



ECONOMICS & MARKETS RESEARCH

ANZ AUSTRALIAN MARKETS WEEKLY

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SURGING LABOUR DEMAND LIKELY TO FORCE RBA'S HAND

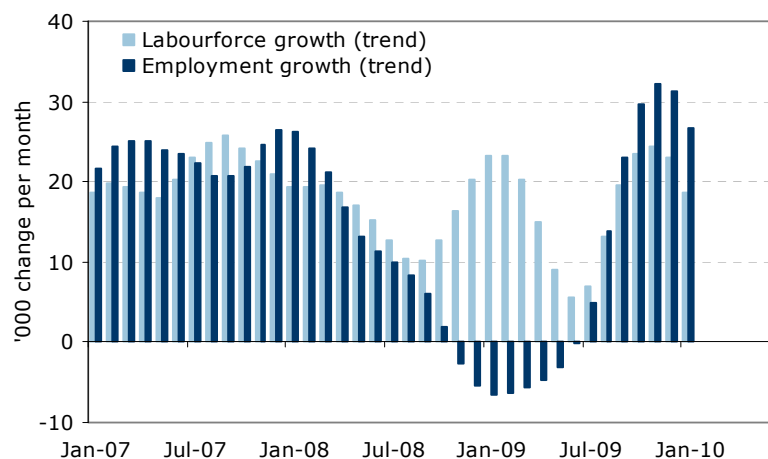
ECONOMIC UPDATE: IT'S ALL ABOUT JOBS

- January's labour force data exceeded all expectations, with over 50k jobs added in the month and the unemployment rate falling 0.2ppts to 5.3%.
- Other data over the past week has been more mixed, with mildly negative signals coming from building approvals and finances and from retail trade data.
- For the RBA as for us, the sheer strength of January's jobs growth figures should outweigh all other Australian domestic data in considering the immediate trajectory.
- While the RBA said it wants to 'wait and see' more evidence of strength in the economy before making its next move, January's jobs growth means a rate rise in March is now far more certain.

CHART OF THE WEEK: JOBS GROWTH SMASHES AHEAD

Employment growth and labour force growth have been rising in tandem for the last 6 months, running neck and neck. But in January 2010, jobs growth smashed ahead, pushing the unemployment rate down to 5.3% as a result.

FIGURE 1. EMPLOYMENT OUTPACES LABOUR FORCE GROWTH



Source: ABS.

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AUSTRALIAN LABOUR MARKET SURGES BEYOND ALL EXPECTATIONS

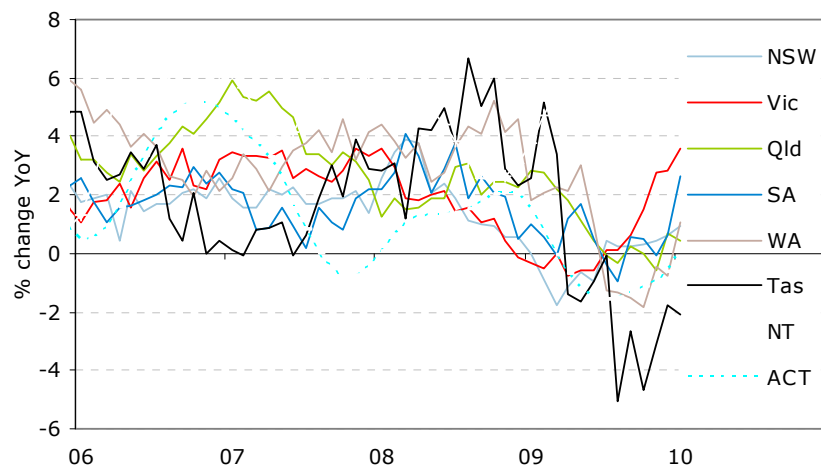
National employment (seas. adj.) grew beyond all expectations in January, with 52.7k jobs added this month, and a total of almost 200k jobs added over the last 5 months. January's jobs growth rates of 0.5% MoM and 1.7% YoY (seas. adj.) were the strongest since mid-2008 and the numeric increase in jobs was the largest since December 2006.

