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.

New Fish, New Policies

We now know the mix of parties forming the new government and have a list of some 70 largely undefined policies agreed between Labour and NZ First and between Labour and the Greens to form the government. Lets examine things from the economics angle to gauge which are relevant to our macroeconomic outlook and what their impact may be.

http://img.scoop.co.nz/media/pdfs/1710/NZLP___NZF_Coalition_Agreement.pdf
http://img.scoop.co.nz/media/pdfs/1710/NZLP___GP_C_S_Agreement.pdf

Regional Economic Development

A Regional Development Fund will be set up and receive $1bn per annum to be allocated toward regional policies such as planting trees and investing in regional rail. Some government functions will be shifted to the regions.

Regional development will be subsidised. By definition this will retard overall productivity and income growth for the country. The driver behind the regional focus is concern that not all parts of NZ are keeping up with our growing cities where business want to locate to access staff, customers, and other businesses. This is a common concern worldwide and not NZ specific. It is happening because economic growth in this technological age comes more and more from well functioning "agglomerations" where people and industry concentrate in one place rather than dispersed centres.

The macroeconomic impact beyond slowing productivity growth will nonetheless be a regional economic stimulus for those parts of NZ which ~~curry~~/find favour with the Fund's controllers. But some years down the track the stimulus will be reversed when a change in government brings back a focus on fiscal rectitude and economic reality. The scene is being set for an eventual (much smaller) repeat of the regional "rationalisation" of the 1980s - 90s. Be careful in your assumptions about the longevity and multiplier effect of the economic impact from the fund. Subsidies and special privileges always end – its just a matter of time.

Until then, forestry wins and farmers have clearly been protected by NZ First from the desires of the Greens with subsidies continuing for irrigation schemes, no water tax, and only a study of farm emissions entering the Emissions Trading Scheme and then only very slowly if it happens.

Economy

The Reserve Bank Act will be reviewed. As discussed in the Weekly Overview of September 7 this will involve decision-making by a committee and adding full employment as a target. In practice there is likely to be no impact on interest rate movements. NZ First came nowhere close to their policy of currency control.

The minimum wage will be boosted to $16.50 an hour on April 1 then $20 by mid-2021. Wage rates have risen some 40% since 2017 while the cost of living has gone up about 20%. But in common with other economies post-GFC wages growth has failed to accelerate in NZ (outside construction) despite a very tight labour market. This is one reason for low productivity growth worldwide – labour resources are not being moved to most productive/higher paying functions by wage pressures forcing low profit businesses out of operation.

The coming boost to minimum wages will make operating more expensive for businesses highly reliant upon low-priced labour. Some will close down. Others will invest in labour-saving technology. There will be some upward pressure on wage rates currently close to minimum wages.

However it is unlikely that the change by itself will be enough to offset the wide range of factors seeming to account for the breakdown in the relationship between labour market tightness and wages growth post-GFC. Therefore there is likely to be only a mild lift in the total wages bill facing NZ businesses and minor addition to inflation and interest rate pressures over the next few years.

Note the absence of any mention of NZ First policies regarding cutting company tax rates. Labour clearly rejected them.

"Strengthen the Overseas Investment Act and undertake a comprehensive register of foreign-owned land and housing."

This covers the policy regarding foreign buying of NZ assets which we expect to be Labour's favoured ban on foreigners buying existing houses and some strengthening of rules regarding buying farmland. We do not know when the ban will be implemented so for the meantime potential foreign buyers face an incentive to accelerate any planned purchase. After that we can anticipate a lesser version of what we have seen in Australia – building resources going into construction of new apartment complexes largely sold to Chinese buyers trying to get funds off their mainland.

This possible increase in Chinese-funded construction will reduce availability of resources for construction of other things in NZ – like 10,000 affordable houses per annum. However, in a continuing climate of restraint on the ability of Chinese people to get funds out of their country it is extremely unlikely that this effect will be all that noticeable until the capital rules in China are relaxed.

