Research

Economy Watch

7 August 2024

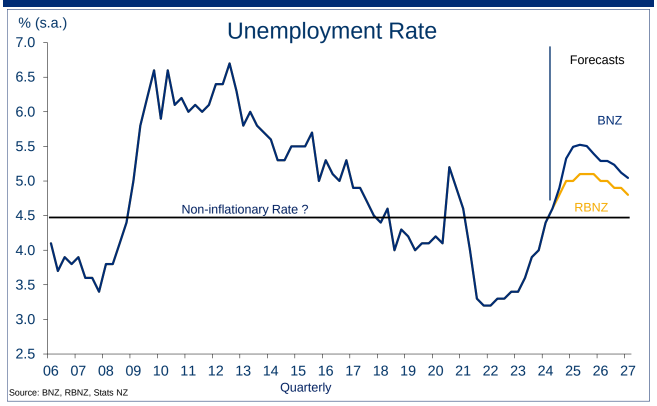
Labour Market Weakening

- **Labour market loosens, but less than market expected**
- **Unemployment rate hits 4.6%; heading higher**
- **Fewer hours worked, despite lift in employment**
- **More downside for economic activity**
- **Wage inflation to cool further**
- **Easing in monetary conditions ahead**

Today's Q2 data shows the labour market continues to loosen, and we think it will loosen further. The unemployment rate rose to 4.6% in Q2 from the 4.3% initially published for Q1 (although the latter was revised up to 4.4% in today's figures). The unemployment rate is now a full percentage point above its 3.6% level a year ago and we think a similar sized lift is likely over the coming 12 months or so.

The unemployment rate matched the RBNZ's (and our) expectation but came in a tick lower than the market consensus of 4.7%. For a market recently looking for as much as 100bps of OCR cuts by the end of the year, this has dampened enthusiasm for such aggressive rate cuts.

Softer



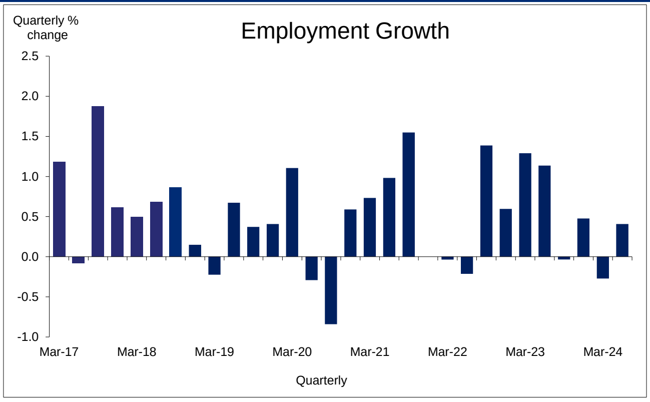
Employment surprised on the high side, with a 0.4% quarterly gain. That was above expectations whether they be the market's -0.2%, our -0.1%, or the RBNZ's +0.1%. An upside surprise, but we are very wary of extrapolating forward this strength given a host of weak lead indicators. And, as we pointed out in our preview, the HLFS can be volatile. It's worth noting that Q1's initially reported 0.2% dip in employment was revised down to -0.3%. Through the quarterly wiggles, it equates to minimal employment growth through the first half of the year.

HLFS/LCI - Q2 2024

	Actual	Mkt Expected	RBNZ Aug MPS	Previous
Employment - qtly % ch	**+0.4**	-0.2	+0.1	**-0.3 R**
Employment - ann % ch	**+0.6**	0.0	+0.3	**+1.3 R**
Participation rate %	**71.7**	71.3	71.5	**71.6 R**
Unemployment rate %	**4.6**	4.7	4.6	**4.4 R**
LCI, private sector - qtly % ch	**+0.9**	+0.8	+0.9	**+0.8**

