ANZ Research

Q4 Labour Market Preview & Forecast Update

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Contact

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A bit revealing

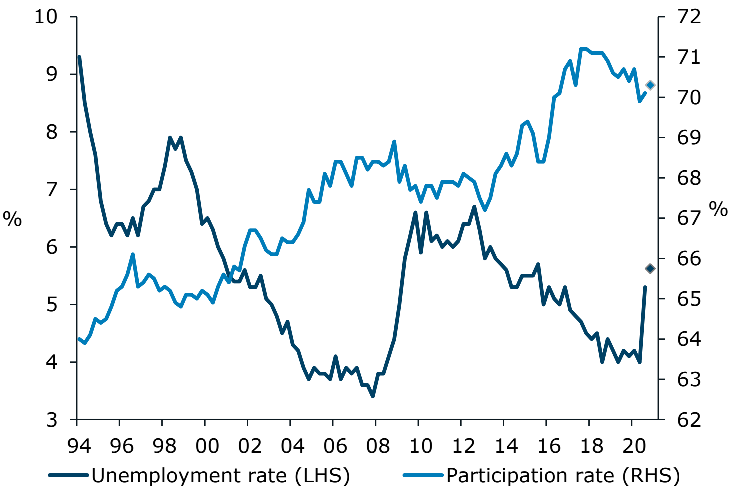
- Data out next week may be noisy but will nonetheless provide more clarity on the extent of recent deterioration in the labour market. The unemployment rate is expected to sit around 5½% (ANZ forecast: 5.6%), with risks tilted to slightly higher. Wage growth is expected to remain soft.
- There is some spare capacity in the labour market, but conditions are much better than previously feared due to our strong economic recovery and policy supports. The medium-term outlook has also improved.
- Weaker economic momentum this year will weigh on employment, keeping the RBNZ cautious. Improvement is expected towards year end, but will be sluggish until the border opens. After that, unemployment is expected to fall faster, raising the spectre of policy normalisation in time.

Key points

Labour market data to reveal a little more underlying weakness

December quarter labour market data are released Wednesday 3 February. Overall, a rise in unemployment is expected from 5.3% to 5.6%, revealing a little more underlying weakness in the labour market. This compares with a pre-COVID rate of around 4%. The deterioration in Q4 does not reflect a significant worsening in conditions over the quarter. Rather, the full extent of previous deterioration will be seen as people return to the labour force and measurement difficulties subside. We are assuming that we see an increase in the unemployment rate on account of slightly higher labour force participation as economic activity has returned to normal (figure 1), but equally we could see revisions to the labour market data over history.

Figure 1. Participation and unemployment rates



Source: Stats NZ, ANZ Research

Employment is expected to have increased modestly (+0.1% q/q), after last quarter's fall (-0.8% q/q). This is the first quarter in which wage subsidy support had rolled off. But a vigorous bounce in Q3 GDP has provided a strong offset. Fluctuations in employment have been very mild compared with the swings we have seen in GDP on account of lockdown. This reflects

December 2020 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	5.6%	5.3%
Participation rate (sa)	%	70.3%	70.1%
Employment (sa)	q/q	0.1%	-0.8%
Employment	y/y	0.0%	0.2%
Wages			
LCI private sector wages (ex-overtime)	q/q	0.5%	0.4%
LCI private sector wages (ex-overtime)	y/y	1.5%	1.6%
QES private sector hourly earnings	q/q	-0.1%	1.4%
QES private sector hourly earnings	y/y	3.1%	3.4%

the strength of our recovery and the potency of policy supports, especially the wage subsidy, in keeping workers attached to their employers, ultimately protecting jobs and incomes.

Noise in the data is possible; modest upside risk to unemployment

Measurement difficulties are expected to have subsided somewhat in Q4, but there is still potential for noise in the data or an unexpected outcome as we learn more, especially on account of potential historical revisions or movements in participation (table 1).

While we expect to see a lift in the labour force participation rate after it tanked when lockdown hit, the extent of retracement this quarter is a key uncertainty and we could see a sharper rise. Likewise, employment could surprise us. The range of available short-term labour market indicators suggest a flat to modest increase in employment is the most likely outcome, but these data can be volatile at the best of times.

Given measurement difficulties on account of lockdown, upward revisions to the unemployment rate in recent quarters would not surprise us. And quite separate from that, known upward revisions to the working-age population will be incorporated, reflecting adjustments for information flow from outcomes-based migration data. This is expected to lead to historical shifts across labour market series. It will change the pace and profile of employment growth over recent history, and could alter the exact combination of employment and participation underlying a given unemployment rate.

