ON TRACK FOR A RAISE

- Labour market data for Q1 2018 is expected to show continued strength in the labour market, with only gradual improvements likely from here.
- Wage inflation is expected to remain modest, but we are anticipating further increases in time. Conditions are in place for firmer wage inflation, even if it is gradual.
- The RBNZ is expected to be more focused on labour market data as it moves to a dual-style mandate. But next week's figures will not change the outlook for the OCR, which is firmly on hold.

KEY POINTS

- The labour market has been strong of late, and we expect this to continue to be the broad theme. Employment growth has been quite volatile recently. In June 2016 there was a step-change increase in employment as a result of HLFS redevelopment. Since then, employment growth has been choppy. Looking through this, employment has been growing at about 1% q/q on average – a very strong rate.
- Given recent strength, we expect employment growth is due for a weaker quarter. We are picking a 0.3% increase, which would see annual growth pull back to 3.0% y/y (from 3.7%). This is consistent with some softening in near-term indicators since mid-2017, including reported hiring in the QSBO, hiring intentions in the ANZ Business Outlook, and growth in ANZ Job Ads. Over the medium term, we expect employment growth will remain robust but slow gradually, with capacity constraints in the broader economy limiting future increases.
- We expect the participation rate will be flat in the quarter at its current elevated level. But we expect the labour force will increase 0.5%, as a result of continued strong growth in the working-age population, which has increased 2.3% over the past year. We expect strong growth in labour supply will continue to be a feature of the labour market, with very strong migration inflows slowing only gradually.
- We expect the unemployment rate to be broadly steady. The unemployment rate was 4.5% in Q4 – consistent with a ‘tight’ labour market and below our estimate of the NAIRU. We are expecting a modest tick up to 4.6% in Q1 2018, but this is in the context of trending gradually lower. With GDP growth expected to grow around trend and not above, declines in the unemployment rate are expected to remain modest over the medium term. In this environment, we think it will be difficult for the unemployment rate to go below 4%. Our expectation is that the unemployment rate will fall to 4.1% in mid-2019 – consistent with further tightening in the labour market.
- Wage inflation is expected to remain modest, but we are anticipating further increases in time. Although it is subdued, wage inflation has increased over the past year, from 1.5% y/y in Q1 2017 to 1.9% y/y in Q4. We expect LCI private sector wage inflation will be stable at 0.4% q/q, which would see annual wage inflation tick up further to 2.0%. We expect QES private sector hourly earnings to soften to 0.5% q/q (from 0.8% in Q4), but for annual growth to nonetheless increase to 3.5% (from 3.1%).

DATA SUMMARY

<table>
<thead>
<tr>
<th>Employment/Unemployment</th>
<th>Last</th>
<th>ANZ exp</th>
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<tbody>
<tr>
<td>Unemployment rate (sa)</td>
<td>% 4.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Participation rate (sa)</td>
<td>% 71.0</td>
<td>71.0</td>
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<tr>
<td>Employment q/q</td>
<td>0.5%</td>
<td>0.3%</td>
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<tr>
<td>Employment y/y</td>
<td>3.7%</td>
<td>3.0%</td>
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<table>
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<tr>
<th>Wages</th>
<th>q/q</th>
<th>y/y</th>
</tr>
</thead>
<tbody>
<tr>
<td>LCI private sector wages (ex-overtime)</td>
<td>0.4%</td>
<td>1.9%</td>
</tr>
<tr>
<td>LCI private sector wages (ex-overtime)</td>
<td>0.4%</td>
<td>2.0%</td>
</tr>
<tr>
<td>QES private sector hourly earnings</td>
<td>0.8%</td>
<td>0.5%</td>
</tr>
<tr>
<td>QES private sector hourly earnings</td>
<td>3.1%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>
• With the labour market tight and capacity pressures expected to continue to build, conditions are in place for wage inflation to increase further – the question is when. Labour market data released next week predate the increase in the minimum wage on 1 April, which will boost wages in Q2 (and have a minimal impact on employment). But over and above that, Government policy may provide a catalyst for broad-based wage increases in time, with annual minimum wage lifts and industrial relations reform expected.

• But any increases in wage inflation will be gradual. A broader pick up in wage inflation is not guaranteed and any increase could prove temporary. Wage inflation has been lower than labour market capacity would suggest since 2013, and we expect this stubborn weakness will dissipate only slowly. As capacity pressures in the labour market build further, we expect wage inflation will increase little by little to around 2.5% y/y in late 2019.

• The RBNZ will now be more focused on labour market data, given it is moving to a dual-style mandate. But we don’t think next week’s figures will change its thinking. The story remains the same: the economy and the labour market are performing well, but price and wage inflation are elusive. Although the economy is arguably near “maximum sustainable” employment, inflation remains well below the midpoint of the RBNZ’s target band. The RBNZ will remain cautious until it sees a definitive broadening in inflationary pressures, with the OCR to remain on hold for some time yet.

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