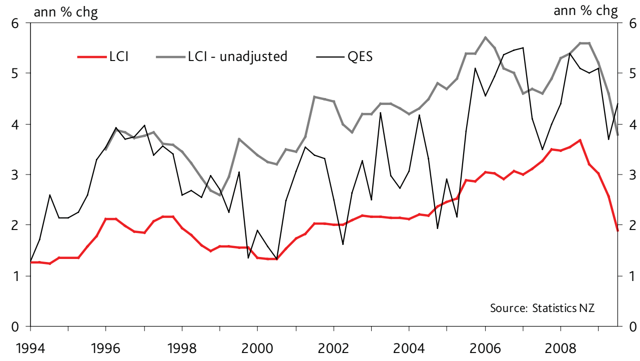
3 November 2009

Labour market finding a floor

2009Q3 LCI and QES review

- **The labour market may have reached the low-point of this cycle.**
- **LCI wage inflation remained low.**
- **The QES registered a 1.7% wage increase and a 1.8% increase in economy-wide earnings. We suspect that self-employed and commission-based workers received the biggest boost in these early stages of recovery.**
- **Employment and activity indicators were consistent with our -0.2% forecast for HLFS employment.**

Private Sector Earnings and Labour Costs



The overall picture that emerged from today's wage and employment data was of a labour market that has reached the bottom of the cycle. Wage inflation remained subdued, while employment and hours worked measures were close to flat.

The Labour Cost Index (LCI) registered private sector pay rises of 0.4% in Q3, in line with our expectations but slightly stronger than the market expected. The apparent acceleration in wage growth over Q2's 0.3% is illusory. Most workers get their annual pay increase in the second half of the year, so the LCI (which Statistics NZ does not seasonally adjust) tends to advance more in the final two quarters. In a seasonally-adjusted sense we'd say wage inflation was unchanged at a low level. The 1.1% increase in public sector pay was partly due to the 4% pay increase given to primary and secondary teachers on July 1.

The LCI measures pay rates for given positions, experience levels etc, whereas the 'unadjusted LCI' includes pay rises given for promotions. Although it is not really a measure of wage inflation, it does tend to follow the labour market cycle more closely, and is therefore worth watching. As expected, it painted a picture of a labour market that has been tortured over the past year, with the annual increase falling from 5.6% to 3.8%. The quarterly rate of increase in the unadjusted LCI rose to 0.9% from 0.6%, again partly on seasonal factors.

The Quarterly Employment Survey (QES) painted an altogether more upbeat picture than the Labour Cost Index. Private sector ordinary time hourly earnings posted a stunning increase of

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Jun-09		Sep-09		Jun-09		Sep-09	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ord time)	0.3	2.6	0.4	1.9	0.8	3.7	1.7	4.4
Public Sector (ord time)	0.4	3.6	1.1	2.9	–0.3	5.6	2.4	5.9
Total (ordinary time)	0.3	2.9	0.5	2.1	0.7	4.5	2.1	5.1
FTEs (s.a.)*	–	–	–	–	-1.2	-3.6	–0.2	-3.5
Paid Hours (s.a.)	–	–	–	–	–1.2	–3.9	0.2	–3.0

Source: Statistics NZ

* Westpac estimate

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

WEB: 77/09

1.7% q/q, to be 4.4% higher than a year ago. The QES measures average wages for everybody currently employed. During recessions, the lowest paid workers are most likely to be laid off, which acts to raise the measured average pay rate. Such compositional effects explain why the QES held up during the recession, but they cannot explain the strong rise this quarter because employment is no longer falling materially. Total economy-wide earnings increased 1.8% in the quarter. Somebody somewhere has received a significant raise. We suspect that the strength in the QES is down to its coverage of the self-employed and commission-based workers, whose earnings are inherently cyclical but are not covered by the LCI. The QES is better at registering the early stages of recovery. Backing this hypothesis, hourly earnings in the rental, hiring and real estate services industry (where many workers are on commission) were up 8.5% in the quarter.

The employment and activity indicators in the QES were consistent with our view that Q3 economic activity expanded modestly and employment fell slightly. Hours paid grew 0.2%, the first increase since June 2008. However, full-time equivalent employment fell 0.2% (seasonally adjusted). This suggests that hours for existing workers were lengthened in Q3, rather than significant new hiring.

It is interesting to reflect on the combination of falling employment and rising gross labour earnings. That has become a bit of a trend for New Zealand. Over the past two years real labour compensation has risen 1.7% while real GDP has fallen 1.2%. Incomes have risen while production has fallen. We put that down to the rising terms of trade, which boosts New Zealanders' incomes and living standards without necessarily boosting the production that takes place in New Zealand.

Implications

Today's data was just the curtain-raiser ahead of Thursday's Household Labour Force Survey, which is the premiere gauge of the labour market. Our forecast of -0.2% employment growth is at the optimistic end of economist forecasts. Today's data adds conviction to our view that employment is no longer falling fast, and therefore Thursday's HLFS could be a positive surprise to markets. However, we still expect the unemployment rate to post another sharp increase, to 6.5%.

Today's data will be interpreted as a mixed bag for the RBNZ. Well-behaved LCI wage inflation means little pressure on total inflation, justifying the RBNZ's low-interest rate policy. However, the shock rise in earnings registered in the QES may raise eyebrows at number 2 The Terrace, if it is interpreted as an early sign of the economy heating up faster than previously thought. We continue to expect the RBNZ to hike the OCR 25bp in March 2010.

Brendan O'Donovan, Chief Economist, Ph: (64-4) 470 8250
Dominick Stephens, Research Economist, Ph: (64-4) 381 1414