Economic Note

Q1 2023 Labour Market Data Review

3 May 2023

Tight labour market starting point seals the deal on another RBNZ hike

- The NZ labour market has remained tight, with sizeable gains in employment, record labour force participation, and with the unemployment rate and other utilisation metrics hovering around record lows.
- Labour cost growth was not as strong as expected, but still hit a record annual high with widespread lifts.
- Both weaker demand and stronger supply should see greater labour market slack emerge over 2023, but the RBNZ is unlikely to shirk from further monetary tightening. OCR cuts are unlikely until well into 2024.

2023Q1 Labour Market data

Household labour Force Survey	Actual	ASB	Market	RBNZ
Employment growth (QoQ)	0.8	0.5	0.5	0.2
Unemployment Rate (%)	3.4	3.5	3.5	3.5
Participation Rate (%)	72.0	71.8	71.7	71.7
Labour Cost Index				
Private Sector (%, QoQ)	0.9	1.0	1.1	1.1
Private Sector (%, ann)	4.5	4.6	4.7	4.7

RBNZ forecasts in the above table are from its February 2023 Monetary Policy Statement

Implications

The labour market follows the cycle, rather than leads it, hence the strength of the Q1 figures were more of an echo of the period of relative NZ economic strength evident in the middle of last year. There also appears to be an element of "catch up" with firms taking the advantage of increased growth in the labour supply to meet acute labour market shortages and address capacity bottlenecks. Statistics NZ acknowledged that the impact of weather events over Q1 impacted the response rate of its surveys (most notably the HLFS and LCI surveys) with disruptions on the North and East of the North Island but noted official national labour market measures were "fit for purpose".

All up, the NZ labour market remains tight, with the unemployment rate slightly above record lows and other metrics pointing to employment remaining well above its maximum sustainable level. Labour costs also advanced at a strong clip, with annual growth hitting a record high, consistent with sizeable increases in household living costs and tight labour market conditions. However, both figures were not quite as strong as the RBNZ, nor we, had expected.

With recession looming and net immigration rebounding strongly, the turning point for labour market pressures looks to be nearing and we envisage a growing margin of spare labour market capacity will emerge over the course of 2023.

Annual inflation is now on the way down and monetary policy settings restrictive, but the RBNZ is unlikely to shirk from further monetary tightening and a period of restraint until it is confident CPI inflation will settle in the 1-3% target range. We still expect a 25bp hike in May and an OCR peak of 5.50%. However, with greater labour market slack set to open over the next 12 months, we expect the RBNZ will eventually cut the OCR from mid-2024.

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Labour Market tightness remains

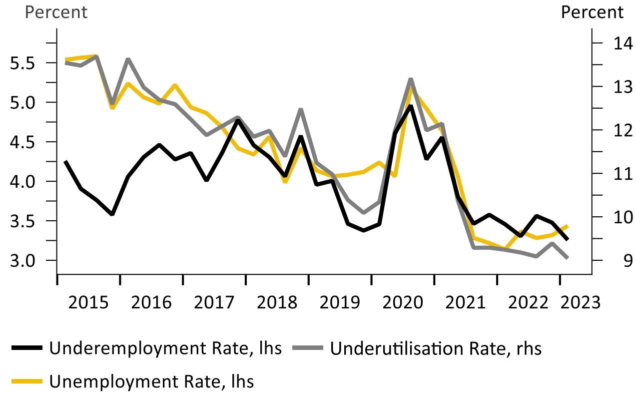
The Q1 figures confirm that the NZ labour market has remained extraordinarily tight. The Q1 unemployment rate from the Household Labour Force Survey remained parked at a historically-low 3.4% of the labour force, fractionally above record lows (3.2%). Broader capacity measures also hinted at slightly less tight labour market conditions, with the underutilisation rate (9.0%) and the underemployment rate (3.2%) both close to record lows.

