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NAB INSIGHTS FROM THE PRELIM Q2 QBS: JULY 2021

WAGES GROWTH AND EXPECTATIONS

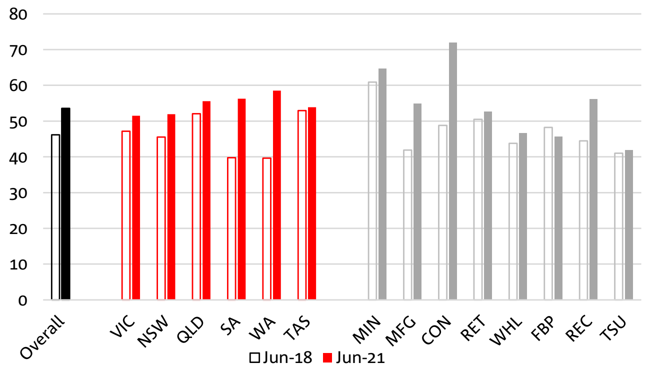
- **The special questions on wages growth in the last six months sees a relatively low proportion of employers saying that they have given pay rises – around 50% – but more in manufacturing and construction.**
- **On expectations for the next 6 months, the expectations of pay rises being given rises to 70% with the highest being in finance, property and business services as well as manufacturing and construction.**
- **While up significantly - suggesting the bottom of the growth in wages might be behind us – it is not that different from responses to the same question 3 years ago. As a result, some caution is required here.**
- **Looking at the quantified wages costs questions some simple relationships suggest that the WPI will move up significantly in H2 2021 – approaching 1% per quarter.**
- **More detailed modelling, however, suggests that that rate of increase will likely be temporary and it won't be till late 2023 till more sustained increases in the wages momentum are experienced. At a time when the unemployment rate is expected to be nearer 4.25% (based on NAB forecasts).**

Current wage momentum

In 2018 we started asking special questions in the quarterly NAB Business Survey (QBS) on how many employers have increased wages rates in the last six months and the number who expect to do so in the next six months. While the question was not part of the survey between Q2 2020 and Q1 2021, it was re-introduced into the Q2 2021 survey. That data is available across the private sector by industry and geography. As such it provides insights on the expected distribution of wage increases, in addition to the normal data on labour costs, price movements, confidence, expectation on capital spending and business outcomes.

While the Q2 QBS has not yet been released, in this special note we use preliminary data from the survey to look at what employers are saying re wages pressures. Are they widespread as markets and some commentators seem to suggest or are they more limited occurrences in some headline industries (very much the RBA view)? The chart below shows the data on recent increases by region and industry as at Q2 2021.

Changes to Wages/Salaries over the last 6 months (net balance)



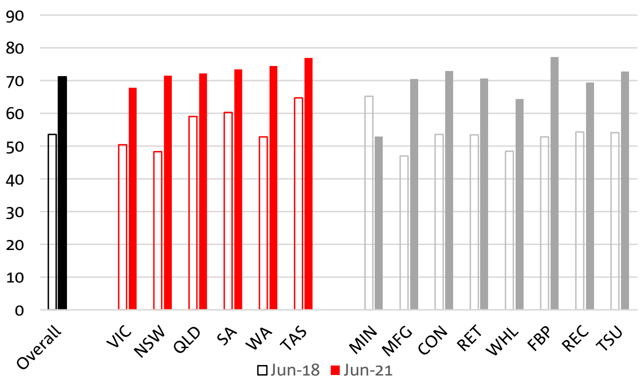
In brief the main conclusions seem to be:

- Overall, the proportion of employers giving pay rises in the last 6 months are quite low - at around 50% -- and are not much higher than 3 years ago.
- By region there is stronger increases reported in SA and WA.
- And, by industry, a higher proportion of pay rises are occurring in construction and manufacturing and possibly finance, property and business services. The former two industries no doubt reflect supply shortages and dwelling construction ramps up

Expected wage momentum in the next six months

Turning then to the near- term outlook. The data is again shown in the chart below.

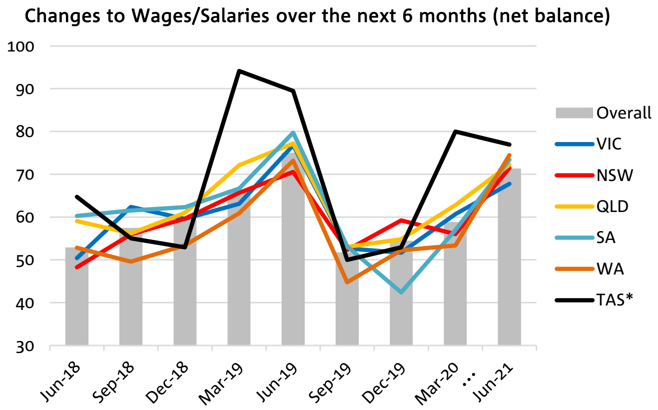
Changes to Wages/Salaries over the next 6 months (net balance)

