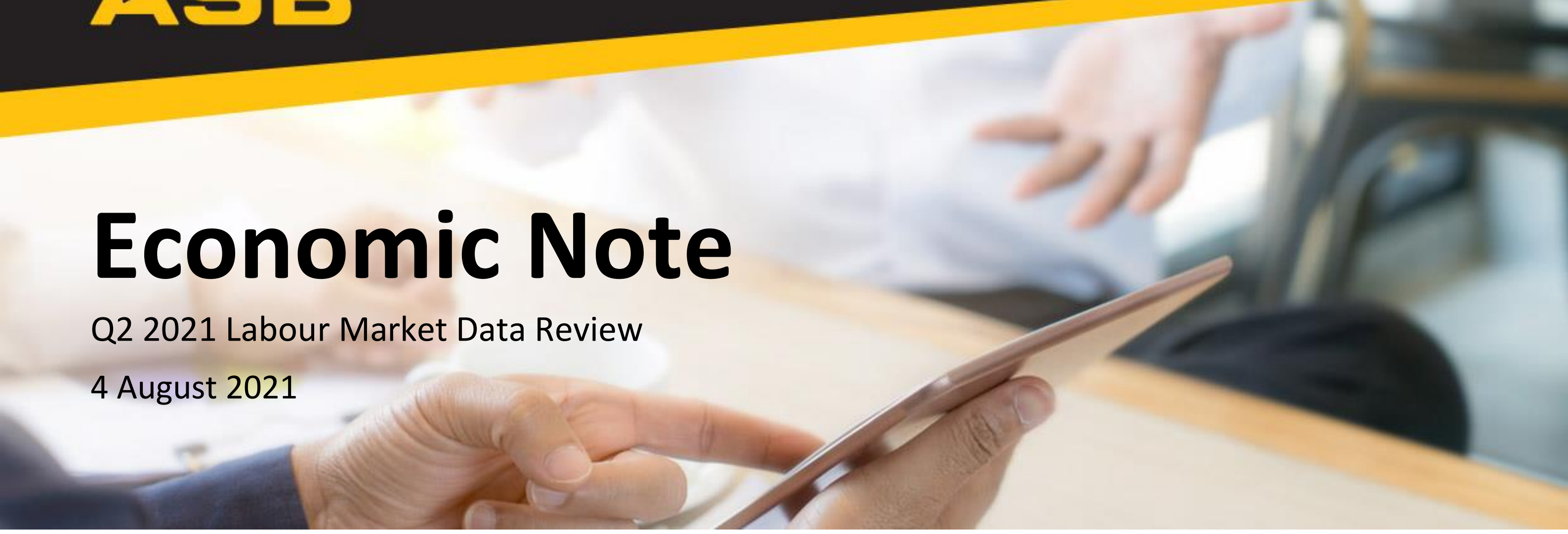


Economic Note

Q2 2021 Labour Market Data Review

4 August 2021

Labour market tightens more than expected

Summary

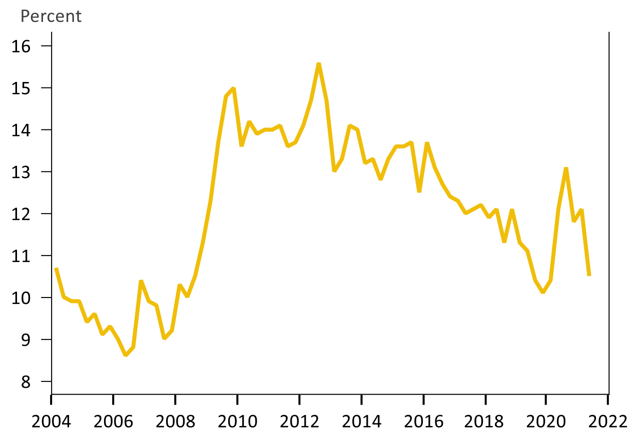
- Unemployment rate falls by more than expected, drops to 4%. The underutilsation rate also falls sharply.
- Wage inflation picked up by more than expected, reflecting the tight labour market.
- The labour market is at maximum sustainable employment – the RBNZ needs to lift the OCR off emergency levels.

