

New Zealand Digest

A migration pullback could lift wages growth

MACRO ECONOMICS

New Zealand

- ▶ Despite strong jobs growth in recent years, the unemployment rate remains elevated and wages growth is weak
- ▶ Strong migration inflows, particularly from Australia, have boosted the supply of labour, keeping the labour market loose
- ▶ Australia's improving labour market could mean New Zealand's migration boom may be nearing its peak, with a potential modest pick-up in wages growth the result

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Migration is still strong, but have we passed the peak?

New Zealand's economy continues to perform well, despite low dairy prices. After a lull through mid-2015, employment grew at an annualised rate of 4.4% over the past two quarters. This is not a new development; annual employment growth has averaged nearly 3% since 2013.

Ordinarily, that would be expected to lead to a rapidly declining unemployment rate and accelerating wages growth as the labour market tightened and firms competed more fiercely for workers. But over the past few years, New Zealand has experienced a migration boom that has seen the supply of available workers grow just as rapidly as firms' demand for them. The result has been only a modest decline in the unemployment rate and weak wages growth. This has even been true in sectors such as construction, where employment growth has been strongest.

In assessing wage and inflation dynamics, the migration cycle is therefore vitally important. Migration from other parts of the world has increased but the major swing in recent years has been in migration between New Zealand and Australia. In 2012 New Zealand had a net outflow to Australia of around 40,000 people. However, recently a small annual net inflow was recorded for the first time since 1991.

While New Zealand's labour market has been strong in recent years, Australia's weakened at the end of the mining investment boom and the unemployment rate rose steadily for several years. More recently though, Australia's jobs growth has picked up and the unemployment rate has peaked. The key question for New Zealand is whether trans-Tasman inward migration flows have now passed the peak.

In this note we build a small model which uses information on labour market conditions across the Tasman to forecast trans-Tasman migration. Our results suggest we may have passed the peak in inward migration to New Zealand. This may, in turn, start to support a modest lift in wages growth, which would help New Zealand to deal with its low inflation challenge.

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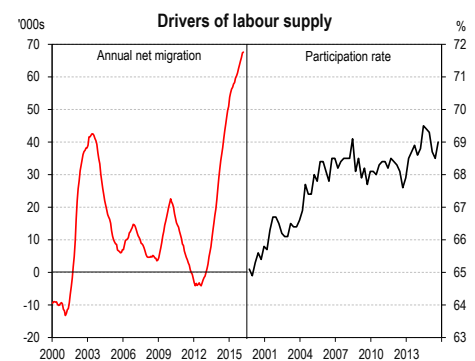
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1. Jobs growth has been strong



Source: Statistics New Zealand

2. Labour supply has also been strong



Source: Statistics New Zealand

Plenty of jobs, but no wages growth

Employment has grown strongly over the past couple of years

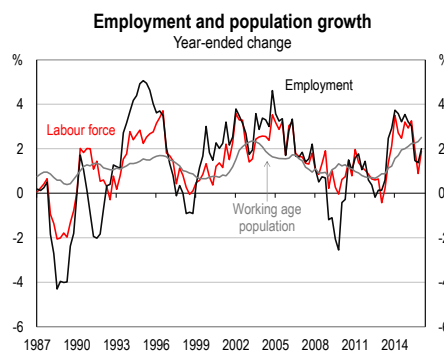
New Zealand's economy has had a good few years. GDP grew by 3.7% in 2014 and last year managed 2.5% growth despite a significant slowdown in national income due to a sharp fall in dairy prices. This growth has created jobs. Since the beginning of 2014 employment has grown at an average annual rate of 2.7%, which is strong by historical standards. In the US, for instance, this rate of growth would equate to around 320k jobs added to non-farm payrolls every month – for more than two years. While New Zealand labour market data can be volatile, this story of strength can be seen across a number of measures from different surveys (Chart 1).

However, at the same time as labour demand picking up, labour supply has grown very strongly. This has been driven by record levels of inward migration and higher labour force participation (Chart 2). Migration has driven growth in the working age population to 2.5% y-o-y, the highest rate on record. Combined with higher participation, this has meant that growth in the labour force has closely matched growth in employment (Chart 3).

