ANZ Research

Q1 Labour Market Data Preview

28 April 2022

Contact

Finn Robinson or Miles Workman for more details.

March 2022 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	3.1%	3.2%
Participation rate (sa)	%	71.0%	71.1%
Employment (sa)	q/q	0.1%	0.1%
Employment	y/y	3.2%	3.7%
Wages			
LCI private sector wages (ex-overtime)	q/q	0.6%	0.7%
LCI private sector wages (ex-overtime)	y/y	3.0%	2.8%
QES private sector hourly earnings	q/q	1.2%	1.4%
QES private sector hourly earnings	y/y	4.6%	4.1%

May the labour force be with you

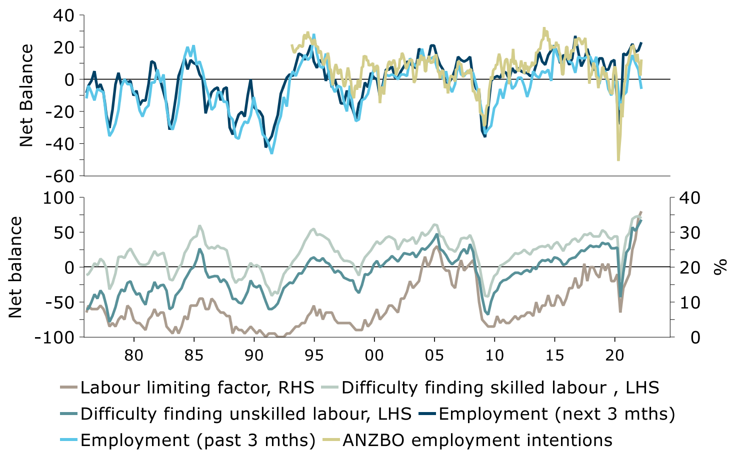
- Q1 labour market data are released on Star Wars Day (May the fourth) next week. We've pencilled in a further decline in the unemployment rate to 3.1% in Q1 (versus 3.2% in Q4). However, the Omicron wave peaked in Q1, so the data could be a little noisy. Looking through near-term volatility, we think the labour market will continue to tighten over the first half of 2022.
- Wage inflation has thus far failed to keep up with the rapidly rising cost of living. But with labour market tightness so widespread, we do expect wage growth to accelerate sharply over 2022. Private sector average hourly earnings are expected to have risen 1.2% q/q in Q1 (4.6% y/y), and we expect labour costs were up 0.6% q/q (3.0% y/y).
- The tight labour market is likely to be a significant source of domestic inflation pressure over 2022, as firms increasingly bid up wages to attract and retain talent. For the RBNZ, that means they need to continue on with aggressive interest rate hikes (including a 50bp hike in May) in order to bring surging domestic inflation pressures to heel.

The view

Stats NZ release Q1 labour market data on Wednesday next week. At the risk of sounding like a broken record, uncertainty is higher than usual right now, given that Q1 saw the peak of the Omicron wave in New Zealand. And that means a wide range of outcomes are possible in next week's data. If participation took a significant hit, then even if employment fell, we could see lower unemployment. Alternatively, if job seekers were unperturbed by COVID, but hiring stalled due to the Omicron disruption, then we could see unemployment rise. Separating the signal from the noise will be challenging.

What is clear, though, is that labour market tightness is showing no meaningful signs of easing. Experienced employment in the Q1 QSBO softened significantly, but employment intentions remain very robust (figure 1, top panel). Measures of labour market stretch in the QSBO, including difficulty finding labour and labour as a limiting factor, are at or close to record highs (in data going back to the 1970s – figure 1, bottom panel).

