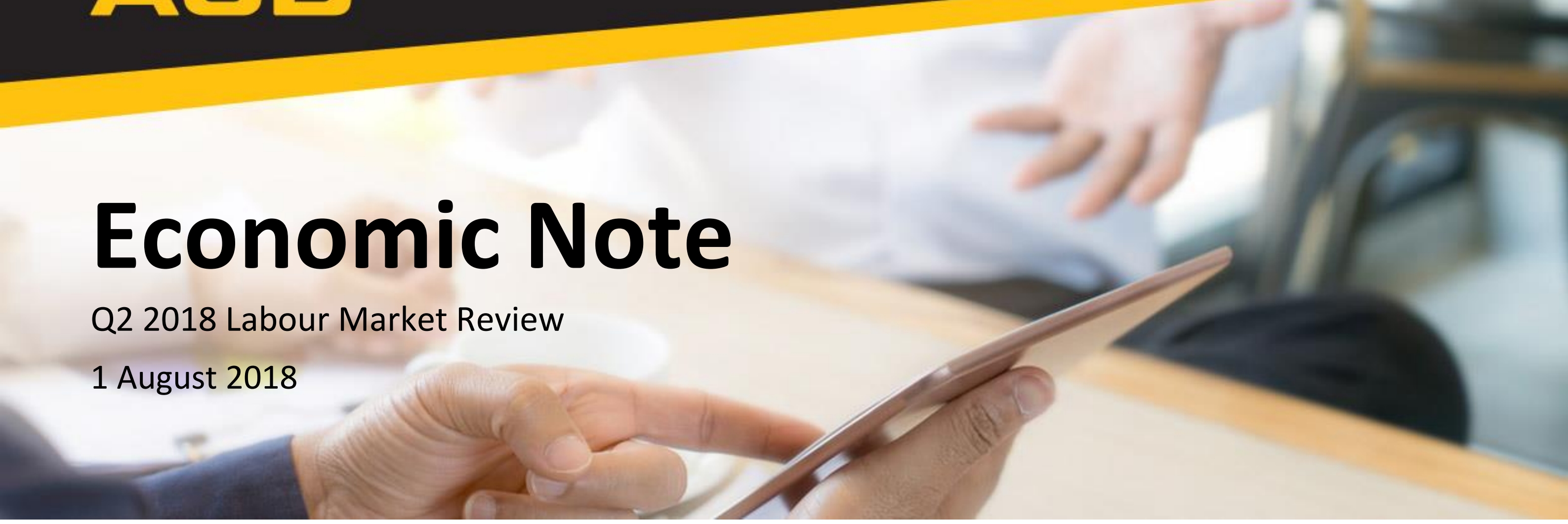


Economic Note

Q2 2018 Labour Market Review

1 August 2018

Labour market solid but contained wage inflation keeps RBNZ on the side-lines

- HLFS employment was in line with expectations (+0.5% qoq versus +0.4% qoq). Measures of labour utilisation remained at historically-high levels, with rising labour force participation pushing up the unemployment rate to 4.5%.
- As expected, increases in the minimum wage triggered a 0.6% qoq increase in private sector LCI wages, with annual inflation (2.1% yoy) the highest in six years. However, distributional measures showed limited evidence that wage inflation is becoming more widespread.
- The labour market is tight, but a moderate outlook for consumer price and wage inflation maintains the need for supportive OCR settings. The next move on the OCR is probably up, but not until late 2019.

Household labour Force Survey	Actual	ASB	Market
Employment growth (QoQ)	0.5	0.5	0.4
Employment growth (YoY)	3.7	3.7	3.6
Unemployment Rate (%)	4.5	4.4	4.4
Participation Rate (%)	70.9	70.8	70.8
Labour Cost Index			
Private Sector (%, QoQ)	0.6	0.6	0.6
Private Sector (%, ann)	2.1	2.1	2.1