HLFS data seasonally adjusted

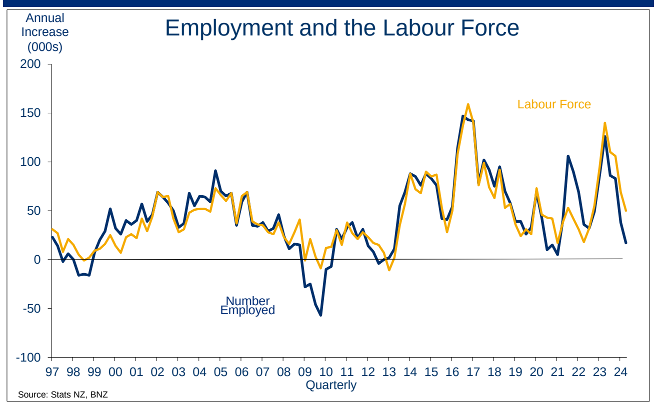
Choppy



In contrast to the HLFS, the QES saw a 0.5% drop in filled jobs in Q2 after a lift in Q1. A different quarterly pattern, but a similar message to the first half of the year regards jobs.

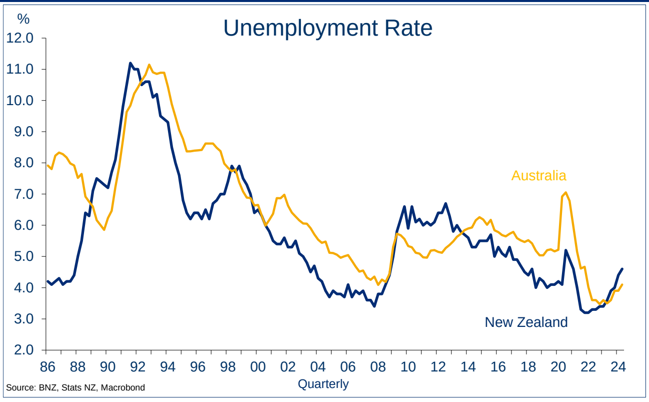
The quarterly lift in HLFS employment was accompanied by an increase in the participation rate to 71.7% from an (upwardly revised) 71.6% in Q1. Combined with an expanding working age population, this keeps the big picture being a case of more people seeing work than there is labour demand such that the unemployment rate continued to rise.

Labour supply rising faster than labour demand



It's worth noting NZ's unemployment rate of 4.6% has pushed further above Australia's latest 4.1% reading. The relative labour markets are worth keeping an eye on, as the net flow of kiwis to Australia has increased over the past year.

Trans-Tasman Changes

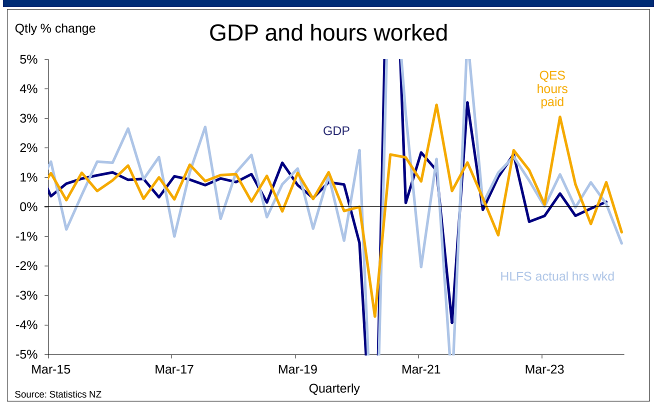


Beneath the upside HLFS employment surprise, there were some much softer looking indicators from an activity point of view. There were more people employed, but a marked decline in the number of hours worked.

HLFS hours worked fell 1.2% in Q2, following a (downwardly revised) 0.1% gain in Q1. QES paid hours were also weak in Q2, dropping 0.9%. This all fits with the HLFS showing more part time employment and full time employment contracting (the latter for the second consecutive quarter). Less hours being worked or paid for is not a good look for GDP.

We already thought GDP contracted in Q2, but today's hours indicators are likely to see us nudge it down a bit further from our current -0.2% pick. We will have a closer look at the details before nudging GDP lower. Lead indicators have been suggesting this, now we have somewhat harder data for the quarter.

