

Now you see it, now you don't

NZ Q2 HLFS employment $-0.3\%q/q$, unemployment rate 6.8%

- Last quarter's outsized labour market improvement has proven to be a wil-o-the-wisp.
- Unemployment 6.8% , only slightly below peak.
- Looks like a normal labour market recovery, not a rapid one.
- RBNZ may hike the OCR slower than previously signalled – we are pencilling in pauses for December and January.

Key results

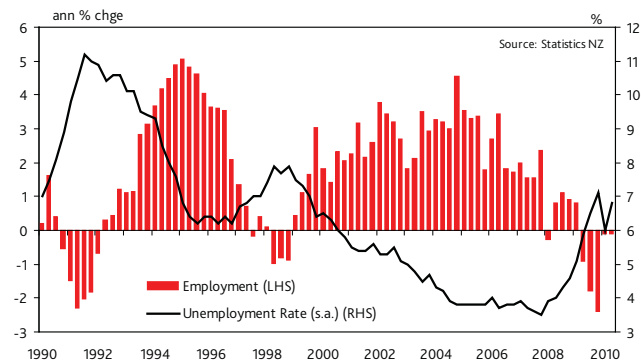
	Q1 2010	Q2 2010	Q2 Expected	
			WBC	Mkt
Employment %q/q	1.0	-0.3	0.4	0.4
Unemployment rate %	6.0	6.8	6.2	6.3
Participation rate %	68.0	68.0	68.1	68.1
Hours Worked s.a %q/q	1.3	0.6	0.7	

For the second quarter in a row, the Household Labour Force Survey (HLFS) has stunned us. Last quarter, the unemployment rate was reported as having dropped from 7.1% to 6.0% . That gave rise to hope that the labour market was improving more rapidly than in past recoveries. However, we were suspicious that the number may have been a false signal, especially in light of the HLFS's volatility over recent years. We awaited the June quarter figures to provide clarity, warning in our preview that anything could happen.

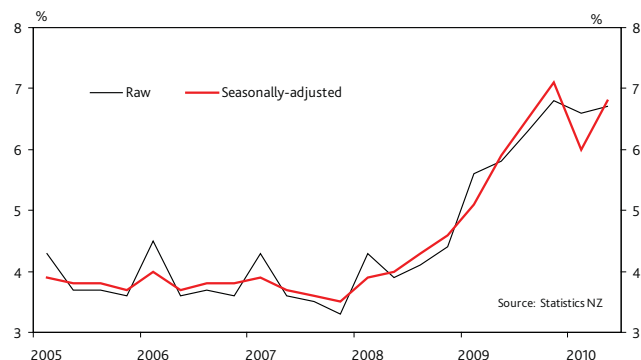
Well, anything did happen, and we now have clarity. Last quarter's unemployment decline was a false signal. The unemployment rate has corrected right back to where, intuitively, one might have expected it to be given economic developments over the past year. Employment fell 0.3% , taking the gloss off last quarter's 1% increase. The prospects of an extraordinary labour market improvement have evaporated.

If the survey is to be taken literally, there have been huge and unprecedented changes in the labour market status of 20-24 year-old men. In the March quarter, an unusually low number of these young men were unemployed, only to re-enter the ranks of the unemployed this quarter. This caused relatively

Household Labour Force Survey



Unemployment rate



modest changes in the raw number of unemployed people – down 5,000 in March and up 2,000 in June. But those modest changes were the opposite of the normal seasonal pattern, so after seasonal adjustment they look huge.

Statistics NZ pointed out that historically, employment and unemployment have tended to be more volatile around economic turning points, both in New Zealand and overseas. Certainly, the direction of change in the HLFS fits with some other data, such as business confidence which was high at the start of the year but dropped sharply in the June quarter.

But the numbers are just too extreme, and too suspiciously concentrated on one group of people, for us to take the HLFS

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at face value. We doubt very much that the unemployment rate really dropped to 6% before bouncing to 6.8%. There may have been an element of sampling error, which is always a risk with surveys. Or perhaps recent changes to employment rules and the sudden availability of workers have altered seasonal patterns, which Statistics NZ would have trouble keeping up with. The seasonally adjusted data has been far more volatile than actual unemployment – we'd normally expect this to be the other way around.

Looking through the volatility may be the best way to interpret this data. The notion that unemployment has dropped only slightly after peaking at 7.1% fits better with our understanding of the broader economy, and is more in line with our a priori forecasts. That would suggest that the labour market is slowly and steadily improving, which fits better with other evidence such as the Quarterly Employment Survey, surveys of hiring intentions, and surveyed difficulty finding labour, all of which have shown steady but unspectacular improvement over the past nine months. Statistics New Zealand recommends paying attention to the trend unemployment rate, which remained steady at 6.7%.

The headlines were extremely weak, but there were a couple of saving graces in the detail of today's data. The fall in employment was entirely due to lower part-time employment. Full-time employment was actually up 0.2%. Along similar lines, the economy-wide number of hours worked was up 0.6%, broadly consistent with our forecast of 0.7% GDP growth over the June quarter. And the total number of "jobless" people actually fell by 7,300 people this quarter ("jobless" includes the unemployed, those available for work but not actively seeking or only seeking through newspapers, and those actively seeking work but not immediately available). In fact, the entire rise in reported unemployment could be down to people shifting out of this category, for example because they were unavailable for immediate employment when the Q1 survey was conducted in February, but were available for an immediate start three months later!

Unemployment remains heavily concentrated on the North of New Zealand. Auckland's unemployment rate of 8.7% is especially concerning, while Northland (9.1%), Bay of Plenty (7.8%), and Gisborne/Hawkes Bay (8.5%) have historically been high unemployment regions. By contrast, unemployment is below 5% in all regions of the South Island.

Implications

Before today's data the Reserve Bank would have been wary of the risk that rapidly declining unemployment could provoke early wage rises and higher inflation. That risk has disappeared. With decent spare capacity in the labour market, it now seems unlikely that wages will drive higher in the near term. This reduces the apparent pressure on near term inflation.

We expect the Reserve Bank will react to news of the weaker labour market by signalling that the pace and extent of OCR hikes will be more moderate. That said, we still expect the OCR will be hiked by 25 basis points in September and October. And we still expect the September *MPS* to outline a plan for returning the OCR to more normal levels. The RBNZ has been at pains to emphasise that the current level of the OCR is "very supportive of economic activity", and has consistently articulated and executed a very clear plan of gradual normalisation. Although today's data was significant, it was not enough to completely derail such a well-developed plan at this early stage.

We now expect the RBNZ will operationalise its "slower pace" idea by pausing after the first 100 basis points of OCR hikes. We are pencilling in pauses for the December and January OCR reviews, although we are not wedded to that timing.

Markets were expecting the unemployment rate to rise, but today's data was still a surprise. The NZD fell about 50pts to 0.7300, and the two-year swap rate dropped 10bp to 3.95%.

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