

Labour Cost Index and Quarterly Employment Survey: September 2008

Key points

- > **Wage inflation rose strongly in the September quarter, and yet to show the "evidence" of reduced domestic cost pressures the RBNZ is looking for.**
- > **However, we do not expect such wage growth to be sustained given the weakening labour market outlook.**
- > **QES employment gauges were mixed, but we remain comfortable with our expectation of a large fall in employment and hours worked in Thursday's HLFS.**
- > **The level of wage inflation will continue to concern the RBNZ, but will not stand in the way of further interest rate cuts.**

Assessment

Another strong increase in wages in Q3. The LCI measure of private sector ordinary time wage inflation rose by a strong 1.1 percent in the September quarter. This took annual growth to a record high 3.7 percent. The comparable public sector measure also rose by 1.1 percent (with the September quarter typically recording strong public sector wage growth due to collective wage agreements coming into effect), taking annual growth to 3.6 percent. On an industry level (and including overtime rates), the biggest annual increases were recorded for health and community services (up 5.7 percent) and local government administration (up 5.4 percent). The other large increase was noted for petrol, coal, chemical and associated manufacturing (up 4.3 percent). A number of respondents reported the reason for the increase in wages over the quarter was to reflect increases in the cost of living. This is a dynamic the RBNZ will keep a very close watch over.

Late cycle strength is typical, but we expect a peak is near. While the magnitude of the wage increase in the quarter was a surprise (and well above market expectations), the fact that wage growth remains elevated shouldn't be. It is typical for wages to be one of the last indicators to turn in response to the economic cycle. With the unemployment rate now turning (and further confirmation of this is likely on Thursday) and firms reporting it much less difficult to find both skilled and unskilled staff, workers will have less bargaining power to push for the wage increases they experienced over recent years. A falling headline inflation rate over coming quarters will also help take pressure off wage indexation adjustments. If a peak in wage growth has not already occurred, we expect it to be very close.

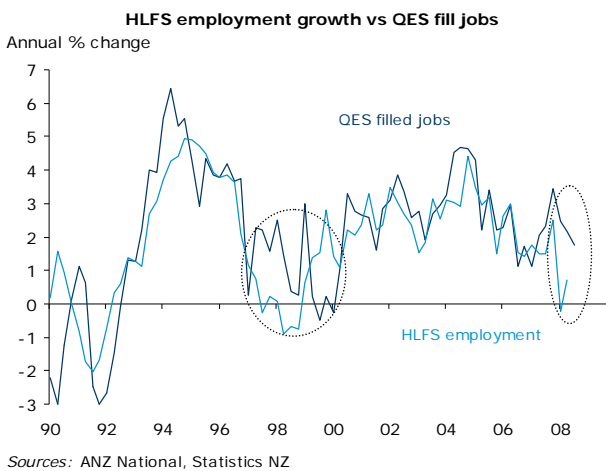
Nevertheless, the level of wage growth will still concern the RBNZ. The Bank singled out labour costs as a concern (among price pressure from other non-contestable areas) at their latest *OCR Review*. Today's data shows that the Bank's concern is justified.

	LCI private sector ordinary		QES private sector ordinary		QES paid hours	
	q/q	y/y	q/q	y/y	q/q	y/y
Sep-06	0.8	2.9	1.9	5.4	0.8	2.9
Dec-06	0.9	3.1	0.6	5.5	0.5	3.7
Mar-07	0.7	3.0	0.7	5.5	-0.1	2.2
Jun-07	0.7	3.1	1.0	4.2	1.3	2.6
Sep-07	0.9	3.3	1.3	3.7	0.3	2.1
Dec-07	1.1	3.5	0.9	4.0	1.2	2.8
Mar-08	0.7	3.5	1.1	4.4	0.1	2.9
Jun-08	0.8	3.5	2.0	5.4	0.4	2.0
Sep-08	1.1	3.7	1.1	5.2	-0.3	1.4
ANZ	0.8	3.4	1.2	5.3	-	-
Market	0.8	3.4	1.2	5.3	-	-



QES employment gauges were mixed. Paid hours fell by 0.3 percent in the quarter, following a 0.4 percent increase in June. Our seasonally

