Opening statement to the Economics Legislation Committee

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Just over a year ago, on the 22nd of March, the Government announced one of the largest fiscal packages in Australia's history in response to the rapidly unfolding pandemic.

The $66 billion package included an effective doubling of the JobSeeker payment; payments to other welfare recipients; and a $35 billion cash flow boost for small and medium sized businesses.

Just eight days later the Government announced the largest single fiscal measure in Australia's history, the JobKeeper program. First announced at a cost of $130 billion, JobKeeper is now likely to cost around $90 billion.

These were difficult times for Australia and the world; in some countries cases and deaths were increasing exponentially. In the face of the profound uncertainty there was a palpable sense of fear in our community.

When I appeared in front of the Senate Select Committee on COVID-19 after the announcement of the JobKeeper program, I noted that designing a program of this nature as a pandemic was unfolding involved trade-offs. I could have easily said that all the Government's measures involved unavoidable trade-offs.

The trade-offs that arise with any government intervention typically include speed and impact versus targeting and associated complexity among many others.

In our view these trade-offs were well considered and a sensible and prudent balance was struck. Moreover, it is our assessment that the economic measures have been highly effective in supporting the Australian economy and are now proving equally successful in driving the recovery.

There is little doubt their effectiveness is underpinned by Australia's first class health response to the pandemic.

Some countries have experienced severe health outcomes and severe economic outcomes.

Other countries have experienced severe health outcomes but smaller negative economic impacts.

Few countries have experienced what Australia has experienced, relatively good health outcomes and smaller economic impacts and now, rapid recovery.

By any measure, Australian Governments have struck the right balance. Our outcomes have been world leading, both in the health and the economic sphere.

Today I would like to cover three areas that I hope are of interest to the Committee.

First a review of economic outcomes and developments since MYEFO.

Second, to outline our expectations of how the labour market will be impacted by the end of the JobKeeper program.

And third, some brief remarks about the prospects for full employment post the pandemic and labour market scarring.

Economic update since MYEFO

Since the MYEFO was published in December, global and domestic economies have outperformed expectations.

Rates of infection have been falling around the world but remain high. This is a reminder that the COVID-19 crisis is far from over, especially with the emergence of new and more infectious variants of the virus.

Nevertheless, the vaccine rollout, better-than-expected economic outcomes in a number of countries and the passing of a very significant stimulus package in the United States has led to more optimism.

The US Stimulus package is worth nearly US$1.9 trillion, and equivalent to over 2 per cent of global GDP. The global recovery will be substantially aided by this stimulus.

In Australia, the December quarter National Accounts showed growth of 3.1 per cent, which followed a strong September quarter outcome. The economy has now recovered 85 per cent of the decline from its pre-COVID level of output.

Growth will now begin to moderate as we move past the initial phase of the recovery. We will need to remain mindful of continued risks to the outlook, including from further outbreaks and ongoing trade and geopolitical tensions.

While the economy is recovering strongly, well supported by fiscal and monetary policy settings, we are well below our pre-pandemic trend economic growth path, and it will take some time to fully recover.

The labour market has also significantly outperformed our expectations. At MYEFO, our forecast was for the unemployment rate to peak in the March quarter of this year at 7½ per cent. It now appears that the peak is behind us following very strong employment outcomes in recent months.

The unemployment rate fell to 5.8 per cent in February, with the participation rate remaining at its record high of 66.1 per cent. The high participation rate is a strong indicator of confidence and compares favourably to outcomes in other countries.

Nonetheless, while outcomes to date have tended to surprise on the upside, there is still significant spare capacity in the labour market.

The unemployment rate and average weekly hours worked remain well off their pre-COVID levels. Underemployment (consisting mainly of those who are available and would like to work more hours than they did in the reference period) has returned to its pre-COVID level. This measure has persistently trended higher in recent decades and remains elevated.

The number of people defined as being in long-term unemployment (that is, those that have been looking for, but without paid work, for a year or more), will jump in coming months. This reflects the flow-on impacts of the spike in unemployment at the onset of the crisis in March and April last year.

While overall employment has recovered to just above its March 2020 level, youth employment remains well below its pre-pandemic level. Employment for those aged 15-24 is still 3.8 per cent lower.

I have previously noted that despite being significantly more affected at the beginning of the pandemic, female employment also recovered faster to finish 2020 broadly in-line with male outcomes.

Female employment is now 0.3 per cent above its pre-crisis level, slightly above the outcome for male employment which is 0.2 per cent below its pre-crisis level. Likewise, hours worked by women are now 0.6 per cent above their March 2020 level, while hours worked by men remain 1.6 per cent lower.

However, it is worth noting that women have been over-represented in both the industries which are most impacted when health and activity restrictions are put in place and in part-time roles which we have seen are more likely to lose work or hours.

According to the ABS, women also took on more of the burden of unpaid work when activity restrictions were put in place through the pandemic.

As such, women are generally likely to be disproportionally affected by the reimposition of any further health restrictions.

The end of JobKeeper

The direct fiscal support that was provided at the height of the crisis has been tapering since September, mostly as a result of workers and businesses graduating off JobKeeper.

As the economy continues to recover, the remaining direct fiscal support will taper further. Although it is worth noting that of the $251 billion in direct measures, around $100 billion is yet to be provided or have its full effect.

Moreover, the support that has been delivered to date will continue to sustain the recovery as the large increase in household savings and stronger business balance sheets are drawn upon. Confidence will be key here, including confidence in the ongoing predictable management of the pandemic.

We are continuing to closely monitor the situation in different sectors and do expect that the end of the JobKeeper program will lead to some businesses closing and jobs being lost.

However, we remain confident that there will continue to be a broad-based recovery in the labour market over 2021, given recent strong employment growth and the decreasing reliance on JobKeeper over recent months.

The total number of JobKeeper recipients has reduced substantially from the start of the program to today. In the first phase of JobKeeper, from March to September 2020, more than 3.8 million individuals were supported. This reduced to 1.6 million individuals at the start of the second phase in September.

That adjustment was smooth; 93 per cent of JobKeeper employees whose firms transitioned off JobKeeper in September were still in employment in December and the national unemployment rate continued to trend down.

Based on data from the month of January, we now estimate that around 1.1 million individuals will be supported by JobKeeper in the March quarter. This is lower than our MYEFO estimate of 1.3 million individuals. It is also reasonable to assume that as the labour market continues to improve over the March quarter, recipients' dependence on the program will continue to decline.

When thinking about the end of the JobKeeper program we have looked at both firms and individuals.

In February, the data tells us that there were around 88,000 workers on zero or very low hours in JobKeeper firms. We expect that this number will have reduced further by the end of the program, and not all of these individuals would be expected to lose employment. But this provides an indication of the number of vulnerable workers in JobKeeper firms.

In terms of businesses, around 110,000 firms receiving the payment in the March quarter experienced a fall in turnover of over 75 per cent in the December quarter relative to the year before. Some of these businesses were still being impacted by the Victorian shutdown, as well as border closures and stricter social distancing restrictions which were in place then but are no longer in place.

While these data give us a guide to the likely transitional effects, determining the overall level of potential job losses is difficult.

The relatively smooth transition from JobKeeper 1.0 to 2.0 gives us reason to believe that the effects will again be moderated by the strong economic and labour market recovery, the ongoing easing of restrictions, the changes that businesses have been making to their operating models and broader policy support measures that are in place.

Taking all of our information together, we believe that in the order of 100,000 to 150,000 JobKeeper recipients may lose employment at the completion of the program, though there is a wide band of uncertainty around this estimate. This does not mean that there will be a commensurate increase in unemployment.

It is important to consider labour market disruptions at the end of JobKeeper in the context of the normal flows into and out of employment.

In a given month during the years leading up to the pandemic, around 400,000 people moved into and out of employment, with a small net increase on average. Most of the people moving out of employment tend to leave the labour force altogether, rather than become unemployed. So the flow of people out of JobKeeper positions is within the normal flows of employment that we regularly observe.

In summary, JobKeeper has played a crucial role in supporting the economy and driving the recovery.

In our view it is appropriate for the program to end as other support measures take effect and to allow the economy to continue adjusting.

As noted in Treasury's JobKeeper Review, the program has a number of features that create adverse incentives which are likely to become more pronounced as the economy recovers. In particular, it distorts wage relativities, it dampens incentives to work, it hampers labour mobility and the reallocation of workers to more productive roles and it keeps businesses afloat that would not be viable without ongoing support.

Our view is that the adjustment away from JobKeeper will be manageable, and that employment will continue to increase over the course of this year, although the unemployment rate could rise a little over coming months before resuming its downward trajectory. In the years ahead we will further evaluate the program to ensure governments can benefit from these learnings.

Prospects for full employment

I would now like to touch on prospects for full employment and labour market scarring.

Following the stronger and faster than expected recovery in the labour market, we are optimistic that the risk of persistent employment impacts (or scarring) from the COVID-19 shock is not as significant as we had previously feared.

I have previously observed that following a recession the NAIRU (the level of unemployment below which inflation would be expected to rise) typically drifts up due to the potential for labour market scarring. Although there is still a risk that certain cohorts will find it difficult to gain employment, we are now optimistic that the aggregate scarring effect is likely to be far less pronounced following the COVID-19 shock.

Increasingly, the recovery from this pandemic looks different to other economic shocks, due both to its speed and nature, and the fact that programs such as JobKeeper have maintained a strong connection between businesses and employees.

Estimates of the NAIRU are well known to be subject to a high degree of uncertainty. The NAIRU is an unobservable variable and must be estimated using a model, a process which typically comes with wide error bands.

Our current estimate falls within a range of 4½ to 5 per cent, compared with 5 per cent previously. Though the confidence interval around this range is much wider.

Notwithstanding the uncertainty inherent in estimating the NAIRU, a lower NAIRU than previously thought is consistent with the recent international experience of countries experiencing very low unemployment with little to no inflation.

And while our models may not yet be capturing more recent changes in relationships, a lower NAIRU than previously thought is also consistent with the low wage growth we have observed in Australia since the GFC.

It is also consistent with elevated levels of underemployment in Australia, as I described earlier. A higher level of underemployment implies a greater degree of spare capacity (or slack) in the labour market for a given level of unemployment.

In the coming weeks, Treasury will release a working paper that sets out our estimation of the NAIRU. We continue to monitor a range of indicators, such as wage growth, in real time to inform our forecasts and judgements about the degree of slack in the labour market.

The extent to which the unemployment rate can be lower before inflation pressures arise will be an ongoing consideration for Government. The Government's two stage fiscal strategy accommodates flexible targeting of the unemployment rate and a considered and prudent approach to medium term consolidation in the light of near term uncertainties.

Conclusion

To conclude, Australia's economic recovery is well underway and running ahead of our expectations. The way in which the Australian economy has weathered this shock should leave us well placed in the years to come. As always, we must be mindful of downside risks, particularly those posed by further outbreaks. It is crucial that all levels of government and society continue to work together to manage health risks and ensure we remain on the path to recovery.