

September 2023 Quarter Labour Market Preview

26 October 2023



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A gradual ascent

- We expect the Q3 labour market statistics (to be released 1 November) to show further loosening, but the lagged response of wages means inflationary pressure stemming from the labour market still has further to run.
- Our forecasts are for the unemployment rate to have risen 0.3ppt to 3.9%, as a 0.4% q/q (3.1% y/y) lift in employment is offset by a solid 0.6% q/q increase in the working-age population and a 0.1%pt lift in the labour force participation rate to 72.5%.
- We're expecting annual wage growth to moderate but given the lagged response of wages to past labour market tightness, wages continue to be a key driver of persistent domestic inflation.
- All up, the labour market continues to gradually loosen, and for now is evolving broadly in line with the RBNZ's expectation. We don't see next week's data as a smoking gun prompting the RBNZ to restart hikes at the November meeting, but nor do we see it as signalling 'job done'. We remain unconvinced that the labour market is turning fast enough to see domestic inflation dissipate in a reasonable timeframe. We think that will require further tightening, with a **25bp hike in February**.

The view

The labour market has continued to ease over the past three months and is approaching sustainable levels – the level of employment that is consistent with stable inflation outcomes – though we estimate that we aren't quite there yet. However, getting to sustainable levels isn't likely to be enough for the RBNZ. The RBNZ ultimately requires a sustained period of employment *below* sustainable levels to return core inflation to target. That's hardly an appealing proposition. But if the labour market remains beyond sustainable levels for too long, we run the risk of inflation normalising above target, via stubborn inflation expectations becoming embedded in wage- and price-setting behaviour. In the long run, that's likely to be far costlier for the economy and result in worse employment outcomes for households.

For the RBNZ, creating slack in the labour market sooner rather than later is paramount for it to have confidence that inflation is on the way out. We expect the labour market to transition to an outright disinflationary state early next year.

Employment growth has moderated from earlier in the year, but has proven more robust than anticipated in recent months. We attribute that to a stronger supply-side recovery. The massive influx of new migrants has likely enabled firms to finally work through previously unmet labour demand. The proportion of firms reporting labour as the primary constraint for their business has eased sharply this year, but has only returned to around pre-COVID levels, and we suspect employment levels were still recovering to some degree in Q3.

September 2023 Quarter

		Exp	Prev
Labour Market			
Unemployment rate (sa)	%	3.9%	3.6%
Participation rate (sa)	%	72.5%	72.4%
Employment (sa)	q/q	0.4%	1.0%
Employment	y/y	3.1%	4.0%
Wages			
LCI private sector wages (ex-overtime)	q/q	1.0%	1.1%
LCI private sector wages (ex-overtime)	y/y	4.2%	4.3%
QES private sector hourly earnings	q/q	2.0%	1.9%
QES private sector hourly earnings	y/y	7.1%	7.7%

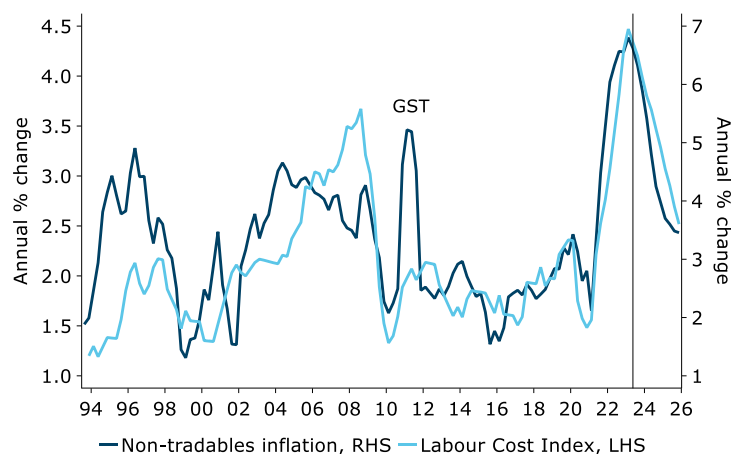
Cutting to the chase, we expect the unemployment rate lifted 0.3%pt to 3.9% in Q3, unchanged from our previous forecast. While we expect employment growth of 0.4% q/q (stronger than our previous forecast of 0.2% q/q), labour supply has grown by more than that – and more than previously expected. The working age population rose 0.6% in Q3, and we also expect that the participation rate lifted 0.1%pt to a fresh record high of 72.5%.

Labour force participation tends to follow the economic cycle, rising in times of labour market stretch as more people are pulled into the workforce due to an abundance of opportunities and attractive rates of pay. Competition for jobs has increased sharply, while job vacancies have fallen steadily over the past year, but we think cost of living pressures are likely to outweigh that in Q3, causing a modest lift in the participation rate. Upside is limited though, given we're already at a record high.

Capacity pressures in the labour market have certainly eased this year and wage growth looks to have passed its peak. But the lagged response of wages is likely to result in persistent wage pressures for some time. We expect the private sector Labour Cost Index rose 1.0% q/q (4.2% y/y), and private sector average hourly earnings (ordinary time) 2.0% q/q (7.1% y/y).

The RBNZ flagged the importance of wage growth at the October Monetary Review, but given the adjustment in wages to past tightness and elevated inflation expectation is still ongoing, this is to a large extent a look in the rear-view mirror.

