

# June 2023 Quarter Labour Market Preview

26 July 2023



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## June 2023 Quarter

		Exp	Prev
<b>Labour Market</b>			
Unemployment rate (sa)	%	3.5%	3.4%
Participation rate (sa)	%	72.0%	72.0%
Employment (sa)	q/q	0.6%	0.8%
Employment	y/y	3.1%	2.4%
<b>Wages</b>			
LCI private sector wages (ex-overtime)	q/q	1.2%	0.9%
LCI private sector wages (ex-overtime)	y/y	4.4%	4.5%
QES private sector hourly earnings	q/q	1.8%	2.1%
QES private sector hourly earnings	y/y	7.7%	8.2%

## A step towards sustainable levels

- We expect the Q2 labour market statistics (to be released 2 August) to show a relatively looser picture than Q1, although in an *absolute* sense, the labour market remains intensely inflationary.
- The unemployment rate is forecast to rise 0.1ppt to 3.5%, as a 0.6% q/q (3.1% y/y) lift in employment is offset by a solid 0.7% q/q increase in the working-age population (bolstered by the recent net migration surge).
- We think wage growth has peaked, with capacity pressures in the labour market and inflation expectations gradually easing. We expect QES private sector average hourly earnings (ordinary time) to rise 1.8% q/q (7.7% y/y), and the productivity-adjusted private sector labour cost index to lift 1.2% q/q (4.4% y/y).
- All up, the labour market is still at intensely inflationary levels and is expected to remain inflationary until 2024. For the RBNZ, it's extremely unlikely the Q2 labour market release will tick any boxes suggesting it was back at 'maximum sustainable levels' in Q2 (we're well through that), but this level is approaching as monetary tightening works through the economy. The Q2 data will give an indication of how quickly the labour market is transitioning to sustainable levels, and a feel for the risks around whether current OCR settings are tight enough to get it there before high domestic inflation becomes problematically embedded in wage and price-setting behaviour.

## The view

To date, the labour market has been somewhat immune to the slowing momentum evident across the economy. While it's not at all unusual for the labour market to lag the broader economic cycle, the RBNZ will grow increasingly wary if the labour market response is looking tardy. With the Q2 CPI data highlighting a worrying persistence in domestic-driven inflation, likely tied to the strength of the labour market and resultant wage growth, a loosening in the labour market is a clear prerequisite for the RBNZ remaining comfortable in its on-hold stance.

While we expect the Q2 labour market statistics to show that the transition towards sustainable employment is underway, with unemployment ticking up and wage growth having peaked, it remains highly uncertain whether that process is occurring fast enough.

The key driver of the transition thus far has been a supply-side recovery. In Q2, the working age population grew 0.7% q/q, largely down to the recent surge in migration, although we expect employment growth of 0.6% q/q has absorbed almost all this new capacity. That's symptomatic of the hangover from the extreme tightness in the labour market seen last year, rather than strengthening labour demand currently. The massive influx of workers has enabled firms to finally work through previously unmet demand, as evidenced by steady (albeit slowing) growth in monthly filled jobs. The next release of monthly filled jobs is on Friday – underpinning our employment growth forecast is an assumption of modest monthly growth in June.

Based on our assumption that the participation rate holds up at its record-high level of 72.0%, we expect the unemployment rate to tick up 0.1ppt to 3.5%. That's a small step towards sustainable (less inflationary) levels, but still very far from where the RBNZ needs to see it.

The participation rate, as always, is a wildcard. It's certainly possible that it declines from its record high as jobseekers become discouraged, given the job market is becoming more competitive and labour shortages and the corresponding pull on people into the workforce is fading. However, cost-of-living pressures have not gone away and household budgets remain under pressure, likely enticing people into the workforce.

While the risks are balanced around our forecast, those opposing forces suggest a number of plausible outcomes either side of 3.5%. Table 1 shows the unemployment rate that would result from relatively small surprises on participation and employment growth.

**Table 1. Illustrative range of unemployment rate outcomes**

	Participation (last 72.0%)		
	71.8%	72.0%	72.2%
	0.4% q/q	3.4%	3.7%
	0.6% q/q	3.2%	3.5%
Employment growth (last 0.8% q/q)	0.8% q/q	3.1%	3.3%
			3.6%

Turning to wages, we think annual growth has now peaked. For private sector average hourly earnings (ordinary time), we've pencilled in a 1.8% q/q lift (7.7% y/y). For the productivity-adjusted labour cost index (ordinary time), we're expecting a 1.2% q/q lift (4.4% y/y). However, wage-price spiral dynamics have not been resolved, and further moderation is necessary.

## Monetary policy implications

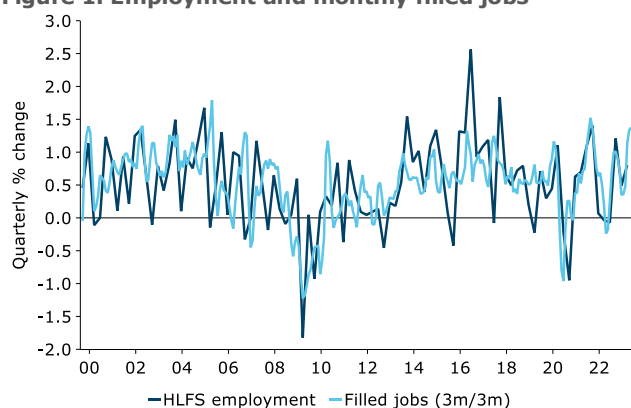
It's a very high hurdle for the RBNZ to recommence hiking in the near term. Since the RBNZ went on hold in May, GDP came in lower than expected, with clear evidence that the economy is slowing (albeit with plenty of cyclone-related noise clouding the signal). Meanwhile, the housing market is now showing clear signs of life, which is an upside risk to the RBNZ's outlook. Non-tradables inflation came in stronger than the RBNZ expected in Q2, indicating the persistence of domestic-driven inflation. That, in part, reflects ongoing tightness in the labour market, made clear by the fact that services and core measures of inflation remained at or near their peaks. The RBNZ will need to see labour market pressures starting to ease to be confident that inflation is sustainably returning to the 2% target.

