METHODOLOGICAL ISSUES CAST A SHADOW ON THE FAVOURABLE DEVELOPMENTS IN THE LABOUR MARKET

3 July 2014

- Employment in Hungary increased to 4.136 mn in Q1 2014, reaching 4.112 mn on the average of April-May period (all data are SWDA). This is an all-time-high level, significantly exceeding the top of the pre-crisis period (3.96 mn SWDA). Nevertheless, **the domestic employment w/o public work participants was 3.825 mn SWDA in Q1, which is below the pre-crisis top but is much higher than in Q4 2013 (3.711 mn),** and we could see a level shift in the employment in January 2014. This significant 125,000 QoQ growth is a consequence of three factors – possible misclassification of public work participants, resampling effect, and underlying improvement – but the current data do not allow their decomposition.

- First, it is very difficult to precisely filter out public work participants. There are two labour statistics, the institutional statistics (INS) and the Labour Force Survey (LFS). As illustrated on Chart 2, the number of public work participants is strongly correlated in the two statistics. Nevertheless, the INS statistics show 31,000 QoQ increase in the number of public work participants in Q1, in contrast with the 9,000 increase in LFS. This 22,000 difference is a huge one within a single quarter. The government introduced a new type of public works scheme, “high prestige” public works, allowing firms in certain industries to hire public workers as well. It is possible that these public workers do not define themselves as “public workers” in the LFS statistics.

- Second, it is puzzling that, starting from the second half of 2013, the LFS statistics showed a slight increase in domestic employment w/o public work participants, and it stagnated in Q1 2014, but we could see a level shift in employment (around 120,000) in January 2014. We could see a similar pattern in Q3 2008, which was a consequence of sample rotation, but that level shift was much smaller (+50,000). In the LFS statistics, 1/6 of the total sample is rotated quarter by quarter. In 2014, the “new” 1/6 part of the sample is based on the 2011 population census (until now the HCSO has used the previous 2001 population census’ data for sampling).

- Third, the abovementioned level shift in Q3 2008 was totally inconsistent with the business cycle trend, so it was easy to filter out the “sample effect”. But now the situation is more complicated. It is clear that labour demand became stronger in the past quarters: the INS statistics showed increasing employment and GDP growth accelerated; so it is very difficult to assess to what extent the employment growth is a consequence of “resampling” and to what extent it is caused by “actual” labour market improvement.

- In Q1, private sector **wages grew faster than we had expected in our medium-term forecast, but we think this is likely to be transitory.** In Q1, private sector wages grew by 1.2% QoQ (not annualized) at variance with our expectation (1% QoQ). This is a little weird, given the surprisingly strong disinflation. The higher-than-expected GDP growth can be an explanation, but the surprise factor in Q1 GDP data came from the taxes and subsidies balance, which component does not improve productivity (see our Report on GDP). Furthermore, employment also grew in Q1 (but its extent is questionable, as mentioned above), so we do not think productivity could explain the higher-than-expected wage growth. We checked the wage development in the construction sector as the construction output skyrocketed in Q1 mainly due to public investments (Q1 growth was 25.4% YoY, SWDA), but the wage growth in this sector was not higher than the total private sector’s average.

- If we focus on regular wages, they grew by 0.6% QoQ, by much less than total wages. This means that bonus payments boosted the wage growth in Q1. This is also puzzling, despite the very healthy growth numbers in manufacturing production (Q1: 9% YoY, SWDA), regular wages grew much faster on QoQ basis in the market service sector than in the manufacturing sector (+1.4% QoQ vs. -0.4% QoQ). This difference was smaller in the case of total wages (1.5% QoQ vs. 0.9% QoQ). So the questions of the puzzle are: why did wages grow faster in the market service segment than in manufacturing, and what is behind the faster-then-expected wage growth in Q1 amid the lower-than-expected inflation environment? (See charts 5-6)

