NZ’s Bolshy Labour Market

- Unemployment rate hits cyclical low
- Wage growth pushing higher
- Maximum sustainable employment achieved
- Data a hurdle for future rate cuts
- But deteriorating global outlook to dominate RBNZ decisions

In an environment of increasing consternation, today’s labour market data were a welcome surprise. Weakening job ads, rising numbers on the unemployment benefit, falling business and consumer sentiment and declining hiring expectations all suggested that this morning’s release could be negative. As it turned out, the surprise was all in the opposite direction.

At the top of the list, the unemployment rate fell to 3.9% (from 4.2% a quarter earlier) to hit its lowest reading since June 2008. We had thought the unemployment rate had troughed at 4.0% back in September 2018. How wrong we were! Importantly, the unemployment rate has been confirmed as being at, or below, the RBNZ’s view of the NAIRU. The Bank has previously put its NAIRU estimate in a range of 3.4% to 4.9% with a mid point of 4.2%.

The drop in unemployment came thanks to a better-than-expected 0.8% increase in employment. This was a welcome bounce following the decline in employment reported over the previous six months. The annual increase in employment rose to 1.7%. We have long argued that employment growth of around 1.5% per annum is all that the economy can cope with given the combination of a low unemployment rate, a high participation rate and moderating working age population growth.

As evidence of at least full employment, the Labour Cost Index is rising at an accelerating rate. The private sector index of all salary and wage rates rose 2.2% in the year ended June 2019. Sure, the data is being influenced by the increase in the minimum wage but there are still two more minimum wage increases to come and, whatever the source, the wage growth still bolsters consumer spending and increases corporate input costs.

We continue to prefer the unadjusted labour cost measure as the “best” indicator of “true” wage pressure. The annual increase in this measure rose to 3.8% - its highest level since March 2011. When adjusted for consumer price inflation, the 2.1% annual movement represents a solid increase in consumer spending power. Incidentally, private sector average hourly earnings rose an annual 4.6%. This was last beaten in March 2009. And it’s worth comparing this with the US where the equivalent measure is rising at 3.2% and is sufficient there to create consternation about wage pressure.
For the economy today’s figures were all good news. More people are being employed, the unemployment rate is low and, on average, consumer spending power is on the increase.

At face value, all of this should tell the RBNZ that there is no need to lower its cash rate any further. Not only is the labour market palpably tight but it was, on balance, tighter than the RBNZ had already assumed. The RBNZ had forecast annual employment growth of 1.3% (cf 1.8% actual) and an unemployment rate of 4.3% (cf 3.9%) while its LCI forecasts were bang on the mark at 2.2%.

We too argue that the labour market data should provide the RBNZ with a stumbling block in the way of an overly aggressive easing stance. However, one piece of data does not a RBNZ decision make.

Firstly, the labour market data are very much lagging indicators of the state of play and there remain multiple leading indicators that are now hinting that a future deterioration in labour market conditions is plausible, indeed likely.

Secondly, the Reserve Bank board is currently meeting in the midst of extreme angst about the potential for the current China-USA trade spat to turn very ugly indeed. And we, too, concede that the risk of such appears to be rising by the minute.

Putting all this together, we reiterate our view that today’s release will have come too late for the RBNZ to fully incorporate it into the Bank’s MPS. While it will provide a source of discussion about future decisions, it should not divert the RBNZ from cutting interest rates tomorrow. And while the data are positive, whichever way you look at it, global risks are likely to dominate RBNZ thinking ensuring that an easing bias is maintained. The only real question is the extent to which the tug-of-war between the domestic real data and international risk determines the extent of what is now an easing cycle.

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