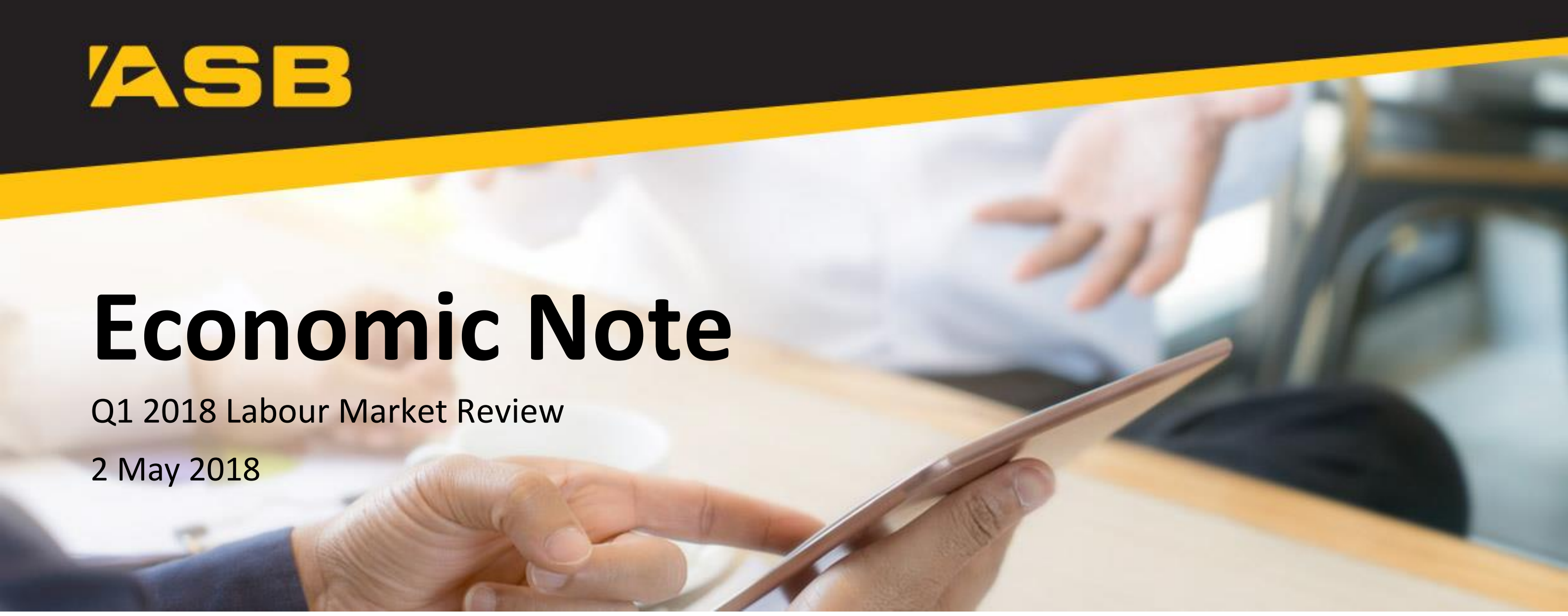

ASB

Economic Note

Q1 2018 Labour Market Review

2 May 2018

Tight labour market, but wage inflation AWOL

- HLFS employment rose 0.6%, in line with market expectations. Measures of labour utilisation were at historically-high levels, with the unemployment rate falling to a new 9-year low of 4.4%.
- The Q1 figures depicted a mild wage backdrop, with few signs of widespread wage pressure. This keeps notions of OCR hikes on the back-burner.
- The labour market is tight and in little need of policy stimulus. Still-low CPI inflation provides the RBNZ with breathing space and we do not expect the first OCR hike until August 2019.

Indicator	Actual	ASB	Market
Employment growth (QoQ)	0.6	0.5	0.6
Unemployment Rate (%)	4.4	4.4	4.4
Participation Rate (%)	70.8	70.9	71.0
Labour Cost Index			
Private Sector (%, QoQ)	0.3	0.4	0.5
Private Sector (%, ann)	1.9	2.0	2.0

Summary & implications

Given the enhanced focus of the labour market in the new RBNZ Policy Targets Agreement (PTA), it was somewhat encouraging to see few signs of quarterly volatility in the Household Labour Force Survey (HLFS). We note that survey volatility from labour market readings could potentially complicate matters for the RBNZ as it deliberates OCR settings, but so far, so good.

