BNZ Weekly Overview

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Labour's Economic Policies

The Colmar Brunton poll released shortly after sending out last week's Overview placed Labour two points ahead of National. The increased probability of a change to a sixth Labour government means businesses need to give more detailed thought to and undertake more critical analysis of the policies Labour are taking to the electorate on September 23. Restricting ourselves to our area of expertise which is economics – not health, education, welfare etc. – we look in this Overview at the following policies

- Monetary
- Fiscal
- Housing
- Workplace
- Immigration

Labour's Monetary Policy

You can't find Labour's monetary policy on their policies web page
http://www.labour.org.nz/policy
but the information needed can be gained by reading the speech delivered by their Finance spokesman Grant Robertson on April 10 this year, available here.
http://www.labour.org.nz/speech_to_victoria_university_school_of_government_seminar_on_a_modern_monetary_policy_framework_for_new_zealand

First, Labour do not appear to view monetary policy as implemented in recent years as necessarily much impeding growth and social outcomes, and the language used reveals intention of working alongside the Reserve Bank in their review. To whit...

"**Let me be clear, we wish to undertake a review alongside the Bank, and to look at the measures and tools the Bank uses. This would include looking at the way inflation is measured, and the adequacy and appropriateness of the tools that the Bank has at its disposal. That level of review of operational matters can only be done in cooperation with the Bank.**"... **"we must protect the independence of the Bank.**"

Labour do not plan altering the 1% - 3% target.
"**It is our intention that the current inflation target band in the Policy Targets Agreement would be maintained."**

But Labour plan **"legislating into the mandate of the Bank a focus on full employment"**

"but it is not our intention to seek a specific numerical target"

So even though Labour have a policy of reducing the unemployment rate to 4%, this is not what the RB will be instructed to achieve.

Overseas it is not uncommon for central banks to be required to target low unemployment, sometimes along with firm growth and external balance. It is not mathematically possible to achieve all goals with just the one weapon of cash rate changes and in practice in the likes of the United States and Australia it remains inflation prospects that drive monetary policy decisions. That is likely to remain the case in New Zealand, even in the event that our current tight labour market potentially pushes unemployment much lower.

A very strict interpretation of the employment goal could have our central bank raising interest rates next year even if inflation was close to 1%. Had our central bank had an employment target they might have tightened monetary policy more rapidly than they did from 2005-08 – a tightening we criticised as too slow and which they eventually admitted should have occurred more rapidly.

The other change proposed by Labour is shifting responsibility for setting the official cash rate from the Governor to a committee including external appointees.

This structure is common overseas, and is favoured by NZ Treasury and many analysts in the private sector. In fact the RB have used a committee of their top internal people since 2013. All that would change is inclusion of some outside experts plus publication of meeting minutes with a three week lag.

Beyond these two changes there is not much to say, except maybe this. In his speech Grant Robertson said...

"**What is needed in my view is the best possible alignment between monetary and fiscal policy.**"

Alignment means balance. Under Labour fiscal policy will be looser than under National, by the looks of it to the tune of at least $7bn over the coming four years. A small extra boost to GDP of perhaps 0.1% - 0.2% a year implies marginally higher inflation than would otherwise be the case, therefore marginally higher interest rates and therefore NZ dollar than would otherwise be the case. The word marginal is the key one here because Labour have been at pains to emphasise a responsible approach to fiscal policy involving not blowing out central government spending as a percentage of GDP, and continuing to reduce the ratio of net crown debt to GDP though at a slightly slower pace than planned by National.

Any boost to interest rates from a looser fiscal policy setting than National is likely to be small and perhaps lost in the wash of the other factors influencing inflation and monetary policy.

Labour's Fiscal Policy

http://www.labour.org.nz/fiscalplan

Lets now switch from Labour's monetary policy to their fiscal policy. Is it reasonable to expect that Labour would, if elected, leave a similar fiscal blowout for the next time National come to power, as happened in 1990 and in 2008?

It is perhaps awareness of the string of fiscal deficits by the fourth, and at the death a spending blowout by the fifth, Labour governments which has encouraged the strong effort by Labour this time to establish fiscal management credentials.