However, strong migration has boosted labour supply and kept unemployment elevated

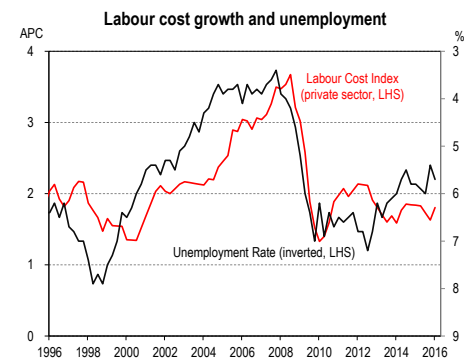
The net result has been an only modest decline in the unemployment rate from an average of 6.9% in 2012 to the current rate of 5.7% (Chart 4). Most of the decline in the unemployment rate actually occurred during 2013; since Q1 2014 the unemployment rate has averaged 5.8%. In short, despite strong labour demand, the labour market has remained fairly loose which has kept the growth in wages subdued. Sluggish wages growth has put downward pressure on domestic inflation, which has been a problem for the RBNZ (see [New Zealand Economics: A challenge for the 25-yr old inflation targeting regime](#), 21 January 2016).

3. Plenty of workers to fill the jobs



Source: Statistics New Zealand

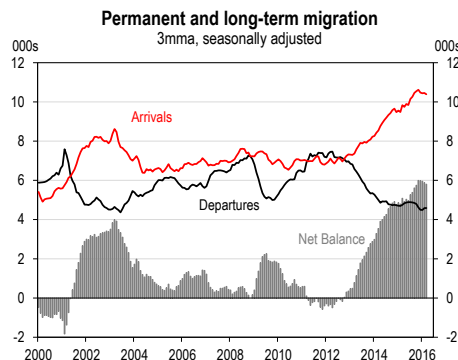
4. Wages growth has been weak



Source: Statistics New Zealand

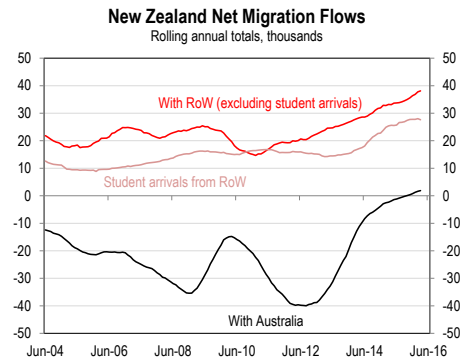
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5. A record net inflow of migrants



Source: Statistics New Zealand

6. Large swing in trans-Tasman migration



Source: Statistics New Zealand

Migration flows from Australia have swung dramatically

We believe that the prospects for continued jobs growth in New Zealand are good, with growth expected to be supported by housing construction in Auckland and rising Asian tourist and student numbers. The greater uncertainty for the labour market over the next year or so is the effect of migration flows. If strong labour demand continues to be met by strong labour supply, wages growth could remain sluggish.

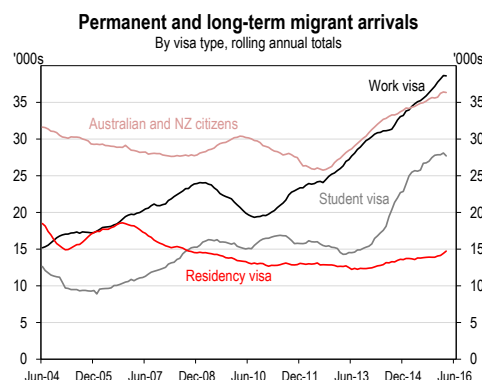
Net inward migration has reached record levels, of 67,600 people, over the past year, which is a big change from 2012, when New Zealand recorded a small net migration outflow of around 1,000 people (Chart 5). The total swing in annual net migration since 2012 has therefore been just under 70,000.

Swings in migration to/from Australia have been the biggest factor in the current migration boom

Of this swing, around 42,000 are attributable to the change in net migration with Australia alone. From a net outflow of nearly 40,000 people in 2012, New Zealand recently recorded a net inflow from Australia for the first time since 1991 (Chart 6). This has been a result of both fewer departures to Australia (which make up the majority of permanent departures from New Zealand) and record levels of New Zealanders returning from Australia. The rest of the swing in net migration has been driven by an annual increase of around 12,000 in the number of students coming to New Zealand on long-term visas, and a rise in net migration (excluding student arrivals) from the rest of the world of around 16,000.

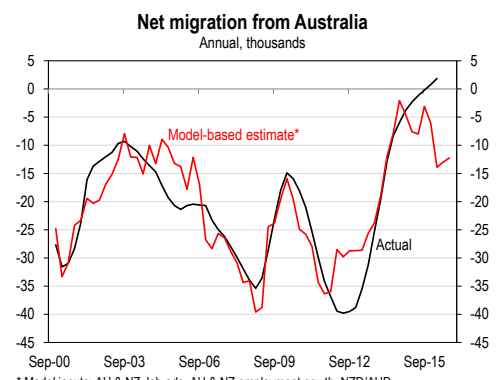
Importantly, most of these swings in migration have likely been driven by economic choices related to work. Looking at arrivals by visa type, the largest increase has been in the number of migrants arriving on a work visa (Chart 7). Typically, trans-Tasman migration flows are largely

7. Migration driven by those seeking work



Source: Statistics New Zealand

8. Is trans-Tasman migration turning?



* Model inputs: AU & NZ Job ads, AU & NZ employment growth, NZD/AUD
Source: ABS, Statistics New Zealand, RBNZ, HSBC

driven by employment choices. Therefore most new arrivals, as well as many of the New Zealanders choosing not to leave for Australia, are likely to have been seeking work.

Are migration flows near a turning point?

Our modelling supports the view that labour market factors drive trans-Tasman migration

Empirical evidence confirms that net migration flows with Australia are largely driven by labour market trends. Using trends in employment growth and job advertisements for both Australia and New Zealand, as well as in the NZD/AUD exchange rate, we have developed a small model that helps to explain migration trends (Chart 8).

The model supports the conclusion that the significant net outflows of migration from New Zealand to Australia from 2010 to 2012 were driven by the very strong Australian job market. The strong AUD also played a part, most likely by increasing the NZD-denominated wages on offer in Australia. Many migrants from New Zealand to Australia move with the intention of returning home within a few years.

The model also does a good job of explaining the large turnaround in migration seen since 2013. During that time, the New Zealand labour market outperformed the Australian market and the NZD climbed by around 20c against the AUD, nearing parity in early 2015.

A stronger Australian labour market could see New Zealand's migration inflow slow

However, the model also suggests that trans-Tasman migration flows could be at a turning point once again. This is being driven by a slightly weaker NZD/AUD exchange rate as well as the improvement in the Australian labour market seen over 2015 (Charts 9 and 10). Although the swing is not likely to be large, we expect the current small annual net inflow to turn into a modest net outflow during 2016.

If wages growth troughs, inflation may also lift

These forecasts for trans-Tasman migration, as well as some evidence in recent months that arrivals from the rest of the world are slowing, suggest that New Zealand's migration boom may be peaking. It is unlikely to happen quickly, but we may begin to see slower growth in the working-age population. As long as employment growth is maintained, as we expect, the labour market may therefore start to tighten and generate a little more wage growth in the coming quarters.

The slowdown in net migration flows over coming quarters would provide the RBNZ with additional confidence that inflation may have passed its trough and should return to the target band over time. We still see a further cut to a cash rate of 2.00% as likely (pencilled in for June), but further cuts may not be needed if the RBNZ believes that inflation will pick up towards its target band over time.

9. Australia's labour market has improved



Source: ABS; HSBC estimates

10. Unemployment seems to have peaked



Source: ABS

Table 11. HSBC's forecasts for Australia and New Zealand

	Year-average			Year-ended						
	2015	2016e	2017e	Q415	Q116e	Q216e	Q316e	Q416e	Q117e	Q217e
%*										
AUSTRALIA										
GDP	2.5	2.6	3.0	3.0	2.6	2.9	2.5	2.5	2.8	3.0
Consumption	2.8	2.8	3.0	2.9	2.8	2.9	2.7	2.7	2.9	2.9
Public consumption	2.8	2.1	1.5	3.6	3.3	2.1	1.8	1.4	1.2	1.4
Investment	-3.8	-1.8	1.6	-3.1	-3.1	-3.1	0.2	-1.2	0.4	1.1
- Dwelling	9.5	4.1	-2.0	9.8	5.6	5.9	3.9	1.3	0.2	-1.6
- Business	-8.9	-7.7	0.2	-12.0	-10.5	-9.7	-6.3	-3.9	-1.7	-0.7
- Public	0.8	12.0	10.4	17.7	15.0	10.2	20.4	4.0	7.2	10.4
Final domestic demand	1.0	1.1	2.4	1.1	0.9	0.7	1.4	1.5	2.0	2.2
Domestic demand	1.1	1.2	2.4	1.5	1.0	0.7	1.6	1.5	2.0	2.2
Exports	6.1	7.3	8.1	5.7	3.9	10.3	6.7	8.2	8.5	8.5
Imports	1.0	1.5	5.9	1.2	-0.9	-0.1	3.1	4.1	5.1	5.6
GDP (% quarter)	--	--	--	0.6	0.5	0.6	0.7	0.6	0.8	0.8
CPI	1.5	1.3	2.4	1.7	1.3	1.3	1.3	1.4	2.2	2.3
Trimmed mean	2.2	1.6	2.3	2.1	1.7	1.5	1.7	1.6	2.0	2.2
Unemployment rate	6.1	5.9	5.6	5.8	6.0	6.0	5.9	5.9	5.8	5.6
Labour price index	2.2	2.3	2.9	2.2	2.2	2.2	2.3	2.5	2.7	2.8
Current A/C (%GDP)	-4.6	-4.5	-4.4	-5.1	-4.8	-4.6	-4.3	-4.2	-4.2	-4.3
Terms of trade	-11.4	-4.6	-2.3	-12.0	-9.2	-5.5	-3.1	0.0	-0.8	-1.6
Budget balance (%GDP)	-2.6	-2.1	-1.5							
Capital city house prices	9.0	2.8	2.0	8.7	7.0	2.7	0.7	1.0	1.6	1.7
Private sector credit	6.3	7.7	8.0	6.8	7.2	8.0	7.7	7.8	7.8	7.8
USD/AUD (end period)	0.73	0.70	0.70	0.73	0.71	0.71	0.70	0.70	0.70	0.70
Cash rate (end period)	2.00	1.50	1.50	2.00	2.00	1.75	1.50	1.50	1.50	1.50
%*										
NEW ZEALAND										
GDP	2.5	2.4	2.4	2.3	2.5	2.7	2.3	2.0	2.3	2.4
Consumption	2.5	2.9	2.4	2.9	3.0	3.1	3.0	2.5	2.5	2.4
Govt consumption	2.2	1.8	2.2	2.5	2.1	1.6	1.7	1.7	1.9	2.1
Investment	3.1	4.1	2.5	0.9	4.7	4.5	2.7	4.4	3.1	2.5
Final domestic demand	2.6	3.0	2.4	2.4	3.2	3.2	2.7	2.8	2.5	2.4
Domestic demand	2.3	3.2	2.4	2.6	3.5	3.1	3.6	2.4	2.5	2.4
Exports	6.7	2.6	4.5	3.6	2.5	3.0	2.1	3.0	3.7	4.5
Imports	3.7	2.1	4.2	0.4	0.6	0.0	3.7	4.3	4.3	4.3
GDP (% quarter sa)	na	na	na	0.9	0.4	0.5	0.5	0.5	0.6	0.6
CPI	0.3	0.6	1.5	0.1	0.4	0.4	0.4	1.1	1.3	1.4
Unemployment rate	5.8	5.7	5.8	5.3	5.7	5.8	5.8	5.7	5.6	5.5
Labour price index	1.8	1.7	2.0	1.6	1.8	1.7	1.8	1.8	2.0	2.0
Current A/C (%GDP)	-3.0	-3.4	-2.9	-3.1	-3.7	-3.6	-3.1	-3.1	-3.0	-2.9
Budget balance (%GDP)	0.1	0.3	0.5							
NZD/USD (end period)	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68	0.68
Cash rate (end period)	2.50	2.00	2.00	2.50	2.25	2.00	2.00	2.00	2.00	2.00

Source: ABS, RBA, RBNZ, Statistics New Zealand, HSBC forecasts. *unless otherwise specified

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