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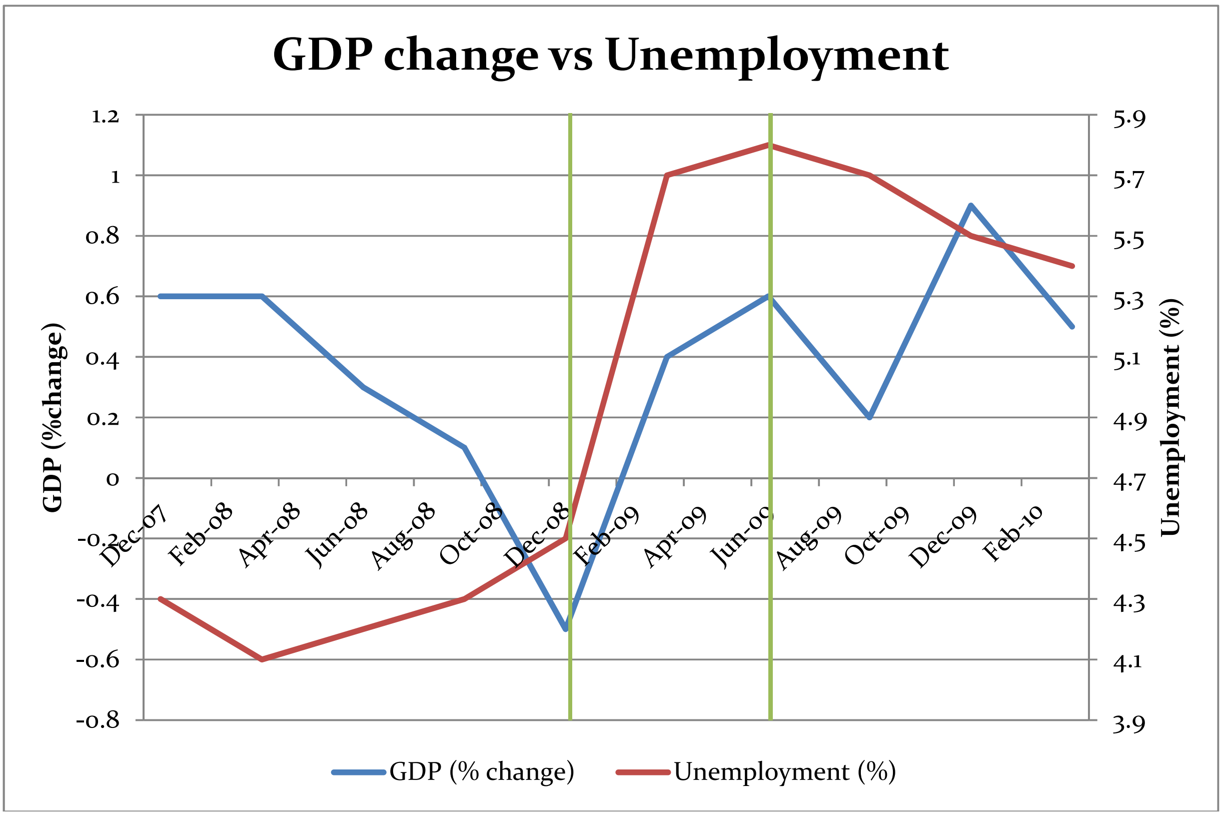
Economic Growth and Unemployment

Since 2008 in Australia

Trends In The Rates Of Economic Growth And Unemployment In Australia Since 2008



ECONOMIC GROWTH

Economic growth involves an increase in the volume of goods and services that an economy produces over time. It is measured by the annual rate of change in real Gross Domestic Product (GDP). That is, the percentage increase in the value of goods and services produced by an economy over a period of time (usually one year), adjusted for inflation.

Economic growth can be expressed as a formula:

$$Economic\ Growth\ (\%) = \frac{real\ GDP_{current\ year} - real\ GDP_{previous\ year}}{real\ GDP_{prevoius\ year}} \times \frac{100}{1}$$

For example:

Year	2008 ($bn)	2009 ($bn)
GDP	451	475

Would mean that:

$$Economic\ Growth\ (\%) = \frac{475 - 451}{451} \times \frac{100}{1}$$

$$= 5.3\%$$

The level of economic growth in a market economy such as Australia fluctuates depending on the business cycle. The changes in the business cycle are caused by the changes in the level of aggregate demand and supply.

Over time, market economies generally experience an overall growth in real GDP however can be affected by fluctuations. A good example of this is the Global Financial Crisis of late 2008. During this time, Australia faced an uncertain future with the 2009-10 budget predicting that the GFC would result in a contraction of 0.5% in 2009-10.

