Property Institute – NZ Economic Issues

Craig Renney – November 2021

A little about me…

- My name is Craig Renney, and I am the CTU Director of Policy and Economist.
- I was the Advisor to Grant Robertson for 5 years, and prior to that worked for the Treasury, MBIE, and the Reserve Bank.
- I wrote the three Budgets for Labour government, provided the economic policy and costings for the 2017 and 2020 Manifestos
- If at any time I use a phrase or jargon that you want explaining – please just ask.

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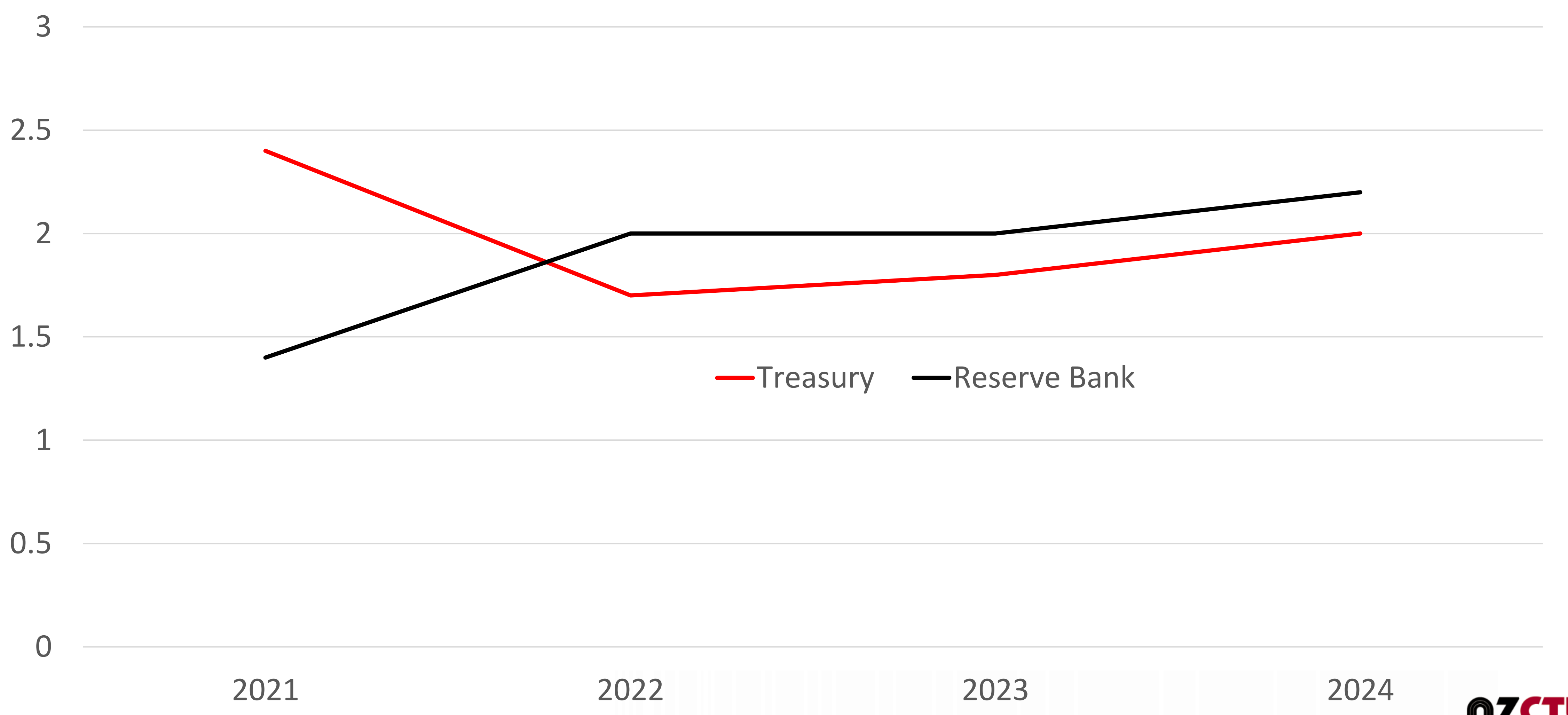
I want to talk to you today about :

- **What has been happening with inflation – and what is likely to happen in the near future?**
- **What does that mean for the New Zealand Economy?**

- **What is the governments thinking for Social Insurance?**
- **What does that likely mean for firms and workers in NZ?**

Inflation in 2021 – Back to the Future?

