WESTPAC ECONOMIC BULLETIN

Labour market update.

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Darren Gibbs, Senior Economist
+64 9 367 3368
darren.gibbs@westpac.co.nz

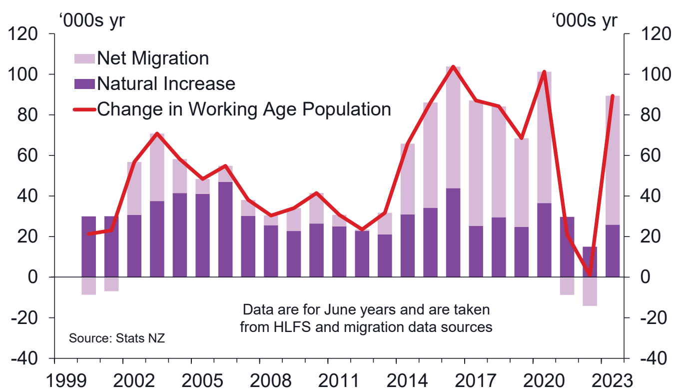
What's happening in the labour market?

- Migrant inflows and increasing participation have driven labour force growth to a more than six-year high.
- Job growth has remained strong as employers have filled longstanding vacancies, but indicators suggest that a slowdown looms.
- Wage growth appears to peaking with indicators pointing to a slower growth over the next year or so.
- The unemployment rate is likely to move higher over the next year or so, but perhaps at a slower pace than the RBNZ has projected.

A projected marked weakening of the labour market forms the lynchpin of the RBNZ's forecast that CPI inflation will move back into the 1-3% target band next year. Following last week's release of the key quarterly surveys, we take a closer look at what these and other indicators are telling us about the current state of the labour market.

Migrants are boosting the working age population.

Contributions to growth in working age population

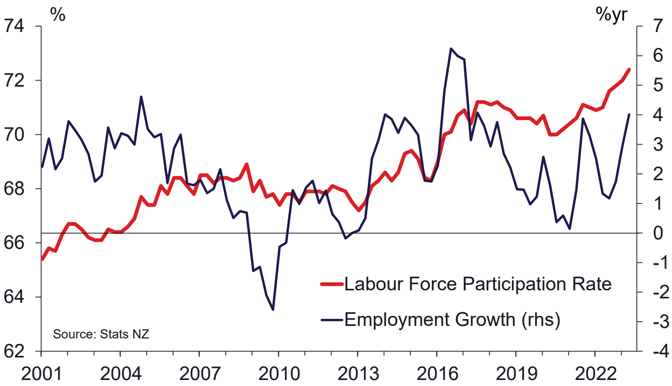


Sustained employment growth requires a growing pool of potential labour. Over the year to June, the working age population (people aged 15+) increased by 2.2%. This amounts to around 90,000 potential entrants to the labour force. By far the most significant driver of growth has been the inflow of migrants, which we estimate has added around 63,000 people to the working age population. This is near the upper end of the range seen in the years leading up to the pandemic.

Labour force participation is still trending up.

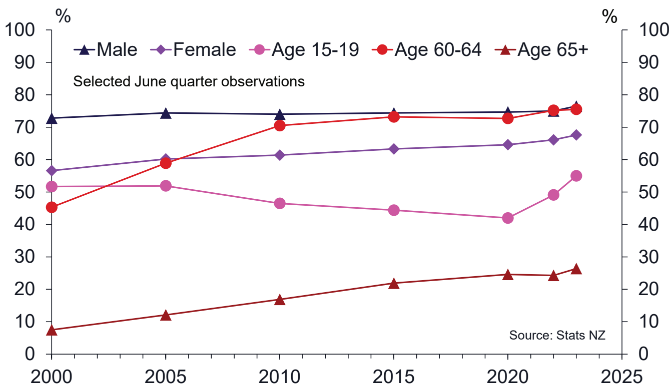
To be considered part of the labour force a person needs to be either already in employment or actively seeking and available to start work. The most surprising aspect of the June labour market surveys was a further rise in the labour force participation rate. Indeed, over the past year the participation rate has increased by a substantial 1.4ppts to 72.4% – an all-time high and the third highest rate in the OECD.