The unemployment rate fell to 5.3%, its lowest since February 2009. And even more positively, the total number of unemployed people fell for the third month in a row, by 22k (and by 49.8k over the last 3 months). This is excellent news for aggregate household incomes and consumption as well as for demand on government welfare services and expenditure. It indicates a real fall in unemployment, and not just a trick of the numbers (as can happen for example, when employment, unemployment and the labour force all grow together at about the same speed). On today's numbers then, it appears as though the unemployment rate – and perhaps more importantly the number of unemployed people – is now definitely trending downwards.

At the same time, we are continuing to see accelerating in labour force growth, up 30.5k this month and 147.8k over the last 5 months. The national labour force growth rate accelerated a touch to 0.3% MoM and 2.0%YoY this month s.a., or 1.8% p.a. trend. The participation rate held steady at 65.3%, but may rise higher in coming months as a greater number of potential workers are 'encouraged' back into the workforce by this apparent jobs boom. In addition, the Australian Government recently announced measures to encourage greater workforce participation among older workers, whose participation rates are typically lower than younger workers and lower than their aged counterparts in comparable countries. This possible increase in participation is the main source of risk around bringing the unemployment rate down further in the short term.

The effect of a small rise in the participation rate is illustrated in this month's data by the example of Victoria. Victoria saw a rise in its unemployment rate, despite having more than half of all the net new jobs this month, mainly because its participation rate jumped from 65.1% to 65.6% in just one month, pushing the number of unemployed and the unemployment rate up again. Victoria's jobs grew 1% MoM and a massive 3.6% YoY, versus estimated labourforce growth of 1% MoM and a very strong 4% YoY.

Among the states, Victoria had the largest numeric and proportional jobs growth (see figure 2), but South Australia saw the biggest fall in its unemployment rate, from 5.3% in December to just 4.4% this month. This was because unlike Victoria, South Australian employment growth (2.2% MoM) was stronger than its labour force growth (1.2% MoM).

FIGURE 2. WHERE ARE THE NEW JOBS? IN VICTORIA AND SA

Source: ABS.

'SPARE' LABOUR MARKET CAPACITY IS NOW LOOKING EXTREMELY TIGHT

About equal numbers of full-time and part-time jobs have been added (96k and 98.7k) over this period, but the proportion of part-time workers has continued to rise, and is now 30.2% of total employment, a new record in this data series (which commenced in 1978). This helps to explain why we are continuing to see a fall in aggregate hours

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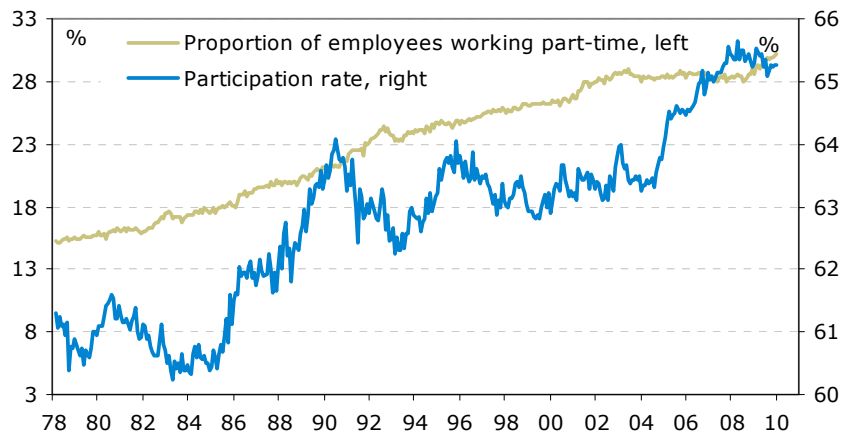
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worked (down 1.1% this month and 1.1% from January 2009). It reflects structural changes in the population and the workforce as much as it does labour demand trends, but has, nevertheless, prompted considerable speculation about spare capacity among 'under-employed' part-time workers.

