Economic Bulletin.

1 November 2019

Preview of Q3 labour market surveys: 6 November, 10:45am.

- We expect the unemployment rate to rise to 4.2% in the September quarter, reversing its surprising drop to an 11-year low in June.
- Indicators of employment growth have softened over the last year as economic growth has slowed.
- However, unemployment has remained surprisingly low to date. Older workers exiting the workforce may be a factor.
- Wage growth is expected to continue its gradual acceleration.
- We expect the Reserve Bank to keep the OCR on hold at its 13 November review. The RBNZ is already braced for a rise in unemployment in the near term, so it would take a worse outcome than what we are forecasting to prompt a change to the OCR outlook.

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	Q2 actual	Q3 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	0.7	0.1	0.6
Unemployment rate	3.9	4.2	-
Hours worked	-1.1	0.0	1.6
Participation rate %	70.2	70.3	-
Quarterly Employment Survey			
FTE employment (s.a.)	0.7	0.3	1.6
Hours paid (s.a.)	0.2	0.4	1.0
Private avg hourly earnings	1.1	1.0	4.3
Labour Cost Index			
All sectors, ordinary time	0.7	0.6	2.2
Private sector, ordinary time	0.8	0.6	2.3
Private, all salary & wage rates	0.8	0.6	2.3

The New Zealand labour market has thrown out some real puzzles this year. A range of indicators suggest that jobs growth has been softening for some time, yet the official unemployment rate fell to an 11-year low in the June quarter. And despite the implied tightness of the labour market, there has been only a hint of a pickup in wage growth so far, outside of government-mandated increases.

Our forecasts imply that the September quarter labour market surveys, to be released next Wednesday, will go some way towards resolving these tensions. We expect the unemployment rate to rise to 4.2%, though there are substantial risks to either side of this number. Employment growth is likely to remain soft, in keeping with the range of indicators that suggest that economic growth was particularly subdued through the September quarter. Even so, given the historically low starting point for unemployment, we expect a further modest uptick in labour costs.

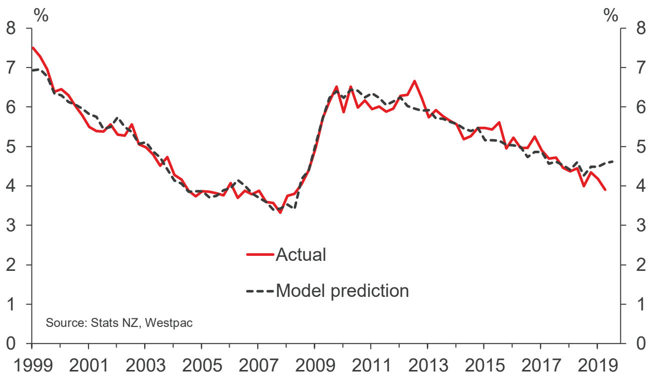
The labour market surveys will be a critical data release ahead of the Reserve Bank's *Monetary Policy Statement* on 13 November. In its August statement the RBNZ was expecting a 4.4% unemployment rate for the September quarter (noting that this forecast was prepared before the surprisingly low June quarter result was published). The RBNZ already shares our view that unemployment will worsen in the near term before it gets better, and we think it would take a substantially worse result than what we're forecasting to prompt the RBNZ to cut the OCR again at its November review.

Forecast details.

For the Household Labour Force Survey (HLFS), we expect the unemployment rate to rise from 3.9% to 4.2%. The decline in the previous quarter was out of step with other labour market indicators, and may have simply reflected the inherent noisiness of the survey. However, we can see arguments for a larger increase, a smaller increase or even a steady result.

