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Editor: Paul Dales

Why wage growth will stay low

- While the latest data showed that employment growth has surged in Australia and New Zealand and the unemployment rate has edged down in both economies recently, this won't be enough to generate inflationary pressures in either labour market.
- A closer inspection of last week's labour market figures reveals that neither labour market is as healthy as the headline figures alone suggest. With plenty of spare capacity still present in the Australian labour market, and net migration expected to remain at elevated levels in New Zealand, we expect wage growth to remain subdued in both economies over the next few years. (See pages 2-3.)
- Meanwhile, it's a relatively quiet week in terms of data releases with New Zealand's international trade data (released on Wednesday) the main highlight. We expect that the trade deficit widened in July as weaker dairy prices weighed on export values.

Data Previews (page 4)

New Zealand International Trade (Wed. 24th Aug.) – Deficit widens

Economic & Market Data (page 5)

Economic Diary & Forecasts (page 6)

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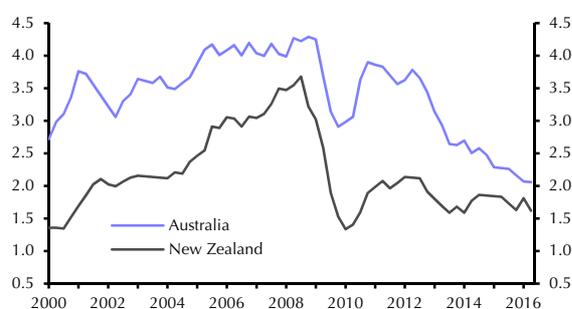
Why wage growth will stay low

Headline labour market figures released in Australia and New Zealand last week were impressive to say the least, with employment surging and the unemployment rates edging down. However, these headline figures were more of a mirage than a miracle and don't alter our view that neither country is likely to experience much inflationary pressure in their labour market over the next few years. This is one reason why low underlying inflation is likely to remain a concern for both economies and probably prompt the RBA and RBNZ to cut interest rates below their current historically low levels.

Do the employment data alter the wage outlook?

At first glance, the latest data for Australia and New Zealand suggests that both labour markets have held up very well recently. In Australia, employment rose by 26,200 in July, which was the largest increase since November last year. And the unemployment rate edged back down to 5.7%. Meanwhile in New Zealand, employment surged in the second quarter by an eye-watering 2.4% q/q, which was the largest quarterly growth rate on record. At face value, this could be a signal that things may be heating up in both labour markets and inflationary pressures might soon follow. **With wage growth stubbornly low in both economies that would be a welcome development. (See Chart 1.)**

CHART 1: WAGE GROWTH (%Y/Y)



Source – Thomson Datastream

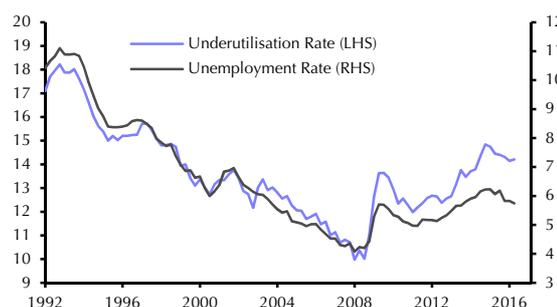
However, a closer examination reveals that the headline figures *overstate* the true strength of the labour markets. For one, although 220,000 jobs

have been created in Australia over the last year, 85% of those have been in part-time positions. That in itself is not a major concern and in part reflects a structural change in the economy as jobs growth shifts from mining to service related employment. (See our *Australia and New Zealand Economics Weekly*, “The part-time problem”, 15th July.)

The problem is that there is a growing number of people who are employed part-time but would be willing to work more. The underutilisation rate attempts to capture this additional dimension of spare capacity by taking account of these workers as well as those who are unemployed.

Chart 2 shows that the unemployment rate alone isn't accurately capturing the amount of spare capacity in the labour market. While it has edged down, the underutilisation rate has remained elevated by historical standards. This explains why annual wage growth stayed at just 2.0% in the second quarter, the lowest rate since records began, despite the downward trend in the unemployment rate.

