

Economic Note

Wage inflation remains steady



NZ Q2 wages review; HLFs Preview – Q2 2008

- The Q2 private sector all-wage LCI increased 0.8% qoq (as expected), and 3.4% yoy.
- The QES jobs measures suggest employment was fairly flat after Q1's sharp decline
- We expect Thursday's HLFs data to show flat employment and a 3.9% unemployment rate.

Wage inflation remained reasonably steady in Q2, with the LCI (private sector including overtime) rising 0.8% qoq and annual growth easing to 3.4% yoy (from 3.5% in Q1). The result is very unsurprising, with the past year's tight labour market pressures continuing to hold wage inflation at elevated rates. Also, LCI wage inflation did not show any sign of accelerating, reassuring the RBNZ that wage-setting behaviour remains well behaved in the current environment of strong cost pressures.

On the employment front, the QES result was strong enough to suggest the HLFs employment measure will not fall further in Q2. QES full time equivalent employment rose 0.3% qoq by our seasonally-adjusted estimate. HLFs employment growth fell very sharply in Q1. We expect employment growth to remain flat in Q2, although there is some risk of a bit more bounce back. Nonetheless, the underlying message is a substantial softening in the labour market over the first half of 2008.

Today's labour market data is unlikely to be a surprise to the RBNZ. We expect the RBNZ will continue to steadily cut the OCR by 25bp at consecutive meetings, taking the OCR down to 6.75%.

Results summary

Labour Cost Index (LCI)

Annual LCI
3.5%.

- Private sector salary and wage rates (including overtime) increased 0.8%qoq (3.4% yoy). ASB(f) = 0.8% qoq, Market=0.8% qoq.
- Salary and wage rates (excluding overtime) for the private sector increased 3.5% yoy.
- Salary and wage rates (excluding overtime) for the public sector increased 3.7% yoy.
- All groups salary and wage rates (including overtime) increased 0.7% qoq (3.5% yoy). Excluding overtime, all groups salary and wages increased 0.7% qoq (3.5% yoy).
- The 'analytical' unadjusted LCI series (i.e. prior to all the adjustments for job and employee quality) increased 0.7% for the quarter, lifting the annual rate up to 5.5%. The private sector unadjusted series also increased 0.8% qoq, holding the annual rate to 5.5%.

[\[Statistics NZ release\]](#)

QES
employment
grows slightly.

Quarterly Employment Survey (QES)

- Full-time equivalent jobs increased 0.8 qoq (non-seasonally adjusted), with annual growth easing to 2.5 yoy. Our seasonally-adjusted estimate suggests 0.3% qoq growth.
- Filled jobs increased 1.7 qoq (non-seasonally adjusted), and 2.2% yoy.
- Seasonally-adjusted total paid hours increased 0.5%, and 2.0% yoy.
- Private sector ordinary time and overtime-inclusive earnings both increased 2.0% qoq and 5.4% yoy.
- Total ordinary time earnings increased 1.8% qoq and 7.4% yoy.

[\[Statistics NZ release\]](#)

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General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

Wages inflation holds steady

LCI wage growth remains elevated

Wage inflation appears to be stabilising..

..reassuring the RBNZ wages remain well behaved

The Q2 the labour cost index (private sector) came out in line with our and market expectations of a 0.8% increase, bringing ordinary time wages to 3.5% yoy and overtime-inclusive wages to 3.4% yoy. The quarterly increase in public sector wages was slightly weaker, at 0.6% (ordinary time), although this follows considerably stronger growth over the previous three quarters.

Overall, this result is a relatively steady one, showing wage inflation ticking along at fairly strong annual rates, but not accelerating.

The labour cost index is important as the RBNZ looks for confirmation that strong inflationary pressures are not flowing onto wage-setting behaviour. The current environment is proving challenging for the RBNZ, with workers likely to be putting pressure on employers to compensate for rising food and fuel prices. Indeed, the rising cost of living is frequently sighted as the reason for increased wages, although these increases appear to remain contained. Firms are also struggling to deal with rising costs and slowing demand, and falling profitability is working to keep a cap on wage growth. Indeed, the RBNZ is betting on lower demand keeping these pressures in check. Easing in difficulties in finding labour should also help ease wage inflation pressures over the coming year.

