5 February 2009

Westpac Institutional Bank

Notes (on data) from a small island

Q4 employment 0.9%q/q, unemployment 4.6%

- **The shock employment increase represents data volatility, not a turnaround.**
- **Unemployment is the best gauge of NZ's labour market, which has so far experienced a gradual downturn.**
- **Hours worked data corroborates other evidence that Q4 GDP could a shocker. There is downside risk to our -0.9% Q4 GDP forecast.**
- **This data presents no impediment to further OCR cuts.**

Key results

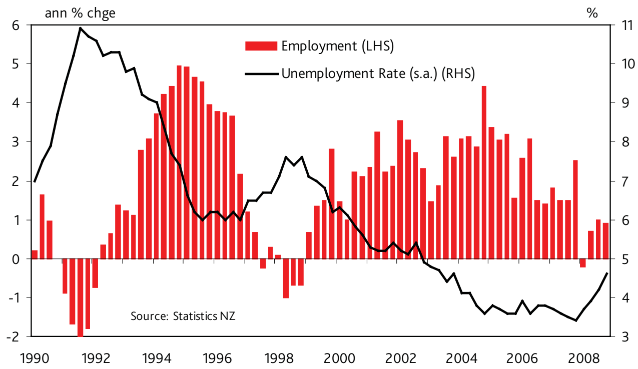
	Q3	Q4	Q4 Expected	
	2008	2008	WBC	Mkt
Employment %q/q	0.1	0.9	-0.6	-0.7
Unemployment rate %	4.2	4.6	4.6	4.6
Participation rate %	68.7	69.3	68.4	68.4

The Household Labour Force Survey threw up a stunning surprise today, with a 0.9% increase in employment versus the market expectation of -0.7%. We ascribe the surprise almost entirely to data volatility. We predict a compensating decline in employment next quarter, in the order of -1.5%.

As we highlighted in our preview of this data, there has been volatility in the Household Labour Force Survey's measure of the participation rate and employment over recent quarters. The source of volatility is the number of people who declare themselves "not in the labour force" versus those who say they are "participating in the labour force". As the participation rate has lurched up and down, employment has lurched in tandem. This probably reflects the natural volatility that occurs in surveys, and is not that meaningful for gauging the state of New Zealand's labour market. Such is life for surveys in a small country.

The best gauge of New Zealand's labour market is the unemployment rate. It rose again to 4.6%, which was in line with our expectation and on the low side of the economists'

Household Labour Force Survey



median forecast. The labour market is gradually easing in response to the ongoing recession. Although there have been well-publicized layoffs in certain industries, other industries which have struggled for years to attract staff are finally seizing the opportunity to fill vacancies, as demonstrated by the industry composition of employment over the past year. The industries most exposed to the housing market downturn and international crisis – agriculture, construction, and manufacturing – have reduced employment levels by between 2% and 5%. Meanwhile, education and health have experienced employment increases of 7% and 4% respectively, presumably addressing pre-existing staff shortages.

As we head into 2009 we expect layoffs in depressed industries to intensify, while vacancies in labour-shortage industries dry up. Consequently, we expect the unemployment rate to rise more rapidly during 2009, hitting 6.4% by the end of the year.

Still, that represents a less severe rate of unemployment than New Zealand experienced in the early-1990s, because there is ample evidence that some firms are hoarding labour. The number of hours worked fell 1.9% this quarter, and growth in part-time work was stronger than full-time. This suggests that firms are responding to the slowdown by taking on staff for fewer hours, and/or giving less overtime, rather than moving straight to layoffs.

For further information, questions or comments contact Brendan O'Donovan, telephone (04) 470 8250, email bodonovan@westpac.co.nz

The 1.9% fall in hours worked was a shocker, and strongly suggests that economic activity fell sharply in Q4 2008. We see downside risk to our already-miserable -0.9% forecast for Q4 GDP. When that data is released in late March, it will put paid to any doubts about the severity of New Zealand's recession thrown up by today's employment figure.

Other indicators certainly support our view that New Zealand is in fact experiencing a labour market downturn. The NZIER's *Quarterly Survey of Business Opinion* shows that firms' employment intentions are at record lows, and that firms are finding it easy to find the skilled staff they need. And Monday's Quarterly Employment Survey showed that employers are paying employees for fewer hours of work.

Market implications

Unemployment is rising at roughly the pace the RBNZ expected, and GDP is shaping up weaker than expected. Employment was strong, but the RBNZ is aware of the data volatility. So all up, this data is no impediment to further OCR reductions from the RBNZ – we continue to expect a 50bp cut in March, and a trough of 2.50%.

That does not mean that this data was void of market implication. Market pricing going into the data probably reflected a perceived risk that the data might be much worse than forecast, and little risk that the data would be better than forecast. With the catastrophe scenario out of play, the market was caught the wrong way around, and swap rates fell by around 10bp. The possibility of a record decline in employment will certainly make the next HLFS an important day for markets, even if it is just data volatility.

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