

The wood for the trees

Q1 2016 labour market preview:

Wednesday 4 May, 10:45am

- Indications are that the labour market started the year in good health.
- We expect further growth in employment in the March quarter, albeit at a slightly slower pace than we saw in late 2015.
- However, the unemployment rate is forecast to edge higher following a surprisingly sharp fall in the December quarter, as growth in the labour force is expected to outpace jobs growth this quarter.
- Despite improving conditions, wage inflation is still expected to remain moderate against a backdrop of weak inflation, falling inflation expectations and strong growth in the labour force.

	Q4 Actual	Q1 Forecast	
	Quarter %	Quarter %	Annual %
Household Labour Force Survey			
Employment growth	0.9	0.6	1.2
Unemployment rate %	5.3	5.7	
Hours worked	1.0	0.6	1.3
Participation rate %	68.4	68.6	

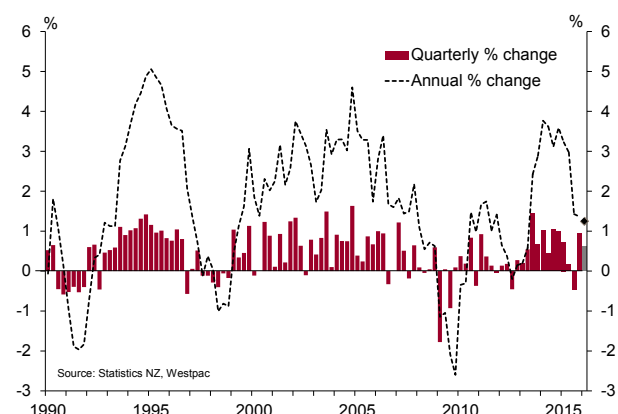
Quarterly Employment Survey			
FTE employment (s.a.)	1.1	0.5	1.7
Hours paid (s.a.)	1.4	0.6	2.4
Private avg hourly earnings	0.4	0.7	3.0

Labour Cost Index			
All sectors, ordinary time	0.4	0.4	1.7
Private sector, ordinary time	0.4	0.5	1.8
Private, all salary & wage rates	0.5	0.4	1.7

The labour market finished 2015 with a flourish as the unemployment rate plunged from 6% to 5.3% - its lowest rate since 2009. A key force behind the spectacular fall in the unemployment rate was a sharp drop in participation, which seemed at odds with the strong, though not spectacular, trend in employment growth. Hence, we're expecting both participation and the unemployment rates to reverse part of the December quarter decline this quarter. That said, we're wary of the potential for further big surprises from the labour market data this quarter.

Indications are that the labour market started 2016 on a pretty firm footing. Headline business confidence has weakened in the early part of the year as firms become increasingly worried about the downstream impact of weaker dairy prices, however, the employment components of these surveys have generally held up much better than headline confidence. Firms report a lift in overtime, reduced labour turnover and that labour is more likely to be a limiting factor of production. And, although they eased a touch in the March quarter, firms' hiring and hiring intentions remain well above average.

Employment growth (including forecast)



And it's not just firms reporting firm labour market conditions. Our own Westpac McDermott Miller Employment Confidence survey showed households also have an optimistic take on labour market prospects. In the March quarter workers were more optimistic about present and future job prospects, and more upbeat about earnings growth prospects.

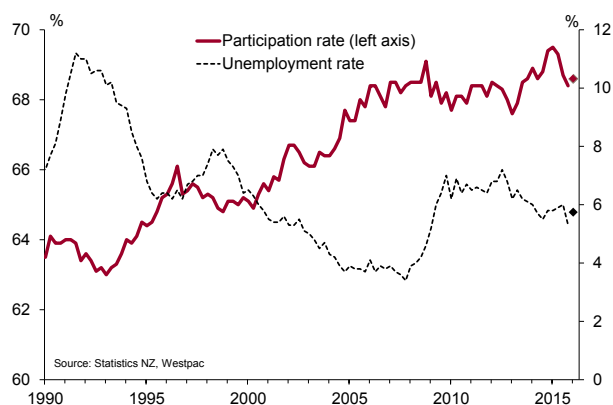
A firm labour market, along with strong house price growth and low interest rates, has supported consumer spending. And while nominal wage growth has been muted, very low wage inflation has helped workers' pay cheques stretch a little further. This dynamic may well continue for much of 2016.

Details

Big picture aside, the quarter to quarter variation in the labour market can be very hard to predict. And after such big changes in the December quarter, we're even more conscious of the potential for unexpected swings in some of the underlying components of key headline measures such as employment or participation that could lead to a big swing in the headline unemployment rate.

