

## HOUSEHOLD LABOUR FORCE SURVEY – DECEMBER 2006

### Key points

- The Q4 HLFS employment report was mixed, with employment growth down 0.1 percent but the unemployment rate also dropping to 3.7 percent, courtesy of a surprising fall in the labour force participation rate.
- Full-time employment was down 0.2 percent, underemployment rose sharply, but there was a large increase in part-time growth of 1.3 percent, and hours worked were up 0.5 percent.
- Today's data muddies the water for the Reserve Bank's March decision. Our bias after Monday's wage report was towards a hike. But given soft demand for labour, the HLFS report does not deliver a smoking gun although two sides can be taken when looking at the data.
- For now we will remain on a prickly fence maintaining a no-change view. Yet it's a position we feel we have to take. Justifying a late cycle hike needs overwhelming evidence.
- Next key data will be the National Bank *Business Outlook*, due on 28 February. The Reserve Bank will be watching this closely for any signs of a continued acceleration in momentum early this year.

### The headlines

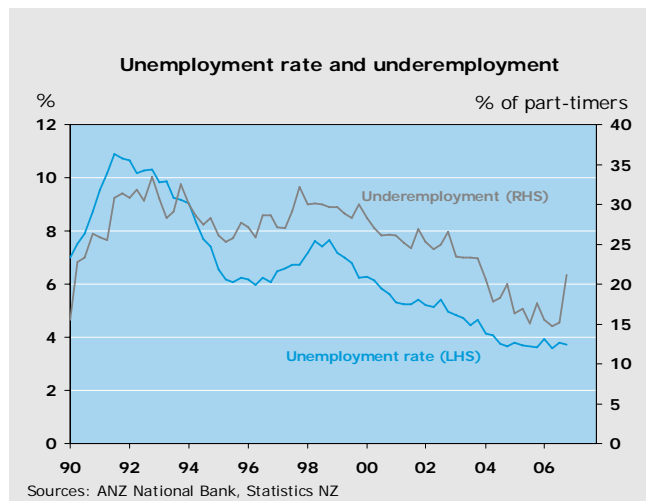
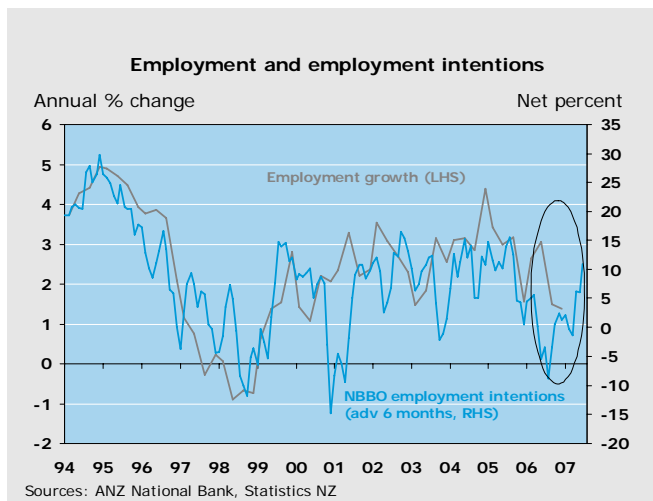
	Actual	ANZ National	Market
Employment growth	-0.1% q/q 1.4% y/y	0.2% q/q 1.8% y/y	0.3% q/q 1.9% y/y
Participation rate (s.a.)	67.9%	68.1%	68.4%
Unemployment rate (s.a.)	3.7%	3.8%	3.8%

