7 February 2018

# Labour Market Keeps Promise of Stronger Wage Inflation

- **Labour market keeps pressing on, post-election**
- **Albeit with mixed messages, especially on wages**
- **Nothing to sway the RBNZ, or us, overall**
- **Hours-worked reiterate caution re Q4 GDP however**
- **Market lifts NZD but interest rates flat-footed**

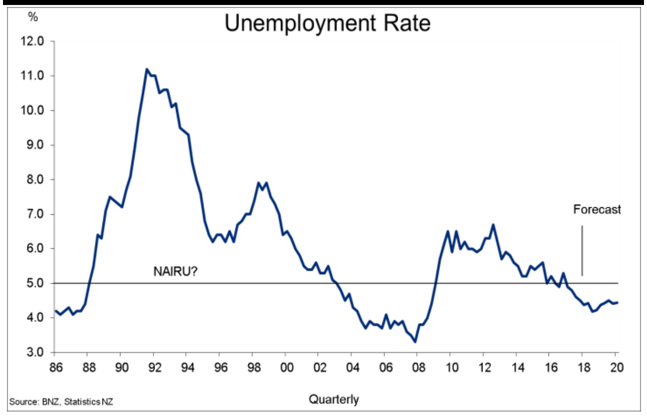
Considering how volatile they have been of late, the NZ labour market data published this morning were reasonably close to expectations. Sure, the Q4 unemployment rate dipped a fraction, to 4.5%, rather than nudging up to 4.7%, as the market expected. And the December quarter employment growth, of 0.5%, surprised the market by +0.1%. However, the Q4 private-sector Labour Cost Index came in 0.1% under expectations, to balance things out.

Today's data certainly add to the impression, however, that the New Zealand labour market is tight and tightening further – but also that, yet again, inflation in wage rates remains frustrated.

Of course, Statistics NZ highlighted today the relative stickiness of its labour underutilisation rate. This snuck up to 12.1% in the December quarter (having been 12.4% a year ago). This is influenced by part-time workers (anyone working less than 30 hours per week) who would like to work more hours.

While this is something to think about, in terms of labour market slack, when we look at all of the information of the state of New Zealand's labour market – anecdote included

Still Tightening




| HLFS/LCI - 2017 Q4 | | | |
|---|---|---|---|
| | **Actual** | Mkt Expected | Previous |
| Employment - qtly % ch | **+0.5** | +0.4 | **+2.2** |
| Employment - ann % ch | **+3.7** | +3.6 | **+4.2** |
| Participation rate % | **71.0** | 71.0 | **71.1** |
| Unemployment rate % | **4.5** | 4.7 | **4.6** |
| LCI, private ordinary - ann % ch | **+1.9** | +2.0 | **+1.9** |

– we get the distinct impression that it's tight and getting tighter. The increasing difficulty in finding staff, as expressed in the latest Quarterly Survey of Business Survey, certainly hammers this point home. And it remains a remarkable course of events, given the still-high net inflow of migrants.

In trying to assess the degree of idle resource in the labour market, we also note that New Zealand's employment rate, even though steady in Q4, remained at a record high. As such it was the third highest in the OECD.

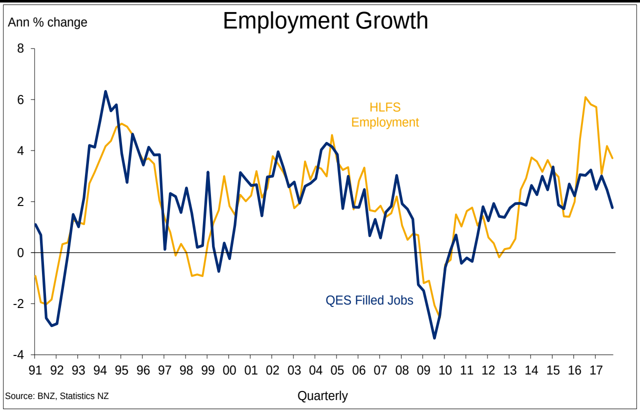
For those struggling to comprehend the 3.7% annual growth reported in the Household Labour Force Survey measure of employment, at least it was slower than Q3's 4.2%. And it was countered by a still-relatively slower gain in the Quarterly Employment Survey (QES) measure on filled-jobs, which in fact cooled to 1.8% y/y, from 2.5% in Q3 and 3.0% in Q2.

There was also conflict between the HLFS and QES judgements on the full-time, part-time, mix of employment. The HLFS is registering a fairly neck and neck race. The QES has full-time employment taking charge, while part-time employment abates.

There are also mixed messages regarding wage and salary inflation. Sure, the market-preferred private-sector LCI was expected to slow in Q4, after a 0.7% gain in Q3 that was flattered by the care-workers' pay settlement of 1 July. But not all the way down to 0.4%. This capped its annual inflation at 1.9%.

Yet the QES measure on average hourly ordinary-time earnings printed annual inflation of 3.1% in Q4, compared to 2.0% in Q3 and 1.2% in Q2. Of course, this series is volatile, and so can't be viewed in quite the same way as

### Strong But Slower




the United States version that got the market all excited last Friday, with its annual inflation of 2.9%.

But it is worth highlighting that New Zealand's average hourly wage rate in the December quarter of 2017 was $28.60. This is not high by developed world standards. This underscores why New Zealand's minimum wage (currently $15.75) is already one of the very highest in the world, relative to local pay rates, and how the new government's push to increase the minimum wage to $20 per hour over the coming few years is set to really up the ante for local businesses.

