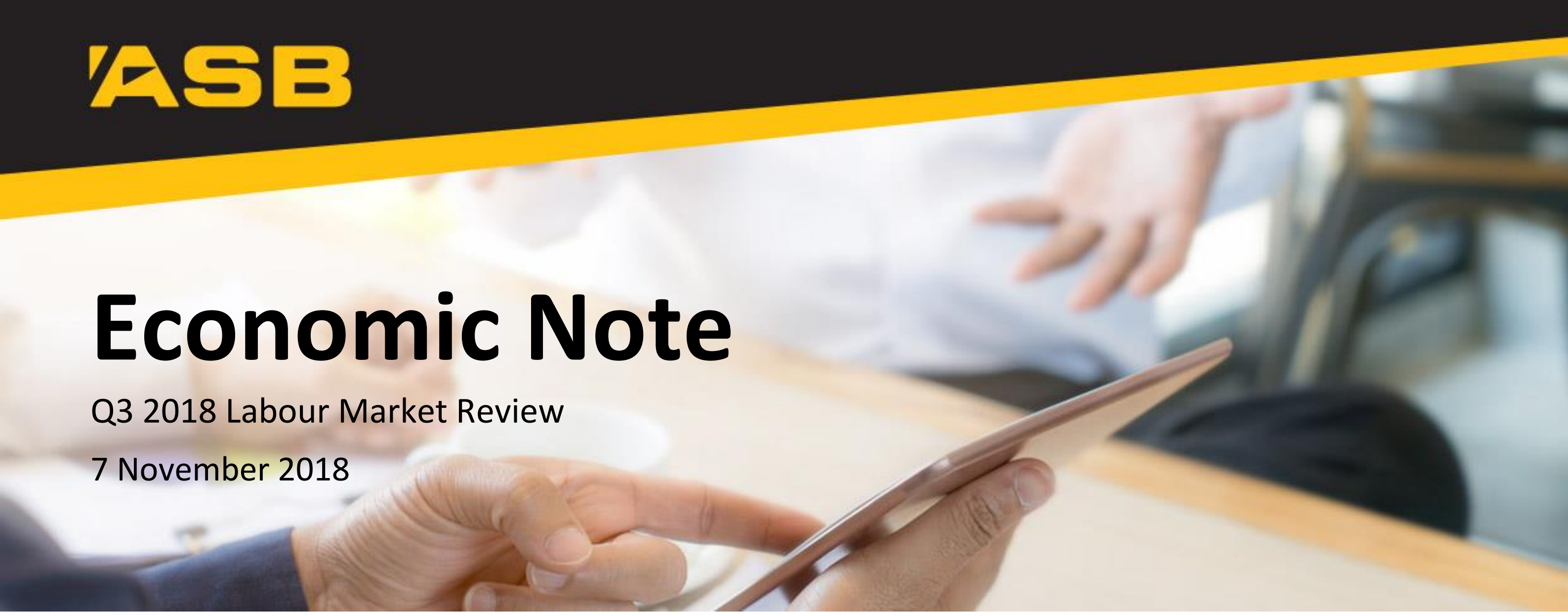

Economic Note

Q3 2018 Labour Market Review

7 November 2018

Strong labour market figures but contained wage growth

- HLFS employment surged 1.1% qoq in Q3 (+2.8% yoy), considerably above market expectations. Measures of labour market utilisation either hit or equalled record levels, with the unemployment rate falling to a 10-year low of 3.9% (4.4% exp). Statistics NZ is “confident” as to the veracity of the HLFS figures.
- Pay equity settlements helped deliver a solid 0.5% qoq increase in private sector LCI wages, but annual LCI inflation eased to 1.9%. Distributional measures showed limited evidence that wage inflation is becoming more widespread.
- The labour market is very tight and the hurdle to an OCR cut has risen. However, the lack of an inflationary smoking gun maintains the need for supportive OCR settings. The next move in the OCR looks to be up, but not until 2020.