QES wage strength due to volatility

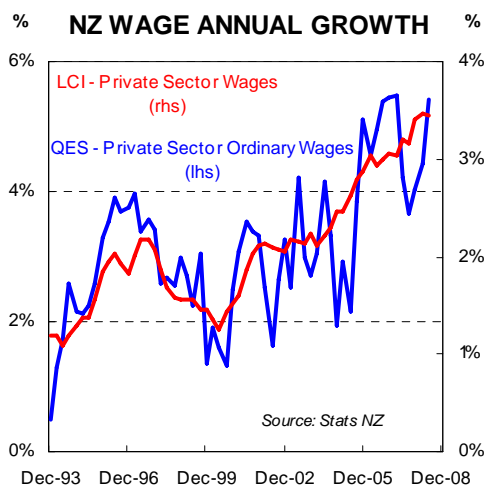
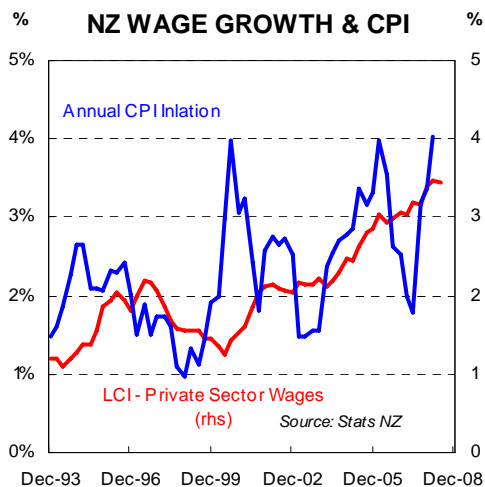
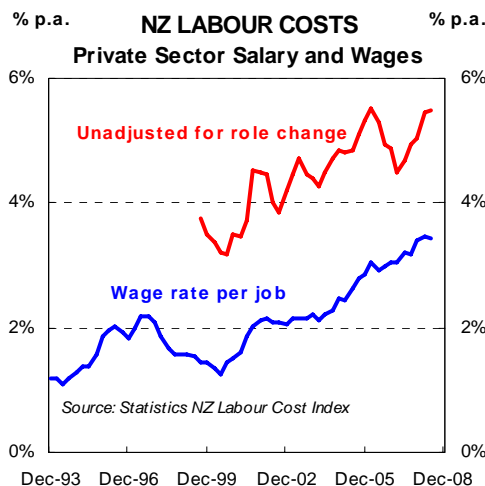
QES wages hit by volatility

QES wage measures revealed a very strong 2.0% qoq increase (5.4% yoy). On face value, this increase appears concerning. However, the QES wage measures often get knocked around by compositional shifts. In Q2 it appears a greater contribution from the health and community service sectors are partly behind the sharp increase in the weighted average total increase.

Looking at the annual rate, the recent rise brings QES wage growth back in line with the more reliable LCI measure – after a period of comparative weakness in the QES measure.

We focus on LCI, elevated wage inflation but not accelerating

Our focus remains on the LCI and the view that while wage inflation remains elevated, it appears to be stabilising – consistent with some early signs of softening labour market conditions.



QES data consistent with little employment growth

QES jobs measure flat

The QES jobs measures were upbeat enough to suggest relatively flat/slight growth in employment after Q1's sharp plunge – as reported by the Household Labour Force Survey. FTE (full-time equivalent) jobs increased 0.8% qoq. Seasonally-adjusted jobs growth was 0.3 by our estimate, implying modest jobs growth.

Strength in manufacturing a surprise

One interesting feature of the QES report was surprisingly strong jobs growth in the manufacturing sector over the past year, up 3.8% yoy. This job growth has not been limited to a pick up in meat processing; it has been fairly broad based across different types of manufactures. That is a somewhat surprising result given the decline in the manufacturing industry's optimism over the past year and high-profile job losses in the media lime-light.

Retail sector weakness not surprising

Meanwhile, the retail industry has shed jobs, down 4.4% yoy. Construction and property and business services job growth was flat, following some time of strong growth. With housing market related weakness and falling residential construction activity, we wouldn't be surprised to see further job losses in these sectors over the coming year.

Expect flat HLFS job growth

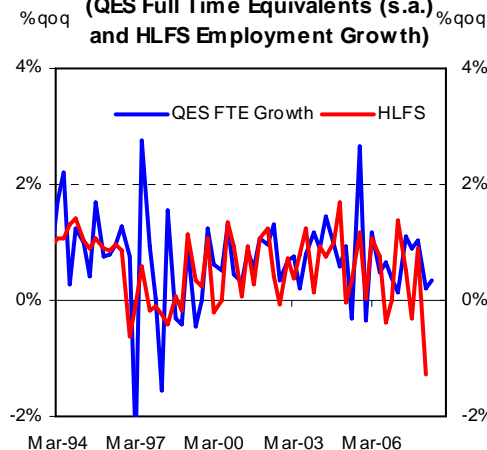
Household Labour Force Survey: Preview

We forecast flat growth in employment in the HLFS figures, due for release on Thursday, following Q1's outsized pullback.

