Westpac Institutional Bank

1 May 2015

Labour market tightening, but wage growth still low

Q1 2015 labour market preview: Wednesday 6 May, 10:45am

- We expect that the unemployment rate will push down to 5.5% in early 2015 as strengthening domestic demand boosts demand for labour.
- While nominal wage inflation is expected to have remained low, this is occurring against a backdrop of weak consumer price inflation. Adjusted for purchasing power, households' real wages are actually growing at a strong pace.

	Q4 actual	Q1 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	1.2	0.8	3.3
Unemployment rate %	5.7	5.5	-
Hours worked	0.2	0.8	0.9
Participation rate %	69.4	69.3	-
Quarterly Employment Survey			
FTE employment (s.a.)	1.3	0.4	3.4
Hours paid (s.a.)	0.7	0.9	2.4
Private avg hourly earnings	0.4	1.0	3.3
Labour Cost Index			
All sectors, ordinary time	0.5	0.5	1.9
Private sector, ordinary time	0.5	0.5	2.1
Private, all salary & wage rates	0.5	0.4	2.0

The labour market is strengthening, pushing the unemployment rate down

It's been a solid start to the year for the New Zealand economy, with businesses reporting firm levels of activity over the past few months. Of note have been the strong gains in retail spending and continued strength in construction. Such strength is even more impressive given the headwinds in the external sector, including earlier dry conditions, falls in commodity export prices, and an elevated NZD.

We expect that the strength in domestic demand has flowed through to an improvement in the labour market. We're expecting the Household Labour Force Survey (HLFS) to show that employment increased by a solid 0.8% in March quarter, which would result in an annual increase of 3.3%. This would be enough to push the unemployment rate down to 5.5% in the March quarter (vs 5.7% in December). Such a strengthening in the labour market would accord with recent business surveys that have shown solid levels of hiring. It would also be consistent with the increasing number of businesses that are reporting difficulties finding suitable workers.

Our expectation for a decline in the unemployment rate assumes a pull pack in the labour force participation rate to 69.3%. This follows a large increase last quarter, but still leaves participation at historically high levels.

The HLFS can be volatile on a quarter-to-quarter basis. Consequently, we'll be watching the Quarterly Employment Survey (QES) as a cross check on the health of the labour market. We expect that the QES will show that the number of full-time equivalent employees grew by 0.4% in the March quarter, to be 3.4% higher for the year - consistent with the economy growing at a firm pace.

Wage growth low, but strong increases in purchasing power

Although the labour market is strengthening, nominal wage growth remains limited. We're expecting March's Labour Cost Index to show that private sector wage and salary rates (including overtime) rose by 2% over the past year. While that's up from last quarter, it's still pretty modest in the context of an economy that's been growing at rates over 3%. Furthermore, despite our expectation that the domestic economy and labour demand will continue growing at a firm pace over the coming year, we still think that any material lift in nominal wage inflation is quite some way off.

The strength of wage growth will be of particular interest to the RBNZ, who like us is expecting a 2% increase in private sector wages. A key reason why we've had low nominal wage growth is that we've had even lower consumer price inflation. In the year to March annual CPI inflation was only 0.1% - its lowest level in well over a decade. This has meant that cost of living adjustments to wages have been limited. With inflation set to remain low for some time, the RBNZ is acutely aware of the risk that there could be a material and long-lasting downshift in wage and price setting behaviour. If this occurred, it would make it harder to for the RBNZ to ensure inflation remains consistent with its target in the future. Consequently, we'll be watching next week's wage data closely for signs of softness.

As we've noted before, it's important to put the apparent weakness in nominal wage inflation in context. Low consumer price inflation has meant that wage increases have been going further in terms of spending ability. After adjusting for changes purchasing power, real wages have been growing at a solid pace for several years now. This is in stark contrast to the mid-2000s when, despite strong nominal wage growth, high rates of general inflation meant that households were actually going backwards in terms of their purchasing power.

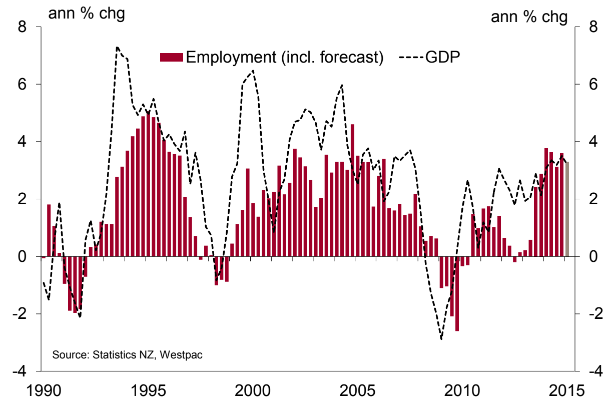
In addition, as the labour market has strengthened, more and more New Zealanders have been receiving wage increases. Over the past year, 59% of wage and salary rates increased, which is the highest level more than five years.

Combined, the above conditions have supported strong growth in spending in the early part of 2015.

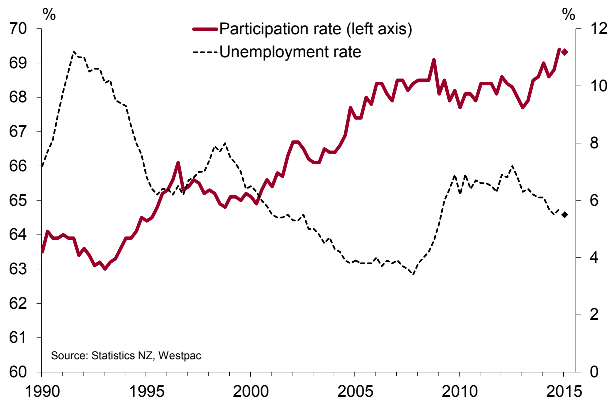
We expect that this favourable picture for households' real earnings also will be reflected in the broader QES measures of earnings. We expect that these will show that households' average hourly earnings have risen by around 3.3% over the past year – well above the rate of inflation.

Satish Ranchhod
Senior Economist

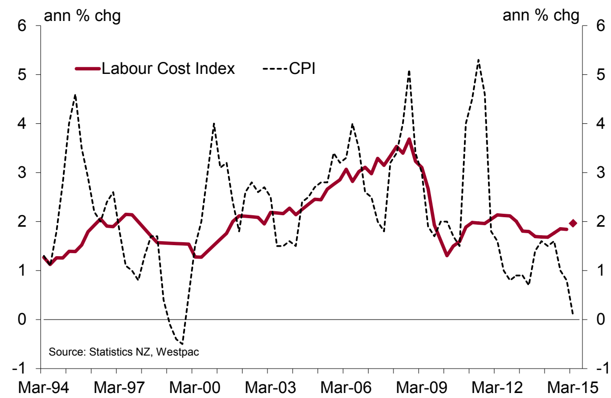
Employment and GDP



Labour force participation and unemployment



LCI and CPI



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