ANZ

Economic Review
NEW ZEALAND

DATE 5 February 2007

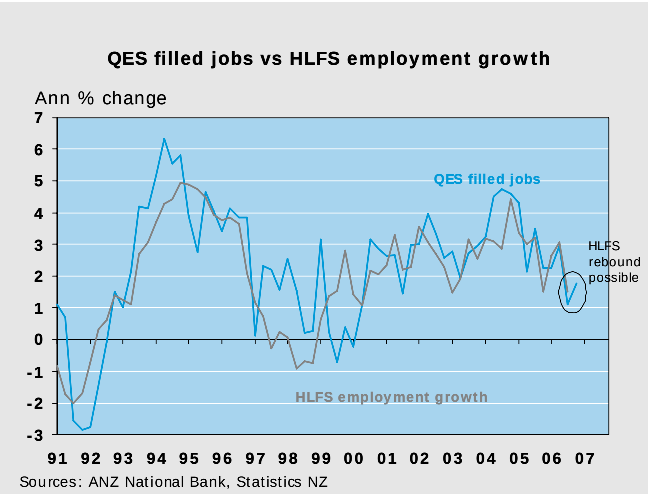
LABOUR COST INDEX AND QUARTERLY EMPLOYMENT SURVEY – DECEMBER 2006

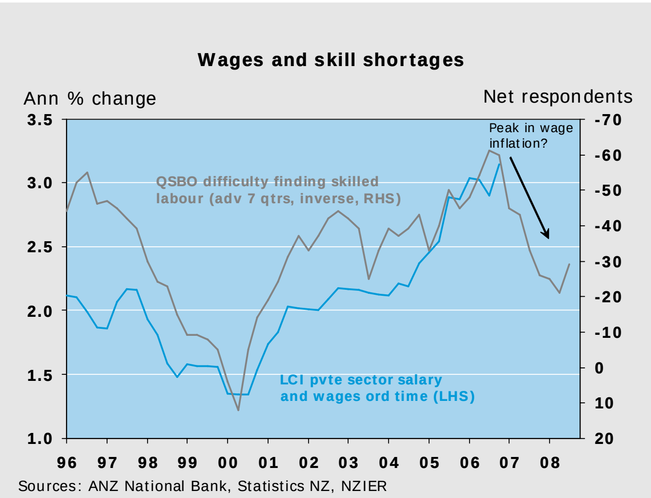
Key points

- **Wage inflation re-accelerated in Q4 to 1 percent for the quarter, taking annual wage inflation to a new peak of 3.2 percent.**
- **QES employment indicators were strong across the board, with filled jobs up 1.8 percent (0.4 percent on a seasonally adjusted basis) and hours paid up 0.9 percent.**
- **While the relationship between the QES and HLFS is not strong, the employment indicators suggest upside risk to our HLFS estimate of 0.2 percent employment growth.**
- **The Reserve Bank will be concerned at the acceleration in wage inflation, as it points to the impact of the tight labour market filtering through into wage setting behaviour.**
- **The 8.9 percent increase in total gross earnings from a year ago will be viewed by the Reserve Bank as an indication that momentum in the housing market and consumer spending will not be moderating anytime soon.**
- **A rate hike in March now looks a fait accompli although we will wait until we see the HLFS result Thursday before formally changing our call.**

The headlines

	Actual	ANZ National	Market
LCI salary and wage ord time (pvte sector)	**1.0% q/q** **3.2% y/y**	0.7% q/q 2.9% y/y	0.7% q/q 2.9% y/y
QES salary and wage ord time (pvte sector)	**0.8% q/q** **5.0% y/y**	1.1% q/q 6.0% y/y	0.6% q/q 5.5% y/y





- **The Labour Cost Index (LCI) measure of private sector ordinary time earnings (the Reserve Bank's preferred wage measure as it is quality adjusted) rose 1.0 percent in the December quarter,** taking annual wage inflation to 3.2 percent – a new record high. The alternative measure of wage growth from the Quarterly Employment Survey (which is affected by compositional shifts) posted a solid but lower than expected increase of 0.8 percent to be 5.0 percent higher than a year ago. LCI Public sector ordinary pay rates eased slightly from September, at 0.8 percent for the quarter and 3.6 percent for the year but continue to outstrip private sector wage growth.

- **Employment indicators from the QES were strong,** with increases in filled jobs (FTEs up 2.8 percent and filled jobs up 1.8 percent) plus an increase in total paid hours by 0.9 percent. After removing seasonal influences, jobs growth was still relatively strong at around 0.4 percent. The increase in FTEs was due to increases from manufacturing, property and business services and accommodation, café and restaurant industries. Full-time employment growth rose 3.8 percent from a year ago, while part-time number fell 0.5 percent. This suggests employers are making use of their existing workforce more by turning part-timers to full-timers. The 8.9 percent annual increase in total gross earning, made up of a 3.8 percent rise in paid hours and a 4.9 percent increase in average earnings, will continue to provide impetus for the housing market and consumer spending.

