WESTPAC ECONOMIC BULLETIN

NZ labour market review, Q3 2022.

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Power to the workers.

- The New Zealand labour market remains extremely tight, with unemployment close to a record low and wages accelerating sharply.
- The results were at least as strong as the Reserve Bank was expecting, and serve to highlight how inflation is increasingly a home-grown issue.
- We continue to expect a 0.75% lift in the Official Cash Rate at the 23 November review.

Today's data releases showed once again that the New Zealand labour market is running hot. The unemployment rate remained close to its record low, and while there was a strong lift in employment, the details highlighted the difficulties that employers are facing in terms of where to find new workers. Not to mention that wage growth is picking up sharply, emphasising that New Zealand's inflation problem is increasingly a home-grown one.

The results were mixed relative to what the Reserve Bank was forecasting in its August Monetary Policy Statement, with unemployment holding steady but employment stronger. The RBNZ was already bracing for some very strong wage growth in

	Quarterly actual		Quarterly expected		Annual
	Q2	Q3	Market	Westpac	Q3
Household Labour Force Survey					
Unemployment rate	3.3	3.3	3.2	3.2	-
Underutilisation rate	9.2	9.0	-	-	-
Employment growth	0.0	1.3	0.5	0.6	1.2
Participation rate	70.9	71.7	71.0	71.1	-
Quarterly Employment Survey					
FTE employment	-1.0	1.5	-	0.6	2.4
Hours paid	-0.5	2.1	-	0.6	2.9
Private average hourly earnings	2.3	2.6	1.7	1.7	8.5
Labour Cost Index					
All sectors, ordinary time	1.1	1.1	-	1.0	3.7
Private sector, ordinary time	1.3	1.1	1.1	1.0	3.8
Private sector, all salary & wage rates	1.3	1.2	1.2	1.0	3.9

the coming quarters, and today's releases generally delivered on that, although one of them – average hourly earnings – beat even the RBNZ's well-above market forecast.

That doesn't necessarily add to the case for a jumbo-sized increase in the Official Cash Rate at the next review on 23 November. But it does emphasise that the RBNZ faces a significant challenge in bringing inflation under control – there's a clear risk of a self-perpetuating upward spiral in wages and prices, in the absence of the circuit-breaker that higher interest rates provide. Any thoughts of the monetary policy cycle being 'mature' or 'well advanced' need to be put into the context of the overall scale of the RBNZ's task.

We continue to expect a 75 basis point increase in the OCR later this month. It seems likely that the options will be between a 50 point and a 75 point move, as they were in the October policy review. What tips us towards a larger move this time is the strong readings on inflation and wages in recent weeks, as well as the unusual three-month gap until the next scheduled policy review in February.

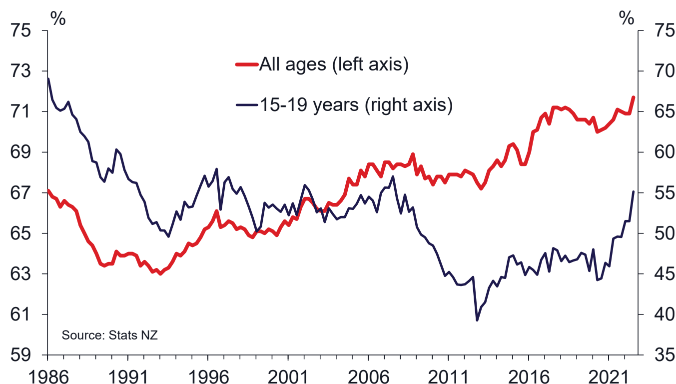
Turning to the details, the unemployment rate remained at 3.3% in the September quarter, close to the record low of 3.2% that it set in December and March. On the face of it, that was a little weaker than the drop to 3.2% that we and the market were forecasting.

Unemployment rate and employment growth

Where we were in agreement, though, was that jobs growth had actually regained some momentum in the September quarter. Indeed, that turned out even stronger than expected – employment was up 1.3% for the quarter, following three quarters straight of zero growth. Those hires didn't come out of the ranks of the unemployed, but from a lift in labour force participation – up sharply from 70.9% to 71.7%, easily a new all-time high.

