Westpac Institutional Bank

The start of a trend?

Preview of 2012Q1 employment data (3 May) and wage data (1 May)

- **We expect the unemployment rate to edge down modestly to 6.2%, and wage inflation to remain fairly subdued.**
- **We expect a statistical bounce in employment growth.**
- **Our forecasts are close to both market and RBNZ expectations. However, large and market-moving surprises are possible on either side.**

March quarter Household Labour Force Survey expectations

	Quarterly % change			Annual
	Previous	Westpac	Market	Westpac
Employment growth %	0.1	0.5	0.4	0.9
Unemployment Rate %	6.3	6.2	6.3	
Hours worked %	-1.4	0.8		1.6
Participation Rate %	68.2	68.3	68.3	

March quarter wage expectations

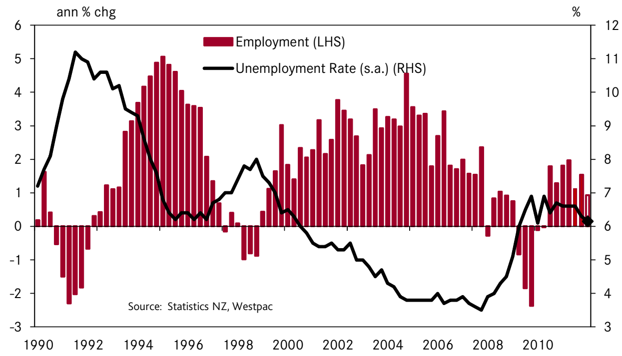
	Quarterly % change			Annual
	Previous	Westpac	Market	Westpac
LCI – All sectors ex overtime	0.6	0.4		2.1
LCI – Pvt sector ex overtime	0.7	0.5	0.5	2.1
LCI – Pvt sector inc overtime	0.7	0.4		1.9
QES wages – Pvt sector	0.0	0.7	0.5	3.2

December's labour market report gave mixed signals: the unemployment rate fell for the first time in three quarters, but growth in jobs and hours worked was very weak. Overall the labour market still looks soft, and we expect only a modest further decline in the unemployment rate in the March quarter, to 6.2%. Certainly that's the message coming from business and consumer surveys, as well as our expectation for still fairly modest economic growth. With unemployment still well above average, we expect wage growth to remain subdued as well.

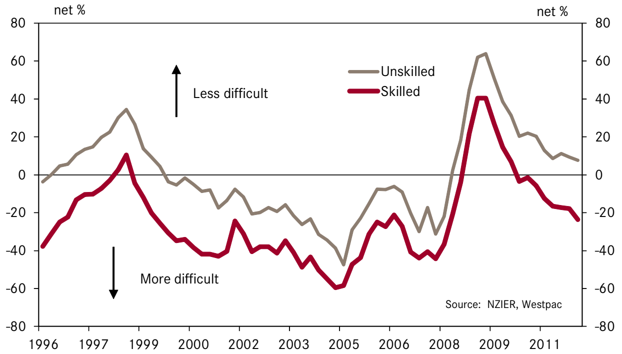
As always there are risks on either side. Given the small changes we're talking about, rounding could easily tip us back into 6.3%. We could also see a higher print if the December fall in unemployment was a statistical blip – a possibility we seriously considered (though as we explain below, the unemployment rate is usually more trustworthy than other labour data, and it's not obvious why this time should be different). On the other hand, if we're genuinely at the start of an unemployment downtrend, this could be steeper than our preferred survey indicators suggest. That's happened in the past, notably after the early 1990s and late 1990s recessions. We don't think we're at that point yet, but it'll be something to watch in coming quarters.

For employment growth our pick, again based on survey evidence, is 0.5%, and we also expect a modest bounce in hours worked. As usual this comes with sizeable health warnings, due to sampling error and seasonal factors (particularly around the summer months). The good news is that swings in employment tend to be matched by swings in the labour force participation rate, leaving the unemployment rate relatively stable.