Labour force participation and employment growth



The participation rate has been trending higher for most of the survey's history, with the dominant influence being a rise in the participation rate of females (indeed, male participation remains lower than in the late 1980s). That said, male and female participation has increased at a similar pace over the past year. The other key trend has been a sharp rise in participation by older age groups, especially that for the 65+ age group (since 2000 this has increased by around 17ppts to 26% today). However, the most striking change on over the past year has been in the participation of those aged 15-19, which has increased almost 6ppts to return to levels not seen since before the GFC. The ready availability of employment has doubtless played a role in encouraging youth to enter the labour force, rather than choose to remain in the education system.

Labour force participation, selected cohorts

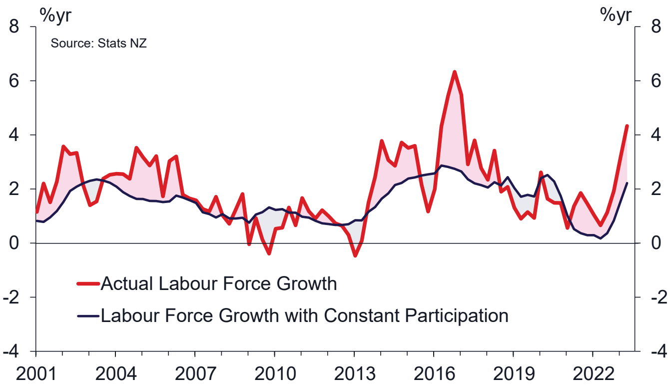


Ethnicity data also casts some light on recent trends in aggregate participation. It is notable that those people of Asian descent have a markedly higher participation rate than the general population (over 79% in the June quarter). The working age population for this group has increased by almost 58,000 over the past year while the labour force has increased by almost 54,000. Therefore, the current net migrant inflow – people of largely Asian descent in their prime working years – is acting to raise the average labour force participation rate across the country.

Labour force growth is at a six-year high.

The labour force grew by 4.3% in the year to June – the most in six years – with an additional 126,000 persons either in employment or actively seeking work. By calculating how the labour force would have evolved given constant participation through time, we estimate that half of the recent growth can be attributed to the rise in labour force participation with the remainder due to growth in the working age population.

Contributions to growth in the labour force

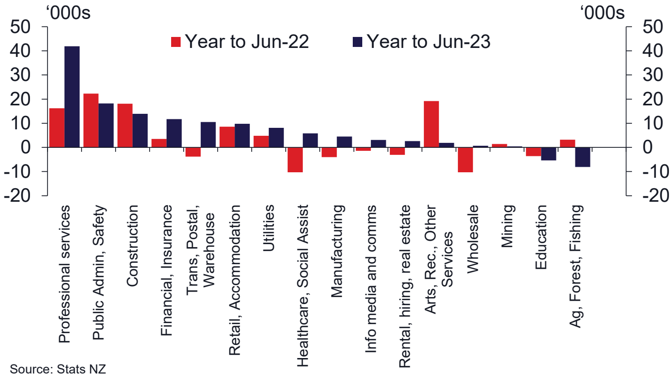


About a third of total labour force growth came from the 15-19 and 65+ age groups, which combined make up just 13% of the overall labour force. And over 40% of the additions to the labour force were of Asian descent, despite these people making up just 13% of the labour force.

Migrants are helping to sustain job growth.

While annual GDP growth has likely slowed to less than 2%, employment growth has remained strong. Indeed, employment grew 1% in the June quarter and was 4% higher than a year earlier – an additional 113,000 people in work. This lifted the employment rate to a record high of 69.8%, which appears to be the third highest in the OECD (sadly, given New Zealand's poor productivity, incomes are not similarly ranked). In large part we think that this growth reflects employers taking advantage of new entrants to the labour force – and especially new migrants – to fill longstanding vacancies. Over 43% of the new jobs created over the past year were filled by people of Asian descent. The household survey points to especially strong growth in employment in professional services, public administration and safety, and in the construction sector. By contrast, employment has declined in the education and agriculture sectors.

