There is a season, turn turn turn

NZ Q4 HLFS employment –0.1%q/q, unemployment rate 7.3%

- **Employment fell in the December 2009 quarter, albeit at the slowest pace in a year.**
- **The unemployment rate spiked to 7.3%, though we think this overstates the degree of weakness in the labour market.**
- **The RBNZ is still on track to deliver a slow but steady tightening from around the middle of 2010.**

Key results

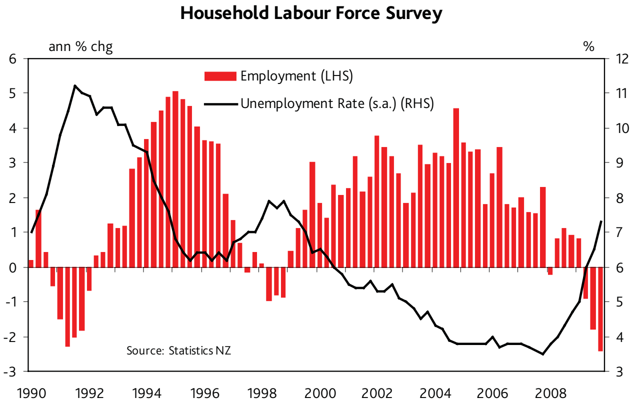
	Q3 2009	Q4 2009	Q4 Expected WBC	Mkt
Employment %q/q	–0.8	–0.1	0.3	–0.1
Unemployment rate %	6.5	7.3	6.7	6.8
Participation rate %	68.0	68.1	68.2	68.1
Hours Worked s.a %q/q	–0.8	–0.4	1.1	

Employment

This week's wages and jobs data showed that the New Zealand labour market remains bogged down by the effects of the 2008-09 recession. In the December 2009 quarter, wages grew at a snail's pace, employment fell by 0.1%, and the unemployment rate jumped to 7.3%, the highest in ten years. We think that the latter overstates the degree of weakness, but the overall message is that the jobs creation machine has yet to kick into action.

For the last year or so we've advocated using the unemployment rate, rather than the number of people employed, as the better gauge of how the labour market is evolving. The employment figures have been unusually volatile in the past few years, probably due to recent changes to the seasonal pattern that are difficult for Statistics NZ to correct for. But it seems these issues with seasonality are creeping into other parts of the calculations as well. So for this time, at least, we're going to reverse our advice and suggest focusing on the employment numbers as a better gauge. That doesn't change the fact that the overall outturn was weaker than we expected – just not as bad as a 7.3% unemployment rate would imply.

The fall in employment went against our top of the market forecast of 0.3% growth. Our view was based in part on the seasonal patterns just mentioned, which over the last few years



have led to strong gains in Q4 only to be followed by sharp drops in Q1. So a 0.1% fall, at a time when seasonal factors should have been pushing it higher, translates to a fairly weak outcome.

Hours worked were also weak, although the 0.4% fall was an improvement on the 0.8% drop in Q3. We had expected to see a lift in hours worked based on recent business indicators, where hiring intentions have picked up and overall activity measures have been consistent with Q4 GDP growth in the order of 1%. We also expected the gap between actual hours worked and 'usual hours' (which includes time spent on sick leave) to narrow in Q4 as the impact of swine flu dropped out; instead, the gap widened further.

Unemployment has hit the same groups as in previous recessions. Youth unemployment (15-24 years old) has risen to 18.4%, from 12.0% a year ago. Unemployment among Maori, and Pacific Islanders has risen from 9.0% to 14.9% in that same time. By industry, construction and manufacturing have been hit hardest during this downturn – though it's worth noting that much of the weakness in the December quarter was found in the retail sector, where the usual seasonal increase in hiring was underwhelming.

Interestingly, both employment growth and the participation rate were right in line with market forecasts. So how did the unemployment rate end up so far out of whack with expectations? It appears to be largely a technical issue – those not enamoured with statistics can skip the next paragraph (as

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with sausages, you may be happier not knowing what goes into them).

The calculation of the unemployment rate starts with the working age population, then works its way down into the sub-groups. Statistics NZ performs separate seasonal adjustments on the first two sub-groups – those in, and those not in, the labour force – which in the past have offset each other, so that the net impact on the working age population has been virtually nil. But in the latest quarter, the combined effect of the seasonal adjustments added an extra 8,000 to the population, and it appears that these 'people' went on to swell the ranks of the unemployed. Without this seasonal quirk, we estimate that the unemployment rate would have been more like 7.0% – admittedly still worse than the average forecast of 6.8%.

We expect this problem to be ironed out in the next release, and along with an underlying pickup in hiring, this should see the unemployment rate drop back below 7% in the March quarter. So we were right on one point: it's very likely that Q4 2009 will mark the peak in the unemployment rate for this cycle.

Wages

The wage data, released on Tuesday, reinforced the message that labour market conditions remained soft at the end of last year. Private sector wages grew by just 0.3%, bringing the annual rate of growth down to 1.5%. Only 44% of workers have had a pay rise in the last year, the lowest proportion since June 2000. And for those who did get a raise, the average increase of 4.4% was down on the last few years.

Market implications

We don't think these figures will materially alter the RBNZ's view. Employment growth was in line with their forecasts; wages growth was a little softer than they expected; the unemployment rate was much worse than their 6.6% forecast but is problematic. The small drop in hours worked represents a downside risk to our forecast of 1.1% growth in Q4 GDP, but is consistent with the RBNZ's pick of 0.6%. On balance, it suggests that their signal for rate hikes to begin "around the middle of 2010" could end up being right on the money.

Accordingly, the market has pushed out the expected timing of the first OCR hike to the June *Monetary Policy Statement* (a week ago the April review was seen as more likely). The NZ dollar fell by 70 points to 0.7000, and the two-year swap rate fell by 10 basis points.

In a speech last week, Dr Bollard made the point that in the process of normalising interest rates, the RBNZ may need to raise the OCR in "meaty chunks" if they see inflation pressures coming through. However, the subdued wage growth to date suggests that there's no immediate pressure for them to move by more than 25bp at a time.

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