- **Employment growth fell by 0.1 percent in Q4, but a drop in the participation rate resulted in the unemployment rate falling to 3.7 percent.** The fall in employment growth follows a 0.5 percent fall in Q3 and takes annual growth to 1.4 percent. This was wholly driven by a 0.9 percent fall in female employment. It appears those females also left the labour force entirely as a fall in the female participation rate saw the total participation rate drop to 67.9 percent from 68.2 percent in Q3. These movements resulted in the unemployment rate dropping slightly to 3.7 percent, the second lowest level in this survey's history, from 3.8 percent in Q3.
- **Full-time employment fell 0.2 percent while part-time employment rose 1.3 percent.**
- **Under-employment is the highest in three years, rising to 21.1 percent of part-time workers.** Underemployment measures the number of part-time workers who would like to work more hours and it rose to a three year high in Q4 from 15.1 percent in Q3 and 17.6 percent in Q4 of 2005. The significant rise in under-employment suggests that demand for labour may not be as strong as what the employment intention surveys are showing.
- **The regional and industrial trends remain mixed.** Employment growth in the construction industries continues to grow considerably with annual growth of 15.6 percent, while the communication services industries also recorded strong annual growth in December. The agriculture and manufacturing industries recorded falls in employment growth (down 2.8 percent and 3.3 percent respectively). The upper North Island excluding Auckland recorded large falls in unemployment, while the lower North Island experienced large increases in unemployment. The Auckland region and the South Island's unemployment rates remained largely unchanged.

### Assessment and implications

- **The HLFS data was a mixed bag, with something for everybody.** The unemployment rate fell to 3.7 percent from 3.8 percent. However, employment growth was weak, down 0.1 percent in the quarter, following a 0.5 percent fall in Q3. The trend employment growth rate fell 0.3 percent, following a 0.1 percent decline in Q3. Full-time employment fell 0.2 percent, though this was offset by a 1.3 percent increase in part-time employment.

- While on the surface, the fall in the unemployment rate suggests that the labour market remains tight, it is not at all conclusive to us that the labour market is actually strengthening.** Employment growth fell in the second half of 2006 and underemployment (a measure of the number of part-timers who would like to work more hours) as a percent of part-timers jumped from 15.1 percent in Q3 to 21.1 percent in Q4. The slight decline in the unemployment rate was driven by females withdrawing from the labour force, causing the participation rate to decline from 68.2 percent to 67.9 percent. Most of the loss in employment came from full-time females, who rather than stay in the labour force, chose to instead leave it.
- Given the low numbers of people unemployed, small changes to the participation rate can have a large effect.** For example, if the participation rate were just 0.1 percentage point higher at 68 percent (given unchanged employment growth), the unemployment rate would have gone up to 3.9 percent. Conversely, a 0.1 percentage point fall in the participation rate would have seen the unemployment rate fall to 3.6 percent.
- Today's data muddies the water for the Reserve Bank.** Against a backdrop of rising wage inflation, it does not provide conclusive evidence of an accelerating labour market. The demand for labour was simply not that strong towards the end of last year. Yet it certainly points to continued capacity constraints, and likely pressure on wage inflation as seen in the labour cost index earlier in the week. While the bias at this stage is certainly pointing towards a hike from the Reserve Bank – and tactically we suspect the Reserve Bank is backed into a corner – we struggle to justify a late cycle tightening given the lack of consistent evidence pointing towards sustained momentum in the economy. Although confidence gauges have rebounded strongly, the run of data has been mixed. At this stage in the economic and monetary policy cycle, there is a risk of pushing the economy over the edge if interest rates are hiked further, and this is something the Reserve Bank will be very mindful of at their March assessment. There is no point hiking once, and 50 basis points at this juncture seem extreme when looking beyond the housing market. The National Bank *Business Outlook* will be a key piece of data to watch in assessing how sustained and broad the strength in the economy has remained into Q1 2007.
- For now, we are sticking to our no-change view. We see little value joining the hordes calling a hike when the decision, in our eyes, remains likely to be finely balanced.** Certainly the strong wage inflation number will raise a red flag at the Reserve Bank. But a key theme running through our minds at present is that the market became too bearish on economic prospects (dovish rates) in early 2006, and the reciprocal seems to be occurring in 2007.



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