ANZ Research

June 2022 Quarter Labour Market Preview

28 July 2022

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Contact

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June 2022 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	2.8%	3.2%
Participation rate (sa)	%	71.0%	70.9%
Employment (sa)	q/q	0.8%	0.1%
Employment	y/y	2.6%	2.8%
Wages			
LCI private sector wages (ex-overtime)	q/q	1.1%	0.7%
LCI private sector wages (ex-overtime)	y/y	3.3%	3.1%
QES private sector hourly earnings	q/q	1.2%	1.9%
QES private sector hourly earnings	y/y	5.8%	5.3%

The biggest constraint

- Q2 labour market data are released next Wednesday (3 August). We anticipate the data will confirm the ongoing labour market tightening we see in timely indicators, survey data, and anecdotes. We expect unemployment declined to 2.8% in Q2 (vs. 3.2% in Q1). And while we can't discount that typical HLFS volatility could see unemployment come in above our expectation, risks are skewed towards a still-lower number.
- Private sector wage inflation is now running at its fastest pace since 2009 (albeit still well behind the cost of living). Further acceleration is likely, with average hourly earnings forecast to have increased by 5.8% y/y in Q2 (vs. 5.3% in Q1), and productivity-adjusted labour costs by 3.3% y/y (vs. 3.1% in Q1).
- The tight labour market is turning into an increasingly intense headache for the RBNZ. The gaping chasm between labour demand and supply is likely to be a key driver of persistently too-high domestic inflation pressure over the next year. We expect ongoing 50bp hikes will bring the OCR to 4% by year-end. That's consistent with market pricing, but a stronger-than-expected jobs report could see a market reaction nonetheless.

The view

We expect next week's labour market report will reinforce what's clear in survey data and anecdotes – finding workers is the primary constraint facing Kiwi businesses, and that difficulty only increased in the first half of 2022. Job vacancies were still increasing in Q2, employment intentions have been robust, difficulty finding labour is at or around record levels, and monthly filled jobs have bounced back convincingly from what we assume was an Omicron-induced dip in Q1, with filled jobs up 1.3% in the three months to June. That's impressive given how difficult firms say it is to find workers. Across the ditch, the Australian economy is experiencing unprecedented labour demand and the lowest unemployment rate since the 1970s (3.5%).

All of these factors suggest that the Kiwi labour market continued to tighten over the June quarter, and will remain tight in the near term. We're forecasting the unemployment rate fell to 2.8% (3.2% in Q1), driven by a 0.8% q/q (2.6% y/y) lift in employment. Previously, we'd pencilled in a 2.9% unemployment rate – but the bounce in monthly filled jobs over Q2 was much stronger than anticipated (and points to the risk of an even lower unemployment print than we've pencilled in, although HLFS volatility could also see unemployment come in higher than our expectation). Participation is assumed to have lifted marginally to 71.0% (70.9% in Q1) as cyclical strength in the labour market and the rising costs of living draw people into the labour force. Participation is close to Q3 2021's record-equalling 71.2%.

The challenge with forecasting unemployment is that everything depends on the relative movements of employment and labour force growth. Table 1 outlines a few scenarios that we could see in next week's data. Our base case is in the centre – a modest increase in employment, leading to a 0.4ppt fall in unemployment to 2.8%. But relatively small variances in the employment or participation numbers (or both) could see unemployment fall into the low 2s, or increase to the low 4s.

A lower-than-expected employment number is quite possible (we've pencilled in a respectable 0.8% q/q bounce as hiring recovered from Omicron disruption in Q1). However, as with GDP over Q1, a weaker number would clearly be more a supply-side story than a lack of demand for workers. And that's inflationary.

Whichever way the numbers land, we think the details of next week's data are likely to confirm what many Kiwi businesses already know – the labour market is incredibly tight, and workers are becoming an increasingly scarce (and expensive) resource. That scarcity looks set to be reflected in a further increase in wage growth. We're anticipating that private sector hourly earnings were up 5.8% y/y in Q2 (5.3% in Q1), and that productivity-adjusted private sector labour costs were up 3.3% y/y (3.1% previously). Q2 also saw the adult minimum wage rise $1.20 to $21.20 as of 1 April 2022 – adding to the already-strong upwards momentum that's pushing Kiwi wages higher.

Table 1. Range of possible unemployment rate outcomes

		Participation (last 70.9%)		
	Darker blue = more likely	Falls to 70.8%	Increases slightly to 71.0%	Lifts to 71.2%
Employment growth (q/q, last 0.1%)	Strong increase (1.0%-2.0%)	1.3%-2.2%	1.5%-2.5%	1.8%-2.8%
	Flat to moderate increase (0%-0.9%)	2.3%-3.2%	**2.6%-3.5% Central 2.8%**	2.9%-3.7%
	Small to moderate fall (-0.1% to -1.0%)	3.3%-4.2%	3.6%-4.4%	3.8%-4.7%

Note: The darker blue the shading, the more likely the outcome is, in our view.

Monetary policy implications

Finding workers is the most challenging constraint that businesses are facing right now. That's clear in our Business Outlook survey – and in the QSBO, where the share of firms reporting labour as the most significant constraint on expanding output hasn't been higher in data going back to the early 1970s (figure 1, over).