HLFS Q1 employment (+0.8% qoq, 2.5% yoy) showed signs of acceleration, consistent with the jump in hiring from the monthly employment data. However, this looks to be a last hurrah as firms took advantage of the increasing availability of labour to plug widespread and acute labour shortages. Linked to this was the acceleration in growth in the supply of labour, with the working age population up sharply in Q1 (+0.5% qoq) and with annual growth of 1.2% the highest in more than two years.

The Q1 figures also showed strong worker attachment to the labour force, with the elevated cost of living likely to encourage more people into work. The participation rate hit a record high (72.0%), with the prospect of paid work enticing potential job seekers back into the labour force. If not for strong labour force participation over the last 12 months, the unemployment rate would have had a '2' in front of it. The employment rate (69.5%) held at a historically-high share of the working age population.

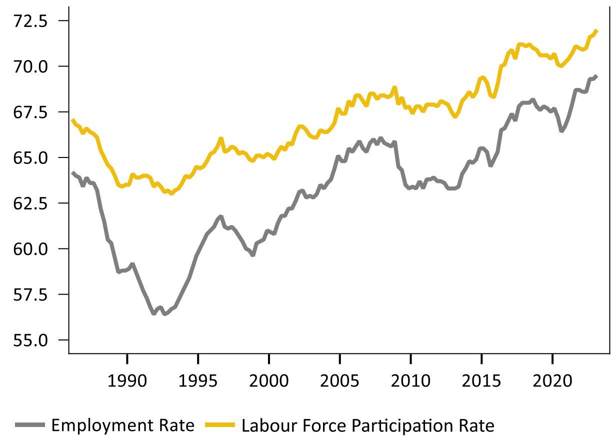
Wider measures provided a more mixed picture, with HLFS hours worked dipping 0.3% qoq (+3.3% yoy) and QES paid hours advancing just 0.2% qoq (1.2% yoy). Filled jobs from the Quarterly Employment Survey (QES) advanced 1.0% qoq (2.2% yoy).

HLFS Underemployment, underutilisation and unemployment rates



Source: Macrobond, ASB

Labour force attachment measures

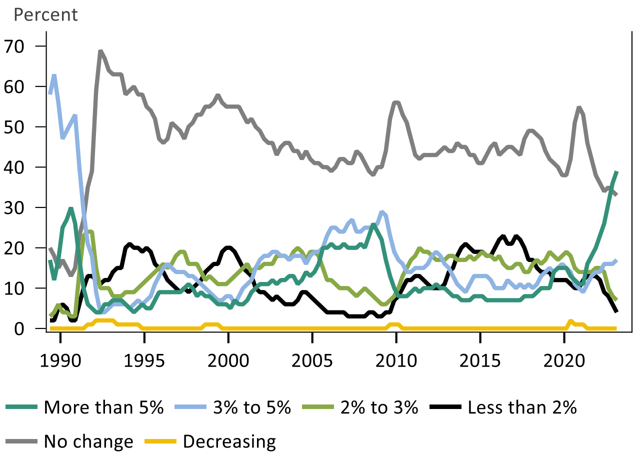


Source: Macrobond, ASB

Labour costs soar

Given continued tightness of the labour market and the soaring cost of living it was a question of how large the increase in labour costs was going to be. Increases were not as chunky as expected, with a 0.9% qoq lift in the private sector LCI (excluding overtime), but with annual LCI inflation still hitting a record high 4.5%. Underpinned by a boost in central government wages, labour costs in the public sector rose 1.4% qoq (4.2% yoy). Looking at the unadjusted LCI (which is typically more analogous to a measure of wage pressures), wage inflation for the private sector rose 1.4% qoq, with the annual rate stable at 6.1% in the March 2023 year, below the 6.7% CPI inflation rate and the 7.7% annual increase in household living costs.