Their policy in pdf format can be found here and it has been updated to reflect latest data and projections from Treasury contained in the Pre-Election Economic and Fiscal Update released on August 23.
https://d3n8a8pro7vhmx.cloudfront.net/nzlabour/pages/8301/attachments/original/1504048898/20170829_-_Labour's_Fiscal_Plan.pdf?1504048898

Labour have adopted five Budget Responsibility Rules, of which three are solid and two are undefined statements. The three important ones from a macroeconomic management point of view are these.

Rule 1
Operating surpluses on average across the economic cycle

That is, Labour plan raising enough revenue to pay for spending goals (e.g. health $8bn, education $6bn, welfare $5bn) so that a string of deficits will not occur. The trick will be raising the revenue they need to achieve their goal and that is where vulnerabilities lie.

Often government plans to raise revenue fail to meet projections, sometimes because of changes in behaviour which happen when people must pay more for something. The taxes planned by Labour include the following so far.

- A levy on water users.
- A $25 international visitors levy
- Helping Auckland Council to fund infrastructure central government might otherwise have to fund by giving the council power to levy a regional petrol tax.
- Cracking down on taxation of multinational companies operating in New Zealand.
- Cracking down on property investors with extension of the brightline test from two years to five years and removal of the remaining ability to offset losses against other income sources.
- Cancelling tax cuts announced by National in the May 2017 Budget.
- Introducing an Emissions Trading Scheme for all gasses. That looks like it might mean animal emissions.

Do Labour's operating surplus projections (based on Treasury growth forecasts) look achievable? Yes, but only if very few new spending increases come along. That is a risky assumption to make for any government, be they centre-left or centre-right.

Labour project operating surpluses rising from 0.9% of GDP over 2017/18 to 2% come 2021/22. National project 2.4% come 2021/22. Spending growth will be offset mainly by extra revenue from cancellation of National's planned tax cuts and Working for Families welfare changes.

Extra spending planned by Labour in the years to March 2022 amounts to $23.4bn while extra revenue runs to $13.7bn. The difference produces a rise in interest costs come 2021/22 of almost half a billion dollars per annum.

The Minister of Finance has claimed that Labour have failed to allow for increasing spending allowances expected to be sought by departments outside of health, education and welfare and that adequate allowance has not been made for inflation and population growth. Labour deny this but it does look like some under-provisioning has occurred, just not as much as the Minister claims.

Because of the absence of an independent body to assess the cost of the spending promises rolled out by parties ahead of the election it is difficult to know if the fiscal deterioration relative to National's projections planned by Labour is accurate. Equally, we lack assessment of the impact National's campaign promises are having on PREFU projections. But Labour do appear to leave little spare room for cost increases beyond 2019 and that raises the possibility that if this Budget Responsibility Rule is to be met tax revenue may need to be boosted and plans for tax rises could form part of the Tax Working Group discussed below.

Rule 2
Reduce Net Core Crown Debt to 20% of GDP come June 2022
It is hard to quibble with this goal as the current ratio is 22%. The 20% target is $11bn above current Treasury projections of 16.7% of GDP so Labour would leave less fiscal space to be put to use in the event of a dire threat to NZ growth such as a new global financial crisis, or need to meet expenditure associated with a new disaster in NZ such as a Wellington earthquake. The "cost" of this reduced buffer will be assessed by voters against the benefits expected to stem from increased spending in areas like health and education.

Rule 3
Keep government spending near 30% of GDP
In their words..."For the last 20 years, Core Crown spending has been around 30% of GDP. We will manage our expenditure carefully to continue this trend."

Technically, with Labour projecting this ratio to fall to 28.5% come mid-2022 they are allowing scope for a jump in spending if desired equivalent to 1.5% of GDP or some $5bn. Presumably if this occurs, meeting Rule 1 regarding operating surpluses might necessitate new revenue sources. So the tax uncertainty remains.

The two non-exact rules Labour also have amongst their Budget Responsibility Rules are

Rule 4
The Government will prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.

This is a statement which seems consistent with the goals of every political party.

Rule 5
The Government will ensure a progressive taxation system that is fair, balanced, and promotes the long-term sustainability and productivity of the economy.

Ditto.

<u>TAX WORKING GROUP</u>

Despite nine years in Opposition Labour have avoided going into this election with a detailed plan for tax reform by kicking the issue into touch through the promise to set up a new study.

