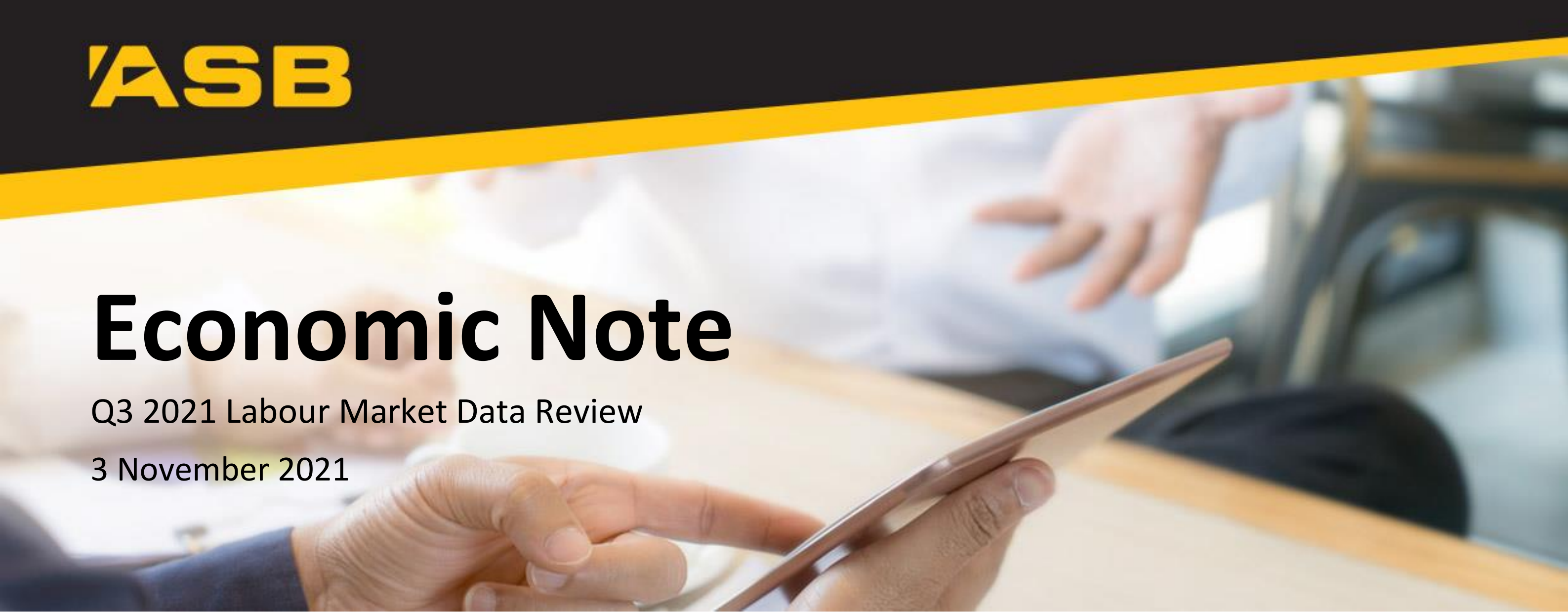


Economic Note

Q3 2021 Labour Market Data Review

3 November 2021

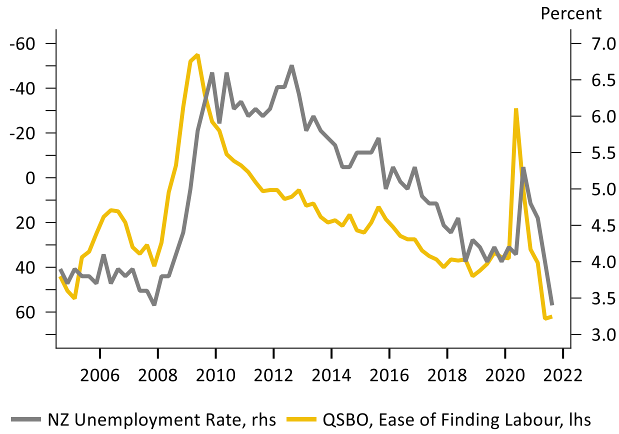
Employers hold onto staff through lockdown

Summary

- The unemployment rate fell by much more than expected, plunging to 3.4% in Q3 2021 from 4%. The labour market continued to tighten despite the community COVID-19 outbreak and Alert Level 4 lockdown.
- Employment jumped higher, also much stronger than expected. Firms appear to be willing to hire/hold onto staff even if they were unable to work during Alert Level 4 restrictions.
- Wage inflation is starting to lift and the very tight labour market and rising cost of living will drive wage inflation higher still over the coming year.

