7 August 2012

Westpac Institutional Bank

Pretty average

2012 Q2 Labour Cost Index and Quarterly Employment Survey

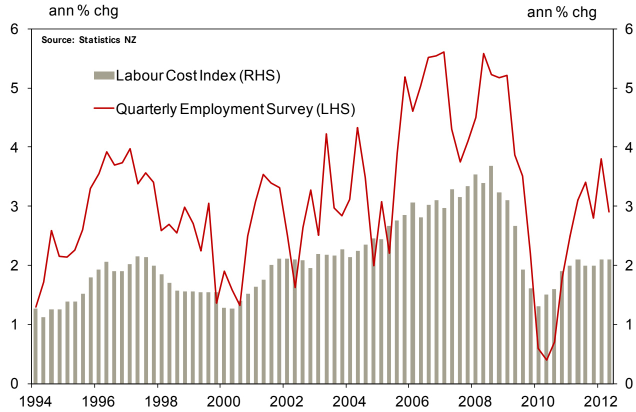
- **Wage inflation continues to track close to historical averages, as expected.**
- **The Canterbury construction sector continues to see strong wage inflation, but so far this has not spilled over to the wider economy.**
- **The Quarterly Employment Survey did show surprisingly strong increases in jobs and hours paid. While some of this is payback for a very weak March print, it suggests some upside risk to our (and the RBNZ's) view of the overall economy in the June quarter.**

Summary

Today's Labour Cost Index (LCI) report came in very much in line with both our and other economists' expectations, and suggests that wage pressures remain much the same as over the past year. If anything, wage growth in the domestic parts of the economy appears to have eased a little. There continues to be strong wage inflation in the Canterbury construction sector, but nationwide wage growth in the sector remains contained. All in all, today's wage reports are one more sign that there is little in the way of concerning inflation pressure about at present, and support the notion that the RBNZ will not hike the OCR until July 2013.

That said, the Quarterly Employment Survey's (QES) employment and activity data – particularly hours paid – came in surprisingly strong. We don't want to overstate the significance of this as an indicator for GDP growth, as the Quarterly Employment Survey is volatile and significantly underpredicted GDP growth in March. Even so, it does suggest fairly robust economic growth over the past half year – certainly stronger than the RBNZ was projecting in its June *Monetary Policy Statement*.

NZ LCI and QES wages (private sector ordinary time)



Wages

The Labour Cost Index (private sector, all salary and wage rates - the RBNZ's preferred measure) rose 0.5% in the March quarter, and was 2.1% higher than a year ago. This is close to historical averages for both annual wage inflation and for the March quarter print (the LCI isn't seasonally adjusted). The fact that for some time we've been seeing average wage inflation rates despite a stubbornly high unemployment rate raises uncomfortable questions about a skills mismatch – perhaps due to regional/occupational disparities reflecting the disruption from the Christchurch earthquakes. But that issue aside, the wage data are suggesting little cause for concern, having been pretty stable over the past year. There has also been little change in the

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Mar-12		Jun-12		Mar-12		Jun-12	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private Sector (ordinary time)	0.5	2.1	0.5	2.1	1.3	3.8	0.2	2.9
Public Sector (ordinary time)	0.4	1.6	0.3	1.6	2.8	3.9	-1.4	3.1
Total (ordinary time)	0.4	2.0	0.5	2.0	1.4	3.8	0.1	2.9
FTEs (s.a.)	-	-	-	-	0.2	1.1	1.1	2.0
Filled jobs (s.a.)	-	-	-	-	0.1	1.2	0.7	1.9
Paid Hours (s.a.)	-	-	-	-	-0.5	0.7	2.1	2.3

Source: Statistics NZ

distribution of wage increases, with 56% of the wages surveyed seeing increases over the past year (down from 57% in March), and the median increase remained at 3%.

The Quarterly Employment Survey's annual hourly earnings measure was much weaker than expected, with the private sector measure rising just 0.2% for the quarter, well below the historical June quarter average of 1.2%. However, QES wages have been particularly volatile recently, and to some extent we may be seeing payback from a surprisingly strong outturn in the March quarter. Certainly, this weak quarterly outturn brings annual QES wage inflation back from a very high 3.7% to 2.9%, just above December's 2.8% and more consistent with the general sense that wage inflation has been flat over the past year. More generally we don't regard this measure as particularly meaningful, as it's more volatile than the LCI and doesn't control for changes in job mix or productivity gains.

Employment and hours

The Quarterly Employment Survey also includes measures of jobs and hours paid, which can be informative in advance of Thursday's Household Labour Force Survey (HLFS) and also serve as an input to our GDP forecast (particularly the service sectors of the economy). Both were very strong indeed, with full-time equivalent (FTE) employment rising a seasonally adjusted 1.1% and hours paid up a whopping 2.1% - the highest quarterly increase since way back in 1997. This comes after a particularly soft March quarter outturn. However, a surprise of this magnitude still leaves hours paid 1.6% higher than six months ago, and suggests some upside risk to our forecast for 0.6% GDP growth in the June quarter.

That said, at this stage we're sticking with our forecast of a mild decline in the unemployment rate to 6.5% in Thursday's HLFS. Even if we gave full value to today's data, volatility in employment can be offset by movements in labour force participation, translating into a muted effect on the unemployment rate.

Regional and sectoral breakdown

The regional and sectoral split of the Quarterly Employment Survey's jobs and hours numbers confirms that to some extent this quarter's strong growth was a bounceback from a surprisingly weak March quarter. There was particularly strong jobs growth in Auckland (up 1.6% on our seasonally adjusted estimates, following on from a 1.7% fall), and in the construction, accommodation, health and real estate sectors (all of which saw big declines last quarter).

That said, there was also strong FTE employment growth in the Canterbury region (up 1%, after a small decline in March), and over the past six months, construction sector employment has risen 3%, only outstripped by the utilities sector. That suggests that construction in Christchurch is feeding through to jobs growth, albeit not yet in particularly smooth fashion. Hours paid also saw strong growth in the wholesale and retail trade, professional services, and health sectors.

However, this employment growth isn't yet feeding through to wage pressure in these sectors – certainly not in the construction sector. According to the LCI measure, annual wage inflation in the sector was 2.2% - down from 2.3% in the March quarter and only a little above the economy-wide average. Wage inflation in the Canterbury region remains significantly higher than in the rest of the country, reflecting the demands of earthquake reconstruction, but even here wage growth appears to have tailed off somewhat from last year (when it was perhaps harder to attract workers to the region).

Wage growth has picked up in the agricultural and manufacturing sectors – possibly reflecting the very strong production growth in agriculture and food processing earlier this year. By contrast wage inflation in the domestic economy generally remains soft. Wage growth in the public sector was unsurprisingly weak (central government wages grew just 1.0% over the past year), but the retail, education, and IT/media/communication sectors also saw wage growth below 2%. Wage growth also eased in the previously strong areas of real estate, professional services, and finance/insurance.

Market reaction

Yet another unsurprising headline LCI print meant there was no market response.

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