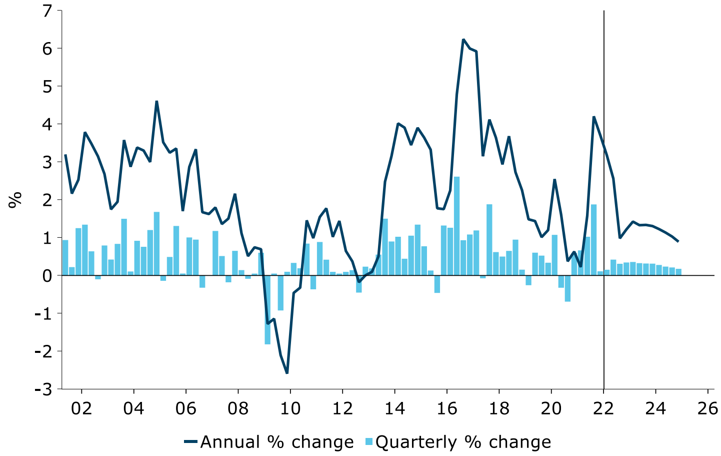
Figure 1. Employment indicators



Source: NZIER, ANZ, Macrobond, ANZ Research

We've pencilled in a small 0.1% q/q (3.2% y/y) lift in employment in the March quarter. There are risks on both sides. On the one hand, job vacancies and hiring intentions are holding up really well. On the other, monthly filled jobs, QSBO experienced employment, and the PSI employment measure all point to a weak number for Q1 – and disruption from Omicron could also see employment growth come in considerably weaker if the hiring process was delayed to the June quarter for enough businesses. Looking further out, we are forecasting employment growth to recover a bit over the rest of 2022 as COVID disruption eases, and the reopening of the border brings more people into the country (figure 2).

Figure 2. Employment growth forecast

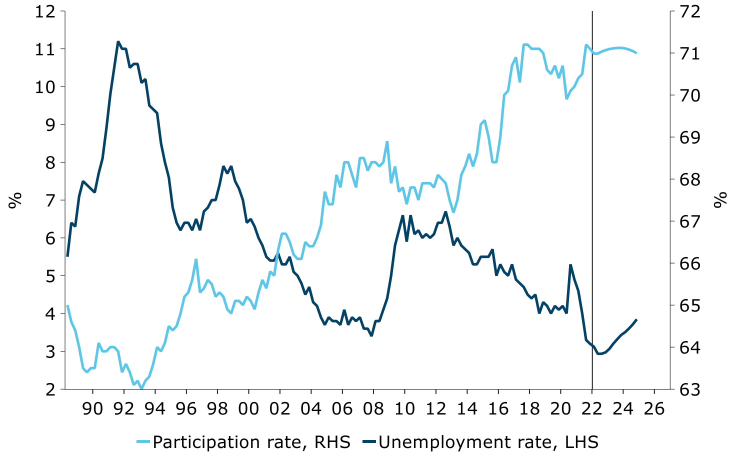


Source: Stats NZ, Macrobond, ANZ Research

On participation, we assume a small COVID-induced decline in the participation rate from 71.1% in Q4, to a still very impressive 71.0% in Q1 (figure 3). However, with labour still in such hot demand, we're forecasting that participation will retain its cyclical strength over our forecast horizon.

All up, that means we're expecting a slight drop in the unemployment rate to 3.1% in Q1, from 3.2% in Q4. But uncertainty is very high right now, and it'll be hard to attach much meaning to the headline unemployment figure without knowing the employment and participation rate details. COVID disruption aside, we continue to expect some further tightening in the labour market over 2022, with the unemployment rate forecast to ease just under the 3% mark to 2.9% over mid-2022 as labour demand continues to outstrip supply (figure 3). But as sharply higher interest rates flow through to reduced demand, we expect to see the unemployment rate drift up slightly to just under 4% by end-2024.

Figure 3. Unemployment and participation forecasts



Source: Stats NZ, Macrobond, ANZ Research

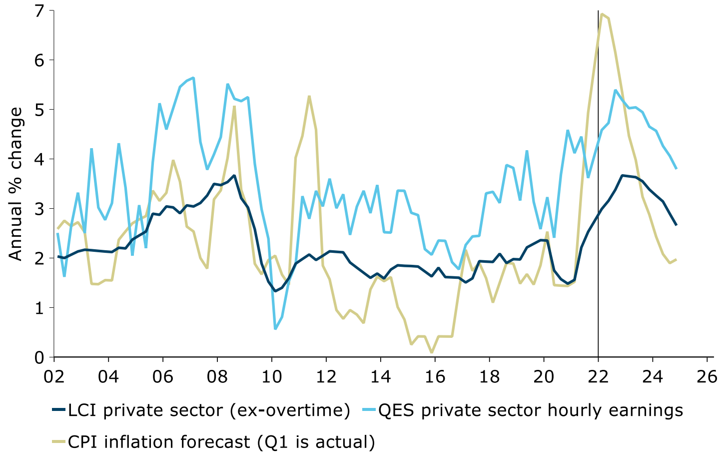
At present, the main risks to the labour market appear to be on the supply side. With the border opening over 2022, we're assuming that we see a positive net inflow of people into the country. That should go some way to meeting domestic demand for workers. However, many traditional destinations for New Zealand emigrants have similarly tight labour markets – with the Australian unemployment rate forecast to fall to 3.3% by end-2022, for example. So there's a risk that we see a net loss of people over the year, especially given the unknown number of people who might leave for long-delayed OEs.