That growth, however, has been fairly narrowly focused. As we noted in our preview, the monthly employment indicator based on tax data showed that about 40% of the jobs growth in the last year had been among teenagers. That result hadn't shown through in the Household Labour Force Survey up until now, but it definitely caught up with the trend this time. We estimate that employment among 15-19 year olds rose by 8% in just the latest quarter, and the participation rate for this age group rose to its highest since 2007. We also saw a strong rise in the number of people working while studying, and a rebound in the proportion of part-time workers.

Labour force participation rates



A lift in youth employment is certainly not unwelcome. But it highlights how few avenues that employers have left to find new workers. Students working part-time may well be helping to fill the gap in areas like hospitality, which have suffered from the absence of the migrant and working-holiday visa crowds in the last couple of years. But labour shortages are a feature across all sectors, all regions, and all skill levels. More often than not, finding the people with the right skills will mean luring them away from another employer. The result is that the demand for workers largely gets channelled into pay rates, rather than employment.

Indeed, wage pressures are clearly building. The Labour Cost Index (LCI) rose by 1.1% in the September quarter, lifting the annual rate to 3.7%, the highest since 2008. Private sector labour costs are running hotter than the public sector – up 3.9% vs 3.1% for the year. The unadjusted analytical measure of the LCI, which excludes pay rises related to promotion or experiences, is running stronger than this, up 5.3% on a year ago (and 5.6% for the private sector).

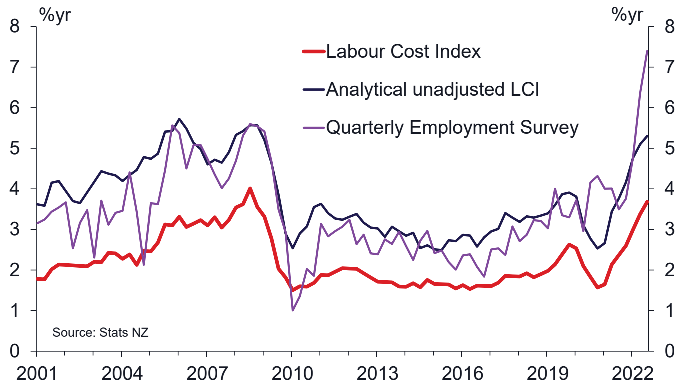
The Quarterly Employment Survey (QES) measure of average hourly earnings is even stronger again. Private sector pay rates were up 2.6% for the quarter, lifting the annual rate to 8.5% – exceeding the previous high of 7.7% in 1990, which is as far back as the survey goes. We should take this measure with a small grain of salt, as it can be quite variable from quarter to quarter. But it is clear that not only is the QES measure outpacing the LCI, but the gap between the two is widening.

Why is this happening? One reason could be due to job title inflation. The LCI measures pay rates by job role. But some employers are having to hire or promote people into more senior positions – with higher salary ranges – in order to be able to pay what's needed to attract or retain them. This may be an attractive option for employers, because it's easier to scale it back once the economy does cool down.

So the question of which wage measure to focus on is really horses for courses. If you're interested in wage growth on a completely like-for-like basis, use the headline LCI. If you're thinking about the overall pressure for pay rises that an individual firm is facing, look at the analytical LCI. And if you want to gauge what workers are actually getting in hand (before tax, and bracket creep), the QES is the best measure, as it also captures the effects of people moving into higher-paying jobs or even sectors.

The QES measure suggests that, until recently, the average worker was falling behind the rising cost of living, but they're now starting to claw that back. That broadly matches how the Covid pandemic has played out. At first it was largely a productivity shock to the economy, as supply chains gummed up and worker absences increased. In these conditions, we would expect real (inflation-adjusted) wages to fall. But we're hearing much less from firms about supply chain issues these days; the overwhelming issue now is labour shortages. And that is a recipe for a rise in real wages.

Measures of wage growth



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