ANZ Research

Q3 Labour Market Data Preview

26 October 2021

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Muddying the water

- Stats NZ release Q3 labour market data on 3 November next week. The data will be very noisy – mixing pre-lockdown momentum with the sudden stop as we headed into Level 4. The full impact of lockdown probably won't be visible until we get the Q4 data (due in February).
- We expect the unemployment rate fell to 3.8% in Q3 (4.0% previous) due to strong employment in the first part of the quarter. Lockdowns will add noise, but looking ahead to 2022, we expect the unemployment rate to continue falling, bottoming out at 3.5%.
- Wage inflation is likely to come in strong – we think private sector labour costs were up 2.7% y/y, and that hourly earnings rose 4.3% y/y in Q3. Those increases aren't keeping up with inflation – we expect wage inflation will increase significantly over the next year, reflecting the cost of living and further labour market tightening.
- Uncertainty is high, and the data could easily come in well ahead of expectations. If it did, that would only reinforce market pricing for a 50bp hike in November. But +50bp would cause a lot of volatility and sit uncomfortably with near-term COVID risks. A similar degree of tightening could be achieved with more optionality by signalling a higher OCR track in the MPS, and/or even adding in a one-off January Review, which has always been an odd hole in the monetary policy calendar.

The view

Labour market data for the September 2021 quarter are released on 3 November. The data are going to be nothing if not noisy. With the latest lockdowns happening in the middle of the quarter, the data will be a strange mix of the considerable pre-lockdown momentum this economy had, plus the sudden stop as the country was plunged into Alert Level 4. There is a wide range of outcomes that we could see next week, really depending on how these two opposing forces balance out.

On the momentum side of the ledger, monthly filled jobs data for July and August showed remarkable strength, given that difficulty finding labour is hovering around record highs. Even in August, of which the country spent half in Level 4 lockdown, filled jobs were up an impressive 0.7% m/m (3.9% y/y). And while these data don't always line up exactly with the HLFS employment data, they're a reasonable indicator of the employment trend (figure 1, over).

Given the strength in the first two months of Q3, it would take a loss of jobs in September almost as large as in April 2020 for filled jobs to decline on a quarterly basis. And we don't think that's likely – firms have learnt the hard way over the past year that workers are incredibly scarce and valuable right now, so they will do their utmost to retain workers. The wage subsidy should have helped in that regard.

We're forecasting that employment rose 0.4% q/q in the September quarter (1.1% previously). The number could easily be stronger than that if the strength in filled jobs translates directly into the number of people entering employment, but it could also be weaker if September was particularly bad for job losses.

September 2021 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	3.8%	4.0%
Participation rate (sa)	%	70.6%	70.5%
Employment (sa)	q/q	0.4%	1.1%
Employment	y/y	2.7%	1.7%
Wages			
LCI private sector wages (ex-overtime)	q/q	0.9%	0.9%
LCI private sector wages (ex-overtime)	y/y	2.7%	2.2%
QES private sector hourly earnings	q/q	1.8%	0.7%
QES private sector hourly earnings	y/y	4.3%	4.5%

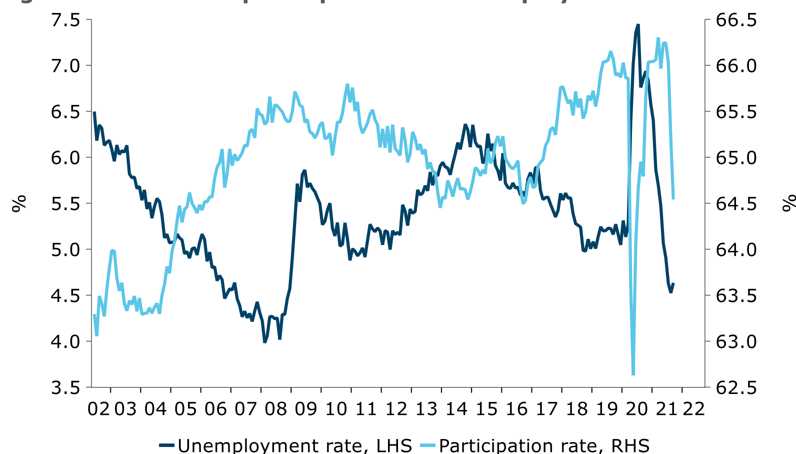
Figure 1. Employment and monthly filled jobs

Source: Stats NZ, Macrobond, ANZ Research

Participation is another source of uncertainty. During 2020, the participation rate fell, with people leaving the labour force as they waited out lockdown or had to look after young families with schools closed. It's possible we'll see a repetition of this in Q3 (albeit smaller) – but again, economic and labour market momentum were so strong coming into August, that it seems unlikely participation would have declined on a quarterly basis. In fact, we're assuming that the participation rate ticked up slightly to 70.6% in the September quarter (70.5% previously). That's really just rounding error – participation is hard to pick at the best of times and could easily be higher or lower.

