REVERSAL

- We expect some of Q3’s phenomenal strength in both labour demand and supply growth to reverse in Q4.
- The underlying message is still likely to be one of a strong labour market overall, albeit with moderating underlying growth.
- Wage growth is up off lows, but is still expected to be modest.
- We do not expect the figures to materially alter the RBNZ’s thinking on the outlook for the OCR, which is still firmly on hold.

KEY POINTS

- We expect a modest contraction in employment in Q4. While picking quarterly movements in HLFS employment has proven to be somewhat of a mug’s game of late, we feel that the phenomenal 2.2% q/q lift in Q3 overstated the strength of labour demand and will at least partially unwind in Q4. We have pencilled in a 0.5% q/q fall, which would see annual growth cool to 2.8% y/y.
- While this pull-back is expected primarily for statistical reasons, it should be acknowledged that labour demand metrics have looked more mixed of late. The level of national job ads is still elevated, but the rate of growth has slowed. On a three-month average basis, annual job ads growth slowed to 6.1% in December, down from the close to 20% pace seen in January 2017. Firms’ hiring intentions from our Business Outlook (at +2.5) ended 2017 at effectively the lowest level since March 2011, although the equivalent measures from the QSBO were not quite as weak. But a pull-back in employment would not necessarily be inconsistent with these signals.
- We also expect the labour force to reverse Q3’s strength too. On the back of a full percentage point lift in the participation rate to a new all-time high of 71.1%, the labour force grew 2.1% q/q in Q3. If employment at least partially unwinds its Q3 strength, the historical correlation with changes in the participation rate implies that it should also reverse course. For what it’s worth, we assume it falls to 70.5%, which would see the overall labour force contract by 0.5% q/q.
- That should leave the unemployment rate broadly steady. While technically our forecast is for it to tick up 0.1%pts to 4.7%, that is still lower than in Q2 and sits within the context of a gradual downward trend. This steady-to-lower unemployment rate theme should be the main focus when interpreting the figures. It is consistent with a labour market that is relatively strong and is still continuing to tighten gradually.
- Once again the question will be whether this tight labour market is filtering into higher wage inflation. We still believe that that will occur in time. The unemployment rate is below our current estimate of the NAIRU (~5.1%). In addition, the shift in policy direction (minimum wage hikes and industrial relations reform) is also consistent with a higher wage growth theme, at least in spirit.
- But evidence of this in the Q4 figures is unlikely to be clear-cut. We expect the private sector Labour Cost Index – our preferred measure of wage inflation – to rise 0.5% q/q (2.0% y/y) in Q4. That is up off its lows, but still only modest relative to history and also the supposed
tightness in the labour market. And if there is any risk to our pick, we’d argue it is skewed modestly lower. Like with inflation more generally, structural factors are continuing to supress the relationship between wage growth and traditional drivers such as the degree of slack evident.

- **We should see a similar theme in alternative Quarterly Employment Survey wage measures.** We see total private sector hourly earnings lifting only 0.2% q/q, versus Q3’s 1.2% q/q lift, with the usual seasonal lift in employment in lower-paid industries (hospitality, retail and horticultural workers in the quarter) contributing to the softer result. This would put annual growth at a modest 2.5%.

- **So we suspect the overall message from the figures will be consistent with recent outturns.** The labour market is strong overall, and is continuing to gradually tighten – although perhaps at a slower pace now – but the missing ingredient remains a sustained pick-up in wage inflation. It is the latter that is likely to be key if we are to see a broadening in domestic inflation pressures in the economy versus the pockets of housing-related price pressure we are seeing right now.

- **Therefore we struggle to see the figures having any material implications for the RBNZ’s thinking on the outlook for monetary policy.** And that is even with the labour market set to take greater prominence in the future, given a likely shift to a dual mandate in the not-too-distant future.

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**Figure 1. Participation and unemployment rates**

**Figure 2. Job ads versus employment growth**

**Figure 3. Unemployment, difficulty finding skilled labour**

**Figure 4. Measures of wage inflation**

Source: ANZ, Statistics NZ, NZIER, Seek, Trade Me
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