1 November 2011

Westpac Institutional Bank

Unanswered questions

2011 Q3 Labour Cost Index and Quarterly Employment Survey

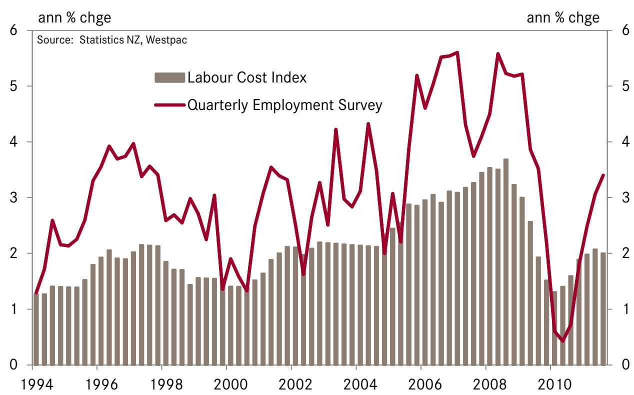
- **Wage growth remained contained, as expected.**
- **QES employment growth was surprisingly soft, but may not be fully picking up the jobs boost from the Rugby World Cup.**
- **Apart from the RWC, and a rebound in quake hit Canterbury, jobs momentum remains weak.**

Summary

Today's Labour Cost Index (LCI) report came in exactly in line with market expectations (just a touch below ours), and showed wage pressures remaining contained in Q3. Meanwhile, jobs and hours data from the Quarterly Employment Survey (QES) were rather softer than we would have picked.

As we explain below, the timing of the QES means that this survey may not fully reflect the Rugby World Cup boost to the labour market that we expect to see in Thursday's Household Labour Force Survey. Because of this we're not going to abandon our fairly strong employment forecasts just yet. But today's data do suggest very little in the way of labour market momentum apart from RWC hiring and a rebound in the Canterbury economy post-earthquake. As such they add to the body of evidence that the economy has lost some steam over the middle of the year.

NZ LCI and QES wages (private sector ordinary time)



That said, we don't think today's report will materially affect the RBNZ's view of the economy, or its policy plans. In its October OCR Review, the RBNZ was already conscious of a more benign tone to recent inflation data, and of a softening economy more generally. But it chose to keep its eye firmly on the two key themes which will drive New Zealand's economic fortunes over the next two years: Christchurch reconstruction, and the strains and stresses in the global economy. We continue to think that the balance of those two forces will start to tilt in favour of rate

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Jun-11		Sep-11		Jun-11		Sep-11	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ordinary time)	0.5	2.1	0.5	2	1.2	3.1	1.3	3.4
Public Sector (ordinary time)	0.3	1.5	0.6	1.8	-0.7	2.2	0.9	2.8
Total (ordinary time)	0.5	1.9	0.6	2	1.1	3	1.2	3.2
FTEs (s.a.)	–	–	–	–	0.3	0.4	0.1	0.5
Filled jobs (s.a.)					0	-0.4	0.7	0.6
Paid Hours (s.a.)	–	–	–	–	0.7	1.6	0	1.3

Source: Statistics NZ

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hikes by the middle of next year. We also continue to think that longer-term, the Reserve Bank remains overly sanguine on the inflation outlook. In the September MPS, the RBNZ forecast labour cost inflation to peak at 2.4% early next year. Even on today's numbers, that looks very optimistic given the tightening in the labour market we expect over the next couple of years.

Wages

The Labour Cost Index (private sector all salary and wage rates - the Reserve Bank's preferred measure) rose 0.5% in the September quarter, in line with market expectations. This leaves annual labour cost inflation up 2.0% on a year ago, unchanged from the June quarter.

Wage growth has gradually been picking up from its trough in early 2010 (when labour cost inflation was 1.3%), reflecting rising inflation expectations and a gradual tightening in the labour market. But wage pressures remain well below pre-recession levels. And the wage pick-up we've seen has been mainly due to more wages posting an increase, rather than the size of wage increases getting larger – over the past year the median increase has consistently been around 3% (it got above 4% at the peak of the last cycle in 2008). That trend didn't really change in the September quarter, with the proportion of wages showing an increase dipping slightly and the median raise increasing a bit (from 2.9% to 3.0%).

The Quarterly Employment Survey's annual hourly earnings measure was stronger, rising 1.3% in the quarter, but this measure of wage inflation doesn't control for changes in job mix or productivity gains, and it's also more volatile than the LCI, so we weren't overly alarmed by this figure.

Employment and hours

The main point of interest in the Quarterly Employment Survey is its measures of employment and hours paid, which give an early indication of the state of the labour market ahead of Thursday's Household Labour Force Survey. And at first blush, these were surprisingly soft: hours were flat (seasonally adjusted), and full-time-equivalent (FTE) employment was up a mere 0.1%. However, we don't think they're the last word, for a couple of reasons. First, QES jobs and HLFS employment don't track each other perfectly at the best of times (the HLFS is a survey of households that tracks people employed, whereas the QES is a survey of employers that tracks the number of jobs). But more importantly, the QES probably hasn't picked up the full impact of the Rugby World Cup on the labour market in the September quarter. The QES is sampled during a week in mid-August, whereas the HLFS is spread over the entire quarter. And FTE employment gives a low weight to part-time jobs. That means the QES numbers would predate a lift in hours worked over September/October RWC period, and they would down-weight part-time and short-term hiring for the event. In fact, the QES measure of total filled jobs (which gives equal weight to full-time and part-time jobs) was up 0.7%, suggesting a RWC effect was there, even if maybe not quite as strong as we had been expecting (Statistics New Zealand's new monthly National Employment Indicator had pointed to something even stronger, surging 1.3% in the month of August alone).

Regional and sectoral breakdown

Breaking today's QES down by region and industry suggests an additional driver of jobs growth in the September quarter: a pickup in the Canterbury economy from its post-earthquake lows. Full-time-equivalent (FTE) employment was stronger in the Canterbury region than elsewhere, consistent with other signs of a pick-up in the region from earthquake disruption (notably the housing market). On our seasonally adjusted estimates, FTE employment grew 1.4% in Canterbury, well above the national average of 0.1%, and higher than greater Auckland (0.1%) or Wellington (0.4%). The rebound from earthquake disruption may also be reflected in strong bounce-backs in the manufacturing, transport and real estate industries, after similarly sized falls in the June quarter.

We did see strong growth in part-time jobs in all three main centres - total filled jobs surged 1.6% (seasonally adjusted) in Wellington, and lifted 0.8% in Auckland, even as full-time equivalent employment growth in those regions was much weaker. This could be a hint of RWC-related hiring in those regions. The evidence on this from the industry breakdown is mixed. There was a notable burst in jobs in the retail sector (filled jobs were up a whopping 3.8%, after a year of declines), but both accommodation and recreational services showed much softer jobs growth. If Rugby World Cup hiring is coming through in the filled jobs numbers, that would be consistent with anecdotes that the RWC both boosted and disrupted activity in those sectors (some hotels would have benefited from the influx of visitors, but others would have seen cancelled conferences, for example).

As in June, we're also seeing early signs of wages in Christchurch lifting as the city repairs for the reconstruction effort. Statistics New Zealand reported that the proportion of people getting wage increases, and the median wage increase, were significantly higher for construction industry workers in Christchurch than elsewhere - and that wage increases overall were slightly higher in Christchurch than the national average.

Market reaction

Market reaction to an unsurprising wage report was negligible.

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