Taken together, a positive print for employment combined with a slight uptick in participation implies a reduction in the unemployment rate from 4.0% in Q2 to 3.8% in Q3. This would be a much better news story than what we've seen in Australia (figure 2), where unemployment has remained near its post-GFC low due only to a plunge in participation – masking the loss of hundreds of thousands of jobs due to lockdown in Victoria and New South Wales. Clearly, the details of next week's New Zealand data are going to matter more than the headline unemployment number.

Figure 2. Australian participation and unemployment rates



Source: ABS, Macrobond, ANZ Research

It's really uncertain how changes in participation and employment will balance out – and we would be cautious about pinning too much on a single number, especially since Q4 is more likely to be where the pain from the current COVID restrictions really starts to bite. Table 1 shows a range of

unemployment outcomes based on different assumptions about employment and participation. Even smallish misses in our forecasts could see unemployment come in between 3.1% and 4.8% – a sizeable range. And forecast misses in the time of COVID have been anything but small.

Table 1. Range of possible unemployment rate outcomes

		Participation (last 70.5%)		
	Darker blue = more likely	Falls to 70.4%	Remains flat at 70.5%	Lifts to 70.6%
Employment growth (q/q, last 1.1%)	Strong increase (0.5% to 1.0%)	3.1%-3.6%	3.3%-3.7%	3.4%-3.9%
	Flat or small increase (0.0% to 0.4%)	3.7%-4.1%	**3.8%-4.2% Central 3.8%**	4.1%-4.4%
	Small fall -0.1% to -0.3%	4.2%-4.4%	4.3%-4.5%	4.5%-4.8%

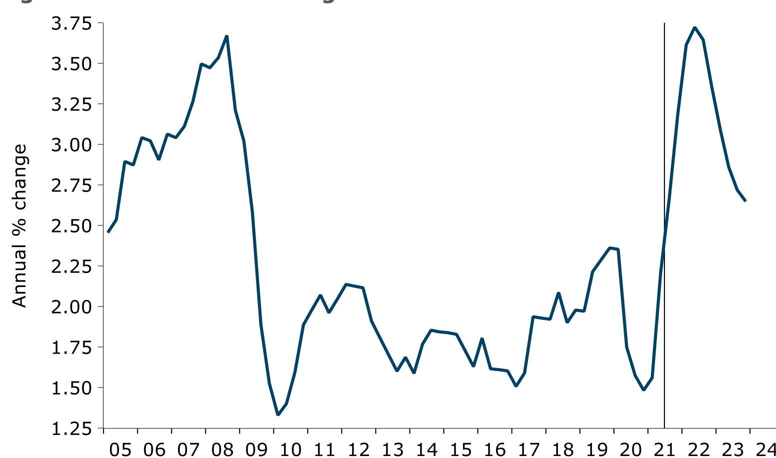
Source: ANZ Research

Turning to wages, Stats NZ released a note last week highlighting how the latest round of labour market data were affected by lockdown. The short answer for wages is that they weren't, really. The reference date for the Labour Cost Index was 15 August, before lockdown, and for the Quarterly Employment Survey, the data were for the pay period on or before 20 August – so just two days of Level 4. That means wages data should reflect the incredible level of labour market tightness we've seen develop over the past year, but won't capture any lockdown impact. We've pencilled in a 0.9% q/q (2.7% y/y) rise in labour costs, and a 1.8% q/q (4.3% y/y) rise in average hourly earnings.

Those numbers are very respectable compared to the post-GFC experience, but it's worth remembering two things. First, there was a period of several years prior to 2009 where labour costs rose over 3% on an annual basis. And second, our Q3 pick for hourly earnings is still well short of what's needed to make up for the 4.9% increase in living costs seen in the 12 months to September, and the 5.8% annual increase we're forecasting for Q1 2022. Wages take time to adjust, and we expect that the tight labour market and painfully high increases in the cost of living should see labour costs rise steeply in coming quarters (figure 3).

Firms will need to pay through the nose to attract and retain workers. The power is in the hands of employees in a way not seen since before the Global Financial Crisis. Firms who don't realise that may find themselves receiving resignation letters as workers jump ship for better offers.

Figure 3. Private sector wage inflation forecast



Source: Stats NZ, Macrobond, ANZ Research

Q4 and beyond

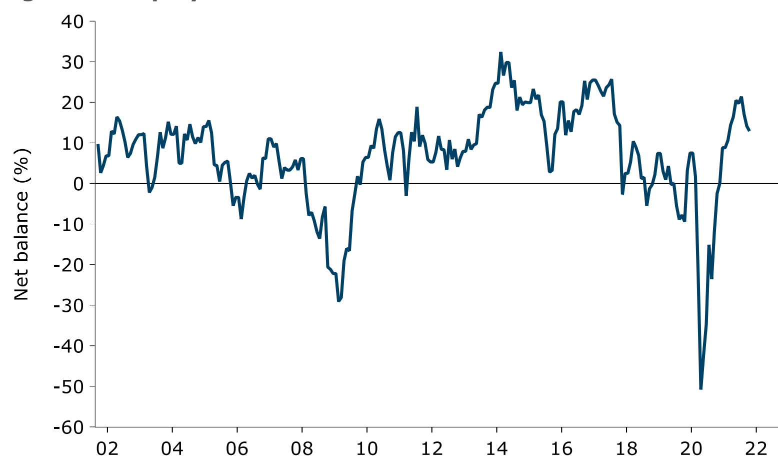
Even if unemployment does decline in Q3, it's not clear how much of a signal we should take from it. Lockdown has continued to drag on, so it's likely that employment over Q4 will be pretty weak (possibly falling). We're tentatively assuming that employment growth was flat in Q4, with the unemployment rate ticking up to 4.0%.

