NZ Insight: Australia and NZ labour markets

14 September 2021

Authors

Catherine Birch
Senior Economist
+61 439 627 968
catherine.birch@anz.com

Finn Robinson
Economist
+64 21 629 553
finn.robinson@anz.com

Contact
research@anz.com

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Not just rugby: NZ beating Australia on wage growth

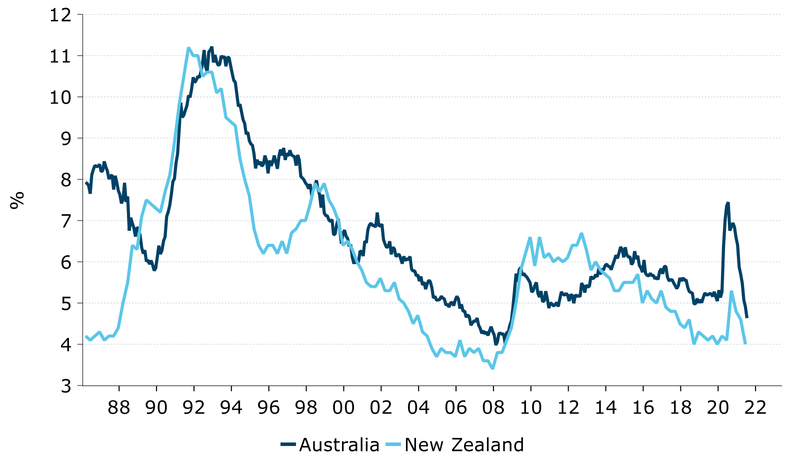
Summary

- There's a sharp disconnect between expectations for interest rate hikes by the RBA and RBNZ. We expect the RBNZ will increase the cash rate at its October 6 meeting, whereas we don't expect the RBA to raise the cash rate until the first half of 2024.
- One reason for this is that even though both countries have seen remarkable labour market recoveries over the past year, only New Zealand has seen wage growth pick up significantly, alongside rising core inflation.
- This may be down to the stronger New Zealand labour market in the years prior to the pandemic, the larger increase in unemployment in Australia during 2020, and the sharper rebound in household inflation expectations in New Zealand.
- The outlook for wage inflation in both Australia and New Zealand is positive, despite outbreaks of the Delta variant of COVID-19 weighing on current activity in both countries.

Policy divergence

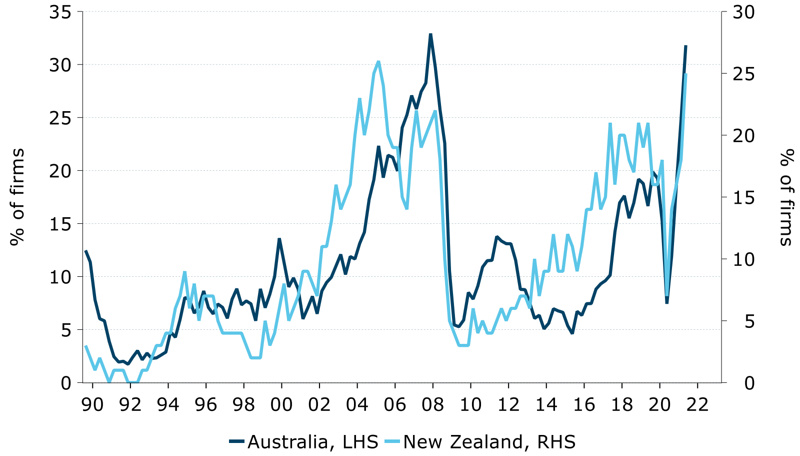
The New Zealand and Australian labour markets have experienced remarkable recoveries over the past year, with unemployment in both countries dropping back to post-2008 lows (figure 1). And labour as a constraint on business output is now around the highest levels we've seen across both countries (figure 2).