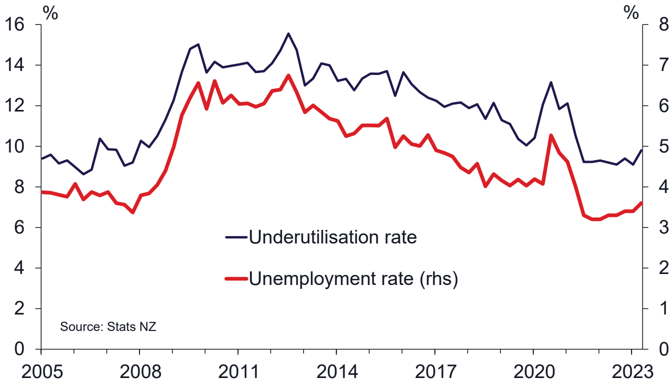
Employment growth by industry



Unemployment is increasing slowly.

While employment growth has been very strong it has been insufficient to absorb the rapid growth in the labour force. As a result, in the June quarter the unemployment rate increased 0.2ppts to 3.6%, up from the cyclical trough of 3.2% in March last year. The unemployment rate for those of European descent has not changed over the past year but that for other ethnicities has increased. Also of note, the underutilisation rate – a broader measure of unemployment that includes, amongst other things, part-timers who would like additional hours – increased to a two-year high of 9.8% in the June quarter. However, it too remains low by historical standards.

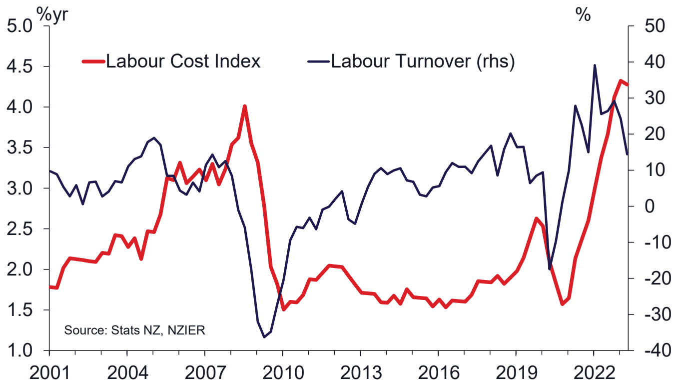
Unemployment and underutilisation



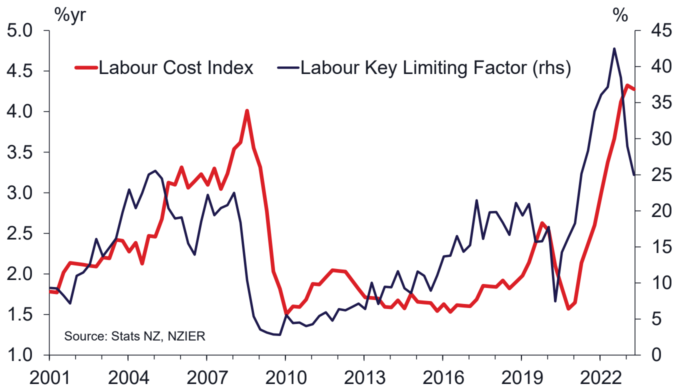
Wage growth looks to be peaking.

Of key importance for the RBNZ is how tightness in the labour market is being translated into wage growth and broader inflation pressures. With the unemployment rate having troughed more than a year ago – albeit having increased only slightly since – it is not unreasonable to think that wage growth might be close to a peak. Similarly, in recent times, business survey measures of labour market turnover (or churn) and the importance of labour in limiting expansion have also moved lower. These measures have often signalled impending changes in the trend of wage growth.

