

Economic Note

05 March 2018

A look into NZ labour market capacity

Summary and implications

On a variety of metrics the labour market is currently tight. While the focus is usually on influences that pertain to the demand for labour, this note takes a closer look at some of the more enduring influences that impact on the supply of labour.

The major take-outs from our research are as follows;

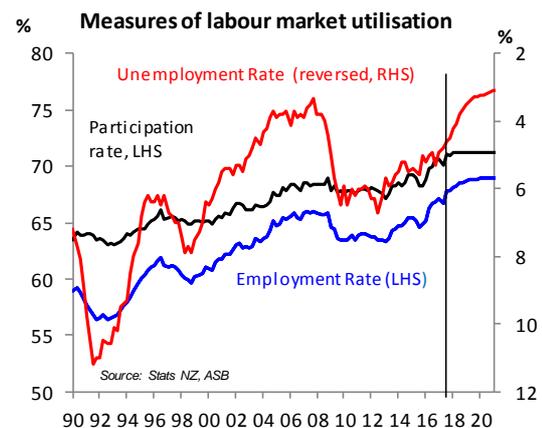
- We expect growth in the labour force to progressively slow over the next decade.
- This slowing has the potential to slow the ‘speed limit’ for New Zealand’s growth and will have widespread implications for the New Zealand economy.
- Changes to the monetary policy framework which give more prominence to the labour market, suggest that the analysis of the labour market will play a considerably more prominent role in interest rate deliberations in New Zealand.

The New Zealand economy is currently in a sweet spot of solid growth and low inflation. **As we have noted, however, capacity constraints could act to slow the pace of domestic expansion and potentially lift inflation.**

Based on a variety of metrics, the labour market is currently tight. Measures such as the employment rate (the number of employed people relative to working-age population), labour force participation rate (the labour force relative to the working-age population), as well as the unemployment rate (number of unemployed people as a proportion of the labour force) are either at close to cyclical or all time extremes.

With the labour market looking increasingly stretched and with population growth set to moderate as net immigration slows, our forecasts assume that more of the growth in economic activity will need to be driven by strengthening labour productivity (defined as increasing output per hour worked). Sustaining high rates of productivity looks to be a challenge considering our poor productivity track record. We will cover the productivity issue in a follow up article in the next few weeks.

Aside from productivity, there are two other elements to labour market capacity. The first is the number of people of working age (typically defined as someone aged over 15 by Statistics NZ as opposed to someone aged 15-64 by the OECD and in most countries). Influences include fertility, mortality of the resident population (which determine the degree of natural change in the resident population) as well as net inflows and outflows from migration between New Zealand and overseas.



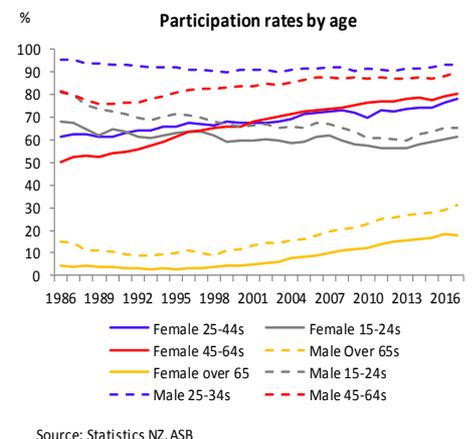
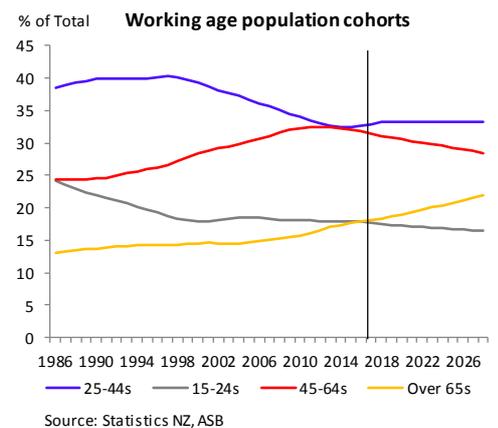
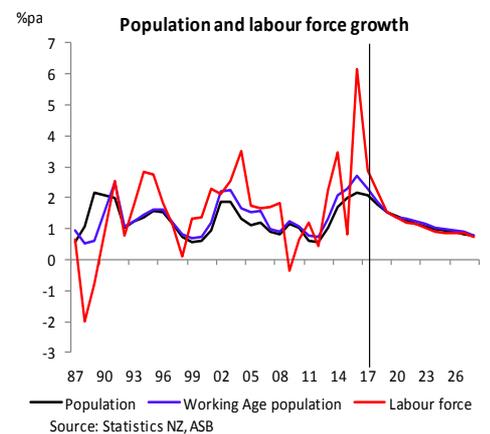
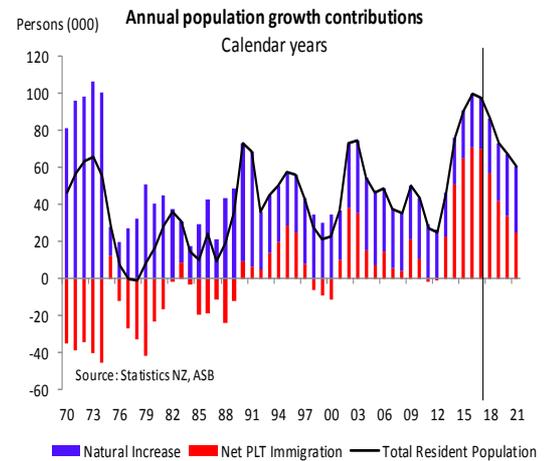
In 2017, our resident population increased by close to 100,000 persons (2.1% of resident population), the second largest increase on record for a calendar year and well above the post 1970 average of slightly more than 40,000 persons per annum. Our working age population rose by 85,000 persons over 2017, with net PLT immigration accounted for more 70% of resident population growth in 2017. This compared to the post 1970 average of only around 5% of population growth coming from net PLT immigration, with NZ tending to be a net exporter of people in the 1970's and early 1980's. However, compared to the 1970's there has been a noticeable deceleration in natural population increase. At around 30,000 persons per annum, this is about half of the 60,000 person natural increase per year that was typically evident in the 1970s. According to estimates from Statistics New Zealand, total fertility rates (the average number of live births that a woman would have during her life) have been steadily declining since the late 1950's/early 1960s and at 2017 were at 1.8, the lowest on record. This has been partly countered by rising female labour force participation.

