Economic Bulletin.

29 October 2021

Preview of Q3 labour market surveys: 3 November, 10:45am.

- We expect the unemployment rate to fall to 3.8% for the September quarter.
- The latest Covid lockdown is likely to distort the headline unemployment rate lower. But even without that effect, we would have been looking at a stronger result.
- There is substantial evidence that the demand for workers is running hot, relative to supply. As a result, we expect to see a further acceleration in wage growth.
- The tight labour market presents a major challenge for the Reserve Bank. In these conditions, even a temporary inflation shock can provide the spark for an ongoing series of wage and price increases.

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	Q2 actual	Q3 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Unemployment rate	4.0	3.8	-
Employment growth	1.1	0.8	3.1
Participation rate	70.5	70.7	-
Quarterly Employment Survey			
FTE employment	1.7	1.0	4.1
Hours paid	3.0	1.0	6.3
Private average hourly earnings	0.7	1.7	4.1
Labour Cost Index			
All sectors, ordinary time	0.7	0.9	2.5
Private sector, ordinary time	0.9	1.0	2.8
Private, all salary & wage rates	0.9	1.0	2.8

Next week's labour market surveys will provide another crucial part of the inflation picture for New Zealand. The labour market has dramatically tightened over the course of this year, and there's evidence that that's remained the case even with the latest Covid lockdown. In this environment, there's a risk that an initial jump in inflation could provide the spark for an ongoing upward spiral in wages and prices. And once that kind of inflation becomes embedded, it's much harder and costlier for the Reserve Bank to squeeze it out of the economy again.

We're expecting a further drop in the unemployment rate in the September quarter, and an acceleration in wage growth. Crucially, we expect both of these to be stronger than what the RBNZ assumed in its most recent forecasts in August. If we're right, that would further bolster the case for a series of OCR hikes over the coming months.

On that point, we should address the fact that interest rate markets have been on an absolute tear in recent days

– market pricing is now consistent with an OCR reaching almost 3% in the next two years. It's likely that some of this reflects runaway momentum in a thin market, rather than a strongly-held view on the cash rate. So while we wouldn't rule out such an outcome, we'd note that there's already a lot of inflation 'fear' baked into the longer-term interest rates that borrowers face.

Details.

For the Household Labour Force Survey (HLFS), we've pencilled in a drop in the unemployment rate from 4.0% to 3.8%. Unfortunately this won't be a clean read on the labour market this time, as the latest Covid lockdown (which began around the middle of the quarter) is likely to bias it downward. We saw this effect during last year's lockdown, when the unemployment rate surprised everyone by falling to 4% before picking up again.

There are two reasons for this. First, to be counted as 'unemployed' you need to be actively seeking work, which isn't all that practical under lockdown conditions. Stats NZ has done some additional questioning to gauge the extent of this issue, but the headline unemployment rate itself won't be adjusted for this.

The thornier issue which can't be corrected for is that the survey response rate was lower than usual, as Stats NZ had to move away from face-to-face interviews and towards online. This drop-off in responses will have been among groups that are normally harder to reach anyway and, while we don't know for certain, it's likely that they have higher rates of unemployment.

While both effects are likely to be smaller this time than they were last year, we don't have a clear sense of how much impact they will have. As such, the risks are to the downside of our 3.8% forecast – that number is more like our guess of the 'true' result rather than what will be published on the day.

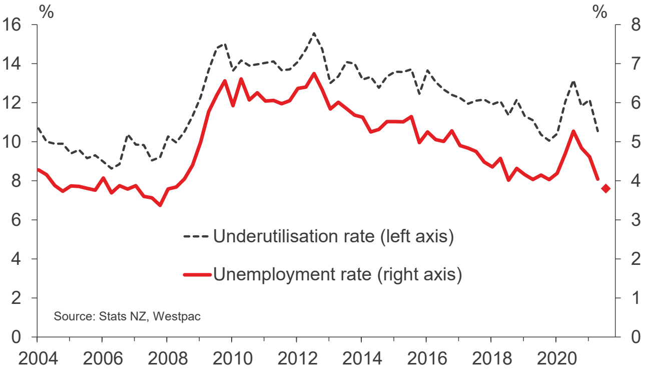
Even without the latest Covid lockdown, we would have been looking for a stronger result this quarter. The monthly employment indicator, based on income tax data, has shown a strong lift in the number of jobs in recent months. Job ads have surged over the course of this year, and even in lockdown they are still running above their pre-pandemic levels. Jobseeker benefit numbers were lower on average over the quarter, even with an uptick at the start of the lockdown. And the NZIER business opinion survey found that hiring intentions were at an all-time high.

This strong demand is coming at a time when the supply of workers is more constrained than normal, as a result of the border closure. The labour force is still growing – Stats NZ estimates that the working-age population has risen by about 0.7% over the last year, but that compares to growth rates above 2% before the pandemic.

As a result, much of that demand is being channelled into competing for the existing pool of workers. And that's a classic formula for higher wage inflation. We saw the first signs of this in the June quarter, with a 0.7% rise in the Labour Cost Index (LCI), and we expect this to accelerate to 0.9% for the September quarter.

The LCI is a slow-moving measure by design, so even a modest-looking acceleration like this would be significant – and would be the biggest quarterly rise since 2008. And this may not even capture the non-wage sweeteners that some employers are reportedly offering, such as signing bonuses and extra leave entitlements.

Unemployment and underutilisation rates



Wage growth, all sectors ordinary time

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