Westpac
Institutional Bank

30 July 2014

On the job

Q2 labour market data preview: 6 August, 10:45am

- We expect that the recent strong jobs growth continued over the June quarter, lowering the unemployment rate from 6.0% to 5.8%.
- Employment growth to date has been largely met through rising labour force participation, implying more slack in the labour market and less upward pressure on wages than otherwise.
- But with participation already at record highs, we suspect that this source of slack is close to being exhausted.
- Wage inflation is likely to have remained subdued, against a backdrop of continued low inflation outturns.

	Q1 actual	Q2 forecast	
	Quarter	Quarter	Annual
Household Labour Force Survey			
Employment growth	0.9	0.7	4.0
Unemployment rate %	6.0	5.8	-
Hours worked	2.7	0.3	3.9
Participation rate %	69.3	69.3	-
Quarterly Employment Survey			
FTE employment (s.a.)	1.1	0.8	3.0
Hours paid (s.a.)	1.5	0.5	3.2
Private avg hourly earnings	0.7	0.6	3.1
Labour Cost Index			
All sectors, ordinary time	0.3	0.4	1.5
Private sector, ordinary time	0.3	0.4	1.6
Private, all salary & wage rates	0.3	0.5	1.7

The New Zealand economy's upturn really hit its straps over the past year, and there is plenty of evidence that the jobs market is now following suit. Business confidence surveys have shown a lift in both actual and intended hiring, online job advertisements are continuing to rise, and the Westpac-McDermott Miller employment confidence survey for June showed a further lift in perceived job opportunities, to their strongest since 2008.

What's surprised us to date, though, is the extent to which the labour market has been able to accommodate this growth in jobs. In particular, a record number of people joining (or re-joining) the labour force has probably kept the unemployment rate higher, and almost certainly kept wage pressures lower, than they otherwise would have been. While there are limits to how far this trend can go, we don't expect the official labour market surveys for the June quarter, released next Wednesday, to differ substantially from the recent story.

For the Household Labour Force Survey (HLFS), we expect another solid lift of 0.8% in the number of people employed, which would equate to a 4% increase from a year earlier. It's likely that some of the strong growth over the last year reflects a catch-up period; over 2012 and early 2013, employment growth in the HLFS was surprisingly flat, in contrast to other labour market indicators at the time which suggested modest growth.

Our employment forecast implies a fall in the unemployment rate from 6.0% to 5.8%, which would be the lowest in five years. However, there are a number of moving parts in this calculation, the most important of which is the labour force participation rate – that is, the share of the working-age population declaring themselves to be either in work (employed) or actively seeking work (unemployed). The participation rate has been highly unpredictable in recent times, sliding from 68.7% to 67.9% over the year to March 2013, then bouncing to a record high of 69.3% by March this year.

It's always possible that the last reading was due to survey noise (we'll find out next week). But our research suggests that a record-high participation rate is at least plausible –

reflecting the combination of a cyclical upswing, sharply rising participation among the over-65s (unlike many countries, government superannuation in New Zealand is not means-tested, so people are not penalised for continuing to work past the retirement age) and a tightening of eligibility for unemployment benefits. It's the short-lived drop in participation in the March 2013 year that seems to be the inexplicable part.

We think there's room for the participation rate to rise a bit further over the next few years, before the negative effects of an ageing population start to dominate. But it's extremely unlikely that it will continue to rise at the same pace that it has over the past year. That means from here on, the growing demand for workers will increasingly have to be met from the ranks of the (officially) unemployed. We expect the unemployment rate to fall to 5.5% by the end of this year and below 5% next year.

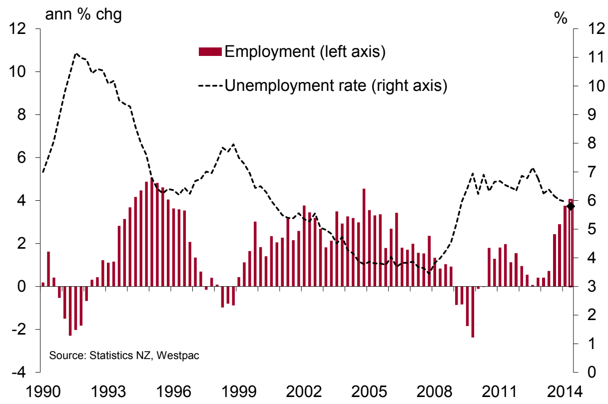
The Quarterly Employment Survey (QES) provides a useful cross-check on the degree of momentum in the labour market. We're expecting some modest growth in the jobs filled and hours paid measures of this survey, consistent with our forecast of a slower 0.7% rise in GDP in the June quarter.

We expect an acceleration in the QES average hourly earnings measure to 3.1%yr, in keeping with the strong pace of jobs growth. However, this measure tends to be volatile, and can be distorted by changes in the mix of jobs or labour productivity.

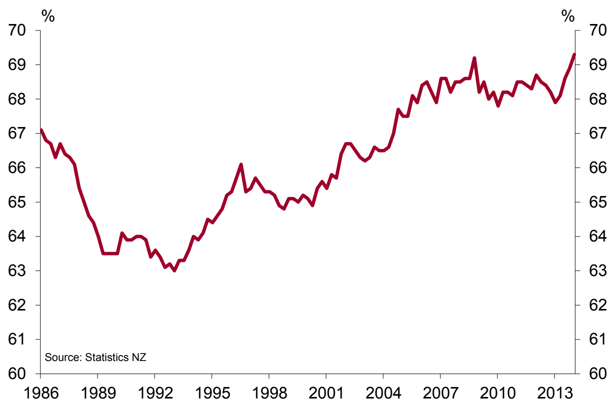
Our preferred measure of wage inflation is the Labour Cost Index (LCI). This measure has actually slowed over the last two years, with private sector ordinary time labour costs rising just 1.6% in the year to March. That's most likely due to the soft inflation outturns in recent years, combined with the existing degree of slack in the labour market – when workers don't have scarcity value, it's difficult to negotiate much more than cost-of-living increases. That situation will evolve as unemployment falls, but any substantial pickup in wage pressures is probably more of a 2015 story. We expect private sector wage inflation to remain at 1.6%yr in the June quarter.

Michael Gordon
Senior Economist

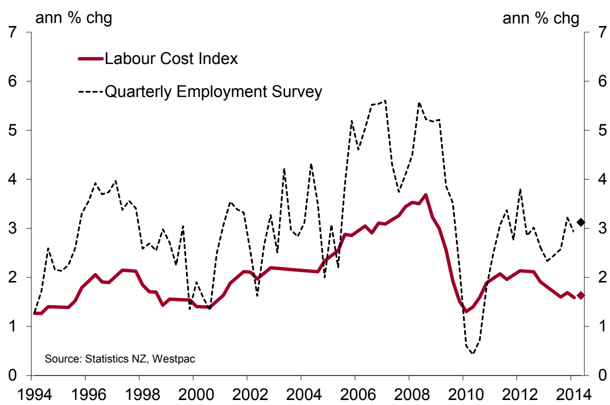
Household labour force survey



Labour force participation rate



LCI and QES wages



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