But then again, such a post-election tax system review is not unusual. On May 8 2009...

"Finance Minister Bill English and Revenue Minister Peter Dunne today welcomed the establishment of a Tax Working Group, which will assist the government in considering the key tax policy challenges facing New Zealand.

The Tax Working Group, co-ordinated by Victoria University's Centre for Accounting, Governance and Taxation Research, will bring together invited private sector and academic experts, as well as Treasury and Inland Revenue officials. It will consider the medium-term direction of the tax system, including assessing policy options."

"A strategic review of the tax system is necessary - particularly in light of the challenges posed by the current economic and fiscal environment and our medium-term goal of a 30 percent top personal tax rate," Mr English said.

http://taxpolicy.ird.govt.nz/news/2009-05-08-tax-working-group-set#statement

Back to Labour's election manifesto....

"We will establish a Tax Working Group in government. It will have a mandate to create a better balanced tax system, including between assets, wealth, income and consumption. Labour is committed to delivering a tax system that is fair, simple, and collected."

Everything is up for grabs apart from Ardern's promise not to introduce a new top tax rate during the first term of a Labour government or apply a land tax to the land the family home sits on. She has said that the Tax Working Group will not consider changes in income tax rates at all. She also has ruled out a capital gains tax applying to the family home though taxes on all other family properties will be considered. Wealth/assets covers the likes of financial assets including bank deposits, government and company bonds, shares, managed fund holdings, plus farms, land, businesses, property and inheritances. Income covers wages and salaries, benefits, dividends, etc. Consumption is what GST hits along with tobacco, alcohol and fuel levels.

We cannot know what Labour may propose and whether they would implement new policies immediately or take them into the next election. Ardern has said if it would help the housing sector she will introduce a capital gains tax on other than the family home before the 2020 general election.

We have no data on holdings of residential investment property broken down by income. We have no data on the proportion of residential investment properties bought and sold over any set period of time. We have no data on the proportion of residential property investors who are "speculators". Similarly, we have insufficiently reliable data on the proportion of the housing stock owned by foreigners.

We mention these things because formulating policy within an information vacuum is extremely difficult. Therefore any projections of revenue expected to flow from policy changes promised by any political party need to be treated with high caution. They could easily prove to be excessively optimistic or pessimistic.

For your guide, here is Treasury's breakdown of who pays what income tax.

https://www.budget.govt.nz/budget/2017/economic-fiscal-outlook/facts-taxpayers.htm

Income	**# of People**	**%**	**Tax Paid $mn**	**%**
Zero	319	9	0	0
1-10,000	359	10	164	0
10,001-20,000	628	17	1,172	4
20,001-30,000	491	13	1,634	5
30,001-40,000	353	10	1,819	6
40,001-50,000	328	9	2,271	7
50,001-60,000	288	8	2,728	8
60,001-70,000	217	6	2,721	8
70,001-80,000	169	5	2,647	8
80,001-90,000	108	3	2,031	6
90,001-100,000	87	2	1,920	6
100,001-125,000	128	4	3,538	11
125,001-150,000	59	2	2,121	6
150,001+	108	3	8,282	25
All	**3644**	**100**	**33,048**	**100**

42% of income tax is paid by the 9% of individuals who earn more than $100,000 a year.

In summary. Labour are heading into the general election with voters unable to know what they might do with the tax system and with doubts in some quarters as to whether adequate modelling has been undertaken of planned and likely spending increases. But whatever they do will be within the confines of a set of Budget Responsibility Rules which can leave us reasonably confident that

- reasonably sound fiscal management aimed at reducing government debt relative to the size of the economy will continue in New Zealand,
- financial scope will continue to be provided for the Crown to handle the next crisis which comes along though $11bn less than under National come 2022,
- credit rating agencies will likely see little need to alter their outlook or commentary on

New Zealand should a change in governing party occur, but

- tax system changes of unknown focus and magnitude may be coming.

Labour's Housing Policy

http://www.labour.org.nz/housing

- There is a shortage of houses in Auckland.
- The shortage has been growing since mid-2000s.
- The shortage will continue to grow because strong population growth will produce growth in housing demand which exceeds growth in supply.
- Supply is constrained by shortages of people and shortages of finance for new developers.
- Prices will continue to trend upward with some short-term wobbles.

