

The human cost of recession

NZ Q3 HLFS employment $-0.8\%/q/q$, unemployment rate 6.5%

- Unemployment rate jumps to 6.5% .
- Hours worked fell sharply, suggesting weakness in Q3 GDP.
- The labour force participation rate is trending down.
- This data supports the RBNZ's relatively dovish stance.

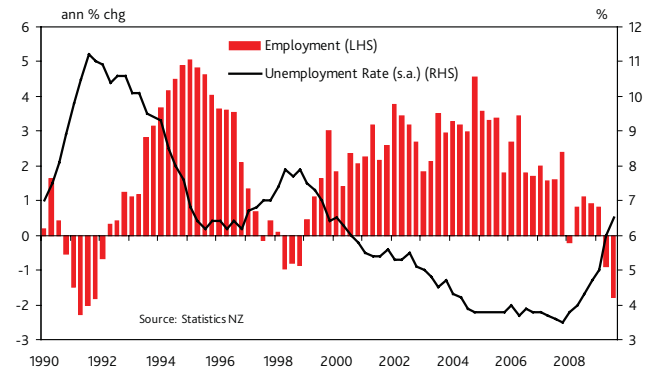
Key results

	Q2 2009	Q3 2009	Q3 Expected	
			WBC	Mkt
Employment %q/q	-0.4	-0.8	-0.2	-0.3
Unemployment rate %	6.0	6.5	6.5	6.4
Participation rate %	68.4	68.0	68.4	68.2
Hours Worked s.a %q/q	-1.9	-0.7%	0.6%	

Today's Household Labour Force Survey confirmed the severe toll that the recent recession took on New Zealand's labour market. The unemployment rate jumped a further half-percentage point to 6.5% , the highest in nine years. Although the level of unemployment is lower than the early-1990s recession, the rate of increase in unemployment has been every bit as severe. One out of every 31 Kiwi workers has become unemployed in the past year and a half.

We always expected today's data to reflect the recession just past, not the recent flush of strong data. The labour market tends to lag economic growth. Although unemployment was bang on our forecast, we regard this HLFS report as weaker than expected. It was not so much the fall in employment – employment growth is extremely volatile, so our forecast error was neither here nor there in an economic sense (more on that below). The really important part was the 0.7% fall in hours worked, coming as it did on top of a 1.9% fall last quarter. We had expected to see a lift in hours worked, reflecting an increase in economic activity over the quarter. Such weak hours worked suggests that the economy may have grown by less than our 0.4% Q3 GDP forecast. (Swine flu may have had an impact on the number of hours people worked in the third quarter – 'usual hours worked', which includes time spent on sick leave, fell only 0.2% .)

Household Labour Force Survey



The participation rate fell from 68.4% to 68.0% . We partly regard this as quarterly volatility (more below). But we do note that the trend participation rate has now eased from its peak of 68.9% to 68.1% . Falling labour force participation is the normal response after a period of rising unemployment, as potential workers become discouraged and pursue other opportunities such as early retirement or study. These people are the hidden unemployed. We have long argued that the rise in labour force participation from 2004 – 2008 was mostly cyclical, not structural.

Unemployment has hit the same groups as previous recessions. Unemployment among youth, Maori, and Pacific Islanders is skyrocketing. Unemployment in Northland is 9.3% , and in Gisborne it is 10% . Male unemployment has risen much faster than female unemployment, as the disproportionately-male construction and manufacturing industries are hit hardest. The North Island is experiencing far more unemployment than the South Island. One noteworthy change is that Auckland's unemployment rate is no longer high by national standards.

We expect this was the last quarter of sharply rising unemployment. For the next year, we forecast the unemployment rate to remain close to its current level, with movements up or down of a couple of tenths of a percent.

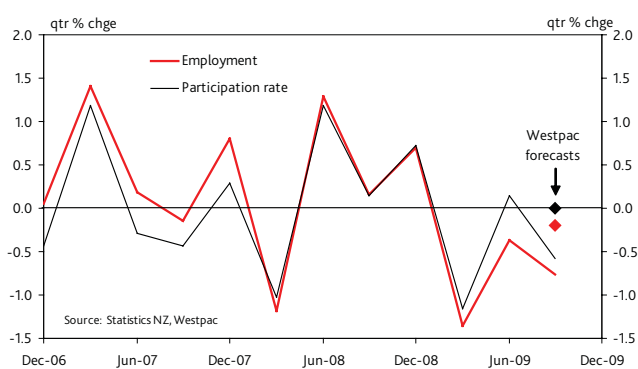
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Volatility in HLFS employment and participation data

For the past two years employment growth has been extremely volatile, negatively autocorrelated (exhibiting a spikey pattern), and highly correlated with the participation rate. This quarter was no exception. Because employment and participation fell in lock-step once again, we are treating the size of the fall in employment with caution.¹ The HLFS basically consists of two questions: 1. Are you in the labour force?; and 2. If you are in the labour force, are you employed? The number of people answering yes to the first question has become extremely volatile, causing volatility in the measured labour force participation rate and employment growth. We have decided to focus our attention on the proportion of people who answer “no” to the second question, which is the unemployment rate.

Employment vs participation rate



Market implications

The Reserve Bank will not materially change its view after this data, which tends to support its dovish stance relative to the market. Interest rate markets moved incrementally closer to the Reserve Bank's view, with two-year swap rates falling 4bp, and the exchange rate fell 30 pips. That was an appropriate reaction to a genuinely weak piece of data. But although this data suggests the economy was slightly weaker than previously thought in Q3, forward looking indicators are still powering ahead, especially in the housing market and commodity price spaces. We expect the RBNZ will be able to maintain its dovish stance only until New Year. We continue to expect inflationary pressures will become too much to bear by March 2010, when the RBNZ will kick off its hiking cycle.

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¹ Regular readers will recall that in our preview we predicted Q3 would be unaffected by the strange pattern that has developed in the HLFS. We were wrong about that.