Westpac

Institutional Bank

31 January 2014

Steady progress

Q4 labour market data preview: 5 February, 10:45am

- Labour market indicators suggest there was a further modest improvement in the December 2013 quarter. We expect the unemployment rate to fall from 6.2% to 6.1%.
- The recent track record of low consumer price inflation is likely to have had a bearing on wages; we expect annual wage growth to slow slightly to 1.5%.
- History shows that the labour market – and particularly wages – can remain subdued even at this stage of an economic upturn. However, we expect to see a more substantial improvement over 2014 than there was in 2013.

	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	1.2	0.6	2.5
Unemployment rate %	6.2	6.1	-
Hours worked	1.6	1.0	2.9
Participation rate %	68.6	68.6	-
Quarterly Employment Survey			
FTE employment (s.a.)	0.8	0.9	3.0
Hours paid (s.a.)	0.8	1.0	3.1
Private avg hourly earnings	1.6	0.5	3.4
Labour Cost Index			
All sectors, ordinary time	0.4	0.4	1.5
Private sector, ordinary time	0.4	0.4	1.5
Private, all salary & wage rates	0.4	0.5	1.6

The official labour market surveys released next Wednesday are likely to show that the jobs market maintained its gradual pace of recovery in the December 2013 quarter. The labour market tends to be a laggard in the economic cycle, so while economic activity clearly shifted into a higher gear in the second half of 2013, we don't expect that increased momentum to have shown up immediately in the employment numbers (and even less so in wage growth).

The December employment figures probably won't have much bearing on market expectations for the first hike in the Official Cash Rate (we expect a 25bp increase in March). The unemployment rate can throw up some unusual results from quarter to quarter, and in any case it tends to be a lagging indicator of inflation pressures. The measures of wage growth may be of more interest, if there's any inkling that expectations of higher inflation are becoming embedded. However, wage inflation tends to evolve very gradually, and we suspect that the recent legacy of very low inflation will be the dominant force in the December quarter figures.

Employment and unemployment

We expect the Household Labour Force Survey (HLFS) to show a drop in the unemployment rate from 6.2% to 6.1%, which would be the lowest since June 2009. Near-term indicators of the labour market have been unanimously positive, but they've also been fairly consistent in saying that the improvement in the December quarter was a modest one. Job advertisements rose at a slightly faster pace, welfare payments fell modestly, business confidence surveys showed a lift in staff numbers, and the Westpac McDermott Miller employment confidence survey found that perceptions of current job opportunities were – by a narrow margin – the least negative in five years.

Those indicators are also consistent with our expectation of a 0.6% rise in employment, though we'd put less weight on this number: the surveyed measure tends to exhibit a great deal of quarterly volatility, in tandem with the labour force participation rate. We note that both measures rose sharply in the September quarter – with participation for over-25s hitting an equal-record high – so we suspect the greater risk is for a downward correction this time.

We're also wary that there was a sharp drop in participation in the December 2012 quarter, some of which may have been due to more young people moving out of the labour force and into study. Statistics NZ later concluded that there was a distortion specific to that survey, and made an ad hoc adjustment to the employment figures for that quarter. But that doesn't exclude the possibility of a new seasonal element to the jobs numbers that we haven't got a handle on yet.

The Quarterly Employment Survey (QES) provides a less volatile cross-check on the degree of slack in the labour market, and also serves as a direct input to GDP for some service sectors. Employment and hours paid accelerated gradually over 2013, and we expect a further uptick in the December quarter, in line with our view that ex-agricultural GDP growth rose to 1% or more. (September quarter GDP rose 1.4% but we estimate that the rebound from the drought early last year accounted around 0.6ppts of this.)

Wages and earnings

The Labour Cost Index (LCI) is our preferred measure of wage inflation, as it's less volatile than the QES average hourly earnings measure and less distorted by changes in the mix of jobs or labour productivity. We expect a 0.4% increase in ordinary time wages, the same pace as the previous three quarters. Since there's a slightly greater tendency for wage reviews to occur later in the year, our forecast implies that wage pressures actually softened a little over 2013 – we see annual growth dropping slightly to 1.5%, the slowest in three and a half years.

That would not be an unusual outcome, nor would it contradict the view that the economy is now entering a boom period. Consumer price inflation fell to a 14-year low of 0.7% by the middle of last year, and while it has accelerated since then, the inevitable backward-looking element of wage negotiations means that higher inflation probably won't feature until this year's round of pay reviews.

Then there are the usual lags from activity to wage pressures. As a point of reference, at the start of the 2000s boom, annual GDP growth was already running above 4% and the unemployment rate had dropped below 6% before wage inflation bottomed out at around 1.5%, much the same as its current pace.

Michael Gordon
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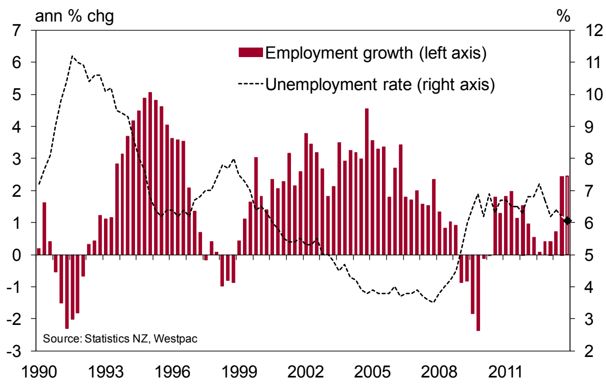
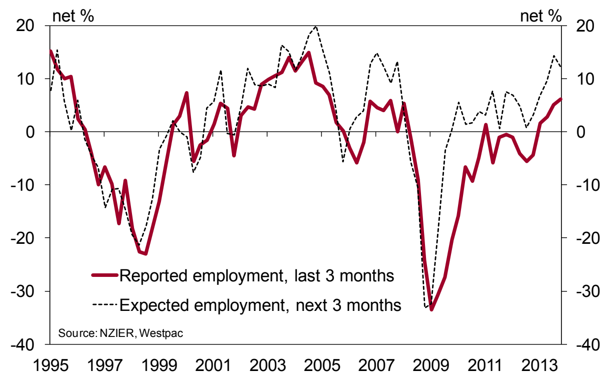
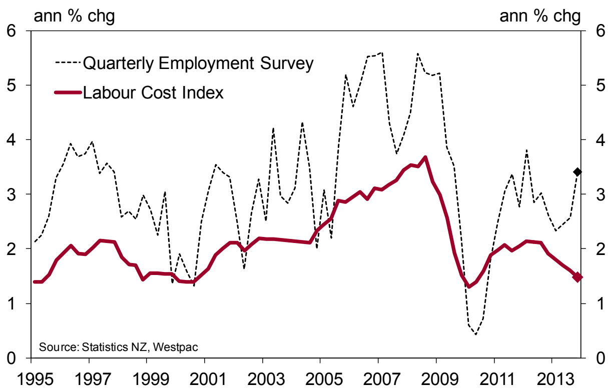
Household Labour Force Survey



Firms' reported and expected hiring



Private sector earnings and labour costs



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