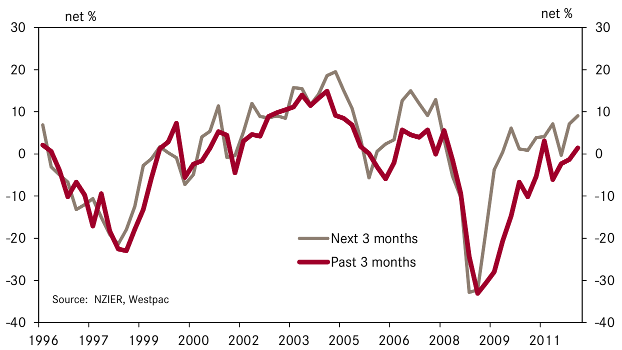
Household Labour Force Survey



Firm's difficulty in finding labour (s.a.)



Employment intentions (s.a.)



Employment and unemployment: the details

According to the NZIER business survey (on our seasonally adjusted estimates), hiring picked up slightly in the last three months. Combined with the statistical see-saw pattern of the employment data, that points to a modest bounce in jobs this quarter, to the tune of 0.5%.

The NZIER survey also showed an increase in the balance of firms reporting that skilled labour is getting harder to find. However, with a net 25% of firms reporting rising skill shortages, that balance is still far from spectacular by historical standards, and suggests only a modest decline in unemployment. On the employee side, households' perceptions of job opportunities have remained stubbornly downbeat, again suggesting little in the way of a fall in unemployment.

But is 6.3% a valid starting point? Our initial reaction to the December quarter unemployment print had been one of scepticism, given the pervasively gloomy tone of the rest of the Household Labour Force Survey, and some puzzling volatility in the female unemployment rate.

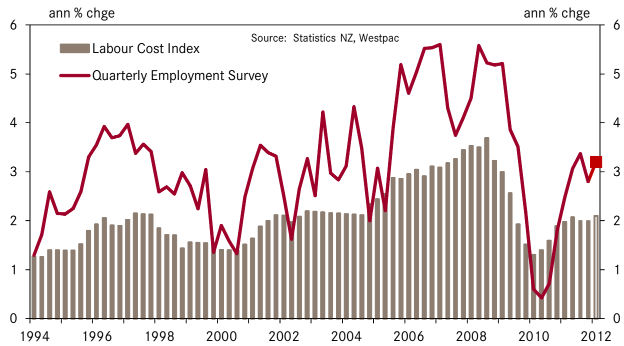
With the benefit of time we're more inclined to trust where the unemployment rate is currently sitting. Historical experience strongly argues in favour of giving the unemployment rate greater credence than employment growth or the participation rate, which are much more vulnerable to statistical wobbles. And while there were indeed some unusual movements in the female unemployment rate recently – it spiked in September before falling back in December – that doesn't by itself cast suspicion on the current level. The September spike could equally have been a rogue number.

Wages and earnings

An unemployment rate of 6.2% is still well above average, and so we expect wage growth to remain fairly subdued. None of the wage inflation measures are seasonally adjusted: our picks are at or slightly below the historical average for the quarter. As always, the measure of greater interest is the Labour Cost Index, which (unlike the Quarterly Employment Survey's average wage) isn't affected by things like changes in the job mix or promotions. For a while now public sector wage inflation has been lower than private, reflecting tougher conditions in the government sector, and we've assumed that continues.

When the Quarterly Employment Survey (QES) comes out on Tuesday, it will also give an advance read on labour market activity, in the form of full-time equivalent (FTE) employment and hours paid. We'll be looking at these with interest, but also a few caveats. Notably, like the NZIER business survey, the QES is employer-based and doesn't include the smallest businesses, and it can underestimate unemployment growth around economic downturns. QES employment fell a lot more steeply than HLFS employment in 2008-9, and was again weaker in late 2010/early 2011. That said, in the last two quarters the two have started to realign, with the QES measure picking up relatively more strongly.
Market implications

Private Sector Earnings and Labour Costs



Our forecasts are very close to the consensus and those of the RBNZ (which forecast an unemployment rate of 6.3% in its March MPS). An outcome in line with our expectations shouldn't generate much of a market response. That said, HLFS employment can be very volatile, and the unemployment can also move unexpectedly, prompting significant market reaction. We would expect the RBNZ to be relatively more sensitive to signs of an unexpectedly weak labour market, which would add to the run of recent evidence pushing it in the direction of holding the OCR low for longer.

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