Economic Update

Q3 2016 Employment Review 2 November 2016

ASB

Beware employment survey adjustments; wages in line

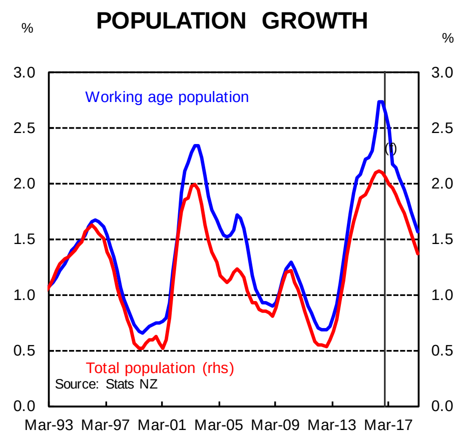
- Unemployment rate drops below 5.0% for the first time in almost 8 years, labour participation marked a record high.
- However, HLFS data still need to be treated with caution given the recent adjustments to the survey.
- Wage inflation lifted on some measures, but was still in line with estimates.

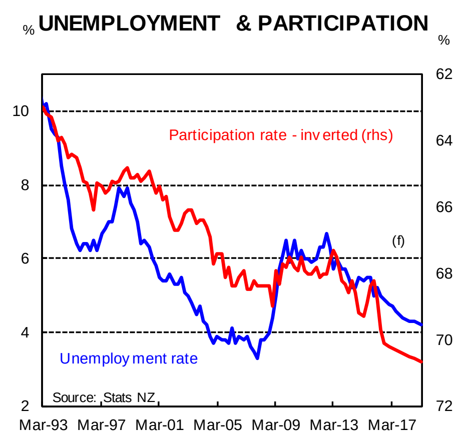
Summary

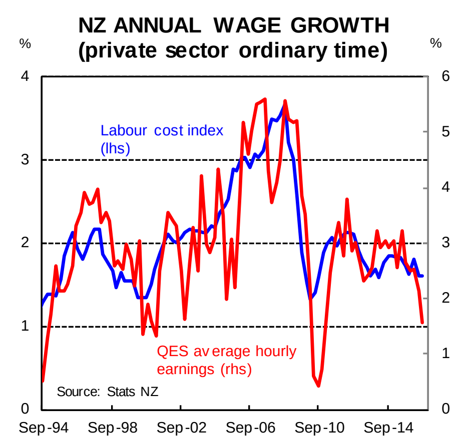
At face value the Q3 labour market figures are very strong. However, it appears there are still uncertainties over the impact that extensive changes to the HLFS survey are having on results. Because of that, the Q3 results should be taken with caution. Measures outside of the HLFS survey need to be looked at for a second opinion of labour market tightness and employment strength. **There may also be question marks over the validity of the quarterly seasonally-adjusted data, given prior series data are still being used for this adjustment process.**

Wages data were in line with expectations for the private sector but public sector increases exceeded forecasts. Construction wages, outside of Canterbury, we very strong. **Even so, overall wage growth is not fast enough to force an inflation rethink.**

We continue to expect the RBNZ to cut the OCR next week by 25bp to 1.75%. We still see some risk of a further cut next year. **But there are no indications in the labour market results that reinforce the need for further OCR cuts beyond next week**, though the RBNZ will downplay the apparent strength of the employment/unemployment figures given ongoing question marks about their reliability.







The details

The unemployment rate declined to 4.9% in Q3, following a downward revision to Q2 to 5.0% from 5.1%. Employment growth registered a sturdy 1.4% qoq. Q3 marks the first sub-5% unemployment read since December 2008 in the new measure of unemployment. **The reason why the fall in unemployment was so mild, despite strong jobs growth, was because of strong labour force growth and a lift in labour force participation to a record high of 70.1%.** However, StatsNZ cautioned that some of the lift in labour participation may be due to survey changes – but is unable to break out exactly what this influence might be. In turn, that raises questions around exactly what the 'true' shift in unemployment is, and how tight the labour market is in effect.

Our forecasts have the unemployment rate ticking down over the coming year, though the uncertainty around the new survey in turn creates some uncertainties around our outlook. This is likely to lead the Reserve Bank of New Zealand to place more weight on the Quarterly Employment Survey, as well as its own Labour Utilisation Composition Index statistics.

As a cross-check on the HLFS results**, full-time equivalent employees (seasonally-adjusted) in the QES saw growth of 0.8% qoq, not as strong as the HLFS employment growth of 1.4%,** but still pointing to healthy job creation in a strongly-growing economy. Hours worked under HLFS (seasonally adjusted) increased 1.2% qoq, close to the QES paid hours result of 1.3%.

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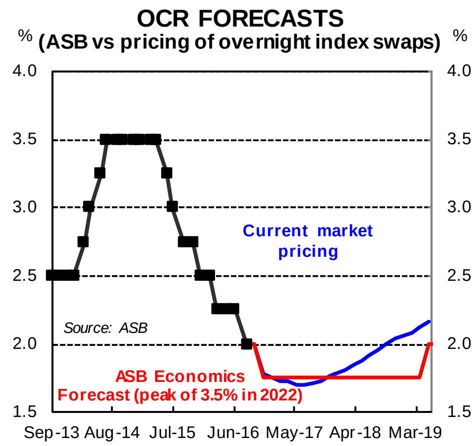
On wage growth, the Labour Cost Index showed private sector labour costs (including overtime) held at 1.6% yoy for the second quarter in a row. Within that, construction wages expanded 2.1% yoy and 2.3% excluding Canterbury construction. **Even so, private sector wage growth remains around 6-year lows.** Public sector wage growth accelerated to 0.7% qoq from 0.2%, pushing the annual pace to 1.7% from 1.3**%. However, wage growth in this sector has lagged the private sector for some months and so there is an element of 'catch-up' at play**. Labour costs before any adjustment for job quality slowed to 2.6% yoy from 2.8%, a 5-quarter low. The QES also showed private sector ordinary time average hourly earnings growth slowing to 1.6% yoy from 2.1%. This wage measure is, however, impacted by changes in the composition of jobs.



Despite the generally improving employment picture, overall wage growth is not yet accelerating, though that is likely to come in time. Accordingly, we still expect the RBNZ to cut the OCR next week, to 1.75% from 2.00%. Beyond that, there is still a risk of further easing in 2017, mainly if the NZD strengthen or inflation expectations weaken further. The labour market figures themselves have not increased the chances of more aggressive RBNZ action.

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