WESTPAC ECONOMIC BULLETIN

Preview of Q4 labour market surveys: 2 February, 10:45am.

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Watching wages as jobs market tightens.

- We expect an unemployment rate of 3.5% for the December quarter.
- While the previous reading of 3.4% was a record-equalling low, the Covid lockdown is likely to have distorted it lower to some degree.
- Hence, our forecast actually represents a further strengthening in the already-tight labour market.
- Strong demand for workers and rising inflation suggests a further lift in annual wage growth.
- However, much of the lift in inflation to date has been a Covid-related cost shock, which is likely to leave workers on the back foot to some degree.
- Low unemployment and rising wages will reinforce the case for the Reserve Bank to continue removing monetary stimulus.

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Unemployment rate	3.4	3.5	-
Employment growth	2.0	0.2	3.8
Participation rate	71.2	71.3	-
Quarterly Employment Survey			
FTE employment	1.1	0.5	3.0
Hours paid	1.2	0.0	4.5
Private average hourly earnings	1.2	1.0	3.7
Labour Cost Index			
All sectors, ordinary time	0.8	0.8	2.8
Private sector, ordinary time	0.7	0.8	2.9
Private, all salary & wage rates	0.7	0.8	2.9

The labour market has become one of the hottest topics in the New Zealand economy, with businesses desperate to find workers and job vacancies soaring to new highs. That demand for workers, combined with the other hot topic right now – the rising cost of living – means that the case for bigger and more widespread pay increases is stronger than it's been for a long time. With that in mind, there'll be keen interest in the December quarter labour market surveys, to be released next Wednesday.

We're expecting a 3.5% unemployment rate for the quarter, up a little from the record-equalling low of 3.4% in the September quarter. However, that previous reading was biased down slightly by the Covid-19 lockdown during the quarter, after the Delta outbreak was identified in August. Those who were unable to look for work during the lockdown did not meet the official definition of unemployed; Stats NZ estimates that including these people would have raised the unemployment rate to 3.6%. In addition, the response rate was lower than usual, and it's likely that non-responses were weighted more towards the unemployed.

As a result, our 3.5% forecast actually represents a further tightening of the labour market in the December quarter. The recent data indicates that the jobs market fared much better through the Delta lockdown. Unlike earlier lockdowns, there was no outright drop in the number of filled jobs, but rather a slowdown from the previous frenetic pace of growth. We expect a 0.2% rise in employment for the December quarter, coming on top of a 2% jump in September.

With firms desperate to find workers, more and more people are being brought into the workforce. We've assumed a slight lift in the participation rate from 71.2% to 71.3%. However, it's getting harder to eke out further gains – the previous reading was already an equal-record high, which is even more remarkable given that an ageing population is increasingly weighing on the overall participation rate over time. It's encouraging that the tight labour market is now seeing a lift in the youth participation rate, which had been declining for many years.

The wage measures in the surveys will be of particular interest this time. Wages are being pressured in two ways. One is that with a labour market this tight, workers are in a stronger position to negotiate a higher pay rate (or take another job that pays more). The other is that the cost of living is rising faster than it has in a long time: tomorrow's CPI release is expected to show annual inflation rising towards 6% over 2021. Even those who have received a bigger pay rise in the last year may find themselves running to stand still.

Unfortunately for workers, we suspect that pay growth is going to lag behind consumer price inflation for a while. Some of the rise in inflation we're seeing is due to strong domestic demand. But a large part of it to date has been a cost shock relating to Covid disruptions globally. And there are no winners when it comes to a cost shock, someone has to bear the pain. The tightness of the labour market will have a bearing on how the pain is shared, but it's unlikely we'll see a scenario where workers are completely spared from it.

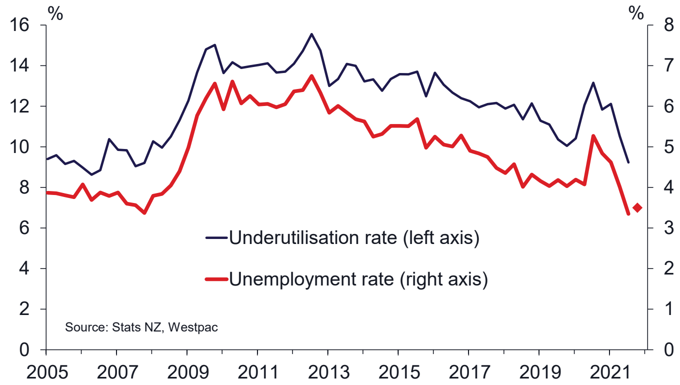
We expect a 0.8% rise in the Labour Cost Index (LCI), a similar increase to the previous quarter. That would see annual wage growth rise to 2.8%, the highest since 2009. That annual pace will rise further over 2022 – we're still coming off some subdued pay increases in late 2020 and early 2021, in the initial wake of the Covid shock. But we think it will take a while to catch up with the rate of inflation, which we expect to remain above the Reserve Bank's target over the course of 2022.

The Quarterly Employment Survey (QES) will probably be a less useful gauge this time around. The September quarter survey was held mid-August, just before the Delta lockdown, so the impact of now-removed Covid restrictions won't have been captured until the December quarter survey.

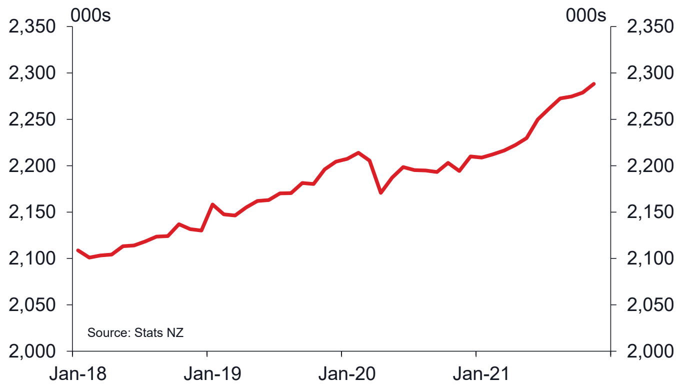
Our unemployment rate forecast is at the higher end of the range of market forecasts, and above the Reserve Bank's forecast of 3.2%. However, forecasts of the change in employment are similar, which indicates that the difference lies in views about the participation rate. Much of the recent growth in jobs has been in the under-25 age group, where there is still substantial room to bring more people into the workforce.

That aside, any unemployment rate starting with a 3 would indicate a tight labour market overall, and certainly beyond what the RBNZ would regard as sustainable maximum employment. That would support our forecast for a continued removal of monetary stimulus over the next couple of years.

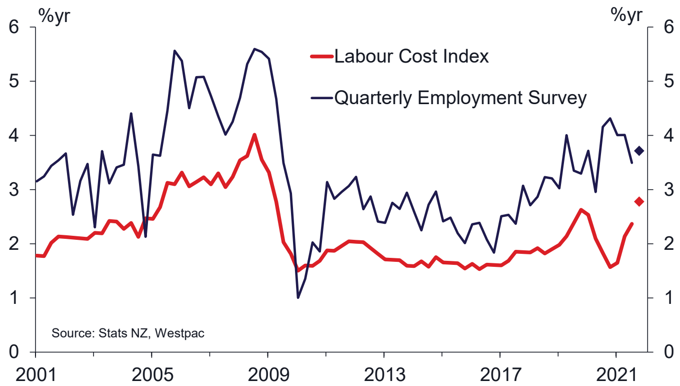
Unemployment and underutilisation rates



Monthly Employment indicator filled jobs



Wage growth, all sectors ordinary time



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