2 August 2017

Working Through The Noise

- Employment dips in Q2
- But it looks like noise rather than signal
- Annual employment growth is tracking around 3%
- Enough to see the unemployment rate edge lower
- Wage inflation may be edging higher, but slower than RBNZ anticipated
- Chance of mid-2018 rate hike diminishing

HLFS/LCI - 2017 Q2			
	Actual	Mkt Expected	Previous
Employment - qtly % ch	**-0.2**	+0.7	**+1.1R**
Employment - ann % ch	**+3.1**	+4.1	**+5.7**
Participation rate %	**70.0**	70.6	**70.6**
Unemployment rate %	**4.8**	4.8	**4.9**
LCI, private ordinary - ann % ch	**+1.6**	+1.6	**+1.5**

HLFS data seasonally adjusted

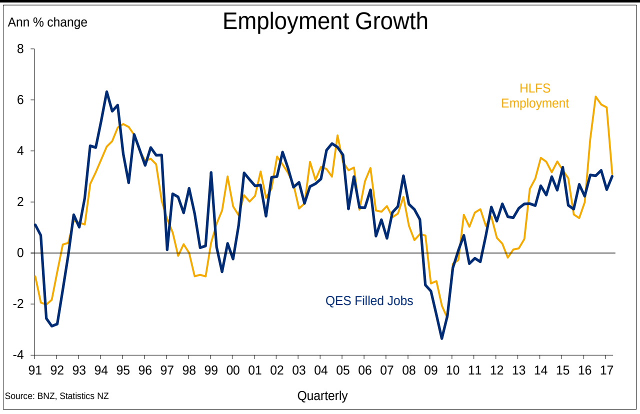
There seems to remain a lot of noise in the official employment data making quarterly movements difficult to trust as an indicator of trend. We say this as today's Household Labour Force Survey (HLFS) shows employment eased 0.2% in the second quarter of the year and the participation rate lurched lower from its record high. This saw employment come in well below market (and our) expectations, but the unemployment rate edge lower and match what was anticipated at 4.8%.

It is not so much that employment fell in the quarter (albeit after a run of very strong run growth) that has us skeptical of the official figures but rather than it goes against a whole host of other indicators pointing to positive, even strong, employment expansion in the period.

Take the Quarterly Employment Survey (QES) released at the same time for example. This survey showed the number of full-time equivalent employees rose 0.7% in the second quarter and a 1.0% increase in filled jobs. Sure there are conceptual differences between the two surveys, but this sort of growth sits better with the likes of very strong employment intentions we have seen in the various business surveys and high and rising job ads. It also fits with firm consumer confidence. Falling employment does not.

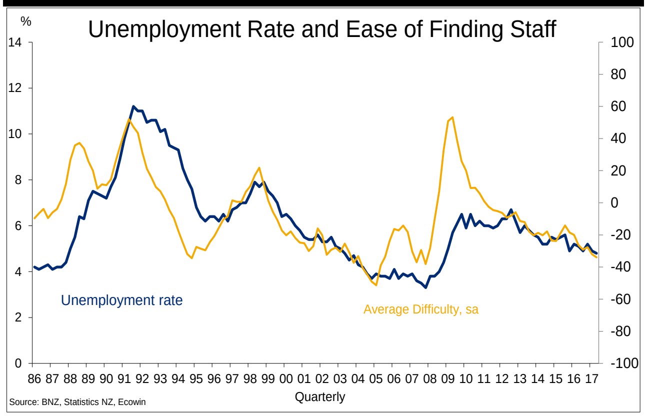
We wonder if methodological changes to the HLFS made in Q2 last year have disturbed the seasonal adjustment mechanisms polluting this year's quarterly change in the process. It is difficult to know. But this should not affect annual employment growth estimates given it is a year since the method changes were made. It is interesting that HLFS annual employment growth of 3.1% matches annual growth in QES filled jobs. We suggest this is a better guide to trend employment growth at present. Across a range of indicators labour demand looks robust. If we are right, expect a bounce back in the official employment figures ahead. That is what we anticipate.

Employment Growth



The unemployment rate edged lower to 4.8% in Q2 from 4.9% in Q1, as the participation rate pulled back to 70.0% from its record high of 70.6% in the previous quarter. The unemployment rate was less affected by the HLFS methodological changes last year and, we think, continues to provide a reasonable overall assessment of the labour market. In a word we would say robust. Indeed, the unemployment rate has fallen to its lowest level since 2008. This fits with the balance of firms in the Quarterly Survey of Business Opinion reporting increasing difficulty finding staff.