However, the Australian economy was able to record a 1.0% annual growth retain the year 2008-09 despite the global financial circumstances experiencing only one quarter of negative growth avoiding a technical recession (two quarters of negative growth).

As can be seen in the above graph, prior to the recession, Australia was maintaining an average quarterly growth rate of around 0.6%, leading up the recession, this rate decreased eventually hitting negative growth in the December '08 quarter. However, as the recovery began, growth began to pick back up again, reaching 0.6% in the June '09 quarter and 0.9% in the December '09 quarter. The latest economic growth figures show the March quarter growing at 0.5%.

UNEMPLOYMENT

Unemployment reflects the number of people who are out of work, but are actively seeking work. To be actively seeking work, a person must also meet certain criteria such as regularly checking job sources and registering with an employment agency.

Unemployment can be expressed as:

$$Unemployment\ Rate\ (\%) = \frac{Number\ of\ persons\ unemployed}{Total\ labour\ force} \times \frac{100}{1}$$

Where the labour force is that section of the population 15 years of age and above who are either working or actively seeking work.

For example:

Labour Force (mil)	Unemployed
13.5	0.7

Would result in an unemployment rate of:

$$Unemployment\ Rate(\%) = \frac{0.7}{13.5} \times \frac{100}{1}$$

$$= 5.6\%$$

Unemployment in Australia reached a 34 year low in 2008 reaching a low of 4.0%. However during the GFC of 2009, there was a reduced demand for labour causing unemployment to peak at around 5.8% (seasonally adjusted) approximately 6 months after GDP first reached its lowest percentage change. Since this peak, unemployment has been steadily decreasing to around 5.4% as of March '10.

The peak unemployment figure of 5.8% was far lower than predicted by Treasury which estimated that unemployment would reach 8.5% by 2010-11.

However, the extent of unemployment may not be captured fully due to the increase in underemployment (those that are not working full time and would like to work more). The decrease in full time jobs has been offset by a rise in part time jobs. Many companies during the recession encouraged workers to share the jobs instead of laying workers off.

Unemployment has significantly decreased since the "end" of the global recession. ANZ has found that in May of 2010, total job advertisements on the internet and in newspapers increased by 4.3% in May, to be 21.7% higher than they were last May (seasonally adjusted). In trend terms, total job ads grew 2.2% month on month and 23.8% year on year.

Causes Of Changes In The Rates Of Economic Growth And Unemployment Since 2008

ECONOMIC GROWTH

One of the most significant factors influencing the economic growth of the Australian economy was the onset of the global financial crisis that spread across the world affecting nearly every single economy. The recession caused a significant decrease in aggregate demand as stock markets crashed and businesses lost confidence.

Australia was affected by the recessions however despite experiencing a global slight decline in growth, Australia managed to retain growth during the 2008-09 year experiencing only one quarter of negative growth. One of the major contributors to this growth was the fact that our exports to countries in particular the demand for minerals in China.

As a resource rich country, Australia benefitted significantly from strong Asian demand for resources. The continued growth of China during the global recession helped the Australian economy helping to provide a 2% boost to the volume of Australia's exports during the first half of 2009 and allowing a buffer against the onset of the recession.

UNEMPLOYMENT

There were many causes that lead to an increase in unemployment from 2008 and the decrease seen in late 2009. Primarily, these causes stem from the global financial crisis and its impacts on the world and Australian economies.

As demand for labour is derived from the demand for the goods and services that the labour produces, an economic downturn with decreased aggregate demand would lead to a decreased demand for labour resulting in an increase in the level of unemployment. Aggregate demand may also have resulted from the decrease in demand for Australian exports by some of our major trading partners in the world market as their economies were hit by the impacts of the GFC.

Government Policies Directed At Influencing Economic Growth And The Level Of Unemployment In The Australian Economy

ECONOMIC GROWTH

Aggregate demand is the total level of expenditure in the economy over a given period of time. It includes consumption, investment, government spending and net export spending. If we substitute in the components of aggregate demand supply we come up with an alternative equilibrium condition – where leakages are equal to injections.

The Australian government can use fiscal policy to influence the level of economic growth in an economy. They may use fiscal policy to stimulate economic growth during an economic downturn which relies on the Keynesian theory that if Savings + Taxation + Imports > Investment + Government Spending + Exports then this will cause the economy to contract. It would follow that if the government were to act counter cyclically and increase spending (aggregate demand), it would bring the economy back towards a state of equilibrium or at least off set a larger decline in the economy.

The Australian government (along with many around the world) introduced two "stimulus packages". Within weeks of the meltdown, the government announced $10.4bn and months later announced a $42bn package. The aim was to boost economic growth and support jobs. The stimulus packages included one off cash payments to those on lower incomes (those with a higher MPC and higher likelihood of spending instead of saving), medium term infrastructure projects (such as Building the Education Revolution) and longer term spending on transport infrastructure.

