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.

By The Numbers
100 Million, 30,000, 10,000, 50,000

100 million trees planted each year probably sounds like an awful lot to most people without experience in bulk tree planting. Having dug 9,000 holes two and a half decades ago for planting whatever the books said would grow just north of Wellington I can attest that one person can actually plant quite a few trees in one day – especially if holes are sunk at the same time as the root trained seedling is planted – rather than the spade-diameter holes I dug.

According to one website I came across one person can plant from 600 trees a day on difficult sites to 1,200 on open fields. Lets use 900.
http://www.forestproductivity.net/planting/species/southern_pines.html

The average Kiwi works 1,752 hours a year.
https://stats.oecd.org/Index.aspx?DataSetCode=ANHRS
Divided by eight hours a day gives us 219 days working. Applied to tree planting for want of any statistics to hand suggesting different from average, that means one person planting just under 200,000 seedlings per annum. 100 million divided by 200,000 means just 500 planters are needed. Even if we assume the planting rate is only 600 seedlings a day there are still only 750 planters needed – plus supervisors!

"Have a supervisor at the site to insure that planting proceeds smoothly and properly. The supervisor should watch for poor practices, such as planters' stripping off roots to make planting of large seedlings easier, slow planters' discarding seedlings to "catch up" with the faster planters, shallow planting, loose packing, and carrying seedlings in hand during planting."

In truth more than 500-750 planters will be needed because you can't plant trees every day in every season.

If the land is available and the seedlings can be grown (commercial nurseries have to produce them and they are busy growing manuka) then 100 million seedlings planted each year sounds highly doable. Go for it. Pity its just monoculture over and over again in this country.

Now lets move onto another job generating programme expected to be implemented by the new government – stripping away 20,000-30,000 per annum low skilled migrants (long-stay students, post-study graduates, and low level work visas). The expectation is that not only will this reduce housing demand (yes, but not to the extent people think) but it will also free up many low skill entry-level jobs for entry-level unemployed people.

Is it realistic to expect this to happen? Not completely. The net addition of job openings facing Kiwis will be far less than 20,000-30,000. Many businesses currently hiring these people will run on fewer staff, cut their hours, mechanise, or close down. There is a reason for the proliferation in recent years of all those small liquor and grocery outlets around Auckland in particular. A ready supply of desperate (exploitable) foreign labour, with exploitation seemingly usually done by their own people.
http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11939220
http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11939346
https://www.auckland.ac.nz/en/about/news-events-and-notices/news/news-2016/12/worker-exploitation-widespread-study.html

Why business closures etc.? Because at the same time as the quantity of cheap (desperate for residency) staff dries up the cost of hiring such-like people will rise courtesy of a higher minimum wage rate.

Is this a bad thing? No. Personally I have long supported faster wages growth in NZ even without any change at all in the pace of productivity growth simply for the same rational applying as has driven house prices higher – demand exceeding supply.

The housing market has functioned perfectly – rationing on the basis of price. The labour market has not – price has not adjusted upwards to sufficiently reflect the tightening of the labour market in very recent years.

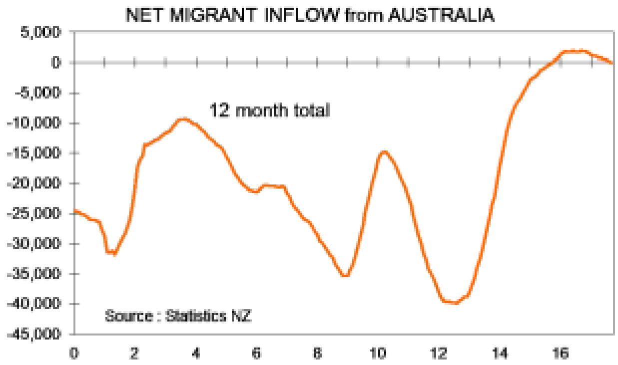
Its got nothing to do with productivity growth and employers saying that higher wages without productivity growth will lead to job losses miss the point – some job losses need to occur as firms which cannot pay the higher wages close down. Economics 101 all over again as we spent the past eight years pointing out in the Auckland housing market.