So what was supposed to happen – May Forecasts



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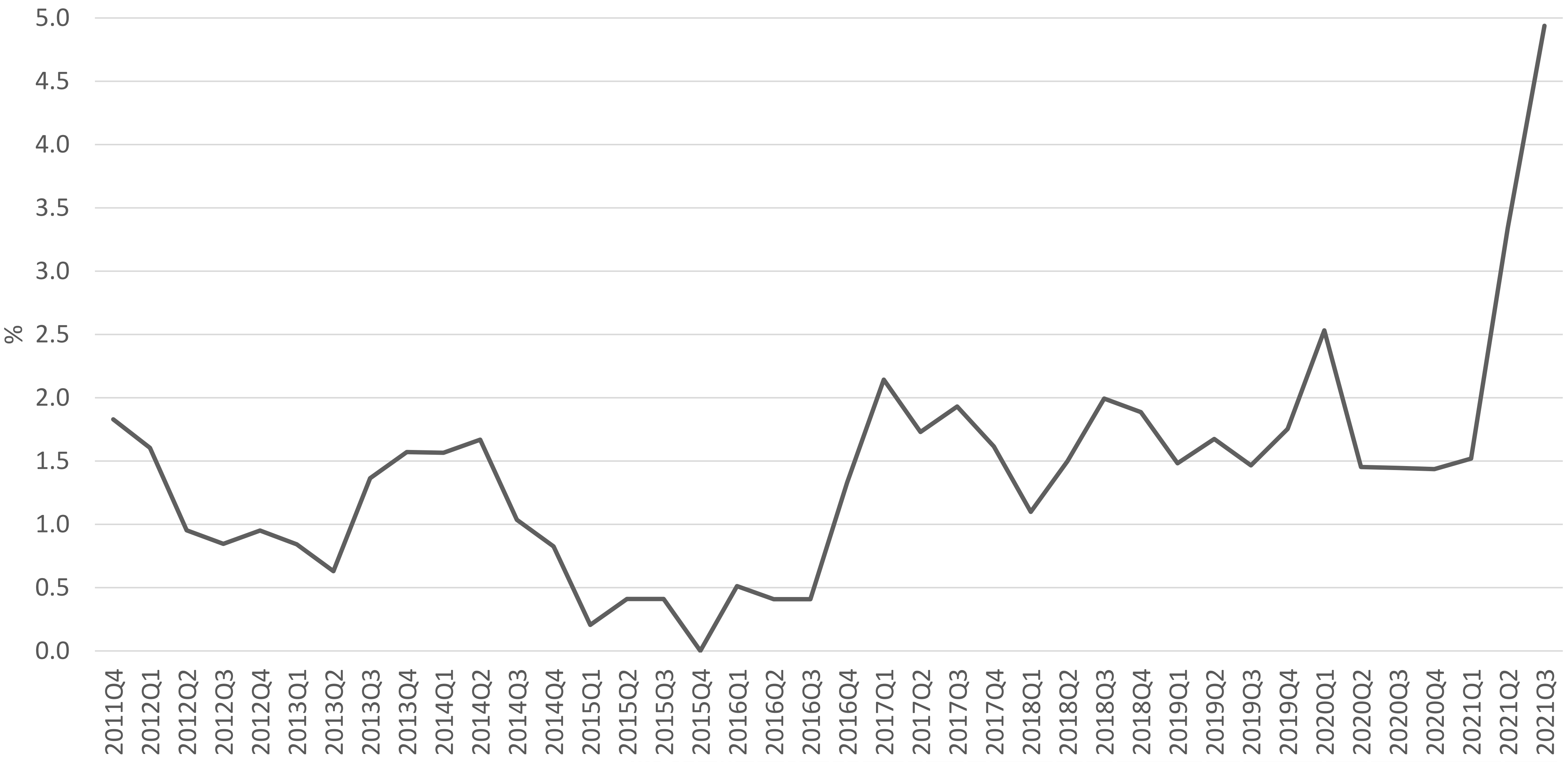
Inflation – What has been happening?



