Economic Note

Q1 2018 Labour Market Preview

30 April 2018

Labour market to tighten further

- We expect to see a moderate 0.5% increase for HLFS employment (3.2% yoy), which should push the unemployment rate down to 4.4%, a fresh 9-year low. Measures of labour utilisation should remain elevated.
- Quarterly labour costs are expected to climb 0.4% qoq on the LCI measure, with private sector, public sector and total annual LCI inflation either at (or just below) 2%. Risks are tilted to the upside.
- The labour market is tight and looks to be in little need of policy stimulus to meet employment objectives in the new PTA. Still-low CPI inflation provides the RBNZ with breathing space and we do not expect the next OCR hike until August 2019.

Q1 Labour Market Forecasts

Indicator	ASB	Prior	Market
Employment growth (QoQ)	0.5	0.5	0.6
Unemployment Rate (%)	4.4	4.5	4.5
Participation Rate (%)	70.9	71	71
Labour Cost Index			
Private Sector (%, QoQ)	0.4	0.4	0.4
Private Sector (%, ann)	2.0	1.9	2.0

Summary & implications

We expect a 0.5% qoq increase in Q1 employment from the Household Labour Force Survey (HLFS), which will see annual growth hold up to 3.2%, above the still historically high growth in working age population. **Measures of labour utilisation are expected to depict a tight labour market backdrop**, with labour force participation and the employment rate print at (or close to) historical highs. The Q1 unemployment rate is expected to fall to 4.4%, a 9-year low. Risks around our unemployment rate pick are tilted to the upside.

Wage inflation is expected to remain moderate given labour market capacity pressures. Annual LCI inflation for both the private and public sector is expected to remain below the 1-3% inflation target midpoint, with the distributional measures confirming a generally contained wage inflation backdrop. **We suspect, however, that we are getting close to another inflexion point for wage inflation and there are clear upside risks to our pick.**

Further pay-equity and minimum-wage increases, along with tight labour market capacity and rising consumer price inflation, are expected to gradually lift overall LCI wage inflation over the next few years. Wages are a key component in the inflation process and over time, domestically-generated inflation will firm. **Moreover, the labour market looks to be in little need of policy stimulus to meet employment objectives in the new PTA.** The OCR looks set to move up, but not until August 2019.

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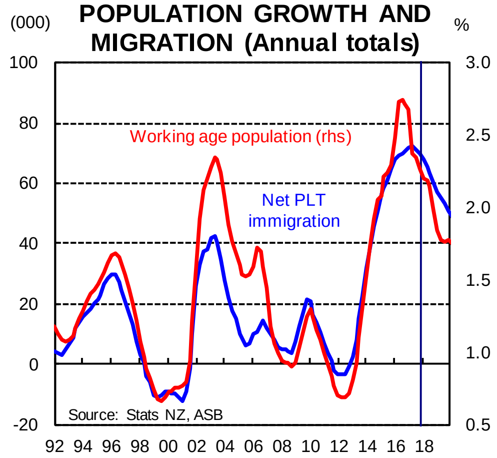
Labour market expected to tighten further

We expect overall HLFS employment to post a moderate 0.5% qoq increase in Q1 2018. Whilst surveyed employment intentions eased further in Q1, they remain at levels consistent with a moderate pace of employment growth. **We expect annual employment growth to slow to just over 3%, with a net addition of around 80,000 jobs to the New Zealand labour market over the past 12 months**. Other published employment measures, including filled jobs and paid hours from the Quarterly Employment Survey (QES) should post moderate increases.

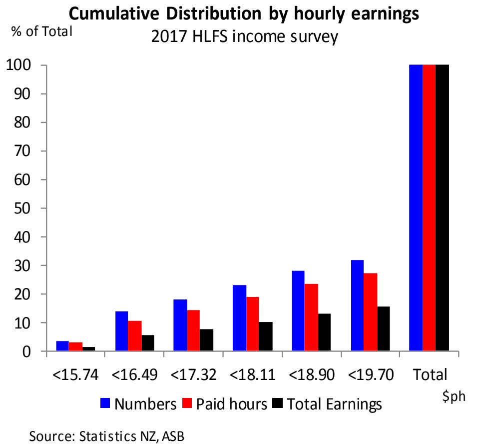
Still-strong growth in the working age population has made it possible for increasing labour demand to translate into more employment. Earlier published figures from Statistics New Zealand confirmed that the working-age population increased by 0.6% in Q1, with the annual growth at a still elevated 2.2%, an addition of close to 85,000 persons over the last 12 months. Net permanent and long-term (PLT) immigration is on a moderating trajectory but we expect the pace of decline to be gradual. As such, we expect the growth in the working-age population to remain elevated at around 1.8% over the 2019 year.



