Economic Preview

New Zealand

1 May 2008

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Labour Market Data Preview: March 2008 quarter

(LCI and QES due 10.45am 5 May, HLFS due 10.45am 8 May)

Key points

> **Wage inflation to remain elevated, showing a degree of persistence from a tight labour market and previously strong economy.**

> **Employment growth should record a pull-back from last quarter's strong surge, contributing to a small increase in the unemployment rate.**

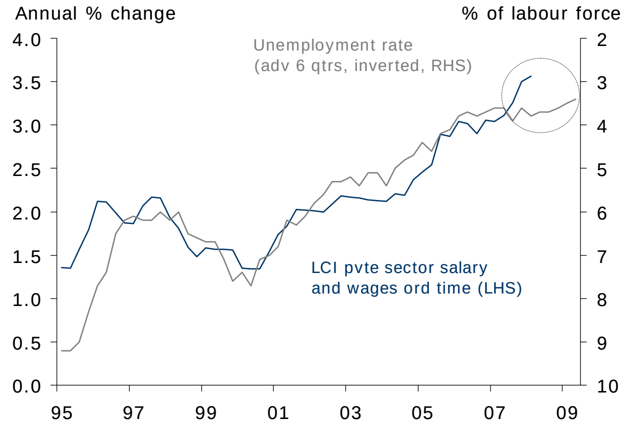
> **On balance, the labour market will remain tight, but may show early signs of softening. The RBNZ will want further evidence before softening their stance further.**

March quarter 2008 expectations		
	ANZ National	**Market**
LCI salary and wage ordinary time (private sector)	**0.8% q/q 3.6% y/y**	0.8% q/q 3.6% y/y
QES salary and wage ordinary time (private sector)	**0.9% q/q 4.3% y/y**	0.9% q/q 4.2% y/y
HLFS unemployment rate (s.a.)	**3.5%**	3.5%
HLFS participation rate (s.a.)	**68.5%**	68.7%
HLFS employment growth	**-0.2% q/q 1.2% y/y**	0.1% q/q 1.4% y/y

A still tight labour market will see the March quarter record strong wage growth. We expect the Labour Cost Index (LCI) measure of private sector ordinary time earnings (which is quality adjusted and hence a pure wage inflation measure) to record an increase of 0.8 percent in the March quarter, taking annual growth to another record high of 3.6 percent. This follows the strongest quarterly increase in the history of the LCI recorded in the December quarter of 1.1 percent. For public sector wages, we expect a 0.6 percent increase following a 0.9 percent increase in the December quarter (public sector wage growth is typically softer in the March quarter). This will take annual public sector wage growth to 3.0 percent. For completeness, the less reliable Quarterly Employment Survey (QES) wage indicator – which is volatile and influenced by compositional changes – is expected to increase by 0.9 percent in the quarter, taking annual growth to 4.3 percent.

Wage growth to show a degree of persistence in the near-term due to its "lagging" nature. Despite economic momentum stalling over the first half of this year, wage growth in the March quarter, and to some extent even over June, will reflect strong activity over 2007 and a low unemployment rate. Looking at the historical relationship with wage growth and the unemployment rate suggests LCI wage growth could remain above 3 percent well into 2009. However, the latest QSBO survey showed firms reporting slightly less difficultly in finding both skilled and unskilled staff. In addition, the RBNZ Governor has been warning wage bargaining parties not to assume tight labour market conditions will continue. Given the deterioration in profit expectations from the recent National Bank *Business Outlook*, firms are unlikely to be able to afford the kind of pay increases seen in recent years. This suggests wage growth will start to moderate over the second half of this year.