Figure 1. Unemployment rates



Source: RBA, Stats NZ, Macrobond, ANZ Research

Figure 2. Labour as a limiting factor/significant constraint



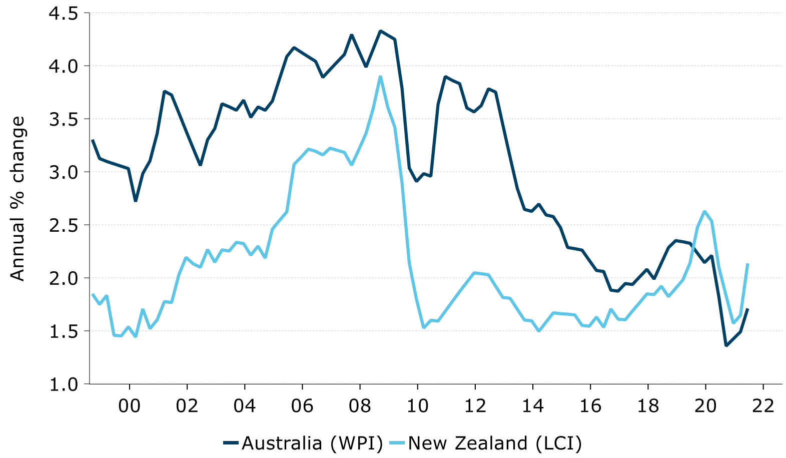
Source: NAB, NZIER, Macrobond, ANZ Research

Despite these remarkable recoveries, we're seeing a sharp disconnect in monetary policy expectations between the two countries. The RBNZ is raring to go with OCR hikes (we think they will pull the trigger in October), while we don't expect the RBA to begin lifting the cash rate until the first half of 2024.

Why is this? As we explored in a previous insight, one reason is that underlying inflation in Australia has remained stubbornly low, partly reflecting weaker wage growth (figure 3). And in contrast to New Zealand, wage growth across many industries in Australia remains below average (figure 4). Robust wage inflation is a key prerequisite for both central banks to be satisfied that they're achieving their goals – but so far, only one country can tick that box.

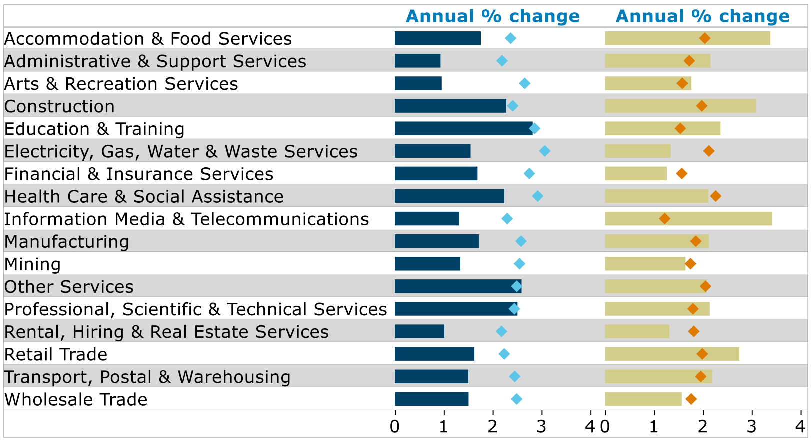
It's noteworthy that from the RBA's point of view, even New Zealand's wage growth of 2.1% y/y would still be too low to support a rate increase. But, it's also clear that wage growth is already accelerating in New Zealand. On a quarterly basis, private sector wages rose 0.9% - the largest single quarter increase since 2008, and we expect annual private sector wage inflation to peak at 3.1% in early 2022 – a very respectable number compared to most years since the 1990s.

Figure 3. Annual wage cost inflation (all industries)



Source: RBA, Stats NZ, Macrobond, ANZ Research

Figure 4. Annual wage cost inflation by industry (private sector)



