ECONOSIGHTS

with Diana Mousina

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Is Australia's tight labour market leading to a wages breakout?

Key points

- The recent tick-up in Enterprise Bargaining Agreements lodged is a result of the tight labour market and also the Fair Work Commissions Annual Wage review back in June. It could threaten the inflation outlook if it persists and broadens out in the employment market.
- However, there are signs that the labour force is weakening. Job vacancies as a share of unemployed persons are declining and leading indicators of jobs growth are weakening. The unemployment rate will rise over 2024. This should keep a lid on wages growth.
- There will be differences in wage and employment outcomes across industries. Conditions in health, education and manufacturing remain tight, with job openings still around their highs. In contrast, job openings have fallen considerably in IT, rental, hiring and real estate, public administration and wholesale industries.
- Upside risks to near-term inflation from higher petrol and food prices alongside the lift in EBA wages increases the chance of another RBA rate rise before the end of the year.

Introduction

Australia's labour market has held up better than expected, despite the biggest interest rate hiking cycle since the late 1980s which has seen a 400 basis point lift to interest rates over a 14 month period since May 2022. The strength in the labour market is helping to keep wages growth elevated. Recently released data on newly lodged Enterprise Bargaining Agreements are showing a spike in wages growth which are increasing concerns that a wages breakout will threaten the inflation outlook. We look at these issues in this edition of *Econosights.*

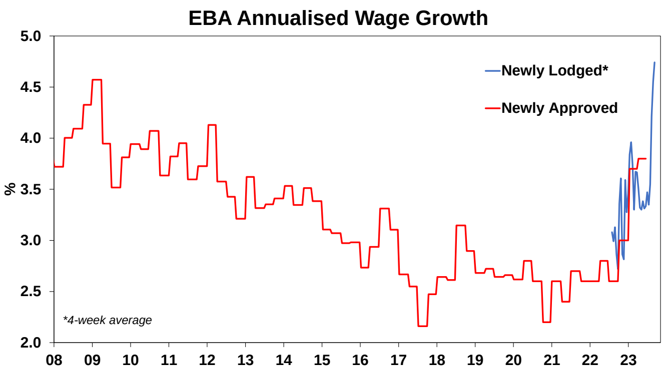
Recent wage outcomes

In Australia, there are a few ways that wages are set. Around 40% of employees are on Enterprise Bargaining Agreements (EBAs), just under 40% are on individual agreements, 21% are on awards and 1% are on the minimum wage. Award wages contain the full terms and conditions of employment for a whole industry or occupation and EBAs are similar, but cover a specific business or businesses, with the employer and a group of employees (usually represented by a union) agreeing to the terms of employment. The Fair Work Commission is responsible for setting the minimum and award wages every year, which happens around June, also known as the "Annual Wage Review". This year, it awarded an 8.6% increase to minimum wages and a 5.75% lift to award wages, starting from 1 July 2023 which will add 0.3 percentage points to annual wages growth. This was larger than most economists (including the Reserve Bank) were expecting. We see wages growth rising by 1.4% in the September quarter (when most of the impact from the minimum wage decision will occur) with annual growth peaking at just over 4% in December 2023. Some EBAs are also linked to the Annual Wage Review outcome so are automatically impacted by these changes.

Given the larger-than-expected impact of Annual Wage Review on wages along with signs of persistently high inflation, the Reserve Bank lifted the cash rate to 4.1% in June and have kept interest rates unchanged since then. The risk was that the Annual Wage Review would have a signalling impact to the rest of the market to demand similar sized wage increases.

The latest Enterprise Bargaining Agreement data showed that wages growth for newly lodged agreements is running at a 4-week average of 4.7% year on year (see the chart below), its largest increase since the report started in 2008, well above the 3.5% average in the first half of the year and higher than the 3-4% wage range that is thought to be sustainable with the RBA's 2-3% inflation target.

The details of the newly lodged EBA report indicate that the highest EBA wage rises are occurring in education, building, metal and civil construction, aged care and healthcare. While this may be partly linked to decisions from the Annual Wage Review, the labour market has remained tighter for longer than expected which may also be adding to wage pressures.



Source: DEWR, AMP

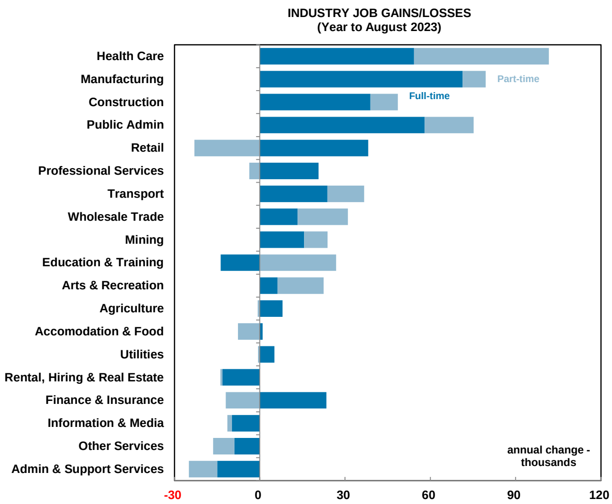
The state of the labour market

On all measures, the labour market remains in very good shape. Employment growth is strong (although has weakened from last year's levels), the unemployment rate is slightly up to 3.7% from its post-pandemic low of 3.4% but is still around a 48-year low, underemployment in the labour force (which is people wanting to work more hours) has also fallen to 6.6% compared to over 8% before the pandemic and there has been a record number of people participating in the labour force which is a sign of "motivated job seekers".

