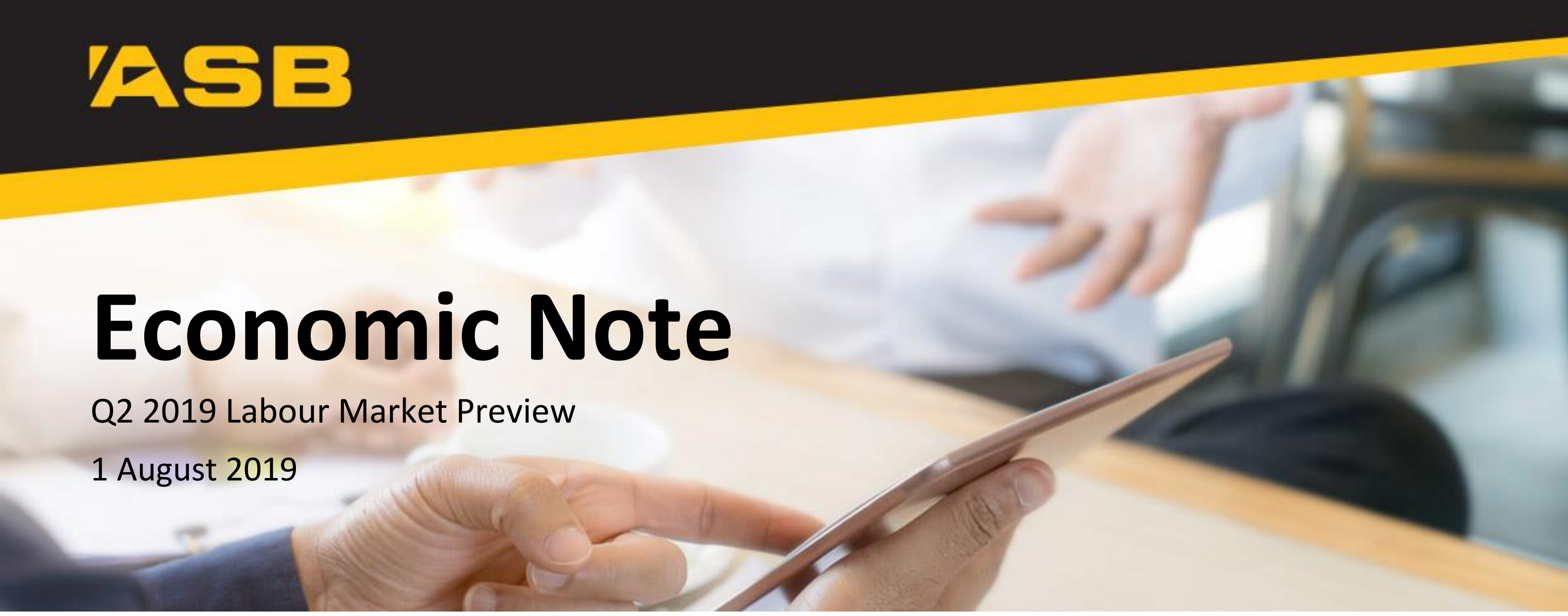

Economic Note

Q2 2019 Labour Market Preview

1 August 2019

Worried about wages

- June quarter labour data will likely confirm the RBNZ met its labour market objectives in Q2.
- But the outlook is deteriorating, and the Bank will be sensitive to downside surprises. Wage growth and labour market capacity measures will be particularly key to watch.
- The data come too late to influence the August MPS RBNZ forecasts, but will inform views on whether the Bank will need to continue cutting the OCR beyond August (as we expect) and the timing of cuts.

Q2 Labour Market Forecasts			
HLFS	ASB	Prior	RBNZ
Employment growth (QoQ)	0.5	-0.2	0.4
Employment growth (YoY)	1.4	1.5	1.3
Unemployment Rate (%)	4.4	4.2	4.3
Participation Rate (%)	70.6	70.4	70.5
Labour Cost Index			
Private Sector (%, QoQ)	0.7	0.3	0.7
Private Sector (%, ann)	2.1	2.0	2.1

Summary and implications

June quarter data are expected to show the labour market in a strong spot. Employment growth and labour force participation are expected to bounce. Unemployment will increase slightly, but remain at very low levels. In other words, the RBNZ will probably get another tick for meeting its "maximum sustainable employment" objective.

The data come too late to be incorporated into the forecasts for the RBNZ's 7 August Monetary Policy Statement (at which we expect the OCR to be cut 25bps to 1.25%). But the outcome will be known when the OCR decision is made and will inform views on whether the RBNZ will need to continue cutting beyond August (as we expect), and when.

Two things will be important to watch in this regard. First, wage growth. It has failed to fire for years and the RBNZ is now openly wondering if extra capacity in the labour market is the reason. We're expecting a strong 0.7% lift in the key LCI wage measure (same as RBNZ), partly thanks to April's 7.3% minimum wage increase. Measures of labour market capacity will also be worth keeping an eye on. The RBNZ is now looking at a range of such measures and our view is that there is already more slack in the labour market than many believe.

