Labour Market Revealing Its Inflationary Teeth

- Unemployment rate nudges back up to 4.2%
- As participation rate rises and employment slows
- Underutilisation rate sets new 11-year low
- Wage inflation beating August MPS expectations
- Even accounting for legislated wage jumps
- But we stick with our Nov/Feb OCR cuts for now

This morning’s labour market data were broadly in line with market expectations. However, the results might have the Reserve Bank wondering if the jobs market is more inflationary than it has judged.

Of course, the Bank has quite a suite of labour market gauges it looks to these days, in order to judge “maximum sustainable employment”. However, it seems to view wage inflation as the ultimate test. Tight is as tight does, as the saying goes. The thing is, wage inflation looks set to beat RBNZ expectations, and by even more than was in evidence in today’s Q3 figures.

To be sure, this is predicated on the labour market holding its present shape. But that’s what we’re forecasting.

Granted, the 0.6% quarterly advance in the key private-sector Labour Cost Index (LCI) was slower than Q2’s gain of 0.8%. But Q2 was impacted by the latest annual hike in the minimum wage (namely 7.3%). So the Q3 outcome was still enough to nudge annual inflation in the private-sector LCI up to 2.3%, from 2.2%.

We forecast this to move further above 2.0% as the coming quarters come to pass (where 2.0% is seen as consistent with the mid-point of the RBNZ’s CPI inflation target band).

Our outlook on LCI inflation is thus stronger than what the RBNZ set out in its August Monetary Policy Statement (MPS). The latter was for annual inflation in the private-sector LCI to come in at 2.0% in Q3 then slow to 1.9% in Q4, post a middling 2.1% across calendar 2020 and then, finally, pick up to 2.5% in 2021.

So, in a way, the Reserve Bank is on course to get the wage inflation it was hoping for out in 2021 as early as 2019. Does this mean the Bank is grossly misreading the inflationary state of the labour market? And how does this relate to non-tradables CPI inflation in Q3 coming in higher than the Bank forecast as well?

To be sure, a part of the ongoing pick-up we see in the private LCI wage inflation reflects the aggressive rise in the minimum wage. However, as government policy, this has also been entirely predictable. So we might wonder why the August MPS was indicating barely-2% LCI inflation, even with these known impacts from the sharply rising minimum wage coming through? If this implied a view of a slightly slack labour market, under the surface, then we would have to wonder about that as well.

Of course, this is quite different to the public sector pay settlements that have entered the public-sector LCI of late.

Admittedly, unusually large pay hikes driven by government policy don’t necessary reflect labour market trends. However, they do provide a lot of impetus to household income nevertheless (albeit with potential negative impacts in the private sector employment to consider alongside this, via such things as minimum wage, imposts and migration of private sector employees to now better-paying public sector jobs).
But if we cut back to the underlying messages from the private-sector LCI, granted, annual inflation of something in twos doesn’t sound all that much. But it is significant when the headline LCI is more in the nature of a unit wage cost measure than a nominal pay measure as commonly understood.

In this vein, we note the unadjusted-LCI printed annual inflation of 3.8% in Q3. After accounting for CPI inflation it was 2.3%. This real rate of increase, in outpacing any measures of labour productivity growth we’ve seen, can be perceived as signalling a relatively tight labour market, as reflected in strong inflation in unit wage costs also.

As for what today’s Household Labour Force Survey (HLFS) said about the state of the labour market, there were mixed messages – but nothing that should have shocked anyone.

Sure, New Zealand’s unemployment rate rose to 4.2% in Q3. But this was from the 3.9% level it fell to in Q2, which most analysts at the time, including us, thought was overdone. So market expectations of a 4.1% result for Q3 shouldn’t have felt that put out by the actual result of 4.2%.

This is especially as there was an accompanying lift in the participation rate – to 70.4%, and from an upwardly revised 70.3% in Q2 (previously 70.2%). Directionally this is usually read as a positive development.

Consequently, the employment rate stayed at a relatively high 67.5% (thus still near the very top of the international league table).

As another sign that there is relatively little spare capacity in the NZ labour market – indeed, that it’s comparatively heated – the HLFS underutilisation rate in Q3 dropped to 10.4%, a fresh 11-year low. This, by the way, is a different message than the one we’re getting from Australia’s more-encapsulating measures of labour market slack. Over there, they tend to show a degree of slack far higher than the measured unemployment rate alone portrays.

Employment slowed to a 0.2% quarterly pace in Q3, as expected by the market, from a downwardly revised gain of 0.6% in Q2 (previously 0.7%). This toned its annual pace to 0.9%, from 1.4%. We got a similar impression from the Quarterly Employment Survey’s filled-jobs series, which registered an annual expansion of 1.1% (after a seasonally adjusted increase of 0.4% in the quarter).

This is a slow to slower message on employment, for sure, but also no worse than the leading indicators had suggested (and continue to suggest). While business’ confidence is dreadful, their hiring expectations are not.

While we can say LCI wage inflation is running higher than the last set of RBNZ forecasts outlined, it’s trickier to draw such conclusions from the HLFS data.

Strictly speaking, the unemployment rate, at 4.2% in Q3, is “stronger” than the 4.3% level that the August MPS forecast. So too was annual employment growth, at 0.9%, versus 0.8%. However, because the August MPS did not have time to build in the Q2 outcomes, and Statistics revised the entire HLFS dataset subsequent to that anyway, it’s difficult to make valid comparisons.

Having said all of this, it’s hard to conclude the labour market is any slacker than the Bank imagined, and is arguably tighter than it figured on. Today’s evidence of stronger core wage and salary inflation backs this up.

As for what today’s labour market data mean for our RBNZ/OCR call, it will go into the pot for the MPS preview we intend to publish in the next day or so. There is a lot else to weigh up, including the usual game of second-guessing the thought processes of the decision-makers (as distinct from the conclusions we would come to).

For right now, however, we should say we haven’t officially changed our call, of a 25bp OCR cut next at next week’s MPS and another at the February MPS.

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