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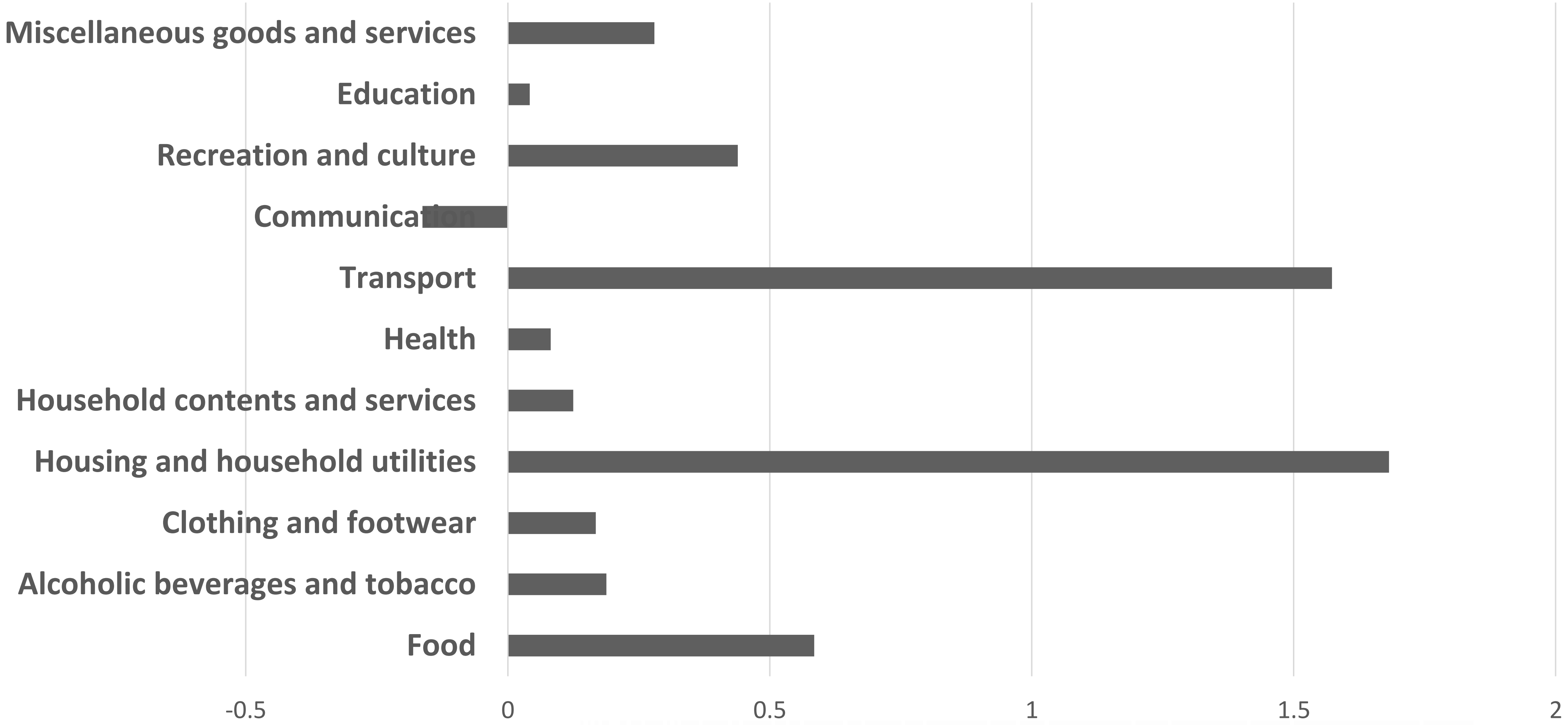
Inflation is an international phenomenon…