Source: ABS, Stats NZ, Macrobond, ANZ Research

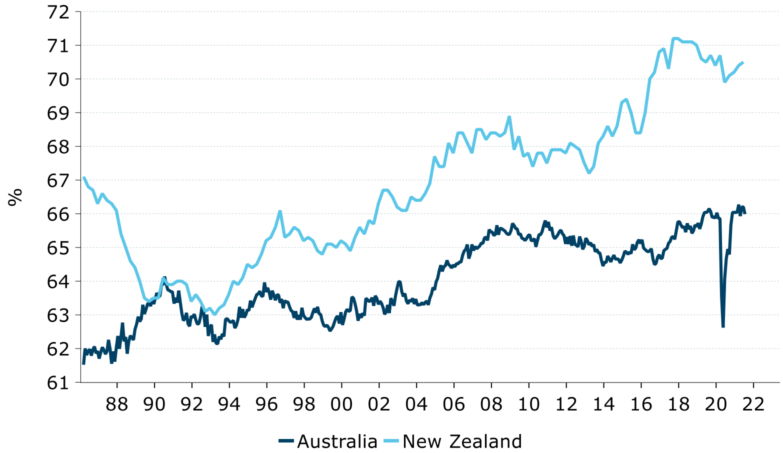
Both countries have experienced rapid labour market recoveries – so why is wage inflation relatively stronger in New Zealand? And what are wages likely to do across both countries going forward?

A stronger starting point

New Zealand entered 2020 with a labour market that the RBNZ judged to be "at or slightly above" maximum sustainable employment. Underlying inflation was building, and wage inflation was showing real strength for the first time since the GFC (although that was boosted by large minimum wage hikes and wage settlements in 2017). Also, compared to Australia, a significantly larger share of the New Zealand working-age population was both in the labour force (figure 5) and employed (figure 6).

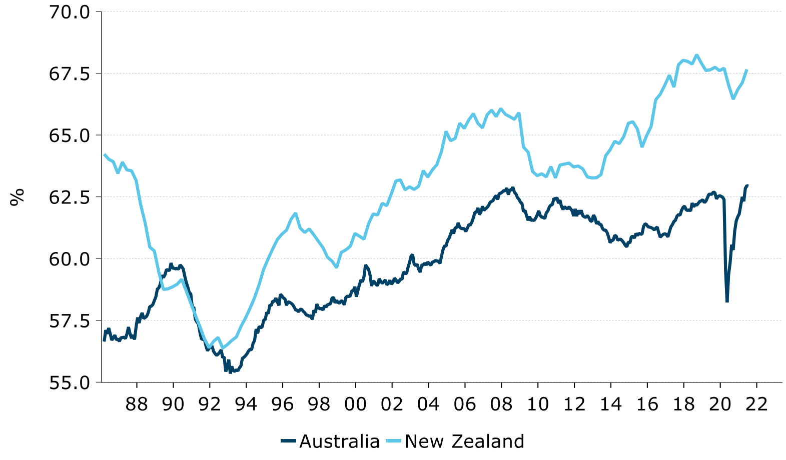
In contrast, Australian wage growth had slowed from 2.4% y/y at the end of 2018 to 2.1% y/y at the end of 2019 and trimmed mean inflation had slipped from 1.8% y/y to 1.6% y/y, further below the RBA's 2-3% target band. The unemployment rate was stuck in the low 5s and clearly above the non-accelerating inflation rate of unemployment (NAIRU), and there was no improvement in underemployment. Employment growth had slowed and labour productivity growth was stagnant.

Figure 5. Labour force participation rate



Source: Stats NZ, Macrobond, ANZ Research

Figure 6. Employment rate (% working-age population)



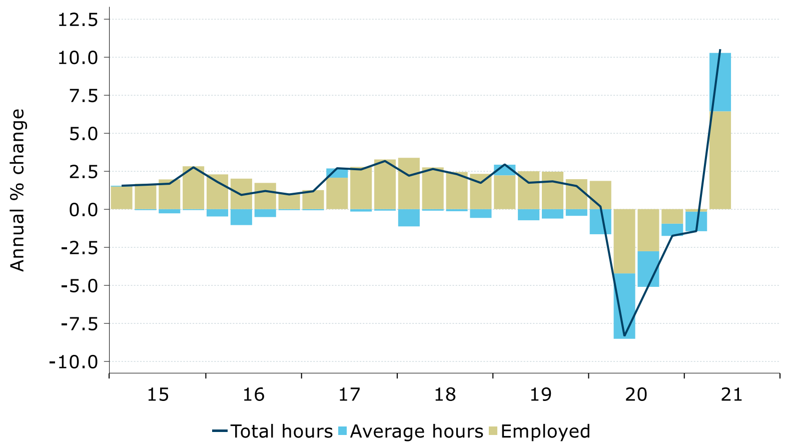
Source: RBA, Stats NZ, Macrobond, ANZ Research