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Fixed Income Desk

László Kovács
+36 1 288 7564
Kovacs.Laszlo@otpbank.hu

Benedek Károly Szűts
+36 1 288 7560
SzutsB@otpbank.hu

FX Desk

Géza Polányi
+36 1 288 7521
PolanyiG@otpbank.hu

András Marton
+36 1 288 7523
MartonA@otpbank.hu

Gábor Réthy
+36 1 288 7524
RethyG@otpbank.hu

Money Market Desk

Gábor Fazekas
+36 1 288 7536
FazekasGa@otpbank.hu

Gábor Heidrich
+36 1 288 7534
HeidrichG@otpbank.hu

Judit Szombath
+36 1 288 7533
SzombathJ@otpbank.hu

Analyst

Győző Eppich
+36 1 473 7274
EppichGyo@otpbank.hu

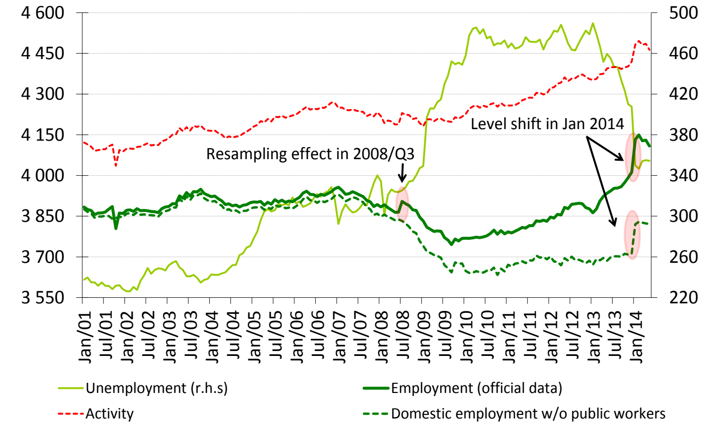
- Let us take a look at wage inflation. **Wage inflation is an indicator, which tries to capture the individual level wage development as many decomposition effects appear in the macro-level wage statistics** (e.g. if the share of higher-wage employees is growing, this phenomenon increases the macro-level wage statistics). Wage inflation is a better indicator of inflation expectations as it is much closer to the “actual” wage settings. We calculated this indicator from full-time employees’ (‘core’ labour force) regular wage component. In the first quarter, wages grew (wage inflation numbers are in the parentheses) by 3.7% YoY (3.5%), 4.0% (4.5%) and 4.2% (2.9%), respectively in the private sector w/o financial intermediation, manufacturing and market services w/o financial intermediation. Furthermore, the within-a-year wage setting was much higher in manufacturing than in the market services, if we calculate this indicator from the wage inflation instead of ‘standard’ wage statistics. The within-a-year wage setting in the total private sector shows gradual decline year by year, meanwhile wage setting in the manufacturing is the same as the previous year’s figure. **The 6M MA of the MoM change of wage inflation also shows the significant deceleration of the wage development**. This means that the low inflation environment gradually drags the wage settings, which can support that the low inflation environment will be permanent. Furthermore, the lower-than-expected inflation environment will appear in the firms’ profitability in the second half of the year, so the recently seen strong bonus payments will not be long-lasting, in our view. (See charts 7-10)

- From inflation point of view, the total wage cost and the ULC development are more important than the development of wages. In the recent quarters, the total wage cost increased to higher extent than gross wages. ULC paints a somewhat different picture as it declined gradually in the past quarters. Nevertheless, we had assumed a decelerating ULC growth in our medium-term forecast, but ULC growth appeared to be higher in Q1 than we had expected (3.7% vs. 3.2%). All in all, we think the main determinants of the medium-term underlying inflation are close to our expectations: imported inflation recently is somewhat lower, but the domestic cost side factors are somewhat stronger. Looking forward, we think that due to the recent developments of the EUR/HUF and the expected bottoming out of the eurozone inflation will raise imported inflation, while the ULC growth will be getting closer to our medium-term forecast’s figure (we think the wage growth will decelerate as a consequence of the abovementioned reasons), so we maintain our 2.5% inflation forecast for 2015. (See charts 13-14)

- From the point of view of GDP growth, we see an adjustment in the wage settings to the low inflation environment, but the newer and newer disinflation surprises have resulted in accelerating real wage growth since the second half of 2012. According to the short-based indices, this acceleration was broken and this phenomenon will soon appear in the YoY numbers too, raising questions about next year’s consumption growth, because the real wage growth – not only in the private sector but also in the public sector – can significantly decelerate, partly due to the deceleration of nominal wages (there was a wage hike in the public sector, in education and healthcare) and partly to the accelerating inflation. The growth of constant price value of the benefits in cash from the government can also decline next year. (See charts 11-12 and 15)