- US inflation rose by 6.2% last year, the fastest rate of growth in 31 years of measurement.
- UK Consumer Price Index rose at the fastest rate since the current system of measurement started (which is 1997).
- EU inflation is at the highest rate in over 10 years at 3.4%. German inflation is currently at 4.1% - the highest rate in over 30 years.
- Despite their current COVID-19 restrictions, Australian inflation leapt. Inflation is at a six year high.
- Chinese producer price index (PPI) rose 10.7% from a year earlier in September, its fastest pace since the data began to be compiled in October 1996.

What is causing this global shift?

- **In short – COVID.**
- **In slightly longer**
  - Global supply chains shut down because of an expectation of global demand reductions.
  - But that didn’t happen
  - Global demand for items like computer chips rocketed – companies ran down their inventories, then asked for more. All at the same time.
  - This is putting huge pressure on logistics. US ports are capacity. Maersk is delaying shipping to the UK. The cost of shipping doubled in a year
  - This put pressure on raw commodity prices. Oil, Gas, Rare Earths, Coal, Proteins. All are at recent highs.
  - This has been exacerbated by co-ordinated fiscal stimulus from US/EU/China – which have started infrastructure programmes.

What's causing inflation to lift in NZ?



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Housing in the Consumer Price Index

- **Inflation is not being directly driven by the cost of existing housing. Prices for existing housing are not included in the Consumer Price Index.**
- **Inflation is being riven by the cost of new housing. The cost of purchasing a new house increased by 12% last year. This was driven by the increases in the cost of materials, and by the cost of construction labour. This was the single biggest contributor to the overall price increase.**
- **Inflation was also being driven by increases in local authority rates. These increased by 7.1% for the year – and were the second largest contributor to inflation. They also look likely to persist in the future given local authority rate setting plans.**
- **'Actual rentals' – which is the code that Stats NZ uses for domestic rents rose 3.2%. But this hides significant regional variation. Wellington rents rose 4.9%, Christchurch 2.3%, and Auckland only 1.4%.**