We expect the Q2 data to signal a small step towards more sustainable levels, but in an absolute sense, the labour market remains far too tight for any comfort. That said, the volatility of the Household Labour Force Survey ought to caution against reading too much into small changes in the unemployment rate. Indeed, given typical volatility, a shift of more than 0.2ppt in the unemployment rate would likely be required for confidence in the signal from a surprise in either direction. However, certainly the only direction that will provide the RBNZ with comfort will be a lift in the unemployment rate towards the May MPS forecast peak of 5.4%.

The RBNZ's forecast in the May MPS had the unemployment rate rising to 3.5% in Q2, in line with our expectation. However, from the second half of 2023, the RBNZ is expecting the unemployment rate to rise as sharply as it did during the Global Financial Crisis. We expect that to occur much more gradually, reflecting our expectation for relatively resilient demand via net migration, sizeable fiscal stimulus the next 12 months, improving business confidence and a pickup in the housing market, all adding to labour market resilience and thus upside risk to medium-term inflation. To be clear, we are forecasting a recession in the second half of the year. It's not a strong story. But we don't see the economy rolling over quite as rapidly as the RBNZ does.

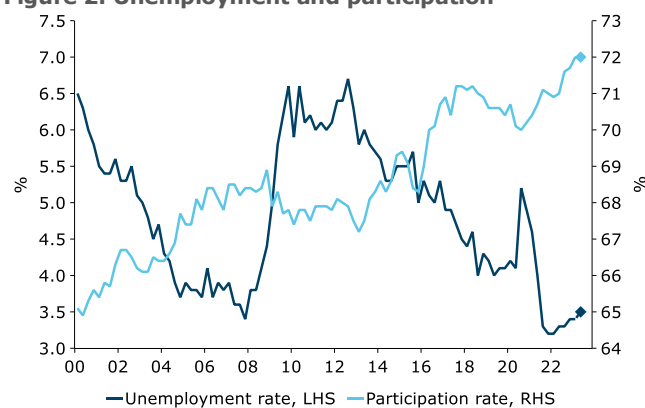
While those risks may not be clear in next week's data, we expect them to become evident as we move further through the year. By November, the RBNZ will have Q2 GDP and Q3 inflation and labour market data to consider. We expect those releases will make the case that capacity in the economy is not opening up quickly enough, resulting in persistent inflation pressures, drawing the RBNZ back to the hiking table. While it's highly unlikely the Q2 labour market will cause the RBNZ to change from its current strategy to "watch, worry and wait" in the near term, the data may add to the RBNZ's discomfort around where the balance of risks lie.

**Figure 1. Employment and monthly filled jobs**



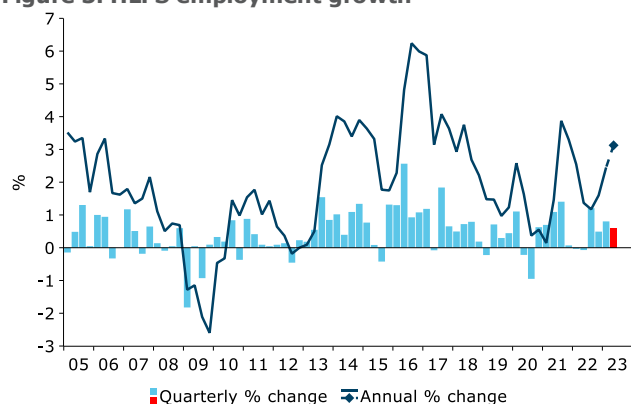
Source: Stats NZ, ANZ, Macrobond, ANZ Research

**Figure 2. Unemployment and participation**



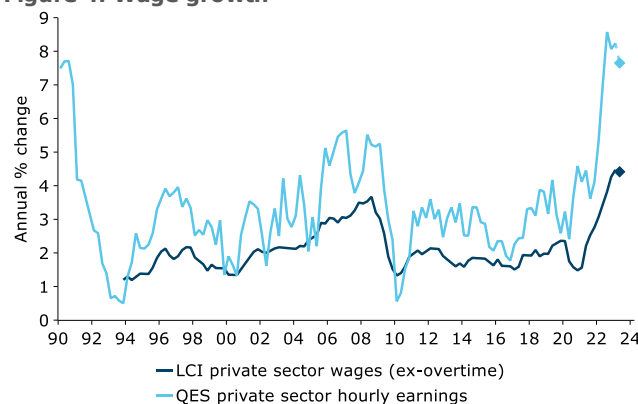
Source: Stats NZ, Macrobond, ANZ Research

**Figure 3. HLFS employment growth**



Source: Stats NZ, Macrobond, ANZ Research

**Figure 4. Wage growth**



Source: Stats NZ, Macrobond, ANZ Research



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