Westpac Institutional Bank

28 October 2016

Building momentum

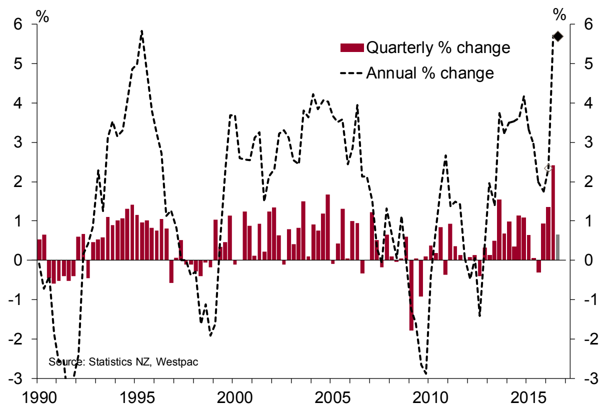
Q3 labour market preview: Wednesday 2 November, 10:45am

- We're expecting to see further growth in employment in September, as the labour market continues to strengthen.
- This is likely to see the unemployment rate fall further to 5%.
- The labour market is gradually tightening. And this should eventually translate to some upward pressure on wages. However, we're not expecting this to emerge quite yet.

	Q2 actual	Q3 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	2.4	0.7	5.5
Unemployment rate %	5.1	5.0	
Hours worked	2.5	0.6	5.7
Participation rate %	69.7	69.8	
Quarterly Employment Survey			
FTE employment (s.a.)	2.4	0.5	5.3
Hours paid (s.a.)	0.2	0.7	2.7
Private avg hourly earnings	0.8	0.7	2.0
Labour Cost Index			
All sectors, ordinary time	0.4	0.5	1.7
Private sector, ordinary time	0.4	0.5	1.8
Private, all salary & wage rates	0.4	0.4	1.7

The New Zealand economy grew 3.6% in the year to June 2016. And indicators suggest this solid momentum has continued into the second half of the year. The construction and tourism sectors remain obvious standouts, but there has also been strong growth in the retail sector, while the buoyant housing market continues to support related service industries. Even some of the key weak spots in the economy aren't looking quite so weak any more. Most notably, dairy prices have rebounded since August. And although it will take several more seasons of improved prices to repair the damage done to balance sheets over the last two seasons, the mood in the sector has undoubtedly brightened.

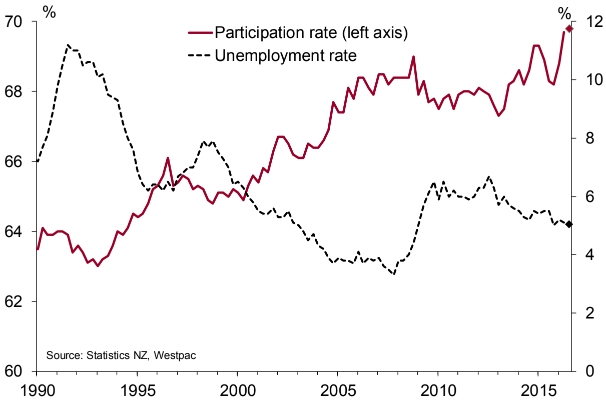
Employment growth (including forecast)



This growth backdrop has supported solid employment growth over the last year (albeit not quite as spectacular as the 5.5% growth recorded in the year to June might suggest, with the June quarter boosted by a change in survey design). The unemployment rate fell to 5.1% in June and we expect the trend of an improving labour market continued in the three months to September. We're forecasting the unemployment rate to fall to 5%.

Unsurprisingly, the steady drop in the unemployment rate combined with the solid growth backdrop are starting to put the squeeze on employers who are reporting that it is becoming increasingly difficult to find both skilled and unskilled labour. Households meanwhile, became sharply more optimistic about their employment prospects in the September Westpac McDermott Miller employment confidence survey. Eventually, this is likely to lead to increasing pressure on wages – but not just yet. With annual inflation currently running at 0.2% and strong growth in the labour force, the low wage inflation dynamic should have a little bit further to run.

