ANZ Research

NZ Insight: How widespread is labour market tightness?

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How widespread is labour market tightness?

Summary

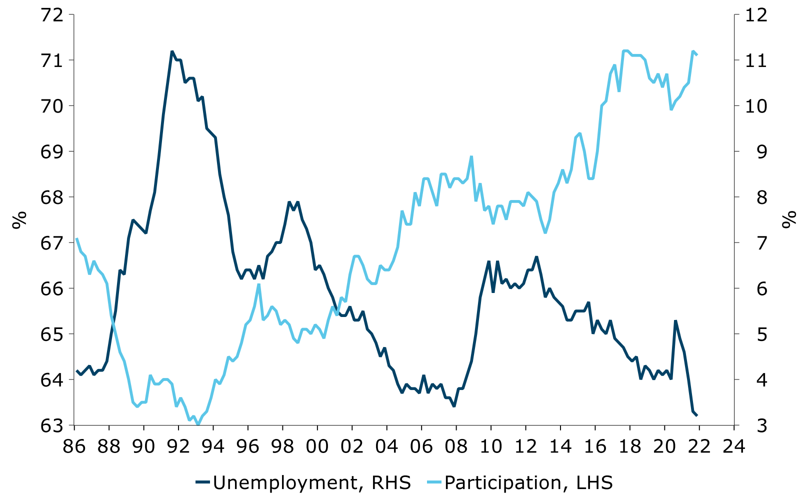
- With the national unemployment rate sitting at a record low 3.2%, and expected to drift even lower over 2022, it's clear that the New Zealand labour market is extremely tight overall. But how widespread is this labour market stretch?
- In short, very. Unemployment and underutilisation are much lower than average across most regions – and even where employment growth has disappointed, it's been because of low labour force growth, rather than a lack of demand. However, the uneven nature of the COVID economy means that not all industries are doing well on the employment front.
- Overall, the main soft spot is wage growth. Wages have picked up – but nowhere near to the level that would typically be implied by current levels of labour market tightness. However, we think that wage growth is set to lift strongly over 2022; it just takes a while for wages to adjust as people go through annual reviews, and employers adjust to the new high-inflation environment.
- With the RBNZ set to lift interest rates steadily over the next 12 months, the tight labour market is the main reason we continue to forecast a soft landing for the economy. As long as employment remains strong, and wage growth picks up as expected, Kiwis should be able to stomach the tough medicine being administered by the RBNZ. But we'll be watching closely for signs that spare capacity is starting to open up in the labour market.

Introduction

The RBNZ has a big job to do to get ahead of the inflation curve. We're forecasting that the RBNZ will lift the OCR 50bps on Wednesday and again at the May Monetary Policy Statement, before continuing in 25bp increments at each meeting until the OCR reaches a peak of 3.5% in April 2023.

With interest rates rising so aggressively, and the housing market and consumer confidence already in retreat, a natural question is, won't that cause a recession? It's a definite risk – but one of the biggest reasons why we are optimistic about the capacity of the economy to absorb rising interest rates is the sheer tightness of the labour market. Unemployment is at a record low of 3.2%, despite the participation rate being very close to its own record high of 71.2% (figure 1).

Figure 1. Unemployment and participation rates



Source: Stats NZ, Macrobond, ANZ Research

Labour demand is so out of line with the current capacity of the labour market to supply that we suspect it'll take a significant rise in interest rates before we really start to see unemployment lift meaningfully above current lows. It's a similar story in the US, where there are almost two job openings per unemployed person!

So that's the rose-tinted-glasses macro view (which assumes no downside risks emerge). But as good as the aggregate numbers are, they always hide the fact that there can be significant differences in labour market outcomes depending on where you live, your age, gender, and ethnicity, and which industry you work in. To gain a more comprehensive overview of how widespread labour market tightness is, we've compiled a broad range of labour market indicators across different industries, regions, and demographic characteristics, to build a picture of labour market tightness in New Zealand.

And it's good news if you're a worker.

The regional story

Looking at the labour force data by region, it's easy to see why stories about severe labour shortages can be found on pretty much any news site you open. Unemployment ranges from 2.7% in Otago and Manawatu-Whanganui to 4.1% in Bay of Plenty (table 1). Underutilisation is a broader measure of labour market slack, capturing part-time workers who want more hours, and people who don't quite meet the definition of unemployed (eg if they want a job but aren't available right now). And according to this measure, most regional labour markets are also much tighter than their historical average.