One of the key uncertainties this quarter is the participation rate. The participation rate reached a record high of 69.6% in March 2015. Participation has been boosted by very strong growth in the working age population, especially an increase in people aged 20-29 (which has in turn been driven by a big lift in net migrants of this age group over 2015). However, since peaking in early 2015, participation has been declining. It's difficult to pin this trend down to a particular cohort (although in the December quarter, lower participation in the under 30 age group was noticeable).

Labour force participation and unemployment rate (including forecasts)



Over the long run, the main drivers of the upward trend in participation have been an aging population, increased participation in the work force by older workers and greater participation in the work force by women. However over a

shorter horizon, participation varies with the economic cycle (a strong labour market generally encourages people to enter the labour force). The recent decline in participation is at odds with relatively strong employment growth. Consequently, we think there will be a small lift this quarter, taking participation back to the levels we saw before the run up over late 2014-early 2015. However, we are mindful that this lift in participation is one of the key risks in our forecasts.

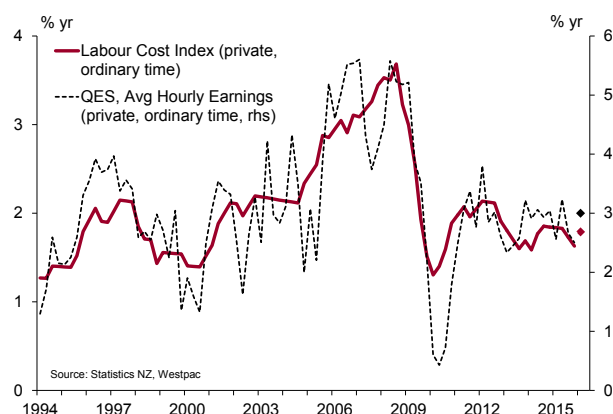
HLFS employment growth has been volatile over the last couple of quarters (0.9% growth in the December quarter followed a 0.5% fall in employment the previous quarter). However, other indicators of the labour market (surveys as well as Statistics New Zealand's new experimental monthly jobs series) suggest that growth has been a bit more "steady as she goes". With most labour market indicators remaining at above average levels at the start of 2016, and reasonable GDP growth expected in the March quarter, we expect to see further modest employment growth at the start of this year. We've pencilled in 0.6% this quarter.

The Quarterly Employment Survey (QES) should corroborate many of the same broad themes of the HLFS in next week's data. We're expecting to see a slightly slower pace of jobs growth (forecasting 0.5% versus 1.1% previous) while wage pressures are likely to remain subdued.

Wages

To date there has been very little sign that solid employment growth has been putting upward pressure on wages. Annual LCI inflation fell to 1.5% in the December quarter and has been below 2% since late 2012. The broader QES measure of wage inflation was up just 0.2% in the December quarter to leave annual inflation at 2.5%. The reason for this is twofold. Strong labour force growth (driven by net immigration and, until recently, a lift in participation) has added to capacity in the labour market. And secondly, inflation lingering near zero has weighed on inflation expectations and kept a lid on annual cost of living adjustments.

Wage inflation



We expect both these factors to eventually unwind (last week's migration data offered a few hints that the net migration tide might be starting to turn and there was a lift in firms reporting difficulty finding unskilled labour in the March QSBO). This could eventually bring with it the risk of a late cycle lift in wage inflation, but we don't think this will be a feature of next week's release.

Implications

In a recent speech, the RBNZ noted that new research suggested that the unemployment rate was a less useful indicator of slack in the labour market than they had previously assumed, instead shining the spotlight on a new labour utilisation composite index. This combines a range of labour market measures into a single measure of the balance between supply and demand in the labour market. In practice this could mean the headline unemployment rate has less influence on RBNZ's thinking about non-tradable inflation pressure than previously.

This aside, the RBNZ sounded a little more constructive about the outlook for inflation in April's OCR Review where they left interest rates unchanged. They noted that they expect to see inflation strengthen in part as capacity pressures gradually build. Consequently, the focus for the RBNZ in next week's labour market report may shift back toward indicators of wage growth, rather than the headline unemployment rate. A much stronger than expected outturn on this front could have the RBNZ contemplating the merits of an August versus June rate cut.

Anne Boniface

Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

David Norman, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity.

Disclaimer continued overleaf.

Disclaimer continued

Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “relevant persons”). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Services Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (“WCM”), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.