Wage growth and labour turnover

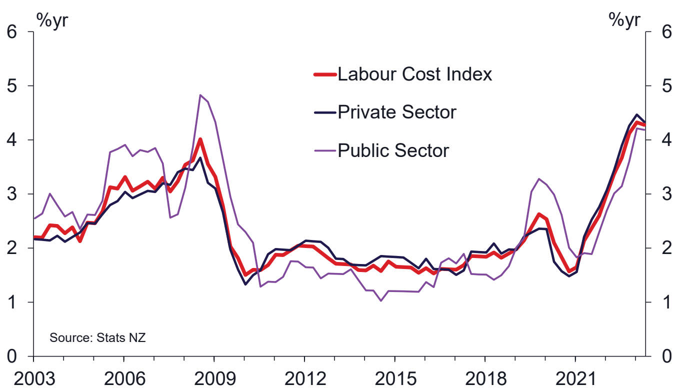


Wage growth and labour constraints



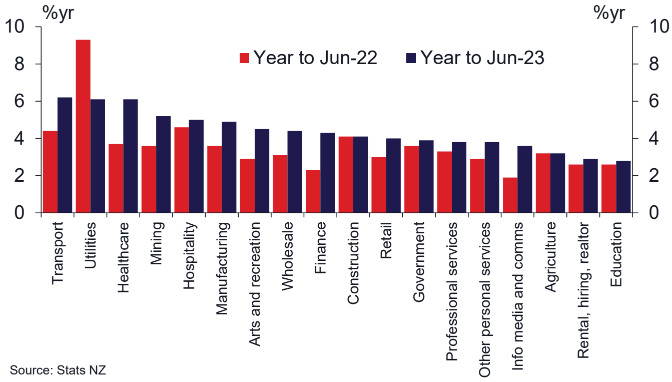
Fortunately, the June quarter Labour Cost Index (LCI) provided some evidence that a peak might be place, with private sector wages rising a less than expected 1.1% – 0.2ppts less than in the same quarter last year and so lowering annual growth slightly to 4.3%. The LCI for the public sector grew 4.2% over the year, not least due to growth of 5.1% in the local government sector. Public sector wages tend to broadly track those in the private sector, albeit sometimes with a slight lag and displaying greater amplitude in their cycle.

Wage growth by sector



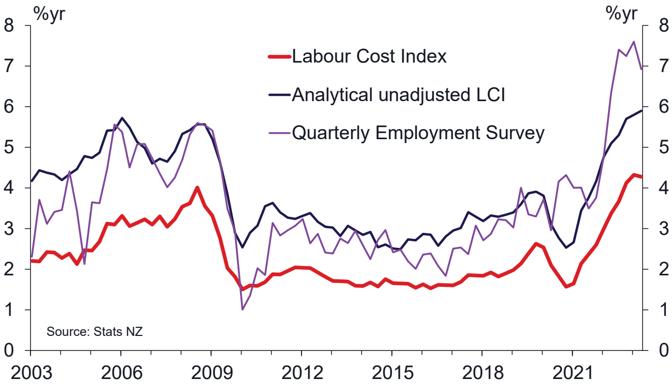
Looking at wages by industry, unsurprisingly some of the steepest increases have been in those where labour shortages have been well publicised, including the transport and healthcare sectors. By contrast growth has been restrained in the rental and real estate industry and the education sector (growth in the latter seems bound to pick up over the coming year given the recent pay rises struck by teachers).

Wage growth by industry



The headline LCI is conceptually similar to a measure of unit labour costs (i.e. wages adjusted for productivity growth), as it ignores the impact of bonuses or promotions. The unadjusted LCI, which captures all pay, is a better measure of workers' take-home pay and thus spending power. The latter indicates that a typical worker's wages grew 5.9% in the year to June – a new cyclical high and close to the 6% lift in the CPI. Average hourly earnings from the Quarterly Employment Survey grew somewhat faster at 6.9%, although down from its cyclical peak. Average earnings are impacted by compositional changes in the work force. The strong jobs growth seen in the professional trades probably goes some way to explaining the relative strength of this measure over the past year.