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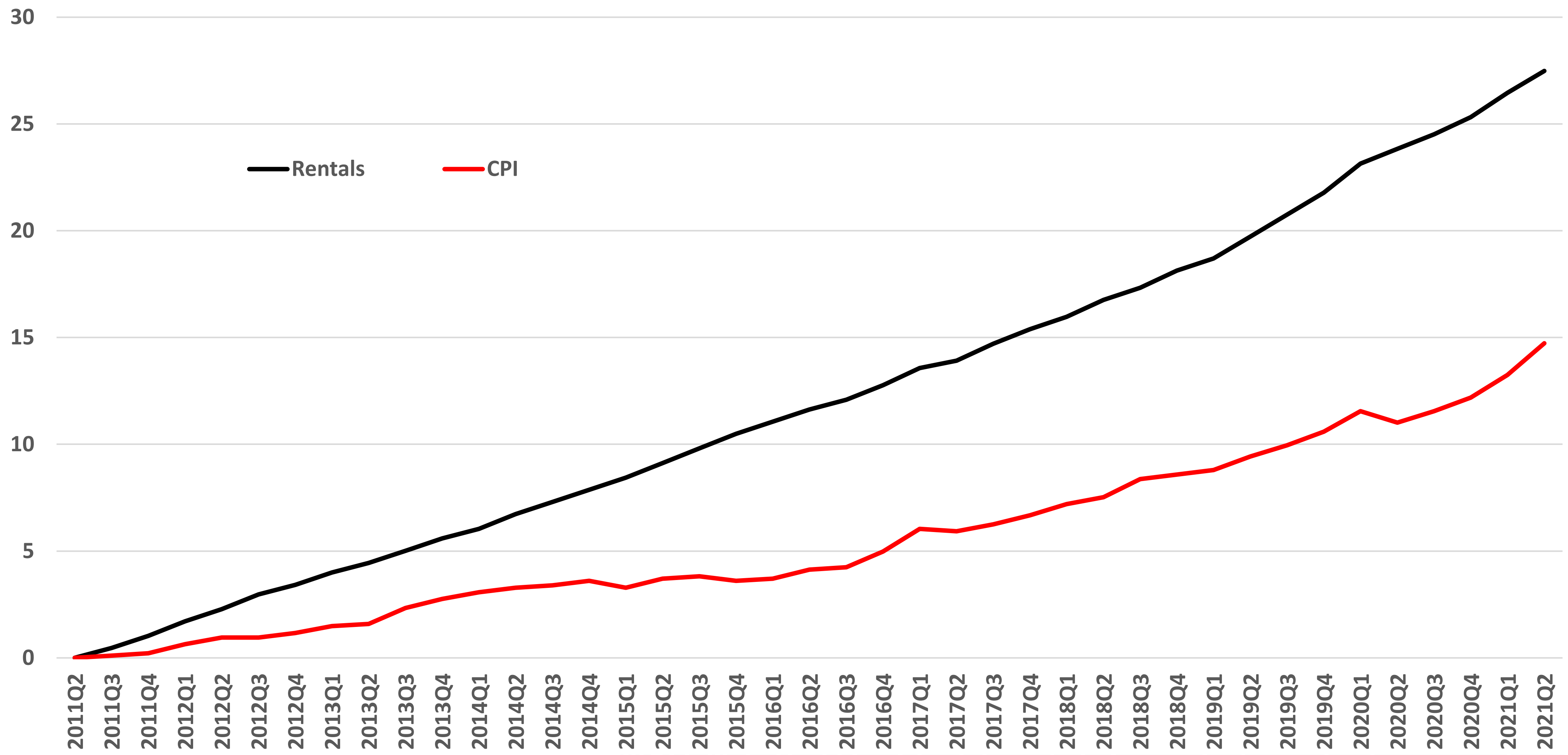
Rentals are a historical problem



