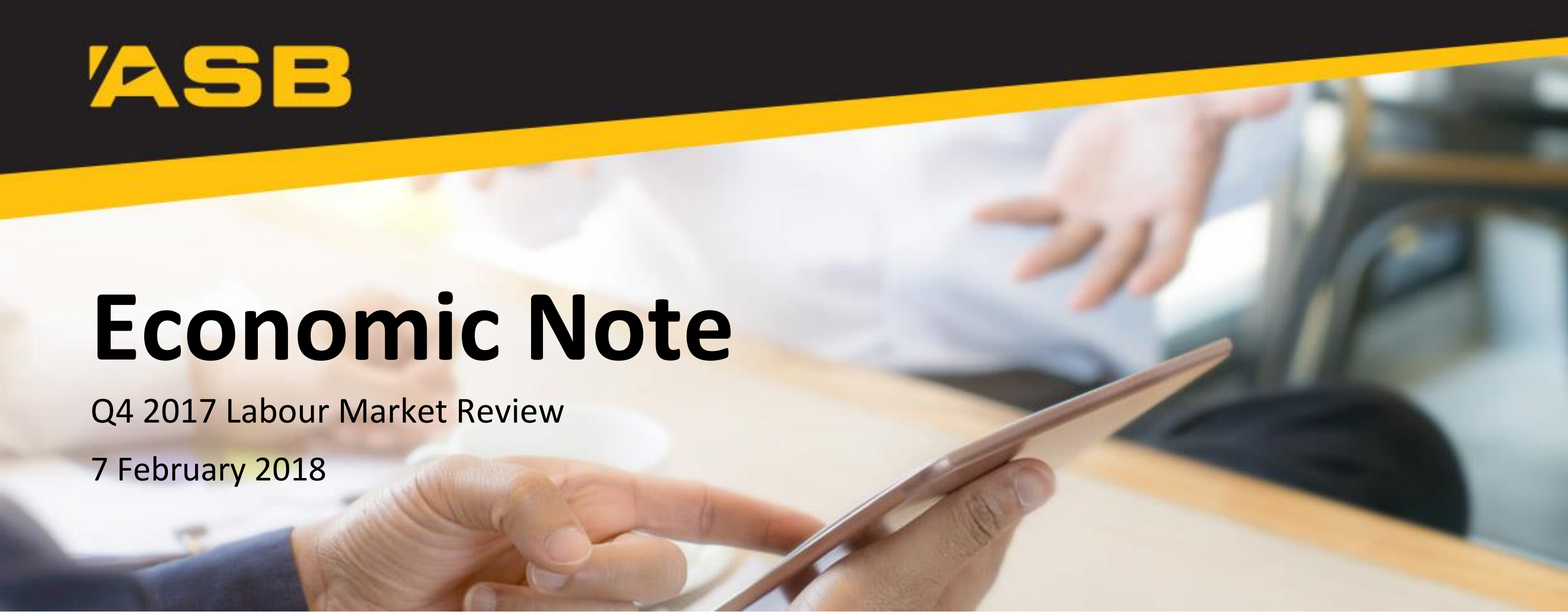

Economic Note

Q4 2017 Labour Market Review

7 February 2018

Contained wage backdrop despite tight labour market

- Employment from the Household Labour Force survey (HLFS) rose in line with market expectations. Measures of labour utilisation were at historically-high levels, with the unemployment rate falling to 4.5% of the labour force, a new 9-year low.
- The Q4 figures depicted a contained wage backdrop, with few signs of widespread wage pressure. The tight labour market and pending increases in the minimum wage are expected to push up overall wages, but there are question marks as to how widespread the increases will be across the labour market.
- The tight labour market keeps the bias tilted towards a higher OCR, but the contained backdrop for wage inflation suggests no immediate need for the RBNZ to deviate from its on-hold stance. The RBNZ will be closely following developments in wage inflation for guidance on future OCR moves.

Indicator	Actual	ASB	Market
Employment growth (QoQ)	0.5	-0.3	0.4
Unemployment Rate (%)	4.5	4.7	4.7
Participation Rate (%)	71.0	70.6	71.0
Labour Cost Index			
Private Sector (%, QoQ)	0.4	0.4	0.5
Private Sector (%, ann)	1.9	1.9	2.0

Summary & implications

The Q4 result from the HLFS was impressive as we had expected some recoil from Q3's strong 2.2% qoq (4.2% yoy) outturn. **On most metrics, the labour market has remained tight, with the unemployment rate falling to a new 9-year low. Aggregate wage inflation, however, has remained low for this stage of the cycle, with annual inflation from the Labour Cost Index still below the inflation target midpoint.**

We expect the unemployment rate to fall below 4% over the next 12 months. Tightening labour market capacity and government policy changes are generally expected to underpin higher rates of wage growth, although there is some uncertainty over the extent to which wages will rise and impact on consumer prices. The low 2018 outlook for consumer price inflation (we expect annual CPI inflation to end 2018 closer to 1% than 2%) and the contained backdrop for wage inflation continues to provide the RBNZ with valuable breathing space. **Our core view remains for the OCR to remain on hold until at least 2019.**

HLFS employment rose 0.5% qoq in Q4 (3.7% yoy), slightly firmer than the 0.4% qoq market consensus. In the quarter, full-time employment rose 0.6% qoq (+3.6% yoy), with a 0.2% qoq fall in part-time employment (+4.1% yoy). The Q4 increase in employment was notable, as we had expected some recoil from Q3's strong 2.2% qoq (4.2% yoy) outturn. Q4 hours worked from the HLFS did decline but this followed the large Q3 rise, with annual growth a still-

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respectable 2.5%.

