Westpac

Institutional Bank

5 November 2014

# Heating up, but not catching fire

## September quarter labour market review

- The unemployment rate fell from 5.6% to 5.4% in the September quarter, its lowest level since 2009.
- The underlying detail was also solid, with robust growth in numbers employed.
- But despite solid growth in employment, wage inflation has remained stubbornly low.
- On balance, today's data indicates that the RBNZ will be able to stay on the side lines for some time, with the OCR not expected to increase until the second half of next year.

### The labour market has continued to strengthen...

The labour market has continued to strengthen, and by a little more than markets expected (though broadly in line with our own expectations). In September the unemployment rate fell from 5.6 to 5.4% – its lowest level since 2009. The decline in unemployment reflected a solid increase in labour demand, with numbers employed increasing by 0.8% over the quarter, to be up 3.2% for the year.

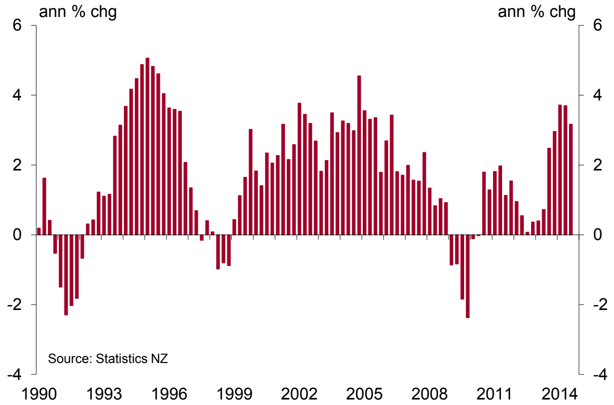
The strength in the labour market was echoed in the employer-based Quarterly Employment Survey which was also released today. It showed that the number of filled jobs in the economy increased by 3% in the year to September, the largest annual increase in six years.

While jobs growth was spread across sectors, the construction sector continues to be a significant engine of growth for the economy, with the number of filled jobs rising by 10,000 over the past year. There was also firm growth in the professional services, finance and accommodation sectors.

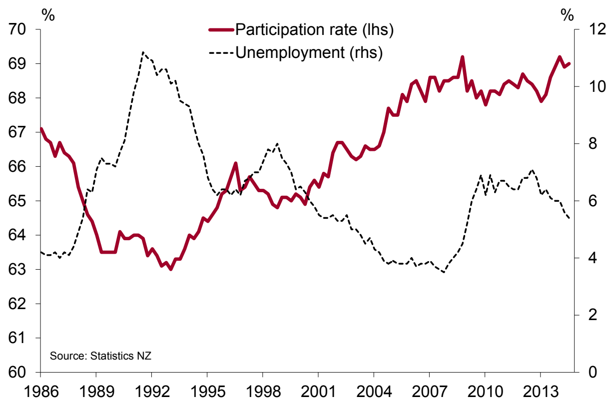
| | Quarterly actual | | Quarterly expected | | Annual |
|---|---|---|---|---|---|
| | 2014 Q2 | 2014 Q3 | Market | Westpac | 2014 Q3 |
| **Household Labour Force Survey** | | | | | |
| Unemployment rate (s.a.) | 5.6 | 5.4 | 5.5 | 5.4 | - |
| Employment (s.a.) | 0.4 | 0.8 | 0.6 | 0.8 | 3.2 |
| Participation rate (s.a.) | 68.9 | 69.0 | 69.0 | 69.0 | - |
| **Quarterly Employment Survey** | | | | | |
| FTE employment (s.a.) | 1.1 | 0.5 | - | 0.4 | 3.2 |
| Hours paid (s.a.) | 0.7 | 0.0 | - | 0.6 | 2.6 |
| Private ave hourly earnings, ord time | 0.5 | 1.4 | 1.1 | 0.8 | 2.9 |
| **Labour Cost Index** | | | | | |
| All sectors, ordinary time | 0.5 | 0.5 | - | 0.6 | 1.7 |
| Private sector, ordinary time | 0.6 | 0.5 | 0.5 | 0.6 | 1.9 |
| Private, all salary & wage rates | 0.6 | 0.5 | 0.5 | 0.6 | 1.9 |

The robust growth in employment signals that the economy is continuing to expand at a healthy pace, even as the boost from high commodity prices earlier in the year has started to fade. Looking forward, surveys of businesses' hiring intentions are consistent with continued solid growth in employment over the coming months.

**Employment and GDP growth**




**Unemployment and labour force participation**




## ...and more people are being encouraged to seek employment...

Gains in employment more than offset an increase in labour force participation, which ticked up to 69% - close to the record high seen earlier in the year.

Increases in participation have been supported by a number of factors. First of all, we've seen strong net immigration of working age people. At the same time, the strengthening economy has encouraged more people to enter the labour force. Finally, those already in the labour force have been choosing to work for longer. We expect these factors to continue boosting the underlying trend in labour force participation for a few more years, before demographic factors contribute to a reversal. In the meantime, this will allow the economy to continuing growing without generating significant inflation.

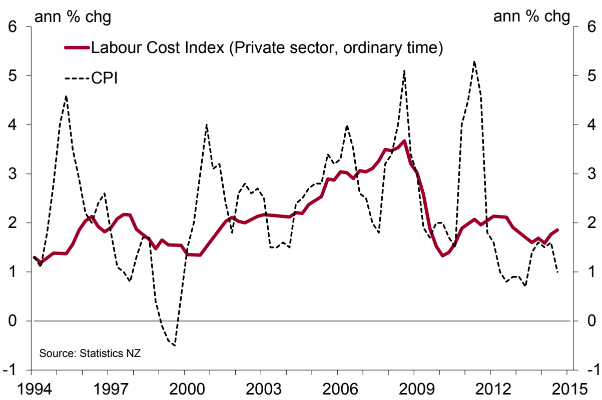
## ...but wage inflation remains subdued...

Wage inflation across all of the measures released today remained subdued. Our preferred measure, the private sector ordinary time Labour Cost Index, increased 0.5% to be up 1.9% for the year (in line with market, but just below our own forecast). Wage inflation has not shown any material pick-up since the financial crisis, and there has been particular softness in public sector wages.

It's important to put the current low wage inflation in context. When New Zealand experienced high rates of nominal wage inflation in the late 2000s, we also experienced high rates of generalised inflation which eroded households' purchasing power. Recently, although we've had low wage inflation, we've had even lower consumer price inflation. Consequently, cost of living adjustments to wages have been modest.

One interesting feature of today's data was the regional breakdown of construction costs. Following the Canterbury earthquakes, we saw wage inflation in Canterbury's construction sector pick up strongly. However, more recently, wage inflation in Canterbury's construction sector has been easing back, and is now running at a similar pace to the rest of the country. The Canterbury rebuild still has a way to go, so we don't expect wage inflation in the region to completely fade away. However, construction activity is now picking up elsewhere, with a particularly strong outlook for Auckland. Consequently, we may start to see more generalised inflation in this sector over the coming years. This is one area that will warrant continued monitoring.

**Wage growth and CPI inflation**




## ...signalling that the RBNZ can remain on hold in the near-term

With the economy projected to grow at a robust pace over the coming year, unemployment is expected to decline further, and some pick-up in wage inflation can be expected over time. But with inflation more generally remaining subdued, the RBNZ will be able to stay on the side lines for some time, with the OCR not expected to increase until the second half of next year.

## Market reaction

The NZD/USD cross rose 40 points on the stronger than expected headline numbers. Swap rates rose just 1 basis point, possibly restrained by continued modest wage inflation.

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