Westpac

Institutional Bank

6 November 2013

Two out of three ain't bad

Q3 labour market survey review

- The unemployment rate continued its downward trend in the September quarter as expected, though with a surprisingly large jump in both numbers employed and labour force participation.
- Strong growth in jobs and hours worked is in line with our view that September quarter GDP will rebound strongly.
- However, wage growth continues to slow, reflecting labour market slack and low past inflation.
- These surveys confirm that while the economy is in a sustained upturn, there is little reason to think that the RBNZ is falling behind the curve on inflation pressures. We continue to expect the first OCR hike in April 2014.

	Quarterly actual		Quarterly expected		Annual
	2013 Q2	2013 Q3	Market	Westpac	2013 Q3
Household Labour Force Survey					
Unemployment rate (s.a.)	6.4	6.2	6.2	6.1	-
Employment (s.a.)	0.4	1.2	0.5	0.6	2.4
Participation rate (s.a.)	68.1	68.6	68.0	68.0	-
Quarterly Employment Survey					
FTE employment (s.a.)	0.7	0.8	-	0.7	2.5
Hours paid (s.a.)	1.3	0.8	-	0.7	2.8
Private ave hourly earnings, ord time	0.4	1.6	1.4	1.4	2.6
Labour Cost Index					
Private sector, ordinary time	0.4	0.4	0.5	0.6	1.6
All sectors, ordinary time	0.4	0.4	-	0.5	1.6
Private, all sal & wage rates	0.5	0.4	0.5	0.5	1.7

There were three key messages from today's September quarter labour market surveys, two of which were very much in line with our view that the New Zealand economy has entered a significant expansion phase. First, the unemployment rate is slowly but steadily tracking lower, notwithstanding some unusual readings through 2012. Second, the drop in unemployment is genuinely associated with a lift in economic activity. That's not a trivial statement when you consider the plight of some countries like the US, where the fall in the unemployment rate has been largely due to huge numbers of people dropping out of the workforce altogether. Strong growth in the number of jobs and hours worked are consistent with our forecast that September quarter GDP growth could be well in excess of 1%.

The third message, however, is that wage inflation has continued to slow, reflecting the degree of spare capacity in the labour market and the legacy of low overall inflation in the last year or so. While it's normal for wage inflation to follow the economic cycle with a substantial lag, today's result went against our expectation that we would start to see an uptick in wage growth by this point.

It's that third message that will probably have the most bearing on how the Reserve Bank interprets these results. The Reserve Bank's mandate is to target inflation, not growth; and it has been clear that it is prepared to wait until it sees definitive signs of rising inflation before acting. Today's wage figures don't suggest there's a lot of inflation pressure in the pipeline just yet. We remain comfortable with our decision to push out the expected timing of the first OCR hike to April next year.

In contrast, financial markets seem to have latched on to the strong employment growth figures, and are giving increased odds on a hike by March. The NZ dollar rose 30 points to 0.8360, and the two-year swap rate rose 3 basis points to 3.53%.

Survey details: Household Labour Force Survey (HLFS)

The HLFS unemployment rate fell from 6.4% to 6.2% in the September quarter, in line with market forecasts and slightly above our expectation of 6.1%. This latest reading confirms that the unemployment rate has been more or less on a gradual downward trend since its post-recession peak in

2010. The notable exception was an upward spike to as high as 7.2% during 2012, a result that was out of line with other labour market indicators at the time.

The big surprise in the HLFS was a sharp rise in both numbers employed and the labour force participation rate (these often move in tandem). Employment rose by 1.2% for the quarter to be up 2.4% on a year ago, the fastest annual growth pace since December 2007. The quarterly increase was shared evenly across full-time and part-time work, although over the last year there's been a marked shift in the composition, with full-time jobs up 3.7% while part-time jobs were down 1.9%.

Meanwhile, the participation rate rose from 68.1% to 68.6%, more than recovering the downturn seen over late 2012 and early 2013. There's also been a significant change in the composition here. Youth participation (15-24 years) has taken a step down over the last year; many of them moved out of the labour force and into study in late 2012, and will likely stay there until they complete their studies. Meanwhile, adult participation (25+ years) had the biggest jump in the September quarter, to a record-equalling 70.5%.

