Economic Review
NEW ZEALAND
DATE 5 November 2007

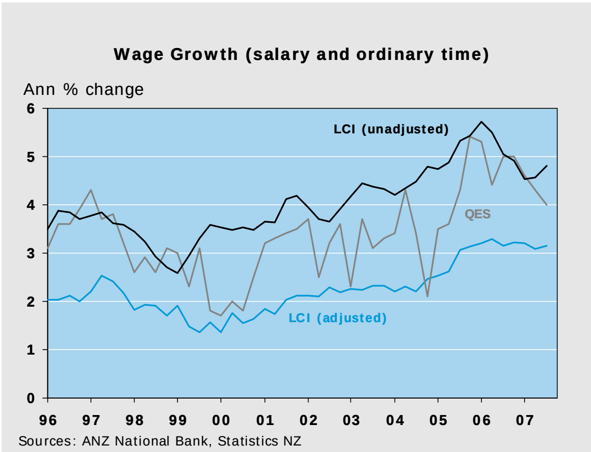
LABOUR COST INDEX AND QUARTERLY EMPLOYMENT SURVEY – SEPT 2007

Key points

- **LCI private sector wage inflation rose to an all-time high in the September quarter.**
- **QES employment indicators were relatively mixed with soft paid hours but solid filled jobs.**
- **Wage growth is likely to remain sticky at around current levels for some time.**
- **The Reserve Bank will remain concerned with the cost-push inflation risks still present within the economy.**

The headlines

	LCI private sector ordinary time		Unadjusted LCI all sectors		QES private sector ordinary time	
	q/q	y/y	q/q	y/y	q/q	y/y
Sep-05	0.9	2.9	1.9	5.3	1.4	3.8
Dec-05	0.7	2.9	1.4	5.4	0.5	5.1
Mar-06	0.7	3.0	1.1	5.7	0.7	4.6
Jun-06	0.6	3.0	1.0	5.5	2.3	4.9
Sep-06	0.8	2.9	1.4	5.1	1.9	5.4
Dec-06	0.9	3.1	1.3	4.9	0.6	5.5
Mar-07	0.7	3.0	0.8	4.5	0.7	5.5
Jun-07	0.7	3.1	1.0	4.6	1.0	4.2
Sep-07	**0.9**	**3.3**	**1.7**	**4.8**	**1.3**	**3.7**
ANZ	**0.9**	**3.2**	**-**	**-**	**2.0**	**4.4**
Market	0.8	3.1	-	-	1.4	3.7



- **The Labour Cost Index (LCI) measure of private sector ordinary time earnings rose 0.9 percent in the September quarter,** taking annual wage inflation to 3.3 percent – an all time high. The alternative measure of wage growth from the Quarterly Employment Survey (which is affected by compositional shifts) rose 1.3 percent to be 3.5 percent higher than a year ago.[1] LCI public sector ordinary pay rebounded from the 0.3 percent growth recorded in the June quarter, rising by 1.3 percent in September and 2.9 percent for the year. This is the second consecutive quarter that annual private sector wage growth has outpaced its public sector counterpart. Prior to the June quarter, public sector wage growth had been growing faster than the private sector since 2001. In the year to the September 2007 quarter, the industry groups with the largest annual increases in salary and wage rates (including overtime) were mining (up 4.9 percent) and finance and insurance (up 4.8 percent). Education and wholesale trade also recorded reasonable increases (both up 3.1 percent).

- **Gross earnings growth is easing, but off a high level.** Gross earnings rose 1.3 percent in the September quarter and 6.1 percent in annual terms. Although down on the peak of close to 9 percent annual growth at the end of 2006, it is still reasonably elevated.

- **QES employment indicators were mixed.** Filled jobs fell 0.1 percent in the September quarter, although this measure is not seasonally adjusted. Our seasonally adjusted estimate show that filled jobs rose 0.7 percent after a 1.2 percent increase in the June quarter. Compared with a year ago, the number of filled jobs is up 2.3 percent, with the number of full-time equivalent (FTE) employees up 2.5 percent. Seasonally adjusted paid hours only rose by 0.2 percent in the quarter, and 2.2 percent for the September 2007 year.