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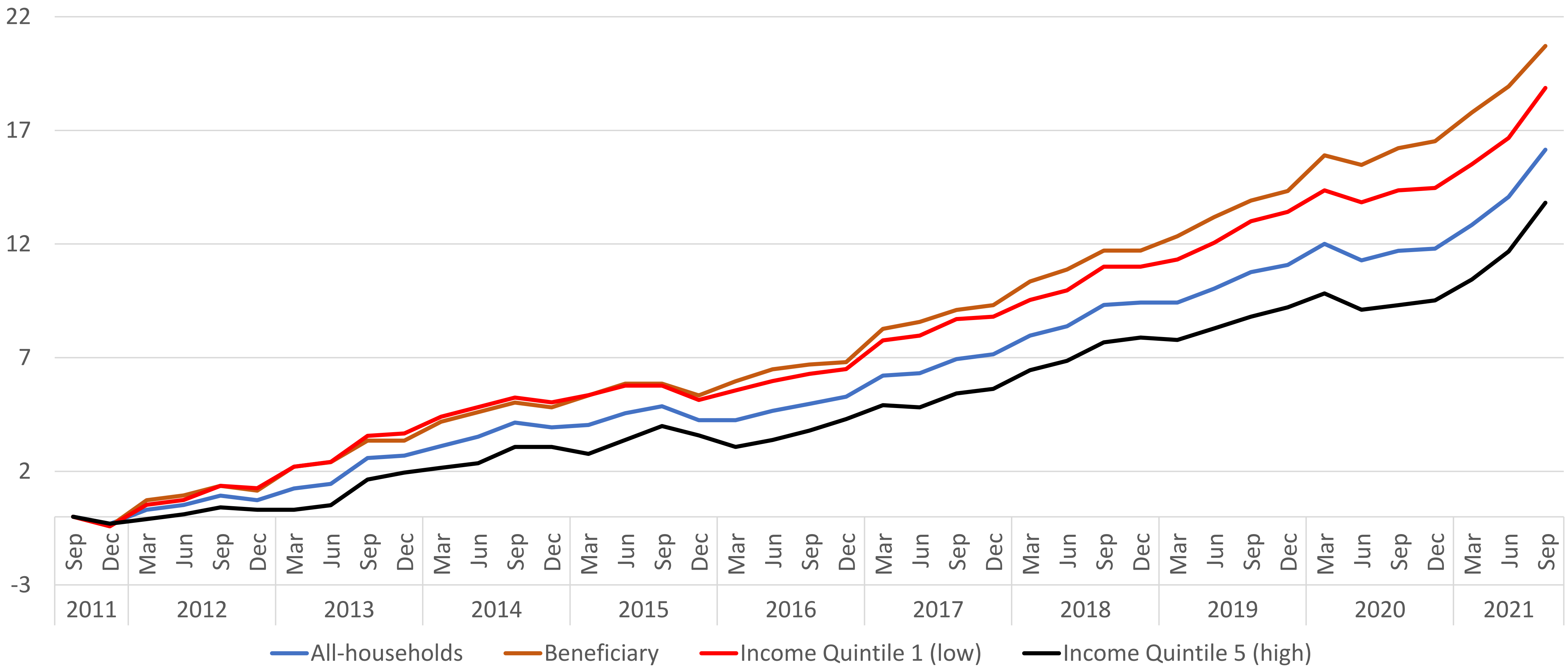
What has not been causing inflation?

- One of the key things that is not causing inflation right now is wages.
- The Labour Cost Index showed an increase of 2.4% last year – roughly half the rate of inflation.
- 42% of all New Zealand employees did not get a pay increase last year.
- 82% got a pay rise less than inflation.
- The Quarterly Employment Survey (which includes things like bonuses, promotions, and overtime) showed an increase of 3.5%. This was driven by increases in overtime payments.
- Wage increases in both the public and private sectors were roughly the same (3.5%/3.6%). They were also equally distributed for male and female workers.

Inequality in the cost of living



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So what does this all mean?

- **Forecasts of Inflation right now fall into two camps**
  - Camp 1 (led by the majority of Reserve Banks around the world)
  - inflation right now is due to temporary factors
  - Inflation expectations 1 year from now are much lower than today
  - After stimulus cash is spent, inflation will return to normal as supply chain constraints are eased
  - Camp 2 (led by most of the private banks around the world)
  - Inflation is here to stay
  - Unless Governments and Reserve Banks do something about it, this will get worse
  - Wage demands lag the real economy – which in turn will drive a second round of inflationary pressure
- **One of them will be right.**

Any Questions

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Social Insurance

First – A Disclaimer…

- I have signed a Non-Disclosure Agreement for all of my work with the Government.
- As a consequence, I can’t tell you anything about the actual programme of work that is taking place on social insurance.

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What is Social Insurance?

- **Social Insurance is a system common to the rest of the OECD and the developed world.**
- **New Zealand is almost alone in not having a form of state-led worker income protection.**
- **Essentially, social insurance is a payment made to those who have recently lost their jobs. It is different to redundancy in that it is paid periodically.**
- **It is paid for through a combination of sources. Some countries (such as the US) charge employers. Some charge employers and employees (most of Europe). Some charge both and have top-ups from the state (most Nordic countries).**
- **Most countries have requirements on recipients. Most also have wrap-around services for the recently unemployed.**

Why have social insurance?

