

WESTPAC ECONOMIC BULLETIN

Labour market review, Q4 2021.

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Accentuate the positive.

- The unemployment rate fell to 3.2% in the December quarter, the lowest on record going back to 1986.
- Wage growth has picked up in recent quarters – but less than we would have expected, given the drum-tight jobs market.
- The Reserve Bank will need to continue raising interest rates, but it can continue to do so at a measured pace.

The December quarter surveys point to an undisputedly strong labour market in New Zealand, with unemployment reaching new lows and wages rising. There's no doubt that the Reserve Bank will need to continue raising interest rates to head off the risk of overheating and persistent inflation pressures; the only question is how far. And in that respect, today's surveys actually argue for a little more caution around the inflation rhetoric that we've been seeing lately.

While wage growth has accelerated over the last year, it hasn't picked up as much as we would have thought, given the clear evidence of skill shortages and strong demand for workers. Maybe this is a sign that 'maximum sustainable employment'

| | Quarterly actual | | Quarterly expected | | Annual |
|---|------------------|------|--------------------|---------|--------|
| | Q3 | Q4 | Market | Westpac | Q4 |
| Household Labour Force Survey | | | | | |
| Unemployment rate | 3.3 | 3.2 | 3.3 | 3.5 | - |
| Underutilisation rate | 9.2 | 9.2 | - | - | - |
| Employment growth | 1.9 | 0.1 | 0.4 | 0.2 | 3.7 |
| Participation rate | 71.2 | 71.1 | 71.2 | 71.3 | - |
| Quarterly Employment Survey | | | | | |
| FTE employment | 1.2 | 1.8 | - | 0.5 | 4.6 |
| Hours paid | 1.3 | 1.4 | - | 0.0 | 6.5 |
| Private average hourly earnings | 1.2 | 1.4 | 1.0 | 1.0 | 4.1 |
| Labour Cost Index | | | | | |
| All sectors, ordinary time | 0.8 | 0.6 | - | 0.8 | 2.6 |
| Private sector, ordinary time | 0.7 | 0.7 | 0.9 | 0.8 | 2.8 |
| Private sector, all salary & wage rates | 0.7 | 0.7 | 0.9 | 0.8 | 2.8 |

is higher than thought – if so, that’s a good problem to have. But it still has a bearing on how much monetary tightening is appropriate.

Our forecast remains for the Official Cash Rate to reach 3% by the second half of next year, including hikes of 25 basis points at every review date this year. In contrast, financial markets have been flirting with the idea of a 50 basis point hike at the *Monetary Policy Statement* later this month. We already viewed that as unlikely – the case for doing so was stronger back in November than it is today. Today’s results – with unemployment no lower than what the RBNZ expected, and wage growth softer – should further downplay the risk of the RBNZ picking up the pace of hikes.

In terms of the details, the Household Labour Force Survey (HLFS) was a bit of a mixed bag. The unemployment rate fell to 3.2% in the December quarter, from a downwardly-revised 3.3% in September. That’s the lowest on record since the survey began in 1986 (though it may well have been lower in the past).

This was lower than our forecast of 3.5%, although the direction was broadly as we expected – as we noted in our preview, the previous result was distorted lower to some degree by the Covid lockdown during the quarter. In contrast, the broader underutilisation rate wasn’t distorted in the same way, so we would have expected more room for this measure to fall – instead it was unchanged at 9.2%.

Employment growth was a touch softer than our forecast at just 0.1%, following a 1.9% jump in the September quarter. Meanwhile, the labour force participation rate edged down from its highs – a slightly unusual combo, as employment and participation tend to move in the same direction. Youth participation dropped back after some solid gains in the previous two quarters.

These forecast misses aside, the overall picture is still one of a very tight labour market. Normally this would be a harbinger of higher wage inflation, and once a spiral of rising prices and wages gets going, it can be costly to break the cycle. So ultimately the wage measures were the key part of today’s releases. And relative to forecasts, they were on the soft side.

The Labour Cost Index (LCI) showed a 0.7% rise in private sector pay rates, compared to our forecast of 0.8% and the RBNZ’s pick of 0.9%. This series tends to evolve quite slowly, so even a seemingly small forecast ‘miss’ like this one is still meaningful. The Quarterly Employment Survey (QES) saw a more robust 1.4% rise in average hourly earnings. However, this measure is more volatile and can be affected by changes in the mix of jobs.

To be clear, the pace of wage growth has picked up in recent quarters, with the LCI up 2.8% on a year ago. But this seems little more than a catch-up after limited pay rises in 2020 in the wake of the Covid shock; wage growth hasn’t busted out of its previous ranges so far.

The issue is not that wages aren’t keeping pace with inflation right now. A large part of the recent spike in inflation has been a global cost shock, driven by Covid disruptions – unfortunately

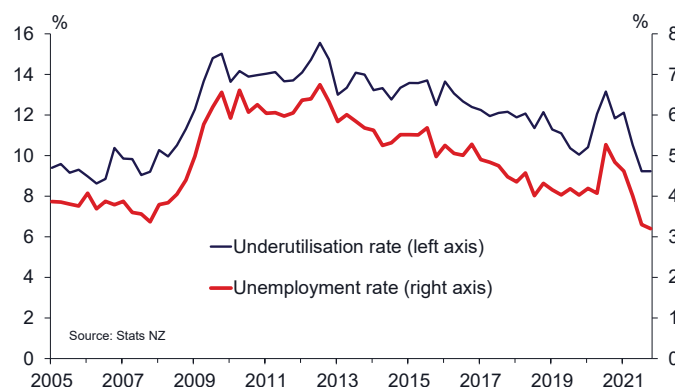
someone has to bear that cost, and even in a very tight labour market we wouldn’t expect workers to be completely shielded from it. Instead, what’s puzzling is that wage growth hasn’t picked up as much as we would have expected given the tightness of the jobs market.

It’s not as though wage pressures are completely absent. Indeed, looking at the distribution of pay rises within the LCI, the pressure is clearly there at both ends of the scale. The proportion of jobs that saw no pay increases is back to its lows, and the proportion with big pay rises (more than 5%), while not at a record high, is certainly back to 2007 levels, when the labour market was also very tight. But there appears to be a ‘missing middle’ that is dragging down the average.

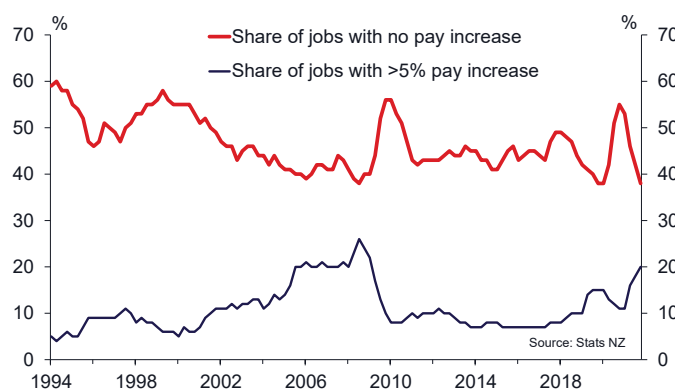
The upshot is that big pay rises are less widespread than the anecdotes would suggest – most likely concentrated in more specialised roles, where workers have more power to name their price in a tight market. And without widespread pay increases, there’s perhaps less risk of a persistent wage-price spiral developing.

We still expect wage growth to pick up over time, as the tight jobs market allows workers to press the case for cost-of-living adjustments (or more). But it will pay to watch the data closely over the coming year, rather than take mounting wage and price pressures as a given.

Unemployment and underutilisation rates



Distribution of wage growth



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