HLFS	Actual	Market	ASB	RBNZ
Employment growth (%, QoQ)	1.0	0.7	1.0	0.2
Unemployment Rate (%)	4.0	4.4	4.4	4.7
Participation Rate (%)	70.5	70.5	70.7	70.4
Labour Cost Index				
Private Sector (ex-overtime %, QoQ)	0.9	0.7	0.8	0.8
Private Sector (ex-overtime %, ann)	2.2	2.1	2.1	2.1

Implications

Today's figures reaffirmed other measures and confirmed the labour market to be tight and at maximum sustainable employment. The unemployment rate dropped sharply and by more than expected, accompanied by a sharp fall in the underutilisation rate. As a consequence of the tight labour market, the rate of wage increases in the private sector has lifted sharply and by more than we expected. We expect the RBNZ to raise the OCR by 25bps in each of the next three OCR review dates (August, October and November), returning the OCR to pre-pandemic levels (1.0%) by the end of the year.

Underutilisation Rate



Source: Macrobond, ASB

Quick Thoughts

The labour market tightened by more than expected in Q2 – with the unemployment rate down to 4% (ASB and market expectations were for a fall to 4.4%). The RBNZ can now be confident that the labour market is at maximum sustainable employment. Importantly, the Q2 underutilisation rate also

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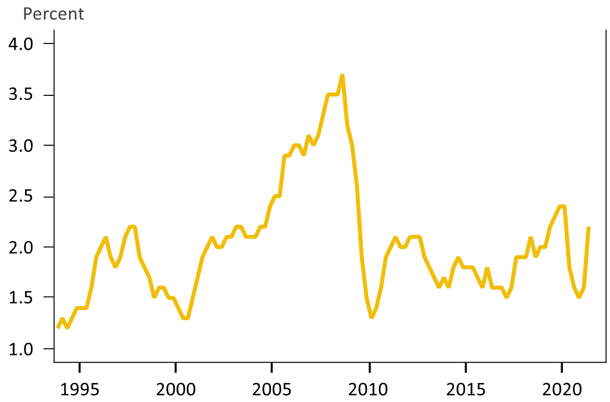
fell sharply, down from 12.1% to 10.5% - very close the the pre-COVID low of 10.1% recorded in December 2019. We also saw a sharp fall in the unemployment rate of 20-24 year olds, that had previously remained stubbornly high up until early 2021.

The labour market now looks to be at full capacity and this is generating strong wage inflation. Wage inflation (Labour Cost Index Private Sector Ordinary Time) lifted by more than expected, up 0.9% over the quarter to be up 2.2% over the year. This lift reflects the tightness of the labour market and will be the first of likely many moves higher over the coming year. The only slither of weakness in the wage inflation report was the soft increase in public sector wages – up just 0.3% over the quarter to be 1.9% higher on year-ago (below the rate of growth for private sector). Softer wage increases in the public sector likely reflects a tightening in public sector budgets given the large rise in Government Debt over the past year due to COVID-19.

Labour Cost Index, Private Sector, Ordinary Time Wage, Annual %



Source: Macrobond, ASB

The proportion of employees receiving large wage increases lifted – the proportion receiving more than 5% lifted from 11% to 16% of all employees. StatsNZ notes that firms report the higher rate if wage increases are to try match market rates and to retain staff in the tight labour market. Also, the rise in the minimum wage in April also contributed to this quarter's lift in wage growth.

A range of labour market measures corroborated the strength of labour demand in Q2. We expect this momentum to continue, and this will push the unemployment rate below its maximum sustainable level. Wage inflation pressures are set to rise further – high rates of consumer inflation over this year will push wage expectations higher as employees look to maintain purchasing power. The tight labour market provides employees with the best bargaining power to achieve higher wage increases. Until the border restrictions can be safely eased, our labour supply will remain struggle to meet the demand generated by NZ's resilient economy and the RBNZ has no option but to limit demand growth in order to keep inflation pressures in check. We expect the RBNZ to return the OCR to pre-COVID levels (i.e. 1%) by the end of the year. Beyond that we expect the RBNZ will lift the OCR at a slower pace, taking into account the economic impact of rising interest rates. We expect the OCR will stabilise at 1.5% by the end of 2022.

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