

Economic Review

New Zealand

2 February 2010

Labour Cost Index and Quarterly Employment Survey: December 2009

Key points

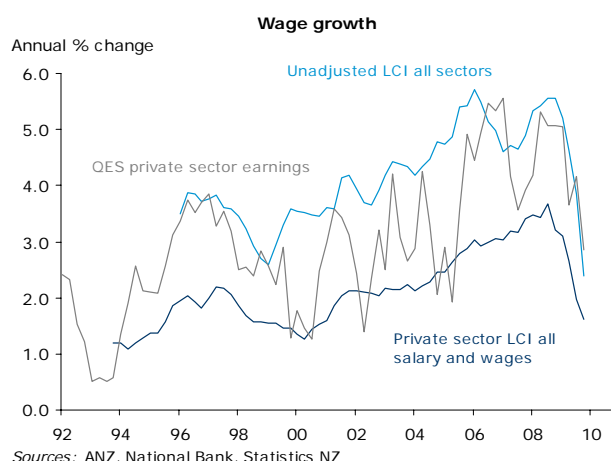
- > **Wage growth remains soft and, as yet, improving prospects for economic growth are yet to filter through into labour demand.**
- > **We expect labour market weakness to continue to act as a drag on de-leveraging households going forward.**
- > **The RBNZ will be comfortable with the benign wage backdrop, in terms of the implication for the medium-term inflation outlook.**

Assessment

Wage growth softens. The Labour Cost Index (LCI) of private sector ordinary time wages (our preferred wage inflation measure as it adjusts for compositional changes within the labour force) rose 0.3 percent in the September quarter. This follows an increase of 0.4 percent in September and takes annual wage growth to 1.5 percent, the lowest annual increase since December 2000 and below the annual rate of inflation.

Overtime wage rates increased by 0.4 percent in the December quarter, with the annual increase (2.2 percent) the lowest in seven years. This indicates that demand is simply not there.

Also of note was the sharp moderation in public sector labour costs, with the comparable public sector measure rising by a quarterly 0.3 percent and the annual increase easing to 2.4 percent from 3.0 percent.



On an industry level the moderation in labour cost inflation was fairly widespread. Most industries recorded quarterly increases under 0.6 percent (the exception being food and beverages (0.8 percent) and arts and recreational services (0.7 percent)).

	LCI private sector ordinary time		QES private sector ordinary time		QES paid hours	
	q/q	y/y	q/q	y/y	q/q	y/y
Dec-07	1.1	3.5	0.9	4.0	1.2	2.3
Mar-08	0.7	3.5	1.0	4.3	-0.1	2.5
Jun-08	0.8	3.5	2.1	5.4	0.3	1.6
Sep-08	1.1	3.7	1.0	5.1	-0.6	0.8
Dec-08	0.7	3.2	0.8	5.0	-1.6	-2.0
Mar-09	0.5	3.0	1.1	5.1	-0.5	-2.4
Jun-09	0.3	2.6	0.8	3.7	-1.2	-3.9
Sep-09	0.4	1.9	1.7	4.4	0.2	-3.0
Dec-09	0.3	1.5	-0.4	3.1	-0.3	-1.8
ANZ	0.3	1.5	0.4	4.0	-	-
Market	0.4	1.6	0.4	4.0	-	-

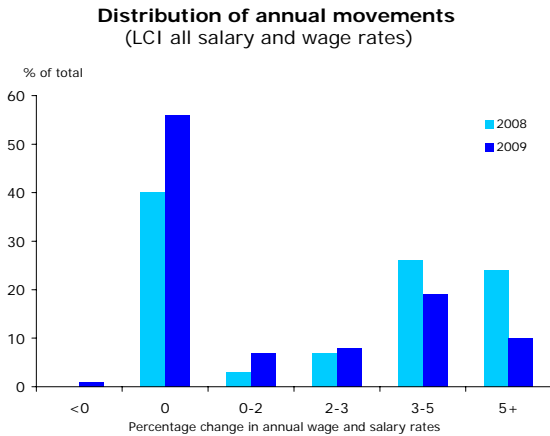
In the December year, the highest industry group increases were public sector, notably education (up 3.4 percent) and health and community services (3.3 percent). Annual wage inflation in these sectors is moving lower and is likely to remain contained as fiscal imperatives dictate.

Other wage measures also confirm that overall wage inflation remains timid. The unadjusted LCI (where labour costs are not adjusted for the quality of labour input) rose by a relatively subdued 0.4 percent in the quarter (2.7 yoy). Of those wage and salary rates that rose, the median annual increase in December (3.7 percent) was the lowest since early 2005.

