

WESTPAC ECONOMIC BULLETIN

Preview of Q1 labour market surveys:
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Running to catch up.

- We expect the unemployment rate to fall to 3.0% in the March quarter.
- This would be another new low in the history of the survey going back to 1986.
- Labour market indicators point to a further tightening in the market in recent months, albeit with some disruptions from the Omicron wave.
- We expect a further acceleration in wage growth, albeit still falling short of the surge in consumer price inflation.
- Our forecast would represent a modest upside surprise to the Reserve Bank's view
 - something that was perhaps already anticipated in this month's decision to lift the OCR by 50 basis points in one go.

| | Q4 actual | Q1 forecast | |
|----------------------------------|-----------|-------------|--------|
| | Quarter | Quarter | Annual |
| Household Labour Force Survey | | | |
| Unemployment rate | 3.2 | 3.0 | - |
| Employment growth | 0.1 | 0.2 | 3.3 |
| Participation rate | 71.1 | 71.0 | - |
| Quarterly Employment Survey | | | |
| FTE employment | 1.8 | 0.2 | 4.9 |
| Hours paid | 1.4 | 0.4 | 6.5 |
| Private average hourly earnings | 1.4 | 1.2 | 4.6 |
| Labour Cost Index | | | |
| All sectors, ordinary time | 0.6 | 0.7 | 2.9 |
| Private sector, ordinary time | 0.7 | 0.7 | 3.1 |
| Private, all salary & wage rates | 0.7 | 0.7 | 3.1 |

The labour market has been pushed into the background to some degree lately, with the surge in inflation dominating the headlines. Yet it remains a crucial part of the story for inflation going forward, which is the real concern for monetary policy. A tight jobs market is the mechanism through which an initial, globally-driven price shock could translate into an ongoing series of domestic wage and price rises.

We think that the March quarter labour market surveys, release next Wednesday, will show that such a dynamic is getting under way. We're forecasting the unemployment rate to fall to 3%, from an already record low of 3.2%. And in turn we expect a further lift in annual wage growth, albeit not keeping pace with the surge in the cost of living.

This would present a modest upside surprise relative to the Reserve Bank's February *Monetary Policy Statement* forecasts. The RBNZ assumed a flat outturn for unemployment in the March quarter, on the way to a gradual rise in from the second half of this year. That forecast reflects the idea that the economy is operating above maximum sustainable employment, and will need to ease back in order to keep inflation under control. That said, the idea of what's "sustainable" matters in terms of what it means for wage inflation, and in that respect the RBNZ's forecasts are similar to our own.

Details.

Our forecast of a 3% unemployment rate is based on a range of indicators pointing to a further tightening in the labour market over the March quarter, though not as assertively as we saw through last year. Jobseeker benefit numbers have continued to drift lower, business surveys point to a lift in employment as the country has moved beyond the Delta lockdown, and job advertisements have almost fully recovered to their pre-Delta highs.

The one note of caution comes from the monthly employment indicator based on tax data, which saw a small drop in February for the first time in over a year (though it's still on track to be up for the quarter). High worker absenteeism during the peak of the Omicron wave might have been a factor here. If so, it may show up in the Household Labour Force Survey (HLFS) as a drop in hours worked more so than a drop in employment.

We've pencilled in a small 0.2% rise in employment for the quarter. That would roughly match the growth in the working-age population, which has been squashed by the loss of migrant inflows over the last couple of years.

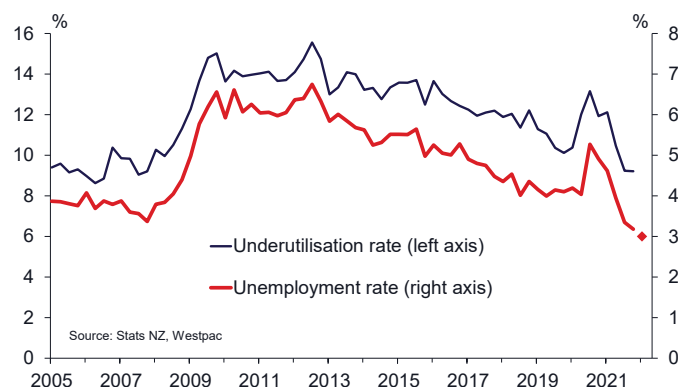
For the Labour Cost Index (LCI), we expect a 0.7% increase for the quarter, which would lift the annual growth rate to 2.9%, the highest since early 2009. The March quarter usually sees a relatively small increase – pay reviews are more common in the second half of the year – so this represents more of an acceleration in the quarterly growth pace than the headline number might suggest.

Given the inevitable comparisons between wage growth and inflation, we should emphasise that the LCI is not a measure of the pay rates that workers are receiving. It is literally what it says on the label: it's an index of the cost of a given unit of labour. It strips out pay increases that are related to experience or seniority – which is a big part of where individuals' pay increases will come from. If we want to look at 'real' wage growth, a more appropriate measure would be the unadjusted analytical series of the LCI (which was up 4.2% in the year to December) or the average hourly earnings measure in the Quarterly Employment Survey (up 3.8%).

Using either measure would still confirm that pay rates haven't kept up with the cost of living over the last year. But that's not surprising given the nature of the inflation shock. Much of the initial surge in inflation has been the product of globally-driven cost shocks. Someone has to wear those costs, and even in a very tight labour market we wouldn't expect the cost to fall entirely on employers.

That situation will change over time, however. By next year we expect that overall inflation will be lower than it is today, but it will also be determined more by demand-side forces. That's more like the conditions under which workers would be able to extract pay increases that outpace the cost of living.

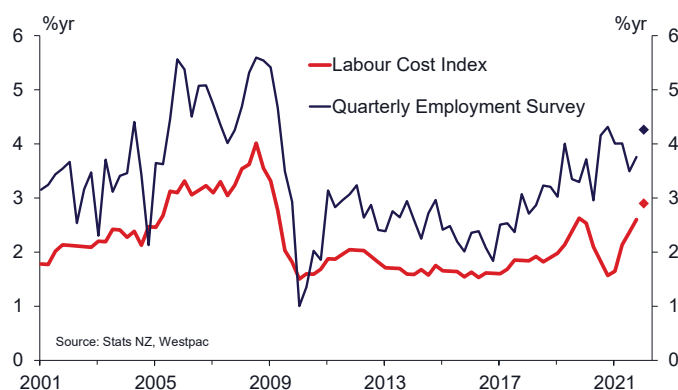
Unemployment and underutilisation rates



Online job advertisements, seasonally adjusted



Wage growth, all sectors ordinary time



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