

WESTPAC ECONOMIC BULLETIN

NZ labour market review, Q2 2022.

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Team Demand to the fore.

- The New Zealand labour market remains extremely tight.
- While the unemployment rate rose slightly, the other survey details point to severe capacity constraints and intensifying wage pressures.
- We now expect the Reserve Bank to lift the OCR to a peak of 4%, most likely by the end of this year.
- The recent resurgence of inflation has been due to a complex mix of supply-side shocks and overheated demand.
- In our view, today's results tip the balance of responsibility for inflation a bit more towards 'Team Demand'.
- That in turn means that monetary policy will hold more of the burden of adjustment.
- We continue to expect a 50 basis point increase in the OCR at the 17 August review, with a signal of more to come.

Unemployment rate and employment growth



The June quarter surveys show that the New Zealand labour market remains extremely tight. Setting aside a slightly higher than expected unemployment rate, the details point to an economy that's running up against capacity constraints, and the upward pressure on wages is intensifying.

The resurgence of inflation in the last year or so has been the product of both supply-side shocks stemming from global forces and Covid disruptions, and overcaffeinated demand as a result of the policy response to the pandemic. It's been a complex mix, and it's not at all clear how much responsibility lies on each side. But today's results tip our thinking a little more towards 'Team Demand' on balance. And that in turn implies that more of the burden of adjustment lies with the Reserve Bank.

We now expect the Official Cash Rate to reach a peak of 4.00% for this cycle. That can be achieved through 50 basis point hikes

	Quarterly actual		Quarterly expected		Annual
	Q1	Q2	Market	Westpac	Q2
Household Labour Force Survey					
Unemployment rate	3.2	3.3	3.1	3.1	-
Underutilisation rate	9.3	9.2	-	-	-
Employment growth	0.0	0.0	0.4	0.5	1.6
Participation rate	70.9	70.8	71.0	71.1	-
Quarterly Employment Survey					
FTE employment	0.2	-0.9	-	0.4	2.1
Hours paid	-0.5	-0.1	-	0.5	-0.7
Private average hourly earnings	1.9	2.2	1.3	1.3	6.4
Labour Cost Index					
All sectors, ordinary time	0.8	1.1	-	0.9	3.4
Private sector, ordinary time	0.7	1.3	1.1	1.0	3.4

at each of the three remaining review dates this year. There is a risk that the tightening stretches out into the early part of next year, although we think that by then there will be a substantial body of evidence that the domestic and global economies are slowing.

This is higher than our previous forecast peak of 3.50%, but is more in keeping with the track that the RBNZ projected in its May *Monetary Policy Statement*. Today's results were fairly close to the RBNZ's expectations, and at this point we don't feel there's much basis for arguing that the RBNZ is going to do less in the next few months than it already had in mind.

Details.

The Household Labour Force Survey (HLFS) showed a small uptick in the unemployment rate to 3.3% in the June quarter. That still leaves it at a very low level – the previous reading of 3.2% was the lowest in the history of the survey going back to 1986. The fact that it rose at all was a surprise, given the widespread evidence of a very tight labour market – we, the rest of the market and the RBNZ all expected it to dip to a new low of 3.1%. But the difference is small enough to put it well within the realm of 'noise'.

The other downside surprise for us was that there was zero employment growth for the second quarter in a row (in contrast to the tax data which pointed to a moderate rise). That was accompanied by a further drop in the labour force participation rate, again weaker than expected.

A quick look at the details suggests an unusually large lift in the number of people who were retired and out of the workforce. There's no obvious reason why retirement should occur in such a lumpy manner, so we'll chalk that one up to sampling error for the quarter. But in the longer term, this is going to be a major ongoing issue for the structure of the labour force: the wave of baby boomers hitting retirement age still has a long way to run.

While the unemployment rate rose slightly, the broader underutilisation rate dipped from 9.3% to 9.2%, taking it back down to its lowest level since 2007. This was largely due to a

sizeable shift from part-time to full-time employment, perhaps due to people working closer to their normal hours as Omicron-related disruptions became less of an issue.

For us, the most important results from today's surveys were in the strength of the wage measures. The Labour Cost Index (LCI) for private sector wages rose by 1.3%, against our forecast of a 1.0% rise – given that this series tends to evolve quite slowly, a 0.3 percentage point miss is quite substantial. It was also a notch higher than the RBNZ's forecast of 1.2%. On an annual basis, the LCI was up by 3.4%, the fastest pace since early 2009.

