

# Recession hits home

## December 2008 quarter labour market preview

- **The employment downturn has entered a new phase. Employment, previously flat, is expected to enter a period of outright decline. Unemployment to begin rising more rapidly.**
- **Markets should focus on the unemployment numbers, since employment figures have been volatile recently.**
- **Wages to rise strongly for one more quarter, mainly due to seasonality.**

### Household Labour Force Survey: turning ugly

When the Household Labour Force Survey is released on Thursday 5 February, we suspect it will show that New Zealand's employment downturn has entered a new phase. The first phase was bad, but not *that* bad. For the first three quarters of 2008, employment was basically flat. Sure, there were layoffs, but for the most part disaffected workers were able to find alternative jobs fairly quickly. Consequently, unemployment rose only modestly.

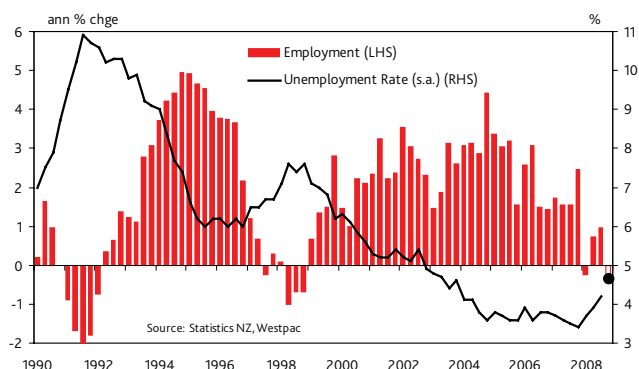
The picture is now uglier. The NZIER's quarterly business survey reveals that more firms have been firing than hiring. We expect overall employment to fall 0.5% q/q, with full-time employment disproportionately weak. We are bracing for something much worse next quarter. In this environment, staff laid off from one firm are much less likely to find work at another. Instead, many will become unemployed. We expect the unemployment rate to rise to 4.6% in Q4, on its way to 6.4% by the end of 2009. The labour force participation rate tends to fall when unemployment rises, so we are forecasting a small fall in participation this quarter.

In the first half of 2008 the employment figures were extremely volatile, dropping precipitously in one quarter and recovering entirely the next. The participation rate moved in tandem with employment, while unemployment was steadier. So uncertainty around our employment forecast is extreme, and it will be difficult to read much into the number. However, we may get a clue from what happens to participation. If both employment

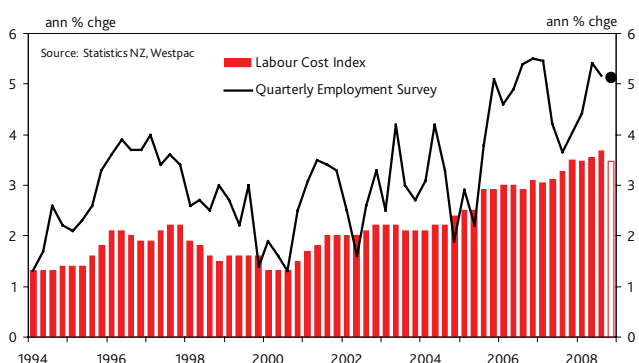
### December quarter labour market expectations

	Quarterly % change		Annual Westpac
	Previous	Westpac	
LCI – All sectors	1.2	0.9	3.5
LCI – Pvt sector	1.1	0.9	3.5
QES wages – All sectors	1.5	0.9	5.4
QES wages – Pvt sector	1.1	0.9	5.1
Employment growth	0.1	-0.5	
Unemployment Rate %	4.2	4.6	
Participation Rate %	68.7	68.5	

### Household Labour Force Survey



### Private Sector Earnings and Labour Costs



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and participation lurch in the same direction, we will treat the numbers aberrant. If employment lurches alone we will treat it as a genuine surprise. Of course, if employment lurches and participation is steadier, then unemployment will lurch too. The upshot of all this is that the market ought to focus more on the unemployment rate and less on employment.

### **Wages: not slowing yet**

New Zealand's suite of wage data is released on Monday 2 February. Wage growth has been very strong in recent years, and hit a record high last quarter. We expect another fairly strong quarter for the key data point on wages, which may surprise some – we outline our reasoning below. In terms of market reaction, the strong wage data was ignored last quarter and we expect a repeat this quarter. Conversely, a very weak wage number might generate a big market reaction, because wages are usually a lagging indicator.

The most important wage data is the Labour Cost Index, for which we expect 0.9% quarterly growth. The first reason for expecting such a strong print is that Statistics New Zealand does not seasonally adjust the LCI, but September and December are the strongest quarters in an emerging seasonal pattern. (The seasonality occurs because more people get their raise in the second half of the year). In seasonally adjusted terms, our forecast is not that strong.

The second reason our wage forecast is not weaker is that LCI wage inflation tends to follow inflation expectations far more than economic growth or unemployment, and inflation expectations were still very high in November when the survey was taken. The "adjustment" process in the LCI tends to strip it of cyclical. However, the unadjusted LCI (released concurrently) tends to be more sensitive to the economic cycle, so we will treat it as a useful lead signal. It jumped a record 1.5% in September 2008. We expect 1.2% in December, before the unadjusted LCI tanks in 2009 along with inflation and employment.

Finally, the Quarterly Employment Survey is also fairly responsive to the economic cycle, but it is extremely volatile meaning it is hard to read much into a single quarterly outturn. We predict 0.9% quarterly growth in private sector average hourly earnings. Over the course of the employment downturn we expect annual growth in average hourly earnings to drop from 5.2% to 1.5%. QES hours paid also gives a hint about the state of economic activity in the fourth quarter, and may generate some market movement. We expect it will be well below zero.

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