2 May 2018

Which Wage Information to Trust?

- **Labour market still rolling along and tight**
- **But key LCI failing to show wage pick-up**
- **Consistent with RBNZ delay**
- **But what is the "real" rate of wage inflation?**

HLFS/LCI - 2018 Q1	Actual	Mkt Expected	Previous
Employment - qtly % ch	**+0.6**	+0.6	**+0.4R**
Employment - ann % ch	**+3.1**	+3.3	**+3.7**
Participation rate %	**70.8**	71.0	**70.9R**
Unemployment rate %	**4.4**	4.4	**4.5**
LCI, private ordinary - ann % ch	**+1.9**	+2.0	**+1.9**

HLFS data seasonally adjusted

Normal The (market) news in this morning's March quarter labour market data was the abject slowness in wage inflation. Well, at least as far as we can trust the Labour Cost Index (LCI) as the best reflection. Indeed, it slowed to just 0.3%, from 0.4% in Q4, in terms of private-sector ordinary-time rates of pay. The market was looking for a quarterly increase of 0.4%.

We don't know what the Reserve Bank expected on this basis, but it did publish an annual expectation of 2.1% in its February Monetary Policy Statement (MPS). The actual result continued to stall, 1.9% y/y.

At face value, today's LCI outturn muddies the water on New Zealand's inflation pulse – much like the recent slowing in annual headline CPI inflation has done. This feeds the idea of delay in respect to any policy tightening from the RBNZ.

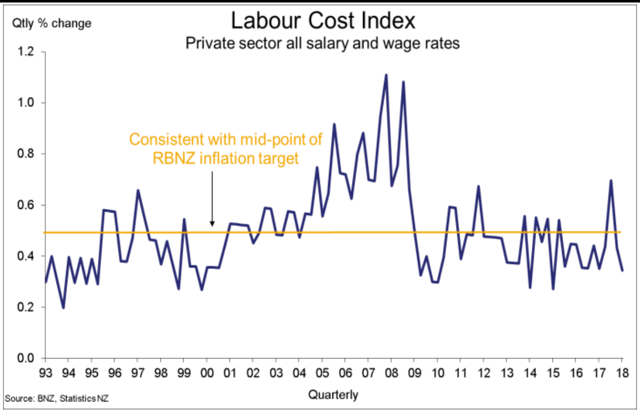
Yet we wouldn't want to be dictated to by recent LCI (and CPI) prints, when it comes to the inflation debate and associated monetary policy prognosis. In part this is because it's about looking forward, as always. And, certainly with respect to the CPI, we envisage a clear pick-up in its annual inflation, to a bit above 2% by the end of this year. With respect to wage inflation, lags are always important to keep in mind (and we know the Q2 2018 data will get a jolt from the hike in the minimum wage, and initially ripple effects).

But we also continue to debate the issue of what the "real" rate of wage inflation is anyway (when tightness in the labour market is otherwise obvious). A lot of this, in turn, is a discussion over measurement.

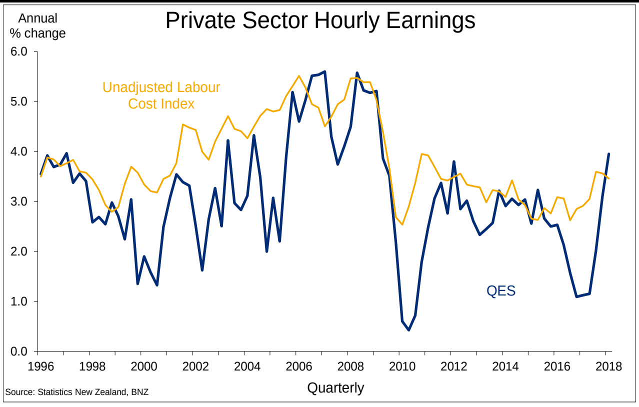
As an example, we would point out that the wage and salary measure from today's Quarterly Employment Survey (QES) was, relative to the LCI, and absolutely, stronger. It lifted a nominal 1.1% in Q1, for an annual pace of 4.0%. Sure, as an average measure, this can be volatile, influenced by composition effects. For this reason we tend to downplay its significance. Still, because it is telling such a different story to the LCI, its force can't be dismissed out of hand.

We also point out that the unadjusted Labour Cost Index was running at a yearly pace of 3.5% in the March quarter,