We suspect the RBNZ's patience for disappointments on wage growth is starting to wear thin. So any weakness in wages or signs of labour capacity opening up could see OCR cuts front-loaded. We continue to expect 25bps cuts in August and November, taking the OCR to 1.00%.

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Labour market still in a strong spot

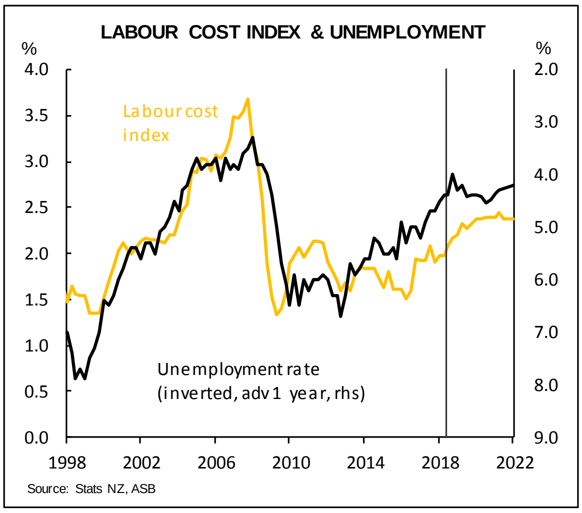
Quarter-to-quarter movements in HLFS labour market statistics remain scarily volatile. We've allowed for the saw-tooth pattern to continue in the June quarter. Employment growth is expected to bounce back 0.5%qoq (RBNZ +0.4%) following the prior quarter's surprise 0.2% decline. This would nevertheless leave annual employment growth at just 1.4%, indicative of the extent to which jobs growth has slowed over the past year.

The unemployment rate is expected to lift from 4.2% to 4.4% as an increase in labour supply, in the form of a bounce-back in the participation rate to 70.6%, more than matches the expected rebound in employment. The QES survey, released at the same time, will provide the usual cross-check on the notoriously choppy HLFS. We expect a slightly larger 0.6% lift in the key employment metric in the QES, paid hours.

All told, June labour market stats will likely confirm the RBNZ broadly met the "maximum sustainable employment" part of its mandate in Q2. However, the worm looks to be turning for the labour market. Months of weak business confidence and crimped profitability now appear to be spilling over into a stalling in hiring. The Bank has also publicly mused about whether there is actually more capacity in the labour market than the likes of the unemployment rate would suggest.

Capacity Measures in Focus

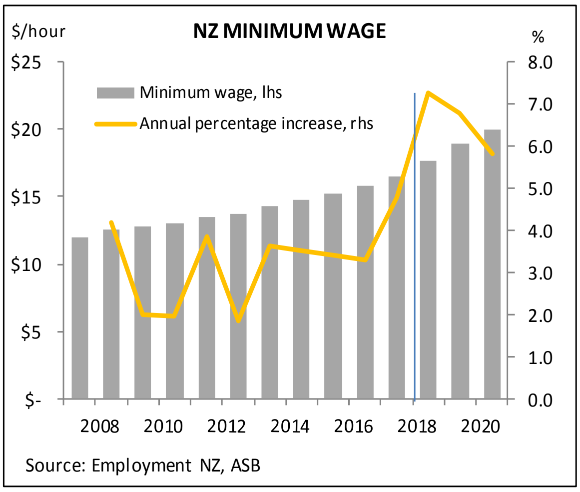
For this reason, broader measures of labour market capacity will be important to watch. The RBNZ has given us a strong steer towards what it believes to be the best of them: Maori unemployment; youth unemployment rates; the underutilisation rate[1], and; the underemployment rate.[2] To this list we'd add HLFS hours worked per person.



We expect labour market slack to pick up (covered in our recent note); signs in the Q2 data of this occurring rapidly could see OCR cuts front-loaded.

Jump in wage growth will flatter the trend

We continue to expect a modest pick-up in wage growth over the next few years, supported by recent tightness in the labour market, various pay settlements (most notably the minimum wage lift), and widespread skill shortages. We've recently shaded down the extent of the expected pick-up though, consistent with our view that spare capacity in the labour market is perhaps not as scant as first thought. The increasing strain on firms' profitability would also suggest wage demands are less likely to be met in full.



June quarter wage data will flatter the underlying trend. We expect a 0.7%qoq increase in the private sector LCI, the (equal) strongest quarterly increase since the Global Financial Crisis (GFC). This would see annual private sector wage inflation tick up from 2.0% to 2.1%. A 7.3% lift in the minimum wage from $16.50/hour to $17.70 will be a major feature, contributing around 0.2 percentage points to the Q2 outturn. Note that the recent teachers' wage settlement won't start to come through until Q3.

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[1] A broad group considered part of the potential labour supply. Includes underemployed workers, unavailable jobseekers, and available potential jobseekers.
[2] Part-time workers who would prefer to work more hours and are available to do so.

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