It's possible that the tightening of unemployment benefit criteria that came into effect in early July had some effect on the latest figures. In the first instance this could have boosted the participation rate, with some people having to make themselves available for work in order to remain eligible. But this would translate into employment growth only to the extent that there are jobs available for those people. So we'd still regard the HLFS results as more a reflection of growing demand for workers rather than increased supply.

In seasonally adjusted terms, the drop in the unemployment rate was spread fairly widely across regions. Employment in Canterbury actually rose by less than the national average, although given its starting point there's less room now for dramatic improvements – the unemployment rate fell from 4.4% to 4.3%, a level that in the past has signified a very tight labour market. The unemployment rate rose in Auckland and Northland, but was flat or fell in the other regions – a further sign that New Zealand's economic upswing is broadening.

The strongest gains in employment were in manufacturing, construction, retail, accommodation and professional services. The most significant decline was in agriculture, although weather conditions rather than number of workers will have dictated that sector's output over the quarter.

Survey details: Quarterly Employment Survey (QES)

The QES provides an additional check on the degree of slack in the labour market, given the ongoing volatility in the HLFS. This survey was broadly in line with our expectations, with a 0.8% rise in full-time equivalent employment, a 0.2% rise in jobs filled, and a 0.8% rise in hours paid. Hours paid in the services sectors – which in many cases serve as a direct input to production GDP – were particularly strong, which provides further support for our forecast of a 1.2% rise in September quarter GDP.

The QES's volatile average wage measure rose by 1.6%, lifting the annual rate of increase from 2.4% to 2.6%. That helped to lift gross weekly earnings by 1.8% for the quarter, continuing the recent run of quarterly earnings growth in excess of 1%.

Survey details: Labour Cost Index (LCI)

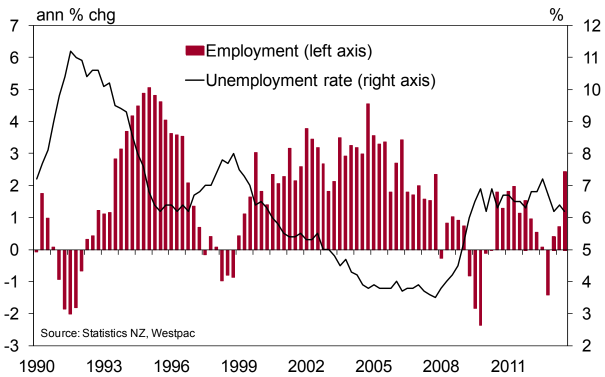
Our preferred measure of New Zealand wage inflation is the LCI, which is less volatile than the QES measure and less distorted by changes in the job mix or labour productivity.

On the basis of this measure there is currently very little wage pressure about. Private sector ordinary time wage growth slowed to 1.6% over the year to September 2013, compared to 2.1% growth in the year before that. Only 54% of those surveyed reported receiving a pay increase in the last year, and within that group the average increase was 3.3% – the lowest figure since September 2000.

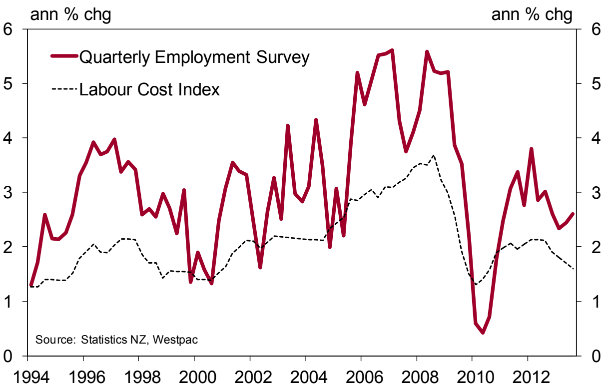
The slowdown in wage growth partly reflects the fall in CPI inflation over the last year, to the extent that pay reviews tend to be based on past inflation. Indeed, the lag between the two means that inflation-adjusted wage growth actually slowed sharply in the latest quarter – nominal wage growth slowed to 1.6%, while annual CPI inflation jumped from 0.7% to 1.4%.

Labour cost pressures resulting to the Canterbury rebuild appear to remain well contained to the region. Construction sector wages in Canterbury were up 3.7% on a year ago, compared to 3.6%yr in the previous quarter. But in the rest of the country, construction sector wage growth actually slowed from 2.1%yr to 1.6%yr.

Household Labour Force Survey



NZ LCI and QES wages



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