The outlook for Australian wages

August 2022

Key points

> Australia's labour market remains in very good shape – the participation rate is at a record high, labour market spare capacity is at its lowest level since the early 1980s, there is close to 1 vacant job for every unemployed person and the unemployment rate is likely to decline to around 3.2% - below full employment (which is around 4%) and its lowest level in 48 years.

> The tight labour market means stronger wages growth is likely. We expect annual wages growth to reach 3¾% by mid-2023 which would alleviate some real wage declines faced by household (especially if inflation slows as we expect) but still far from unsustainable levels that would lead to concerns about a wage-price spiral.

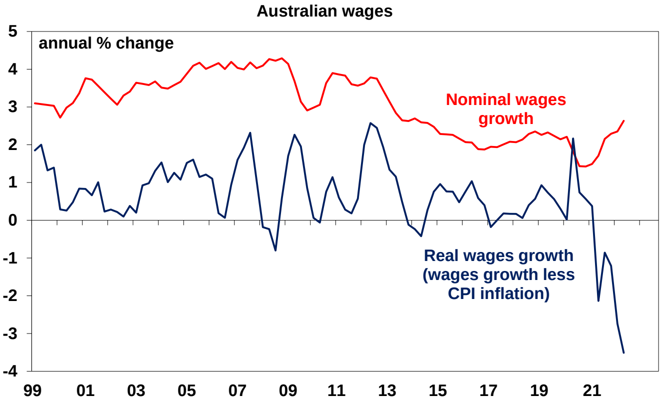
Introduction

In Australia, wages growth has lagged behind the recent rise in inflation. But, the tight labour market should mean that wages growth rises. This *Econosights* looks at the outlook for wages.

The June quarter wages

The June quarter wage price index released today showed a rise of 0.7% (below expectations of 0.8%) with a lift in annual growth to 2.6%. Private sector wages rose by 0.7% and public sector wages were up by 0.6% which shows that there is still some inertia in public-sector wage settings. Including bonuses, wages were stronger and rose by 0.8% indicating that employers are compensating staff with additional benefits which makes sense as the labour market is tight. While wages growth is rising, it is occuring slowly which reduces risk around a wage-price spiral but also means that real wages growth has fallen as inflation has outpaced wage prises. Real wages growth is down by 3.5% over the year – no wonder consumer sentiment has tanked to recession-like levels!

Australian wages



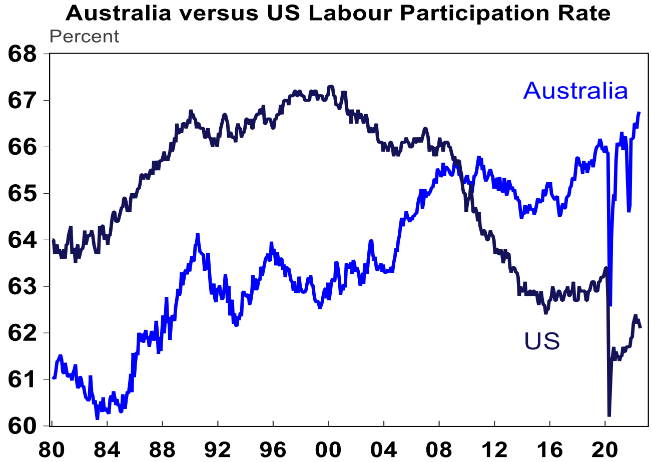
Source: ABS, AMP

The lower than expected rise in June quarte rwages increases the risk that the RBA pivots on its recent hawikshness and hikes by 0.25% in September, rather than recent rises of 0.5%.