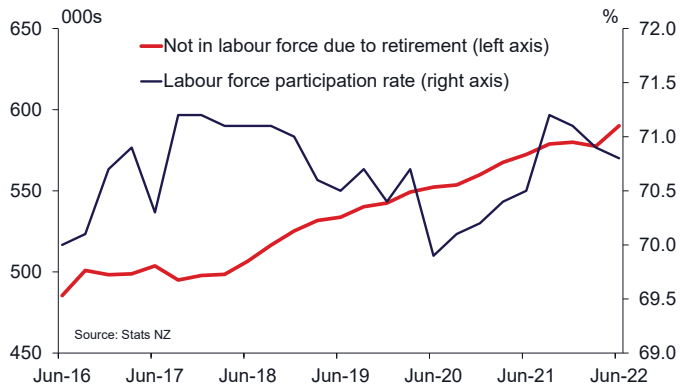
The LCI measures the cost of a given unit of labour, excluding pay increases related to promotions or experience. To get a better sense of what workers are actually receiving in their pocket, we can look at the unadjusted LCI, which was up 5.1% on a year ago. Alternatively we can look at the average hourly earnings measure from the Quarterly Employment Survey (QES), although this tends to be jumpier from quarter to quarter. This measure was up 6.4% on a year ago, quite a lot higher than our forecast of 5.5%.

Obviously none of these measures have kept pace with the cost of living, with consumer prices up 7.3% over the same period. But the shortfall hasn't been as severe as expected, and that will have consequences for the Reserve Bank. If rising living costs are having less of a braking effect on consumer spending than thought, then higher interest rates will have to do more of the work.

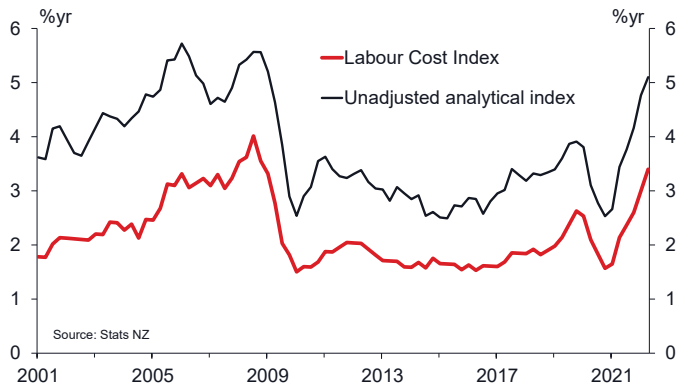
The breakdown of the LCI shows that wage rises are also becoming more widespread. Two-thirds of all job roles received a pay increase in the last year, the highest proportion going back to 1991. And over a quarter of jobs saw a pay increase of more than 5% (though that includes the minimum-wage roles that received a 6% increase in the June quarter.)

Notably, the reasons that employers give for wage rises are increasingly around matching market rates and retaining staff. In other words, the biggest driver of wage inflation is the demand-pull of intense competition for a largely fixed pool of workers, not the cost-push of rising living costs.

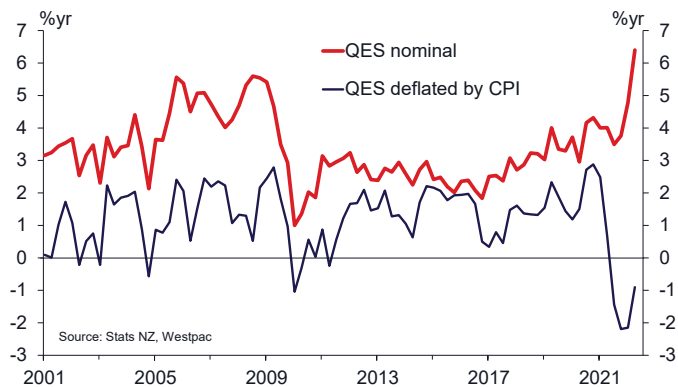
Labour force participation



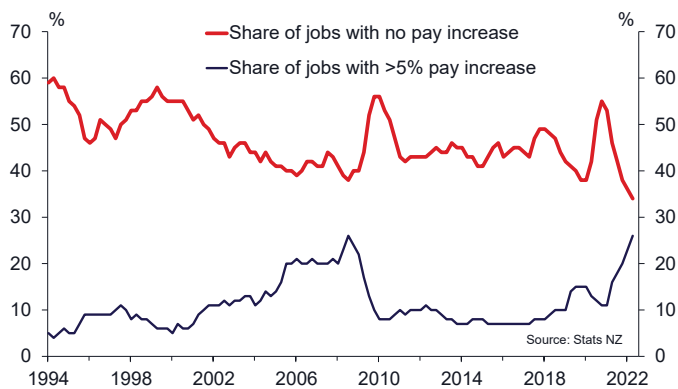
Labour Cost Index, annual growth



Nominal and real wage growth



Distribution of wage growth



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