The key takeout from the Q1 labour market report was that the labour market has remained tight, with the unemployment rate at a 9-year low and with measures of labour utilisation at historically-high levels. However, wage inflation has remained low considering the tight labour market. We expect further increases in the minimum wage and the tight labour market to eventually push wages higher, with the OCR moving up in August 2019.

Details

HLFS employment rose 0.6% qoq in Q1 (3.1% yoy), in line with the market consensus. Figures from the HLFS have been volatile from time to time, but the Q1 survey posted the second consecutive moderate increase following mid-2017 volatility. HLFS employment growth at 3.1% yoy remained above the (still-strong, but moderating) 2.2% yoy growth in working age population and the 2.5% yoy growth in the labour force.

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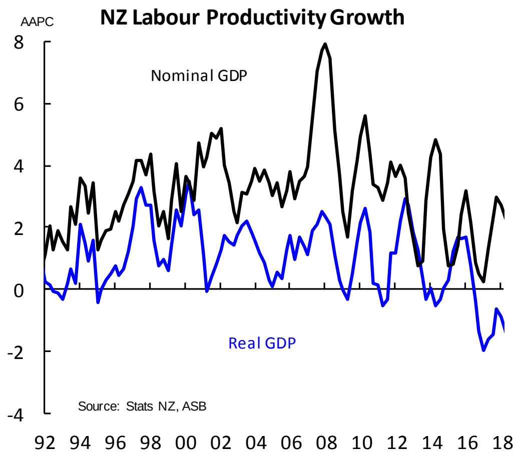
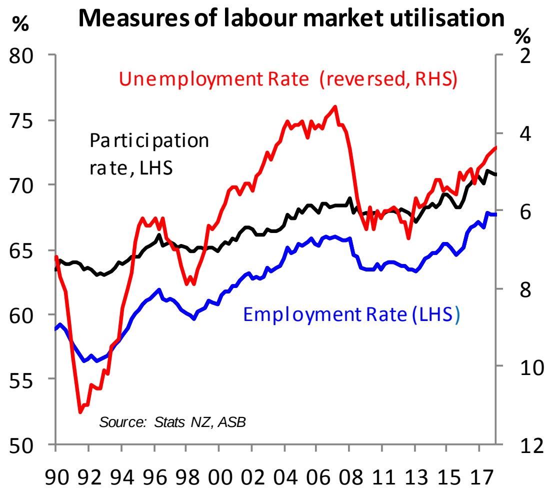
Quarterly movements in employment from the Quarterly Employment Survey (QES) were generally weaker than the HLFS measure, with the QES showing a 0.2% qoq fall in filled jobs (+1.2% yoy). Annual growth in full-time equivalent employment (FTE) from the Quarterly Employment Survey (QES) posted a moderate 1.7% increase. However, courtesy of the sizeable increase in average hourly earnings, total gross earnings from the QES posted a solid 1.2% qoq increase, with the 5.7% annual increase in gross earnings the highest since the end of 2015. **Amidst the backdrop of low CPI inflation (just 1.1% yoy in the March 2018 year), strong growth in real labour incomes should provide strong impetus to consumer spending.**

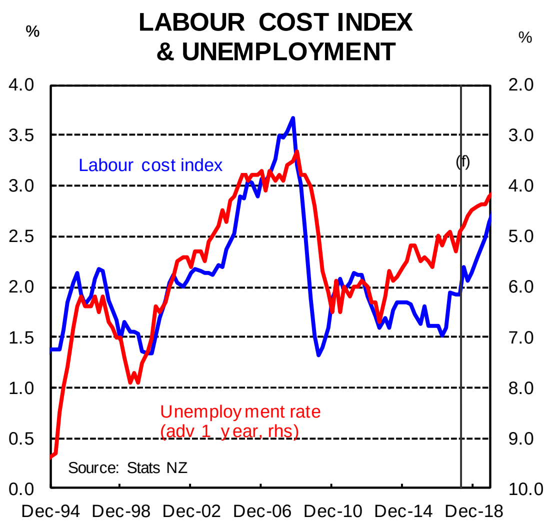


HLFS hours worked did rebound (+ 1.7% qoq) but this followed 2017Q4 falls and 2017Q3 rises, leaving annual growth a robust 4.9%. Given that this is likely to be higher than the sub 3% annual GDP growth we expect over that period, it is likely to represent a period of negative annual labour productivity. **At a time of widespread capacity constraints, boosting labour productivity remains is a key challenge for the New Zealand economy.** (See our note here).