And so to Labour's housing policy, or any other party's. It does not matter. Outcomes will be similar because no party is proposing letting in 50,000 foreign workers to build standardised houses ASAP and promising finance to get private sector building done.

Having said that, Labour's policy mix has capacity to help constrain the pace of house price rises for lower-priced properties by boosting supply. But it will come at the price of higher rents on average and potentially increased price rises for middle to upper priced properties as construction resources are diverted toward low-priced houses.

Ban Foreigners

"Labour will ban foreign speculators from buying existing New Zealand homes"

Not all foreign buyers are speculators. Labour will adopt Australia's policy of banning sales of existing dwellings to all foreigners. Labour have not made it clear whether they will exempt Aussies as Australia exempts Kiwis. But there are no data showing accurately the true role of foreign buyers in pushing up NZ house prices, there are ways around such rules, and having such rules has not stopped house prices in Australia's major eastern cities rising to high multiples of average household incomes.

The policy makes sense in a world where housing has become an internationally traded investment asset since the 2000s. But actual impact is unlikely to amount to much – especially because the policy will still allow foreign buying of new dwellings. If that means more houses being built that sounds good. But in a capacity constrained economy that means fewer builders putting up houses for Kiwis wanting to get a new house built. And it may make building 10,000 "affordable" houses a year also more difficult.

Hit Quick Sellers

"Labour will extend the bright line test from the current two years to five years. This will target speculators who buy houses with the aim of making a quick capital gain. Current exemptions from the bright line test will continue"

"Labour will never apply the bright line test to owner-occupied homes or inherited properties. It will be grandfathered, so the extension to five years will not apply to houses bought before the change comes into effect."

This was inevitable as soon as the two year test was imposed by the current government. It will discourage speculators on the upward leg of the housing cycle when quick gains can be made. But outside that period it will likely have minimal impact because absence of reported quick price gains will keep such people out of the market anyway. The policy will constrain price rises during boom periods.

But, the comprehensive capital gains tax regimes in place overseas have failed to either constrain boom periods or prevent houses rising to high multiples of incomes.

The change is logical but is unlikely to have much measurable impact on prices. It will also tend to reduce housing turnover relevant to real estate agents because investors will hold onto properties for longer periods, shifting their focus from tax free capital gains to income. That means the policy will tend to place extra upward pressure on rents. How much is as unknown as the proportion of houses sold in recent years which have been bought by "speculators". Note – every asset market has speculators.

Hit Tax Loopholes

"Speculators will no longer be able to use tax losses on their rental properties to offset their tax on other income"

"For a smooth transition, this change will be phased in over five years, with loss deductibility reducing by 20 per cent a year."

Not all people using this ability are speculators. The policy will undoubtedly have some impact. What we cannot know however is how long it will take accountants to figure out ways around the new rules. And because negative gearing is usually only a short-lived situation for long-term investors be they large scale owners or small scale Mum and Dads, it is possible the policy will lead to less rental accommodation being built and made available. But in a capacity constrained economy the building will simply switch toward owner-occupiers, and if investors do not buy an existing house an owner-occupier will. The policy will free up properties for purchase by owner-occupiers, but not grow actual housing supply.

KiwiBuild

"Labour's KiwiBuild programme will build 100,000 high quality, affordable homes over 10 years, with 50% of them in Auckland. Standalone houses in Auckland will cost $500,000 to $600,000, with apartments and townhouses under $500,000. Outside Auckland, houses will range from $300,000 to $500,000."

The houses will be sold only to first home buyers who will have to pay back any capital gain if they sell within five years. That is a clause potential buyers will need to think very carefully about if there is a chance they might have to shift for work or other reasons within five years. Finding builders will be a major challenge – land not so much as in Auckland the dwellings will have to be mainly apartments and townhouses and there is an oversupply of developable land now courtesy of the Unitary Plan.

Can cost be kept below $600,000 a unit? Maybe. On September 1 at www.realestate.co.nz there were 713 properties listed in Auckland City with an advertised price (not auction etc.) Of these 136 were priced less than $600,000.

