3 August 2022

Labour market begins to turn?

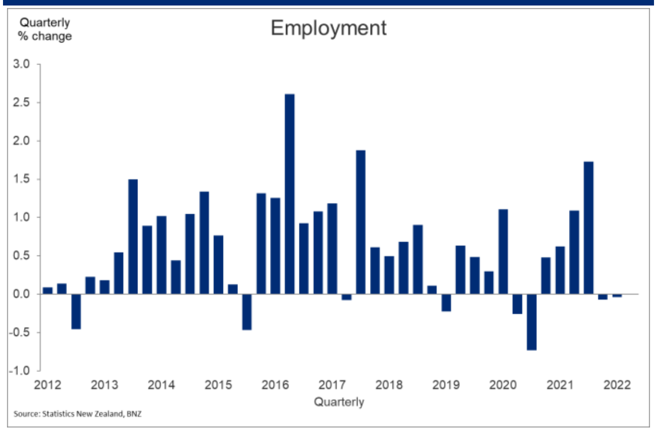
- **Unemployment rate may have passed its low**
- **As job growth stalls**
- **But wage pressures remain extreme**
- **Requiring further work from the RBNZ**
- **Though not as much as some had feared**

We thought today's labour market data might provide us with an excuse to revise our expected RBNZ interest rate track higher. In the event, it did nothing of the sort. Overall, the detail of today's report suggests the labour market might be softening even faster than the Reserve Bank has anticipated.

This is not to say we are anywhere near approaching the RBNZ's goal of maximum sustainable employment but there are some signs that progress is starting to be made. And bear in mind that employment is typically a lagging indicator so to the extent there are already indications of a turning point, at a time when rate hikes have potentially much further to go, will provide the RBNZ with some solace.

Of significant importance here is the fact that there has now been no employment growth for three consecutive quarters. In fact, cumulatively 3,000 jobs have been lost over that period. That said, it is difficult to see how employment can grow when the supply of labour is so restricted.

Employment growth stalls

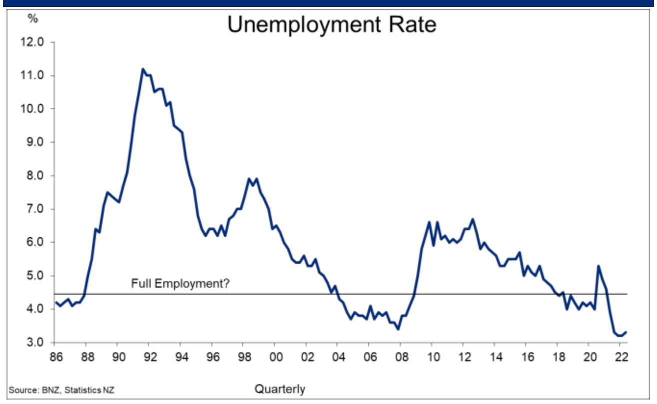


This is where interpreting the swathe of data released today becomes very difficult. In looking at the Household Labour Force Survey (HLFS) it would appear the employment data don't necessarily indicate that the demand for labour is diminishing. Instead it would appear business needs are being met by increased hours worked rather than increased numbers of workers. In the June quarter HLFS hours worked rose a fairly heady 0.8%. While useful from an employer's perspective, increasing hours worked is not a sustainable way to increase labour supply. It is, however, consistent with our expectation that Q2 GDP was fairly robust.

But wait, according to the Quarterly Employment Survey (QES) hours paid for by business declined by 0.7% (and QES filled jobs fell 1.1%)! This tells a very different story to the above and indicates a much softer Q2 GDP than we are anticipating.

Whatever the truth of the matter, the RBNZ had been expecting a 0.3% increase in HLFS employment for the quarter, which explains why it had assumed the unemployment rate would fall to 3.1%. This was very similar to our own expectations. But with no employment growth the unemployment rate instead rose to 3.3%. The rate would have been even higher had the participation rate not dropped to 70.8% when it was expected to stabilise at 70.9%.

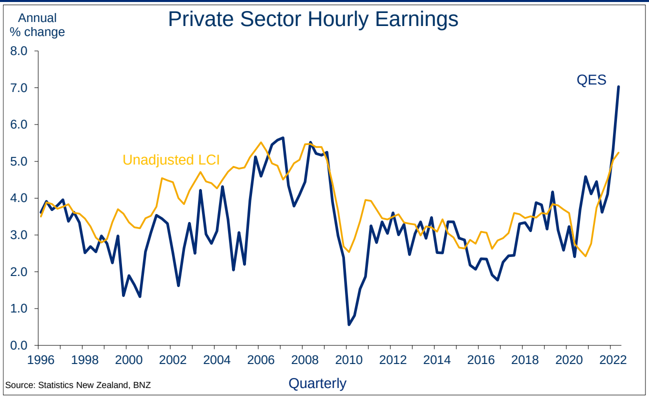
Turning point?



The decline in the participation rate is a tad disconcerting as it's the third consecutive fall. If it keeps falling then it will further reduce the available pool of labour making it harder for the unemployment rate to rise and, in so doing, putting further upward pressure on wages.

And it is on the wage front where things don't look so good from an RBNZ perspective. The Private Sector Labour Cost Index (LCI) did come in near enough to expectations. The RBNZ was looking for 1.2% for the quarter, 3.4% for the year. The actual outturn was 1.3% and 3.4%, respectively, with rounding issues at play. The LCI is the RBNZ's "preferred" measure of wage inflation but, in our opinion, is not that helpful in understanding what is going on in the labour market in terms of costs to employers and, hence, impact on future selling prices. For this, we prefer to look at the unadjusted labour cost index, which rose an annual 5.2% and the QES average earnings measure which has exploded 7.0% (compared to an RBNZ expectation of 5.6%).

Wages skyrocket



Ongoing wage inflation will have a major bearing on future CPI inflation, especially of the non-tradables variety. Only when wage inflation abates will the RBNZ feel it is completely winning the game. This, alone, argues that the RBNZ must continue to push ahead with its general rate hike agenda. However, what the data today do not argue for is an acceleration of that process. Talk of a 75 basis point increase at the August meeting should now be beaten into submission. The more interesting question, now, should be when do the 50s stop?

We will not be changing our rate expectations on the basis of today's figures. For now, we will keep with our view that the RBNZ hikes 50 basis points in August. We have this followed up with two 25 point increases in October and November. However, as we have said many times in the past, there is a risk the RBNZ will need to throw in another 50 in October. That risk remains.

While our rate view is unchanged, we will now go through our labour market forecasts with a fine-tooth comb. Increasingly, it feels like a turning point has been reached such that we may now have seen the lows in the unemployment rate. The speed at which that rate is now expected to rise will be critical in determining where and when the cash rate might peak. In this regard we remain comfortable with our expectation of a peak of 3.50% to 3.75% late this year/early next.

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