

NEW ZEALAND ECONOMICS

Labour Cost Index and Quarterly Employment Survey

– March 2011 quarter

3 May 2011

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WAGE GROWTH MODEST BUT INCREASED DEMAND FOR LABOUR EVIDENT

KEY POINTS

- Today's wage data was softer than market expectations, with wage inflation not of immediate concern to the Reserve Bank.
- LCI private sector wage inflation (excluding overtime) rose by 0.4 percent (2.0 percent y/y) in the March quarter, slightly lower than market expectations. Including overtime, quarterly private sector LCI wages also increased by 0.4 percent (2.0 percent y/y).
- The unadjusted LCI rose by 0.7 percent (3.9 percent y/y). This is not the preferred measure, but the higher rates of wage inflation on this measure are worth noting.
- After showing strong rates of growth over the past few years, public sector ordinary time LCI wage growth continues to undershoot that seen in the private sector, increasing by only 0.5 percent in the December quarter (1.4 percent y/y).
- The QES wage measures are more volatile. QES private sector ordinary average hourly earnings rose by 0.3 percent (2.5 percent y/y).
- In seasonally adjusted terms, paid hours from the QES rose by 0.7 percent, whereas filled jobs rose by 0.6 percent in the March quarter. Normally these numbers give a rough steer on employment and hours in the upcoming HLFS (Thursday), but because the earthquake will impact more on the HLFS than the QES (due purely to survey timing) it is difficult to draw any implications for the HLFS from today's data.

	LCI private sector ordinary time		QES private sector ordinary time		QES paid hours	
	q/q	y/y	q/q	y/y	q/q	y/y
Mar-08	0.7	3.5	1.1	4.5	-0.2	2.3
Jun-08	0.8	3.5	2.1	5.6	0.1	1.3
Sep-08	1.1	3.7	1.0	5.2	-0.5	0.7
Dec-08	0.7	3.2	0.9	5.2	-1.4	-2.0
Mar-09	0.5	3.0	1.1	5.2	-0.8	-2.6
Jun-09	0.3	2.6	0.8	3.9	-1.4	-4.0
Sep-09	0.4	1.9	0.7	3.5	-0.3	-3.8
Dec-09	0.3	1.5	-0.4	2.2	0.1	-2.5
Mar-10	0.3	1.3	-0.4	0.6	0.8	-0.8
Jun-10	0.4	1.4	0.6	0.4	1.2	1.8
Sep-10	0.6	1.6	1.0	0.7	0.2	2.3
Dec-10	0.6	1.9	0.6	1.8	-0.2	2.1
Mar-11	0.4	2.0	0.3	2.5	0.7	2.0
ANZ	0.6	2.2	0.5	2.7	0.5	-
Market	0.5	1.8	0.6	1.8	-	-

DATA REVIEW

DATA WRAP

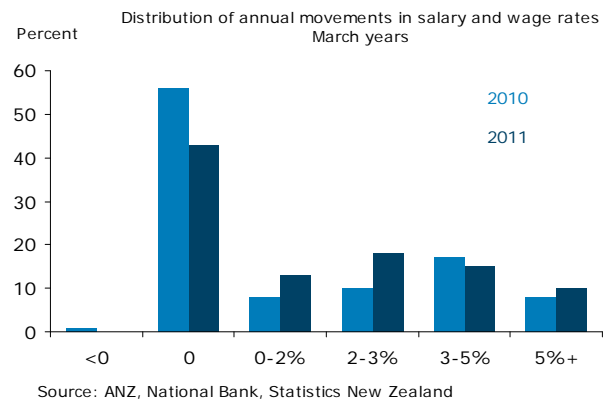
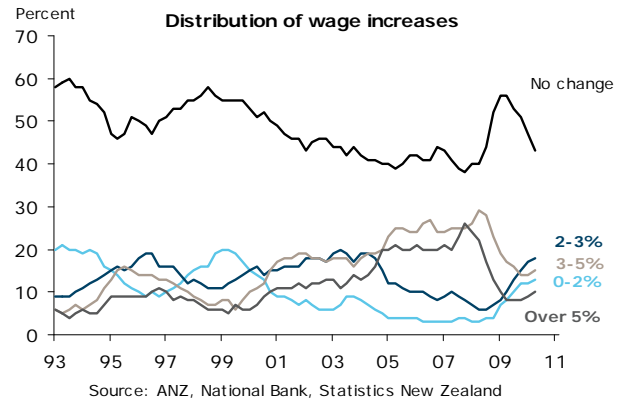
LCI private sector wage inflation (excluding overtime) rose by 0.4 percent (2.0 percent for the March 2011 year). This was weaker than the market consensus of a 0.6 percent increase. Including overtime, private sector salary and wage rates also increased 2.0 percent for the year, the highest annual increase since September 2009. Public sector wage rates increased 0.5 percent, with annual wage inflation on this measure (1.4 percent) close to decade lows. Private sector ordinary time hourly earnings from the QES rose by a moderate 0.3 percent in March (+2.5 percent y/y).