Some background on labour market dynamics and its impact on wages

After an initial Covid-related decline in early 2020, the level of total employment bounced back to its pre-Covid average by early 2021 which indicates that demand for labour was solid (in contrast, US non-farm payrolls only got back to its pre-Covid level in July 2022). But, the *supply* of labour also surged over the past 2½ years, with the participation rate (the labour market as a share of the total working age population) now at 66.8% (a record high), versus the pre-Covid average of 66% which reflects employees wanting to take advantage of a strong labour market and a fall in the availability of short-term foregin workers (which are not captured in the Australian employment figures) because of the closed borders. In contrast, the US participation rate at 62.1% is well below its pre-Covid level of over 63% (see the chart below). The rise in Australian labour supply has played a role in constraining wages growth.

Australia versus US Labour Participation Rate

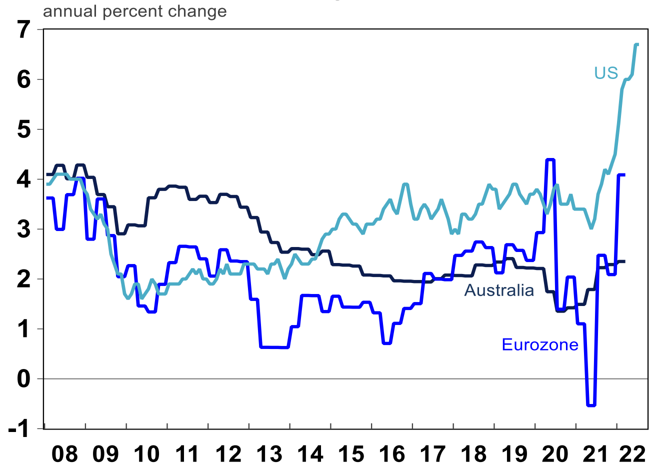


Source: Macrobond, AMP

Labour underutilisation (the sum of unemployment and the underemployment rate) is a measure of spare capacity and has fallen to 9.6% in Australia from its pre-Covid average of ~14%, which is its lowest level since 1982 (see the chart below). This indicates that the labour market has tightened, which should be positive for wages. Interestingly, underutilisation remains higher in Australia compared to the US (US underutilisation is at at 6.7%) and has been since 2014 which partly explains why US wages growth has also been stronger recently versus Australia.

In this recent cycle, wages growth has been stronger in our global counterparts than in Australia, with US wages running at 5.2% per annum, UK 4.6% and the Eurozone at 4.1% (see the chart below). This reflects more elevated inflation outcomes in these countries recently, which has caused employees to seek higher compensation, a faster bounce back in Australia's participation rate (which increases the supply of labour and puts downward pressure on wages), a larger degree of spare capacity in the labour market and inertia in the wage setting process (mainly because of multi-year Enterprise Bargaining Agreements).