Our forecasts and most demographic projections assume that resident population growth will slow over the next few years. The major swing variable is the moderation in net PLT immigration from historically high levels. This reflects both a slowing in PLT arrivals from record highs and a strengthening in PLT departures from cyclical lows. Our forecasts also assume that rates of natural population increase will remain moderate. Population projections suggest that growth in the working age and total population is expected to slow from 2%+ annual rates over the last few years to around 1% by 2025.

As well as this slowing population growth, the population will be ageing. According to recent [Demographic projections](#) produced by Statistics NZ, the median age of the population is expected to rise from just over 37 years in 2016 to above 40 by 2033 and above 45 by 2068. Persons aged over 65 are expected to climb from 15% of the resident population at present to over one quarter of total population by 2058. This will largely be at the expense of proportionately fewer working age persons. The dependency ratio – a measure of the share of population not typically of working age (under 15 and 65+) is expected to rise from 53 persons per 100 people aged 15-64 to 77 by 2068.

The second element is the degree of attachment of the working age population to the labour force. As was shown at the start of this note, the NZ labour market is tight on a number of metrics. Our forecasts suggest it will tighten further over the next year or two. There is scope to increase the number of hours worked within the labour force - hours worked within the economy would be 3% higher if the average number of hours per employee returned to historical averages. However, this might not be practical or feasible given the shifts in economic and population structure that the economy has gone through.

What has been evident since at least the early 1990s has been the increase in labour force participation by older age cohorts. Influences such as increased life expectancy, improved health, budgetary concerns, institutional changes (the qualification age for NZ Superannuation was progressively raised from 60 to 65

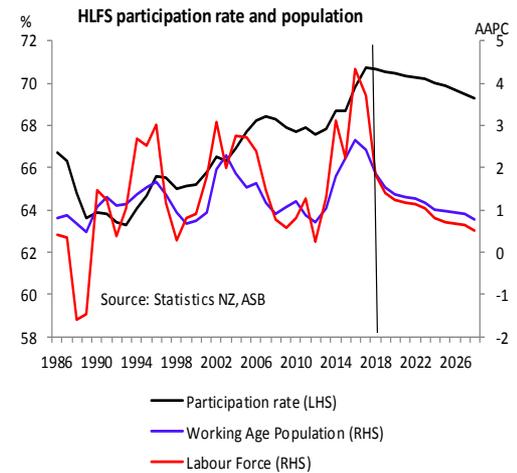


between 1992 and 2001), technological change and the increasing flexibility of the labour force are all likely to be influential. The counter to this has been declining rates of labour force participation by younger age cohorts (15-19) as they pursue more education and training.

We have also seen a steady rise in workforce participation for females aged over 25's, with the increase in female participation particularly evidence for the over 45s. Female participation rates are generally lower, but they have been closing the gap with male counterparts, particularly for the 45-64 cohorts.

Will an ageing population be offset by rising participation for these cohorts, leaving overall participation close to record highs?

The future is inherently uncertain, with increasing globalisation and rapid rates of technological change suggesting that the workplace could be a considerably different place in a decade or so for now. Putting these to one side, our best guess is that participation rates for older age cohorts and older aged females will continue to trend up. However, this is unlikely to offset the impacts of an ageing population structure. All else equal, we are likely to see a modest easing in the overall labour force participation rate over the next decade or so.



Easing labour force participation rates and slowing growth in the working age population are expected to combine and slow labour force growth over the next few years. **Our estimates suggest that annual growth in the labour force could fall below 1% as soon as in five or six years' time.** Lower labour force growth may not necessarily have an impact on per-capita incomes, but it will have implications for the provision and funding of infrastructure as well as the supply side performance or 'speed limit' of the economy. **This, and the forthcoming changes to the monetary policy framework (which give more prominence to the labour market), suggest that the analysis of the labour market will play a considerably more prominent role in interest rate deliberations in New Zealand.**

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