ANZ Research

Labour Market Stats 2021Q2 & OCR call change

4 August 2021

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Contact

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Data summary

		Latest
Labour market		
HLFS unemployment rate (sa)		4.0%
HLFS participation rate (sa)		70.5%
HLFS employment (sa)	q/q	1.0%
HLFS employment	y/y	1.7%
HLFS hours worked (sa)	q/q	1.6%
Wages		
LCI private sector wages (ex-overtime)	q/q	0.9%
LCI private sector wages (ex-overtime)	y/y	2.2%
QES private sector hourly earnings (ex-overtime)	q/q	0.7%
QES private sector hourly earnings (ex-overtime)	y/y	4.5%

Boiling point

Bottom line

- **We now expect the OCR will be raised at the August, October, and November meetings, with two more hikes in February and May bringing the OCR to a terminal rate of 1.5% by mid-2022.**
- Today's data shows we've flown past full employment, and the economy is becoming quite overheated. The RBNZ needs to hike the OCR promptly to get on top of this. We now expect faster hikes this year, but have tweaked our OCR endpoint down from 1.75% to 1.5% in light of the RBNZ's recent announcement that they will further tighten macroprudential policy.
- The unemployment rate dropped again to 4.0% in the June quarter, lower than our forecast for 4.4%. That's well below a downwardly revised 4.6% in Q1, and the peak of 5.3% in Q3 2020. Employment rose 1.0% q/q, more than offsetting a small uptick in participation to 70.5% (70.4% previous), leading to a much lower unemployment rate even as the labour force expanded.
- The tight labour market is flowing through into wages, with labour costs up 0.9% q/q (2.2% y/y), and average hourly earnings up 4.5% y/y in the year to June. Given the strength in today's data, we think that's only the beginning of strong wage rises this year. The balance of power in the labour market has shifted markedly towards workers over the past year, and this is showing up in employees' bank accounts.

The details

Today's labour market data emphatically confirmed signals from other more timely indicators: the labour market is extremely tight, workers are scarce, and wages are rising sharply – which is all contributing to unsustainably high underlying inflation pressure. The unemployment rate dropped sharply to 4.0% in the June quarter (4.6% previously). The number of unemployed people dropped 12.4% (17,000 people) in the June quarter, which Stats NZ note is a record decline. Unemployment is now down to a level that the RBNZ didn't even expect to reach by the end of their forecast horizon in the May MPS. Overall, measures of labour market slack show that employment has blown through its current maximum sustainable level.

There was broad-based strength across a range of key labour market metrics:

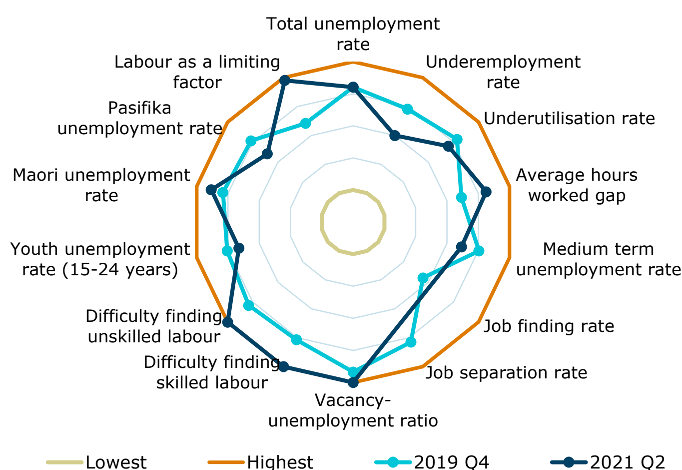
- Employment increased 1.0% q/q (1.7% y/y), versus 0.6% in Q1. The strength in employment that we've seen in recent quarters has been pleasantly surprising – given the difficulty finding labour reported by firms and the disruption from COVID, we initially thought the economy would struggle to add jobs at pace. But it looks like firms are having considerable success filling some of their record numbers of vacancies from the domestic labour force.