If and when rising wages lead to some businesses crying foul and closing down this is not a sign of a crisis but of inefficient and barely profitable businesses being weeded out.

And so onto our next number of 10,000. Is it reasonable to think that by the end of this parliamentary term 10,000 affordable homes will be getting built each year? It will be difficult but there is a chance that this level will be achieved, and it will be gained by the ages old process of what we economists call “crowding out”.

When the government sector expands there is a tendency to crowd out the private sector. In this case what we mean is that the construction of 10,000 affordable houses is highly likely to be achieved by houses which would otherwise have been built without the programme not being built.

In New Zealand we do not have enough people to build 10,000 houses on top of the 31,000 already consented to be built in roughly the coming year. The construction sector is fully stretched and more demands for staff will come from planned generalised increases in government spending, some people going into jobs 20,000 – 30,000 migrants would otherwise have down, some going to a tertiary institution for a free year, some going to or staying in Australia (yes, the Trans-Tasman cycle has turned again).



If 10,000 affordable houses are built some other houses will not be. Which brings us more accurately to the new Minister of Housing’s comment that he wants to see 40,000 – 50,000 houses being built each year. Minimal chance.

In Auckland dwelling supply will continue not to keep up with growth in demand – though were there a construction swing toward more lower-priced houses being built that would seem to be a socially good thing – keeping in mind however that as demand for middle to upper priced house construction goes unsatisfied there will be a price response which will increasingly make it attractive for builders to move resources into those price brackets.

New Finance Minister

I listened to two TV interviews given by the new Finance Minister Grant Robertson this past week and have just a small number of observations to make.

There was an absence of what we saw the last time a Labour Finance Minister came in anew – hefty criticism of Treasury and slamming the business sector. The new Minister made clear his intention to work in partnership with business, unions, iwi etc. in ensuring the economy could deliver on desired social goals.

He was calm – no sign of stress or frustration. But that will come later on when the aspirational words almost certainly fail to deliver in timely fashion the glorious vision he and others in the new government earnestly think they can achieve if we all try really really hard and work together in a collaborative manner. (Housing affordability, end of homelessness, strong per capita GDP growth.) Lofty goals and values in Opposition are one thing. Grappling with the reality of people who are not prepared to sacrifice themselves and their freedom for long in the future social goals set by other people is something entirely different and something which aspirational people often fail to understand and end up either disappointed about and sad – or vindictive. Often they just move onto the next heart-grabbing thing – like Elon Musk.

The Finance Minister did not mention the wide range of factors which have driven growth in the NZ economy in recent years and cited only population growth, housing, and over and over again “speculation”. This seems like it could be his blindspot – not understanding true growth drivers, thinking that the economy has failed recently, and therefore erroneously concluding that the government has a moral duty to ride in as saviour with things like R&D tax credits, a regional infrastructure slush fund, taxes on “speculators” etc.

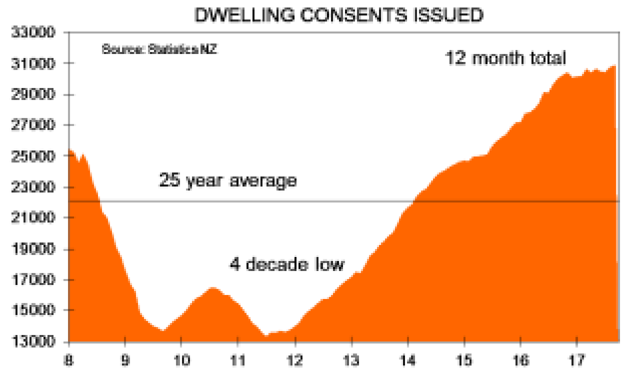
Having said that, the Minister clearly does not share the strange view of Mr Peters that a storm is coming. He also avoided references to the failure of capitalism made also by Mr Peters and the new PM. It is not capitalism which has failed but the National Party in their inability to address traditional blind spots around those who for one reason or another fail to keep up with other people. Some groups of people have been left behind. That is why a Labour government is needed now and then and had they not been awarded the prize by Mr Peters this time would probably have romped in come 2020. Just as Labour eventually loses fiscal control and becomes too meddlesome, National eventually get too ignorant of those of lesser ability or circumstance.

