All work, no pay

NZ labour market review, December quarter 2017

7 February 2018

- New Zealand's unemployment rate fell to a nine-year low in the December quarter, in line with our expectations.
- However, a broader range of measures suggests that there is still some slack remaining in the labour market.
- Wage growth remains very subdued, even after accounting for low inflation.
- There is no urgency for the Reserve Bank to raise interest rates in this environment.

The New Zealand labour market tightened further in the December 2017 quarter, in line with our expectations. The unemployment fell from 4.6% to 4.5%, a new nine-year low. The number of people employed rose by 0.5%, and the participation rate fell only slightly from its all-time high in the September quarter.

The rate of unemployment fell steadily but gradually over the course of 2017. The pace of growth in the wider economy slowed in that time, but the labour market tends to be a laggard in the economic cycle – the unemployment rate didn't start consistently falling until 2013, several years after the recovery from the Global Financial Crisis began. It may be that firms are still playing catch-up on staffing levels after the strong growth in activity in previous years.

We recommend focusing on the unemployment rate as the most reliable gauge of the labour market, as the details within the Household Labour Force Survey (HLFS) tend to be choppy. The June quarter survey showed softness in employment growth and participation, followed by a surge in both measures in the September quarter. The continued rise in employment in the December quarter suggests that the jump in the September quarter was largely a corrective move (though still overstating the strength of jobs growth to some degree).

	Quarterly actual		Quarterly expected		Annual
	2017Q3	2017 Q4	Market	Westpac	2017 Q4
Household Labour Force Survey					
Unemployment rate (s.a.)	4.6	4.5	4.7	4.5	-
Employment (s.a.)	2.2	0.5	0.4	0.3	3.7
Participation rate (s.a.)	71.1	71.0	71.0	70.8	-
Quarterly Employment Survey					
FTE employment (s.a.)	0.7	0.2	-	0.9	2.1
Hours paid (s.a.)	0.7	0.4	-	0.9	2.3
Private ave hourly earnings, ord time (all sectors)	1.2	0.8	0.5	0.5	3.1
Labour Cost Index					
All sectors, ordinary time	0.7	0.4	0.5	0.4	1.9
Private sector, ordinary time	0.6	0.4	-	0.4	1.8
Private, all sal & wage rates	0.7	0.4	0.5	0.5	1.9

Over the last year, the HLFS has recorded a 3.7% rise in the number of people employed, with some of the biggest gains seen in professional services and the public sector. While the construction sector continues to draw in workers (up 5% in the last year), it's less of a standout than it used to be in terms of growth.

As unemployment has fallen, forecasters and policymakers have become increasingly concerned with the question of how much lower it can go before stoking the fires of inflation. There's no way to clearly determine where that tipping point lies, but for what it's worth, an unemployment rate of 4.5% is within the range of what we would consider 'neutral'. In other words, we don't appear to have been in 'tight' territory at any point in the last nine years.

That goes some way towards explaining the lack of any pickup in wage growth to date. The Labour Cost Index rose by 0.4% in the December quarter, in line with our expectation, but falling short of market expectations for a rise to 0.5%. The LCI has been rising at the same quarterly pace for more than two years now, aside from a bump in the September quarter due to the pay equity settlement for healthcare workers.

The absence of wage inflation to date is less puzzling in real terms. After adjusting for expected inflation, wage growth in recent years has been comparable with what we saw in the mid-2000s – the difference between then and now being that inflation expectations are much lower today.

But even this isn't a completely satisfactory answer. Inflation, both actual and expected, has risen from its lows in the last year or so. Yet we haven't seen a compensating rise in wage growth, even as the labour market has continued to tighten.

It's possible that there is more slack in the labour market than the standard measures imply. The 'underutilisation' rate, a broader measure that includes underemployed workers and potential jobseekers, has not shown the same degree of improvement: it rose slightly to 12.1% in the December quarter, and has been broadly unchanged over the last year.

The Reserve Bank won't have much time to absorb today's results ahead of its *Monetary Policy Statement* tomorrow, but there is little in the details that is likely to surprise them. The fall in the unemployment rate was in line with the projections in the November MPS. And while the lack of any pickup in wage growth may be disappointing, it is at least consistent with the RBNZ's recent narrative about a low-inflation environment.

In these circumstances, there is no urgency for the RBNZ to raise interest rates. Financial markets are increasingly coming to this realisation: in recent weeks, pricing for the first OCR hike has been pushed out into the first quarter of 2019. We maintain our view that the RBNZ won't be moving until late 2019.

Michael Gordon
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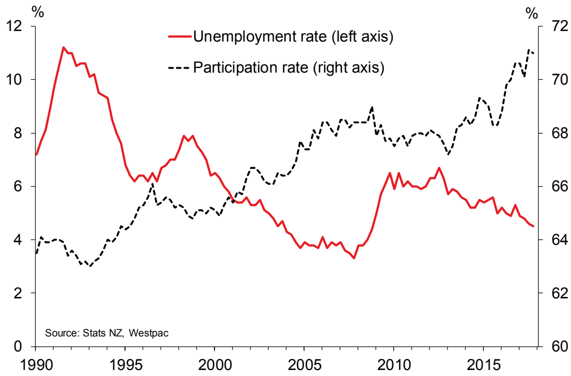
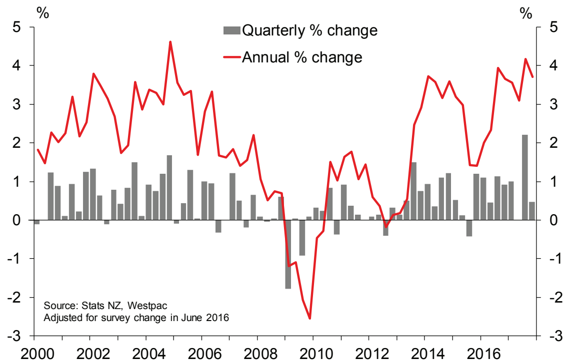
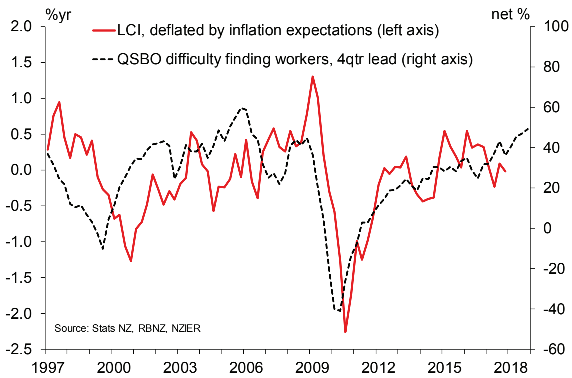
Labour force participation and unemployment



Employment growth



Labour Cost Index



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