



ECONOMIC BULLETIN

NZ labour market review, December quarter 2023.



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

Small steps

- The labour market continued to soften in the December quarter, with the unemployment rate ticking up to 4.0%.
- Employment growth has slowed below the pace of population growth.
- And private sector wage inflation has passed its peak.
- But labour market conditions haven't eased as much as the Reserve Bank would have expected by this point.
- Today's results reinforce that the first OCR cut is likely to be later than what financial markets are currently pricing in.

Today's labour market surveys will have come as something of a mixed blessing for the Reserve Bank. On the one hand, their efforts to take the heat of the economy are still bearing fruit – unemployment has continued to rise from its lows, and wage inflation has (mostly) passed its peak. But at the same time, they haven't made as much progress as they would have hoped at this point, adding to the risk that inflation could prove to be more stubborn than thought.

The unemployment rate rose from 3.9% to 4.0% in the December quarter, returning it to its pre-Covid low. Employment is still on the rise, up 0.4% for the quarter and 2.4% over the last year. But in the context of a slowing economy, hiring is not keeping pace with the migration-led surge in population growth.

The rise in unemployment was less than the 4.2% that we and the Reserve Bank had forecast, although the reasons for the 'miss' were fairly minor. Employment growth was a

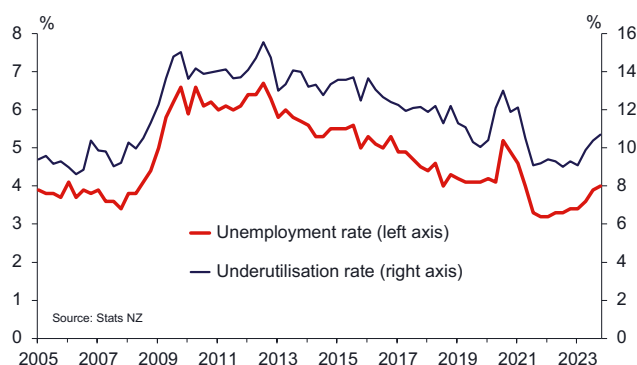
	Quarterly actual		Quarterly expected		Annual
	Q3	Q4	Market	Westpac	Q4
Household Labour Force Survey					
Unemployment rate	3.9	4.0	4.2	4.2	-
Underutilisation rate	10.4	10.7	-	-	-
Employment growth	-0.1	0.4	0.3	0.3	2.4
Participation rate	72.0	71.9	72.0	72.0	-
Hours worked	0.3	0.8	-	-	1.5
Quarterly Employment Survey					
Private sector average hourly earnings	2.0	0.5	-	-	6.6
Labour Cost Index					
All sectors, ordinary time	1.0	1.1	-	0.8	4.3
Private sector, all salary & wage rates	0.9	1.0	0.8	0.8	3.9
- Unadjusted LCI ordinary time	1.1	1.5	-	-	5.7
Public sector, all salary & wage rates	2.2	1.5	-	-	5.7

little higher than expected, although much in line with the previously-published Monthly Employment Indicator. At the same time, the labour force participation rate dipped slightly to 71.9%. We had assumed an unchanged 72.0%, but as we noted in our preview, we didn't have a strong stance on that number as it's been quite variable recently.

Although the requirement to “support maximum sustainable employment” has been removed from its mandate, the RBNZ still has good reason to take careful note of these figures. The unemployment rate in particular has proven to be a useful real-time indicator of how hot the economy is running. And a 4% unemployment rate is still quite low by historic standards – probably at the very lowest end of the range of what we would consider to be non-inflationary.

A broader measure of spare capacity in the labour market, the underutilisation rate, saw a more substantial rise for the quarter from 10.4% to 10.7%. Even then, it was more of a return to its pre-Covid lows than a sign of outright weakness.

Unemployment and underutilisation rates



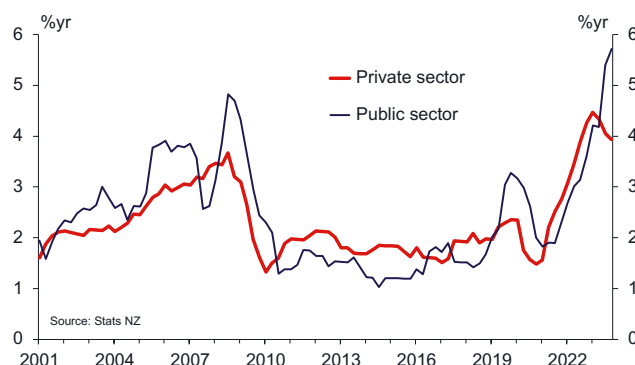
The other unwelcome surprise for the RBNZ was that wage inflation was also stronger than expected. The Labour Cost Index (LCI) rose by 1.0% for the private sector, against forecasts of a 0.8% rise. The annual rate of increase slowed to 3.9%, from 4.1% last quarter and a peak of 4.5% in March last year.

For now it's more useful to focus on private sector rather than economy-wide pay rates, due to some unusually large increases in the public sector recently. The 1.5% rise for the quarter most likely reflects the pay equity agreement for nurses, and comes after a 2.2% rise in the September quarter that included the collective agreements for schoolteachers. These increases are unlikely to be repeated to the same degree in the future.

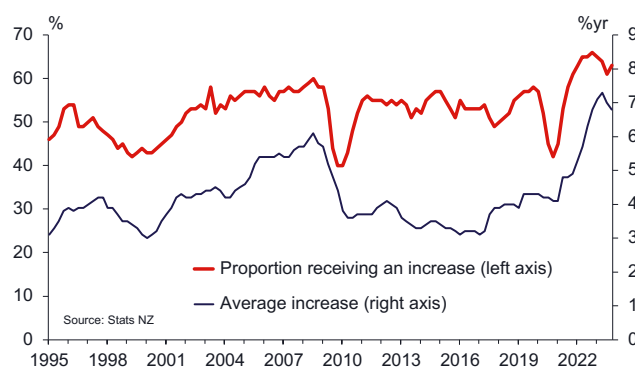
Private sector wage inflation has clearly passed its peak; what's less certain is whether it will continue to track down to something more consistent with 2% inflation. The breakdown of the LCI shows that while the average pay increase is getting smaller, the breadth of pay increases remains very high (and actually ticked up again in the latest quarter). That's quite different from what

we've seen in previous downturns, and adds to the risk that inflation pressures could prove harder to dislodge this time.

Public and private sector wage growth



Distribution of private sector wage growth



Implications for the RBNZ.

The RBNZ will be left with a lot to contemplate in its Monetary Policy Statement later this month. The stronger than expected labour market figures will need to be balanced against weaker near-term growth and a greater than expected easing in consumer price inflation. But it seems safe to say that the RBNZ will be much less inclined towards interest rate cuts this year than what the market is currently pricing.

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