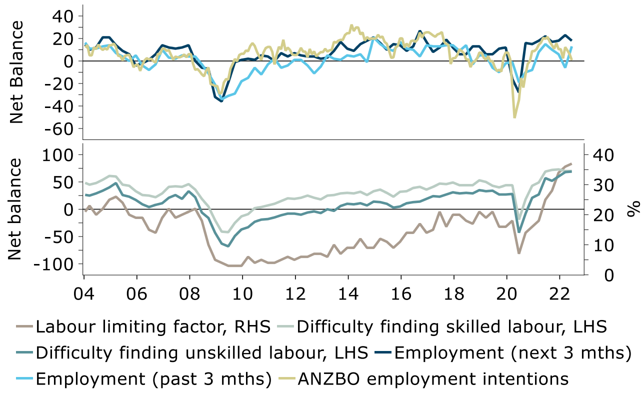
With domestic inflation pressures only continuing to intensify over the first half of 2022, this tight labour market is turning into a headache for the RBNZ. Low unemployment is good. But it can be highly inflationary if it's due to the excessive (in hindsight) policy stimulus that's been flowing through a supply-constrained economy (as opposed to, say, a structural improvement in the ability of the labour market to match job seekers with vacant positions). Right now, demand for workers is still miles ahead of supply – and that's going to be a key driver of domestic inflation pressures over the coming year.

So for the RBNZ, good news will be bad news next week. They're aiming to put the inflation genie back in the bottle – and every incremental tightening that we see in the labour market makes that job harder. We're anticipating the RBNZ will be hiking in 50bp increments through the rest of 2022 (bringing the OCR to 4% by year end). The catalyst for the upward revision to our OCR forecast was the starting point surprise for non-tradable inflation. But it's also notable that our forecast for a 2.8% unemployment rate is lower than the RBNZ's May MPS forecast of 3.1%. Should the labour market surprise the

RBNZ with its strength, it will lower the bar for ongoing 50bp hikes. It could even put a 75bp hike on the table in August should the RBNZ become concerned that they're still not raising interest rates fast enough given the scale of the inflation challenge. But there's no sign that what the RBNZ is doing isn't working (look at housing), so ongoing 50s look more likely.

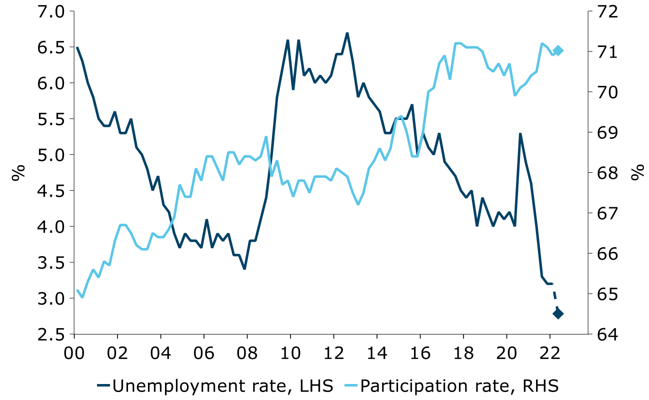
Our central view remains that signs of slowing demand in the economy will become increasingly hard to discount over the second half of this year – and that should give the RBNZ the leeway to ease off the brakes (ie stop hiking) after the OCR hits 4% at the November MPS. Monetary policy takes time to flow through to the real economy and finally price pressures. By the time we get to November, it will be just over a year since the first OCR hike from the record low of 0.25% - and well over a year since mortgage rates started rising. And over that time, we're forecasting the RBNZ will have delivered 375bps of hikes – the fastest increase in the OCR since it was introduced in 1999. That's going to take heat out of the economy – it just takes 1-2 years to fully feel the effects on inflation and the labour market. But we will feel it.

Figure 1. Labour market indicators



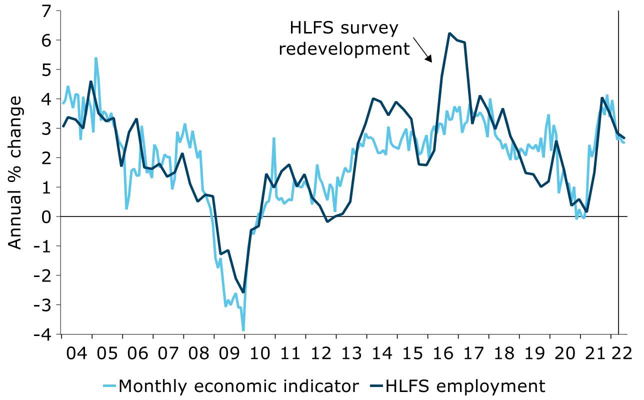
Source: NZIER, Macrobond, ANZ Research

Figure 2. Unemployment and participation



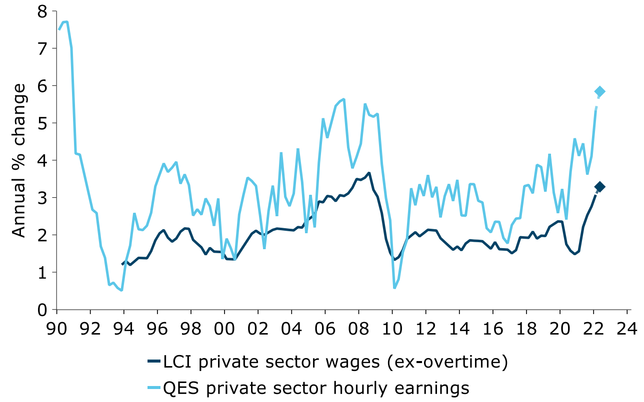
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. Employment and filled jobs growth



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Wage growth



Source: Stats NZ, Macrobond, ANZ Research

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