7 February 2012

Westpac Institutional Bank

No pressure yet

2011 Q4 Labour Cost Index and Quarterly Employment Survey

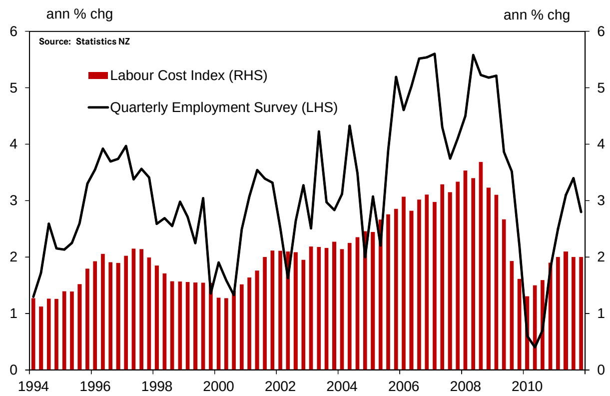
- **Wage growth was a bit stronger than expected but remains subdued.**
- **Wage growth in the construction sector continues to outstrip other sectors, particularly in Christchurch.**
- **The Quarterly Employment Survey is consistent with December quarter employment growth around 0.5%.**

Summary

Today's Labour Cost Index (LCI) report was a bit stronger than we or the market had expected. But the surprise wasn't huge, and the overall tone of the report suggested little in the way of upward momentum in wages late last year. The RBNZ has been assessing wage inflation as 'below average levels' and today's data won't prompt a major change to that view.

Within a still fairly soft overall labour market picture, some areas are firming, notably in the construction sector. Wage and jobs growth has also been above average in related areas such as real estate. This is consistent with the beginnings of Christchurch reconstruction – Statistics NZ continue to note construction sector wage pressures in the city are well above the rest of the country – and may also reflect signs of life in the housing market and residential building more generally. It's likely that

NZ LCI and QES wages (private sector ordinary time)



the housing market is starting to feel a boost from record low interest rates. While current subdued wage and inflation data give the RBNZ ample room to watch and wait as the European sovereign debt crisis plays out and the pace of the Christchurch rebuild picks up, by the end of this year we expect it to steadily remove that support.

The Quarterly Employment Survey's (QES) hours paid and jobs figures leave us comfortable with our picks for 0.4% GDP growth and 0.5% employment growth in the December quarter, though it's worth noting that the QES is a snapshot of the labour market

Table: LCI and QES Summary

	Labour Cost Index				Quarterly Employment Survey			
	Sep-11		Dec-11		Sep-11		Dec-11	
	qtrly	annual	qtrly	annual	qtrly	annual	qtrly	annual
Private sector (ordinary time)	0.5	2	0.7	2	1.3	3.4	0	2.8
Public sector (ordinary time)	0.6	1.8	0.4	1.8	0.9	2.8	0.9	3.4
Total (ordinary time)	0.6	2	0.6	2	1.2	3.2	0.1	2.8
FTE employment (s.a.)					0.2	0.5	0.6	2.1
Filled jobs (s.a.)					0.7	0.6	0.5	1.9
Paid hours (s.a.)					0.1	1.3	0.6	1.9

Source: Statistics NZ

For further information, questions or comments contact Dominick Stephens, Chief Economist, Ph: (64–9) 336 5671, email dominick_stephens@westpac.co.nz

taken in mid-November and as such won't capture any Rugby World Cup effects.

Wages

The Labour Cost Index (private sector all salary and wage rates - the Reserve Bank's preferred measure) rose 0.7% in the September quarter, above our and market expectations for an increase of 0.5%. This is a little above average for the December quarter (the LCI isn't seasonally adjusted) but it leaves annual private sector labour cost inflation up 2.0% on a year ago, unchanged from the September quarter and just a touch higher than at the end of 2010. Wage inflation has lifted from its early 2010 lows (when it sat at 1.3%) as inflation expectations have picked up and unemployment has fallen from its post-recession peaks. However, with the labour market still soft, wage growth remains well below the levels (high 2's and above) that we routinely saw in the 2005-2008 period.

The details of the report also didn't suggest a strong pickup in wage momentum. Public sector retrenchment and cost cutting remain a drag on overall wage growth. While private sector labour cost inflation was stronger than expected, public sector wages surprised on the downside, rising 0.4% in the quarter and 1.8% over the year.

Furthermore, both the distribution and size of wage increases were roughly unchanged from September. 57% of those surveyed saw salaries and wages increase over a year ago (up from 56% in the June survey) and the median pay increase remained at 3.0%. The proportion of those reporting wages increasing by more than 3% over the year rose a touch (from 25% to 26%) – still well below the more than 50% reporting wage rises of this magnitude back in 2008.

The Quarterly Employment Survey's annual hourly earnings measure was weaker than expected, with the private sector average wage staying flat over the quarter, whereas we'd expected a modest rise. However, as this measure of wage inflation doesn't control for changes in job mix or productivity gains, and is generally more volatile than the LCI, we don't regard it as a very informative indicator of evolving wage pressures.

Employment and hours

The Quarterly Employment Survey's measures of jobs and hours paid are of greater interest: the full-time equivalent (FTE) employment measure can be informative ahead of Thursday's Household Labour Force Survey (we prefer looking at FTE employment rather than filled jobs, as the FTE measure downweights part-time jobs which have the potential to double-count people holding multiple jobs), and QES paid hours feed into the December quarter GDP estimate. At this stage neither suggests a strong reason to change our 0.4% pick for GDP, and our 0.5% expectation for employment growth. (Today's measure of hours paid rose 0.6%, whereas we expect a decline in the HLFS hours worked, but this is likely a timing effect – back in September the reverse was true, with hours worked rising strongly and hours paid about flat.)

It's worth noting that both the September and December quarter QES were sampled outside of the Rugby World Cup – the September survey in mid-August and the December survey in mid-November. As such the QES jobs and hours numbers won't pick up any potential effects of the tournament on the labour market – certainly not in the December quarter. However, the sum of information we have to date – including weak part-time jobs growth in the Q3 HLFS, and little in the way of a lift in the labour components of the NZIER's quarterly business survey – suggest that the Cup left a fairly faint trace on employment patterns overall.

Regional and sectoral breakdown

While the labour market remains subdued in aggregate, there are signs in the QES of a pickup in hiring in the construction and broader real estate sectors after a long period in the doldrums, consistent both with the beginnings of Christchurch reconstruction late last year and signs of renewed life in the housing market. On our seasonally adjusted estimates FTE employment rose nearly 3% in the construction industry and 6.5% in the rental and real estate sectors. There was also above average jobs growth in finance and professional and technical services. By contrast employment growth remained soft in the retail sector, health and education, and arts and entertainment. That breakdown is also showing through in the LCI data. Annual wage inflation is now above 2% in the construction, real estate, finance and professional services sectors, whereas it remains more modest in sectors such as retail trade, education and the arts.

At this point construction sector wage inflation is not especially high overall, at 2.3%. However, some construction sector workers are already seeing significant increases, particularly in Christchurch. Statistics NZ noted that in Christchurch, nearly 60% of those in the construction sector saw wages increase over the year to December (vs 46% for New Zealand as a whole) and the average wage increase for those construction workers that saw increases was nearly 8% in Christchurch (as opposed to just under 5% nationwide).

Market reaction

Market reaction to a broadly unsurprising wage report was negligible.

Dominick Stephens, Chief Economist, Ph: (64–9) 336 5671
Felix Delbrück, Senior Economist, Ph: (64–9) 336 5668