Economic Preview

New Zealand

31 October 2008

Labour Market Data Preview: September 2008 quarter

(LCI and QES due 10.45am 3 November, HLFS due 10.45am 6 November)

Key points

> **Wage inflation still elevated, but likely to be near peak, if not there already.**

> **Employment figures remain a lottery given recent volatility, but we expect a sizeable pull-back.**

> **The unemployment rate is the cleanest measure, and is expected to rise to 4.3 percent.**

> **Volatility aside, the data is expected to reinforce the speed at which the labour market is turning and provide some of the "evidence" the RBNZ is looking for of easing domestic inflation pressures.**

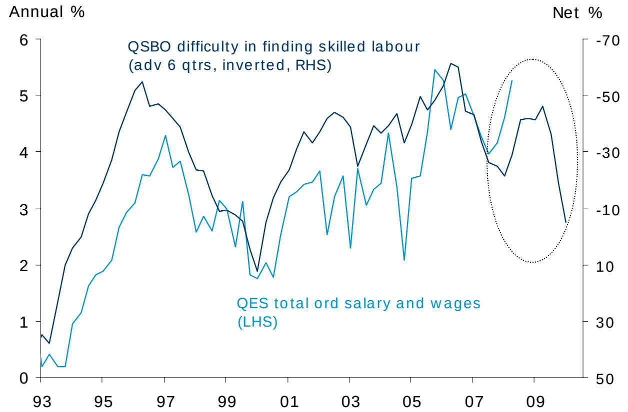
March quarter 2008 expectations		
	ANZ National	Market
LCI salary and wage ordinary time (private sector)	**0.8% q/q 3.4% y/y**	0.8% q/q 3.4% y/y
QES salary and wage ordinary time (private sector)	**1.2% q/q 5.3% y/y**	1.2% q/q 5.3% y/y
HLFS unemployment rate (s.a.)	**4.3%**	4.3%
HLFS participation rate (s.a.)	**68.0%**	68.3%
HLFS employment growth	**-1.0% q/q -0.2% y/y**	-0.6% q/q 0.3% y/y

The September quarter labour market data takes on added importance. Despite the aggressive interest rate cut by the RBNZ at its latest *OCR Review*, the Bank took the time to remind all of its focus on medium-term inflation and its concern at the recent stickiness shown. While this appears to be largely targeted at non-contestable pockets (which are arguably beyond the Bank's control), labour costs were also explicitly singled out. The RBNZ has stated that further monetary policy easing is warranted, but this is conditional on *"evidence of actual reductions in domestic cost pressures"*. As a key driver of medium-term inflation, the labour market outlook will be a key focus and be looked towards to provide this "evidence".

Wage growth should remain high in the September quarter. We expect the Labour Cost Index (LCI) measure of private sector ordinary time earnings (which is quality adjusted and not exposed to compositional changes) to record an increase of 0.8 percent in the September quarter. This takes annual growth to 3.4 percent, slightly below the 3.5 percent growth recorded in the June quarter. Public sector wage growth usually posts a solid increase in the September quarter, which we suspect is due to collective wage agreement negotiations. We expect a 1.3 percent quarterly increase (the same as the previous two September quarters) holding annual growth unchanged at 3.7 percent. For completeness, the less reliable (and volatile) Quarterly Employment Survey (QES) wage measure is expected to increase by 1.2 percent for the quarter and 5.3 percent for the year.

But a peak is near, if it has not occurred already. The fact wage growth remains elevated despite the weak domestic economic conditions is not surprising. Wages are typically one of the last indicators to turn in response to a weaker economic environment. Yet with the unemployment rate rising and skill shortages easing sharply (as reported by the latest QSBO survey), wages are unlikely to post the strong increases experienced over recent times. Annual wage growth is likely to ease below 3 percent (on an LCI basis) by the middle of next year.