In macroeconomic terms there is nothing worth commenting on in the Labour-NZ First document under their headings of R&D, Health, Education, Defence, Housing, Law and Order, Superannuitants, Environment, and Democracy. (Many changes are important from numerous angles, but not macroeconomically)

Immigration

The statement comments contain zero details, no numbers. But we anticipate Labour's policies being implemented, aimed at cutting low skill inflows 20,000 – 30,000 per annum. Auckland inner-city apartments and businesses will be hit by fewer students, less spending, fewer students able to work, fewer being exploited (often by their own people it seems). Walking along Queen Street will become easier. Timing of this clampdown is however uncertain.

With regard to the Labour Greens agreement ...

Little macroeconomic impact, but clearly opportunities opening in the development of alternative energy sources, cycleways, conservation, clean water management, recycling, etc.

Experience tells us that at a time of change like this many people will over-extrapolate or misinterpret the change. Maybe they will talk about things such as an intergenerational war starting, dominance of greenies, death of capitalism and return of socialism/Muldoonism and so on. Offshore the commentators have no idea of how to reasonably interpret what is happening here. According to The Australian newspaper we are reverting to socialism. According to USA Today we have elected a Trump character. Idiots.

My personal interpretation is that there are many things this government is not. It is not a return to Muldoonism involving exchange rate controls, dominance of the state etc. NZ showed the world that such an approach fails for a wide variety of reasons including incompetence of politicians as economic managers, erosion of vital economic flexibility, misdirection of investment, and over-reliance on often severely wrong predictions. The Regional Development Fund is the closest NZ First will ever get to resurrecting Rob Muldoon and his multitudinous policy failures which saw NZ plunge down the OECD per capita income ladder during the 1970s-80s. But there still exist a few of his dinosaur descendants out there so don't be surprised to see some occasional exclamations of joy from the old, old hands.

This government does not look like a return to cloth cap unionism. The Council of Trade Unions has stressed that they are not seeking a return of the right to strike in support of industry-wide agreements in the form of the planned Fair Pay Agreements. Business NZ have made relaxed noises, and the PM-elect has said she anticipates just 1-2 FPAs per annum. But the balance of power will shift some tad toward organised labour. If such a shift causes an acceleration in the pace of average wages growth then great.

The government does not appear bent on revenge and driven by envy as was the case for the fifth Labour government which came into power in November 1999. Back then they immediately raised personal tax rates despite no fiscal need to do so, ignored the business sector for a year, and made big changes to workplace legislation. Having said that, once pressures build and hopes of big gains in areas like housing affordability are perhaps are not as great as they like, we could see some lashing out and blame-laying occurring.

The presence of NZ First means one cannot conclude that this government will focus on shifting resources from Baby Boomers and the elderly to younger generations. Their presence has also clearly dominated that of the Greens so a view that this is an anti-farming government cannot at all be supported.

So what is the new government inherently about? The PM seemed to sum it up quite well when asked that sort of question in the weekend's Q & A TV programme. She replied addressing homelessness, housing affordability and quality, the environment, child poverty, and wages growth. Who could disagree with extra focus on any of these things? One could also add in regional economic development and restricting foreign buying of assets.

And why did NZ First go with Labour? In hindsight it is simple to see. Labour's policies are closer to those of NZ First than National's.

- Restricting foreign buying of NZ assets
- Reducing immigration
- Raising minimum wages
- Altering the Reserve Bank Act
- Cutting the Superannuation age of eligibility back to 65.
- Restarting contributions to the NZ Super Fund
- Boosting regional investment
- Raising student allowances

Some random thoughts

As an employer, if you think getting staff who consistently pass drug tests now is hard, imagine how many you will be laying off if dope is legalised, especially as the CTU plan further tightening of health and safety legislation. You will eventually risk prosecution if knowing staff dope up you avoid testing them. Currently some employers who know their staff are doped up do not test. Bring on the robots.

In fact staff availability all up is about to get worse. This will not just be because of plans to cut immigration, plans to put people to work planting 100 million trees each year, but the free year for first time entrants to tertiary level study. Next year it seems reasonable to expect some young people to opt for a year receiving a (rising) student allowance, burning some couches and drinking rather than immediately making the hard decision to enter into the workforce. Options to start work immediately abound in the primary sector, hospitality, construction, retail. Not everyone needs or is suited for a degree.