CHART 2: AUS. UNEMP. RATE & UNDERUTILISATION RATE (%)



Source – Thomson Datastream

In New Zealand, the surge in employment in the second quarter, which generated a fall in the unemployment rate to a seven-year low of 5.1%, was also somewhat misleading. Changes to questions in the household labour force survey meant that a sizable number of people who had previously identified themselves as not in the labour force, instead recorded themselves as self-employed. This generated a one-off jump in employment. **So, while**

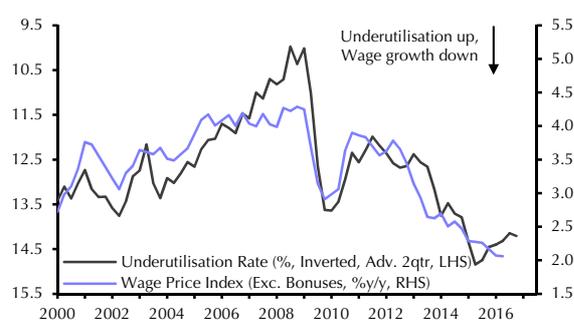
other indicators are consistent with a fairly healthy labour market, the second quarter figures significantly overstate that strength.

Outlook for wage growth remains weak

Given that a closer inspection of last week's labour market data reveals that the health of both labour markets hasn't improved to the extent that the headline figures suggest, we haven't altered our view that wage growth is likely to remain subdued in both economies. In fact, what matters for the outlook for wage growth is what has happened to the fundamental drivers of the low wage environment in each economy recently.

In Australia, as we mentioned previously, the key driver is the degree of spare capacity in the labour market. **The current rate of underutilisation suggests there is still plenty of spare capacity in the labour market and it points to only a moderate pick-up in wage growth over the near-term.** (See Chart 3.) We expect wage growth to remain below 2.5% until at least the end of next year.

CHART 3: AUS. UNDERUTILISATION RATE & WAGE GROWTH

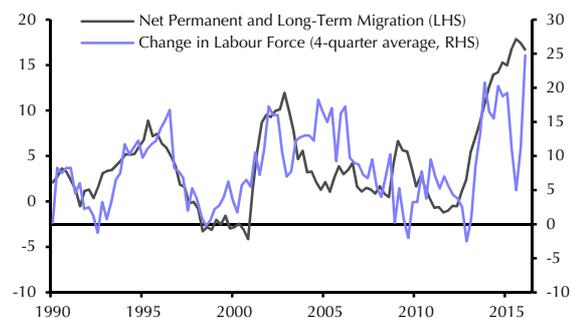


Source – Thomson Datastream

In New Zealand, for the first time, StatsNZ also produced an underutilisation rate. But, unlike in Australia, it fell in the second quarter and remains only marginally above the long-run average. This isn't surprising given that New Zealand doesn't have the same problem of a rising share of part-time workers. **It seems more likely that subdued wage growth in New Zealand is instead the product of the historically high surge in net migration over the last few years.** While these migrants have undoubtedly boosted demand, Chart 4 shows that they have also

supported labour supply. And it is for this reason that wage growth has remained low.

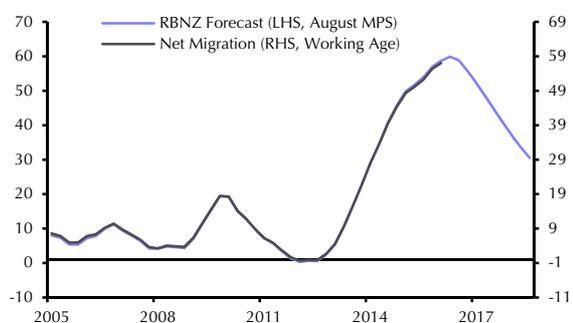
CHART 4: NZ NET MIGRATION & LABOUR FORCE (QRT, 000s)



Source – Thomson Datastream

Although net migration appears to be near its peak, it is expected to stay at elevated levels over the next few years. (See Chart 5.) As a result, wage growth is also likely to remain subdued in New Zealand. We estimate that wage growth will stay below 2.0% until at least 2018.