- The participation rate also continued its recovery, increasing to 70.5% (70.4% previously). While the longer-term outlook for the participation rate is negative (given the aging population), the current rebound is helping to ease some of the intense pressure in the labour market.
- Private sector labour costs were up 0.9% q/q (2.2% y/y) – that's a big increase in a slow-moving series. Private sector average hourly earnings (ordinary time) jumped 0.7% q/q (4.5% y/y) as the intense labour shortage shifts the balance of power in favour of workers, and as the most recent lift in the minimum wage to $20/hr lands in bank accounts. Public sector labour costs were up only 0.3% in the June quarter, possibly reflecting public sector wage restraint. On a quarterly basis, wages were a shade below our expectation, but these numbers are still very strong, especially in light of the lacklustre wage growth we saw after the GFC. And in the light of today's data, we only see wages accelerating from here. Notably, over half of the roles captured in the Labour Cost Index saw wage rates rise in the year to June 2021.
- Finally, underutilisation ticked down sharply by 1.6ppts to 10.5%, led by the fall in the unemployment rate. Given the RBNZ's emphasis on underutilisation in the July Monetary Policy Review, this is a very strong signal. Underemployment also ticked down to 3.8% (non-sa), below where it was in June 2019, and, consistent with an increase in average weekly hours worked to 34.1, from 33.9 previously.

Monetary policy implications

The RBNZ watches a wide range of labour market indicators to build up a full picture of labour market slack (or in this case, the lack thereof!). We've plotted these charts in figure 1. The innermost ring shows the worst outcome for each of these indicators since 2000, while the outer ring shows the strongest outcome. For comparison, we plot the indicators as they were in 2019 Q4 – when the RBNZ last assessed that we were at or even above full employment. As the RBNZ notes, we don't necessarily want to be on the outer ring, because that might mean that the economy is running too hot to be sustainable.

Figure 1. RBNZ labour market indicators*



*Job finding and separation rates not available yet for Q2

Source: Stats NZ, MBIE, NZIER, Macrobond, ANZ Research

An uncomfortable number of these indicators are now on the outside ring (ie as high as they've been in the past 20 years). The labour market has recovered extremely quickly, and in fact we're seeing a much tighter labour market than in 2019. Combine these indicators with the strength in wage inflation, and it's difficult to escape the conclusion that the economy has reached boiling point.

As we've said for some time now, the RBNZ can tick the labour market box. Once again, the labour market has leapfrogged their expectations, and by such a margin that the economy is looking even more stretched than we thought. The RBNZ is also overachieving on the price side of the dual mandate, with headline inflation expected to rise from 3.3% y/y in Q2 to a peak of 4.2% y/y in Q3 (with core measures also very strong). Surging wage inflation and inflation expectations mean that there is very strong underlying momentum in this inflation impulse too – it's not just a matter of temporary shipping disruptions. That means the RBNZ can't rely on transitory factors dropping out to get inflation back down – they need to act, and they need to act promptly.

As a result, we've tweaked our OCR call. We now expect the RBNZ will raise the OCR in 25 basis point increments at the August, October, and November meetings this year – promptly reversing the emergency stimulus provided at the start of COVID this year, and hopefully getting ahead of the inflationary curve. A tight labour market, strong wage and core inflation, and surging inflation expectations are a potent mix. While the headline numbers aren't problematic in themselves, the RBNZ will very concerned about the potential for things to escalate further, as that could result in needing to have interest rates higher for longer down the track, making a soft landing harder to bring about.

We expect that the RBNZ will raise rates further, but at a slower pace, at the February and May 2022 meetings, lifting the OCR to a terminal rate of 1.5% in mid-2022. That's a slightly lower level than our previous forecast of 1.75%.

The downwards revision to our assumption for the OCR endpoint reflects the RBNZ's proposal to further tighten loan-to-value ratio (LVR) restrictions for owner-occupiers, announced yesterday. The RBNZ is consulting on reducing the "amount of lending banks can do [for owner-occupiers] above an LVR of 80 percent to 10 percent of all new loans", from the current 20 percent level. If implemented, this would be in effect from 1 October 2021. They are also consulting on debt-to-income limits.

This tightening of macroprudential policy settings should weigh on the housing market, and wider economic momentum, lessening the need for OCR hikes further out, though the impact is highly uncertain. The faster unwind of the 75bp COVID OCR cuts also at the margin implies a lower endpoint will be needed to do the job of cooling the economy. With household debt at record highs and 80% of mortgage debt floating or fixed for less than a year, we don't doubt the Reserve Bank's ability to get traction.

Market reaction

The financial markets implications of our forecasts are nuanced, and that's because while on the one hand we are now calling for a more accelerated tightening profile in the near term, we have also shaved 0.25% off our OCR end-point. We now expect a trio of back-to-back hikes in August, October and November, followed by just two further hikes in H1 2022.

Today's data and our new OCR forecasts point to further yield curve bear-flattening as the short end grinds higher on the prospect of rapid-fire hikes by year-end, and the long end prices in a lower terminal rate. Our expectation is that it is the near-term outlook (ie the OCR moving higher sooner) rather than the terminal rate discussion that will dominate FX market sentiment, especially with the Fed and RBA both seemingly in no hurry to hike just yet, and the enormous uncertainty about how things will unfold next year.

