ASB

Economic Note

Q1 2020 Labour Market Review

6 May 2020

An outlook for the labour market

- Q1 labour data limited in their usefulness, but confirm a strong starting point prior to COVID-19 blindside.
- The RBNZ and NZ Government are already responding to the likely much worse readings on the labour market we will get over the next two quarters.
- Most of this note is devoted to the outlook. We expect unemployment to rise to 9.0% in Q2 and 9.4% in Q3.

Household labour Force Survey	Actual	ASB	Market
Employment growth (QoQ)	0.7	-0.3	-0.2
Unemployment Rate (%)	4.2	4.4	4.4
Participation Rate (%)	70.4	70.0	70.0
Labour Cost Index			
Private Sector (%, QoQ)	0.3	0.3	0.5
Private Sector (%, ann)	2.4	2.3	2.4

Summary and implications

Most first quarter data have been rendered largely obsolete thanks to the outbreak of COVID-19. Today's labour market data were no different. They revealed only the beginnings of what we expect to be a material deterioration in the labour market this year. Still, we can at least take some comfort from the fact the starting point prior to COVID-19 hitting is one of full employment, solid wage growth, and an unemployment rate close to the lowest level in 11 years.

More timely labour market data suggest the pace of job losses is likely to rise steeply from here. We expect the unemployment rate to rise sharply in the second quarter, but the peak (we have 9.4% on the board) will likely come in Q3 as firms adjust to life without the government wage subsidy. We expect it will take several years before the unemployment rate moves lower on a sustained basis. This has clear negative implications for household spending and the housing market.

There are no financial market implications from today's data. The RBNZ and NZ Government are already responding to the likely much worse readings on the labour market we will get over the next two quarters. We expect the RBNZ to keep its foot on the gas for some time. It has already slashed rates to 0.25% and embarked on a $33b quantitative easing programme (QE). We expect the QE programme to be upsized significantly next week and for the Government to roll out more measures to support firms and workers in the May budget. Look out for our more detailed previews of both later in the week.

Old news

The March quarter labour market data were always going to be limited in their usefulness. Hence the short shrift given to them by financial markets today. Not only was Q1 relatively unaffected by the COVID-19 disruptions that

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subsequently upended NZ's economic outlook, but the surveying methodology used by Stats NZ meant that only a fraction of the late March deterioration in the labour market was picked up in today's figures. Consequently, rather than the minutiae of today's figures, most of this note is devoted to the outlook.

It is worth highlighting though that NZ is extremely fortunate in that the starting point for the labour market prior to COVID-19 hitting was one of largely full employment, solid wage growth, and an unemployment rate close to 11-year lows. Indeed, today's read on the Q1 jobs market revealed stronger-than-expected outcomes almost across the board. Employment rose a solid 0.7% over the quarter, quashing widespread expectations of a small fall. Employment indicators from the QES survey were similarly strong. Filled jobs and paid hours rose 1.0% qoq and 0.6%, respectively.

Moreover, the labour force participation rate clawed back the previous quarter's surprising fall, rising to 70.4% (70.0% expected). Even with this relatively strong lift in participation, the unemployment rate only rose 0.2 percentage points to 4.2%. Taken altogether, these numbers support our sense gained from other Q4/Q1 data that the NZ economy was starting to build a solid head of steam prior to COVID-19 hitting.

The one soft spot in today's figures was wage growth. This was a surprise to market expectations but not so much ourselves. The key measure of wage inflation we look at – the Labour Cost Index – lifted just 0.3% over the quarter (2.4% yoy). We're quick to note that March is typically a seasonally weak month for wages so suggesting that wage growth was already coming off prior to COVID-19 is probably overstating the case.

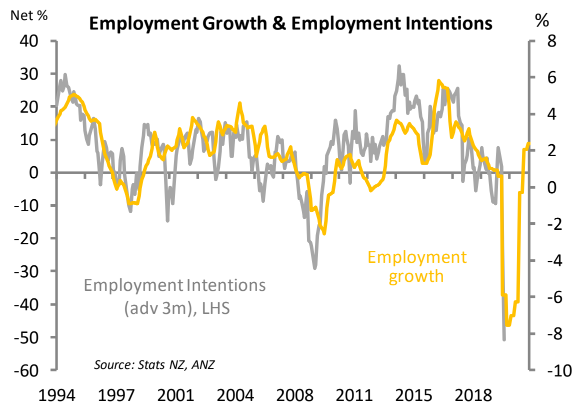
Job losses will increase steeply from here