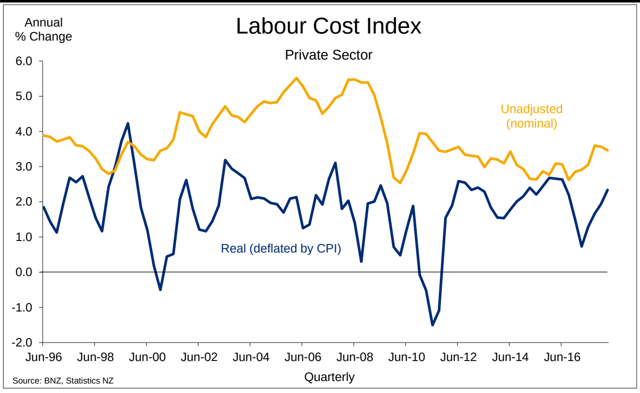
Disappointing



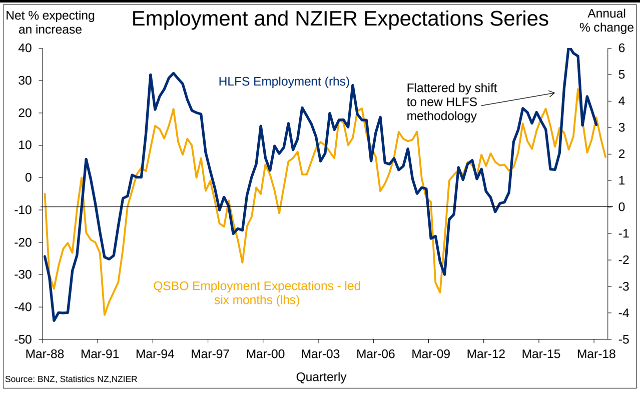
Not Weak At All



Really Good



Cooling



within the private sector. This was even though its quarterly increase, of 0.6%, was, like for the headline LCI, a fraction shy of what we anticipated. The bigger point is that the unadjusted-LCI expresses wage and salary inflation quite a bit stronger than the LCI itself, and is a better reflection of nominal changes in pay, in our opinion.

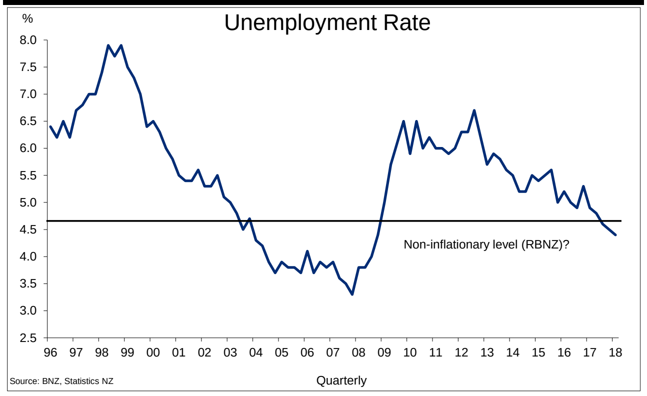
Our proposition that income increases are more robust than the headline LCI alone would suggest, is reinforced by looking at inflation-adjusted wages. Taking the unadjusted-LCI, for example, yields an annual increase of 2.3% in real terms. This continues a strong run of real expansion over the past many years, in fact. It helps explain the strength in household spending over the period.

As for the "real" state of the labour market itself, this morning's statistics, for the most part, painted a picture of ongoing strength, and stretch.

The unemployment rate dropped a notch further, to 4.4% – just as the market, the RBNZ, and we, expected. This was the lowest since 2008 (and well below Australia's 5.5%, we might add).

Quarterly employment growth, as per the Household Labour Force Survey (HLFS), also met market, with +0.6%. However, its annual result, at 3.1%, was under

We've Only Just Begun?



the market's pick of +3.3%, reflecting slight downward revisions to recent history.

The participation rate eased to 70.8%, from 70.9% (revised from 71.0%), which also took some edge off the strong-activity messages from the HLFS.

So too did the QES filled-jobs measure. It registered annual growth of 1.2%. This was slower than Q4's 1.8%, and 3.0% back in Q2 of last year.

Yet the messages on hours worked were more mixed than slow. Sure, the QES version – namely paid-hours – increased a bare 0.1% in the March quarter, seasonally adjusted. However, the HLFS hours-worked measure jumped 1.7%, for an annual gain of a whopping 4.9%. This left us caught betwixt and between regarding overall economic activity in the March quarter. We are left thinking a 0.6% increase on Q1 GDP.

As for what today's labour market data mean for the Reserve Bank, we wouldn't want to jump to conclusions. Ultimately, it's about the forecasts. And the Bank will be presenting its latest set of these at its MPS next week. This will obviously be overseen by new Governor Adrian Orr, but driven by a veritable team of RBNZ personnel, as usual.

Certainly, what interests us about next week's MPS is how the Bank talks about the labour market, in the context of its now-explicit (PTA) mandate to "contribute to supporting maximum sustainable employment." We say this with the February MPS having forecast the unemployment rate to press a bit lower over the next couple of years, in the context of an increasing positive output gap (excess demand). This was integral to generating enough inflation in the non-tradables CPI to achieve 2% CPI inflation, given ongoing subdued inflation in tradables prices. In this there is a sense of imbalance.

This is underscored by recent RBNZ suggestions that the unemployment rate, even at 4.5%, was a little under its "neutral" (NAIRU) rate of 4.7% (albeit in a wide range of estimates). It was an unusually explicit statement from the

Bank, perhaps related to the new government's stated desire that it would like to see the jobless rate below 4.0%.

The labour market path is certainly shaping up to be important in our economic considerations; the interface between a business sector that is becoming a bit cautious and a household sector that has recently been on a roll. Data noted, our impression of the labour market is one of extreme tightness, albeit with some of the momentum pointers coming off the boil since the election.

If the latter translates into demonstrably slower employment growth then the ongoing high level of migration will be harder to digest. This would imply the jobless rate might be close to plumbing its lows. But it would have to back up noticeably, in order to prevent the pick-up in wage inflation we still envisage – conscious of the lags, not to mention measurement issues.

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