CHART 5: NEW ZEALAND ANNUAL NET MIGRATION (000s)



Sources – RBNZ, StatsNZ

With wage growth likely to stay low in Australia and New Zealand for some time and the recent sustained strengthening in both currencies meaning that neither country will import much inflation either, both central banks will struggle to return inflation to target over the forecast period. In Australia, we expect inflation will be lower for longer than the RBA currently expects which may prompt the Bank to cut rates from 1.5% to 1.0% by next year. A similar situation in New Zealand may see the RBNZ cut rates from 2.0% to 1.5%.

Kate Hickie

Data Preview – New Zealand International Trade (Jul.) 08.45 AEST Wed. 24th Aug.

Forecasts	Previous	Median	Capital Economics
Trade Balance (sa)	-\$78m	-	-\$200m
Trade Balance (nsa)	+\$127m	-\$300m	-\$450m

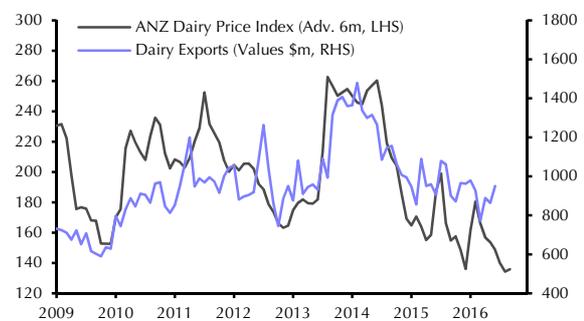
Deficit widens

We expect that the seasonally adjusted trade deficit widened in July as a weaker dairy price may have weighed on export values.

After remaining essentially unchanged in June, we estimate total export values fell by around 5% m/m in July on a seasonally-adjusted basis. This is based on our view that earlier falls in the prices of key agricultural exports, such as dairy, probably dragged on export values. (See Chart 1.) Import values probably declined by around 1.1% m/m again in July as weaker oil imports weighed on total import values. As such, we've pencilled in a widening in the seasonally adjusted trade deficit from \$78m to \$200m. The non-seasonally adjusted trade balance probably moved from a surplus of \$127m to a *deficit* of \$450m. Such a widening would suggest that after

probably providing a considerable boost to GDP growth in the second quarter, the external sector may not provide the same level of support in the third quarter.

CHART 1: DAIRY EXPORT VALUES & DAIRY PRICE



Source – Thomson Datastream

Latest Data & Main Forecasts

LATEST ECONOMIC INDICATORS (%M/M OR %Q/Q(%Y/Y) UNLESS STATED)

Australia Monthly Indicators	Apr	May	Jun	Jul
Change in Employment (actual)	-200	+19,300	+10,800	+26,200
Unemployment Rate (%)	5.7	5.7	5.8	5.7
Retail Sales	+0.1%(+3.6%)	+0.2%(+3.4%)	+0.1%(+2.8%)	-
International Trade Balance (\$m)	-1824	-2418	-3195	-
Australia Quarterly Indicators	Q3 2015	Q4 2015	Q1 2016	Q2 2016
GDP	+1.0%(+2.7%)	+0.7%(+2.9%)	+1.1%(+3.1%)	-
Consumer Prices (nsa)	+0.5%(+1.5%)	+0.4%(+1.7%)	-0.2%(+1.3%)	+0.4%(+1.0%)
Current Account (\$bn, as a % of GDP)	-19.8(-4.8%)	-22.6(-5.5%)	-20.8(-5.0%)	-
New Zealand Quarterly Indicators	Q3 2015	Q4 2015	Q1 2016	Q2 2016
GDP (production basis)	+0.9%(+2.3%)	+0.9%(+2.3%)	+0.7%(+2.8%)	-
Consumer Prices (nsa)	+0.3%(+0.4%)	-0.5%(+0.1%)	+0.2%(+0.4%)	+0.4%(+0.4%)
Change in Employment (actual)	-7,000	+22,000	+32,000	+58,000
Unemployment Rate (%)	5.5	5.0	5.2	5.1
Current Account (sa) (\$bn, as a % of GDP)	-1.7(-2.8%)	-2.2(-3.5%)	-1.5(-2.4%)	-

