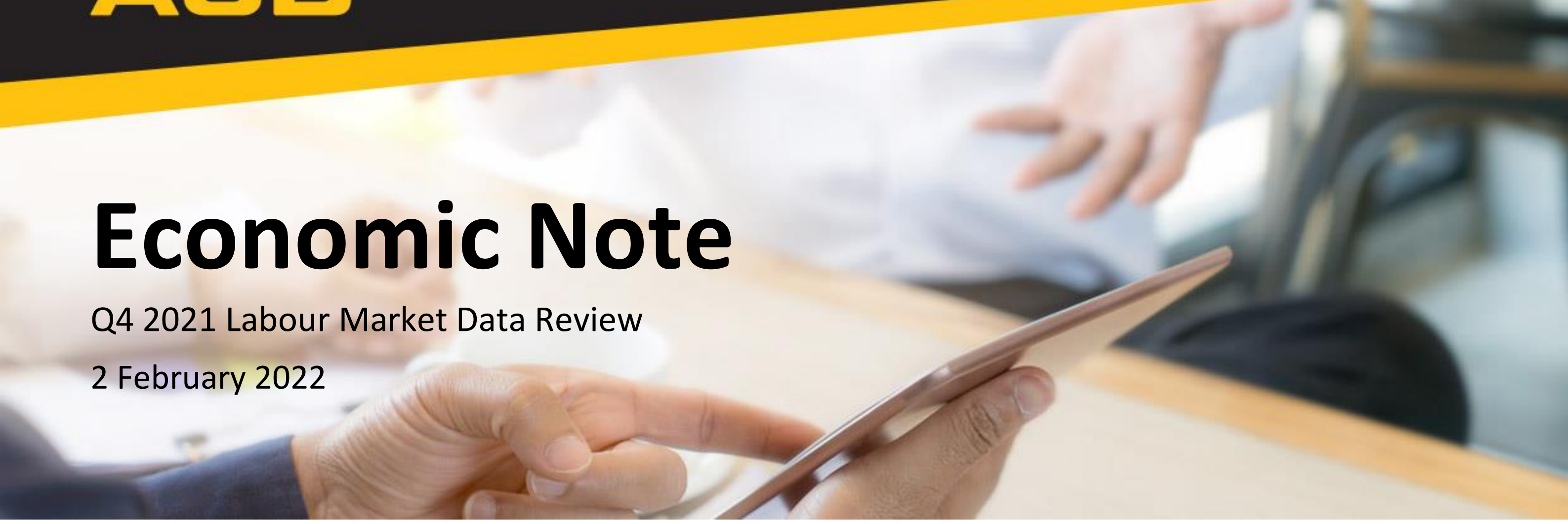

Economic Note

Q4 2021 Labour Market Data Review

2 February 2022

Labour market set to tighten further in 2022

Summary

- The unemployment rate ends 2021 at a record low, with employment above its maximum sustainable level
- Wage growth was more moderate than expected, but more sizeable rises are set to come in 2022 as workers seek compensation for the skyrocketing cost of living
- The labour market is biased to tighten further over 2022 and we expect inflation to remain persistently high
- **We now expect the OCR to peak at 2.75%** in early 2023, with both upside and downside risks to the interest rate outlook

2021Q4 Labour Market data

Household labour Force Survey	Actual	ASB	Market	RBNZ
Employment growth (QoQ)	0.1	0.1	0.4	0.4
Unemployment Rate (%)	3.2	3.2	3.3	3.2
Participation Rate (%)	71.1	71.1	71.2	71.2
Labour Cost Index				
Private Sector (%, QoQ)	0.7	0.9	0.9	0.9
Private Sector (%, ann)	2.8	2.9	2.9	2.9

Implications

The Q4 unemployment rate fell to 3.2%, a record low for the post-1986 quarterly history of the Household Labour Force Survey. The HLFS was bang on with ASB expectations and suggests that employment ended 2021 above its maximum sustainable level. We have changed our OCR call in light of the tight labour market and high medium-term inflation outlook. **A steady pace of 25bp hikes is expected each meeting, with the OCR now peaking at 2.75% in early 2023.** Risks to the OCR onlook are two-sided. On the downside, the tightening in financial conditions would hit the housing market, crimp domestic spending, and require more moderate OCR tightening. On the upside, inflation could prove to be more ingrained and capacity pressures more intense than is commonly assumed.

Labour market tightens as 2021 draws to a close

The Q4 unemployment rate fell to 3.2%, a record low for the post-1985 quarterly history of the Household Labour Force Survey. Quarterly HLFS employment growth retraced after the extremely strong Q3 jump (up just 0.1% qoq). The annual growth in employment slowed to 3.7% but remained well above that of growth in the labour market (1.9% yoy) and working age population (0.6% yoy). Other metrics, including the participation rate (71.1%), underutilisation rate (9.2%) and employment rate (68.8%) were consistent with a stretched labour market. Hours worked (+7.6% qoq) and hours worked per employee (33.5) rebounded from the Q3 lockdown lulls.