Household labour Force Survey	Actual	ASB	Market
Employment growth (QoQ)	1.1	0.4	0.5
Employment growth (YoY)	2.8	1.9	2
Unemployment Rate (%)	3.9	4.5	4.4
Participation Rate (%)	71.1	70.9	70.9
Labour Cost Index			
Private Sector (%, QoQ)	0.5	0.5	0.5
Private Sector (%, ann)	1.9	1.9	1.9

Summary & implications

According to the Household Labour Force Survey (HLFS) figures the labour market has tightened further, with participation and employment rates either at (or equal to) record highs, and the underemployment rate and unemployment rate at 10-year lows. Employment growth was considerably stronger than expected and was in contrast to (generally weakening) hiring intentions from business sentiment surveys. Statistics NZ seems “confident” that the figures depict genuine strength, but we are not so sure and we suspect the RBNZ would have been perplexed (but also pleasantly surprised) by today’s outturn. There is always the possibility of some reversal to emerge in the Q4 HLFS, which will be released on the 7th of February, one week ahead of the February 2019 Monetary Policy Statement. Whatever their underlying cause, volatility in the figures will add another layer of complexity for RBNZ policy deliberations.

Quarterly wage growth was supported by the healthcare wage settlements, but remained contained overall. We expect that wage inflation will progressively firm from late 2019, with the OCR starting to move up from 2020. This expectation is conditional on the economy retaining sufficient momentum to push inflation higher. On the basis of today’s figures the hurdle to an OCR cut has certainly increased. Plenty can happen between now and then and the RBNZ will want to see concrete evidence of firming inflation before lifting the OCR. This looks to be 2020.

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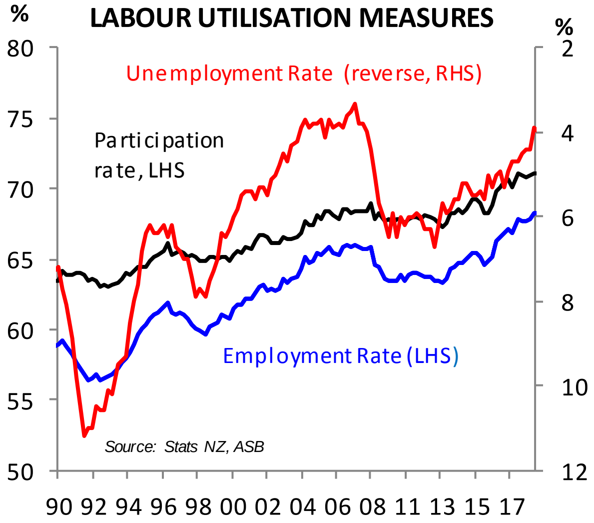
Please refer to the important disclosures at the end of this document.

Details

Labour market very tight

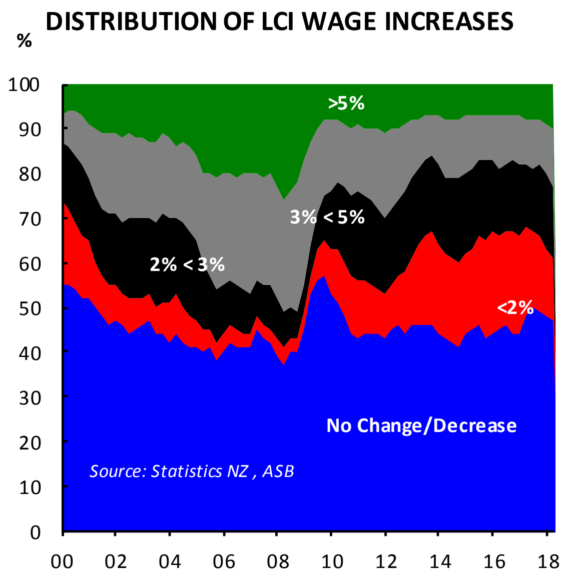
The HLFS survey suggests that the labour market significantly tightened in Q3. The labour force participation rate surged to 71.1% of the labour force (70.9% in Q2) to its joint highest on record. The Q3 HLFS employment rate rose to 68.3%, a record high (67.8% in Q2). The **Q3 HLFS unemployment rate fell to 3.9%, its lowest since June 2008, and towards the lowest bound of the RBNZ's estimated 3-5%-5.3% range for the Non-Accelerating Inflation Rate of Unemployment (NAIRU)**. The seasonally-adjusted underutilisation rate (a measure of slack within the existing employment market) fell to 11.3%, its lowest in 10 years.