On the supply side, rising participation has pulled many more people into the workforce, but many of those additional people are only willing or able to work part-time. Indeed, for many workers, workforce participation is probably only possible on a part-time and/or flexible basis, due to age, health, family care or study requirements. While it is true that a higher proportion of workers now work part-time (under 35 hours per week), only 7.8% indicated that they are willing and able to work more hours than they currently have (that is, they are 'underemployed') in the latest ABS underemployment survey in November, compared with 6.4% in November 2008. Assumptions that this part-time worker group represents a large pool of 'spare' labourforce capacity for the economy going forward may therefore be overstated. If anything, the 'spare' capacity present in the current workforce (as indicated by the fall in aggregate work hours and average work hours) seems more likely to come from those already working full-time increasing their hours and overtime hours; the proportions working 50+ and 60+ hours has also fallen but could presumably rise again.

Although low unemployment is welcome news for many reasons, these relatively small and shrinking measures of 'spare' capacity in the labour market do not augur well for the inflation outlook. Skill shortages are already an issue in several key industry sectors (healthcare, engineering, resources infrastructure) and wages pressures are likely to quickly rebuild and spread. This will put upward pressure on an already borderline inflation outlook, in terms of the RBA target band.

FIGURE 3. RISING PARTICIPATION AND PART-TIME RATES ARE LINKED



Source: ABS.

THE WAIT AND SEE APPROACH DELIVERS MORE STRONG DATA

Only just over a week ago economists were left scratching their collective heads at the RBA's wait and see approach to the further tightening monetary policy. A case could be made, with a renewed focus on inflation, that the December quarter numbers in isolation of strong activity data were perhaps not sufficient to see the RBA hike in February. This is despite annual inflation rates still above the target band. For example, if you assume the December quarter read for trimmed mean inflation of 0.6% in the quarter persists in the next three would approximately give an annualized rate of inflation at 2.4%. Indeed, the RBA's forecasts released in last week's Statement on Monetary Policy showed it is exactly this scenario they are expecting. To us these set of forecast represent a good result with only a gradual path of cash rate hikes assumed. However, to our mind, the RBA's forecasts are a best case scenario, especially on inflation and the recent activity data seems to support this contention.

So what has the wait and see approach brought us thus far. Trade data came in with a wider deficit due to strong imports in the month. A look at the detail, we see

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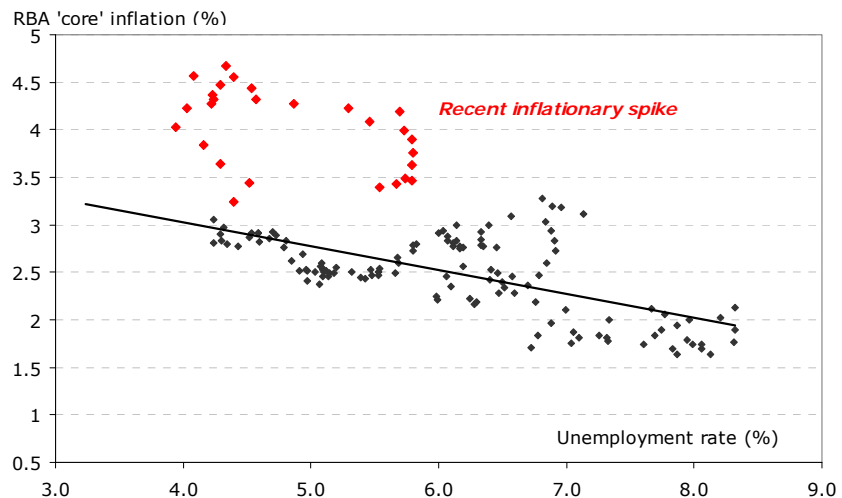
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that the ABS estimated import volume growth in excess of 7%, the strongest growth since Q4 2002, reflecting a domestic economy that is clearly recovering well (import volumes are estimated to have risen 13% in the last six months the strongest growth since the economic recovery in 1994).

