ANZ Insight: Holding on and letting go – high stakes for monetary policy

4 August 2025

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Confused by acronyms or jargon? See a glossary here.

Key points

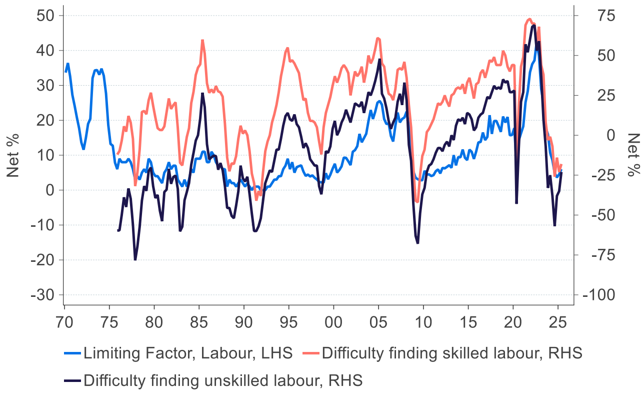
- Firms appear to have been hoarding labour in anticipation of an eventual economic recovery. We estimate this has kept the unemployment around 0.5% pts lower than otherwise in recent quarters.
- If the recovery doesn't materialise with the gusto firms have been anticipating, the labour market could be hit with a double whammy: weaker-than-otherwise demand for labour and a shedding of hoarded labour.
- The recent deterioration in the high-frequency data combined with signs that firms' capacity to hold out for the recovery is diminishing suggests risks are skewed to weaker labour market outcomes than we or the RBNZ have been forecasting for the next year or so.
- If firms are forced to "right-size" their labour input with layoffs instead of the economic recovery doing it for them, the OCR would likely need to be cut below the 2.5% terminal we have pencilled in in order to avoid a persistent inflation undershoot.
- Despite recent CPI and inflation expectations data remaining a little too high for comfort, we think the RBNZ will need to start putting more weight on these downside medium-term inflation risks. That suggests a dovish pivot could be on the cards at some point this year.

Some firms appear to have been hoarding labour

Difficulty finding labour was turned up to 11 in the wake of the pandemic. It was a unique set of economic conditions: an overstimulated economy saw labour demand surge, while border restrictions severely limited firms' access to imported labour. The NZIER's Quarterly Survey of Business Opinion saw labour as a limiting factor on production and difficulty finding both skilled and unskilled labour hit their highest levels ever recorded – impressive for series that stretch back 50 years! Fast forward to today and these indicators are now running below their long-run averages.

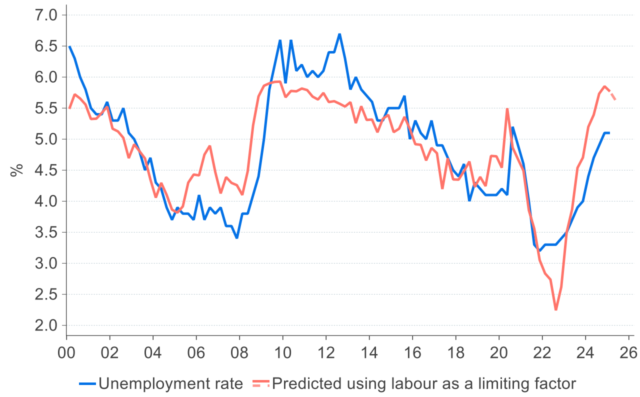
Regression analysis reveals that all three of these indicators predicted a lower unemployment rate than actually came to pass in 2021-2022, possibly owing to mismatching effects, such as difficulty transitioning workers from the struggling international tourism sector to the overheated residential construction sector. There's no question firms would have hired more workers had they been able to find some with the required skills. But now, these same models suggest the unemployment rate should be around 0.5% points above the 5.1% recorded in Q1 2025, suggesting that after a few years of really scrambling to find workers, some firms are holding onto more labour than they currently need in anticipation of an eventual recovery.