Labour force participation and unemployment (including forecasts)



Details

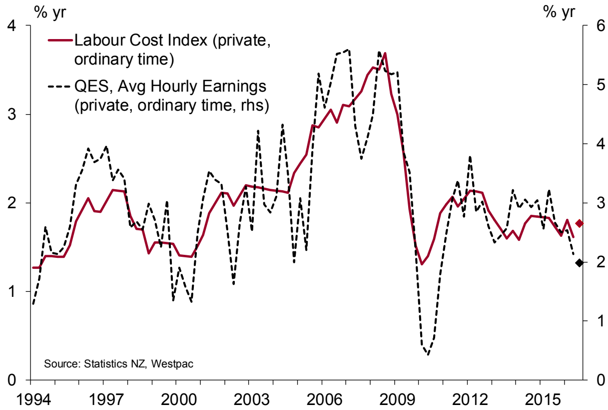
Quarterly volatility in the HLFS survey is always a difficult one to get a handle on, and this quarter is no different. Major changes to Statistics New Zealand's methodology were incorporated into the June HLFS release. This meant that 'genuine' employment growth in that quarter was certainly less than the 2.4% growth recorded. But just how much less is up for debate. So with these changes muddying the waters, we'd suggest focusing on the unemployment rate for the least polluted gauge on how the labour market is faring. And on that front, we expect to see further improvement.

While unaffected by survey changes, the employment components of the QES survey were surprisingly soft in Q2 given the 1% GDP growth recorded in the quarter. While movements in the HLFS (which surveys households) and QES (which surveys firms) don't always match up from quarter to quarter, they do tend to tell much the same story over time. This quarter, we're expecting a solid 0.7% growth in hours paid and 0.5% growth in FTEs.

Wages

Low inflation and strong growth in participation and the labour force have kept a lid on nominal wage growth to date. In June, annual LCI inflation was 1.6%, and has been below 2% since mid-2012. There has been more sign of life in the broader QES measure of wage inflation which rose 0.8% in the June quarter to be up 2.1% on a year ago. We don't expect the story to change this quarter and are forecasting annual LCI and QES wage inflation of 1.7% and 2% respectively.

Labour Cost Index (private sector, ordinary time)



But we don't expect this to be the case forever. Firms, most notably in the construction sector, are finding it increasingly difficult source both skilled and unskilled workers. This is likely to become even more acute as the epicentre of construction activity moves from Canterbury to Auckland. Anecdotally, firms are already finding it difficult to convince staff to relocate. Inevitably, attracting workers to New Zealand's most expensive city will probably require an improved pay packet. What's more, while firms surveyed in the QSBO in September reported a strong lift in hiring intentions and expected overtime over the next three months, the measures of actual hiring and overtime over the last three months fell, perhaps hinting that firms are finding it tougher to get the workers they want. There was also a steep increase in the number of firms reporting labour as a limiting factor of production in September.

Implications

The Reserve Bank will get two key pieces of information next week ahead of its November *Monetary Policy Statement* – inflation expectations and labour data. Of the two, inflation expectations will probably hold greater sway (not least because of the potential difficulties interpreting some aspects of the HLFS data in the wake of methodology changes). The potential for inflation expectations to decline further has long been a worry for the RBNZ. A further decline would not be welcomed and would probably cement a November cut. But even a strong inflation expectations outturn won't necessarily see the Bank backing off the long-signalled November rate cut, although it could have a bearing on the RBNZ's bias toward any further easing.

Anne Boniface
Senior Economist

Contact the Westpac economics team

Michael Gordon, Acting Chief 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

Sarah Drought, Economist +64 9 336 5696

Any questions email: economics@westpac.co.nz

Disclaimer

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order")

Disclaimer continued

or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.