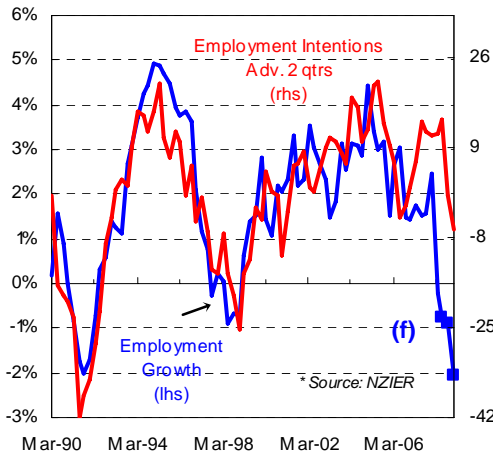
Unemployment to rise to 3.9%

Business surveys point to further slackening of labour demand in Q2 as the economic downturn bit further. The unemployment rate is also likely to head up noticeably to 3.9%, based on assumptions of declining employment and further growth in the labour force. The wildcard for the extent of the lift in unemployment is likely to be the participation rate. In Q1 the participation rate dropped back quite substantially to 67.7% from 68.6% after having been 68% or above since mid-2005. Given the extent of the fall we have assumed that the participation rate will hold steady. In contrast, the pattern of late has been for participation to move up and down in line with employment.

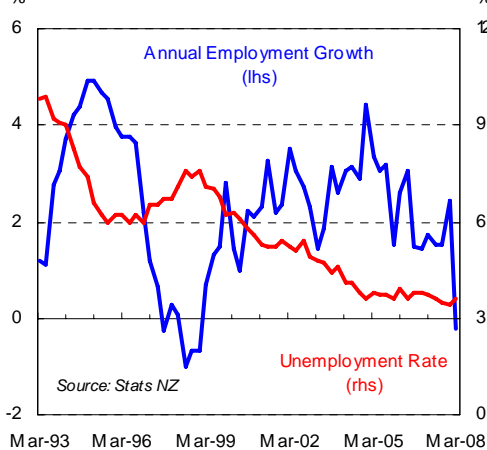
QUARTERLY EMPLOYMENT (QES Full Time Equivalents (s.a.) and HLFS Employment Growth)



EMPLOYMENT & INTENTIONS Net %



EMPLOYMENT & UNEMPLOYMENT %



Elevated wage inflation not surprising

Implications

Wage growth on an LCI basis remains in line with RBNZ expectations. The QES measures are on the strong side, but less reliable in giving a steer on underlying wage pressures. Wage growth should be remaining upbeat in the here and now given the recent tightness of the labour market, and that has been the key message from the release.

HLFS job growth flat, labour market softening

The QES jobs measures suggest that jobs didn't fall further over the quarter. Consequently, we have nudged up our Q2 HLFS employment forecast to a flat outcome, with the unemployment rate now expected to rise less sharply, to 3.9% from Q1's 3.6%. However, anecdotes suggest a swift shift in the balance of the labour market is currently underway. Q2 employment may now turn out to be fairly flat (or even recover slightly after Q1's outsized fall). But beyond that quarter we expect to see employment weaken as employers rein in hiring and in some cases downsize through attrition.

RBNZ to keep cutting rates

With wages behaving, for now, roughly as the RBNZ expected, we remain of the view that the RBNZ will continue to steadily cut the OCR by 25bp at consecutive meetings, taking the OCR down to 6.75%. What will shape the RBNZ's view on wages going forward is this Thursday's HLFS survey, for which our revised forecasts still point to continuation of Q1's slackening of labour market tightness.

Some background to the data

Labour Cost Index: The LCI measures changes in salary and wage rates for a fixed quantity and quality of labour input at various levels. An experimental 'unadjusted' LCI series is also released. In addition to price change, it reflects quality change within occupations.

Quarterly Employment Survey: The QES is a quarterly, and often volatile, measure of average hourly and average weekly (pre-tax) earnings, average weekly paid hours, and the number of filled jobs. It reflects not only changes in pay rates, but also compositional and other changes across and within the paid workforce.

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