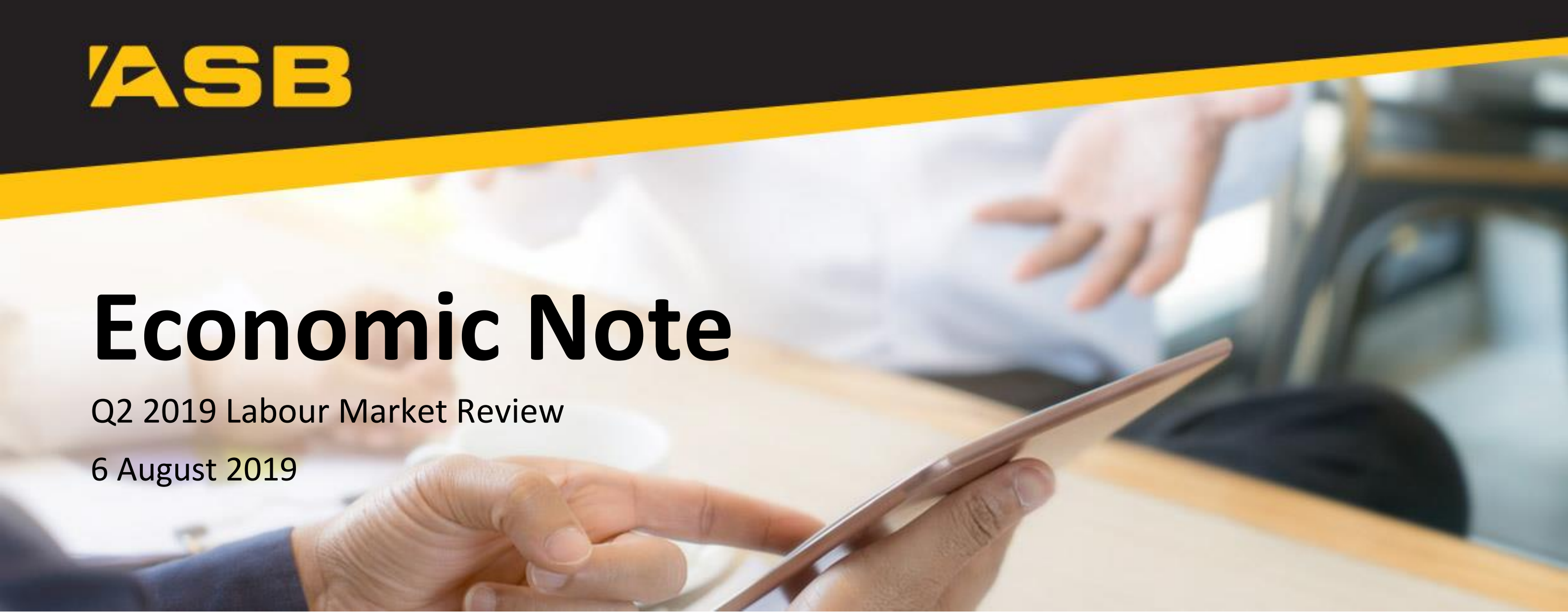

Economic Note

Q2 2019 Labour Market Review

6 August 2019

Labour Market Radiates Some Warmth

- Q2 labour market statistics were much stronger than expected. The unemployment rate fell to an 11-year low in contrast to widespread expectations for an increase.
- Broader measures of labour market capacity confirmed the labour market was genuinely tighter than expected in Q2.
- Wage inflation surged 0.8%qoq, largely as expected, and driven by April's 7.3% minimum wage increase.
- Despite escalating global risks, today's data support our view of measured RBNZ easing. We continue to expect a 25bps rate cut at tomorrow's meeting, with a follow-up cut in November, taking the OCR to 1.00%.

