

Wages rising, jobs falling

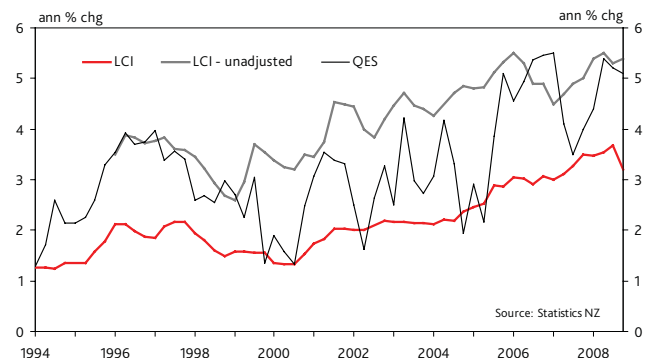
2008Q4 LCI and QES review

- **Headline LCI wage inflation was below expectation, further opening the door for rate cuts from the RBNZ.**
- **The details were strong, giving an overall impression that wage growth peaked in 2008 Q4, but was yet to turn down.**
- **Activity indicators suggest that the NZ economy fell off a cliff in 2008 Q4, and employment has been hit hard.**
- **We now expect -0.6% employment growth in Thursday's HLFs, and a 4.6% unemployment rate.**

The Labour Cost Index registered a 0.7% quarterly increase in Q4 2008, which was a little below both the market and our expectation of 0.9%. The quarterly increases in the first three quarters of the year were 0.6%, 0.8%, and 1.1%. We interpret today's result as an indication that last quarter's record quarterly wage growth was an anomaly. That's significant. Last quarter's number had us, and presumably the Reserve Bank, slightly worried about the impact spiralling wage costs could have on inflation, and the associated difficulties presented to businesses during a slowdown. Such concerns have been assuaged. The Reserve Bank will now have no inflation worries to prevent it from further reducing the OCR aggressively.

Although the headline LCI was weaker than expected, we do not interpret this as evidence that wage growth is plunging earlier than would be normal during a recession. The wider gamut of wage measures was stronger than expected. The unadjusted LCI

Figure 1: Private Sector Earnings and Labour Costs



(which includes promotions) tends to be more responsive to the economic cycle. It increased 1.5%, equal to last quarter's 1.5%. Equally, the Quarterly Employment Survey's Average Hourly Earnings measure registered a 0.9% quarterly increase and a 5.1% annual increase, which was bang-on our expectation. These measures tend to suggest wage growth has peaked but has not yet turned downwards, which is what one would expect – wages are a lagging indicator.

We expect wage inflation to turn down in earnest during 2009. LCI wage inflation is forecast to fall to 2.9% over 2009, from the current 3.3%. Falls in the more cyclical unadjusted-LCI and QES measures could be more dramatic. These wage measures could fall to 1.5% from their current above-5% rates of annual increase.

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Sep-08		Dec-08		Sep-08		Dec-08	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ord time)	1.1	3.7	0.7	3.2	1.1	5.2	0.8	5.1
Public Sector (ord time)	1.1	3.6	0.9	3.5	2.2	6.4	0.9	5.3
Total (ordinary time)	1.2	3.6	0.7	3.3	1.5	5.5	0.9	5.5
FTEs (s.a.)*	-	-	-	-	-0.1	1.6	-1.1	-0.8
Paid Hours (s.a.)	-	-	-	-	-0.4	1.4	-1.4	-1.4

Source: Statistics NZ

* Westpac estimate

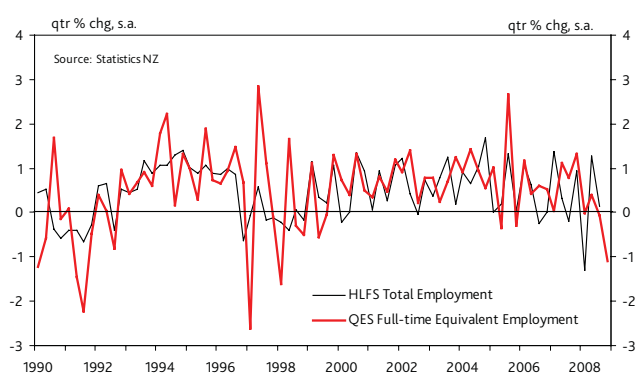
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The employment and activity indicators in the QES were unequivocal in confirming our impression that New Zealand economic activity fell off a cliff in the last quarter of 2008. Total hours worked fell 1.4% (seasonally adjusted), posing further downside risk to our already-abysmal -0.9% Q4 GDP forecast. Remember, this hard landing has followed three quarters of milder recession. Not surprisingly, employment has been hit hard. Full-time-equivalent filled jobs fell 1.1% (seasonally adjusted), by far the weakest quarterly number since 1998. We have revised down our forecast for Q4 employment ahead of Thursday's Household Labour Force Survey – we now expect -0.6% employment growth. We continue to expect the unemployment rate to lift to 4.6%.

Figure 2: QES and HLFS Employment



Compared to a year ago, employment has fallen most in manufacturing, construction, wholesale & retail trade, accommodation, finance & insurance, and property & business services. Indeed, the only industries to escape declining employment are electricity, transport, and those dominated by the public sector such as health.

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