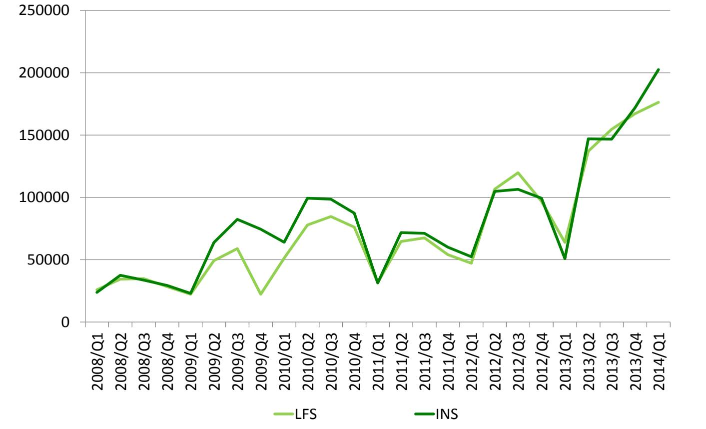
- Despite the higher-than-expected real wage growth, households’ consumption expenditure grew at a very moderate pace (1.5% YoY and 0.3% QoQ, SWDA). We think this is partly a consequence of households’ precautious behaviour, which also undermines the “so strong” employment growth in the LFS statistics. Furthermore, we think that households’ behaviour depends on the individual-level wage growth (we try to capture it with the wage inflation) stronger than on “macro-level” wage growth. And we could see that individual-level wage growth pointed to lower wage increase. These factors resulted in skyrocketing gross and net savings in Q1.

Chart 1: Summary chart of labour market
(LFS, monthly, SA, ths. people)



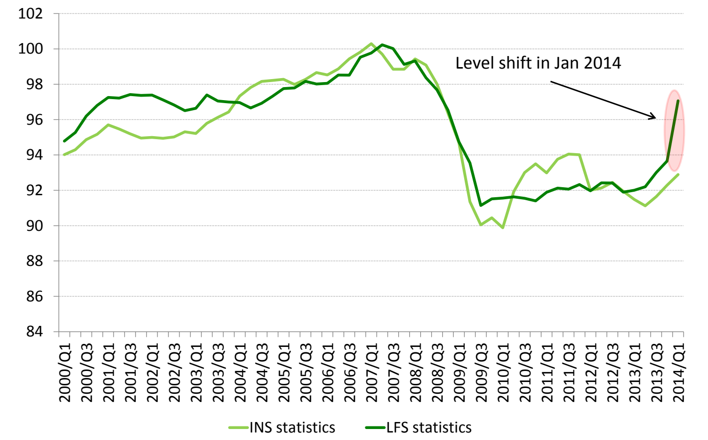
Sources: HCSO, OTP Research

Chart 2: Number of public workers
(people)



Sources: HCSO, OTP Research

Chart 3: Non-farm private sector employment in the LFS and INS statistics (quarterly data, SA, 2008H1=100)

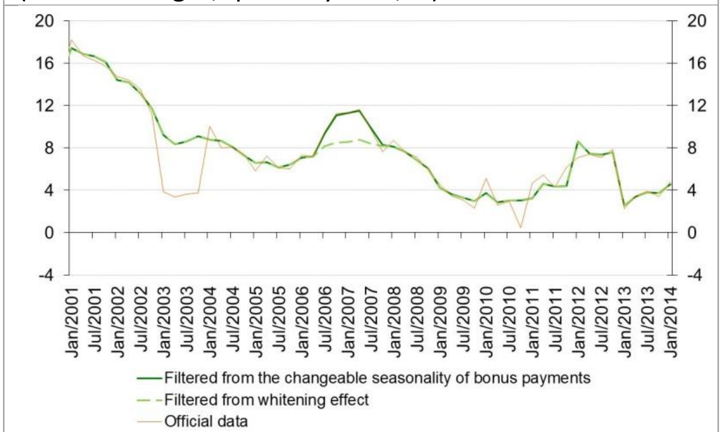


Sources: HCSO, OTP Research

Chart 4: Job vacancies
(SA, unit)