LATEST MARKET DATA*

Instrument/rate		1 mth ago	1 week ago	Latest*	Instrument/rate	1 mth ago	1 week ago	Latest*	
Official Rates	Australia	1.75	1.50	1.50	Global Yields	US 10yr	1.55	1.56	1.55
	NZ	2.25	2.00	2.00		Euro 10yr	-0.03	-0.09	-0.08
	US	0.25-0.50	0.25-0.50	0.25-0.50		Japan 10yr	-0.23	-0.10	-0.09
Aus Rate Expects. (30 day)	Dec 2016	1.41	1.35	1.36	Equity Indices	S&P/ASX 200	5451	5508	5508
	Jun 2017	1.33	1.25	1.25		S&P/NZX 50	7155	7354	7385
NZ Rate Expects. (90 day)	Dec 2016	2.06	1.99	2.01	Currencies	US\$/Aus\$	0.75	0.77	0.77
	Jun 2017	1.96	1.86	1.81		US\$/NZ\$	0.70	0.72	0.73
Gov't Yields	Aus 10yr	1.92	1.85	1.87	Commodities	Aus\$/NZ\$	0.94	0.94	0.95
	NZ 10yr	2.26	2.12	2.15		Oil (US\$/pb)	46.7	46.0	50.3
						Gold (US\$/oz)	1332	1339	1350
						Iron Ore (US\$/t)	56.5	61.0	61.3

*Latest as of 00.10 AEST 19th August 2016.

MAIN ECONOMIC & MARKET FORECASTS (%Q/Q (%Y/Y) UNLESS STATED)

Australia	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	2017	2018
GDP	+0.7(+2.9)	+1.1(+3.1)	+0.2(+3.0)	+0.5(+2.5)	+0.5(+2.3)	(+2.7)	(+2.8)	(+2.8)
CPI Inflation (nsa)	(+1.7)	(+1.3)	(+1.0)	(+1.0)	(+0.9)	(+1.1)	(+1.8)	(+2.0)
Core CPI Inflation ¹ (nsa)	(+2.3)	(+1.9)	(+1.8)	(+1.7)	(+1.5)	(+1.8)	(+1.6)	(+1.8)
Unemployment Rate (%)	5.8	5.8	5.7	5.7	5.6	5.7	5.5	5.3
RBA Cash Rate, End Period (%)	2.00	2.00	1.75	1.50	1.50	1.50	1.00	1.50
US\$/Aus\$, End Period	0.73	0.77	0.74	0.72	0.70	0.70	0.65	0.75
New Zealand	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	2017	2018
GDP (production basis)	+0.9(+2.3)	+0.7(+2.8)	+0.7(+3.2)	+0.2(+2.6)	+0.6(+2.3)	(+2.7)	(+3.0)	(+3.0)
CPI Inflation (nsa)	(+0.1)	(+0.4)	(+0.4)	(+0.6)	(+1.1)	(+0.6)	(+1.7)	(+1.8)
Core CPI Inflation ¹ (nsa)	(+0.9)	(+1.0)	(+1.0)	(+1.1)	(+1.1)	(+1.1)	(+1.2)	(+1.2)
Unemployment Rate (%)	5.0	5.2	5.1	5.0	4.9	5.1	4.8	4.6
RBNZ Cash Rate, End Period (%)	2.50	2.25	2.25	2.00	1.75	1.75	1.50	2.25
US\$/NZ\$, End Period	0.68	0.69	0.71	0.70	0.65	0.65	0.65	0.75
Aus\$/NZ\$, End Period	0.94	0.90	0.96	0.97	0.93	0.93	1.00	1.00

¹Excludes food, households energy and vehicles fuel.