We then got retail sales and a weak number on nominal sales for the month was food for thought but a fairly strong 1.1% gain, in volume terms, for the quarter suggests consumers were happy to keep spending. This is supported by the consumer confidence index results this week that showed that although we saw a slight contraction in sentiment in February, the level remains strong. Building approvals were out the same day as retail and recorded another solid monthly read, up 2.2% in December and 53.3%YoY. So clearly the building industry finds the current level of interest rates accommodative to say the least.

Housing finance figures were sharply weaker for December reflecting the fall in first home buyer numbers from record levels as the grants were wound back rather than any higher interest rate impact alone. Indeed, with Governor Stevens' comments this week on asset bubbles and Australia's recent house price performance some steam coming out of the property market can hardly be seen as a bad result.

FIGURE 4. THE UNEMPLOYMENT RATE CAN'T GO TOO MUCH LOWER WITHOUT CONSEQUENCES



So today's labour force data was the clincher. Employment figures blew market expectations away and at over 52K were three times the market expectation, taking the unemployment rate to 5.3%. This strength of the labour market in recent months combined with strong data reads since the February RBA meeting make the prospect of a hike in March a real prospect (market pricing has shifted markedly suggest a March hike is a 50% chance). Any spare capacity in the economy is being used up fast and it was in 2008, when the unemployment eased to under 4.5%, that we saw inflation accelerate and break out of the topside of the band (see Figure 4.). To us the RBA is clearly walking a fine line, and the activity data suggests that the risks to inflation are skewed firmly to the upside. As such the RBA we still believe the RBA will need to act sooner rather than later to ensure the core/underlying measures of inflation return to the target band.

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DATA WRAP

- **Westpac's Consumer Confidence** weakened by 2.6% for the month of February, in comparison to plus 5.6% the previous month. The index remains relatively elevated at 117.0 indicating a greater number of optimists in the survey.
- The **number of Housing Finance Approvals** for the month of December fell to -5.5%, an improvement on November's release of -6.1%.
- The **Value of Loans** taken in December increased 1.9% however was slightly weaker than the previous months read at 1.7%.
- The value of **Owner Occupier loans** fell by- 4.7%, softer than - 2.9% for the month of November.
- The **Consumer Inflation Expectation** report released was stable at 3.5%.
- The **change in the number of people employed** for the month of January increased strongly, jumping to +52.7K.
- The **Unemployment Rate** for January improved, falling to 3.2% from 3.5%
- **Full Time Employment** for January increased to 15.9K, a large jump from the previous month at 37.5K.
- **Part Time Employment** for January increased to 36.9K from the previous release of 30.2K.
- The **Participation Rate** for January was stable at 65.3%, the same figure as the previous month.

FORECASTS

AUSTRALIAN ECONOMIC INDICATORS	2008	2009 F	2010 F	2011 F
Economic activity (annual % change)				
Private final demand	4.1	0.3	3.4	4.6
Household consumption	2.4	1.6	2.5	3.0
Dwelling investment	2.6	-5.3	11.5	5.6
Business investment	13.9	0.8	7.9	9.2
Public demand	6.7	2.1	7.0	4.6
Domestic final demand	4.5	0.8	4.2	4.6
Inventories (contribution to GDP)	-0.4	-0.5	0.6	-0.1
Gross National Expenditure (GNE)	4.3	0.2	4.8	4.5
Exports	3.8	1.1	2.3	5.4
Imports	11.4	-6.7	12.8	9.2
Net Exports (contribution to GDP)	-1.6	1.7	-2.2	-1.0
Gross Domestic Product (GDP)	2.2	0.9	3.1	3.3
Prices and wages (annual % change)				
Inflation: Headline CPI	4.4	1.8	2.4	2.8
Underlying *	4.4	3.8	3.0	2.7
Wages	4.1	3.6	2.9	3.3
Labour market #				
Employment (annual % change)	2.2	0.3	2.6	2.0
Unemployment rate (annual average %)	4.2	5.6	5.2	4.8
External sector				
Current account balance: A\$bn	-54.3	-54.3	-74.5	-74.1
% of GDP	-4.4	-4.3	-5.7	-5.3

* Average of RBA weighted median and trimmed mean statistical measure.

Actual labour market data for 2008 and 2009, forecasts for 2010 and 2011.

