improved access to childcare, more flexible work arrangements, an increase in part-time employment opportunities and the expansion of the services sector, as well as the gradual decline in the unemployment rate since the 1990s.[2] The participation rate of older workers has also increased, consistent with improved employment opportunities, reduced retirement rates and a rise in longevity. The participation rates of both these groups, however, remain low compared with prime-age males. The male participation rate also increased over the few years prior to the 2008–2009 downturn, in contrast to the gradual decline over the previous few decades. While the overall participation rate fell modestly during the 2008–2009 downturn (e.g. as discouraged workers left the labour force), and by less than in previous downturns, it has since retraced much of the decline to again be close to the highs recorded in 2008. The male participation rate, however, is still nearly ½ percentage point below its peak in 2007.

1 See Plumb M, M Baker and G Spence (2010), 'The Labour Market during the 2008–2009 Downturn', RBA *Bulletin*, March, pp 1–6.

2 See Betts T, E Connolly and D Orsmond (2007), 'Trends in Employment and Labour Supply', RBA *Bulletin*, September, pp 1–7.

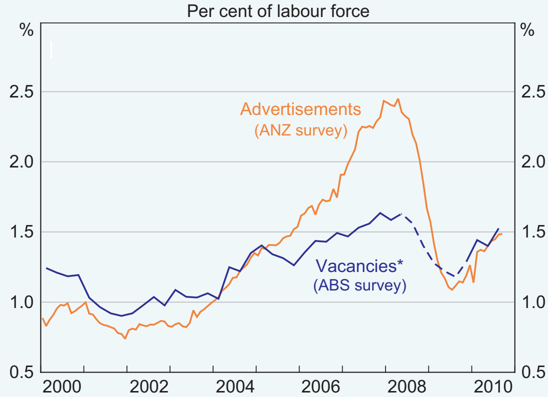
As the labour market tightens, it can become more difficult for firms to find suitable employees to fill vacancies. There are presently mixed signals from employers in this regard. In business surveys and the Bank's liaison, most firms are reporting that finding labour is currently not a major issue; the difficulty of obtaining suitable labour has risen to a little above average levels, though it remains well below its level prior to the downturn when the labour market was tight (Graph C5). To date, reports of skills shortages have been largely confined to mining-related occupations and some specialised professions. In contrast, data on vacancies give a mixed picture on the tightness of the labour market (Graph C6). As a proportion of the labour force, the ABS measure of job vacancies – which is estimated from a quarterly survey of firms – is currently around its levels in early 2007 when labour market conditions were quite tight and some employers had difficulties filling vacant positions. However, the ANZ measures of print and internet job advertisements suggest the labour market is not as tight, although assessment of these data over time is complicated by changes in firms' use of internet and newspaper advertising (for example, changes in the propensity to use multiple advertisements for the same vacancy). ✠

Graph C5
Difficulty Finding Suitable Labour



* Net balance of firms finding it harder to get labour than three months ago
** Per cent of firms indicating that availability of suitable labour is a constraint on output
Sources: ACCI-Westpac; NAB

Graph C6
Job Vacancies and Advertisements
Per cent of labour force



* This series was discontinued after May 2008 and subsequently reinstated; dashed line represents estimates for that period
Sources: ABS; ANZ