More Difficult To Find Staff

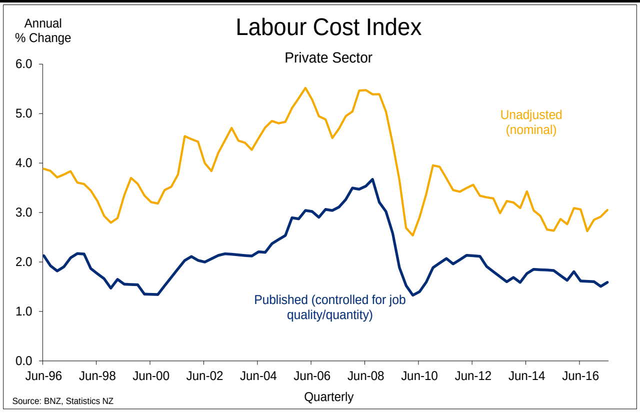


On wages, the 0.4% increase in the closely-watched private-sector Labour Cost Index was in line with market (and our) expectations. It was enough to round annual wage inflation on this measure up to 1.6% in Q2 from 1.5% in Q1. In raw, unadjusted, form, the private sector LCI rose 0.9% in the quarter to push annual wage inflation up to 3.1% from 2.9%. We discount the 0.8% quarterly lift in average hourly earnings as this is notoriously affected by shifts in the composition of the labour force and hours worked. Overall, there are ever so slight hints here of some pick up in wage inflation as the unemployment rate has hovered around 5.0% over the past year or so. Overall QES total gross weekly earnings rose a strong 1.5% in Q2 to up 5.1% on a year ago.

The unadjusted LCI wage inflation is well in excess of CPI inflation (that is running at 1.7%), indicating expansion in real wages and a hint of acceleration. This will support household spending ahead.

Our forecasts suggest a bit more wage inflation ahead. Reported labour constraints are part of this, along with the effects of a 3.3% increase in the minimum wage and a significant aged care worker wage settlement to enter the data in Q3. Also, after tax incomes are set to rise with the tax threshold adjustments slated for 1 April 2018.

A Hint Of Wage Inflation?

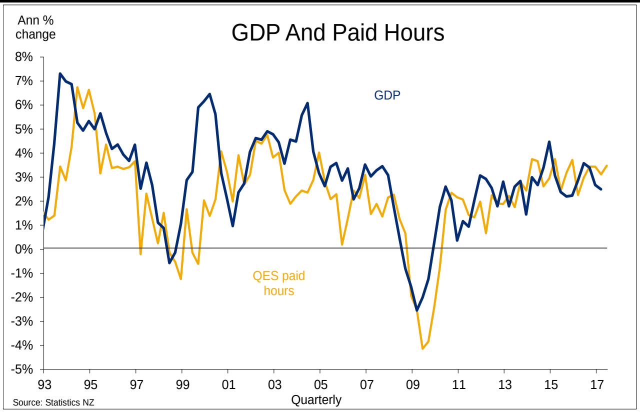


For the RBNZ today's data was likely marginally weaker than its expectations, as far as we can tell. In its May MPS, the Bank forecast the unemployment rate falling to 4.6% by Q1 2018 so today's result is unlikely to be materially different to the Bank's thoughts for the current quarter or alter its near term view. A negative tinge comes from private sector LCI annual wage inflation coming in a tick lower than RBNZ forecasts. And, noise or not, falling official employment is not a good look. Today's labour market data, on its own and in its entirety, may well not be too different to the Bank's forecasts. But given that CPI has already undershot expectations and the NZD continues to run significantly higher than RBNZ projections, it can only add to the idea that the chances of an OCR hike by mid-2018 are diminishing.

Next week's MPS will be principally about CPI inflation forecasts. Given all that has occurred since the May MPS, we see broad downward pressure coming on the Reserve Bank's inflation forecasts – partly as the new, lower, standing point is included but also as the much stronger-than-expected NZD feeds into the forecasts. Even so, we suspect the Bank will do its best to try to maintain a neutral stance on the OCR. We don't think the RBNZ will signal a cut. We maintain our view that, whether or not inflation responds, our economy is currently sufficiently capacity constrained and growing well enough that it needs no extra stimulus from the central bank. But, the market would be well advised to take notice of the way the balance of information has shifted since the RBNZ's previous full set of forecasts.

Speaking of how the economy is evolving, note that the details of today's data is supportive of our view that economic growth picked up in Q2. We noted the increase in full-time equivalent employees and more filled jobs in the QES above. In addition, QES paid hours rose 0.9% indicating more work done. HLFS total actual hours worked rose 1.0% although is more difficult to trust. Overall, there is plenty to support our initial Q2 GDP growth estimate that sits at 0.9%.

Helpful For Q2 GDP Computations



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