A smaller hole to dig out of

The New Zealand labour market weathered the 2020 storm remarkably well, especially given that the Level 4 Lockdown was one of the strictest in the world. The Australian unemployment rate lifted from 5.1% pre-COVID to a peak of 7.4%, a much larger increase than New Zealand's (4.0% to 5.3%). While Australia's unemployment has since dropped to below pre-COVID rates (something New Zealand has yet to achieve), there were a lot more employment relationships severed by COVID than in New Zealand.

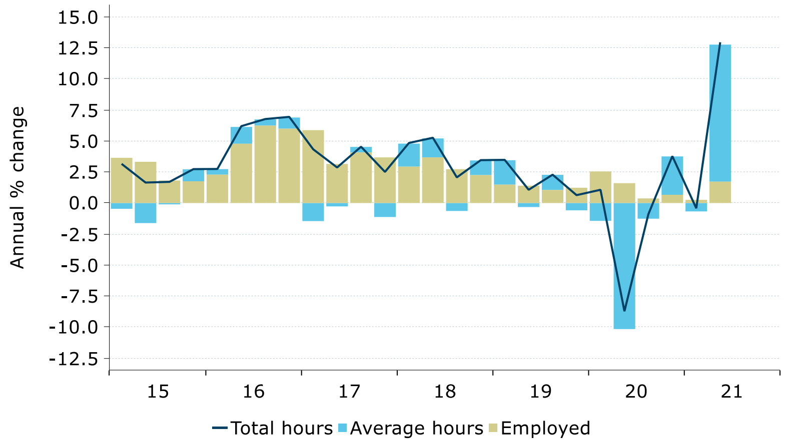
Generally speaking, labour markets tend to recover faster when firms adjust to tough times by reducing average hours worked, rather than letting people go. As we can see in figures 7 and 8, most of the adjustment in total hours worked in New Zealand came through average hours worked, whereas in Australia, about half of the adjustment came through people losing their jobs.

Figure 7. Australia contribution to change in total hours worked



Source: ABS, Macrobond, ANZ Research

Figure 8. New Zealand contribution to change in total hours worked



Source: Stats NZ, Macrobond, ANZ Research

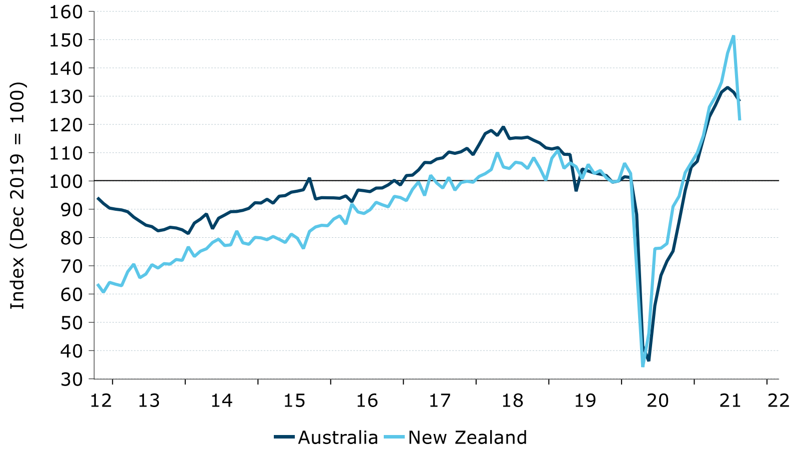
Hiring difficulties and disruption

Another factor that has already helped to drive wages higher in New Zealand – and should eventually do the same in Australia – has been the difficulty finding workers. Not only have borders been closed, but COVID-19 has impacted sectors very differently. Job losses have been concentrated in customer-facing areas, particularly tourism. Job vacancies have been in areas like construction, where workers often need to have formal training (eg apprenticeships). It's hard for people to move between industries and/or regions, especially when there are long stretches of time where the movement of people is almost completely curtailed by lockdown restrictions.