Figure 1. Labor scarcity was turned up to 11



Source: Stats NZ, NZIER, Macrobond, ANZ Research

Figure 2. Business survey regression

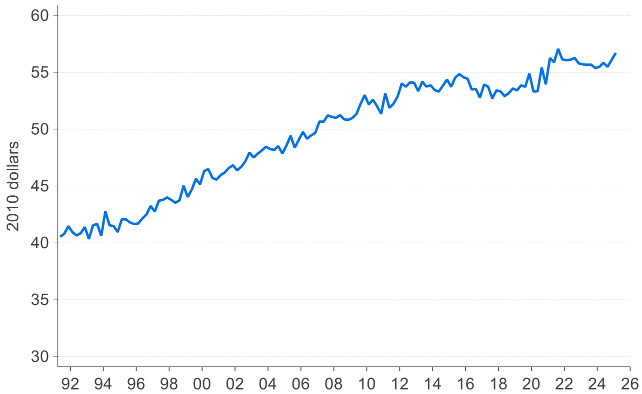


Source: Stats NZ, NZIER, Macrobond, ANZ Research

Many other indicators support this "labour hoarding" theory:

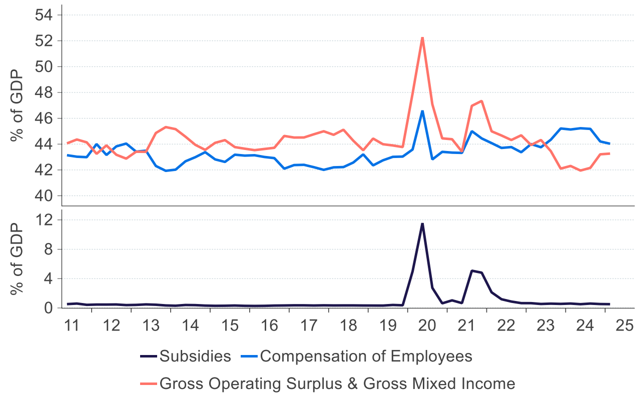
- Real GDP per hour worked started drifting lower from 2022 (but has recently ticked up as GDP growth outpaced hours in Q4 2024 and Q1 2025, figure 3).
- Compensation of employees as a share of total GDP started lifting from around mid-2023 as the share of businesses' profits sank (figure 4).

Figure 3. Output per hour worked



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Shares of income GDP



Source: Stats NZ, Macrobond, ANZ Research

The motivation behind labour hoarding is intuitive: it is typically costly to hire and train new staff, and if firms expect the current lull in demand to be temporary (and they have the balance sheet capacity to pay for it), it might make sense to hold onto workers so the business is well positioned to respond when demand for its goods and/or services picks up again.

But what happens if the economic recovery many firms have been anticipating doesn't arrive with the gusto they have been expecting, and firms decide to start shedding hoarded labour? In this scenario there could be two forces contributing to worse labour market outcomes than otherwise: the impact of weaker-than-expected GDP growth on labour demand, and the unwinding of past labour hoarding. These forces would very likely feed one another.

What if "normal" correlations reassert themselves?

We can explore this scenario by comparing the current unemployment rate to that predicted by an Okun's law-based model[1]. While there's a wide range of models one can use, we'll stick with our best-fitting dynamic model: this provides a good fit over history and doesn't rely on estimates of the output gap and/or natural rate of unemployment.[2]

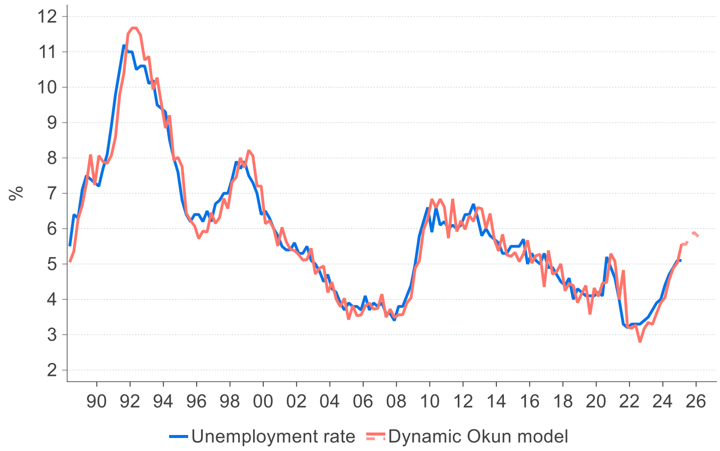
Based on recent GDP outturns, this model predicts the unemployment rate in Q1 "should" have been around 5.6%, rather than 5.1%. That's a similar result to the business survey regression analysis discussed previously.

Looking further ahead, plugging in our forecast for GDP growth suggests that if labour hoarding were to stop containing upward pressure on the unemployment rate, it would lift to just under 6% by the end of the year (figure 5).

