3 May 2017

Labour Market Still Booming in Everything But Wages

- Q1 labour market data generally strong
- But wage inflation still lagging, for now
- Nothing out of line with Feb MPS forecasts
- But next week's MPS all about the CPI track
- Hours affirm our caution around Q1 GDP

Will nominal wage inflation remain moderate, or is it bound to pick up? This is a key question for monetary policy, as we look to next week's Monetary Policy Statement. In terms of activity there is no question that New Zealand's labour market retains strong momentum, and is, at the margin, still tightening the screws. Be that as it may, wage and salary measures have not responded in their usual manner, or at least not quite.

According to this morning's Household Labour Force Survey (HLFS) employment rose a seasonally adjusted 1.2% in the March quarter, for an annual gain of 5.7%. While some of the annual result reflects a step-shift in Q2 2016 – when measurement methods were modernised – the recent quarterly results suggest there's much more to it than that.

Yet with such unbelievable HLFS results it also pays to cross-check with the Quarterly Employment Survey (QES) measure of employment, its filled-job series. This printed annual growth of a lesser 2.5% in the Q1, compared to 3.2% in Q4. Seasonally adjusted, QES filled jobs increased 0.3% in the quarter. It's not unusual for the QES and HLFS to be telling different stories on jobs, but it's worth noting the stark variation at present.

In addition, we note that employee hours in the March quarter were nowhere near as robust as the HLFS headcount increases. The paid-hours variable in the QES, for instance, increased just 0.1% while the HLFS hours-worked figured dropped 0.6%. To be sure, the latter

HLFS/LCI - 2017 Q1	Actual	Mkt Expected	Previous
Employment - qtly % ch	+1.2	+0.8	+0.7R
Employment - ann % ch	+5.7	+5.3	+5.8
Participation rate %	70.6	70.5	70.5
Unemployment rate %	4.9	5.1	5.2
LCI, private ordinary - ann % ch	+1.5	+1.6	+1.6

HLFS data seasonally adjusted

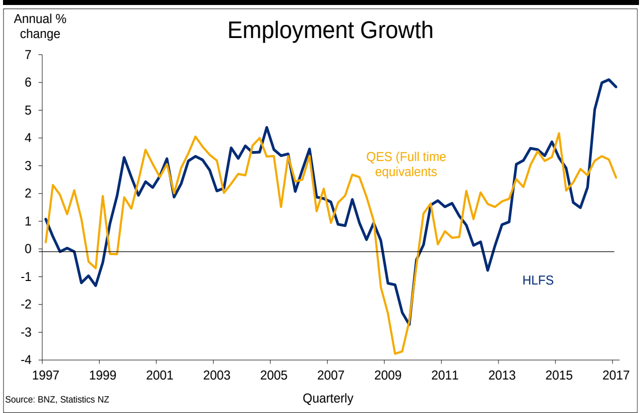
follows an outsized run over prior quarters that bore little resemblance to GDP growth. However, the hours input data do suggest that our reservations regarding Q1 GDP growth (0.7%) is justified, unless we see counter-strong evidence.

Nonetheless, there is still enough momentum in the labour market to have the official unemployment rate trending lower. In seasonally adjusted terms it fell to 4.9%, from 5.2% in Q4. This was in spite of the participation rate edging up to a new record high, of 70.6%, from 70.5%, and high immigration. As we mentioned in Monday's Weekly, while we "felt" as if the jobless rate should fall in Q1, we struggled to forecast this from a technical/statistical standpoint.

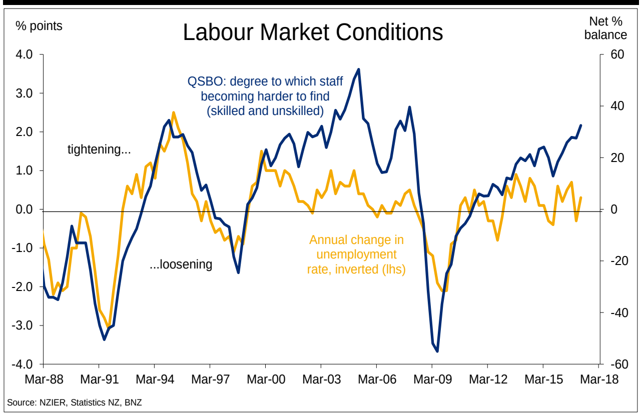
Of course, had the unemployment rate edged up a bit, those crying foul over high immigration would no doubt have felt they had further ammunition for their cause. But the fact is that New Zealand's labour market has enough go-forward to absorb the rapidly expanding supply of labour. And by the look of recent staffing intentions amongst the business sector we can expect this to continue for a while longer. They are relatively upbeat.

