1 February 2013

Westpac Institutional Bank

Out of kilter

Preview of 2012Q4 employment data (7 Feb) and wage data (5 Feb)

- **We expect a modest correction in the volatile Household Labour Force Survey (HLFS), with the unemployment rate falling back to 7.0%.**
- **We have been taking the HLFS with a grain of salt. Most labour market indicators softened over 2012, but not by nearly as much.**
- **Surprises on the day are likely, but both the RBNZ and the markets have also begun to discount the HLFS.**
- **Indicators continue to point to fairly steady wage growth for now.**

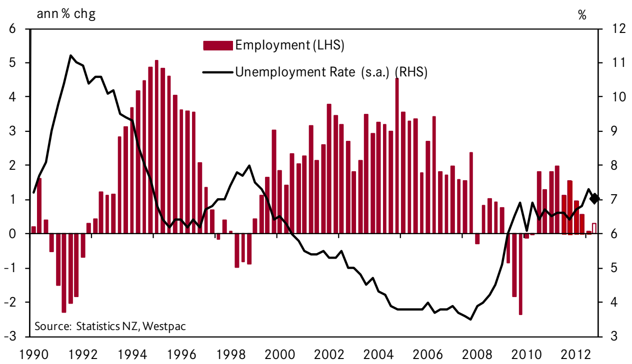
December quarter Household Labour Force Survey expectations

	Quarterly % change		Annual
	Previous	Westpac	Westpac
Employment growth %	-0.4	0.4	0.3
Unemployment Rate %	7.3	7.0	
Hours worked %	-0.8	0.3	-0.5
Participation Rate %	68.4	68.4	

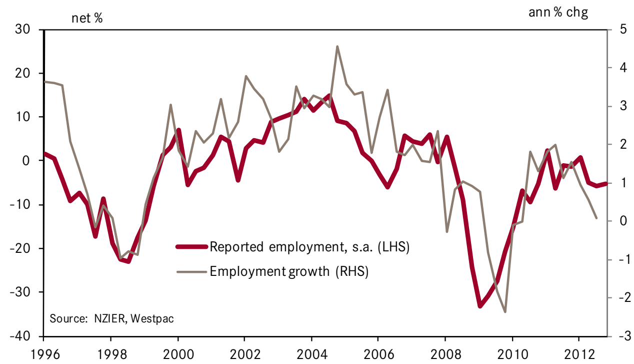
December quarter wage expectations

	Quarterly % change		Annual
	Previous	Westpac	Westpac
LCI – All sectors ex overtime	0.5	0.5	1.8
LCI – Pvt sector ex overtime	0.5	0.5	2.0
LCI – Pvt sector inc overtime	0.5	0.5	1.9
QES wages – Pvt sector	1.4	0.4	3.4

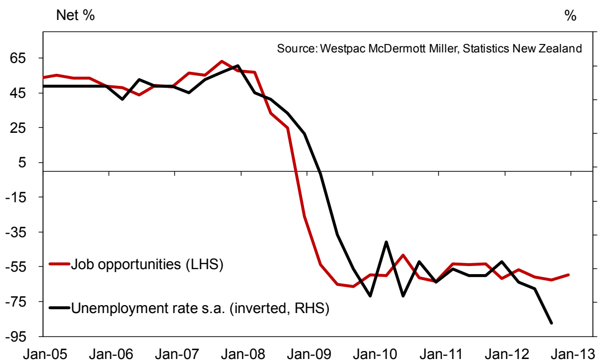
Household Labour Force Survey



Firms' reported hiring and employment growth



Households' reported job opportunities and unemployment



Next week we will get an update of the suite of official labour market indicators for the December quarter, including the employer-based Quarterly Employment Survey (QES), the household-based Household Labour Force Survey (HLFS), and the Labour Cost Index (LCI).

Both the official and unofficial labour data – the latter include job vacancies and household and business surveys such as the Quarterly Survey of Business Opinion (QSBO) and the Westpac McDermott Miller Employment Confidence Survey – have all softened over 2012 to some extent.

However, none has weakened as much as the HLFS, which showed the number of people employed falling in both the June and September quarters – despite a growing economy – and the unemployment rate shooting up to 7.3%, the highest in thirteen years.