Another scenario is to add in a negative growth surprise: shaving around 0.5 to 1%pt from annual GDP growth over the next year or so (i.e. a slower recovery than we are forecasting) combined with the shedding hoarded labour effect would see the unemployment rate lift to a little above 6% by the end of the year.

These scenarios illustrate that while risk is never one-sided, there's plenty of scope for further deterioration in the labour market beyond the 5.2% peak in the unemployment rate that the RBNZ is forecasting.

Figure 5. Okun model



Source: Stats NZ, Macrobond, ANZ Research

Do firms have the balance sheet capacity to hold onto labour until the recovery gathers momentum?

This is a difficult question, but many indicators suggest fatigue is starting to set in:

- Business liquidations are near a decade high (looking through the monthly volatility), though some of this is timing effects caused by evolving IRD tolerance for tax arrears.
- Non-performing loans to businesses also suggest balance sheet stresses are starting to bite. However, these are nowhere near as high as they were following the Global Financial Crisis (figure 6).
- The gap between firms' reported costs and prices is elevated relative to history, and close to that seen in the midst of the pandemic. But unlike during the pandemic, subsidies from the Government (as outlined in figure 4 on page 2) are not helping to cover the gap. Unless costs fall, to align costs with prices firms will either need to increase their prices (a prospect the RBNZ is clearly very worried about) or reduce their costs (such as shedding underutilised labour) – or go bust.

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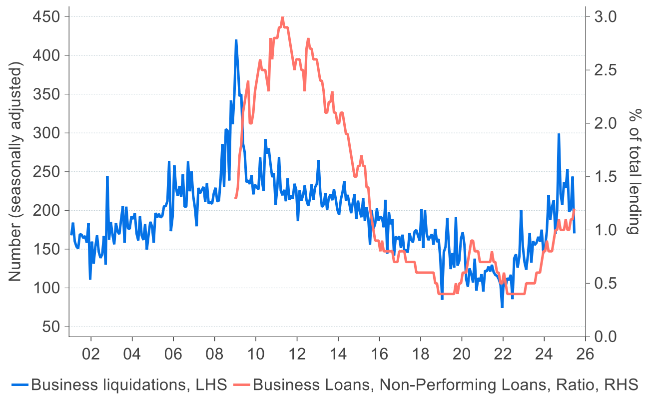
[1] Okun's law (named after the economist Arthur Okun), describes the relationship between unemployment and economic output, showing how cyclical changes in employment levels are closely tied to fluctuations in economic activity.

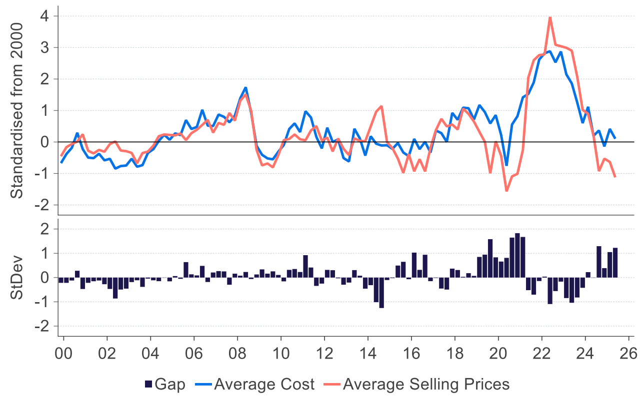
[2] We found the broad conclusions reached here to be replicable using other model specifications.

Figure 6. Liquidations and non-performing loans



Source: Companies Office, RBNZ, Macrobond, ANZ Research

Figure 7. Firms' reported costs and pricing



Source: NZIER, Macrobond, ANZ Research

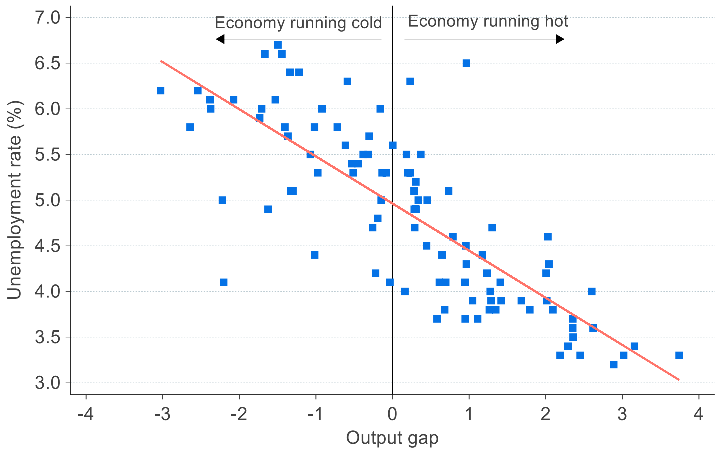
All in all, most signals suggest firms have less balance sheet strength to hold onto labour than they did a year ago. And that increases the risk that the current softening in economic momentum (as indicated by the high-frequency data) causes firms to "right size" their labour inputs the painful way. We aren't expecting large-scale layoffs, but we do expect that employment shrank in Q2, based on indicators such as monthly filled jobs and ANZBO reported past employment.