AUSTRALIAN INTEREST RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
RBA cash rate	3.75	4.00	4.25	4.50	4.75	4.75
90 day bill	4.19	4.35	4.75	4.85	5.00	5.00
3 year bond	4.62	4.70	5.00	5.05	5.30	5.55
10 year bond	5.51	5.30	5.50	5.45	5.60	5.75
3s10s yield curve	0.90	0.60	0.50	0.40	0.30	0.20
3 year swap	5.24	5.15	5.45	5.50	5.75	6.00
10 year swap	6.08	5.90	6.05	6.00	6.15	6.30
INTERNATIONAL INTEREST RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
RBNZ cash rate	2.50	2.50	3.00	3.75	4.00	4.00
NZ 90 day bill	2.77	2.80	3.63	4.22	4.30	4.30
US Fed funds note	0.25	0.25	0.25	0.25	0.75	1.25
US 2 year note	0.88	1.20	1.50	1.75	2.20	2.65
US 10 year note	3.70	4.10	4.30	4.25	4.40	4.45
Japan call rate	0.10	0.10	0.10	0.10	0.10	0.10
ECB refinance rate	1.00	1.00	1.00	1.00	1.50	1.75
UK repo rate	0.50	0.50	0.50	0.50	1.00	1.25

For additional information on interest rates please refer to ANZ's *Interest Rate Strategy Weekly*.



FORECASTS

FOREIGN EXCHANGE RATES	CURRENT	MAR 10 F	JUN 10 F	SEP 10 F	DEC 10 F	MAR 11 F
Australian exchange rates						
A\$/US\$	0.8872	0.89	0.87	0.86	0.85	0.82
NZ\$/US\$	0.6982	0.70	0.68	0.67	0.65	0.64
A\$/¥	79.73	79.2	78.3	79.1	79.9	78.7
A\$/€	0.6439	0.64	0.64	0.65	0.65	0.64
A\$/£	0.5674	0.56	0.55	0.55	0.55	0.53
A\$/NZ\$	1.2707	1.27	1.28	1.28	1.31	1.28
A\$/C\$	0.9394	0.93	0.92	0.92	0.92	0.89
A\$/CHF	0.9446	0.95	0.95	0.95	0.97	0.95
A\$/CNY	6.0562	6.08	5.86	5.72	5.58	5.31
A\$ Trade weighted index	69.20	68.9	67.9	67.0	66.5	64.0
International cross rates						
US\$/¥	89.86	89.0	90.0	92.0	94.0	96.0
€/US\$	1.3777	1.38	1.35	1.33	1.30	1.28
€/¥	123.81	123	122	122	122	123
£/US\$	1.5636	1.60	1.58	1.57	1.55	1.55
€/£	0.8811	0.86	0.85	0.85	0.84	0.83
US\$/C\$	1.0588	1.05	1.06	1.07	1.08	1.08
US\$/CHF	1.0647	1.07	1.09	1.11	1.14	1.16
US\$ index	79.79	79.5	80.9	82.1	83.7	84.8
Asia exchange rates						
US\$/CNY	6.8304	6.83	6.74	6.65	6.56	6.47
US\$/HKD	7.7694	7.79	7.81	7.79	7.80	7.80
US\$/IDR	9358	9300	9500	9300	9000	8800
US\$/INR	46.46	45.5	46.0	45.0	44.0	43.5
US\$/KRW	1157	1150	1175	1125	1100	1050
US\$/MYR	3.4215	3.34	3.37	3.40	3.40	3.35
US\$/PHP	46.279	46.0	46.5	46.0	45.0	45.0
US\$/SGD	1.4117	1.39	1.40	1.40	1.41	1.40
US\$/THB	33.160	33.00	32.50	32.50	32.50	32.00
US\$/TWD	32.044	31.50	31.90	31.50	30.50	30.00
US\$/VND	18713	18500	18500	18500	19300	19300
Pacific exchange rates						
PGK/US\$	0.3752	0.392	0.381	0.395	0.386	0.372
FJD/US\$	0.5099	0.516	0.507	0.502	0.495	0.484

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