Still, there is the risk that if aggregate demand for labour gets cold feet, for whatever reason, and net immigration stays very high, then the unemployment rate could well

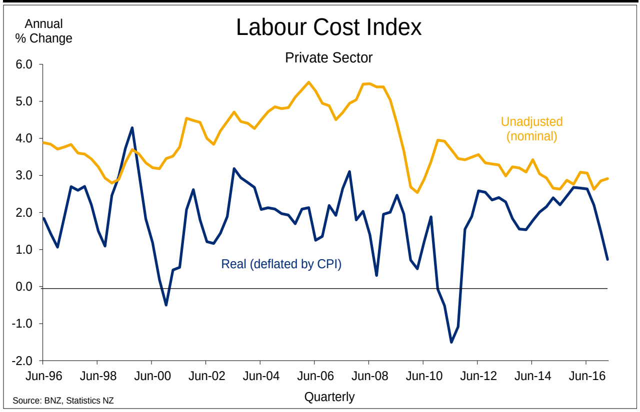
Which Way Is Up?



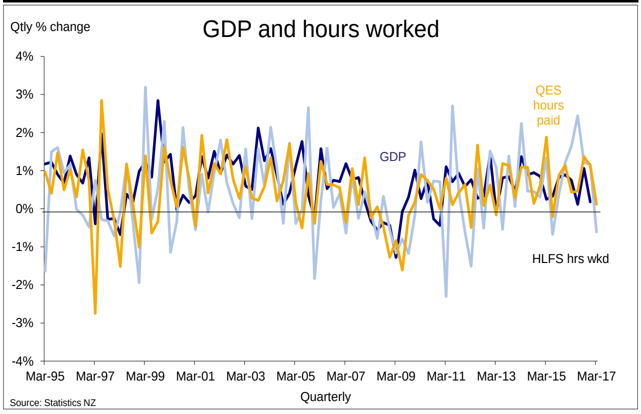
Tightening



The Real Pinch Begins



Not So Flash



rupture higher. Nearer term, labour market sentiment also bears watching in view of September's close-fought general election.

If there is a real "weakness" in the latest labour data has been in wages. But even that is debatable. Granted, while the 0.4% increase in the closely-watched private-sector Labour Cost Index was in line with market expectations, it was verging on 0.3%, and its yearly pace slowed to 1.5%, from 1.6%. But in raw, unadjusted, form it increased 0.7%, for an annual increase of 2.9%. As for the QES measure on nominal wages and salaries, it continues to look volatile, although, at 1.1% y/y, obviously slower than the unadjusted-LCI.

We still wonder the extent to which the lull in CPI inflation over 2015/16 has limited wage claims compared to what they would otherwise have been. But we'll get a feel for this cost-of-living compensation process, as CPI inflation has recently picked up to 2.2% y/y. And it will likely stay up around that mark over the coming year or two, in our opinion. Whereas real (CPI-adjusted) wage inflation has borne a reasonable relationship to the staffing constraint measures we monitor, it might be the nominal measure that sustains the story over the coming period.

What will the Reserve Bank make of today's labour market numbers? While the activity outturns were broadly robust, and wages lagging, none of it looked out of line with what the Bank was forecasting.

In particular, the Bank has long forecast the unemployment rate to be on a falling trajectory. In its February Monetary Policy Statement (MPS), for example, it expected the jobless rate to be 4.9% in the March quarter of 2017, on its way down to 4.5% in early 2018. And 4.9% it turned out to be today.

The February MPS also forecast "Labour Costs" to be running at an annual 1.6% in Q1 (and 2.0% in Q1 2018). We take this to mean the private-sector Labour Cost Index, although the Bank doesn't provide a glossary on this anymore. If we're right, then this inflation indicator turned out to be a little less than the Bank expected.

Yet, next week's MPS is shaping up to be principally about CPI inflation forecasts directly, not so much the various bits that might feed into it. Given all that has occurred since the February MPS, we see broad upward pressure coming on the Reserve Bank's inflation forecasts – certainly for calendar 2017, but also 2018 to some extent. Even so, we suspect the Bank will do its best to try to maintain a neutral stance on the OCR, albeit for not as far out as late 2019 this time. The market will probably keep looking through this, as it assesses the chances of the RBNZ having to lift its OCR well before that.

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