NEW ZEALAND ECONOMICS

Labour Cost Index and Quarterly Employment Survey – September 2010 quarter

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WAGE GROWTH CONTAINED BUT ONE TO WATCH

KEY POINTS

- **Today's data showed a larger than expected increase in wage inflation, but the overall increase remains modest. This is not yet of concern to the Reserve Bank.**

- LCI private sector wage inflation (excluding overtime) rose by 0.6 percent (1.6 percent y/y) in the September quarter. The unadjusted LCI rose by 1.3 percent (3.4 percent y/y). This is not the preferred measure, but the pick-up in this series is worth noting.

- **Public sector ordinary time LCI wage growth has finally dropped below the private sector,** increasing by only 0.3 percent in the September quarter (1.3 percent y/y).

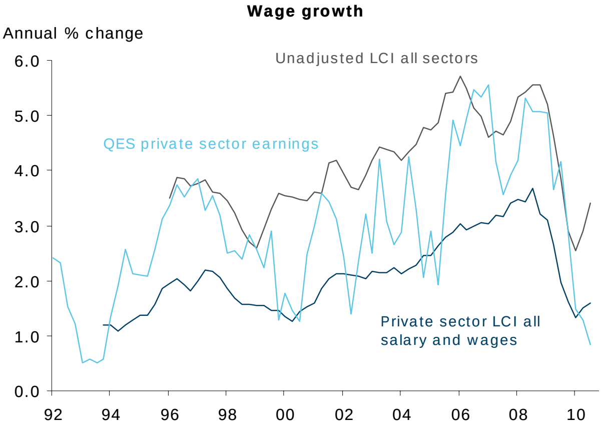
- In seasonally adjusted terms, paid hours in the QES increased by 0.2 percent, whereas filled jobs fell by 0.4 percent in the September quarter. Although the correlation is loose, **this suggests Q3 employment readings from the HLFS may be weaker than we thought.** It also suggests some potential weakness in Q3 services GDP.

	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	1.0	4.3	-0.1	2.5
Jun-08	0.8	3.5	2.1	5.4	0.2	1.5
Sep-08	1.1	3.7	1.0	5.1	-0.6	0.8
Dec-08	0.7	3.2	0.8	5.0	-1.5	-2.0
Mar-09	0.5	3.0	1.1	5.1	-0.6	-2.4
Jun-09	0.3	2.6	0.8	3.7	-1.4	-3.9
Sep-09	0.4	1.9	1.7	4.4	0.3	-3.0
Dec-09	0.3	1.5	-0.4	3.1	-0.1	-1.7
Mar-10	0.3	1.3	-0.4	1.6	1.1	0.0
Jun-10	0.4	1.4	0.6	1.4	1.2	2.5
Sep-10	**0.6**	**1.6**	**1.0**	**0.7**	**0.2**	**2.3**
ANZ	**0.4**	**1.4**	**1.0**	**1.8**	**-**	**-**
Market	0.4	1.4	0.7	1.5	-	-

DATA REVIEW

DATA WRAP

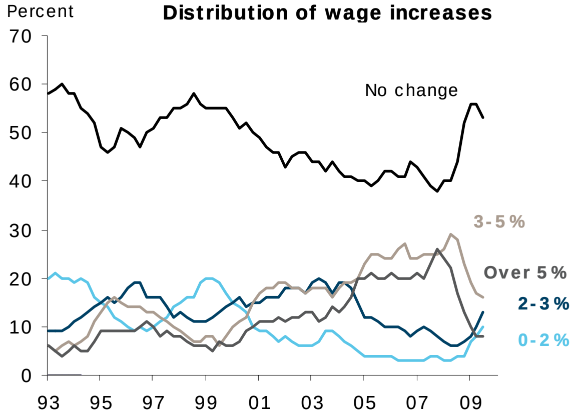
LCI private sector wage inflation (excluding overtime) rose by 0.6 percent (1.6 percent for the September 2010 year). This was stronger than the market consensus and our expectation of a 0.4 percent increase. Public sector wage rates increased by a more moderate 0.3 percent, with annual wage inflation on this measure, at 1.3 percent, the lowest since the June 1999 year. Despite the stronger than expected outturn, wage measures were generally contained.



Sources: ANZ, National Bank, Statistics NZ

Private sector ordinary time hourly earnings from the QES rose by 1.0 percent in September, to their lowest annual increase since September 2000 (+0.7 percent). **However, 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 1.3 percent quarterly increase, with the annual rate of wage inflation jumping up to 3.4 percent. This was the largest quarterly increase since the December 2008 quarter, when the unemployment rate was still at 4.6 percent and employers had been struggling to find staff over the preceding few years.

The distribution of annual increases from the LCI did not highlight a broad based strengthening in wage pressure. In fact, the portion of pay increases greater than 3 percent (22 percent of the total in the September 2010 year) is the lowest it has been since June 2001. What has been apparent, however, has been the growing proportion of survey salary and wage rates obtaining increases in the 2 to 3 percent range. With more than 50 percent of jobs not receiving a wage increase in the September quarter bargaining power is still weighed towards employers.



