

Confirmation or cancellation?

2010Q2 employment and wage data preview

- HLFS may reveal the truth behind last quarter's precipitous fall in unemployment – aberration or confirmation?
- We expect slow employment growth, a tick up in unemployment, and slow wage growth.
- However, uncertainty rules. A further fall in the unemployment rate should not be ruled out.

June quarter employment expectations

	Quarterly % change		Annual Westpac
	Previous	Westpac	
Employment growth	1.0	0.4	0.7
Unemployment Rate %	6.0	6.2	
Hours worked %	1.7	0.3	1.3
Participation Rate %	68.1	68.1	

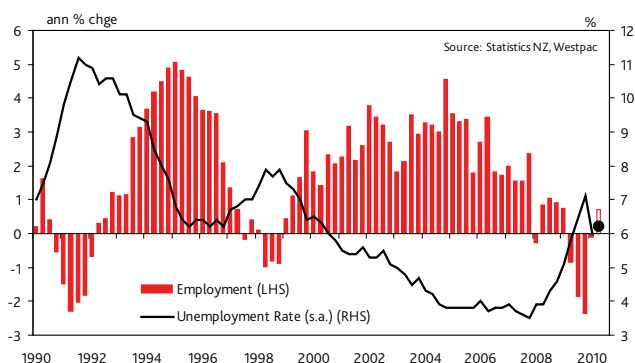
Employment and unemployment (Thursday 5 August)

Last quarter's Household Labour Force Survey was one of the most surprising pieces of economic news we've seen. All and sundry were expecting only the slightest growth in employment, and the unemployment rate was tipped to rise above 7.3%. Instead, the HLFS suggests that employment had rocketed ahead by 1% and unemployment had fallen to 6%. The details were just as strong as the headline – employment growth was entirely full-time, hours worked rose 1.7%, and underemployment fell. The labour market picture was seemingly so inconsistent with the slow emergence from recession suggested by other data, that we immediately began to question its validity. When the June quarter HLFS is released on Thursday, we may finally get clarity on whether the labour market is really improving at the rate suggested last quarter.

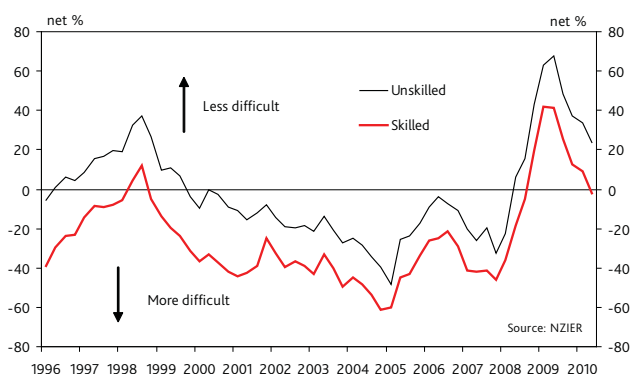
Our forecasting models (based on survey data) suggest that June quarter employment growth was 0.4%. If the participation rate remained flat as we expect, that would see the unemployment rate correct slightly to 6.2%. We'd expect full-time work to account for most of the new jobs, and we'd expect to see a further lengthening of the average work week as some employers offered more overtime.

The risks to our forecast depend on the underlying cause of last quarter's outsized data. One possibility is that the HLFS

Household Labour Force Survey



Firms' difficulty of finding labour



led us astray last quarter, perhaps through simple sampling error or problems with seasonal adjustment. Such is always a risk with survey data. In that case the errors could be corrected this quarter, and unemployment could rebound higher than our 6.2% forecast. As an aside, our analysis suggests that the peak unemployment rate, currently reported as 7.1%, is likely to be revised lower.

The other possibility is that we forecasters got it badly wrong last quarter, while the HLFS correctly reported developments. After all, the consensus of NZ economists has a poor record in forecasting unemployment, with a consistent bias towards too-high forecasts. Forecasters consistently overstated the likely employment decline during the recession, and may now

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.

be understating employment growth in recovery. Perhaps employers are finding it easier to find workers now, whereas employment growth was hamstrung by a shortage of workers last decade. Finally, the 90-day probation rules might have removed some risk for employers, encouraging them to employ despite the uncertain environment.

The history of large drops in unemployment doesn't help us determine the truth. There have been four previous occasions when the unemployment rate fell by more than $\frac{3}{4}$ of a percentage point in a single quarter. On two occasions, it went on to post a further decline in the subsequent quarter. It "rebounded" on the other two occasions, each time by 0.1 percentage points.

Large unemployment falls in history

	Initial change	Subsequent change
Jun-92	-1.1%	0.1%
Jun-94	-1.3%	-0.6%
Jun-95	-0.8%	-0.2%
Jun-06	-0.9%	0.1%
Mar-10	-1.1%	?

Market implications

The fairest assessment is that this quarter's HLFs data is highly uncertain. While we are forecasting slow employment growth and marginally higher unemployment, we acknowledge that the range of plausible outcomes is wide. By contrast, it feels like financial markets are placing great faith in the idea of an unemployment rebound. Markets would get a major shock if the unemployment rate printed below our forecast, while there would be little reaction if the number printed as high as 6.4%. The RBNZ has adopted the same agnostic stance as us, and is forecasting no change in the unemployment rate.

QES and LCI (Tuesday 3 August)

The Quarterly Employment Survey will take on unusual importance for markets this quarter. The QES gave the first hint that something was up with the labour market last quarter, when it reported 1% growth in FTE employment and 1.1% growth in hours worked (both seasonally adjusted).

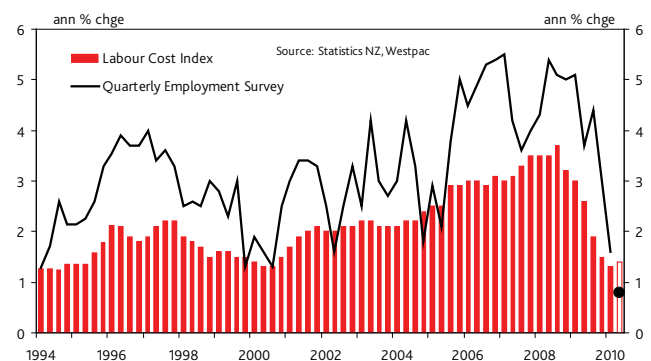
On the wage front, we expect the Labour Cost Index will reveal another quarter of slow wage inflation. Although unemployment is falling, employers still have the upper hand, and June tends to be one of the softer quarters for wage growth. The upturn in wage inflation is due later this year, by our reckoning.

The QES measure of average weekly pay is likely to be soft again. It is a simple average of the wages being paid to workers. Much of the growth in employment is low-skilled workers and young people, and their re-entry into the workforce tends to depress the average wage.

June quarter wage expectations

	Quarterly % change		Annual
	Previous	Westpac	Westpac
LCI – All sectors ex overtime	0.3	0.4	1.6
LCI – Pvt sector ex overtime	0.3	0.4	1.4
LCI – Pvt sector incl overtime	0.3	0.4	1.4
QES wages – All sectors	-0.4	0.0	1.5
QES wages – Pvt sector	-0.4	0.0	0.8

Private Sector Earnings and Labour Costs



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

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