Figure 1. LCI and non-tradables forecast



Source: Stats NZ, Macrobond, ANZ Research

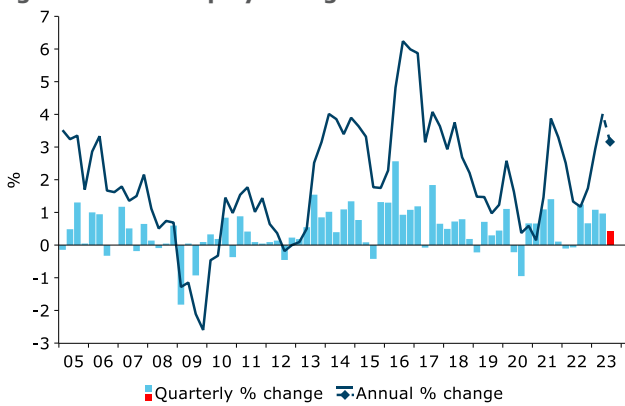
Monetary policy implications

We don't expect the Q3 labour market data to be a game changer for the RBNZ's November meeting. The RBNZ revised its Q3 unemployment rate forecast lower at the August MPS to 3.8%, reducing the chance of a hawkish surprise. However, from next quarter the RBNZ expects the unemployment rate to rise sharply, heading above 5% in the first half of next year. We too expect the labour market to continue to loosen, but it is regarding the expected pace where we diverge. We're not convinced that the labour market is about to capitulate. Capacity pressures have loosened significantly, and benefit numbers have been on a steady rise, but surveyed employment intentions remain positive and job vacancies have stopped

their free fall in recent months. Forward-looking indicators point to softening, certainly, but not capitulation.

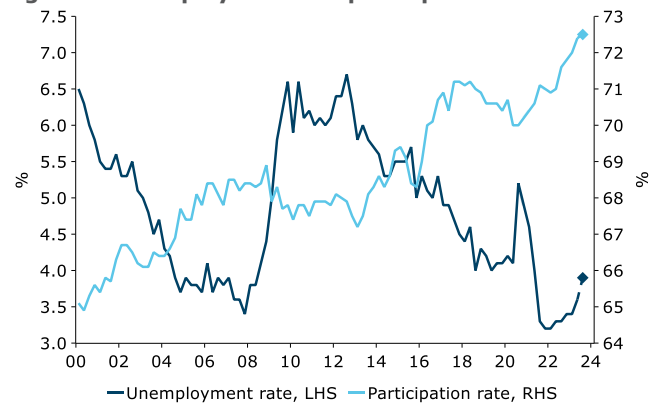
The RBNZ has seen progress – it's clear that monetary policy is cooling demand and inflation. But progress doesn't signal "job done", particularly in the context of meaningful demand impetus coming from both fiscal policy and booming net migration. We are yet to see the full impacts of past tightening, but we see the risks as skewed to current policy settings not being sufficient for the RBNZ to return inflation to target in an appropriate timeframe. By February, the RBNZ will have the Q4 CPI and labour market and Q3 GDP data. We expect these data to highlight continued persistence in domestic inflation, a labour market that, while meaningfully cooler, remains inflationary and an economy that is slowing, but not rolling over. We think that suite of data will prove enough evidence that there is more work to do, drawing the RBNZ back to the hiking table.

Figure 2. HLFS employment growth



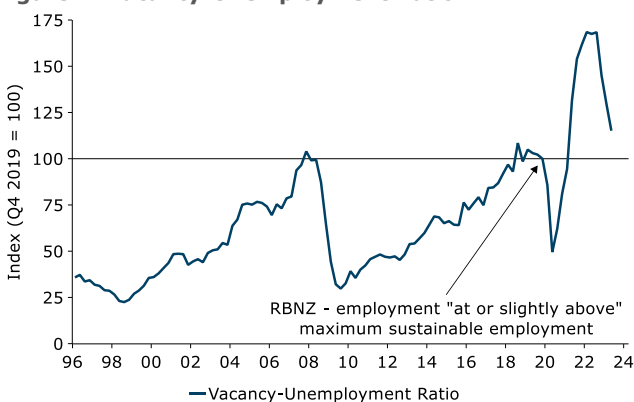
Source: Stats NZ, Macrobond, ANZ Research

Figure 3. Unemployment and participation



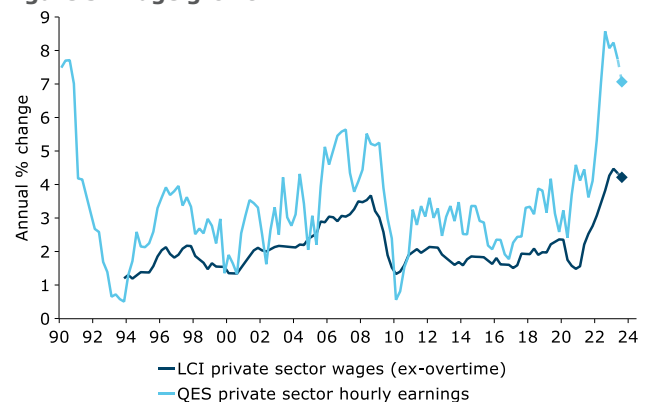
Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Vacancy-Unemployment Ratio



Source: Stats NZ, MBIE, Macrobond, ANZ Research

Figure 5. Wage growth



Source: Stats NZ, Macrobond, ANZ Research



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