

Labour Cost Index and Quarterly Employment Survey: June 2008

Key points

- > **Wage inflation still elevated and showing typical late cycle persistence to a previous tight labour market.**
- > **QES employment gauges such as paid hours and filled jobs rebounded slightly, but off a weak Q1.**
- > **Given the loose correlation between the QES and HLFs, we are comfortable sticking with our expectations of HLFs employment growth of 0.2 percent and an increase in the unemployment rate to 3.8 percent.**

Assessment

Wage inflation remains solid. The LCI measure of private sector ordinary time wage inflation rose by 0.8 percent in the June quarter, leaving annual growth unchanged at a record high 3.5 percent. Mining (up 5.3 percent), health and community services (5.1 percent) and finance and insurance (4.9 percent) experienced the largest wage increases in the year to June. The former is likely to be a result of some spill-over from the mining boom in Australia. Public sector wage growth only rose by 0.6 percent in the quarter. However, annual growth has increased to 3.7 percent, with strong contributions coming from the local government sector (up 4.5 percent). This is likely to continue to put upward pressure on private sector wages in the coming quarters as relativity adjustments are demanded. For completeness, the unadjusted LCI, which does not adjust for productivity improvements like the headline LCI does, rose by 1.2 percent in the June quarter, keeping annual growth at 5.5 percent. The more volatile (and less reliable) QES wage measure rose by 2.0 percent for the quarter and 5.4 percent for the year.

It is too early to see wage growth slow in response to the turn in the economic cycle.

Wages are typically one of the last indicators to turn and are showing classic late-cycle persistence. As a result, we are not reading too much into the strength in today's numbers. However, we do note that a number of respondents reported cost of living adjustments as a key reason for wage increases in the quarter and this will be of some concern to the RBNZ. Although it is to be expected to a degree, the RBNZ will not want this behaviour to become fully entrenched. It remains a key area to watch.

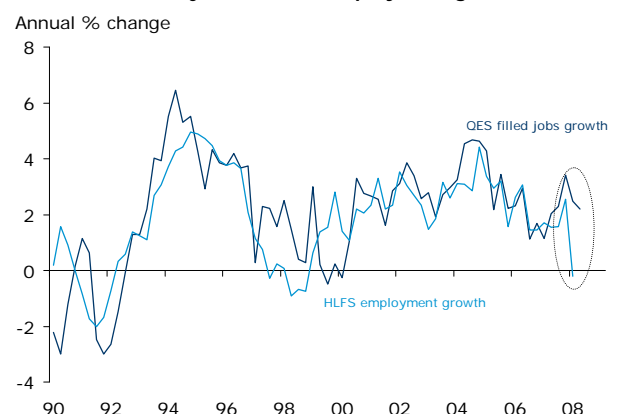
But we suspect wage inflation is close to peaking.

It is still possible that we see further gains in wage inflation over the coming quarters, particularly for industries with widely reported skill shortages such as health and IT. Nevertheless, we are of the view that wage inflation is at, or very close to, their peaks, and is set to ease towards the end of this year. Particularly now that firms are reporting less difficulty

in finding staff and also as the unemployment rate rises, providing less bargaining power to employees. There is also the reality that the pressures on business margins will not enable firms to pay the increases seen in recent years.

	LCI private sector ordinary		QES private sector ordinary		QES paid hours	
	q/q	y/y	q/q	y/y	q/q	y/y
Jun-06	0.6	3.0	2.3	4.9	0.9	3.2
Sep-06	0.8	2.9	1.9	5.4	0.8	2.9
Dec-06	0.9	3.1	0.6	5.5	0.5	3.7
Mar-07	0.7	3.0	0.7	5.5	-0.1	2.1
Jun-07	0.7	3.1	1.0	4.2	1.4	2.6
Sep-07	0.9	3.3	1.3	3.7	0.3	2.1
Dec-07	1.1	3.5	0.9	4.0	1.2	2.8
Mar-08	0.7	3.5	1.1	4.4	0.0	2.9
Jun-08	0.8	3.5	2.0	5.4	0.5	2.0
ANZ	0.8	3.6	1.5	4.9	-	-
Market	0.8	3.6	1.1	4.5	-	-

QEF filled jobs vs HLFs employment growth



Sources: ANZ National, Statistics NZ

QES employment gauges rebounded from weak March quarter readings.

Seasonally adjusted paid hours rose by 0.5 percent following a flat result in March, while filled jobs (not seasonally adjusted) rebounded 1.7 percent following the 2.4 percent decline in Q1. Our seasonally adjusted estimates of filled jobs show a more muted 0.6 percent increase,

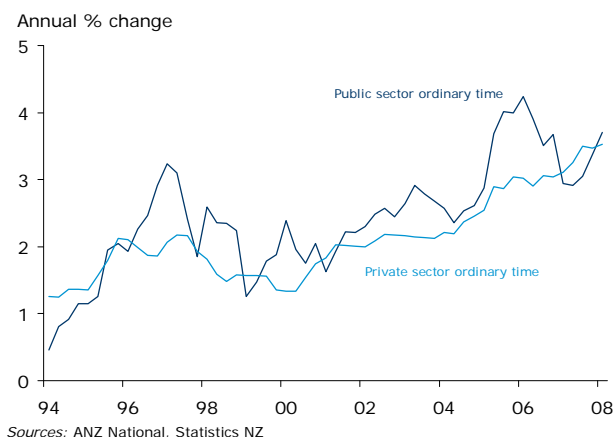
consistent with the rebound in HLFS employment growth that we are looking for in the June quarter, following the 1.3 percent fall in March. Looking at the paid hours series for the finance, insurance, property and business services sectors, sharp declines in the quarter points to weakness (contraction) in services GDP for Q2.

Late cycle support still exists, but is slowly reducing. The fact that total gross earnings rose by 1.8 percent in the quarter and 7.4 percent from a year ago shows that the labour market is still providing some support to households. However, with annual inflation now running at 4.0 percent (which doesn't include debt servicing costs) and Thursday's HLFS report to confirm that the labour market has turned, these income gains are increasingly being whittled away. There is also further evidence of the rebalancing underway in the economy from the spending to the earnings side of the economy. Annual filled jobs growth for construction has slowed to just 0.1 percent and is down 4.6 percent for retail. However, manufacturing filled jobs growth has risen to 3.9 percent after shedding close to 20,000 jobs between 2004 and 2007.

Implications

There is nothing in today's data to stand in the way of the RBNZ continuing to cut rates this year. While elevated inflation expectations still poses the risk of seeping into wage and therefore price setting behaviour, on balance the RBNZ's judgement that the weak growth environment will limit the extent of future wage increases remains.

Private and public sector LCI wage growth



Sources: ANZ National, Statistics NZ

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