Other wage growth measures

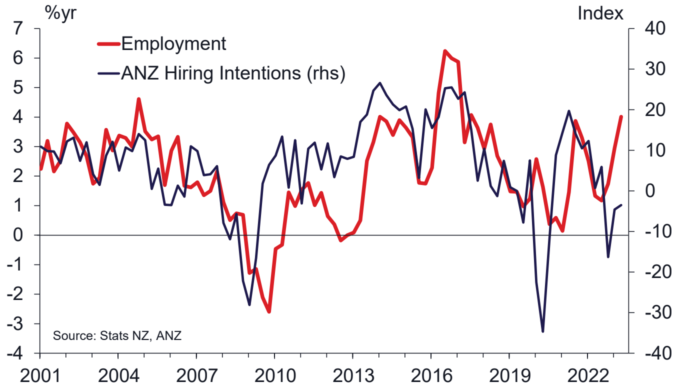


Jobs market likely to loosen slowly.

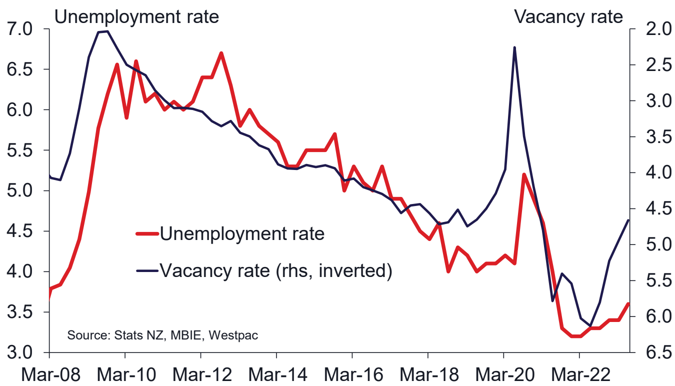
Looking ahead, from the supply side, we expect that growth in the working age population will remain slightly above historical average levels with New Zealand likely to continue to attract a higher-than-average net inflow of migrants. However, with the labour force participation rate already far above the OECD average, we wonder how much scope there is for this to further boost labour force growth over coming years. On the one hand, female participation remains 9ppts below that for males and pressures on household finances could yet see this gap narrow further. On the other hand, as hiring begins to slow to rates that reflect growth in domestic demand, we imagine that the recent increase in participation amongst youth will reverse as more people opt to continue in education and training. More generally, during periods when labour conditions are relatively weak, workers tend to be discouraged from participating in the labour force, moderating the measured uplift in the unemployment rate.

Turning to prospects for labour demand, business survey measures of hiring intentions suggest that a slowdown in job growth looms. That said, at least for now, such indicators are still above levels normally consistent with zero job growth. Measures of online job advertising have slowed materially in recent months, suggesting that pent-up demand for labour is being filled an/or withdrawn. However, the level of job vacancies remains high by historical standards.

Employment and ANZ hiring indicator



Unemployment rate and vacancy rate



Importantly, assuming that the labour force participation rate is near its peak, growth in employment will need to slow considerably in coming quarters if the unemployment rate is to meet the RBNZ's forecast of 4.6% by year end (and 5.4% by the end of 2024). Our sense is that the near-term risks to job growth are tilted to the upside (in coming months we will be paying close attention to the monthly employment indicator). As a result, we think that the unemployment rate will likely be slower to increase than the RBNZ projected in its May *Statement*.

This likely means that wage growth will also be slow to decline from its current cyclical peak, especially if wage setting behaviour is heavily influenced by past inflation outcomes rather than forecasts of lower future inflation. This will also likely slow the descent of non-tradeables inflation from its current elevated level. And it underpins our view that the OCR is likely to remain at current or higher levels for at least another year, absent new developments that pose downside momentum to the economy and inflation.

Contact the Westpac economics team

Kelly Eckhold, Chief Economist
+64 9 348 9382

Satish Ranchhod, Senior Economist
+64 9 336 5668

Darren Gibbs, Senior Economist
+64 9 367 3368

Nathan Penny, Senior Agri Economist
+64 9 348 9114

Paul Clark, Industry Economist
+64 9 336 5656

Shania Bonenkamp, Graduate
shania.bonenkamp@westpac.co.nz

Any questions email:
economics@westpac.co.nz

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