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.

Faster Wages Growth Is A Good Thing

Economists are currently delivering quite a few warnings about rising wage claims driving inflation higher. The implication given is that accelerating wages growth is a bad thing and we should be wary of upward pressure on interest rates and the exchange rate.

It was certainly right to be worried about such dynamics back in the old days when there were near direct links between cost increases to businesses and subsequent selling price rises, and when there were lots of reasonably skilled unemployed people sloshing around the country potentially being priced out of work by high wage rates.

Neither of these two key conditions exists today so warnings about the woe which may follow accelerating wage rises are well misplaced. Businesses cannot easily raise selling prices when costs go up as we consumers are voracious in our online searching for cheaper product sources. That is one reason why businesses are failing despite a strong economy and if you are supplying a business in a strong sector you should not assume payment is guaranteed. Plenty of businesses these days are trading beyond their means making bold assumptions about finance, costs, labour availability etc. and when they go down you risk getting dragged under as well if your exposure is great.

But most importantly, the vital element which needs to happen in our economy at the moment in order to boost productivity growth and raise the average standard of living is a sharp acceleration in the pace of wages growth. Low wages growth is a problem for many people. Accelerating wages growth will assist the economic solution we seek of faster productivity growth.

Labour is in short supply. The price of labour needs to rise so that this valuable resource is allocated to the employers with the most profitable products who can afford to pay the higher rates to secure the few people on offer. This means the closing down of employers who produce goods and services for which profits are low. That's capitalism and its process of creative destructionism and it is the very thing which business lobby groups refuse to acknowledge as they champion capitalism from a government non-interference point of view then misleadingly say that wages growth cannot accelerate without an increase in productivity.

House prices have soared with no change in house productivity. Oil and gold prices change with no productivity changes. Economics is all about the process of how equilibrium prices are set and how they change in response to things which shift demand and supply curves. The supply of labour curve has not shifted out to the right as quickly as the demand for labour curve. Equilibrium wages need to go up and until businesses acknowledge this and start paying more for our most valuable resource they will refrain from undertaking the productivity-boosting investment they need to do **in response** to rising wage costs.

And what if inflation does go up? So what? The world's problem is inflation too low, not too high for one thing. More importantly, if growth does have to slow down for a while to allow the labour market to adjust (higher interest rates from tighter monetary policy achieving this) then so be it. That's for the Reserve Bank to worry about and neither employees or businesses are paid by the RB to do their job for them.

Wages growth needs to accelerate and the hiking of minimum wage rates should be seen as a valuable step toward achieving this important development. Dynamics in the public sector look a bit different. But if the ultimate outcome of faster public sector wages growth is extra upward pressure on wages in the private sector then that is a great thing whilst the labour market remains tight.

Housing

This week provided us with a good example as to why talk about rising consent numbers in Auckland soon starting to reduce the housing shortage should be ignored. Many people have long said that 13,000 houses need to be built in Auckland each year in order to start addressing the shortage. But people have translated that to mean 13,000 consents. But they are not the same thing.

It looks like only 80% - 90% of gross consent numbers add to net housing stock. Some consents don't get acted on for one thing. Some involve demolition of existing houses and that is what we learnt this week will happen in Mangere. Some 10,000 houses are to be built. Some 10,000 consents will eventually be issued. But almost 3,000 existing houses are to be demolished. The net gain will be only just above 70% of the number of consents issued.

Regarding construction constraints, one emailer last week pointed out that New Zealand's ageing hosing stock will require an increasing number of tradespeople just to keep everything in running order. Maintenance and upgrading insulation, energy efficiency etc. will soak up resources which could otherwise have been employed constructing new houses.

But it could be worse than we think. In Australia some commentary recently has noted that houses tend to require renovations after 30 – 35 years and a surge in construction in the late-1980s and early 1990s over there will place extra pressure on construction labour.

Here in New Zealand we saw a lift in annual dwelling consent numbers from 15,000 in 1980 to almost 25,000 in 1986 so there might also be a renovation blip here as well though not a huge one. It could be swamped in fact by the general move to renovate coming from the many tv programmes on doing houses up.

Are You Seeing Something We Are Not?

If so, email me at tony.alexander@bnz.co.nz and let me know.

If I Were A Borrower What Would I Do?

Over the June quarter the Consumers Price Index rose by 0.4% which (yet again) was below market expectations. Annual inflation has now lifted to 1.5% from 1.1% in the March quarter but was down from 1.7% a year earlier. The underlying measure I look at which excludes fuel and food showed no change in the June quarter and was ahead only 1.1% from a year earlier.

There is very little inflation in New Zealand and every single forecast made since 2009 of a persistent rise in inflation and persistent rise in interest rates has been wrong – 100% of the time.

There is nothing in the June quarter CPI to suggest inflationary pressures are starting to bubble and that the Reserve Bank will be thinking seriously about trying to slow the economy's pace of growth by raising interest rates.

Borrowers look like enjoying an environment of low interest rates for a number of years yet, especially as downside risks to world growth start to grow stronger. As for investors seeking a low risk term deposit – sucks to be us.

If I were borrowing at the moment I would remain inclined to fix most of my debt for two years. Perhaps I would have some fixed for three years, but I would not fix longer than that given the cost and the downside risks to world growth slowly building in response to spreading trade tensions, and problems in emerging markets.

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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