Plus, New Zealand's population is aging. A big driver of our rising labour force participation rate over the past few decades has been increased participation by female and older workers. But participation still tends to drop off as workers age – and at some point that could be enough to see the participation rate fall meaningfully. Lower participation would also hinder the ability of the domestic labour market to meet demand.

Given the tightness in the labour market (and downside risks to labour supply) it's clear that Kiwi wages are overdue a serious upgrade. Many indicators, including job vacancies and difficulty finding labour, are at or above record highs. And yet, wage growth is still below the levels we saw in the mid-2000s. We assume that's because wages just take longer to adjust. For example, workers have to go through annual reviews or switch jobs before getting a larger pay rise. Given that labour turnover reached a new record high in the Q1 QSBO, we expect to see that coming through in much stronger wage growth over 2022.

For completeness, we've pencilled in a 1.2% q/q (4.6% y/y) lift in private sector average hourly earnings in Q1, and a 0.6% q/q (3.0% y/y) lift in the productivity-adjusted Labour Cost Index (figure 4). The 6% lift in the minimum wage will come through in the June quarter's data. We're forecasting that wage inflation will accelerate over 2022, and catch up to CPI inflation in early 2023. But as the dampener of OCR hikes flows through the economy and into the labour market, that should see wage growth slow to levels more consistent with low and stable inflation over 2024 and beyond.

Figure 4. Wage inflation forecasts



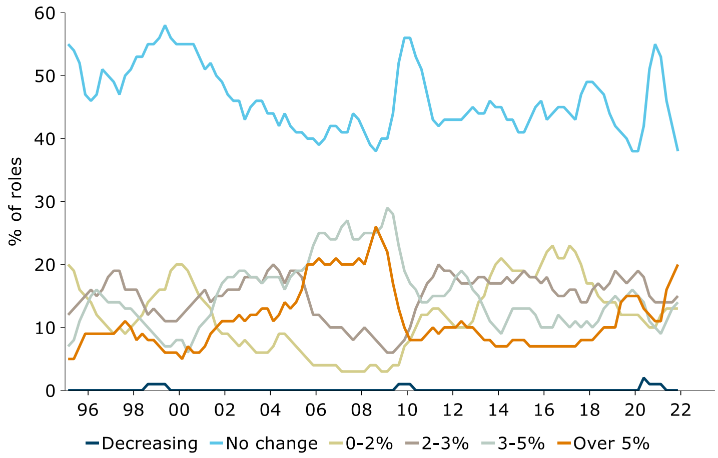
Source: Stats NZ, Macrobond, ANZ Research

Monetary policy implications

The strong labour market that we're forecasting is really important for the RBNZ to be able to engineer a soft landing for our overheated economy. Higher interest rates and the surging cost of living will certainly stretch many Kiwi households. But so long as wage growth picks up and unemployment stays low, we should get through it.

However, one side effect of the tight labour market is, inconveniently, more inflation pressure. As we noted recently, wage growth is largely being driven by the surging cost of living and the balance of power shifting towards workers. Wage growth isn't being driven by productivity growth – if anything that has been hindered by the impact of COVID disruption. And there are signs that much larger wage rises are on the way, with a significant uptick in the share of jobs receiving greater than 5% pay rises in the Q4 labour market data (figure 5). Without a rise in productivity, firms can't afford to keep putting wages up indefinitely without also putting up prices. So as wages rise over 2022, that's also likely to generate a lot of domestic inflation pressure.

Figure 5. Distribution of annual wage rises



Source: Stats NZ, Macrobond, ANZ Research

This all means that even though we're tentatively forecasting that Q1's 6.9% CPI inflation print was the peak in inflation for New Zealand, the RBNZ still has a big job to do to bring domestic inflation pressures back in line. Without further aggressive interest rate hikes, including another 50bp hike in May, the tight labour market and rising inflation expectations could easily drive a self-reinforcing upwards spiral of domestic inflation.

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

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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