WAGGING THE DOG

- The labour market is expected to have stabilised in the June quarter, with the unemployment rate flat at a low level. Wage inflation is expected to have been strong, boosted by the higher minimum wage, while the underlying wage pulse remains modest.
- Wage and price inflation look set to increase further from here, but transitory cost-push factors are at play. In this environment, we expect the RBNZ will remain cautious. They will be focused on trend inflation, which is expected to continue increasing only gradually.

**KEY POINTS**

- **The labour market has gradually tightened and is close to full employment.** HLFS employment data has been volatile recently. Looking through this, employment has been growing at a strong rate since 2014. However, this has been broadly matched by solid population growth and increases in labour force participation. The resulting strong growth in labour supply has seen the unemployment rate decline only gradually to its current low level of 4.4%. We estimate that the unemployment rate is now at or slightly below neutral, meaning the labour market is "tight".

- **We expect that the labour market stabilised in the June quarter, with the unemployment rate flat at 4.4% (sa).** Employment is expected to have grown 0.4% q/q (sa) in the June quarter to be up 3.6% y/y. Softening in employment growth is consistent with recent moderation in hiring intentions in business surveys and softer growth in ANZ Job Ads. Labour demand is expected to have been matched by growth in the working-age population of 0.5% q/q (sa) (2.1% y/y). The participation rate is something of a lottery; we assume it held steady at 70.8% (sa).

- **Modest tightening in the labour market is expected from here.** Over the medium term, we expect employment growth will remain robust but slow gradually, with the economy forecast to grow broadly around trend. At the same time, growth in the labour force is expected to moderate as the migration cycle gradually abates. As labour supply growth eases, we expect the unemployment rate will decline further (to 4.1% in 2020), consistent with modest tightening in the labour market.

- **Nominal wage inflation has been subdued in recent years.** LCI private sector wage inflation was 1.9% y/y in the March quarter, flattered by Q3’s pay settlement for care and support workers, which is contributing 0.2%pts to total LCI wage inflation. Excluding this temporary boost, the underlying nominal wage pulse has been anaemic for the past couple of years, although in real terms wages have been growing near their average rate.

- **Strong wage growth is expected in the June quarter, boosted by the higher minimum wage.** The increase in the minimum wage from $15.75 to $16.50 per hour that came into effect on the 1st of April is expected to add 0.2% to the private sector LCI and 0.35% to QES hourly earnings, with some spill-overs into pay negotiations for workers who are not on the minimum wage. As a result, the private sector LCI is expected to increase 0.6% q/q, with annual growth ticking up to 2.1%. QES hourly earnings are expected to increase 1.1% q/q (4.2% y/y).
• **Further increases in the minimum wage and higher wage expectations will continue to boost wage inflation in coming years.** The minimum wage is planned to be increased to $20 per hour by 2021 and we expect higher wage expectations will continue to spill over into public sector pay settlements and negotiations more generally. In total, we expect these temporary factors will boost LCI wages by 0.6-0.9% over the next few years.

• **The underlying wage pulse is expected to improve gradually.** Looking through the impacts of minimum wage increases and pay settlements, conditions are in place for the underlying wage pulse to improve. The labour market is close to full employment and expected to tighten a little from here. And recent underlying weakness in wage inflation is expected to dissipate gradually. Wage inflation is expected to increase to 2.4% y/y by the end of 2020.

• **While wage and price inflation are expected to lift, we expect the RBNZ will remain cautious.** Transitory cost-push factors including minimum wage impacts, higher oil prices and exchange rate depreciation are muddying the inflation outlook. In this environment, we expect that the RBNZ will focus on trend inflation, which is expected to continue increasing only gradually. It will be looking to see broad-based, persistent increases in inflation pressure, consistent with future inflation close to the target midpoint. As such, we expect the RBNZ will remain cautious even as inflation increases – with the OCR to remain on hold for some time yet.
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