Summary & implications

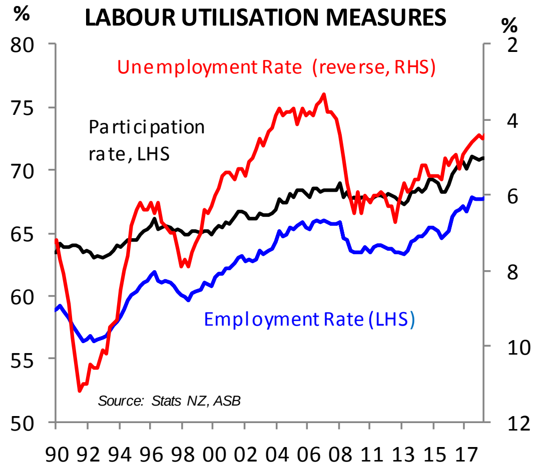
The key takeout from the Q2 labour market report was that the labour market has remained solid, with strengthening annual employment growth and with measures of labour utilisation at historically-high levels. Increasing attachment to the labour force saw the Q2 unemployment rate tick up but this remains historically low. Increases in the minimum wage triggered an increase in wage inflation, but there remains limited evident that a generalised front of higher wage inflation is building within the economy.

The RBNZ is now tasked with "supporting maximum sustainable employment within the economy" alongside its price stability mandate. We adjudge that the tight labour market currently looks to be in little need of additional policy stimulus to meet employment objectives in the new Policy Targets Agreement (PTA). Encouragingly for the RBNZ, past survey volatility from the HLFS has abated. A solid outlook for growth and firming wage inflation is expected to see the RBNZ lift the OCR by the end of next year. However, downside risks to the growth and employment outlook appear to have grown, particularly if currently weak business confidence translates into outcomes. This highlights the need for ongoing policy support through leaving the OCR low.

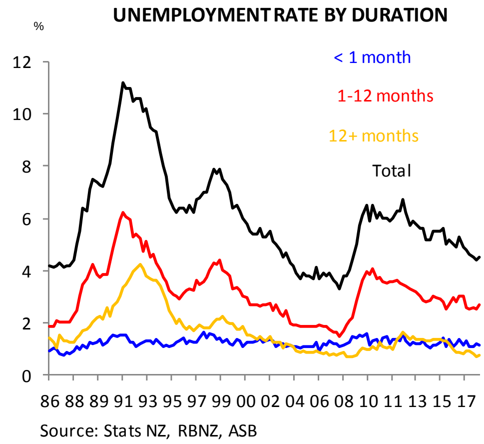
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz
Mark Smith – Senior Economist (649) 301 5657 mark.smith4@asb.co.nz

Details

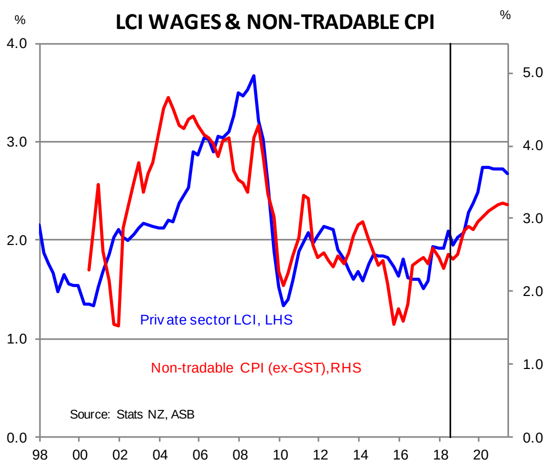
HLFS employment rose 0.5% qoq in Q2 (3.7% yoy), broadly in line with the market consensus. Figures from the HLFS have been volatile from time to time, but the Q2 survey posted the third consecutive moderate increase following mid-2017 volatility. Q2 hours worked from the HLFS rebounded 1.4% (5.4% yoy), continuing recent quarterly volatility, and not a great omen for economy-wide productivity over 2018. Annual employment growth firmed to 3.7%, with the economy adding 94,000 jobs over the last 12 months, with the growth in employment well above the (still-strong, but moderating) 2.2% yoy growth in working age population. The Quarterly Employment Survey (QES), posted a 0.8% qoq increase in filled jobs (1.2% yoy), and a 1.1% increase in paid hours (2.4% yoy).



