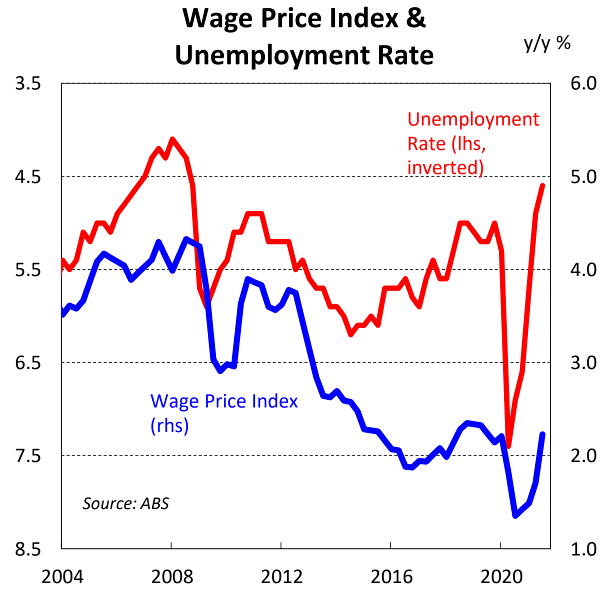
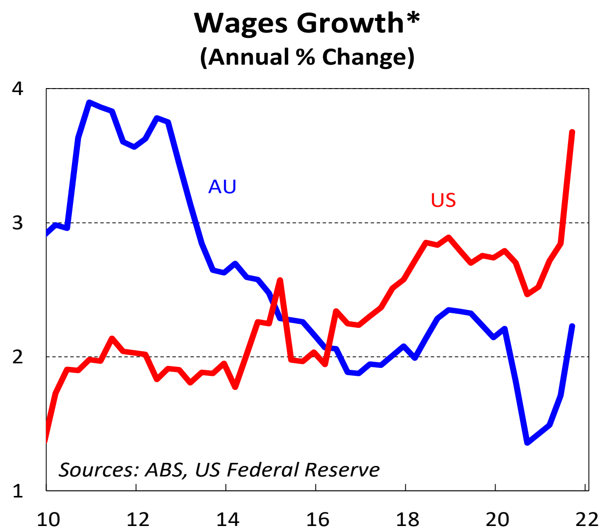
Wednesday, 17 November

Wage Price Index

Private Sector Wages Growth At 7-Year High

- **Wages growth is heating up, albeit from a low base. Wages rose 0.6% in the September quarter, to be 2.2% higher over the year. This takes annual growth to a 2-year high, back to its pre-pandemic level. Pressure on wages is building as labour shortages persist, particularly in industries impacted by international border closures.**
- **Private sector wages rose 0.6% in the September quarter to be 2.4% higher over the year, marking the strongest annual rate since late 2014. Public sector wages, however, are lagging, rising 0.5% in the quarter to be up 1.7% over the year. This partly reflects a period of public sector wages freezes, which have now been lifted.**
- **The Reserve Bank (RBA) suggests wages growth will need to be over 3% to get inflation sustainably back in the target band. We are still some way from this goal. Markets are pricing in a cash rate hike for as early as mid next year, but today's data backs the RBA's view that a hike may not materialise until 2023.**
- **The lift in wages growth in Australia is subdued relative to other major economies such as the US and UK. It partly reflects labour force participation rates remaining well under pre-pandemic levels in these other countries.**
- **Leading indicators suggest the labour market is tightening and labour shortages remain an issue. Wage pressures are building. The resumption of skilled migration should help alleviate some of these pressures.**





*Wage Price Index used for AU, Employment Cost Index used for US

Wages

Wages growth is heating up, albeit from a low base. Wages rose 0.6% in the September quarter, to be 2.2% higher over the year, the fastest pace in 2 years. It follows quarterly growth of 0.4% in the June quarter. It also takes annual growth back to its pre-pandemic level.

Pressure on wages is building as labour shortages persist, particularly in industries impacted by international border closures. Indeed, job vacancies are around their highest level in a decade and the unemployment rate is set to head lower over the coming year. There was an increase in ad hoc wage rises as businesses sought to retain and attract staff.