Labour costs, Distribution of annual movement



Source: Macrobond, ASB

Wage increases were widespread. The distributional figures showed 67% of jobs had annual wage increases (66% in the Q4 data). Of the jobs, 17% saw increases between 3-5% (16%) whereas a record 39% saw increases greater than 5% (36%). Median (5.8% versus 5.4% last quarter) and mean annual increases (7.1% vs 6.7% last quarter) rose.

Average hourly earnings from the Quarterly Employment Survey (QES) posted a sizeable increase, with the annual increase ticking up to 7.6%. QES average weekly earnings advanced at a solid 7.1% clip over the March 2023 year.

Looking Ahead

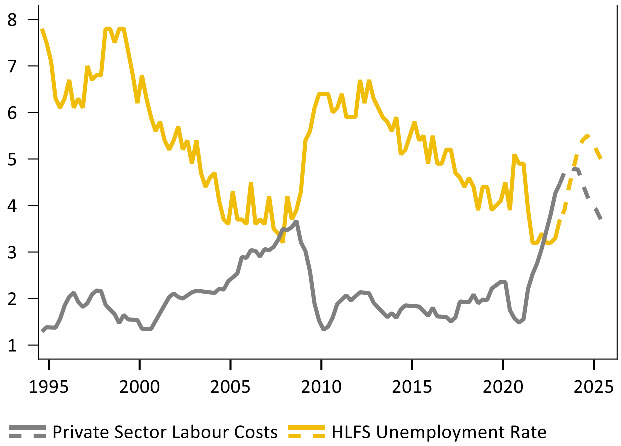
The starting point for the labour market is tight, with employment above its maximum sustainable level. Annual labour cost growth is at a record high, consistent with record levels for non-tradable CPI inflation.

Nonetheless, a turning point looks to be close, with the demand for labour and hiring set to weaken. We expect economic activity to contract over 2023 and this should translate into much lower labour *demand*.

Adding to this, will be increasing labour *supply*. Growth in the working age population (and labour force) is also expected to strengthen by the end of the year given the strong pick-up in net immigration to NZ. Both of these drivers will act to push the unemployment rate to around 5½% by late next year, with employment moving below its maximum sustainable level. Wage growth is expected to decline next year as labour market capacity picks up and workers compete for less plentiful work.

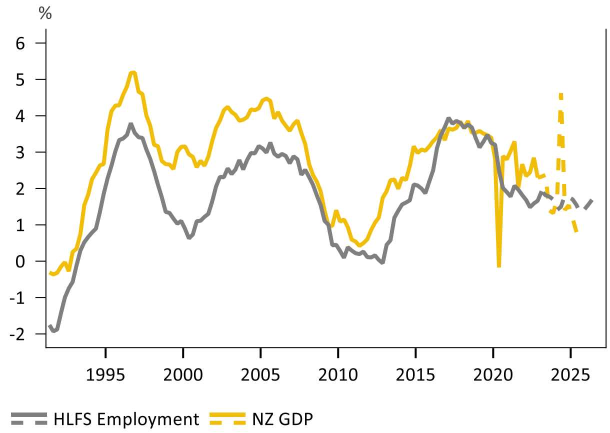
What will the RBNZ do? Since late 2021, 500bps of OCR tightening has been delivered, the most on record. At 5.25%, the OCR is well into restrictive territory according to our and RBNZ estimates. However, the starting point for the labour market and inflation remains miles away from where they will need to be to provide the best chance for achieving sustained growth in future. We expect a 25bp hike in May, and a 5.50% OCR peak this cycle. More downside risks are emerging, but the OCR will not be cut until the RBNZ is confident there is sufficient slack in the labour market that will see CPI inflation settle in the 1-3% target range. We expect OCR cuts to commence from mid-2024 and view current market pricing (which includes 25bps of cuts by year end and more than 150bps of cuts by late 2024), as being a tad premature.

Labour Costs and the Unemployment Rate



Source: Macrobond, ASB

GDP and Employment Growth (ASB forecasts added)



Source: Macrobond, ASB

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