The switch in construction sector resources toward building low-priced dwellings will mean decreased construction of higher priced dwellings. This will tend to boost prices of this housing stock. In addition, to the extent the targeted KiwiBuild programme encourages first home buyers currently living at their parents' house to shift out earlier than would have otherwise been possible, the net boost to New Zealand's housing stock will be less than if construction resources were not corralled toward production of low-priced units. The programme will not change the key fundamental of a shortage of houses.

Affordable Housing Authority

"Labour will establish the Affordable Housing Authority, an independent Crown entity with a fast-tracked planning process, tasked with leading large-scale housing developments and cutting through red tape"

The AHA will oversee KiwiBuild and also work with other large scale projects. It will hold all surplus urban Crown land and use where possible for new developments.

The affordability focus sounds good. But again, resource constraints will prove a source of frustration.

Dole for Apprenticeships

"...subsidise employers to take on around 4,000 young people for on the job training in fields including building and construction

Labour will pay the dole to employers who take on an apprentice. Sounds good. No reason beyond shortages of trainers and potential shortages of good recruits to suggest this would not be achievable. Some of those potential good recruits may however opt instead for a year's free paid study at university.

Auckland Zoning

"Labour will remove the Auckland urban growth boundary and free up density controls. This will give Auckland more options to grow, as well as stopping land bankers profiteering and holding up development. New developments, both in Auckland and the rest of New Zealand, will be funded through innovative infrastructure bonds."

Little impact. There is no longer a shortage of developable land within Auckland's urban boundary (for small scale projects at least). There is a shortage of builders and finance. Detail would be useful on the “innovative infrastructure bonds”.

Beyond these policies aimed at influencing the pace of house construction and house prices facing buyers, there are Labour’s social housing policies and specific renter policies. The former fall outside the scope of our analysis and expertise and there are plenty of better informed people working in the social housing field able to give more informed insight into likely effectiveness on social problems of such policies. Suffice to say that without a safe, healthy home, pervasive negative effects loom large in terms of occupants’ health, education, earnings, and societal participation. Hopefully Labour’s policies could make a big difference.

With regard to renters policies such as increasing 42 day notice periods to 90 days, abolishing no cause” tenancy terminations, rent increase limits, banning letting fees etc. – the effect will be to reduce the attractiveness to investors of holding properties for rent. Compensation is likely to be sought through higher rents on average.

The policies on housing Labour are taking into the election have capacity to help improve housing access for young Kiwis. But in the absence of rapid growth in the quantity of builders, electricians, engineers, quantity surveyors etc., and with the new restraints on bank funding of developers, real world impact on prices is likely to be very limited while rents will face upward pressure. This is an inevitable development of increasing costs and decreasing after-tax returns to landlords.

Labour’s Workplace Relations Policy

http://www.labour.org.nz/workplace_relations_policy

Labour have listed 34 changes they intend making in the area of workplace relations, listed at the url above. They include a range of measures designed to strengthen the power, position and workplace access of unions and promote collective bargaining to boost employee and contractor negotiating strength. We will not analyse all 34 proposals, just the main ones highlighted on Labour’s main policy page.

Raise minimum wage to $16.50 and pay a minimum of the Living Wage to core public servants

The current adult minimum wage rate is $15.75 an hour. In New Zealand the pace of wages growth has failed to respond to the tightening up of labour availability. This is a global phenomena. Measures which boost wages in an environment where equilibrium labour prices are failing to adjust will improve human capital utilisation through shifting of people from low paying low productivity roles to higher paying higher productivity ones.

Fair Trial Periods

Employers will have to justify dismissal/non-retention of people employed for a trial period. Currently no reason needs to be provided. Given that there is no evidence the current regime has boosted job numbers, tightening of rules for this classification of employees will probably have little meaningful impact.
http://www.treasury.govt.nz/publications/informationreleases/90-day-trial-periods/pdfs/90-day-3413831.pdf

However the new proposed free service for dismissed trial employees to take claims against employers for dismissal is a new element which could discourage some hiring at the extreme margin.

Introduce Fair Pay Agreements

“Fair Pay Agreements (FPAs) will be agreed by businesses within an industry and the unions representing workers within that industry. FPAs will set basic standards for pay and other employment conditions within an industry, according to factors including job type and experience.”