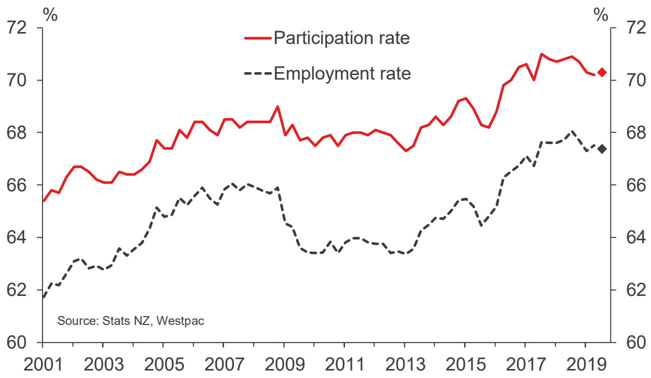
The chart below shows a simple forecasting model for the unemployment rate, based on benefit numbers, job advertisements, and various employment measures from the *Quarterly Survey of Business Opinion*. Unemployment has surprised on the low side for the last several quarters, and the current gap is unusually large: the model suggests a rate of 4.6% for the June quarter, against the actual result of 3.9%. We see a risk that unemployment could snap higher at some point, to be more in line with these indicators.

Unemployment rate



On the other hand, it may be that this model is missing some changes in the structure of the labour market. There has been a notable drop in labour force participation in recent quarters, going against the run of play in previous years. The fall has been concentrated in the 55-64 age group, with early retirement seemingly a major factor. If these people do indeed stay out of the workforce, it's possible that unemployment (which covers those who are actively looking for work) could remain low even at a time of subdued jobs growth.

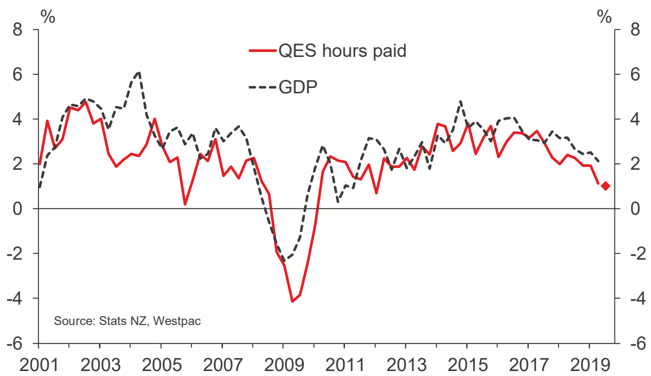
Employment and participation rates



Slowing jobs growth has been a consistent result across the labour market surveys. We expect the HLFS measure of employment to be close to flat for the September quarter, with annual growth slowing to just 0.6%. That probably overstates the extent of the slowdown, however, and our forecast is contingent on the surveyed participation rate remaining below last year's levels.

The Quarterly Employment Survey (QES), which covers employers rather than households, tends to correspond more closely with the pace of GDP growth. We have assumed a 0.4% rise in the hours worked measure for the September quarter, which is broadly in line with our GDP forecast.

Hours paid and GDP, annual changes



Even with the recent softening in employment growth, the labour market has now entered what we would consider to be 'tight' territory, and there are signs that wage growth is finally stirring. We expect a 0.6% rise in the Labour Cost Index (LCI) for the September quarter, which would lift annual growth to a ten-year high of 2.2%.

We recognise that some of the recent lift in wage growth has been due to government policies rather than market forces. In particular, the 0.8% rise in the June quarter was boosted by a large 7.3% increase in the minimum wage. There's nothing quite as significant on the cards for the September quarter, but there are a few factors to note, including the first round of the primary teachers' pay settlement, and the next round of last year's nurses pay agreement.

The LCI is by construction a slow-moving measure of labour costs, as it excludes pay increases that are related to promotions, or changes in the composition of jobs. These factors are captured in the Quarterly Employment Survey (QES) measure of average hourly earnings, which has seen a marked acceleration in the last couple of years (though it too has been boosted by government policies such as minimum wage hikes). We expect a 1% rise in average hourly earnings for the September quarter, keeping annual growth above 4%.

Wage growth (all sectors, ordinary time)

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