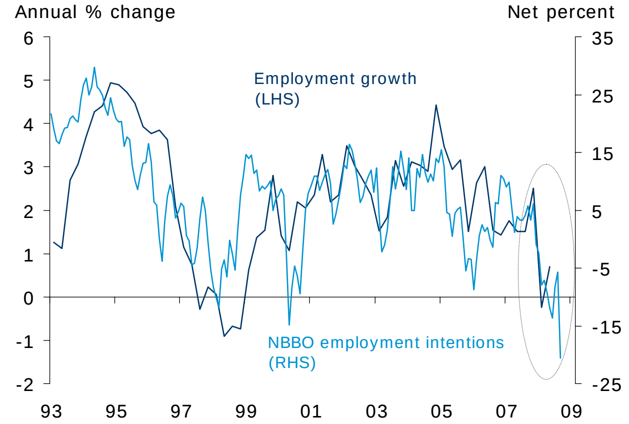
QSBO difficulty in finding labour and wages



Sources: ANZ National, NZIER, Statistics NZ

Volatility in the HLFS makes quarterly employment predictions a lottery. Following a 1.3 percent fall in the March quarter, employment rebounded by the same magnitude in the June quarter. It is difficult to imagine that this is actual job creation and destruction and is more likely to be statistical noise. Given anecdotes and employment intentions from recent business surveys, we expect employment growth to pull-back by 1.0 percent. But of course, a larger fall cannot be ruled out. Volatility aside however, annual employment looks set to head into negative territory over the second half of this year, with sectors heavily weighted towards the domestic economy (construction, retail, business and financial services) likely to be leading the weakness. Certainly, the anecdotes at present are strongly indicating the labour market is turning rapidly, and we expect the unemployment rate – the cleaner measure of the labour market – to bear this out.

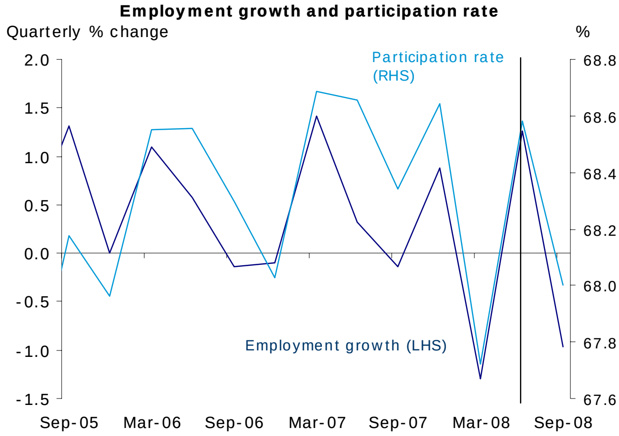
Employment and employment intentions



Sources: ANZ National, Statistics NZ

The participation rate, as always, poses risk to our estimates, and it has experienced the same degree of volatility over the past couple of quarters as employment growth has. We expect the participation rate to ease to 68.0 percent, following its surge to 68.6 percent last quarter. This should see the unemployment rate rise to 4.3 percent from 3.9 percent in June, which would be the highest level since December 2003.

Employment growth and participation rate



Sources: ANZ National, Statistics NZ

Looking forward we expect the unemployment rate to continue rising, and hit 6 percent in early 2010, rising in a steady fashion by around 0.3 percentage points per quarter. However, the risk – given economic prospects – is pointing to a more aggressive rise over 2009, and in fact even late 2008. Certainly there are pockets of strength that remain in the labour market, but we are equally mindful of the reality that two-thirds of the jobs growth within the economy over the past five years was centred in housing centric areas including construction, retailing, and business services.

Financial market implications

Just like the CPI data a couple of weeks ago, the market reaction to the wage data is likely to be asymmetrical. Stronger than expected wage inflation is likely to be brushed aside by the market, as it will be viewed as historical. But signs of easing wage pressures will be taken as confirmation the RBNZ can continue front-loading the easing cycle. Likewise with the HLFS data, any upside surprise in the unemployment rate will have the market lock in expectations of a 50bps cut in the OCR in December and get them thinking about a similar sized cut to follow in January.

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