

Worker uprising

Q1 labour market review

- Employment rose sharply again in the March 2014 quarter, with an equally sharp rise in labour force participation leaving the rate of unemployment broadly unchanged at 6%.
- The strengthening economy has attracted more people into the workforce, lifting the participation rate to a record high.
- However, the growing number of active jobseekers, along with ongoing low inflation, has meant that wage pressures have remained very muted.
- The New Zealand economy has accommodated the current upswing without encountering the degree of capacity pressures that we might have anticipated at this stage. That argues for less urgency in raising interest rates; our OCR call is currently under review.

For the third quarter in a row, New Zealand experienced a surprisingly strong lift in employment in the March quarter, combined with a sharp rise in the number of people declaring themselves to be actively in the workforce. The net result was that the unemployment rate was broadly steady at 6%, against expectations of a fall to 5.8%, while wage pressures remained soft – even more so than we expected – outside of a few obvious pockets such as the construction sector.

The labour force participation rate of 69.3% in the March quarter was the highest on record – an impressive achievement given that, as with all Western nations, we'd expect to see demographic trends working against participation as more baby boomers reach retirement age. That raises questions about how much higher it can go in this cycle, before labour starts to become a scarce resource again. But we have to acknowledge how things have panned out to date: the strengthening economy has been enough to draw more people into the workforce without the inducement of significant wage increases. There's also evidence that firms

	Quarterly actual		Quarterly expected		Annual
	2013 Q4	2014 Q1	Market	Westpac	2014 Q1
Household Labour Force Survey					
Unemployment rate (s.a.)	6.0	6.0	5.8	5.8	-
Employment (s.a.)	1.0	0.9	0.6	0.5	3.7
Participation rate (s.a.)	68.9	69.3	68.9	68.8	-
Quarterly Employment Survey					
FTE employment (s.a.)	0.3	1.1	-	0.7	3.0
Hours paid (s.a.)	0.4	1.5	-	0.7	3.8
Private ave hourly earnings, ord time	0.3	0.7	1.0	0.9	2.9
Labour Cost Index					
All sectors, ordinary time	0.5	0.3	-	0.5	1.5
Private sector, ordinary time	0.6	0.3	0.5	0.5	1.6
Private, all salary & wage rates	0.6	0.3	0.5	0.4	1.7

have been investing in more capital as well as workers to accommodate the upswing.

The bottom line is that this just does not look like an economy that's currently running around 1% above its non-inflationary potential, as the RBNZ assessed it to be in the March *Monetary Policy Statement*. And that implies the need to bring interest rates back to more normal levels is less pressing than thought. We'll be reviewing our forecast OCR track as part of our quarterly *Economic Overview*, which is released next week.

Financial markets seem to agree with our assessment, with the New Zealand dollar down half a cent and two-year swap rate falling three basis points after the data release. Interest rates are factoring in a 25 basis point OCR hike at the June MPS, but a pause is now viewed as more likely at the July OCR review.

Survey details: Household Labour Force Survey (HLFS)

HLFS employment rose 0.9% in the March quarter, compared to our forecast of a 0.5% increase. Compared to a year ago, the number of people employed was 3.7% higher, the fastest annual rate of growth in a decade. The rise in employment over the quarter was met by a 0.9% increase in the labour force, leaving the unemployment rate more or less unchanged at 6.0% (it nudged down from 6.01% to 5.96% before rounding).

The rate of participation rose from what we considered an already-high 68.9% in December to a new record high of 69.3% in March (the previous record was a brief spike to 69.2% in December 2008). That's a jarring turnaround from the same time last year, when the participation rate had fallen to a three-year low of 67.9%.