While moderate wage growth is to be expected at this stage in the cycle, not all of the wage measures were equally contained. The private sector unadjusted LCI wage measure (which adjusts for employment shifts between industries and occupations but not for increases due to quality changes within occupations) recorded a 0.7 percent quarterly increase, with the annual rate of wage inflation holding up at 3.9 percent.

The distribution of annual increases from the LCI did not highlight a broad-based strengthening in wage pressure. The portion of wage increases greater than 3 percent (25 percent of the total in the March 2011 year) continues to rise from its trough in the September 2010 year (22 percent), but remains well below its late-2008 peak, when over half of workers were receiving pay rises of more than 3 percent. However, the proportion of workers receiving no pay increase is dropping sharply, down to 43 percent from a peak of 56 percent only a year ago. Bargaining power is still largely on the side of employers, but the

picture is changing fairly quickly.



Public sector wage rates were in a 0.7 to 2 percent annual range, with higher wage increases evident for electricity, gas and water, and for health care. The lowest annual increase was for public administration and this is where government spending cuts are likely to be more acute.

By occupation, private sector wage annual wage movements were in a -0.2 percent to 2.9 percent range. Higher wages increases were evident in the primary and manufacturing sectors and in the technical services areas. Annual wage movements were respectable in retail (up 1.6 percent y/y), but the anaemic 0.2 percent quarterly increase for March suggests the difficult retail environment is affecting wages. Construction sector LCI wage inflation (at 1.8 percent y/y) is contained for now, but rising.

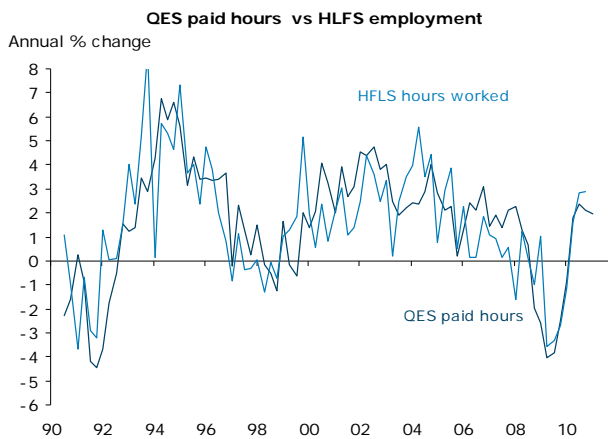
Inflation from the government sector provided mixed signals. Salary and wage rates from the local government sector are outpacing the private sector at 2.1 percent y/y, but the tight fiscal rein is being increasingly reflected in low central government wage growth (+0.5 percent q/q, +1.3 percent y/y).

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Statistics NZ assets there was no material impact on the March 2011 quarter LCI from the Christchurch earthquake on 22 February. The response rate for pay rates collected from Christchurch respondents was lower than usual (84 percent versus 96 percent in the March 2010 quarter). The usual treatment for missing pay rates in the current quarter is to use the last reported pay rate, but the March LCI pay rate movements for responding businesses were used to bring the Christchurch response rate up to its usual level.