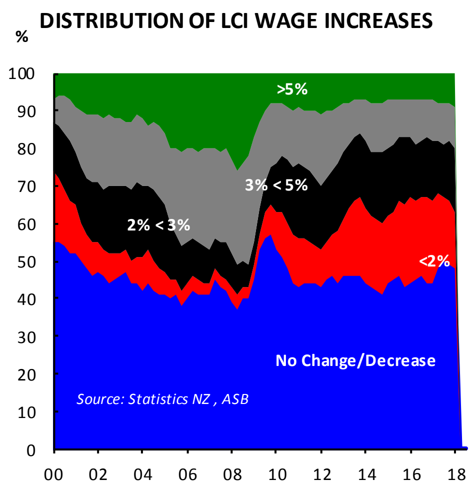
The HLFS survey continued to depict a tight labour market. The labour force participation rate rose 0.1 percentage points to 70.9% of the labour force (70.8% in Q1) to lie just shy of record highs. The Q2 HLFS employment rate held steady at record highs at 67.7%. The seasonally-adjusted underutilisation rate (a measure of slack within the existing employment market) was historically low at 12% (11.9% in Q1).



Rising workforce participation helped lift the Q2 HLFS unemployment rate to 4.5%, still close to decade lows and well within the RBNZ's estimated 3-5%-5.3% range for the Non-Accelerating Inflation Rate of Unemployment (NAIRU). Our analysis of unemployment by duration suggests that the unemployment rate was boosted by a lift in cyclical unemployment (1-12 month duration), confirming slightly more slack in the labour market. Average hours worked per employee did firm (to 34.2), but it still remains below historical averages (34.5).



Courtesy of the April increase in the minimum wage, private sector LCI wages from the Labour Cost Index (LCI) firmed 0.6% qoq, with annual inflation (2.1% yoy) rising to a six-year high. Wage inflation from the public sector was a more tepid 0.3% qoq (1.4% yoy), with overall LCI wage inflation ticking up to 0.5% qoq (1.9% yoy). Wage inflation from the all-sector unadjusted LCI measure also firmed (+ 0.8% qoq), but the 3.3% annual rate of change was on par with recent outturns. By contrast, average hourly earnings on the QES measure were up a tepid 0.1% qoq (+3.0% yoy), but these figures are volatile and subject to survey noise.



The distributional measures continued to confirm a contained inflation backdrop. The 2018Q2 LCI report confirmed that 37% of salary and wage rates had achieved a wage increase above 2% over the last 12 months (34% in Q1), with close to half reporting no annual increase (48%). Median and mean increases from the LCI ticked up, but remained moderate at 2.5% and 3.3%, respectively.

Policy implications

Next week sees the Reserve Bank's (RBNZ) August Monetary Policy Statement (MPS). The RBNZ is now tasked with "supporting maximum sustainable employment within the economy" alongside its price stability mandate. In our view, the tight labour market currently looks to be in little need of additional policy stimulus to meet employment objectives in the new Policy Targets Agreement (PTA). Past survey volatility from the HLFS looks to have been considerably dampened, which has undoubtedly made life easier for the RBNZ in terms of distinguishing between the policy "signals" from the data as opposed to outright "noise".

We expect that a still-solid outlook for economic growth and moderating growth in the working age population should keep the labour market tight. The unemployment rate still looks set to fall to the low 4's by the end of the year. **The tight labour market and further increases in the minimum wage will be catalysts in pushing wage inflation higher (see our note here), with the OCR moving up from next November.** We note that the path of OCR increases will depend on the extent to which rising wages will be matched by rising labour productivity.

We note, however, that this expectation is conditional on the economy retaining sufficient momentum to push inflation higher. However, downside risks to the growth and employment outlook look to have grown, particularly if currently weak business confidence translates into outcomes. This highlights the need for ongoing policy support, with the RBNZ expected to keep its policy options open and portray a neutral policy bias next week.

Market reaction

The NZD/USD has dipped 20 points on the higher unemployment rate print. There was minimal reaction in the local interest rate market.

ASB Economics & Research			**Phone**
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Mark Smith	mark.smith4@asb.co.nz	(649) 301 5657
Senior Economist	Jane Turner	Jane.turner@asb.co.nz	(649) 301 5853
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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