Westpac Institutional Bank

31 July 2015

Labour demand softening while wage growth remains low

Q2 2015 labour market preview: Wednesday 5 August, 10:45am

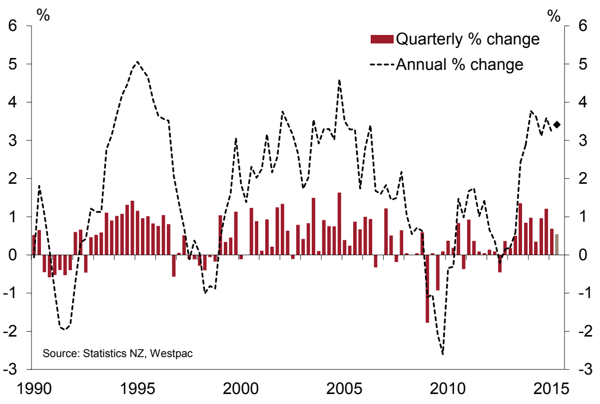
- We expect the unemployment rate to rise to 5.9% in June as demand for workers softens.
- Wage inflation is expected to have remained low, with any material pick-up someway off.
- With wage growth likely to remain low and consumer price inflation starting to pick up, households' purchasing power will come under increasing pressure over the coming year.

	Q1 actual	Q2 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	0.7	0.5	3.4
Unemployment rate %	5.8	5.9	-
Hours worked	1.4	0.4	3.0
Participation rate %	69.6	69.6	-
Quarterly Employment Survey			
FTE employment (s.a.)	1.7	0.3	3.3
Hours paid (s.a.)	2.0	0.3	3.3
Private avg hourly earnings	0.2	0.3	2.4
Labour Cost Index			
All sectors, ordinary time	0.3	0.4	1.6
Private sector, ordinary time	0.3	0.4	1.7
Private, all salary & wage rates	0.3	0.4	1.7

Storm clouds have emerged on the economic horizon, and labour demand is softening

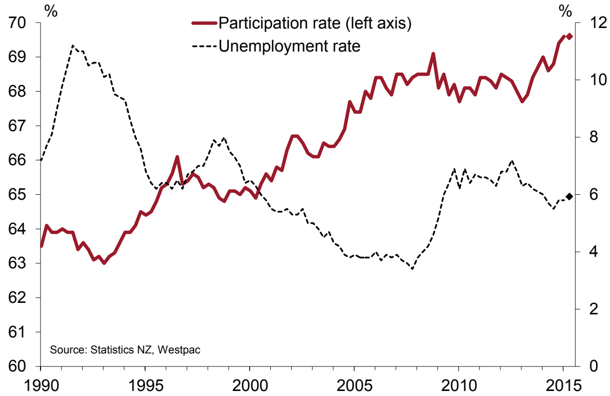
Signs that the New Zealand economy is losing steam have been mounting in recent weeks. Dairy prices have fallen, business confidence has declined, and the Canterbury rebuild is levelling off. Over the coming year, these developments will lead to a marked slowed down in economic activity. And we're already seeing early signs that this is feeding through to softer labour market conditions, with recent business surveys pointing to a slowdown in hiring through mid-2015.

Employment growth (including forecast)



Over time, we expect that the softening in economic conditions will result in the unemployment rate pushing higher. However, on a quarter-to-quarter basis, labour market data are notoriously volatile. We're expecting next week's Household Labour Force Survey (HLFS) to show that the unemployment rate picked up to 5.9% in June (compared to 5.8% in March). Underlying this is a slowdown in labour demand, with employment growth expected to have eased back to 0.5% from 0.7% in the previous quarter. That will still leave annual employment growth at a healthy 3.4%. However, it won't be enough to offset the continued strong growth in the population as a result of record levels of net immigration over the past year.

Labour force participation and unemployment (including forecasts)



The key risk around our forecasts is what happens to the participation rate. In the March quarter, the participation rate rose to a record high of 69.6%. We expect this to have been sustained in June. However, late last year there was a very sharp increase in labour force participation among those aged 15 to 24. While this is consistent with the age profile of new migrants, there is the risk that participation does fall back to more average levels in June. If it did, we could see the unemployment rate falling, despite softening labour demand.

As the HLFS can be volatile on a quarter-to-quarter basis, 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 0.3% in the June quarter (down from 1.7% in March).

Wage growth to remain low even as the inflation environment becomes less friendly

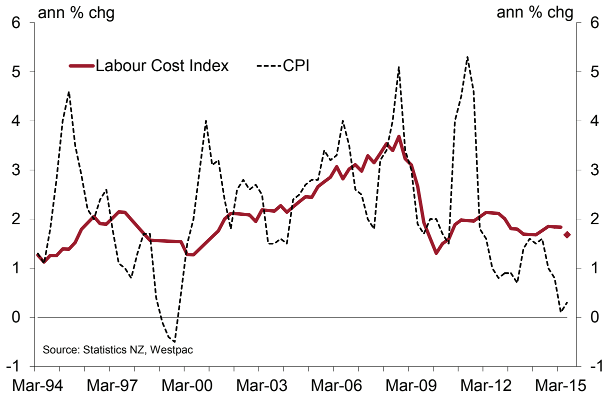
Nominal wage growth hasn't shown any material acceleration for several years now. We're expecting June's Labour Cost Index to show that annual private sector wage and salary growth has moderated to 1.7%, while the broader QES measure of average hourly earnings growth is expected to have pushed down to 2.4%.

Furthermore, with confidence in the economy wavering and some of the big drivers of growth coming off, any material lift in nominal wage inflation looks like it's some way off.

Over the past year the softness in wage inflation was less of a concern as households' real purchasing power was still growing at a solid pace. That was because while wage inflation was low, inflation in the prices of goods and services was even lower. Notably, last year's sharp falls in petrol prices had, until recently, put quite a bit of cash back into households' pockets.

But over the coming year households' purchasing power is going to start looking a lot less healthy. Petrol prices have reversed their earlier declines and the fall in the NZD will result in the prices for a range of imported goods rising over the coming months. Combined with lingering softness in wage growth and a likely pick-up in unemployment, this means that many households will find that their spending power is getting squeezed.

LCI and CPI



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