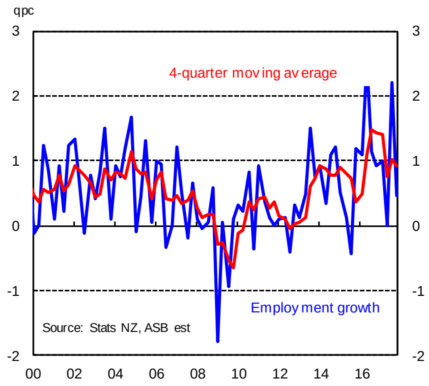
Consistent with the number of economic supports underpinning the expansion, employment increases were reasonably broad-based across industries, with the professional, scientific and support services, construction and manufacturing sectors seeing solid increases. Signs of strength were particularly evidence in Waikato, Wellington and Auckland employment. The increase in employment from the HLFS was corroborated from moderate increases in filled jobs (0.3% qoq) and paid hours (0.4% qoq) from the less-volatile Quarterly Employment Survey (QES).

On most metrics the labour market looks tight. Annual employment growth at 3.7% yoy continued to outstrip the (historically high) 2.3% yoy growth in working age population. **Measures of labour utilisation also remained elevated.** The HLFS labour force participation rate eased marginally to 71% of the labour force (71.1% in Q3), but was still the second highest on record. **This helped push the Q4 HLFS unemployment rate down to 4.5%, its lowest since the December 2008 quarter.** The HLFS employment rate (employment as a portion of working age population) held steady at record highs (67.8%). The seasonally-adjusted underutilisation rate (a measure of slack within the existing employment market) lifted a touch, but at 12.1% was at historically low levels. Average hours worked per employee did ease further below historical averages (to 33.5 versus 34.5).

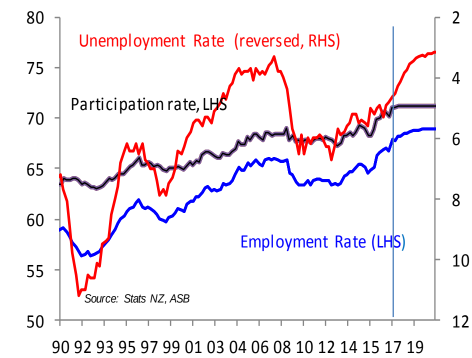
Despite the tight labour market the Q4 data depicted a contained wage backdrop. Q4 posted rises from the Labour Cost Index (LCI) of 0.4% qoq, 1.8% yoy overall. Private sector salary and wage rates rose 0.4% qoq (1.9% yoy), whilst the 0.8% qoq increase in local government sector wages (+1.9% yoy) providing a 0.5% qoq lift to public sector wage and salary rates (1.5% yoy). Wage inflation from the unadjusted LCI measure was still elevated at 0.9% qoq (3.3% yoy), suggesting part of the increase in wages had been driven by higher productivity (the headline LCI measure aims to adjust for productivity). There were also more sizeable increases in average hourly earnings on the QES measure – up 0.8% qoq (+3.1% yoy).

There was also limited flow-through to the wider labour market from the Q3 increases in the minimum wage and the health care worker settlements. Median increases (2.4-2.5% for the quarter and year) remained relatively mild. Moreover, only 15% of jobs reported a quarterly increase in wage/salary rates (14% in Q3). Distributional data confirmed that only 33% of salary and wage rates had achieved a wage increase above 2% over the last 12 months (32%), with 19% achieving more than 3% (18%). Around 49% of salary and wages showed no annual increases, with the remaining 17% showing annual increases of 2% or less. Looking through the sector breakdowns showed that outside of the healthcare and social assistance sector (+6.1% yoy) and arts/recreation services (+3.3% yoy), annual LCI wage inflation for the private sector remained at or below 2%. This is consistent with still-moderate rates of core CPI inflation.

QUARTERLY EMPLOYMENT GROWTH

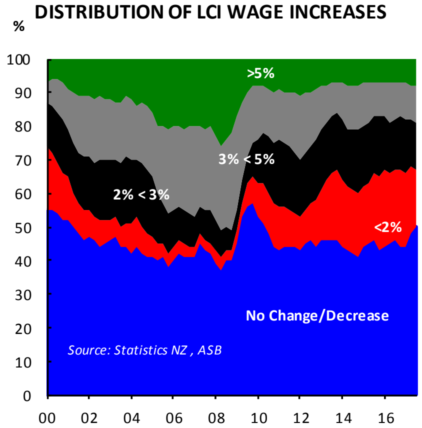


Measures of labour market utilisation



LABOUR COST INDEX & SKILL SHORTAGES

DISTRIBUTION OF LCI WAGE INCREASES



A solid outlook for economic growth and moderating growth in the working age population is expected to keep the labour market tight. **We expect the unemployment rate to fall below 4% over the next 12 months. Moreover, cost-push influences and government policy changes are expected to underpin wage growth going forward.** We expect an additional 0.3 to 0.5 percentage points on annual wage inflation over the next few years**. However, there is some uncertainty over the wage profile and question marks remain as to how large and widespread the lift to wages will be.**

Market reaction and policy implications

The Q4 labour market report was the last significant domestic data release prior to tomorrow's Reserve Bank's February Monetary Policy Statement (November 9). The NZD/USD spiked 50 points following the stronger than expected HLFS report, with the 2-year swap rate up 1basis point.

At face value the unemployment rate at 9-year lows will add to medium-term inflationary pressure. However, the low 2018 outlook for consumer price inflation (we expect annual CPI inflation to end 2018 closer to 1% than 2%) and the contained backdrop for wage inflation provide the RBNZ with valuable breathing space. **Our core view remains for the OCR to remain on hold until at least 2019.**

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