As was put to me recently, what some current students would prefer is that the last year of study be free – not the first. The first year of uni study largely sorts out the wheat from the chaff. Better to reward and encourage those who apply themselves. Presumably universities will receive extra funding for the extra chaff to come?

The third most important person in the new government after the PM and Deputy PM – the incoming Finance Minister Grant Robertson – has yet to say much. His fiscal challenge won't be huge but it will be ongoing and he could easily suffer from the fatigue Finance Ministers can suffer from ideologically wanting to allocate more funding but having to repeatedly say no to people with whom one has spent years making spending plans while in Opposition. History tells us that eventually centre-left governments in New Zealand leave a fiscal mess for a centre-right government to deal with. Eventually. Not at the start. The new Finance Minister will be under constant pressure to prove his fiscal credentials. Michael Cullen as Finance Minister under the fifth Labour government certainly did so – until his last budget when the flood gates were not just opened, they were blown up.

On Wednesday afternoon the incoming Housing Minister Phil Twyford gave some details on how the KiwiBuild programme of supplying 10,000 affordable homes to the market per annum will work. While there will be attempts to form partnerships with existing large-scale builders to construct dwellings the government would also look to secure dwellings already planned to be built in some subdivisions such as Hobsonville. And they would buy off the plan perhaps 30% - 40% of apartments from future developments planned by developers of large residential complexes. That is a boost in **demand**, not supply. The KiwiBuild net construction boost is not going to be 10,000 p.a.

Eventually the government plans raising annual consent issuance up from the current 31,000 to between 40,000 and 50,000. "Our goal is to ramp that up to 40,000 or 50,000 and also build more state houses."

However there are insufficient resources in New Zealand to allow that to happen without taking builders away from non-residential projects so it will be a struggle. But here's hoping that KiwiBuild does come close to the desired 10,000 p.a. within three years as planned because the accommodation shortage in Auckland is large and still growing. Good luck Phil. The risk is the KiwiBuild programme pushes construction costs up at an even faster pace which will have a flow on effect to the viability of many currently planned developments. Current buyers of off the plan apartments yet to start should be a bit more worried about whether their project happens at all, and whether they may be scrubbed out then invited to repurchase at a higher price.

The clear risk is that KiwiBuild ends up simply displacing work which would otherwise be done.
http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11936574

The last time a Labour government came in, business lobby groups and businesspeople generally jumped on them holus bolus, criticised those of us of more measured opinion, and lobbied commentators like myself to join the attack. I succumbed. Sorry Michael. My message to you lobbyists this time – settle down, accept this focussing of attention on those left behind in recent years, and pay your staff more. This is not a cheap country to live in, but yes, paying higher wages will put some firms out of business and force some perhaps substantial restructuring and automation.

If I Were A Borrower What Would I Do?

The inflation outlook has got a little bit worse, and risks of growth in the government's debt issuance programme in coming years have increased. The drift for borrowing costs will be a little bit more upward. At this stage however there is really no serious justification for thinking that the post-GFC inflation dynamic is about to change and rate rises loom large and soon.

We still see the Reserve Bank tightening monetary policy from the second half of next year.

If I were borrowing at the moment I would still be inclined toward a mix of one to three year fixed rates. The jumps from three years at 5.09% to four years at 5.89% or five years at 6.09% are still too big to seriously consider – unless you think this is the death of capitalism and the return of Muldoonism and mine pit unionism – in which case one might lock in as long as possible.

Discussion of Labour's economic policies can be found here.
http://tonyalexander.co.nz/wp-content/uploads/2017/09/WO-September-7-2017.pdf

Discussion of NZ First's policies is here.
http://tonyalexander.co.nz/wp-content/uploads/2017/09/WO-September-28-2017.pdf

In this Overview we discussed and discounted a repeat of the 2000 Winter of Discontent which happened the last time Labour came to power 18 years ago.
http://tonyalexander.co.nz/wp-content/uploads/2017/08/WO-August-31-2017.pdf

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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