

Research Economy Watch

6 May 2026

Pre-conflict labour market unsurprising

- **Unemployment rate ticks down**
- **Employment growth modest**
- **Labour market still slack**
- **Participation rate eases**
- **Wage inflation on expectations**
- **Nothing to alter our monetary policy views**

Today's Q1 labour market data was always going to have a dated feel to it given it largely pre-dated the conflict in the Middle East. It was going to take a set of numbers materially different to expectations to meaningful move financial markets. That didn't happen.

We thought the data would show labour market slack and it did, judging by the full mix of indicators.

The unemployment rate did ease a point to 5.3% in Q1 from 5.4% in Q4. That was a tick lower than market expectations and two ticks lower than what we had pencilled in. It matched the RBNZ's February MPS pick.

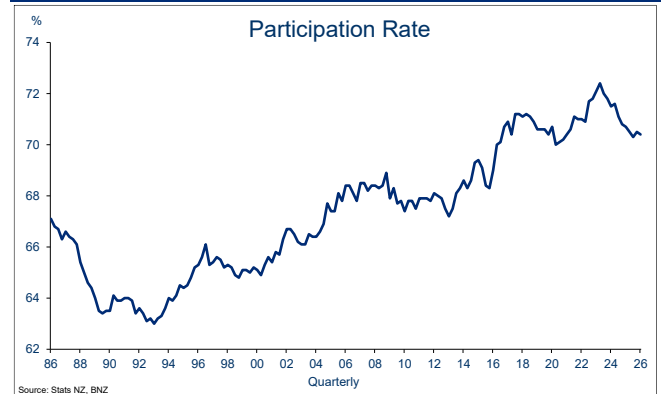
A tick downward



While a mild dip in the unemployment rate is to be welcomed, we don't see the tick lower as representing a tighter market. It essentially reflects the participation rate dipping a point, to 70.4%. We highlighted this dynamic as a risk. Had the participation rate not eased, the unemployment rate would have been flat. A lower participation rate can reflect discouraged workers.

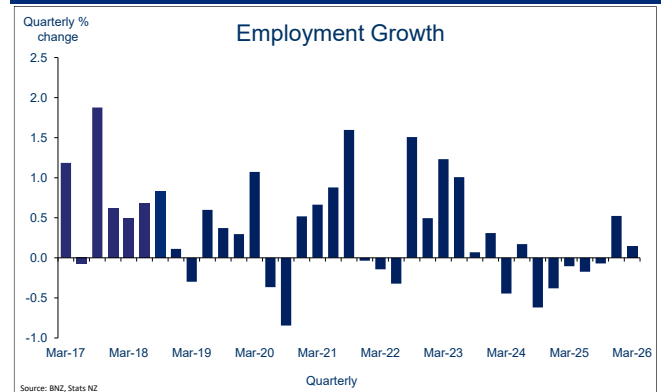
Adding to a sense that the market is not necessarily tighter than the previous quarter was a flat underutilisation rate at 12.9%.

Participation edges lower again



Employment growth was modest in Q1, at 0.2% q/q. This matched our expectations, was a tick lower than the 0.3% market consensus, and two ticks under the RBNZ's 0.4%. If there was a slight firmer-than-market-expected feel from the unemployment rate outcome, the employment outcome has the opposite tone.

Modest positive

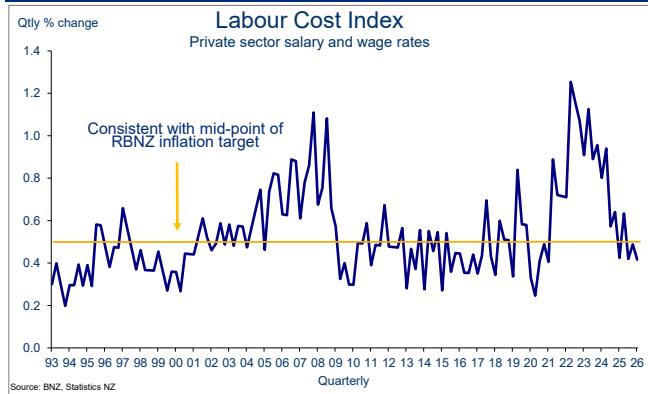


Wage indicators were very close to expectations. The LCI private sector measure rose 0.4% q/q, matching our, the market, and RBNZ expectations. Annual inflation rounded to 2.0% as we thought. The RBNZ had 1.9%.