Household labour Force Survey	Actual	ASB	Market
Employment growth (QoQ)	0.8	0.5	0.3
Employment growth (YoY)	1.7	1.4	1.2
Unemployment Rate (%)	3.9	4.4	4.3
Participation Rate (%)	70.4	70.6	70.5
Labour Cost Index			
Private Sector (%, QoQ)	0.8	0.7	0.7
Private Sector (%, ann)	2.2	2.1	2.1

Summary and implications

Today's data show the labour market remained in an extremely strong state in Q2, confounding our/market/RBNZ expectations for a lift in unemployment and a continued slowdown in employment growth. While the jump in employment growth may be a touch overstated, it's hard to argue with the fact the labour market finished Q2 in a genuinely tighter-than-expected position. The data don't change our view on RBNZ policy – we still expect a 25bps rate cut tomorrow and a further cut in November, taking the OCR to 1%. In an environment of rapidly escalating global risks, the stronger starting point for the labour market means the RBNZ can afford to take a measured approach to policy easing.

The RBNZ will be pleased it continued to meet its "maximum sustainable employment" labour market objectives in Q2. But it will be wary that more timely indicators suggest the worm has turned for the labour market. The broader economic slowdown now looks entrenched, and will likely translate into additional labour market slack ahead. Firms are reporting acute margin pressure and employment intentions are consistent with firms cutting staff. More policy support will be required to keep employment near its maximum sustainable level.

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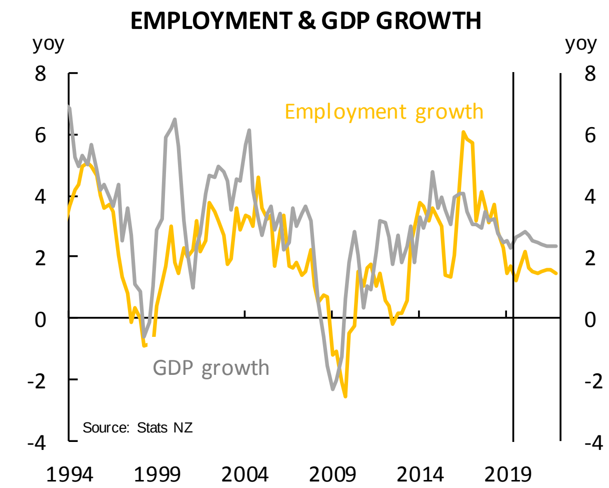
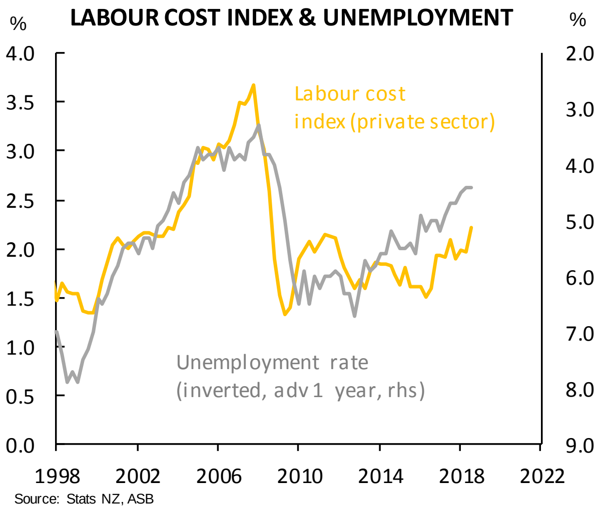
Today's labour market data were stronger than expected across the board. June quarter employment bounced back 0.8%qoq, following the previous quarter's 0.2% decline. As a result, annual employment growth actually picked up slightly from 1.5% to 1.7%, halting the slowdown in hiring that had been in train since early 2018. The employment rate lifted from 67.5% to 67.7%. All in all, it was another gong for the RBNZ in continuing to meet its labour market objectives.