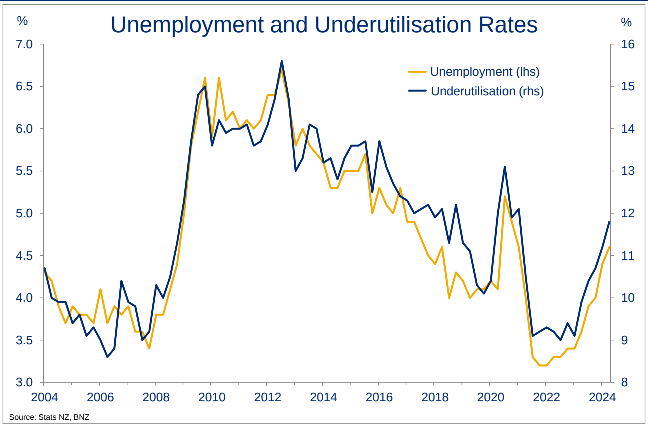
Not A Good Look For GDP



A downward growth adjustment would see the economy further underperforming the RBNZ's 0.1% GDP pick for Q2, suggesting a larger output gap than the Bank anticipated and associated reduction in inflationary pressures. The broader labour market notoriously lags the economic cycle. Weak economic growth points to more labour market slack ahead.

Slack is already appearing. If the lift in the unemployment rate to date, or its clear upward trajectory, is not quite yet enough to convince some, then maybe the chunky lift in the underutilisation rate will. The latter rose to 11.8% in Q2, up from 11.2% in Q1, and significantly higher than its 9.9% recorded a year ago.

Slack Developing



Wage inflation is already easing. The RBNZ's preferred wage indicator, the private sector LCI index rose 0.9% in Q2. This saw its annual inflation ease to 3.6% from 3.8%, matching both our and the RBNZ's expectations. The quarterly outcome was a tick higher than the 0.8% gain expected by the market. The all-sector LCI index rose by more (4.3% y/y) as settlements of collective agreements in healthcare and education drove a 6.9% annual gain in the public sector.

The unemployment rate and LCI wages matched RBNZ expectations. However, also important for policy considerations is whether the RBNZ still see peak unemployment not that much higher than now given a host of softer indicators including GDP likely to undershoot the Bank's prior expectations.

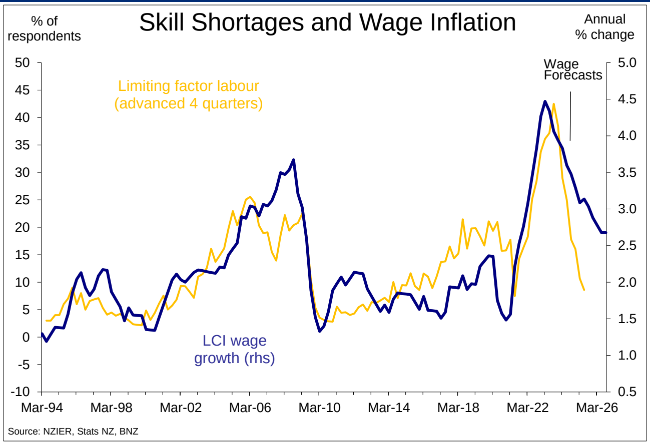
We expect annual inflation in the private sector LCI index to ease further, given the clear softening in the labour market already well underway and the usual lags involved. It is not just the lift in the unemployment or underutilisation rates described above, but a host of other indicators such as the QSBO's labour as a constraint indictor that point to markedly slower unit labour cost inflation ahead. Indeed, wage inflation may well slow faster than we currently project.

All this points to easier monetary conditions ahead. Like we said in yesterday's MPS preview, we think the RBNZ will remove the near-term tightening bias from its forecast rate track next week and replace it with an easing bias. And the first-rate cut will be brought forward substantially, and the OCR track will bottom out at 3.0% or lower.

As we also said yesterday, we remain more confident with the view that the cash rate will be 100 basis points lower by February of next year than we do with our expectation that the bank will pull the trigger in August.

The market trimmed the chance of an RBNZ 25bp OCR cut in August to about 50/50 and moved closer to our 100bps view through to February post today's data (although the market still prices around 125bps of cuts to that point).

Labour Constraint Gone



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