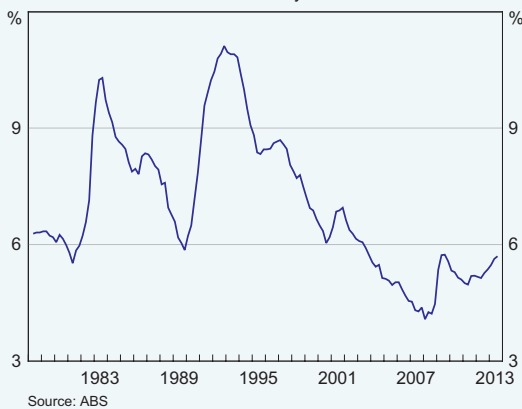


Box B

The Increase in the Unemployment Rate

Since mid 2011, the unemployment rate has risen by around $\frac{3}{4}$ percentage point to $5\frac{3}{4}$ per cent. This increase has been fairly gradual, which contrasts with previous episodes of rising unemployment that have typically been much sharper (Graph B1). The unemployment rate remains below the average of the past few decades, but it is around the highest it has been since 2003, and the increase has been accompanied by a decline in both wage growth and inflation pressures. There are a number of factors that may have contributed to the rise in the unemployment rate, including cyclically weak demand for labour resulting in employment growing more slowly than labour supply, as well as structural influences that affect the efficiency with which unemployed workers are matched to vacant jobs.

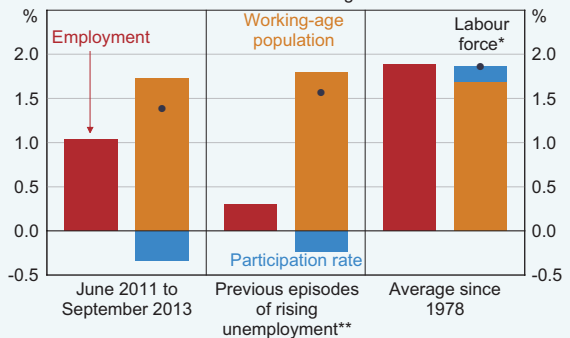
Graph B1
Unemployment Rate
Quarterly



The increase in the unemployment rate over the past couple of years is not the result of a reduction in employment. In annualised terms, employment has grown at an average pace of 1 per cent. But this growth has not kept pace with the growth in

the labour force (the number of people working or available and actively looking for work), which has been around 1.4 per cent annually (Graph B2). As a result, the number of unemployed, and their share of the labour force, has increased.

Graph B2
Employment and Labour Force Growth
Annualised average



* The dot denotes the percentage change in the labour force, which is approximately equal to the sum of the percentage change in the working-age population and the percentage change in the participation rate
 ** Previous episodes include the six episodes between 1978 and 2010 where the quarterly unemployment rate has risen by more than $\frac{1}{4}$ percentage point
 Sources: ABS; RBA

Growth in the labour force is determined by two factors: the growth in the working-age population and changes in the participation rate. The growth in the working-age population is largely influenced by demographic and policy developments and is relatively insensitive to economic cycles: it has averaged 1.7 per cent per year since mid 2011. In contrast, the participation rate tends to decrease during slowdowns as incentives to search actively for a job decline. While labour force participation has declined since mid 2011, this decline has been only slightly larger in magnitude than the average in previous episodes of rising unemployment.

The subdued pace of employment growth since mid 2011 appears to have largely reflected a weakening

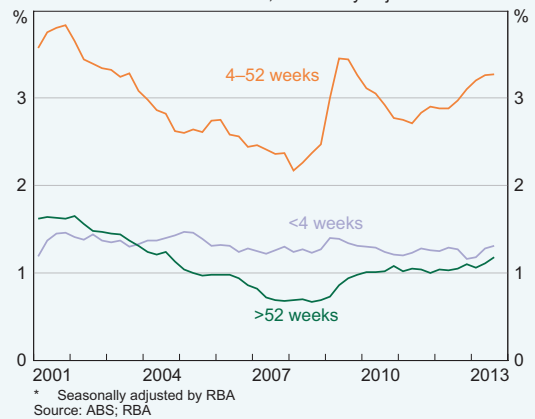
in employers' demand for labour, as seen across a number of indicators. The growth of output over recent years has been a bit below its longer-term average and indicators of firms' demand for new employees – job vacancies, job advertisements and business surveys of employment intentions – have shown pronounced declines. Slower growth in output, including because of the elevated level of the exchange rate (which has seen a loss of competitiveness in many traded-sector industries), has also seen some firms focus on containing costs, including labour costs. This may have helped to contribute to faster growth in labour productivity than the average of the decade prior to June 2011.

Over the past year or so, a deterioration in the prospects for some mining projects and the transition to the less labour-intensive production phase of the mining boom have also weighed on the demand for labour in mining and mining-related industries. Moreover, the increase in unemployment since mid 2011 has been concentrated among male workers, who tend to account for a larger share of employment in mining and other more cyclical industries.

Subdued employment growth, and a rising unemployment rate, can also reflect the ability to match unemployed workers to vacant jobs. Workers differ in their qualifications, experience and place of residence, while jobs differ according to the skills required and the location of employment. So both unemployed workers and employers may need to search for a period of time before finding an appropriate 'match'.