What could that mean for inflation?

While "maximum sustainable employment" is no longer part of the RBNZ's remit, the fact remains that labour market conditions do most of the heavy lifting when it comes to setting underlying inflation pressures on the right path. Non-tradable CPI inflation (chiefly domestic driven) is closely linked with labour costs, which are determined (in large part) by the balance between labour supply and labour demand.

Indeed, the unemployment rate is a key metric for determining the degree of spare capacity in the economy (and thus medium-term inflation pressures, and OCR decisions): the RBNZ uses it to help calibrate their estimate of the output gap, resulting in a strong correlation (figure 8).

Figure 8. RBNZ's output gap vs the unemployment rate (2000-2025)



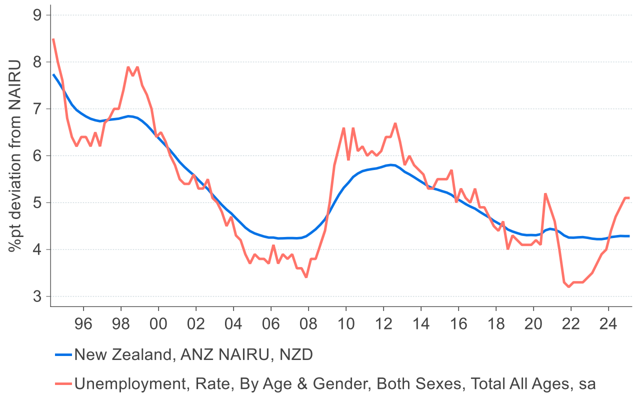
Source: Stats NZ, RBNZ, Macrobond, ANZ Research

Structural changes in the labour market[3] can influence the level of the unemployment rate that might be expected to result in stable inflation at any given time (also known as the NAIRU: non-accelerating inflation rate of unemployment).

To estimate the NAIRU, we run a suite of state space models structured to separate the cyclical and structural forces pushing and pulling on the labour market. For Q1 2025 our central estimate for NAIRU is around 4.3% (figure 9). Figure 10 plots the resulting "unemployment gap" (the gap between our estimated NAIRU and the unemployment rate, including our forecast for Q2) against the RBNZ's output gap, providing a visualisation of how a decent forecast miss in the unemployment rate could impact the RBNZ's assessment of spare capacity.

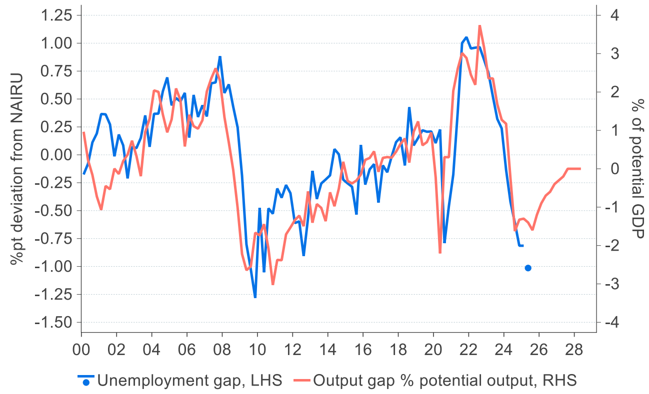
[3] eg. demographic change, rising participation among female and older workers, changes in industry composition, skills mismatches, labour mobility, productivity, matching efficiency, changes to employment law, inflation expectations, tax rates, minimum wages.

