29 April 2016

The wood for the trees

Q1 2016 labour market preview: Wednesday 4 May, 10:45am

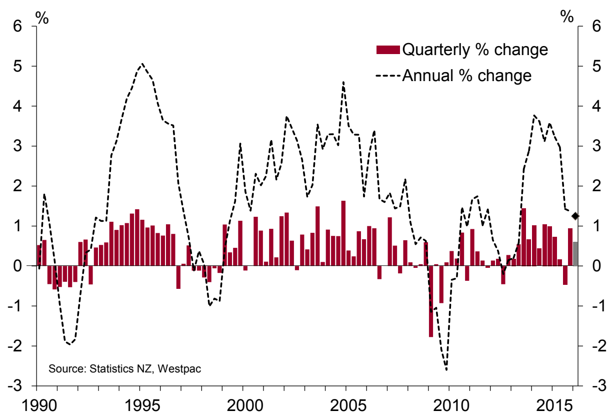
- Indications are that the labour market started the year in good health.
- We expect further growth in employment in the March quarter, albeit at a slightly slower pace than we saw in late 2015.
- However, the unemployment rate is forecast to edge higher following a surprisingly sharp fall in the December quarter, as growth in the labour force is expected to outpace jobs growth this quarter.
- Despite improving conditions, wage inflation is still expected to remain moderate against a backdrop of weak inflation, falling inflation expectations and strong growth in the labour force.

	Q4 Actual	Q1 Forecast	
	Quarter %	Quarter %	Annual %
Household Labour Force Survey			
Employment growth	0.9	0.6	1.2
Unemployment rate %	5.3	5.7	
Hours worked	1.0	0.6	1.3
Participation rate %	68.4	68.6	
Quarterly Employment Survey			
FTE employment (s.a.)	1.1	0.5	1.7
Hours paid (s.a.)	1.4	0.6	2.4
Private avg hourly earnings	0.4	0.7	3.0
Labour Cost Index			
All sectors, ordinary time	0.4	0.4	1.7
Private sector, ordinary time	0.4	0.5	1.8
Private, all salary & wage rates	0.5	0.4	1.7

The labour market finished 2015 with a flourish as the unemployment rate plunged from 6% to 5.3% - its lowest rate since 2009. A key force behind the spectacular fall in the unemployment rate was a sharp drop in participation, which seemed at odds with the strong, though not spectacular, trend in employment growth. Hence, we're expecting both participation and the unemployment rates to reverse part of the December quarter decline this quarter. That said, we're wary of the potential for further big surprises from the labour market data this quarter.

Indications are that the labour market started 2016 on a pretty firm footing. Headline business confidence has weakened in the early part of the year as firms become increasingly worried about the downstream impact of weaker dairy prices, however, the employment components of these surveys have generally held up much better than headline confidence. Firms report a lift in overtime, reduced labour turnover and that labour is more likely to be a limiting factor of production. And, although they eased a touch in the March quarter, firms' hiring and hiring intentions remain well above average.

Employment growth (including forecast)



And it's not just firms reporting firm labour market conditions. Our own Westpac McDermott Miller Employment Confidence survey showed households also have an optimistic take on labour market prospects. In the March quarter workers were more optimistic about present and future job prospects, and more upbeat about earnings growth prospects.

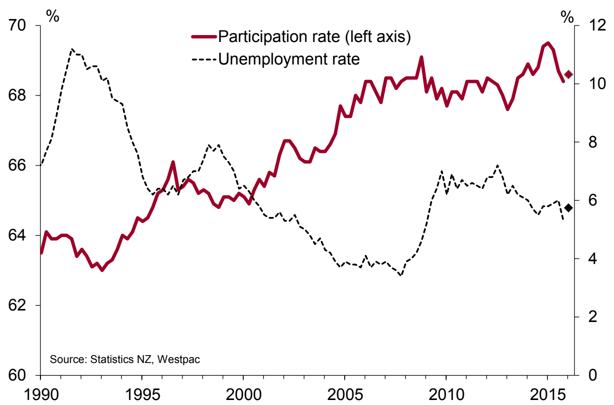
A firm labour market, along with strong house price growth and low interest rates, has supported consumer spending. And while nominal wage growth has been muted, very low wage inflation has helped workers' pay cheques stretch a little further. This dynamic may well continue for much of 2016.