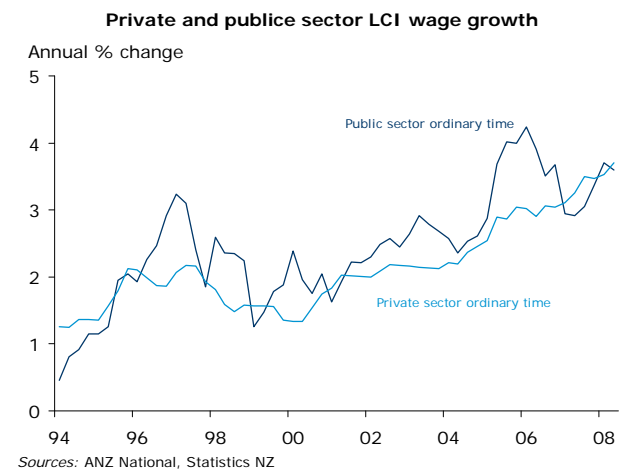
adjustment estimate of filled jobs rose by 0.3 percent. Splitting out the government administration, education and health sectors from paid hours, the “market” sector experienced a 0.5 percent contraction over the quarter, while “non-market” rose 1.3 percent. This is a very similar story to the June quarter and reinforces that it is really only the government sector that is providing the engine for growth at present. The increase in filled jobs in the quarter is somewhat of a surprise given the anecdotes received and trends from recent business surveys. One interesting dynamic is the gap that has opened up between the QES filled jobs measure and HLFS employment growth of late. It is a similar theme that was present over 1997/98 – the last time the economy entered a slowdown and the labour market weakened. Perhaps this is due to the fact that the QES is a survey of employers, while the HLFS is a survey of households. During a slowdown, employers may report that workers are still on their payroll, despite not giving them any work, while households may report themselves as out of work. If this is the case, this gap between the two is likely to be sustained for a time yet. The HLFS is also a much more comprehensive survey, as the QES does not include the agricultural sector and also potentially misses a number of those who are self-employed.



We remain comfortable with our expectations for the HLFS on Thursday. The correlation between the HLFS and QES surveys is poor on a quarterly basis. As a result, there is nothing really in today’s data to change our view of a sharp 1.0 percent contraction in employment growth in the quarter and an increase in the unemployment rate to 4.3 percent. We expect hours worked – a better indication of overall economic activity – to have fallen, suggesting a contraction in Q3 GDP growth.

Implications

While there is limited “evidence” for easing domestic cost pressures as yet for the RBNZ, there is nothing in today’s data to stand in the way of further interest rate cuts. At their latest *OCR Review* the RBNZ stated that further monetary policy easings were warranted, but this was conditional on “evidence of actual reductions in domestic cost pressures”. As a key driver of medium-term inflation, the labour market will be viewed as a key part of this “evidence”. With wage inflation still elevated this evidence is not yet apparent. However, the RBNZ will be well aware that wage increases of the magnitude seen in recent years will not be maintained if the unemployment rate is increasing sharply and the economy is slowing. Thursday’s data will provide a more important read.



NEW ZEALAND DISCLOSURE INFORMATION

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing

Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

Criminal convictions

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;

- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;
- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third

parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

Record Keeping

The Bank will keep adequate records of the deposit of investment moneys or property and all withdrawals and dealings with such money or property, using the account/investment number allocated to your investment. You may have access to those records upon request.

Auditing

The Bank's systems and operations are internally audited on a regular basis. The financial statements of the Bank and its subsidiaries are audited annually by KPMG. However, this does not involve an external audit of the receipt, holding and disbursement of the money and other property.

Use of Money and Property

Money or property held by the Bank for a specific purpose communicated to the Bank (e.g. the purchase of an interest in a security) may not be used by the Bank for its own purposes and will be applied for your stated purpose. No member of the Bank's staff may use any money or property deposited with the Bank, for their own purposes or for the benefit of any other person. In the absence of such instructions, money deposited with the Bank may be used by the Bank for its own purposes, provided it repays the money to you upon demand (or where applicable, on maturity), together with interest, where payable.

NEW ZEALAND DISCLAIMER

The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

This document is provided for informational purposes only and does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this document can be reproduced, altered, transmitted to, copied to or distributed to any other person without the prior express permission of the Bank.

This document is a necessarily brief and general summary of the subjects covered and does not constitute advice. You should obtain professional advice before acting on the basis of

This document has been prepared by ANZ National Bank Limited.

ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639 <http://www.anz.co.nz> e-mail ecnmcs@anz.com

any opinions or information contained in it. The information contained in this document is given in good faith, has been derived from sources perceived by it to be reliable and accurate and the Bank shall not be obliged to update any such information after the date of this document. Neither the Bank nor any other person involved in the preparation of this document accepts any liability for any opinions or information (including the accuracy or completeness thereof) contained in it, or for any consequences flowing from its use.

UNITED STATES DISCLAIMER

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZ S") (an affiliated company of Australia and New Zealand Banking Group Limited ("ANZBG") and the Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any fixed income securities referred to herein should contact ANZ S 1177 Avenue of the Americas, New York, NY 10036 USA, Tel: 1-212-801-9160, Fax: 1-212-801-9163, not its affiliates.

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 ANZBG, the Bank, ANZ S, 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 ANZBG, the Bank, ANZ S 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 be directly or indirectly related to specific recommendations or views expressed in this document. ANZBG, the Bank, ANZ S, 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.