Westpac

Institutional Bank

Grinding higher

Q4 2015 labour market preview: Wednesday 3 February, 10:45am

- Employment growth is expected to rebound in the December quarter.
- However, growth in the labour force continues to outpace employment growth, implying a further lift in the unemployment rate to 6.1%.
- Rising unemployment and a subdued inflation backdrop means there is little upward pressure on wages.
- Labour market data is the key release between now and the March *Monetary Policy Statement*. A weak outturn would support arguments in favour of a March rate cut.

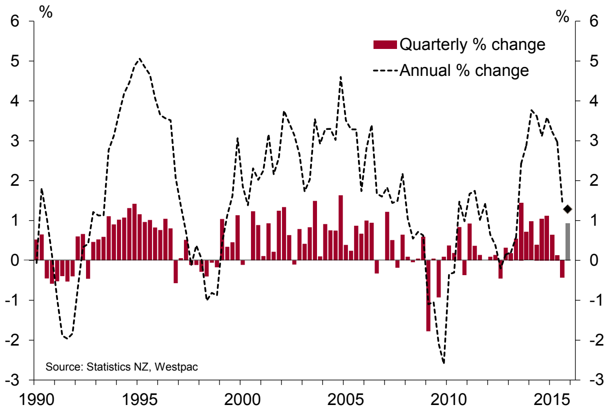
	Q3 actual	Q4 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	-0.4	0.9	1.3
Unemployment rate %	6	6.1	
Hours worked	0.4	0.5	1.1
Participation rate %	68.6	68.9	
Quarterly Employment Survey			
FTE employment (s.a.)	0.7	0.9	2.5
Hours paid (s.a.)	0.9	0.6	2.9
Private avg hourly earnings	0.9	0.4	2.6
Labour Cost Index			
All sectors, ordinary time	0.4	0.5	1.6
Private sector, ordinary time	0.4	0.5	1.7
Private, all salary & wage rates	0.4	0.4	1.6

Rising unemployment rate despite strong employment growth

The middle of 2015 saw confidence knocked by freefalling dairy prices and a turbulent global economy. Little wonder then that firms became more cautious about hiring new staff and the pace of growth in employment slowed noticeably. But fast forward to the end of 2015, and attitudes had improved. The mood amongst both firms and households became noticeably brighter on the back of lower interest rates, strong construction growth and a resurgent tourism sector. Firms reported a lift in hiring and hiring intentions, the number of jobs advertised picked up and workers confirmed that jobs became just a little easier to come by.

Consequently, we're expecting next week's Household Labour Force Survey (HLFS) to show a rebound in employment growth in the December quarter and are forecasting a 0.9% quarterly lift in employment. While that would be a solid quarterly gain, the slower growth in the economy through the middle part of last year is still evident in the annual data. Annual employment growth is expected to be just 1.3% - the slowest pace since mid-2013.

Employment growth (including forecast)



Over the past year, an important backdrop to developments in the labour market, and indeed the New Zealand economy, has been surging population growth on the back of a big lift in net immigration. Add very high rates of participation to the mix, and growth in the labour force has continued to outpace employment growth, pushing the unemployment rate higher. This quarter, once we take into account a rebound in labour force participation after a surprisingly sharp fall in September, we're forecasting the unemployment rate to rise to 6.1%. This would be the fifth quarter in a row the unemployment rate has risen.

Labour force participation and unemployment (including forecast)

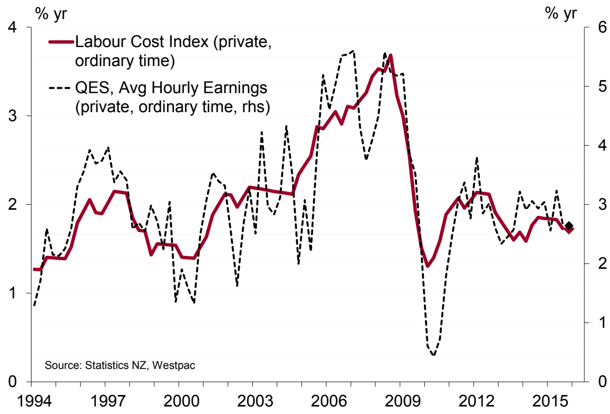
Of course anything can (and does) happen with employment data from quarter to quarter. Many of the underling drivers of key headline measures, such as unemployment rate, can be pretty volatile. Indeed one reason we're expecting such a strong lift in employment growth this quarter (aside from underlying fundamentals) is because the fall in both employment and participation in the September quarter was surprisingly large.

But usual data volatility aside, we're expecting the Quarterly Employment Survey (QES) to corroborate the same broad themes of the HLFS next week. That is, a modest pickup in the pace of jobs growth in the final quarter of the year and subdued wage inflation (more on this below). We expect that the number of Full Time Equivalent employees grew by 0.9% in the quarter, up from 0.7% growth in the September quarter.

Wage growth remains subdued

A key theme permeating labour market data over the last year has been subdued wage inflation. The gradual lift in the unemployment rate combined with near-zero inflation, has left workers with little leverage when it comes to annual wage negotiations. We expect this continued in the December quarter and are forecasting 1.5% annual growth in the labour cost index, down a touch from the 1.7% growth we saw a year earlier. The broader QES measure of average hourly earnings growth is expected to be up 2.6% on a year ago.

Labour Cost Index and Average Hourly Earnings (including forecast)



While wage growth has been subdued, workers have benefitted from low inflation keeping a lid on prices. Most noticeably, falling petrol prices on the back of plummeting international oil prices have certainly helped workers' pay checks stretch a little bit further. But despite this, rising unemployment and weak wage growth are likely to be a headwind to further growth in consumer spending this year.

Market Implications

Next week's labour market data is one of the most important releases in the calendar ahead of the Reserve Bank's March *Monetary Policy Statement*. Very low inflation already has the RBNZ on high alert, and labour market indicators (both the unemployment rate and wage growth) are important signals of how much spare capacity is in the domestic economy. The more spare capacity in the economy, the less pressure there is on firms to raise prices. This will sound a warning bell for the RBNZ which is relying on rising non-tradable inflation to help push the CPI back into its 1-3% target band.

So with market expectations for a March OCR cut balanced on a knife edge (current pricing is for around 45% chance of a rate cut in March), a weaker than expected outturn could go a long way to convincing markets that a rate cut will come sooner rather than later. Likewise, it would support our own call for a March rate cut.

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