

Softer wage growth gives RBA a temporary reprieve

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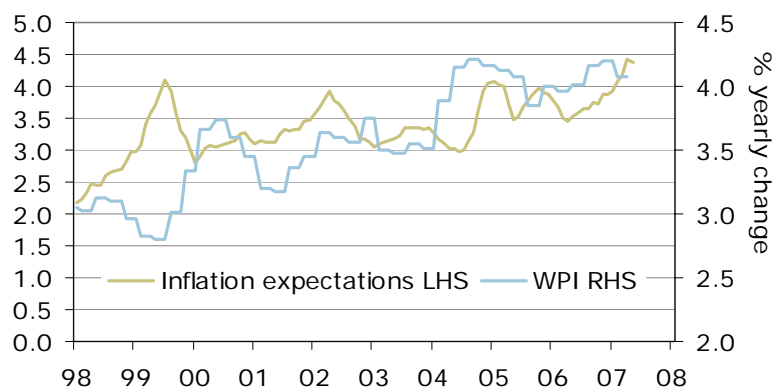
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Key points

- According to the Wage Price Index, **wage growth eased in Q1, notwithstanding tightness in the labour market and ongoing skill shortages.**
- The aggregate wage price index rose by 0.9% in Q1, below market expectations of a 1.1% rise and driven by lower private and public sector wage growth. Annual wage growth also eased slightly to 4.1% and remains within recent ranges.
- **Today's figures will give the RBA some more breathing room to wait and watch the data flow for any signs of slowing domestic demand and inflationary pressures.**
- **However the RBA is not out of the woods yet and wage growth could reaccelerate in coming quarters.** Anecdotes and industry surveys are highlighting wage pressures. Also, the threat to wages is unlikely to disappear in the short-term with strong labour demand, high profile large wage outcomes in the public sector and changes to industrial relations in recent months.
- **From the RBA's perspective, a key risk to the inflation outlook is the likelihood that higher inflation and inflation expectations will feed into higher wage demands.** While this was not evident in the Q1 numbers, we think it is more likely to be felt in Q2 (see chart below).
- Other wage measures are also more worrisome than the highly engineered WPI, which removes any compositional change and other factors which add to labour costs for business such as higher rates of promotion and are thus relevant for consumer price inflation. Broader wage measures such as average weekly ordinary time earnings (AWOTE) and non-farm compensation per employee in the national accounts were both running at an annual rate of 4 ¾% in Q4 2007, well above the WPI.
- Tomorrow's Average Weekly Earnings and AWOTE data will thus provide some further insight into whether today's WPI figures are giving an accurate reading on wage pressures. However, with the WPI printing so low, this is unlikely to trigger a monetary policy response at the next meeting.

Higher inflation expectations a key upside risk to wage growth

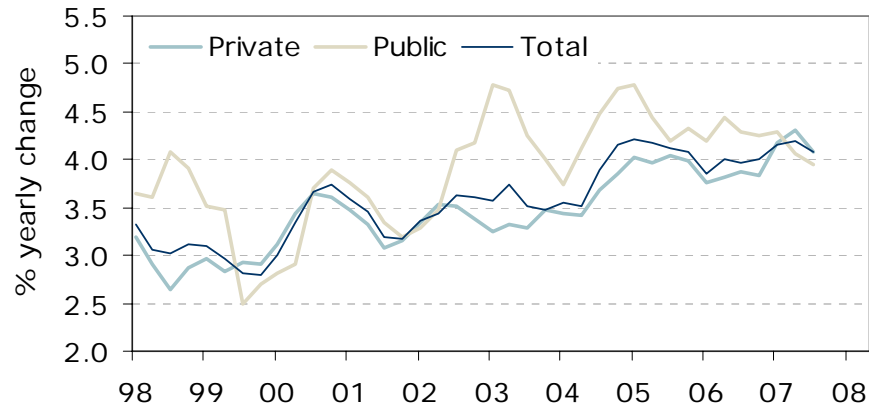


Sources: ABS and MI

The finer detail

Softer than expected wage growth was evident in both the private and public sector wages in Q1. Public sector wage growth eased to 0.8% in the quarter and 3.9% over the year, the softest readings since 2004. Private sector wage growth eased to 0.9% in quarterly terms. The annual rate also eased to 4.1% from 4.3% last quarter, although remains relatively elevated by recent standards.

Both private and public sector wages ease in Q1



There remain significant disparities across the states, with annual wage growth highest Western Australia and South Australia given their exposure to the booming mining sector (see table below). Wage growth in Queensland has actually eased in recent quarters, however, from an annual rate of 4.8% in Q2 2006 to the national average of 4.1% this quarter.

In quarterly terms, wage growth was the highest in Western Australia, but also in New South Wales and Victoria. This may be something to keep an eye on going forward, because the last thing the RBA wants is for higher wage rates in mining-driven states to spread more broadly through the economy.

Wage price index by state, annual % change (original)

	Mar-08	Dec-07	Yr to Mar-08
NSW	1.0	0.7	3.7
Vic	1.0	1.0	3.7
Qld	0.8	1.1	4.1
SA	0.9	1.2	4.6
WA	1.0	1.3	5.9
Tas	0.9	0.9	3.6
NT	0.8	1.0	3.6
ACT	0.8	1.0	4.0
Total	0.9	1.0	4.1

Source: ABS and ANZ

By industry, the largest increases this quarter were in mining (+1.7%), education (+1.6%), personal & other services (+1.3%) and transport and storage (+1.2%). In contrast, a number of sectors posted quite low wage increases. Wage growth in accommodation, cafes & restaurants and communication services was very weak (+0.3%). Retail trade and health and community services also posted smallish increases (+0.6%). While some of these low outcomes may be seasonal (the industry data is not seasonally adjusted), it does raise the possibility that there will be a rebound next quarter in these industries.

The ABS has cautioned that the seasonally adjusted figures may be more volatile than usual as the seasonal factors have been impacted by the changed timing of minimum wage decisions in recent years. This does not change our interpretation that today's figures were soft, however, with growth in both the seasonally adjusted and original figures easing.

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