Table 1. Regional labour market indicators heatmap

	Underutilisation rate (%)	Unemployment rate (%)	Employment growth (% y/y)	Labour force growth (% y/y)
Northland	8.7	3.3	5.4	2.9
Auckland	8.7	3.1	4.8	2.3
Waikato	9.8	3.3	2.3	0.6
Bay of Plenty	10.2	4.1	2.9	1.5
Gisborne/Hawke's Bay	10.7	3.7	-5.1	-7.0
Taranaki	10.1	3.9	2.4	0.1
Manawatu-Whanganui	9.2	2.7	5.1	3.0
Wellington	9.1	2.9	4.3	2.4
Tasman/Nelson/Marlborough/West Coast	10.5	2.9	2.2	2.3
Canterbury	9.2	3.3	4.8	3.6
Otago	10.0	2.7	3.6	2.4
Southland	10.0	3.3	0.3	0.3

Source: Stats NZ, Macrobond, ANZ Research

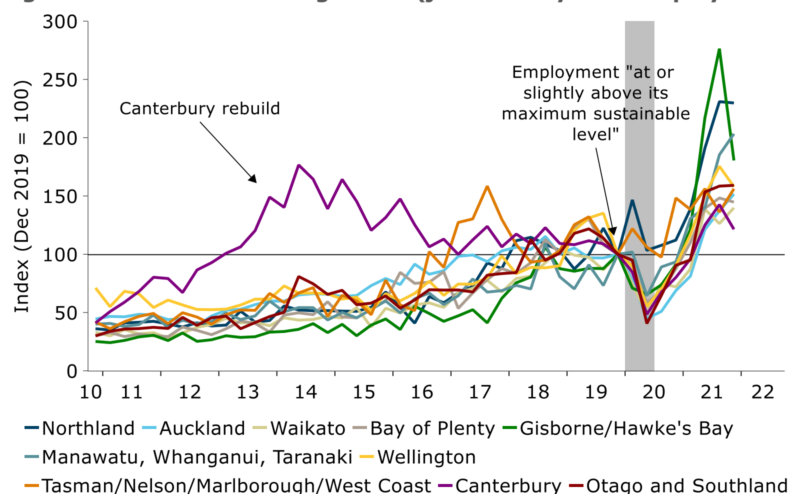
Note: The heatmap indicates how strong each labour market indicator is relative to its own historical average. For example, although the unemployment rate is higher in Gisborne/Hawke's Bay than it is in Southland, it is further below its historical average than Southland is. When calculating the historical average for unemployment, employment, and the labour force, data since 2000 is used, to avoid the structural changes over the 1980s and 1990s. Underutilisation starts in 2004. The more orange (blue) the cell is the stronger (weaker) the labour market indicator is compared to the past two decades. We've seasonally adjusted the underutilisation and unemployment rates.

The only real soft spot here appears to be labour force growth – several regions are seeing weaker labour force growth than usual, and none are seeing abnormally strong growth. But that's actually a positive in terms of labour market stretch. As noted above, the participation rate is currently close to its joint-record high of 71.2% last achieved in Q3 2021. So without a large net inflow of migrants (more on this later), it's only natural that we're seeing labour force growth slow as the domestic labour supply is close to being tapped out.

In short, we can see clear signs in table 1 that regional labour markets are increasingly supply constrained. Conditions therefore continue to favour strong wage rises over 2022. That is of course a good thing for workers, but with COVID still impacting productivity, lifts in wage costs are likely to be passed on to the consumer to some extent, watering down those wage gains. It's part of why we see non-tradables (ie domestic) inflation staying higher than the RBNZ's comfort zone for some time – despite rapid monetary tightening.

