WESTPAC ECONOMIC BULLETIN

Preview of Q4 labour market surveys: 1 February, 10:45am.

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Upward pressure on wages to continue.

- We estimate that unemployment held steady at 3.3% for the December quarter.
- The tight labour market has spurred a sharp pickup in wage growth over the last year. We expect to see that continue in the latest quarter.
- The Reserve Bank is already braced for some very strong figures next week, recognising that the labour market tends to lag behind the economic cycle.
- We expect further OCR increases this year, although this week's inflation figures have tipped us towards a 50bp rise next month rather than the 75bps that the RBNZ signalled.

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Unemployment rate	3.3	3.3	-
Employment growth	1.3	0.3	1.5
Participation rate	71.7	71.8	-
Quarterly Employment Survey			
FTE employment	1.5	0.7	1.5
Hours paid	2.1	0.7	2.2
Private average hourly earnings	2.6	1.8	9.0
Labour Cost Index			
All sectors, ordinary time	1.1	1.1	4.1
Private sector, ordinary time	1.1	1.2	4.3
Private, all salary & wage rates	1.2	1.2	4.4

As we've entered the new year, there has been a growing question around the strength of the New Zealand economy, and in turn around how far the Reserve Bank should continue down its hawkish path. But if you're looking for something that could dissuade the RBNZ from further interest rate hikes, next week's labour market surveys probably won't provide it. The labour market tends to lag the broader economic cycle, and the resurgence of wage inflation in particular likely has further to run.

We estimate that the unemployment rate remained at 3.3% in the December quarter. If so, this would mean that unemployment has held at more or less the same low level for a year and a half straight – as good an indication as any that the economy has hit the wall in terms of spare capacity. While surveys suggest that hiring intentions are starting to ease off from their highs, the shortage of workers is still a major headache for businesses.

We've assumed a modest 0.3% lift in the number of people employed over the quarter. We note that the monthly and weekly employment indicators, which are drawn from tax data, suggest a somewhat healthier growth rate than this. The return to a net inflow of migrants in recent months will have helped to power some of that growth in employment, and to ease labour shortages in some areas. However, the Household Labour Force Survey (HLFS) may be slow to pick up on this source of growth – it covers the resident population, which means you have to be in the country for more than a year to be within scope for the survey.

Despite a tight labour market and a surge in the cost of living, wage growth remained fairly modest in 2021. But it picked up the pace significantly in 2022, and we suspect that it has further to go. For the Labour Cost Index (LCI), we expect another 1.1% rise in pay rates for the December quarter. That would lift the annual growth rate to 4.1%, exceeding the previous high of 4% that it reached in 2008 just before the Global Financial Crisis.

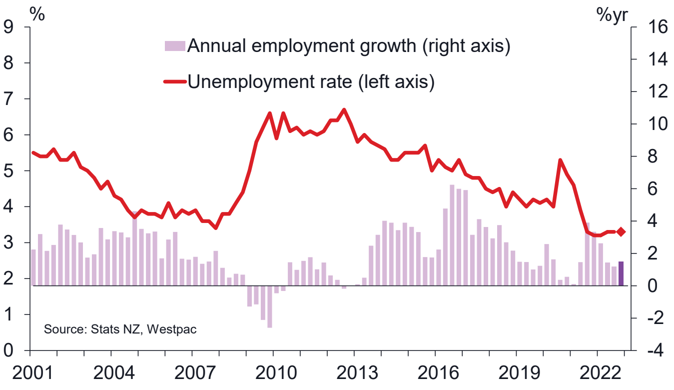
Average hourly earnings as measured by the Quarterly Employment Survey (QES) have taken off even faster than that, rising by 7.4% in the year to September. That was the fastest rate of increase on record going back to 1990. We're braced for a further acceleration to around 8% this time.

The large and growing gap between these two wage growth measures is somewhat disconcerting. We suggested some reasons for this in our review of the September quarter figures, but ultimately we don't get enough of a look under the hood to be sure about what's going on. What we can safely say is that both of them are high and rising, and nowhere near consistent with a return to 1-3% inflation in the foreseeable future.

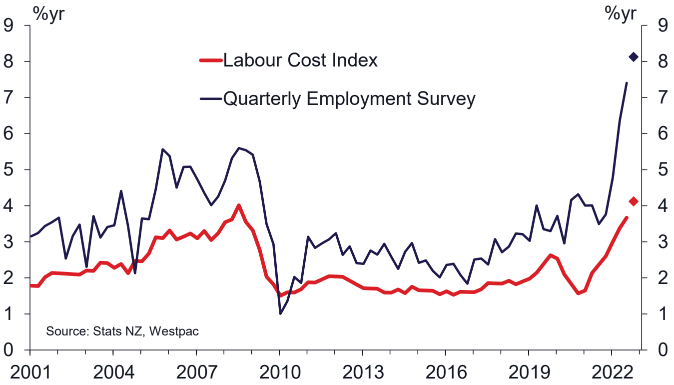
Notably, the acceleration in wage growth marks New Zealand out from some of its peers. While almost everyone has seen a surge in consumer prices, the evidence for a feedback loop between wages and prices has been mixed around the globe – wage inflation has either been slow to emerge (Australia), or seems to have already passed its peak (the US). In contrast, the risk of a wage-price spiral developing in New Zealand is high enough to keep the RBNZ on red alert.

Our forecasts for next week are more or less the same as what the RBNZ expected in its November *Monetary Policy Statement*. While it's generally agreed that the RBNZ has more work to do to bring inflation under control, after this week's CPI figures we've shifted our forecast from a 75 basis point hike to a 50 point hike at the February review. Market opinion is now leaning in this direction as well, but next week's results will help to seal the case for a larger or a smaller move.

Unemployment rate and employment growth



Wage growth, all sectors ordinary time



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