3 October 2023

Unemployment surge cemented in

- **QSBO portends rapidly easing labour market**
- **Capacity constraints now minimal**
- **Expected stalling in growth may result in lay offs**
- **Short term inflation is too high but RBNZ must trust the lags**
- **RBNZ should look through short term inflation strength**

The clear message in today's NZIER Quarterly Survey of Business Opinion (QSBO) is that the labour market continues to soften and aggressively so. We have long said the secret to stabilising prices in the medium term is to alleviate the excess demand that had developed in the labour market during the COVID era. We maintain that view.

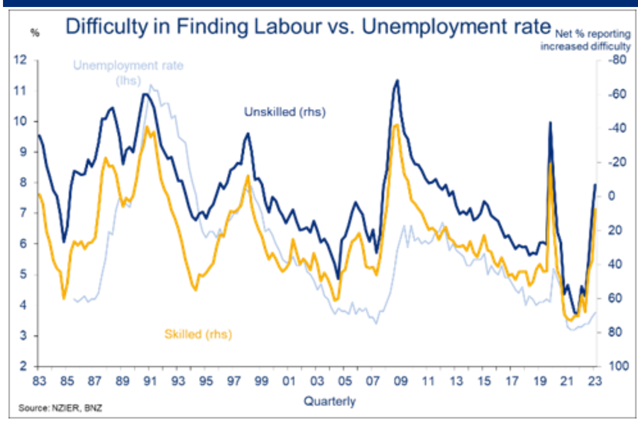
This being so, we believe the RBNZ should trust the leading indicators and stand pat with its interest rate settings until such time that moribund growth and the weakening labour market provide the disinflationary impetus that it desires.

The weakening in the labour market is clear for all to see. And don't forget the Reserve Bank utilises many of these QSBO measures directly in its determination of how far the economy is from maximum sustainable employment.

Of most importance to us is the continued dramatic correction in the difficulty of finding labour. A net 7.7% of businesses say it is getting more difficult to find skilled labour. This is a far cry from the 37.6% who thought likewise a quarter ago and the peak of 73.0% in December 2021. Excluding the first quarter of COVID lockdown, the reading is the lowest it has been since December 2010.

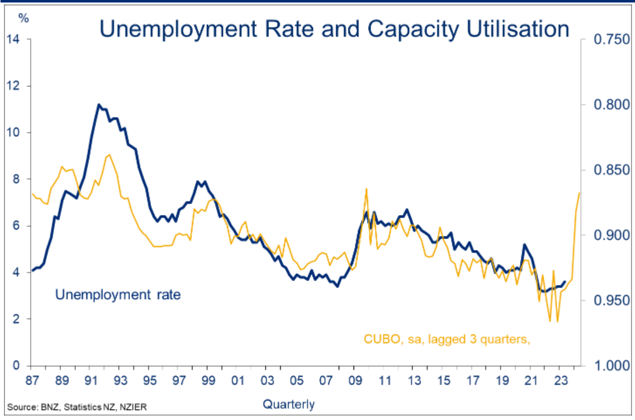
As for unskilled labour, a net 6.8% of businesses said it is now getting outright easier to find such folk. Ex-COVID you need to go back to March 2012 to find an easier reading. The RBNZ is forecasting the unemployment rate to rise to 5.3%. These data suggest the unemployment rate could go higher than that.

Labour getting easy to find?



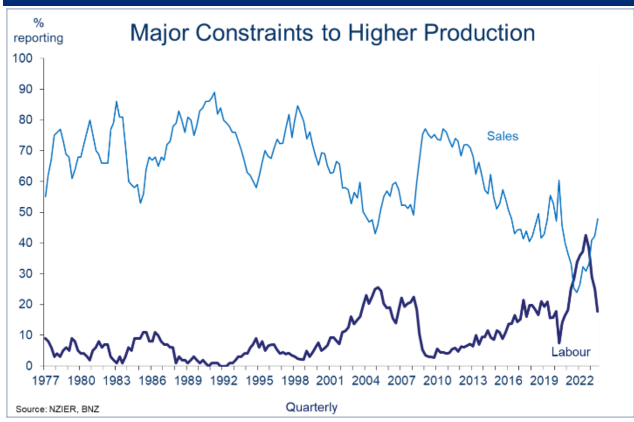
If you want to give yourself a real scare have a look at the historical relationship between NZIER's Capacity Utilisation variable (CUBO) and the unemployment rate. We had thought last quarter's slump in CUBO might be an aberration but, on a seasonally adjusted basis, it fell further this quarter.

