

New Zealand Economic Update

Labour cost index

- Wage growth slowest in eight years
- Upside risk to our 2Q unemployment rate forecast
- Labour market conditions to remain weak

Private sector labour costs (as measured by the LCI) in New Zealand rose just 0.3%q/q in 2Q (J.P. Morgan 0.6%, consensus 0.5%), below all market economists' forecasts. The 2Q result marked the slowest quarterly wage growth since early 2000. From a year ago, wage inflation eased to the slowest pace in eight years, rising just 2.6%oya. All sector wage growth slowed to 0.3%q/q, or 2.9% from the previous year.



The Quarterly Employment Survey (QES), also released today, showed average hourly earnings rose 4.5%oya in 2Q. The survey showed that demand for labour continued to decline in 2Q, with full-time equivalent employees and filled jobs falling further from a year ago, down 3.2% and 2.1%, respectively. Statistics New Zealand said that the manufacturing sector was the main contributor to both these decreases, although falls were also recorded in the construction, wholesale trade, and retail trade industries.

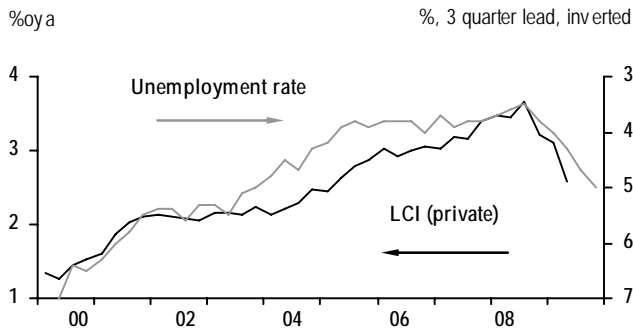
Indeed, barring today's wage numbers, the weakness in the Kiwi labour market has not been as severe as expected given the economy has been in recession since the start of 2008. That said, the second quarter labour market indicators may signal a change. The next key economic data to watch are Thursday's June quarter employment numbers. Indeed, following the weakness in the LCI today, there is upside risk to our unemployment rate forecast of 5.5% in 2Q. Probably more indicative of the weakness in the labour market, however, will be the elevated level of underemployed workers. Of the 473,500 people employed part-time in 1Q, 21.1% wanted to work

more hours, a number likely to rise in 2Q.

Soft wage growth and rising job insecurity, with the unemployment rate expected to rise for at least the next 12 months, means that private consumption will remain weak in the foreseeable future. In our forecasts, household spending will fall by 1.6% this year, but if labour market indicators deteriorate faster than expected, the risks to our private consumption growth forecast will be skewed to the downside.

Households are unlikely to get further interest rate relief, however. The statement that accompanied the RBNZ's 'no change' decision last week was decisively more dovish but, in our view, the aggressive pace at which the RBNZ cut the cash rate in this easing cycle means that the RBNZ Governor probably will be wary of leaving the cash rate too low for too long. Our forecast calls for rate hikes from 3Q10.

New Zealand: LCI and unemployment



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