Research

Economy Watch

4 February 2026

Labour market lags economic cycle

- **Labour market still slack, but signs of turning**
- **Employment grows more than expected**
- **So too does unemployment**
- **As more people enter the market**
- **Wage inflation match expectations**

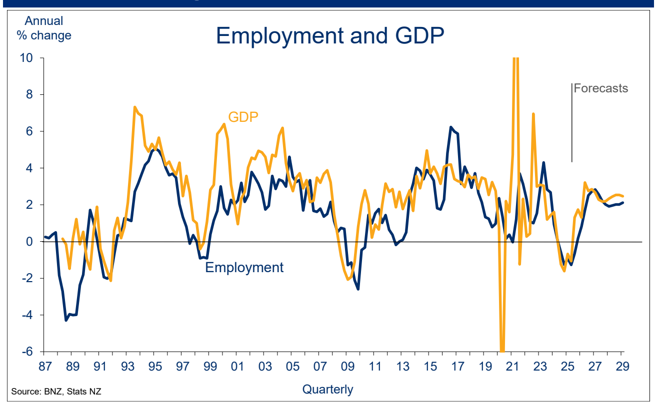
The themes of today's mass of labour market data were much as we outlined in our preview. First, it is too early to see major changes in the labour market as it tends to lag the economic cycle. Second, there are more signs of improvement in the details. Within a decimal point or two the headline figures broadly confirmed our priors.

To be sure, the headline outcomes offered something for doves and hawks alike.

Doves could point to another nudge higher in the unemployment rate to 5.4% from 5.3%. That is the highest unemployment rate since September 2015. It was a tick higher than the 5.3% expected by us, the market, and the RBNZ. It is sombre reading, albeit close to expectations.

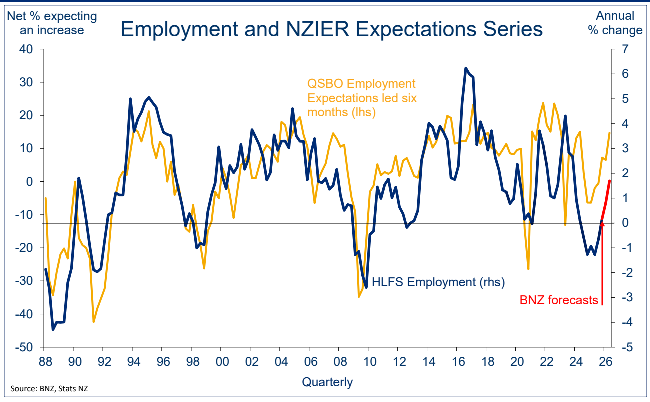
Hawks could point to stronger undercurrents in the detail, especially the return to employment growth. Employment rose 0.5% q/q, its first quarterly expansion in 18 months and its strongest gain since June 2023. Annual employment growth has turned positive, up 0.2% y/y. Net job losses are a thing of the past. It is an encouraging development.

Labour market lags

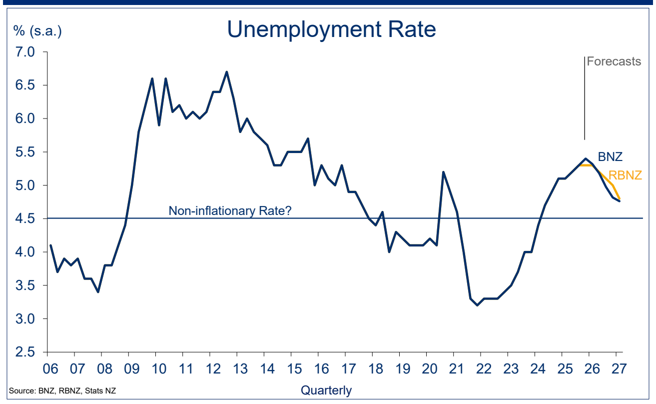


The good news is business employment intentions are strongly positive. This suggests further employment growth ahead.

More employment



And more unemployment

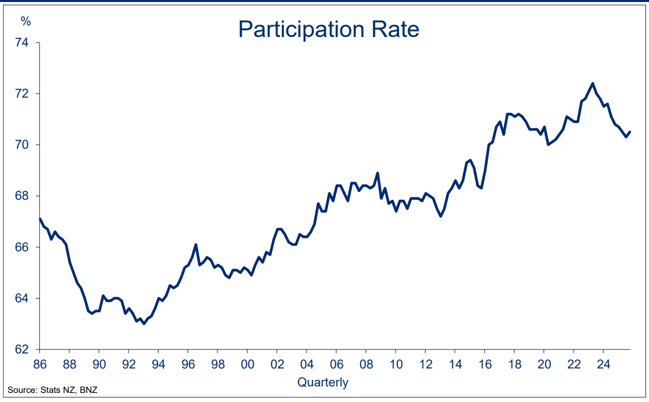


This all raises the question of how the unemployment rate can rise when employment has clearly strengthened? The answer is that more people are entering the labour market. The participation rate rose to 70.5% from 70.3%, a touch more than expected. We had 70.4%, the market and RBNZ anticipated 70.3%.

