ECONOMIC BULLETIN

Preview of Q4 labour market statistics: 7 February, 10:45am.

1 Feb 2024 | **Michael Gordon**, Senior Economist | +64 9 336 5670 | +64 21 749 506 | michael.gordon@westpac.co.nz

The heat is off

- **We expect the unemployment rate to rise further in the December quarter, from 3.9% to 4.2%.**
- **Strong population growth is driving a rise in both jobs and the labour force, but the former is not keeping pace with the latter.**
- **Wage growth has passed its peak, as both skill shortages and cost-of-living pressures have eased.**
- **Our forecasts are in line with the Reserve Bank's most recent projections, so they don't alter our near-term outlook for monetary policy.**
- **While employment is no longer directly in the RBNZ's mandate, it's a useful guide to how hot the economy is running, and in turn the extent of future inflation pressures.**

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Unemployment rate	3.9	4.2	-
Employment growth	-0.2	0.3	2.4
Participation rate	72.0	72.0	-
Labour Cost Index			
All sectors, ordinary time	1.0	0.8	3.9
Private sector, ordinary time	0.8	0.8	3.7

The labour shortages that once gripped the New Zealand economy are now clearly easing. Higher interest rates have contributed to a softening in demand, at the same time that a surge in inward migration has helped to fill in skill shortages. The unemployment rate has risen from its record lows, and wage inflation – typically one of the most lagging aspects of an economic cycle – has passed its peak.

Next Wednesday's labour market surveys are likely to show more of the same in the December quarter. We're expecting the unemployment rate to rise from 3.9% to 4.2% – still a low level compared to history, but taking it into what we'd regard as the 'not too hot, not too cold' range.

The labour surveys are the last major data release ahead of the Reserve Bank's *Monetary Policy Statement* at the end of this month. Our estimates are mostly in line with the RBNZ's previous forecasts from November. So if the results pan out as expected, the RBNZ will most likely stick with its recent messaging: we're making progress on taming inflation, but there's still a long way to go, and the greater risk is in taking their foot off the brakes prematurely.

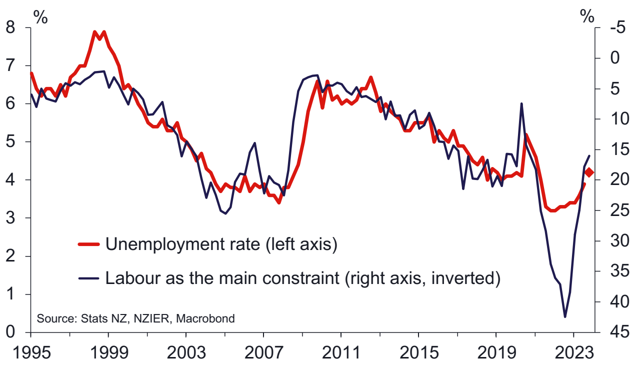
Although the requirement to "support maximum sustainable employment" has now been removed from the RBNZ's mandate, the labour market figures will still hold significance. The unemployment rate is one of the best real-time gauges of the economy (that is, it's generally robust to any future data revisions). The RBNZ will look to the unemployment rate as a gauge of how hot the economy is running, and hence how quickly those stubborn inflationary pressures will recede.

Forecast details.

At a bird's-eye level, there are several indicators that point to a further rise in the unemployment rate in the December quarter:

- The number of people receiving the Jobseeker Support benefit has been steadily rising;
- Job advertisements have not only moderated, but have fallen below pre-Covid levels;
- Business surveys show that the difficulty of finding workers has eased dramatically compared to the previous couple of years.

Unemployment and labour shortages



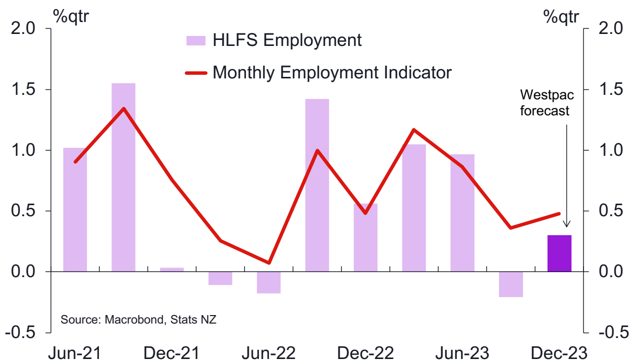
We expect the unemployment rate to rise from 3.9% to 4.2% this quarter, on its way to 5% or more over the course of this year. It's still currently quite low compared to history (the record low was 3.2%, seen through much of 2022), but it's entering a range where a tight labour market no longer appears to be adding to inflationary pressures.

Within that forecast we still see employment growing, just not fast enough to keep up with population growth. Our usual guide for this is the monthly employment indicator (MEI), which rose by 0.5% on average over the quarter; we've translated this into a 0.3% rise in the Household Labour Force Survey (HLFS) measure of employment. The two measures can diverge at times – for instance the MEI suggested a 0.4% rise in the previous quarter, while the HLFS showed a surprise 0.2% fall. But in annual terms the two measures are broadly in agreement at the moment – about 2.5% growth in the last year – so we've set our forecast on that basis.

In contrast, Stats NZ has reported that the working-age population rose by 0.6% over the quarter, and 3% in the last year. Since New Zealand reopened its border, record net inflows of migrants have boosted population growth sharply (and incoming migrants are largely working-age).

The return of migrants has also noticeably reshaped the workforce. During the border closure, employers increasingly resorted to hiring teenagers to fill labour shortages; teen employment rose by 13% over 2022. But as migrant workers returned, all of the jobs growth since then has been in the older age groups, and teen employment has fallen back significantly.

Quarterly employment growth



In our forecast we've assumed the participation rate will hold steady at 72.0%. Migrants are a relatively high-participation group – many of them arrive on temporary work visas – so during a period of high net migration we'd expect the overall participation rate to be high too. And indeed it has been recently: it reached a new record high of 72.4% in the June quarter, before it unexpectedly dropped to 72.0% in September.

We're not able to discern whether this fall was genuine, or perhaps due to an unusual cohort entering or exiting the survey sample. In the absence of any further information, we've assumed that it will remain unchanged this time. A rebound in the participation rate would leave the risks pointed towards a higher unemployment rate than what we're forecasting.

Turning to wages, we expect a 0.8% rise in the overall Labour Cost Index (LCI) for the December quarter. On an annual basis, wage inflation has just passed its peak, and we expect it to slow further from 4.2% to 3.9%. The turning point in wage inflation has been more obvious in the private sector; there was a sharp lift for the public sector in the September quarter due to some large wage agreements taking effect, but that won't be repeated this time.

The Quarterly Employment Survey (QES) measure of average hourly earnings is more volatile than the LCI and hence harder to forecast, but we'd also expect it to slow on an annual basis. The QES doesn't adjust for changes in the composition of jobs, so it's more a reflection of what the average worker is getting in hand, rather than a like-for-like measure of wage rates. The QES has been outpacing the CPI over the past year, though it's debatable whether workers have fully clawed back the ground that was previously lost to inflation.

Wage growth, all sectors ordinary time

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