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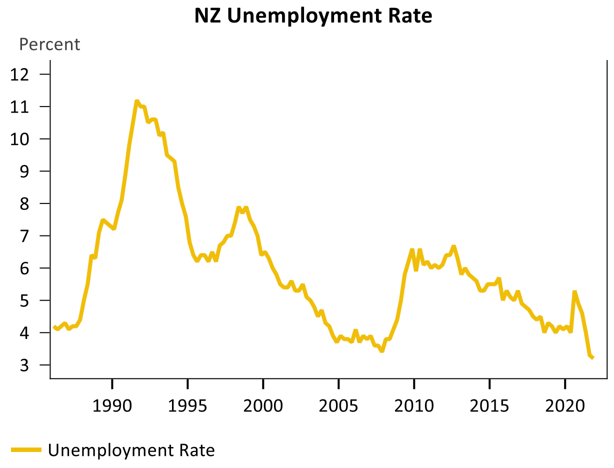
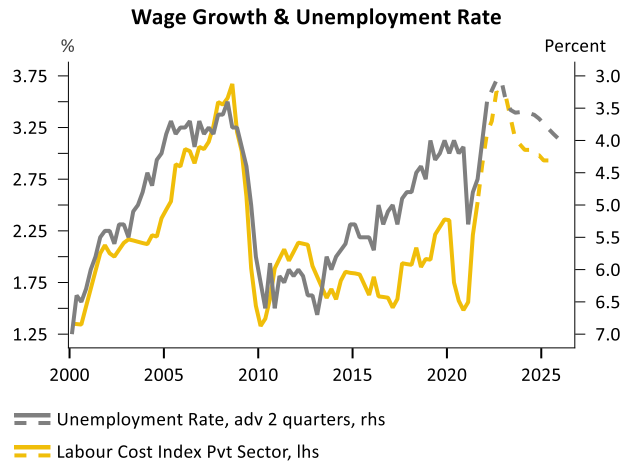
The Quarterly Employment Survey (QES) showed strong demand for labour in Q4, with sizeable 1.8% qoq and 4.6% yoy rises in full-time equivalent employment. Combined with further strong increases in paid hours (1.4% qoq, 6.5% yoy) and a reasonable 1.4% qoq rise in average hourly earnings (4.1% yoy), this has bolstered household incomes, although high inflation and rising mortgage interest rates are likely to increasingly gnaw away at the purchasing power of consumers and act to crimp discretionary household spending.



Source: Macrobond, ASB

Wage inflation contained, but set to pick-up over 2022

Wage increases (LCI private sector wages excluding overtime) were more moderate than expected at 0.7% qoq, 2.8% yoy). A look at the industry splits shows that larger industries were concentrated across a few groups – utilities, healthcare, some retail – with median increases for the private sectors steady at 3.0%. Increased from the analytical unadjusted LCI came at 1.1% qoq (4.5% yoy) and were in a similar ballpark to increases earlier in 2021. The distributional measures showed an elevated 51% of jobs had wage increases of 2% or less. Average hourly earnings from the QES registered a solid 1.4% qoq (4.1% yoy) clip.



Source: Macrobond, ASB

Other signs suggest that wage pressures were starting to stir. The proportion of jobs reporting increases from a year ago (61%) has continued to creep higher. The portion of jobs reporting more than a 5% increase rose to 20%, the highest since 2009. Given the escalation in living costs and the tight labour market the proportion of jobs registering sizeable increases looks set to rise.

We expect the labour market to tighten further and for wage inflation to accelerate over 2022 given the tightening labour market and rising cost of living. The unemployment rate looks set to move lower earlier this year and could well push below 3%. We expect annual LCI inflation to move above 3% in 2022, consistent with our expectation that pressures on medium-term inflation will build.

Short-term disruptions ahead

So far, the NZ labour market has not fully borne the brunt of the highly contagious Omicron variant that has impacted economies overseas. The surge in Omicron cases in NZ suggests this is only a matter of time and we expect the supply of labour to be impacted in early 2022. Hours worked, employment and the participation rate are due to fall as worker absenteeism rises. This, in turn could significantly disrupt labour supply and exacerbate the high degree of labour market tightness and will likely push the unemployment rate lower heading into 2022. Moves by the Government to reduce booster waiting times to 3 months suggest that they are also aware of this risk. A relaxation of the border restrictions would also likely alleviate pronounced and widespread labour shortages, so we await tomorrow's speech by PM Ardern with interest.

The experience overseas has been that Omicron will deliver a short-term hit, but this will unfortunately tighten the (already) highly stretched labour market further. An unemployment rate with a 2 in front of it in early 2022 is a possibility. Where they can, it would be prudent for businesses and households to brace for more disruption and plan accordingly.

Change in ASB's OCR view: The RBNZ will have more work to do

We have changed our OCR call in light of increasing pressures on (truncated) supply side capacity and our view of the upside risks to the medium-term inflation outlook. A steady pace of 25bp increases is expected at each RBNZ decision until early 2023, **with the OCR to peak at 2.75%.**

We are still in a global pandemic and uncertainty is high. **Risks to the OCR onlook are two-sided.** On the downside, the tightening in financial conditions would hit the housing market, which along with other increases in the cost of living will crimp domestic spending and require more moderate OCR tightening. On the upside, inflation could prove to be more ingrained and capacity pressures more intense than is commonly assumed.

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