One way to visualise the level of labour market tightness across regions is to look at the vacancy-unemployment ratio. While not a comprehensive measure of labour market slack, this ratio does give some sense of how labour demand (ie job vacancies) is shaping up relative to supply (ie unemployed). All regions have significantly higher levels of labour market tightness than in 2019 Q4, which was a time when the RBNZ said "employment is at or slightly above its maximum sustainable level" (figure 2). We're clearly well past that point – and the RBNZ needs to resolve the mismatch between supply and demand in the domestic economy in order to restore price stability, and support the labour market remaining strong for longer. It's super important to note that the RBNZ doesn't "want" or "need" people to be out of jobs. Rather, the fact is simply that monetary policy cannot sustainably drive employment above its maximum sustainable level – that level is determined by lots of things, but monetary policy is not one of them. If it tries, it will just cause boom-bust cycles that hurt vulnerable workers the most.

Figure 2. Labour market tightness (job-vacancy to unemployment ratio)



Source: MBIE, Stats NZ, Macrobond, ANZ Research

For the RBNZ to be comfortable that the labour market won't drive domestic inflation persistently above target, they'd probably want to see the job-vacancy to unemployment ratio drop back to levels seen in 2019. That doesn't require a significant rise in unemployment – it could be achieved by using higher interest rates to dampen demand in the economy enough such that the insatiable demand for labour by Kiwi firms eases. Unfortunately, if inflation continues to surge and larger interest rate hikes become more urgent, it will become harder for the RBNZ (and other central banks for that matter) to bring demand back into line without causing some increase in unemployment.

The industry view

So at the regional level, it's clear labour market pressures are widespread. But we know that COVID has had a very unequal impact on different industries, so it's worth having a look from the industry point of view.

And here, the picture is a lot less clear cut. On balance, filled jobs and hours worked are rising strongly across most industries – and that's reflected in labour costs starting to increase to above-average levels (table 2). But we can also see that for several services industries, filled jobs and hours worked have actually dropped markedly – particularly in rental, hiring & real estate and in wholesale trade. With indicators of labour market stretch still elevated, those drops in employment likely reflect reallocation of workers between different industries (possibly as they chase higher wages and/or better opportunities in this tight labour market).

Table 2. Labour market indicators by industry (annual average % change)

	Filled jobs growth	Hourly earnings growth	Private sector labour costs	Hours paid	Average hours worked	GDP per hour worked
Accommodation & Food Services	1.0	12.2	3.8	-0.8	-1.7	14.8
Electricity, Gas, Water & Waste	27.4	3.8	3.3	29.9	1.9	-21.0
Construction	5.5	5.4	2.8	7.6	2.0	2.5
Retail Trade	4.4	8.0	1.6*	8.8	4.3	0.4
Health Care & Social Assistance	9.3	6.1	2.5	12.5	3.0	-3.3
Arts, Recreation & Other Services	6.4	1.6	2.0	12.2	5.5	-8.9
Public Administration & Safety	12.1	2.5	1.6	15.3	2.9	-9.7
Financial & Insurance	3.0	2.5	1.5	2.7	-0.3	-5.1
Manufacturing	6.2	2.2	2.2	9.8	3.3	-5.4
Education & Training	2.2	-0.2	1.9	4.4	2.1	-5.1
Transport, Postal & Warehousing	-2.1	3.7	2.5	1.0	3.2	8.7
Information Media & Telecommunications	-3.6	5.0	1.5	-1.0	2.8	4.2
Prof, Sci, Tech, Admin & Sppt	-5.1	5.4	2.2	-2.3	2.8	11.2
Rental, Hiring & Real Estate	-5.9	-3.0	1.3	-6.2	-0.3	9.1
Wholesale Trade	-8.3	0.2	1.9	-7.6	0.8	19.5
Total all industries	2.8	3.8	2.3	5.4	2.6	0.3

Source: Stats NZ, Macrobond, ANZ Research

* Public administration and safety in the labour costs column is a public sector industry.

Note: Heatmap indicates how strong each labour market indicator is relative to average. The more orange (blue) the cell is, the stronger (weaker) the labour market indicator is compared to the past two decades.

Something that's notable is we're not yet seeing the level of broad-based wage pressure we'd expect, given how tight the labour market is. Hourly earnings growth is soft in many industries, and labour costs are significantly above average only in construction and accommodation & food services. But we don't think this will last.