The broad mix of labour market data looked to be much in line with RBNZ projections. Indeed, that was confirmed by Governor Breman at this afternoon's Financial Stability Report (FSR) press conference.

Wage inflation met our expectations. But there remain questions about how slack the labour market is given that wage inflation is not as low as it might be given the level of unemployment. There are also indicators suggesting firms are having more difficult finding skilled labour. There appears to be a mismatch between those looking for work and those looking to hire.

As expected



Deviations from expectations across the range of today's labour market indicators were small and the data largely pre-dates the conflict.

Interest is in what lies ahead. We remain of the view that there remains some upward pressure on the unemployment rate ahead as labour force growth is expected to outpace employment growth. The latter is likely to be soft in the near term, consistent with recent employment outcomes and softer employment intentions.

A slack labour market tends to put downward pressure on wage inflation, other things constant. But we continue to wonder about this dynamic in the current environment.

Other things are not constant. There is a chance of more inflation for any given level of unemployment rate compared to recent history. There is a risk that the dominant causation runs from inflation to unemployment rather than the other way around.

Upward pressure on business costs is pressuring margins and profitability with flow on effects to firms' hiring intentions. We have already seen the latter drop.

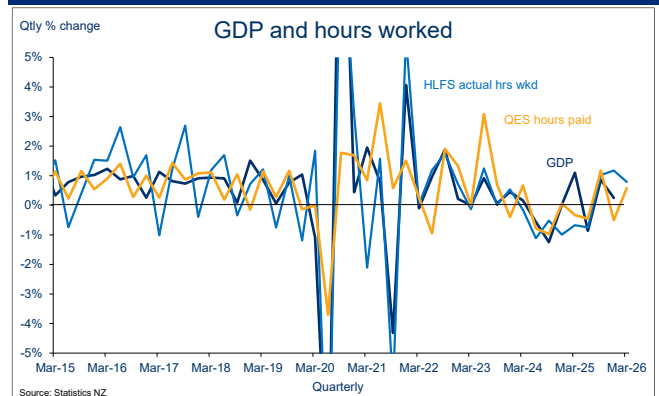
Inflation is currently stemming from other sources like energy. Consumers are feeling it. Consumer inflation expectations have lifted and confidence has collapsed.

Higher inflation increases the chance that employees demand compensation to cover it. Such demands will be difficult for businesses to meet given cost pressures of their own.

Global supply shocks present difficult conditions. The real income hit must show up somewhere. We continue to see a period of higher prices and less activity ahead compared to what would have otherwise been the case absent the conflict.

As for activity in Q1, today's data were constructive. HLFS hours worked rose a solid 0.8% q/q. QES paid hours and filled jobs both increased 0.6% q/q. None of those look inconsistent with our Q1 GDP pick of 0.9%. It adds to evidence that economic recovery was well underway before the war. Growth is expected to slow sharply in Q2.

Q1 GDP supportive



Back at its February Monetary Policy Statement, the RBNZ had built in Q1 growth of 1.1% q/q. In today's FSR, the RBNZ noted risks from the Middle East conflict. In addition to acknowledging significant economic effects already in NZ, including higher fuel costs, the Bank said 'while economic growth had been recovering prior to the conflict, we are now likely to see a somewhat slower recovery, affecting job growth, and debt servicing.'

Slower economic growth does not necessarily mean easier monetary policy. Indeed, at the current juncture, the dented activity outlook is more a result of inflation rather than a good guide to where inflation will travel in future. But those dynamics need continuous monitoring. It is the balance of changes in, and outlook for, both supply and demand that will shape the outlook for medium term inflation and policy response.

We remain of the view that the inflationary outlook will see interest rates lift this year. There was nothing in today's labour market data to alter that view or give any clarity on the precise path forward.

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