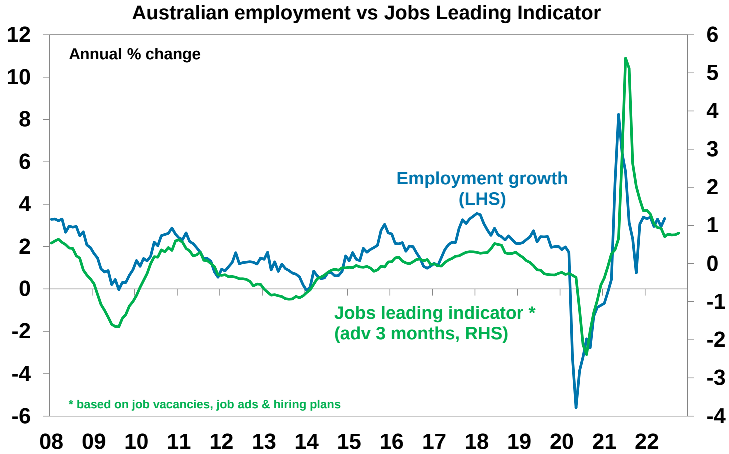
Global Wages Growth



Source: Macrobond, AMP

The outlook for Australian wages growth

Australian employment vs Jobs Leading Indicator

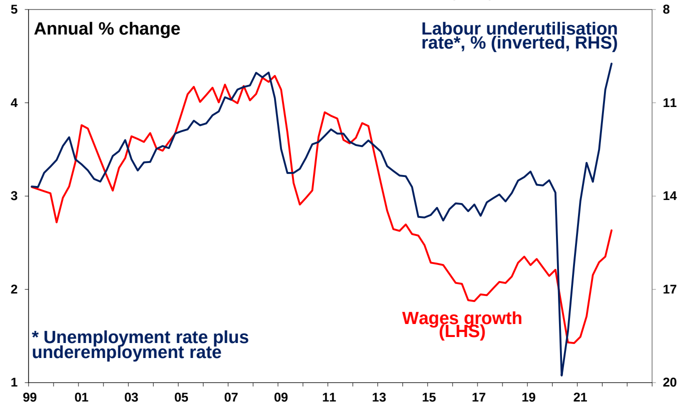


Source: ABS, Bloomberg, AMP

Some leading indicators of employment growth are starting to soften. ANZ job advertisments fell in July and the Indeed job advertisments have been trending down in recent weeks. But, these indicators are slowing from very high levels and job vacancies are at record highs (there is close to 1 vacant job for every unemployed person) which means that employment is still likely to be solid from here. Our Jobs Leading Indicator (which consists of job advertisments, vacancies and business survey indicators of employment - see chart above) is pointing to decent employment growth ahead (although well down from recent levels). So, the unemployment rate is likely to fall further, along with labour market spare capacity.

Solid employment growth sould see the unemployment rate decline to 3.2% by the end of the year (its lowest level since 1974) which is well below full employment (around 4%) before a pick up in the unemployment rate later in 2023 as the economy slows. This fall in near-term spare capacity or underutilisation should be positive for wages growth and we expect annual wages growth to reach 3¾% in 2023.

Labour underutilisation and wages growth

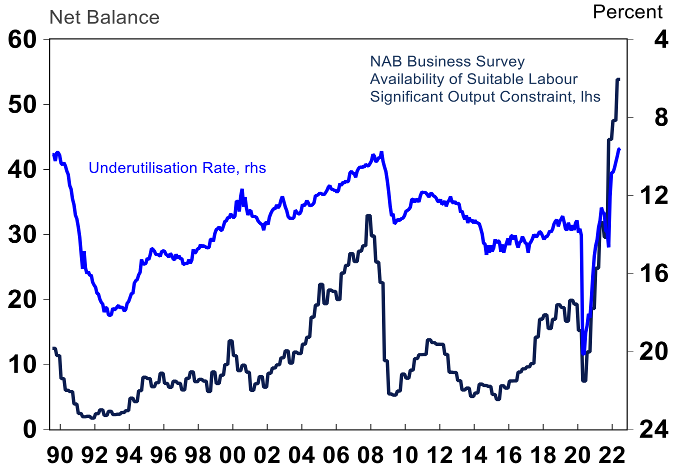


Source: ABS, Bloomberg, AMP

Labour and skills shortages

The closure of Australia's international borders in 2020/21 led to an increase in labour and skills shortages in Australia and it still remains an issue for businesses, despite the re-opening of the international border earlier this year. In the latest quarterly NAB business survey, a record number of firms are indicating that the availablity of labour is a significant output constraint on their firm (see the chart below) which is also in-line with the labour market underutilisation rate rising to its lowest level since 1982. Despite these labour and skills shortages, the upwards pressure on wages growth has been less than feared so far.

Australia: Tight labour market indicators



Source: Macrobond, AMP

The re-opening of the international border earlier this year should help to alleviate some of these skills shortages and could put some downward pressure on wages, especially if the government decides to increase its migration cap (which will likely be announced in the October budget or after the National Jobs and Skills summit in early September). So far, the pace of employment-related international arrivals has been slow to restart.

Conclusion

The Australian labour market remains in very good shape with the unemployment rate below full employment which is reducing spare capacity. The tight labour market is expected to lead to a lift in wages growth and we expect 3¾% annual wages growth by mid-2023.

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