Unemployment declining

Q4 labour market preview, 7 February, 10:45am

2 February 2018

- We expect a further tightening of the labour market over the December quarter, with the unemployment rate falling to a new nine-year low of 4.5%.
- Both employment and labour force participation have been very volatile recently. We expect some payback from their sharp gains in the September quarter, without affecting the broader picture of a stronger jobs market.
- To date, strong demand for workers has not led to an acceleration in wage growth, suggesting that there is still some slack remaining in the labour market. We expect that wage growth remained subdued in the December quarter.

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	2.2	0.2	3.5
Unemployment rate	4.6	4.5	
Hours worked	2.4	0.3	3.3
Participation rate %	71.1	70.8	
Quarterly Employment Survey			
FTE employment (s.a.)	0.8	0.9	2.8
Hours paid (s.a.)	0.8	0.9	2.8
Private avg hourly earnings	1.2	0.5	2.8
Labour Cost Index			
All sectors, ordinary time	0.6	0.4	1.8
Private sector, ordinary time	0.7	0.4	1.9
Private , all salary & wage rates	0.7	0.5	1.9

The December quarter labour market surveys will be released next Wednesday. We expect a continuation of what we saw over 2017: a steady improvement in the unemployment rate, but with no evidence as yet of a pickup in wage growth compared to recent years.

Our forecasts are broadly in line with what the Reserve Bank was expecting in its November *Monetary Policy Statement*. Unfortunately the labour market surveys will be released just a day before the next *MPS* (normally there's another week between the release dates), so there will be little opportunity for the RBNZ to absorb any surprises that may crop up. We suspect the RBNZ would be willing to look through any surprises on the unemployment rate in the near term, but would take more notice of an acceleration in wage growth.

Details

For the Household Labour Force Survey (HLFS), we expect a small decline in the unemployment rate from 4.6% to 4.5%, which would be a new nine-year low. Job advertisements, benefit numbers and business opinion surveys all point to steady rather than rapid improvement in the jobs market over the quarter.

We usually recommend focusing on the unemployment rate as the most reliable indicator, as the details within the HLFS can be jumpy from quarter to quarter. That's likely to be the case again in the December quarter survey. Recently, we've seen a small drop in employment in the June quarter, followed by a whopping 2.2% rise in the September quarter. That was matched by some sharp moves in the labour force participation rate, down to 70.1% in June before jumping to a record high of 71.1% in September.

It's hard to judge the extent to which these movements are genuine or a product of sampling error, but we're inclined to think that the September quarter figures overstate the case. We've assumed some pullback in the participation rate, and a relatively small 0.2% rise in employment, for the December quarter. But we recognise that these measures could surprise in either direction, without affecting the unemployment rate itself.

For the Labour Cost Index (LCI), we expect a 0.4% rise in private sector salaries and wages – no change from the pace of growth that we've seen over the last couple of years (apart from the 0.7% rise last quarter, which included the equal pay settlement for aged and disability care workers). The LCI tends to evolve very slowly, due to the way that it is constructed – for instance, it excludes pay increases that are related to experience and promotions. The unadjusted LCI, which does include these kinds of pay increases, has shown a bit more of a pickup in the last year, but there's not much in it.

We have no evidence to suggest there was a stirring of wage pressures in the December quarter. Indeed, the latest Westpac-McDermott Miller employment confidence survey found fewer workers reporting a rise in earnings over the last year.

Looking ahead

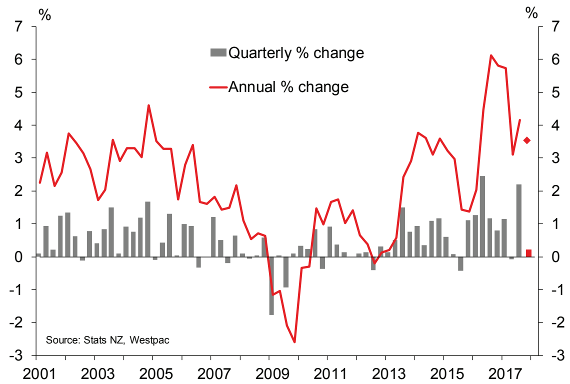
There is no doubt that the labour market is going to feature more prominently in discussions about the economy in 2018. Firstly because, after several years of strong economic growth, much of the spare capacity that arose from the Global Financial Crisis has been eliminated. At some point, a tightening labour market should lead to a pickup in wage growth. But it's not clear whether we've reached that point yet – or indeed whether the recent pace of improvement will continue. There has already been a slowdown in the rate of GDP growth over the last year, and we expect a further slowing in 2018.

Secondly, we have a new Labour-led government that is committed to tipping the balance of power more towards workers, through changes to employment laws, higher minimum wages and a shift towards collective agreements. In a weak economy these policies might dissuade firms from hiring; but in a strong economy where workers are in short supply, employers may simply have to accept a higher cost of labour (and pass it on as higher prices).

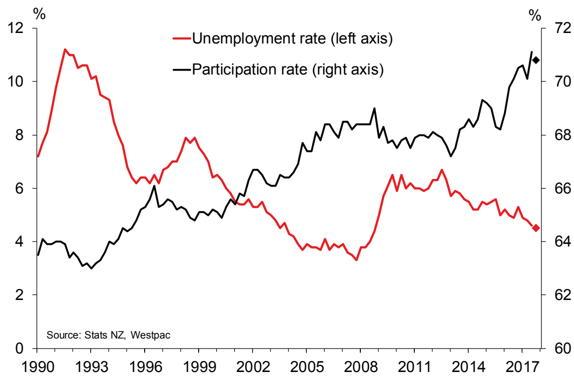
On top of this, the new government plans to include employment as well as price stability in the Reserve Bank's monetary policy goals. This probably wouldn't have made much difference to the RBNZ's actions in years past – employment and inflation both argued for keeping interest rates low. But when the labour market moves into 'tight' territory, there is more scope for conflict between the two mandates – the critical issue being how the proposed employment mandate is specified.

Michael Gordon
Senior Economist

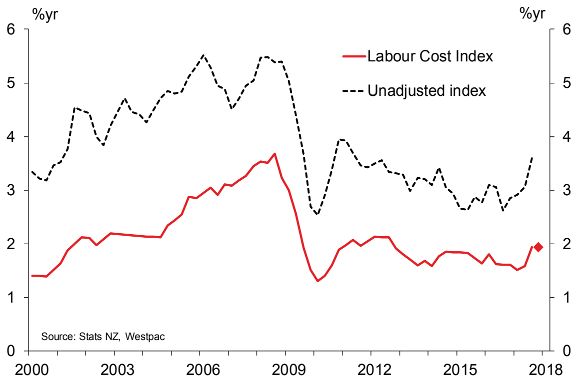
Employment growth (including forecast)



Unemployment and participation rates



Labour Cost Index



Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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