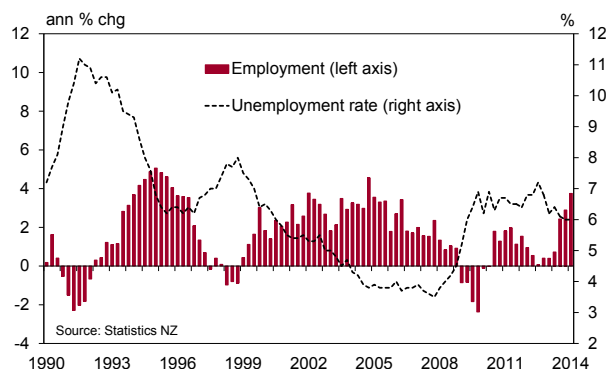
We'd caution that year-on-year comparisons of the HLFS might overstate the case. A year or so earlier we were puzzling over why employment and participation were looking so dismal in an otherwise strengthening economy, and we still can't rule out that there were some measurement issues with the survey at the time.

But the absolute level of the participation rate can't be dismissed. The prospect of a strengthening economy seems to be encouraging more and more people to actively enter (or re-enter) the labour force, just as firms are stepping up their hiring plans. This has easily swamped the effect of an ageing population, which would have otherwise dictated a gradual downward trend in labour force participation (as we've seen in other Western nations). At some point in the future this effect will start to dominate, but it may happen later, and certainly from a stronger starting point, than we had assumed.

The details of the HLFS showed that Canterbury remains the hotspot for jobs growth, with the Christchurch rebuild obviously driving a surge in construction employment (up 36% on a year ago) but with solid growth across a range of

other sectors. The seasonally adjusted unemployment rate in Canterbury has now fallen to 3.3% – fast approaching the low of 2.8% reached just before the 2008 recession.

Household labour force survey



Survey details: Quarterly Employment Survey (QES)

The employment measures of the QES backed up the findings of the HLFS, with hours paid, filled jobs and full time-equivalent employment all rising by more than 1% over the quarter. We're currently forecasting a 1.1% rise in March quarter GDP; these employment measures give us some comfort around that forecast, both in terms of their generally strong tone, and in terms of the strong growth in hours worked in the various service sectors where the QES serves as a direct input to production GDP.

The QES's volatile measure of average hourly wages rose by 0.7% over the quarter, following a subdued 0.3% increase in the December quarter. Even so, the annual growth rate slowed from 3.2% to 2.9%.

Survey details: Labour Cost Index (LCI)

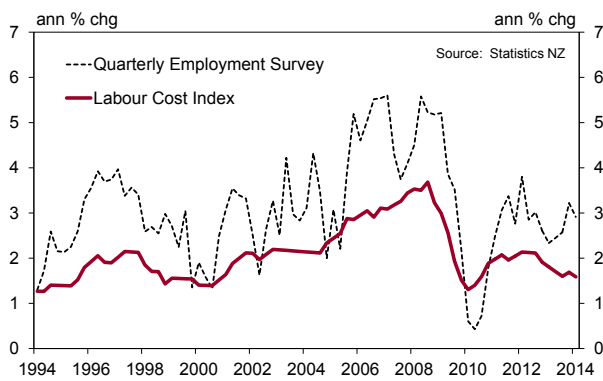
Our preferred measure of wage inflation is the LCI, which is less volatile than the QES measure and less distorted by changes in the mix of jobs or labour productivity. While the December quarter LCI had shown some tentative signs that wage inflation may be starting to tick higher again, the pace slowed right down again in the March quarter. Private sector ordinary time wages were up 1.6% on a year ago, down from 1.7%yr, while public sector wages were up just 1.2%yr, the slowest rate of increase since 1995.

The breakdown of the LCI shows that, for those job positions where wages have been increased in the past year, the range of pay increases has changed markedly over the last year or so: far fewer are receiving increases in the range of 3-5%, while many more have received increases of less than 2%. The legacy of sub-2% inflation over the last couple of years has had

a clear impact on pay negotiations. Continued low inflation over the near term, combined with the reduced difficulty of finding workers as more people enter the workforce, suggests that wage growth could remain muted for some yet.

The clear exception to weak wage growth has been the construction industry, which is to be expected given the demands of the Canterbury rebuild and the pickup in housing construction elsewhere. Construction wages and salaries were up 3.0% yr in Canterbury and 1.7%yr in the rest of the country – in both cases a modest acceleration compared to the December quarter, but below the peak rate of growth that was seen in late 2012-early 2013. Rising wages have been part of the formula needed to attract more workers into the industry and to the Canterbury region in particular.

LCI and QES wages



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