

Normal transmission resumes

March quarter 2016 labour market review

- The unemployment rate rebounded in the March quarter, lifting to 5.7%. But this only partially reversed the sharp fall last quarter.
- Overall we interpret today's data as strong as employment lifted sharply.
- This is a sign that the New Zealand economy was solid in the March quarter.
- Wage inflation remains subdued, although the quarterly outturn was a touch higher than the market had pencilled in.

The labour market most certainly started 2016 on a very firm footing. The most striking feature of today's data was the big lift in employment. That's a sign the New Zealand economy continued to expand at a solid pace in the first three months of the year. It's also a sign that while confidence surveys show that firms are wary of the risks to the New Zealand economy posed by the dairy downturn, for now those concerns have been trumped by solid demand in the here and now.

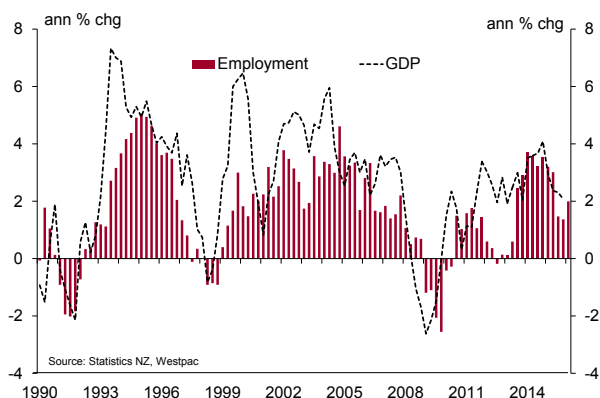
We're wary that this won't necessarily remain the case forever. The hit to dairy incomes will bite even harder over the next six months, and it looks as if most farmers will struggle to cover their costs next season as well. But we're also conscious that there is more to the New Zealand economy than just the dairy sector. The labour intensive construction sector is one segment we expect to be a big contributor to growth this year, while the buoyant housing market, and a renewed appetite for debt is supporting consumer spending and service sectors more generally. Add a healthy labour market to the mix, and there's further reason to expect household spending growth will underpin reasonable GDP growth - this year at least.

	Quarterly actual		Quarterly expected		Annual
	2015 Q4	2016 Q1	Market	Westpac	2016 Q1
Household Labour Force Survey					
Unemployment rate (s.a.)	5.4	5.7	5.5	5.7	-
Employment (s.a.)	1.0	1.2	0.6	0.6	2.0
Participation rate (s.a.)	68.5	69.0	68.6	68.6	-
Quarterly Employment Survey					
FTE employment (s.a.)	1.2	1.3	-	0.5	2.6
Total weekly hours paid (s.a.)	1.3	0.5	-	0.6	2.3
Private ave hourly earnings, ord time	0.2	0.3	0.5	0.7	2.5
Labour Cost Index					
All sectors, ordinary time	0.4	0.4	0.3	0.5	1.8
Private sector, ordinary time	0.4	0.4	-	0.4	1.6
Private, all salary & wage rates	0.4	0.4	0.3	0.4	1.8

But while growth in employment rose at its fastest pace since September 2013, strong net immigration (on top of the long run trend increases in participation by women and older workers) has ensured there's been plenty of people willing to join the labour force. We were surprised and sceptical last quarter when the fall in participation led to a sharp fall in the unemployment rate. Today's data vindicates that view, with the bounce in participation, back up to 69%, less surprising than the earlier marked decline. That gives us a bit more confidence that the 5.7% unemployment rate in the March quarter is a better reflection of the underlying position of the labour market than the (upwardly revised) 5.4% unemployment rate reported the previous quarter. Abstracting from the quarterly volatility in the data, our impression is that the labour market has gradually improved over the last year.

Strong jobs growth was apparent across both the HLFs and QES surveys this quarter. This pushed annual employment growth to 2%, and 2.6% respectively. That's not quite back to the pace we saw in 2014, but a notable improvement nonetheless. We're conscious of a two speed economy developing between sectors domestically. Looking at a split of employment across sectors, jobs growth in the construction sector has been a standout over the last year.