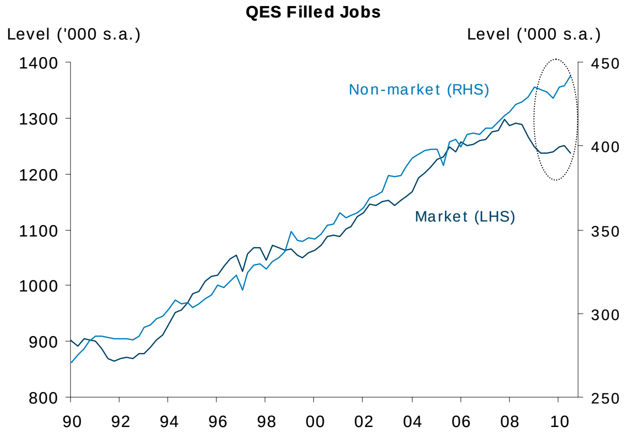
Source: ANZ, National Bank, Statistics New Zealand

However, there still appear to be pockets of strength. Across the occupation groups reported in the LCI, annual increases ranged from 0.6 percent (for forestry and logging) to 2.4 percent (for professional, scientific and technical services). Most of the occupation groups reporting higher wage increases were in the mining, wholesaling and manufacturing sectors, and it was of interest to see wage increases in central government administration at the lower end of the scale.

An important focus leading up to Thursday's HLFS will be September quarter employment. On this front the 0.4 percent seasonally adjusted fall in QES filled jobs in September was weaker than we had expected. The correlation between quarterly movements in employment from the HLFS and QES measures is not particularly tight (correlation coefficient of 0.55) but at face value it suggests some downside risk to our 0.5 percent pick for quarterly HLFS employment. QES measures for employment remain considerably below mid 2008 peaks (2.0 percent lower for QES filled jobs and 1.3 percent lower for QES paid hours).

Filled jobs by sector show a fairly weak picture. Market sector filled jobs declined by 1.0 percent, with much of the weakness evident in filled jobs for domestic-orientated sectors. Filled jobs and paid hours in the services sector were mixed, although the 0.2 percent fall in business services paid hours point to a flat outturn for Q3 real estate and business services value added, which accounts for 15 percent of GDP.

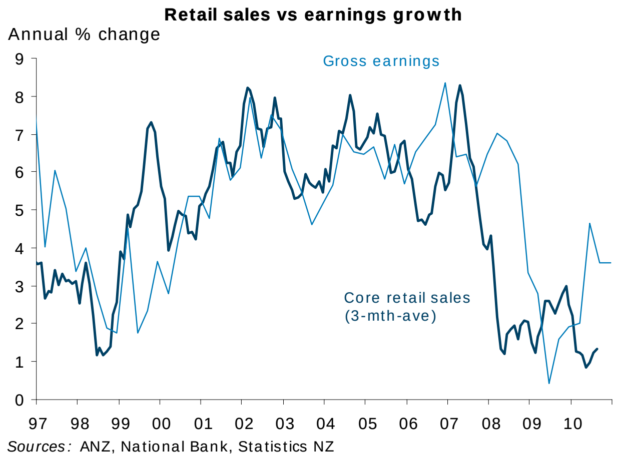
DATA REVIEW



Sources: ANZ, National Bank, Statistics NZ

The dependence of employment on government spending remains evident with filled jobs from the non-market sector increasing by 1.3 percent, even if wage growth has eased off. Increasing healthcare employment (up 1.5 percent) and more employment in public administration (up 2.9 percent) accounted for the bulk of this.

Of some concern for the rebalancing of the economy was a further drop in filled jobs for export orientated firms (-0.5 percent q/q), with employment in this sector now 15 percent below June 2008 levels.



Sources: ANZ, National Bank, Statistics NZ

On a more promising note, the climb in average hourly earnings produced a 0.8 percent increase in gross earnings, which were 3.6 percent higher than a year ago. It highlights a reasonable recovery in labour income growth. On the face of it, this suggests we could see a pick-up in consumer spending and housing market activity towards year end and into next year. However, the more likely scenario is that households will use most of the increased income to continue paying down debt.

IMPLICATIONS

Today's labour market outturns suggest a softer than expected HLFS outturn for Thursday. It also suggests that Q3 GDP could be weaker than our 0.5 percent pick, though we will wait for more partial data before making any revision. However, the increase in hours paid per employee signals that we will continue to see a cyclical recovery in average hours towards historical averages. At the very least, the rise in labour incomes will allow households to speed up the deleveraging process if they choose not to spend it.

The RBNZ will be broadly comfortable with the benign wage backdrop. However, the sharp pick-up in the unadjusted LCI is worth keeping an eye on. This is not the preferred measure, but can sometimes give a lead on turning points. The RBNZ is assuming that the coming spike in consumer price inflation will not spill into higher wages. So far so good, but wage data will be of heightened importance over the coming year or two. With skill shortage measures in the QSBO moving up and permanent and long-term (PLT) departures to Australia remaining high, the risk is that upward wage inflation pressures could emerge much sooner than initially thought.

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