

Fading echoes of recession

2010Q2 LCI and QES review

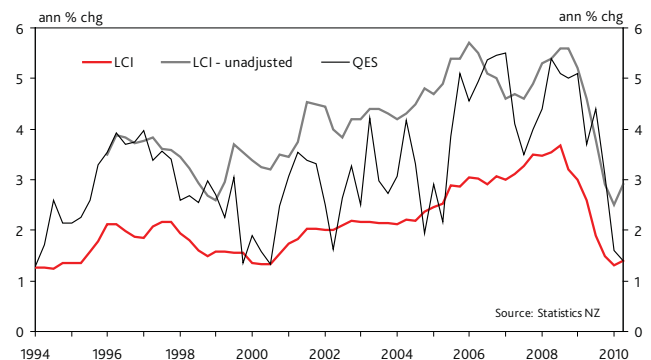
- Wage growth still subdued, but there are positive signs for the year ahead.
- Evidence that the economy was still recovering steadily in Q2.
- No reason to alter our forecasts for Thursday's HLFs, 0.4% employment growth and 6.2% unemployment expected.

Wage growth remained subdued in the second quarter of 2010, but there are signs of better times ahead. Activity indicators suggested the economy remains on track for a steady and respectable recovery.

The Labour Cost Index (LCI) advanced 0.4% in Q2, a slight improvement over last quarter's 0.3%. Private-sector wages were up 0.5%, while public sector wage growth had its weakest showing since 1999, with just 0.2% growth over the quarter. This year's minimum wage increase was smaller than previous years, further moderating wage growth.

Today's wage weakness is an echo of last year's recession rather than a sign of things to come, since wages tend to lag the economic cycle. According to the blue-print of recovery that we have mapped out, we expect wage inflation will accelerate only until later this year. There were certainly a few signs in the details of today's data to suggest that higher wage inflation does indeed lie ahead. First, quarterly growth in the unadjusted LCI jumped to 1%, from 0.5% last quarter. The unadjusted LCI

Private Sector Earnings and Labour Costs



is more sensitive to labour market conditions than the heavily-sanitised official index. Second, overtime wage rates were up 0.7%, a sharp acceleration over earlier quarters. Historically, bouts of rapid wage growth have been preceded by accelerating overtime rates.

The Quarterly Employment Survey (QES) confirmed the picture of modest wage growth, with average hourly earnings up 0.6% in the quarter. Consistent with the LCI, overtime wage rates accelerated more rapidly (+1.5%), and public sector wage growth was zero.

The employment and activity indicators in the QES held more interest for markets. Total hours paid were up 1.2% (seasonally

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Mar-10		Jun-10		Mar-10		Jun-10	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ord time)	0.3	1.3	0.4	1.4	-0.4	1.6	0.6	1.4
Public Sector (ord time)	0.5	2.3	0.2	2.1	0.8	3.7	-0.1	3.9
Total (ordinary time)	0.3	1.5	0.4	1.6	-0.4	2.2	0.7	2.2
FTEs (s.a.)*	-	-	-	-	1.1	-0.5	0.5	1.3
Paid Hours (s.a.)	-	-	-	-	1.1	-0.1	1.2	2.5

Source: Statistics NZ

* Westpac estimate

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

For all clients: Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141, incorporated in Australia ("Westpac"). The information contained in this report: does not constitute an offer, or a solicitation of an offer, to subscribe for or purchase any securities or other financial instrument; does not constitute an offer, inducement or solicitation to enter a legally binding contract; and is not to be construed as an indication or prediction of future results. The information is general and preliminary information only and while Westpac has made every effort to ensure that information is free from error, Westpac does not warrant the accuracy, adequacy or completeness of the Information. The Information may contain material provided directly by third parties and while such material is published with necessary permission, Westpac accepts no responsibility for the accuracy or completeness of any such material. In preparing the Information, Westpac has not taken into consideration the financial situation, investment objectives or particular needs of any particular investor and recommends that investors seek independent advice before acting on the Information. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. Except where contrary to law, Westpac intends by this notice to exclude liability for the information. The information is subject to change without notice. Westpac expressly prohibits you from passing on this document to any third party. Westpac Banking Corporation is registered in England as a branch (branch number BR000106) and is authorised and regulated by The Financial Services Authority. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised and regulated by The Financial Services Authority. © 2010 For Australian clients: WARNING - This document is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

adjusted), building on last quarter's 1.1% growth. This confirms the notion that economic growth remained robust in the second quarter, and suggests our 0.7% forecast for Q2 GDP growth may be a little light. Although consumer spending has slowed, the export sector has kept growth chugging along. We are going through more of an economic rebalancing than a slowdown.

We were looking for full-time equivalent employment growth in the QES to provide some guidance ahead of Thursday's all-important Household Labour Force Survey. In the end, today's 0.5% growth in FTE employment (s.a.) left us feeling comfortable with our forecast for 0.4% employment growth and 6.2% unemployment in the HLFS. The odds of a wild outturn in the HLFS, on either the strong side or the weak side, now seem a little longer.

Market implications

Evidence of decent economic growth was slightly surprising to markets, so 2-year swap rates rose 2 basis points and the NZD was up about 15 pips.

The data were consistent with the "steady recovery" view espoused by the Reserve Bank and Westpac. We continue to expect a steady series of OCR hikes over the next two years, as projected by the RBNZ. In stark contrast, markets have gotten into a bit of a funk over the slightly-weaker tone to recent domestic data, and have taken to pricing an extremely muted hiking cycle. Current market pricing suggests that the OCR will peak below its previous record low! We think there is very little evidence to support that view. As evidence of recovery becomes increasingly abundant, we expect swap rates will rise.

Brendan O'Donovan, Chief Economist, Ph: (64-4) 470 8250

Dominick Stephens, Senior Economist, Ph: (64-4) 381 1414