Private sector wages rose 0.6% in the September quarter to be 2.4% higher over the year, marking the strongest annual growth rate since late 2014. Public sector wages, however, are lagging, rising 0.5% in the quarter to be up 1.7% over the year. This partly reflects a period of public sector wages freezes, which have now been lifted.

By pay settings

Wages growth can also be considered by different methods of setting pay. In the September quarter, jobs under individual arrangements drove the largest portion of wages growth. Wages for these jobs tend to respond faster to labour market conditions than jobs covered by enterprise agreements and award wages. Inertia in wage-setting practices mean the recovery in the jobs market could take some time to flow through to a material lift in wages growth in these categories.

The Reserve Bank's liaison program suggests firms have been relying on measures other than raising base wages to reward staff, such as bonuses, to minimise increases in their cost base. However, the longer these labour shortages persist, the greater the risk that base pay gains need to be provided to attract and/or retain staff.

By industry

In quarterly terms, professional, scientific and technical services recorded the fastest growth (1.3%), followed by construction (1.1%). Public and private administration & safety as well as accommodation & food each grew 1.0% over the quarter. Wages growth in all these sectors is well above their long-run averages, reflecting labour shortages associated with the freeze on migration. Wages growth was weakest in the mining sector (0.4%), as well as retail trade, finance & insurance services and electricity, gas, water & waste services (0.5% each).

Professional, scientific and technical services also experienced the largest wages growth in annual terms (3.4%), recording its largest annual growth since early 2013. Construction (2.6%) and accommodation and food (2.5%) also experienced notable wage increases.

Annual wages growth was weakest in the electricity, gas, water & waste services sector (1.2%), as well as mining (1.5%) and arts & recreation (1.5%). The latter has been heavily impacted by the pandemic.

Annual growth rates in almost every sector remain below their long-run averages, although they are generally trending up from recent pandemic-induced lows.

By state

The ACT and Tasmania again reported the strongest growth in quarterly wages, alongside the NT, each reporting a 1.0% rise.

Quarterly growth was solid across all states with NSW, Victoria and Queensland recording a 0.9% increase in wages, despite ongoing lockdowns in NSW and Victoria. SA and WA were the weakest performers, with quarterly growth of 0.7% and 0.8%, respectively.

On an annual basis, growth was highest in Tasmania (2.7%), followed by the NT (2.4%) and Victoria (2.6%). SA (1.8%) and WA (1.9%) had the slowest rates of annual growth. Annual wages growth has returned to pre-pandemic levels in all states.

Monetary policy

Wages are closely watched by economists because they are a key driver of underlying inflationary pressures, and in turn, a key consideration for monetary policy. The Reserve Bank (RBA) has set a goal post of 3% for annual wages growth. We are still some way from reaching this goal. The RBA has suggested wages growth will likely need to be over 3% to get inflation sustainably back in the 2–3% target band. While markets are pricing a cash rate hike for as early as the middle of next year, today's data backs our view that a cash rate hike may not materialise until 2023.

Some people have questioned why the Reserve Bank has continued to underscore that the cash rate will remain at a record low for some time, effectively ruling out a lift in 2022. In short, it is because wages growth and subsequently consumer price inflation remains much lower in Australia than some other major economies.

While wages are picking up in Australia, they remain subdued relative other major economies like the US and UK, where wages growth has shot to its highest levels in a decade. This partly reflects labour force participation rates remaining well below pre-pandemic levels in these countries. In contrast, ahead of the delta outbreak, labour force participation in Australia had hit record highs. In other words, there has been a significant, persistent reduction in the labour supply in some countries, including the US and the UK, which has put upwards pressure on wages growth.

This, in turn, has put more pressure on consumer prices, amongst other factors such as supply-chain disruptions. Subsequently, both the Federal Reserve and Bank of England look set to wind back stimulus ahead of the Reserve Bank.

Outlook

Leading indicators suggest the labour market is tightening and labour shortages remain an issue. Wage pressures are building. The resumption of skilled migration should help alleviate some of these pressures.

We are upbeat on the outlook for wages. We expect wages growth will hit 2.8% by the end of next year and continue to increase in 2023. This reflects our forecast that the unemployment rate will fall below 4% by the end of 2022. The unemployment rate has not been consistently around these levels since the 1970s.

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