The Treasury

Budget 2017 Information Release

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[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Reference: T2017/552 BM-3-6-1

THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 14 March 2017

To: Minister of Finance (Hon Steven Joyce)
Associate Minister of Finance (Hon Simon Bridges)
Associate Minister of Finance (Hon Amy Adams)

Deadline: None
(if any)

Aide Memoire: Budget 2017 Preliminary Economic Forecasts - Labour Market Forecast

- The labour market is forecast to steadily tighten over the next three years, with employment growth consistently outpacing strong growth in the labour force
- The pace of tightening in the labour market is uncertain, particularly given uncertainties around the pace of migration-led population growth and high participation rates

This Aide Memoire provides further information on the labour market variables in the Budget 2017 preliminary economic forecasts following your concern at Fiscal Issues on 7 March regarding the high unemployment rate forecast.

Recent developments

Unemployment increased to 5.2% in the December quarter of 2016 (from 4.9%), surprising Treasury and market economists who were anticipating a decline to around 4.8%. Employment growth was strong in the quarter (+19,000 people), broadly in line with expectations. However, growth in the labour force (+29,000) was larger than expected, a combination of high working age population growth (+17,000) and a lift in the participation rate to a new record of 70.5%. As a result, the number of unemployed increased by 10,000 and the unemployment rate lifted.

Data challenges

Caution needs to be applied looking at recent data from the Household Labour Force Survey (HLFS). The HLFS design changed in the June 2016 quarter and data before and after this period are not directly comparable. HLFS annual employment growth lifted to around 6% over the second half of 2016. The Quarterly Employment Survey (QES) measures of jobs growth, running at around 3.0-3.5%, are likely a more accurate guide to actual annual employment growth at present (Figure 1).

Outlook

The labour market is forecast to steadily tighten over the next three years, similar to the outlook in the Half Year forecasts, albeit beginning from a higher starting point for unemployment. In our view, the higher unemployment rate early in the forecast underpins our judgement that the economy will continue to operate with a degree of spare capacity for some time, that inflation pressures will build gradually, and that real GDP growth will accelerate to 4%.

Employment growth is forecast to average around 14,000 new jobs per quarter over this period (Figure 2), similar to the rate of job creation over the past two years of about 16,000 (excluding the June quarter 2016). Over the full forecast period, employment increases by 200,000 people (50,000 more than in the Half Year forecasts). The employment rate remains around its current record level of 66.9% across the forecast.

Growth in the labour force is also expected to remain elevated, particularly in the short term. The working age population continues to grow at a fast rate, bolstered by high levels of net working age migration. The participation rate is also assumed to remain at a high level, averaging 70.0% over the forecast period, reflecting trends in rising participation of women and older people (Figure 3). Taken together, this sees growth in the labour force averaging around 12,000 per quarter over the next three years. Over the full forecast period the labour force expands by 184,000 people.

With employment growth outstripping labour force growth, the number of unemployed and the unemployment rate steadily decline (Figure 4). The unemployment rate falls to Treasury's estimate of the long run unemployment rate (the non-accelerating inflation rate of unemployment or NAIRU) of around 4¼% in mid-2019. The labour market is expected to remain broadly balanced after this time.

While we are confident that the labour market will tighten given the economic outlook, the judgements made above influence the pace of tightening and there is some uncertainty around these judgements. High employment growth typically creates an "encouraged worker" effect that lifts participation rates; stronger employment growth than forecast may not necessarily result in a faster reduction in unemployment if it also boosts participation and therefore the labour force. That said, participation rates are already at record levels and if there is limited scope for them to increase further, or if they were to decline, a faster fall in unemployment could occur. In this situation, stronger wage inflation pressures could be expected as spare capacity in the labour market is used up faster. Flows of working age migrants are a further source of uncertainty which could lead to either a higher or lower working age population than anticipated, with corresponding implications for the unemployment rate.

The preliminary forecasts presented here will be updated as further information comes to hand. You will receive the final economic and tax forecasts on Thursday 27 April.

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Figure 1 – Annual employment growth

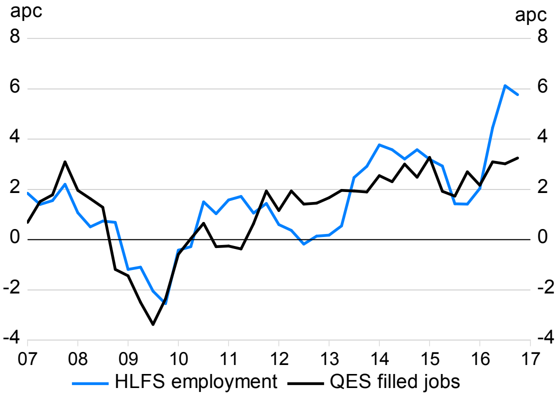

Figure 2 – Employment and labour force growth (quarterly change)

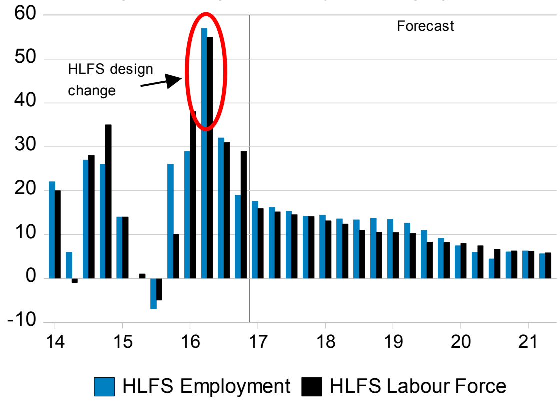

Figure 3 – Participation rate

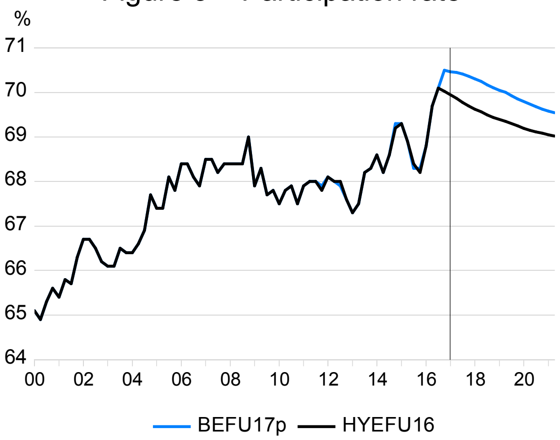

Figure 4 – Unemployment rate