Westpac

Institutional Bank

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Labour demand softening, conditions to ease further

June quarter 2015 labour market review

- June quarter labour market data have added to signs that the economy has lost momentum through mid-2015.
- The unemployment rate has pushed up to 5.9%. Underlying this was a softening in labour demand.
- Wage inflation remains moderate.
- Overall, today's data supports our expectation that the RBNZ will need to continue cutting the OCR over the coming months to support growth and inflation.

Slowing momentum in the economy has resulted in unemployment pushing higher

In recent weeks we've been highlighting signs that the economy has been losing momentum in response to a levelling off in construction activity and falls in global dairy prices. These developments have already seen consumer and business confidence falling sharply. But today's labour market data provided a more concrete sign that the economy is slowing.

The unemployment rate increased to 5.9% in the June quarter. Underlying this was cooling labour demand. The Household Labour Force Survey (HLFS) showed that employment growth moderated in the June quarter to +0.3%, while the employer-based Quarterly Employment Survey (QES) showed that the number of filled jobs fell by 0.7% - both lower than expected. Reinforcing this picture of softening demand for workers were falls in the various measure of labour hours over the quarter.

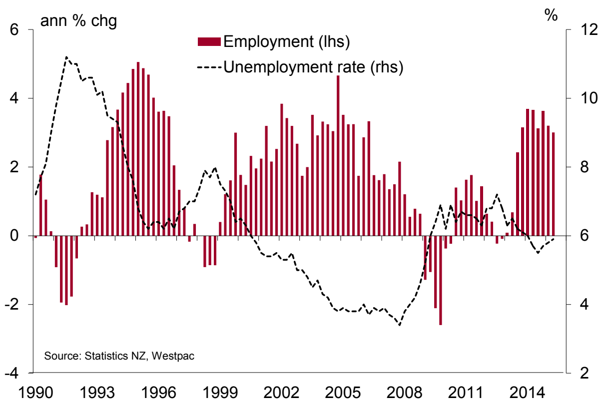
	Quarterly actual		Quarterly expected		Annual
	2015 Q1	2015 Q2	Market	Westpac	2015 Q2
Household Labour Force Survey					
Unemployment rate (s.a.)	5.8	**5.9**	5.9	5.9	-
Employment (s.a.)	0.6	**+0.3**	0.5	0.5	**+3.0**
Participation rate (s.a.)	69.5	**69.3**	69.6	69.6	-
Quarterly Employment Survey					
FTE employment (s.a.)	1.6	**-0.7**	-	0.4	**+2.1**
Hours paid (s.a.)	2.0	**-0.6**	-	0.3	**+2.4**
Private ave hourly earnings, ord time	0.2	**+1.2**	0.5	0.3	**+3.2**
Labour Cost Index					
All sectors, ordinary time	0.5	**+0.5**	-	0.4	**+1.6**
Private sector, ordinary time	0.5	**+0.5**	0.5	0.4	**+1.8**
Private, all salary & wage rates	0.4	**+0.5**	0.5	0.4	**+1.8**

This weakness in labour demand was partially offset by a pull-back in labour force participation from 69.5% to 69.3%. But this wasn't enough to stop the unemployment rate pushing higher.

Some of the softness in the June quarter labour data does reflect a pull-back after over-sized gains earlier in the year. However, looking over a range of labour market indicators in recent months, we are left with a softer labour market picture than we had assumed a few months ago.

These developments don't mean that the economy is toppling over just yet. But it's clear that the wind is coming out of the economy's sails, and a period of softer economic activity and employment growth is on the cards. Consistent with this, businesses have already been reporting a reduction their hiring intentions over the coming year.

Employment and Unemployment



Rotation in the drivers of growth

It's not just the strength of the growth that's changing. The underlying composition of growth has been evolving also. Notably, while demand in the construction sector is still strong, the sector is no longer the main driver of employment growth. That title now goes to the manufacturing sector.

A key reason for the slowdown in construction sector hiring is that activity related to the Canterbury rebuild is now levelling off. We still expect demand for construction workers in Canterbury (and elsewhere) will remain strong for some time. But with reconstruction now well advanced, we do not expect employment in the construction sector to grow at the rapid pace seen in recent years.

Consistent with this rotation in the drivers of employment, we've seen employment growth in Canterbury slow sharply over the past year. Auckland remains the key driver of employment growth, with strong gains also seen in the Bay of Plenty and Waikato.

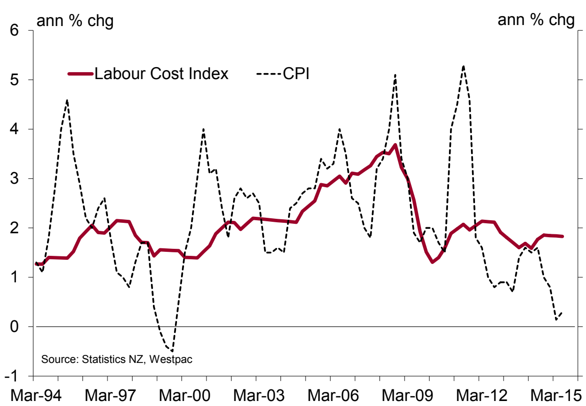
Outlook for wage growth still subdued

Wage inflation has remained stubbornly low. The private sector LCI (including overtime) rose by 0.5% in the March quarter, to be up 1.8% for the year. The broader QES measure of wage inflation did pick up to 3.2%. But even this measure has failed to break higher over the past year despite firm GDP growth. In fact, we haven't seen any material lift in nominal wage growth for four years now. And with signs that momentum in the economy is slowing, it's likely that wage inflation will remain subdued for some time yet.

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 start looking a lot less healthy. Petrol prices have reversed their earlier declines, and the fall in the NZD will result in the prices of 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 their budgets getting squeezed.

LCI and CPI



RBNZ to cut further

Today's labour market data reinforces our expectations that the RBNZ will need to cut the OCR to 2.0%. The headwinds for growth are building, and underlying inflation remains subdued. Against this backdrop, we expect that the economy is going to need a significant shot in the arm to boost activity and inflation.

Market reaction

Today's data was a little softer than markets expected. After the data was released we saw the NZD drop by 25 points, while the 2-year swap rate fell 1 basis point.

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