Measures of labour utilisation remained elevated. The labour force participation rate eased marginally to 70.8% of the labour force (70.9% in Q4) and the HLFS employment rate held steady at record highs (67.7%). **This helped push the Q1 HLFS unemployment rate down to 4.4%,** the lowest since the December 2008 quarter. Moreover, the seasonally-adjusted underutilisation rate (a measure of slack within the existing employment market) was historically low at 11.9% (was 12.2% in Q4). Average hours worked per employee did firm, but it still remains below historical averages (to 33.9 versus 34.5).



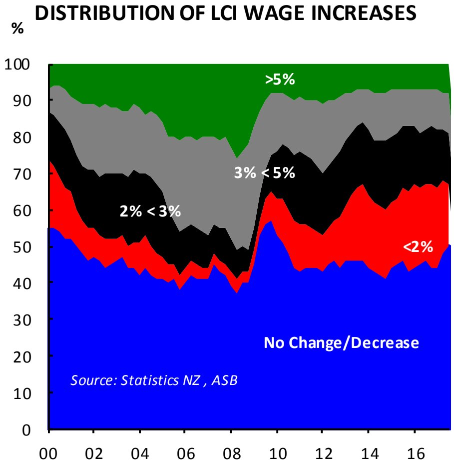
The sector details highlighted some contrasts. Growth in filled jobs from the Quarterly Employment Survey was strongest in parts of the employment-rich services areas, including education and training (7.5% yoy), information, media and telecommunications (8.75 yoy) and retail trade (5.5% yoy). However, declines for finance and insurance services (-2.6% yoy), accommodation and food services (-5.0% yoy) were evident, while the sluggish housing market is likely impacting hiring in the rental, hiring and real estate sector (-2.7% yoy). Of concern for the duration of the construction sector expansion, filled jobs in the construction sector declined in Q1, with the number of jobs 3.3% lower than 12 months ago.



Wage inflation remained low for this stage of the cycle. Q1 posted rises of 0.3% qoq for private (1.9% yoy) and public sector (1.5% yoy) wage and salary rates from the Labour Cost Index (LCI) (0.3% qoq, 1.8% yoy overall). Wage inflation from the unadjusted LCI measure also moderated to 0.6% qoq (3.2% yoy). There were also sizeable increases in average hourly earnings on the QES measure – up 0.9% qoq (+3.6% yoy).

As was the case in the December figures, those for the March 2018 quarter showed limited flow through to the wider labour market from July 2017 increases in the minimum wage and the health care worker settlements. Annual LCI wage inflation for all sectors excluding the impact of the health care worker settlements was a mild 1.6%. Median increases (2.4-2.5% for the quarter and year) remained relatively mild. Moreover, only 12% of jobs reported a quarterly increase in wage/salary rates (15% in 2017 Q4), the lowest in 3 years.

Distributional data also depicted a benign wage inflation backdrop. It confirmed that only 34% of salary and wage rates had achieved a wage increase above 2% over the last 12 months (33% in 2017Q4), with 18% achieving more than 3% (19%). Around 49% of salary and wages showed no annual increases (49%), with the remaining 17% showing annual increases of 2% or less (17%).



Policy implications

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 to the low 4's by the end of the year. The tight labour market and future minimum wage increases are expected to push core CPI inflation towards the upper part of the 1-3% inflation target range. But right now, still-low CPI inflation of 1.1% p.a. provides the RBNZ with breathing space and we do not expect the next OCR hike until August 2019. We note that the path of OCR increases will depend on the extent to which rising wages will be matched by rising labour productivity.

The labour market report is published on Wednesday, May 2, one week before the Reserve Bank's (RBNZ) May Monetary Policy Statement (MPS). This will be the first MPS under new Governor Adrian Orr, and the first under the new policy targets agreement (PTA) which added the requirement of the RBNZ to aim towards "supporting maximum sustainable employment within the economy" (see our takeout of the PTA here). **The labour market looks in little need of additional policy stimulus in our view.** Despite encouraging signs of late, we note that readings from the HLFS can be volatile, which could add another layer of complication for the RBNZ as it deliberates OCR settings.

Market reaction

The NZD/USD spiked 30 points, which proved to be short-lived as the softer wage inflation details were digested by markets. There was also a brief spike in the 2-year swap rate.

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