Westpac Institutional Bank

Catch-up

NZ Q1 Household Labour Force Survey: employment 1.7%q/q, unemployment rate 6.2%

- **A pervasively strong labour market report, both in the headline and in the details.**
- **The Canterbury labour market tightened further, but improvement was also seen in other regions.**
- **We would interpret some of this improvement as catch-up with other labour market indicators – the HLFS had been unusually weak over much of 2012.**
- **Our overall assessment continues to be that the labour market improved modestly in early 2013 after tracking broadly sideways over 2012.**

Employment and unemployment

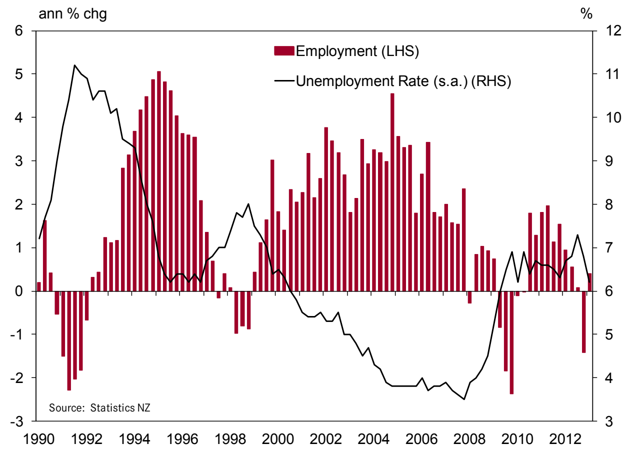
	Q4	Q1	Q1 expected	
	2012	2013	Westpac	Market
Employment %q/q	-0.9	1.7	1.3	1.0
Unemployment rate %	6.8	6.2	6.8	6.8
Participation rate %	67.2	67.8	67.9	67.8
Hours Worked s.a %q/q	0.3	3.2	0.6	-

The HLFS today gave an unusually clear signal that the labour market has improved. The data was much stronger than expected by us, the RBNZ, or the markets. The headlines were startling – this is the lowest unemployment rate since early 2010, and the biggest quarterly increase in employment in the history of the survey! What's more, the details supported the strong headline, as we explain below. The improvement was also fairly broad-based, showing through in a range of domestically-focussed industries and a majority of the country's regions – not just in Canterbury, though the labour market there has tightened further.

We would caution that while the signal in today's data is clear, that does not mean it is "correct." Last year, the HLFS was much weaker than other labour market indicators, particularly outside Canterbury. We suspect some of this quarter's improvement reflects "catch-up" by the survey. We continue to recommend paying attention to a wider range of labour market indicators, including but not focussing on the HLFS. That approach points to a modest improvement in the labour market in early 2013, after moving more or less sideways over 2012.

The RBNZ is likely to take a similar approach. The importance of today's data for the RBNZ is that the HLFS is no longer sending confusing messages at odds with other information about the

Employment and Unemployment



state of the economy. In the September quarter of last year, the unemployment rate leapt unexpectedly to 7.3%. The RBNZ, alongside most other economists, suspected that was probably a rogue signal. But nobody could be absolutely certain – there was always the possibility that the labour market really had weakened significantly. Today's data strongly discounts that risk. The central bank is now free to focus on the other factors affecting inflation - the Canterbury rebuild and rising house prices on the upside, Government austerity and the high exchange rate on the downside.

Details

We had expected a bounceback in employment from last quarter's surprise drop, with a corresponding rise in the labour force participation rate.

In the event we got much more than we bargained for – but not for the reasons we expected. Part-time employment did rise (by 1.3%) but remains more than 6% lower than a year ago. Rather, the (less volatile) full-time employment category rose 1.8%, and is now 2.3% higher than a year ago. And it wasn't just population growth – as a share of population, the employment rate rose back to 63.7%, the highest since June last year. Adding to the signal of a stronger labour market were very strong increases in hours worked: usual hours worked were up 2.2% (2.3%yr), whereas 'actual' hours worked (which include temporary factors like overtime) rose a whopping 3.2% in the quarter!

These numbers are big enough to eliminate much of the recent gap between the HLFS and other economic indicators. For example, employment among wage and salary earners (which avoids some of the definitional differences between the HFLS and the Quarterly Employment Survey) was up a very solid 2% over a year ago, similarly to the 1.5% increase in the QES's comparable measure. The lift in hours worked also eliminates an implausible surge in labour productivity that the weak HLFS over the past year (compared to GDP) had implied. Indeed, on our forecast for 0.8% GDP growth in the March quarter, the latest HLFS says that productivity fell slightly over the past year. That raises the possibility that the latest HLFS is a bit overcooked, but it's not inconsistent with what we would expect from a shift in the economy to relatively low-productivity construction-related activity.

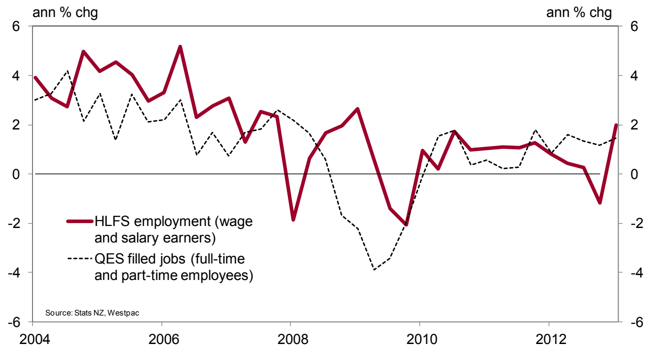
Survey breakdowns

Industry: Employment increases were broad-based, but with a focus on the domestic economy: there were solid increases across domestically-focused service sectors, whereas employment fell for a second quarter in the agri sector and for the sixth quarter in a row in the export-focussed wholesale trade sector.

The construction sector was not a standout here, but we suspect that this is an area where the HLFS continues to underestimate recent jobs growth. Employment in the sector rose 1.9%, the first increase in 5 quarters – but remains 1.7% lower than a year ago. Such weak jobs growth is hard to square with the strong economic growth we've seen in the sector, as well as some other labour market indicators – notably Tuesday's Quarterly Employment Survey, which showed construction sector FTEs up 9.9% over the year.

Region: Canterbury's labour market has tightened further. The (seasonally adjusted) unemployment rate in the region has fallen from 4.8% to just 4.1%, the lowest since late 2008, before the recession really started to take its toll on the labour market. However, improvement was also seen elsewhere. Stats NZ estimate that outside Canterbury the unemployment rate fell from 7.2% to 6.5%, the lowest since December 2011. Indeed, on our estimates unemployment fell in all regions except Northland, Taranaki, and Otago.

QES vs HLFS employment – wage and salary earners



Age: Youth unemployment remains high, but saw substantial improvement this quarter – among 15-19 year olds, it was down to 25% from 30%, and among 20-24 year olds, it fell to 9.5% from 12.9%, the lowest since late 2008. That said, labour force participation among 15-19 year olds has only partly recovered from last quarter's plunge and remains extremely low, at just 42.6%. We're not sure why this drop in youth participation should have occurred late last year – it may be that recent changes to youth benefits have encouraged teenagers to focus on training and study, though we have yet to be convinced that this impact will persist. Participation among older age groups (notably 55-59 year olds and those aged 65+) largely rebounded from last quarter's drop.

Market reaction

The data was much stronger than expected by markets. The NZD rose 0.6 cents against the USD, and the 2-year swap rate rose 4 basis points.

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