The HLFS employment figures were also strong. HLFS employment surged 1.1% qoq in Q3 (+2.8% yoy), well above the market consensus (+0.5% qoq), with the economy adding 73,000 jobs in the September 2018 year, with the growth in employment well above the (still-strong, but moderating) 2.1% yoy growth in working age population. Seasonally-adjusted estimates from Statistics NZ showed that full-time (+0.7% qoq) and part-time (+1.6% qoq) employment both rose, but that hours worked were flat over Q3, with annual growth in hours worked slowing to 2.2% yoy. The Quarterly Employment Survey (QES), by contrast, posted a modest 0.3% qoq increase in filled jobs (1.2% yoy), and a 0.6% increase in paid hours (2.3% yoy).

But wage growth contained

Wage growth, however, remained modest. Supported by the second round of the $2bn healthcare worker settlement (LCI wages for community and personal service workers firmed 1.8% qoq, 4.1% yoy), private sector wages from the Labour Cost Index (LCI) rose 0.5% qoq in Q3 (+1.9% yoy). LCI wage inflation from the public sector was a more tepid 0.4% qoq (+1.5% yoy), with overall LCI wage inflation ticking up to 0.5% qoq (1.8% yoy). Wage inflation from the all-sector unadjusted LCI measure also firmed (+ 0.9% qoq), but the 3.3% annual rate of change was on par with recent outturns. Average hourly earnings on the QES measure were also solid, rising 1.0% qoq (+2.9% yoy).



The distributional measures depicted a contained inflation backdrop, with a hint that wages might be starting to stir. The 2018Q3 LCI report confirmed that 39% of salary and wage rates had achieved a wage increase above 2% over the last 12 months (37% in Q2), with 47% reporting no annual increase (48% in Q2). Median and mean increases from the LCI ticked up to 2.7% and 3.9%, respectively in Q3 (2.5% and 3.3% in Q2).

Policy implications

Tomorrow at 9am is the release of the Reserve Bank's (RBNZ) November Monetary Policy Statement (MPS), providing the RBNZ with little time to take into account today's data into its policy deliberations. Recall, that the RBNZ is now tasked with "supporting maximum sustainable employment within the economy" alongside its price stability mandate. In our view, **the very tight labour market currently looks to be in no need of additional policy stimulus to meet employment objectives in the new Policy Targets Agreement (PTA).**

Today's HLFS figures were strong and were at odds with at odds with business sentiment figures that had pointed to a scaling back in employment intentions. It further illustrates the marked disconnect between weak employment, investment and activity intentions in the sentiment measures and still-strong outturns for employment and capital imports. The RBNZ is tasked with delivering on its price stability and employment objectives, which are based on actual outcomes rather than what the sentiment measures say. The RBNZ are likely to remain wary and will wait for the official GDP growth data before deciding on a course of action. **On the basis of today's very strong HLFS figures the hurdle to an OCR cut has risen and currently looks to be very high.**

However, past survey volatility from the HLFS looks to have re-emerged, and there is the possibility of some reversal to emerge in the Q4 HLFS, which will be released on the 7th of February ahead of the February 2019 Monetary Policy Statement on the 13th. Statistics NZ seems "confident" that the figures depict genuine strength, but we are not so sure and we suspect the RBNZ would have been perplexed by today's outturn. Whatever their underlying cause, volatility in the figures will add another layer of complexity for RBNZ policy deliberations.

By the same token, however, the Q3 labour market data did not scare the inflationary horses and is unlikely to prompt a rethink on OCR settings. We expect that wage inflation will progressively firm from late 2019, with the OCR starting to move up from 2020. This expectation is conditional on the economy retaining sufficient momentum to push inflation higher. Plenty can happen between now and then and the RBNZ will want to see concrete evidence of firming inflation before lifting the OCR. This looks to be a 2020 story to us.

Market reaction

The considerably stronger than expected HLFS print triggered sizeable market reaction. The NZD/USD spiked 70 points to around 67.4 US cents, with the yield on the 2-year swap up around 6bps (to 2.11%), a close to three-month high.

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