While there is much uncertainty regarding how to define an industry in modern times of rapid changes, what form arbitration would take, who would negotiate etc. the big question being asked by businesses is this. Will unions gain the right to strike in support of industry agreements?

Council of Trade Unions President Richard Wagstaff has said “"There's no prospect, zero prospect of industrial action from this,"... “The CTU's proposals did not include a mechanism for industrial action during FPA negotiations.”
https://www.stuff.co.nz/business/96182177/labour-needs-to-detail-its-fair-pay-agreement-policy

The reforms planned in this area are on face value less deep than the unwinding of the Employment Contracts Act which the fifth Labour government implemented through the Employment Relations Act.

However, included in the detailed list of Labour's workplace policies are

-abolition of the youth wage,
-ensure NZ employment law applies to everyone working in NZ including foreigners,
-restore union right to initiate collective bargaining with imposition of a duty on parties to reach agreement,
-ensure reasonable union access to workplaces,

Labour's Immigration Policy

http://www.labour.org.nz/immigration

Labour aim to reduce net inflows by 20,000 – 30,000 mainly through tightening up on work visa eligibility for students. Impact will largely be restricted to main city employers of such students in generally low paying service jobs – positions increasingly producing stories of staff exploitation in recent years, often by employers who are themselves relatively recent migrants.

Back door migration via study
The government is already starting to move in this area whereby migrants on a student visa undertake very low level courses, work part-time, then can receive a one-year work visa which may lead eventually to residence.

"**Labour will stop issuing student visas for courses below a bachelor's degree which are not independently assessed by the TEC and NZQA to be of high quality.**

Labour will also limit the ability to work while studying to international students studying at Bachelor-level or higher. For those below that level, their course will have to have the ability to work approved as part of the course."

Labour estimate these changes will reduce inflows by up to 10,000 people per annum.

Post-study work visa
This visa will only be available to those who have undertaken at least a bachelor's degree.

This change is estimated to cut inflows by up to 12,000 people per annum.

Work visas
It is hard to pin down exactly what Labour will do here. They appear to intend that training of local people will be sufficient to offset up to 8,000 work visa migrants – almost entirely in low skill categories. It seems optimistic that such training of Kiwis can occur and produce the desired results.

Labour intend developing a regionally-based work visa programme which may ensure regions with low skill staff attract staff from offshore who have to go to the relevant region rather than to a larger location potentially without such a skills shortage.

KiwiBuild Visa
House building firms will be able to bring in a skilled tradesperson on a three year visa who would not normally be eligible if they pay at least the living wage, and take on an apprentice for each person hired – maximum of 1,500 at any given time (not per annum.) This policy will add a small number of extra people into the construction sector.

Exceptional Skills Visa
Up to 1,000 people per annum (including partners and children) may shift to NZ even if they cannot get enough points to come in on the Skilled Migrant Category. Applicants must be exceptional in their field. Seems reasonable.

Summary

Monetary policy
-Nothing likely to noticeably alter current policy implementation by the Reserve Bank.

Fiscal policy
-The three Budget Responsibility Rules are reassuring but doubts exist as to whether sufficient scope exists for unbudgeted rises in spending outside health and education. The Tax Working Group opens the field for a range of potential new taxes which may prove necessary to meet future spending plans and avoid deficits.

Housing Policy
-Negative for investors and positive for first home buyers at the margin. But unlikely to much improve average housing affordability because of capacity constraints on supply growth, the large and growing queue of eager young buyers, and

firm population growth. Rents will tend to increase and there may be additional upward pressure on prices for dwellings above entry level.

Workplace Relations Policy
-Will slightly boost wage costs for some employers whilst eroding some flexibility in setting minimum workplace conditions and remuneration. High uncertainty regarding exactly what will be in Fair Pay Agreements and Labour have not explicitly ruled out introducing the ability to strike in support of industry deals though this seems unlikely.

Immigration Policy
-Will target a 20,000 – 30,000 reduction in migrants, largely students doing low value courses, and work visas for low skill jobs.
-Coupled with one year free university education boosting student numbers this policy may strongly reduce staff availability for low skilled entry level jobs in the main centres.

National's Economic Policies

Having done the exercise for Labour now lets do it for National.