Why has the HLFS been such an odd man out? The HLFS is a notoriously volatile survey at the best of times, and to some extent the September quarter may just have been another 'rogue' outturn.

But there are deeper reasons why the HLFS may be behaving oddly, both related to the disruption from the Canterbury earthquakes. First, there are signs that quake-related disruption has made it harder and costlier for employers in Christchurch to attract and retain the right staff. Since the quakes, job vacancies, sklled labour shortages, and wages in Canterbury have shot up, despite little overall movement in the region's unemployment rate.

The HLFS may also be struggling to keep up with population movements since the quakes: the survey is designed to track dwellings, not people. A lot of the survey's weakness in recent quarters was concentrated among the self-employed, who don't get picked up either by the QES or the QSBO. We strongly suspect that's a statistical quirk – the HLFS has also been reporting implausibly weak employment growth in the construction sector. Either way, it's affecting the numbers and may continue to do so.

The upshot is that next week's HLFS is as hard to predict as ever. On balance we've assumed a partial correction in the survey to more 'sensible' levels. We're picking a fall back in the unemployment rate to 7%, and modest employment growth (broadly in line with the latest measure of firms' reported employment in the QSBO). As always the unemployment rate will also depend on what happens to the labour force participation rate. That usually moves up and down with employment, but recently it too has been out of whack. We're picking it to stay flat at 68.4%, where it's been for four out of the last six quarters.

With all the uncertainty currently surrounding the HLFS, we'll be paying closer attention than usual to the jobs figures from the QES. QES full-time equivalent (FTE) employment and hours paid have suffered from their own bout of volatility recently. Looking through that volatility, the overall trend has been for hours and employment to increase, but more slowly than GDP. If that trend continues we should see a moderate pickup in FTE employment and hours paid – maybe 0.6% or so. On an annual basis that would see FTE employment growth accelerate modestly from 1.6% to 1.8%.

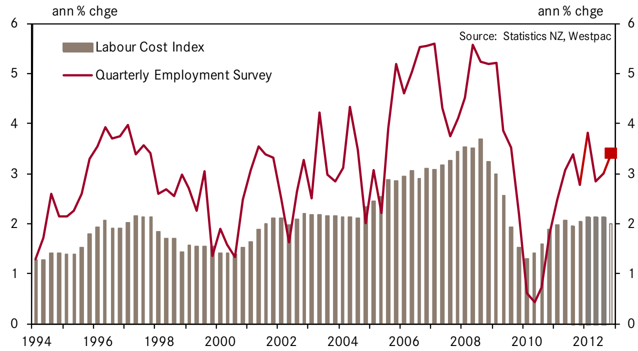
QES paid hours will be of special interest as they feed directly into estimates of activity in the service sectors of the economy, and as such are an important input into our forecast for December quarter GDP.

Wages and earnings

We expect the Labour Cost Index (the 'private sector, all salary and wage rates' measure preferred by the RBNZ) to increase 0.5% in the December quarter (the wage data aren't seasonally adjusted). This would see the annual rate ease back slightly to 1.9% from 2% last quarter. Wage inflation has been trucking along close to 2% for more than a year now.

The Quarterly Employment Survey's (QES) average wage is more volatile and and less meaningful, being heavily affected by changes in the mix of jobs both in the economy and in the survey sample.

Private Sector Earnings and Labour Costs



That being said, we're assuming QES wages will rise 0.4%, about average for a December quarter, reflecting a moderate increase in hours paid and a solid pickup in total earnings as the economy gathers steam.

Market implications

Our forecasts are broadly in line with the market consensus. Usually we warn that employment or unemployment surprises on either side could generate a strong market reaction. However, both the RBNZ and financial markets seem to be increasingly discounting the HLFS. After the huge September quarter surprise the NZ dollar fell less than a cent and interest rates fell only modestly. In particular, we'd expect markets to largely discount another implausibly high unemployment outturn, given the overall positive thrust of New Zealand domestic data recently.

While we'll be looking at the details of the LCI and QES releases closely, these surveys don't usually receive much of a market response.

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