The strong demand for labour and prospect of firmer wages is expected to encourage strong attachment to the labour market. Indeed, we expect the HLFS participation rate and the employment rate to remain elevated over the next few years. With a **solid outlook for employment, we expect that capacity pressures within the existing labour market will gradually intensify, with the unemployment rate moving towards 4% by the end of next year.** We expect the unemployment rate to have edged down to 4.4%, a nine-year low, although risks are tilted towards a higher unemployment rate if participation holds up by more than we expect.

Wages poised to stir

Private sector LCI wage inflation troughed at 1.5% yoy in March 2017, but the subsequent climb has been very gradual for this stage of the cycle. **Low headline CPI inflation and strongly growing labour supply have helped to contain wage growth**. Indeed, following the pay-equity settlement and minimum-wage related boost to Q3 wages, moderate increases were posted for both private and public sector LCI wages in Q4 (private +0.4% qoq, public 0.5% qoq). There were also few signs of a broadening front of wage increases developing. The distributional measures showed that about half of all jobs had not experienced a wage increase in the 2017 year that was not productivity related, with only about one-third of jobs getting a wage increase above 2%, on par with the last 2 years. Median and mean increases (2.4% and 3.2%) were also mild over 2017.



We expect another moderate quarterly outturn for wage growth, with 0.4% qoq quarterly increases expected for both private sector (2.0% yoy) and public sector (1.7% yoy) LCI wages (0.4% qoq, 1.9% yoy overall). **We suspect, however, that we are getting closer to another inflexion point for wage inflation and there are clear upside risks to our pick.** There are two factors underpinning this. First, the labour market is tight, and with CPI inflation set to firm (albeit gradually), wages looks set to follow. Second, prospective increases as a result of minimum wage increases, with the minimum wage set to progressively increase to $20 per hour by 2021, a cumulative increase of more than 25% since 2017 levels. Back in 2017, just 3% of paid hours were on (or below) the minimum wage at the time, accounting for less than 2% of total hourly earnings according to Statistics NZ estimates.

Over the next few years, we expect increases in the minimum wage to outpace other wage increases. There will also be a flow-on to other wages as workers attempt to preserve relativities. Depending on the assumptions used our estimates suggest anywhere from 5-10% of paid hours would be impacted. All else equal this would add 0.2 to 0.4 percentage points to annual CPI inflation though to 2021. We will outline our thinking in a forthcoming note.

All up, we expect annual LCI wage inflation to move above 2½% for both the private sector and all sectors combined by the end of next year. Whilst economy-wide productivity has been sub-par (see our recent note here on productivity), we expect annual wage inflation from the unadjusted LCI measure (which includes compensation for productivity gains) of wage increases to remain close to 3½% yoy. The resultant increase in real wages of approximately 2% over the year will provide some impetus to household spending.

Market reaction and policy implications

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.**

In the February MPS the RBNZ thought that labour market conditions would tighten further, with the unemployment rate declining from 4.4% in 2018Q1 to 4.1% by the end of the projection period, somewhat below the 4.7% RBNZ estimate of the non-accelerating inflation rate of unemployment (NAIRU). In combination, the tightening in capacity pressure, increases in the minimum wage, and rising headline inflation are expected to increase wage growth over the projection, with annual private sector LCI wage inflation rising from 2% in 2018Q1 to 2.7% by mid-2020.

Our view is that the low rates of headline CPI inflation rate will keep the OCR on ice, but that increasing pressure on labour market capacity and the minimum wage will add to wage inflation. **With wages a key component in the inflation process, we expect the OCR to start moving up from August 2019, but that OCR moves will be gradual, culminating in a low OCR endpoint of about 3.5% this cycle.**

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