

Stronger than it looks

December quarter 2014 labour market review

- Although unemployment unexpectedly rose in December, conditions in the labour market have actually remained firm.
- The increase in unemployment was due to increasing numbers of people entering the labour market, which has pushed labour force participation to a record high.
- Labour demand remained firm, with strong growth in numbers employed.
- While employment has been growing at a firm pace, wage inflation has remained soft, and is likely to remain so for some time.
- Overall, today's data is consistent with an economy that is growing at a firm pace, but with limited inflation, indicating that the RBNZ can remain on the side-lines for some time yet.

Unemployment unexpectedly increased...

The unemployment rate increased by more than expected in the December quarter, rising from 5.4% to 5.7% (in contrast to market expectations for a modest fall to 5.3%). But rather than reflecting weakness in the underlying economy, the increase in the unemployment rate is actually a symptom of New Zealand's strong economic outlook. This has encouraged more people to enter the labour force from both on- and off-shore, resulting in the labour force growing by a massive 76,000 people over the past year. We've also seen the participation rate rising to a record 69.7%, with particularly large increase in participation by younger workers, aged 15 to 25.

...but conditions in the labour market have actually remained firm...

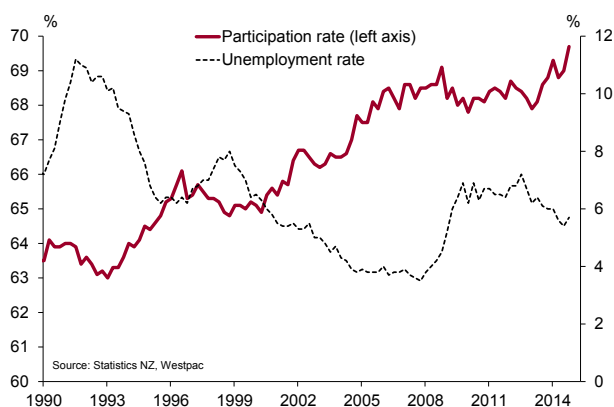
Looking at employment and labour demand gives us a clearer picture of what's happening in the economy, and highlights the strength of the domestic economy. The HLFS showed that the number of people employed rose by 1.2% in the December

	Quarterly actual		Quarterly expected		Annual
	2014 Q3	2014 Q4	Market	Westpac	2014 Q4
Household Labour Force Survey					
Unemployment rate (s.a.)	5.4	5.7	5.3	5.3	-
Employment (s.a.)	0.8	1.2	0.8	0.9	3.5
Participation rate (s.a.)	69	69.7	69.1	69.2	-
Quarterly Employment Survey					
FTE employment (s.a.)	0.5	0.6	-	0.5	3.3
Hours paid (s.a.)	0.1	0.7	-	0.9	3
Private ave hourly earnings, ord time	1.5	0.5	0.3	0.3	2.7
Labour Cost Index					
All sectors, ordinary time	0.5	0.5	-	0.5	1.7
Private sector, ordinary time	0.5	0.5	0.5	0.5	1.8
Private, all salary & wage rates	0.5	0.5	0.5	0.5	1.8

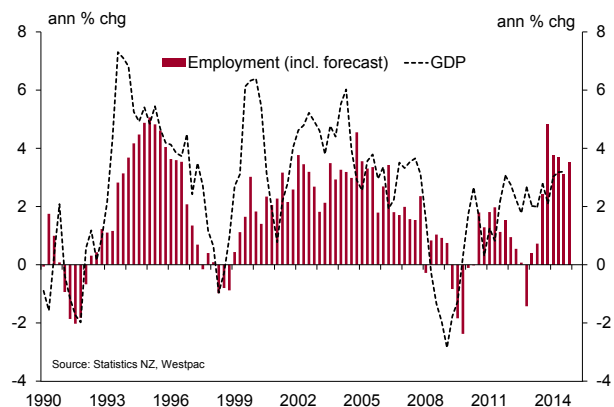
quarter, to be up 3.5% for the year. This resulted in the proportion of the population that is in employment rising to its highest level since 2008. Strength in the labour market was echoed in the employer-based Quarterly Employment Survey (QES) which showed the number of full-time equivalent employees rose 0.6% for the quarter, to be up 3.3% over the year. There was also solid growth in labour hours over the past year.

This strength in employment is consistent with the economy continuing to expand at a healthy pace. Looking across the economy, the construction sector continues to be a significant engine of jobs growth, with numbers employed in the sector rising by around 25,000 over the past year. There was also firm growth in the professional services, and government sectors. By region, jobs growth has been centred on Auckland, Waikato, Canterbury and the Bay of Plenty.

Labour force participation and unemployment



Employment and GDP



...with continued strength expected over the coming year

Looking forward, we may see some volatility in headline labour market figures over the coming quarters following the sharp

movements in the December quarter. In particular, some of the strong increases in participation at the end of 2014 may prove to be transitory (participation estimates are notoriously volatile, particular for younger workers), and this could swing estimates of the unemployment rate around a bit. However, the underlying outlook for the labour market is positive. Strong growth in domestic activity is expected over the coming year, and this will encourage continued gains in employment. Consistent with this, surveys of businesses' hiring intentions picked up in late 2014.

Wage inflation remains subdued...

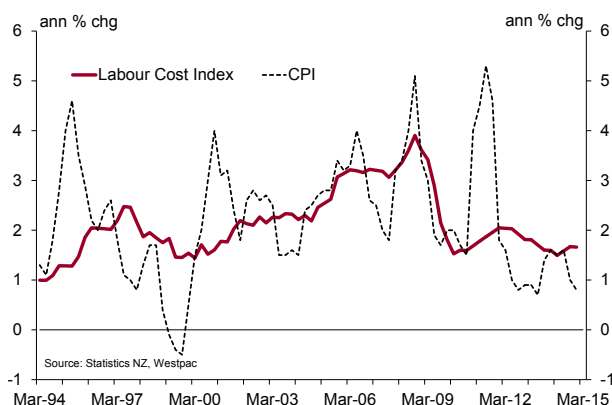
But despite solid growth in employment, wage inflation has remained stubbornly low. Our preferred measure of wage inflation, the private sector ordinary time Labour Cost Index, increased 0.5% to be up 1.8% for the year. Wage inflation has not shown any material pick-up since the financial crisis, and there has been particular softness in public sector wages.

...but households' purchasing power is increasing

As we've noted before, it's important to put current low wage inflation in context. During the mid-2000s when New Zealand had strong growth in nominal wage rates, we also had high rates of general inflation that eroded households' purchasing power. In recent years, while we've had low wage inflation, we've had even lower consumer price inflation. This has meant that cost of living adjustments to wages have been limited.

Looking at the broader QES measures of earnings, we see that in real terms (that is, adjusted for changes in purchasing power) households' average hourly earnings have risen by around 2% over the past year. Limited price increase for many goods and services, as well as outright declines in the prices of goods such as petrol, have effectively put money back in consumers' pockets. This helped support strong growth in spending in the final quarter of 2014.

LCI and CPI



RBNZ to remain on hold for time

Today's labour market data reinforces our expectations that the RBNZ will keep rates on hold for some time. Employment and GDP have been growing at a firm pace, and the outlook for both is positive. However, this has yet to generate significant inflation. This is giving the RBNZ time to wait and see how the economy responds to the significant forces that it is currently being buffeted by, including continuing volatility in the global economy and dry conditions domestically.

Market reaction

Despite the surprise on the headline unemployment rate, market reaction to today's data was limited. This is consistent with the underlying strength of the employment data, which helped to offset concerns about the lift in the unemployment rate.

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