CUBO slumps



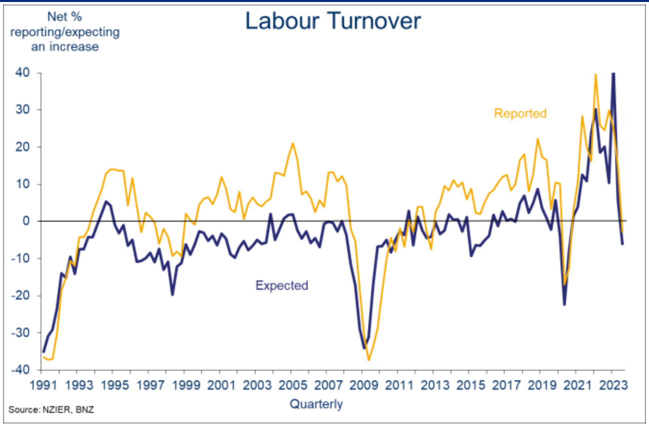
Labour as the major constraint to production (another RBNZ favourite) has also fallen again. 18% of respondents said labour was their biggest problem. This is still above the 11% average for this series but it's a mile away from the 43% who said this a year earlier. It is the lowest reading since December 2020 and has now been aggressively overtaken by the 48% who think sales is the major factor constraint.

Labour constraint diminishes



Another measure of labour market tightness is turnover. A net 3% of businesses reported turnover has fallen. Ex COVID this is the weakest reading since December 2012. Note that the 2010 to 2012 period, the level many of these indicators have now reverted to, saw an unemployment rate averaging 6.2%, CPI inflation 2.5% and a cash rate of 2.6%.

Labour turnover slumps



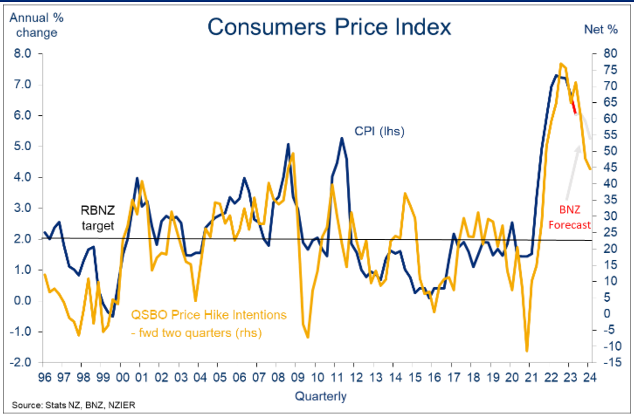
Be that as it may, note that there is no evidence the easing in the labour market is complete yet. The pace of deterioration would suggest there is a very good chance there is more to come. In this regard, note that, on a seasonally adjusted basis, a net 14% of businesses still expect trading conditions to deteriorate. This is consistent with the economy moving back into recession. So far, most forecasts of a rising unemployment rate are predicated on the rapid supply of labour outstripping demand but if the economy does remain weak, then layoffs will also start to contribute.

Recession forecast

The problem for the central bank is that short term inflation continues to be bolstered by rising input costs for corporates. Those of a hawkish bent will acknowledge that pricing intentions are falling but not fast enough. They will note that a net 44.6% of survey respondents still expect to raise prices and that this is only modestly lower than the 47.8% who felt this way a quarter ago.

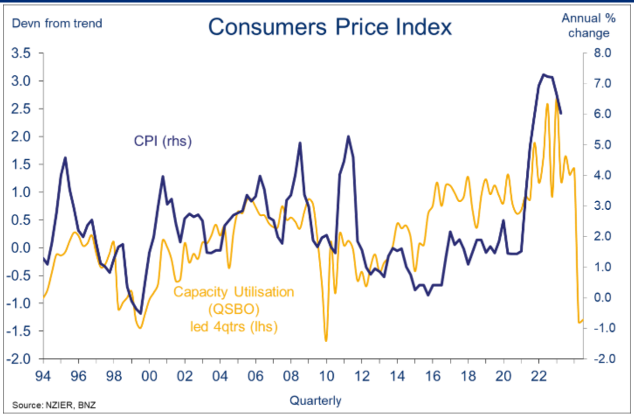
They are right to be concerned by this but we are quick to point out that, for now at least, the pace of decline in inflation expectations is still consistent with the drop in inflation that both we and the central bank are forecasting. And with demand falling, wage price pressure easing and pressure on profits diminishing, there will be less need, or ability, to raise prices going forward.

Pricing intentions still too high?



In line with this note also that the slump in capacity utilisation is suggestive of a much weaker inflationary environment ahead.

CUBO says otherwise



All told, we think today's data significantly increase the likelihood the RBNZ will look through near term upside surprises in the CPI. Near term inflationary concerns are very real and there remains the risk that an incoming government eases fiscal policy in an inflationary manner. However, we think the Reserve Bank needs to trust the lags. The economy has stalled, the labour market is easing rapidly. It would be very unusual times indeed if this didn't dent inflation in due course. The RBNZ may need to keep interest rates elevated for longer to achieve its objectives but there is little evidence crushing the economy any further is warranted.

stephen_toplis@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

Stuart Ritson
Senior Interest Rate Strategist
+64 9 9248601

Mike Jones
BNZ Chief Economist
+64 9-956 0795

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