This is arguably a positive sign. It looks like the opposite of the discouraged worker effect. People may be sensing some pickup in employment opportunities and are entering the market. Had the participation rate not lifted in Q4, the unemployment rate would have been lower.

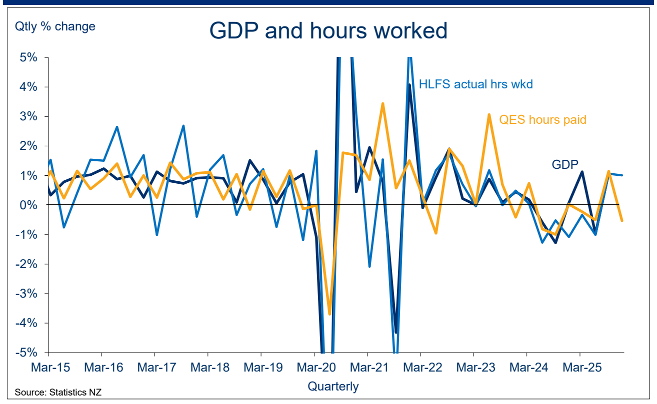
Another way of looking at the balance of those influence influences is via the employment rate. It edged a tick higher to 66.7%. A greater share of the working age population was employed in Q4 compared to Q3.

As more people enter the labour market



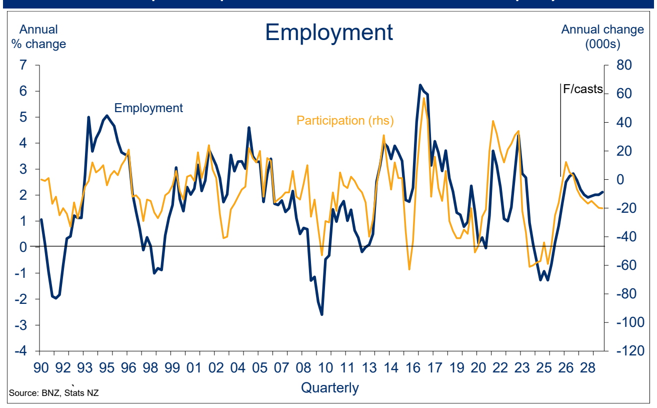
Adding support to the stronger undercurrents is the fact that HLFS hours worked rose a firm 1.0% q/q, its second consecutive quarter of robust quarterly growth. In contrast, QES paid hours fell 0.5%, giving back half of its previous chunky increase. The balance of the employment and hours worked indicators seem consistent with our forecast that economic activity forged ahead in Q4.

Mixed, but supportive on balance



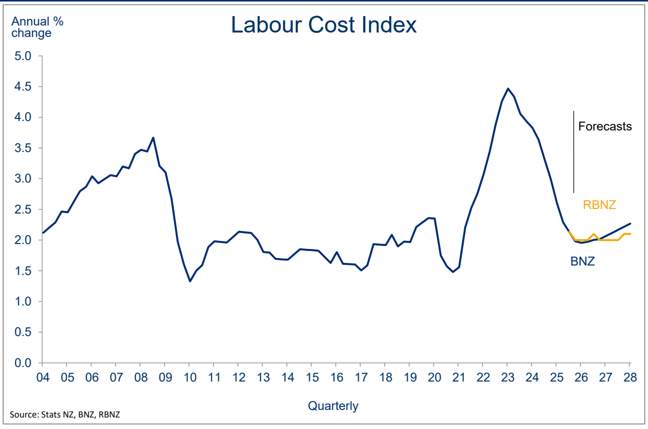
With strengthening employment, we see the unemployment rate nudging lower in 2026. We remain of the view that it will take time to do so meaningfully. We may finesse our forecasts after trawling through all the details in today's data. But generally, we continue to see the unemployment rate remaining above 5.0% for some quarters yet. This follows from our expectation that participation will continue to push higher with employment, as it usually does.

Labour force participation tends to lift with employment



The labour cost index for private sector employees rose 0.5% in the quarter to be up 2.0% for the year. This not only matched our forecasts, but it was also in line with market and RBNZ forecasts.

Matched expectations



From an inflation assessment perspective, the wage outcome provides a fair assessment of the balance of today's labour market information. There were some marginally weaker that expected bits and there were some marginally stronger than expected bits. They net to no major surprise.

We see no reason to change our broad thinking on the economy, the labour market, or policy outlook because of today's data. We remain of the view that some monetary policy stimulus will be removed later this year. The market remains of a similar view. Short end interest rates nudged around 4 basis points lower post data release, but still essentially prices an OCR hike by September and two hikes by year end.

We also remain of the view that the RBNZ is unlikely to endorse current market pricing at this juncture, including half a chance of a hike by July.

At face value, a nudge higher in the unemployment rate compared to expectations may encourage the RBNZ to not rush to hike rates. But there is enough in the employment details, along with other recent indicators of economic activity and inflation, to suggest some removal of monetary stimulus will be required this year.

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