Overall a good performance in the interviews by Mr Robertson, good statements on monetary and fiscal policy, and pleasing comments regarding working with business. But a revealed paucity of understanding of the diversity of factors which drive economic growth. No citing of successful NZ companies. No recognition of the growth restraint from inadequate labour resource. It’s not just migration and speculation versus long-term investment, skills, and an active, earnest new age government.

House Construction Growing Slightly

On Tuesday we learnt that there is a new small upward trend emerging in the number of consents being issued for new dwellings to be built around New Zealand. In seasonally adjusted terms the 2.3% fall in numbers in September coming after rises in the previous four months means that for the September quarter numbers rose 7.6% after rising 2.8% in the June quarter and 1.4% in the March quarter.

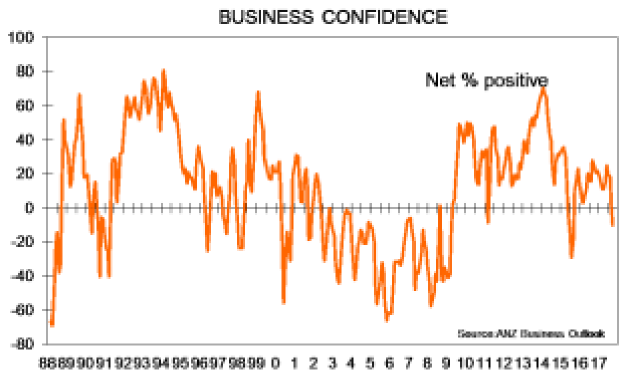
The annual total now stands at 30,892 from 30,736 in August and 29,999 a year ago. This is a slow 3% annual average gain and it will be interesting to see if the recent small acceleration in growth can be maintained in the face of resource shortages. Probably not as the labour market keeps tightening up.



Business Confidence Down – But Hiring Strong

On Tuesday we also received the results of the latest monthly ANZ Business Outlook Survey. The problem of course is that this survey has yet to capture the effects of the new government with most responses sent in three or so weeks ago – before NZ First opted for Labour over National. And even the next survey will still occur in a week’s time in an environment of insufficient clarity over key policies like Fair Pay Agreements.

The survey for October recorded a further fall in business confidence about the economy over the next 12 months, down to a net 10% pessimistic from neutral in September and a net 18% optimistic in August before the polls showed National could be on the way out.



Interestingly however, while sentiment declined this month (including own activity expectations down to 22% from 30% and 38% in August) employment intentions remained at a net 15% positive. August was 17%, July 26%. So there was some easing three months back, but nothing new now. On average in the past ten years this measure has sat at 10%. So recent readings suggest slightly above average demand for staff.

For your guide, don't expect to see business sentiment readings go back to the highs of the past few years anytime soon. There is a structural shift these type of measures undertake when a Labour government comes in – downward, and a structural shift upward when National come in.

Housing

The big news this week was not the further decline in listings around the country revealed in a report based on the realestate.co.nz website (they really do need to pay for some branding advice), but the effective ban on foreign house buying.

Contrary to the denial by National that such a ban was possible the new government has easily found a way around violating or renegotiating trade and investment treaties by simply reclassifying all residential land as "sensitive". That means in the same class as fronting water, historical sites etc. Clever.

The legislation will be passed before the end of the year and means that while Kiwis and Aussies can buy what they want, everyone else who cannot attach a certificate proving they are a citizen or NZ resident is out of luck. They can of course apply for an exemption – good luck with that.

The ban will take some foreign buyers out of the market therefore will take some upward price pressure away. This is a positive thing given the way NZ property prices have soared in recent years. It aligns NZ with the foreign buying policies of almost all other countries. And it is something I advocated before Labour adopted it as policy a few years ago.