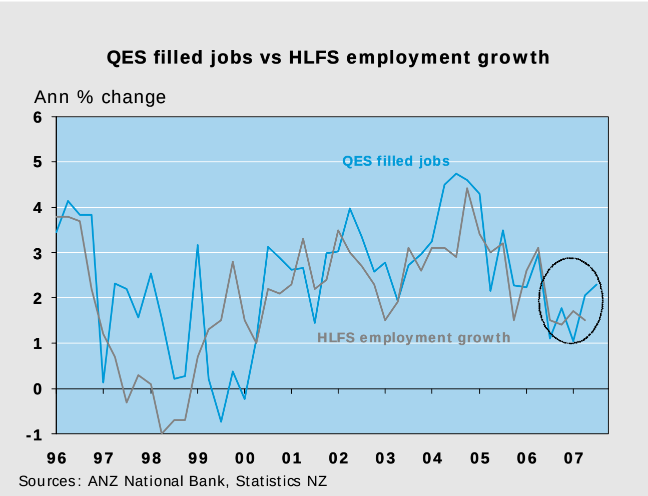
[1] The LCI measures changes in salary and wage rates for a fixed quantity and quality of labour input, while QES average earnings statistics reflect not only changes in pay rates, but also compositional and other changes across and within the paid workforce. A more comparable measure between the two series, the unadjusted LCI, rose 1.7 percent in the quarter and 4.8 percent in annual terms.

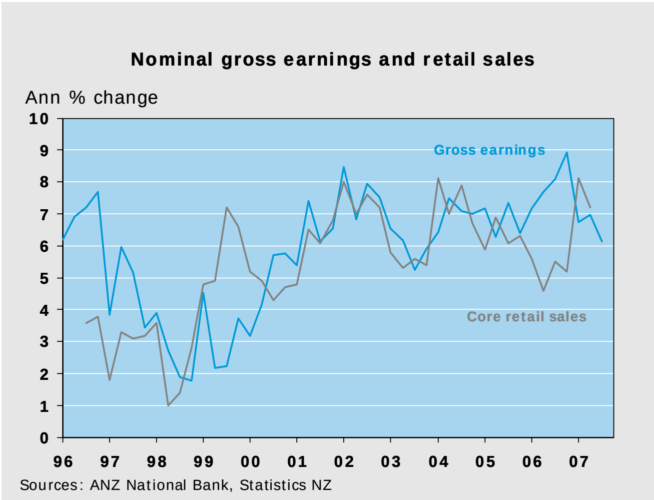
Assessment and implications

Wage growth rose to an all-time high in September. The tight labour market and firms continuing to report difficultly in finding both skilled and unskilled staff are likely key drivers behind the elevated level of private sector wage growth. With the labour market set to remain tight in the near-term, and net migration unlikely to add much by way of labour supply in the interim, wage inflation is likely to remain at current elevated levels for some time. Although gross earnings growth has eased from its peak at the end of 2006, it remains consistent with annual nominal retail sales growth of around 6 percent.

At the margin, there may be a small amount of downside risk to our estimate for Thursday's HLFS employment growth. Though the seasonally adjusted filled jobs growth of 0.7 percent is broadly in line with our estimate of HLFS employment growth at 0.6 percent, we note that the correlation of the annual growth rates is higher. In this regard, the 2.3 percent annual growth in filled jobs from the QES implies downside risk to our 2.5 percent annual growth in HLFS employment growth. The other employment activity indicator from the QES was the hours paid measure, which rose a modest 0.2 percent in the quarter – suggesting Q3 economic activity may be subdued following a strong first half.

The cost-push inflation risks will continue to concern the Reserve Bank. On balance today's wage inflation data reinforces the vigilance still required by the Reserve Bank and emphasises the cost-push inflation risks still evident within the economy. Although we feel there is no smoking gun in this release (nor do we feel there will be any in the HLFS on Thursday) to prompt the Reserve Bank to shift from their wait-and-see stance, it does emphasise the likelihood of rates remaining on hold for some time.





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