Monetary Policy
– no changes

Fiscal Policy
– projections as outlined in the August 23 PREFU with the cost of election campaign promises to be covered by annual operating allowances. Fiscal management plans as outlined in Budget documents – surpluses, net debt to 15% of GDP.

Housing
– new urban planning law for cities

Workplace
– no changes

Immigration
– no changes

First Home Buyers

Three weeks ago we wrote that first home buyers face opportunities in Auckland over the coming year to pick up properties being sold by under-capitalised investors realising that the over-supply of subdividable property means their potential for capital gain is less than they were thinking. This week we can add another incentive for first home buyers to be sniffing more strongly in the market and making low ball offers – the prospect of a Labour government shifting rental policies in favour of tenants.

As we have noted many times in recent years, the structural repricing of the country's housing stock and the shifting out of life stages means a higher proportion of people on average living in rented accommodation. That means legislation and rules relevant to the rental market will inevitably shift and that under a National government changes would be slow but under a Labour government there would be faster changes.

This week Labour announced a range of policy promises which would make renting out a property a less easy proposition for small scale investors.

- Abolish "no cause" terminations of tenancies.
- Extend 42 day notice periods to 90 days.
- Limit rent increases from every six to every 12 months.
- Include a formula for calculating rent increases in tenancy agreements.
- Ban letting fees (usually one week's rent).

For skilled investors the changes won't necessarily mean all that much. Professionals with decent-sized portfolios view owning properties as a business and like any businessperson know how to adjust to rule changes in a professional manner. One change is likely to be higher rents on average, stronger information sharing to identify bad tenants, perhaps fixed short lease terms as insurance against unevictable bad tenants.

But this cycle has brought a lot of inexperienced people into property investment (though not as many as had LVRs not been introduced from October 2013). Some will be poorly capitalised and lack experience in tenant management

Some will be looking to sell in the coming year because they won't be bothered with the hassle, see little prospect of much if any short-term capital gain, and don't have the fortitude to hang in for the long-term. Labour's policies if elected will tend to boost the number of landlords looking to sell.

So the message to first home buyers is again what we wrote three weeks ago. Be in no hurry, but start throwing low-ball offers in and don't let real estate agents scare you and cause you to bid up your own price.

At this point in the cycle the talking power of the agents has to focus on convincing vendors to adjust their price downward, not on buyers to adjust their price upward. Be staunch. Real estate agents face falling incomes as turnover declines with a lot worse to come – not just as annual turnover slips from 80,000 to 65,000 and less, but as a rising proportion of sales will be of newly built houses. Without contracts with developers for such sales agents face very tough times in the next few years.

In theory professional investors can also take advantage of this selling. But the tightening of bank lending criteria will be an impediment for many. Some banks are reported to be looking for 40% equity cover not just for a new mortgage but the entire portfolio. And the test rate used for calculating servicing ability which was 6% - 6.5% a year ago is now above 7.5% for most investors apparently – again for their entire portfolio.

Further tightening is likely, especially under a Labour government because shifting of after tax income toward low income earners will tend to reduce nationwide household savings whilst boosting spending. Bank funding challenges are likely to grow – offset to some degree by reduced credit demand from property investors.

Best guess for how long this window of opportunistic purchasing will last in Auckland? 12-15 months maybe. Perhaps longer. Hard to say.

If I Were A Borrower What Would I Do?

This week we have cut our two year fixed home loan rate from 4.79% to 4.69%. Other rates are unchanged. This is only a small cut, but it is enough to make me shift my preference from a mixture of floating (repayment flexibility) and fixed rates of one, two, and three years to a mixture of floating and just two and three year terms. The one year rate of 4.59% is only 0.1% less than the two year rate and paying a 0.1% premium for a year's extra rate certainty seems like a good deal to me.

If war breaks out on the Korean peninsula interest rates are likely to fall.

NZ Dollar

Next week.

If I Were An Investor ...I'd see a BNZ Private Banker

The text at this link explains why I do not include a section discussing what I would do if I were an investor.
http://tonyalexander.co.nz/regular-publications/bnz-weekly-overview/if-i-were-an-investor/

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. **This edition has been solely moderated by Tony Alexander**. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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