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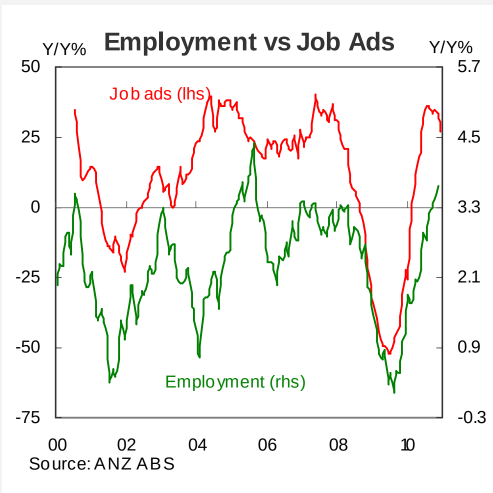
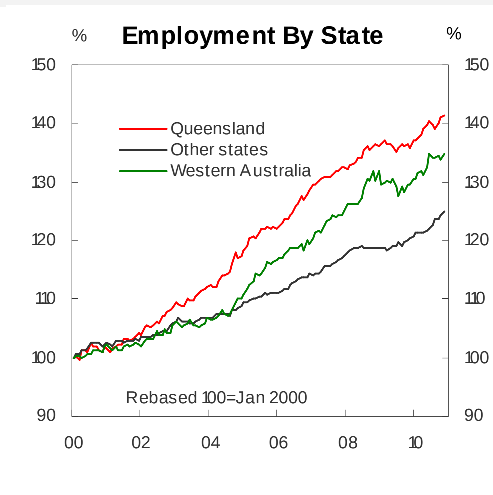
PRE-DATA SNAPSHOT – LABOUR REPORT

Damp December

Wednesday, 12 January 2011

- Our forecasts surrounding the December labour report – due tomorrow – would have been higher without the above-average rainfall in Queensland and the other eastern States. In the lead up to the floods in Queensland, 2010 was one of the wettest on record, which has been a challenge to retailers, builders, miners and tourism operators.
- The labour market is continuing to recover following the GFC. Lead indicators suggest it will strengthen further into the new year. St.George expects some 25,000 new jobs were created in December, which would see the unemployment rate fall from 5.2% to 5.1%.
- The more direct effect from the Queensland floods on employment is likely to be felt in the first half of this year.





At this point there are two countering pressures affecting the labour market. The first is the temporary but clearly negative impact from the floods in Queensland. The second is the underlying upswing in demand as recovery takes greater hold across the economy.

It is important to isolate the two. Prior to the floods our original expectation was a strong 40,000 increase in new jobs in December and a fall in the unemployment rate from 5.2% to 5.0%. Now we expect employment to be 25,000 and unemployment to fall to 5.1%.

Our original forecast is consistent with lead indicators such as job vacancies and more general economic signals, including the beginnings of the record investment boom (led by the resources sector), the ongoing stimulus from the rising terms of trade, and a broader recovery in non-mining industries. These lead indicators have remained relatively strong, despite the RBA's decision to raise rates in November.

Put together with the robust November numbers, it would have signalled unemployment is again trending downwards – albeit more gradually given the still low number of hours being worked.

The relationship between vacancies and employment is shown in the chart above. The job vacancy series is volatile but larger well-established movements are followed by activity. Over the last two years since the GFC, vacancies have led employment in a v-shaped recovery since the global financial crisis. Demand for labour is now around its peak for the last decade.

Vacancies suggest the pace of employment growth may not move much higher but remain around current levels in the near term. If so, demand is strong enough to push down the unemployment rate and see more employers opting for full time positions.

On the one hand this picture suggest there is considerable momentum in the labour market. On the other, the floods risk seeing a sharp slowdown in job creation, even if it is short lived. Queensland accounts for 29% of the national economy. Employment levels in the sunshine state are the third highest after NSW and Victoria. Also the rate of employment growth has been highest in Queensland versus the other states over the last ten years.

We pared back our expectations for December based on anecdotes retailers and building developers were being challenged by un-seasonal rain along the eastern coast, including New South Wales and Victoria. 2010 was one of the wettest years on record. In Queensland coal railings and production were being halted in the first and second weeks of December.

More concerning is that the more direct effects from the Queensland floods are yet to come and will show up in the next three to six months of labour reports for 2011. Forecasting the impact is difficult especially as the floods have not yet subsided. Large areas of agricultural land are untenable – although much of Queensland's wheat was harvested prior to the floods and some key crops such as bananas have gone unscathed.

Coal production has been cut back sharply, which while reducing hiring in the near term, is unlikely to result in significant layoffs given current skill shortages. Small businesses in many of the country towns will probably be most affected.

While labour demand is almost certain to be cut due to the flooding there is a reasonable possibility it will more than recover in the second half of the year due to the clean up and repair of damaged homes and infrastructure.

The floods delay the eventual shift towards full capacity in employment. conditions than we have now. When the labour market does reach full capacity – the natural rate of unemployment is estimated to be around 4.5% to 5% – this is likely to put upward pressures on wages and inflation going forward.

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