Westpac Institutional Bank

25 January 2017

Following on

Q4 labour market preview: Wednesday 1 February, 10:45am

- We're expecting to see further growth in employment in December on the back of firm economic activity.
- This is likely to see the unemployment rate fall further to 4.8%.
- While the labour market is tightening, it will take some time for this to feed into wage costs. We expect wage inflation to remain subdued in the December quarter.

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	1.4	0.6	5.9
Unemployment rate %	4.9	4.8	
Hours worked	1.2	0.7	5.9
Participation rate %	70.1	70.2	
Quarterly Employment Survey			
FTE employment (s.a.)	0.8	0.8	2.9
Hours paid (s.a.)	1.3	0.5	2.6
Private avg hourly earnings	0.3	0.4	1.7
Labour Cost Index			
All sectors, ordinary time	0.4	0.4	1.7
Private sector, ordinary time	0.4	0.4	1.6
Private, all salary & wage rates	0.4	0.4	1.6

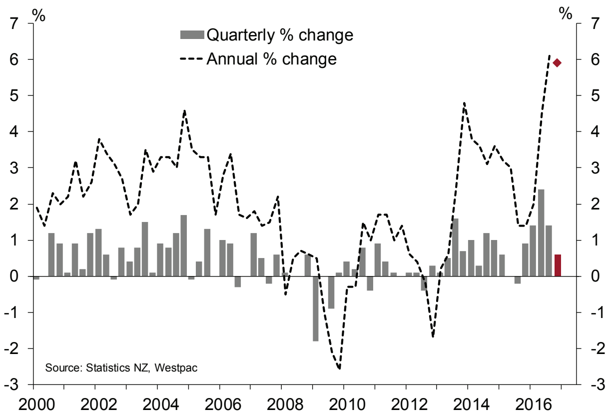
Strong economic activity is boosting labour demand...

The New Zealand economy had a pretty solid innings over 2016. GDP growth picked up to 3.0% in the year to September. And business surveys and other measures of economic activity point to continued firm economic growth through the final part of the year.

This strength in economic activity has seen the New Zealand labour market continuing to firm. We expect the Q4 Household Labour Force Survey (HLFS) to show that employment levels increased by 0.6% in December quarter. While that's a bit slower than what we've seen in the past few quarters, it's still a healthy clip.

Methodological changes in the June quarter mean that interpreting the health of the labour market could be a little tricky. In particular, annual employment growth in the HLFS will appear exaggerated. As a cross check, we'll be watching the Quarterly Employment Survey (QES) which will be released at the same time. We expect that it will show that the number of full-time equivalent employees grew by 0.8% in the December quarter, to be 2.9% higher for the year - consistent with an economy growing at a firm pace.

Employment growth (including forecast)



Increases in employment are expected to be widespread, with the largest gains expected in service sectors (such as professional services) and construction. These sectors have been key drivers of GDP growth, and businesses in these sectors have reported that they have continued to increase staff numbers in recent months.

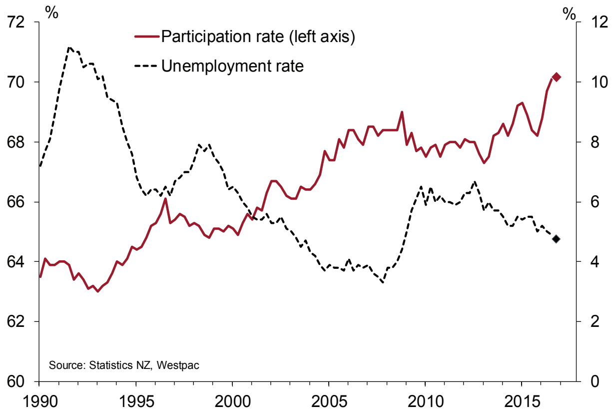
One notable source of downside risk to our employment forecast is the effects of the Kaikoura earthquakes, which struck halfway through the quarter. These events had a severe impact on some smaller centres in the upper part of the South Island, and caused disruptions in Wellington. Activity in many industries was affected, with retail spending and tourism particularly hard hit. Reconstruction following the earthquakes will boost overall economic activity and employment over time. However, demand in some parts of the economy, for instance regional tourism, may be subdued for some time.

...and the unemployment rate is trending down despite rising labour force participation

New Zealand's labour force participation rate rose to a record high of 70.1% in the September quarter. We expect it will edge a little higher again in December, up to 70.2%. Strengthening economic activity and the related increases in employment opportunities have encouraged more and more people to enter the labour force. On top of this, large numbers of working age people (including returning New Zealanders) entered the country over the past year, attracted by our favourable economic conditions.

But even with strong growth in the labour force, increases in economic activity over the past year have seen the labour market tightening. The unemployment fell to 4.9% in September - the first time it's been below 5% since 2008. And since then business have continued to report higher than usual levels of difficulty finding suitable labour. Combined with continued growth in employment, we expect the unemployment rate pushed down again to 4.8% in the December quarter.

Labour force participation and unemployment (including forecasts)



However, the strengthening labour market is yet to pass through to higher wage growth

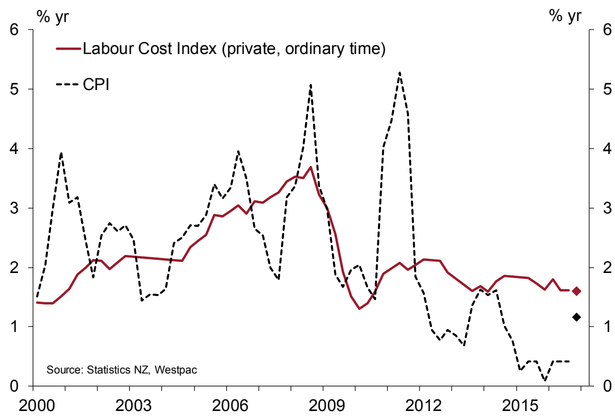
While the labour market has been strengthening, this hasn't translated into higher wage inflation just yet. We're expecting December's Labour Cost Index to show that wage rates rose by only 1.6% over the past year, while the broader QES measure of average hourly earnings growth is expected to have risen by 1.7% - both largely unchanged from last quarter and still low.

But while wage growth is currently low, this won't be the case forever. We expect that strong demand for workers, as well as increasing cost of living adjustments will contribute to rising wage inflation over the coming year.

Businesses, especially in the construction sector, are finding it increasingly difficult to source both skilled and unskilled workers. This is likely to become even more acute as the epicentre of construction activity moves from Canterbury to Auckland. Anecdotally, firms are already finding it difficult to convince staff to relocate. Inevitably, attracting workers to New Zealand's most expensive city will probably require an improved pay packet.

On top of this, one of the key reasons for low wage inflation in recent years has been the low level of consumer price inflation. However, inflation has been rising, with further gradual gains expected over the coming year. At the same time, inflation expectations, which are a key influence on how businesses set wages and prices, have lifted off their lows.

Labour Cost Index and CPI inflation (including forecasts)



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