

Research Economy Watch

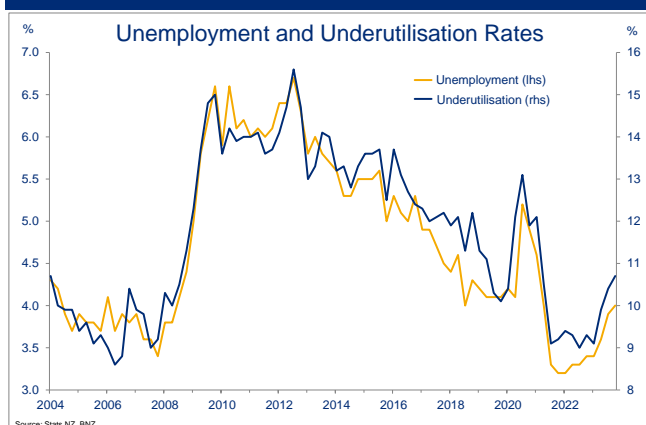
7 February 2024

Labour Market Strength Surprises

- **Labour data stronger than RBNZ expectations**
- **Increases the probability of a rate hike**
- **But trend softening still intact**
- **Unemployment rate set to go a lot higher**
- **Wage pressures should diminish**

The labour market continues to soften. The unemployment rate is the highest it's been since June 2021. And it looks like it's going to go a lot higher yet. In addition, the underutilisation rate has jumped to its highest level since March 2021. The employment rate is falling, and don't forget that employer surveys reveal it is getting much easier to find staff thanks largely to soaring net inward migration.

Labour underutilised



In theory, all the above is consistent with an economic slowdown and a central bank that should be getting increasingly comfortable that a period of aggressive rate increases is doing its job. But the problem is today's data were not as weak as the RBNZ forecast when it released its November Monetary Policy Statement. In particular: the employment rate was 69.0% but the RBNZ forecast 68.9%, quarterly employment growth was 0.4% against a 0.2% prediction and the unemployment rate was 4.0% compared with a 4.2% pick. To cap things off, the key Labour Cost Index rose 1.0% for the quarter when the RBNZ was forecasting just 0.8%.

The RBNZ has been surprised to the downside with the economy's growth outlook but downplayed this. It was surprised to the downside with the headline inflation outcome and downplayed this. It's difficult to imagine that

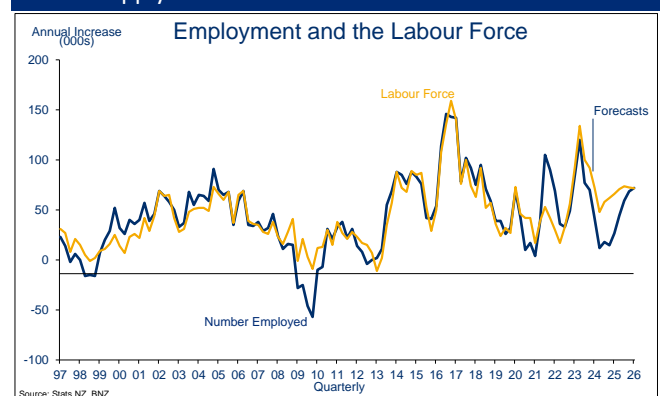
these data will be downplayed given they support the RBNZ's general sense of nervousness about the economy's inflationary outlook.

Adding to this nervousness will be what the data imply for productivity (really weak) and unit labour cost inflation (really high) both of which suggest upward pressure on prices.

With all this in mind, it is highly unlikely the Reserve Bank will adopt a stance at its February 28 Monetary Policy Statement that is any less hawkish than it was when it presented its views in November. In November there was a firm tightening bias and no inclination to lower rates until H2 2025. The question now being asked is will the RBNZ actually hike? We have been warning that the chance of a February rate hike was non-zero (as opposed to the zero chance of a cut). That non-zero chance has now got a little bigger. So, it was no surprise to see the short end of the New Zealand market nudge higher following the labour market release, pricing in a small chance of a rate hike.

While we can't rule out a hike we will stick, for now at least, with our no-change call. We still believe the broad picture represents a general reduction in inflationary pressures and stress again that lags mean that the full impact of the last 250 basis points of tightening have still not been felt.

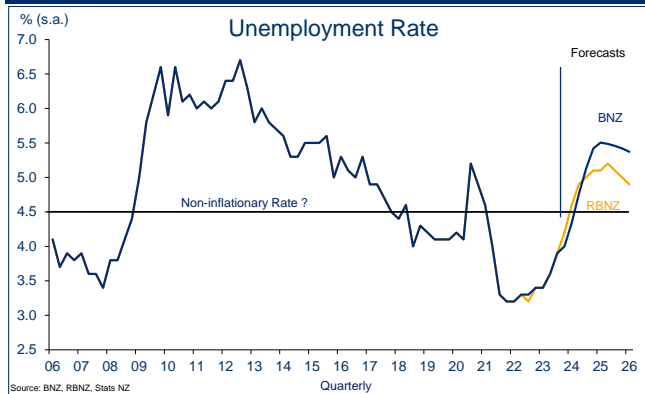
Labour supply exceeds demand



Generally, much uncertainty continues to surround the strength of the labour market. To start with, it seems highly unlikely employers, facing into relatively weak demand conditions, will be able to continue absorbing the

surge in immigration-driven labour supply. In the year ended December 2023 New Zealand's working age population rose an unprecedented 3.0%. Even if Q4's surprising 0.4% increase in employment is sustained (unlikely) labour supply looks set to increasingly outweigh demand unless migration falls rapidly.

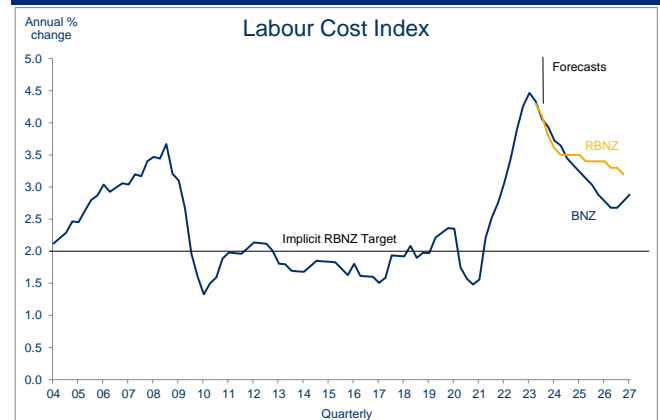
Driving unemployment higher



We also wonder how much the December quarter was impacted by the General Election. Our gut feel is that employment growth will fall from this quarter's move but only time will tell. For what it's worth the Quarterly Employment Survey already says employment is falling with paid hours down 0.5% for the quarter, filled jobs - 0.3% and full time equivalents -0.6%. Volatility in these data make interpreting the QES problematic but worth noting nonetheless.

Whichever way you look at it wage data were robust. This came as no surprise to us with the movement in the Labour Cost Index (private sector all salary and wage rates) coming in at 1.0% for the quarter, 3.9% for the year. Employment lags economic activity. Wage growth lags employment. So, it makes sense that wage data continues to reflect past labour market tightness. The good news from an inflation fighter's perspective is that annual wage inflation continues to fall. And with the unemployment rate increasing, headline inflation falling, and the minimum wage growth set at just 2.0%, we think wage inflation will ultimately end up surprising (the RBNZ included) to the downside.

Wage inflation peaks



stephen_toplis@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis

Head of Research
+64 4 474 6905

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 2, BNZ Place
1 Whitmore St
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

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