Aggregate labour market indicators point to wage growth reaching levels last seen in the late 2000s (figure 3) – it just takes a while for those wage increases to flow through to workers, given the predominance of annual wage reviews, and the fact that we've just gone through a decade of low nominal wage growth. It takes time for wage-setting behaviour to adjust. Plus, as we noted in a previous insight, the biggest wage rises come when people switch jobs, but COVID has created significant barriers to labour mobility over the past few years. With those restrictions increasingly behind us, we may see an improvement in labour mobility (the "Great Resignation"), which should bring stronger wage rises as workers start to reap the benefits of extremely high levels of labour demand.

Figure 3. Unemployment and wage growth forecasts

Source: Stats NZ, Macrobond, ANZ Research

A final point on the industry level data is that in many industries, firms are getting less bang for their buck from workers – ie GDP per hour worked has fallen (and at a national level, was only up 0.3% in all of 2021: Table 2, final column). That makes sense – COVID has been a negative labour supply shock (not least due to things like social distancing requirements). But it means that in many industries, not only are firms paying more for their employees; they're getting less output per worker. And you can't sustain that indefinitely – you need to put up your prices.

This hit to productivity is a key reason why the labour market is so inflationary. If rising wages were a result of higher labour productivity, then firms wouldn't necessarily need to lift prices (or at least not as much) because they generate more revenue per worker. But right now, they need to lift prices to cover the higher wage bill, which lifts inflation (and erodes the wage gains that workers are receiving). With wage growth set to accelerate over 2022, this inflationary cycle will likely only get worse – and it's why the RBNZ needs to act now to soften the domestic demand impulse.

Unequal experiences

A final lens through which to view the labour market is through different demographic characteristics. We see a similar story here as in the regional analysis – labour force growth has slowed due to the constraints on domestic labour supply, and that's contributed to much lower-than-average unemployment, even if employment growth has also been below par for some (table 3).

Table 3. Labour force indicators by ethnicity and sex

	Unemployment rate (%)	Employment growth (% y/y)	Labour force growth (% y/y)
European	2.5	4.9	3.7
Maori	6.9	6.0	3.7
Pacific	5.4	-2.2	-6.5
Asian	2.8	5.4	2.7
MELAA	5.2	0.3	-1.9
Male	3.1	2.4	0.9
Female	3.3	5.2	2.9

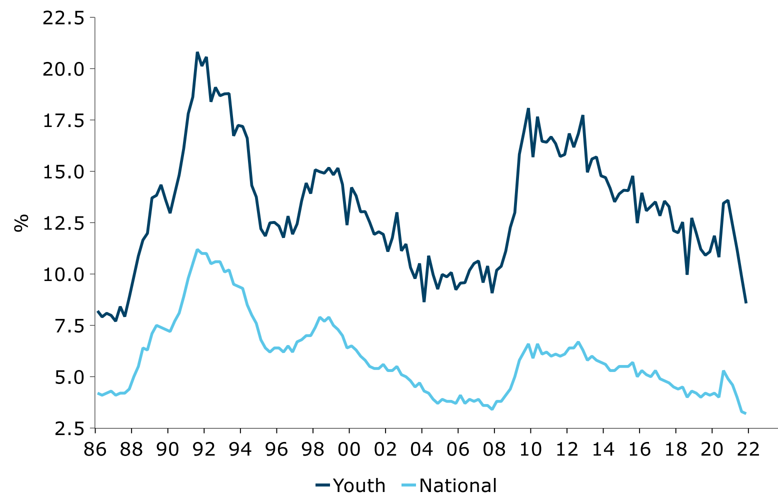
Source: Stats NZ, Macrobond, ANZ Research

Note: Heatmap indicates how strong each labour market indicator is relative to average. The more orange (blue) the cell is the stronger (weaker) the labour market indicator is compared to its average over the past two decades. We have seasonally adjusted the unemployment rate data for different ethnicities (Stats NZ provide seasonally adjusted male and female unemployment rates).

It's immediately obvious from the first column of Table 3 that even though unemployment is much lower than average across all groups, it's still much higher for Māori, as well as Pasifika and Middle Eastern, Latin American, and African Kiwis (MELAA). That reflects structural inequities in New Zealand's labour market, which have persisted through multiple business cycles.