Figure 9. ANZ NAIRU estimate



Source: Stats NZ, NZIER, BusinessNZ, Macrobond, ANZ Research

Figure 10. Unemployment gap vs RBNZ output gap



Source: Stats NZ, NZIER, BusinessNZ, Macrobond, ANZ Research

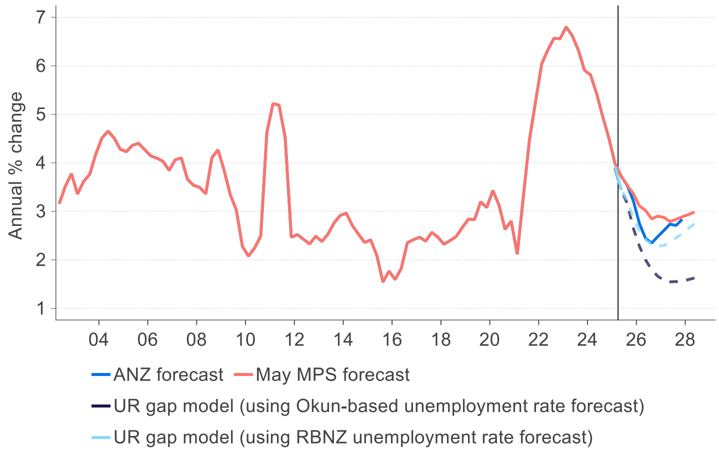
Is the RBNZ putting enough weight on risks to the labour market outlook?

Using a simple dynamic regression, figure 11 shows a "no judgements" forecast for annual non-tradable inflation using two different measures of the unemployment gap: one using the RBNZ's May MPS forecast for the unemployment rate (and our NAIRU estimate); the other using the unemployment rate forecast derived from the Okun's law-based model (using the RBNZ's GDP growth forecast). We've added our and the RBNZ's actual forecast for non-tradable inflation on the chart for context.

Of note:

- The non-tradable inflation forecast using the RBNZ's unemployment rate forecast is weaker than the non-tradable forecast presented in the May MPS, suggesting the RBNZ is imposing positive judgement to their inflation outlook, as we discuss on the next page.
- The forecast based on Okun's law, where labour input is right-sized by shedding hoarded labour (i.e. a higher unemployment rate) results in a much more persistent non-tradable inflation undershoot (assuming non-tradables will need to settle around 3% for headline inflation to settle around 2%, as has historically been the case). To prevent such an undershoot, the RBNZ would be expected to cut the OCR to a decidedly stimulatory level (i.e. below 2.5%) in this scenario.
- Our forecast for non-tradable inflation is weaker than the RBNZ's. We suspect this is partly owing to slightly smaller positive judgements and a little more weight on our assessment of spare capacity.

Figure 11. Non tradable inflation forecasts



Source: Stats NZ, Macrobond, ANZ Research

The RBNZ has good reasons to apply positive judgement to their inflation outlook

Comparing the RBNZ's published inflation forecast to that predicted by their labour market forecasts suggest they have added some positive judgements to their inflation outlook – and for good reasons; we have done the same, but possibly by a lesser extent (it's hard to know). Some parts of the CPI are simply not that sensitive to monetary conditions and have been running hot lately for reasons other than where we are in the business cycle, including administered prices, demographic change, and even perceptions around risk (e.g. natural disasters and insurance costs. We estimate these insensitive components currently account for about half a percent on annual inflation. That impact is of a similar magnitude to the forecast undershoot in inflation we came up with using the RBNZ's labour market outlook, suggesting that because these pockets of the CPI are running hot, the RBNZ requires the rest of the basket (the interest rate sensitive parts) to compensate. That means running the economy with more spare economic capacity than otherwise (i.e. a weaker labour market than otherwise).

This "extra" (structural) inflation is unlikely to go away any time soon, unfortunately, but we do think that half a percent a year is a reasonable upper bound for what we might see over the next few years, and we don't see it as a barrier to the RBNZ pivoting to a more dovish stance over coming months, particularly if labour market outcomes start to disappoint.

Putting it all together

Firms appear to have hoarded labour in anticipation of an economic recovery. However, if that recovery fails to materialise with sufficient strength (as many high-frequency indicators are currently suggesting), firms may be forced to "right-size" their labour inputs through layoffs instead of waiting for demand to catch up. This shift could amplify the rise in unemployment and exert downward pressure on inflation, necessitating a lower OCR than the 2.5% terminal rate we are currently pencilling in.

While inflation still isn't quite where the RBNZ want it to be, and structural/ administrative price pressures are a worry, it may not take much of a slowdown before the market-driven side of the CPI basket threatens an undershoot in inflation. And with the OCR only one decent-sized net demand shock away from potentially bumping into effective lower-bound constraints, we think that's a risk to be taken seriously. We'll be watching the data closely over coming quarters for signs that firms are starting to shed their hoarded labour.

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