Clearly there's going to be quite a bit of noise in the labour market data over the next six months. So to put things into context, we've updated our medium-term forecast too. This is obviously likely to change with next week's starting point data, but the broad story is likely to remain similar, and presenting them here is helpful context for interpreting next week's data.

Moving into next year, it looks like while COVID restrictions aren't going to disappear any time soon, they will gradually become less onerous as vaccination rates rise. And that means economic activity should be able to pick up, hopefully without too much scarring from the latest lockdown. We therefore expect that, as long as the wheels don't fall off the economy (and in particular, the housing market), we should see the labour market continue tightening.

We expect that the unemployment rate could drop to a low of around 3.5% over 2022 – a level we've seldom seen in data stretching back to 1986. That's a bit better than our previous expectation of a 3.8% low for the unemployment rate, and reflects not just the strength in filled jobs over July and August, but also the continuing resilience of forward-looking indicators like employment intentions, which are still well-above pre-COVID levels (figure 4).

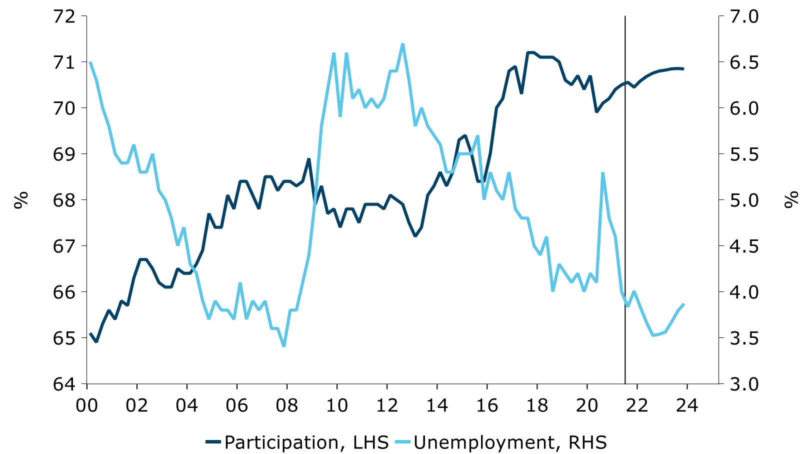
Figure 4. Employment intentions from the ANZ Business Outlook



Source: Macrobond, ANZ Research

With the RBNZ expected to raise the OCR to 2.00% by the end of 2022 (which we would consider a contractionary level), we do expect to see unemployment nudge up a tad in 2023, settling just under 4% in the longer run (figure 5). That is of course an "all going well" forecast, with downside risks to growth and upside risks to inflation not manifesting.

Figure 5. Unemployment and participation rate forecasts



Source: Stats NZ, Macrobond, ANZ Research

RBNZ implications

If labour market developments pan out as we expect, it would support our current forecast of 25bp OCR hikes at every meeting up to and including August, taking the OCR to 2%.

However, it's quite easy to envisage a scenario where the data next week are so strong that the urgency for monetary policy tightening is ratcheted up yet another notch. For example, we could see the unemployment rate drop into the low 3s, even with rising participation over the quarter (a more intense version of the top right cell in table 1). If the details are that strong (ie the super-low unemployment isn't due to falling participation, which would be a weak or just noisy signal), the risks of a wage-price spiral would be front and centre for the RBNZ.

In that instance, market odds on a 50bp hike in November (currently 25%) would likely rise. While we wouldn't rule it out, at a time of such extreme COVID-related near-term uncertainty that would be very bold, and not consistent with the kōtuku speech about treading cautiously at such times. A stitch in time saves nine, but there are gentler ways of delivering more tightening that preserve more optionality should downside risks materialise.

One of these options could be simply forecasting a higher terminal OCR in the November MPS. That would be credible, and cause swap rates to rise further, taking mortgage rates with them. Alternatively, or in addition, the RBNZ could consider adding in a Monetary Policy Review in January, filling in what's always been an odd gap in the monetary policy calendar. One of the strongest arguments for a 50bp hike is that it's a very long time until the February Monetary Policy Statement. So why not just fix that? It is not unheard of for the RBNZ to adjust its meeting dates – last year the RBNZ MPC met for at least two unscheduled meetings, and the March meeting was cancelled. Of course, we're not in the thick of a crisis, but things are very uncertain, and by January, we'll have a better steer on how reopening from COVID was going. It seems like a win-win to us.

To be clear, our central view is that next week's data will not force the RBNZ's hand to hike 50bps or consider the alternative strategies mentioned above. A noisy outturn that raises as many questions as it answers seems most likely. But given how much uncertainty there is right now, we can't rule out a very strong release, and it is worth highlighting the potential paths the RBNZ could take in that instance.

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