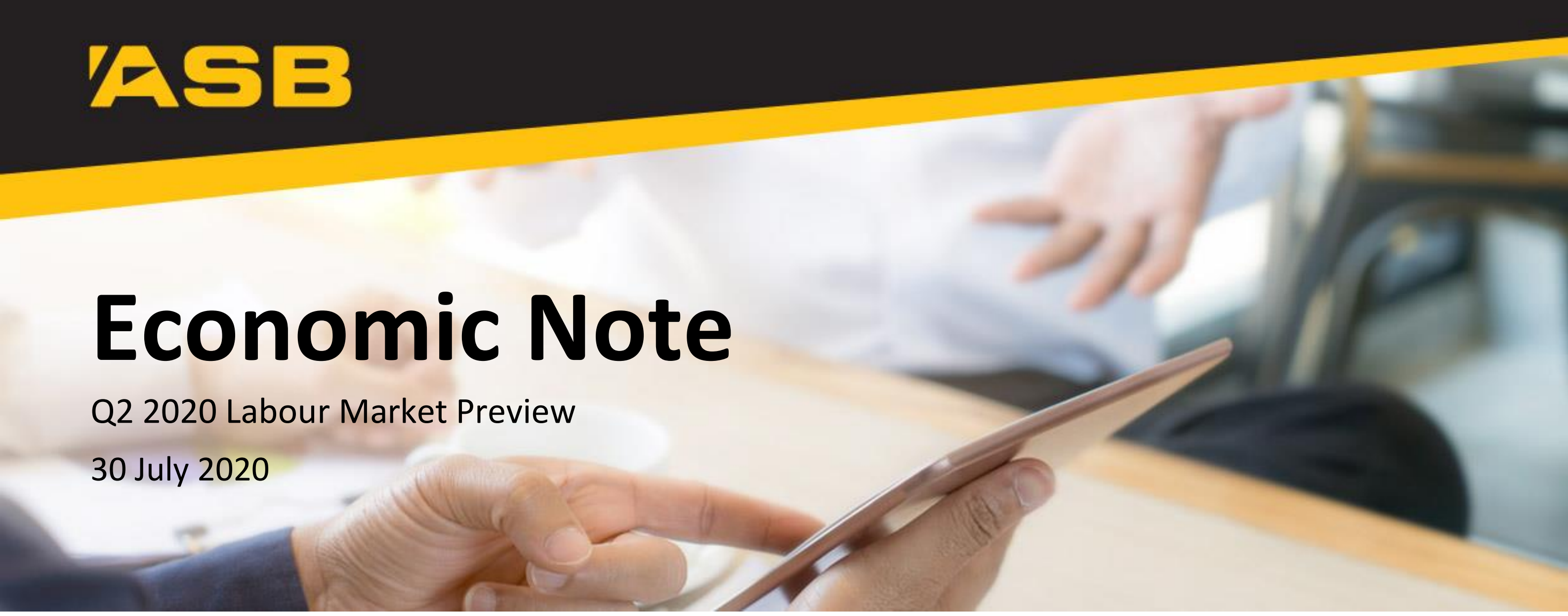

Economic Note

Q2 2020 Labour Market Preview

30 July 2020

Waypoint on a regrettable journey

- June quarter labour data represent a waypoint on NZ's journey towards a materially slacker labour market.
- The wage subsidy limited the Q2 damage, but we still expect the unemployment rate to rise to 6.4%.
- Uncertainty is higher than usual - the unemployment rate could conceivably print anywhere in a 5-8% range.
- Implications for the 12 August RBNZ meeting are likely to be limited

Q2 Labour Market Forecasts		
HLFS	**ASB**	Prior
Employment growth (QoQ)	-2.8	0.7
Employment growth (YoY)	-1.8	1.6
Unemployment Rate (%)	6.4	4.2
Participation Rate (%)	69.4	70.4
Labour Cost Index		
Private Sector (%, QoQ)	0.5	0.3
Private Sector (%, ann)	2.0	2.4

Summary and implications

Notoriously choppy in 'normal' times, labour market data to be released next week could be even more of a handful this time around. We're expecting employment to contract 2.8% and the unemployment rate to jump from 4.2% in Q1 to 6.4% in June, as the COVID crisis forced some firms to shed workers. The wage subsidy in place for most of the quarter will limit, or at least postpone, the damage to some extent.

The COVID impact on labour supply is the big uncertainty. Depending on whether workers laid off during lockdown chose to remain in the labour force or not (the so-called participation rate), the unemployment rate could conceivably print anywhere in a 5-8% range. Broader measures of labour market slack like hours worked and underutilisation will thus be important for context.

The odds probably favour a stronger set of data than what the RBNZ had factored into its May forecasts (7% unemployment rate) but, whatever happens, we don't think the data will have a large bearing on the 12 August RBNZ decision. Not only can the data be choppy, but we also know things are likely to get worse from here. We don't expect unemployment to peak until Q4. Employment is set to will remain below the Bank's Maximum Sustainable Employment target for some time, keeping the Bank in a mood to grind monetary policy easier.

The Q2 labour data due on the 5th August will provide the first "official" read on COVID-19's effect on the NZ labour market. Most of the June quarter was spent in varying stages of lockdown. We know from more timely "unofficial" data that the labour market deteriorated significantly through the quarter. We just don't know by how much.