QES

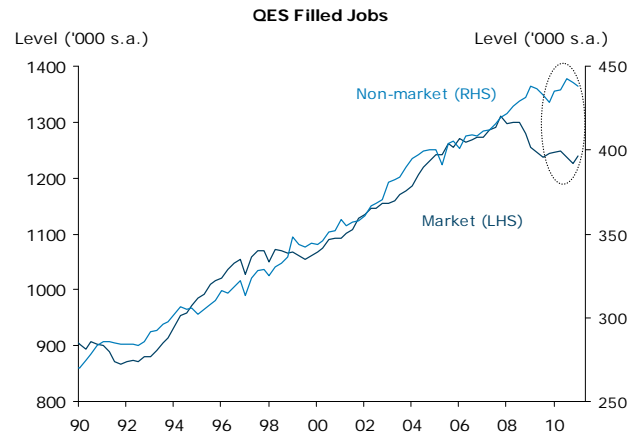
On Thursday all eyes will be on HLFS employment. Usually QES filled jobs give a (very) rough steer on this. However, this time round, the QES survey was completed just prior to the February 22 earthquake, whereas adjustments will need to be made to the HLFS because of survey issues to do with the quake. It would therefore be very risky to read too much into the 0.7 percent rise in paid hours, or the 0.6 percent increase in filled jobs, as HLFS indicators. QES measures for employment remain considerably below mid 2008 peaks (2.9 percent lower for QES filled jobs and 1.6 percent lower for QES paid hours).



Filled jobs in the market sector staged a 1.0 percent seasonally adjusted increase for March, whereas non-market filled jobs fell 0.6 percent. Paid hours showed a similar pattern. Market sector paid hours increased 1.2 percent (s.a.) but non-market paid hours declined 0.6 percent seasonally adjusted.

Our seasonally adjusted estimates of filled jobs show sector differences, with strong quarterly increases for construction (up 4.3 percent), forestry and mining (up 3.2 percent), real estate services (up 4 percent), and wholesale trade (up 3.3

percent). The labour market picture remains mixed, with sizeable declines in filled jobs for retail (down 0.9 percent q/q), and transport (down 2.8 percent q/q). Manufacturing filled job levels were virtually static.



However, the QES suggests a more employment-rich recovery may be in prospect. With paid hours per employee now above historical average, with increasing demand for labour is now likely to be met from more employment.

On another positive note, the climb in average hourly earnings produced a 4.6 percent annual increase in gross earnings. With the October 2010 tax cuts, annual after tax earnings growth has in effect been even stronger. While the process of household balance sheet repair has some way to run, wage earners may soon start to convert some of their additional earnings into spending.

IMPLICATIONS

Today's labour market outturns suggest the labour market was steadily strengthening prior to the February earthquake. We believe the quake will provide only a temporary blip in the trend. Due partly to the recovery, but mostly due to strange seasonality of late causing a strong see-saw pattern in the data, there is a good chance that the unemployment rate could come in lower than our below-consensus forecast of 6.5 percent. It could in fact be a blinder. But if so, some of it will be statistical noise that overstates the fundamental condition of the labour market.

The RBNZ will be broadly comfortable with the moderate wage backdrop. Wage growth typically lags the economic cycle, so relatively low rates of wage inflation at this juncture are of little

DATA REVIEW

surprise, with LCI annual wage inflation still tracking along at moderate levels.

The RBNZ remain comfortable that the spike in consumer price inflation will not spill into higher wages. So far so good, but wage data will need to be closely watched over the coming year or two. **Annual CPI inflation is set to peak at a time when the demand for labour is improving.** With skill shortage measures in the QSBO moving up, and a risk of more permanent and long-term (PLT) departures to Australia, the risk is that upward wage inflation pressures could emerge much sooner than generally anticipated. We still expect the improving economic and labour market outlook and concerns over inflation will prompt the RBNZ to start removing the March insurance cut, starting with a 25 basis point increase at the December MPS.

IMMEDIATE MARKET REACTION

The wage data was weaker than market expectations, which saw wholesale interest rates and the NZD ease slightly.

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