As we can see in figure 9, job vacancies in both Australia and New Zealand dropped sharply at the onset of the pandemic as firms ceased hiring, and in many cases were forced to let people go. But since then, the strength of the economic recovery in both countries has meant that businesses have struggled to keep up with strong demand. Strong domestic economic momentum has seen demand for Kiwi and Australian workers surge, with job vacancies now well above pre-COVID levels in both countries. With both borders still closed, firms who might usually take on overseas staff (particularly for seasonal work) have been forced to hire domestically – adding further pressure into already-tight labour markets. And even though large parts of Australia have been in lockdown over the past couple of months, ANZ Job Ads have only fallen 3.7% since June (compared with a 64% plunge in three months during the national lockdown last year). New Zealand job ads did fall 19.9% in August (ANZ seasonal adjustment), but so far that's a much smaller drop than in 2020, and job ads were still well-above pre-COVID levels.

Prior to the latest lockdowns, the strength in Australian job vacancies was broad-based across industries rather than being overly concentrated in industries with large shares of migrant workers. This suggests that closed borders aren't the only or even the most significant reason for increased difficulty finding labour, with almost a third of businesses reporting labour was a significant constraint on output in Q2. The strong economic recovery (again pre-lockdowns) and significant momentum in private sector demand, supported by the public sector, has underpinned escalating demand for labour and the tightening of the labour market, with labour supply constraints accelerating the process.

Figure 9. Job ads



Source: MBIE, Macrobond, ANZ Research

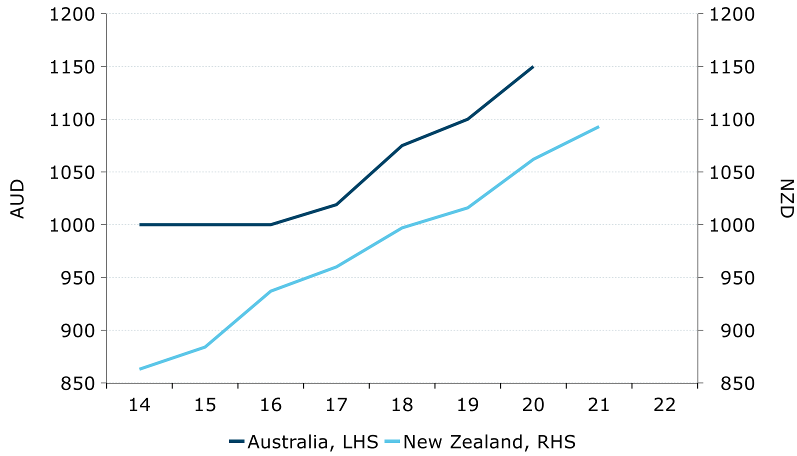
All up, that suggests there are more employers chasing fewer workers in both New Zealand and Australia, and that's putting the power in the hands of job-seekers. We've already seen this in New Zealand, with private sector wage costs up 2.2% y/y in June (and set to rise above 3% over the next year). While in Australia we're not seeing this translate into stronger wage growth quite yet, we do expect it to accelerate from late-2021 or early-2022.

Turning off the immigration tap

Historically, a big issue for New Zealand has been 'brain drain', ie skilled Kiwis heading overseas, including to Australia, to take advantage of higher salaries (and these days, lower living costs).

If we look at median weekly earnings data for Australia and New Zealand, it's clear that even though wage growth has been stronger in New Zealand recently, median incomes in Australia are still much higher, and the gap hasn't shrunk significantly over the past several years (figure 10).[1] That said, the net outflow of Kiwi citizens did slow remarkably over the 2010s (figure 11) – and research by the RBNZ has partly attributed this to relative improvements in the Kiwi labour market over that period.

