NZ unemployment higher than expected at 5.8% in March quarter, unchanged from upwardly revised 5.8%; annual jobs growth strong at 3.2%; participation up to new record high 69.6%

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Employment grew strongly again in the March quarter, but unemployment rose unexpectedly and wage inflation remained below the Reserve Bank's target as migration of young men and rising workforce participation more than soaked up the jobs growth.

The figures suggest household income growth and consumer spending will continue strongly through 2015, but that nominal wage inflation remains weak enough for the Reserve Bank to consider rate cuts later in the year. ASB changed its interest rate view from seeing a 50% chance of a rate cut later this year to now expecting two rate cuts to 3% by the end of this year. Deutsche Bank also changed its view to expecting two OCR cuts later this year.

The New Zealand dollar fell more than half a cent to near a one month low of 74.6 USc and wholesale interest rates fell 6-8 basis points on increased market expectations of a rate cut later this year.

Statistics New Zealand reported the unemployment rate was unchanged at 5.8% in the March quarter from an upwardly revised 5.8% in the December quarter, but largely because the labour force participation rate rose to a new record high of 69.6% to overwhelm the strong annual jobs growth of 3.2%.

The unemployment rate has bounced from a five year low of 5.5% in the September quarter of last year, although it is down from 6.0% a year ago. The trend unemployment rate rose to 5.9%, its highest in 12 months.

The number of unemployed people rose 3,000 in the quarter to 146,000, including a rise of 6,000 in male unemployment to 71,000 and a 3,000 fall in female unemployment to 75,000.

The number of people employed rose 16,000 or 0.7% in the quarter, but this was more than soaked up by a rise in the workforce of 16,000 as the participation rate rose 0.2%, including an extra 16,000 men and 2,000 women. The 0.7% jobs growth was a bit below market expectations for 0.8% growth.

"High net migration for the 20–34-year age groups contributed to the growing working-age population," Statistics NZ said.

Average ordinary time hourly earnings were unchanged for the quarter at NZ$28.77/hour and annual inflation was 2.1%, which was the lowest increase since the year to the June 2013 quarter.

The figures reinforce the recent trends of solid jobs growth with low inflation and the indications of only modest wage growth will be watched closely by the Reserve Bank, which said last week it could cut interest rates if wage growth settled at levels below the inflation target, which is 2% under the current Policy Targets Agreement.

Statistics New Zealand reported salary and wage inflation including overtime was 0.3% for the quarter and 1.7% for the year.

It said the Labour Cost Index (LCI) measure of wage inflation, which strips out the effects of promotions and is closely watched by economists and the Reserve Bank as a 'truer' measure of wages, rose 0.3% in the quarter. This was below the 0.5% seen in the December quarter and below the 0.4% expected by economists.

Economist reaction

ASB Chief Economist Nick Tuffley said the bank had moved to forecast the RBNZ would cut the OCR twice later this year -- one 25 basis point cut in September and one in October.

"We believe the risks of inflation taking too long to make a sustained return to the 2% mid-point of the inflation target have now got high enough to warrant a response," Tuffley said.

"Accordingly, we think the RBNZ will give inflation a nudge up through 50bp of cuts, most likely 25bp in each of September and October. But an earlier start is conceivable," he said, adding there was a 60% chance of cuts occurring.

"The main risk from a lower OCR is the housing market through the likelihood of added price growth. Even there, we would expect the RBNZ to keep working on making the financial system even more resilient, while exhorting local and central government to do more to address the root causes of Auckland's housing imbalance."

ANZ Senior Economist Philip Borkin said data was consistent with solid GDP growth in 2015.

"However, the main news was again the significant growth in labour supply, with another solid gain in the working age population and record participation ensuring the unemployment rate remained unchanged (at an upwardly revised level)," Borkin said.

"This supply response is capping wage inflation – which surprised on the downside and is even showing signs of further moderation based on some measures – reinforcing that the labour market is at the heart of the current "solid growth but low inflation" conditions the economy is experiencing," he said.

"It ensures the risks around OCR settings are skewed downwards."

Westpac Senior Economist Satish Ranchod said the data was weaker than expectations with "lingering unemployment and soft wage inflation despite continued firm jobs growth."

"Wage inflation continues to be dampened by low consumer price inflation, which has meant that cost of living adjustments to wages have been limited," Ranchod said.

While the economy is growing at a solid pace, there is lingering spare capacity in the labour market and nominal wage pressures remain subdued. This reinforces our expectations that the OCR will remain on hold for some time, and at the margin, adds to risk of cuts over the coming year," he said.

BNZ Senior Economist Craig Ebert said the data was not strong enough to soothe the Reserve Bank's concerns about inflation failing to strengthen as forecast.

"Accordingly, the possibility of the OCR being reduced is increasing. But we are not changing our cash rate call on the basis of today's data," Ebert said, adding however that BNZ still saw the OCR on hold for the forseeable future.

He said the jobs growth was not weak, pointing to a 4.1% rise in full time equivalent employment in the quarter from a year ago, which was the strongest growth since 1996.

However, the markets were focused on the failure of the unemployment rate to fall and the weak annual LCI inflation of 1.8% for the private sector.

"This (the unemployment rate) was the number that genuinely surprised us, when all the talk has been that staff are becoming more difficult to find. It could just be that the flood of net immigration that the country is experiencing is proving just as hard to absorb," Ebert said.

He said the LCI result was below the Reserve Banks's expectations.

"In its March Monetary Policy Statement the Bank predicted a 2.0% annual gain in the private-sector (all salary and wage rates) Labour Cost Index. It actually came in at 1.8%. Normally this would have passed the market by. But with the Reserve Bank recently noting the importance of wage and price setting behaviour in its policy considerations, any misses, even fractional ones, are now seen as a big deal," Ebert said.

Political reaction

Employment Minister Steven Joyce said the strong jobs growth was encouraging and pointed to jobs growth of 194,000 since the 2011 Budget as more than the 171,000 forecast in that Budget. He also pointed to hourly wage growth of 2.1% being higher than inflation of 0.1%.

Green Party Housing Spokesman and male leadership candidate Kevin Hague said wage inflation was not keeping up with house prices.

“Young New Zealanders see the growing gap between their wages and house prices and despair that the National Government is ignoring their hopes to one day own their own home,” Hague said.

“No matter how hard people save, with such a huge difference between low wage growth and dramatic house price rises, many working New Zealanders are being forced to give up on the idea of home ownership because of the Government’s inaction," he said.

“The simple fact is that a house in Auckland earns more than a working person does."

(Updated with more details and context and reaction from economists and politicians, ASB's changed view to seeing rate cuts in 2015)