Will the change validate those forecasts floating around of Auckland house prices on average falling 13%? No. Demand growth continues to exceed supply growth. But the next couple of years will bring some shuffling of property ownership as many investors sell because either

- they cannot find a developer to buy their land to build townhouses,
- they cannot fund negative cash flows unable to be offset against other income in an environment when capital gains will prove elusive, or
- they do not want the extra hassles for landlords about to arrive in the form of compulsory warrants of fitness, limitations on rent rise frequency, increased notice to tenants to leave etc.

Did You Know

Since 1963 under 12 three year terms of National governments average house prices have risen by 9.2% per annum. Under Labour's 6 terms they have risen 16.8% per annum on average. If we confine ourselves only to the 1990+ low inflation period the average per annum rise under National has been 6.6% versus 12.6% under Labour.

Personally I would not blindly extrapolate these numbers to a forecast that if Labour stay nine years again this time that come 2026 average house prices will be some 113% higher than they are now. Instead, lets just use this simple piece of analysis to remind ourselves that thoughts of house prices sitting flat for many, many years and affordability getting really, really better for young people are probably well misplaced.

Long-term hold is the trick in the NZ property market (residential and rural particularly). Long term hold.

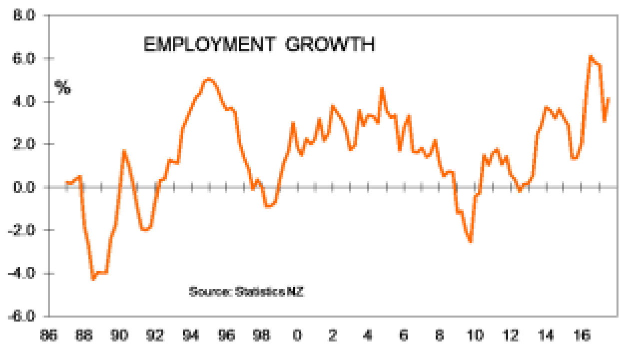
Strong Labour Market

If you think the ban on foreign buying will have a decent negative impact on the housing market then here is a counter to that – soaring jobs growth.

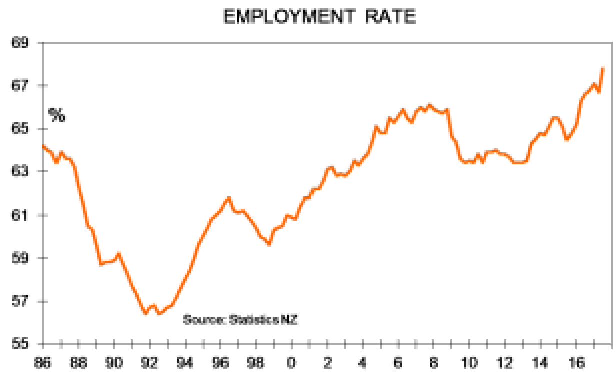
We learnt on Wednesday that during the September quarter there was a large 2.2% rise in job numbers throughout NZ. That is an extra 56,000 people in work. Compared with a year earlier job numbers were up 4.1% or 103,000. Part-time employment has grown 2.7% from a year ago, full-time 4.6%.

This is a very strong result which bodes well for strength in things like retail spending, travel, finance demand, and house purchasing.

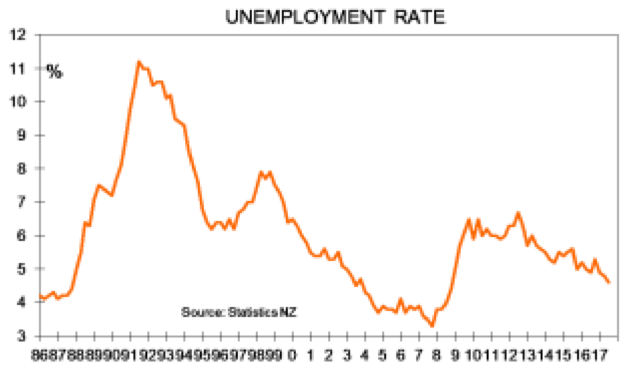
Jobs growth was spread across a range of industries including Construction 10%, Manufacturing 3.8%, Transport 10.3%, Professional Services 12%, Public Admin 9.2%.