Besides the headline figures in the employment data, one of the best gauges to the strength of the labour market is looking at the level of job vacancies available per unemployed person. Prior to the pandemic, the ratio of available jobs per unemployed averaged at 0.3 (see the chart below) and this shot up to 0.94 in mid-2022 – indicating that there was close to one available job for every person who was unemployed. A decrease in job vacancies (which have fallen by 18% since their high) and an increase in unemployment has led to a slight dip in the ratio of job vacancies to unemployed at 0.72, but this is still at a very high level relative to history and indicates that there the labour market is still tight, although it is weakening at the margin.

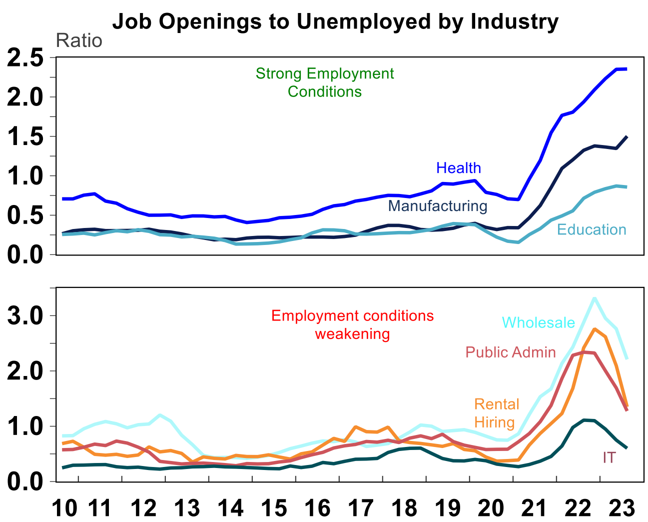
Source: ABS, AMP

Over the past year, jobs growth has been highest across the health care, manufacturing, construction and public administration sectors (see the chart below). Job losses have occurred in administration and support services, other services and information and media.



Source: ABS, AMP

To get a better understanding of the pressure within sectors, we also look at job vacancies by industry – see the chart below.



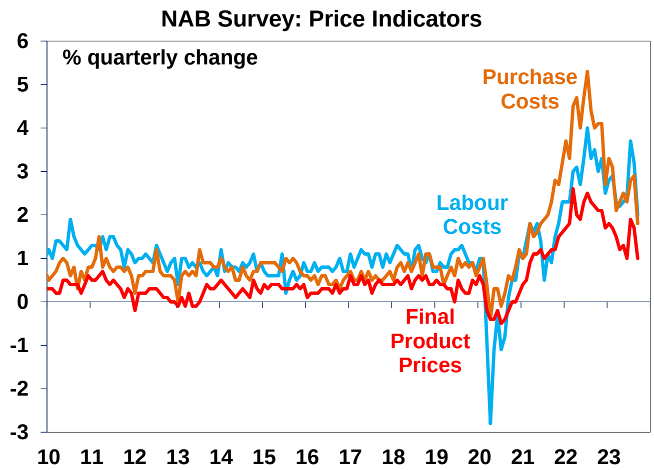
Source: Macrobond, AMP

As a proportion of unemployed persons, job vacancies remain high in manufacturing, education and healthcare which indicates that these industries could continue to see elevated wage pressures. Many of these industries are also the ones seeing the highest growth in recent EBAs. Job vacancies have fallen the most in public administration, rental hiring and real estate services, information, media and telecommunications and wholesale trade, so these sectors are likely to see slower wages growth looking ahead.

Implications for investors

We expect the labour market to weaken from here in response to the tightening in interest rates and a further slowing in economic growth. This is certainly the signal from the leading indicators of jobs growth like job vacancies, job advertisements and business hiring intentions which are pointing to a slowing (but not a collapse) in employment demand. Australia's strong population growth means that the inflow to the population every month needs to be very high (around 37,000) just to keep the unemployment rate unchanged, assuming that the participation rate is steady, which will be increasingly difficult. We see the unemployment rate reaching 4.5% by mid-2024.

The lift in recent EBA wage outcomes may concern the RBA but it's unclear if wages growth is as high in the broader market, especially for those on individual agreements. The latest September NAB business survey showed a slowing in labour costs (see the chart below) after a large rise in July that looked to be linked to the Annual Wage Review.



Source: NAB, AMP

There is also a risk that near-term inflation surprises higher. Oil prices are up by over 20% since mid-year and could lift further if the situation in Israel leads to the involvement of oil producing countries which leads to a further increase in petrol prices. Food inflation remains elevated and a move to an El Niño weather pattern could increase prices further. So, the risk of another rate rise by the end of the year has risen, with a probability of 40% in either November or December (we think it's unlikely that there would be two more interest rate increases). A November rate rise could eventuate if the September quarter inflation data surprises higher and results in the RBA raising their inflation forecasts (which are also updated in the same week as the November RBA Board meeting and the Board members have access to these updates). Or, the RBA could decide to wait for the next set of quarterly wages data, which is released in late November. However, we think that another interest rate increase would be a policy mistake, especially as inflation is likely to slow in the medium-term as the economy weakens and would further increase the risk of an Australian recession in 2024.

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