Bearing all this in mind, the outcome next week is highly uncertain. We could imagine outcomes for Q4 in the range of 5% to 6½%, with something in the range of 5.4-5.8% considered most likely. Relative to our pick of 5.6%, we see risks as being skewed modestly towards a higher print, with 5.7% the most likely alternative. But despite uncertainty and potential for noise in the data, we think the trend of recent deterioration will be clear.

Table 1. Possible unemployment rate outcomes (last: 5.3%)

		Participation (last: 70.1%; pre-COVID 70.7%)		
Employment	Darker blue = more likely	Unchanged 70.1%	Partial bounce *Central: 70.3%*	Strong 70.5%
	Lift +0.4 to 0.6%	4.9-5.1%	5.2-5.3%	5.4-5.6%
	Broadly unchanged -0.1% to 0.3% *Central: 0.1%*	5.2-5.5%	**5.4-5.8% Central: 5.6%**	5.7-6.1%
	Soft -0.2% to -0.4%	5.6-5.8%	5.9-6.1%	6.2-6.4%

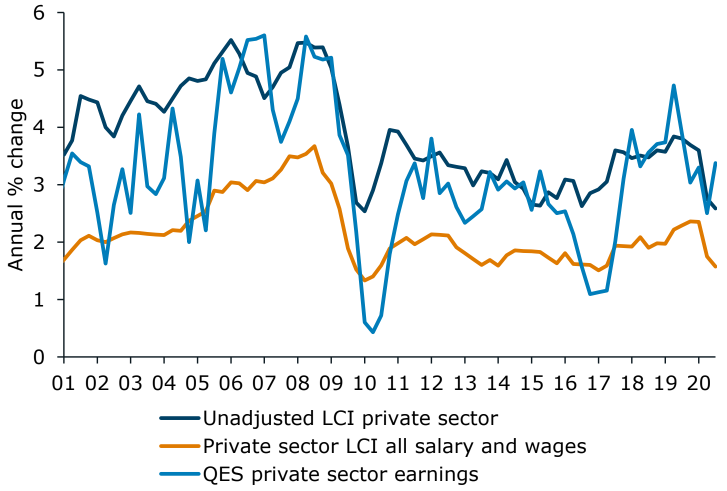
Source: Stats NZ, ANZ Research

Wage inflation to remain weak

Wage inflation is expected to have remained soft in Q4, but lift a little in quarterly terms. Our preferred measure of wage inflation – the LCI adjusted measure – is expected to have lifted 0.5% q/q, following last quarter's 0.4% lift, retracing some of the extreme weakness seen through Q2 and Q3 on account of lockdown, in spite of the minimum wage increase.

Overall, though, wage inflation remains modest, with annual inflation forecast to dip from 1.6 to 1.5% y/y (figure 2). Firms are likely reluctant to put through higher wages in light of uncertainty and other cost pressures. However, divergent outcomes by industry are likely – as with employment. Skill shortages may see pressures in some pockets, but weakness in other areas. The QES measure of wages has been volatile, and is expected to show some technical retracement from last quarter's strong print, softening from 3.4 to 3.1% y/y.

Figure 2. Measures of wage inflation



Source: Stats NZ, ANZ Research

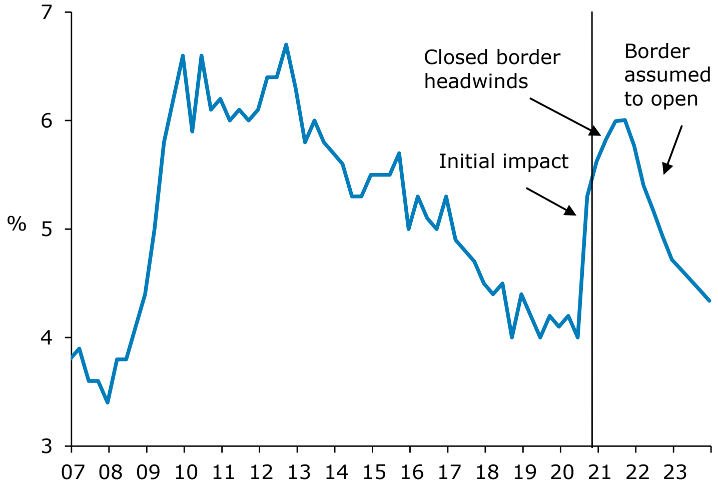
Economic wobble to weigh this year, but outlook better

Some spare capacity in the labour market has opened up in aggregate, but conditions are clearly much better than was expected when we were looking down the barrel of the COVID-19 crisis, and the outlook has continued to improve – meaning a negative OCR is now looking unlikely. Significant divergence is evident, however, with firms in some industries shedding workers, while others grapple with acute skill shortages.

As we move through 2021, we expect that economic headwinds, and their impacts on particular sectors, will become more apparent too, weighing on overall employment and seeing a further gradual lift in the unemployment rate. The impact of this phase of the economic downturn is expected to have a greater-than-usual effect on employment, reflecting the fact that industries most affected by the closed border tend to be quite reliant on labour.

But overall, the outlook has improved – and we have recently updated our forecasts to reflect this. With the starting point and outlook for GDP looking more positive, the labour market is expected to fare better than we had expected last year. Unemployment is expected to peak around 6% in the middle of this year (previously 7%). From there, improvement is expected to be gradual prior to border reopening, with headwinds weighing on broader economic activity, and skill mismatches remaining a problem. Once the border opens, a more rapid improvement in the labour market will be possible, particularly as the recovery accelerates and evens out. Spare capacity will linger for a while, but is forecast to dissipate by early 2023.

Figure 3. Unemployment rate forecast



Source: Stats NZ, ANZ Research

Wage inflation to remain soft, but not deteriorate markedly

Wage inflation is expected to remain modest, particularly in the short term, with annual wage inflation to trough at 1.4% y/y in Q1. But we do not expect to see a significant deterioration from there. Spare capacity and a low inflation environment will weigh, but skills mismatch is expected to provide some offset, while a further increase in the minimum wage on 1 April will provide a further boost – but likely dampen employment relative to otherwise.

Overall, for a given level of unemployment, wage inflation is expected to be slightly higher, temporarily, through this next phase of the COVID crisis. This is because the closed border and divergent outcomes across the economy have made it harder to match the right people to the right jobs. That means that although wage inflation will improve slowly, we do not expect to see a marked deterioration, even as the unemployment rate increases a little more. Once we see the border reopen and the unemployment rate fall, this will see wage inflation improve, but again only gradually as skills mismatch eases.

Labour market conditions to keep RBNZ cautious

Continued deterioration in the labour market early this year is expected to weigh on the RBNZ's thinking, underpinning our view that the LSAP timeframe will be extended in February and the OCR will be taken a little lower in May to finish the easing cycle.

But the outlook for policy is delicately balanced. The RBNZ's November MPS forecasts included a peak in the unemployment rate of 6.4%, but we expect this will be revised down on the back of a buoyant housing market, resilient business sector and better starting point and outlook for GDP. The starting point and outlook for inflation has also improved.

The RBNZ is forward looking and focused on the medium term and the outlook is clearly better, but they will also want to see improvements in the economy realised (not just forecast), given the spectrum of risks. This tension makes deliberations difficult. On balance, with labour market outcomes still moving in the wrong direction for now and downside risks ever-present, we think that a little more easing remains the path of least regrets to shore up the outlook.

But the question of eventual policy normalisation is starting to loom, too. With the RBNZ very active in providing stimulus while the outlook has been precarious, they will likewise not want to be sluggish to tighten once their goals are reached.

Scope for steady improvement in unemployment and inflation over 2022 raises the possibility of monetary policy normalisation once downside risks recede (once COVID-19 herd immunity is reached, in particular) and the RBNZ’s targets are firmly in view. Based on our current forecasts, the labour market and inflation will be at or near their targets in mid-2023, at which point the RBNZ may be comfortable with embarking on policy tightening. But there is a lot that could happen between now and then: upside risks could bring this timing forward into 2022, while downside risks could see alternative tools, like a negative OCR, deployed or the OCR remaining at its record low for much longer. A gradual approach to normalisation seems likely based on the current outlook, but the speed of tightening will ultimately depend on economic momentum as headwinds recede and the recovery accelerates.

For now, we maintain the view that tightening will be off the table until the outlook is more assured, with risks skewed towards more stimulus, not less, over 2021, especially with unemployment still rising. But a path to normality does look to be within our sights, even if the road ahead is bumpy, and risks to the outlook are in both directions.

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