- Those who lose their jobs often face lifetime consequences in the form of wage scarring.
- There are significant problems with the delivery of private insurance in unemployment. Those who need it often can't afford it. Those who can afford it often balk at the price.
- Insurers face adverse selection problems. Essentially, the more likely you think you are to lose your job the more you will want insurance. Which makes it very expensive.
- In many countries, social insurance is available for more than just straight redundancy. Most OECD countries also cover job loss as a consequence of health conditions.
- An increasingly dynamic job market, characterised by no 'jobs for life' means that individuals will need support to change career.

How does Social Insurance operate?

- In most countries social insurance is operated through an organisation at arms-length from government (Like ACC). They create investment pools to pay for claims.
- Claimants must usually have made contributions for a 'qualifying period' and then get insurance for a 'defined period'.
- The insurance is paid at a replacement rate – i.e. a percentage of previous salary. Usually up to a maximum rate (again like ACC)
- Claimants must usually have not 'actively contributed' to their employment loss. You can't burn the factory down and then claim.
- Insurance is paid to the individual, regardless of family income.
- Insurance is income for tax, welfare, and other purposes. You can't claim both insurance and jobseeker support.
- The insurer works with the employee to actively get them back into work.

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What problems might this solve in NZ?

- **Wage Scarring causes real problems**
  - According to research by the OECD those who lose their jobs in New Zealand face some of the highest wage scarring in the developed world
  - According to research by economists at Motu – Wage Scarring costs New Zealand $3bn in a 'normal year'. In a recession year this rises to $15bn.
- **Unemployment causes productivity issues for the whole economy**
  - New Zealand already has low labour productivity. Skills mismatches caused by unemployment are cited by the IMF, OECD and others as a key reason.
- **Benefits for most people are inadequate or unavailable.**
  - NZ out of work benefits are among the lowest in the OECD
  - Welfare is calculated at the household level in NZ. Around Two-thirds of all potential claimants get nothing from the benefits system.

What are the macroeconomic consequences?

- **Economic evidence since the Second World War has shown that those countries with social insurance tend to have less pronounced economic cycles**
  - Social Insurance acts as a 'stabiliser' in the economy. During recessions workers incomes don't fall as quickly when compared with other countries
  - That stabiliser keeps spending going in the economy for longer. This reduces the impact of the 'economic shock'
  - Funds collected during good times reduce consumption during growth phases, which in turn lowers inflation
  - This means that the peak and trough of an economy are reduced. This has implications for things such as interest rates (which move less) and for investment (which is easier to deliver)
  - It also means that government debt doesn't balloon as much during a recession – as there is a pool of savings for such a purpose.

Why would the government do this now?

- **This government has been committed to changing the welfare state since its election.**
- **COVID-19 showed that without such a system, the government is required to step in to support individuals during a financial disaster.**
- **That is extremely expensive. The COVID-19 Wage Subsidy Scheme to date alone has cost more than $15bn. It would be better to do this in a way that is both permanent, and reduces future fiscal exposure.**
- **New Zealand is a small, open economy that is prone to both internal and external shocks. It is also going to face challenges from the changing nature of work, sectoral change, and from climate change.**
- **New Zealand has no other system in place to support workers. No statutory redundancy. No statutory notice period. Other solutions in this area create problems themselves.**

What is the process from here?

- The Minister of Finance signalled that work is underway on this at Budget 21 in May.
- The Minister stated that "There will be wider public consultation later this year".
- If this occurs, and that consequent public reaction is not negative, then legislation could commence later in this term.
- Any decisions would be made by Cabinet and would be conducted in the usual way – i.e., there would be Select Committee, further consultation and regulatory impact statements.

Any Questions