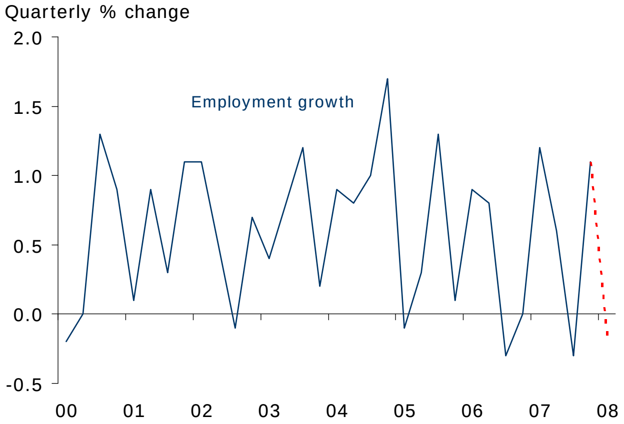
Wages and unemployment rate



Sources: ANZ National, Statistics NZ

'Volatile' will likely remain the keyword for the HLFS survey. Given the strong 1.1 percent increase in employment growth in the December quarter, and the very autoregressive nature of the HLFS survey, we expect employment growth to contract in the March quarter by 0.2 percent, which will take annual employment growth to 1.2 percent. The greatest level of uncertainty always resides around the participation rate. Small changes can have large implications for the unemployment rate. Nonetheless, we are expecting the participation rate to fall to 68.5 percent, from 68.7 percent in the December quarter. This, along with the fall in employment, is expected to see the unemployment rate increase from 3.4 percent to 3.5 percent – still very low by historical standards.

Volatile employment growth



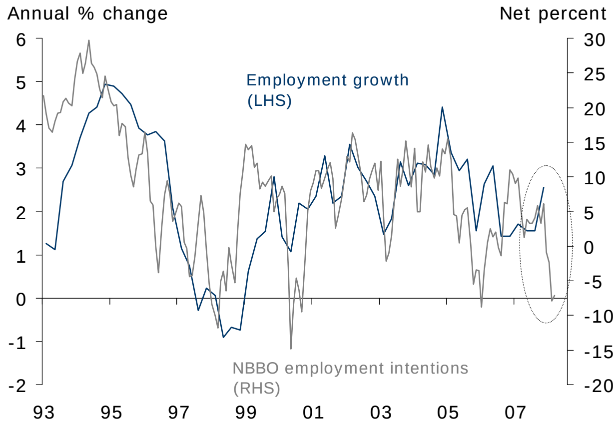
Sources: ANZ National, Statistics NZ

We will be closely eyeing sectors linked to the housing market and related pockets. Given the weakness in the housing market and signs that it is broadening, particularly into retail, employment developments in these sectors will be critical. Over the past five years the construction, retail, finance and business services sectors have collectively contributed 171,000 of the 254,000 jobs added within the economy (67 percent). We will be looking for any signs that the weaker activity within these sectors is beginning to filter into firms' labour decisions. We expect to see early signs of a softening in the labour market, starting with those sectors most closely linked to housing.

On balance, the wage and employment reports will reinforce that the labour market remains tight. Wage growth at record high levels, and an unemployment rate still very low by historical standards reinforces that the labour market remains a key source of inflationary risk for the RBNZ. We believe that, having won the battle over housing, the labour market is the RBNZ's next inflation battlefront.

At this stage firms appear to be trying to pull the price lever to recover lost margins (with pricing intentions remaining elevated). But we suspect passing on higher prices may be difficult to achieve given the weakening demand environment. With firms' profitability expectations at multi-decade lows, and cost pressures intensifying, it will only be a matter of time before staff levels are assessed as stresses on bottom lines mount. This certainly appears increasingly to be the case, with the employment intentions readings in the National Bank *Business Outlook* survey in negative territory for three consecutive months.

Employment and employment intentions



Sources: ANZ National, Statistics NZ

Prospects for lower interest rates remain contingent on a turn in the labour market. While employment intentions are pointing to that, given the lack of inflation headroom facing the RBNZ, they will want to see it in the hard data, and be confident that it will be sustained. Given the lagging and volatile nature of the LCI and HLFS surveys, this means the June quarter labour market data (due in early August) is shaping up as a more important read for the RBNZ to assess underlying trends, and the key to unlocking the start of the easing cycle.

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