- **Most of the strength in filled jobs and hours paid came from the business services industries** with weekly paid hours increasing by 13.8 percent and 11.8 percent for finance and insurance and property and business services respectively compared with 12 months ago.

Assessment and implications

- **Wage growth rose to a new record high in December.** The calls that wage growth had passed its peak last quarter look to have been a little premature with private sector wage growth increasing to 3.2 percent in the December quarter (from 2.9 percent in September). More significantly, the increases in private sector wage growth looks to be a spillover from previously strong public sector wage growth and therefore suggests there is the potential for this to continue over the next few quarters.

- **Business services hours paid rose strongly, and suggest potential upside risks to Q4 GDP.** Finance & Insurance, and Real Estate & Business Services, which account for almost 20 percent of GDP, look set to expand by over 1½ percent in Q4 based on the QES employment data. This has the potential to result in an upward surprise in Q4 GDP released at the end of March.

- **Today's data suggests there is some upside risk to our 0.2 percent projection (market 0.3 percent) for employment growth in the Household Labour Force Survey.** Although the correlation between the QES and the HLFS is weak, the unanimously strong QES employment indicators in the quarter are hard to ignore and suggests there is potential for employment growth to also surprise the market. Annual growth in QES filled jobs sits at 1.8 percent and FTE growth at 2.8 percent. Given quarterly volatility, the annual growth rates are perhaps a better "target" for convergence. Convergence between the HLFS and QES annual movements suggests 0.2 percent employment growth, and 0.9 percent FTE growth in the HLFS survey.

- **Strong earnings growth solidifies the sustained upturn view.** With total gross earnings up close to 9 percent on a year ago, it is perhaps little surprise to see re-accelerating housing and spending activity. A turn in the labour market remains the missing link broadening the slow-down seen over 2005 and early 2006 to include the household sector, thereby removing pressure on medium-term inflation.

- **The acceleration in wage inflation will be a concern to the Reserve Bank.** The Reserve Bank has not been unduly concerned about wage inflation before, focusing their attention instead on the housing market and domestic demand. The Reserve Bank had expected the drop in headline inflation and the corresponding drop in inflation expectations to keep wage inflation contained. In the December *MPS*, the Reserve Bank expressed confidence that wage inflation will remain contained, and projected wage inflation to remain close to current levels (of under 3 percent) until mid-2007. Today's wage inflation number will give them a large sense of discomfort, as it suggests that the combination of a tight labour market, past high headline inflation and possibly some spillover from higher public sector wage growth, is seeping into wage setting behaviour. Given the Reserve Bank's concerns about medium-term inflation pressure, they will be wary that the acceleration in wage inflation will find its way into general consumer prices.

- **On balance, a rate hike in March now looks a fait accompli.** However given recent volatility in the Household Labour Force Survey, we will wait until we receive the results before formally changing our call.

Important Notice

Australia and New Zealand Banking Group Limited is represented in:
AUSTRALIA by:
Australia and New Zealand Banking Group Limited ABN 11005 357 522
10th Floor 100 Queen Street, Melbourne 3000, Australia
Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:
Australia and New Zealand Banking Group Limited
ABN 11 005 357 522
Minerva House, PO Box 7, Montague Close, London, SE1
9DH, United Kingdom
Telephone +44 20 7378 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:
ANZ Securities, Inc. (Member of NASD and SIPC)
6th Floor 1177 Avenue of the Americas
New York, NY 10036, United States of America
Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:
ANZ National Bank Limited
Level 7, 1 Victoria Street, Wellington, New Zealand
Telephone +64 4 802 2000

In Australia and the UK, ANZ Investment Bank ("ANZIB") is a business name of Australia and New Zealand Banking Group Limited, ABN 11 005 357 522 ("ANZ Bank"), which holds an Australian Financial Services licence no. 234527 and is authorised in the UK by the Financial Services Authority ("FSA"). In New Zealand, ANZ Investment Bank is a business name of ANZ National Bank Limited WN / 035976 ("ANZ NB").

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZSI") (an affiliated company of ANZ Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZSI upon request. Any US person(s) receiving this document and wishing to effect transactions in any securities referred to herein should contact ANZSI, not its affiliates.

This document is being distributed in the United Kingdom by ANZ Bank for the information of its market counterparties and intermediate customers only. It is not intended for and must not be distributed to private customers. In the UK, ANZ Bank is regulated by the FSA. Nothing here excludes or restricts any duty or liability to a customer, which ANZ Bank may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA. This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy. In addition, from time to time ANZ Bank, ANZ NB, ANZSI, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZ Bank, ANZ NB, ANZSI or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request. The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable.

The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will directly or indirectly relate to specific recommendations or views expressed about any securities or issuers in this document. The author's compensation will, be based upon, among other factors, the overall profitability of ANZ, including profits from investment banking revenues.

ANZ Bank, ANZ NB, ANZSI, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation. Where the recipient of this publication conducts a business, the provisions of the Consumer Guarantees Act 1993 (NZ) shall not apply.