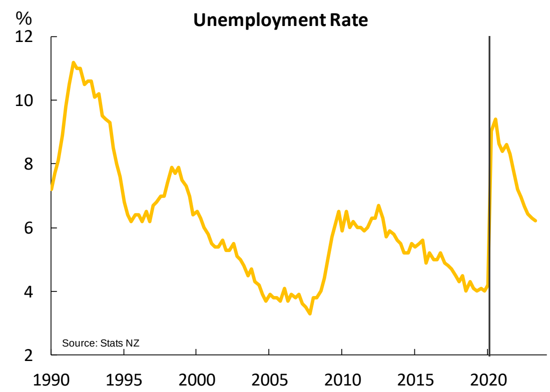
More timely labour market data support our view that the pace of job losses is likely to rise steeply from here. Jobseeker data show a further 27,000 "work ready" people have filed for the jobseeker benefit since the end of March. And surveyed employment intentions from the latest ANZ confidence survey are consistent with around half of firms expecting to cut staff numbers over the coming year. This points to a collapse in employment of 6-8% yoy in coming quarters. This is pretty close to our own forecasts.

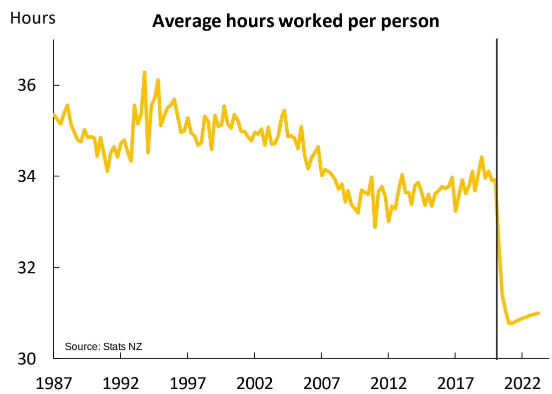
We expect the unemployment rate to rise sharply in the second quarter, but the peak will likely come in Q3 (we have 9.4% in our forecasts). This is when firms will be adjusting to life without the government wage subsidy, which is set to expire in June. The subsidy take-up has been huge, it's currently covering 60% of the employed workforce. It is conceivable that next week's government Budget will see some sort of extension to the wage subsidy scheme. Such an outcome would prompt a revision to our unemployment expectations.

Alongside the unemployment rate, other measures of labour market capacity like underutilisation and hours worked per person will be important to watch in coming quarters. We expect the latter to fall dramatically as firms cut employee hours as a way of avoiding redundancies for as long as they can. Hours worked per person is very likely fall to the lowest level since records began in the late 1980s (chart opposite).

General weakness in the employment market will eventually show up in lower wage growth. Recall wage inflation had







(finally) started to accelerate over the past 12-18 months, helped along by various legislative changes like the minimum wage increases. But we now expect wage inflation to fall from 2.4% yoy currently to 1.0% by the middle of 2021. This mix of rising unemployment and falling wage growth has clear negative implications for household spending and the housing market.

There are also implications for the RBNZ. The labour market is very quickly moving from the RBNZ's target position of "maximum sustainable employment" to one of significant slack. Indeed, we think the projected increase in unemployment will likely understate just how much labour market capacity is opening up. Some of those finding themselves jobless will give up on seeking employment altogether and drift out of the labour force (thereby not be captured as "unemployed" as defined within the Household Labour Force Survey). We also expect population growth to decline this year now that migration has been brought to a sudden halt. And this will further serve to limit the increase in the labour force, contributing to a lower unemployment rate than otherwise.

It will take several years before the unemployment rate moves lower on a sustained basis and hence closes the gap to estimates of the NAIRU (non-accelerating inflation rate of unemployment) that RBNZ-watchers like ourselves focus on. Our forecasts have the unemployment rate remaining above 7% until mid-2022.

This being the case, we expect the RBNZ to keep its foot on the gas for some time. It has already slashed the OCR to 0.25% and embarked on a $33b quantitative easing programme. We expect the programme to be significantly upsized next week and for the Government to roll out more measures to support firms and workers in the May Budget. Look out for our more detailed previews of both later in the week.

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