

Q4 Labour Market Data Preview

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Is that your best offer?

- We expect to see a small bounce in the unemployment rate from 3.9% to 4.1% in Q4. Last quarter we saw a large fall, likely reflecting some noise, amidst genuine tightening in the labour market. But while the labour market is in a strong position, we may have seen the best this cycle has to offer.
- Wage inflation is expected to have firmed to 2.1% y/y, reflecting previous tightening in the labour market, the higher minimum wage, and a boost **from last year's nurses' pay settlement**. But underlying wage inflation is expected to continue to improve only gradually.

Key points

December quarter labour market statistics are released on 7 February.

We expect to see an increase in the unemployment rate from 3.9% to 4.1% in Q4 (seasonally adjusted), **after last quarter's** very large, unexpected drop of 0.5%pts. The unemployment rate can be volatile at times and we expect the **extent of last quarter's** fall probably partly reflects noise in the data. That said, we are inclined to give the data the benefit of the doubt and take a fair degree of signal from the genuine tightening in the labour market on the back of acute labour shortages and previous strength in the economy.

Looking through the noise, the labour market is expected to have been broadly stable in the December quarter, consistent with continued – but moderating – GDP growth and cautious hiring intentions in business surveys. Employment growth is expected to soften from 2.8% to 2.6% y/y. In the quarter, employment is expected to have grown a soft 0.3%, with an element of **pay-back from last quarter's strong 1.1% q/q print**. Labour force participation is expected to have remained elevated at 71% of the working-age population.

Given **recent data volatility**, **next week's labour market** release is surrounded by a greater-than-usual degree of uncertainty. We would not be surprised to see further noise (and/or revisions). Indeed, there is a real risk that we see a greater bounce in the unemployment rate than we currently expect, given the **extent of last quarter's fall**. But until we hear otherwise, the data is what it is. **We don't want to discount** the possibility that a bounce-back may not occur – **the extent of last quarter's fall is not unprecedented**.

Either way, it's fair to say that the labour market is currently in a strong position, with spare capacity having been absorbed following a number of years of solid economic expansion. This strength has been supporting household sentiment and spending. But growth momentum has continued to fade of late and clouds are forming over the outlook, with a number of headwinds expected to make strong growth from here a challenge. It appears likely we have seen the best this cycle has to offer, with further meaningful improvement in the labour market looking difficult to achieve.

In light of this, we expect the labour market to tighten only very modestly over the medium term, as the net migration cycle eases. We expect to see continued, but not spectacular, employment growth – consistent with our view that it will be difficult for the economy to grow above trend.

December 2018 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	4.1%	3.9%
Participation rate (sa)	%	71.0%	71.1%
Employment (sa)	q/q	0.3%	1.1%
Employment	y/y	2.6%	2.8%
Wages			
LCI private sector wages (ex-overtime)	q/q	0.6%	0.5%
LCI private sector wages (ex-overtime)	y/y	2.1%	1.9%
QES private sector hourly earnings	q/q	0.3%	1.4%
QES private sector hourly earnings	y/y	3.0%	3.6%

We expect that wage inflation firmed in December quarter. Nominal LCI private sector wages are expected to have risen **0.6% q/q, with the nurses' pay** settlement expected to provide a boost. The impact of this is uncertain, but we have pencilled in a 0.1%pt contribution. Annual wage inflation is expected to have firmed from 1.9% to 2.1% y/y, **with Q2's** increase in the minimum wage continuing to contribute; we estimate +0.2%pts from this.

Temporary factors aside, we also expect to see a nudge higher in underlying wage inflation from 1.7% to 1.8% y/y, reflecting recent tightening in the labour market. Underlying wage inflation remains fairly subdued, and has inched up only very gradually – a trend we see continuing. In coming years, we expect wage inflation will be boosted by further increases in the minimum wage (to \$20 per hour by 2021), with some spill-over effects to pay discussions more generally. But underlying wage inflation is expected to increase only modestly, reflecting previous tightening in the labour market and lingering weakness that is expected to dissipate only slowly.

Although nominal wage inflation has been weak, productivity growth has been low too, and labour costs for firms have risen in real terms. Firms are finding it very difficult to find skilled labour and rising labour costs are adding to downbeat sentiment, given an apparent limited ability to pass these costs on.

In light of the headwinds we see building for the economy, we remain of the view that OCR cuts will eventually be needed to keep the labour market near its maximum sustainable level and see inflation return sustainably to target.

Figure 1. Participation and unemployment rates



Figure 2. Employment and economic growth

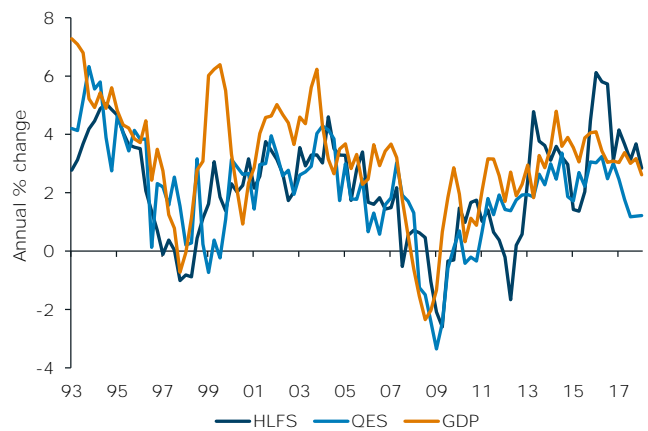
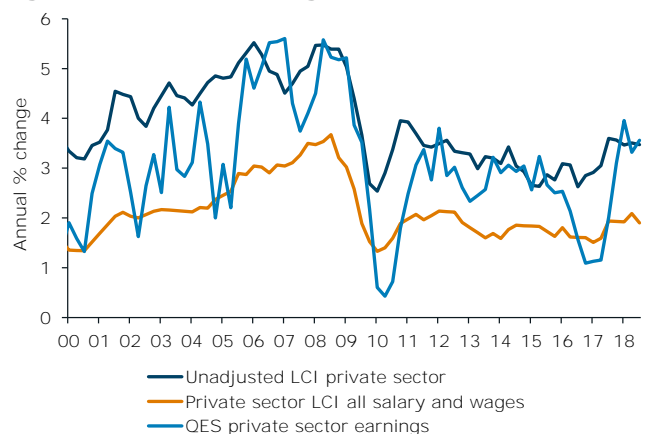


Figure 3. Unemployment and ease of finding skilled labour



Figure 4. Measures of wage inflation



Source: ANZ, Statistics NZ, NZIER



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