Many workers have a short search period between leaving one job and finding a new job and so are unemployed only temporarily. A commonly used (albeit imperfect) estimate of this form of unemployment, which is termed 'frictional' unemployment, is the number of unemployed persons that have been unemployed for less than four weeks; this measure has remained more or less constant (as a share of the labour force) for some time (Graph B3).

Graph B3
Unemployment by Duration
 Share of labour force, seasonally adjusted*



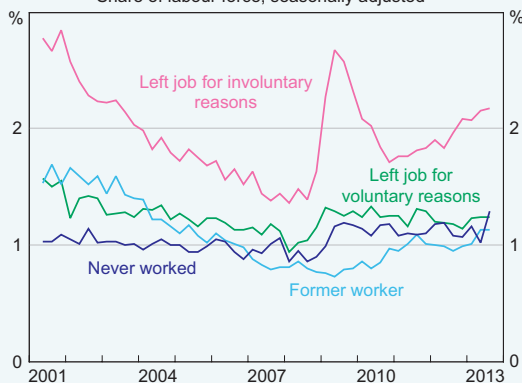
Other structural factors can also inhibit the overall efficiency of matching in the labour market, leading workers to spend a longer period of time in unemployment and contributing to a higher unemployment rate. Structural unemployment occurs when unemployed persons lack the skills or experience to obtain secure employment. Broader structural changes in the economy may be one cause of structural unemployment; for example, workers that were previously employed in industries or regions where labour market conditions have weakened could face difficulties in retraining or relocating in order to obtain jobs elsewhere. Sustained weakness in labour demand may also cause an increase in structural unemployment, as the skills of unemployed workers diminish or become redundant after a prolonged period out of employment.

It is difficult to assess the extent to which such structural factors have contributed to the recent rise in unemployment. The rate of long-term unemployment (measured as the share of the labour force that has been unemployed for more than a year) has risen only slightly in recent years. Rather, most of the increase in the unemployment rate has been attributable to individuals that have been

unemployed for between 4 and 52 weeks, who are more likely to be unemployed for cyclical reasons. Looking at the reasons reported for unemployment, most of the increase in unemployment can be attributed to unemployed persons that have left their job involuntarily in the past two years, with a large proportion of such job losses likely to occur for cyclical reasons (e.g. retrenchment or business closure) (Graph B4). Since mid 2011, persons unemployed for reasons that are most likely to relate to structural unemployment – namely, ‘former workers’ (those whose last full-time job was more than two years ago) and those that have never worked before – have made only modest contributions to the aggregate increase in unemployment.¹ However, as the former worker measure of unemployment largely relies on the last period of employment having been at least two years ago, it would demonstrate a change in structural unemployment only with a lag. Both measures are also likely to capture some share of workers who are unemployed for cyclical rather than structural reasons.

Changes in the relationship between unemployment and job vacancies, as shown by the Beveridge curve, provide another way of assessing the level of frictional and structural unemployment. Movements along the (downward sloping) Beveridge curve will generally reflect cyclical changes in labour market conditions; for instance, a decline in the demand for labour results in a decrease in the number of vacancies (as a share of the labour force), as firms search for less labour, and so an increase in the unemployment rate. In contrast, changes to the rates of frictional and structural unemployment will show up as outward or inward shifts in the position of the Beveridge curve; that is, for a given vacancy rate the unemployment rate is either higher or lower. The significant decline in the vacancy rate since mid 2011 has coincided with a smaller increase in the unemployment rate than the average historical relationship would have indicated (Graph B5). While this may be a function of the noise that naturally exists in this relationship, it may also be consistent with labour market matching having become slightly more efficient over this period.²

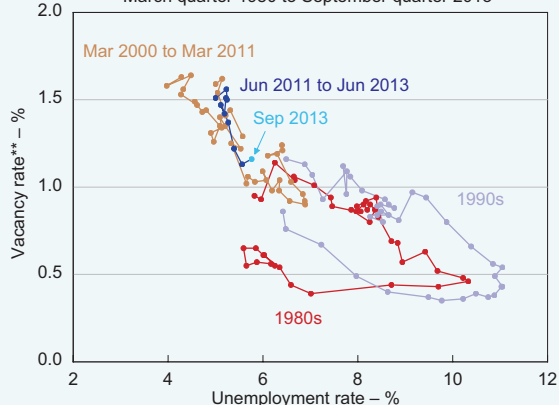
Graph B4
Unemployment by Reason*
Share of labour force, seasonally adjusted**



* Those that have 'left' a job have worked for at least two weeks in the past two years; 'former workers' last worked more than two years ago
** Seasonally adjusted by RBA
Sources: ABS; RBA

1 For more on the link between these measures and structural unemployment, see Connolly G (2011), 'The Observable Structural and Frictional Unemployment Rate (OSFUR) in Australia', paper presented to the 40th Australian Conference of Economists, Canberra, 11–13 July.

Graph B5
Beveridge Curve
March quarter 1980 to September quarter 2013*



* Mid month of quarter
** Ratio of vacancies to the labour force; this survey was suspended between the June quarter 2008 and the December quarter 2009
Sources: ABS; RBA

2 See Edwards K and L Gustafsson (2013), 'Indicators of Labour Demand', RBA Bulletin, September, pp 1–11.