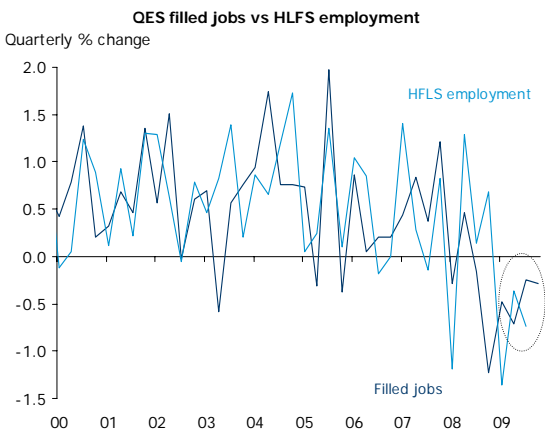
In addition, average hourly earnings from the Quarterly Employment Survey (QES) fell by 0.4 percent, to be up 3.7 percent on a year ago, although this measure is volatile and susceptible to compositional changes.

The distribution of annual increases indicated that the moderation in wage inflation was broad-based. There were significantly fewer pay increases of more than 5 percent (10 percent), but a continued rise in the proportion of workers not receiving any increases (56 percent), the highest for at least a decade. Annual wage increases above 3 percent accounted for less than 30 percent of

surveyed salary and wage rates, as compared to 50 percent at the end of 2008.



Labour demand gauges also looked weak. The other important focus of this morning's data was the filled jobs and paid hours employment gauges from the QES. While the correlation between these and Thursday's HLFS is not exact, they are still important to monitor in their own right. Seasonally adjusted paid hours fell 0.3 percent, more than reversing September's increase. While actual filled jobs increased strongly, this was entirely seasonal, with the seasonally adjusted filled jobs falling by 0.3 percent in the quarter.

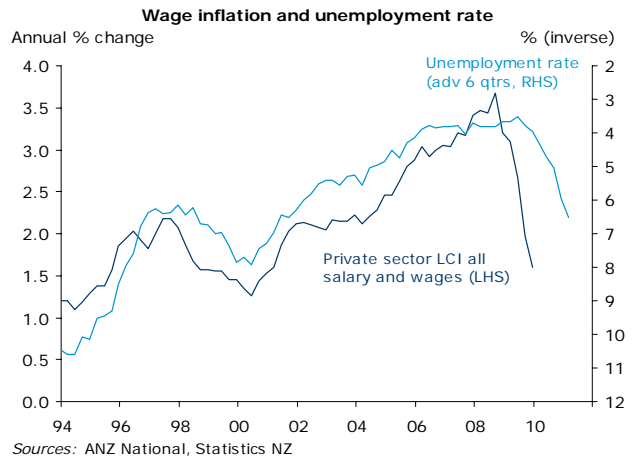


Sources: ANZ National, Statistics NZ

As yet, improving business confidence has not filtered through into the demand for labour. **It also suggests that employment growth from Thursday's HLFS is likely to be subdued.**

Implications

Wage growth is typically one of the last 'indicators' to turn as the economy slows and so **the generally soft numbers today shouldn't really come as a surprise. However, the speed at which wage growth has slowed has been reasonably pronounced.**



Today's outturn again demonstrates the flexibility of the labour market. Faced with the choice of accepting lower wage increases and working reduced hours, or running the risk of losing their jobs, employees and employers have opted for the former course of action.

Employers are likely to have been rather pragmatic when it comes to staffing decisions during this cycle (perhaps due to memories of previous shortages in the previous cycle) and are often looking at other means – other than job losses – to contain the wage bill. Limiting wage increases are one of the options that they have used. **As such, we continue to expect that wage inflation will remain moderate going forward,** even as the economy continues to gather forward momentum.

Today's data confirms our view that employment growth in Thursday's HLFS is likely to be weak. We expect that employment will remain flat (-0.1 percent) and for the unemployment rate to rise to 6.8 percent. While the level of the latter is modest by historical standards, it's near doubling since the late 2007 trough (3.5 percent) represents a sizeable deterioration in labour market prospects.

The critical thing to watch for the labour market going forward is the fact that the significant slack that is currently present within the current workforce could mean that the economic recovery is less employment rich. Firms will likely look to increase their current workforces' hours rather than adjust absolute staffing levels. This will mean the unemployment rate may not fall as quickly as has occurred in previous recoveries. The labour market is likely to remain a key headwind for de-leveraging households.

In terms of the implication for monetary policy, the RBNZ will be comfortable with the benign wage backdrop, in terms of the implication for the medium-term inflation outlook. We remain comfortable with our view of a June start to the tightening cycle, as the RBNZ seeks evidence of stabilisation/improvement in the labour market before hiking rates.



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