

Wages knocked down, but they'll get up again

2010Q1 LCI and QES review

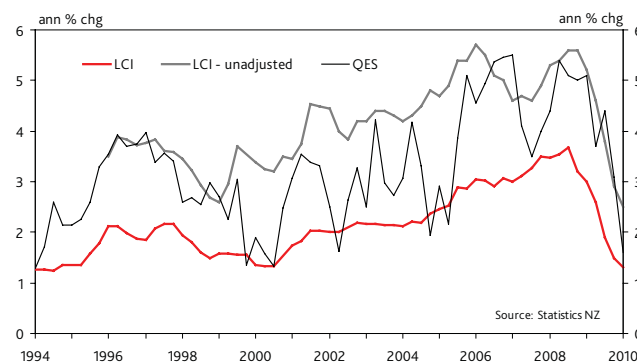
- Wage growth remains very subdued due to the weak labour market and subdued inflation.
- Employment indicators stronger than expected, economy is accelerating.

Wage growth remains very subdued, as expected, but the labour market and economy appear to be heating up a little more rapidly than previously thought.

The Labour Cost Index advanced just 0.3%, slightly below market expectations and our own forecast. Wage pressures remain very subdued at present due to the lagged effect of the weak labour market and subdued inflation. Indeed, annual private sector wage inflation has hit a nine-year low of 1.3%. Confirming the picture of ultra-weak wage growth, the unadjusted LCI registered quarterly growth of just 0.5% (annual 2.5%). The unadjusted LCI mismeasures wage inflation, but it is often a superior guide to the state of the wage cycle.

The Quarterly Employment Survey showed that average hourly earnings fell 0.4%, but we do not necessarily read that as a sign of weakness. The QES is a simple average of wages actually paid, not a measure of wage inflation. During the recession, low-paid workers were laid off disproportionately, meaning the average of wages paid actually rose strongly. We have long anticipated that during the recovery, firms would re-hire low-paid workers, which would actually drive down the average of

Private Sector Earnings and Labour Costs



wages paid. Perversely, falling QES wages could be a sign that the employment recovery is under way!

That idea is backed up by the employment indicators in the QES, which were clearly stronger than expected. Seasonally adjusted full-time equivalent employment rose 1.0%, posing some upside risk to our forecast of 0.1% employment growth in Thursday's HLFS. Hours paid rose 1.1%, suggesting that economic growth may have been a touch stronger in Q1 than our forecast of 0.8% growth, which was already very bullish compared to others.

Wage growth is unlikely to remain this weak for long. The improving economy will soon lead to greater employment

Table: LCI and QES Summary

| | Labour Cost Index | | | | Quarterly Employment Survey | | | |
|---------------------------|-------------------|--------|--------|--------|-----------------------------|--------|--------|--------|
| | Dec-09 | | Mar-10 | | Dec-09 | | Mar-10 | |
| | qtrly | annual | qtrly | annual | qtrly | annual | qtrly | annual |
| Private Sector (ord time) | 0.3 | 1.5 | 0.3 | 1.3 | -0.4 | 3.1 | -0.4 | 1.6 |
| Public Sector (ord time) | 0.3 | 2.4 | 0.5 | 2.3 | 0.7 | 5.7 | 0.8 | 3.7 |
| Total (ordinary time) | 0.4 | 1.8 | 0.3 | 1.5 | -0.2 | 4.0 | -0.4 | 2.2 |
| FTEs (s.a.)* | - | - | - | - | -0.1 | -2.5 | 1.0 | -0.5 |
| Paid Hours (s.a.) | - | - | - | - | -0.2 | -1.7 | 1.1 | -0.1 |

Source: Statistics NZ

* Westpac estimate

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growth and pressure on wages. The Australian boom will add a boost to wages over and above what one would normally expect from an NZ recovery, especially in the construction industry. And GST, ACC charges, tobacco excise, the Emissions Trading Scheme and the rising cost of food and petrol could all add to the cost of living over the next year, giving employees added motivation in wage negotiations.

Market implications

Those who have been forecasting a double-dip recession will be seriously rethinking at this point. Overall economic activity is accelerating, not decelerating. The recession has been over for so long that now even the labour market has had time to respond.

From our perspective, we had been anticipating a weak day for markets when the HLFS was released on Thursday. Now we are not so sure. The risk now seems skewed towards something slightly stronger than our forecast of 0.1% employment growth and 7.4% unemployment.

At the margin, today's data will give the Reserve Bank even greater comfort that the economy is firmly on the path to recovery, allowing it to take its foot off the accelerator by normalising the OCR. Yes, inflation and wage pressure are very subdued at this second. But the clear acceleration across a wide range of activity metrics shows beyond doubt that inflation will lurk down the line if the OCR is not normalised sooner rather than later. We place a very high probability on a June OCR hike.

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