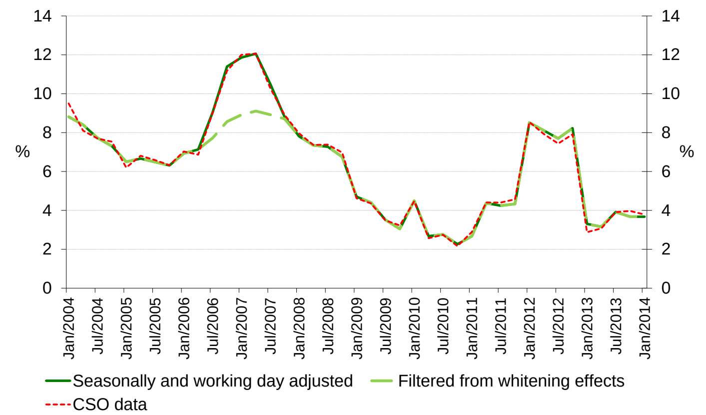
Sources: HCSO, OTP Research

Chart 5: Wages in the private sector*
(annual changes, quarterly data, %)



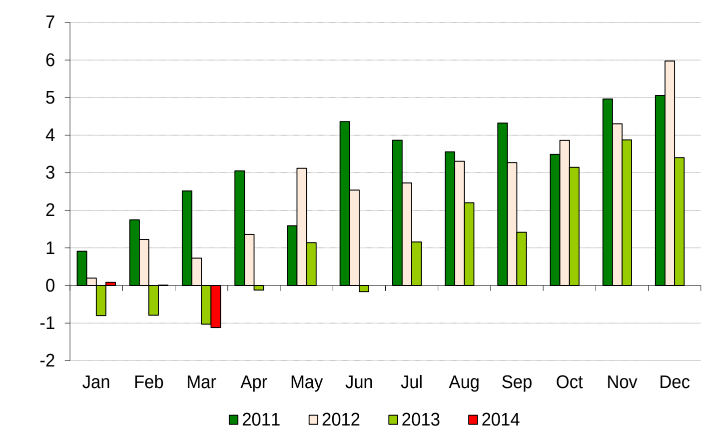
Sources: HCSO, OTP Research
*: w/o financial intermediation

Chart 6: Regular wages in the private sector*
(annual changes, quarterly data, %)



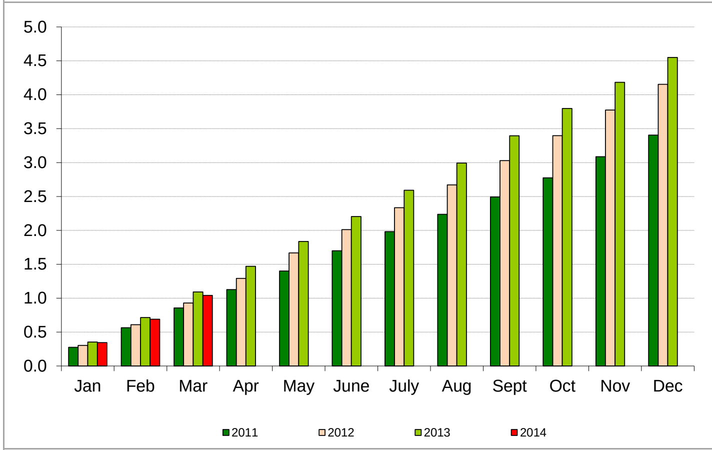
Sources: HCSO, OTP Research
*: w/o financial intermediation

Chart 7: Wage settings in manufacturing
(Previous December=0, %)



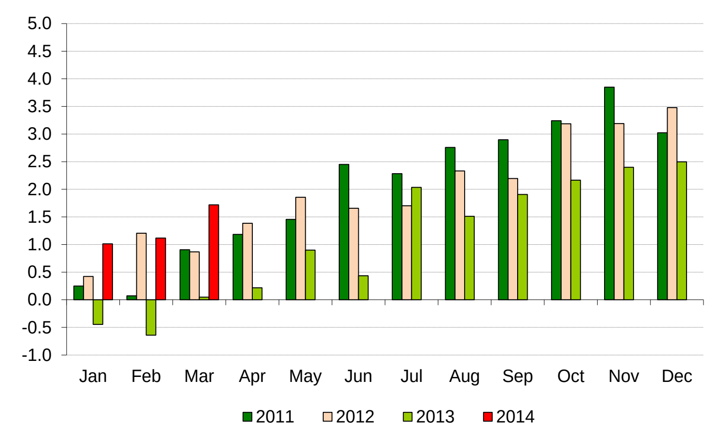
Sources: HCSO, OTP Research

Chart 8: Wage inflation* in manufacturing
(Previous December=0, %)