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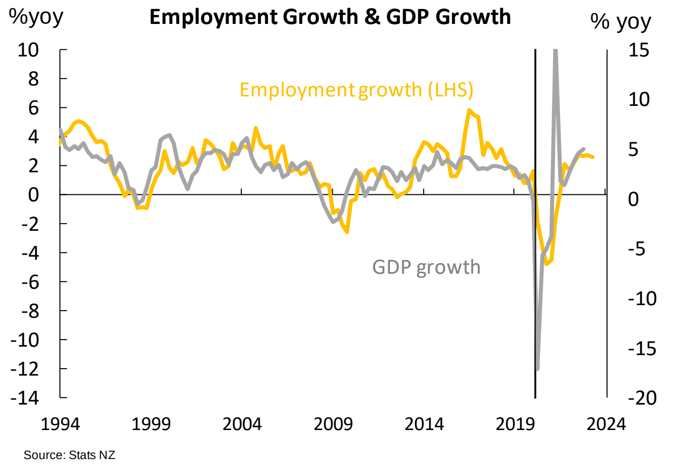
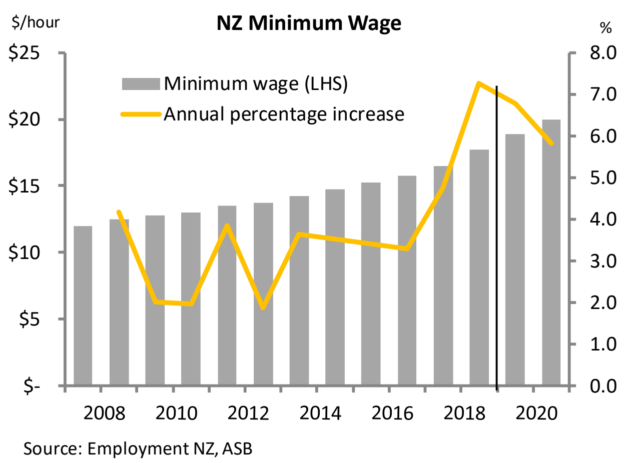
There's also the question of where in the vast array of indicators on offer will deteriorating labour market conditions show up the most – number of jobs lost, labour market participation, hours worked, or something else. Given this uncertainty, we think it will be important to judge the reports as a whole rather focusing too intently on the unemployment rate. Given the various moving parts, the unemployment rate could conceivably print anywhere in a 5-8% range without surprising us greatly.

We expect that employment contracted 2.8% over the quarter, amounting to a loss of around 74k jobs. This would have been far higher were it not for the wage subsidy, which was in effect for most of the quarter. Indeed, as shown in the chart opposite, the expected fall in employment is light compared to the expected 17% contraction in GDP over the quarter. Assuming a one percentage point fall in the participation rate to 69.4%, we're forecasting the unemployment rate to rise to 6.4%, from 4.2% in Q1.



The participation rate – the percentage of the working age population in the labour force – is critical. If you're not in the labour force you can't be counted as "unemployed". And in Australia and the US, for example, labour force participation rates plummeted far more than anyone expected in response to COVID, and this blunted what would have otherwise been even sharper increases in reported unemployment rates. It seems that many workers who lost their jobs, particularly early in the COVID crisis, opted to quit the labour force for a while rather than immediately look for another job. As an example, a two-percentage point drop in the NZ participation rate – a similar magnitude to what we initially saw in Australia and the US – would see the unemployment rate lift to 'just' 5% (assuming employment falls as expected). Clearly such an outcome should not be taken as a sign of strength in the labour market.

Just as important for gauging labour market slack will be broader measures of labour market utilisation. We expect a big increase in underemployment (people who are employed but would like to work more), and a huge (10%+) quarterly decline in hours worked. This will drag hours worked per person – a key slack indicator the RBNZ watches closely – down to record lows, perhaps around 30 hours/week. Labour productivity measures will look similarly woeful. Clearly a good chunk of all this reflects the reality of a bunch of people being paid to sit and home and watch Netflix. The degree of slack will thus be overstated in some areas and some smoothing with Q3 data will be required.



Wages data will probably be less relevant than usual. For one thing, wage inflation lags labour market activity and the broader cycle so the full extent of the recession will not be immediately obvious. The Q2 read on wage inflation will also be overstated by the increase in the minimum wage that went through in April. We estimate that the lift from

$17.70 per hour to $18.90 will account for around a third of the overall 0.5% qoq increase we're forecasting in the Q2 Labour Cost Index. This sort of quarterly outcome would see annual wage inflation slow to 2.0% from last quarter's 11-year high of 2.4%. We expect further slowing to around 1% yoy by the middle of next year.

For the RBNZ, the labour data come exactly a week before the release of the 12 August Monetary Policy Statement, likely too late to be factored into the Statement's economic forecasts. The odds perhaps favour a stronger set of data than what the RBNZ had factored into its May forecasts (unemployment rate of 7%) but we don't think this will have a great bearing on the August decision. Notoriously volatility in 'normal' times, the data this time around could be wildly so. We also know Q2 figures are but a waypoint on the journey towards a materially slacker labour market. The unemployment rate will eventually settle a long way above the RBNZ's estimated 4.2-4.8% NAIRU (non-accelerating inflation rate of unemployment) range, and employment will remain below the Bank's Maximum Sustainable Employment target for some time. The Bank is forward-looking and will thus remain in a mood to keep grinding monetary policy easier.

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