Details

Big picture aside, the quarter to quarter variation in the labour market can be very hard to predict. And after such big changes in the December quarter, we're even more conscious of the potential for unexpected swings in some of the underlying components of key headline measures such as employment or participation that could lead to a big swing in the headline unemployment rate.

One of the key uncertainties this quarter is the participation rate. The participation rate reached a record high of 69.6% in March 2015. Participation has been boosted by very strong growth in the working age population, especially an increase in people aged 20-29 (which has in turn been driven by a big lift in net migrants of this age group over 2015). However, since peaking in early 2015, participation has been declining. It's difficult to pin this trend down to a particular cohort (although in the December quarter, lower participation in the under 30 age group was noticeable).

Labour force participation and unemployment rate (including forecasts)



Over the long run, the main drivers of the upward trend in participation have been an aging population, increased participation in the work force by older workers and greater participation in the work force by women. However over a shorter horizon, participation varies with the economic cycle (a strong labour market generally encourages people to enter the labour force). The recent decline in participation is at odds with relatively strong employment growth. Consequently, we think there will be a small lift this quarter, taking participation back to the levels we saw before the run up over late 2014-early 2015. However, we are mindful that this lift in participation is one of the key risks in our forecasts.

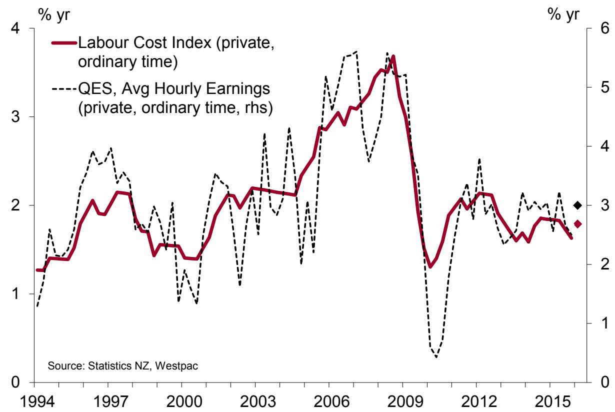
HLFS employment growth has been volatile over the last couple of quarters (0.9% growth in the December quarter followed a 0.5% fall in employment the previous quarter). However, other indicators of the labour market (surveys as well as Statistics New Zealand's new experimental monthly jobs series) suggest that growth has been a bit more "steady as she goes". With most labour market indicators remaining at above average levels at the start of 2016, and reasonable GDP growth expected in the March quarter, we expect to see further modest employment growth at the start of this year. We've pencilled in 0.6% this quarter.

The Quarterly Employment Survey (QES) should corroborate many of the same broad themes of the HLFS in next week's data. We're expecting to see a slightly slower pace of jobs growth (forecasting 0.5% versus 1.1% previous) while wage pressures are likely to remain subdued.

Wages

To date there has been very little sign that solid employment growth has been putting upward pressure on wages. Annual LCI inflation fell to 1.5% in the December quarter and has been below 2% since late 2012. The broader QES measure of wage inflation was up just 0.2% in the December quarter to leave annual inflation at 2.5%. The reason for this is twofold. Strong labour force growth (driven by net immigration and, until recently, a lift in participation) has added to capacity in the labour market. And secondly, inflation lingering near zero has weighed on inflation expectations and kept a lid on annual cost of living adjustments.

Wage inflation



We expect both these factors to eventually unwind (last week's migration data offered a few hints that the net migration tide might be starting to turn and there was a lift in firms reporting difficulty finding unskilled labour in the March QSBO). This could eventually bring with it the risk of a late cycle lift in wage inflation, but we don't think this will be a feature of next week's release.

Implications

In a recent speech, the RBNZ noted that new research suggested that the unemployment rate was a less useful indicator of slack in the labour market than they had previously assumed, instead shining the spotlight on a new labour utilisation composite index. This combines a range of labour market measures into a single measure of the balance between supply and demand in the labour market. In practice this could mean the headline unemployment rate has less influence on RBNZ's thinking about non-tradable inflation pressure than previously.

This aside, the RBNZ sounded a little more constructive about the outlook for inflation in April's OCR Review where they left interest rates unchanged. They noted that they expect to see inflation strengthen in part as capacity pressures gradually build. Consequently, the focus for the RBNZ in next week's labour market report may shift back toward indicators of wage growth, rather than the headline unemployment rate. A much stronger than expected outturn on this front could have the RBNZ contemplating the merits of an August versus June rate cut.

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