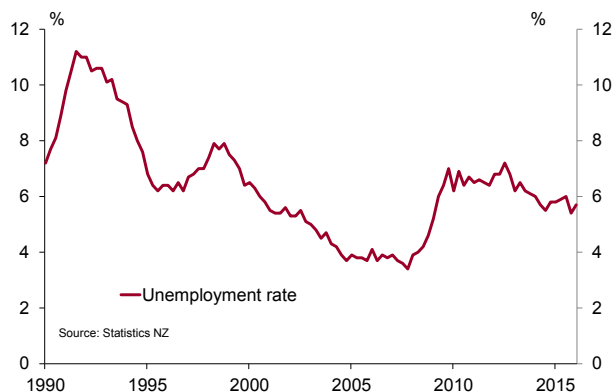
Employment and GDP



Unlike the December quarter when we were left scratching our heads when strong employment growth coincided with falling participation market (and tends to remove some of the volatility in the headline unemployment rate), today's move was a return to normal transmission. The 1.2% growth in employment was accompanied by a chunky rise in the participation rate. Looking across cohorts the lift in participation was largely driven by a return to the workforce of the under 35's who mysteriously disappeared back in in December. Participation in this age group can be quite volatile from quarter to quarter as students shift in and out of the labour force.

Put the two together and it feels as if a 5.7% unemployment rate is a fair reflection of how the New Zealand economy is tracking right now.

Unemployment rate

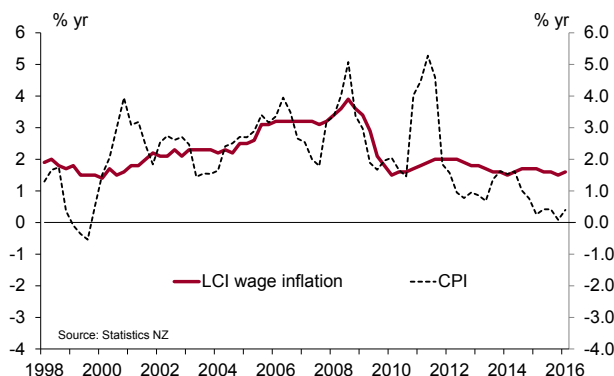


Wages

Despite the strengthening in the labour market, wage inflation has remained stubbornly low. The private sector LCI (including overtime) rose by 0.4% over the quarter, to be up 1.8% on the year. That's just a small increase on the 1.6% annual pace last quarter. Similarly the broader QES measure of wage inflation was flat at 2.5%.

Both strong growth in the labour force (driven by rapid population growth on the back of surging net immigration) and very low inflation and inflation expectations have been keeping a lid on wages to date, and this theme continued in the March quarter. We expect both these factors will ultimately prove (at least partly) temporary. Inflation, while low, isn't forecast to fall any further, and there were hints in the latest monthly migration data that the tide is starting to turn. This brings with it the risk of stronger wage growth further down the track, but this is likely a story for next year, and beyond.

LCI wage inflation



Implications

Today's data painted a picture of a fairly strong jobs market, but little upward pressure on wages. For the RBNZ this simply reinforces the situation they have been facing over the past year. The New Zealand economy continues to perform well on

the activity front, supported by very strong population growth. But that very same population growth is one of the reasons strong domestic activity is not translating into inflation pressure as it has done in the past. What's more, while the lift in the unemployment rate generally signals less stretch in the labour market, the Reserve Bank's newly developed Labour Utilisation Composite Index includes a much broader range of indicators, many of which have strengthened over the last quarter.

Consequently, while today's data was probably stronger than expected at the margin, it hasn't changed our thinking on the RBNZ. We continue to expect the RBNZ to cut the OCR by 25 basis points in June. Between now and then, the housing market data will be very important as, of course, will be exchange rate developments.

Anne Boniface

Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

David Norman, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

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