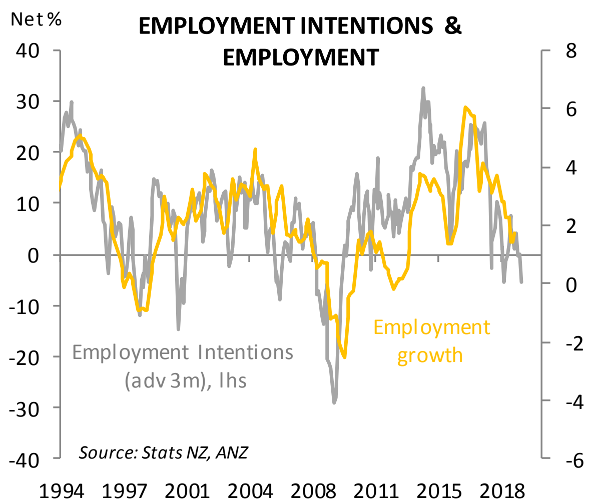


We usually look at employment measures from the QES as a cross-check on the often-volatile HLFS employment series. **Notably, these measures painted a slightly softer picture.** Filled jobs rose 0.4% over the quarter and paid hours lifted just 0.2%. Annual growth in both measures continued to cool (to 1.0% and 1.1%, respectively), more in line with the slowdown in employment growth we've been seeing across other labour market indicators**.**



The unemployment rate unexpectedly fell from 4.2% to 3.9%. This essentially reflected a jump in employment without any corresponding response in labour supply. Indeed, the participation rate held steady at 70.4% (ASB: 70.6%). This is slightly unusual from a historical perspective as employment and participation usually move together. Falling participation amongst the older cohorts looks to be a key driver.

While employment growth might have been overstated slightly, it appears the labour was genuinely tighter than we and the RBNZ expected in Q2. Importantly, almost the entire suite of broader labour market capacity indicators we recently flagged as important tightened in Q2. Despite the fall in headline unemployment, the gap between Maori & youth unemployment and headline unemployment still crunched in. The underutilisation rate – another important measure of labour market stretch the RBNZ looks at – also fell (to 11% from 11.3% in Q1).



We estimate that the NAIRU (non-accelerating inflation rate of unemployment) is currently hovering just above 4%, the bottom of the RBNZ's recently estimated range (4.0-5.5%). **From this perspective, the decline in the unemployment rate in Q2 will be a welcome development from the RBNZ's perspective, as it indicates the labour market remains on the tighter side of neutral**. We expect the degree of slack to pick up over the coming 12 months though as the NAIRU continues to trend lower and labour demand cools.

Wage growth was about as strong as expected. Private sector LCI wages rose 0.8% qoq in Q2, to be up 2.2% for the year. This was the largest quarterly increase since the Global Financial Crisis in 2008. The 7.3% lift in the minimum wage in April was a prominent feature of the wages data, as had been expected. This was on display in the disaggregated data, with the retail trade and accommodation industry outperforming with a 1.8% increase lift in wages over the quarter. Solid quarterly increases outside of this sector were relatively broad-based, indicating there was some broader spillover from the minimum wage hike.

Wider measures from the Labour Cost Index were consistent with acceleration in Q2. In the June 2019 year, 47% of salary and wage rates achieved a wage increase above 2% over the last 12 months (up from 44% in Q1), with 41% reporting no annual increase, the lowest since 2015. Median and mean increases from the LCI picked up in the June quarter to 3.0% and 4.1% (from 2.8% and 3.4% last quarter).

We continue to expect a modest pick-up in wage growth over the next few years, supported by recent tightness in the labour market, various pay settlements (the teachers' agreement will come through from Q3), and widespread skill shortages.

Market reaction

Unsurprisingly, the NZ dollar and NZ wholesale interest rates jumped on the release of the stronger-than-expected jobs numbers, reversing the global-led declines on the open. OIS-implied pricing for the next three RBNZ meetings has reverted back to levels prevailing prior to this week's bout of global risk aversion. A 25bps cut tomorrow is fully priced, September is roughly 50/50, and another cut is fully priced by November. This pricing looks about fair to us, particularly in light of escalating global risks.

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