Backing up our comments and the many anecdotes regarding tightness in the labour market we saw that during the September quarter the employment rate – the proportion of the working age population in a job – jumped to 67.8% from 66.7% in the June quarter and 66.6% a year earlier. This is a record high. Where are the people supposed to come from to build extra houses – old folks homes?



The unemployment rate has now fallen to 4.6% from 4.8% in the June quarter and 4.9% a year ago. National have almost delivered Labour's goal of a 4% unemployment rate – meaning that soon the new government will need to start encouraging the Reserve Bank to raise interest rates!



Speaking of monetary policy – do we yet see accelerating wages growth? Yes, sort of. For the overall measure we follow which captures changes in ordinary time rates of pay for an unchanging mix of jobs. This measure recorded growth of 0.9% in the September quarter from 0.7% in the June quarter and 0.6% a year ago. The annual rate of change lifted to 3.4% from 2.6% a year ago.

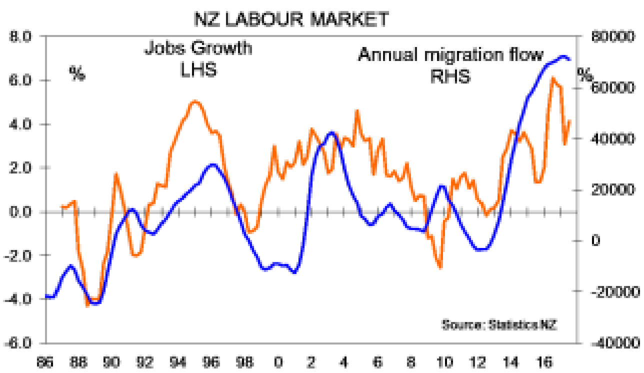
However the latest quarter captured a significant lift in remuneration for care and support workers and it looks like this has added about 0.3% to the quarterly and annual rates of change. So on a quarterly basis the underlying 0.6% is actually the second slowest September quarter result since 1998.

Nonetheless, at an underlying annual pace of change of 3.1% the pace of growth in wages is above 2.6% a year ago 2.7% two years back, and 2.5% three years ago. There is therefore evidence of a mild acceleration in the pace of wages growth – at last. It is hardly enough to cause the Reserve Bank to sit up and pay attention. But taken in conjunction with the 2.2% jobs growth during the September quarter and plans by the new government to cut labour supply, boost labour demand, and raise minimum wage rates, it is reasonable to expect that the pace of average wages growth will pick up further.

In fact, this is about to get very interesting because net immigration is turning around from high levels which have supplied the staff which employers want. This turnaround will be accentuated by the government crackdown on sub-degree courses and low level work visas. It will be further accentuated by the improving labour market in Australia.

What usually happens with NZ net migration flows is that they change primarily in response to a change in the pace of jobs growth in New Zealand. Take a look at the following graph. Annual jobs growth is plotted in orange on the left side axis. The annual net migration inflow is plotted in blue measured on the right side axis.

The key point to note is the way in which changes in the net migration flow tend to follow changes in jobs growth with a one to two year lag. (Ignore the 2009-11 GFC-influenced period.) The coincident upturn of net migration flows and jobs growth in 2012 can be put down to the downturn in Australia's minerals and energy sector sending a lot of Kiwis back/discouraging many from heading there.

