MAKING A WAGER

BOTTOM LINE

- The labour market was broadly stable in the June quarter. The unemployment rate rose 0.1% to 4.5%, due to slightly higher labour force participation.

- Wages are being boosted by the minimum wage lift, but underlying wage growth has stagnated. We expect that the RBNZ will "look through" temporary factors boosting wage and price inflation, retaining a cautious approach to monetary policy, with the OCR on hold for some time yet.

KEY POINTS

- **Employment growth moderated in the June quarter.** HLFS employment grew 0.5% q/q. Employment growth has been resilient, despite softer hiring intentions and job ads growth, and annual growth remains elevated at 3.7% y/y. HLFS employment data has been volatile of late and may be overstating strength in labour demand. Growth in QES filled jobs increased 0.8% q/q to be up a more modest 1.2% y/y. At the very least, divergences between the HLFS (which surveys households) and the QES (which surveys businesses) point to continuing noise in the statistics.

- Although labour demand continues to support employment growth, labour productivity growth remains weak. Growth in hours worked/paid has been strong in recent years and that theme continued in Q2. HLFS hours worked were up 1.4% q/q (2.4% y/y), while QES hours paid were up 1.1% (5.4% y/y). With the economy growing at or a bit below trend, this suggests weakness in productivity growth has continued as firms continue to throw labour at the problem of increasing output.

- The participation rate was broadly flat at the high level of 70.9%. That, plus a 0.5% q/q increase in the working age population, means labour demand was matched by solid growth in labour supply. The unemployment rate ticked up to 4.5%, driven by the small lift in the participation rate. The participation rate can be noisy – looking through this, the labour market is tracking broadly sideways.

- The labour market remains tight. The unemployment rate at 4.5% is close to estimates of full employment, consistent with firms experiencing difficulty in finding skilled labour. The underutilisation rate ticked up to 12.0% and remains historically high. This high level may imply that there is more spare capacity available in the labour market than the unemployment rate alone suggests, with employees willing to work more. Or it could be a symptom of mismatch of employers’ needs and workers’ skills or location. The labour market is expected to tighten further, but only modestly, given weakness in forward indicators of labour demand, such as employment intentions in our business confidence survey.

- Wage inflation was strong, boosted by the minimum wage increase. Our preferred measure of wages – the private sector Labour Cost Index – increased 0.6% q/q. The increase in the minimum wage on April 1 provided a boost to the tune of 0.2%pts, as we had expected (based on self-reporting by firms, which will include spill-over effects). In annual terms, wage growth ticked up to 2.1%, with the minimum wage increase and Q3’s pay settlement for care workers contributing 0.5%pts combined.
Although the labour market is tight, underlying nominal wage inflation is weak. Excluding temporary factors, underlying private sector wage inflation is running at 1.6% y/y. Underlying wage growth has stagnated at a subdued rate. In part this weakness relates to the subdued inflationary environment; real wages have been growing at about average rates.

Other measures confirmed this weakness. The all-sectors LCI was up 0.5% q/q (0.4% excluding the minimum wage impact). This measure is running at a subdued 1.5% y/y excluding temporary impacts. Public sector wages grew a weak 0.3% q/q (1.4% y/y). The unadjusted private sector LCI rose 1% to see annual nominal wage inflation stable at 3.5%. QES average hourly earnings rose 0.2%, following recent strength, with earnings up 3.3% over the year. This measure can be thrown around by compositional changes and tends to be quite volatile.

We expect that wage inflation will increase further from here, with minimum wage rises and public sector pay settlements providing a boost. These factors will contribute 0.2%pts to LCI wage inflation per year in coming years. But the underlying wage pulse is expected to improve only gradually, with only limited impacts on inflation.

While the labour market has performed well, clouds may be forming. Businesses are downbeat and the labour market could falter if this flows through into hiring. Rising labour costs are impacting firms. Real unit labour costs (the cost to produce an extra unit of output) have been growing well above average rates, in part due to weakness in labour productivity growth.

We expect the RBNZ will “look through” the temporary factors boosting wage inflation. Until we see a broadening in inflation pressures, including a sustained lift in core inflation, the RBNZ will remain cautious, with the OCR on hold for some time yet.
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