Unfortunately, there's not a lot monetary policy can do here. It's a blunt tool that isn't able to target its impact towards certain areas. The best thing the RBNZ can do to support better labour market outcomes for everyone is to restore price stability, ensure that the current economic expansion can be sustained, and support ongoing employment growth for longer. Young people too have certainly benefitted from the current strength in labour demand, with the youth unemployment rate now within one percentage point of its all-time low of 7.7% (figure 4).

Figure 4. Youth unemployment rate (15-24 years)



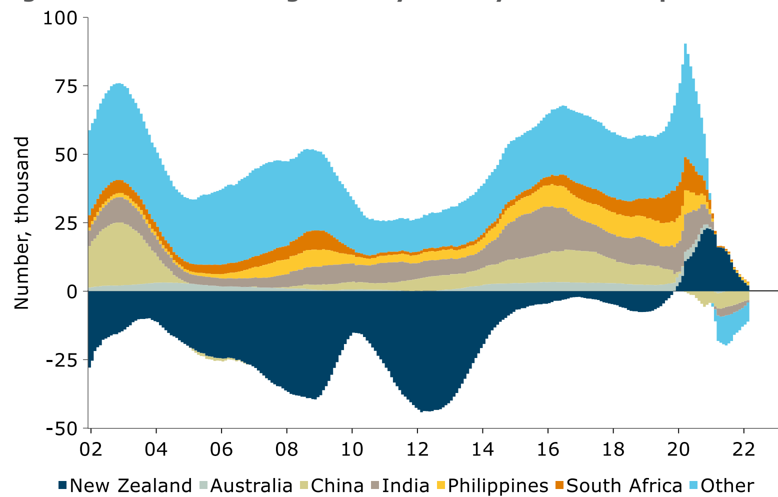
Source: Stats NZ, Macrobond, ANZ Research

Will the border opening help ease constraints?

The labour market is clearly very constrained by the inability of domestic labour supply to meet demand, and that's likely to drive wage inflation over 2022 to levels we haven't seen since before the GFC. The biggest wildcard here is net immigration. In the 2010s, very high levels of net immigration were a key driver of growth in the labour force, as well as overall economic growth (through more bums on seats, rather than productivity improvements).

With the border opening over 2022, the question is, will that lift labour supply for New Zealand, or shrink it? This is a question we've addressed in a previous insight. While the timing for the border reopening has shifted since the note was published, the basic principles are the same. The Australian labour market is set to tighten significantly over 2022 – and if history is any judge, that could see an exodus of Kiwis in search of higher wages and lower living costs. Previously, high outflows of Kiwis have been offset by inflows from other countries (figure 5). But much depends on how tightly immigration settings are calibrated by the Government – and also on the appetite of people overseas to come to a country on the side of the world after two years where travel has been nigh-on impossible.

Figure 5. Annual net migration by country of citizenship



Source: Stats NZ, Macrobond, ANZ Research

Should we see net immigration turn significantly negative over 2022, then the labour market could tighten even further than the record levels we're already forecasting. All else equal, that would require the RBNZ to tighten monetary policy even further to try and bring demand back in line with supply. And such a tightening would be a serious challenge for economic growth at a time where population growth is getting pretty close to zero on a quarterly basis.

Bringing it all together

Labour market tightness is extreme in New Zealand. In this insight we've covered off a range of indicators to try to get a sense of exactly how broad-based these labour market pressures are. And the answer is "very". While some industries are still struggling, across different regions and demographics overall, we haven't seen a labour market this tight on record. We think that's going to generate significant wage pressures over 2022 as the war for talent continues, and easing COVID restrictions make it easier for workers to switch jobs.

For the RBNZ, the broad-based strength in the labour market is both a comfort and a concern. It should give the domestic economy the resilience needed to get through a period of sharply higher interest rates without the wheels falling off. But at the same time, we expect to see wage inflation accelerate to levels not seen since before the GFC, with firms facing higher wage bills but meagre (and in many cases negative) productivity growth. The inflationary labour market reinforces the need to get in front of the inflation curve – and that requires further interest rate rises over 2022 and into 2023.

But how many? It depends on the labour market holding up. Given the importance of the labour market to our economic outlook, we'll be keeping a very close eye on timely indicators, looking for any potential signs of softening. Job vacancies, monthly filled jobs data, and employment intentions in our Business Outlook are all key timely data that will hopefully give us an early warning if labour market pressures are easing by more than anticipated.

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