Data Snapshot

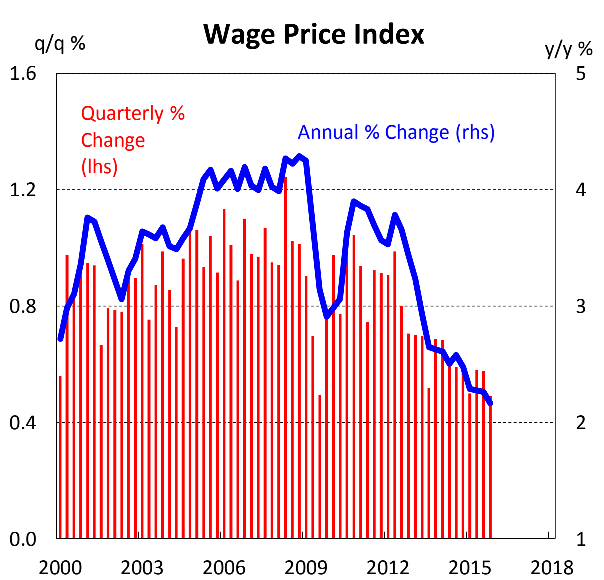
Wednesday, 24 February 2016

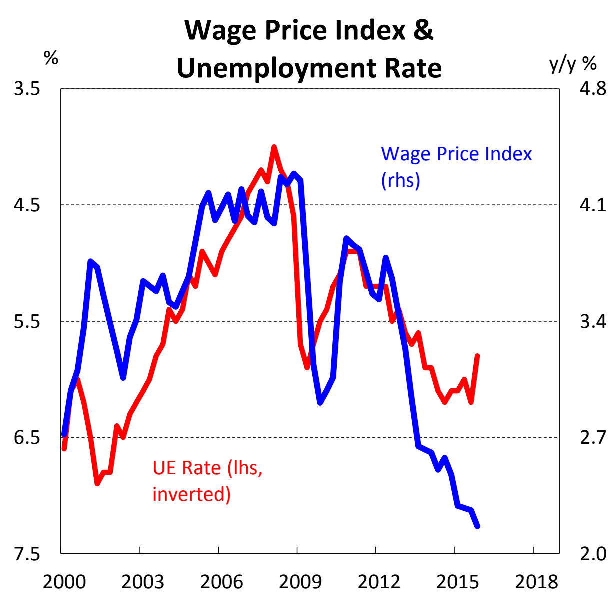
Bank of Melbourne

Wage Price Index

Annual Wages Growth at Record Low

- **The wage price index rose 0.5% in the December quarter, following an increase of 0.6% in the September quarter. This was below our own and market expectations and the smallest increase in wages since the March quarter last year.**
- **The annual rate fell to 2.2% in the year to the December quarter, which is the lowest on record since the series began in 1997, and well below the RBA's unofficial "line in the sand" for wages inflation of 4.5%. It follows three quarters of annual growth at 2.3%. Although low, wages growth is still running above headline inflation.**
- **Slow wages growth has likely allowed employment to grow at a stronger pace than current, below-trend, economic growth would suggest. The unemployment rate was 6.0% in January 2016, down from 6.3% a year earlier.**
- **The slow rate of wages growth was broad-based across industries and States. Annual wages growth was equal to or below 2.8% in all industries and equal to or below 2.4% in all States.**
- **The slow pace of wage growth suggests domestic inflation will remain contained, despite inflationary pressure from the lower Australian dollar. As it stands, we expect the RBA will leave rates on hold through 2016.**





The wage price index rose 0.5% in the December quarter, following an increase of 0.6% in the September and June quarters. The annual rate fell to 2.2% in the year to the December quarter, the lowest on record since the series began in 1997. Whilst wages growth is low, it is above the annual rate of headline inflation, which sat at 1.7% in the year to the December quarter. The rate of wages growth, however, remains well below the RBA's 'line in the sand' for wages inflation of 4.5%. The slow pace of wage growth points to spare capacity within the labour market and an intense focus on cost containment. Given the modest expectation for economic growth over the next 12 months it seems likely that wage growth will remain subdued.

In its recent Statement on Monetary Policy, the RBA noted wages growth had slowed more than the level of the unemployment rate would historically suggest. It said this may be explained in part by increased labour market flexibility, which may have given firms greater scope "to adjust wages in response to a given change in demand for their goods and services". It said lower wages growth is "likely to have encouraged firms to employ more people than they would have otherwise."

Slow wages growth has played an important role in allowing employment to continue to grow at a reasonable pace despite below-trend economic growth. This has meant the unemployment rate has been kept lower than might otherwise have been the case. The unemployment rate was 6.0% in January 2016, down from 6.3% a year earlier.

Public sector wage growth slowed to an increase of 0.5% in the December quarter, following an increase of 0.8% in the September quarter. For the year to the December quarter, public sector wage growth eased to 2.6%, from 2.8% in the year to the September quarter. Private sector wages rose 0.5% in the December quarter, which was the same increase in private sector wages as the previous three quarters. For the year to the December quarter, private sector wages rose 2.0%. This was the slowest annual growth in private sector wages on record, since the series began in 1997, and equal to the 2.0% increase in core inflation over the same period.

By Industry

Wage growth in annual terms remained slow across all industries. No industry saw wages growth in excess of 2.8% over the year to the December quarter. The strongest sector for wages growth was finance & insurance services (2.8%), followed by education & training (2.6%) and retail and manufacturing (both at 2.5%).

The weakest wages growth for the year to December quarter was private administration & support services (1.4%). This was closely followed by mining wages, which rose 1.5% in the year to the December quarter representing quite a turnaround from a peak of 6.7% growth in mining industry wages in the year to June 2008. A slowdown in engineering construction in recent years, as the mining investment downturn continues, weighed on construction industry wage growth which lifted 1.6% in the year to the December quarter.

By State

Annual wage growth was subdued across all States and territories, at 2.4% or below. Victoria and the Northern Territory saw the 'strongest' wages growth at 2.4%, followed by South Australia

(2.3%), Tasmania (2.2%), New South Wales (2.1%), Queensland (2.0%) and Western Australia (1.8%). The slowest wages growth in the year to the December quarter was in the ACT (1.7%).

Implications for the RBA

Today's data confirms that wages inflation remains low. The slow pace of wage growth suggests domestic inflation will remain contained, despite inflationary pressure from the lower Australian dollar.

With inflation low, the hurdle for a rate cut from the RBA is lower. Downside risks to the global economy have increased and keep open the possibility of another rate cut. In its recent commentary, however, the RBA has sounded relatively upbeat on the domestic economy. As it stands, we expect the RBA will leave interest rates on hold through 2016.

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