As well, automatic stabilisers work within the budget to counter balance to some extent the decrease in economic growth. As unemployment rises, unemployment benefits are paid out to ensure that those not in a job still have income. As well, as business profits decrease, taxation receipts decrease (progressive taxation). This means that businesses have reduced costs allowing them to allocate their resources more efficiently.

UNEMPLOYMENT

The Australian government's macroeconomic policy can influence the cyclical level of unemployment through its influence on the business cycle. As unemployment levels increased during the GFC, the government shifted to highly expansionary macroeconomic policy. By increasing government spending and encouraging consumption, macroeconomic policy was able to support jobs particularly in sectors in which would have been more severely impacted by a reduction in demand such as retail.

However, despite this, unemployment still rose as macroeconomic policy could not fully offset falling business confidence and the decline in demand.

Other Internal Or External Influences On Australia's Economic Growth And Employment Performance Since 2008

ECONOMIC GROWTH

Monetary policy was used by the Reserve Bank of Australia to help encourage demand and expand the economy. The RBA moved drastically and significantly cut interest rates at the onset of the GFC to encourage demand in the economy. In reducing household servicing costs, the RBA allowed many households to sustain a higher level of consumption than otherwise would have been possible. Likewise, in reducing business costs, the RBA encouraged investment in the economy with cheaper access to money.

During late 2009, the RBA because a slight tightening of monetary policy moving the official cash rate up 25 basis points gradually over a period of months. This was designed to limit the impact that inflationary expectations arising due to Australia's recovery from the economic downturn. By controlling inflation, the RBA ensures that there is sustainable economic growth employment during the recovery period.

As well, the Australian dollar depreciated significantly as speculators moved to invest in more stable currencies. Imports become more expensive and exports cheaper which means that lower import spending and greater export revenue will help to increase Australia's growth rate.

UNEMPLOYMENT

Monetary policy was used by the RBA during the peak of the GFC when it cut interest rates from a peak of 7.35% to 3%. These cuts were designed to support households and businesses in reducing their debt servicing costs allowing them to maintain their cash flows and consumption (to some extent). This meant that businesses faced reduced costs in the wake of declining demand and allowed them to delay any reductions in their own costs such as laying off workers. Extreme monetary policy was used in head off recession and rising unemployment.

Forecast Trends In The Rates Of Economic Growth And Unemployment In The Next Twelve Months.

ECONOMIC GROWTH

Treasury figure from the 2009-10 budget predicts that Australia will experience 2.0% growth in the 2009-10 year increasing to 3.5% growth in the 2010-11 financial year. As well, Treasury also predicts growth in areas such as business investment and household consumption as shown in the table below.

Treasury Forecasts

	2008-09 outcomes	2009-10 forecasts	2010-11 forecasts
Economic Growth	1.3%	2.0%	3.25%
Household Consumption	1.9%	2.75%	3.5%
Business Investment	6.6%	-2.0%	7.0%
Inflation (CPI)	1.5%	3.25%	2.5%
Wage Price Index	3.8%	2.75%	3.75%
Current Account (% GDP)	-3.0%	-4.75%	-3.75%

It can clearly been seen that although there was a drop in business investment during the GFC, it will return to normal levels after the recovery which will be beneficial to employment as business begin to hire more employees, increase investment resulting in economic growth. Household consumption is also expected to begin to rise, again contributing to the growth in the economy.

UNEMPLOYMENT

Treasury Forecasts

	2008-09 outcomes	2009-10 forecasts	2010-11 forecasts
Unemployment Rate	5.7%	5.35%	5%
Participation Rate	65.4%	65.25%	65.5%
Employment Growth	0.1%	2.5%	2.25%

Treasury predicts that unemployment will decrease following the recovery but at a slower rate after a period. There is also a lag factor associated economic growth and unemployment declining as shown in the first graph so although economic growth may increase significantly, it may take a while before unemployment declines. As well, businesses may not feel the need to employ people if there is still some speculation about the strength of the recovery, opting instead of delay hiring of staff until more stable economic conditions.

However, recent instability in Europe has led to speculation that the world may dip back into a recession (double dip recession). The IMF and the EU have been working hard, providing guarantees and stimulus to struggling economies as well as enforcing austerity measures. Despite this, the markets still remain unsure of the outcome and are therefore quite unstable.

However, it is likely that despite overseas crises, Australia will continue to grow fuelled by the mining sector (at the risk of running a two speed economy). Economic growth will continue and the unemployment rate will decline as the economy recovers. Some sectors of the economy are still struggling (such as retail) however a recovery back, or close to, pre GFC levels should be seen within the next 12 months.