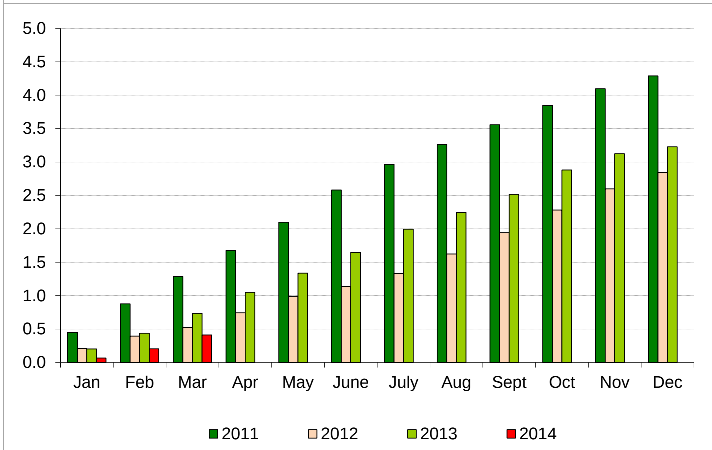
Sources: HCSO, OTP Research
**: see the definition on the top of Page 2 with bold*

Chart 9: Wage settings in market services*
(Previous December=0, %)



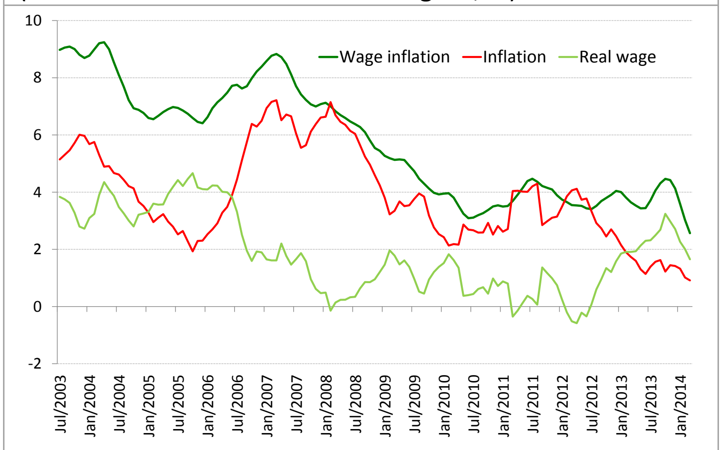
Sources: HCSO, OTP Research
*: w/o financial intermediation

Chart 10: Wage inflation* in market services**
(Previous December=0, %)



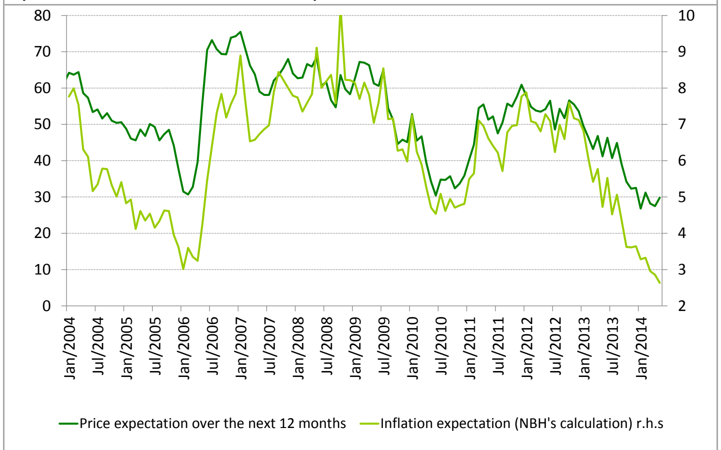
Sources: HCSO, OTP Research
**: see the definition on the top of Page 2 with bold*
**: w/o financial intermediation

Chart 11: Wage inflation development
(6M MA of annualized MoM changes*, %)



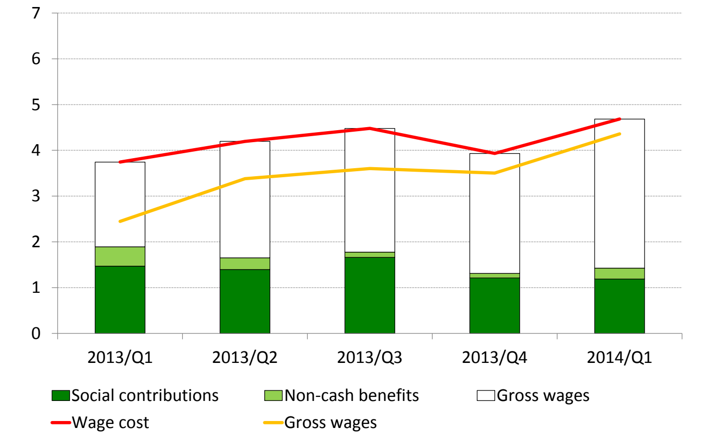
Sources: HCSO, OTP Research
**: calculated from SWDA trend component, inflation component: inflation w/o volatile items and all governmental measures*