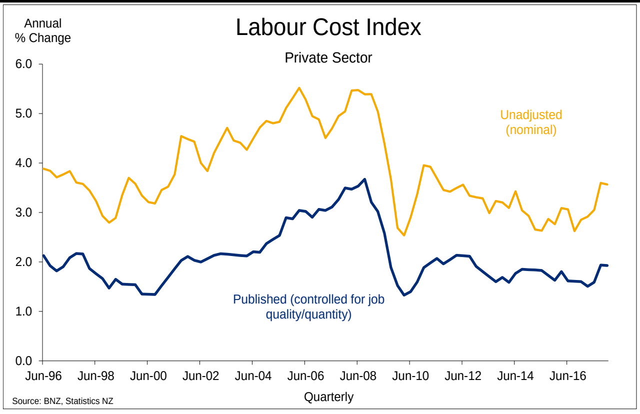
Of course, the legislated increase in the minimum wage is only one of many of the new government's policies that will directly boost wage and salary inflation in New Zealand over the coming years. This will obviously be good for household spending power. However, it will also be interesting to see how local firms roll with these punches from a hiring point of view (conscious of the view that relatively low wage inflation over recent years might well have made it more affordable to take on extra staff).

Having said this, there is the ongoing debate about the true rate of wage inflation in New Zealand, anyway. While the headline private Labour Cost Index, for example, was running at just 1.9%, its unadjusted equivalent was doing 3.6% y/y. We believe the latter is closer to the truth. And if we relate it back to CPI inflation the bottom line is of solid growth in real pay rates (in turn consistent with tightness in the labour market).

And in the spirit of "talking up" the local labour market we also note the strength in the tax revenue stemming from it. For the three months to November, individuals' tax (principally PAYE) was steaming at an annual pace near 10%. It's hard to reconcile this with the suggestion of low inflation in nominal wage rates, at least across the labour market as a whole.

Still, we remain reserved about growth in Q4 real GDP, picking 0.5% versus the Reserve Bank's last published expectation of 0.9% (although subject to review at

### Struggling to Pick Up



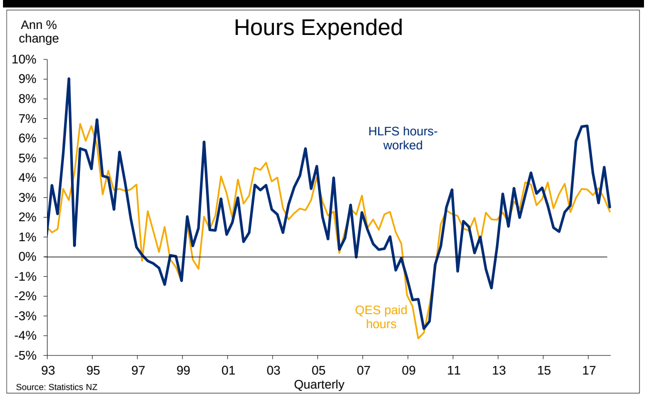

tomorrow's update). Our reserve has been reiterated by the weakness in December quarter hours-worked. Indeed, this HLFS measure fell a seasonally adjusted 0.6% in the quarter, slowing its annual rate of advance to 2.5%, from 4.5% in Q3. The QES paid-hours variable also decelerated in Q4, to 2.3% y/y, from 3.0% in Q3, based on a quarterly increase of 0.4%.

Nonetheless, today's labour market figures seem very much in line with RBNZ thinking. While its November Monetary Policy Statement (MPS) didn't publish its expectations on the Q4 outturns, we infer from its forecasts for the March quarter 2018 that the Q4 labour market data were very close to on track. This will doubly please the Bank, as it would have has finalised its macro-economic forecast some days ago, for the purposes of tomorrow morning's MPS.

With this potential fly in the ointment out of the way, we can return to our script, that the Bank will probably hold the line tomorrow, keep its OCR forecasts essentially unaltered from November. While there might be some near-term weakness in GDP and CPI inflation to note, it doesn't seem to pertain to the labour market.

As for market reaction to this morning's labour market news, the currency market chose to respond to the lower

### Meaning Slower GDP?



than (market) anticipated jobless rate and slightly higher employment outcome, rather than the fractional undershoot on the Labour Cost Index. NZD initially jumped about 40 pips, to around 0.7340. Still, this occurred right when global equity markets were finding a toe-hold, after their vicious correction over prior days, while NZ wholesale interest rates were caught largely flat-footed, looking to tomorrow's RBNZ Statement.

craig_ebert@bnz.co.nz

# Contact Details

## BNZ Research

**Stephen Toplis**
Head of Research
+64 4 474 6905

**Craig Ebert**
Senior Economist
+64 4 474 6799

**Doug Steel**
Senior Economist
+64 4 474 6923

**Jason Wong**
Senior Markets Strategist
+64 4 924 7652

**Nick Smyth**
Interest Rates Strategist
+64 4 924 7653

## Main Offices

**Wellington**
Level 4, Spark Central
42-52 Willis Street
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

**Auckland**
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

**Christchurch**
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854

## National Australia Bank

**Peter Jolly**
Global Head of Research
+61 2 9237 1406

**Alan Oster**
Group Chief Economist
+61 3 8634 2927

**Ray Attrill**
Head of FX Strategy
+61 2 9237 1848

**Skye Masters**
Head of Fixed Income Research
+61 2 9295 1196

**Wellington**
Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

**Sydney**
Foreign Exchange +61 2 9295 1100
Fixed Income/Derivatives +61 2 9295 1166

**London**
Foreign Exchange +44 20 7796 3091
Fixed Income/Derivatives +44 20 7796 4761

**New York**
Foreign Exchange +1 212 916 9631
Fixed Income/Derivatives +1 212 916 9677

**Hong Kong**
Foreign Exchange +85 2 2526 5891
Fixed Income/Derivatives +85 2 2526 5891