28 January 2011

Westpac Institutional Bank

Calmer waters?

Preview of 2010Q4 employment data (3 Feb) and wage data (1 Feb)

- **Recent labour market data have been unusually volatile. Looking through the noise, indicators point to a further modest improvement in the December quarter.**
- **Labour market conditions should continue to pick up over 2011 as the economy emerges from its soft patch.**

December quarter Household Labour Force Survey expectations

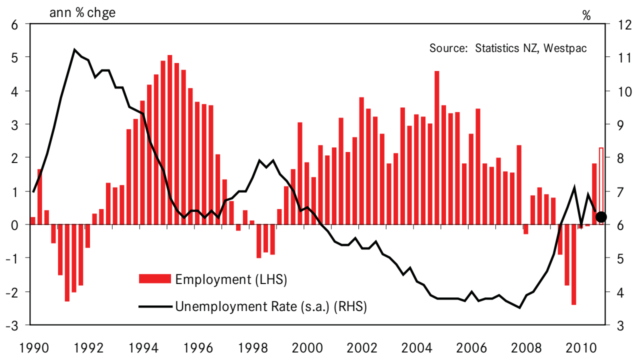
	Quarterly % change		Annual
	Previous	**Westpac**	**Westpac**
Employment growth	1.0	0.5	2.3
Unemployment Rate %	6.4	6.2	
Hours worked %	0.8	0.4	3.3
Participation Rate %	68.3	68.3	

The Household Labour Force survey has seen some wild gyrations over the past year, with the unemployment rate see-sawing between 7.1% (in December), 6% (in March) and 6.9% (in June), before easing back to 6.4% in September.

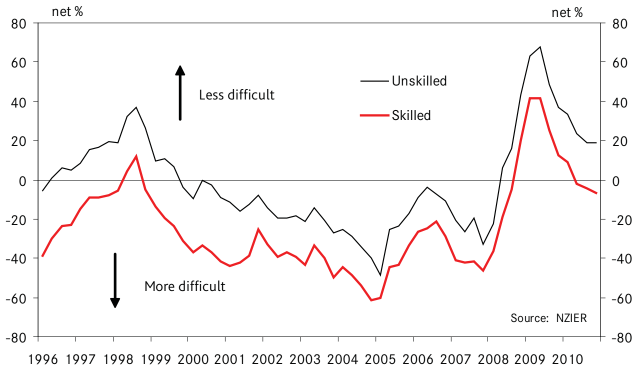
Since then the indicators – most notably, a further improvement in firms' surveyed employment intentions – have been pointing to employment growth around 0.5% in the December quarter and, assuming no change in labour force participation, a further slight decline in the unemployment rate. (The market is a little more pessimistic than we are, picking 0.2% employment growth and a flat unemployment rate.)

Of course, the employment figures are volatile at the best of times and if recent history is anything to go by what the headline number will be on the day is anyone's guess. We tend to have a little more confidence in our unemployment forecasts, given that swings in employment growth tend to be offset by similar movements in labour force participation (a measured spike in employment coincides with a measured spike in people lining up for work). We suspect the March 2010 unemployment number was a rogue result (possibly caused by unusual seasonal movements during the months when summer jobs normally end). Of course, the December

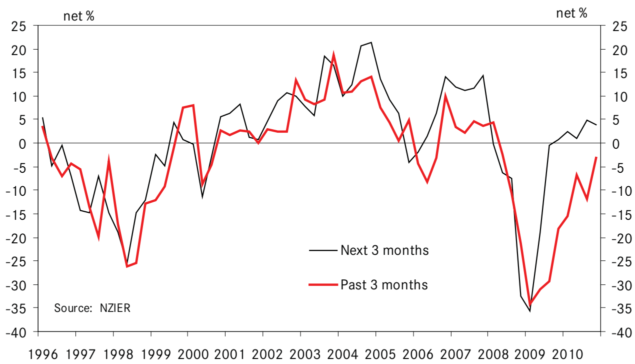
Household Labour Force Survey



Firms' difficulty of finding labour



Employment intentions



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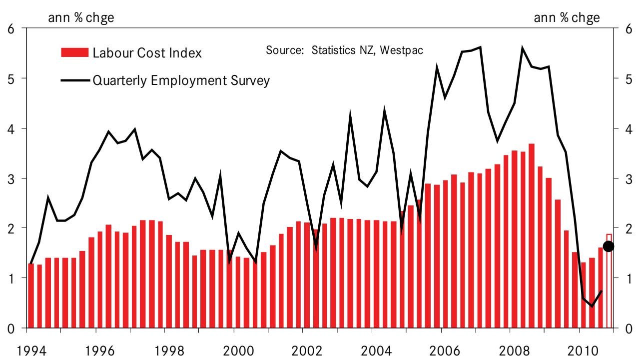
quarter is when all the summer jobs usually start, and trying to adjust for that could throw the employment around again this time. What was unusual last March was that we didn't see the same pattern in labour force participation, and so the volatility passed through to the unemployment rate.

Looking at a broader range of data, there have been some signs of a slowdown in the labour market around the middle of the year in keeping with the broader weakness in the economy at that time. For example, seasonally-adjusted filled jobs from the QES (an alternative, employer-based measure of employment with its own volatility, coverage and measurement issues) softened a little in September, the part-time share of workers nudged up, and so did the share of part-time workers who are 'underemployed'. Overall, though, the picture is of a labour market that troughed early last year and should continue on a gradual trend of improvement over 2011. Employment is up since the start of the year, hours worked have been increasing over the past three quarters, and alternative indicators of labour market slack (such as firms' reported ease of finding labour) have also improved.

December quarter wage expectations

	Quarterly % change		Annual
	Previous	**Westpac**	**Westpac**
LCI – All sectors ex overtime	0.5	0.5	1.7
LCI – Pvt sector ex overtime	0.6	0.6	1.9
QES wages – All sectors	1.0	0.6	2.0
QES wages – Pvt sector	1.0	0.5	1.6

Private Sector Earnings and Labour Costs



A gradual dissipation in economic, and specifically labour-related, spare capacity should make itself felt in a slow grind upwards in wage inflation. There is still substantial slack in the economy – the aforementioned ease of finding labour remains above historical averages – and wage inflation has been very subdued over the past year (the QES more so than the Labour Cost Index because it does not strip out performance-based pay increases or changes in the jobs mix over the cycle). But on an annual basis wage growth appears to have bottomed out. We expect a further slight improvement in annual wage inflation in the December quarter. Our forecast of around 0.5% quarterly wage inflation (in line with the market for the LCI, a bit stronger for the QES measure) is dragged down somewhat by seasonal factors (neither the LCI or QES wage are officially seasonally adjusted, and pay rises are typically concentrated in the September quarter). We do not expect significant GST-related wage increases.

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