Household labour Force Survey	Actual	ASB	Market	RBNZ
Employment growth (QoQ)	2.0	0.5	0.4	0.3
Unemployment Rate (%)	3.4	3.9	3.9	3.9
Participation Rate (%)	71.2	70.6	70.5	70.5
Labour Cost Index				
Private Sector (%, QoQ)	0.7	0.8	0.8	0.6
Private Sector (%, ann)	2.5	2.6	2.6	2.4

Difficulty Finding Labour & The Unemployment Rate



Source: Macrobond, ASB

Implications

The labour market remains extremely tight and there appears to be little impact on labour demand from the COVID-19 community outbreak and lockdown over the second half of the quarter. Given the Alert Level 3 lockdown has continued in Auckland, Waikato and Northland to varying degrees, we may see some dent in employment demand over Q4. But, given the starting point for Q3, the labour market is set to remain very tight regardless.

Annual wage inflation lifted from 2.2% to 2.5%, and the quarterly increase was faster than the RBNZ expected at the August Monetary Policy Statement. The lift follows stronger than expected lifts in generalised inflation and, given the relatively tight state of the labour market, will reinforce RBNZ concerns that the current inflation spike will have lasting impacts on wage- and price-setting behaviours. We expect the RBNZ will lift the OCR another 25 basis points in November and lift the OCR to 2% by the end of next year.

Labour demand extremely strong over Q3 despite COVID-19 outbreak

Labour demand was extremely strong over Q3, driving the labour market to extremely tight conditions. The unemployment rate plunged from 4% to just 3.4% - a rate last seen in December 2007. The fall in the unemployment rate was much larger than expected – expectations were widely centred on 3.9%. With a sharp fall in unemployment

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rate, it was unsurprising that all the key measures of underutilisation also fell. There is no doubt that the RBNZ is meeting its labour market mandate (maximum sustainable employment) and indications are that, even with the current hit to economic activity due to the COVID-19 outbreak, the labour market is set to remain very strong and very tight.

Employment growth lifted a whopping 2% over the quarter, much stronger than expected. There was very little apparent impact on hiring demand from the community COVID-19 outbreak and lockdowns which marred the second half of the quarter. But while the number of jobs lifted, the number of hours worked declined 6.6% qoq. This suggests firms were confident to look through the lockdown and continue to hire people (or hold onto staff recently hired) even if they weren't able to work due to Alert Level 4 restrictions.

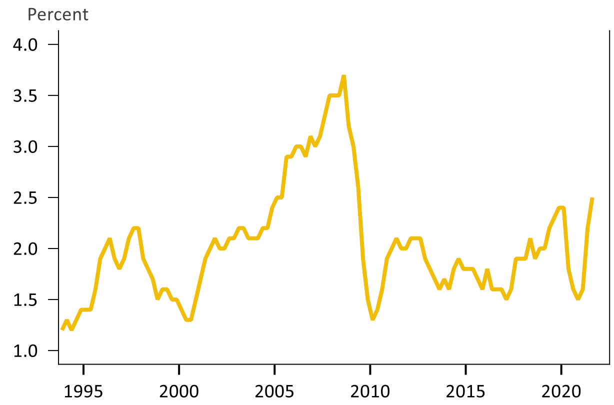
The Quarterly Employment Survey (QES) also confirmed strong increases in employment, although suggests gains were slightly less than in the HLFS survey (the latter is prone to more quarterly volatility). The QES survey largely reflects the state of the labour market prior to the community outbreak.

At this point of time it is hard to say what the impact on the labour market would have been if it wasn't for the community COVID-19 outbreak – perhaps employment would have been even higher. Or potentially, with a lower response rate than usual, it's possible the HLFS survey has not picked up the full impact of the lockdown on employment. Looking ahead, the Alert Level 3 restrictions have continued into the December quarter for Auckland, Waikato and Northland (to varying degrees for the latter) and these could start to take a toll on those working in industries which have been forced to remain closed. But even if employment were to dip in Q4, given the starting point for the labour market ahead of the COVID-19 the labour market would remain in a very buoyant situation overall.

Wage inflation simmering, set to break out into rapid boil

Wage inflation increases were slightly more modest than expected, up 0.7% over the quarter vs. ASB and market expectations of a 0.8% qoq lift. However, the quarterly lift was slightly stronger than the RBNZ's August Monetary Policy Statement forecast of a 0.6% increase. Annual wage inflation (LCI private sector ordinary time) lifted to 2.5% from 2.2% and, given the extremely tight labour market and rising cost of living, we expect wage inflation will continue to rise to an annual rate of 3% over the coming year.

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



Source: Macrobond, ASB

The tight labour market is starting to drive wage inflation higher – in Q3 2021 26% of wage increases were to match market rates or to retain staff, up from 20% a year-ago. In particular, for those receiving wage increases of 5% plus, 44% of the increases were due to market matching pressure. With the unemployment rate plunging to very low levels, this source of pressure on wage inflation is set to continue.

However, it's the higher cost of living that remains the primary driver of wage increases (58% in Q2 2021) – and this highlights that risk that very high Consumer Price Index (CPI) inflation results seen over recent quarters (and which are expected to persist over the coming year) are likely to engrain themselves into wage and price setting behaviour.

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