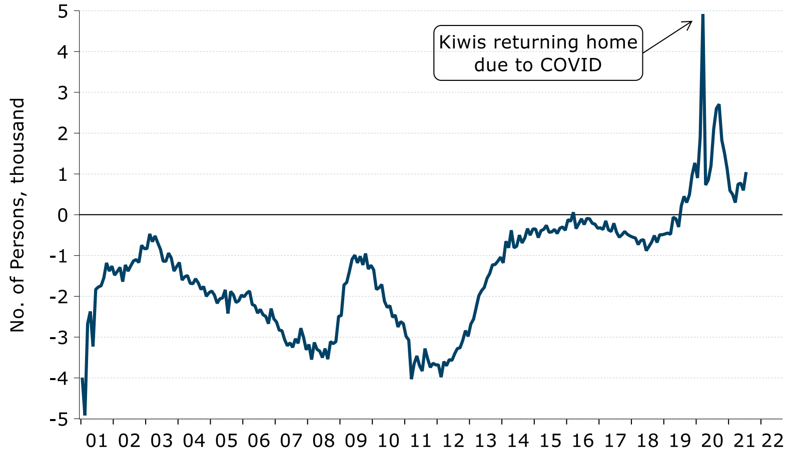
Figure 10. Median weekly incomes (AUD)



Source: ABS, Stats NZ, Macrobond, ANZ Research

[1] We haven't adjusted for different tax rates, pension systems, or cost of living in these figures.

Figure 11. Monthly net immigration of New Zealand citizens

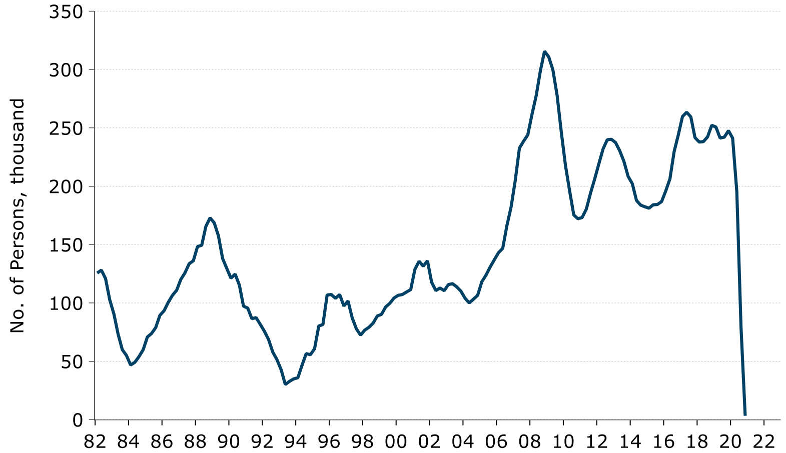


Source: Stats NZ, ABS, Macrobond, ANZ Research

But for New Zealand, there's a real risk that we see skilled workers flock to Australia, particularly once vaccination rates are high enough to allow COVID restrictions to ease. While that would increase the bargaining position of workers who choose to stay in New Zealand, it'll make it even harder for firms to fill key positions, forcing them to go through the process of hiring people from overseas. And there's still a lot of uncertainty around the future of both immigration policy in New Zealand and the practical ability to bring people through the quarantine bottleneck.

Australia has also seen seismic shifts in immigration over the past year. Net annual immigration has fallen to pretty much zero, after running at 250,000 annually in the years leading up to the pandemic (figure 12). Poaching Kiwis won't get close to making up for that deficit, and will likely mean that until borders start to open up, both labour markets will remain incredibly constrained. That leaves the balance of power firmly in the hands of the workers – and once they start to exercise this power, wage inflation should lift considerably.

Figure 12. Australian net immigration (annual total)