Chart 12: Inflation expectations
(% and balance indicator)



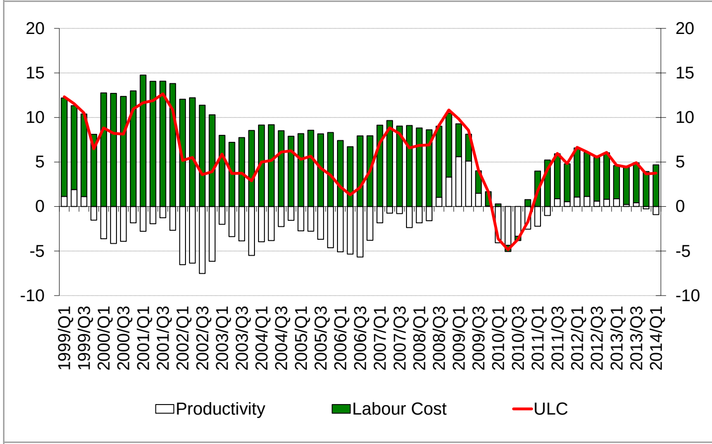
Sources: Eurostat, NBH, OTP Research

Chart 13: Decomposition of total wage cost
(annual changes, %)



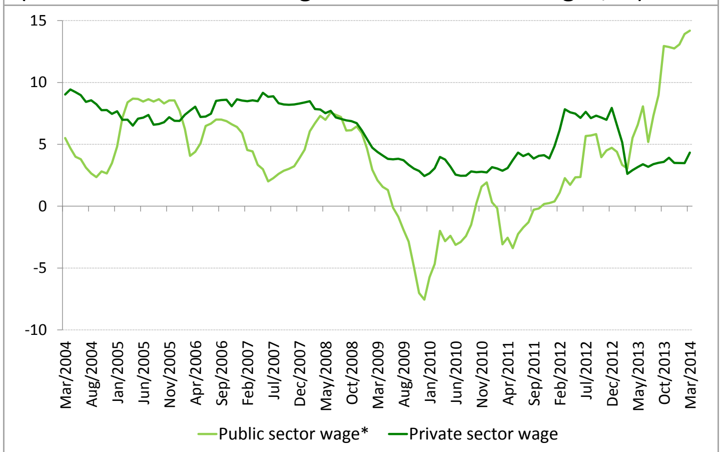
Sources: HCSO, OTP Research

Chart 14: Development of the ULC
(annual changes, %)



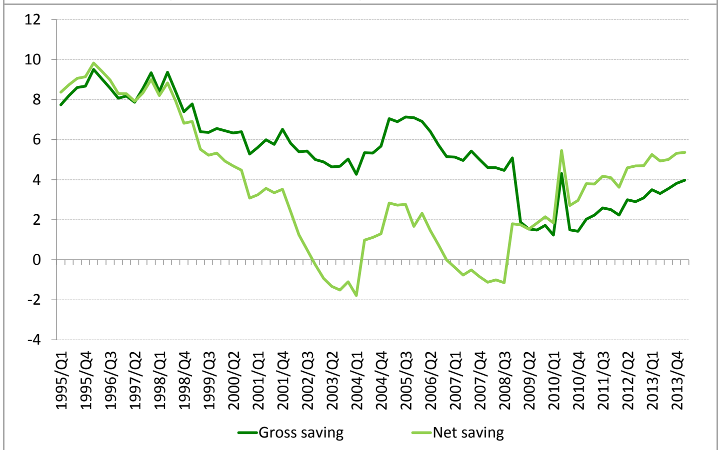
Sources: HCSO, OTP Research

Chart 15: Wage development
(3M MA of annual changes of the nominal wages, %)



Sources: HCSO, OTP Research
**: w/o public workers*

Chart 16: Underlying* Gross and Net savings of the households (SA, in % of GDP)



Sources: Eurostat, NBH, OTP Research
**: it does not contain the other financial assets and liabilities, or the pension funds reserves. We think this saving indicator captures better the "actual" saving behaviour of the households*

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