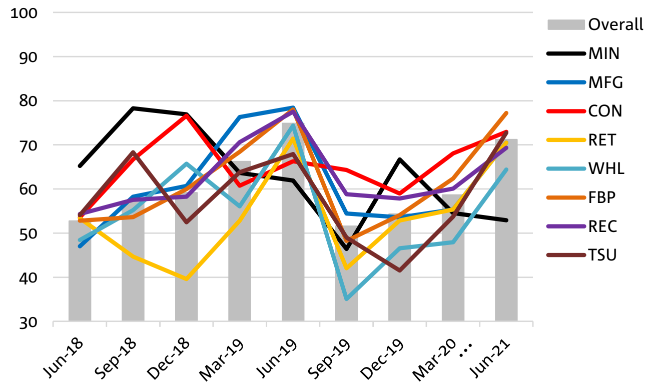


A few observations are obvious:

- There has been a large step up in the number of employers expecting to give pay increases.
- That is a broad based expectation across all the states – but especially so in WA (compared to 2018).
- By industry the increases are also broad based but especially so in manufacturing and finance property and business services.
- That said it is interesting to look at the expectations data through time. Which we also have based on the QBS special questions.

Alan Oster, Chief Economist





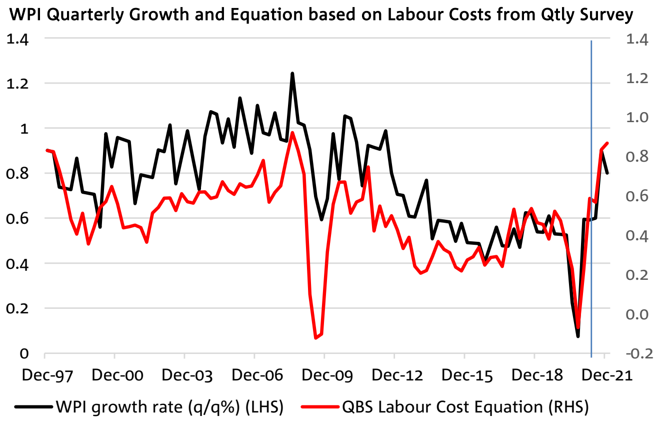
The above charts suggest:

- That while high by 2018 expectations, current expectations are not that much higher than in mid 2019.
- But clearly expectations have significantly increased from the lows of late 2019.
- Again Tasmania seems to have seen highest expectations for a while but the recent increases are more broad based.
- Leading the expected increases are finance, property and business services, construction and transport. But the expectations are still low for recreational services [eyeballing chart its mining which is very low.
- And finally, it seems clear that the lows in wage rises are behind us.

Other Wages Data from the QBS

The QBS also contains quantitative estimates of labour cost growth (which should reflect changes in employment and not just wages per person) both now and for the next three months. Interestingly econometrically there is not a lot of difference between the relationship from current cost increases to 3 month- out expectations. The latter however has the benefit of giving a small forward view.

The following chart shows a simple equation based on the Q2 expectations for Q3 – and we have also assumed Q4 expectations do not change much from the current expectations for Q3. The message is also fairly clear - expect a pick up in wages pressures into H2 – but not in Q2 itself.



Results from our NAB Wages Equation

Finally, it is interesting to see what a simple econometric equation - that in the past has a reasonable and stable relationship with private sector wages- implies. While the model tended to over-estimate actual WPI growth in the three years prior to COVID, suggesting that other factors have been in play (such as structural changes within , it hopefully provides a guide to the likely direction of wage growth (assuming our forecasts for the equation variables are correct).

The equation is based on

– Productivity (2.5 year rolling average)

– Level of underutilisation

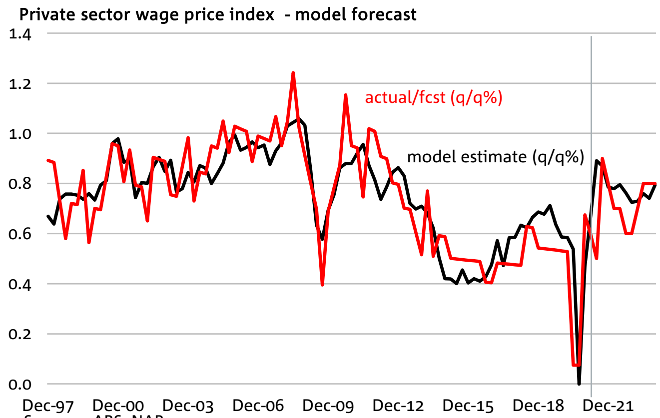
– Change in underutilisation

– Change in terms of trade

– and inflation.

In the near term, a key driver of a similar short term increase in wages growth (centred around mid-2021) is the speed of the change in the under-utilisation of labour, and this is generally being reinforced by the other variables as well.

It also suggests that this will be prove to be a temporary acceleration in private sector wages, with growth to ease back in 2022 – unless the rate of improvement in the labour market accelerates even faster than recently. Broad based wages growth then moderately re-accelerates over 2023 as the unemployment falls below 4.5% and even lower to around 4.2% by late 2023.



Sources: ABS, NAB

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