Source: ABS, Macrobond, ANZ Research

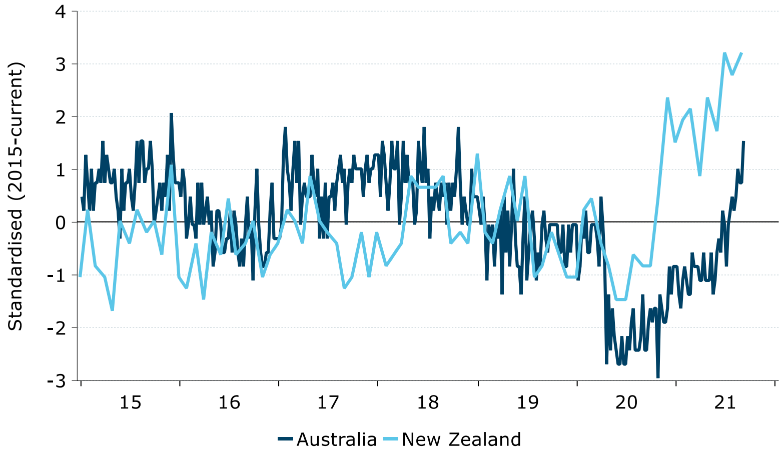
Expectations become reality

Another point to make is the importance of inflation expectations when thinking about wages and inflation. If everyone expects higher inflation, then workers will be more likely to ask for larger raises, and firms will expect that higher cost of living adjustments will need to be factored into pay reviews.

There are some really interesting differences here. Firstly, inflation expectations amongst households fell a lot more in Australia during 2020 (figure 13). Secondly, New Zealand household inflation expectations surged in the second half of 2020, while Australians' expectations only gradually ground higher.

The rapid increase in inflation expectations in New Zealand could go some way to explaining the faster recovery in wage growth. While New Zealand businesses may feel they can lift prices for their goods and services without losing customers or market share and therefore feel they can afford to lift wages, Australian businesses may still be hesitant to offer higher wages if they don't feel they can lift their prices to compensate yet. Given that Australian households' expectations are rising rapidly now though, we could see further pressure coming through this channel in coming months.

Figure 13. Household inflation expectations



Source: Roy Morgan, Macrobond, ANZ Research

So what's next for Australia and New Zealand?

While both New Zealand and Australia have experienced setbacks lately, with outbreaks of Delta forcing lockdowns, the medium-term outlook remains very positive for their respective labour markets. We're not expecting the current lockdown in New Zealand to have persistent impacts on the labour market, and the Australian labour market is expected to recover quickly as restrictions ease, even if unemployment may rise temporarily due to the extended lockdown in some states.

New Zealand's economic recovery has more or less been a step ahead of most of its trading partners due to the early exit from pandemic restrictions in 2020 – but signs are good for Australia too, with many indicators of labour market slack tightening significantly in recent quarters. With household inflation expectations in Australia now rising, we may have the final pieces in place for a sustained rise in wage pressure.

But for now, the near-term path of both countries depends crucially on the daily case count, and the speed of the vaccine rollout.

Contact us

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Sharon Zollner
Chief Economist

Follow Sharon on Twitter
@sharon_zollner

Telephone: +64 27 664 3554
Email: sharon.zollner@anz.com

General enquiries:
research@anz.com

Follow ANZ Research
@ANZ_Research (global)

David Croy
Senior Strategist

Market developments, interest rates, FX, unconventional monetary policy, liaison with market participants.

Telephone: +64 4 576 1022
Email: david.croy@anz.com

Susan Kilsby
Agricultural Economist

Primary industry developments and outlook, structural change and regulation, liaison with industry.

Telephone: +64 21 633 469
Email: susan.kilsby@anz.com

Liz Kendall (Maternity leave)
Senior Economist

Research co-ordinator, publication strategy, property market analysis, monetary and prudential policy.

Telephone: +64 27 240 9969
Email: elizabeth.kendall@anz.com

Miles Workman
Senior Economist

Macroeconomic forecast co-ordinator, fiscal policy, economic risk assessment and credit developments.

Telephone: +64 21 661 792
Email: miles.workman@anz.com

Finn Robinson
Economist

Macroeconomic forecasting, economic developments, labour market dynamics, inflation and monetary policy.

Telephone: +64 21 629 553
Email: finn.robinson@anz.com

Kyle Uerata
Economic Statistician

Economic statistics, ANZ proprietary data (including ANZ Business Outlook), data capability and infrastructure.

Telephone: +64 21 633 894
Email: kyle.uerata@anz.com

Natalie Denne
PA / Desktop Publisher

Business management, general enquiries, mailing lists, publications, chief economist's diary.

Telephone: +64 21 253 6808
Email: natalie.denne@anz.com

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Last updated: 9 April 2021

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