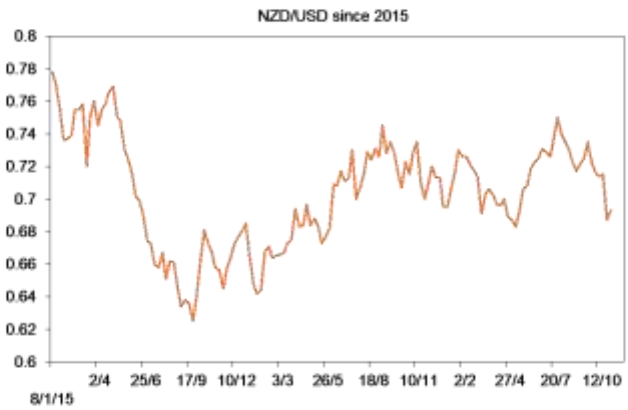


Jobs growth is running at 4%. Booming net immigration has suppressed the extent of the decline in the unemployment rate. But now, with jobs growth set to remain firm (fiscal stimulus, construction, tourism, above average employment intentions) yet net inflows easing already (not plummeting, just coming off) the labour market is set to enter a whole new level of tightness – unless net immigration fails to fall or jobs growth falls away sharply.

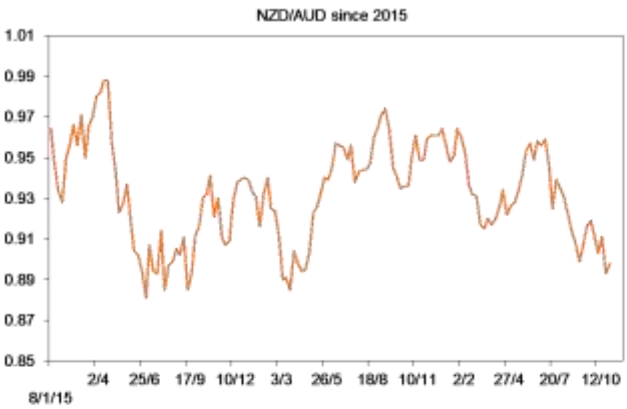
Employers had best be licking their pencils factoring higher wages growth into their calculations.

NZD

Just ahead of the September 23 general election the NZD was buying US 72.9 cents and 92.1 Aussie cents. Now it buys US 69.3 cents and AUD89.7 cents. These declines of 3.6 cents and 2.4 cents respectively reflect uncertainty about the impact on the NZ economy and to a lesser extent monetary policy settings of the new government. This means that once the uncertainty is removed through solid information on things like changes to immigration rules, the revamped fiscal outlook, changes in labour legislation, etc. we could see the NZD recover some ground.



However, it will take some time for this certainty to appear. And for the next few weeks the NZD could easily be hit lower by one of the new senior ministers by accident or design making comments indicating a desire for the NZD to go lower and perhaps a desire for the Reserve Bank to engineer such a movement.



The RB will not do so of course but in an environment where changes are coming to the RB Act there will be enough jittery players around to generate some currency selling.

This means good business for parties involved in advising on and selling protection against unexpected currency movements. But it means increased uncertainty facing importers and exporters.

As long as the terms of trade remain near record levels it is hard to envisage much of a sustained decline in the NZD. Especially as the slight increase in inflation anticipated to come from new government policies will likely cause our central bank to become slightly less sanguine about the inflation outlook. Speaking of which, the NZD rose about half a cent on Wednesday following the far stronger than expected employment numbers.

For your guide, Wednesday morning also brought a comment from Moodys Investor Services that NZ's outlook is stable, they expect GDP growth of 3% this year and 2.8% next, they see support from tourism, migration, construction and low interest rates. They say that housing market risks remain high but won't undermine the financial system's stability over the coming year. No mention was made at all regarding the fiscal outlook or proposed monetary policy changes – no concerns in other words.

If I Were A Borrower What Would I Do?

Inflation is going to be higher than would otherwise have been the case given things like the recent slight weakening of the NZD, Auckland's coming petrol tax, higher minimum wages, increasing costs facing investment property owners, tighter labour market, fiscal stimulus. The chances have increased that the Reserve Bank will shift the timing of their first monetary policy tightening from late-2019 to early that year if not late next year. But financial markets have long ago priced in such a timetable anyway. So when the Reserve Bank release their final Monetary Policy Statement for the year on November 9 market reaction to a changed rates track is likely to be limited.

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
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz