BNZ Weekly Overview

21 February 2019

ISSN 2463-4328

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.

Our Economy

Caution Needed On Interpreting Migration Data

Last year when Statistics NZ advised that they would be changing the way they calculate and present monthly migration data they noted the relatively large standard errors which would surround recent month estimates. We noted the huge ranges and said that for all intents and purposes we would lose insight into up to date migration flow changes. And so it has come to pass. A month ago SNZ used their model to estimate that in the year to November 2018 there was a net migration gain for NZ of 43,415 people, down from 53,780 a year earlier. A decline near 10,000 was an acceleration from a decline of near 9,000 in the previous November year.

Hence projections from most of us that migration will probably be around 30,000 in just over a year from now then 20,000 a year after that. But this week SNZ revised every month of the past year with some monthly net flow estimates shifting by over 500, and all of them on the upside. That bespeaks not of a standard error issue but a hugely recalibrated model.

So now the net flow for the year to November 2018 is estimated at 47,997, a decrease of only about 6,000 from a year earlier. The decrease in the net inflow now seems to be slowing down, not speeding up!

The estimate for the year to December is 48,278 – higher than the year to November.

After some 16 months the data will be much more accurate than the old method based on what people said they would do when entering and leaving the country - something no longer possible as departure cards have been removed. And we can be quite certain that over 2017 the net migration gain was about 53,000 from 62,000 over 2016. But as for what the flow really was over 2018, we will need to wait quite a few months before knowing for near sure.

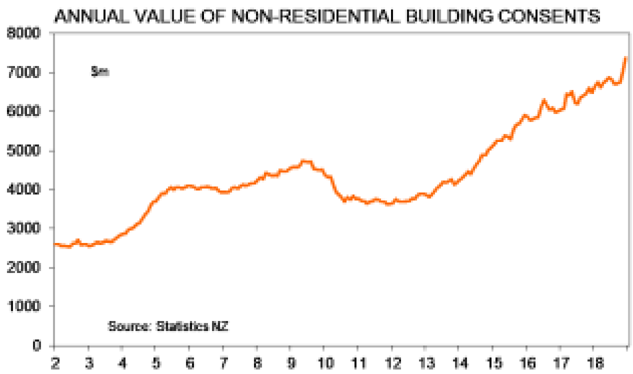
Is this relevant? At the margin yes because net migration flows have been a key influence on population change in Auckland in particular. There is natural sensitivity surrounding the impact of big sustained net inflows on the housing market and levels of traffic congestion. It is important the up to date data are accurate because imagine if the recent one month annual gain were to continue. It would reignite interest in the housing market which could prompt a new tightening up of migration rules by the Labour-led government. But what if the data were then revised to show no upward trend? In that case employers would likely have been deprived of a workforce and there would be negative economic implications.

So the best we can do given the difficult job which Statistics NZ now have is not to gratuitously rag on them. We have all developed estimation models which subsequently turned out to be rubbish. But instead we need to remind investors and policy makers that the data need to be treated with a high degree of caution and we should not too confidently extrapolate anything which has happened in perhaps the most recent three months' worth of published data.

Oh, one final thing. Last week I reported that using the new data the net migration since the start of 2001 for NZ was about 20,000 more than we thought based on outcomes data. Now the difference is more like 24,000. Whatever your calculation is of the NZ housing shortage, increase it a bit more. And the shortage in Auckland is likely to grow given that it seems like the pace of easing in the country's net migration gain is quite gradual.

Commercial Building

For your guide, data recently released show that while there are indications of a flattening out in house construction, for non-residential construction growth is quite strong. In calendar 2018 the value of consents issued for the construction of non-residential buildings was $7.4bn. This was 14% ahead of the $$6.5bn total for 2017. Five years back in 2013 the total was $4.2bn.



Growth in the value of consents issued over the past year has been flat for hotels and motels – which is surprising considering the capacity issues in the sector. Then again, experienced operators will know not just that the sector is vulnerable to shocks, but that there has long been a tendency to overbuild in good times, leading to slashing of room rates. Currently room rates are extremely high.

There has been 40% growth in the past year for the value of retailing and restaurant consents, 20% for storage facilities, 16% for factories, and 40% for farm buildings. The farming sector is in good health overall.

For offices and admin buildings a decline of 30% was recorded for all of 2018. This lumpy sector now only accounts for 11% of the value of non-residential construction. This is the lowest proportion on record since 1990. Back then the proportion was above 40% for a while and the average since 1990 has been 19%.

The broad relevance of these strong commercial construction numbers overall is that there is plentiful demand for people with building and trades-related skills to work outside the residential construction sector. This is another reason why growth in house building from current levels will be very difficult to achieve. And this is why the Reserve Bank is correct to point out what many of us have been warning of since KiwiBuild was announced. Higher levels of building under the KiwiBuild banner will crowd out other construction.

Capital Gains Tax

There is little chance that the CGT as proposed by the Tax Working Group this morning will be implemented in its suggested form. It is bad enough that no adjustment would be made for inflation, but taxing at people's marginal tax rate would deliver a 33% cost for most asset owners and this would be almost the highest such rate on the planet. All other countries have a range of exemptions and discounts and as currently suggested New Zealand's CGT would divert investment offshore.

One central argument used by proponents is that absence of a CGT has been a major contributor to rising property values in NZ, especially in recent years. But as I have been at pains to point out since 2011, there are many, many factors accounting for rising property prices in NZ and absence of a CGT is only one of them. Introducing it will not change other fundamentals such as low interest rate returns, rising construction costs, low land and builder availability, people flocking to cities and so on.

Applied to housing a CGT will likely lead to higher rents, not just because landlords will seek compensation. As some investors sell and others do not build rental accommodation the relative reduction in rental property supply will push equilibrium rents upward. This will boost government Accommodation Allowance expenditure while making life a lot harder for people who already cannot find sometimes any rental accommodation.

An argument is that people will switch their investable funds from property to useful things (as if supplying someone a home is not useful). But returns on the NZ sharemarket over the medium and long-term have exceeded returns on housing investment, yet people have still preferred the relative stability of property.

New Zealand needs more investment in the capital base. But such investment tends to raise the value of firms and this will be taxed. A CGT at the margin will encourage business operators to use surplus cash for personal expenses rather than investment.

It makes no sense that if CGT is introduced some classes of businesses, like farms, should be excluded in response to lobbying which has just started. It would be a nightmare getting every asset in the country valued as at a particular day as a starting point for capital gain considerations.

Investing in shares will not become more attractive for individuals. Instead the incentive for investors will be to shift their funds offshore.

Should there be a CGT in NZ? Yes. But our tax system is very efficient and does not provide the same level of work for accountants here as happens overseas. Introducing a CGT will be a boon for tax advisors as methods are found to minimise the impact and perhaps shift it through time.

If residential property is the desired target then simply extending the bright-line test from five years to seven or ten seems the cleanest approach and one the government will probably take into the 2020 general election.

Housing

Just a note this week that over the past year there has been a 73% rise in the number of people on the waiting list for social housing and the total sits above 10,000. Eventually this skyrocketing revealed problem will prompt the government to refocus KiwiBuild away from affordable housing for graduate doctors to social housing they and councils are simply not providing. And when they do it seems the level of maintenance of some of this housing stock is truly appalling.

As Labour find their dreams and high flying speeches unfortunately well exceed of the reality of what can be achieved in the real world a default back to focussing on where they can truly make a difference is likely. The Housing Minister has already caved in his opposition to using motels to house our poorest and rightly so. But at least they will soon be inspected! Alternatives are simply not there and every week if not day brings us examples of the lack of capacity in the building sector to boost construction. Wellington's ever more expensive Town Hall fix-up. Maintaining Kapiti Coast state houses. The Commercial Bay development in Auckland's CBD.

I mentioned in an article written recently for OneRoof that we are bombarded with stories about house prices each month because there are three sources of price levels and movements. Actually there are four. They are REINZ sales prices of which I use the House Price Index series as they are the most accurate up to date measures. Then there are asking prices from listings on realestate.co.nz. We also get QVNZ data, and asking prices from Trademe. For Auckland you could also add monthly Barfoot and Thompson data.

I don't bother reporting all of them because that just removes clarity.

Your Strategy

-Things to consider in your next annual strategy session.

Wage Rises

Employers need to stop lobbying the government for more migrants to be allowed into the country simply because they won't pay higher wages and have underbid for contracts. Recently in both the early childhood sector and public transport sector lobby groups have asked the government to let them bring in more people from offshore because they cannot find the staff they need in NZ.

The NZ labour market certainly is tight and going to get even more so. But the answer to attracting staff is to pay more. The effect will be to force some low profit enterprises out of business and this is the most vital thing that can happen in an economy short of resources. These resources – people, land, buildings, capital, systems – will get reallocated to those businesses able to turn a profit at higher wages. The lack of business failure is one reason why NZ productivity growth is so low, as we learnt earlier today.

Growth in multifactor productivity – the growth in output not accounted for by increased inputs of labour and capital – was only 0.3% in the year to March 2018. This followed only 0.6% growth the year before. Average productivity growth since 1997 has been 0.8% per annum.

It's not necessarily insufficient business investment – which fell 3% over the June and September quarters last year – but lack of business churn.

If business lobby groups get their way and the government responds to their demands by letting in more people from offshore desperate to work and perhaps gain residency here, then consumers for a while get low prices. But wages growth will remain muted and the continuing business practice of bidding very low to win contracts will continue.

Thankfully it seems fairly unlikely that a Labour government supported by NZ First will accede to such demands. For businesses the message is clear. Raise your bids when submitting prices for contracts, pay higher wages, invest in labour-saving equipment and technologies, and pull back from focussing on maximising output. Instead focus on highest yielding customers because of the capacity constraints.

If I Were A Borrower What Would I Do?

Nothing new really this week. The old days of being able to run scary stories of imminent inflation and the need to hedge have no validity nowadays. Fixing for terms of usually two years then sometimes three and sometimes one is probably going to be the optimal approach for most borrowers for the next decade or so.

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 here. http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz