Economic Note

Q1 2019 Labour Market Preview

26 April 2019

HLFS volatility set to persist, with benign wage pressures

- The Q1 labour market prints are expected to rebound from their Q4 "weakness", with elevated labour market utilisation and a historically-low unemployment rate.
- We expect modest increases in labour costs, with a 0.4% qoq increase in the Private Sector Labour Cost Index (LCI) and annual LCI wage inflation steady at 2.0%.
- Our expectation is that the labour market will remain tight over 2019, but that wage growth will fail to fire sufficiently to push medium-term inflation higher. We expect 50bps of OCR cuts over 2019.

Q1 Labour Market Forecasts			
Household labour Force Survey	ASB	Prior	RBNZ
Employment growth (QoQ)	0.6	0.1	0.5
Employment growth (YoY)	2.4	2.3	2.3
Unemployment Rate (%)	4.2	4.3	4.2
Employment Rate (%)	68.1	67.9	67.9
Participation Rate (%)	71.0	70.9	
Labour Cost Index			
Private Sector (%, QoQ)	0.4	0.5	0.5
Private Sector (%, ann)	2.0	2.0	2.1

Summary and implications

- We expect some modest strengthening from the 'soft' Q4 HLFS labour prints, with employment growth set to firm, the unemployment rate to ease, and with measures of labour utilisation to tighten.
- The RBNZ looks to be clearly meeting its PTA objectives in terms of "supporting maximum sustainable employment within the economy".
- However, wage growth is still expected to remain modest, with distributional measures continuing to depict a contained wage inflation backdrop.
- Wage growth looks like it won't strengthen enough to keep inflation outturns comfortably within the 1-3% inflation target.
- ASB expects 50bps of OCR cuts over 2019, with reasonable odds of a RBNZ cut in May.

Labour market expected to remain tight

Correctly picking outturns from the Household Labour Force Survey (HLFS) remains a lottery. Following a strong set of prints for the September 2018 quarter, the December 2018 quarter outturn showed modest recoil, with sluggish employment growth, a tick up in the unemployment rate (to 4.3%) and with the labour force participation rate (70.9%) and employment rate (67.9%) both down from multi-year highs. The underutilisation rate (a broader measure

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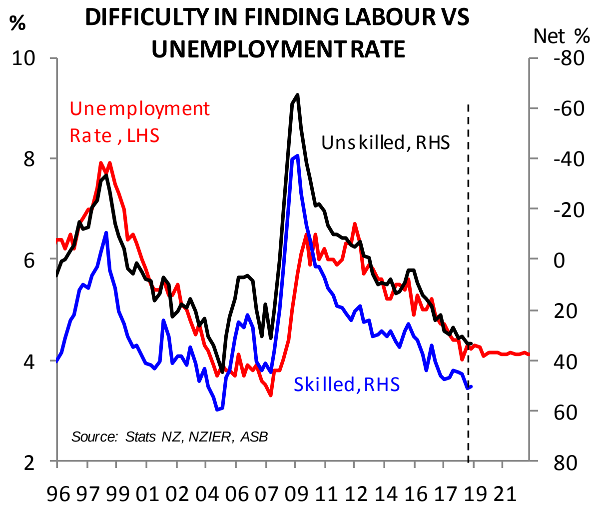
of labour market slack) rose to 12.8%, the highest in close to two years.



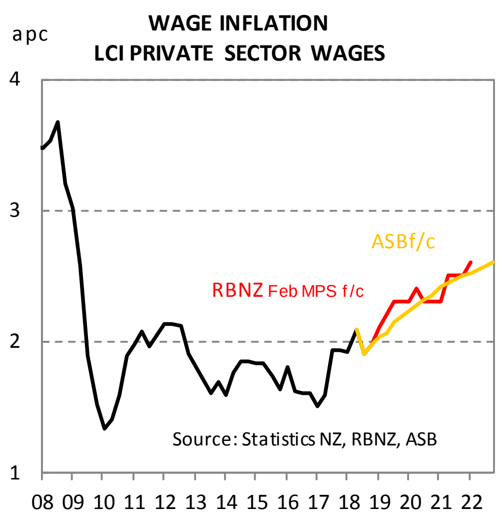
We expect the Q1 HLFS figures to show a marginally tighter labour market. HLFS employment is expected to climb 0.6% qoq (+2.4% yoy). Both the labour force participation rate (71% of the working age population), and the employment rate (68.1%) are expected to retrace Q4 falls. The unemployment rate is expected to decline to 4.2% of the labour force. The improvement in quarterly employment is consistent with modestly firmer survey readings of experienced employment from the 2018Q1 Quarterly Survey of Business Opinion (QSBO). The lower HLFS unemployment rate is also consistent with survey evidence that has highlighted the difficulties firms have found in getting both skilled and unskilled labour. Other published employment measures, including filled jobs and paid hours from the Quarterly Employment Survey (QES) should post more moderate quarterly increases and still-moderate rates of annual growth.