Economic Diary & Forecasts

AUSTRALIA & NEW ZEALAND

Date	Country	Release/Indicator/Event	Time		Previous*	Median*	CE Forecast*
			AEST	(NZST)			
Mon 22 nd	-	-	No Significant Data Released		-	-	-
Tue 23 rd	-	-	No Significant Data Released		-	-	-
Wed 24 th	 NZ	Trade Balance (Jul)	(sa) 08.45	(10.45)	-\$78m	-	-\$200m
	 NZ	Trade Balance (Jul)	(nsa) 08.45	(10.45)	+\$127m	-\$300m	-\$450m
	 Aus	Skilled Vacancies (Jul)	11.00	(13.00)	+0.8%(+10.1%)	-	-
	 Aus	Construction Work Done (Q2)	11.30	(13.30)	-2.6%(-6.7%)	-2.0%(-10.7%)	-
Thu 25 th	-	-	No Significant Data Released		-	-	-
Fri 26 th	-	-	No Significant Data Released		-	-	-

*m/m(y/y) unless otherwise stated; p = provisional estimate

KEY FORTHCOMING EVENTS/DATA

1 st Sep	Australian Retail Sales (Jul)	6 th Sep	RBA Policy Announcement
1 st Sep	Australia Private Capital Expenditure (Q2)	22 nd Sep	RBNZ Policy Announcement

Selected Recent Publications

Date	Publication	Title
Mon 15 th	Capital Daily	Is China's credit cycle starting to turn?
	India Economics Update	Gold bond scheme showing signs of success
	Precious Metals Update	PGMs rally might have gone too far
	European Economics Update	Italy's stagnation may soon turn to recession
	US Housing Market Update	Why our house price forecast is top of the pack
Tue 16 th	Capital Daily	Will political tensions halt the outperformance of Russian bonds?
	UK Commercial Property Update	What can financial market volatility tell us about pricing?
	China Economics Update	Slow take-up to limit impact of Shenzhen-HK Connect
	Global Economics Update	Global imbalances to remain small by past standards
	Global Markets Update	Are Treasuries vulnerable to waning demand from overseas?
Wed 17 th	Latin America Watch	Brazil's CA deficit narrows, but more work to do elsewhere
	Capital Daily	Are rising foreign hedging costs a threat to US Treasuries?
	New Zealand Data Response	Labour Market (Q2)
	Japan Economics Update	Governor Kuroda is mulling another policy surprise
	Africa Economics Update	Zambia faces a painful period of post-election austerity
	Industrial Metals Update	China Industrial Metals Demand Monitor (Jul.)
	Middle East Economics Update	Saudi economy probably contracted in Q2
Thu 18 th	European Economics Update	Dutch investment growth set to slow sharply
	China Chart Book	G20 blues lie ahead
	US Economic Outlook	Growth should pick up as headwinds fade
	Capital Daily	Is the yen finally topping out?
	Australia Data Response	Labour Market (Jul.)
	Middle East Chart Book	Gulf non-oil sectors struggle as austerity bites
	India Markets Monitor	Rally in equities has further to run
	China Economics Update	Capital Flows Monitor (Jul.)
	India Markets Monitor	Rally in equities has further to run
	China Economics Update	Capital Flows Monitor (Jul.)
Fri 19 th	Metals Watch	Western investors to drive gold prices higher
	Global Economics Update	Putting the global slowdown into perspective
	Emerging Markets Chart Book	Turnaround in industry supporting EM recovery
	European Economics Update	How the ECB could overcome its QE limitations
	UK Consumer Monthly	Little sign of immediate post-referendum hit to spending
	Capital Daily	What's behind the renewed slide in the US dollar?
	Australia & NZ Economics Weekly	Why wage growth will stay low
	Emerging Asia Economics Weekly	-
Japan Economics Weekly	-	
UK Economics Weekly	-	
European Economics Weekly	-	
Canada Economics Weekly	-	
US Economics Weekly	-	

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