While we're confident the RBNZ will promptly unwind its emergency cuts, market pricing will likely reflect the uncertainty about the medium-term outlook. We have already seen the NZD and expectations for the OCR move up following today's data, (with around 62bps now priced in by November, up from around 51bps at yesterday's close), but both markets likely have further to run. This data is consistent with the entire term structure of interest rates going higher, but the sooner the RBNZ gets started, the less work it likely has to do in total, and a lower terminal rate does suggest that rates will peak earlier at a slightly lower rate.

Figure 2. Unemployment and participation

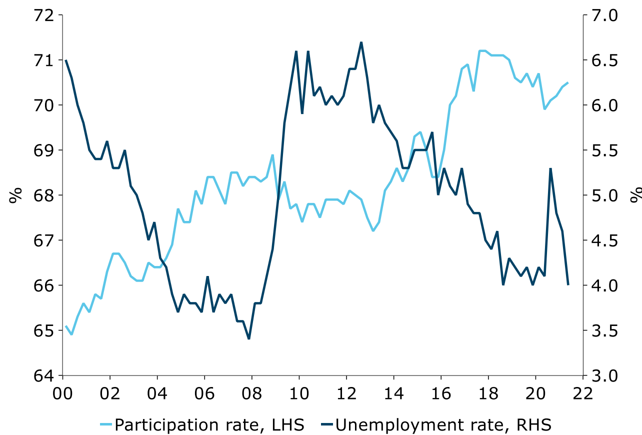


Figure 3. Employment and GDP growth

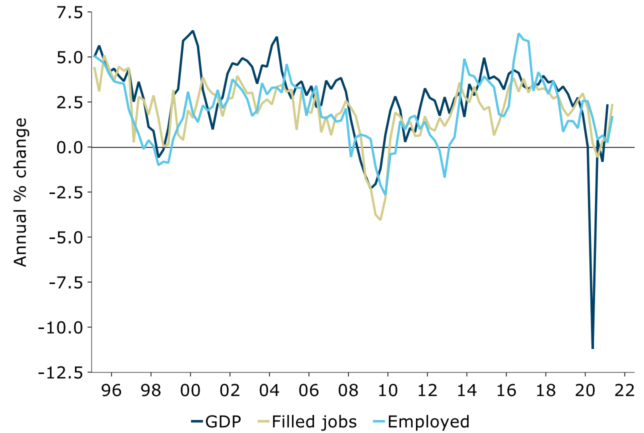


Figure 4. Change in employment by industry

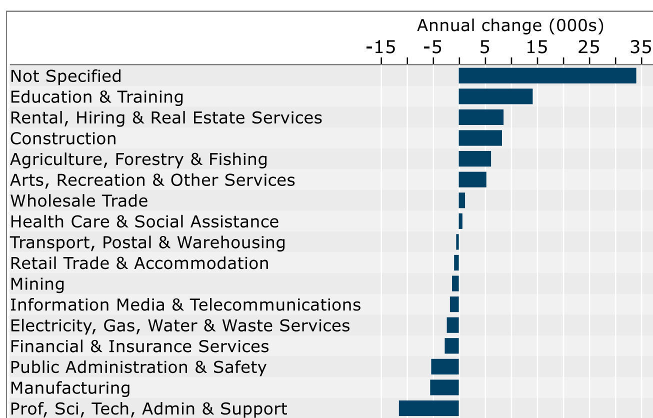
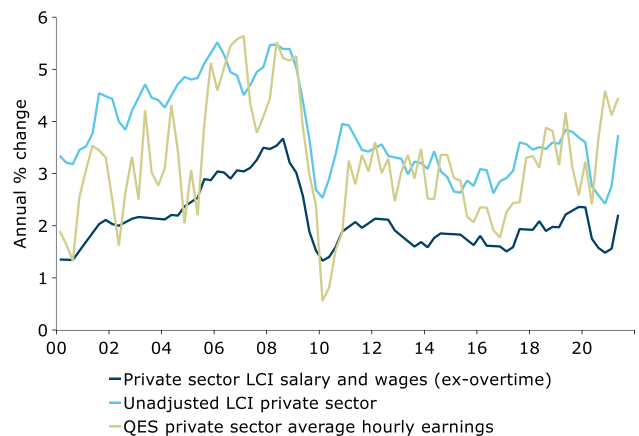


Figure 5. Wage growth – private sector



Source: Stats NZ, Macrobond

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