Annual growth in the working-age population is slowing. Earlier published figures from Statistics New Zealand confirmed that the working-age population increased by 0.4% in Q1 (+1.9% yoy), with the addition of 72,000 persons over the last 12 months, the lowest in 4½ years. We expect growth in the working-age population to continue to cool as net permanent and long-term (PLT) immigration slows. We note that the phasing out of the migration departure cards has made it more difficult to predict what the working age population is likely to be in future.

A margin of spare capacity is expected to remain within the existing labour market. The HLFS underutilisation rate (persons unemployed and under employed) is expected to ease, but remain reasonably elevated at around 12% of the labour force. HLFS hours worked per employee (currently 32.8) is very low. If this ratio returned to historical averages (34.5), it would boost hours worked within the economy by around 5%.

We expect the labour market to remain tight given slower growth in the labour supply. The unemployment rate is expected to hover around 4% by late 2019. The HLFS participation rate and employment rate are expected to remain elevated. However, we expect continued quarterly volatility in the HLFS figures, which is reflective of the small sample of the survey, to continue to make life more difficult for the RBNZ. Weaker survey results for firms' employment intentions in the March 2019 quarter QSBO flag a weaker Q2 2019 outturn, consistent with the see-saw pattern of recent HLFS outturns.

Modest wage growth expected



We expect a 0.4% quarterly increase in private sector LCI wages, with annual wage inflation steady at 2.0%. Median and mean wage increases from the LCI are expected to remain contained at around 2.5% yoy. Risks around our LCI picks are tilted to the downside. We expect that the distributional measures will continue to generally highlight a benign backdrop for wage growth.

This year is pivotal for the wage outlook. Our view had been that stretched labour market capacity and the boost to wages provided by minimum wage increases and moves towards more Fair Pay agreements for the lower paid would be sufficient to trigger a generalised firming in overall wages. **The failure to date for wages to come to the party has challenged that view.** Moreover, anecdotal and survey evidence (notably, the 2019Q1 QSBO) highlighted that firms are under increasing margin pressures and are struggling to pass on higher costs. Rather than offer higher wages, we expect firms to offer workers increased flexibility and other non-wage benefits to keep employees on side.

Also linked to our more moderate wage outlook was our weaker outlook for productivity growth, a key determinant of wages. Low wage inflation has also been a worldwide phenomenon, with increasing casualisation of the labour market and globalisation acting as structural wage suppressants.

Market reaction and policy implications

The labour market report is published on Wednesday, May 1, a week before the Reserve Bank's (RBNZ) February Monetary Policy Statement (MPS) on the 8th of May. Market pricing is currently around 50% priced for a 25bps OCR cut, with Governor Orr earlier alluding to the importance of the Q1 CPI and labour market prints to determine the RBNZ OCR view. Markets are likely to remain somewhat sceptical over HLFS outturns following recent volatile outturns. However, a weak set of labour market prints will likely see the market add to the rate cuts already priced in, with the NZD also nudged lower. Numbers stronger than market expectations will likely see market pricing take out some of the risk of a May OCR cut. To us, however, the case for a lower OCR is still strong and we are likely to see market pricing remained biased towards a lower OCR over the next 12 months.

We expect the RBNZ will not jump to too many conclusions if a 'strong' HLFS print emerges, maintaining that the labour market backdrop remains broadly consistent with its monetary policy remit of "supporting maximum sustainable employment within the economy". Flexibility and pragmatism are the keywords here. However, developments on the wage front will be critical. **Continued weakness in wage inflation despite close to full employment will be more difficult for the RBNZ to shake off, especially if employment figures disappoint**. With GDP growth over 2019 expected to undershoot the February 2019 MPS forecasts (3.0% yoy) and move closer to the RBNZ downside scenario (in which the OCR was cut by 50bps), the weaker outlook for medium-term inflation necessitates a lower OCR. We expect 50bps of OCR cuts over 2019, with the first cut possibly as soon as the May MPS. We acknowledge that the timing of OCR moves is fluid and conditional on the NZD, actions from overseas central banks as well as developments directly pertaining to the domestic labour market and inflation.

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